

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

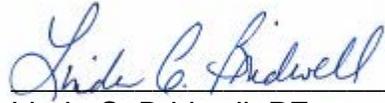
In the Matter of:

ELECTRONIC APPLICATION OF SOUTH)	
EASTERN WATER ASSOCIATION, INC. FOR)	CASE NO.
A RATE ADJUSTMENT PURSUANT TO 807)	2021-00126
KAR 5:076)	

NOTICE OF FILING OF COMMISSION STAFF REPORT

Notice is hereby given that, in accordance with the Commission's Order of March 22, 2021, the attached report containing the findings of Commission Staff (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 22, 2021 Order, South Eastern Water Association (South Eastern Water) is required to file written comments regarding the findings of 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, South Eastern Water SHALL NOT FILE the original paper copy of its comments at this time, but rather shall file original paper copies within 30 days of the lifting of the current state of emergency. Due to COVID-19, Staff is unable to physically sign this report. When Staff is able to safely 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.



Linda C. Bridwell, PE
Executive Director
Public Service Commission
P.O. Box 615
Frankfort, KY 40602

DATED JUN 14 2021

cc: Parties of Record

Case No. 2021-00126

STAFF REPORT
ON
SOUTH EASTERN WATER ASSOCIATION
CASE NO. 2021-00126

South Eastern Water Association (South Eastern Water) is a water utility organized pursuant to KRS Chapter 273 that owns and operates a water distribution system through which it provides retail water service to approximately 7,065 residential customers, and 74 commercial customers, that reside in Pulaski County, Kentucky.¹ On March 15, 2021, South Eastern Water tendered 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 March 22, 2021. Staff issued its first round of formal discovery on April 8, 2021, a second round of formal discovery on May 3, 2021.

The Commission notes that in its 2019 Annual Report South Eastern Water reported a water loss of 18.7928 percent.² Commission regulation 807 KAR 5:066(6)(3) states that for rate making purposes a utility's water loss shall not exceed fifteen (15) percent of total water produced and purchased, excluding water consumed by a utility in its own operations.

The Commission is placing greater emphasis on monitoring utilities that consistently exceed the 15 percent water loss threshold and strongly encourages South Eastern Water to pursue reasonable actions to reduce its water loss. Failure by South

¹ *Annual Report of South Eastern Water Association to the Public Service Commission for the Calendar Year Ended December 31, 2019 (Annual Report)* at 12 and 49.

² *Id.* at 57.

Eastern Water to make significant process towards reducing water loss may cause the Commission to pursue additional action with the utility.

To comply with the requirements of 807 KAR 5:076, Section 9,³ South Eastern Water used the calendar year ended December 31, 2019, as the basis for its application. Using its Pro Forma test-year operations, South Eastern Water determined that a revenue increase of \$228,386, or 5.54 percent, over test-year normalized revenues of \$4,120,296 is warranted as shown in the table below.⁴ The rates requested by South Eastern Water would increase the residential monthly bill of a typical residential customer using 3,000 gallons per month by \$2.05, from \$37.08 to \$39.13, or approximately 5.53 percent.⁵

	South Eastern Water Association
Pro Forma Operating Expenses Before Income Taxes	\$ 3,696,030
Plus: Avg. Annual Principal and Interest Payments	736,361
Additional Working Capital	<u>147,272</u>
Total Revenues Requirement	4,579,663
Less: Other Operating Revenue	(135,580)
Interest Income	(67,199)
Misc. Income	<u>(28,202)</u>
Revenue Required From Water Sales	4,348,682
Revenue from Sales at Present Rates	<u>(4,120,296)</u>
Required Revenue Increase	228,386
Percentage Increase	5.54%

³ 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.

⁴ Application, Attachment 5.

⁵ *Id.*, Attachment 1.

To determine the reasonableness of the rates requested by South Eastern Water, Staff performed a limited financial review of South Eastern Water'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 measurable⁶ 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.

Staff's findings are summarized in this report. William Foley reviewed the calculation of South Eastern Water's Overall Revenue Requirement. Sam Reid reviewed South Eastern Water's reported revenues and rate design.

