

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF HENRY COUNTY WATER)	
DISTRICT #2 FOR RATE ADJUSTMENT)	CASE NO.
PURSUANT TO 807 KAR 5:076)	2016-00377

ORDER

By this Order, the Commission approves an increase to the water service rates of Henry County Water District #2 ("Henry District"). The approved water rates will generate approximately \$172,195 in additional annual revenues, a 5.2 percent increase to pro forma present water rate revenues of \$3,298,755. The monthly bill of a typical residential customer¹ will increase from \$42.35 to \$44.56, an increase of \$2.21, or 5.2 percent.

Pursuant to 807 KAR 5:066, Section (6)3, water loss is limited to 15 percent for ratemaking purposes. As noted in the Commission Staff Report issued February 9, 2017, ("Staff Report") Henry District's test-year water loss was 17.1 percent. Accordingly, Commission Staff ("Staff") reduced test-year expenses by \$9,916 to account for the 2.1 percent excess water loss.²

The Commission is placing greater emphasis on monitoring utilities that consistently exceed the fifteen (15) percent unaccounted-for water loss threshold and strongly encourages Henry District to pursue reasonable actions to reduce its

¹ A typical residential customer purchases 5,000 gallons of water per month through a 5/8-inch x 3/4-inch meter.

² Staff Report (filed Feb. 9, 2017) at 9–11.

unaccounted-for water loss. Failure by Henry District to make significant progress towards reducing unaccounted-for water loss may cause the Commission to pursue additional action with the utility.

On October 26, 2016, Henry District submitted an application ("Application") to the Commission pursuant to 807 KAR 5:076 requesting to increase its water service rates by 5.2 percent. The Commission accepted the Application on November 23, 2016, after Henry District cured all filing deficiencies. To ensure the orderly review of the Application, the Commission issued a procedural Order on December 5, 2016, requiring Commission Staff ("Staff") to prepare and file a report containing its findings regarding the rate increase requested in the Application. The Order required that all parties file comments or objections to Staff's findings. The Order stated that a party's failure to file an objection to a finding would be deemed as a waiver of all objections to the finding.

On February 9, 2017, Staff issued a report wherein it found that Henry District's adjusted test-year operations support a 13.24 percent water service rate increase. The water rates calculated by Staff were presented in Attachment A of the report. These rates would increase a typical residential customer's monthly bill from \$42.35 to \$47.96, an increase of \$5.61, or 13.24 percent. Staff also found that Henry District was not compliant with the depreciation requirements of the Commission's final Order in Case No. 2009-00370.³

On February 24, 2017, Henry District filed with the Commission comments to Staff's report wherein it requested that the Commission authorize the 5.2 percent water

³ *Application of Henry County Water District No. 2 for Approval to Adjust Water Rates and Charges, Construct and Finance a Proposed Waterworks Project, and Implement a System Development Charge* (Ky. PSC Aug. 12, 2010).

rate increase originally requested in the Application. Henry District did not object to any of Staff's findings, but it stated that Staff had misinterpreted a prior Commission Order and requested that the Commission clarify the language in the Commission's Order in Case No. 2009-00370 concerning the depreciable lives of Transmission and Distribution Mains and Meters and Meter Installations that were installed prior to the date of the Commission's final Order in that case. Henry District stated that, per its understanding, the assets acquired prior to the final Order in Case No. 2009-00370 should be depreciated using the lives originally identified for those assets.⁴ Henry District did not request that a conference or hearing be held.⁵

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

1. Henry District, a water district organized pursuant to KRS Chapter 74, owns and operates a water distribution system through which it provides retail water service to approximately 4,492 customers in the Kentucky counties of Carroll, Henry, Oldham, Shelby, and Trimble.
2. The calendar year ended December 31, 2015, should be used as the test period to determine the reasonableness of Henry District's water service rates.

⁴ Letter from Dale Jennings, Chairman, Henry County Water District #2, to Talina Mathews, Executive Director, Public Service Commission (Feb. 24, 2017).

⁵ *Id.*

3. Based upon pro forma test-year operations, after adjusting for known and measurable changes, Henry District's pro forma present rate revenues and total pro forma operating expenses are \$3,413,517⁶ and \$2,744,263,⁷ respectively.

4. Henry District has two outstanding debt issuances payable to the Kentucky Rural Water Finance Corporation ("KRWFC") and two outstanding debt issuances payable to the Kentucky Infrastructure Authority ("KIA"). The five-year average annual principle and interest payment on these debts for the years 2017 through 2021 is \$921,755.⁸

5. The Commission has historically used a Debt Service Coverage ("DSC") method to calculate the revenue requirement for water districts or associations with outstanding long-term debt.

6. Application of the Commission's DSC method to Henry District's pro forma operations results in an Overall Revenue Requirement of \$3,850,369. A revenue increase of \$436,852 from water service rates is necessary to generate the overall revenue requirement.⁹

7. The water service rates requested by Henry District in the Application and in its February 24, 2017 response to Staff's report will not produce \$436,852 in additional annual revenues. The rates requested by Henry District will produce \$172,195 in

⁶ Staff Report, at 4. \$3,298,755 (Revenue from Water Sales) + \$106,685 (Other Water Revenues) + \$8,077 (Interest and Dividend Income) = \$3,413,517.

