COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF NORTH)CASE NO.MCLEAN COUNTY WATER DISTRICT FOR AN)2020-00238ALTERNATIVE RATE ADJUSTMENT))

NOTICE OF FILING OF COMMISSION STAFF REPORT

Notice is hereby given that, in accordance with the Commission's Orders of August 20, 2020, 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 August 20, 2020 Order, North McLean County Water District is required to file written comments regarding the findings of Staff no later than 14 days from the date of this report. Pursuant to the Commission's Orders in Case No. 2020-00085,¹ issued March 16, 2020, and March 24, 2020, North McLean County Water District SHALL NOT FILE the original paper copy at this time, but rather shall file original paper copy within 30 days of the lifting of the current state of emergency. Due to COVID-19, Commission Staff is unable to physically sign this report. When Commission Staff is able to sign this report, a notice of filing with the executed signature page will be made in this case docket.

¹ Case No. 2020-00085, *Electronic Emergency Docket Related to the Novel Coronavirus COVID-*19 (Ky. PSC Mar. 16, 2020), Order at 5–6. Case No. 2020-00085, *Electronic Emergency Docket Related to the Novel Coronavirus COVID-*19 (Ky. PSC Mar. 24, 2020), Order at 1–3.

Lindsey L. Flora Deputy Executive Director Public Service Commission P.O. Box 615 Frankfort, KY 40602

DATED NOV 17 2020

cc: Parties of Record

STAFF REPORT

ON

NORTH MCLEAN COUNTY WATER DISTRICT

CASE NO. 2020-00238

North McLean County Water District (North McLean District) is a water utility organized pursuant to KRS Chapter 74 that owns and operates a water distribution system through which it provides retail water service to approximately 1,307 retail customers, and three wholesale customers, that reside in McLean County, Kentucky.¹ On August 04, 2020, North McLean District tendered an application to the Commission requesting to adjust its water rates pursuant to 807 KAR 5:076, and it was determined to be deficient. The deficiency was cured on August 12, 2020, and considered filed. To ensure the orderly review of the application, the Commission established a procedural schedule by Order dated August 20, 2020. Commission Staff (Staff) issued two rounds of formal discovery.

To comply with the requirements of 807 KAR 5:076, Section 9,² North McLean District used the calendar year ended December 31, 2019, as the basis for its application.

Using its pro forma test-year operations, North McLean District determined that a revenue increase of \$94,236, or 12.36 percent, over test-year normalized revenues of \$762,288 is warranted as shown in the table below.³ The rates requested by North

¹ Annual Report of North McLean County District to the Public Service Commission for the Calendar Year Ended December 31, 2019 at 12 and 49.

² 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.

³ Application, Attachment 5.

McLean District would increase the residential monthly bill of a typical residential customer using 4,000 gallons per month by \$3.91, from \$31.84 to \$35.75, or approximately 12.28 percent.⁴

Revenue Requirment Determination- Operating Ratio Method								
Pro Forma Operating Expenses Before Income Taxes	\$	784,387						
Divided by: Operating Ratio		0.88						
Sub-Total		891,349						
Less: Pro Forma Operating Expenses Before Income Taxes		(784,387)						
Net Income Allowable		106,962						
Add: Interest Expense		2,126						
Pro Forma Operating Expenses Before Taxes		784,387						
Total Revenue Requirement		893,475						
Less: Other Operating Revenue		(30,244)						
Non-operating Revenue		0						
Interest Income		(6,707)						
Total Revenue Required from Rates for Service		856,524						
Less: Revenue from Sales at Present Rates		(762,288)						
Required Revenue Increase	\$	94,236						
Percentage Increase		12.36%						

To determine the reasonableness of the rates requested by North McLean District, Staff performed a limited financial review of North McLean 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 to be material. Insignificant and immaterial discrepancies were not necessarily pursued or addressed.

⁴ Application, Attachment 1.

