

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF MORGAN)	CASE NO.
COUNTY WATER DISTRICT FOR A RATE)	2020-00386
ADJUSTMENT PURSUANT TO 807 KAR 5:076)	

ORDER

On December 10, 2020, Morgan County Water District (Morgan District) filed an application with the Commission, pursuant to 807 KAR 5:076, requesting to adjust its rates for water service. The Commission had ordered Morgan District to file for an adjustment in rates pursuant to the November 22, 2019 Order in Case No. 2019-00041,¹ to which Morgan District was a party due to its sustained excessive water loss and related financial distress.²

In its application, Morgan District requested rates that would increase annual water sales revenues by \$374,842, a 26.45 percent increase in two phases to pro forma present rate water sales revenues.³

To ensure the orderly review of the application, the Commission established a procedural schedule by Order dated January 11, 2021, which, among other things, required the Commission Staff (Staff) to file a report (Staff Report) containing its findings

¹ See 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*.

² *Id.*

³ Application, Attachment 3.

regarding Morgan District's application. On March 10, 2021, an informal conference was held between Morgan District and Staff to discuss additional information that was required to complete the Staff Report and an amended procedural schedule that included additional discovery requests that was issued on March 23, 2021.

Pursuant to the amended procedural Order, on April 6, 2021, Staff issued a Staff Report summarizing its findings regarding Morgan District's requested rate adjustment. In the Staff Report, Staff found that Morgan District's adjusted test-year operations support revenues required from rates of \$1,743,358 and that an annual revenue increase of \$326,393, or 23.03 percent, over pro forma present rate revenues of \$1,416,965, is necessary to generate the overall revenue requirement of \$1,773,916.⁴ In addition to the recommendations regarding the base rate revenue requirement and authorized rates, Staff further recommended a monthly surcharge to fund water loss reduction efforts of \$5.87 per active meter be authorized by the Commission.⁵

On April 13, 2021, Morgan District filed, with the Commission, its comments on the Staff Report wherein it objected to the removal of certain labor expenses from nonrecurring charges, but did not contest the adjustment. Morgan District accepted the findings and recommendations presented in the Staff Report, but requested the inclusion of the debt service and coverage for the United States Department of Agriculture, Rural Development (RD) loan approved in Case No. 2021-00146⁶ in the final calculation of the

⁴ Staff Report at 3 and 19.

⁵ *Id.* at 6.

⁶ Case No. 2021-00146, *Electronic Application of Morgan County Water District for a Certificate of Public Convenience and Necessity to Construct a System Improvements Project and an Order Approving a Change in Rates and Authorizing the Issuance of Securities Pursuant to KRS 278.023* (Ky. PSC Apr. 26, 2021).

revenue requirement. With its comments, Morgan District did not request that a conference or hearing be held.⁷

The evidentiary hearing was held on April 21, 2021, and testimony was presented on behalf of Morgan District by consultants, Alan Vilines of Kentucky Rural Water Association (KRWA), and Paul Nesbitt of Nesbitt Engineering. Shannon Elam, general manager of Morgan District also testified at the hearing.⁸ Mr. Elam reiterated Morgan District's acceptance of the findings and recommendations in the Staff Report⁹ and Mr. Vilines explained the utility accepted the findings and recommendations in the Staff Report but noted its objection to including certain labor expenses in nonrecurring charges.¹⁰

WATER LOSS

Pursuant to 807 KAR 5:066, Section (6)3, water loss is limited to 15 percent for ratemaking purposes. As noted in the Staff Report, Morgan District's test-year water loss was 39.804 percent. Accordingly, Staff reduced test-year expenses by \$199,863 to account for the 24.804 percent excess water loss.¹¹

The Commission is placing greater emphasis on monitoring utilities that consistently exceed the 15 percent unaccounted-for water loss threshold. Morgan District was a party to Case No. 2019-00041 due to its sustained excessive water loss, and the

⁷ Letter from Shannon Elam, Morgan District general manager (filed on Apr. 13, 2021).

⁸ Hearing Video Transcript (HVT) of the Apr. 21, 2021 Hearing.

⁹ *Id.* at 3:01:51–3:02:24.

¹⁰ *Id.* at 40:42–43:18.

¹¹ Staff Report at 16–17.

Commission recognizes that Morgan District has filed the current case as a result of ordering paragraph 2 of Appendix G of the November 22, 2019 Order in that case.¹² While Morgan District did not specifically request a surcharge to fund water loss efforts in its application, the Commission finds that the recommendations made in the Staff Report are consistent with prior Commission action in cases involving water districts with excessive unaccounted-for water loss.¹³ The Commission recognizes 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 county impair a water district's ability to make the necessary action to focus on its leak detection and repair. 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.¹⁴

The Commission recommended more frequent rate cases and pursuing qualified infrastructure improvement surcharges; the proceeds of which will be devoted exclusively to infrastructure improvement and replacement in its report entitled, "*Confronting the Problems Plaguing Kentucky's Water Utilities: An Investigative Report by the Kentucky*

¹² See Case No. 2019-00041, *Electronic Investigation into Excessive Water Loss by Kentucky's Jurisdictional Water Utilities* (Ky. PSC Nov. 22, 2019), Appendix G.

¹³ 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, *Electronic 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. 2019-000119, *Electronic Application of Estill County Water District No. 1 for a Surcharge to Finance Water Loss Control Efforts* (Ky. PSC Mar. 24, 2020).

