

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF ADAIR)	CASE NO.
COUNTY WATER DISTRICT FOR AN)	2021-00315
ALTERNATIVE RATE ADJUSTMENT)	

NOTICE OF FILING OF COMMISSION STAFF REPORT

Notice is hereby given that, in accordance with the Commission's Order of September 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 September 23, 2021 Order, Adair County Water District (Adair District) is required to file written comments regarding the findings of Commission Staff no later than 14 days from the date of this report. The Commission directs Adair District to the Commission's July 22, 2021 Order in Case No. 2020-00085¹ regarding filings with the Commission.



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

DATED DEC 16 2021

cc: Parties of Record

¹ Case No. 2020-00085, *Electronic Emergency Docket Related to the Novel Coronavirus COVID-19* (Ky. PSC July 22, 2021), Order (in which the Commission ordered that for case filings made on and after March 16, 2020, filers are NOT required to file the original physical copies of the filings required by 807 KAR 5:001, Section 8).

STAFF REPORT
ON
ADAIR COUNTY WATER DISTRICT
CASE NO. 2021-00315

Adair County Water District (Adair 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 7,556 residential customers, and 395 commercial customers that reside in Adair County, Kentucky.¹ On September 2, 2021, Adair District filed an application with the Commission requesting to adjust its water rates pursuant to 807 KAR 5:076. The application was filed pursuant to the Commission's Order in Case No. 2020-00308.² To ensure the orderly review of the application, the Commission established a procedural schedule by Order dated September 23, 2021. Staff issued its first round of formal discovery on October 6, 2021, and a second round of formal discovery on November 5, 2021.

The Commission notes that in its 2020 Annual Report, Adair District reported a water loss of 13.08 percent.³ Commission regulation 807 KAR 5:066(6)(3) states that for ratemaking purposes a utility's water loss shall not exceed 15 percent of total water

¹ *Annual Report of Adair District to the Public Service Commission for the Calendar Year Ended December 31, 2020* (2020 Annual Report) at 12 and 49.

² Case No. 2020-00308, *Electronic Application of the Adair County Water District for a Certificate of Public Convenience and Necessity to Construct a System Improvements Project and an Order Approving a Change in Rates and Authorizing the Issuance of Securities Pursuant To KRS 278.023* (filed May 14, 2020) at 9, ordering paragraph 16.

³ 2020 Annual Report at 57 and 58.

produced and purchased, excluding water consumed by a utility in its own operations. At a 13.08 percent water loss, the annual cost to Adair District is \$39,128.⁴

To comply with the requirements of 807 KAR 5:076, Section 9,⁵ Adair District used the calendar year ended December 31, 2020, as the basis for its application. Using its pro forma test-year operations, Adair District determined that a revenue increase of \$216,705, or 5.34 percent, over test-year normalized revenues of \$4,055,131 was warranted,⁶ as shown in the table below. The rates requested by Adair District would increase the residential monthly bill of a typical residential customer using 3,830 gallons per month⁷ by \$2.12 from \$39.71⁸ to \$41.83 or approximately 5.34 percent.⁹

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	Purchased <u>Power</u>	<u>Chemicals</u>
Pro Forma Expenses	\$ 120,769	\$ 178,360
Times: Total Water loss	13.0807%	13.0807%
Excess Water Loss Reductions	<u>\$ 15,797</u>	<u>\$ 23,331</u>
Total		<u><u>\$ 39,128</u></u>

⁵ The reasonableness of the proposed rates shall be determined using a 12-month historical test period, adjusted for known and measurable changes, that coincides with the reporting period of the applicant's annual report for the immediate past year.

⁶ Application, Exhibit D, Revenue Requirements Calculation.

⁷ Application, Exhibit K.

⁸ First 1,000 gallons at \$19.90; Next 4,000 gallons at \$7.00 $((2,830/1000) \times \$7.00) = \$19.90 + \$19.81$ for a typical residential bill of \$39.71.