Staff's findings are summarized in this report. William Foley reviewed the calculation of North McLean District's Overall Revenue Requirement. Jason Green reviewed North McLean District's reported revenues and rate design.

SUMMARY OF FINDINGS

1. <u>Overall Revenue Requirement and Required Revenue Increase</u>. By applying the Operating Ratio Method, as generally accepted by the Commission, Staff found that North McLean District's Overall Revenue Requirement is \$856,524 and that a \$94,236 revenue increase, or 12.93 percent, to pro forma present rate revenues is necessary to generate the Overall Revenue Requirement.

2. <u>Water Service Rates</u>. In the application, North McLean District proposed to increase all of its monthly water service rates evenly across the board by approximately 12.36 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 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 North McLean District and allocated the \$117,761 revenue increase Staff found warranted evenly across the board to North McLean 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 \$34.28 to \$39.11, an increase of \$4.83, or approximately 14.09 percent.

3. <u>Non-Recurring Revenues</u>. During the test year, North McLean District earned \$21,091 in non-recurring charges. North McLean District provided a detailed breakdown of the charges as shown in the table below.

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Non Recurring Revenue Sources	Amount
Reconnect Charges	\$4,140
Penalty	16,951
Total	\$21,091

PRO FORMA OPERATING STATEMENT

North McLean District's Pro Forma Operating Statement for the test year ended

December 31, 2019, as determined by Staff, appears below.

Operating Revenues	Test Year		Adjustment	(Ref.)	Pr	Pro Forma	
Sales of Water							
Metered Water Sales	\$	762,288	7,106 66,993	(A) (B)	\$	836,387	
Other Water Revenues			00,000	(-)	Ŧ	000,001	
Total Other Water Revenues		30,244	(8,145)	(C)		22,099	
Total Operating Revenues	\$	792,532	65,954		\$	858,486	
Operating Expenses							
Operation and Maintenance Expenses							
Salaries and Wages - Employees		219,807	400	(D)			
		,	12,193	(E)		232,400	
Salaries and Wages - Officers		16,200	(400)	(F)		15,800	
Employee Pensions and Benefits		9,179	()	()		9,179	
Purchased Water		333,674	66,254	(G)			
			648	(H)		400,576	
Purchased Power		10,587	17	(H)		10,604	
Materials and Supplies		39,291				39,291	
Contractual Services		14,566				14,566	
Rents		2,040				2,040	
Transportation Expenses		14,584				14,584	
Insurance		13,385				13,385	
Miscellaneous Expense		19,122				19,122	
Total Operation and Maintenance Expenses		692,435	79,111			771,546	
Depreciation		71,067	376	(I)		71,443	
Taxes Other Than Income		20,885	933	(J)		21,818	
		704 007	00 404			004 007	
Utility Operating Expenses		784,387	80,421			864,807	
Net Operating Income		8,145	(14,467)			(6,322)	
Gain on Disposition of Property		(243)	243	(K)		-	
Utility Operating Income	\$	7,902	\$ (14,224)		\$	(6,322)	

(A) <u>Billing Analysis Adjustment.</u> North McLean District provided a billing analysis in the application that contained significant errors and was not an accurate representation of revenues generated from water sales. North McLean District filed a corrected billing analysis on August 12, 2020, that was determined to be an accurate representation of revenues from water sales for the test period. The normalized test-period revenue from water sales of \$769,394 was applied and an adjustment of \$7,106 was made.

(B) <u>Purchase Water Adjustment.</u> Subsequent to the test year, the Commission, pursuant to 807 KAR 5:068, authorized North McLean District to increase its water rates in order to pass through the wholesale water rate increase of its supplier.⁵ By applying the current retail rates authorized by the Commission to the applicable water sales shown in the billing analysis provided by North McLean District's application, Staff determined that pro forma present-rate revenues from retail sales should be stated at \$836,387 and an adjustment of \$66,993 was made.

