

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF SOUTHERN)	CASE NO.
WATER AND SEWER DISTRICT FOR AN)	2022-00099
ALTERNATIVE RATE ADJUSTMENT)	

ORDER

On March 30, 2022, Southern Water and Sewer District (Southern District) filed its Alternative Rate Filing (ARF) application with the Commission pursuant to 807 KAR 5:076. Southern District filed this proceeding in compliance with the final Order in Case No. 2019-00131,¹ and the October 1, 2021 Order in Case No. 2020-00121.² In Case No. 2019-00131, Southern District was ordered to file an ARF application within 90 days of the one-year anniversary of the completion of the replacement of all of its customer meters. Southern District completed the replacement of all of its customer meters on October 5, 2020,³ meaning that its ARF application was to be filed on January 5, 2022. By Order issued October 1, 2021,⁴ the Commission found that Southern District should file its ARF application based on its 2021 annual report and financial data, rather than 2020 because Southern District did not resume billing its customers for actual usage until

¹ See Case No. 2019-00131, *Application of Southern Water and Sewer District for an Alternative Rate Adjustment*, final Order (Ky. PSC Nov. 7, 2019).

² Case No. 2020-00121, *Electronic Southern Water and Sewer District Meter Replacement Surcharge Monitoring*, (Ky. PSC Oct 1, 2021).

³ See Case No. 2020-00121, Annual Progress Report (filed May 7, 2021).

⁴ Case No. 2020-00121, Order (Ky. PSC Oct 1, 2021).

November 2020.⁵ The Commission ordered Southern District to file an ARF application using its 2021 annual report on or before April 1, 2022, to permit a decision to be based on a complete year of financial data using the new customer meters.⁶

In its application, using its pro forma test-year operations, Southern District determined that a base rate revenue increase of \$275,222, or 8.22 percent was necessary to achieve the revenue requirement.⁷ However, Southern District requested that no change to its rates be made at this time. Southern District stated that it did not believe a rate increase was appropriate because it has engaged in operational changes that have resulted in lowering its costs over the past few years and has plans for more changes in the near future. Southern District requested additional time in which to implement more operational changes and proposed filing another ARF in 2024.⁸

To ensure the orderly review of the application, the Commission established a procedural schedule by Order dated May 3, 2022, which, among other things, required the Commission Staff to file a report containing its findings regarding Southern District's application. By Order issued September 9, 2022, the Commission incorporated the record of Case No. 2020-00121 into this proceeding by reference and announced that

⁵ See Case No. 2019-00131, (Ky. PSC June 6, 2019) Order, (Ky. PSC July 17, 2019), Order, and (Ky. PSC Nov. 7, 2019), Order, from June 6, 2019, until installation of new customer meters was complete, Southern District's residential customers were charged a flat monthly fee, not a volumetric rate. Additionally, Southern District's commercial customers were charged a flat monthly fee from June 6, 2019 until July 7, 2019. See also 807 KAR 5:0076, Section 3, requires the Commission to base a utility's request for an alternative rate adjustment on the applicant's annual reports for the immediate past year, and 807 KAR 5:006, Section 4, requires utilities to file annual reports with the Commission on or before March 31 of each year.

⁶ Case No. 2020-00121, Order (Ky. PSC Oct. 1, 2021).

⁷ Application, Schedule of Adjusted Operations and Revenue Requirements (filed Mar. 30, 2022).

⁸ Application, Reasons for Application Attachment (filed Mar. 30, 2022).

discovery would be conducted into a number of matters related to Southern District's financial condition including a Citizens Bank of Kentucky loan having an origination date of November 17, 2017. Southern District responded to four requests for information from Commission Staff.⁹ There are no intervenors in this proceeding.

The Commission Staff's Report was issued on August 26, 2022 (Commission Staff's Report), summarizing Commission Staff's findings and recommendations regarding Southern District's application and its request that its rates not be raised. In the Commission Staff's Report, Commission Staff found that Southern District's required revenue from water sales is \$3,648,686 to meet the Overall Revenue Requirement of \$3,741,325 and that a \$299,178 revenue increase, or 8.93 percent, to pro forma present rate revenues is necessary to generate the Overall Revenue Requirement. In the absence of a cost of service study (COSS), Commission Staff allocated its recommended revenue increase evenly across the board to calculate its recommended water rates. Commission Staff also recommended that Southern District be allowed to continue assessing a monthly meter replacement surcharge of \$5.25 per active meter for the remainder of the 60-month period as ordered by the Commission on November 7, 2019, in Southern District's last rate proceeding.¹⁰

Southern District filed its response to Commission Staff's Report on September 6, 2022. Southern District stated that it concurred with Commission Staff's calculations as

⁹ Southern District's Response to Commission Staff's First Request for Information (Response to Staff's First Request) (filed June 10, 2022); Southern District's Response to Commission Staff's Second Request for Information (Response to Staff's Second Request) (filed July 18, 2022); Southern District's Response to Commission Staff's Third Request for Information (Response to Staff's Third Request) (filed Aug. 10, 2022); Southern District's Response to Commission Staff's Fourth Request for Information (Response to Staff's Fourth's Request) (filed Oct. 25, 2022).

¹⁰ Case No. 2019-00131, Order (Ky. PSC Nov. 7, 2019).

presented in the Commission Staff's Report, but restated that it did not wish to burden its customers with an additional rate increase so soon after the change to a volumetric rate, which occurred in 2020.¹¹ Further, Southern District stated that it did not agree with the removal of labor expenses from certain nonrecurring charges, but that it did not wish to contest that adjustment in this case.¹² The Commission held a formal hearing in this proceeding on November 9, 2022.