SUMMARY OF FINDINGS

1. Overall Revenue Requirement and Required Revenue Increase. By applying the Debt Service Coverage method, as generally accepted by the Commission, Staff found that South Eastern Water's required revenue from rates is \$4,364,047 to meet the Overall Revenue Requirement of \$4,526,392; representing a \$243,751 or 5.92 percent revenue increase to Pro Forma present rate revenues.

⁶ Commission regulation 807 KAR 5:076, Section 9 sets the standard for the determination of the reasonableness of proposed rates and states, in pertinent part, that the test period shall be "adjusted for known and measurable changes." See also Case No. 2001-00211, *The Application of Hardin County Water District No. 1 for (1) Issuance of Certificate of Public Convenience and Necessity; (2) Authorization to Borrow Funds and to Issue its Evidence of Indebtedness therefor; (3) Authority to Adjust Rates; and (4) Approval to Revise and Adjust Tariff* (Ky. PSC Mar. 1, 2002); Case No. 2002-00105, *Application of Northern Kentucky Water District for (A) an Adjustment of Rates; (B) a Certificate of Public Convenience and Necessity for Improvements to Water Facilities if Necessary; and (C) Issuance of Bonds* (Ky. PSC June 25, 2003); Case No. 2017-00417, *Electronic Proposed Adjustment of the Wholesale Water Service Rates of Lebanon Water Works* (Ky. PSC July 12, 2018).

2. Monthly Water Service Rates. South Eastern Water proposed to increase all of its monthly retail water service rates evenly across the board by approximately 5.54 percent. South Eastern Water has not performed a cost of service study (COSS). In response to Staff's First Request for Information (Staff's First Request), South Eastern Water 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.⁷

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 South Eastern Water and allocated the \$241,251 revenue increase across the board to South Eastern Water's monthly retail and wholesale 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 \$4,364,047 Revenue Required from Water Sales, an approximate 5.92 percent increase. These rates will increase a typical residential customer's monthly water bill from \$37.08 to \$39.25, an increase of \$2.17, or approximately 5.85 percent.⁸

PRO FORMA OPERATING STATEMENT

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

⁷ Staff's First Request for Information (filed Apr. 19, 2021), Item 3.

⁸ The typical residential customer uses approximately 3,000 gallons per month.

	Test Year	Adjustment	(Ref.)	Pro Forma
Operating Revenues				
Total Metered Sales	\$ 4,197,989	(90,182)	(A)	
		(27,218)	(B)	
		12,489	(C)	\$ 4,093,078
Sales for Resale	-	27,218	(B)	27,218
Other Water Revenues				
Forfeited Discounts	-	90,182	(A)	90,182
Misc. Service Revenues	96,925	(96,925)	(D)	-
Other Water Revenues	10,262	(6,352)	(E)	
		920	(F)	4,830
Total Operating Revenues	\$ 4,305,176			\$ 4,215,308
Operating Expenses				
Operation and Maintenance Expenses				
Salaries and Wages - Employees	449,520	68,079	(G)	517,599
Salaries and Wages - Officers	41,500	6,500	(I)	48,000
Employee Pensions and Benefits	13,944	1,584	(H)	
		10,352	(J)	25,880
Purchased Water	1,452,694	5,044	(K)	
		(55,289)	(L)	1,402,449
Purchased Power	81,260	(3,082)	(L)	78,178
Materials and Supplies	200,776			200,776
Contractual Services	66,201			66,201
Rental of Bldg./Real Property	3,463			3,463
Transportation Expenses	48,632			48,632
Insurance- General Liability & Other	102,673			102,673
Insurance- Other	160,996	(95,752)	(M)	65,244
Advertising	2,385			2,385
Commission Expense	16,535			16,535
Bad Debt	18,065	(6,352)	(E)	11,713
Miscellaneous Expense	210,193	80,188	(N)	290,381
Total Operation and Maintenance Expenses	2,868,837			2,880,108
Depreciation	983,514	(276,050)	(O)	707,464
Amortization	2,724			2,724
Taxes Other Than Income	182,271	5,208	(P)	
		(135,016)	(Q)	52,463
Utility Operating Expenses	4,037,346	(405,858)		3,642,759
Net Operating Income	267,830	405,858		572,549
Miscellaneous income	28,202	(28,068)	(R)	134
Income Available to Service Debt	\$ 296,032	\$ 377,790		\$ 572,683

(A) Late Fees. In its application, South Eastern Water proposed an adjustment to reduce reported metered water sales by \$90,182.⁹ This adjustment is to recategorize late fees that were miscategorized. Staff agrees that South Eastern Water's adjustment is appropriate and accepts South Eastern Water's adjustment.

