

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF SOUTHERN)	CASE NO.
MADISON WATER DISTRICT FOR A RATE)	2022-00129
ADJUSTMENT PURSUANT TO 807 KAR 5:076)	

ORDER

On May 24, 2022, Southern Madison Water District (Southern Madison District) filed an application with the Commission requesting an adjustment to its water rates pursuant to 807 KAR 5:076. In its application, Southern Madison District requested rates that would increase annual water sales revenues by \$70,972, or a 3.82 percent across-the-board increase to present rate water revenues. In addition, Southern Madison District proposed a Water Loss Surcharge of \$1.94 per bill.

To ensure the orderly review of the application, the Commission established a procedural schedule by Order dated June 15, 2022. Southern Madison District responded to two discovery requests from Commission Staff. On September 20, 2022, the Commission, on its own motion, found that the procedural schedule should be amended to allow Commission Staff additional time to prepare and file a Commission Staff Report, extending the date of the Commission Staff Report from September 21, 2022, to October 5, 2022. Pursuant to the Commission's September 20, 2022 Order, Commission Staff issued a report (Commission Staff's Report) on October 5, 2022, summarizing its findings regarding Southern Madison District's application. The Commission Staff's Report indicated that Southern Madison District's adjusted test-year

operations support an overall revenue requirement of \$2,330,218 and that an increase of \$424,983, or 22.84 percent, is necessary to generate the overall revenue requirement.

On October 6, 2022, Southern Madison District filed its comments on the Commission Staff's Report with the Commission.¹ In its response, Southern Madison District did not agree with Commission Staff's removal of certain labor expenses from nonrecurring charges but did not wish to contest that adjustment in this case. Southern Madison District concurred with the remaining findings presented in the Commission Staff's Report. In addition, Southern Madison District did not request that an informal conference or hearing be held.

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 to the utility's ratepayers. The Commission's standard of review for a utility's request for a rate increase is well established. In accordance with KRS 278.030 and case law, Southern Madison District is allowed to charge its customers "only 'fair, just and reasonable rates.'"² Further, Southern Madison District bears the burden of proof to show that the proposed rate increase is just and reasonable under KRS 278.190(3).

BACKGROUND

Southern Madison District is a water utility organized pursuant to KRS Chapter 74 that owns and operates a water distribution system through which it provides retail water

¹ Southern Madison District's Response to Commission Staff's Report (filed Oct. 6, 2022).

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

service to approximately 5,222 residential customers, 108 commercial customers, 13 industrial customers, and 8 public authorities that reside in Garrard and Madison counties, Kentucky.³ The Commission’s records indicate that Southern Madison District has not filed a rate adjustment, other than a Purchased Water Adjustment pursuant to KRS 278.015(2), since at least 1985

TEST PERIOD

The calendar year ended December 31, 2020, was used as the test year to determine the reasonableness of Southern Madison District’s existing and proposed water rates, as required by 807 KAR 5:076, Section 9.⁴

SUMMARY OF REVENUE AND EXPENSES

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

	2020 Test-Year	Pro Forma Adjustments	Staff's Report Pro Forma
Operating Revenues	\$ 1,895,469	\$ (5,662)	\$ 1,889,807
Operating Expenses	2,245,130	(194,538)	2,050,592
Net Operating Income	(349,661)	188,876	(160,785)
Interest Income	15,428	-	15,428
Income Available for Debt Service	<u>\$ (334,233)</u>	<u>\$ 188,876</u>	<u>\$ (145,357)</u>

³ *Annual Report of Southern Madison Water District to the Public Service Commission (Annual Report) for the Calendar Year Ended December 31, 2020 (2020 Annual Report) at 12 and 49.*

⁴ Southern Madison District had not filed its 2021 Annual Report when this application was filed.

REVIEW AND MODIFICATIONS TO COMMISSION STAFF'S FINDINGS

Southern Madison District proposed adjustments to revenues and expenses to 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 as they represent known and measurable⁵ levels of revenues and expenses that should be reflected in rates.