¹⁴ HVT of the Apr. 21, 2021 Hearing, 46:30, Alan Vilines stating he agrees with the Commission's policy to implement surcharges to fund water loss reduction and infrastructure improvement.

Public Service Commission November 2019,” which was fully incorporated in the final Order in Case No. 2019-00041.¹⁵

The Commission finds that a monthly surcharge is a reasonable means for Morgan District to be afforded the opportunity to recover costs for its efforts to reduce water loss and Morgan District should be authorized to assess a monthly water loss reduction surcharge of \$5.87 per active meter over 48 months from the date of entry of this Order. Morgan District should be restricted to expending any funds collected under the surcharge subject to the authorization by the Commission. Morgan 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 provide a detailed spending plan for the proceeds of the surcharge. To ensure that such a plan provides sufficient detail for the Commission to make a determination as to the reasonableness of the expenditures requested in the comprehensive unaccounted-for water loss reduction plan, the Commission further finds that Morgan District should be permitted to use surcharge proceeds to contract with and pay a certified engineer or consultant to draft the plan.

Morgan District was ordered specifically in the final Order in Case No. 2019-00041, to revise its leak adjustment policy to align the expenses of the utility with the amount charged to the ratepayer for a leak.¹⁶ Morgan District submitted a revised version of its leak adjustment policy in its May 22, 2020 filing in response to the Commission’s April 7,

¹⁵ See 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.

¹⁶ *Id.*, Appendix G.

2020 Order in Case No. 2019-00041.¹⁷ At the hearing on April 21, 2021, Mr. Elam agreed to clarify the time period used to determine a customer's average usage in the revised leak adjustment policy and that the utility has already started keeping record of the expenses to the utility when installing a tap.¹⁸ Morgan District was also ordered specifically to file an application for alternative rate adjustment, pursuant to 807 KAR 5:076, within six months.¹⁹ Morgan District required a rate increase due in large part to its decision not to implement the full amount of the rate increase recommended by Staff in Case No. 2016-00068.²⁰ The final Order in Case No. 2019-00041 stated:

Despite being increased in August 2017,²¹ Morgan District's current rates fail to ensure sufficient revenue to pay operating expenses, adversely affecting Morgan District's financial condition. Morgan District should file an application for alternative rate adjustment, pursuant to 807 KAR 5:076, within six months of the date of entry of this Order.²²

The Commission entered an Order on April 7, 2020, granting an extension until September 22, 2020, to the parties of Case No. 2019-00041 to comply with the November 22, 2019 Order, and requiring a progress report be filed by May 22, 2020.²³ Morgan

¹⁷ *Id.*, Morgan County Water District's Response Report to PSC Order of April 7, 2020 (filed May 22, 2020).

¹⁸ Elam, explaining the utility is recording any extra time spent installing a tap: HVT of the Apr. 21, 2021 Hearing, 2:28:14–2:30:09; explaining that the utility will make changes to clarify the leak adjustment policy: HVT of the Apr. 21, 2021 Hearing, 2:30:29–2:31:55 and 2:46:30–2:47:03.

¹⁹ Case No. 2019-00041, Appendix G.

²⁰ See Case No. 2016-00068, *Application of Morgan County Water District for Rate Adjustment*, (Ky. PSC Aug. 17, 2016).

²¹ *Id.*

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

²³ See *Id.*, Order (Ky. PSC Apr. 7, 2020).

District included a revision to its leak adjustment policy and attached new policies to its filing on May 22, 2020.²⁴ Morgan District filed a motion for an extension of time on September 18, 2020, in which it requested additional time to comply with the requirement to file an alternative rate adjustment from the November 22, 2019 Order.²⁵ The Commission denied Morgan County's motion, stating that Morgan District had ignored

the clear directives of the November 22, 2019 Order and the attached investigative report at Appendix L, which describes at length the difference between a base rate increase and increasing rates as a part of obtaining a USDA/RD loan. Morgan District's financial predicament based upon its mistakes in failing to accept the rate recommendation of the Commission in Case No. 2016-0068, and failing to include depreciation as part of a prior USDA/RD loan is an example of the poor financial planning discussed in the report.²⁶

Morgan District filed this case on December 10, 2020, to comply with the Commission's November 22, 2019 Order and October 13, 2020 Orders.²⁷ At the hearing in this matter, Mr. Elam and Mr. Nesbitt both acknowledged that Morgan District, as early as 2018, was aware that its rates were not sufficient to fund the utility's operations as and indicated that the utility understood the ramifications of not accepting the full amount of rates recommended by Staff in Case No. 2016-00068 during the July 2019 hearing in Case No. 2019-00041.²⁸ However Morgan District did not file this rate case until December 10, 2020. Despite the Commission naming Morgan District as a party to Case

²⁴ *Id.* Morgan County Water District's Response Report to PSC Order of April 7, 2020 (filed May 22, 2020).

²⁵ *Id.*, Morgan County Water District's Motion for Extension of Time (filed Sept. 18, 2020).

²⁶ *Id.*, Order (Ky. PSC Oct.13, 2020) at 2.

²⁷ *Id.*, final Order (Ky. PSC Nov.22, 2019).

²⁸ HVT of July 9, 2019 Hearing, 1:10:50–1:13:32; 2:09:25–2:11:40.