(B) Sales for Resale. In its application, South Eastern Water proposed an adjustment to reduce reported metered water sales by \$27,218¹⁰. This adjustment is to recategorize Sales for Resale that were miscategorized. Staff agrees that South Eastern Water's adjustment is appropriate and accepts South Eastern Water's adjustment.

(C) Billing Analysis. In its application, South Eastern Water proposed to increase reported metered water sales by \$12,489.¹¹ This adjustment was to normalize annual water sales to reflect the increase in rates approved in Case No. 2020-00049.¹² Staff agrees that South Eastern Water's adjustment is appropriate and accepts South Eastern Water's adjustment.

(D) Miscellaneous Service Revenues. In its application, South Eastern Water proposed an adjustment to decrease Miscellaneous Service Revenues by \$61,789.¹³ South Eastern Water proposed this adjustment in order to align the revenues to the test

⁹ Application, Attachment 5, Adjustment A.

¹⁰ *Id.*, Adjustment B.

¹¹ *Id.*, Adjustment C.

¹² Case No. 2020-00049, *Petition of South Eastern Water Association, Inc. For A Certificate of Public Convenience and Necessity, Financing, and Adjustment of Rates Pursuant To KRS 278.023*, (Ky. PSC Mar. 16, 2020).

¹³ Application, Attachment 5, Adjustment D.

year adjusted trial balance amount of \$35,136.¹⁴ Staff agrees with South Eastern Water's decision to reconcile the Pro-Forma revenue calculations with the Test year's adjusted trial balance. Therefore, Staff agrees with South Eastern Water's adjustment to decrease Miscellaneous Service Revenue by \$61,789. Following the Commission's recent decisions, Staff has reviewed South Eastern Water's Nonrecurring Charges. Staff researched Commission records and was unable to find documentation supporting the current charges. Staff's Second Request for information (Staff's Second Request), Item 9, requested South Eastern Water to provide cost justification for all nonrecurring charges in its filed tariff. South Eastern Water did not provide cost justification for the Nonrecurring charges. South Eastern Water responded to Staff's Second Request that the charges were submitted to the Commission in 1996 and 1997 and that no current cost justification could be found for these charges.¹⁵ Because no costs have been identified in support of these nonrecurring charges, the charges have been reduced to zero. Therefore, Staff proposed a total adjustment to reduce Miscellaneous Service Revenues by \$96,925. South Eastern Water should provide cost justification for the nonrecurring charges in its response to this Staff Report for the Commission to consider.

(E) Other Water Revenues. In its application, South Eastern Water reported Other Water Revenues of \$10,262.¹⁶ The amount is composed of Membership Fees of \$3,910 and Customer Returns of \$6,352. Upon speaking to the South Eastern Water's

¹⁴ South Eastern Water's Response to Staff's Initial Request for Information (Staff's Initial Request), (filed Apr. 19, 2021), Item 2.

¹⁵ Response of South Eastern Water to the Commission Staff's Second Request (filed May 13, 2021), Item 9.

¹⁶ Application, Attachment 5.

CPA firm, Staff determined that the Customer Returns account is the name South Eastern Water uses when it collects money on previously written off Bad Debts submitted to a collection agency. Staff disagrees with this classification, as the Bad Debts turned over to a collection firm would already have been recorded as revenue in the Total Metered Sales account. When written off as bad debt the amount due is transferred to a Bad Debt Expense, therefore collections made on the bad debt should be recorded as a reduction to the Bad Debt Expense instead of recorded as additional revenue. Therefore, Staff reduced Other Water Revenues and Bad Debt Expense by \$6,352.

(F) Other Water Revenues. As stated above in Adjustment (E), South Eastern Water's Other Water Revenues includes \$3,910 in membership fees. When Staff asked for additional information about the membership fees, South Eastern Water supplied Staff with information that the amount should be \$4,830.¹⁷ Therefore, Staff increased Other Water revenues by \$920.

