

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF GRANT)	CASE NO.
COUNTY SANITARY SEWER DISTRICT FOR AN)	2019-00424
ALTERNATE RATE ADJUSTMENT)	

NOTICE OF FILING OF COMMISSION STAFF REPORT

Notice is hereby given that, in accordance with the Commission's Order issued on January 2, 2020, 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 January 2, 2020 Order, Grant County Water and Sewer District is required to file written comments regarding the findings of Commission Staff no later than 14 days from the date of this report.



Kent A. Chandler
Executive Director
Public Service Commission
P.O. Box 615
Frankfort, KY 40602

DATED MAR 17 2020

cc: Parties of Record

STAFF REPORT
ON
GRANT COUNTY SANITARY SEWER DISTRICT
CASE NO. 2019-00424

Grant County Sanitary Sewer District (Grant District) is a sewer district created by an ordinance of the Grant County Fiscal Court pursuant to KRS Chapter 74 and 67, providing wastewater service to approximately 1,572 retail customers and five wholesale customers that reside in Grant County, Kentucky.¹ On December 09, 2019, Grant District filed an application (Application), pursuant to 807 KAR 5:076, requesting to increase its wastewater service rates. To ensure the orderly review of the Application, the Commission established a procedural schedule by Order dated January 2, 2020.

To comply with the requirements of 807 KAR 5:076, Section 9, Grant 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, Grant District determined that it could justify a revenue increase of \$136,527, or 19.47 percent to its retail wastewater customers, as shown in the table below.² The rates requested by Grant District would

¹ *Annual Report of Grant County Water and Sewer District to the Public Service Commission for the Calendar Year Ended December 31, 2018 (Water Annual Report)* at 25 and 36.

² Application, Attachment 6, Revenue Requirements Calculation.

increase the monthly bill of a typical residential customer³ by \$6.86, from \$35.19 to \$42.05, or approximately 19.50 percent.⁴

Pro Forma Operating Expenses	\$ 672,489
Plus: Average Annual Debt Principal & Interest Payments	190,824
KIA Loans & Capital Lease	<u>19,082</u>
 Total Revenue Requirement	 882,395
Less: Other Operating Revenue	(26,971)
Miscellaneous Nonoperating Income	(15,842)
Interest Income	<u>(1,871)</u>
 Revenue Required from Rates	 837,711
Less: Revenue from Sales at Present Rates	<u>(701,184)</u>
 Required Increase in Revenue from Rates	 <u>\$ 136,527</u>
Required Revenue Increase as a percentage	<u>19.47%</u>

To determine the reasonableness of the rates requested by Grant District, Commission Staff (Staff) performed a limited financial review of Grant 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 made when their effects were deemed material. Insignificant and immaterial discrepancies were not necessarily pursued or addressed.

³ According to Grant District in its customer notice, a typical residential customer purchases 3,700 gallons of water per month through a 5/8-inch x 3/4-inch meter. The customer notice stated an average of 3,700 gallons; however, in the calculation of the average monthly bill Grant District utilized the figure of 3,713 gallons.

⁴ Application, Attachment 2, Customer Notice of Proposed Rate Adjustment.

This report summarizes Staff's findings. William Foley reviewed the calculation of Grant District's Overall Revenue Requirement. Elizabeth Stefanski reviewed Grant 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 Grant District's Total Revenue Requirement is \$817,071, and that a \$73,945 revenue increase, or 10.35 percent, to pro forma present rate revenues is necessary to generate the Total Revenue Requirement.

2. Wastewater Service Rates. Grant District proposed to increase all of its monthly retail wastewater service rates evenly across the board by approximately 19.50 percent.⁵ Grant 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 in the absence of a COSS. Staff followed the method proposed by Grant District and allocated the \$73,945 revenue increase across the board to Grant District's monthly retail wastewater service rates.

The rates set forth in Appendix B to this report are based upon the revenue requirement as calculated by Staff and will produce sufficient revenues from wastewater sales to recover the \$788,229 Revenue Required from Rates, an approximate 10.35 percent increase. These rates will increase a typical residential customer's monthly wastewater bill from \$35.19 to \$38.85, an increase of \$3.66, or approximately 10.40 percent.