Billing Analysis Adjustment. In the Commission Staff's Report, Commission Staff calculated net billing adjustments, leak adjustments and mis-read meters, of (\$8,191) to the current billing analysis, which produced a normalized revenue of \$1,860,465.⁶ Southern Madison District provided test-year information about forfeited discount revenue, \$9,193, and miscellaneous service revenue, \$30,925, which were included in the Total Retail Water Sales revenue test-year amount.⁷ Commission Staff reclassified the late payment charges of \$9,193 and the nonrecurring charge revenue of \$30,925 by decreasing Total Metered Sales and increasing Other Water Revenue by those amounts. The adjustment to balance the Adjusted Test Year amount and the Normalized Revenue amount is an increase to Metered Water Sales of \$5,114.⁸ The Commission finds that

⁵ See 807 KAR 5:001E, 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).

⁶ Commission Staff's Report at 9–10.

⁷ Commission Staff's Report at 9–11, Adjustment A.

⁸ Commission Staff's Report at 9–11, Adjustment A.

these adjustments are known and measurable changes to Total Metered Sales, are reasonable, and should be accepted.

Forfeited Discounts. In the Commission Staff's Report, Commission Staff recommended an increase to Southern Madison District's test-year Other Water Revenues by \$18,075⁹ to reflect the normalization of late payment fees. Given that the test year occurred during the moratorium regarding the collection of late payment fees due to the COVID-19 pandemic, Commission Staff normalized the revenue from Forfeited Discounts to the 2019 level. The Commission finds that Commission Staff's adjustment represents a known and measurable change to Other Water Revenues, is reasonable, and should be accepted.

Other Water Revenues – Nonrecurring Charges. In the Commission Staff's Report, Commission Staff discussed Southern Madison District's Nonrecurring Charges in which estimated labor costs, previously included in determining the amount of Nonrecurring Charges, are removed. Southern Madison District had incorrectly included nonrecurring charges revenue in its retail sales revenue. Commission Staff recommended revised Nonrecurring Charges and a decrease to Retail Sales of Water of \$30,925 and an increase to Other Operating Revenues of \$11,267.¹⁰ The Commission

⁹ Commission Staff's Report at 11, Adjustment B.

¹⁰ Commission Staff's Report at 11, Adjustment C.

Staff's Report noted that contrary to Commission precedent¹¹ estimated labor expenses incurred for work during normal business hours were included in the estimates used to determine the amount of Southern Madison District's nonrecurring charges. Commission Staff recommended that Southern Madison District's nonrecurring charges be reduced to reflect the removal of those estimated labor costs.¹² As stated earlier, Southern Madison District disagreed with the removal of the labor expenses from its nonrecurring charges, but indicated it did not wish to contest those adjustments in this case.¹³

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.¹⁴ 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 should be eliminated from the charges. The Commission finds that the calculation of Nonrecurring Charges should be revised and only the 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 cost incurred to provide the service.

¹¹ Case No. 2022-00054, *Electronic Application of Beech Grove Water System, Inc. for a Rate Adjustment Pursuant to 807 KRS 5:076* (Ky. PSC Sept. 27, 2022), Case No. 2022-00068, *Electronic Application of Lake Village Water Association, Inc. for a Rate Adjustment Pursuant to 807 KRS 5:076* (Ky. PSC Oct. 4, 2022), Case No. 2022-00099, *Electronic Application of Southern Water and Sewer District for an Alternative Rate Adjustment* (Ky. PSC Dec. 20, 2022), Case No. 2022-00117, *Electronic Application of Bronston Water Association, Inc. for a Rate Adjustment Pursuant to 807 KRS 5:076* (Ky. PSC Oct. 12, 2022), Case No. 2022-00221, *Electronic Application of Northeast Woodford County Water District for a Rate Adjustment Pursuant to 807 KRS 5:076* (Ky. PSC Jan. 20, 2023).

¹² Commission Staff's Report at 5–7.

¹³ Southern Madison District's Responses to the Commission Staff's Report, paragraph 2.

¹⁴ Case No. 2020-00141, *Electronic Application of Hyden-Leslie County Water District for an Alternative Rate Adjustment* (Ky. PSC Nov. 6, 2020).

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.

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 \$11,267 to Other Water Revenue to be reasonable.

Salaries and Wages – Employees & FICA. In its application, Southern Madison District proposed an adjustment to decrease test-year Salaries and Wages – Employees Expense by \$19,782, as well as decrease FICA taxes by an associated \$1,092, citing the changes in staffing and salary levels since the test year.¹⁵

In the Commission Staff's Report, Commission Staff recommended adjustments to increase test-year Salaries and Wages – Employees by \$46,558 and increase test-year FICA taxes by an associated \$5,086 as a result of normalizing amounts using current employee count, compensation, and test-year hours worked. The Commission finds that these adjustments are known and measurable and are accepted.