On December 5, 2022, Southern District filed a position statement announcing its reconsideration of its earlier stance against implementing a rate increase at this time. Southern District stated that it now requests the Commission "use its discretion to increase water rates up to but not to exceed 8.3 percent."¹³ Southern District maintained that when it filed its application in this matter, it failed to fully consider the effect of increased inflation on its ability to operate.¹⁴ Southern District stated that it may be forced to increase pay for initial hires as well as for existing employees in order to have the personnel needed to operate the utility.¹⁵ Additionally, Southern District acknowledged the price it pays for chemicals, office supplies, gasoline and other items needed to provide service has increased.¹⁶ The Commission finds that Southern District's position statement fails to meet the regulatory requirements of an amendment to proposed rates pursuant to 807 KAR 5:076, Section 8. Unless it is responding to findings set forth in a

¹¹ Southern District's Response to Commission Staff's Report (filed Sep. 6, 2022).

¹² Southern District's Response to Commission Staff's Report.

¹³ Southern District's Position Statement (Position Statement) (filed Dec. 5, 2022) at 2.

¹⁴ Position Statement at unnumbered page 2.

¹⁵ Position Statement at unnumbered page 2.

¹⁶ Position Statement at unnumbered page 2.

Commission Staff report, a utility may amend the rates it proposed in an ARF application only by first filing a written notice of the proposed amendment with the Commission and publishing notice of the amended proposed rates in a manner consistent with 807 KAR 5:076, Section 5. Because Southern District merely filed a post-hearing position statement asking the Commission to “use its discretion” in approving a rate increase not to exceed 8.3 percent, it failed to provide notice to its customers of its amended proposal. Therefore, the position statement fails to conform to the applicable regulation and cannot be considered an amendment of the proposed rates. The case now stands submitted for a decision by the Commission. In making a decision in this matter the Commission has considered the totality of the evidence of record, including the application and exhibits, Commission Staff Report, hearing testimony, and the post-hearing position statement filed by Southern District.

LEGAL STANDARD

Alternative rate adjustment proceedings, such as this one, are governed by Commission regulation 807 KAR 5:076, which establishes a simplified process for small utilities to use to request rate adjustments, with the process designed to be less costly to the utility and the utility ratepayers. The Commission’s standard review of a utility’s request for a rate increase is well established. In accordance with KRS 278.030 and case law, Southern District is allowed to charge its customers “only fair, just and reasonable rates.”¹⁷ Further, Southern District bears the burden of proof to show that any proposed rate adjustment is just and reasonable under KRS 278.190(3).

¹⁷ *City of Covington v. Public Service Commission*, 313 S.W.2d 391 (Ky. 1958); and *Public Service Comm’n v. Dewitt Water District*, 720 S.W.2d 725 (Ky. 1986).

WATER LOSS

Pursuant to 807 KAR 5:066 (6)(3), water loss is limited to 15 percent for ratemaking purposes. The Commission Staff's Report noted that Southern District's reported test-year water loss was 54.7978 percent.¹⁸ At a 54.7978 percent water loss, the annual cost of water loss in excess of 15 percent is \$360,558 and the total annual cost of water loss to Southern District is \$519,710, as calculated in the table below.

	Water	Power	Chemicals	Total
Purchased Cost (SAO)	\$ 342,556	\$ 428,312	\$ 204,950	\$ 975,818
Exclude Natural Gas		(4,694)		(4,694)
Exclude Telephone	0	(22,709)	0	(22,709)
Adjusted Purchase Costs	\$ 342,556	\$ 400,909	\$ 204,950	\$ 948,415
Water Loss Percent	54.7978%	54.7978%	54.7978%	54.7978%
Total Water Loss	<u>\$ 187,713</u>	<u>\$ 219,689</u>	<u>\$ 112,308</u>	<u>\$ 519,710</u>
Adjusted Purchase Costs	\$ 342,556	\$ 400,909	\$ 204,950	\$ 948,415
Water Cost for Internal Use (5.7082%)	(19,554)	(22,885)	n/a	(42,439)
sub-total	<u>\$ 323,002</u>	<u>\$ 378,024</u>	<u>\$ 204,950</u>	<u>\$ 905,976</u>
Percent of Water Loss Disallowed	39.7978%	39.7978%	39.7978%	
Water Loss in Excess of Allowed Amount	<u>\$ 128,548</u>	<u>\$ 150,445</u>	<u>\$ 81,565</u>	<u>\$ 360,558</u>

In Case No. 2019-00131, the Commission approved a \$5.25 per customer meter-replacement surcharge for 60 months or until the cost of new meters had been assessed.¹⁹ Using meter-replacement surcharge proceeds, Southern District replaced all of its customer meters as part of its effort to reduce unaccounted-for water loss and is in the process of installing ultra-sonic master meters to aid it in locating and responding

¹⁸ *Annual Report of Southern District to the Public Service Commission for the Calendar Year Ended December 31, 2021* (2021 Annual Report) at 57.

¹⁹ Case No. 2019-00131, Order (Ky. PSC Nov. 7, 2019).

to leaks. Additionally, Randy Conley, current manager of Southern District for Utilities Management Group (UMG), testified that Southern District is now prosecuting individuals for water theft.²⁰ The Commission encourages Southern District to make installation of master meters a priority and to take steps to further address its unaccounted-for water loss.