No. 2019-00041 due to its sustained excessive water loss, the utility acknowledging its financial deficits, the assistance of a professional consultant, and the Commission ordering the utility to file a rate case to address its lack of funds, the utility did not file a rate case for almost two years.

The Commission acknowledges the impact that COVID-19 has had on all utilities and that small utilities in distress are disproportionately disadvantaged in times of crisis. However, Morgan District's plans were to file a case pursuant to KRS 278.023 prior to the end of 2019. The final Order in Case No. 2019-00041 was entered on November 22, 2019, the contents of which, among other things, went into great detail differentiating alternative rate filings pursuant to 807 KAR 5:076 versus the filings under KRS 278.023 that included an adjustment of rates. Morgan District should implement written policies to prevent similar delays and misunderstandings in the future. The importance of a written policy is to outlast the inevitable turnover of utility boards and turnover at the Commission.²⁹ Accordingly, the Commission finds that Morgan District should create a written policy that addresses review of its rate sufficiency, the frequency of filing a base rate case, and implementing the full recommended rate increase.

Mr. Elam testified at the hearing in Case No. 2019-00041 about his awareness of the necessity of depreciation funds and the fact that in the past, the deprecation funds had been used for bond payments if the utility could not make the payment otherwise.³⁰ The report at Appendix L of the November 22, 2019 Order discussed the issues related

²⁹ HVT of the Apr. 21, 2021 Hearing, 2:07:50–2:09:57, discussion stating that a utility must take the full amount recommended by the Commission, however there is not an Order and policy may change with turnover. The direct way to address the policy changes will be at the utility level.

³⁰ Case No. 2019-00041, Transcript of the Testimony of PSC Hearing July 9, 2019, at 20–21.

to the fact that a base rate case is the only time that the Commission can review of a utility's depreciation schedule or depreciation policies.³¹ Staff advised Morgan County about the damage to the financial health of the utility because of the lack of records to account for its assets. Staff contacted the utility and its consultants on multiple occasions to gather the missing records, only to discover that the records had not been properly kept. Mr. Vilines testified that the lack of funds is Morgan District's most significant current difficulty.³² Mr. Vilines also noted the fact that Morgan District had poor bookkeeping and accounting records that caused its depreciation schedule to be lacking pertinent information. He also explained how the utility was financially burdened because it could not assign the proper deprecation lives to its assets and account for required maintenance and upgrades.³³ In addition to the need for a rate increase, Mr. Vilines agreed that a rate case could have addressed all three of the obstacles Morgan District identified in discovery responses in Case No. 2019-00041: a lack of funds, a lack of employees dedicated to leak detection, and a lack of leak detection equipment.³⁴

Mr. Elam noted that his plans include making sure that utility creates policies to ensure a fully funded depreciation account.³⁵ It is understandable that when a utility is building itself up after a financial crisis, it has to address one task at a time. In this case, there has been action from the utility; however, the priority should have been to take

³¹ Case No. 2019-00041, Appendix L.

³² HVT of the Apr. 21, 2021 Hearing, 26:50–27:44.

³³ *Id.* at 26:05–27:44.

³⁴ *Id.* at 32:07–32:27

³⁵ *Id.* at 2:31:55–2:34:12.

action on the utility's most significant problems first. The November 22, 2019 Order prioritized two actions for Morgan District to undergo: a revised leak adjustment policy and to file an alternative rate adjustment, pursuant to 807 KAR 5:076.³⁶ Mr. Elam expressed his motivation for keeping the utility on track to regain a healthy financial viability, but acknowledged that he has no previous experience managing a water utility and is learning about the position of general manager.³⁷ The Commission finds that Morgan District should create a written policy to ensure that it has a depreciation fund and adequate depreciation schedule. The Commission also finds that Morgan District should maintain its records properly to make an informed determination of the reasonable lives of its assets.

Along with the other parties to the investigation in Case No. 2019-00041, it was recommended that Morgan District "begin installing zone meters to help identify problem areas,"³⁸ and to dedicate personnel to leak detection and water loss prevention.³⁹ It is encouraging that Mr. Elam is signed up to attend the management program offered by the KRWA in May 2021 and that he explained how the utility is utilizing the resources available through its Area Development office and organizations like KRWA. Mr. Elam sought additional guidance on best policies and practices. The Commission directs Mr. Elam to the resources recommended in the investigative report filed with the November

³⁶ Case No. 2019-00041, (Ky. PSC Nov. 22, 2019) Appendix G.

³⁷ HVT of Apr. 21, 2021 Hearing, 2:49:12.

³⁸ Case No. 2019-00041, *Electronic Investigation into Excessive Water Loss by Kentucky's Jurisdictional Water Utilities* (Ky. PSC Nov. 22, 2019) at 6.

³⁹ *Id.* at 7.

