COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF WESTERN LEWIS RECTORVILLE WATER AND GAS DISTRICT FOR RATE ADJUSTMENT FOR SMALL UTILITIES PURSUANT TO 807 KAR 5:076	))))	CASE NO. 2017-00074

NOTICE OF FILING OF STAFF REPORT

Notice is hereby given that, in accordance with the Commission's Order of May 25, 2017, 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 May 25, 2017, Order, Western Lewis Rectorville Water and Gas District is required to file written comments regarding the findings of Commission Staff no later than 14 days from the date of this report.

John S. Lyons
Acting Executive Director
Public Service Commission
P.O. Box 615
Frankfort, KY 40602

DATED JUL 1 7 2017

cc: Parties of Record

STAFF REPORT

ON

WESTERN LEWIS RECTORVILLE WATER AND GAS DISTRICT

CASE NO. 2017-00074

Western Lewis Rectorville Water and Gas District ("Western Lewis") provides gas service to approximately 527 residential and commercial/industrial customers residing in Lewis and Mason counties, Kentucky.[1] On February 14, 2017, Western Lewis tendered an application ("Application") to the Commission pursuant to 807 KAR 5:076 requesting to adjust its base gas rates. After Western Lewis corrected filing deficiencies, its Application was accepted for filing on March 6, 2017.

To ensure the orderly review of the Application, the Commission established a procedural schedule by Order dated March 16, 2017. On May 11, 2017, Western Lewis moved for an extension of time to file its responses to Staff's Second Request for Information ("Staff's Second Request"), stating that it required the extra time to be able to fully and completely respond to Commission Staff's ("Staff") inquiries. In its May 25, 2017 Order, the Commission found good cause to grant Western Lewis's request to file its responses to Staff's Second Request on or before May 26, 2017, and extended the date the Staff Report would be issued from June 9, 2017 to July 10, 2017.

To comply with the requirements of 807 KAR 5:076,[2] Section 9, Western Lewis used the calendar year ended December 31, 2015, as the basis for its Application.

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[1] *Annual Report of Western Lewis Rectorville Water and Gas District Gas Division to the Public Service Commission for the Calendar Year Ended December 31, 2015* ("2015 Annual Report") at 9 and 26.

[2] The reasonableness of the proposed rates shall be determined using a twelve (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.

Western Lewis calculated its requested revenue requirement using the operating ratio method historically accepted by the Commission.[3] Pursuant to this method, the allowable revenue requirement is calculated by dividing pro forma operating expenses by 88 percent. Using operations reported for the test year, Western Lewis determined that a revenue increase of $194,301, or 50.51 percent, is warranted.[4] However, the base gas rates requested by Western Lewis will actually produce a revenue increase of $383,384, or 466 percent over test-year revenues from base gas rates of $82,255. According to Western Lewis, its requested rates would increase the monthly bill of an average customer by $50.51, from $29.58 to $80.09, or approximately 171 percent.[5]

In the Application, Western Lewis provided financial exhibits in support of the Overall Revenue Requirement and Required Revenue Increase as summarized below.

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[3] An operating ratio measures the difference between operating revenues and operating expenses. It is defined by the following equation.

$$\text{Operating Ratio} = \frac{\text{Operation \& Maintenance Exp.} + \text{Depreciation} + \text{Taxes}}{\text{Gross Revenues}}$$

The Commission has found that the operating ratio is a reasonable and necessary alternative to the rate of return method for calculating the allowable NOI for small investor owned utilities. Specifically, it has found that the rate of return method cannot be used because there is "no basis" upon which to determine a rate of return for these utilities, Case No. 95-236, *Application of Thelma Waste Control, Inc. for a Rate Adjustment Pursuant to the Alternative Rate Filing Procedure for Small Utilities* (Ky. PSC. Apr. 15, 1996) at 6. Further, it has found that the operating ratio method is appropriate when plant investment is low and operating expenses are high, Case No. 7982, *Notice of Application of Fern Lake Company* (Ky. PSC. Aug. 27, 1981) at 3.

