

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)	

NOTICE OF FILING OF COMMISSION STAFF REPORT

Notice is hereby given that, in accordance with the Commission's Order of March 23, 2021, 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 March 23, 2021 Order, Morgan 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. Pursuant to the Commission's Orders in Case No. 2020-00085,¹ issued March 16, 2020, and March 24, 2020, Morgan County Water District SHALL NOT FILE the original paper copy at this time, but rather shall file original paper copy within 30 days of the lifting of the current state of emergency. Due to COVID-19, Commission Staff is unable to physically sign this report. When Commission Staff is able to sign this report, a notice of filing with the executed signature page will be made in this case docket.

¹ Case No. 2020-00085, *Electronic Emergency Docket Related to the Novel Coronavirus COVID-19* (Ky. PSC Mar. 16, 2020), Order at 5–6. Case No. 2020-00085, *Electronic Emergency Docket Related to the Novel Coronavirus COVID-19* (Ky. PSC Mar. 24, 2020), Order at 1–3.



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DATED APR 06 2021

cc: Parties of Record

Case No. 2020-00386

STAFF REPORT
ON
MORGAN COUNTY WATER DISTRICT
CASE NO. 2020-00386

Morgan County Water District (Morgan 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 2,835 retail customers that reside in Morgan County, Kentucky.¹ On December 10, 2020, Morgan District filed an application to the Commission requesting to adjust its water rates pursuant to 807 KAR 5:076. To ensure the orderly review of the application, the Commission established a procedural schedule by Order dated January 11, 2021. Commission Staff (Staff) issued two rounds of formal discovery. Subsequent to the issuance of the procedural schedule in this matter, an informal conference was held on March 10, 2021. As a result of the discussions in the information conference, the Commission extended the due date of the Staff Report in its Order of March 23, 2021, and issued additional discovery.

To comply with the requirements of 807 KAR 5:076, Section 9,² Morgan District used the calendar year ended December 31, 2019, as the basis for its application.

Using its pro forma test-year operations, Morgan District determined that a revenue increase of \$374,842, or 26.45 percent, over test-year normalized revenues of

¹ *Annual Report of Morgan County District to the Public Service Commission for the Calendar Year Ended December 31, 2019* at 12 and 49.

² The reasonableness of the proposed rates shall be determined using a 12-month historical test period, adjusted for known and measureable changes, that coincides with the reporting period of the applicant's annual report for the immediate past year.

\$1,417,274 is warranted as shown in the table below.³ The rates requested by Morgan District would increase the residential monthly bill of a typical residential customer using 3,000 gallons per month by \$4.60, from \$34.83 to \$39.43, or approximately 13.21 percent during Phase 1, and by \$4.59, from \$39.43 to \$44.02, or approximately 11.60 percent during Phase 2.⁴

Pro Forma Operating Expenses	\$1,549,313
Plus: Average Annual Principal and Interest Payments	245,868
Additional Working Capital	<u>49,174</u>
Overall Revenue Requirement	1,844,355
Less: Other Operating Revenue	(45,589)
Interest Income	(75)
Nonutility Income	<u>(6,575)</u>
Revenue Required from Rates	1,792,116
Less: Pro Forma Present Rate Service Revenues	<u>(1,417,274)</u>
Required Revenue Increase	<u>\$ 374,842</u>
Percentage Increase	<u>26.45%</u>

To determine the reasonableness of the rates requested by Morgan District, Staff performed a limited financial review of Morgan 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.

³ Application, Attachment 5.

⁴ Application, Attachment 1.

Staff's findings are summarized in this report. Ariel Miller reviewed the calculation of Morgan District's Overall Revenue Requirement. Jason Green reviewed Morgan District's reported revenues and rate design.

SUMMARY OF FINDINGS

1. Overall Revenue Requirement and Required Revenue Increase. By applying the Operating Ratio Method, as generally accepted by the Commission, Staff found that Morgan District's Overall Revenue Requirement is \$1,773,916 and that a \$326,393 revenue increase, or 23.03 percent, to pro forma present rate revenues of \$1,416,965 is necessary to generate the Overall Revenue Requirement.

