


COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF MILBURN WATER)	CASE NO.
DISTRICT FOR AN ALTERNATIVE RATE)	2018-00314
ADJUSTMENT)	

NOTICE OF FILING OF STAFF REPORT

Notice is hereby given that, in accordance with the Commission's Order of October 22, 2018, the attached report containing the findings of Commission Staff regarding the Applicant's proposed rate adjustment has been filed in the record of the above-styled proceeding. Pursuant to the Commission's October 22, 2018 Order, Milburn Water District is required to file written comments regarding the findings of Staff no later than 14 days from the date of entry of this Staff Report.



Gwen R. Pinson
Executive Director
Public Service Commission
P.O. Box 615
Frankfort, KY 40602

DATED JAN 15 2019

cc: Parties of Record

STAFF REPORT
ON
MILBURN WATER DISTRICT
CASE NO. 2018-00314

Milburn Water District (Milburn District), a water district organized pursuant to KRS Chapter 74, provides water service to approximately 136 customers¹ in Carlisle County, Kentucky.² On September 17, 2018, Milburn District filed its application (Application) requesting to adjust its water and sewer rates pursuant to 807 KAR 5:076. To ensure the orderly review of the Application, the Commission established a procedural schedule by Order dated October 22, 2018.

To comply with the requirements of 807 KAR 5:076, Section 9,³ Milburn District based its requested rates on a historic test period that coincides with the reporting period shown in its most recent Annual Report on file with the Commission, the calendar year ended December 31, 2017.

Using its pro forma test-year operations, Milburn District determined that it could justify a revenue increase of \$28,558, or 52.41 percent, as shown in the table below.⁴ The proposed rates would increase the monthly bill of an average residential customer using 4,000 gallons by \$17.41, from \$33.20 to \$50.61, or 52.44 percent.

¹ *Annual Report of Milburn Water District to the Public Service Commission for the Calendar Year Ended December 31, 2016* (2016 Water Annual Report) at 38.

² 2017 Water Annual Report at 12.

³ The reasonableness of the proposed rates shall be determined using a 12-month historical test period, adjusted for known and measureable changes, that coincides with the reporting period of the applicant's annual report for the immediate past year.

⁴ Application, Revenue Requirement Calculation-Operating Ratio Method.

	Milburn District
Operating Expenses	\$ 74,440
Divided by: Operating Ratio	<u>88%</u>
Overall Revenue Requirement	84,591
Less: Other Operating Revenue	<u>1,543</u>
Revenue Requirement - Water Rates	83,048
Less: Normalized Revenue from Water Service	<u>(54,489)</u>
Required Revenue Increase	<u>\$ 28,559</u>
Percentage Increase	<u>52.41%</u>

To determine the reasonableness of the rates requested by Milburn District, Staff performed a limited financial review of Milburn District's test-year operations. The scope of Staff's review was limited to determining whether operations reported for the test year were representative of normal operations. Known and measurable changes to test-year operations were identified and adjustments were made when their effects were deemed material. Insignificant and immaterial discrepancies were not necessarily pursued or addressed.

Staff's findings are summarized in this report. Travis Leach reviewed the calculation of Milburn District's Overall Revenue Requirement. Elizabeth Stefanski and Eddie Beavers reviewed Milburn District's reported revenues and rate design.

Summary of Findings

1. Overall Revenue Requirement and Required Revenue Increase. By applying the Operating Ratio Method, as generally accepted by the Commission, Staff found Milburn District's Overall Revenue Requirement for its water division to be \$61,279. A revenue

increase of \$10,401, or 20.28 percent, is necessary to generate the Overall Revenue Requirement.

2. Water Service Rates. In the Application, Milburn District proposed to increase all of its monthly water service rates evenly across the board by approximately 52.41 percent. The Commission has previously found that the allocation of a revenue increase evenly across the board to a utility's current rate design is an appropriate and equitable method of cost allocation in the absence of a cost-of-service study. Finding no evidence of a cost-of-service study having been performed in this case, Staff followed the method proposed by Milburn District and allocated the \$10,401 revenue increase Staff found warranted evenly across the board to Milburn District's current monthly water service rates. Shown in the Attachment to this report are the monthly water service rates as calculated by Staff. These rates would increase a typical residential customer's monthly bill from \$33.20 to \$39.94, an increase of \$6.74, or approximately 20.30 percent.