Tap-On Fees. In its application, Southern Madison District proposed an adjustment to reduce Salaries & Wage Expense – Employees by \$20,955 as well as

¹⁵ Application, Attachment #4, Reference B.

Materials & Supplies Expense by \$48,895 to properly remove expenses related to tap-on fees.¹⁶

In the Commission Staff's Report, Commission Staff recommended the Commission accept Southern Madison District's proposed adjustment as it accurately reflects the removal of labor and materials expense related to tap-ons in the test-year. The Commission finds that the adjustment is reasonable and should be accepted.

Salaries and Wages – Officers. In its application, Southern Madison District proposed an adjustment to increase Salaries and Wages – Officers by \$979 to accurately annualize Commissioner Fees based on a full year of payments.¹⁷

In the Commission Staff's Report, Commission Staff recommended the Commission accept Southern Madison District's proposed adjustment as it accurately reflects a full year of compensation for its commissioners. The Commission finds that the adjustment is reasonable and should be accepted.

Employee Pensions and Benefits. In the Commission Staff's Report, Commission Staff recommended that an adjustment be made to reduce Employee Pensions and Benefits expense by \$78,440 to account for the pro forma County Employee Retirement System (CERS) contributions according to the adjustment to Employee Salaries and Wages expense discussed above, as well as the reduction of test-year health and dental insurance premiums to the national averages as published by the Bureau of Labor Statistics. The Commission finds that the adjustment proposed by Commission Staff

¹⁶ Application, Attachment #4, Reference H.

¹⁷ Application, Attachment #4, Reference C.

accurately reflects pro forma levels of CERS contributions as well as applies Commission precedent regarding health and dental insurance premiums and is accepted.¹⁸

Water Loss. In its application, Southern Madison District proposed adjustments to Purchased Water and Purchased Power Expense of \$123,771 and \$4,413 respectively, to account for the district's unaccounted-for water loss in excess of 15 percent.¹⁹

In the Commission Staff's Report, Commission Staff recommended the Commission accept Southern Madison District's proposed adjustments as they accurately represent the test-year cost of lost water. The Commission finds that the adjustment is reasonable and should be accepted.

Contractual Services. In the Commission Staff's Report, Commission Staff recommended adjustments that increase test-year Accounting Contractual Expenses by \$10,791 and Legal Contractual Expenses by \$1,250 after finding that the amounts were understated when compared to the utilities financial records. Given that Commission Staff's adjustment represents a correction to understated test-year expenses, the Commission finds that the adjustments accurately represent test-year expenses and are therefore reasonable and should be accepted.

Bank Charges Misclassification. In the Commission Staff's Report, Commission Staff recommended adjustments that increase test-year Miscellaneous Expenses by \$23,161 and decrease Insurance - Other Expense by the same amounts after finding that the Bank Charges Expense were mistakenly recorded in Insurance – Other Expense in their financial record. Given that the adjustment proposed by Commission Staff corrects

¹⁸ Case No. 2022-00050, *Electronic Application of Jessamine-South Elkhorn Water District for a Rate Adjustment Pursuant to 807 KAR 5:076* (Ky. PSC Sept. 22, 2022).

¹⁹ Application, Attachment #4, Reference G.

mistakenly recorded test-year expenses, the Commission finds that the adjustments accurately represent test-year expenses and are therefore reasonable and should be accepted.

Bank Charges Increase. In its application, Southern Madison District proposed an adjustment to increase Miscellaneous Expense by \$12,000 to account for an increase in Bank Charges for online payments placed into effect since the test-year.²⁰

In the Commission Staff's Report, Commission Staff recommended the Commission accept Southern Madison District's proposed adjustments as they accurately represent the pro forma level of Bank Charge expenses. The Commission finds that the adjustment is reasonable and should be accepted.

Depreciation Expense. In the Commission Staff's Report, Commission Staff recommended accepting the adjustment proposed by Southern Madison District to increase test-year Depreciation Expense by \$3,486, calculated by adjusting the useful lives of the Southern Madison District's assets to the midpoint of the lives found in the National Association of Regulatory Utility Commissioners' (NARUC) report titled *Depreciation Practices for Small Utilities* (NARUC Study) published in 1979.²¹ The Commission finds that the adjustment keeps with Commission precedent²² and is a known and measurable change to test-year Depreciation Expense, and is accepted.