2. Water Service Rates. Morgan District proposed to increase all of its monthly retail and wholesale water service rates evenly across the board by approximately 26.45 percent. Morgan District is proposing a phased-in approach to implementing the rate increase, whereby approximately half of the increase will be recovered during the first year, which the remainder of the increase will be recovered after the first year. Morgan District has not performed a cost of service study (COSS). In response to Commission Staff's First Request for Information (Staff's First Request), Morgan District stated that it did not complete a COSS at this time as there has not been any material change in the water system to warrant a COSS.

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 absence of a COSS. Finding no such evidence in this case, Staff followed the method

proposed by Morgan District and allocated the \$326,428 revenue increase across the board to Morgan District's monthly retail and wholesale water service rates.

Staff did not follow Morgan's District's proposal to implement the total amount of the revenue increase over a phased-in increase in the rates. The revenue increase of 23.03 percent, particularly when compared to the impact of the average customer's bill, does not place a significant hardship on Morgan District's customers. Furthermore, a phased-in approach increase to rates would impact Morgan District's ability to fully fund depreciation. While depreciation is a non-cash item, restricting the collection of these funds could put Morgan District on a backwards slide towards financial instability in the future. In addition, as discussed in adjustment (N) below, Staff believes this issue is amplified by Morgan District's inability to provide specific records regarding the original costs of its assets on its depreciation schedule. As a result of this inability, Staff notes that depreciation expense for the test year is likely understated, and Morgan District will not have the ability to collect revenue it otherwise would have had the opportunity to collect. Based on the foregoing, Staff recommends the total amount of the revenue increase to be implemented in a single phase.

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 water sales to recover the \$1,743,358 Revenue Required from Rates, an approximate 23.03 percent increase. These rates will increase a typical residential customer's monthly water bill from \$34.83 to \$42.86, an increase of \$8.03, or approximately 23.05 percent.

3. Nonrecurring Revenues. During the test year, Morgan District earned \$23,851 in nonrecurring charges. Morgan District provided a detailed breakdown of the charges as shown in the table below.⁵

Nonrecurring Charge	Number of Occurences	Amount Collected
Meter Test Request	3	\$ 150
Service Call/Investigation	216	21,181
Returned Payment	24	650
Reconnection	10	1,800
Late Payment Charge	1	20
Non-Reporting Fire Department	1	<u>50</u>
Total Charges In Test Year		<u>\$ 23,851</u>

4. Water Loss Surcharge. As noted in adjustment (L) below, 807 KAR 5:066, Section (6)3, limits water loss to 15 percent for ratemaking purposes. Morgan District was a party to Case No. 2019-00041 due to its sustained excessive water loss, and pursuant to ordering paragraph 2 of the November 22, 2019 Order in that case, Morgan District was required to file the application in this proceeding to adjust its water service rates.⁶ While Morgan District did not specifically request a surcharge to fund water loss efforts in its application, Staff notes that the use of a surcharge is consistent with prior Commission action in cases involving water district with excessive unaccounted-for water

⁵ Morgan District's Response to Commission Staff's Third Request (filed Mar. 27 2021), Item 5.

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

loss.⁷ In its report entitled, “*Confronting the Problems Plaguing Kentucky's Water Utilities: An Investigative Report by the Kentucky Public Service Commission November 2019*” that was fully incorporated in the final Order in Case No. 2019-00041, 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.⁸ Staff believes that Morgan District’s operations could be significantly impaired and Morgan District will be unable to properly fund water loss reduction projects if it is not afforded the opportunity to recover expenses disallowed by the regulation. As such, Staff recommends the Commission authorize a surcharge of \$5.87 dedicated specifically to leak detection and repair efforts with 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. Staff additionally recommends that the Commission order Morgan District to draft and file a qualified infrastructure improvement plan, and be authorized to use funds from the collection of the surcharge to contract with a professional engineer to draft such a plan.

PRO FORMA OPERATING STATEMENT

⁷ 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, *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 Sep. 30, 2019); and Case No. 2019-00019, *Electronic Application of Estill County Water District No. 1 for a Surcharge to Finance Water Loss Control Efforts* (Ky. PSC Mar. 24, 2020).

⁸ 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*, 24-25.

Morgan District's Pro Forma Operating Statement for the test year ended December 31, 2019, as determined by Staff, appears below.