(C) <u>Non-Recurring Charges.</u> Following the Commission's recent decision set out in the final Order issued in Case No. 2020-00141, Hyden-Leslie County Water District's recent Alternative Rate Filing,⁶ Staff has reviewed North McLean District's nonrecurring charges. In Case No. 2020-00141, the Commission found that since personnel are paid during normal business hours regardless of whether they are on a field visit or not, labor costs included in non-recurring charges that occur during regular business

⁵ Case No. 2020-00320, *Electronic Purchased Water Adjustment Filing of North McLean Water District* (Ky. PSC Oct. 21, 2020).

⁶ Case No. 2020-00141, *Electronic Application of Hyden-Leslie County Water District for an Alternative Rate Adjustment* (Ky. PSC Nov. 6, 2020)

hours should be eliminated. Staff has reviewed the most recent non-recurring cost justification⁷ and has adjusted charges by removing field labor costs and office/clerical labor costs from the charges. For non-recurring charges that occur after normal business hours, following Case No. 2020-00141, Staff removed the office/clerical labor costs. Additionally, Staff adjusted the mileage rate to the current allowable by the Internal Revenue Service (IRS) of \$0.575 per mile.⁸ Such adjustments result in the following revised non-recurring charges:

Non-Recurring Charge	<u>Normal Hours</u>	<u>After Hours</u>
Service Call	\$8.64	\$48.42
Disconnect Fee	\$17.25	\$54.06
Reconnect Fee	\$17.25	\$54.06
Cut-Lock Charge	\$48.63	\$48.63

The adjustments result in a net decrease to non-recurring charges and a corresponding

Non-Recurring Charges											
	Utility										
Charges	Pro	o Forma	Adj	ustment	Pro Forma						
2019 Reconnection Normal Hours	\$	5,880	\$	(3,982)	\$	1,898					
2019 Reconnection After hours		143		(35)		108					
Meter Test		18		-		18					
Cut-lock		96		(47)		49					
Service charge		6,163		(4,081)		2,082					
Totals	\$	12,300	\$	(8,145)	\$	4,155					

increase to the revenue requirement of \$25,097 as shown below.

 $^{^7}$ TFS2019-00366 (Ky. PSC filed June 28, 2019); the tariff was accepted for filing by the Commission by letter dated July 31, 2019.

⁸ https://www.irs.gov/tax-professionals/standard-mileage-rates

(D) <u>Salaries and Wages - Employees.</u> In its application, North McLean District reported Salaries and Wages - Employees expense of \$219,807.⁹ Staff agrees with the methodology used by North McLean District, but disagrees with the amount North McLean District calculated for salaries and wages. Using wage and hour information provided by North McLean District's accountant in an email, Staff calculated a total salaries and wages result of \$220,207 as shown below. Therefore, Staff increased the salaries and wages account by \$400.

Job Title	Total Hours	Test Year Normal Hours	W	Pro Forma Wages Rate		Pro Forma Normal Wages	Test Year Ovvertime Hours	Ovvertime Overtime		0	Pro Forma Overtime Wages		Total ro Forma Wages
Maintenance worker	2,569	2,088	\$	19.87	\$	41,489	481	\$	29.81	\$	14,324	\$	55,812
Maintenance Superindent	2,484	2,087		24.54		51,215	397		36.81		14,614		65,829
Secretary	2,113	2,089		23.02		48,089	24		34.53		829		48,918
Secretary	2,089	2,089		18.50		38,647	-		27.75		-		38,647
Mower	172	172		12.00		2,064	-		18.00		-		2,064
						181,503					29,766		211,269
							IRA Contrab	ution	S				14,875
							Total Pro For	rma V	Vages				226,144
							Less: Adjusti	ng Er	ntries				(5,937)
					Pro Forma Adjustment				220,207				
							Test Year Sal	aries	and wage	ed			219,807
							Salaries and	Wage	es adjustr	nent		\$	400

(E) <u>Salaries and Wages.</u> North McLean District provided all employees but one with a 3 percent increase to wages at the beginning of 2020, the remaining employee received a 6 percent increase to wages.¹⁰ However, in its review, Staff discovered that a

⁹ Application, Attachment 4.

