

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF LETCHER)	
COUNTY WATER AND SEWER DISTRICT FOR A)	CASE NO.
RATE ADJUSTMENT PURSUANT TO 807 KAR)	2022-00431
5:076)	

NOTICE OF FILING OF COMMISSION STAFF'S REPORT

Notice is hereby given that, in accordance with the Commission's Order of February 16, 2023, as amended by Orders entered May 18, 2023 and June 1, 2023, the attached report containing the findings of Commission Staff regarding the Applicant's proposed rate adjustment has been filed in the record of the above-styled proceeding. Pursuant to the Commission's February 16, 2023 Order, Letcher County Water and Sewer District (Letcher District) is required to file written comments regarding the findings of Commission Staff no later than 14 days from the date of service of this report. The Commission directs Letcher District to the Commission's July 22, 2021 Order in Case No. 2020-00085¹ regarding filings with the Commission.



Linda C. Bridwell, PE
Executive Director
Public Service Commission
P.O. Box 615
Frankfort, KY 40602

DATED JUL 27 2023

cc: Parties of Record

¹ Case No. 2020-00085, *Electronic Emergency Docket Related to the Novel Coronavirus COVID-19* (Ky. PSC July 22, 2021), Order (in which the Commission ordered that for case filings made on and after March 16, 2020, filers are NOT required to file the original physical copies of the filings required by 807 KAR 5:001, Section 8).

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COMMISSION STAFF'S REPORT
ON LETCHER COUNTY WATER AND SEWER DISTRICT

Letcher County Water and Sewer District (Letcher 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 service to approximately 3,023 residential customers, 65 commercial customers, 18 public authorities, and 4 bulk loading stations that reside in Letcher County, Kentucky.¹

On January 17, 2023,² Letcher District filed its application with the Commission requesting an adjustment to its water rates pursuant to 807 KAR 5:076. To comply with the requirements of 807 KAR 5:076, Section 9,³ Letcher District used the calendar year ended December 31, 2021, as the basis for its application. The application was filed

¹ *Annual Report of Letcher District to the Public Service Commission for the Calendar Year Ended December 31, 2021* (2021 Annual Report) at 12 and 49.

² Letcher District tendered its application on December 24, 2022. By letter dated January 5, 2023, the Commission rejected the application for filing deficiencies. The deficiencies were subsequently cured, and the application is deemed filed on January 17, 2023.

³ 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.

pursuant to the Commission's Order in Case No. 2022-00081,⁴ which required Letcher District to file an application for an adjustment of its base rates by July 1, 2023. Letcher District's last base rate increase pursuant to the alternative rate filing procedure was in Case No. 2017-00211.⁵ Since that matter, Letcher District has only adjusted its rates pursuant to a purchased water adjustment. To ensure the orderly review of the application, the Commission established a procedural schedule by Order dated February 16, 2023. Letcher District responded to three requests for information from Commission Staff.⁶ On May 18, 2023, and again on June 1, 2023, the Commission, on its own motion, amended the procedural schedule revising the due date for Commission Staff's Report. Pursuant to the June 1, 2023 amended procedural schedule, Commission Staff's Report is due on July 28, 2023.⁷

WATER LOSS

The Commission notes that in its 2021 Annual Report, Letcher District reported a water loss of 17.5071 percent.⁸ While performing the billing analysis an error was discovered that incorrectly reported water sold. This error reduced water sold by 17,472,300 gallons for the test year. Actual water sold during the test year was

⁴ Case No. 2022-00081 *Electronic Application of Letcher County Water and Sewer District for Deviation from 807 KAR 5:006, Section 7* (Ky. PSC Jun. 21, 2022), Order at 4, ordering paragraph 1.

⁵ Case No. 2017-00211, *Electronic Application of Letcher County Water and Sewer District for Alternative Rate Adjustment*,

⁶ See Letcher District's Response to Commission Staff's First Request for Information (Staff's First Request) (filed Mar. 20, 2023); Letcher District's Response to Commission Staff's Second Request for information (Staff's Second Request) (filed May 1, 2023); Letcher District's Response to Commission Staff's Third Request for information (Staff's Third Request) (filed June 23, 2023).

⁷ Procedural Schedule Amendment Order (Ky. PSC Jun. 1, 2023).

⁸ 2021 Annual Report at 57.

160,944,700 gallons resulting in an actual unaccounted for water loss of 24.98 percent.⁹ Commission Staff also reviewed the 2017 through 2020¹⁰ and 2022¹¹ annual reports and reviewed the water loss as shown below. Commission Staff did not assess whether similar issues exist with other reporting years.

Year	Water Loss
2017	18.82%
2018	12.09%
2019	10.36%
2020	12.90%
2022	18.45%

Commission regulation 807 KAR 5:066, Section 6(3), states that for ratemaking purposes, a utility's water loss shall not exceed 15 percent of total water produced and purchased, excluding water consumed by a utility in its own operations. At a 24.98 percent water loss, the 2021 total annual cost of water loss to Letcher District is \$208,855, while the annual cost of water loss in excess of 15 percent is \$83,434.

	Purchased Water	Purchased Power	Total
Purchased Water and Power expenses	\$ 784,615	\$ 51,528	\$ 836,143
Multiplied by: Test- Year Water Loss Percentage	24.98%	24.98%	24.98%
Total Cost of Water Loss	<u>\$ 195,984</u>	<u>\$ 12,871</u>	<u>\$ 208,855</u>
Purchased Water and Power expenses	\$ 784,615	\$ 51,528	\$ 836,143
Multiplied by: Water Loss in Excess of 15%	9.98%	9.98%	9.98%
Cost of Water Loss in Excess of the 15% Limit	<u>\$ 78,292</u>	<u>\$ 5,142</u>	<u>\$ 83,434</u>

⁹ Application, Attachment 4, Schedule of Adjusted Operations, References, Adjustments D & E.