Pro Forma Operating Statement

Milburn District's Pro Forma Operating Statement for their water division for the test year ended December 31, 2017, as determined by Staff, appears below:

Staff's Pro Forma Income Statement

	2017 Annual Report	Pro Forma Adjustments	Adj. Ref.	Pro Forma Operations
Operating Revenues:				
Metered Water Sales	\$ 54,489	(3,197)	(A)	\$ 51,292
Misc Service Revenues	1,543	(1,543)	(B)	0
Total Operating Revenues	56,032	(4,740)		51,292
Operating Expenses:				
Operation & Maintenance:				
Purchased Water	24,230	(5,663)	(C)	18,567
Purchased Power	2,098	(490)	(C)	1,608
Fuel for Power Production	17	(4)	(C)	13
Materials and Supplies	7,151			7,151
Contractual Services	17,243	(300)	(D)	16,943
Other Services - Commissioner's Fees	0	300	(D)	300
Water Testing	1,178			1,178
Insurance	1,879			1,879
Miscellaneous	2,368	(982)	(E)	1,386
Total Operation & Maintenance	56,164	(7,139)		49,025
Depreciation Expense	6,155	(3,026)	(F)	3,129
Taxes Other Than Income	1,771			1,771
Utility Operating Expenses	64,090	(10,164)		53,926
Net Utility Operating Income	\$ (8,058)	\$ 5,424		\$ (2,634)

(A) Billing Analysis Adjustment. Milburn District provided a billing analysis, which is based on the water usage and water sales revenue for the entire 12-month test year, with its application.

Staff has reviewed Milburn District's billing analysis provided in the Application and finds that the water sales revenues determined by the billing analysis of \$51,292 for all customers is an accurate representation of normalized test-year revenue from water sales; therefore, Staff has decreased water sales revenue by \$3,197.

(B) Other Operating Revenue. Milburn District incorrectly recorded deposits received for new customers as Miscellaneous Service Revenue in the test-year totaling \$1,543. To best correct this reporting error, Staff decreased the test-year Miscellaneous Service Revenue income by \$1,543.

(C) Excess Water Loss. Milburn District reported test-year purchased water expense of \$24,230, purchased power expense of \$2,098, and fuel for power production of \$17. Staff determined Milburn District’s test-year purchased water expense should be decreased by \$5,663, purchased power expense decreased by \$490, and fuel for power production expense decreased by \$4 as explained below.

807 KAR 5:066, Section 6(3),⁵ limits water loss to 15 percent for ratemaking purposes unless an alternative level is found reasonable by the Commission. In the below table, Staff determined Milburn District’s test-year water loss was 38.37 percent or 23.37 percent above the 15 percent allowable limit.

With the adjustments in the table below, Staff removed from Milburn District’s test-year operations the cost of purchasing, pumping, and treating the excess water loss.

Account	Test Year	Times: Excess Water Loss	Pro Forma Adjustment
Purchased Water	\$ 24,230	23.37%	\$ 5,663
Purchased Power	2,098	23.37%	490
Fuel for Power Production	17	23.37%	4

⁵ Unaccounted-for water loss. Except for purchased water rate adjustments for water districts and water associations, and rate adjustments pursuant to KRS 278.023(4), for ratemaking purposes a utility's unaccounted-for water loss shall not exceed fifteen (15) percent of total water produced and purchased, excluding water used by a utility in its own operations. Upon application by a utility in a rate case filing or by separate filing, or upon motion by the commission, an alternative level of reasonable unaccounted-for water loss may be established by the commission. A utility proposing an alternative level shall have the burden of demonstrating that the alternative level is more reasonable than the level prescribed in this section.

(D) Commissioner's Salaries. In the test year, Milburn District recorded Contractual Service Expenses of \$17,243. Included in this amount is \$300 paid as Commissioner's Fees. As these are not a contractual fee being paid, staff has reduced Contractual Service Expense by \$300 and increased Other Services – Commissioner's Fees by the same amount in order to more accurately reflect pro forma expenses.