[4] Application, ARF Form 1 – Attachment RR-OR – January 2014. $578,962 (Total Revenue Requirement from Rates Service including PGA Revenues) - $384,661 (Reported Test-Year Revenues including PGA Revenues) = $194,301 ÷ $384,661 = 50.51%.

[5] *Id.* Customer Notice.

Pro Forma Income Statement

Account Titles	Test Year	Pro Forma Adjustments	Pro Forma Operations
Operating Revenues:			
Gas Service Revenues	$ 384,661	$ 143,568	$ 528,229
Other Gas Revenues	10,000	-	10,000
Total Gas Operating Revenues	394,661	143,568	538,229
Operating Expenses:			
Operation and Maintenance Expenses:			
Other Gas Supply Expenses	174,148	-	174,148
Distribution Expenses	9,145	60,000	69,145
Administrative & General Expenses	237,261	23,300	260,561
Total Gas Operation & Maint Exp.	420,554	83,300	503,854
Depreciation	17,020	-	17,020
Taxes Other Than Income Tax	9,510	-	9,510
Total Gas Operating Expenses	447,084	83,300	530,384
Net Operating Income	$ (52,423)	$ 60,268	$ 7,845

Revenue Requirement Calculation - Operating Ratio Method
as Presented by Western Lewis

Pro Forma Operating Expenses (Net of Purchased Gas Costs & Income Taxes)		$ 356,236
Divide by:	Operating Ratio	88%
Revenue to Cover Operating Ratio		404,814
Less:	Pro Forma Operating Expenses (Net of Purchased Gas Costs & Income Taxes)	(356,236)
Net Income Allowable		48,578
Add:	Pro Forma Operating Expenses before Income Tax	356,236
	Cost of Natural Gas	174,148
Total Revenue Requirement - Base Rates and Customer Charges		578,962
Less: Other Operating Revenues		-
Total Revenue Requirement (Staff Base Rates)		578,962
Less: Operating Revenues (Less: Gas & Transportation Costs)		(384,661)
Revenue Increase		$ 194,301

To determine the reasonableness of the rates requested by Western Lewis, Staff performed a limited financial review of Western Lewis'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.

Staff is relying on the information gathered at the limited financial review and from Western Lewis's responses to its requests for information to develop its findings. Staff's findings are summarized in this report. Ariel Miller and Mark Frost reviewed the calculation of Western Lewis's Overall Revenue Requirement. Leah Faulkner and Matthew Baer reviewed Western Lewis'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 Western Lewis's Overall Revenue Requirement to be $118,789. A revenue increase of $20,360, or 24.752 percent, above base gas rate revenues is necessary to generate the Overall Revenue Requirement.

2) Base Gas Rates. Staff recommends that the Commission approve the base rates set forth in Appendix A, as they will produce the recommended revenue requirement from base rates of $102,615.

3) Allocation and Assignment of Costs Between the Divisions. In Case No. 2014-00266, Staff found that Western Lewis "did not make proper assignment and allocation of many transactions between its Water and Gas Division." [6] Western Lewis was using an operating revenue factor to allocate its shared costs between the two

[6] Case No. 2014-00266, *Application of Western Lewis-Rectorville Water & Gas District for Rate Adjustment for Small Utilities Pursuant to 807 KAR 5:076*, (Ky. PSC Nov. 7, 2014) at 3–4.

divisions. In its report, Staff made numerous adjustments to correct and to properly assign or allocate costs to the appropriate division by using a customer number allocation factor. Staff recommended that Western Lewis be required to revise its accounting procedures and internal controls so that proper assignment and allocations of revenues and expenses are recorded in the original books of entry in all future reporting periods.

In reviewing the supporting financial records, Staff discovered that Western Lewis continues to use an operating revenue factor to allocate costs between its water and gas divisions. Staff believes that the operating revenue factor does not result in an accurate allocation of costs between the two divisions. An increase in revenues in one division resulting from a rate increase should not directly impact the operational costs of that division.

