

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF NORTH)	
MERCER WATER DISTRICT FOR RATE)	CASE NO.
ADJUSTMENT MADE PURSUANT TO)	2016-00325
807 KAR 5:076)	

ORDER

On November 16, 2016, North Mercer Water District ("North Mercer") tendered an application with the Commission pursuant to 807 KAR 5:076 requesting to adjust its rates for water service. By letter dated November 30, 2016, the Commission notified North Mercer that its application was rejected as deficient. On December 9, 2017, North Mercer submitted information curing the filing deficiencies, and by letter dated December 12, 2016, the Commission notified North Mercer the application was deemed filed. In its application, North Mercer requested rates that would increase annual water sales revenues by \$481,314, a 24.41 percent increase to pro forma present rate water sales revenues, as determined by North Mercer, in an amount of \$1,971,576.

PROCEDURE

By Order dated December 27, 2016, the Commission established a procedural schedule through which North Mercer's application would be reviewed. Pursuant to the procedural Order, Commission Staff ("Staff") issued a report on March 22, 2017, containing its findings regarding North Mercer's requested rate adjustment. As summarized in its report, by applying methods and practices that are generally accepted

by the Commission, Staff found that North Mercer's adjusted test-year operations support an increase of \$336,064, or 17.12 percent, to pro forma present rate revenues for total water service rate revenue of \$1,962,578. Staff also found that North Mercer should change the depreciable lives assigned to certain assets when calculating depreciation for accounting and ratemaking purposes.

The schedule required that comments to the report be filed within 14 days of the date of the report. On April 1, 2017, North Mercer filed responses to Staff's report wherein it accepted Staff's findings and requested that no informal conference or hearing be held.

STAFF REPORT FINDINGS MODIFICATIONS

The following are the Commission's modifications to the findings contained in the Staff Report:

Employee Contribution for Health, Dental, and Life Insurance

North Mercer currently pays 100 percent of the monthly premiums for health insurance for its employees, their spouses, and dependents. Additionally, North Mercer currently pays 100 percent of the monthly premiums for dental insurance for an employee with a single dental plan and 100 percent of the employee's portion of the monthly premiums with a family dental plan. North Mercer also pays 100 percent of life insurance premiums for all of its employees.

The Commission expects North Mercer to increase efforts to reduce expenses related to employee benefits by establishing a policy that requires employees to pay a portion of their healthcare and dental insurance premiums. The Commission finds that North Mercer should exercise financial prudence and reduce expenses by limiting

contributions to its employees' health care and dental plans to levels more commensurate with those of other businesses.

Accordingly, the Commission will adjust North Mercer's test-year expenses for employee's health and dental insurance based on national average employee contribution rates. The Commission has reduced health insurance expenses for salaried employees by \$29,848, based on a 32 percent family employee contribution rate.¹ The Commission has also reduced dental insurance expenses for employees in the amount of \$2,076, based on a 60 percent employee contribution rate.² For this case, the Commission will accept the test-year expense for life insurance premiums for employees. However, for any future North Mercer rate-increase requests, cost recovery for paid life insurance premiums will be capped at the lesser of two times the employee's annual salary or \$100,000.

Salaries and Wages

The Commission is concerned about the lack of information to evaluate salaries and wages paid to North Mercer's employees, especially given that no basis or justification has been provided for its annual wage and salary increases. The Commission has begun placing more emphasis on performance-based evaluations of salary and benefits provided by utility providers as they relate to competitiveness in a

¹ Bureau of Labor Statistics, Healthcare Benefits, July 22, 2016, Table 4, private industry workers. (<https://www.bls.gov/news.release/pdf/ebs2.pdf>)

² The Willis Benefits benchmarking Survey, 2015. (https://www.willis.com/documents/publications/Services/Employee_Benefits/20151230_2015WillisBenefitsBenchmarkingSurveyReport.pdf)

broad marketplace.³ Future rate applications filed by North Mercer should include a performance-based validation method to justify raises that were granted to North Mercer’s employees.

Rates

Attachment A of the Commission Staff report contained a typographical error under the 5/8-Inch Meters heading. It shows that the \$7.75 per 1,000 gallon rate is applicable for all usage “Over 10,000 gallons.” It should read for all usage “Over 1,000 gallons.”