In addition, in the Commission Staff's Report, Commission Staff recommended an adjustment to increase depreciation expense by \$1,746 to account for the capitalized

²⁰ Application, Attachment #4, Reference I.

²¹ Commission Staff's Report at 12, Adjustment F.

²² Case No. 2022-00050, *Electronic Application of Jessamine-South Elkhorn Water District for a Rate Adjustment Pursuant to 807 KAR 5:076* (Ky. PSC Sept. 22, 2022).

costs associated with test-year tap-ons, discussed above. The Commission finds that the adjustment correctly allows for the recovery of the capitalized costs and is therefore reasonable and should be accepted.

Based on the Commission's findings discussed above, the following table summarizes Southern Madison District's adjusted pro forma operations.

	Test Year	Southern Madison Water District Proposed Adjustments	Commission Staff Adjustment	Commission Staff Pro Forma	Commission Adjustments	Commission Pro Forma
Operating Revenues						
Total Metered Sales	\$ 1,895,469	\$ (35,641)	\$ (9,193)			
			(30,925)			
			5,114	\$ 1,860,465		\$ 1,860,465
Other Water Revenues						-
Forfeited Discounts	-		18,075	18,075		18,075.00
Misc Service Revenues	-		11,267	11,267		11,267.00
						-
Total Operating Revenues	1,895,469	(35,641)	(5,662)	1,889,807	-	1,889,807.00
Operating Expenses						
Operation and Maintenance Expenses						
Salaries and Wages - Employees	330,112	(19,782)	46,558			
		(20,955)	(20,955)	355,715		355,715
Salaries and Wages - Officers	13,421	979	979	14,400		14,400
Employee Pensions and Benefits	227,094	(5,403)	(78,440)	148,654		148,654
		(97,070)				
		6,117				
Purchased Water	1,068,505	(123,771)	(123,733)	944,772		944,772
Purchased Power	38,093	(4,413)	(4,411)	33,682		33,682
Materials and Supplies	174,806	(48,895)	(48,895)	125,911		125,911
Contractual Services - Accounting	11,424		10,791	22,215		22,215
Contractual Services - Other	7,200		1,250	8,450		8,450
Insurance - General Liability	20,248			20,248		20,248
Insurance - Other	27,594		(23,161)	4,433		4,433
Miscellaneous Expenses	72,413	12,000	12,000			-
			23,161	107,574		107,574
Total Operation and Maintenance Expenses	1,990,910	(301,193)	(204,856)	1,786,054	-	
Depreciation Expense	229,388	-51	3,486			
		3435	1,746	234,569		234,569
Taxes Other Than Income	24,832	(1,092)	5,086	29,918		29,918
Total Operating Expenses	2,245,130	(298,901)	(194,538)	2,050,541	-	2,050,541
Utility Operating Income(Loss)	<u>\$ (349,661)</u>	<u>\$ 263,260</u>	<u>\$ 188,876</u>	<u>\$ (160,785)</u>	<u>\$ -</u>	<u>\$ (160,785)</u>

REVENUE REQUIREMENTS

In its application, Southern Madison District did not utilize either the Debt Service Coverage (DSC) or Operating Ratio method, instead opting to only recover expenses with no allowance for additional working capital or equity growth, as shown below.

	Southern Madison District
Pro Forma Operating Expenses	\$ 1,946,228
Less: Interest Income	<u>(15,428)</u>
Revenue Requirement - Water Rates	1,930,800
Less: Normalized Revenue from Service	<u>(1,859,828)</u>
Required Revenue Increase	<u>\$ 70,972</u>
Percent Increase	<u>3.82%</u>

While Southern Madison District did not propose any recovery except for expenses, the Commission finds that allowing for equity growth allows small water utilities to maintain a healthy financial position by providing cash reserves to offset unforeseen increases in operating expenses. By applying the Operating Ratio Method, the Commission finds Southern Madison District's Overall Revenue Requirement to be \$2,304,036. A revenue increase of \$398,801, or 21.44 percent, is necessary to generate the Overall Revenue Requirement.