⁵ *Id.*

PRO FORMA OPERATING STATEMENT

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

	Test Year	Adjustments	(Ref.)	Pro Forma
Operating Revenues				
Sewage Service Revenues	\$ 701,184	\$ 13,570	(A)	
		(470)	(B)	\$ 714,284
Other Operating Revenues	26,971			26,971
Total Operating Revenues	728,155	13,100		741,255
Operating Expenses				
Owner/Manager-Management Fee	123,912	26,280	(C)	
		(18,935)	(D)	
		(444)	(E)	130,813
Treatment System:				
Sludge Hauling	17,700			17,700
Utility Service-Water Cost	2,560			2,560
Other-Labor, Materials and Expenses	15,120			15,120
Rents	9,000			9,000
Fuel/Power Purchased for Pumping & Treatment	87,188			87,188
Chemicals	15,205			15,205
Miscellaneous Supplies & Expenses				
Collection System	757			757
Pumping System	4,115			4,115
Treatment and Disposal	29,931			29,931
Maintenance Expenses				
Maintenance of Collection Sewer System	1,333			1,333
Maintenance of Pumping System	19,241			19,241
Maintenance of Treatment and Disposal Plant	10,112			10,112
Customer Accounts Expenses				
Internal Labor, Materials and Expenses	14,294			14,294
Uncollectable Accounts	10,223			10,223
Administrative and General Expenses				
Administrative and General Salaries	5,900			5,900
Office Supplies and Other Expenses	9,351			9,351
Outside Services Employed	47,211			47,211
Insurance Expenses	14,431			14,431
Transportation Expense	5,002			5,002
Miscellaneous General Expenses	77			77
Total Sewer Operation and Maintenance Expenses	442,663	6,901		449,564
Depreciation Expense	201,674			201,674
Taxes Other Than Income	1,872			1,872
Total Operating Expenses	646,209	6,901		653,110
Net Operating Income	81,946	6,199		88,145
Interest and Dividend Income	1,871			1,871
Miscellaneous Non Operating Income	15,842	(15,842)	(F)	-
Income Available to Service Debt	\$ 99,659	\$ (9,643)		\$ 90,016

(A) Billing Analysis Adjustment. Grant District charges rates for sewer usage based on the water consumption of its customers on a tiered schedule based on water meter size. Grant District provided a billing analysis for the 12-month test year in its Application. Grant District's Billing Analysis in its Application includes rates for commercial customers that are not in the current tariff. Staff contacted Grant District by phone to inquire whether the rates listed in the Application as Commercial were being billed. Grant District confirmed that the incorrect rates were being billed to commercial customers. Grant District was advised by Staff to discontinue billing at the incorrect rates and to follow up with a letter to the Commission. Grant District submitted a supplement to the application⁶ on February 5, 2020, stating that it would charge the "Monthly Sewer Rates as contained in Appendix A" of the final Order in Case 2005-00314.⁷ Staff calculated that the adjustment for incorrectly billed revenues is a \$13,570 increase to normalized revenue.⁸

Staff notes that, pursuant to KRS 278.160(2), a utility must demand and collect no more and no less than the rates prescribed in its tariff. Therefore, to the extent that Grant District underbilled commercial customers, Grant District should bill those customers for the difference in the rate Grant District charged and the rate Grant District was authorized to charge, subject to the two-year limitation found in KRS 278.225. To the extent that Grant District overbilled commercial customers, Grant District should refund those

⁶ See *Supplemental Application of the Grant County Sanitary Sewer District for an Alternate Rate Adjustment*, (filed Feb. 5, 2020).

⁷ Case No. 2005-00314, *Application of the Grant County Sanitary Sewer District for Authority to Adjust Rates* (Ky. PSC Apr. 12, 2006).

⁸ See Appendix A.

customers for the difference in the rate Grant District charged and the rate Grant District was authorized to charge, subject to the five-year limitation found in KRS 413.120.