Additionally, the Bulk Sales rate in Attachment A was omitted. North Mercer’s bulk water sales is delivered through a quarter-coin-operated machine and can only be increased in increments of \$0.25. Therefore, the Bulk Sales rate should be increased from \$0.25 to \$0.50 per 80 gallons.

SUMMARY

The Commission finds that, based on the modifications to the findings of the Staff Report, North Mercer’s pro forma operations should be as follows:

	<u>Staff Pro Forma Operations</u>	<u>Commission Adjustments</u>	<u>Commission Pro Forma Operations</u>
Operating Revenues	\$ 2,026,092		\$ 2,026,092
Operating Expenses	<u>1,838,754</u>	<u>\$ (31,924)</u>	<u>1,806,830</u>
Net Operating Income	187,338		219,262
Interest Income	<u>10,078</u>		<u>10,078</u>
Income Available for Debt Service	<u>\$ 197,416</u>	<u>\$ 31,924</u>	<u>\$ 229,340</u>

³ See Case No. 2015-00312, *Application of Kenergy Corp. for a General Adjustment in Rates* (Ky. PSC Sept. 15, 2016), at 15, and Case No. 2016-00169, *Application of Licking Valley Electric, Inc. For a General Adjustment of Rates* (Ky. PSC Feb. 16, 2017) at 8.

REVENUE REQUIREMENT DETERMINATION

Based upon the Commission's findings and determinations herein, North Mercer requires an increase in revenues of \$304,140, or 15.50 percent, as shown below.

Pro Forma Operating Expenses	\$ 1,806,830
Plus: Average Annual Principal and Interest Payments	444,567
Additional Working Capital	<u>88,913</u>
Overall Revenue Requirement	2,340,310
Less: Other Operating Revenue	(63,514)
Interest Income	<u>(10,078)</u>
Revenue Required From Rates	2,266,718
Less: Pro Forma Present Rate Revenue	<u>(1,962,578)</u>
Required Revenue Increase	<u>\$ 304,140</u>
Percent Increase	<u>15.50%</u>

RATE DETERMINATION

Using the revenue requirement determined reasonable herein, the Commission has attached its revised Cost of Service Study as Appendix B. Staff's revised rates are included as Appendix A.

Having considered the evidence of record and being otherwise sufficiently advised, the Commission finds that:

1. North Mercer was organized pursuant to KRS Chapter 74. It owns and operates facilities that distribute water to approximately 4,518 customers in Anderson, Boyle, Mercer, and Washington counties, Kentucky.⁴

⁴ Annual report of North Mercer Water District to the Public Service Commission for the Calendar Year Ending December 31, 2015 ("Annual Report") at 12 and 53.

2. The calendar year ended December 31, 2015, should be used as the test year to determine the reasonableness of North Mercer’s existing and proposed rates.

3. Based upon pro forma test-year operations, North Mercer’s total pro forma present rate revenue and total pro forma operating expenses, after adjusting for known and measurable changes, are \$2,036,170⁵ and \$1,806,830, respectively.

4. North Mercer currently has three outstanding bond series payable to the United States Department of Agriculture Rural Development (“RD”), and one bond series and one loan, both payable to the Kentucky Infrastructure Authority (“KIA”). The five-year average annual principal and interest payments for the years 2017 through 2021 on all outstanding debt instruments is \$444,567.⁶

5. The Commission has historically used a Debt Service Coverage (“DSC”) Methodology to calculate the revenue requirements of water districts with long-term debt.

6. North Mercer’s pro forma operations, as calculated by Staff using the DSC Methodology and incorporating the Commission’s modifications, support a total revenue requirement of \$2,266,718 and an increase to water sales revenue of \$304,140, or 15.50 percent.

⁵ Staff Report at 5.

Revenues and Income	
Pro Forma Present Rate Water Sales	\$ 1,962,578
Miscellaneous Service Revenue	63,514
Interest Income	<u>10,078</u>
Total	<u>\$ 2,036,170</u>

⁶ Staff Report at 21.

7. North Mercer presently uses service lives for various water assets that are at variance with those found in a survey of the National Association of Regulatory Utility Commissioners (“NARUC”) of “average service lives currently being used by water utilities throughout the country for water facilities designed and installed and maintained in accordance with good water works practice.”⁷

8. The Commission has previously used the NARUC Survey to establish the service lives of water assets when there is no evidence in the record that supports alternative lives.⁸

9. North Mercer’s assignment of service lives for these asset groups is not reasonable and should be revised to conform to the NARUC Survey for ratemaking and accounting purposes in all future reporting periods.