¹⁰ *Annual Report of Letcher District to the Public Service Commission for the Calendar Year Ended December 31, 2017* (2017 Annual Report) at 56. *Annual Report of Letcher District to the Public Service Commission for the Calendar Year Ended December 31, 2018* (2018 Annual Report) at 57. *Annual Report of Letcher District to the Public Service Commission for the Calendar Year Ended December 31, 2019* (2019 Annual Report) at 57. *Annual Report of Letcher District to the Public Service Commission for the Calendar Year Ended December 31, 2020* (2020 Annual Report) at 57.

¹¹ *Annual Report of Letcher District to the Public Service Commission for the Calendar Year Ended December 31, 2022* (2022 Annual Report) at 57.

DISCUSSION

Using its pro forma test-year operations, Letcher District determined that a base rate revenue increase of \$581,730, or 35.58 percent, was necessary to achieve the revenue requirement.¹² On May 15, 2023, in response to Staff’s Second Request , Letcher District filed a revised Revenue Requirement Calculation and determined that an updated base rate revenue increase of \$521,922, or 35.00 percent, was necessary to achieve the revenue requirement as shown in the table below.¹³ The revised Revenue Requirement was based on Letcher District’s filing a revised 2021 Annual Report on April 28, 2023. The revised 2021 Annual Report was filed to reflect the completion of the 2021 audit which was not complete when the application was filed,¹⁴ but was subsequently completed on April 28, 2023.

	Original Application	Revised Application
Pro Forma Operating Expenses	\$ 2,090,456	\$ 1,931,849
Plus: Average Annual Debt Service	165,859	165,859
Debt Service Coverage Requirement	33,172	33,172
Overall Revenue Requirement	2,289,488	2,130,881
Less: Other Operating Revenue	(71,396)	(116,614)
Interest Income	(1,518)	(1,230)
Revenue Required from Water Sales	2,216,574	2,013,037
Less: Normalized Revenues from Water Sales	(1,634,844)	(1,491,115)
Required Revenue Increase/(Decrease)	\$ 581,730	\$ 521,922
Percentage Increase	35.58%	35.00%

¹² Application, Attachment 5, Revenue Requirement Calculation – Debt Coverage Method Table.

¹³ Letcher District’s Supplemental Response to Staff’s Second Request (filed May 15, 2023), LCWSD_Supplemental_DR2.xlsx, RevReq tab.

¹⁴ Letcher District’s Response to Staff’s First Request, Item 1c.

To determine the reasonableness of the rates requested by Letcher District, Commission Staff performed a limited review of Letcher District's test-year operations. The scope of Commission Staff's review was limited to determining whether operations reported for the test year were representative of normal operations. Known and measurable¹⁵ changes to test-year operations were identified and adjustments made when their effects were deemed material. Insignificant and immaterial discrepancies were not necessarily pursued or addressed.

Commission Staff's findings are summarized in this report. William Foley reviewed the calculation of Letcher District's Overall Revenue Requirement and Jason Green reviewed Letcher District's reported revenues and rate design.

SUMMARY OF FINDINGS

1. Overall Revenue Requirement and Required Revenue Increase. By applying the Debt Service Coverage (DSC) method, as generally accepted by the Commission, Commission Staff determined that Letcher District's required revenue from water sales is \$2,137,018 to meet the Overall Revenue Requirement of \$2,227,076 and that a \$391,970 revenue increase, or 22.46 percent, to pro forma present rate revenues is necessary to generate the Overall Revenue Requirement.

¹⁵ Commission regulation 807 KAR 5:076, Section 9, sets the standard for the determination of the reasonableness of proposed rates and states, in pertinent part, that the test period shall be "adjusted for known and measurable changes." See also Case No. 2001-00211, *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); and Case No. 2017-00417, *Electronic Proposed Adjustment of the Wholesale Water Service Rates of Lebanon Water Works* (Ky. PSC July 12, 2018).

2. Monthly Water Service Rates. Based upon the revenue requirement, Letcher District proposed to increase all of its monthly retail water service rates evenly across the board. Letcher District did not perform a cost of service study (COSS).¹⁶ Letcher District stated that it did not complete a COSS at this time as there has not been any material change in the water system to warrant a COSS.¹⁷

The Commission has previously found that the allocation of a revenue adjustment 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. Finding no such evidence in this case, Commission Staff followed the method proposed by Letcher District and allocated the \$391,970 revenue increase across the board to Letcher District's monthly retail and wholesale water service rates.

The rates set forth in the Appendix to this report are based upon the revenue requirement, as calculated by Commission Staff, and will produce sufficient revenues from water sales to recover the \$2,137,018, Revenue Required from Water Sales, an approximate 22.46 percent increase. These rates will increase a typical retail residential customer's monthly water bill from \$39.77 to \$48.70, an increase of \$8.93, or approximately 22.46 percent.¹⁸ These rates will increase the monthly wholesale rate from \$0.00389 per gallon to \$0.00476 per gallon, an increase of \$0.00087, or approximately 22.37 percent.

¹⁶ Letcher District's Response to Staff's First Request, Item 14a.

¹⁷ Letcher District's Response to Staff's First Request, Item 14b.

¹⁸ Application, Attachment 1, Retail Customer Notice, typical residential customer uses approximately 3,500 gallons per month.