Staff agrees with the findings that were made in the Staff Report in Case No. 2014-00266 and has reallocated the shared costs using the customer number allocation factor. In the test period, Western Lewis allocated 35 percent of the shared costs to its gas division, but by using the customer allocation factor, Staff is reducing the gas allocation factor to 19.143 percent.[7] Commission finds that the reallocation of the operating expenses to Western Lewis's gas division will result in an overall decrease in the revenue requirement of $85,708, as calculated in Attachment B.[8]

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[7] Customer Levels as of December 31, 2015

Gas Division	527	19.143%
Water Division	2,226	80.857%
Totals	2,753	100.000%

[8] Western Lewis allocated 65% of the gas consultant cost to the water division. In its reallocation, Staff included 100% of this cost in the gas division's operating expenses.

Staff agrees with the findings in the Staff Report in Case No. 2014-00266, in that the Commission should direct Western Lewis to "make the necessary revisions to its accounting procedures and internal controls so that proper assignment and allocation of revenues and expenses are recorded in its books of original entry in all future reporting periods."[9] Staff believes that the Commission should also direct Western Lewis to submit in writing its agreement to the above requirement and to set a deadline by which it will submit its revised accounting procedures and internal controls for the Commission to review.

Pro Forma Operating Statement

The Pro Forma Operating Statement for the test year ended December 31, 2015, as determined by Staff, appears below.

	Test Year Operations	Reallocation Adjustments	Reallocated Test Year Operations	Pro Forma Adjustments	Adj. Ref.	Pro Forma Operations
Operating Revenues:						
Revenues - Base Gas Rates	$ 384,661	$ -	$ 384,661	$ (302,406)	A	$ 82,255
Other Operating Revenues:						
Other Gas Revenues	10,000	0	10,000	6,174	B	16,174
Total Gas Operating Revenues	394,661	0	394,661	(296,232)		98,429
Operating Expenses:						
Operation and Maintenance Expenses:						
Salaries & Wages - Employees	90,297	(40,910)	49,387	(967)	C	48,420
Salaries & Wages - Commissioners	7,000	(3,171)	3,829	(3,829)	D	0
Retirement Expense	6,256	(2,834)	3,422	2,615	E	6,037
Purchased Gas	174,148	0	174,148	(174,148)	F	0
Purchased Power	18,592	(8,423)	10,169	(10,169)	G	0
Chemicals and Water Testing	3,390	(1,536)	1,854	(1,854)	H	0
Materials and Supplies	6,986	(4,312)	2,674	0		2,674
Professional Fees	9,065	6,142	15,207	(12,675)	I	2,532
Maintenance Expenses	8,113	(538)	7,575	(2,810)	J	4,765
Rental Expense	621	(281)	340	(340)	K	0
Insurance	32,075	(14,533)	17,542	(1,477)	L	16,065
Utilities and Telephone	1,752	(794)	958	0		958
Office and Program Expense	23,725	(10,748)	12,977	(5,905)	M	7,072
Total Gas Operation & Maint Exp.	382,020	(81,938)	300,082	(211,559)		88,523
Depreciation and Amortization	17,020	0	17,020	(5,560)	N	11,460
Taxes Other Than Income Tax	8,321	(3,770)	4,551	0		4,551
Total Gas Operating Expenses	407,361	(85,708)	321,653	(217,119)		104,534
Net Operating Income	$ (12,700)	$ 85,708	$ 73,008	$ (79,113)		$ (6,105)

[9] Final Order at 4.

(A) Operating Revenue – Base Rate. Western Lewis reported total test-period operating revenues from gas sales of $384,661. Included in this amount are purchased gas costs and gas transmission fees. These costs are recovered by Western Lewis through its purchased gas adjustment and have been excluded for purposes of determining base rate revenue.

In 2015, Western Lewis reported gas sales of 39,017 Mcf,[10] with 6,545 customer bills used in its billing analysis. By applying the gas sales to Western Lewis's current tariffed base rates and the test-period customer bills to the monthly customer charge of $1.00, Staff calculates revenues from base gas rates of $82,255. Staff is reducing Western Lewis's operating revenues from gas sales to eliminate the purchased gas costs and gas transmission fees.

(B) Other Gas Revenues. Western Lewis reported other gas operating revenues of $10,000 in the test year. However, Staff determined that the actual test-year other operating revenues was $16,174,[11] resulting in an increase to operating revenues of $6,174.

