

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF SOUTHERN WATER AND)	CASE NO.
SEWER DISTRICT FOR AN ALTERNATIVE)	2019-00131
RATE ADJUSTMENT)	

ORDER

On April 19, 2019, Southern Water and Sewer District (Southern District) filed an application (Application) with the Commission, pursuant to 807 KAR 5:076, requesting to adjust its rates for water service.

In its Application, Southern District requested rates that would increase annual water sales revenues by \$942,589, a 32.29 percent increase to pro forma present rate water sales revenues.

To ensure the orderly review of the Application, the Commission established a procedural schedule by Order dated May 16, 2019, which, among other things, required the Commission Staff (Staff) to file a report containing its findings regarding Southern District's Application. However, due to delayed responses to some requests made by Staff, an amended procedural schedule was issued on July 17, 2019.

On April 29, 2019, the Attorney General filed a motion to intervene, and by Order dated May 1, 2019, the Attorney General's motion was granted.

Pursuant to the amended procedural Order, on August 15, 2019, Commission Staff (Staff) issued a report (Report) summarizing its findings regarding Southern District's requested rate adjustment. In its Report, Staff found that Southern District's adjusted

test-year operations support an overall revenue requirement of \$3,773,268. Staff deemed Southern District's customer usage data woefully inadequate, and therefore it was unable to determine a fair, just, and reasonable percentage across-the-board increase. Staff did not calculate a required revenue increase over Southern District's current rates, but rather performed a Cost-of-Service Study (COSS) with the available information provided by Southern District's Application, the PSC 2018 Annual Report, Direct Testimony, and Staff Requests for Information.

Based on the COSS, Staff calculated a new set of rates, which included a recommended flat rate, a customer charge, and a volumetric rate, to be charged to customers as new meters are installed and an additional Meter Replacement Surcharge. This COSS utilized information that Staff calculated in its revenue requirement. However, Staff was unable to perform the routine revenue requirement calculation due to Southern District's inability to explain and provide data concerning the operations and maintenance expenses normally relied upon by Staff. The revenue requirement that Staff was able to calculate was culled from information using the Application, the PSC 2018 Annual Report, Direct Testimony, and Staff Requests for Information. The COSS was then developed by using this revenue requirement that lacks the supporting data normally utilized by Staff in its reviews. In addition to Staff's findings regarding Southern District's rates, Staff also made a number of recommendations for the Commission to consider which included but was not limited to, requiring Southern District to apply the Customer Charge and Volumetric Rates to each retail customer as soon as the customer's meter is installed. Additionally, it was recommended that the Commission require Southern District to

prepare and file a new alternative rate filing application (ARF) once a full calendar year of usage data and expense data becomes available.

On August 29, 2019, the Attorney General filed his comments to Staff's Report in which he agreed with most of Staff's pro forma adjustments but took exception to Staff's treatment of test-year employee salaries. Additionally, the Attorney General stated that the Staff Report did not address the issue of the mismatch between the invoices and payments for Frasure Electric, as was discussed at length at the hearing in this case. Finally, the Attorney General commented that he was concerned with the overall level of revenue requirement recommended by Staff and stated that the rates, if approved, may well be the highest retail water rates in the Commonwealth.

On September 9, 2019, Southern District filed with the Commission its comments on Staff's Report in which Southern District stated that it agreed generally with Staff's findings. With its comments, Southern District explained its intentions regarding any overcollection resulting from the interim flat rate and commercial rates.¹

On September 6, 2019, it was announced that Southern District will receive \$1.5 million from federal Abandoned Mine Land (AML) Economic and Community Development Pilot Program Grant funds (AML Pilot Funds) to upgrade water meters. However, the funds will not be disbursed until January 2020 at the earliest, and likely much later.²

On October 15, 2019, Southern District filed amended comments whereby it rejected the flat rate of \$55.17 proposed in the Staff Report and instead requested to

¹ Letter from Steven P. Bailey, counsel for Southern Water and Sewer District.