IT IS THEREFORE ORDERED that:

1. The findings contained in the Staff Report, as modified herein, are adopted and incorporated by reference into this Order as if fully set out herein.

2. The water service rates proposed in North Mercer’s Application are denied.

3. The water service rates shown in Appendix A to this Order are approved for water service rendered on and after the date of this Order.

⁷ National Association of Regulatory Utility Commissioners, *Depreciation Practices for Small Water Utilities* (Aug. 15, 1979) at 11.

⁸ Case No. 2006-00398, *Application of Northern Kentucky Water District for Approval of Depreciation Study* (Ky. PSC Nov. 21 2007); and Case No. 2012-00278, *Application of Graves County Water District for an Adjustment in Rates Pursuant to the Alternative Rate Filing Procedure for Small Utilities* (Ky. PSC Sept. 5, 2012).

4. Within 20 days of the date of this Order, North Mercer shall file revised tariff sheets with the Commission, using the Commission's electronic Tariff Filing System, containing the rates set forth in Appendix A to this Order.

5. North Mercer shall use the Commission-approved service lives set forth below to depreciate water plant assets for accounting purposes in all future reporting periods. No adjustment to accumulated depreciation, or retained earnings should be made to account for this change in the accounting estimate.

Reservoirs and Tanks	45, 50
Transmission and Distribution Mains	63
Meters and Meter Installations	40
Hydrants	50
Structures and Improvements	35
Other Plant and Misc. Equipment	10
Transportation Equipment	7
Office Furniture and Equipment	10, 20

6. In future rate applications, North Mercer shall provide information supporting wage and salary increases as described in this Order.

By the Commission

ENTERED
MAY 19 2017
KENTUCKY PUBLIC
SERVICE COMMISSION

ATTEST:


Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2016-00325 DATED **MAY 19 2017**

The following rates and charges are prescribed for the customers in the area served by North Mercer Water District. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of the Commission prior to the effective date of this Order.

Monthly Water Rates

5/8-Inch Meters

First	1,000 gallons	\$ 18.22	Minimum Bill
Over	1,000 gallons	7.69	per 1,000 gallons

1-Inch Meters

First	2,500 gallons	\$ 29.76	Minimum Bill
Over	2,500 gallons	7.69	per 1,000 gallons

2-Inch Meters

First	10,000 gallons	\$ 87.43	Minimum Bill
Over	10,000 gallons	7.69	per 1,000 gallons

Bulk Loading Station	\$ 0.50	per 80 gallons
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APPENDIX B

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2016-00325 DATED **MAY 19 2017**

NORTH MERCER WATER DISTRICT
ALLOCATION OF PLANT VALUE

	TOTAL	COMMODITY	DEMAND	CUSTOMER
Structures & Improvements	\$206,041		\$206,041	
Land & Land Rights	48,802		48,802	
Pumping Equipment	48,996		48,996	
Distribution Reservoirs & Standpipes	1,695,007		1,695,007	
Transmission & Distribution Mains	12,644,980		12,644,980	
Hydrants	21,588			\$21,588
Meters & Meter Installations	2,258,692			2,258,692
SUBTOTAL	\$16,924,106	\$0	\$14,643,826	\$2,280,280
PERCENT	100.00%	0	86.53%	13.47%
General Plant (1)				
Transportation Equipment	211,742		183,213	28,529
Office Furniture & Equipment	36,550		31,625	4,925
Power Operated Equipment	63,809		55,212	8,597
Miscellaneous	2,866		2,480	386
Tools, Shop & Garage Equipment	7,032		6,085	947
Other Plant & Misc. Equipment	648,245		560,903	87,342
Total General Plant	970,244		839,518	130,726
TOTAL VALUE	\$17,894,350	\$0	\$15,483,344	\$2,411,006

(1) General Plant allocated based on overall weighted allocation of all other plant.