3. Nonrecurring Charges. Following the Commission’s recent decisions,¹⁹ Commission Staff reviewed Letcher District’s Nonrecurring Charges. The Commission found that because district personnel are currently paid during normal business hours and their salaries and wages are an expense recovered in rates, estimated labor costs previously included in determining the amount of Nonrecurring Charges should be eliminated from the charges to avoid double recovery of the same expense. Letcher District provided updated cost justifications for all of the Nonrecurring Charges listed in its tariff.²⁰ Commission Staff reviewed the cost justification information provided by Letcher District and has adjusted these charges by removing Field Labor Costs and Office/Clerical Labor Costs. The revisions that were provided included updating and increasing the amount for transportation to \$17.60 for all Nonrecurring Charges that include transportation expense in its calculations. For the Service Reconnection Charge, the Field Labor Costs of \$13.00 per hour and Office/Clerical Labor Costs of \$28.25 per hour were both removed. Letcher District did not provide cost justification for the Returned Check Charge; therefore, this charge was reduced to \$0.00. Such adjustments result in the following revised Nonrecurring Charges:

	<u>Nonrecurring Charge</u>	
	<u>Current Charge</u>	<u>Revised Charge</u>
Reconnection Charge	\$45.00	\$18.00
Returned Check Fee	\$20.00	\$0.00

¹⁹ Case No. 2020-00141, *Electronic Application of Hyden-Leslie County Water District for an Alternative Rate Adjustment* (Ky. PSC Nov. 6, 2020); Case No. 2020-00167, *Electronic Application of Ohio County Water District for an Alternative Rate Adjustment* (Ky. PSC Dec. 3, 2020); Case No. 2020-00196, *Electronic Application of West Daviess County Water District for an Alternative Rate Adjustment* (Ky. PSC Dec. 30, 2020); and Case No. 2020-00195, *Electronic Application of Southeast Daviess County Water District for an Alternative Rate Adjustment* (Ky. PSC Dec. 30, 2020).

²⁰ Letcher District’s Response to Staff’s Second Request, Item 10.

The adjustments to the Nonrecurring Charges result in a decrease in Other Operating Revenue of \$4,505 as shown below.

	Occurrences	Current Charge	Revised Charge	Adjustment	Pro Forma
Reconnection Charge	155	\$45.00	\$18.00	\$ (4,185)	\$2,790
Returned Check Fee	16	\$20.00	\$0.00	\$ (320)	\$0
Pro Forma Test Year NRC Revenue					\$2,790
Less: Test Year NRC Revenue					<u>\$7,295</u>
Adjustment					<u>\$ (4,505)</u>

Additionally, it was discovered in Letcher District’s current tariff that a specific amount of \$60.00 is charged for customer deposits. Specific language is also used in its tariff that states “deposit amounts will not exceed two-twelfths (2/12) of the average annual bill of customers in each class where bills are rendered monthly.” Commission Staff disagrees with Letcher District’s approach to charge a specific amount for customer deposits in Letcher District’s tariff, as the average customer bill would change with each subsequent increase or decrease in rates for each customer class. Letcher District should revise its tariff to state that customer deposits shall be charged two-twelfths of the average bill for each customer class.

PRO FORMA OPERATING STATEMENT

Letcher District’s Pro Forma Operating Statement for the test year ended December 31, 2021, as determined by Staff, appears in the table below.

	Revised Test Year Operations	Letcher District Proposed Adjustment	Commission Staff's Adjustments	Total Pro Forma Adjustments	Adj. Ref	Revised Pro Forma Operations
Operating Revenues:						
Residential	\$ 1,433,103		\$ 253,933	\$ 253,933	(A)	\$ 1,687,036
Commercial	56,815			-		56,815
Bulk Loading Stations	1,197					1,197
Revenues - Sales of Water	1,491,115		253,933	253,933		1,745,048
Miscellaneous Service Revenues	116,614		(4,505)	(4,505)	(B)	
			(23,281)	(23,281)	(C)	88,828
Total Operating Revenues	1,607,729		249,428	249,428		1,833,876
Operating Expenses:						
Operation and Maintenance:						
Salaries and Wages - Employees	232,191		59,496	59,496	(D)	
			(6,984)	(6,984)	(E)	
			2,000	2,000	(M)	286,702
Employee Pensions and Benefits	121,957	(40,440)	14,650	14,650	(F)	
			11,299	11,299	(G)	
			960	960	(M)	148,865
Purchased Water	784,615	(78,292)	-	(78,292)	(H)	
			5,511	5,511	(M)	711,834
Purchased Power	51,528	(5,142)	-	(5,142)	(H)	
			362	362	(M)	46,748
Materials and Supplies	106,088		(16,297)	(16,297)	(E)	
			(631)	(631)	(M)	89,160
Contractual Services	67,137		(472)	(472)	(M)	66,665
Rental Equip.	1,560		(11)	(11)	(M)	1,549
Transportation Expenses	33,671		(237)	(237)	(M)	33,434
Insurance	28,395		(199)	(199)	(M)	28,196
Advertising	380		(3)	(3)	(M)	377
Miscellaneous Expenses	13,055		(92)	(92)	(M)	12,963
Total Operation and Mnt. Expenses	1,440,577	(123,874)	69,353	(14,081)		1,426,496
Depreciation Expense	801,408	(215,181)	(242,523)	(242,523)	(I)	
			548	548	(J)	559,433
Amortization	15,910	(3,978)	-	(3,978)	(K)	11,932
Taxes Other Than Income	16,987		5,327	5,327	(L)	
			(157)	(157)	(M)	22,157
Total Operating Expenses	2,274,882	(343,033)	(167,452)	(254,864)		2,020,018
Net Utility Operating Income	(667,153)	343,033	416,880	504,292		(186,142)
Interest Income	1,230		-	-		1,230
Net Income before Contributions	\$ (665,923)	\$ 343,033	\$ 416,880	\$ 504,292		\$ (184,912)

(A) Billing Analysis Adjustment. Letcher District provided a billing analysis listing the water usage and water sales revenue for the 12-month test year in its application. In the 2021 Annual Report, total metered water sales revenue reported for

the test year is \$1,491,115.²¹ Letcher District provided a billing analysis to calculate a normalized revenue amount based on the usage during the test year using the rates authorized in its current tariff to be \$1,745,047.²² Letcher District stated that it had problems with some of its meters periodically registering incorrect customer usage. In instances when this occurred, Letcher District removed those usage numbers from the billing analysis.²³ Consequently, Commission Staff increased test-year water sales revenue by \$253,933 to reflect the revenues from water rates reported in the billing analysis of \$1,745,048.