⁹ Application, Exhibit K.

	<u>Adair County Water District</u>
Pro Forma Operating Expenses	\$ 2,745,162
Plus: Avg. Annual Principal and Interest Payments	1,450,304
Debt Coverage Requirement	<u>290,061</u>
Overall Revenue Requirement	4,485,527
Less: Other Operating Revenue	(190,641)
Miscellaneous Service Revenue	-
Interest Income	<u>(23,050)</u>
Revenue Required From Water Sales	4,271,836
Revenue from Sales at Present Rates	<u>(4,055,131)</u>
Required Revenue Increase	<u>216,705</u>
Percentage Increase	5.34%

To determine the reasonableness of the rates requested by Adair District, Staff performed a limited financial review of Adair 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 measurable¹⁰ 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.

¹⁰ 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).

Staff's findings are summarized in this report. William Foley reviewed the calculation of Adair District's Overall Revenue Requirement. Sam Reid reviewed Adair 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 Adair District's required revenue from water sales is \$5,248,767 to meet the Overall Revenue Requirement of \$5,398,095 and that a \$1,199,636 revenue increase, or 29.44 percent, to pro forma present rate revenues is necessary to generate the Overall Revenue Requirement.

2. Monthly Water Service Rates. Based upon the revenue requirement, Adair District proposed to increase all of its monthly retail water service rates evenly across the board. Adair District did not perform a cost of service study (COSS). In response to Commission Staff's First Request for Information, Adair 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.¹¹

The Commission has previously found that the allocation of a revenue adjustment 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

¹¹ Adair County District's Response to Commission Staff's First Request for Information (filed Oct. 20, 2021) (Response to Staff's First Request), Item 10.b.

proposed by Adair District and allocated the \$1,193,636 revenue increase across the board to Adair District's monthly retail water service rates.

The rates set forth in the Appendix to this report are based upon the revenue requirement, as calculated by Staff, and will produce sufficient revenues from water sales to recover the \$5,248,767 Revenue Required from Water Sales, an approximate 29.44 percent increase. These rates will increase a typical residential customer's monthly water bill from \$39.71 to \$51.40, an increase of \$11.69, or approximately 29.44 percent.¹²

3. Nonrecurring Charges. Following the Commission's recent decisions,¹³ Staff has reviewed Adair 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 eliminated from the charges. In response to Staff's First Request, Adair District referenced the case in which the rates were approved for the Nonrecurring Charges that are listed in its tariff.¹⁴ Staff reviewed the cost justification information provided by Adair District and have adjusted these charges by removing Field Labor Costs and

¹² The typical residential customer uses approximately 3,830 gallons per month.

¹³ Case No. 2020-00141, *Electronic Application of Hyden-Leslie County Water District for an Alternative Rate Adjustment* (Ky. PSC Nov. 6, 2020), 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).

¹⁴ Case No. 2008-00474, *Application of Adair County Water District to Revise Certain Nonrecurring Charges* (Ky. PSC Sept. 25, 2009).

Office/Clerical Labor Costs. Such adjustments result in the following revised Nonrecurring Charges:

<u>Nonrecurring Charges</u>		
	<u>Normal Hours</u>	<u>After Hours</u>
Connection/Turn on Charge	\$ 12.88	\$ 30.98
Meter Re-Read Charge	12.88	30.98
Meter Test Charge	12.88	
Re-Connection	12.88	30.98
Service Call/ Investigation	12.88	30.98
Meter Reading Re-Check Charge	12.88	30.98
Return Check Charge	6.60	

The adjustments to the Nonrecurring Charges results in a decrease in Other Operating Revenue of \$18,463 as shown below.