(E) Water Deposit Refunds. As discussed in Item (B), Milburn District recorded deposits received in the test year in Miscellaneous Service Revenues. In addition, Milburn District recorded deposits returned to customers in the test-year totaling \$982 in Miscellaneous Expense. Staff has reduced Miscellaneous Expense by the same amount.

(F) Depreciation. The Commission has historically relied upon the report published in 1979 by the National Association of Regulatory Utility Commissioners (NARUC) titled Depreciation Practices for Small Water Utilities (NARUC Study). When no evidence exists to support a specific life that is inside or outside the NARUC ranges, the Commission has historically used the mid-point of the NARUC ranges to depreciate the utility plant. In following with the Commission's historical practice of using the mid-point of the NARUC ranges to calculate depreciation, Staff finds that Milburn District's test-year depreciation expense should be \$3,129. Accordingly, Staff has reduced depreciation expense by \$3,026 as shown below:

Asset Account	Original Cost	Life	Depreciation Expense
2006 Tower Painting	\$ 22,405	15	\$ 1,494
2006 Transmission Lines	7,525	62.5	120
2011 Water Building	3,500	38	93
2014 Tower Painting	19,990	15	1,333
2014 Meters	3,577	40	89
Pro Forma Depreciation Expense			\$ 3,129
Less: Test Year Depreciation			(6,155)
Pro Forma Adjustment			\$ (3,026)

Overall Revenue Requirement and Required Revenue Increase

By applying the Operating Ratio Method, as generally accepted by the Commission, Staff found Milburn District's Overall Revenue Requirement for its water division to be \$61,693. A revenue increase of \$10,401, or 20.28 percent, is necessary to generate the Overall Revenue Requirement.

The operating ratio methodology⁶ is used when there is no basis for a rate-of-return determination, the cost of the utility has fully or largely been funded through contributions, or there is little or no outstanding long-term debt. Staff is of the opinion that an operating ratio of 88 percent will allow Milburn District sufficient revenues to cover its reasonable operating expenses, and provide for reasonable equity growth. Staff finds the Operating Ratio Method is appropriate, as the district's only outstanding long-term debt will be paid off within two years.

⁶ Operating Ratio is defined as the ratio of expenses, including depreciation and taxes, to gross revenues. It is illustrated by the following equation:

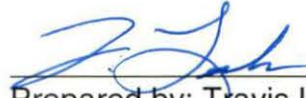
$$\text{Operating Ratio} = \frac{\text{Operating Expenses} + \text{Depreciation} + \text{Taxes}}{\text{Gross Revenues}}$$

Staff notes that if Milburn District intends to extend its single two-year term note it may do so up a total of six years,⁷ after which the district will be required to seek approval of the Commission in order to extend the note past the six-year limit.

	Staff	District
Operating Expenses	\$ 53,926	\$ 74,440
Divided by: Operating Ratio	<u>88%</u>	<u>88%</u>
Overall Revenue Requirement	61,279	84,591
Add: Interest Expense	414	0
Less: Other Operating Revenue	<u>0</u>	<u>1,543</u>
Revenue Requirement - Water Rates	61,693	83,048
Less: Normalized Revenue from Water Service	<u>(51,292)</u>	<u>(54,489)</u>
Required Revenue Increase	<u>\$ 10,401</u>	<u>\$ 28,559</u>
Percentage Increase	<u>20.28%</u>	<u>52.41%</u>

⁷ KRS 278.300(8). This section does not apply to notes issued by a utility, for proper purposes and not in violation of law, that are payable at periods of not more than two (2) years from the date thereof, or to like notes, payable at a period of not more than two (2) years from date thereof, that are issued to pay or refund in whole or in part any such notes, or to renewals of such notes from time to time, not exceeding in the aggregate six (6) years from the date of the issue of the original notes so renewed or refunded.

Signatures:



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ATTACHMENT

ATTACHMENT TO A STAFF REPORT OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2018-00314 DATED JAN 15 2019

Staff Calculated
Monthly Water Rates

First 2,000 Gallons	\$21.82	Minimum Bill
Next 3,000 Gallons	9.06	per 1,000 Gallons
Next 5,000 Gallons	8.29	per 1,000 Gallons
Next 10,000 Gallons	7.51	per 1,000 Gallons
Over 20,000 Gallons	6.83	per 1,000 Gallons

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