	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	(301,497)		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	(413,661)		1,486,826
Net Operating Income	(411,406)	432,913		(39,069)
Interest Income	75			75
Nonutility Income	6,575	(6,575)	(O)	-
Income Available to Service Debt	\$ (404,756)	\$ 426,338		\$ (38,994)

(A) Reported Water Sales. Morgan District reported \$1,407,839 for its test year water sales. Staff examined Morgan District's general ledger for the test year and determined that it recorded \$1,423,675 in metered sales to its residential and commercial customers. Staff therefore determined an increase of \$15,836 is necessary to properly reflect actual sales for the test year and made a pro forma adjustment accordingly.

(B) Billing Analysis Adjustment. Morgan District provided a billing analysis showing the gallons of water billed to retail customers during the test year. Applying the water service rates that were in effect during the test year to the water sales shown in the billing analysis, Staff determined that a billing analysis adjustment is appropriate that decreases test-year revenues by \$6,710.

(C) Bulk Water Sales. During the test year, Morgan District recorded on its general ledger \$309 in bulk water sales. Morgan District did not record this income separately on its Annual Report. In order to properly separate test year retail Water Sales into the appropriate categories, Staff increased Bulk Water Sales \$309 to accurately reflect the general ledger.

(D) Late Payment Penalties. In its application, Morgan District proposed to reclassify from water sales \$26,326 for amounts collected as late payment penalties. Staff examined the 2019 general ledger provided in response to Staff's First Request, Item 1.a.,⁹ and determined that in addition to adjustment (A) above, late payment penalties had not been recorded on Morgan District's annual report. Staff agrees to the increase of \$26,326 to Forfeited Discounts for late payment penalties collected, but

⁹ Morgan District's Response to Commission Staff's First Request for Information (filed Feb. 3, 2021), Item 1.a. at 1, attachment provided as an Excel spreadsheet entitled "Item_1a_-_General_Ledger_2019.xlsx."

disagrees that this is the result of a reclassification adjustment, and therefore no corresponding decrease from Water Sales was made.

(E) Annual Report Inaccuracy. In its application, Morgan District proposed to reduce Miscellaneous Service Revenues \$1,403 for a reimbursement of a relocation project.¹⁰ In response to Commission Staff's Third Request for Information (Staff's Third Request), Item 3, Morgan District provided a breakdown of what was included in Miscellaneous Service Revenue that results in the amounts reported on its Annual Report.¹¹ An analysis of the general ledger¹² confirms that the only amounts to be properly recorded in Miscellaneous Service Revenues are the entries that are in account 471 – Misc. Service Revenue that total \$23,850. Staff increased Miscellaneous Service Revenues by \$3,185 to properly reflect the balance of Miscellaneous Service Revenues collected in the test year.

(F) Nonrecurring Charges. Following the Commission's recent decisions,¹³ Staff has reviewed Morgan District's Nonrecurring Charges. The Commission found that as district personnel are currently paid during normal business hours, estimated labor costs previously included in determining the amount of Nonrecurring Charges should be

¹⁰ Application, Attachment 5, References, Adjustment C.

¹¹ Morgan District's Response to Commission Staff's Third Request for Information (filed Mar. 27, 2021), Item 3.

¹² Morgan District's Response to Staff's First Request, Item 1.a. at 1, attachment provided as an Excel spreadsheet entitled "Item_1a_-_General_Ledger_2019.xlsx."

¹³ Case No. 2020-00141, *Electronic Application of Hyden-Leslie County Water District for an Alternative Rate Adjustment* (Ky. PSC Nov. 6, 2020), and Case No. 2020-00167, *Electronic Application of Ohio County Water District for an Alternative Rate Adjustment* (Ky. PSC Dec. 3, 2020), Case No. 2020-00196, *Electronic Application of West Daviess County Water District for an Alternative Rate Adjustment* (Ky. PSC Dec. 30, 2020), and Case No. 2020-00195, *Electronic Application of Southeast Daviess County Water District for an Alternative Rate Adjustment* (Ky. PSC Dec. 30, 2020).

eliminated from the charges. Staff has reviewed the most recent cost justification information provided in Morgan District's 2019 tariff filing, and has adjusted these charges by removing Field Labor Costs and Office/Clerical Labor Costs. Such adjustments result in the following revised Nonrecurring Charges:

Nonrecurring Charge	Normal Hours
Meter Test Request	\$ 35.40
Service Call/Investigation	17.40
Returned Payment	2.00
Reconnection	17.40