<u>Charges</u>	<u>Number of Occurrences</u>	<u>Utility Pro Forma</u>	<u>Adjustment</u>	<u>Staff Pro Forma</u>
Returned Check Fee	33	\$ 825	\$ (607)	\$ 218
Connection/Turn on Charge	954	28,620	(16,332)	12,288
Re-Connection	89	2,670	(1,524)	1,146
Totals		<u>\$ 32,115</u>	<u>\$ (18,463)</u>	<u>\$ 13,652</u>

PRO FORMA OPERATING STATEMENT

Adair District's Pro Forma Operating Statement for the test year ended December 31, 2020, as determined by Staff, appears below.

	Test Year	Adjustment	(Ref.)	Pro Forma
Operating Revenues				
Total Metered Sales	\$ 3,783,548	271,583	(A)	\$ 4,055,131
Other Water Revenues				
Miscellaneous Service Revenues	64,404	80,337	(B)	
Rents from Water Property		(18,463)	(C)	126,278
Other Water Revenues				
Total Operating Revenues	<u>\$ 3,847,952</u>	<u>333,457</u>		<u>\$ 4,181,409</u>
Operating Expenses				
Operation and Maintenance Expenses				
Salaries and Wages - Employees	624,947	22,434	(D)	
Salaries and Wages - Officers	119,495	(24,750)	(E)	622,631
Employee Pensions and Benefits	546,306	10,392	(F)	129,887
Purchased Water		(152,565)	(G)	
Purchased Power	196,280	(38,761)	(H)	354,980
Chemicals	178,360			196,280
Materials and Supplies	211,829			178,360
Contractual Services	10,875	(57,750)	(E)	154,079
Water Testing	15,014			10,875
Transportation Expenses	26,766			15,014
Insurance	71,663			26,766
Bad Debt	23,307			71,663
Miscellaneous Expense	399,872			23,307
Total Operation and Maintenance Expenses	<u>2,424,714</u>	<u>(241,000)</u>		<u>2,183,714</u>
Depreciation	1,444,896	(39,307)	(I)	
Amortization		1,941	(J)	1,407,530
Taxes Other Than Income		63,834	(K)	63,834
Income Tax Expense				
Utility Operating Expenses	<u>3,869,610</u>	<u>(214,532)</u>		<u>3,655,078</u>
Utility Operating Income	(21,658)	547,989		526,331
Income Available to Service Debt	<u>(21,658)</u>	<u>547,989</u>		<u>526,331</u>

(A) Billing Analysis. In its application, Adair District proposed an adjustment to increase test year revenues by \$271,583.¹⁵ The adjustment normalizes sales revenues due to an increase in rates approved in Case No. 2020-00308.¹⁶ Staff finds that Adair District's proposed adjustment is appropriate and accepts the adjustment.

(B) Miscellaneous Service Revenues- Late Payment Fees. In its application, Adair District proposed to increase Late Payment Fees Revenues by \$126,237¹⁷ to account for the moratorium regarding the collection of late payment fees from March through December 2020 due to the COVID-19 pandemic. For this adjustment, Adair District decided to increase the test year miscellaneous service revenues to the average amount as the late payment fees recorded for 2017, 2018, and 2019. Staff disagrees with Adair District's decision to use the past three-year's miscellaneous service revenues average as the benchmark. Staff instead averaged the past three-year's late payment fees to provide a more accurate estimation for the test-year late payment fees.¹⁸ Therefore, Staff increased Miscellaneous Service Revenues by \$80,337 as calculated in the table below.

¹⁵ Application, Exhibit C, Schedule of Adjusted Operations - Water Utility, Adjustment A

¹⁶ Case No. 2020-00308, *Electronic Application of the Adair County Water District for a Certificate of Public Convenience and Necessity to Construct a System Improvements Project and an Order Approving a Change in Rates and Authorizing the Issuance of Securities Pursuant To KRS 278.023* (filed May 14, 2020), at 9, ordering paragraph 16.

¹⁷ Application, Statement of Adjusted Operations, Adjustment B.

¹⁸ Adair District's Response to Commission Staff's Second Request for Information (filed Nov. 18, 2021) (Response to Staff's Second Request).