(C) Lump-Sum Vacation Pay. In the test year, Western Lewis paid to its employees $5,050 for their unused vacation. Western Lewis pays its full-time employees a lump-sum payment for any vacation time not used by the end of the calendar year. It is the Commission's historic practice to exclude, for ratemaking purposes, these type of

[10] Response to Staff's Second Request, Item 1.

[11] $2,145 (Connection Fes) + $60 (Returned Checks) + $2,700 (Meter Connection) + $11,269 (Late Charges) = $16,174.

employee payments. Accordingly, Staff is reducing Salaries and Wages – Employee Expense by $967[12] to eliminate the vacation payout allocated to the gas division.

(D) Commissioner Fees. Western Lewis reported paying its commissioners $20,000 in the test year. Because Western Lewis's commissioners had obtained the six instructional hours of water district management training required by KAR 74.020(7)(a), the Board of Commissioners voted to increase their salaries during their August 11, 2015 meeting. However, KAR 74.020(6) requires:

> . . . salary shall be fixed by the county judges/executive with the approval of the fiscal court; in multicounty districts, it shall be fixed by the agreement between the county judges/executive with the approval of their fiscal courts.

Western Lewis was unable to provide the required approval from the judges/executive with the fiscal courts in Lewis and Mason counties. For this reason, Staff is reducing the gas division's operating expenses by $3,829[13] to eliminate the reallocated commissioner fees.

(E) Retirement Expense Pursuant to Governmental Accounting Standards Board ("GASB") Statement No. 68 ("GASB 68"). Western Lewis provides pension benefits and post-retirement health care benefits to its employees by participating in the County Employee Retirement System ("CERS"). As a participating member, Western Lewis is required to contribute a percentage of its employee wages to CERS. The table below summarizes the CERS contribution rates for each of the previous six fiscal years beginning July 1.

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[12] $5,050 (Employee Vacation Payout) x 19.143% (Allocation Factor – Gas) =$967.

[13] $20,000 (Commissioner Fees) x 19.143% (Allocation Factor – Gas) =$3,829.

Fiscal Year Beginning July 1	Employer Contribution Rate
2011	16.93%
2012	18.96%
2013	19.55%
2014	18.89%
2015	17.67%
2016	17.06%

During the test year, Western Lewis contributed $40,278 to CERS on behalf of its employees. Prior to the test year, Western Lewis was required to report annual pension costs and post-retirement health care costs pursuant to GASB Statement No. 27 ("GASB 27"). GASB 27 required that Western Lewis report its CERS contributions as employee retirement expense. GASB 27 did not require that Western Lewis report a liability on its financial statements for a portion of either CERS's Net Pension Liability ("NPL") or CERS's underfunded post-retirement health care costs.

The accounting and reporting requirements for the CERS pension benefit changed during the test year due to the passage and implementation of GASB 68. The accounting for post-retirement health care costs did not change. Beginning in the test year, GASB 68 requires that Western Lewis report the following for pensions:

1) A charge against Retained Earnings to account for the cumulative effect of switching from GASB 27 to GASB 68;

2) Western Lewis's proportionate share of the CERS NPL;

3) Deferred Inflow of Resources and Deferred Outflow of Resources related to pensions; and

4) Annual pension expense that includes:

a. Pension contributions to CERS during the reporting period that were made prior to the NPL's measurement date;

b. The amortization of Western Lewis's proportionate share of Deferred Outflow of Resources and Deferred Inflow of Resources related to pensions;

c. Western Lewis's proportionate share of the plan's actuarially determined annual pension expense; and

d. The increase or decrease that occurs during the reporting period to the amount of North Mercer's proportionate share of the CERS NPL.