(G) Salaries and Wages- Employees. South Eastern Water proposed to increase its test-year salaries and wages expense by \$112,567 to reflect increases in employee wages subsequent to the test year and the addition of a new employee. In its review, South Eastern Water District provided test year and current wage information as well as test-year hours worked.¹⁸ Staff normalized Salaries and Wages Expense using test-year hours worked and current pay rates in addition to adding the new employee.

¹⁷ South Eastern Water's Response to Staff's Second Request, (filed May 13, 2021), Item 8.

¹⁸ South Eastern Water's Response to Staff's Initial Request, (filed April 19, 2021), Items 1e and 1f and South Eastern Water's Response to Staff's Second Request, (filed May 31, 2021), Item 1.

Accordingly, as shown below, Staff increased Pro Forma Salaries and Wages expense by \$68,079.

Test Year hours with Current Wages								
Employee Number	Total Hours	Test Year Normal Hours	Current Wages Rates	Pro Forma Normal Wages	Test Year Overtime Hours	Current Overtime Wage Rates	Pro Forma Overtime Wages	Total Pro Forma Wages
138	1,833	1,833	\$ 18.50	\$ 33,911	-	\$ 27.75	\$ -	\$ 33,911
228	2,080	2,080	26.44	55,000	-	39.66	-	55,000
2316	1,926	1,859	19.50	36,251	67	29.25	1,960	38,210
4901	2,080	2,080	38.46	80,000	-	57.69	-	80,000
4920	1,824	1,824	18.50	33,735	-	27.75	-	33,735
5309	1,979	1,919	19.00	36,461	60	28.50	1,710	38,171
5347	1,930	1,930	18.00	34,731	-	27.00	-	34,731
6465	1,985	1,913	19.00	36,347	72	28.50	2,052	38,399
6784	2,175	1,974	19.00	37,506	201	28.50	5,729	43,235
6913	2,241	1,931	20.00	38,620	310	30.00	9,300	47,920
7666	2,065	1,936	19.00	36,784	129	28.50	3,677	40,461
8600	1,829	1,829	18.50	33,827	-	27.75	-	33,827
		23,107						
								Pro Forma Wages
								\$ 517,599
								Total Pro Forma Wages
								517,599
								Less: Test Year Wages
								(449,520)
								Pro Forma Adjustment
								\$ 68,079

(H) Employee Pensions and Benefits. In its application, South Eastern Water proposed an adjustment increasing Employee Pensions and Benefits by \$2,877.¹⁹ This adjustment was to account for the increase contribution to employee pensions due to the increase in employee wages and the inclusion of the additional employee hired subsequent to the close of the test year. Staff agrees with the methodology South Eastern Water utilized in the calculation, however, as shown above in Staff's Adjustment (G), Staff revised the amount of the Salaries and Wages-Employee increase. Based upon the revised salaries and ages, Staff increased Employee Pensions and Benefits by \$1,584.

¹⁹ Application, Attachment 5, Adjustment E.

Employee Pensions and Benefits	
Pro Forma Salaries and Wages- Employees	\$ 517,599
Times: 3.00% Pension Contribution Rate	<u>3.00%</u>
Pro Forma Employee Pension Contribution	15,528
Less: Test Year Employee Pensions and Benefits	<u>(13,944)</u>
Employee Pensions and Benefits Adjustment	\$ 1,584

(l) Salaries and Wages- Officers. In its test year, South Eastern Water reported a test year Salaries and Wages Expense-Officers of \$41,500.²⁰ South Eastern Water responded to Staff's Initial Request with the number of Board members, as well a statement that each Board member is eligible for a payment of \$500 per month.²¹ South Eastern Water currently has eight board members. Staff confirmed via a conversation with a South Eastern Water representative that the board's salary is fixed per month and not dependent upon meeting attendance. Pursuant to KRS 273A.115 Section (2)(a), a water association may pay reasonable compensation to its board members for services rendered. Staff believes South Eastern Water should be permitted to recover, for rate making purposes, the amount determined reasonable by the association and its members, who are the rate payers. Staff annualized the Salaries and Wages- Officers expense to \$48,000 annually. Therefore, as shown below, Staff increased Employee Wages and Salaries-Officers by \$6,500.

²⁰ *Id.*, Attachment 5.