Year	Late Payment Fees
2017	\$ 105,462
2018	107,506
2019	104,815
Average Late Payment Fees Collected	105,928
Less: Test Year Late Payment Fees	<u>(25,590)</u>
Late Payment Fees Adjustment	<u>\$ 80,337</u>

(C) Miscellaneous Service Revenues - Nonrecurring Charges. As shown above, the adjustments to the Nonrecurring Charges results in a decrease in Other Operating Revenue of \$18,463.

(D) Salaries and Wages - Employees. In its application, Adair District proposed an adjustment to decrease Salaries and Wages - Employees Expense by \$36,238.¹⁹ The adjustment was proposed to account for increases in the Employee Salaries, and the change in the number of full-time employees subsequent to the test year.²⁰

Adair District has a total staff of 24 hourly and 7 salaried employees between the water and sewer divisions. Adair District has 16 hourly employees who perform tasks exclusive to the water division, 4 who perform tasks exclusively for the sewer division, and 2 (Office Manager and a Customer Service Representative) who perform tasks for both water and sewer divisions. Discussions with an Adair District employee revealed Adair District currently allocates the 2 hourly employees' wages based on a time allocation study performed when Adair District merged with the existing utility. The study

¹⁹ Application, Statement of Adjusted Operations, Adjustment C.

²⁰ *Id.*, Exhibit C.1.

looked at the tasks the 2 employees performed and determined what percentage of tasks performed for the water division and which were for the sewer division.

Adair District is unable to provide the time allocation study and reported it has gone missing. Staff recommends the Commission to accept the allocation methodology for hourly employees. Staff also recommends that the Commission order Adair District to complete an updated time allocation study and supply it with the next rate case.

Staff used the information available to calculate Salaries and Wages - Employees expense as \$647,381. Therefore, Staff made an increase to Salaries and Wages - Employees of \$22,434 as shown below.

Employee Position	Test Year Total Hours	Test Year Salary Hours	Current Wages Rate	Test Year Normal Wages	Test Year Overtime Hours	Test Year Overtime/Bonus Rate	Test Year Overtime Wages	Total Pro Forma Wages	Percent Water Allocation	Water Pro Forma Wages
Field Supervisor	2,282	2,080	23	46,987	201.5	\$ 33.89	6,828	53,815	100%	53,815
Chief WP Operator		Salary	62,500	62,500			-	62,500	100%	62,500
Office Manager	2,081	2,080	26	53,560	1.2	38.63	47	53,607	81%	43,422
DW Op Class III	2,282	2,080	17	35,880	202.0	25.88	5,227	41,107	100%	41,107
DW OP Class III/ Collection Op Clas II	2,227	2,080	20	41,600	146.5	30.00	4,395	45,995	100%	45,995
WP Operator Class IVA	2,127	2,080	20	41,600	47.0	30.00	1,410	43,010	100%	43,010
WP Operator Class IVA	2,114	2,080	18	37,440	34.0	27.00	918	38,358	100%	38,358
WP Operator Class IIIA	2,165	2,080	17	35,360	85.0	25.50	2,168	37,528	100%	37,528
DW Operator in Training	2,297	2,080	13	27,040	217.0	19.50	4,232	31,272	100%	31,272
DW Operator in Training	2,125	2,080	12	24,960	45.0	18.00	810	25,770	100%	25,770
DW Operator in Training	2,122	2,080	12	24,960	41.5	18.00	747	25,707	100%	25,707
WP Operator Class IVA	2,080	2,080	16	33,280	-	24.00	-	33,280	100%	33,280
Customer Service Representative	2,080	2,080	10	20,800	-	15.00	-	20,800	100%	20,800
Customer Service Representative	2,082	2,080	16	33,280	2.2	24.00	53	33,333	88%	29,333
Customer Service Representative	2,081	2,080	16	33,280	0.5	24.00	12	33,292	100%	33,292
DW Operator in Training	2,080	2,080	10	20,800	-	15.00	-	20,800	100%	20,800
Customer Service Representative	2,081	2,080	16	33,280	1.0	24.00	24	33,304	100%	33,304
Customer Service Representative	2,081	2,080	13.50	28,080	0.5	20.25	10	28,090	100%	28,090
								Total Pro Forma Wages		647,381
								Less: Test Year Wages		(624,947)
								Pro Forma Adjustment		<u>22,434</u>