The adjustments to the Nonrecurring Charges results in a decrease to the charges and an increase to the total revenue requirement of \$19,694 as shown below:¹⁴

Charge	Number of Occurrences	Test Year	Adjustment	Pro Forma
Meter Test Request	3	\$ 150	\$ (44)	\$ 106
Service Call/Investigation	216	21,181	(17,423)	3,758
Returned Payment	24	650	(602)	48
Reconnection	10	1,800	(1,626)	174
Late Payment Charge	1	20	-	20
Non-Reporting Fire Department	1	50	-	50
		<u>\$ 23,851</u>	<u>\$ (19,694)</u>	<u>\$ 4,157</u>

Staff notes that Morgan District erroneously included \$20 in late payment charges in its Nonrecurring Charge account. Staff did not reclassify this amount to forfeited discounts, but rather, made no adjustment to the late payment charge and included it in pro forma

¹⁴ Morgan District's Response to Staff's Third Request, Item 5.

operations and properly excluded it from the Revenue Required from Rates in the final calculation of the revenue requirement.

(G) Salaries and Wages. In its application, Morgan District proposed to increase Salaries and Wages \$47,254 to reflect increases in pay rates and to normalize wages for a new employee hired in 2020.¹⁵ In response to Staff's First Request, Morgan District provided the workpapers for the pro forma adjustments made in its application.¹⁶ Additionally, in response to Commission Staff's Second Request for Information (Staff's Second Request), Morgan District confirmed one of its employees that had minimal hours reported for the test year is currently a full-time employee and provided a summary of the hours worked in 2020.¹⁷ In light of this information, Staff recalculated pro forma wages using the hours worked summarized in the table below and increased pro forma salaries and wages by \$60,576:

¹⁵ Application, Attachment 5, References, Adjustment E.

¹⁶ Morgan District's Response to Staff's First Request, Item 3, attachment provided as an Excel spreadsheet entitled "Item_3_-_SAO_Adjmts.xlsx."

¹⁷ Morgan District's Response to Staff's Second Request for Information (filed Mar. 3, 2021), Item 4.a. and 4.c., attachment provided as a PDF entitled "MCWD_RFI_#2_Item_4b.pdf."

<u>Employee Title</u>	<u>Pro Forma Hours Worked</u>	<u>Pro Forma Overtime Hours</u>	<u>Pro Forma Hourly Rate</u>	<u>Pro Forma Wages</u>
General Manager	2080		23.08	\$ 48,006
Office Manager	2080	3	15	31,268
Customer Service Rep 1	2080		12.5	26,000
Customer Service Rep 2	1854	2.5	10.5	19,506
Field Manager	2136	141	14	32,865
Field Technician 1	2124	71	10.5	23,420
Field Technician 2	2137	99	11	25,141
Field Technician 3	2080		11	22,880
Leak Detection Employee	2080		10	<u>20,800</u>
Pro Forma Salaries and Wages Expense				\$ 249,886
Less: Test Year Expense				<u>(189,310)</u>
Increase to Test Year				<u><u>\$ 60,576</u></u>

As a result of the increase to salaries and wages, a corresponding adjustment to payroll taxes must also be made. Staff increased pro forma Taxes Other Than Income \$4,683 as calculated below:

Pro Forma Salaries and Wages Expense	\$ 249,886
Times: 7.65 FICA Rate	7.65%
Pro Forma Payroll Taxes	19,116
Less: Test Year	<u>(14,433)</u>
Increase to Taxes Other Than Income	<u><u>\$ 4,683</u></u>

(H) Expenses Related to Installation of Taps. In its application, Morgan District proposed to remove from operating expenses \$39,715 to capitalize expenses related to the installation of meter taps.¹⁸ Morgan District stated that the amount removed was

¹⁸ Application, Attachment 5, References, Adjustment D.

calculated based on the amount of tap fees collected during the test year. In response to Staff's Second Request, Morgan District provided the number of taps installed for the test period, but was unable to provide any documentation of the amounts actually expended to install customer taps, including the single 1-inch meter installed in 2019.¹⁹ Morgan District's current tariff sets a standard 5/8- x 3/4-inch meter tap fee at \$1,450, which was revised in 2019. Any larger sized meters are installed at actual cost. Staff is concerned that if Morgan District does not keep sufficient documentation to calculate the expenses to install a customer tap that it is unlikely that Morgan District would be able to properly bill customers for meter sizes larger than the standard meter tap for which the fee is set. Staff recommends the Commission require, in the Order in this proceeding, that Morgan District retain sufficient information in its utility records to properly calculate the expenses required to install its meter taps. In the absence of sufficient information in the record to properly calculate the expenses required to install its test year meter taps, Staff calculated the estimated cost to install 44 taps based on its revised tap fee for a standard 5/8- x 3/4-inch meter, and reduced Salaries and Wages expense and Materials and Supplies expense equally for a total reduction of \$63,800 as shown in the calculation below.