(B) Nonrecurring Charges. As discussed in the Nonrecurring Charges section above, the adjustments to the nonrecurring charges result in a decrease in Miscellaneous Service Revenues of \$4,505.

(C) Miscellaneous Service Revenues – Water Tap Revenues. In the Supplemental Response Worksheet, Letcher District reported \$116,614 in Miscellaneous Service Revenues.²⁴ This amount is composed of \$23,281 Tap fees, \$35,281 Late Fees and \$58,272 Other Misc. Income.²⁵ According to the Uniformed System of Accounting, revenue generated from the installation of meters is not treated as revenue, but is to be treated as Contributions in Aid of Construction²⁶ and credited to Account 271 –

²¹ 2021 Annual Report at 49.

²² Application, Attachment 6, Billing Analysis.

²³ Letcher District's Response to Staff's First Request (filed Mar. 20, 2023), Item 21b.

²⁴ Letcher District's Supplemental Response to Staff's Second Request (May 15, 2023), LCWSD_Supplemental_DR2.xlsx, Proforma tab.

²⁵ Letcher District's Response to Staff's Second Request (filed May. 15, 2023), Item 5a.

²⁶ Uniform System of Accounts for Class A/B Water Companies, at 98, Section 334 Meters and Meter Installation, Note C.

Contributions in Aid of Construction; and not included in Miscellaneous Service Revenues. Therefore, Commission Staff decreased Miscellaneous Service Revenues by \$23,281.

(D) Salaries and Wages – Employees. Letcher District provided its test-year, and current list of employees, number of hours worked, and employee wages.²⁷ Letcher District provided the current salary paid to the General Manager.²⁸ In addition, Letcher District increased employee wages subsequent to the test year.²⁹ Commission Staff normalized the test-year Salaries and Wages – Employees at current salaries and wage rates. Therefore, based on the normalized test year, Commission Staff increased Salaries and Wages – Employees by \$59,496 as shown below.

Position Title	Status	Test Year		Pro Forma Wage Rate	Pro Forma		Total
		Reg. Hrs	O. T. Hrs		Reg. Wages	O. T. Wages	
Accounts Clerk	Full-Time	2,080	0.48	\$ 10.70	22,256	8	22,264
Billing Clerk	Full-Time	2,080		9.93	20,654	0	20,654
O&M	Full-Time	2,080	32.18	16.20	33,696	782	34,478
O&M	Full-Time	2,080	100.47	11.55	24,024	1,741	25,765
Distribution Supervise	Full-Time	2,080	21.00	18.41	38,293	580	38,873
General Manager		Salary			81,901		81,901
O&M	Full-Time	2,080	32.00	10.50	67,248	504	67,752
Total Salaries and Wages					<u>\$ 288,072</u>	<u>\$ 3,615</u>	<u>\$ 291,687</u>
Normalized Employee Salaries & Wages							291,687
Less: Test-Year Employee Salaries & Wages							<u>(232,191)</u>
Salaries and Wages Adjustment							<u>\$ 59,496</u>

²⁷ Letcher District's Response to Staff's First Request (filed Mar. 20, 2023), Item 2, 2_LCWSD_Staffing_Records.xlsx.

²⁸ Letcher District's Response to Staff's Third Request (filed Jun. 23, 2023), Item 6.

²⁹ Letcher District's Response to Staff's First Request (filed Mar. 20, 2023), Item 2, 2_LCWSD_Staffing_Records.xlsx.

(E) Expenses Related to Meter Installations. During the test year, Letcher District installed 36 new water connections, all of which were 5/8- x 3/4-inch,³⁰ and collected \$23,281 in tap fees.³¹ Letcher District included the labor and materials used for setting meters in the salaries and materials expense and does not keep a record of the amounts used to install new customer connections.³² The Uniform System of Accounts (USoA) for Class A/B Water Systems requires that these costs be capitalized as Utility Plant in Service and depreciated over their estimated useful lives.³³ Therefore, Commission Staff calculated that Salaries and Wages – Employees and Materials and Supplies should be reduced by \$6,984 and \$16,294 respectively, as shown below. Additionally, Commission Staff capitalized the costs and made a corresponding adjustment to test-year depreciation as shown in Adjustment (I).

Test-Year Tap Fees Collected	<u>\$23,281</u>
Multiplied by Salaries and Wages Percentage- 30%	\$6,984
Multiplied by Materials and Supplies Percentage-70%	<u>\$16,297</u>

(F) Employee Pensions and Benefits – Insurance. In the Supplemental Response Worksheet, Letcher District proposed an adjustment to decrease Employee Pension and Benefits by \$40,440 to limit expenses associated with providing employees medical insurance.³⁴ All of Letcher District’s Employees have single-coverage health

³⁰ Letcher District’s Response to Staff’s Third Request (filed June 23, 2023), Item 3a.

³¹ Letcher District’s Response to Staff’s First Request (filed Mar. 20, 2023), Item 15b, 15b_LCWSD_Tap_Fee_Collected.pdf.

³² Letcher District’s Response to Staff’s First Request (filed Mar. 20, 2023), Item 15d.

³³ USoA, Accounting Instruction 19 and 33.