² Letter from Division of Abandoned Mine Lands (AML Letter) (filed Sept. 26, 2019).

reduce the current flat monthly rate for residential customers from \$58.82 per month³ to \$53.57 to offset the \$5.25 Meter Replacement Surcharge. Southern District filed evidence that, with the implementation of interim flat rates, its financial condition had improved marginally and that the \$53.57 flat rate would provide sufficient revenue to prudently operate and maintain the utility, seek loan funding and begin the meter replacement program.

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, Southern District's test-year water loss was 62.52 percent. Accordingly, Staff reduced test-year expenses by \$461,596 to account for the 47.52 percent excess water loss.⁴

Southern District's high water loss amount is a direct result of years of willful mismanagement and neglect by the previous manager, Dean Hall, who resigned in April 2019, and previous Board of Commissioners (Board), all of whom resigned in February 2019. During their tenure, Mr. Hall and the then-Board failed to test meters, which are at least 15 years old, and failed to take any action to address the aging infrastructure. In his responses to the three most recent annual inspections, Mr. Hall offered various excuses for failing to test the meters as required by regulatory law, including lack of cash flow and that he was pursuing grants to replace the meters. Mr. Hall avowed that he would begin testing meters by a certain date if new meters had not been obtained; he neither obtained

³ Case No. 2019-00131, *Application of Southern Water and Sewer District for an Alternative Rate Adjustment* (Ky. PSC Jun. 6, 2019) at 6.

⁴ Staff Report at 10.

new meters nor reinstated meter testing. Similarly, despite frequent declarations that new meters would be installed in the near future, Mr. Hall's statements were contradicted by the then-Board, who said that there were no plans to obtain new meters. Finally, despite repeated assertions that Mr. Hall had developed, and the Board had approved, a water loss reduction plan, there is no evidence that a water loss plan was created, much less implemented.

Southern District's current Board was appointed in February 2019, and the current management company, Utility Management Group, LLC (UMG), was hired in March 2019. Notably, one of the first priorities of the current Board and UMG was to replace the existing meters. To that end, UMG developed a timeline for developing a request for proposal (RFP), soliciting bids, selecting a vendor, and installing meters. Given our focus on encouraging water utilities to pursue reasonable actions to reduce unaccounted-for water loss, the Commission appreciates that Southern District and UMG made it a first concern to address water loss through increased leak detection and by timely moving to replace its current meters, with new radio read meters.

BACKGROUND

Southern District is a water district organized pursuant to KRS Chapter 74. It owns and operates a water distribution system through which it provides water service to approximately 5,399 customers in Floyd and Knott counties, Kentucky.⁵ Southern District produces most of its water; however, it also purchases water from the city of Pikeville and

⁵ *Annual Report of Southern District Water and Sewer District to the Public Service Commission for the Calendar Year Ended December 31, 2018 (Annual Report)* at 12 and 48.

the Prestonsburg City Utilities Commission. Southern District's last adjustment of rates pursuant to 807 KAR 5:076 was in Case No. 2012-00309.

TEST PERIOD

The calendar year ended December 31, 2018, was used as the test year to determine the reasonableness of Southern District's existing and proposed water rates, as required by 807 KAR 5:076, Section 9.

SUMMARY OF REVENUE AND EXPENSES

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

	<u>2018 Annual Report</u>	<u>Pro Forma Adjustments</u>	<u>Staff Pro Forma Operations</u>
Operating Revenues	\$2,906,431	\$ 75,009	\$2,981,440
Operating Expenses	<u>3,789,539</u>	<u>(588,058)</u>	<u>3,201,481</u>
Net Operating Income	(883,108)	663,067	(220,041)
Gain on Disposition of Utility Property	19,300	(19,300)	-
Nonutility Income	26,091		26,091
Interest Income	<u>4,001</u>		<u>4,001</u>
Income Available for Debt Service	<u>\$ (833,716)</u>	<u>\$ 643,767</u>	<u>\$ (189,949)</u>

MODIFICATIONS TO STAFF'S FINDINGS

Southern District proposed adjustments to revenues and expenses to reflect current and expected operating conditions. In its Report, Staff proposed additional adjustments. The Commission accepts the findings contained in the Staff Report but makes one additional adjustment and one comment below.