Number of Taps Installed in 2019	44
Times: Tariffed Tap Fee	<u>\$ 1,450</u>
 Total Projected Cost to Install Taps	 63,800
Times: 50 Percent	<u>50%</u>
 Reduction to Labor, Materials and Supplies	 <u><u>\$ 31,900</u></u>

¹⁹ Morgan District's Response to Staff's Second Request, Item 1.a-c.

In addition to the reduction in expense, Staff capitalized its estimate for the 2019 meter taps in its adjustment to Depreciation Expense described in adjustment (N) below.

(I) Retirement Expense. Morgan District provides pension benefits and post-retirement health care benefits to its employees by participating in the County Employee Retirement System (CERS). In its application, Morgan District proposed to increase its CERS contributions related to employee retirement by \$18,448 to reflect the adjustment it made to pro forma wages.²⁰ Staff notes that in the workpapers that show the calculation of Morgan District’s proposed pro forma adjustments,²¹ the total adjustment is based on a test year pension contribution of \$35,589. In response to Staff’s Second Request, Morgan District provided as an attachment, a printout from CERS detailing the actual payments made to CERS by Morgan District in the test period totaling \$51,141.²² Based on the information provided by Morgan District, Staff recalculated the increase to CERS contributions based on Staff’s pro forma wage calculation in adjustment (G) above, and the test year contributions paid by Morgan District as shown below.

Pro Forma Salaries and Wages Expense	\$ 249,886
Times: Current CERS Contribution Rate	24.06%
Pro Forma Pension Contributions	60,123
Less: Test Year Actual Contributions	<u>(51,141)</u>
Increase to Employee Benefits	<u>\$ 8,982</u>

Accordingly, Staff increased Employee Pensions and Benefits by \$8,982.

²⁰ Application, Attachment 5, References, Adjustment E.

²¹ Morgan District’s Response to Staff’s First Request, Item 3, attachment provided as an Excel spreadsheet entitled “Item_3_-_SAO_Adjmts.xlsx.”

²² Morgan District’s Response to Staff’s Second Request, Item 3, attachment provided as a PDF entitled “MCWD_RFI__2_Item_3.pdf.”

(J) Adjustment for GASB 68 and 75. As a participating member of CERS, Morgan District is required to contribute a percentage of its employee wages to CERS. In the fiscal year, beginning July 1, 2019, the CERS contribution rate was 24.06 percent.²³ The CERS pension expense Morgan District reported in the test year conformed to the requirements of the Governmental Accounting Standards Board Statement No. 68 and No. 75 (GASB 68 and 75).

In its application, Morgan District proposed to decrease Employee Pensions and benefits by \$61,062 to normalize expenses related to CERS contributions to the amount actually paid by Morgan District in the test period and to remove the effects of the journal entries made to conform to the requirements of GASB 68 and 75.

In Case No. 2016-00163,²⁴ Staff discussed in great detail how reporting requirements for GASB 68 would affect a utility's income statement and balance sheet. In that proceeding, 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.²⁵ Consistent with Staff's previous practice, Staff agrees with the proposal to adjust expenses related to GASB 68 and 75, but has recalculated the amount based on the information provided in response to Staff's Second Request regarding its actual payments

²³ Kentucky Retirement Systems, Contribution Rates. (<https://kyret.ky.gov/Employers/Pages/Contribution-Rates.aspx>)

²⁴ Case No. 2016-00163, *Alternative Rate Adjustment Filing of Marion County Water District* (Ky. PSC Aug. 11, 2016), Staff Report on Marion County Water District at 11–27.