22, 2019 Order in Case No. 2019-00041, which directed utilities to “several user-friendly guides to which water systems can refer in addition to any in-person training received, including “The Water Board Bible: The handbook of modern water utility management” by Ellen G. Miller and Elmer Ronnebaum; “Getting Results From Your Experts: Engineers, Attorneys & More” by Ellen G. Miller and Elmer Ronnebaum; “Practical Personnel Management for Small Systems” by Ellen G. Miller; “Customers and You: Practical Communications for Small Systems” by Ellen G. Miller; and the “Financial Accounting Guide for Small Water”⁴⁰ The Commission also referenced best practices shared from Northern Kentucky Water District and Kentucky-American Water Company in that report.⁴¹ These resources, along with Morgan District’s commitment to providing training to its manager and employees, will help provide guidance on better internal controls, such as the board creating a written policy for the use of the utility’s debit or credit card, including a limit and description of what should be purchased with the card.⁴² Morgan District should also develop a contract for its pay roll services to ensure a duty of care, as well as set expectations with which to comply.⁴³

Mr. Elam also explained that an employee was hired to be dedicated to leak detection based upon the recommendations from the Commission and that employee had

⁴⁰ Case No. 2019-00041, Appendix L, 9–11, footnotes 35–39.

⁴¹ *Id.*

⁴² HVT of the Apr. 21, 2021 Hearing, 2:35:37–2:38:20. Discussing the lack of a policy for using the debit card, and lack of a limit to purchases that can be made without prior approval. Also, that an employee of a local bank performs payroll duties for free because a county employee once held those duties and passed those down.

⁴³ *Id.* Discussing the practice of a county employee performing pay roll duties for free.

received training from KRWA.⁴⁴ Morgan District has not yet installed zone meters; however, Mr. Elam testified that he and Mr. Nesbitt had discussed the benefit of those in the future.⁴⁵ Additional recommendations from the November 22, 2019 Order to all parties included revising policies for record-keeping and funding regarding meter testing and replacement, evaluating the need for more frequent rate increases, and reevaluating the roles of boards and managers regarding water loss and leak detection.⁴⁶ Morgan District was ordered along with the other parties to Case No. 2019-00041 to improve its policies on water loss reduction and create better business practices to improve the financial health of the utility.⁴⁷ All of the parties to Case No. 2019-00041 were also ordered to follow the water loss calculation adopted by the Commission in Case No. 2018-00394.⁴⁸ Mr. Elam testified that the greatest gains made by Morgan District since the final Order in Case No. 2019-00041 were in revising its flushing schedule, focusing on asset management, developing an extensive GIS mapping system and hiring a dedicated employee for leak detection.⁴⁹

Morgan District has acknowledged the mistakes it made in the past and has taken steps to correct those. Additionally, throughout the investigation in Case No. 2019-00041 and this case, the utility has taken guidance suggested by the Commission and its Staff

⁴⁴ HVT of the Apr. 21, 2021 Hearing, 2:41:42–2:42:19.

⁴⁵ *Id.* at 2:49:50–2:50:44.

⁴⁶ Case No. 2019-00041, *Electronic Investigation into Excessive Water Loss by Kentucky's Jurisdictional Water Utilities* (Ky. PSC Nov. 22, 2019) at 7.

⁴⁷ *Id.* at 9.

⁴⁸ *Id.*

⁴⁹ HVT of the Apr. 21, 2021 Hearing, 2:41:42–2:44:50.

to correct current practices and revise submissions to meet Commission standards. The responses submitted in both cases and the testimony given at the April 21, 2021 hearing show a commitment to improving the financial and operational health of the utility and putting policies in place to ensure its viability beyond the board or employees currently in place. The Commission acknowledges the progress made, yet there is much improvement to be made. The utility will continue to provide status reports and submit improvement plans in Case No. 2021-00206, as the Commission will monitor its water loss surcharge. Therefore, the Commission finds that Morgan District's response to the April 7, 2020 Order along with the additional materials submitted in this case are sufficient to comply with the requirements of the November 22, 2019 Order in Case No. 2019-00041.

BACKGROUND

Morgan District is a water district organized pursuant to KRS Chapter 74. It owns and operates a water distribution system through which it provides water service to approximately 2,835 customers in Morgan County, Kentucky.⁵⁰ Morgan District does not produce any of its own water; rather, it purchases its water from the city of West Liberty and the Cave Run Water Commission. Morgan District last adjusted its water service rates pursuant to the alternative rate filing adjustment procedure on August 17, 2016.⁵¹

TEST PERIOD

⁵⁰ *Annual Report of Morgan County Water District to the Public Service Commission for the Calendar Year Ended December 31, 2019 (Annual Report)* at 12 and 49.

⁵¹ Case No. 2016-00068, *Application of Morgan County Water District for Rate Adjustment* (Ky. PSC Aug. 17, 2016).

The calendar year ended December 31, 2019, was used as the test year to determine the reasonableness of Morgan District's existing and proposed water rates, as required by 807 KAR 5:076, Section 9.

SUMMARY OF REVENUE AND EXPENSES

The Staff Report summarizes Morgan District's pro forma income statement as follows:⁵²

	<u>2019 Annual Report</u>	<u>Pro Forma Adjustments</u>	<u>Staff Pro Forma Operations</u>
Operating Revenues	\$ 1,428,505	\$ 19,252	\$ 1,447,757
Operating Expenses	<u>1,839,911</u>	<u>(353,085)</u>	<u>1,486,826</u>
Net Operating Income	(411,406)	372,337	(39,069)
Interest Income	75		75
Nonutility Income	<u>6,575</u>	<u>(6,575)</u>	<u>-</u>
Income Available for Debt Service	<u>\$ (404,756)</u>	<u>\$ 372,337</u>	<u>\$ (38,994)</u>

REVENUE REQUIREMENT ADJUSTMENTS

Reported Water Sales. In the Staff Report, Staff recommended the Commission increase water sales by \$15,836 to match actual amounts billed to customers in 2019 supported by Morgan District's general ledger.⁵³ The Commission finds that this adjustment meets the ratemaking criteria of being known and measurable⁵⁴ and is reasonable and should be approved.