To implement GASB 68 during the test year, Western Lewis relied on the results of the CERS actuarial valuation for the fiscal year ended June 30, 2014. Using the 2014 valuation, Western Lewis reported the following account balances to account for GASB 68 and its impact on Western Lewis's test-year beginning balance on Retained Earnings.[14]

NPL	$ 244,000
Impact on Retained Earnings	(252,127)
Deferred Outflows	32,532
Deferred Inflows	27,000
Retirement Expense	17,875

In Case No. 2016-00163,[15] after considering the effects of GASB 68 on Marion County Water District's ("Marion District") test-year operations, the Commission found that, except for the NPL, the difference between the amounts reported for retirement costs

[14] Note that Western Lewis's implementation of GASB 68 resulted in its reporting of test-year retirement expense in the amount of $17,875, or $22,403 less than the amount of its actual test-year contributions to CERS that were allocated to the CERS pension fund.

[15] Case No. 2016-00163, *Alternative Rate Adjustment Filing of Marion County Water District* (Ky. PSC Nov. 10, 2016).

pursuant to GASB 68 and those that would have been reported pursuant to GASB 27 should be accounted for as a regulatory asset, as allowed by GASB 62. The Commission found that its method would mitigate the impact of GASB 68 on Marion District's Balance Sheet. Taking such action would smooth the level of annual retirement expense reported by Marion District in future reporting periods because the annual expense would always be equal to the amount of Marion District's contributions to CERS, which historically have been fairly constant.

Staff finds that the method of accounting for retirement costs applied by the Commission to Marion District will provide the same benefits to Western Lewis and should, therefore, be applied in this proceeding. Application of the Commission's method to Western Lewis's audited retirement costs requires the following journal entry:

	Dr.	Cr.
Regulatory Asset	$ 244,000	
Deferred Inflows	27,000	
Retirement Expense	13,659	
Retained Earnings		$ 252,127
Deferred Outflows		32,532

The above journal entry results in the Staff adjusted account balances shown below:

Regulatory Asset	$ 244,000
NPL	244,000
Impact on Retained Earnings	
Deferred Outflows	
Deferred Inflows	
Retirement Expense	31,534

By applying the customer allocation factor to the restated test-year retirement expense of $31,534, Staff increased the gas division's allocated retirement expense by $2,615.[16]

(F) Natural Gas Purchases and Transmission Fees. Western Lewis reported net natural gas purchases and transmission fees of $174,148. Given that the natural gas purchases and transmission fees are recovered through Western Lewis's purchased gas adjustment, Staff reduced operating expenses by $174,148 to exclude these costs from the determination of Western Lewis's revenue requirement.

(G) Purchased Power. In the test year, Western Lewis allocated to its gas division $18,592 of the purchased power that was used to pump water. The reallocation of the shared expenses in Attachment B reduces the gas division's allocation of purchased power expense to $10,169. Since this expense is a direct cost of the water division, Staff reduced operating expenses by $10,169 to remove this cost from the gas division's operations.

(H) Chemicals. In the test year, Western Lewis allocated to its gas division $3,390 for water chemical and testing. The reallocation of the shared expenses in Attachment B reduces the gas division's allocation of chemical expense to $1,854. Since

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Restated Retirement Expense	$ 31,534
Times: Number of Customer Allocation Factor	19.143%
Retirement Expense Allocated to Gas	6,037
Less: Reallocated Test Year Operations	(3,422)
Adjustment	$ 2,615

these expenses are direct costs of the water division, Staff reduced operating expenses by $1,854 to remove these costs from the gas division's operations.

(l) Gas Consultant. On May 20, 2015, Western Lewis entered into a contract with RussMar Utility Management ("RussMar") wherein RussMar agreed to provide the following services: (1) an annual leakage survey; (2) annual regulator inspections; (3) annual valve inspections; (4) annual CP readings; (5) public awareness program implementation; and (6) submission of annual PHMSA report(s).[17] The contract requires Western Lewis to pay RussMar $1,750 per month in the initial year of the contract and $1,300 per month in the remaining two years of the contract term.

Western Lewis proposed to increase its test-year operating expenses by $18,300 to reflect the costs of the RussMar contract. Western Lewis explained that it had blended the monthly fees of $1,750 and $1,300 to calculate its pro forma adjustment. In response to a Staff interrogatory, Western Lewis stated that $12,675 of the gas consultant fee was already included in the test-year operating expenses and revised its proposed adjustment to an expense increase of $6,500.[18]

The Commission's Division of Inspections conducted a periodic inspection of Western Lewis's gas system on June 13–16, 2017. In its report that was released on June 26, 2017, Western Lewis was cited for seven deficiencies. Western Lewis stated in its Application that it expected RussMar to provide it with the required training that would keep the District up to date on current laws and regulations relating to gas service.[19] Staff

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[17] Response to Commission Staff's First Request for Information, Item 17.d.(2).