²¹ South Eastern Water's Response to Staff's Initial Request (filed Apr. 19, 2021), Item 1i.

<u>Commissioners</u>	<u>Pro Forma Salaries</u>
Joe Dale Crawford	\$ 6,000
Mark Davis	6,000
Grant Treado	6,000
Bobby Crow	6,000
Ernest Stout Jr.	6,000
Wade Bumgardner	6,000
Dwight Faulkner	6,000
Dennis Faulkner	6,000
Total	<u>\$ 48,000</u>
Test Year Salaries	<u>41,500</u>
Adjustment	<u><u>\$ 6,500</u></u>

(J) Discretionary Pension Contributions. In its application, South Eastern Water includes an adjustment to Employee Pensions and Benefits of \$11,214.²² South Eastern Water calculated this contribution amount by multiplying the Pro Forma Gross Salaries and Wages-Employees of \$562,087 by the 2.00 percent contribution rate. Staff agrees with the methodology used by South Eastern Water however, due to Staff's Adjustment (G) above, Salaries and Wages- Employees Staff calculated a contribution amount of \$10,352 is determined as shown below.

<u>Discretionary Contribution</u>	
Pro Forma Wages	\$ 517,599
Times 2% contribution Rate	<u>2.00%</u>
Discretionary Contribution Amount	\$ 10,352

(K) Purchased Water. In its test year, South Eastern Water reported a purchased water expense of \$1,452,694.²³ In response to Staff's Second Request, South

²² Application, Attachment 5, Adjustment F.

²³ *Id.*, Attachment 5.

Eastern Water provided a breakdown of the gallons of water purchased from its vendor during the test year; this amount does not match the reported amount.²⁴ Based upon these purchases, Staff calculated a Purchased Water expense of \$1,457,738. Therefore, Staff increased Purchased Water expense by \$5,044 in order to reconcile the test year amount with the reported purchased amount.

Purchased Water			
Period	Thousand	Dollars	Total
	Gallons	per 1,000	
	Purchased	Gallon	
Jan-2019	48,270	\$ 2.50	\$ 120,675
Feb-2019	48,525	2.50	121,313
Mar-2019	47,831	2.50	119,578
Apr-2019	41,872	2.50	104,680
May-2019	43,216	2.50	108,040
Jun-2019	50,649	2.50	126,623
Jul-2019	51,738	2.50	129,345
Aug-2019	54,095	2.50	135,238
Sep-2019	52,289	2.50	130,723
Oct-2019	49,632	2.50	124,080
Nov-2019	52,066	2.50	130,165
Dec-2019	42,912	2.50	107,280
	Purchased Water Expense		1,457,738
	Test Year Purchased Water		<u>1,452,694</u>
	Adjustment		\$ 5,044

(L) Expenses Attributable to Water Loss. In its application, South Eastern Water proposed an adjustment of \$58,180 to Purchased Water and Purchased Power to account for excess water loss.²⁵ This adjustment is in accordance with Commission

²⁴ South Eastern Water's Response to Staff's Second Request (filed May 13, 2021), Item 4a.

²⁵ Application, Attachment 5, Adjustment G.

precedent of not allowing recovery of expenses for water loss in excess of 15 percent. Staff agrees with South Eastern Water’s methodology. However, Staff disagrees with South Eastern Water’s proposed adjustments. When adjustment (K) is included in the purchased water calculation it results in a decrease to Purchased Water Expense of \$55,289, and Purchased Power Expense by \$3,082. The adjustments result in a net decrease to Revenue Requirement of \$58,371 as shown in the table below.

	Purchased Water	Purchased Power
Purchased Water from 2019 Annual Report	\$ 1,457,738	\$ 81,260
Times: Water loss Above 15 Percent	-3.7928%	-3.7928%
Excess Water Loss Reductions	<u>\$ (55,289)</u>	<u>\$ (3,082)</u>
Total		<u><u>\$ (58,371)</u></u>

(M) Employee Health Insurance. South Eastern Water proposed an adjustment to decrease Employee Pensions and Benefits of \$87,384.²⁶ This adjustment includes \$19,568 to align with the Bureau of Labor Statistic’s national average for an employer’s share of health insurance premiums and a Pro Forma adjustment of \$67,816 to account for a new insurance carrier that resulted in annual premium savings. South Eastern Water currently pays 100 percent of the monthly premiums for single and family health coverage and life insurance for its eligible full-time employees. Staff notes that the Commission has consistently made ratemaking adjustments to reduce the cost of employee benefit packages paid by some utilities when certain aspects of those benefit packages were found to be unreasonable based on a review of total salaries and fringe benefits. The

²⁶ *Id.*, Attachment 5, Adjustment H.