BACKGROUND

Southern District is a water district organized pursuant to KRS Chapter 74. It owns and operates a water distribution system through which it provides retail water service to approximately 5,224 residential customers, 204 commercial customers, and 2 wholesale customers in Floyd and Knott counties, Kentucky.²¹ Southern District produces a portion of its own water and also purchases water from the city of Pikeville and Prestonsburg City Utilities Commission. A review of the Commission's records indicates that Southern District's last alternative rate adjustment occurred on November 7, 2019.²²

TEST PERIOD

The calendar year ended December 31, 2021, was used as the test year to determine the reasonableness of Southern District's existing and proposed water rates, as required by 807 KAR 5:076, Section 9.²³

²⁰ Hearing Video Transcript (HVT) of the Nov. 9, 2022 Hearing at 11:55:29–11:58:00.

²¹ 2021 Annual Report at 12 and 49.

²² Case No. 2019-00131, Order (Ky. PSC Nov. 7, 2019).

²³ The reasonableness of the proposed rates shall be determined using a 12-month historical test period, adjusted for known and measurable changes, that coincides with the reporting period of the applicant's annual report for the immediate past year.

SUMMARY OF REVENUE AND EXPENSES

The Commission Staff's Report summarizes Southern District's pro forma income statement as follows:

	Test-Year Operations	Commission Staff's	
		Pro Forma Adjustments	Pro Forma Operations
Operating Revenues	\$ 3,656,455	\$ (243,491)	\$ 3,412,964
Operating Expenses	3,708,868	(487,430)	3,221,438
Net Utility Operating Income	<u>\$ (52,413)</u>	<u>\$ 243,939</u>	<u>\$ 191,526</u>

REVIEW AND MODIFICATIONS TO COMMISSION STAFF'S FINDINGS

Southern District's proposed adjustments to revenues and expenses reflect current and expected operating conditions. In the Commission Staff's Report, Commission Staff proposed additional adjustments. The Commission accepts the findings contained in the Commission Staff's Report. The Commission has no further modifications to the revenue requirement calculated in the Commission Staff's Report.

REVENUE REQUIREMENTS

Billing Analysis. Southern District provided usage data by meter size, listing the water usage and water sales revenue for the 12-month test year. The current rate structure is a single customer charge and volumetric rate for all customers as stated in the current tariff on file with the Commission.²⁴ Southern District originally had considered requesting a change in the rate structure but chose to continue with the current rate structure.²⁵

²⁴ Southern District's Tariff PSC KY No. 1, 9th Revised, Sheet No. 4.

²⁵ HVT of the November 9, 2022 Hearing at 12:05:38–12:07:40.

Commission Staff calculated the data provided within a normalized billing analysis and determined that annual base rate revenues of \$3,349,508 for all retail and wholesale customers is an accurate representation of the normalized test-year revenue from water sales. In the Commission Staff's Report, Commission Staff recommended a decrease to Southern District's test-year retail and wholesale Water Sales Revenue of \$194,628.²⁶ The Commission finds that this adjustment is reasonable because an examination of Southern District's billing analysis was completed by Commission Staff and a normalized revenue was based on the information provided.

Late Payment Fees. Southern District included the test-year late payment revenue in the amount of \$83,003. Commission Staff recommended a decrease to Southern District's test year Late Payment Fees of \$20,417,²⁷ to account for the moratorium regarding the collection of late payment fees due to the COVID-19 pandemic. The Commission finds that this adjustment, which is the average of the years of 2017-2019 late-payment fees, follows Commission precedent,²⁸ is a known and measurable change²⁹ to Forfeited Discounts, is reasonable, and should be accepted.

²⁶ Commission Staff's Report at 10, Adjustment A.

²⁷ Commission Staff's Report at 11, Adjustment B.

²⁸ Case No. 2021-00475, *Electronic Application of Carroll County Water District No. 1 for an Adjustment of Rates Pursuant to 807 KAR 5:076* (Ky. PSC June 28, 2022).

²⁹ See 807 KAR 5:001, Section 16.1.(a); Case No. 2001-00211, *The Application of Hardin County Water District No. 1 for (1) Issuance of Certificate of Public Convenience and Necessity; (2) Authorization to Borrow Funds and to Issue Its Evidence of Indebtedness Therefore; (3) Authority to Adjust Rates; and (4) Approval to Revise and Adjust Tariff* (Ky. PSC Mar. 1, 2002); Case No. 2002-00105, *Application of Northern Kentucky Water District for (A) an Adjustment of Rates; (B) a Certificate of Public Convenience and Necessity for Improvements to Water Facilities if Necessary; and (C) Issuance of Bonds* (Ky. PSC June 25, 2003); Case No. 2017-00417, *Electronic Proposed Adjustment of the Wholesale Water Service Rates of Lebanon Water Works* (Ky. PSC July 12, 2018); and Case No. 2019-00080, *Electronic Proposed Adjustment of the Wholesale Water Service Rates of the City of Pikeville to Mountain Water District* (Ky. PSC Dec. 19, 2019).

