

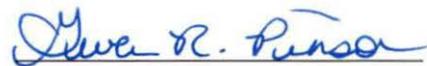
COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF PENDLETON COUNTY)	
WATER DISTRICT FOR AN ALTERNATIVE)	CASE NO.
RATE ADJUSTMENT)	2019-00310

NOTICE OF FILING OF COMMISSION STAFF REPORT

Notice is hereby given that, in accordance with the Commission's Order of October 16, 2019, 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 October 16, 2019 Order, Pendleton County Water District is required to file written comments regarding the findings of Commission Staff no later than 14 days from the date of this report.



Gwen R. Pinson
Executive Director
Public Service Commission
P.O. Box 615
Frankfort, KY 40602

DATED JAN 15 2020

cc: Parties of Record

STAFF REPORT
ON
PENDLETON COUNTY WATER DISTRICT
CASE NO. 2019-00310

Pendleton County Water District (Pendleton 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 2,417 customers that reside in Campbell, Grant, and Pendleton counties, Kentucky.¹ On September 3, 2019, Pendleton District filed an application (Application) requesting to increase its water service rates pursuant to 807 KAR 5:076. After deficiencies were cured, Pendleton District's Application was accepted for filing on September 18, 2019. To ensure the orderly review of the Application, the Commission established a procedural schedule by Order dated October 16, 2019.

To comply with the requirements of 807 KAR 5:076, Section 9, Pendleton District based its requested rates on a historical test period that coincides with the reporting period shown in its most recent Annual Report on file with the Commission at the time it filed the Application, the calendar year ended December 31, 2018.

Using its pro forma test-year operations, Pendleton District determined that it could justify a revenue increase of \$185,756, or 13.98 percent, as shown in the table below.² The rates requested by Pendleton District would increase the monthly bill of a typical

¹ *Annual Report of Pendleton County Water District to the Public Service Commission for the Calendar Year Ended December 31, 2018, (Annual Report)* at 12 and 51.

² Application, Revenue Requirement Calculation-Debt Coverage Ratio Method.

residential customer by \$5.75, from \$41.12 to \$46.87, or approximately 13.98 percent. Pendleton District presented financial exhibits in the Application that shows how it calculated the amount of increase it justified. The exhibits are shown below in condensed form.

Pro Forma Operating Expenses	\$ 1,462,998
Plus: Average Annual Principal and Interest Payments	111,415
Additional Working Capital	<u>12,149</u>
Overall Revenue Requirement	1,586,562
Less: Other Operating Revenue	(38,578)
Interest Income	<u>(12,207)</u>
Revenue Required from Rates	1,535,777
Less: Decrease in Pro Forma Operating Expenses	<u>(21,430)</u>
Adjusted Revenue Required from Rates	1,514,347
Less: Revenue from Sales at Present Rates	<u>(1,326,093)</u>
Required Increase in Revenue from Rates	188,254
Less: Difference Between Revenue from Rate Tables and Reported Revenues	<u>(2,498)</u>
Required Increase in Revenue from Rates	<u>\$ 185,756</u>
Percent Revenue Increase	<u>13.98%</u>

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

Staff's findings are summarized in this report. David Foster reviewed the calculation of Pendleton District's Overall Revenue Requirement. Elizabeth Stefanski reviewed Pendleton 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, Staff found that Pendleton District's Overall Revenue Requirement is \$1,570,135 and that an \$185,944 revenue increase, or 13.95 percent, to pro forma present rate revenues is necessary to generate the Overall Revenue Requirement.

2. Water Service Rates. Pendleton District proposed to increase all of its monthly retail water service rates evenly across the board by approximately 13.98 percent.³ Pendleton District has not performed a cost-of-service study (COSS). The Commission has previously found that the allocation of a revenue increase evenly across the board to a utility's rate design is appropriate when there has been no evidence entered into the record demonstrating that this method is unreasonable and in the absence of a COSS. Finding no such evidence in this case, Staff followed the method proposed by Pendleton District and allocated the \$185,944 revenue increase across the board to Pendleton District's monthly retail water service rates.

The rates set forth in the Appendix to this report are based upon the revenue requirement, as calculated by Staff, and will produce sufficient revenues from water sales to recover the \$1,519,350 Revenue Required from Rates, an approximate 13.95 percent

³ Pendleton District's response to Deficiency Letter (filed Sept. 18, 2019).

increase. These rates will increase a typical residential customer's monthly water bill from \$39.90 to \$45.47, an increase of \$5.57, or approximately 13.95 percent.⁴

PRO FORMA OPERATING STATEMENT

Pendleton District's Pro Forma Operating Statement for the test year ended December 31, 2018, as determined by Staff, appears below.