10	<u>2019 Wages</u>	2020 Wages	% increase
	\$19.87	\$20.47	3%
	24.54	25.28	3%
	23.02	24.39	6%
	18.50	19.06	3%

part-time employee left the utility and was not replaced and therefore, should be removed from pro forma operations, as North McLean District could not confirm a rehire date. Staff then normalized salaries and wages expense using test-year hours worked and current pay rates shown below. Accordingly, Staff increased pro forma salaries and wages expense by \$12,193.

Job Title	Total Hours	Test Year Normal Hours	۷	2020 Vages Rates		Pro Forma Normial Wages	Test Year Overtime Hours	Ov	2020 ertime ge Rates	Pro Forma Overtime Wages	Total To Forma Wages
Maintenance worker	2,569	2,088	\$	20.47	\$	42,741.36	481	\$	30.71	\$14,769.11	\$ 57,510
Maintenance Superindent	2,484	2,087		25.28		52,759.36	397		37.92	15,054.24	67,814
Secretary	2,113	2,089		24.39		50,950.71	24		36.59	878.04	51,829
Secretary	2,089	2,089		19.06		39,816.34	-		28.59	-	39,816
									-		 -
					\$	186,267.77				\$30,701.39	\$ 216,969
							IRA Contrab	ution	S		\$ 15,431
							Total Pro Fo	rma V	Vages		232,400
					Less: Test Year Wages w/ adjustment		 220,207				
							Pro Forma A	djust	ment		\$ 12,193

(F) <u>Salaries and Wages - Officers.</u> North McLean District reported test-year salaries for commissioners of \$16,200.¹¹ However, North McLean miscalculated the total, as shown on the table below; the total for commissioners' salaries for the test year is \$15,800. Therefore, Staff reduced Salaries and Wages – Officers by \$400, and increased Salaries and Wages - Employees by \$400.

¹¹ Application, Attachment 4.

Commissioners	 est Year alaries
Carrol Troutman Dale Chandler Gary Floyd Keith Ayer Russell Bell	\$ 2,700 2,700 2,700 5,000 2,700
Total Test Year Salaries	\$ 15,800 16,200
Adjustment	\$ (400)

(G) <u>Purchased Water.</u> In its application, North McLean District reported purchased water expense of \$333,674.¹² North McLean District responded to Staff's initial data request with a breakdown of the gallons purchased from its different vendors.¹³ However, since the test year North McLean District received notice that their wholesale water suppliers increased the cost of water for North McLean District.¹⁴ The new rates increase future water purchases expense for North McLean District, Staff therefore recalculated the amount of water purchased from North McLean's suppliers with the current purchased rate. This resulted in a purchased water expense of \$399,928. Therefore, as shown below Staff calculated an increase of \$66,254 to Purchased Water Expense.

¹² *Id*.

¹³ Initial Responses from North McLean (filed Aug. 27, 2020), Item 5.

¹⁴ Case No. 2020-00320, *Purchased Water Adjustment Filing of North McLean Water District* (Ky. PSC Oct. 14, 2020).

		Purchased Water									
	McLean Co. F										
Period	Purchased	Dollars	Purchased	D	ollars	Total					
Jan-2019	9,560	\$ 3.22	322	\$	3.85	\$	32,023				
Feb-2019	8,936	3.22	214		3.85		29,598				
Mar-2019	8,984	3.22	209		3.85		29,733				
Apr-2019	8,957	3.22	374		3.85		30,281				
May-2019	10,758	3.22	367		3.85		36,054				
Jun-2019	10,196	3.22	543		3.85		34,922				
Jul-2019	11,353	3.22	189		3.85		37,284				
Aug-2019	11,506	3.22	643		3.85		39,525				
Sep-2019	11,120	3.22	243		3.85		36,742				
Oct-2019	9,916	3.22	524		3.85		33,947				
Nov-2019	8,983	3.22	271		3.85		29,969				
Dec-2019	8,914	3.22	298		3.85		29,850				
			Purchased Wa	ter Exp	pense	\$	399,928				
			Test Year Purc	Test Year Purchased Water							
			Adjustment	\$	66,254						

