

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF MARTIN COUNTY WATER	)	
DISTRICT FOR APPROVAL OF A PROPOSED	)	CASE NO. 2010-00300
INCREASE IN RATES FOR WATER SERVICE	)	

ORDER

On September 8, 2010, Martin County Water District ("Martin District") applied to the Commission for an adjustment in water rates. Having performed a limited financial review of Martin District's operations, Commission Staff has prepared the attached report that contains Commission Staff's findings and recommendations regarding the proposed rates.

Finding that Martin District should be afforded the opportunity to respond to Commission Staff's findings and recommendation, the Commission HEREBY ORDERS that:

1. All parties shall have 14 days from the date of this Order to file with the Commission written comments, if any, on the findings and recommendations contained in the attached Commission Staff Report and to request a hearing or an informal conference with Commission in this matter.

2. A party's failure to file with the Commission written objections to a finding or recommendation contained in the Commission Staff Report within 14 days of this Order shall be deemed as agreement with that finding or recommendation and a waiver of any right to object to that finding or recommendation.

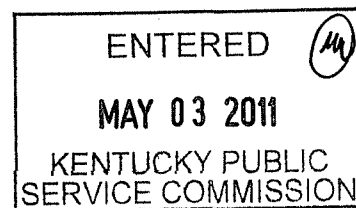
3. Any party that requests a hearing in this matter shall specifically identify in its written request for hearing all objections to the findings and recommendations set forth in the Commission Staff Report and shall provide a brief summary of testimony that it expects to present at hearing.

4. Within 14 days of the date of this Order, Martin District shall file with the Commission in writing its position on Commission Staff's recommendations regarding the assessment of a surcharge whose proceeds would be used to address Martin District's non-revenue water problems.

5. If Martin District wishes to amend its application to apply in this proceeding for assessment of a surcharge whose proceeds would be used to address Martin District's non-revenue water problems, as Commission Staff has recommended, it should request such amendment in its response to the Commission Staff Report.

6. If the Commission does not receive any written request for a hearing or for an informal conference with Commission Staff within 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:

*Stephanie Bell for Jeff Deroven*  
Executive Director

STAFF REPORT  
ON  
MARTIN COUNTY WATER DISTRICT  
CASE NO. 2010-00300

Pursuant to a request by Martin County Water District ("Martin District") for assistance with the preparation of a rate application, Commission Staff performed a limited financial review of Martin District's test period operations for the calendar year ending December 31, 2008. The scope of Staff's review was limited to obtaining information as to whether the test period operating revenues and expenses were representative of normal operations. Insignificant or immaterial discrepancies were not pursued and are not addressed herein.

Mark Frost and Eddie Beavers of the Commission's Division of Financial Analysis performed the limited review. This report summarizes Staff's review and recommendations. Mr. Beavers is responsible for the pro forma revenue adjustment, the Cost-of-Service Study, and the calculation of the recommended rates. Mr. Frost is responsible for all pro forma expense adjustments, the revenue requirement determination, and the line-loss surcharge.

Upon completion of its limited review, Commission Staff assisted Martin District in the development and preparation of its rate application, which Martin District filed with the Commission on September 8, 2010. Commission Staff finds that Martin District's application accurately reports Martin District's test-period operations and the proposed pro forma adjustments meet the rate-making criteria of known and measurable. Appendix A to this report is Martin District's pro forma operating income statement.

Appendix B to this report contains an explanation of each pro forma adjustment accepted by Staff.

As shown in Table 1, Martin Districts requested pro forma operations supports a revenue requirement from rates of \$2,155,156, an increase of \$294,346 or 15.818 percent above the normalized revenue from rates of \$1,860,810.

Table 1: Revenue Requirement			
	Avg. Debt		
	Service	Coverage	Requirement
Debt Service Coverage - RD & GMAC	\$ 161,503	x 0.2	= \$ 32,301
Debt Service Coverage - KACO	\$ 15,433	x 0.1	= 1,543
Total Debt Service Coverage			\$ 33,844
Average Annual Debt Service			176,937
Add: Pro Forma Operating Expenses			1,278,202
Depreciation			715,169
Taxes Other Than Income			+ 43,680
Total Revenue Requirement			\$ 2,247,832
Less: Other Income & Deductions			- 16,627
Revenue Requirement from Operations			\$ 2,231,205
Less: Other Operating Revenues			- 76,049
Revenue Requirement from Water Sales			\$ 2,155,156
Less: Pro Forma Revenue - Water Sales			- 1,860,810
<b>Requested/Recommended Increase</b>			<b>\$ 294,346</b>
<b>Percentage Increase</b>			<b>15.818%</b>