⁵² See Appendix A to the Staff Report for a complete pro forma.

⁵³ Staff Report at 8, Adjustment A.

⁵⁴ 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."

Billing Analysis Adjustment. In the Staff Report, Staff recommended the Commission accept Morgan District's proposed adjustment to increase test-year revenues from water sales by \$27,748 to reflect its current billing analysis filed with the application.⁵⁵ The Commission finds that this adjustment meets the ratemaking criteria of being known and measurable and is reasonable and should be approved.

Bulk Water Sales. In the Staff Report, Staff recommended the Commission reclassify \$309 in bulk water sales into its own category of water sales to accurately reflect the amounts reported on the general ledger.⁵⁶ The Commission finds that the effect of this adjustment causes the pro forma to accurately reflect test year sales as reported on Morgan District's books, and should be approved.

Late Payment Penalties. In the Staff Report, Staff recommended the Commission increase Forfeited Discounts \$26,326 that appeared on Morgan District's general ledger, but was not properly reported on Morgan District's annual report.⁵⁷ The Commission believes the evidence of record supports Staff's assertion that this amount was not properly included in Morgan District's annual report and finds that it should be included in pro forma operations.

Annual Report Inaccuracy. In the Staff Report, Staff proposed to adjust Miscellaneous Service revenues by \$3,185 to reflect the test year balance of non-recurring charges recorded in general ledger account, 471 – Misc. Service Revenue.⁵⁸

⁵⁵ Staff Report at 8, Adjustment B.

⁵⁶ *Id.*, Adjustment C.

⁵⁷ *Id.*, Adjustment D.

⁵⁸ *Id.* at 9, Adjustment E.

The Commission finds that this adjustment properly reflects the level of Miscellaneous Service Revenue experienced by Morgan District during the test period and should be accepted.

Nonrecurring Charges. In the Staff report, Staff recommended the Commission decrease Nonrecurring Charges by \$19,694 to reflect recent Commission decisions regarding labor costs during normal business hours that were previously included in the calculation of a utility's nonrecurring charge.⁵⁹ The Commission finds that this adjustment accurately reflects recent Commission precedent on this issue and should be accepted.

Salaries and Wages. In the Staff Report, Staff recommended the Commission increase pro forma salaries and wages by \$60,576 and additionally make a corresponding increase to pro forma taxes other than income by \$4,683 to reflect the current staffing level at Morgan District which included an additional full time employee that worked minimal hours during the test year.⁶⁰ The Commission finds that the proposed adjustments meet the ratemaking criteria of being known and measurable and should be accepted.

Expenses Related to Installation of Taps. In the Staff Report, Staff recommended the Commission decrease and capitalize on its depreciation schedule test year expenses of \$63,800 to reflect the District's current tap fee multiplied by the number of taps installed during the test period.⁶¹ Staff further recommended the Commission require Morgan District to retain sufficient information in its utility records going forward to properly

⁵⁹ *Id* at 9–10, Adjustment F.

⁶⁰ *Id.* at 11, Adjustment G.

⁶¹ *Id.* at 12–14, Adjustment H.

calculate the expenses directly related to the installation of its meter taps.⁶² The Commission finds that in the absence of utility records to properly account for expenses related to the installation of meter taps, the alternative method proposed by Staff is a reasonable method to perform the reduction in test-year expenses to be capitalized on Morgan District's depreciation schedule. Further, the Commission finds that Staff's recommendation to require Morgan District in the future to keep a precise record of the expenses related to its meter taps is reasonable.

Retirement Expense. In the Staff Report, Staff recommended the Commission increase Employee Pensions and Benefits expense by \$8,982 to reflect the pro forma adjustment to Salaries and Wages expense as discussed in adjustment (G) of the Staff Report.⁶³ The Commission finds, based on the evidence of record, the adjustment proposed by Staff accurately reflects the level of retirement expense that will increase as a result of the pro forma adjustment that the Commission has additionally found reasonable regarding salaries and wages and therefore should be accepted by the Commission.

Adjustment for GASB 68 and 75. In the Staff Report, Staff recommended the Commission reduce Employee Pensions and Benefits expense by \$45,510 to reverse the effect of adjustments made by Morgan District's auditor to be in compliance with the requirements of GASB 68 and 75.⁶⁴ The Commission finds that it is proper to include

⁶² *Id.*

⁶³ *Id.* at 14, Adjustment I.

⁶⁴ *Id.* at 15–16, Adjustment J.

actual test year contributions to the County Employees' Retirement System, and this adjustment should be accepted for ratemaking purposes.

Employee Benefits. In the Staff Report, Staff recommended the Commission accept Morgan District's proposed adjustment to reduce Employee Pensions and Benefits to net an increase to health insurance premiums subsequent to the test year and reduce premiums paid by Morgan District to bring its contributions in line with the Bureau of Labor Statistic's national average for single coverage based on recent Commission decisions on this issue.⁶⁵ The Commission finds that the adjustment proposed by Morgan District, and subsequently by Staff, meets the criteria formerly set by the Commission, is known and measurable, and should be accepted.