³⁴ Letcher District’s Supplemental Response to Commission Staff’s Second Request (May 15, 2023), LCWSD_Supplemental_DR2.xlsx, Proforma tab.

insurance.³⁵ Subsequent to the test year, insurance premiums have increased.³⁶ Letcher District currently pays 100 percent for full-time Employee's health insurance plan, Retirement through the County Employee Retirement Services (CERS), Life Insurance, Flexible Spending account FEBCO card, and an HRA Account. The Commission continues to place greater emphasis on evaluating employees' total compensation packages, including both salary and benefits programs, for market and geographic competitiveness to ensure the development of a fair, just and reasonable rate. The Commission found that, in most cases, 100 percent of employer-funded health care does not meet those criteria.³⁷

Commission Staff reviewed Letcher District's proposed adjustment and disagrees with its methodology. In its calculation, Letcher District first removed 22 percent of the monthly insurance premiums and then determined the remaining monthly premiums. Letcher District then multiplied the remaining insurance premiums by 12 months to determine the annual employer portion of insurance premiums of \$40,440.³⁸ Letcher District proposed to remove the \$40,440 from Employee Pensions and Benefits.³⁹ Commission Staff disagreed with Letcher District's proposed adjustment. Instead,

³⁵ Letcher District's Response to Staff's Third Request (filed Jun. 23, 2023), Item 7a.

³⁶ Letcher District's Response to Staff's Third Request (filed Jun. 23, 2023), Item 7b.

³⁷ Case No. 2020-00167, *Electronic Application of Ohio County Water District for an Alternative Rate Adjustment* (Ky. PSC Dec. 3, 2020); Case No. 2020-00296, *Electronic Application of Allen County Water District for an Alternative Rate Adjustment* (Ky. PSC Feb. 3, 2021).

³⁸ Letcher District's Response to Staff's First Request (filed Mar. 20, 2023), Item 10, 10_LCWSD_Adjustments.xlsx, Adj. C Tab.

³⁹ Letcher District's Supplemental Response to Staff's Second Request (May 15, 2023), LCWSD_Supplemental_DR2.xlsx, Proforma tab.

consistent with precedent;⁴⁰ Commission Staff proposed to reduce single health insurance premiums by 22 percent.⁴¹ However, Commission Staff reviewed the General Ledger and determined the monthly premiums have increased for health and Life Insurance Premiums subsequent to the test year,⁴² resulting in a net increase to Employee Pensions and Benefits. Letcher District provided the most recent total monthly premiums per employee for each benefit⁴³ and the test-year amount reported for insurance premiums, including the increased premiums.⁴⁴ Accordingly, utilizing the most recent invoice amounts, and the test-year amount from the General Ledger, Commission Staff recalculated the proposed adjustment and increased Employee Pension and Benefits Expense by \$14,650 as shown below.

Type of Premium	Number of Employees	Monthly Premium	Average Employee Contribution Rate	Monthly Premium Adjustment	Allowable Employer Premium
Employee Health Insurance	6	\$ 4,320	22%	\$ (950)	\$ 3,370
FEBCO	6	36	0%	-	36
HRA	6	798	0%	-	798
Life	7	28	0%	-	28
Total Pro Forma Monthly Premium Times: 12 Months		<u>\$ 5,182</u>		<u>\$ (950)</u>	<u>4,232</u> <u>12</u>
Total Pro Forma Annual Premiums Less Test Year					<u>50,784</u> <u>(36,134)</u>
Employee Pensions and Benefits Adjustment					<u>\$ 14,650</u>

⁴⁰ Case No. 2019-00053, *Electronic Application of Jackson Purchase Energy Corporation for a General Adjustment in Existing Rates*, (Ky. PSC June 20, 2019) at 8–12.

⁴¹ Bureau of Labor Statistics, *Healthcare Benefits*, March 2020, Table 3, private industry workers. (<https://www.bls.gov/news.release/pdf/ebs2.pdf>).

⁴² Letcher District’s Response to Staff’s First Request (filed Mar. 20, 2023), Item 1a, 1a_LCWSD-General Ledger_2021.xlsx, Account 604.00 Pensions and Benefits.

⁴³ Letcher District’s Response to Staff’s Third Request (filed June 23, 2023), Item 7b.

⁴⁴ Letcher District’s Response to Staff’s First Request (filed Mar. 20, 2023), Item 1a, 1a_LCWSD-General Ledger_2021.xlsx, Account 604.00 Pensions and Benefits.

(G) Employee Pensions and Benefits - CERS. During the test year, Letcher District participated in the CERS through the Letcher County Fiscal Court.⁴⁵ As explained in Adjustment (C) above, Commission Staff increased Salaries and Wages - Employees to \$291,687. Effective July 1, 2023, the contribution rate for nonhazardous employees is 23.34 percent.⁴⁶ Accounting for the revised Salaries and Wages, and the current contribution Rate; Commission Staff calculated the pro forma CERS contribution of \$689,080. Therefore, Commission Staff increased Employee Pensions and Benefits by \$11,299 as shown below.

<u>Employee Pensions and Benefits</u>	
Pro Forma Salaries and Wage- Eligible Employees	\$291,687
Multiplied by: Employer Contribution Rate Fiscal	<u>23.34%</u>
Pro Forma CERS- Employer Contribution	68,080
Less: Test Year Employee Pensions and Benefits	<u>(56,781)⁴⁷</u>
Employee Pensions and Benefits Adjustment	<u><u>\$11,299</u></u>

(H) Expenses Attributable to Water Loss. In the Supplemental Response Worksheet, Letcher District proposed adjustments to reduce Purchased Water Expense by \$78,292, and Purchased Power Expense by \$5,142 to reflect the removal of costs for water in excess of 15 percent.⁴⁸ During the test year, Letcher District reported a revised

⁴⁵ Letcher District's Response to Staff's Third Request (filed May. 1, 2023), Item 9.