Commission continues to place greater emphasis on evaluating employees' total compensation packages, including both salary and benefits programs, for market and geographic competitiveness to ensure the development of a fair, just and reasonable rate. It has found that in most cases, 100 percent of employer-funded health care does not meet those criteria.²⁷

Consistent with precedent in which the Commission has reduced benefit expenses for utilities that pay 100 percent of an employee's health insurance coverage; Staff reduced South Eastern Water's single health insurance premiums by 21 percent and family health insurance premiums by 33 percent.²⁸ Factoring in for the preceding, Staff decreased Insurance-Other by \$95,752, as shown in the calculation below:

²⁷ Case 2020-00167, *Electronic Application of Ohio County Water District for an Alternative Rate Adjustment* (filed December 2, 2020). Case 2020-00296, *Electronic Application of Allen County Water District for an Alternative Rate Adjustment* (filed Feb. 3, 2021).

²⁸ Bureau of Labor Statistics, Healthcare Benefits, March 2017, Table 10, private industry workers. (<https://www.bls.gov/ncs/ebs/benefits/2017/ownership/private/table10a.pdf>)

Type of Premium	Employer Contributions	Average Employee Contribution Rate	Monthly Premium Adjustment	Pro Forma Monthly Premium
Single Health Insurance ²⁹	\$ 4,350	21%	\$ (914)	\$ 3,436
Family Health Insurance ³⁰	2,833	33%	(935)	1,898
Life Insurance ³¹	102			102
Total	\$ 7,286			
Total Pro Forma Monthly Premium				5,437
Times: 12 Months				<u>12</u>
Total Annual Pro Forma Premium				65,244
Less: Test Year				<u>(160,996)</u>
Adjustment				<u>\$ (95,752)</u>

(N) Miscellaneous Expense. In its application, South Eastern Water proposed an adjustment to Miscellaneous Expense of \$80,186.³² South Eastern Water proposed this adjustment in order to reconcile Miscellaneous Expenses to the Adjusted Trial Balance. South Eastern Water submitted a copy of its 2019 Adjusted trial Balance to Staff.³³ Staff agrees with South Eastern Water's methodology. However, Staff reviewed the accounts that made up Miscellaneous Expense, as shown below, and calculated a different adjustment. Therefore, Staff increased Miscellaneous Expense by \$80,188.

²⁹ \$496.97*8 Employees and \$374.57*1 Employee.

³⁰ \$944.24*3 Employees.

³¹ \$8.75*11 Employees and \$6.21*1 Employee.

³² Application, Attachment 5, Adjustment I.

³³ South Eastern Water's Response to Staff's Initial Request (filed Apr. 19, 2021), Item 1a.

Miscellaneous Expense Breakdown		
5045	Bank Charges	\$ 1,162
5055	Dues and subscription	5,813
5081	Loan admin. Fees	3,688
5085	Billing expense	35,059
5087	Collections expense	685
5095	Office supplies	25,201
5100	Utilities	10,408
5115	Repairs and Maintenance	77,897
5120	Uniforms and laundry	8,294
5125	Medical expense	195
5140	Supplies	6,514
5142	Security	561
5150	Telephone	6,100
5152	Training expense	781
5165	Meter Reading	108,023
Total Miscellaneous Expense		\$ 290,381
Less: Test Year Miscellaneous Expense		(210,193)
Miscellaneous Expense Adjustment		\$ 80,188

(O) Depreciation Expense. In its application, South Eastern Water proposed to decrease its test year Depreciation Expense of \$983,514 by \$276,050.³⁴ This adjustment was the result of South Eastern Water’s proposal to adjust the lives assigned to certain assets that were outside of the life ranges in accordance with the National Association of Regulatory Utility Commissioners’ (NARUC) report titled *Depreciation Practices for Small Utilities* (NARUC Study) published in 1979. In addition, the adjustment involves annualizing Depreciation Expense for assets that were installed during and subsequent the test year

To evaluate the reasonableness of the depreciation practices of small water utilities, the Commission has historically relied upon the NARUC Study mentioned above.