Nonrecurring Charges. In the Commission Staff's Report, Commission Staff discussed Southern District's Nonrecurring Charges, in which estimated labor costs, previously included in determining the amount of Nonrecurring Charges, are removed. The Commission continues to follow its previous decisions regarding Nonrecurring Charges: personnel are paid during normal business hours and their salaries are recovered through rates.³⁰ Allowing a utility to recover the same labor expense twice is not fair, just and reasonable. Therefore, estimated labor costs previously included in determining the amount of Nonrecurring Charges shall be eliminated from the charges. The Commission finds that the calculation of Nonrecurring Charges shall be revised and only marginal costs related to the service should be recovered through a special nonrecurring charge for service provided during normal working hours. The Commission requires that charges be directly related to the actual costs incurred to provide the service. It is unreasonable to allocate an expense already incurred as a day-to-day cost of maintaining a system, such as the salary of a distribution operator, to a nonrecurring service such as the connection and reconnection of a meter during normal working hours. The perceived unfairness from removal of these costs does not outweigh the mismatch of costs and revenues. This approach to ratemaking is entirely consistent with the Commission's history of ensuring that rates reflect, to a reasonable degree, the principle of cost causation while simultaneously taking into account the health of the utility, and the ability of the utility to provide the adequate, efficient, and reasonable provision of service. The implementation of rates that significantly deviate from the actions and expenses

³⁰ Case No. 2020-00141, *Electronic Application of Hyden-Leslie County Water District for an Alternative Rate Adjustment* (Ky. PSC Nov. 6, 2020).

underlying the service provided can create material issues with a utility's ability to meet its approved revenue requirement, particularly a utility with razor thin margins. In keeping with precedent, the Commission finds this adjustment to be reasonable.

The nonrecurring charges shall each be reduced by the estimated labor costs stated in the cost justification sheets. The Commission finds the revised nonrecurring charges set out in Appendix B and the adjustment of (\$1,239) to be known and measurable and consistent with Commission precedent.³¹ The Commission finds that the Other Water Revenues should be further adjusted by (\$138)³² that was identified upon Commission Staff's review of the 2021 general ledger.

The Commission finds the nonrecurring charges to be reasonable and should be accepted.

Tap Fee Revenue. In the Commission Staff's Report, Commission Staff recommended a decrease to Other Water Revenues of \$809 and \$15,215,³³ respectively to reclassify tap on fees as contributed capital. The Commission finds that this adjustment is consistent with acceptable accounting practices outlined in the Uniform System of Accounts for Class A/B Water Districts and Associations (USoA),³⁴ is reasonable, and should be accepted.

³¹ Commission Staff's Report at 11, Adjustment C.

³² Commission Staff's Report at 11, Adjustment C.

³³ Commission Staff's Report at 12, Adjustment D.

³⁴ The USoA, which has been adopted as the acceptable accounting standard for water districts by the Commission, requires water districts to credit contributions from customers that pay all or part of the cost of service to account 432 – Proceeds from Capital Contributions and the corresponding expenses associated with the installation of such services to account 215.2 – Donated Capital.

Salaries and Wages – Employees. In the Commission Staff’s Report, Commission Staff recommended Southern District’s proposed decrease to Salaries and Wages – Employees of \$35,225³⁵ to reflect the net effect of vacancies, new hires, and authorized wage increases subsequent to the test year.

The Commission finds that this adjustment is a known and measurable change to Salaries and Wages – Employees, is reasonable, and should be accepted.

Capitalization of Cost of Customer Taps. In the Commission Staff’s Report, Commission Staff recommended a decrease to operating expenses in an aggregate amount of \$24,000³⁶ to reflect the capitalization of customer taps. The Commission finds the adjustment proposed by Commission Staff is consistent with the accounting standards outlined in the USoA as described in the section on Tap Fee Revenue above, is reasonable, and should be accepted.

Salaries and Wages – Commissioners. In the Commission Staff’s Report, Commission Staff recommended an increase to Southern District’s Salaries and Wages – Commissioners of \$12,000³⁷ to compensate for vacancies during the test period and for training completed. The Commission finds that this adjustment is a known and measurable change to Salaries and Wages – Commissioners, is reasonable, and should be accepted.

Employee 401(k) Pension. In Commission Staff’s Report, Commission Staff recommended accepting Southern District’s proposed adjustment to Employee Pensions

³⁵ Commission Staff’s Report at 12-13, Adjustment E.

³⁶ Commission Staff’s Report at 13, Adjustment F.

³⁷ Commission Staff’s Report at 13, Adjustment G.

and Benefits expense of \$1,867³⁸ to reflect the net effect of vacancies, new hires, and authorized wage increases subsequent to the test year. The Commission finds that this adjustment is a known and measurable change to Employee Pensions and Benefits, is reasonable, and should be accepted.

Employee Pensions and Benefits – Insurance. In Commission Staff’s Report, Commission Staff recommended the Commission accept Southern District’s proposed decrease to Employee Pensions and Benefits of \$31,853³⁹ to reflect the adjustment of single insurance premiums paid by Southern District from 100 percent to 79 percent for single coverage and 66 percent for family coverage to be consistent Commission precedent regarding premiums paid for health benefits. The Commission finds that this adjustment is a known and measurable change to Employee Pensions and Benefits, is reasonable, and should be accepted.

Water Loss. In Commission Staff’s Report, Commission Staff recommended adjustments to Purchased Water, Purchased Power, and Chemicals by \$128,548, \$150,445, and \$76,910,⁴⁰ respectively to adjust for ratemaking purposes the cost to pump/treat water loss in excess of 15 percent. The Commission finds that this adjustment properly applies Commission regulation 807 KAR 5:066 Section (6)(3), is a known and measurable change to the test period, is reasonable and should be accepted.

Capital Expenditures. In Commission Staff’s Report, Commission Staff identified a purchase charged to materials and supplies that should have been capitalized, and

³⁸ Commission Staff’s Report at 14, Adjustment H.