⁴⁶ Kentucky Public Pensions Authority, CERS Employer Contribution Rates, Contribution Rates - Kentucky Public Pensions Authority. (<https://www.kyret.ky.gov/Employers/Pages/Contribution-Rates.aspx>).

⁴⁷ Letcher District's Response to Staff's First Request (filed Mar. 20, 2023), Item 1a, 1a_LCWSD-General Ledger_2021.xlsx, Account 604.00 Pensions and Benefits.

⁴⁸ Letcher District's Supplemental Response to Staff's Second Request (May 15, 2023), LCWSD_Supplemental_DR2.xlsx, Proforma tab.

water loss of 24.98 percent.⁴⁹ In the Revised Statement of Adjusted Operations, Letcher District changed the adjustments to \$78,292 and \$5,142 respectively.⁵⁰ As previously mentioned, Commission regulations prohibit the recovery of expenses for water loss in excess of 15 percent. Commission Staff reviewed purchased Water Expense and Purchased Power Expense and agrees with Letcher District’s revised proposed decrease of \$78,292 for Purchased Water expense and proposed decrease of \$5,142 for Purchased Power Expense for a net decrease of \$83,434 as shown in the table below.

	Purchased Water	Purchased Power	Total
Purchased Water and Power expenses	\$ 784,615	\$ 51,528	\$ 836,143
Multiply by: Water Loss in Excess of 15%	9.98%	9.98%	9.98%
Cost of Water Loss in Excess of the 15% Limit	<u>\$ 78,292</u>	<u>\$ 5,142</u>	<u>\$ 83,434</u>

(l) Depreciation. In the Supplemental Response Worksheet, Letcher District proposed an adjustment increasing Depreciation Expense by \$215,181 to reflect the changing of useful service lives of assets.⁵¹ Letcher District proposed to adjust the useful lives of assets to the recommended range based on common Commission practices.⁵² The Commission has also historically relied upon the report published in 1979 by the National Association of Regulatory Utility Commissioners (NARUC) titled *Depreciation Practices for Small Water Utilities* (NARUC Study). When no evidence exists to support

⁴⁹ Application, Attachment 4, References, Adjustments D & E.

⁵⁰ Letcher District’s Supplemental Response to Staff’s Second Request (May 15, 2023), LCWSD_Supplemental_DR2.xlsx, Proforma tab.

⁵¹ Letcher District’s Supplemental Response to Staff’s Second Request (May 15, 2023), LCWSD_Supplemental_DR2.xlsx, Proforma tab.

⁵² Application, Attachment 4, 04_SAO_w_Attachment.pdf, References, Adjustment G.

a specific life that is outside the NARUC ranges, the Commission has historically used the midpoint of the NARUC ranges to depreciate the utility plant. Upon examination, Commission Staff found no evidence to support depreciable lives that vary significantly from the midpoint of the NARUC ranges. Commission Staff agreed with Letcher District's depreciation methodology; however, when Commission Staff calculated the total depreciation expense, it calculated \$558,885 instead of the proposed \$589,706. Commission Staff decreased Letcher District's Depreciation Expense by a further \$27,342⁵³ to make a total adjustment of \$242,523 for an Adjusted Depreciation Expense inclusive of Adjustment (I) of \$559,443 as shown below.

Catagories	Service Life Range	Test Year Depreciation	Depreciation Adjustment	Adjusted Depreciation
Meters	35 - 45	33,425	-	33,425
Transmission & Distribution Mains	50 - 75	665,715	(239,658)	426,058
Meters	35 - 45	5,000	-	5,000
Structures and Improvements	10 - 15	77,086	3,336	80,422
Tools, Shop & Garage Equipment	15 - 20	7,943	(4,766)	3,177
Power Operated Equipment	10 - 15	772	(308)	464
Communications Equipment	10	1,990	-	1,990
Office Furniture & Equipment	20- 25	655.60	(408)	247.22
Transportation Equipment	7	8,822	(720)	8,102
Sub-total		<u>\$ 801,408</u>	<u>\$ (242,523)</u>	<u>\$ 558,885</u>
Depreciation on Capitalized Tap Fees			548	548
Total			<u><u>\$ (241,975)</u></u>	<u><u>\$ 559,433</u></u>

(J) Capitalization of Test-Year Water Taps. As explained in Adjustment (D) above, the expenses related to the installation of new water connections are capital expenditures that should be capitalized as Utility Plant in Service and depreciated over their estimated useful lives. Letcher District confirmed that it does not keep records of

⁵³ Commission Staff's proposed adjustment \$242,523 – Letcher District's Proposed adjustment \$215,181 = \$27,342.

the dollar amounts of labor and materials used to install new customer taps.⁵⁴ Letcher District also records the tap fees as revenue rather than as a capital asset,⁵⁵ and a review of the depreciation schedule for the test year did not record any new meters added to the assets for the year.⁵⁶ Therefore, Commission Staff calculated the annual depreciation amount for the test year and increased depreciation expense by \$548 as shown below.

Test Year Water Connections Expenses	\$ 23,281
Divided by useful Life of 42.5 Years	<u>42.5</u>
Pro Forma Depreciation Adjustments	<u>\$ 548</u>

(K) Amortization. In the Supplemental Response Worksheet, Letcher District proposed an adjustment to decrease Amortization Expense by \$3,978 to reflect a correction in the life of the Amortization of Blackey WTP’s bonds.⁵⁷ During the test year, the Amortization of the Blackey WTP was recorded over a 30-year service life. However, Commission Staff reviewed the loan for city of Blackey and determined it had a 40-year payment life. Commission Staff agrees with the proposed adjustment for the amortization of the Blackey WTP and decreased Amortization by \$3,978 to \$11,932.