[18] Response to Staff's Second Request, Items 11.a. and 11.b.

[19] Application, References, ARF Form 1 – Attachment SAO-G-September 2011 at 2.

finds that the seven cited deficiencies is evidence that the contract with RussMar is not providing Western Lewis with the expected operational benefits. Accordingly, Staff is reducing operating expenses by $12,675 to remove the recorded test-year payments to RussMar and finds that Western Lewis's adjustment should be denied.

(J) Maintenance. Western Lewis reported $7,575 for test-year maintenance expense. Western Lewis stated that:

> Water expense related to water taps were removed from test-year expenses and capitalized on Western Lewis' depreciation schedule, as they were over the $5,000 capitalization threshold. The gas taps were removed from income and included as Contributions In Aid – Customer Taps, however, they were not removed from Materials and Supplies: Gas expenses in the amount of $2,810.[20]

When it depreciated the cost of its water taps, Western Lewis recognized that the cost of a tap is a capital expenditure that should be depreciated rather than recorded as an expense. Accordingly, Staff is reducing the gas division's maintenance expense by $2,810 to remove the cost of the test-year gas taps. The depreciation of the gas taps is contained in Item M below.

(K) Rental of Equipment. In the test year, Western Lewis allocated to its gas division $621 of the equipment rental expense. The reallocation of the shared expenses in Attachment B reduces the gas division's allocation of equipment rental expense to $340. This expense represents costs that were associated with maintenance of the water division. Accordingly, Staff reduced operating expenses by $340 to remove this cost from the gas division's operations.

[20] Response to Staff's Second Request, Item 8.d.

(L) Insurance. In the test year, Western Lewis reported paying $36,747 in employee health insurance premiums, of which $12,861 was allocated to the gas division. The reallocation of the shared expenses in Attachment B reduces the gas division's allocation of Insurance expense to $7,034. Western Lewis currently pays 100 percent of the cost of each employee's single health insurance benefit, and it requires the employees to pay for any additional coverage.[21] All of Western Lewis's employees have opted for single health insurance coverage.

In recent decisions, the Commission has found that utilities should exercise financial prudence and reduce operating expenses by limiting their contributions to their employees' health care plans to levels more commensurate with those of other businesses.[22] To comply with the Commission's current practice, Staff is adjusting Western Lewis's test-year expenses for employee single health insurance premiums by 21 percent,[23] the national average employee contribution rate. A 21 percent reduction results in a decrease to allocated employee health insurance expense of $1,477.[24]

(M) Office and Program Expense. In the test year, Western Lewis reported the payment of $67,788 in office program expenses, of which $23,725 was allocated to the

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[21] Responses to Staff's First Request for Information, Item 11.

[22] *See* Case No. 2016-00325, *Electronic Application of North Mercer Water District for Rate Adjustment made Pursuant to 807 KAR 5:076* (Ky. PSC May 19, 2017) at 2 and 3. *See* Case No. 2016-00435, *Application for Adjustment of Nebo Water District* (Ky. PSC June 5, 2017) at 3.

[23] Bureau of Labor Statistics, Healthcare Benefits, March 2016, Table 10, private industry workers. (https://www.bls.gov/ncs/ebs/benefits/2016/ownership/private/table10a.pdf)

[24] $36,747 (Employee Health Insurance Expense) x 21% (Employee Contribution Rate) = $7,717 x 19.143% = $1,477.

gas division. The reallocation of the shared expenses in Attachment B reduces the gas division's allocation of office and program expense to $12,977.

Subsequent to the test year, Western Lewis discontinued the use of contract labor to read its meters and began using its full-time employees. In the test year, Western Lewis paid $30,847 to an outside contractor to perform the meter reading function. Staff is reducing office and program expense by $5,905[25] to remove the allocated contract meter reading cost from the gas division's operating expenses.