Excess Water Loss. In the Staff Report, Staff recommended the Commission accept Morgan District's proposed adjustment to reduce test year expenses for Purchased Power and Purchased Water expenses attributable to water loss pursuant to 807 KAR 5:066, Section 6(3).⁶⁶ The Commission finds the adjustment proposed by Morgan District and further recommended by Staff properly reflects the limitations imposed by the regulation and should be accepted.

Reclassification of Purchased Power Expense. In the Staff Report, Staff recommended the Commission accept Morgan District's proposed adjustment to reclassify \$35,182 of purchased power expenses that were incorrectly classified as miscellaneous expenses in Morgan District's annual report.⁶⁷ The Commission finds that

⁶⁵ *Id.* at 16, Adjustment K.

⁶⁶ *Id.*, Adjustment L.

⁶⁷ *Id.* at 17, Adjustment M.

purchased power expenses should be reported by Morgan District in the correct category in order to properly perform the proposed reduction accepted by the Commission regarding its excessive water loss and the reclassification adjustment should be accepted.

Depreciation Expense. In the Staff Report, Staff recommended the Commission reduce depreciation expense by \$116,847,⁶⁸ which was supported by the calculations outlined by Staff in Appendix A to the report.⁶⁹ In addition to the findings regarding the level of detail of Morgan District's depreciation schedule discussed earlier in this Order, the Commission finds, that in the absence of proper recordkeeping and documentation which has been represented by Morgan District in this proceeding through its application and multiple requests for information, the depreciation rates presented by Staff in Appendix A represent a reasonable alternative level of depreciation expense and should be accepted by the Commission. In addition to the findings above, which state that the Commission should require Morgan District to keep adequate records to properly classify its assets on its asset ledger, the Commission notes that in future proceedings, Morgan District should be prepared to classify its assets that properly utilize the 1979 report published by the National Association of Regulatory Utility Commissioners (NARUC) titled *Depreciation Practices for Small Water Utilities* (NARUC Study).

Nonutility Income. In the Staff Report, Staff recommended the Commission reduce Nonutility Income by \$6,575 for funds received as part of an Abandoned Mine Lands

⁶⁸ *Id.* at 17–18, Adjustment N.

⁶⁹ *Id.*, Appendix A.

grant. The Commission finds that the funds received should not be classified as income to Morgan District and therefore should be included in the pro forma adjustments.

Debt Service Payments and Additional Working Capital. In the Staff Report, Staff recommended the Commission include in the calculation of Morgan District's Overall Revenue Requirement, \$239,242 in principal and interest payments on Morgan District's current indebtedness, and \$47,848 in corresponding additional working capital.⁷⁰ Subsequent to the issuance of Staff's Report, the Commission approved a Certificate of Convenience and Necessity (CPCN) and associated indebtedness to the United States Department of Agriculture Rural Development (RD) pursuant to KRS 278.023 in Case No. 2021-00146.⁷¹ In Morgan District's comments to the Staff Report, it requested recovery of the debt service and corresponding coverage of the approved loan and included as an attachment, the debt service schedule on the RD loan.⁷² The Commission finds that through its approval of the indebtedness to RD in that case, Morgan District should be permitted recovery of both the principal and interest payments and additional working capital as proposed by Morgan District in its comments and has included these amounts in the final calculation of the revenue requirement.

Based upon the Commission's findings and determinations herein, Morgan District requires an increase in revenues of \$338,270, or 23.87 percent above pro forma present rate revenues, as shown below:

⁷⁰ *Id.* at 19–21.

⁷¹ Case No. 2021-00146, *Electronic Application of Morgan County Water District for a Certificate of Public Convenience and Necessity to Construct a System Improvements Project and an Order Approving a Change in Rates and Authorizing the Issuance of Securities Pursuant to KRS 278.023* (Ky. PSC Apr. 26, 2021).

⁷² Letter from Shannon Elam, Morgan District general manager (filed on Apr. 13, 2021).

Pro Forma Operating Expenses	\$ 1,486,826
Plus: Average Annual Principal and Interest Payments	249,139
Additional Working Capital	<u>49,828</u>
Overall Revenue Requirement	1,785,793
Less: Other Operating Revenue	(30,483)
Interest Income	<u>(75)</u>
Revenue Required from Rates	\$ 1,755,235
Less: Pro Forma Present Rate Service Revenues	<u>(1,416,965)</u>
Required Revenue Increase	<u>\$ 338,270</u>
Percentage Increase	<u>23.87%</u>

RATE DESIGN

Morgan District proposed to increase all of its monthly retail water service rates evenly across the board by approximately 26.45 percent. Morgan District has proposed a phased-in approach to implementing the rate increase, whereby approximately half of the increase would be recovered during the first year and the remainder of the increase would be recovered after the first year. Mr. Vilines testified that he recommended a gradual or phased-in approach due to the large amount of the increase in rates needed by the utility.⁷³ As referenced previously, Morgan District required a such a large rate increase due in large part to its decision not to implement the full amount of the rate increase recommended in Case No. 2016-00068.⁷⁴ Morgan District has not completed a cost of service study (COSS) at this time as there has not been any material change in the water system to warrant a COSS. The Commission finds that the full amount of rate

⁷³ HVT of the Apr. 21, 2021 Hearing, 39:30–40:40.