⁴ \$1,092,923.78 Test Year Normalized Current Rate Revenue for Residential Meters / 27,394 Residential bills in test year = \$39.90 average residential customer monthly bill. \$39.90 multiplied by 13.95% = \$5.57 increase in typical customers bill. \$39.90 + \$5.57 = \$45.47, the typical customer bill after increase.

	<u>Test Year</u>	<u>Adjustment</u>	<u>(Ref)</u>	<u>Pro Forma</u>
Operating Revenues				
Sales of Water				
Metered Water Sales	\$ 1,245,791	7,313	(A)	\$ 1,253,104
Sales for Resale	80,302			80,302
Total Sales of Water	1,326,093	7,313		1,333,406
Other Water Revenues				
Forfeited Discounts	22,843			22,843
Miscellaneous Service Revenues	11,835			11,835
Rents from Water Property	3,900			3,900
Total Other Water Revenues	38,578			38,578
Total Operating Water Revenues	1,364,671	7,313		1,371,984
Operating Expenses				
Operation and Maintenance Expenses				
Salaries and Wages - Employees	333,558	16,318	(B)	349,876
Salaries and Wages - Officers	24,000			24,000
Employee Pensions and Benefits	221,965	(6,380)	(C)	215,585
		(72,817)	(D)	142,768
Purchased Water	430,167	35,069	(C)	465,236
Purchased Power	22,927			22,927
Materials and Supplies	47,087			47,087
Contractual Services - Accounting	23,540			23,540
Contractual Services - Water Testing	4,752			4,752
Contractual Services - Other	32,888			32,888
Rents	2,221			2,221
Transportation Expenses	17,070			17,070
Insurance	25,966			25,966
Bad Debt Expense	5,500			5,500
Miscellaneous Expenses	3,329			3,329
Total Operation and Maintenance Expenses	1,194,970	(27,810)		1,167,160
Depreciation Expense	237,960			237,960
Taxes Other Than Income	30,068	1,248	(B)	31,316
Total Operating Expenses	1,462,998	(26,562)		1,436,436
Net Operating Income	(98,327)	33,875		(64,452)
Gains (Losses) on Disposition of Property	1,700			1,700
Interest Income	12,207			12,207
Total Utility Operating Income	\$ (84,420)	\$ 33,875		\$ (50,545)

(A) Billing Analysis Adjustment. Pendleton District provided a billing analysis for the 12-month test year in its Application. Pendleton District's Summary of Billing

Analysis included three adjustments to the 2018 PSC Annual Report amount to which Staff requested additional details. The adjustments were listed as an Unbilled Revenue subtraction, an Unbilled Revenue addition and Customer Account Adjustments. Pendleton District's additional detailed information explaining the adjustments indicated that the Unbilled Revenue subtraction was from December 2018 water usage that had not been billed by the end of the test year; the Unbilled Revenue addition was from December 2017 water usage that was billed and collected during the test year. The adjustment titled Customer Account Adjustments included leak adjustments, misread meters as well as customer turn over. Staff reviewed and approves the adjustments. Staff determined a normalized billing analysis for Pendleton District produces \$1,333,406 of revenues from all retail customers and is an accurate representation of the normalized test-year revenue from water sales. Therefore, Staff has increased water sales revenue by \$7,313.

(B) Salaries and Wages - Employees. Pendleton District reported \$333,558 in wages paid to its employees. In its Application, Pendleton District proposed to increase this amount by \$16,318 to account for the addition of a new employee that occurred during the test year. Pendleton District stated that this amount includes an increase in pay in order to retain the new employee and also includes the required four hours a month the employee is to be on call for after-hours emergencies. Staff agrees with Pendleton District's proposed increase to Salaries and Wages Expense and adjusted pro forma expenses by \$16,318.

To account for the increase in pro forma wages, it was also necessary to calculate the increase in payroll taxes. Accordingly, Staff increased Pendleton District's Taxes Other Than Income by \$1,248 to reflect these changes as shown in the calculation below.