During the test period, Southern District recorded in its general ledger to Frasure Electric totaling \$62,500 for electrician's services. During the hearing held on May 9, 2019, Staff introduced into the record invoices that Staff obtained during its limited financial review for Frasure Electric from Southern District totaling \$33,009.87. When questioned about the mismatch between the amounts invoiced and what was paid, representatives for Southern District were unable to reconcile the mismatch. In comments filed in this proceeding, the Attorney General pointed out that the Staff Report failed to address this mismatch. The Commission finds that the checks written in excess of the amounts invoiced from Frasure Electric have not been substantiated with evidence to support the amounts paid, and therefore the excess amounts should be removed for ratemaking purposes. Accordingly, the Commission finds that the revenue requirement should be reduced by \$29,490.

The Attorney General also commented that Staff neglected to address the amount of reported test year expenses for the current management structure and the reduced number of employees from the test year.⁶ In support of his comment, the Attorney General argued that, based on the reduction from Southern District's 2018 employee count and with UMG's current management and operation of the District, employment expenses are not as high as the amount listed in Staff's Report. The Attorney General further argued that, while the Commission should make adjustments to reflect that Southern District no longer has a general manager, the Commission should not make an adjustment to reflect the cost of UMG's management contract. The Commission is not persuaded by the Attorney General's arguments. The Attorney General has not

⁶ Case No. 2019-00131, Attorney General's Comments on Staff Report (filed Aug. 29, 2019) at 4.

considered that the decreased costs from the employee vacancies will be offset by costs resulting from the management contract. The overall impact of the employee vacancies on Southern District’s operating expenses, and ultimately its revenue requirement, is unknown. For the above reasons, the Commission denies the Attorney General’s proposed adjustment.

The result of the Commission’s adjustment to final pro forma operations is shown in the calculation below.

	<u>Staff Pro Forma Operations</u>	<u>Commission Adjustments</u>	<u>Final Pro Forma Operations</u>
Operating Revenues	\$2,981,440		\$2,981,440
Operating Expenses	<u>3,201,481</u>	<u>\$ (29,490)</u>	<u>3,171,991</u>
Net Operating Income	(220,041)	29,490	(190,551)
Gain on Disposition of Utility Property	-		-
Nonutility Income	26,091		26,091
Interest Income	<u>4,001</u>		<u>4,001</u>
Income Available for Debt Service	<u>\$ (189,949)</u>	<u>\$ 29,490</u>	<u>\$ (160,459)</u>

REVENUE REQUIREMENTS

Based upon the Commission’s findings and determinations herein, Southern District requires revenue from rates of \$3,651,440.

Pro Forma Operating Expenses	\$3,171,991
Plus: Average Annual Principal and Interest Payments	476,489
Additional Working Capital	<u>95,298</u>
Overall Revenue Requirement	3,743,778
Less: Other Operating Revenue	(62,246)
Interest Income	(4,001)
Nonutility Income	<u>(26,091)</u>
Revenue Required from Rates	<u>\$3,651,440</u>

RATE DESIGN

Southern District in their Application proposed increased rates using a two-step declining block rate design as their current rate schedule follows. Commission Staff, under the direction of the Commission, performed a Modified Commodity-Demand Cost of Service Study. In this COSS, Staff revised the rate design to a per month customer charge and a two-step declining block volumetric rate design. The Commission accepts Staff's recommendation as proposed in its Report concerning the revised rate design, as stated in Staff's COSS. With regard to the final rates, the Commission finds that the flat rate that is calculated based on the revenue requirement shown above shall be reduced by the amount of surcharge, as was requested by Southern District in its amended comments to the Report. Therefore, the Commission finds that a flat rate should be established in the amount of \$49.46 per residential meter, per month.