³⁹ Commission Staff’s Report at 14, Adjustment I.

⁴⁰ Commission Staff’s Report at 15, Adjustment J.

recommended a decrease to operating expenses of \$5,000⁴¹ and corresponding depreciation of \$250⁴² to reflect a 20-year life of the asset. The Commission finds that this adjustment is known and measurable, is reasonable, and should be accepted.

Taxes Other than Income – FICA. In Commission Staff's Report, Commission Staff recommended the Commission accept Southern District's proposed adjustment to Taxes Other than Income Expense by \$2,832⁴³ to account for the increased contribution amount of pro forma wage adjustment discussed above, multiplied by the FICA percentage rate of 7.65 percent. The Commission finds that this adjustment, is a known and measurable change to Taxes Other than Income, is reasonable and should be accepted.

Depreciation Expense. In Commission Staff's Report, Commission Staff recommended the Commission accept Southern District's proposed decrease to depreciation expense of \$43,000⁴⁴ to reflect the net effect of additions to plan in service since December 31, 2021, as well as adjustments of asset service lives to the mid-point of the service life range set for in the National Association of Regulatory Utility Commissioners (NARUC) Publication *Depreciations Practices for Small Water Utilities* (NARUC Study). The Commission finds that the adjustment as proposed by Southern District, and further recommended by Commission Staff properly applies the results of the

⁴¹ Commission Staff's Report at 15, Adjustment K.

⁴² Commission Staff's Report at 16-17, Adjustment N.

⁴³ Commission Staff's Report at 16, Adjustment L.

⁴⁴ Commission Staff's Report at 16, Adjustment M.

NARUC Study, is a known and measurable change, is reasonable, and should be accepted.

Non-Utility Income. In Commission Staff's Report, Commission Staff recommended a decrease to Other Water Revenue of \$11,045⁴⁵ to reclassify income attributable to garbage billing and collection services performed on behalf of PCUC. The Commission finds the recommended adjustment is a known and measurable change, is reasonable, and should be accepted.

Based upon the Commission's findings discussed above, the following table summarizes Southern District's adjusted pro forma:⁴⁶

	<u>Commission Staff's Report Pro Forma</u>	<u>Commission Adjustments</u>	<u>Final Pro Forma</u>
Total Operating Revenues	\$3,412,964	-	\$3,412,964
Utility Operating Expenses	<u>3,221,438</u>	<u>-</u>	<u>3,221,438</u>
Net Utility Operating Income	191,526	-	191,526
Interest and Dividend Income	23	-	23
Nonutility Income – Wastewater Billing		2,859	2,859
Nonutility Income – Garbage Collection Billing	<u>26,301</u>		<u>26,301</u>
Total Utility Operating Income	<u><u>\$220,709</u></u>	<u><u>-</u></u>	<u><u>\$220,709</u></u>

REVENUE REQUIREMENTS

Based upon the Commission's findings and determinations, Southern District requires an increase in revenues of \$299,178, or 8.93 percent above pro forma present

⁴⁵ Commission Staff's Report at 17, Adjustment O.

⁴⁶ See Appendix C to this Order for a complete pro forma.

rate revenues, as shown below. The increase is required for Southern District to remain operational and financially sound and have an opportunity to provide adequate, efficient, and reasonable service to its customers.

Pro Forma Operating Expenses	\$ 3,221,438
Plus: Average Annual Principal and Interest Payments	436,698
Additional Working Capital	<u>83,189</u>
Overall Revenue Requirement	3,741,325
Less: Other Operating Revenue	(63,456)
Interest Income	(23)
Nonutility Income	<u>(29,160)</u>
Revenue Required from Rates	3,648,686
Less: Pro Forma Present Rate Service Revenues	<u>(3,349,508)</u>
Required Revenue Increase	<u>\$ 299,178</u>
Percentage Increase	8.93%

WATER LOSS SURCHARGE

In the Commission Staff's Report, Commission Staff recommended no change to Southern District's current meter replacement surcharge. The current surcharge will end no later than November 17, 2024.⁴⁷ The Commission reminds Southern District that an evaluation of the sufficiency of its rates and the need for a water loss surcharge should be conducted by Southern District's management following the acceptance of Southern District's 2024 annual report by the Commission. In its report entitled *Confronting the Problems Plaguing Kentucky's Water Utilities: An Investigative Report by the Kentucky Public Service Commission November 2019* that was fully incorporated in the final Order in Case No. 2019-00041, the Commission recommended more frequent rate cases and

⁴⁷ Case No. 2019-00131, The Surcharge was approved on November 7, 2019 and is to run for 60 months or until the cost of new meters has been assessed whichever occurs first.

pursuing qualified infrastructure improvement surcharges, the proceeds of which will be devoted exclusively to infrastructure improvement and replacement.⁴⁸ When the Commission approves a water loss surcharge, the annual surcharge collection reflects the amount disallowed for excessive water loss pursuant to 807 KAR 5:066, Section 6(3). The use of a surcharge is consistent with prior Commission action in cases involving water utilities with excessive unaccounted-for water loss.⁴⁹ In establishing water-loss surcharges, the Commission recognized that the adjustments required comply with the 15 percent line-loss limitation in 807 KAR 5:066, Section 6(3), could severely restrict cash flow and could impair a water district's ability to take the necessary action to focus on its leak detection and repair. Using a surcharge to fund a water utility's water loss reduction efforts allows the Commission to place strict controls governing the surcharge proceeds to ensure their effective use, public acceptance of the surcharge and public confidence in the water utility's use of those funds.