Commission Staff’s recommended revenue requirement from water sales will allow Martin District to cover its pro forma operating expenses, meet its debt service requirements, and provide for future equity growth. A cost-of-service study supports Martin District’s proposed rates. Commission Staff finds that this study’s methodology and calculations are reasonable. Based upon adjusted test-period water sales, these rates, which are set forth in Appendix C, will produce revenues of \$2,155,156. Therefore, Staff recommends that the Commission accept the proposed rates.

Based upon its review of Martin District’s records and operations, Commission Staff has found that Martin District lacks adequate labor, materials and equipment

necessary to address its excessive water loss and adequate funds to sustain the level of effort necessary to reduce excessive water loss. As shown in Table 2, Martin District's annual level of non-revenue water for the period from 2005 to 2009 fluctuated between 49.1 percent and 60.6 percent. During the test period, its non-revenue water was 60.6 percent of its total water production and purchases and was valued at \$167,482.

Table 2: Annual Non-Revenue Water	
Year	Non-Revenue Water
2005	61.8%
2006	50.9%
2007	49.1%
2008	60.6%
2009	57.0%

In accordance with 807 KAR 5:066, Section 6(3), Commission Staff has recommended a reduction of \$167,482<sup>1</sup> in Martin District's operating expenses for ratemaking purposes. This reduction will limit the funds available to the water district to address its non-revenue water problem. Commission Staff is concerned that this reduction will severely restrict Martin District's cash flow and prevent Martin District from taking action necessary to focus on leak detection and repair.

Given these circumstances, Commission Staff recommends that Martin District consider applying to the Commission for authority to assess a surcharge whose proceeds are restricted to addressing non-revenue water reduction efforts. Such surcharge is consistent with Commission action in other cases involving water districts

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<sup>1</sup> \$1,322 (Purchased Water) + \$130,592 (Purchased Power) + \$35,568 (Chemicals) = \$167,482.

with high non-revenue water problems.<sup>2</sup> The amount of the surcharge would be based upon the amount of expenses that 807 KAR 5:066, Section 6(3), requires to be disallowed. Using past Commission practice as a guide, the proposed surcharge would allow for the assessment and collection of \$167,482 annually for a period of 36 months or until \$502,446 had been assessed. Based upon the number of bills that Martin District issues annually, the amount of the proposed monthly surcharge would be \$3.93.<sup>3</sup>

The assessment of a surcharge is consistent with the suggestions of the independent auditors who conducted a management audit of Martin District in 2006 and 2007.<sup>4</sup> These auditors suggested the use of such a surcharge to provide revenues necessary to correct Martin District's non-revenue water problems.

Commission Staff recommends that any authorization to assess such a surcharge be subject to the following conditions: (1) The filing of comprehensive non-revenue water-reduction plan that identifies the sources of the excessive non-revenue

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<sup>2</sup> See, e.g., Case No. 9262, *The Application of The Muhlenberg County Water District, a Water District Organized Pursuant to Chapter 74 of the Kentucky Revised Statutes for a General Adjustment of Rates and Revision of Rates* (Ky. PSC Oct. 9, 1985); Case No. 9290, *The Notice of Lake Village Water Association, Inc. of a Tariff Amendment Adjusting Rates; Notice of Tariff Adjustment Imposing a Temporary Special Rule to Limit the Availability of Water Service Connections; Application for a Certificate of Public Convenience and Necessity; Application for Authority to Issue a Promissory Note and Mortgage to the Farmers Home Administration; and Application that It be Included in the Demonstration Project to Define Excessive Water Loss* (Ky. PSC Dec. 30, 1985); Case No. 96-126, *An Investigation into the Operations and Management of Mountain Water District* (Ky. PSC Aug. 11, 1997).

<sup>3</sup> \$167,482 (Annual Non-Revenue Water Limitation) ÷ 42,709 (Number of Bills) = \$3.92146.