(H) <u>Excess Water Loss.</u> Commission regulation 807 KAR 5:066, Section 6(3), limits water loss to 15 percent, for ratemaking purposes unless the Commission finds an alternative level reasonable. In the below table, Staff determined North McLean District's test-year water loss was 15.1621 percent, or .1621 percent above the 15 percent allowable limit.¹⁵

With the adjustments in the table below, Staff is removing from North McLean District's test-year operations the cost of purchasing the excess water loss. Therefore, Staff reduces Purchased Water by \$541 and Purchased Power by \$17 with a net adjustment of \$558.

¹⁵ Annual Report of North McLean County District to the Public Service Commission for the Calendar Year Ended December 31, 2019 at 57.

	Purchased	Ρι	ırchase
	Water	F	Power
Purchased Water from 2019 Annual Report	\$ 333,674	\$	10,587
Times: Water loss Above 15 Percent	-0.1621%		-0.1621%
Excess Water Loss Reductions	\$ (541.00)	\$	(17.00)

(I) <u>Depreciation Expense.</u> In the application, North McLean District reported its depreciation expense as \$71,067.¹⁶ To evaluate the reasonableness of the depreciation practices of small water utilities, 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 outside the NARUC ranges, the Commission has historically used the midpoint of the NARUC ranges to depreciate the utility plant. Upon examination, Staff found that the appropriate adjustment would reduce test-year depreciation by \$376 as shown in the table below. Therefore, Staff reduced Depreciation Expense by \$376.

¹⁶ Application, Attachment 4.

	 Curre	ent:		Pro Forma:						
Asset	Original	Depreciation			Dep					
Category	Cost		xpense	Life	Expense		Di	fference		
Electric Pumping Equip	\$ 90,780	\$	2,270	20.0	\$	4,539	\$	2,270		
Hydrants	34,402		673	40-60		673		-		
Meter Install/Road Bores	34,573		845	40-50		775		(70)		
Meters	249,429		9,852	35-45		6,236		(3,616)		
Misc. Equipment	5,754		668	15-20		329		(339)		
Office Equipment	6,098		578	20-25		243		(335)		
Power Operated Equipment	12,972 745 10-15 910		910		165					
Structures & Improvements	447,542		8,058	35-40		8,192		134		
Tanks	222,286		5,818	30-60		4,940		(878)		
Tools/Shop/Garage Equip	1,863		82	15-20		82		-		
Transmission Mains	2,346,834		36,596	50-75		37,549		953		
Transportation Equipment	48,825		4,883	7		6,975		2,093		
		Pro	Forma Dep	reciation E	xpens	e		71,443		
		Test	Year Depre	eciation Ex	pense			71,067		
		Pro	Forma Adju	stment			\$	376		

(J) <u>Taxes Other Than Income, FICA.</u> As discussed in Item (E), Staff increased North McLean District's Salaries and Wages - Employees account by \$12,193. Staff has adjusted FICA to reflect pro forma salaries and wages recommended herein. As shown below, Staff determined that test-year FICA taxes should be increased by \$1,091 to reflect the increase to pro forma Salaries and Wages - Employees expense.

Pro Forma Wage Adjustment	\$ 12,193
Times: 7.65 Percent FICA Rate	 7.65%
Increase in FICA	\$ 933

(K) Losses on Disposition of Property. During the test year, North McLean District wrote off obsolete office equipment. The difference between the book value and the accumulated depreciation for the office equipment is \$243. Losses from the disposal of property is not a routine transaction in the normal course of business and, therefore, should be removed from the test year. Staff recommends an adjustment to Losses on the Disposition of Property of \$243 to remove the effects of this extraordinary item. In

addition, the depreciation expense of the office equipment needs to be removed from the depreciation account. Therefore, Staff also recommends decreasing the depreciation account by the same amount.