The operating ratio methodology²³ is used when there is no basis for a rate-of-return determination, the cost of the utility has fully or largely been funded through contributions, or there is little or no outstanding long-term debt. Since Southern Madison District does not currently have any outstanding debt, the Commission is of the opinion that an operating ratio of 89 percent will allow Southern Madison District sufficient revenues to cover its reasonable operating expenses and provide for reasonable equity

²³ Operating Ratio is defined as the ratio of expenses, including depreciation and taxes, to gross revenues. It is illustrated by the following equation:

$$\text{Operating Ratio} = \frac{\text{Operating Expenses} + \text{Depreciation} + \text{Taxes}}{\text{Gross Revenues}}$$

growth. The Commission concludes that the Operating Ratio Method is appropriate, as the district does not currently have any outstanding debt.

Operating Expenses	\$ 2,050,592
Divide by: Operating Ratio	<u>89%</u>
Overall Revenue Requirement	2,304,036
Less: Other Operating Revenue	(29,342)
Interest Income	<u>(15,428)</u>
Revenue Requirement - Water Rates	2,259,266
Less: Normalized Revenue from Service	<u>(1,860,465)</u>
Required Revenue Increase	<u>\$ 398,801</u>
Percentage Increase	<u>21.44%</u>

WATER LOSS REDUCTION SURCHARGE

In the Commission Staff Report, the Commission Staff recommended that the Commission approve Southern Madison District's requested Water Loss Reduction Surcharge of \$1.94 per active meter per month for 48 months to help lower system losses to more acceptable levels.²⁴ The surcharge would produce \$128,187 per year for total collections over the four-year period of \$512,750.²⁵ The annual surcharge collection reflects the amount disallowed for excessive water loss pursuant to 807 KAR 5:066, Section 6(3).

²⁴ Commission Staff's Report at 7–8.

²⁵ \$1.94 (Monthly Water Loss Reduction Surcharge) x 66,076 (Annual Number of Bills) = \$128,187 (Annual Water Loss Reduction Surcharge Collections) x 4 (Four Year Collection Period) = \$512,750.

The use of a surcharge is consistent with prior Commission action in cases involving water districts with excessive unaccounted-for water loss.²⁶ In establishing water-loss surcharges, the Commission recognized that the adjustments required to be made to 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.²⁷ Using a surcharge to fund a water district's water loss reduction project 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 district's use of those funds.²⁸ 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, Appendix L, the Commission recommended more frequent rate cases and pursuing qualified infrastructure improvement surcharges,²⁹ the proceeds of which will be devoted exclusively to infrastructure improvement and replacement.

²⁶ 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).

²⁷ See Case No. 2018-00311 *Electronic Application of Cawood Water District for an Alternative Rate Adjustment* (Ky. PSC April 8, 2021) at 3.

²⁸ See Case No. 2018-00429 *Application of Graves County Water District for an Alternative Rate Adjustment* (Ky. PSC Sept. 30, 2019) at 3.

²⁹ 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.

Therefore, the Commission finds that a monthly surcharge is a reasonable means for Southern Madison District to recover the cost of its efforts in water leak detection and repair in order to reduce the increased expense and lost revenue from unaccounted-for water loss.³⁰ The Commission finds that a monthly water loss reduction surcharge of \$1.94 per active meter over 48 months should be approved. Southern Madison District should be restricted to expending the funds collected under the surcharge subject to authorization by the Commission. Southern Madison District should file a qualified infrastructure improvement plan, including a comprehensive unaccounted-for water loss reduction plan that establishes priorities, a time schedule for eliminating each source of unaccounted-for water loss, and provides a detailed spending plan for the proceeds of the requested surcharge. The proceeds from the surcharge shall be kept in a separate, interest-bearing account. The proceeds of Southern Madison District's Water Loss Reduction Surcharge should be used solely to fund Southern Madison District's unaccounted-for water loss reduction efforts as recommended in the Commission Staff's Report.

RATE DESIGN

Southern Madison District proposed to increase its monthly retail and wholesale water service rates by approximately 3.82 percent across the board. Southern Madison District has not performed a cost of service study (COSS). Southern Madison District

³⁰ 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.

stated that it did not complete a COSS at this time as there has been no material changes in the water system.³¹

The Commission has previously found 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.³² In the Commission Staff's Report, Commission Staff followed the method previously accepted by Southern Madison District and allocated Commission Staff's calculated revenue increase across the board to Southern Madison District's monthly retail water service rates. Southern Madison District accepted Commission Staff's findings and requested approval of the recommended rates and charges listed in the Commission Staff's Report.³³

The rates contained in the Appendix will generate the appropriate revenue required from rates to support its calculated revenue requirement of \$2,259,266. The importance of a utility seeking timely rate increases cannot be overemphasized. The failure of Southern Madison District over the past few years to carry out its financial responsibility and increase rates gradually alongside increases in expenses has created the situation of the Commission now having to balance the importance of a financially viable utility, with adequate working capital and depreciation expense recovery, with the harm

³¹ Southern Madison District's Response to Commission Staff's First Request for Information (Staff's First Request) (filed Apr. 14, 2022), Item 4.