(E) Expenses Related to Meter Installations. During the test year, Adair District installed 121 new water connections.²¹ Adair District reported \$82,500 for the installation

²¹ Response to Staff's First Request, Item 6.

of new water tap fees.²² Adair District included the labor and materials used for setting meters in the salaries and expenses,²³ and did not separate the costs between labor and materials.²⁴ The Uniform System of Accounts for Class A/B Water Systems (USoA) requires that these costs be capitalized as Utility Plant in Service and depreciated over their estimated useful lives.²⁵ Therefore, Staff calculated that Salaries and Wages-Employees and Materials and Supplies should be reduced by \$24,750 and \$57,104, respectively, as shown below. In addition, Staff has capitalized the costs and made a corresponding adjustment to test-year depreciation as shown in adjustment (J).

Total amount collected for Water Taps	\$ 82,500
Times: 30% labor	24,750
Times: 70% Materials	57,750

(F) Salaries and Wages - Officers. During the test year, Adair District reported Salaries and Wages- Officers of \$119,495²⁶ and paid each of its commissioners \$1,800 per year.²⁷ Adair District included the attorney's and general manager's salaries and the General Manager's \$1,803 Water Bonus in Salaries and Wages- Officers. Adair District has four departments: County Water, City Water, Sewer, and Water Plant. County Water, City Water, and Water Plant are merged and classified as part of the water division, while Sewer is classified as part of the sewer division. Adair District currently allocates 25

²² *Id.*, Item 1b.

²³ Response to Staff's Second Request, Item 3.

²⁴ Response to Staff's First Request, Item 7.

²⁵ USoA, Accounting Instruction 19 and 33.

²⁶ Application, Exhibit C, Schedule of Adjusted Operations - Water Utility.

²⁷ *Id.*, Wages_Calculations-PSC_Filings.xlsx.

percent of commissioner wages, general manager salary, attorney salary, and bonuses to each department. Therefore, Adair District allocates 75 percent of Officer's Salaries to water and 25 percent to sewer. Staff disagrees with this methodology and proposes using the number of customer allocation factor.²⁸

Staff calculated test year Employee Salaries and Wages - Officers for the water division to be \$129,887. Therefore, Staff increased Salaries and Wages – Officers by \$10,392 as shown below.

<u>Commissioners</u>	<u>Test Year Salaries</u>	<u>Percent Allocated</u>	<u>Allocation to Water</u>
General Manager	\$ 125,000	82%	\$ 102,500
General Manager's Bonus	1,803	100%	1,803
Attorney	22,200	82%	18,204
William Harris	1,800	82%	1,476
David Jones	1,800	82%	1,476
Richard Grant	1,800	82%	1,476
Junior Brown	1,800	82%	1,476
Joseph Pyles	1,800	82%	1,476
	Total		129,887
	Less: Test Year Salaries		<u>(119,495)</u>
	Adjustment		<u><u>10,392</u></u>

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	<u>Number of Customers</u>	<u>Percent Allocation</u>
Water Customers	7,966	82%
Sewer Customers	<u>1,739</u>	<u>18%</u>
Total Customers	9,705	100%

(G) Employee Pensions and Benefits- Retirement Contributions. In its application, Adair District proposed a net adjustment decreasing Employee Pension and Benefits by \$18,248, which is partially due to an increase of \$33,113 for Retirement Increase.²⁹ The increase to retirement contributions is to account for the increased contribution rate, subsequent to the test year, from 24.06 percent to 26.95 percent.³⁰

Staff calculated the retirement contributions amount by combining the Pro Forma Salaries and Wages Expense with the General Manager’s and Accountant’s salaries, then multiplying by the new contribution rate of 26.95 percent. As shown below Staff calculated a Pro Forma Retirement contribution of \$200,329. Therefore, Staff made an adjustment reducing Employee Pensions and Benefits by \$152,565.