(B) Billing Analysis Adjustment. Grant District provided a billing analysis for the 12-month test year in its Application. Grant District's Summary of the Billing Analysis included four 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, a Leak Adjustment subtraction, and a Billing Error subtraction. Grant District's additional detailed information explaining the adjustments indicated that the Unbilled Revenue subtraction was prior year revenue that was billed and collected in the test year and the Unbilled Revenue addition was from December 2018 revenue that was earned during the test year, but billed in the next fiscal period. Grant District provided additional detail concerning leak adjustments and billing errors as well. Staff reviewed and accepted the Pro Forma adjustments in Grant District's Billing Analysis, resulting in a decrease to water sales revenue of \$470.⁹

Staff determined a normalized billing analysis for Grant District produces \$714,284 of revenues from all retail customers and is an accurate representation of the normalized test-year revenue from water sales.

(C) Owner/Manager and Management Fee. In its Application, Grant District proposed to increase the Owner/Manager Fee of \$123,912 for the test period by \$26,280.¹⁰ This adjustment was the result of an amendment to the management contract Grant District has with Bullock Pen Water District (Bullock Pen District) in which Bullock

⁹ Application, Attachment 7, Billing Analysis.

¹⁰ Application, Attachment 5, Schedule of Adjusted Operations.

Pen District runs Grant District in exchange for a management fee. The contracted amounts for provided Field Services increased from \$3,500 to \$4,600 and for Office/Administrative Personnel from \$5,800 to \$7,620 per month. This is a combined increase of \$2,920 per month. According to Grant District, the amendment was executed in October of the test year; therefore, the amendment was in effect for three months of the test year.¹¹ Grant District's proposed adjustment was intended to annualize the new Management Fee. Staff agrees that Grant District's proposed adjustment to the Owner/Manager and Management Fee is a known and measurable adjustment and therefore increased pro forma expenses by \$26,280.

(D) Employee Health Insurance Benefits. The management contract Grant District has with Bullock Pen District requires employees to perform service and management duties for Grant District. Therefore, a portion of the contracted amount is the result of Bullock Pen District's Employee benefits being paid by Grant District. Bullock Pen District pays 100 percent of the monthly Health 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 ensuring 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. The Employer Contributions

¹¹ *Id.*

for employees performing work for Grant District is allocated based on the percentage of hours worked for Grant District compared to the hours worked on Bullock Pen District business, according to the second amendment to the Management Contract, as shown below.

Employee	Policy Type	Premium Amount Less Credit	Time Allocated to Sewer District	Employer Contributions
Service Employee #1	Family	\$ 1,777	30.47%	\$ 541
Service Employee #2	Family	1,651	30.47%	503
Service Employee #3	Family	2,173	30.47%	662
Service Employee #4	Single	1,126	30.47%	343
Office Manager	Family	2,234	60.00%	1,341
Clerical Employee #1	Family	2,163	36.56%	791
Clerical Employee #2	Family	1,614	36.56%	590
Total		<u>\$ 12,738</u>		<u>\$ 4,771</u>

Additionally, consistent with recent Orders in which the Commission has reduced benefit expenses for utilities that pay 100 percent of an employee’s health and dental insurance coverage, Staff reduced Grant District’s single-coverage health insurance premiums by 21 percent and family-coverage health insurance premiums by 34 percent, which is the national average employee contribution rate.¹² Factoring in for the preceding, Staff determined the net adjustment to Grant District’s test-year health insurance expense should be a decrease of \$18,935 as shown in the table below.

¹² 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>)

Type of Premium	Employer Contributions	Times: Average Employee Contribution Rate	Monthly Premium Adjustment	Pro Forma Monthly Premium
Health Insurance- Single	\$ 343	21%	\$ (72)	\$ 271
Health Insurance- Family	4,428	34%	(1,505)	\$ 2,922
	<u>4,771</u>			
Total Pro Forma Monthly Premium				3,193
Times: 12 Months				<u>12</u>
Total Annual Pro Forma Premium				38,316
Less: Test Year				<u>57,251</u>
Adjustment				<u>\$ (18,935)</u>

(E) Employee Dental Insurance Benefits. Bullock Pen District pays \$24.51 per month for employee-only Dental insurance premiums for each of its employees. If an employee of Bullock Pen District elects coverage other than an employee-only policy, Bullock Pen District pays \$24.51 of the monthly premium, regardless of policy type. Taking into account the statements regarding employer-sponsored benefits discussed in Item (D) above, Staff determined there should be an adjustment to Grant District's management contract expense with regard to dental premiums paid. Staff allocated the premium amounts for dental coverage based on the same percentage of hours worked as discussed above.