⁷ *Id.*

⁸ *Id.* at 26.

⁹ *Id.* at 24.

additional annual revenues, which is sufficient for Henry District to meet KRWFC's DSC ratio requirement.¹⁰

8. The record contains no evidence that permitting Henry District to assess the requested water service rates will result in any degradation or reduction in the quality of water service currently provided by Henry District.

9. A utility may assess rates that fail to produce a level of revenues that accepted ratemaking methodologies would regard as sufficient or adequate. Absent evidence that the quality of the utility's service will decline or be degraded as a result of

¹⁰ KRWFC requires Henry District to assess water service rates that will generate net revenues that are equal to at least 120 percent of Henry District's average annual debt payments. As shown below, the rates requested by Henry District will generate net revenues that produce a DSC Ratio of 163.51 percent, which is above KRWFC's minimum requirement.

Pro Forma Present Rate Revenues	\$ 3,298,755
Plus: Additional Annual Revenues from Requested Rates	172,195
Other Operating Revenues	106,685
Interest Income	<u>8,077</u>
 Total Revenue	 3,585,712
Less: Pro Forma Operation and Maintenance Expenses	(2,003,658)
Cost of Excess Water Loss Eliminated for Rate Making Purposes (includes Purchased Water and Purchased Power)	(9,916)
Taxes Other Than Income Taxes	<u>(65,007)</u>
 Net Revenues Upon Which DSC Ratio is Calculated	 1,507,131
Divide by: Average Annual Debt Payments	<u>921,755</u>
 DSC Ratio	 <u>163.51%</u>

this level of revenue, the water service rates requested by Henry District should be approved by the Commission.¹¹

10. The Commission reviewed Henry District's depreciation practices in Case No. 2009-00377.

11. In Case No. 2009-00377, Staff and Henry District entered into a stipulated agreement ("Stipulation") wherein both parties agreed that:

11. The National Association of Regulatory Utility Commissioners ("NARUC") has reported that the average services lives in use by small water utilities for water mains is 50 to 75 years and for water meter installations is between 40 and 50 years.

12. In determining the appropriate level of depreciation expense for water mains and water meter installations, the expense for those items should be based upon a service life that is within those ranges.

13. For water mains and water meter installations installed after a final decision in Case No. 2009-00370, Henry District will use a service life of 60 years and 40 years respectively.¹²

12. In Case No. 2009-00377, the Commission found that:

6. a. Henry District has calculated its test period depreciation expense related to its water transmission and distribution mains using a 25-year life or a 33-year depreciable life.

b. Henry District has calculated its test period depreciation expenses for meters and meter installations using a 10-year life.

¹¹ *Utilities Operating Co. v King*, 143 So.2d 854, 45 PUR3d 439, 443 (Fla. 1962) ("[I]n the absence of some showing that the service to the public will suffer by allowing the utility to charge rates which will not produce a fair return, the utility and not the Commission has the right of decision as to the rates it will charge so long as they do not exceed those which would produce a fair return as determined by the Commission.") See also Case No. 2006-00410, *The Application of Hardin County Water District No. 1 for a General Rate Adjustment Effective on and after December 2, 2006* (Ky. PSC Aug. 2, 2007); and Case No. 98-398, *Adjustment of Rates of the Kentucky Turnpike Water District and the Imposition of an Impact Fee* (Ky. PSC June 30, 1999).

¹² Stipulation filed with the Commission on June 11, 2010 at 2-3.

c. Generally, water transmission and distribution mains of small water systems should be depreciated over a period from 50 years to 75 years.

d. Generally, a small water system's meters and meter installations should be depreciated over a period of 40 years to 50 years.

e. In establishing test period depreciation expense, Henry District has understated the useful lives of its water transmission and distribution mains and its meters and meter installations.

f. Assuming a 50-year depreciable life for Henry District's water transmission and distribution mains and a 40-year depreciable life for its meter and meter installations, Henry District's test period depreciation should be \$645,650 or approximately \$161,672 less than Henry District reported for the test period.¹³

13. In Case No. 2009-00370, after reducing test period depreciation by \$161,672 to reflect the change in the depreciable lives for water mains and meter installations, the Commission ordered that:

4. When calculating and recording depreciation expense on such assets as distribution and transmission mains and meter installations in future reporting periods, Henry District shall assign a depreciable life to such assets that is within the range that National Association of Utility Commissioners ("NARUC") specifies for small water utilities.¹⁴

14. In this proceeding, Staff noted in its report that, while Henry District is depreciating water mains and meter installations installed subsequent to August 12, 2010, using a 60-year life and 40-year life, respectively, in accordance with the Stipulation and the Commission's Order in Case No. 2009-00370, Henry District is not depreciating water mains and meter installations that were installed prior to August 12, 2010 in accordance with the Commission's Order in Case No. 2009-00370. Staff noted that Henry District

¹³ (Ky. PSC Aug. 12, 2010) at 4–5.