²⁵ *Id.* at 26.

made to CERS.²⁶ Accordingly, Staff reduced Employee Pensions and Benefits expense by \$45,510 as shown in the calculation below:

Test Year CERS and OPEB Expense	\$ 96,651
Less: Test Year Actual Contributions	<u>(51,141)</u>
Reduction to Normalize CERS and OPEB Expense	<u><u>\$ 45,510</u></u>

(K) Employee Benefits. In its application, Morgan District proposed to decrease Employee Pensions and Benefits by \$1,306 based on the net result of an increase to health insurance premiums experienced subsequent to the test period, and to reduce premiums paid by Morgan District by the Bureau of Labor Statistic’s national average for single coverage based on recent Commission decisions regarding this issue.²⁷ Staff has examined the workpapers provided in response to Staff’s First Request, and the Anthem invoice provided in response to Staff’s Second Request, and agrees with the calculation as proposed by Morgan District. Accordingly, Staff decreased Employee Pensions and Benefits by \$1,306 in the Pro Forma calculation.

(L) Excess Water Loss. Morgan District’s test-year water loss was 39.804 percent.²⁸ Commission regulation 807 KAR 5:066, Section 6(3), limits water loss to 15 percent for ratemaking purposes unless the Commission finds an alternative level is reasonable. Morgan District proposed to reduce its test-year expenses for Purchased Water and Purchased Power by \$199,863 to reflect the limitation stated in the

²⁶ Morgan District’s Response to Staff’s Second Request, Item 3, attachment provided as a PDF entitled “MCWD_RFI__2_Item_3.pdf.”

²⁷ Application, Attachment 5, References, Adjustment H.

²⁸ Annual Report at 57.

regulation.²⁹ Staff agrees that the regulation has been properly applied by Morgan District in its proposal and therefore reflected each reduction to Pro Forma expenses.

(M) Reclassification of Purchased Power Expense. In its application, Morgan District proposed to reclassify \$35,182 reported in Miscellaneous Expense to Purchased Power as it was incorrectly reported in the test year.³⁰ Staff has reviewed the general ledger provided in response to Staff's First Request, and agrees that this adjustment is necessary to properly reflect the level of purchased power expense in the test year.³¹ Accordingly, Staff reclassified \$35,182 from Miscellaneous Expense into Purchased Power in the Pro Forma calculation.

(N) Depreciation Expense. In its application, Morgan District proposed to reduce depreciation expense \$93,199 to reflect adjustments to the lives of certain assets that fall outside the ranges recommended by the National Association of Regulatory Utility Commissioners (NARUC) in its report published in 1979 titled *Depreciation Practices for Small Water Utilities* (NARUC Study).³² When no evidence exists to support a specific life that is outside the NARUC ranges, the Commission has historically used the midpoint of the ranges included in the NARUC Study to depreciate utility plant. While Staff agrees that in absence of evidence to support an alternative life, several concerns have arisen during the pendency of this case in the preparation of this report. First, Staff made multiple telephone inquiries to Morgan District, its independent auditor that maintains the

²⁹ Application, Attachment 5, References, Adjustment I.

³⁰ *Id.*, Adjustment J.

³¹ Morgan District's Response to Staff's First Request, Item 1.a. at 1, attachment provided as an Excel spreadsheet entitled "Item_1a_-_General_Ledger_2019.xlsx."

³² Application, Attachment 5, References, Adjustment K.

depreciation schedule Morgan District uses to record its annual depreciation expense, and third-party engineering entities who performed projects on behalf of Morgan District to obtain more specific information regarding the items recorded on its asset ledger. As a result of the telephone inquiries, Staff met with representatives of Morgan District for an informal conference on March 10, 2021, and the issue of the lack of detail of the asset ledger was, among other things, discussed. Additionally, Staff issued a third request for information to obtain sufficient detail regarding the assets referred to as “Water Lines” on Morgan District’s depreciation schedule and Morgan District provided responses on March 27, 2021.³³ Morgan District was unable to provide the requested information in all of the above referenced instances. As a result, Staff is unable to properly assign lives to Morgan District’s water assets based on the NARUC study. Therefore, Staff calculated the adjustment to depreciation expense based on the data available and recommends a decrease to depreciation expense of \$116,847 as shown in the calculation in Appendix A. Staff notes that if sufficient data were available to properly assign the midpoint of the average of the NARUC lives to Morgan District’s assets it is likely the pro forma reduction to Morgan District’s depreciation would be less than the one recommended currently by Staff. Staff further recommends the Commission require Morgan District to properly maintain its asset ledger on a going-forward basis that provides sufficient detail to properly classify the book value of Morgan District’s assets.