(N) Depreciation. In its application, Western Lewis reported a test-year depreciation expense of $17,020,[26] but attached a depreciation schedule to its Application supporting a test-year depreciation expense of $7,853.[27] Western Lewis agreed that the correct test-year depreciation is $7,853 rather than the amount that was reported in its Application.[28]

Western Lewis proposed to increase the gas division's operating expenses by $60,000 to reflect "Repairs and Maintenance; Gas line extension/Rebuilding regulator station."[29] In its response to a Staff interrogatory, Western Lewis stated that the proposed maintenance expense increase was actually capital expenditures that should be

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[25] $30,847 (Outside Contract Labor) x 19.143% (Customer Allocation Factor) = $5,905.

[26] Application, Schedule of Adjusted Operations – Gas Utility, ARF Form – Attachment SAO – September 2011 at 1.

[27] Western Lewis Rectorville Water District Gas Division, Plant and Depreciation Schedule, December 31, 2015.

[28] Response to Staff's Second Request, Item 9.a.

[29] Application, Schedule of Adjusted Operations – Gas Utility, ARF Form – Attachment SAO – September 2011 at 1 and References at 2.

depreciated rather than expensed.[30] Western Lewis proposed to depreciate the $31,164 cost of the regulator station over 15 years and the $53,670 cost of its line extension over 40 years, resulting in an increase to pro forma depreciation expense of $3,420.[31] Staff finds that the proposed depreciation lives are reasonable and is including the $3,420 in its pro forma depreciation expense. Staff is also depreciating the cost of the new service connections of $2,810 over 15 years, resulting in an increase of $187.

Staff finds that an overall decrease to test-year depreciation expense of $5,560 is reasonable.

Calculation of Overall Revenue Requirement
and Required Revenue Increase

Using the operating ratio method, Staff determined that Western Lewis requires an overall revenue requirement of $118,789. As shown below, a $20,360 base rate revenue increase, or 24.752 percent, is necessary to produce the overall revenue requirement.

Pro Forma Operating Expenses	$	104,534
Divide by: Operating Ratio		88%
Overall Revenue Requirement		118,789
Less: Other Operating Revenue		(16,174)
Revenue Requirement from Base Rates		102,615
Less: Operating Revenue - Base Rates		(82,255)
Required Increase	$	20,360
Percentage		24.752%

[30] Response to Staff's Second Request, Item 10.

[31] *Id.* 9.b. $31,164 (Regulator Station) ÷ 15 (Years) = $2,078; $53,670 (Line Extension) ÷40 (years) = $1,342; $2,078 + $1,342 = $3,420.

Rate Calculated by Staff

Western Lewis currently has a declining block rate design consisting of a minimum bill including up to 1 Mcf usage, and three additional blocks of 1 to 5 Mcf, 5 to 10 Mcf, and over 10 Mcf, plus a $1.00 monthly customer charge. Western Lewis proposes to continue the use of its $1.00 monthly customer charge as well as a minimum bill including 1 Mcf with a base rate of $10 plus the Gas Cost Recovery ("GCR") rate, and with all over 1 Mcf usage charged at a flat base rate of $10 plus the GCR rate. Western Lewis's proposed rates and rate design are as follows:

Customer Charge	$1.00 per month		
	Base Rate	GCR Rate	Total Rate
1 Mcf or less (Minimum bill)	$10.00	$2.7567[32]	$12.7567
All Mcf over 1	$10.00	$2.7567	$12.7567

In response to a Staff request for information, Western Lewis confirmed that it preferred the proposed rate design because it could be easily integrated into the existing billing system set up. It further indicated its willingness to consider changing to a rate design of a fixed monthly customer charge and one volumetric rate for all Mcf sold.[33] Staff recommends that Western Lewis change its rate design to one that is simpler and more common, with a $10 fixed monthly customer charge and a flat rate for all Mcf sold. Using Staff's revenue requirement of $118,789, Staff determines the flat monthly rate to be $.9530 per Mcf.[34]

[32] GCR rate in effect at the time Western Lewis filed its Application.

[33] Response to Staff's Second Request, Item 5.