METER REPLACEMENT SURCHARGE

As noted above, Southern District will receive federal AML Pilot Funds to replace its meters, which are 15 years old, have not been tested in over 10 years, and, from sample testing, are running at least 20 percent slow, which means that customers likely use 20 percent more water than the meter measures. Additionally, there are a large

number of zero-read meters within the system. However, the AML Pilot Funds will not be available until sometime in 2020. While the funds have been announced, there are multiple levels of approval from federal agencies, which cumulatively take several months, at a minimum, before the funds can be disbursed.⁷ Additionally, the expenditures must be in compliance with the Kentucky Model Procurement Code, which will require additional documentation that governs the expenditure of grant funds that will not be effective until after the grant is officially awarded after the start of 2020.⁸ Given this timeline, if Southern District waits until the AML Pilot Funds are disbursed, it likely could not begin installing new meters until Spring 2020, at the earliest.

There is a financial urgency to replacing the meters as soon as possible. Due to the large number of zero read meters, the Commission determined that instituting a flat rate on an interim basis for residential customers was the only equitable way to ensure that all of Southern District's customers received fair, just, and reasonable treatment. However, each residential customer will be moved from the flat rate to a volumetric rate when a new meter is installed at that customer's location. Thus, the sooner new meters are installed, the sooner Southern District customers are moved from a flat rate to a volumetric rate. Under the volumetric rate, residential customers can better manage water usage, with the opportunity to lower their water bill. The flat rate was based upon the number of customers times the total revenue required by Southern District. Customers will receive a refund of the overcollection if their average usage in the 12

⁷ AML Letter at 1–2.

⁸ *Id.* at 2.

months after new meters are installed is less than 4,000 gallons. Therefore, the sooner new meters are installed, the sooner the refund mechanism will be activated.

Waiting until the AML Pilot Funds are available to install new meters will adversely impact residential customers by delaying the opportunity to reduce customers' monthly bill and delaying refunds to eligible customers. For this reason, the Commission finds that it is reasonable to implement the Meter Replacement Surcharge, effective with this Order, so that Southern District can purchase and begin installing new meters without delay. The Commission has been advised that the AML Pilot Funds will be redirected to Southern District's other infrastructure needs, thus avoiding a subsequent increase in rates to address additional infrastructure replacement.

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. 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 Southern District's pro forma operations results in an Overall Revenue Requirement of \$3,743,778.
3. The water service rates proposed by Southern District should be denied.
4. The water service rates and surcharge set forth in the Appendix to this Order are fair, just, and reasonable and should be approved.

5. The use of a monthly surcharge assessed over a 60-month period is a reasonable means of funding Southern District's meter replacement efforts.

6. Southern District should be permitted to assess a surcharge of \$5.25 per month per customer for a period of 60-months or until the cost of new meters has been assessed, whichever occurs first, to fund its meter replacement efforts subject to the following conditions:

a. Within 90 days of the entry of a Final Order, Southern District should file with the Commission a comprehensive plan that establishes priorities and a time schedule for replacing its current meters and provide a spending plan for the proceeds of a surcharge.

b. Southern District should deposit surcharge collections in a separate interest-bearing account.

c. No surcharge proceeds should be withdrawn from the separate interest-bearing account until the Commission has approved Southern District's comprehensive meter replacement plan.

d. Southern 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 its purpose; and invoices supporting each payment.

e. Surcharge proceeds should not be used to reimburse Southern District for meter replacement expenses incurred prior to the issuance of a Final Order in this proceeding.

f. Southern District's failure to comply with any conditions attached to its assessment of the surcharge should result in termination of the surcharge, and the refund of collected surcharge proceeds disbursed on expenses outside the scope of expenses approved by the Commission.

7. Southern District should be required to file a new ARF application within 90 days of the one-year anniversary of the completion of the total replacement of its metering system.

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 Southern District are denied.