³² Case No. 2022-00054, *Electronic Application of Beech Grove Water System, Inc. for a Rate Adjustment Pursuant to 807 KRS 5:076* (Ky. PSC Sept. 27, 2022), Case No. 2022-00068, *Electronic Application of Lake Village Water Association, Inc. for a Rate Adjustment Pursuant to 807 KRS 5:076* (Ky. PSC Oct. 4, 2022), Case No. 2022-00117, *Electronic Application of Bronston Water Association, Inc. for a Rate Adjustment Pursuant to 807 KRS 5:076* (Ky. PSC Oct. 12, 2022).

³³ Southern Madison District's Response to Commission Staff's Report, paragraph 2.

represented by such a large, one-time increase in rates. Therefore, in an effort to avoid a significant hardship on Southern Madison District's customers, the Commission finds that a two-year phase-in approach is appropriate.

The rates set forth in the Appendix to this Order are based upon the revenue requirement the Commission has found to be fair, just and reasonable and will produce sufficient revenues from water sales to recover the \$2,259,266 Revenue Required from Rates, an approximate 21.44 percent increase over the normalized test-year water sales of \$1,860,465. Phase 1 rates, which will be in place for 12 months, will increase a typical residential customer's monthly water bill from \$26.30 to \$31.05, an increase of \$4.75 or approximately 18.06 percent, which includes a water loss recovery surcharge of \$1.94³⁴ requested by Southern Madison District in its application.³⁵ Phase 2 rates, including the water loss recovery surcharge of \$1.94, will increase a typical residential customer's monthly water bill from \$31.05 to \$33.86, an increase of \$2.81 or approximately 9.05 percent.³⁶

RATE CASE FREQUENCY

In Case No. 2019-00041 and the resulting investigative report, the Commission discussed the problems that can occur when utilities avoid a review of their financial

³⁴ $\$31.05 [\$29.11 \text{ (Average Bill New Water Rates)} + \$1.94 \text{ (Water Loss Reduction Surcharge)}] - \$26.30 \text{ (Average Bill Current Water Rates)} = \$4.75 \text{ (Total Difference in Customer Bill)} \div \$26.30 \text{ (Average Bill Current Water Rates)} = 18.06\%$

³⁵ Application, Attachment #2, Reasons for Application.

³⁶ $\$33.86 [\$31.92 \text{ (Average Bill New Water Rates)} + \$1.94 \text{ (Water Loss Reduction Surcharge)}] - \$31.05 \text{ (Average Bill Phase 1 Water Rates)} = \$2.81 \text{ (Total Difference in Customer Bill)} \div \$31.05 \text{ (Average Bill Phase 1 Water Rates)} = 9.05\%$

records.³⁷ A key recommendation from that investigative report was that water districts should monitor the sufficiency of their base rates closely and, in general, apply for base rate adjustments on a more frequent basis.³⁸ The Commission notes that Southern Madison District had not sought a general base rate adjustment since 1994.³⁹ The Commission notes that from 2016 thru 2021, Southern Madison District has not earned a positive net income⁴⁰ and has lost \$1,272,923 as shown below.

Year	Net Income before Contributions
2016	\$(105,303) ⁴⁰
2017	\$(112,824) ⁴¹
2018	(153,705) ⁴²
2019	(126,360) ⁴³
2020	(368,620) ⁴⁴
2021	(406,111) ⁴⁵
Total Net Income before Contributions	(1,272,923)

³⁷ Case No. 2019-00041, *Electronic Investigation into Excessive Water Loss by Kentucky's Jurisdictional Water Utilities* (Ky. PSC. Nov. 22, 2019), Order.

³⁸ Case No. 2019-00041, Nov. 22, 2019 Order.

³⁹ Case No. 1994-00150, *In The Matter of the Application of Southern Madison Water District for a Rate Adjustment Pursuant to the Purchased Water Adjustment Clause* (Ky. PSC May 11, 1994).