<u>Categories</u>	<u>Adjusted Loan Life</u>	<u>Test Year Amortization</u>	<u>Amortization Adjustment</u>	<u>Pro Forma Amortization</u>
Amortization of Blackey WTP	40	<u>15,910</u>	<u>(3,979)</u>	<u>11,932</u>
Total Amortization		<u>\$ 15,910</u>	<u>\$ (3,979)</u>	<u>\$ 11,932</u>

⁵⁴ Letcher District’s Response to Staff’s First Request, Item 15d.

⁵⁵ Letcher District’s Response to Staff’s First Request, Item 15c.

⁵⁶ Letcher District’s Response to Staff’s First Request, Item 19, 19_LCWSD_Depreciation.xlsx.

⁵⁷ Letcher District’s Supplemental Response to Commission Staff’s Second Request (May 15, 2023), LCWSD_Supplemental_DR2.xlsx, Proforma tab.

(L) Taxes Other Than Income – FICA. Letcher District recorded Payroll Taxes of \$16,987.⁵⁸ However, as explained in Adjustment (C) above, Commission Staff calculated a pro forma Salaries and Wages – Employees expense of \$291,687. Letcher District does not provide compensation to board members.⁵⁹ Commission Staff calculated Payroll Taxes of \$22,314, an increase of \$5,327 as shown below.

Salaries and Wages – Employees	\$ 291,687
Salaries and Wages – Officers	<u>-</u>
Total Applicable Pro Forma Salaries and Wages	291,687
Multiplied by FICA Contribution Rate	<u>7.65%</u>
FICA Payroll Taxes	22,314
Less: Test Year Payroll Taxes	<u>(16,987)</u>
Payroll Tax Adjustment	<u><u>\$ 5,327</u></u>

(M) Allocation of expenses to Sewer Division. During the test year, Letcher District operated both a water and sewer division. Letcher District did not allocate expenses incurred during the test year between the water and wastewater operations.⁶⁰ However, Letcher District does separate its assets used to calculate Depreciation Expense between water assets and wastewater assets.⁶¹ Therefore, Commission Staff proposed to allocate a portion of the expenses from the water division to the sewer

⁵⁸ Letcher District’s Response to Staff’s First Request (filed Mar. 20, 2023), Item 1c, 1c_LCWSD_wtb_adjustments_2021.xlsx, Account 408.30 Payroll Tax.

⁵⁹ Letcher District’s Response to Staff’s First Request (filed Mar. 20, 2023), Item 9b, 9b_LCWSD_Board_Members.pdf.

⁶⁰ Letcher District’s Response to Staff’s First Request (filed Mar. 20, 2023), Item 1b.

⁶¹ Letcher District’s Response to Staff’s First Request (filed Mar. 20, 2023), Item 19, 19_LCWSD_Depreciation.XLSX.

division. Commission Staff calculated an allocation percentage based upon the proportion of the number of customers for both the water and wastewater divisions.

<u>Division</u>	<u>Number of Customers</u>	<u>Percentage</u>
Water Customers	3,110	99.30%
Sewer Customers	<u>22</u>	<u>0.70%</u>
Total Customer Count	<u><u>3,132</u></u>	<u><u>100%</u></u>

Taking Adjustments (C) through (G), and (H) and (I), as shown above, into account, Commission Staff multiplied Salaries and Wages – Employees, Employee Pensions and Benefits, Purchased Water, Purchased Power, Materials and Supplies, Contractual Services, Rental Equipment, Transportation Expenses, Insurance Advertising Expenses, Miscellaneous Expenses, and Taxes Other Than Income by the allocation percentage for the wastewater division calculated above; then removed the wastewater portion of the expenses. Therefore, Commission Staff proposes several adjustments to expenses for a net decrease of \$10,047.

<u>Expenses</u>	<u>Post-adjustment Amounts</u>	<u>Allocation Percentage</u>	<u>Allocation Adjustment</u>
Salaries and Wages - Employees	\$ 284,703	0.70%	\$ 2,000
Employee Pensions and Benefits	136,607	0.70%	960
Purchased Water	706,323	0.70%	4,961
Purchased Power	46,386	0.70%	326
Materials and Supplies	89,791	0.70%	631
Contractual Services	67,137	0.70%	472
Rental Equip.	1,560	0.70%	11
Transportation Expenses	33,671	0.70%	237
Insurance	28,395	0.70%	199
Advertising	380	0.70%	3
Miscellaneous Expenses	13,055	0.70%	92
Taxes Other Than Income	<u>22,314</u>	0.70%	<u>157</u>
Total Allocation Adjustment	<u><u>\$ 1,430,322</u></u>		<u><u>\$ 10,047</u></u>

OVERALL REVENUE REQUIREMENT AND
REQUIRED REVENUE INCREASE

The Commission has historically applied a Debt Service Coverage (DSC) method to calculate the Overall Revenue Requirement of water districts and water associations.⁶² This method allows for recovery of (1) cash-related pro forma operating expenses; (2) recovery of depreciation expense, a non-cash item, to provide working capital;⁶³ (3) the average annual principal and interest payments on all long-term debts; and (4) working capital that is in addition to depreciation expense.