Employee	Policy Type	Employer Premium Amount	Time Allocated to Sewer District	Employer Contributions
Service Employee	Employee, spouse, child	\$ 25	30.47%	\$ 7
Service Employee	Employee, spouse, child	25	30.47%	7
Service Employee	Employee	25	30.47%	7
Service Employee	Employee	25	30.47%	7
Office Manager	Employee, spouse	25	60.00%	15
Clerical Employee	Employee	25	36.56%	9
Clerical Employee	Employee, 2+ children	25	36.56%	9
Total		<u>\$ 175</u>		<u>\$ 61</u>

Then, Staff calculated its adjustment based on its current monthly premiums and the national average employee contribution rate for dental insurance,¹³ which results in a decrease of \$444 as shown in the calculation below.

Type of Premium	Employer Contributions	Times: Average Employee Contribution Rate	Monthly Premium Adjustment	Pro Forma Monthly Premium
Dental Insurance	\$ 61	60%	<u>\$ (37)</u>	\$ 24
Total Pro Forma Monthly Premium Times: 12 Months				<u>24</u> 12
Total Annual Pro Forma Premium Less: Test Year				288 <u>732</u>
Adjustment				<u>\$ (444)</u>

(F) Miscellaneous Non-Operating Income. During the test year, Grant District disposed of a district vehicle and received a payment from Selective Insurance Company

¹³ Willis Benefits Benchmarking Survey, 2015
(https://www.willis.com/documents/publications/Services/Employee_Benefits/Willis_Survey_011216_R1.pdf)

for a fire that occurred at Grant District in 2017. Combined, these total \$15,842. Gains from the disposal of property and insurance reimbursements are not routine transactions in the normal course of business and, therefore, should be removed from the test year. Therefore, staff decreased Miscellaneous Non-Operating Income and reduced pro forma income by \$15,842.

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;¹⁴ (3) the average annual principal and interest payments on all long-term debts, and (4) working capital that is in addition to depreciation expense.

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

¹⁴ 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).

	Grant District	Staff
Pro Forma Operating Expenses	\$ 672,489	\$ 653,110
Plus: Average Annual Debt Principal & Interest Payments	190,824	149,055 (1)
KIA Loans & Capital Lease	<u>19,082</u>	<u>14,906 (2)</u>
Total Revenue Requirement	882,395	817,071
Less: Other Operating Revenue	(26,971)	(26,971)
Miscellaneous Nonoperating Income	(15,842)	0
Interest Income	<u>(1,871)</u>	<u>(1,871)</u>
Revenue Required from Rates	837,711	788,229
Less: Revenue from Sales at Present Rates	<u>(701,184)</u>	<u>(714,284)</u>
Required Increase in Revenue from Rates	<u>\$ 136,527</u>	<u>\$ 73,945</u>
Required Revenue Increase as a percentage	<u>19.47%</u>	<u>10.35%</u>

(1) Average Annual Principal and Interest Payments. At the time of Staff's review, Grant District had two outstanding loans payable to the Kentucky Infrastructure Authority (KIA), and one lease payable to the BB&T bank. In its Application, Grant District requested recovery of the average annual principal and interest payments on its indebtedness, based on a three-year average of the annual principal and interest payments for the years 2019 through 2021. Staff finds that because the 2019 payments have already been made, and, at the time of this Report, the calendar year 2019 has passed, the five-year average between 2020 and 2024 would be more appropriate to calculate Grant District's debt service. Staff believes that a five-year average is more appropriate for the calculation than the three-year average proposed by Grant District. Grant District's lease is expected to be paid in 2023, and Grant District has not applied for a general increase in rates or an alternative rate filing since its initial rates were approved in 2006. Therefore, the five-year average is more appropriate because after

February 2023 Grant District's financial position will change significantly. As shown below, the five-year average for the Debt Service is \$149,055.

