

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF SANDY HOOK WATER	)	CASE NO.
DISTRICT FOR RATE ADJUSTMENT	)	2016-00265
PURSUANT TO 807 KAR 5:076	)	

ORDER

On July 19, 2016, Sandy Hook Water District ("Sandy Hook") tendered an application to the Commission requesting to increase its water service rates pursuant to 807 KAR 5:076. By an Order entered on August 4, 2016, the Commission established a procedural schedule to ensure the orderly review of Sandy Hook's application. The Commission amended the procedural schedule through an Order entered on October 17, 2016. The procedural schedule, as amended, provided for, among other things, a written report containing findings and recommendation to be filed by Commission Staff and the opportunity for written comments on and objections to the report of Staff to be filed by the parties.

Commission Staff performed a limited financial review of Sandy Hook's operations, and on November 15, 2016, filed with the Commission and served upon all parties a written report containing Staff's findings and recommendations regarding Sandy Hook's requested rate adjustment. On November 22, 2016, Sandy Hook filed written comments to Staff's report wherein it stated that it was in agreement with the report and waived its right to a hearing.

On November 29, 2016, the Attorney General submitted written comments addressing compensation, operational expenses, and rate design and impact.<sup>1</sup> The Attorney General stated that “[a]lthough the Attorney General supports Sandy Hook’s decision not to burden ratepayers with the higher rate recommended by Commission Staff, the record does not demonstrate the reasonableness of certain expenses.”<sup>2</sup>

Following a review of the written comments and consideration of the record, Staff amended its original findings and recommendations. The Commission finds that Staff’s amended report should be filed into the record. We find that Sandy Hook and the Attorney General should be afforded the opportunity to respond to Commission Staff’s amendments to its report.

The Commission HEREBY ORDERS that:

1. Sandy Hook and the Attorney General shall have 14 days from the date of this Order to file with the Commission:

2. a. Written comments on and any objections to the findings and recommendations contained in the attached Amended Commission Staff Report; and

b. Any additional evidence for the Commission to consider.

3. A party’s failure to file written objections to a finding contained in the Amended Commission Staff Report within 14 days of this Order shall be deemed a waiver of all objections to that finding.

4. If a party requests a hearing or informal conference, the party shall make the request in its written comments and state the reason why a hearing or informal conference is necessary.

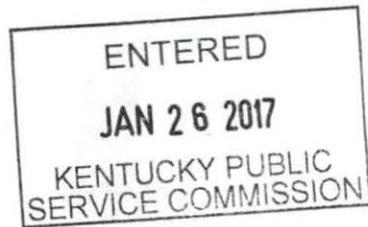
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<sup>1</sup> Attorney General’s Comments (filed Nov. 29, 2016) at 3 through 8.

<sup>2</sup> *Id.* at 3.

5. If the Commission does not receive any written request for a hearing within the 14 days of the date of this Order, this case shall stand submitted to the Commission for decision based upon the existing record.

By the Commission



ATTEST:

*Lawrence D. Greenwald*  
Executive Director *for*

AMENDED  
STAFF REPORT  
ON  
SANDY HOOK WATER DISTRICT  
CASE NO. 2016-00265

On July 19, 2016, Sandy Hook Water District ("Sandy Hook") tendered an application to the Commission requesting to increase its water service rates pursuant to 807 KAR 5:076. Applying the DSC method to calculate their Overall Revenue Requirement of water districts and water associations, Sandy Hook determined that a revenue increase of \$161,442, or 25.56 percent, was warranted. This method allows for recovery of: 1) cash related pro forma operating expenses; 2) depreciation expense, a non-cash item, to provide working capital;<sup>3</sup> 3) the average annual principal and interest payments on all long-term debts, and 4) working capital that is in addition to depreciation expense.

In order to evaluate the reasonableness of Sandy Hook's pro forma financial statements, revenue requirement calculation, and requested water service rates,

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<sup>3</sup> The Kentucky Supreme Court has held that the Commission must permit a water district to recover its depreciation expense through its rates for service to provide internal funds for renewing and replacing assets. See *Public Serv. Comm'n of Kentucky v. Dewitt Water Dist.*, 720 S.W.2d 725, 728 (Ky. 1986). Although a water district's lenders require that a small portion of the depreciation funds be deposited annually into a debt reserve/depreciation fund until the account's balance accumulates to a required threshold, neither the Commission nor the Court requires that revenues collected for depreciation be accounted for separately from the water district's general funds or that depreciation funds be used only for asset renewal and replacement. The Commission has recognized that the working capital provided through recovery of depreciation expense may be used for purposes other than renewal and replacement of assets. See Case No. 2012-00309, *Application of Southern Water and Sewer District for an Adjustment in Rates Pursuant to the Alternative Rate Filing Procedure for Small Utilities* (Ky. PSC Dec. 21, 2012).