<sup>4</sup> Barrington-Wellesley Group, Inc., *Management and Process Audit of Martin County Water District for the Kentucky Public Service Commission* (Mar. 19, 2007) at I-8.

water and the amount of non-revenue water from each source, establishes priorities and a time schedule for eliminating each source of non-revenue water, and provides a specific spending plan for the surcharge's proceeds;<sup>5</sup> (2) Commission approval of Martin District's comprehensive non-revenue water reduction plan; (3) Deposit of surcharge collections in a separate interest-bearing account; (4) The filing of monthly activity reports with the Commission that include a statement of monthly surcharge billings and collections, a monthly surcharge bank statement, a list of each payment from the account, its payee and a description of its purpose, and invoices supporting each payment; (5) The filing of monthly water-loss reports with the Commission, and (6) Revocation of the surcharge and refund of all surcharge proceeds if the water district fails to comply with any condition.

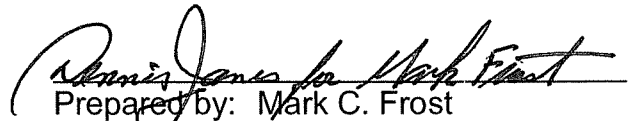
If the Commission authorizes Martin District to assess a non-revenue water surcharge, those collections constitute contributions and should be accounted for in the manner prescribed by the Uniform System of Accounts for Class A and B Water Districts and Associations. The monthly billing should be debited to customer accounts receivable and credited to the contribution account. When the non-revenue water surcharge is actually collected from the customer, special funds would be debited and the customer account credited.

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<sup>5</sup> The Commission has previously required Martin District to prepare a written comprehensive non-revenue water reduction plan. Case No. 2006-00303, *An Investigation Into the Management and Operation of Martin County Water District* (Ky. PSC Apr. 2, 2008). According to the Commission's Management Audit Branch, Martin District has yet to complete such study.

In summary, Commission Staff is of the opinion that Martin District requires additional funds to address its non-revenue water problems, but that such funds should be subject to strong controls to ensure their effective use, public acceptance of the surcharge, and public confidence in the water district's use of those funds.

Signatures



Prepared by: Mark C. Frost  
Financial Analyst, Water and Sewer  
Revenue Requirements Branch  
Division of Financial Analysis



Prepared by: Eddie Beavers  
Rate Analyst, Communications, Water  
and Sewer Rate Design Branch  
Division of Financial Analysis



APPENDIX A  
STAFF REPORT CASE NO. 2010-00300  
PRO FORMA OPERATIONS

	Test-Period Operations	Pro Forma Adjustments	Adj. Ref	Pro Forma Operations
Operating Revenues:				
Revenues - Metered Water Sales	\$ 1,840,977	19,833	(a)	1,860,810
Other Operating Revenues:				
Forfeited Discounts	\$ 0	0		\$ 0
Miscellaneous Service Revenues	6,110	0		6,110
Other Water Revenues	69,939	0		69,939
Total Other Operating Revenues	\$ 76,049	0		76,049
Total Operating Revenues	\$ 1,917,026	\$ 19,833		\$ 1,936,859
Operating Expenses:				
Operation & Maintenance:				
Salaries & Wages	\$ 496,041	\$ 39,301	(b)	\$ 535,342
Employee Pension & Benefits	148,997	60,707	(c)	209,704
Purchased Water	2,429	(1,322)	(d)	1,107
Purchased Power	243,866	(130,592)	(e)	113,274
Chemicals	65,484	(35,568)	(f)	29,916
Materials & Supplies	146,074	(33,199)	(g)	112,875
Contractual Services - Accounting	39,000	0		39,000
Contractual Services - Mgt.	4,525	0		4,525
Contractual Services - Water Testing	26,092	0		26,092
Contractual Services - Other	18,963	0		18,963
Rent - Building/Real. Property	5,500	0		5,500
Transportation	49,439	0		49,439
Insurance - Vehicle	9,258	(2,975)	(h)	6,283
Insurance - Gen. Liability	15,834	647	(h)	16,481
Insurance - Worker's Compensation	14,143	7,301	(h)	21,444
Insurance - Other	4,081	(4,081)	(h)	0
Advertising	3,714	0		3,714
Bad Debt	55,012	0		55,012
Miscellaneous	29,531	0		29,531
Total Operation & Maintenance	\$ 1,377,983	\$ (99,781)		\$ 1,278,202
Depreciation	599,760	115,409	(i)	715,169
Amortization	0	1,015	(j)	1,015
Taxes Other Than Income:				
Public Service Com. Assessment	0	0		0
Payroll Taxes	39,927	3,753	(k)	43,680
Utility Operating Expenses	\$ 2,017,670	\$ 20,396		\$ 2,038,066
Net Utility Operating Income	\$ (100,644)	\$ (563)		\$ (101,207)
Other Income & Deductions:				
Interest Income	16,627	0		16,627
Net Income Available for Debt Service	\$ 84,017	\$ (563)		\$ 84,580