Increase to Pro Forma Wages	\$ 16,318
Times: 7.65%	<u>7.65%</u>
Increase to Payroll Taxes	<u>\$ 1,248</u>

(C) Employee Pensions and Benefits. Pendleton District reported test-year Employee Pensions and Benefits expense of \$221,965. Pendleton District currently pays 100 percent of the monthly health, dental, and life insurance premiums for its eligible full-time employees. Staff notes that in recent Orders, the Commission has made ratemaking adjustments to reduce the cost of employee benefit packages paid by some utilities when certain aspects of those benefits packages were found to be unreasonable based on a review of total salaries and fringe benefits. The Commission is placing greater emphasis on evaluating employees' total compensation packages, including both salary and benefits programs for market and geographic competitiveness, and to ensure the development of a fair, just, and reasonable rate. It has found in most cases 100 percent of employer-funded health care does not meet those criteria. Factoring in for the preceding, Staff determined the net adjustment to Pendleton District's test-year health insurance⁵ and dental expense⁶ should be a decrease of \$6,380 as shown in the calculation below.

⁵ Bureau of Labor Statistics, Healthcare Benefits, March 2019, Table 10, private industry workers. (<https://www.bls.gov/ncs/ebs/benefits/2019/ownership/private/table10a.pdf>)

⁶ Willis Benefits Benchmarking Study, 2015. (https://www.willis.com/documents/publications/Services/Employee_Benefits/Willis_Survey_011216_R1.pdf).

Type of Premium	Current Monthly Premium	Times: Average Employee Contribution Rate	Monthly Premium Adjustment	Pro Forma Monthly Premium
Single Health Insurance	\$ 1,974	21%	\$ (415)	\$ 1,559
Family Health Insurance	4,495	34%	(1,528)	2,967
Dental Insurance	175	60%	(105)	70
Life Insurance	38		-	38
Total Pro Forma Monthly Premium				\$ 4,634
Times: 12 Months				12
Total Annual Pro Forma Premium				55,609
Less: Test Year				(61,989)
Adjustment				\$ (6,380)

(D) Retirement Expense Pursuant to GASB 68. Pendleton District provides pension benefits and post-retirement health care benefits to its employees by participating in the County Employee Retirement System (CERS). As a participating member, Pendleton District is required to contribute a percentage of its employee wages to CERS. In the fiscal year, beginning July 1, 2018, the CERS contribution rate was 24.06 percent.⁷ The CERS pension expense Pendleton District reported in the test year conformed to the requirements of the Governmental Accounting Standards Board Statement No. 68 (GASB 68).

In its Application, Pendleton District proposed to decrease its Employee Pensions and Benefits Expense by \$72,817, reflect the addition of a new employee, reflect the increase in employer contribution rates paid to CERS, and remove the effects of the journal entries made to conform to the requirements of GASB 68.⁸

⁷ Kentucky Retirement Systems, Contribution Rates. (<https://kyret.ky.gov/Employers/Pages/Contribution-Rates.aspx>)

⁸ Application, Attachment B, Adjustment B.

In Case No. 2016-00163,⁹ Commission Staff discussed in great detail the reporting requirements of GASB 68 and how those requirements would affect a utility's income statement and balance sheet. In that proceeding, Commission Staff found that the annual pension expense should be equal to the amount of a district's contributions to CERS, which historically have been fairly constant. Consistent with Staff's previous practice, Staff agrees with the adjustment proposed by Pendleton District. Accordingly, Staff decreased Employee Pension and Benefits Expense by \$72,817.

(E) Purchased Water Expense. Pendleton District proposed an adjustment to increase Purchase Water Expense in the amount of \$35,069. This was to account for wholesale water rates that were approved by the Commission in Case No. 2018-00291 for Pendleton District's wholesale provider, Northern Kentucky Water District. Staff agrees that this adjustment is reasonable and therefore included it in Pro Forma operations. Staff has included the calculation below.

	Test Year HCF	Times: New Rate	Total
Test Year Usage in HCF	106,416	\$ 2.98	\$ 317,120
Plus: Fixed Service Charges			<u>4,912</u>
Total Pro Forma Water Costs			322,032
Less: Test Year Water Expense			<u>(286,963)</u>
Pro Forma Adjustment in Purchased Water Rates			<u>\$ 35,069</u>

⁹ Case No. 2016-00163, *Alternative Rate Adjustment Filing of Marion County Water District* (PSC Ky. Aug. 11, 2016), Staff Report on Marion County Water District at 10–27.