Therefore, the Commission reminds Southern District that after the Commission accepts Southern District's 2024 annual report Southern District may wish to file an application to institute a water loss surcharge to fund Southern District's water loss reduction efforts.

⁴⁸ Case No. 2019-00041, *Electronic Investigation into Excessive Water Loss by Kentucky's Jurisdictional Water Utilities* (Ky. PSC Nov. 22, 2019), Appendix L, *Confronting the Problems Plaguing Kentucky's Water Utilities: An Investigative Report by the Kentucky Public Service Commission November 2019* at 24–25.

⁴⁹ See Case No. 96-126, *An Investigation into the Operations and Management of Mountain Water District* (Ky. PSC Aug. 11, 1997); Case No. 2011-00217, *Application of Cannonsburg Water District for (1) Approval of Emergency Rate Relief and (2) Approval of the Increase in Nonrecurring Charges* (Ky. PSC June 4, 2012); Case No. 2018-00017, *Application of Martin County Water District for an Alternative Rate Adjustment* (Ky. PSC Nov. 5, 2018); Case No. 2018-00429, *Application of Graves County Water District for an Alternative Rate Adjustment* (Ky. PSC Sept. 30, 2019); and Case No. 2019-00119, *Electronic Application of Estill County Water District No. 1 for a Surcharge to Finance Water Loss Control Efforts* (Ky. PSC Mar. 24, 2020).

RATE DESIGN

In its application, Southern District estimated that it needed an approximately 8.22 percent increase in its retail water and wholesale rates, but requested that the Commission not increase rates due to operational changes that are expected to have a significant impact on Southern District's Financial situation. Southern District's position statement filed on December 5, 2022, asked that the Commission use its discretion and approve a rate increase of no more than 8.3 percent. Southern District has not performed a cost-of-service study (COSS). Southern District stated that it did not complete a COSS at this time because there have been no material changes in the water system.⁵⁰

The Commission finds that the allocation of a revenue increase evenly across the board to a utility's rate design is appropriate when there has been no evidence entered into the record demonstrating that this method is unreasonable and in the absence of a COSS. In the Commission Staff's Report, Commission Staff followed the practice found by the Commission to be acceptable and allocated Commission Staff's calculated revenue increase across the board to Southern District's monthly retail and wholesale water rates.

In an effort to avoid a significant hardship on Southern District's customers, the Commission finds that a two-year phase-in approach is appropriate. Although applying a two-year phase-in will not allow for depreciation reserves to be fully funded in the first year, it will allow for adequate revenues to cover expenses and debt service and a portion of depreciation reserves. Southern District's representatives testified that Southern

⁵⁰ Southern District's Response to Staff's First Request, Item 5.

District relies heavily on grants to fund needed infrastructure repair and replacement.⁵¹ However, Chairman Jeff Prater also testified that the fundamental mechanism for any utility to upgrade its infrastructure is through funding depreciation in its rates.⁵² Southern District has not historically funded its depreciation, and has therefore not had cash reserves with which to upgrade or replace its infrastructure. In ordering a rate increase of 8.93 percent to be phased in over a two year period, the Commission is not ignoring the economic difficulties about which Southern's Commissioner, Donald Daniels testified.⁵³ Rather, the Commission is enabling Southern District to fund depreciation so that it can reinvest in its infrastructure, and phasing in the increase to avoid as much hardship on customers as possible.

In 2019 when Southern District needed to replace all of its customer meters because many were no longer registering water sales at all, Southern District did not have the financial ability to fund the meter replacement or the financial stability required to readily obtain a loan. Prior to this, in April 2019, Southern District borrowed \$150,000 from Floyd County Fiscal Court to enable it to pay its operating expenses.⁵⁴ Southern District worked for many months after the meter replacement surcharge was approved to

⁵¹ HVT of the Nov. 9, 2022 Hearing at 09:09:56–09:15:31. Witness Chairman Jeff Prater testified that the Estill Bottom line relocation project and the Mink Branch tank replacement were conducted using grant funds. Also, HVT at 09:40:00–09:43:39, Chairman Prater also testified that the Lackey to Wayland water line replacement project is being funded through grants, and it sometimes takes four to five years to get grant approval for needed projects.

⁵² HVT of the Nov. 9, 2022 Hearing at 09:44:00–09:44:39.

⁵³ HVT of the Nov. 9, 2022 Hearing at 09:53:53–10:37:31, Commissioner Daniels testified that the economy in Southern District's service area is in very poor shape and the area recently was flooded, many families lost homes and possessions. Commissioner Daniels testified that now is a really hard time to raise rates on neighbors.

⁵⁴ Case No. 2019-00131, HVT of the May 9, 2019 Hearing at 05:09:46–05:12:08.

find financing to replace its meters, and to find financing to repay Floyd County Fiscal Court.⁵⁵ Funding depreciation will assist Southern District in avoiding the need for emergency financing in the future. If Southern District continues to regularly re-evaluate the sufficiency of its rates and seeks appropriate rate adjustments and the institution of a water loss surcharge at the expiration of the meter replacement surcharge, Southern District will be making strides at having the needed capital to reinvest in its infrastructure.