APPENDIX B  
STAFF REPORT CASE NO. 2010-00300  
PRO FORMA ADJUSTMENTS

**a. Revenue from Water Sales:** This adjustment reflects the results of Commission Staff's billing analysis and the current tariffed rate.

	Bills	Gallons	Revenue
Normalized Revenue from Water Sales - Existing	3,559	226,177,212	\$ 1,860,810
Less: Reported Revenue from Water Sales			- 1,840,977
Pro Forma Adjustment			\$ 19,833

**b. Salaries & Wages - Employees:** This adjustment reflects the test period actual hours, the current wage rates, and the new crew as recommended by the management audit.

Pro Forma Current Staff	\$ 469,526
New Three-Man Crew	+ 65,816
Pro Forma Salaries and Wages	\$ 535,342
Less: Reported Salaries and Wages	- 496,041
Pro Forma Adjustment	\$ 39,301

**c. Employee Pensions & Benefits:** This adjustment reflects the current retirement contribution rate, the current employee insurance premiums, and the employee benefits for the new crew.

Employee Insurance Benefits - Current Staff	\$ 109,220
Employee Insurance Benefits - New Three-Man Crew	27,305
Pensions - Current Staff	62,543
Pensions - New Three-Man Crew	+ 10,636
Pro Forma Pensions and Benefits	\$ 209,704
Less: Reported Pensions and Benefits	- 148,997
Pro Forma Adjustment	\$ 60,707

**d. Purchased Water:** This adjustment eliminates the cost of water purchased in excess of the Commission's allowable non-revenue water limitation of 15 percent.

Test-Period Purchased Water	\$ 2,429
Divided by: Water Purchased	÷ 404
Purchased Water Cost per 1,000 Gallons	\$ 6.012
Allowable Purchases	184.100
Multiplied by: Purchased Water per 1,000 Gallons	\$ 6.012
Pro Forma Purchased Water Expense	\$ 1,107
Less: Reported Purchased Water Expense	- 2,429
Pro Forma Adjustment	\$ (1,322)

**e. Purchased Power:** This adjustment eliminates the electricity cost incurred to produce water in excess of the Commission's allowable non-revenue water limitation of 15 percent.

Electric - Source of Supply Pumping	\$ 85,526
Electric - Water Treatment	61,726
Electric - Transmission and Distribution	+ 93,800
Electric - Water Treatment & Distribution	<u>\$ 241,052</u>
Divided by: Water Purchased/Produced	<u>÷ 628,504</u>
Electric Cost per 1,000 Gallons	<u>\$ .384</u>
Allowable Purchases	287,655.544
Multiplied by: Electric Cost per 1,000 Gallons	<u>\$ .384</u>
Pro Forma Electric Cost to Treat & Transmit Water	<u>\$ 110,460</u>
Less: Actual Test-Period Expense	<u>- 241,052</u>
Pro Forma Adjustment	<u><u>\$ (130,592)</u></u>

**f. Chemicals:** This adjustment eliminates the chemical cost incurred to produce water in excess of the Commission's allowable non-revenue water limitation of 15 percent.

Test-Period Chemical Cost	\$ 65,484
Divided by: Water Purchased/produced	<u>÷ 628,504</u>
Chemical Cost per 1,000 Gallons	<u>\$ .104</u>
Allowable Purchases	287,655.544
Multiplied by: Chemical Cost per 1,000 Gallons	<u>\$ .104</u>
Pro Forma Chemical Expense	<u>\$ 29,916</u>
Less: Actual Test-Period Expense	<u>- 65,484</u>
Pro Forma Adjustment	<u><u>\$ (35,568)</u></u>

**g. Materials and Supplies:** This adjustment removes capital and nonrecurring expenditures that were incorrectly expensed in the test period.