Commission Staff performed a limited financial review of Sandy Hook's test-year operations for the calendar year 2015. On November 15, 2016, Commission Staff issued a report finding that Sandy Hook's adjusted test-year operations would support a revenue requirement of \$824,420, which would require a revenue increase of \$165,363, or 26.82 percent.<sup>4</sup>

On November 22, 2016, Sandy Hook filed its response to Commission Staff's report wherein it accepted Staff's findings, requested to implement rates that Sandy Hook calculated in its application, and affirmed that no informal conference or hearing need be held.

The Attorney General filed responses to Staff's report which discussed several of the report findings, specifically, employee compensation, operational expenses, and rate design, as well as the frequency that Sandy Hook requests rate increases. After considering the Attorney General's comments, Commission Staff is amending its original findings. Except as discussed herein, the findings in Staff's original report remain unchanged.

#### Summary of Findings

Using its revised pro forma operations, Commission Staff calculates Sandy Hook's Overall Revenue Requirement to be \$776,450; \$47,970 less than the amount calculated by Staff in its original report. To generate the Overall Revenue Requirement, Sandy Hook must increase its current rates in a manner that generates \$117,393 in additional annual revenue, a 19.04 percent increase. In order to generate the additional

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<sup>4</sup> Staff Report at 19.

revenues, Staff increased all of Sandy Hook's current water service rates evenly across the board. The rates calculated by Staff are set forth in the Appendix to this order.

Amended Pro Forma Operating Statement

The Amended Pro Forma Operating Statement for the test year ended December 31, 2015, as determined by Commission Staff, appears below.

	Original Pro Forma Operations Staff Report	Revised Adjustments	Adj. Ref.	Revised Pro Forma Operations
Operating Revenues				
Sales of Water	\$ 616,568			\$ 616,568
Miscellaneous Service Revenues	42,136			42,136
	<u>658,704</u>			<u>658,704</u>
Operating Expenses				
Operation and Maintenance Expenses				
Salaries and Wages - Employees	204,541			204,541
Employee Pensions and Benefits	56,548			56,548
Purchased Power	56,861			56,861
Materials and Supplies	21,282			21,282
Contractual Services	10,650			10,650
Transportation Expenses	11,037			11,037
Insurance	13,470			13,470
Regulatory Commission Expenses	560			560
Misc. Expense	132,273	(48,750)	(A)	83,523
Total Operation and Maintenance Expenses	507,221	(48,750)		458,471
Depreciation Expense	181,251	780	(A)	182,031
Taxes Other Than Income	13,173			13,173
	<u>701,645</u>	<u>(47,970)</u>		<u>653,675</u>
Net Operating Income	(42,942)	47,970		5,028
Gain on Disposition of Property	1,505			1,505
Interest Income	353			353
	<u>\$ (41,084)</u>	<u>\$ 47,970</u>		<u>\$ 6,886</u>

(A) Salaries and Wages. In Staff's original report, Staff adjusted Sandy Hook's test year employee wage expense to \$205,541 and included this amount in

Sandy Hook's pro forma operating expenses. In the AG's response, the AG questions the reasonableness of the level of test year wages, in the amount of \$205,626, by comparing this amount to the \$113,702 wage expense for four employees reported by Sandy Hook for the year 2011 in its response to the AG's request for information.<sup>5</sup> The AG argues that this increase in wage expense resulted from Sandy Hook's increased staffing levels and wage rate increases that have occurred since 2011. The AG noted that in Sandy Hook's April 9, 2015 Board of Commissioner's meeting minutes, "Sandy Hook appears to have a policy of annual raises of up to 5 percent unless Sandy Hook has financial difficulties or an employee demonstrates poor performance."<sup>6</sup>

During its review, Staff was neither made aware of, nor was provided with, any written policy that Sandy Hook has in place regarding annual pay increases. Staff reviewed Commissioner Meeting Minutes and noted that during the years 2014, 2015, and 2016, employees received raises of 2.5 percent,<sup>7</sup> 1.5 percent,<sup>8</sup> and 2 percent,<sup>9</sup> respectively. Contrary to the AG's belief that Sandy Hook has a policy of annual pay raises of up to 5 percent, Staff did not observe where a 5 percent pay raise has been implemented.

Additionally, Staff questions the accuracy of Sandy Hook's response to the AG's Request for Information. Upon review of Sandy Hook's 2011 Annual Report to the PSC, Staff notes that Sandy Hook reported a staffing level of five employees and a Salaries

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<sup>5</sup> Sandy Hook's Response to AG-2(a)(ii).

<sup>6</sup> AG's Response to Staff Report at 3-4.

<sup>7</sup> Sandy Hook Commissioner Meeting Minutes, February 13, 2014.

<sup>8</sup> Sandy Hook Commissioner Meeting Minutes, June 11, 2015.

<sup>9</sup> Sandy Hook Commissioner Meeting Minutes, January 21, 2016.

and Wage expense of \$171,219,<sup>10</sup> as compared to the four employees and \$113,702 wage expense listed in Sandy Hook's response to the AG.