⁴⁰ *Annual Report of Southern Madison Water District to the Public Service Commission* (Annual Report) for the Calendar Year Ended December 31, 2016 at 20.

⁴¹ *Annual Report of Southern Madison Water District to the Public Service Commission* (Annual Report) for the Calendar Year Ended December 31, 2017 at 20.

⁴² *Annual Report of Southern Madison Water District to the Public Service Commission* (Annual Report) for the Calendar Year Ended December 31, 2018 at 21.

⁴³ *Annual Report of Southern Madison Water District to the Public Service Commission* (Annual Report) for the Calendar Year Ended December 31, 2019 at 22.

⁴⁴ 2020 Annual Report, at 21.

⁴⁵ *Annual Report of Southern Madison Water District to the Public Service Commission* (Annual Report) for the Calendar Year Ended December 31, 2021 at 21.

The Commission will require that Southern Madison District's Board of Commissioners implement measures to ensure this does not continue; including policies of conducting internal financial reviews on an annual basis to ensure that its water rates are sufficient. The Commission also recommends that Southern Madison District's Board of Commissioners consider filing periodic rate cases with the Commission every three to five years and in furtherance of the recommendation, requires the utility implement a written policy to that effect to maintain a regular review of the utility's finances. These are best practices to ensure that there is not a 28-year gap between base rate cases in the future and net losses are curtailed before they become overly burdensome. If Southern Madison District requires assistance in conducting its annual internal rate reviews to ensure the sufficiency of its rates, Southern Madison District may request that the Commission allow its Financial Analysis Staff to provide it assistance.

SUMMARY

After consideration of the evidence of record and being otherwise sufficiently advised, the Commission finds that the recommendations contained in the Commission Staff's Report, as discussed above, are supported by the evidence of record and are reasonable. The Commission has historically used the Operating Ratio method to calculate the revenue requirement for water districts or associations with little to no outstanding long-term debt.⁴⁶ Applying the Operating Ratio method to Southern Madison District's pro forma operations results in an Overall Revenue Requirement of \$2,304,036 and, based upon pro forma present rate service revenues of \$1,860,465, a revenue increase of \$398,801 from water service rates is necessary to generate the overall

⁴⁶ Case No. 2020-00021, *Electronic Alternative Rate Adjustment Filing of Farmdale Water District* (Ky. PSC July 7, 2020).

revenue requirement. The Commission further finds that allocating the calculated revenue increase across the board to Southern Madison District's monthly retail water service rates in two phases to be fair, just and reasonable.

IT IS THEREFORE ORDERED that:

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

2. The rates proposed by Southern Madison District are denied.

3. The Connection Fees and Nonrecurring Charges set forth in the Appendix to this Order are approved for service rendered by Southern Madison District on and after the date of this Order.

4. Monthly Water Rates set forth in the Appendix to this Order are approved for service rendered by Southern Madison District on and after the date of this Order.

5. Southern Madison District's Board of Commissioners shall implement new policies to improve the financial health of the District; including policies of conducting internal financial reviews on an annual basis to ensure that its water rates are sufficient.

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

7. Southern Madison District shall use the midpoint of the depreciable lives of the NARUC Study ranges, as proposed in the application and agreed upon by Commission Staff, to depreciate water plant assets for accounting purposes in all future

reporting periods. No adjustment to accumulated depreciation or retained earnings should be made to account for this change in the accounting estimate.

8. Southern Madison District is authorized to assess a monthly Water Loss Reduction Surcharge of \$1.94 per meter per month for 48 months, or until \$512,750 has been assessed, whichever comes first, to fund its unaccounted-for water loss reduction efforts as set forth in the Commission Staff's Report, subject to the conditions set forth in ordering paragraph 7.

9. The Commission shall open a separate proceeding, Case No. 2023-00070⁴⁷ to monitor the surcharge proceeds collection and expenses, subject to the following conditions:

a. Within 120 days of the date of service of this Order, Southern Madison District shall file with the Commission a qualified infrastructure improvement plan, including a comprehensive unaccounted-for water loss reduction plan that establishes priorities and a time schedule for eliminating each source of unaccounted-for water loss and provides a detailed spending plan for the proceeds of a surcharge.

b. Southern Madison District shall deposit surcharge collections in a separate interest-bearing account. On the 15th day of each month for 48 months from the date of this Order or until all surcharge proceeds are expended, Southern Madison District shall file with the Commission a monthly activity report that includes a statement of monthly surcharge billings and collections; a monthly surcharge bank statement; a list of each payment from the account, its payee, a description of the purpose; and invoices supporting each payment.