Vendor	Description	
USA Bluebook	Horizontal Boring	\$ (1,809)
CI Thornburg	3" Water line Extension & valves	(4,842)
CI Thornburg	2" Meter & Parts	(534)
CI Thornburg	3" Meter & Parts	(2,576)
CI Thornburg	Parts to relocate Line	(2,004)
CI Thornburg	Prefab Meter Boxes	(2,800)
CI Thornburg	Handheld Radio/Read Device	(4,007)
CI Thornburg	Prefab Meter Boxes	(1,500)
CI Thornburg	Precision Digital Trident Meter	(2,500)
CI Thornburg	Prefab Meter Boxes	(1,520)
CI Thornburg	Plant Master Meter	(1,000)
CI Thornburg	50 Sensus Meters	(2,063)
Tri-State Directional Boring	Road Boring	(3,000)
Lexington Herald Leader	Advertisement - Contract Bids	(1,845)
Lexington Herald Leader	Advertisement - Contract Bids	+ (1,199)
Pro Forma Adjustment		<u><u>\$ (33,199)</u></u>

**h. Insurance:** These adjustments reflect the current insurance premiums for general liability, property, automobile, and workers compensation.

Description	Policy Period		Premium	Reported	Adjustment
	From	To			
Vehicles	07/23/09	07/23/10	\$ 6,283	\$ 9,258	\$ (2,975)
Gen. Liability	07/23/09	07/23/10	16,481	15,834	647
Workers Comp	07/15/09	07/15/10	21,444	14,143	7,301
Earthquake	07/01/08	07/01/09	+ 0	+ 4,081	+ (4,081)
Totals			<u>\$ 44,208</u>	<u>\$ 43,316</u>	<u>\$ 892</u>

**i. Depreciation:** This adjustment: (1) includes a full year depreciation on test-period plant additions; (2) reflects depreciation on plant placed in service after the test period; and (3) depreciates capital expenditures that were removed from test-period operating expenses.

(1) Normalized Depreciation (Full Year)	\$ 49,155
(2) New Construction	64,572
(3) Items Expensed in Test-Period	+ 1,682
Pro Forma Adjustment	<u>\$ 115,409</u>

**j. Amortization:** This adjustment reflects amortizing the nonrecurring expenditures that were removed from test-period operating expenses.

	Cost	Amortization	
		Life	Expense
Advertisement - Contract Bids	\$ 1,845	3	\$ 615
Advertisement - Contract Bids	\$ 1,199	3	+ 400
Pro Forma Adjustment			<u>\$ 1,015</u>

**k. Taxes Other than Income Taxes:** This adjustment computes payroll taxes using the normalized payroll.

Payroll Taxes - Current Staff	\$ 38,237
Payroll Taxes - New Three-Man Crew	+ 5,443
Pro Forma Payroll Taxes	<u>\$ 43,680</u>
Less: Reported Payroll Taxes	- 39,927
Pro Forma Adjustment	<u>\$ 3,753</u>

APPENDIX C  
STAFF REPORT CASE NO. 2010-00300  
STAFF'S RECOMMENDED RATES

5/8" x 3/4" Meter

First	2,000	Gallons	\$	26.50	Minimum Bill
Over	2,000	Gallons	\$	6.70	Per 1,000 Gallons

1" Meter

First	5,000	Gallons	\$	46.60	Minimum Bill
Over	5,000	Gallons	\$	6.70	Per 1,000 Gallon

1 1/2" Meter

First	10,000	Gallons	\$	80.10	Minimum Bill
Over	10,000	Gallons	\$	6.70	Per 1,000 Gallons

2" Meter

First	20,000	Gallons	\$	147.10	Minimum Bill
Over	20,000	Gallons	\$	6.70	Per 1,000 Gallons

3" Meter

First	30,000	Gallons	\$	214.10	Minimum Bill
Over	30,000	Gallons	\$	6.70	Per 1,000 Gallons

4" Meter

First	50,000	Gallons	\$	348.10	Minimum Bill
Over	50,000	Gallons	\$	6.70	Per 1,000 Gallons

Joe Hammond  
Manager  
Martin County Water District (Water Division)  
387 East Main Street, Suite 140  
Inez, KY 41224

Honorable Kennis Maynard  
Martin County Attorney  
P. O. Box 414  
Inez, KENTUCKY 41224

Honorable David Edward Spenard  
Assistant Attorney General  
Office of the Attorney General Utility & Rate  
1024 Capital Center Drive  
Suite 200  
Frankfort, KENTUCKY 40601-8204