(B) Miscellaneous Expenses. Sandy Hook reported \$132,524 for test-year miscellaneous expenses. Included were expenses of \$48,750 for replacement of water mains that were damaged due to flooding and water mains in need of replacement at Sandy Hook's plant. Proper accounting requires that the cost of the mains be reported as a depreciable asset in account 101, Utility Plant in Service.<sup>11</sup> Staff removed the costs of the main replacements from miscellaneous expenses and increased test-year depreciation expense by \$780.<sup>12</sup> Staff reviewed the other entries to the Miscellaneous Expense account and believes them to be reasonable expenses.

(C) Rate Design and Frequency. Staff has considered the AG's comments regarding rate design and the frequency of Sandy Hook's rate applications. As the AG points out, Sandy Hook's current rates were established in 2013 in Case No. 2013-00379, a proceeding in which pursuant to KRS 278.023 the Commission had no authority to modify or reject any portion of the agreement between Sandy Hook and Rural Development ("RD"), an agency of the United States Department of Agriculture.<sup>13</sup> As to the increases to these rates, the AG agrees with Staff that "any increase in rates should be applied evenly across the board."<sup>14</sup>

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<sup>10</sup> *Annual Report of Sandy Hook Water District to the Public Service Commission for the Calendar Year Ended December 31, 2011 ("Annual Report")* at 13 and 51.

<sup>11</sup> Uniform System of Accounts for Water Districts and Associations at 40.

<sup>12</sup> \$48,750 (Cost of Line Replacement) ÷ 62.5 (Years) = \$780

<sup>13</sup> *Application of Sandy Hook Water District for a Certificate of Public Convenience and Necessity to Construct, Finance and Increase Rates Pursuant to KRS 278.023* (KY PSC Nov. 12, 2013) at 1 and 2.

<sup>14</sup> AG's Written Comments at 8.

The AG states that a utility's service rates have a life of five years, and that likely harm to Sandy Hook's customers caused by the 25.56 percent increase sought by Sandy Hook could have been avoided if Sandy Hook had requested reasonable increases in a timely manner.<sup>15</sup> Staff notes that Sandy Hook's current rates have been in effect for less than five years, and Staff anticipates that the life of the rates approved in this proceeding will be approximately five years.

Staff believes that the principle of gradualism concerns the gradual shifting of costs between customer classes to the class of customer causing the cost. Staff does not believe that it supports any reduction to Sandy Hook's Overall Revenue Requirement or the rates calculated by Staff.

#### Overall Revenue Requirement and Required Revenue Increase

Commission Staff originally determined that Sandy Hook required \$165,363 in additional annual revenues, an increase of 26.82 percent. Commission Staff amends the increase to an increase of \$117,393, or 19.04 percent, as shown below.

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<sup>15</sup> *Id.* at 7.

	Original Staff Report	Amended Report
Pro Forma Operating Expenses	\$ 701,645	\$ 653,675
Plus: Average Annual Principal and Interest Payments	102,312	102,312
Additional Working Capital	<u>20,462</u>	<u>20,462</u>
Overall Revenue Requirement	824,420	776,450
Less: Other Operating Revenue	(42,136)	(42,136)
Interest Income	<u>(353)</u>	<u>(353)</u>
Revenue Required From Rates	781,931	733,961
Less: Pro Forma Present Rate Revenue	<u>(616,568)</u>	<u>(616,568)</u>
Required Revenue Increase	<u>\$ 165,363</u>	<u>\$ 117,393</u>
Percent Increase	<u>26.82%</u>	<u>19.04%</u>

Signatures:




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APPENDIX

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE  
COMMISSION IN CASE NO. 2016-00265 DATED **JAN 26 2017**

Monthly Water Rates

5/8-Inch Meter

First	2,000 gallons	\$ 28.57 Minimum bill
Next	8,000 gallons	11.19 per 1,000 gallons
Next	40,000 gallons	10.00 per 1,000 gallons
All Over	50,000 gallons	8.81 per 1,000 gallons

1-Inch Meter

First	5,000 gallons	\$ 62.14 Minimum bill
Next	5,000 gallons	11.19 per 1,000 gallons
Next	40,000 gallons	10.00 per 1,000 gallons
All Over	50,000 gallons	8.81 per 1,000 gallons

1 1/2-Inch Meter

First	10,000 gallons	\$ 118.09 Minimum bill
Next	40,000 gallons	10.00 per 1,000 gallons
All Over	50,000 gallons	8.81 per 1,000 gallons

2-Inch Meter

First	20,000 gallons	\$ 218.09 Minimum bill
Next	30,000 gallons	10.00 per 1,000 gallons
All Over	50,000 gallons	8.81 per 1,000 gallons

3-Inch Meter

First	30,000 gallons	\$ 318.09 Minimum bill
Next	20,000 gallons	10.00 per 1,000 gallons
All Over	50,000 gallons	8.81 per 1,000 gallons

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