The rates set forth in Appendix A and Appendix B to this Order are based upon the revenue requirement the Commission has found to fair, just and reasonable and will produce sufficient revenues from water sales to recover the \$3,648,686 Revenue Required from Rates, an approximate 8.93 percent increase. The rates in Phase 1 will increase a typical residential customer's monthly water bill from \$38.87 to \$40.50 an increase of \$1.63, or 4.19 percent. The rates in Phase 2 will increase a typical residential customer's monthly water bill from \$40.50 to \$42.34 an increase of \$1.84 or 4.74 percent.⁵⁶

Southern District filed a loan modification agreement dated December 2, 2021, with its application.⁵⁷ The loan modification was for loan number 389285-38626 at Citizen's Bank of Kentucky, and was signed by Jeff Prater, Southern District's Chairman.

⁵⁵ See Case No. 2019-00131, Request for Approval to Award Meter Bid Package (filed Sep. 9, 2019) and Case No. 2021-00121, Promissory Note (filed July 17, 2020) Southern District did not obtain the CoBank loan used to purchase new customer meters until May 22, 2020. See also, Case No. 2019-00243, *Electronic Application of Southern Water & Sewer District for Approval of Financing Pursuant to KRS 278.300*, (Ky. PSC Aug. 14, 2019) In August 2019, Southern District was able to obtain a longer term loan to repay Floyd fiscal Court

⁵⁶ Commission Staff found an error in the Commission Staff's Report calculation of the effect on the typical residential customer's monthly water bill from \$38.87 to \$42.34 an increase of \$3.47, or 8.93 percent.

⁵⁷ Application, Attachment 8, Outstanding Debt Instruments 8.4 (filed March 30, 2022).

The maturity date listed on the modification is November 20, 2023, and the principal amount owed is listed as \$48,981.98.⁵⁸ The original promissory note, bearing the same loan number, was signed on November 17, 2017, by Southern District's former manager, Dean Hall.⁵⁹ The original principal amount was \$125,984, and the note matured on November 20, 2019.⁶⁰ The loan proceeds were used to purchase five trucks for use by Southern District in its utility operations. On November 25, 2019, Southern District's Chairman, Jeff Prater signed a change in terms agreement in relation to this loan. At that time the principal amount was \$89,249.84, and the loan maturity date was November 20, 2021. Therefore, the original note dated November 17, 2017, was rewritten on two occasions, November 25, 2019 and December 2, 2021. The term of the indebtedness for this loan is November 17, 2017 through November 20, 2023, a period of six years and three days. Southern District did not seek Commission approval for the original loan or at the time of either modification⁶¹

Pursuant to KRS 278.300(8) a utility may issue evidence of indebtedness without first obtaining Commission approval if the debt is for a proper purpose, not in violation of law, and is payable at a period of not more than two years. These loans may be renewed, but the aggregate period of such loans cannot exceed six years from the date of issue of the original note. Here, Southern District has issued evidence of indebtedness, for a proper purpose and not in violation of law, and the notes were each payable in two year

⁵⁸ Application, Attachment 8, Outstanding Debt Instruments, 8.4

⁵⁹ Southern District's Response to Staff's First Request, Item 3a.

⁶⁰ Southern District's Response to Staff's First Request 3b

⁶¹ HVT of the Nov. 9, 2022 Hearing at 09:24:33–09:26:20. Chairman Prater testified that Southern District's board believed this loan conformed to statutory requirements, and therefore, no approval was sought.

periods. However, the total period from issue to maturity exceeded six years. The Commission finds that Southern District violated KRS 278.300 in re-writing a two year debt for a period exceeding six years without receiving Commission approval. However, the Commission finds that Southern District's violation was not willful, and therefore, the penalty provided for under KRS 278.990⁶² will not be assessed.

The Commission cautions Southern District about the possible peril in which it places itself when it fails to obtain competent, appropriate, legal advice in matters before the Commission or concerning matters that should come before the Commission. In this instance appropriate legal counsel could have advised Southern District of the importance of avoiding the additional three days in the loan term. It is concerning to the Commission that Southern District sought only the advice of a non-lawyer consultant from Kentucky Rural Water before deciding that these loan modifications did not require Commission approval⁶³. Southern District's management should pay more careful attention to the statutory and regulatory requirements imposed upon a public utility in Kentucky.

SUMMARY

After consideration of the evidence of record and being otherwise sufficiently advised, the Commission finds that the findings and recommendations contained in the Commission Staff's Report are supported by the evidence of record and are reasonable. The Commission has historically used a DSC method to calculate the revenue requirement for water districts or associations with outstanding long-term debt. Applying the DSC method to Southern District's pro forma operations results in an Overall Revenue

⁶² KRS 278.990 provides for financial penalties to be assessed against utilities, their agents, and managers for violation of any provision of KRS 278 or a violation of a Commission order.

⁶³ HVT of the Nov. 9, 2022 Hearing at 09:28:30 –09:29:38.

Requirement of \$3,741,325, a required revenue from water sales of \$3,648,686, and increase in revenue from water sales of a \$299,178 or 8.93 percent.

The Commission finds that allocating the calculated revenue increase across the board to Southern District's monthly water service rates and to phase this increase over two years to be fair, just and reasonable. The record contains no evidence that permitting Southern District to assess water service rates at a level lower than could be supported will result in any degradation or reduction in the quality of water service currently provided by Southern District. 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 this level of revenue, the 8.93 percent increase in water service rates recommended by Commission Staff in the Commission Staff's Report is approved by the Commission.⁶⁴

IT IS THEREFORE ORDERED that:

1. The findings and recommendations contained in the Commission Staff's Report are adopted and incorporated by reference into this Order as if fully set out herein.
2. The rates calculated by Southern District in its original application are denied.
3. The request by Southern District to limit a rate increase to 8.3 percent is denied.