³⁴ Application, Attachment 5, Adjustment J.

South Eastern Water proposed to adjust the lives of assets that were outside of the NARUC ranges to the mid-point of the depreciable life ranges. In this proceeding, Staff found no evidence to support depreciable lives that vary significantly from the midpoint of the NARUC ranges moreover, after further review of South Eastern Water’s plant ledger, Staff agrees with South Eastern Water’s proposed decrease to Depreciation Expense of \$276,050.

(P) Taxes Other than Income, FICA. South Eastern Water proposed an adjustment to increase Taxes Other Than Income-FICA by \$8,469 to reflect Pro Forma Salaries and Wages changes.³⁵ However, as discussed in Adjustment (G), Staff modified Salaries and Wages-Employees. As shown below, Staff determined that test-year FICA taxes should be increased by \$5,208 to reflect the increase to Pro Forma Salaries and Wages-Employees expense.

Taxes other than Income- FICA	
Pro Forma Wage Adjustment	\$ 68,079
Times: 7.65 Percent FICA Rate	<u>7.65%</u>
FICA Adjustment	\$ 5,208

(Q) Taxes Other Than Income- Utility Tax. During the test year, South Eastern Water proposed an adjustment decreasing Taxes Other Than Income by \$135,016.³⁶ This is due to South Eastern Water collecting sales tax and school taxes on behalf of others. Because these taxes are not expenses incurred by South Eastern Water, they were removed. Staff agrees with South Eastern Water’s adjustment, since South Eastern

³⁵ *Id.*, Attachment 5, Adjustment E.

³⁶ *Id.*, Attachment 5, Adjustment L.

Water is not collecting revenues nor incurring any expenses and are functioning as a pass through entity, it should not be able to recover the taxes.

(R) Miscellaneous Income. South Eastern Water reported \$28,202 of Miscellaneous Income for the test year.³⁷ Staff examined the General Ledger and determined \$25,951 was a result of an adjustment made by South Eastern Water's independent auditor.³⁸ Staff contacted the auditor and it was explained that the adjustment was necessary to balance the proper amounts of its long-term debt accounts and interest expense for the test period. Therefore, Staff concludes the adjustment is not income realized by South Eastern Water, and its effects should not be included in the Pro Forma operations for ratemaking purposes. In addition, \$2,117 is recorded from an insurance payout that South Eastern Water received during the test-year.³⁹ Insurance payouts are not a routine transaction in the normal course of business and, therefore, should be removed from the test year for a total reduction to Miscellaneous Income of \$28,068.

OVERALL REVENUE REQUIREMENT AND REQUIRED REVENUE INCREASE

The Commission has historically applied a debt service coverage (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)

³⁷ *Id.*, Attachment 5, Adjustment N.

³⁸ South Eastern Water's Response to Staff's Initial Request, (filed Apr. 19, 2021), items 1a, 2019_GL_Detail, at 287.

³⁹ *Id.*

recovery of depreciation expense, a non-cash item, to provide working capital;⁴⁰ (3) the average annual principal and interest payments on all long-term debts, and (4) working capital that is in addition to depreciation expense.

	South Eastern Water Association	Staff	
Pro Forma Operating Expenses	\$ 3,696,030	\$ 3,642,759	
Plus: Avg. Annual Principal and Interest Payments	736,361	736,361	(1)
Additional Working Capital	<u>147,272</u>	<u>147,272</u>	(2)
 Total Revenues Requirement	 4,579,662	 4,526,392	
Less: Other Operating Revenue	(135,580)	(95,012)	
Interest Income	(67,199)	(67,199)	
Misc. Income	<u>(28,202)</u>	<u>(134)</u>	
 Revenue Required From Water Sales	 4,348,681	 \$ 4,364,047	
Revenue from Sales at Present Rates	<u>(4,120,296)</u>	<u>\$ (4,120,296)</u>	
 Required Revenue Increase	 228,386	 243,751	
Percentage Increase	5.54%	5.92%	

1. Average Annual Principal and Interest Payments. At the time of Staff's review, South Eastern Water had four outstanding United States Department of Agriculture, Rural Development (USDA/RD) Loans, and one Kentucky Rural Water Finance Corporation loan. In its application South Eastern Water requested recovery of the average annual principal, interest on its indebtedness based on a five-year average

⁴⁰ 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).

of the annual principal, and interest and fee payments for the years 2022 through 2026.⁴¹

Staff agrees with the methodology South Eastern Water proposes. As shown below, Staff calculated an Average Principal and Interest Payment of \$736,361.