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

4. Southern District is authorized to assess a surcharge of \$5.25 per month per customer for 60 months or until the cost of new meters has been assessed, whichever occurs first, to fund its meter replacement efforts subject to the following conditions:

a. Within 90 days of the entry of a final Order, Southern District shall file with the Commission a comprehensive plan that establishes priorities and a time schedule for replacing its current meters and provide a spending plan for the proceeds of a surcharge.

b. Southern District shall deposit the surcharge collections into a separate interest-bearing account.

c. No surcharge proceeds shall be withdrawn from the separate interest-bearing account until the Commission has approved Southern District's comprehensive meter replacement plan.

d. Southern District shall 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 its purpose; and invoices supporting each payment.

e. Surcharge proceeds shall not be used to reimburse Southern District for meter replacement expenses incurred prior to the issuance of a final Order in this proceeding.

f. Southern District's failure to comply with any conditions attached to its assessment of the surcharge shall result in termination of the surcharge and the refund of collected surcharge proceeds disbursed on expenses outside the scope of expenses approved by the Commission.

5. The Commission shall open a separate case to monitor the surcharge proceeds collection and expenses, and compliance with the conditions set forth in ordering paragraph 4.

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

7. Within 90 days of the one-year anniversary of the completion of the replacement of all its meters, Southern District shall file with the Commission a new ARF

application supported by a historical test period with 12 months of usage data utilizing the new metering system.

8. Southern District shall use the staff calculated depreciable lives based on the National Association of Regulatory Utility Commissioners ranges, 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.

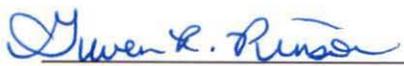
9. This case is closed and removed from the Commission's docket.

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By the Commission

ENTERED
NOV 07 2019
KENTUCKY PUBLIC
SERVICE COMMISSION

ATTEST:


Executive Director

Case No. 2019-00131

APPENDIX

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2019-00131 DATED **NOV 07 2019**

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

Monthly Water Rates

Residential Customers Only
Before New Meter Installation

Flat Rate \$ 49.46 per month

After New Meter Installation*

Customer Charge \$ 10.45 Monthly Minimum Bill
First 2,000 Gallons 11.20 per 1,000 Gallons
Over 2,000 Gallons 8.61 per 1,000 Gallons

Commercial Customers Only

Customer Charge \$ 10.45 Monthly Minimum Bill
First 2,000 Gallons 11.20 per 1,000 Gallons
Over 2,000 Gallons 8.61 per 1,000 Gallons

Wholesale Customers

City of Hindman \$ 4.43 per 1,000 Gallons
Knott County Water District 4.43 per 1,000 Gallons
City of Wheelwright 4.43 per 1,000 Gallons

Meter Replacement Surcharge

Applies to all customers

Meter Replacement Surcharge** \$ 5.25 per month

* As each residential customer meter is installed at the premises, then each customer account will move from the residential flat rate stated above to the customer charge and volumetric rate stated above.

** This Meter Replacement Surcharge shall remain in effect for 60 months from the date of a final Order by the Public Service Commission in Case No. 2019-00131 for all customers (residential or commercial customers) or until the total cost of the meter replacement has been collected.

*Southern Water & Sewer District
245 Kentucky Route 680
P. O. Box 610
McDowell, KY 41647

*Jeff Prater
Chairman
Southern Water & Sewer District
245 Kentucky Route 680
P. O. Box 610
McDowell, KY 41647

*Justin M. McNeil
Office of the Attorney General Office of Rate
700 Capitol Avenue
Suite 20
Frankfort, KENTUCKY 40601-8204

*Kent Chandler
Assistant Attorney General
Office of the Attorney General Office of Rate
700 Capitol Avenue
Suite 20
Frankfort, KENTUCKY 40601-8204

*Larry Cook
Assistant Attorney General
Office of the Attorney General Office of Rate
700 Capitol Avenue
Suite 20
Frankfort, KENTUCKY 40601-8204

*Rebecca W Goodman
Assistant Attorney General
Office of the Attorney General Office of Rate
700 Capitol Avenue
Suite 20
Frankfort, KENTUCKY 40601-8204

*Steven P. Bailey
Attorney
Bailey Law Office, P.S.C.
181 East Court Street
Prestonsburg, KENTUCKY 41653