OVERALL REVENUE REQUIREMENT AND REQUIRED REVENUE INCREASE

By applying the Operating Ratio Method, as generally accepted by the Commission, Staff found North McLean District's Revenue Requirement from Rates for Service to be \$954,148. A revenue increase of \$117,761 or 14.08 percent is necessary to generate the Overall Revenue Requirement.

The operating ratio methodology¹⁷ 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 North McLean District sufficient revenues to cover its reasonable operating expenses and provide for reasonable equity growth. Therefore, Staff finds the Operating Ratio Method is more appropriate as North McLean District has only one outstanding debt.

¹⁷ Operating Ratio is defined as the ratio of expenses, including depreciation and taxes, to gross revenues. It is illustrated by the following equation:

	North McLean District	Staff
Pro Forma Operating Expenses Before Income Taxes	\$ 784,387	\$ 864,807
Divided by: Operating Ratio	0.88	0.88
Sub-Total	891,349	982,735
Less: Pro Forma Operating Expenses Before Income Taxes	(784,387)	(864,807)
Net Income Allowable	106,962	117,928
Add: Interest Expense	2,126	218
Pro Forma Operating Expenses Before Taxes		864,807
Total Revenue Requirement	893,475	982,954
Less: Other Operating Revenue	(30,244)	(22,099)
Non-operating Revenue	0	0
Interest Income	(6,707)	(6,707)
Total Revenue Required from Rates for Service	856,524	954,148
Less: Revenue from Sales at Present Rates	(762,288)	(836,387)
Required Revenue Increase	\$ 94,236	<u>\$ 117,761</u>
Percentage Increase	12.36%	<u>14.08%</u>

1. <u>Interest Expense.</u> In its application, North McLean District stated interest expense to be \$2,126.¹⁸ However, since North McLean District has already made the interest payments on its long-term debts for 2020, those payments have been recovered through North McLean District's existing rates. Therefore, only debt service payments that will be made after new rates are placed into effect should be considered in determining North McLean District's interest expense. At the time of Staff's review, North McLean District had one outstanding loan payable to the Independence Bank of Kentucky.¹⁹ Staff determined that the five-year average, for the years 2021 through 2025, for interest expense would be \$218 as shown below.

¹⁸ Application, Attachment 5.

¹⁹ Id., Attachment 7.

2021-2025	-ive-Year Average	ge of Debt F	ayment	S
Year	45156-10		Annual Debt	
2021 2022 Totals	\$	787 <u>303</u> 1,090	\$	787 <u>303</u> 1,090
Divide by: 5 years Average Annual Intere	est Payment		\$	5 218

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Signatures

Prepared by: William Foley Revenue Requirements Branch Division of Financial Analysis

Prepared by: Jason Green Rate Design Branch Division of Financial Analysis

APPENDIX

APPENDIX TO A STAFF REPORT OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2020-00238 DATED NOV 17 2020

Monthly Water Rates

First	2,000	Gallons	\$22.43	Minimum bill
Next	8,000	Gallons	0.00834	per 1,000 Gallons
Next	30,000	Gallons	0.00763	per 1,000 Gallons
Over	40,000	Gallons	0.00696	per 1,000 Gallons

Non-Recurring Charges

Service Call	\$8.64
Service Call (After Hours)	\$48.42
Disconnect Fee	\$17.25
Disconnect Fee (After Hours)	\$54.06
Reconnect Fee	\$17.25
Reconnect Fee (After Hours)	\$54.06
Cut-Lock Charge	\$48.63

*North McLean County Water District 217 Hill Street P. O. Box 68 Livermore, KY 42352

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