2022-2026 Five-Year Average of Debt Payments											
Year	2004 RD Loan		2006 RD Loan		2011 RD Loan		2015 KRWFC Loan		2020 RD Loan		Total
	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	
2022	\$38,567	\$63,169	\$53,018	\$96,946	\$81,631	\$79,168	\$ 150,000	\$77,047	\$ 46,719	\$49,691	\$ 735,956
2023	40,348	61,388	55,385	94,579	83,600	77,199	155,000	72,473	47,595	48,814	736,381
2024	42,038	59,698	57,857	92,107	85,402	75,397	160,000	67,748	48,487	47,922	736,656
2025	44,152	57,584	60,440	89,524	87,676	73,123	165,000	62,873	49,396	47,013	736,781
2026	46,191	55,545	63,138	86,826	89,790	71,009	170,000	57,125	50,323	46,086	736,033
Totals	211,296	297,384	289,839	459,981	428,100	375,896	800,000	337,266	242,520	239,526	3,681,807
Divide by: 5 years											5
Average Annual Interest Payment											<u>736,361</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. South Eastern Water requested recovery of an allowance for working capital that is equal to 120 percent of its average annual debt payments for its bond payable to the USDA/RD, the Kentucky Infrastructure Authority, and Kentucky Rural Water Finance Corporation at the time of its application.

USDA/RD requires that South Eastern Water 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 South Eastern Water's methodology. Therefore, \$147,272 is included it in the revenue requirement.

⁴¹ Application, Attachment 5, Table B Debt Service Schedule.

Average Annual Principal and Interest	\$	736,361
Times: DSC Coverage Ratio		<u>120%</u>
Total Net Revenues Required		883,633
Less: Average Annual Principal and Interest Payments		<u>(736,361)</u>
Additional Working Capital	\$	<u><u>147,272</u></u>

Signatures

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

Prepared by: Sam Reid
Rate Design Branch
Division of Financial Analysis

APPENDIX

APPENDIX TO A STAFF REPORT OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2021-00126 DATED JUN 14 2021

Monthly Water Rates

5/8 x 3/4-Inch Meter

First	2,000	Gallons	\$ 27.38	Minimum bill
All Over	2,000	Gallons	0.01187	per Gallon

1-Inch Meter

First	5,000	Gallons	\$ 62.97	Minimum bill
All Over	5,000	Gallons	0.01187	per Gallon

1 1/2-Inch Meter

First	10,000	Gallons	\$ 122.31	Minimum bill
All Over	10,000	Gallons	0.01187	per Gallon

2-Inch Meter

First	20,000	Gallons	\$ 240.97	Minimum bill
All Over	20,000	Gallons	0.01187	per Gallon

3-Inch Meter

First	30,000	Gallons	\$ 359.63	Minimum bill
All Over	30,000	Gallons	0.01187	per Gallon

4-Inch Meter

First	50,000	Gallons	\$ 596.96	Minimum bill
All Over	50,000	Gallons	0.01187	per Gallon

6-Inch Meter

First	100,000	Gallons	\$1,190.28	Minimum bill
All Over	100,000	Gallons	0.01187	per Gallon

Wholesale Rate 0.00391 per Gallon

NON-RECURRING CHARGES

Returned Check Fee	\$0.00
Meter Test Request Charge	\$0.00
Reconnection Charge	\$0.00
Service Charge	\$0.00

*Alan Vilines
Kentucky Rural Water Association
Post Office Box 1424
1151 Old Porter Pike
Bowling Green, KENTUCKY 42102-1424

*Morris Vaughn
Manager
South Eastern Water Association, Inc.
147 East Somerset Church Road
Somerset, KY 42503

*South Eastern Water Association, Inc.
147 East Somerset Church Road
Somerset, KY 42503