OVERALL REVENUE REQUIREMENT AND REQUIRED REVENUE INCREASE

The Commission has historically applied a DSC method to calculate the Overall Revenue Requirement of water districts and water associations. 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;¹⁰ (3) the average annual principal and interest payments on all long-term debts, and (4) working capital that is in addition to depreciation expense.

Staff's calculations of the Overall Revenue Requirement and Required Revenue Increase using the DSC method is shown below.

	<u>Staff</u>
Pro Forma Operating Expenses	\$ 1,436,436
Plus: Average Annual Debt Payments	111,416
Additional Working Capital	<u>22,283</u>
Overall Revenue Requirement	1,570,135
Less: Other Operating Revenue	(38,578)
Interest Income	<u>(12,207)</u>
Revenue Required From Rates	1,519,350
Less: Pro Forma Present Rate Revenues	<u>(1,333,406)</u>
Required Revenue Increase	<u>185,944</u>
Percent Increase	<u>13.95%</u>

¹⁰ 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. Pendleton District currently has two outstanding bonds payable to the Kentucky Rural Water Finance Corporation (Kentucky Rural Water) and one bond payable to the U.S. Department of Agriculture, acting through Rural Development (RD). One of the bonds payable to Kentucky Rural Water, specifically, KY Rural Water Revenue Bonds Series 2013C, was not authorized by the Commission. Staff determined that the 2013C Rural Water Revenue Bonds were a result of refinancing a series of bonds, which were approved by the Commission in Case No. 2001-00172, to realize debt service savings. KRS 278.300(1) states that no utility shall issue any securities or evidence of indebtedness, or assume any obligation or liability in respect to the securities or evidences of indebtedness of any other person until it has been authorized to do so by Order of the Commission. Accordingly, prima facie evidence exists that Pendleton District violated KRS 278.300(1). The Commission may pursue a separate action against Pendleton District to show cause and present evidence on its failure to adhere to the procedures of KRS 278.300(1). In instances in which it is shown that the proceeds of an authorized loan were used to pay for current operating expenses, the Commission has disallowed rate recovery, finding that such action would constitute retroactive ratemaking. Staff has determined that Pendleton District used the proceeds of the Series 2013C revenue bonds to fund capital projects and purchase capital assets, and therefore finds that Pendleton District should be allowed rate recovery of the associated debt service.

Staff finds that the average annual debt payment that should be included in the calculation of Pendleton District's Overall Revenue Requirement should be equal to the three-year average for the years 2019 through 2021, or \$111,416. This three-year

average, which is calculated below, allows Pendleton District recovery of the debt payments that will be made during the anticipated five-year life of the rates authorized by the Commission in this proceeding.

Three-Year Average of Debt Payments	
Year	Annual Debt Payment
2019	\$ 109,777
2020	113,288
2021	111,183
Three-Year Total	334,247
Divide by: 3 years	3
Average Annual Principal and Interest Payment	<u>\$ 111,416</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. Following the Commission's historic practice, Staff calculated Pendleton District's allowance for additional working capital based on a DSC ratio of 1.20, to be \$22,283, as shown below. Staff included this amount in the calculation of Pendleton District's Overall Revenue Requirement.

Average Annual Principle and Interest	\$ 111,416
Times: DSC Ratio	<u>120%</u>
Total Net Revenues Required	133,699
Less: Average Annual Principal and Interest Payments	<u>(111,416)</u>
Additional Working Capital	<u>\$ 22,283</u>

Signatures



Prepared by: David P. Foster
Division of Financial Analysis



Prepared by: Elizabeth Stefanski
Division of Financial Analysis

APPENDIX

APPENDIX TO A STAFF REPORT OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2019-00310 DATED **JAN 15 2020**

Monthly Water Rates

5/8 x 3/4 Meter through 2 inch Meter

First 2,000 Gallons	\$25.70	Minimum Bill
Next 3,000 Gallons	11.12	Per 1,000 Gallons
Next 10,000 Gallons	10.50	Per 1,000 Gallons
All Over 15,000 Gallons	9.12	Per 1,000 Gallons

Pendleton County High School

First 125,000 Gallons	\$1,167.26	Minimum Bill
Over 125,000 Gallons	9.12	Per 1,000 Gallons

Griffin Industries

First 400,000 Gallons	\$3,675.26	Minimum Bill
Over 400,000 Gallons	9.12	Per 1,000 Gallons

City of Butler

First 1,672,917 Gallons	\$7503.15	Minimum Bill
Over 1,672,917 Gallons	4.48	Per 1,000 Gallons

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