⁷⁴ See Case No. 2016-00068, *Application of Morgan County Water District for Rate Adjustment*, (Ky. PSC Aug.17, 2016).

increase should be implemented because the full amount is required at this time by the utility to improve its financial state and fully fund depreciation.

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 Staff Report, Staff followed the method proposed by Morgan District and allocated Staff's calculated revenue increase across the board to Morgan's monthly retail water service rates.

The rates set forth in Appendix A 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 \$1,755,235 Revenue Required from Rates, an approximate 23.87 percent increase. Pursuant to the final Order in Case No. 2021-00146, Morgan District was authorized to increase its retail water service rates by the rates calculated by RD in its application.⁷⁵ The revenue requirement percentage calculated in this Order is based on base rate revenues provided in the billing analysis in Morgan District's application and does not reflect the revised rates approved in Case No. 2021-00146. Therefore, the approved rates as shown in Appendix B will reflect an increase to a typical residential customer's monthly water bill from \$38.83 to \$43.15, an

⁷⁵ Case No. 2021-00146, *Electronic Application of Morgan County Water District for a Certificate of Public Convenience and Necessity to Construct a System Improvements Project and an Order Approving a Change in Rates and Authorizing the Issuance of Securities Pursuant to KRS 278.023* (Ky. PSC Apr. 26, 2021) at 6, ordering paragraph 14.

increase of \$4.32, or approximately 11.13 percent over the rates approved in Case No. 2021-00146.⁷⁶

SUMMARY

After consideration of the evidence of record and being otherwise sufficiently advised, the Commission finds that:

1. The findings contained in the Staff Report are supported by the evidence of record and are reasonable.
2. Morgan District should maintain its records following the date of this Order that are sufficient to determine the actual costs incurred to install its meter taps.
3. Morgan District should develop a written policy to address internal controls for use of its debit and credit card, contract for payroll duties, and use of the full recommended rate amount in future base rate cases with the Commission.
4. The Commission has historically used a DSC method to calculate the revenue requirement for water districts or associations with outstanding long-term debt. Application of the Commission's DSC method to Morgan District's pro forma operations results in an Overall Revenue Requirement of \$1,785,793. A revenue increase of \$1,755,235 from water service rates is necessary to generate the overall revenue requirement.
5. The water service rates proposed by Morgan District should be denied.

⁷⁶ Current average bill calculated by using the rates approved in Case No. 2021-00146 *Electronic Application of Morgan County Water District for a Certificate of Public Convenience and Necessity to Construct a System Improvements Project and an Order Approving a Change in Rates and Authorizing the Issuance of Securities Pursuant to KRS 278.023* (Ky. PSC Apr. 26, 2021). The typical residential customer uses approximately 3,000 gallons per month.

6. The water service rates set forth in Appendix B to this Order are fair, just and reasonable and should be approved.

7. Morgan District should be authorized to assess a monthly surcharge of \$5.87 per meter for 48 months to fund its water loss control efforts, subject to the conditions set forth in finding paragraph 7.

8. The Commission should open a separate case to monitor the surcharge proceeds collection and expenses, with the following conditions:

a. Within 120 days of the date of this Order, Morgan District should 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. Morgan District should deposit surcharge collections in a separate interest-bearing account.

c. Morgan District should file monthly activity reports with the Commission that include a statement of monthly surcharge billings and collections; a monthly surcharge bank statement; a list of each payment from the account, its payee, and a description of the purpose; and invoices supporting each payment.

d. Morgan District should file monthly water loss reports with the Commission.

e. Surcharge proceeds should not be used to reimburse Morgan District for unaccounted-for water loss reduction expenses incurred prior to the date of this Order.

f. Morgan District's surcharge and water loss detection and repair program is subject to annual Commission reviews that will examine the progress of the water loss detection and repair program and expenditures made with surcharge proceeds and consider adjustments to the program and the surcharge amount.

g. Morgan District's failure to comply with any conditions attached to its assessment of the surcharge will 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.

9. Morgan District should use the midpoint of the depreciable lives of the NARUC ranges, as proposed in the application and agreed upon by 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.

10. Morgan District should begin maintaining its records sufficient to properly determine the proper assignment of the depreciable lives utilizing the ranges included in the NARUC Study on a going forward basis.

IT IS THEREFORE ORDERED that:

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

2. The water service rates proposed by Morgan District are denied.

3. The rates set forth in Appendix B to this Order are approved for services rendered by Morgan District on and after the date of this Order.

4. Within 20 days of the date of entry of this Order, Morgan 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.

5. Morgan District shall maintain its records following the date of this Order that are sufficient to determine the actual costs incurred to install its meter taps.

6. Morgan District shall develop a written policy to address internal controls for use of its debit and credit card, contract for payroll duties, and use of the full recommended rate amount in future base rate cases with the Commission.

7. Morgan District shall use the midpoint of the depreciable lives of the NARUC ranges, as proposed in the application and agreed upon by 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. Morgan District shall begin maintaining its records sufficient to properly determine the proper assignment of the depreciable lives utilizing the ranges included in the NARUC Study on a going forward basis.