Series	2020	2021	2022	2023	2024	Total 2020-2024
KIA- Loan #A209-35-KIA #1	\$ 13,952	\$ 13,952	\$ 13,952	\$ 13,952	\$ 13,952	\$ 69,758
KIA- Loan #A12-01-KIA #2	62,958	62,958	62,958	62,958	62,958	314,789
BB&T Lease	113,914	113,914	113,914	18,985	-	360,728
Totals	190,824	190,824	190,824	95,894	76,909	745,275
Divided by 5 Years						5
5 Year Average Debt Service						<u>\$ 149,055</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. Grant District requested recovery of an allowance for working capital that is equal to 110 percent of its average annual debt payments for its bonds payable to RD and the note payable to KIA at the time of its Application.

RD requires that Grant District charge rates that produce net revenues that are at least 110 percent of its average annual debt payments. Following the Commission's historic practice, and while Staff agrees with the percentage rate Grant District employed in its calculation, Staff has recalculated the allowance for additional working capital using the new average Annual Debt Principal and Interest Payments as shown below.

Average Annual Principal and Interest	\$ 149,055
Times: DSC Coverage Ratio	<u>110%</u>
Total Net Revenues Required	163,961
Less: Average Annual Principal and Interest Payments	<u>(149,055)</u>
Additional Working Capital	<u>\$ 14,906</u>

Signatures



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



Prepared by: Elizabeth Stefanski
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APPENDIX A

APPENDIX TO A STAFF REPORT OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2019-00424 DATED **MAR 17 2020**

Billing Analysis for: Grant County Sanitary Sewer District						
Test Period From: 1/1/2018 to 12/31/2018						
CURRENT TARIFF RATES FILED WITH THE PSC						
Normalized with All Adjustments						
	Meter Size	Bills	Normalized Gallons Sold	Normalized Revenue	Revenue at Current InCorrect Rate- Calculated by Utility	Difference
	5/8 inch	545	1,747,010	18,252.70	\$ 19,894.00	\$ (1,641.30)
Adjusted	3/4 inch	18375	66,152,350	643,016.84	\$ 646,631.57	\$ (3,614.73)
	1 inch	186	1,666,000	14,223.24	\$ 10,994.00	\$ 3,229.24
	1.5 inch	36	487,000	4,374.00	\$ 2,870.00	\$ 1,504.00
	2 inch	183	3,684,000	34,417.41	\$ 20,325.00	\$ 14,092.41
	3 inch	0	0	0.00		\$ -
	4 inch	0	0	0.00		\$ -
	6 inch	0	0	0.00		\$ -
	8 inch	0	0	0.00		\$ -
	10 inch	0	0	0.00		\$ -
	Totals	19,325	73,736,360	\$714,284.19	\$ 700,714.57	\$ 13,569.62
					Actual Billed	Net Underbilled

APPENDIX B

APPENDIX TO A STAFF REPORT OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2019-00424 DATED **MAR 17 2020**

Monthly Sewer Rates

5/8 x 3/4 Meter

First 2,000 Gallons	\$23.24	Minimum Bill
Next 3,000 Gallons	9.11	Per 1,000 Gallons
Next 5,000 Gallons	7.46	Per 1,000 Gallons
Over 10,000 Gallons	5.86	Per 1,000 Gallons

1-inch Meter

First 5,000 Gallons	\$50.57	Minimum Bill
Next 5,000 Gallons	7.46	Per 1,000 Gallons
Over 10,000 Gallons	5.86	Per 1,000 Gallons

1 1/2-inch Meter

First 10,000 Gallons	\$87.87	Minimum Bill
Over 10,000 Gallons	5.86	Per 1,000 Gallons

2-inch Meter

First 20,000 Gallons	\$146.47	Minimum Bill
Over 20,000 Gallons	5.86	Per 1,000 Gallons

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