	<u>Letcher District Revised</u>	<u>Commission Staff</u>	
Pro Forma Operating Expenses	\$ 1,931,849	\$ 2,020,018	
Plus: Average Annual Debt Service	165,859	172,549	(1)
Debt Service Coverage Requirement	<u>33,172</u>	<u>34,510</u>	(2)
Overall Revenue Requirement	2,130,881	2,227,076	
Less: Other Operating Revenue	(116,614)	(88,828)	
Interest Income	<u>(1,230)</u>	<u>(1,230)</u>	
Revenue Required from Water Sales	2,013,037	2,137,018	
Less: Normalized Revenues from Water Sales	<u>(1,491,115)</u>	<u>(1,745,048)</u>	
Required Revenue Increase/(Decrease)	<u>\$ 521,922</u>	<u>\$ 391,970</u>	
Percentage Increase	<u>35.00%</u>	<u>22.46%</u>	

⁶² Case No. 2022-00124, *Electronic Application of Elkhorn Water District for a Rate Adjustment Pursuant to 807 KAR 5:076* (Ky. PSC Oct. 24, 2022). Case No. 2021-00475, *Electronic Application of Carroll County Water District #1 for an Adjustment of Rates Pursuant to 807 KAR 5:076* (Ky. PSC June 28, 2022).

⁶³ The Kentucky Supreme Court has held that the Commission must permit a water district to recover its depreciation expense through its rates for service to provide internal funds for renewing and replacing assets. See *Public Serv. Comm'n of Kentucky v. Dewitt Water Dist.*, 720 S.W.2d 725, 728 (Ky. 1986). Although a water district's lenders require that a small portion of the depreciation funds be deposited annually into a debt reserve/depreciation fund until the account's balance accumulates to a required threshold, neither the Commission nor the Court requires that revenues collected for depreciation be accounted for separately from the water district's general funds or that depreciation funds be used only for asset renewal and replacement. The Commission has recognized that the working capital provided through recovery of depreciation expense may be used for purposes other than renewal and replacement of assets. See Case No. 2012-00309, *Application of Southern Water and Sewer District for an Adjustment in Rates Pursuant to the Alternative Rate Filing Procedure for Small Utilities* (Ky. PSC Dec. 21, 2012).

1. Average Annual Principal and Interest Payments. At the time of Commission Staff's review, Letcher District had three outstanding waterworks revenue bonds⁶⁴ and one outstanding KIA Loan.⁶⁵ In its application, Letcher District requested recovery of the average annual principal and interest on its indebtedness based on an average of the annual principal, and interest and fee payments for the three years following the test year, which is 2022 through 2024.⁶⁶ However, because the statutory date for a final Order to be issued in this proceeding is November 17, 2023, the 2022 and 2023 payments will be recovered through Letcher District's existing rates. Therefore, only Debt Service payments that will be made after the new rates are placed into effect should be considered in determining Letcher District's Annual Interest and Fees expense. Commission Staff calculated the average annual principal and interest on a five-year average for the years 2024 through 2026. As shown below, Commission Staff calculated an Average Interest and Fees of \$172,549.

⁶⁴ Case No. 2005-00227, *The Application of Letcher County Water and Sewer District for a Certificate of Public Convenience and Necessity to Construct, Finance and Increase Rates Pursuant to KRS 278.023* (Ky. PSC Jul. 13, 2005). Case No. 2007-00070, *The Application Of Letcher County Water and Sewer District for a Certificate of Public Convenience and Necessity to Construct and Finance Pursuant to the Provisions of KRS 278.020 And KRS 278.023* (Ky. PSC Mar. 6, 2007), Order at 2, ordering paragraphs 3 and 6.

⁶⁵ Case No. 2007-00480, *Construct and Finance a Water System Improvements Project* (Ky. PSC Jan. 15, 2008).

⁶⁶ Application, Attachment 5, Revenue Requirement Calculation – Debt Coverage Method.

2024 -2026 Debt Service Schedule

Debt	2024		2025		2026		Total
	Principal	Interest & Fees	Principal	Interest & Fees	Principal	Interest & Fees	
RUS - 2005 Bonds	\$ 17,000	\$28,530	\$ 18,000	\$27,765	\$ 19,000	\$26,955	\$137,250
Blackey- 1998 Bonds	16,000	14,800	16,000	14,000	17,000	13,200	91,000
RUS - 2007 Bonds	20,000	32,588	21,000	31,763	21,500	30,897	157,748
KIA - 2009 Loan	41,472	2,515	41,887	1,996	42,307	1,471	131,648
Total	\$ 94,472	\$78,433	\$ 96,887	\$75,524	\$ 99,807	\$72,523	517,646
Divided by 3 years							<u>3</u>
Average Annual Principal, Interest, and Fees							<u>\$172,549</u>

2. Additional Working Capital. The DSC method, as historically applied by the Commission, includes an allowance for additional working capital that is equal to the minimum net revenues required by a district's lenders that are above its average annual debt payments. In its application, Letcher District requested recovery of an allowance for working capital that is equal to 120 percent of its average annual debt payments for its Waterworks Revenue Bonds and KIA Loan at the time of its application.

Following the Commission's historic practice, Commission Staff agrees with Letcher District. Therefore, as calculated below and shown in the table above, \$34,510 is included in the revenue requirement.

Average Annual Principal and Interest	\$ 172,549
Times DSC Coverage Ratio	<u>120%</u>
 Total Net Revenues Required	 207,058
Less: Average Annual Principal and Interest Payments	<u>(172,549)</u>
 Additional Working Capital	 <u>\$ 34,510</u>

Signatures

/s/ William Foley

Prepared by: William Foley
Revenue Requirement Branch
Division of Financial Analysis

/s/ Jason Green

Prepared by: Jason Green
Rate Design Branch
Division of Financial Analysis

APPENDIX

APPENDIX TO COMMISSION STAFF'S REPORT OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2022-00431 DATED JUL 27 2023

The following rates and charges are prescribed for the customers in the area served by Letcher County 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.

Monthly Water Rates

All Meter Sizes

First	2,000 Gallons	\$34.39 Minimum Bill
Over	2,000 Gallons	0.00954 Per Gallon

<u>Wholesale Rate</u>	\$0.00476 Per Gallon
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Nonrecurring Charges

Service Reconnection Charge	\$18.00
Returned Check Charge	\$0.00

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