(O) Nonutility Income. Morgan District reported \$6,575 of nonutility income for the test year. Staff examined the general ledger for 2019 and determined that this was funds received as a part of an AML grant and therefore should not have been recorded

³³ Morgan District’s Response to Staff’s Third Request for Information, Item 1.

as income to Morgan District. Staff reduced Nonutility Income of \$6,575 from Pro Forma operations.

OVERALL REVENUE REQUIREMENT AND REQUIRED REVENUE INCREASE

By applying a debt service coverage (DSC) method, Staff determined Morgan District's Overall Revenue Requirement to be \$1,773,916. Staff calculated a revenue increase of \$326,393, or 23.03 percent, is necessary to generate the Overall Revenue Requirement. A comparison of Morgan District's and Staff's calculation of the Overall Revenue Requirement and the Required Revenue Increase using a DSC method is shown below.

	Morgan District	Staff	
Pro Forma Operating Expenses	\$1,549,313	\$ 1,486,826	
Plus: Average Annual Principal and Interest Payments	245,868	239,242	(1)
Additional Working Capital	49,174	47,848	(2)
Overall Revenue Requirement	1,844,355	1,773,916	
Less: Other Operating Revenue	(45,589)	(30,483)	
Interest Income	(75)	(75)	
Nonutility Income	(6,575)	-	
Revenue Required from Rates	1,792,116	1,743,358	
Less: Pro Forma Present Rate Service Revenues	(1,417,274)	(1,416,965)	
Required Revenue Increase	<u>\$ 374,842</u>	<u>\$ 326,393</u>	
Percentage Increase	<u>26.45%</u>	<u>23.03%</u>	

(1) In its application, Morgan District proposed to include in its revenue requirement the five-year average of its annual principal and interest payments on its bonds payable to the United States Department of Agriculture Rural Development (RD)

and for a loan payable to Kentucky Rural Water Finance Corporation (KRWFC).³⁴ In its responses to Staff's Third Request, Morgan District provided Excel spreadsheets provided by RD that revealed the complete amortization schedule on its bonds payable. Using this information, Staff recalculated the five-year average of Morgan District's bonds and loan payable summarized in the table below:

Year	Annual Debt Payment
2021	\$ 239,600
2022	238,006
2023	240,493
2024	238,317
2025	<u>239,792</u>
Total	1,196,208
Divide by: 5 years	<u>5</u>
Average Annual Principal and Interest Payment	<u><u>\$ 239,242</u></u>

(2) Morgan District included in its calculation of the revenue requirement \$49,174 for an additional working capital component that it states is required by Morgan District's bond resolutions.³⁵ 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. RD requires that Morgan District charge rates that produce net revenues that are at least 120 percent of its average annual debt payments. Following the Commission's historic practice, Staff agrees with Morgan District's proposal to include

³⁴ Application, Attachment 5, Table B.

³⁵ *Id.*

additional working capital on its RD bonds, but has recalculated the amount based on the average annual principal and interest payments calculated by Staff above. The calculation of Morgan District's additional working capital is summarized below:

Average Annual Principal and Interest	\$ 239,242
Times: DSC Coverage Ratio	<u>120%</u>
Total Net Revenues Required	287,090
Less: Average Annual Principal and Interest Payments	<u>(239,242)</u>
Additional Working Capital	<u>\$ 47,848</u>

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Signatures

Prepared by: Ariel Miller
Revenue Requirements Branch
Division of Financial Analysis

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

APPENDIX A

APPENDIX TO A STAFF REPORT OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2020-00386 DATED APR 06 2021