¹⁴ *Id.* at 8.

continued to depreciate these assets using lives that fall outside the NARUC ranges, in violation of the Commission's Order.¹⁵ In its report, Staff adjusted Henry District's test-year depreciation expense in this proceeding to account for the change to the Commission-approved lives.

15. Staff also adjusted test-year depreciation expense accrued by Henry District on Distribution Reservoirs and Standpipes. Staff noted that the NARUC range for this asset account group is 30–60 years and that Henry District depreciated these assets using either a 25-year life or a 33-year life. Finding no evidence in this proceeding to support a life that greatly deviates from the midpoint of the NARUC range, 45 years, Staff adjusted the life for this account group to 45 years.¹⁶

16. In response to Staff's report, Henry District did not object to Staff's findings, but it requested clarification of the Commission's August 12, 2010 Order regarding the depreciation of water mains and meter installations that were installed prior to August 12, 2010. Henry District stated that its "understanding was that the newly acquired assets be depreciated using the stipulated lives, but that all previously acquired assets would remain at their original identified useful life."¹⁷

17. Henry District's understanding of the Commission's August 12, 2010 Order in Case No. 2009-00370 is incorrect. The "original identified useful life" for "all previously acquired assets," as referred to by Henry District, were outside the NARUC ranges in Case No. 2009-00370. In its August 12, 2010 Order, consistent with the stipulation signed

¹⁵ Staff Report at 17–20.

¹⁶ *Id.* at 20.

¹⁷ See Henry District's response to Staff's Report.

by Henry District in Case No. 2009-00370, the Commission changed these lives for ratemaking purposes to lives that fall within the NARUC ranges and, in ordering paragraph number 4, required that Henry District use lives within the NARUC ranges when calculating and recording depreciation on these assets for accounting purposes in all future reporting periods. Staff correctly calculated depreciation on these assets in this proceeding using the lives previously authorized by the Commission.

18. The approved services lives for Transmission and Distribution Mains; Meters and Meter Installations; and Distribution Reservoirs and Standpipes are summarized below and should be used by Henry District when calculating and recording depreciation expense for accounting purposes in all future reporting periods. No adjustment to Accumulated Depreciation or Retained Earnings should be made to account for the cumulative effect of this change in accounting estimate.

Account Group	Service Life
Transmission and Distribution Mains	
Installed on or Prior to August 12, 2010	50 Years
Installed Subsequent to August 12, 2010	60 Years
Meters and Meter Installations	40 Years
Distribution Reservoirs and Standpipes	45 Years

19. Pursuant to 807 KAR Section (2), Henry District is required to file its 2016 Annual Financial and Statistical Report ("2016 Report") with the Commission on or before March 31, 2017.

20. On March 13, 2017, Henry District requested that it be permitted to file its 2016 report on or before May 31, 2017, and on March 30, 2017, that request was granted.

21. Henry District will report Depreciation Expense in the 2016 Report and include a copy of the calculation of the Depreciation Expense reported using the Commission approved depreciable lives for all assets.

IT IS THEREFORE ORDERED that:

1. The monthly water service rates requested by Henry District in the Application and in its February 24, 2017 response to Staff's report are approved.

2. Henry District shall charge the water service rates that are set forth in Appendix A for water service rendered on and after the date of this Order.

3. Henry District shall use the "PSC Approved Service Life" set forth below to depreciate water plant assets for ratemaking and accounting purposes in all future reporting periods. No adjustment shall be made to accumulated depreciation or retained earnings to account for this change in accounting estimate.

<u>Account Group</u>	<u>Service Life</u>
Transmission and Distribution Mains	
Installed on or Prior to August 12, 2010	50 Years
Installed Subsequent to August 12, 2010	60 Years
Meters and Meter Installations	40 Years
Distribution Reservoirs and Standpipes	45 Years

4. Henry District shall include a copy of the calculation of the Depreciation Expense reported in the 2016 Report using the Commission approved depreciable lives for all assets.

5. Within 20 days of the date of this Order, Henry District shall file revised tariff sheets with the Commission, using the Commission's electronic Tariff Filing System, setting forth the water service rates approved herein.

By the Commission

ENTERED
APR 28 2017
KENTUCKY PUBLIC
SERVICE COMMISSION

ATTEST:


Executive Director

Case No. 2016-00377

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2016-00377 DATED **APR 28 2017**

The following water service rates and charges are prescribed for the water customers in the area served by Henry County Water District #2. 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

First	1,500 gallons	\$ 19.74	Minimum bill
Next	3,500 gallons	7.09	per 1,000 gallons
Next	5,000 gallons	6.47	per 1,000 gallons
Next	10,000 gallons	5.24	per 1,000 gallons
Next	30,000 gallons	4.01	per 1,000 gallons
Over	50,000 gallons	2.72	per 1,000 gallons
Wholesale		\$ 2.72	per 1,000 gallons

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