9. The Commission shall open a separate proceeding, Case No. 2021-00206,⁷⁷ to monitor the surcharge proceeds collection and expenses, subject to the following conditions:

⁷⁷ Case No. 2021-00206, *Electronic Morgan County Water District's Unaccounted-For Water Loss Reduction Plan, Surcharge and Monitoring* (Ky. PSC June 9, 2021).

a. Within 120 days of the date of this Order, Morgan 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. Morgan District shall be permitted to use surcharge proceeds to contract with and pay a certified engineer or consultant to draft the plan.

c. Morgan District shall deposit surcharge collections in a separate interest-bearing account.

d. On the 15th day of each month for 48 months from the date of this Order or until all surcharge proceeds are expended, Morgan 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, and a description of the purpose; and invoices supporting each payment.

e. On the 15th day of each month for 48 months from the date of this Order or until all surcharge proceeds are expended, Morgan District shall file a monthly water loss report with the Commission.⁷⁸

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

⁷⁸ The report format is found at <https://psc.ky.gov/Home/UtilForms> under "Water Use & Loss Calculations (Excel format)."

g. Morgan 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.

h. Morgan District shall debit monthly billings for the surcharge to customers' accounts receivable and credit the contribution account.

i. When Morgan District collects the surcharge from the customers, it shall debit special funds and credit the customer account.

j. One year after the date of entry of this Order and annually thereafter, Morgan District shall file in Case No. 2021-00206 a schedule of the estimated and actual progress of the water loss detection and repair program, and estimated and actual expenditures made with surcharge proceeds, for the purpose of evaluating whether adjustments to the program or to the surcharge amount are required.

k. Morgan 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.

10. Morgan District has complied with the November 22, 2019 Order in Case No. 2019-00041⁷⁹ and should be dismissed as a party to that case.

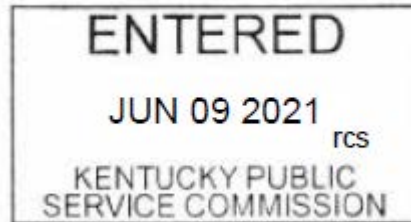
11. A copy of this Order shall be filed in Case No. 2019-00041.⁸⁰

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

⁷⁹ See Case No. 2019-00041, *Electronic Investigation into Excessive Water Loss by Kentucky's Jurisdictional Water Utilities* (Ky. PSC Nov. 22, 2019).

⁸⁰ *Id.*

By the Commission



ATTEST:


Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2020-00386 DATED JUN 09 2021

	Test Year	Adjustment	(Ref.)	Pro Forma
Operating Revenues				
Retail Sales of Water	\$ 1,407,839	\$ 15,836	(A)	
		(6,710)	(B)	\$ 1,416,965
Bulk Sales of Water	-	309	(C)	309
Other Water Revenues				
Forfeited Discounts	-	26,326	(D)	26,326
Miscellaneous Service Revenues	20,666	3,185	(E)	
		(19,694)	(F)	4,157
Total Operating Revenues	1,428,505	19,252		1,447,757
Operating Expenses				
Operation and Maintenance Expenses				
Salaries and Wages - Employees	189,310	60,576	(G)	
		(31,900)	(H)	217,986
Employee Pensions and Benefits	148,997	8,982	(I)	
		(45,510)	(J)	
		(1,306)	(K)	111,163
Purchased Water	770,593	(191,137)	(L)	579,456
Purchased Power for Pumping	-	35,182	(M)	
		(8,726)	(L)	26,456
Chemicals				-
Materials and Supplies	85,232	(31,900)	(H)	53,332
Contractual Services	32,431			32,431
Transportation Expense	16,600			16,600
Insurance	17,516			17,516
Advertising	1,286			1,286
Miscellaneous Expense	55,091	(35,182)	(M)	19,909
Total Operation and Maintenance Expenses	1,317,056	(240,921)		1,076,135
Taxes Other Than Income	14,433	4,683	(G)	19,116
Depreciation	508,422	(116,847)	(N)	391,575
Total Operating Expenses	1,839,911	(353,085)		1,486,826
Net Operating Income	(411,406)	372,337		(39,069)
Interest Income	75			75
Nonutility Income	6,575	(6,575)	(O)	-
Income Available to Service Debt	\$ (404,756)	\$ 365,762		\$ (38,994)

APPENDIX B

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2020-00386 DATED JUN 09 2021

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

5/8- x 3/4-Inch Meter

First	2,000	gallons	\$ 31.49	Minimum bill
Next	3,000	gallons	0.01166	per gallon
Next	5,000	gallons	0.01080	per gallon
Next	5,000	gallons	0.00995	per gallon
All Over	15,000	gallons	0.00909	per gallon

1-Inch Meter

First	5,000	gallons	\$ 66.62	Minimum bill
Next	5,000	gallons	0.01080	per gallon
Next	5,000	gallons	0.00995	per gallon
All Over	15,000	gallons	0.00909	per gallon

2-Inch Meter

First	15,000	gallons	\$ 168.93	Minimum bill
All Over	15,000	gallons	0.00909	per gallon

6-Inch Meter

First	100,000	gallons	\$943.03	Minimum bill
All Over	100,000	gallons	0.00909	per gallon

Wholesale Water Rate \$0.00528 per gallon

Water Loss Surcharge \$5.87 per meter per month

Nonrecurring Charges

Meter Test Request	\$35.40
Service Call/Investigation	\$17.40
Returned Payment Fee	\$ 2.00
Reconnection Fee	\$17.40

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Estill County Water District #1
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