Asset Number	Asset	Date Placed Into Service	Original Cost	Morgan District Life	Current Depreciation	Staff Life	Adjusted Depreciation	Pro Forma Adjustment
1	Laser Printer	12/5/2002	\$ 1,099	5.0	\$ -	Fully Depreciated	\$ -	\$ -
2	Equipment	7/1/1995	7,285	5.0	-	Fully Depreciated	-	-
5	Boring Equipment	4/9/2009	11,000	5.0	-	Fully Depreciated	-	-
6	Telemetry System	1/1/2003	15,600	5.0	-	Fully Depreciated	-	-
9	2008 Ford F-150 Pickup	1/4/2008	16,326	5.0	-	Fully Depreciated	-	-
10	2008 Ford F-150 Pickup2	1/3/2008	16,326	5.0	-	Fully Depreciated	-	-
11	2008 Chevy Colorado	2/5/2008	15,498	5.0	-	Fully Depreciated	-	-
12	Telemetry System	1/1/2004	3,900	5.0	-	Fully Depreciated	-	-
27	Phase 12 Telemetry	7/12/2010	270,375	10.0	27,038	Fully Depreciated	-	(27,038)
28	Kubota Excavator w/ Trailer	7/11/2018	26,500	5.0	5,300	12.5	2,120	(3,180)
30	Leased 2018 Ford F-150	4/5/2018	28,554	5.0	5,711	5.0	5,711	-
31	Leased 2018 Ford F-150	10/31/2018	34,633	5.0	6,927	5.0	6,927	-
32	Leased 2017 Ford F-150	1/1/2018	39,839	5.0	7,768	5.0	7,968	200
33	Leased 2017 Ford F-150	1/1/2018	27,911	5.0	5,582	5.0	5,582	-
13	Water Lines	4/1/1993	1,060,000	50.0	21,200	62.5	16,960	(4,240)
14	Water Lines	7/1/1996	2,047,065	50.0	40,941	62.5	32,753	(8,188)
15	Water Lines 203 Project	12/3/1999	285,223	50.0	5,704	62.5	4,564	(1,141)
16	Water Line 203 Extension	10/13/2000	83,203	50.0	1,664	62.5	1,331	(333)
17	Water Haul Station	12/31/1998	18,000	20.0	-	Fully Depreciated	-	-
18	Water Lines - Hwy 172 Project	12/5/2002	1,709,559	50.0	34,191	62.5	27,353	(6,838)
19	Water Lines - Ezel Expansion Project	12/5/2002	993,078	50.0	19,862	62.5	15,889	(3,972)
20	Water Lines - White Oak Expansion	1/1/2003	1,722,021	50.0	34,440	62.5	27,552	(6,888)
21	WL - Liberty St/Havens Branch	1/1/2004	3,000	5.0	-	Fully Depreciated	-	-
22	Phase 10 Water Lines	1/1/2006	4,228,030	50.0	84,561	62.5	67,648	(16,912)
23	Water Lines - Phase 11	2/29/2008	4,073,608	50.0	81,472	62.5	65,178	(16,294)
24	Phase 12 Water Lines	7/12/2010	2,632,374	50.0	52,647	62.5	42,118	(10,529)
25	Phase 12A Waterlines	5/21/2010	1,317,000	50.0	26,340	62.5	21,072	(5,268)
26	Water Lines Phase 14	8/31/2015	1,623,704	50.0	32,474	62.5	25,979	(6,495)
29	Water Lines - MCWD System Improv	9/7/2018	729,991	50.0	14,600	62.5	11,680	(2,920)
	2019 Meter Taps	2019	63,800	N/A	-	20	3,190	3,190
			<u>\$ 23,104,502</u>		<u>\$ 508,422</u>		<u>\$ 391,575</u>	<u>\$ (116,847)</u>

APPENDIX B

APPENDIX TO A STAFF REPORT OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2020-00386 DATED APR 06 2021

Monthly Water Rates

5/8- x 3/4-Inch Meter

First	2,000	gallons	\$ 31.28	Minimum bill
Next	3,000	gallons	0.01158	per gallon
Next	5,000	gallons	0.01073	per gallon
Next	5,000	gallons	0.00988	per gallon
All Over	15,000	gallons	0.00903	per gallon

1-Inch Meter

First	5,000	gallons	\$ 66.17	Minimum bill
Next	5,000	gallons	0.01073	per gallon
Next	5,000	gallons	0.00988	per gallon
All Over	15,000	gallons	0.00903	per gallon

2-Inch Meter

First	15,000	gallons	\$ 167.80	Minimum bill
All Over	15,000	gallons	0.00903	per gallon

6-Inch Meter

First	100,000	gallons	\$936.72	Minimum bill
All Over	100,000	gallons	0.00903	per gallon

Wholesale Water Rate \$0.00524 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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