⁴⁷ Case No. 2023-00070, *Electronic Southern Madison Water District Unaccounted-For Water Loss Reduction Plan, Surcharge and Monitoring*.

c. On the 15th day of each month for 48 months from the date of service of this Order or until all surcharge proceeds are expended, Southern Madison District shall file a monthly water loss report with the Commission.⁴⁸

d. Southern Madison District shall not use any surcharge proceeds for reimbursement of unaccounted-for water loss reduction expenses without prior Commission authorization.

e. Southern Madison District shall consider all surcharge collections as contributions and shall account for them in the manner that the Uniform System of Accounts for Class A and B Water Districts and Associations prescribes.

f. Southern Madison District shall debit monthly billings for the surcharge to customers' accounts receivable and credit the contribution account.

g. When Southern Madison District collects the surcharge from the customers, it shall debit special funds and credit the customer account.

h. One year after the date of service of this Order and annually thereafter, Southern Madison District shall file in Case No. 2023-00070 a schedule of the estimated and actual progress of the water loss detection and repair program, and estimated and actual expenditures made with the surcharge proceeds, for the purpose of evaluating whether adjustments to the program or to the surcharge amount are required.


10. Southern Madison District's failure to comply with the conditions set forth in ordering paragraph 7 shall result in termination of the surcharge and the refund of collected surcharge proceeds disbursed on expenses or projects outside the scope of expenses and projects approved by the Commission.

⁴⁸ The report format is found at <https://psc.ky.gov/Home/UtilForms> under "Water Use & Loss Calculations (Excel Format)."

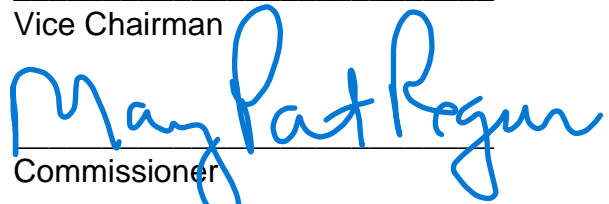
11. This case is closed and removed from the Commission's docket.

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PUBLIC SERVICE COMMISSION


Chairman

Vice Chairman


Commissioner



ATTEST:


Executive Director

APPENDIX

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2022-00129 DATED MAR 09 2023

The following rates and charges are prescribed for the customers in the area served by Southern Madison Water 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.

Monthly Water Rates

Phase 1

First	2,000	Gallons	\$14.878	Minimum Bill
Next	1,000	Gallons	0.007335	Per Gallon
Next	3,000	Gallons	0.006881	Per Gallon
Next	4,000	Gallons	0.006371	Per Gallon
Next	15,000	Gallons	0.005407	Per Gallon
Next	25,000	Gallons	0.005075	Per Gallon
Over	50,000	Gallons	0.004466	Per Gallon
Water Loss Reduction Surcharge ; limited to 48 months			\$1.94	Per month

Phase 2

To be implemented one year after Phase 1

First	2,000	Gallons	\$16.319	Minimum Bill
Next	1,000	Gallons	0.008046	Per Gallon
Next	3,000	Gallons	0.007548	Per Gallon
Next	4,000	Gallons	0.006989	Per Gallon
Next	15,000	Gallons	0.005930	Per Gallon
Next	25,000	Gallons	0.005566	Per Gallon
Over	50,000	Gallons	0.004898	Per Gallon
Water Loss Reduction Surcharge			\$1.94	Per month

Nonrecurring Charges

5/8 x 3/4 Inch Water Tap On	\$1,337
All Larger Meter sizes	Actual
Late Payment Charge	10%
Connection Turn-On Charge	\$15.50
Field Collection Charges	\$15.50
Meter Re-read Charge	\$15.50
Service Call/Investigation	\$15.50
Meter Test Charge (5/8 x 3/4)	\$15.50
Meter Test Charge (1 1/2 or larger)	Actual
Turn On Charge After hours	\$51.00
Field Collection - After hours	\$51.00
Meter Re-read After hours	\$51.00
Service Call - After hours	\$51.00
Returned Check Charge	\$0.75
Meter Relocation Charge	Actual
Damage to Meter Equipment	Actual

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