[34] ($118,789 Revenue Requirement - $16,174 Other Revenues - $65,450 customer charge revenue) ÷ 39,017 Mcf = $.9530 per Mcf (rounded).

Signatures:

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Division of Financial Analysis

Ariel Miller

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Rate Design Branch
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Prepared by: Matthew Baer
Rate Analyst, Gas and Electric
Rate Design Branch
Division of Financial Analysis

ATTACHMENT A
STAFF REPORT, CASE NO. 2017-00074
RATE CALCULATED BY STAFF

RETAIL RATES:

Customer Charge	$10.00 per month

Monthly usage

	Base Rate
All Mcf	$.9530

ATTACHMENT B
STAFF REPORT, CASE NO. 2017-00074
REALLOCATION OF SHARED EXPENSES

Account Title	Total Expenses	Direct/Allocated			Gas Division
Advertising	501	Allocated:	19.143% to the Gas Division	$	96
Automobile Expense	1,744	Allocated:	19.143% to the Gas Division		334
Bank Service Charges	600	Allocated:	19.143% to the Gas Division		115
Bond Certificate	3,385	Allocated:	19.143% to the Gas Division		648
Chemicals	2,470	Allocated:	19.143% to the Gas Division		473
Continued Education	2,313	Allocated:	19.143% to the Gas Division		443
Credit Refund	250	Allocated:	19.143% to the Gas Division		48
Depreciation	316,777	Direct:	to the Gas Division		17,020
Deposit Interest	189	Allocated:	19.143% to the Gas Division		36
Dues and Subscriptions	218	Allocated:	19.143% to the Gas Division		42
Independent Contractor	30,847	Allocated:	19.143% to the Gas Division		5,905
Insurance	382	Allocated:	19.143% to the Gas Division		73
Insurance: Employee Health	36,747	Allocated:	19.143% to the Gas Division		7,034
Insurance: Liability	51,128	Allocated:	19.143% to the Gas Division		9,787
Maintenance: Fuel	13,971	Allocated:	19.143% to the Gas Division		2,674
Materials and Supplies	7,833	Direct:	to the Gas Division		7,833
Materials and Supplies: Gas	(845)	Direct:	to the Gas Division		(845)
Mileage	2,164	Allocated:	19.143% to the Gas Division		414
Miscellaneous	(3)	Allocated:	19.143% to the Gas Division		(1)
Office Expense	4,418	Allocated:	19.143% to the Gas Division		846
Office Supplies	2,900	Allocated:	19.143% to the Gas Division		555
Payroll Expenses	257,990	Allocated:	19.143% to the Gas Division		49,387
Payroll Expenses: Commissioner Fees	20,000	Allocated:	19.143% to the Gas Division		3,829
Payroll Taxes	23,775	Allocated:	19.143% to the Gas Division		4,551
Postage and Delivery	10,435	Allocated:	19.143% to the Gas Division		1,998
Postage and Delivery: Gas	482	Allocated:	19.143% to the Gas Division		92
Professional Fees: Accounting	10,300	Allocated:	19.143% to the Gas Division		1,972
Professional Fees: Consulting	2,926	Allocated:	19.143% to the Gas Division		560
Professional Fees: Gas Consultant	12,675	Direct:	to the Gas Division		12,675
Program Expense	12,473	Allocated:	19.143% to the Gas Division		2,388
Rent	1,775	Allocated:	19.143% to the Gas Division		340
Repairs: Gas Meters	253	Direct:	to the Gas Division		253
Retirement Expense	17,875	Allocated:	19.143% to the Gas Division		3,422
Telephone	4,779	Allocated:	19.143% to the Gas Division		915
Trash Pickup	227	Allocated:	19.143% to the Gas Division		43
Utilities: Electric (Water)	53,120	Allocated:	19.143% to the Gas Division		10,169
Utilities: Gas	174,148	Direct:	to the Gas Division		174,148
Water Testing	7,213	Allocated:	19.143% to the Gas Division		1,381
Reallocated Operating Expenses					321,653
Less: Test-Year Operating Expenses Gas Division					407,361
Reallocation Adjustment				$	(85,708)

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