Note: Figures used were derived from 2015 Annual Report

NORTH MERCER WATER DISTRICT

ALLOCATION OF DEPRECIATION EXPENSE

	TOTAL	COMMODITY	DEMAND	CUSTOMER
Structures & Improvements	\$139,063		\$139,063	
Pumping Equipment	32,297		32,297	
Distribution Reservoirs & Standpipes	612,478		612,478	
Transmission & Distribution Mains	4,892,739		4,892,739	
Hydrants	14,496			\$14,496
Meters & Meter Installations	861,149			861,149
SUBTOTAL	\$6,552,222	\$0	\$5,676,577	\$875,645
PERCENT	100.00%	0	86.64%	13.36%
General Plant (1)				
Transportation Equipment	135,093		117,039	18,054
Office Furniture & Equipment	29,858		25,868	3,990
Power Operated Equipment	63,809		55,282	8,527
Miscellaneous	1,829		1,585	244
Tools, Shop & Garage Equipment	7,031		6,091	940
Other Plant & Misc. Equipment	410,995		356,069	54,926
Total General Plant	648,615		561,933	86,682
TOTAL VALUE	\$7,200,837	\$0	\$6,238,510	\$962,327

Note: Figures used were derived from 2015 Annual Report

NORTH MERCER WATER DISTRICT

ALLOCATION OF OPERATION AND MAINTENANCE EXPENSE

	TOTAL	COMMODITY	DEMAND	CUSTOMER
Employees Salaries	\$393,558		\$222,599	\$170,959
Employee Pensions & Benefits	139,713		79,023	60,690
Purchased Water	629,216	\$629,216		
Purchased Power	23,274	23,274		
Materials & Supplies	67,190		67,190	
Contractual Services - Maintenance	21,173		21,173	
SUBTOTAL	\$1,274,124	\$652,490	\$389,985	\$231,649
LESS COMMODITY	-\$652,490			
SUBTOTAL	\$621,634		\$389,985	\$231,649
PERCENT	100.00%		62.74%	37.26%
Water Testing	15,650		9,818	5,832
Transportation Expense	28,455		17,851	10,604
Commissioner Salaries	15,300		9,599	5,701
Insurance	36,346		22,802	13,544
Bad Debt Expense	5,054		3,171	1,883
Miscellaneous Expense	34,340		21,543	12,797
Amortization Expense	2,815		1,766	1,049
Contractual Services - Misc.	18,052		11,325	6,727
Taxes	34,046		21,359	12,687
TOTAL	\$1,464,182	\$652,490	\$509,218	\$302,474

NORTH MERCER WATER DISTRICT

SUMMARY OF ALLOCATIONS

	TOTAL	COMMODITY	DEMAND	CUSTOMER
Plant Percentages	100.00%		86.53%	13.47%
Available For Debt Service	\$533,480.00		\$461,601.24	\$71,878.76
Depreciation Percentages	100.00%		86.64%	13.36%
Total Depreciation	342,648.00		296,856.20	45,791.80
Total Operation & Maintenance	1,464,182.00	\$652,490.00	509,218.25	302,473.75
REVENUE REQUIREMENT	\$2,340,310.00			
<i>Less: Other Operating Revenue</i>	<i>-63,514.00</i>			<i>-63,514.00</i>
<i>Less: Interest Income</i>	<i>-10,078.00</i>			<i>-10,078.00</i>
REVENUE REQUIRED FROM RATES	\$2,266,718.00	\$652,490.00	\$1,267,675.69	\$346,552.31

NORTH MERCER WATER DISTRICT CALCULATION OF WATER RATES

	TOTAL	FIRST 1,000	OVER 1,000
FROM BILLING ANALYSIS:			
COMMODITY PERCENTS	100.00%	20.38%	79.62%
ACTUAL COMMODITY SALES	221,799,670	45,208,000	176,591,670
PEAK DEMAND WEIGHTED FACTOR		2	1
PEAK DEMAND WEIGHTED SALES	267,007,670	90,416,000	176,591,670
DEMAND PERCENTS	100.00%	33.86%	66.14%
COMMODITY COSTS	\$652,490.00	\$132,992.84	\$519,497.16
DEMAND COSTS	\$1,267,675.69	\$429,269.19	\$838,406.50
CUSTOMER COSTS	\$346,552.31	\$346,552.31	
TOTAL COSTS	\$2,266,718.00	\$908,814.34	\$1,357,903.66
DIVIDE BY BILLS/GALLONS		49,876	176,591,670
CALCULATED RATES		\$18.22	\$7.69
		FIRST 1,000	OVER 1,000

*North Mercer Water District
P. O. Box 79
Salvisa, KY 40372

*Mischell Lee
North Mercer Water District
P. O. Box 79
Salvisa, KY 40372