⁶⁴ *Utilities Operating Co. v King*, 143 So2d 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).

4. The Nonrecurring Charge rates set forth in Appendix A to this Order are approved for service rendered by Southern District on and after the date of this Order.

5. Phase 1 rates set forth in Appendix A to this Order are approved for water services rendered by Southern District on and after January 1, 2023.

6. Phase 2 rates set forth in Appendix B to this Order are approved for water services rendered by Southern District on and after January 1, 2024.

7. One month prior to the effective date of the Phase 2 rates, Southern District shall notify its customers of the implementation of the Phase 2 rates by publishing one-time notice of the increase in a newspaper of general circulation in its territory or placing an insert in bills rendered to its customers.

8. Within 45 days of publishing notice required in ordering paragraph 6, Southern District shall file proof of publication of the notice to the Commission as required pursuant to 807 KAR 5:076, Section 5(3).

9. Within 20 days of the date of service of this Order, Southern District shall file with this Commission, using the Commission's electronic Tariff Filing System, new tariff sheets setting forth the rates and charges approved by this Order and their effective date, and also stating that the rates and charges were authorized by this Order.

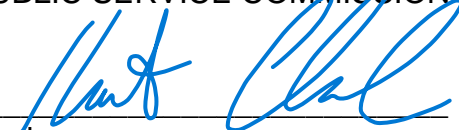
10. Southern District shall use the midpoint of the depreciable lives of the NARUC Study ranges, as recommended by Commission Staff, to depreciate water plant assets for accounting purposes in all future reporting periods. Southern District shall not make adjustments to accumulated depreciation or retained earnings to account for this change in the accounting estimate.

11. Any documents filed in the future pursuant to ordering paragraphs 8 and 9 shall reference this case number and shall be retained in the post-case correspondence file.

12. This case is closed and removed from the Commission's docket.

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PUBLIC SERVICE COMMISSION


Chairman

Vice Chairman


Commissioner

ENTERED
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KENTUCKY PUBLIC
SERVICE COMMISSION

ATTEST:


Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2022-00099 DATED DEC 20 2022

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

PHASE 1

Monthly Water Rates

Customer Charge		\$10.81	Minimum Bill
First	2,000 Gallons	\$0.01170	Per Gallon
Over	2,000 Gallons	\$0.00900	Per Gallon
Wholesale Water		\$0.00463	Per Gallon

Nonrecurring Charges

Connection/Turn On Charge	\$20.00
Connection/Turn On Charge, After Hours	\$88.00
Meter Re-read Charge	\$20.00
Meter Test Charge	\$50.00
Reconnection Charge	\$20.00
Reconnection Charge, After Hours	\$88.00
Returned Check Charge	\$10.00
Service Call/Investigation Charge	\$20.00
Service Call/Investigation Charge, After Hours	\$88.00

APPENDIX B

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2022-00099 DATED DEC 20 2022

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

PHASE 2

Monthly Water Rates

Customer Charge		\$11.39	Minimum Bill
First	2,000 Gallons	\$0.01220	Per Gallon
Over	2,000 Gallons	\$0.00938	Per Gallon
Wholesale Water		\$0.00483	Per Gallon

APPENDIX C

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2022-00099 DATED DEC 20 2022

	Test Year	Commission Staff Adjustment	Commission Adjustment	Final Pro Forma
Operating Revenues				
Sales of Water	\$ 3,472,502	\$ (198,574)		\$ 3,273,928
Sales for Resale	71,634	3,946		75,580
Forfeited Discounts	83,003	(20,417)		62,586
Other Water Revenues				
Meter Service	809	(809)		
Tap Fees	15,215	(15,215)		
Other	2,247	(1,377)		
Wastewater Billing and Collection Fees	11,045	(11,045)		870
Total Operating Revenues	3,656,455	(243,491)	<u> </u>	3,412,964
Operating Expenses				
Operation and Maintenance Expenses				
Salaries and Wages - Employees	721,850	(35,225)		
		(7,200)		679,425
Salaries and Wages - Commissioners	18,000	12,000		30,000
Employee Pensions and Benefits	204,152	(1,867)		
		(31,853)		170,432
Purchased Water	342,556	(128,548)		214,008
Purchased Power for Pumping	428,312	(150,445)		277,867
Chemicals	204,950	(76,910)		128,040
Materials and Supplies	206,762	(16,800)		
		(5,000)		184,962
Contractual Services - Acctg & Legal	61,531			61,531
Contractual Services - Mgmt Fees	213,438			213,438
Contractual Services - Other	39,745			39,745
Transportation	62,179			62,179
Insurance	106,224			106,224
Advertising	5,059			5,059
Bad Debt	106,691			106,691
Miscellaneous	19,500			19,500
Total Operation and Maintenance Expenses	2,740,949	(441,848)	<u> </u>	2,299,101
Taxes Other Than Income	63,345	(2,832)		60,513
Amortization	2,460			2,460
Depreciation	902,114	(43,000)		
		250		859,364
Total Operating Expenses	3,708,868	(487,430)	<u> </u>	3,221,438
Net Operating Income	(52,413)	243,939		191,526
Interest Income	23			23
Nonutility Income - Wastewater Billing		2,859		2,859
Nonutility Income - Garbage Collection Billing	26,301			26,301
Income Available to Service Debt	\$ (26,089)	\$ 246,798	<u> </u>	\$ 220,709

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