Salaries and Wages	\$ 743,335
Times: Contribution percentage	<u>26.95%</u>
Retirement contribution	200,329
Less: Test year Retirement Contribution	<u>(352,894)</u>
Employee Pensions and Benefits adjustment	<u><u>(152,565)</u></u>

(H) Employee Pensions and Benefits- Insurance Premiums. In its application, Adair District proposed a decrease to its Employee Pensions and Benefits by \$47,575 for Health insurance premiums and \$3,785 for dental insurance premiums.³¹ The adjustment reflects Adair District’s limit for employer’s contribution to employee health insurance expenses adjustment to the insurance, as well as the fact that subsequent to the test

²⁹ *Id.*, Statement of Adjusted Operations, Adjustment D.

³⁰ Application, Exhibit C.3.

³¹ *Id.*, Statement of Adjusted Operations, Adjustment D.

year, Adair District is paying a portion of the new full time employee's health, life, and disability insurance. Adair Currently pays employees 100 percent of a single Health insurance plan of \$871 per month.

The 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. The Commission has found that, in most cases, 100 percent of employer-funded health care does not meet those criteria.³²

Staff agrees with Adair District's methodology. However, Staff disagrees with Adair District's proposed adjustment. 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 Adair District's single health insurance premiums by 22 percent,³³ and dental insurance premiums by 40 percent³⁴ as shown in the calculation below. Accordingly, Staff decreased Employee Pensions and Benefits by a net of \$38,761.

³² Case No. 2020-00167, *Electronic Application of Ohio County Water District for an Alternative Rate Adjustment* (Ky. PSC Dec. 3, 2020). Case No. 2020-00296, *Electronic Application of Allen County Water District for an Alternative Rate Adjustment* (Ky. PSC Feb. 3, 2021).

³³ Bureau of Labor Statistics, Healthcare Benefits, March 2020, Table 3, private industry workers. (<https://www.bls.gov/news.release/pdf/ebs2.pdf>).

³⁴ Case No. 2019-00268, *Application of Knott County Water and Sewer District for an Alternative Rate Adjustment* (Ky. PSC Mar. 24, 2020). Case No. 2020-00167, *Electronic Application of Ohio County Water District for an Alternative Rate Adjustment* (Ky. PSC Mar. 5, 2021). Case No. 2020-00296, *Electronic Application of Allen County Water District for an Alternative Rate Adjustment* (Ky. PSC Feb. 3, 2021).

Type of Premium	Employer Contributions	Average Employee Contribution Rate	Monthly Premium Adjustment	Pro Forma Monthly Premium
Single Health Insurance ³⁵	\$ 16,122	22%	\$ (3,547)	\$ 12,575.00
Dental Insurance ³⁶	521	40%	(208)	313
Total Pro Forma Monthly Premium				12,888
Times: 12 Months				<u>12</u>
Total Annual Pro Forma Premium				154,651
Less: Test Year				<u>(193,412)</u>
Adjustment				<u>\$ (38,761)</u>

Depreciation. In its application, Adair District proposed to reduce its test year Depreciation expense of \$1,444,896 by \$1,069,962.³⁷ The adjustment is to reflect an adjustment to the service lifetimes according to the report published in 1979 by the National Association of Regulatory Utility Commissioners (NARUC) titled *Depreciation Practices for Small Water Utilities* (NARUC Study). The proposed adjustment also adds to the depreciation schedule facilities added as a result of a Rural Development (RD) funded project. The adjustment would reduce Depreciation expense by \$320,094 to \$1,124,802. Adair District proposed to phase in the depreciation expense over three years and requested to include one third of the annual depreciation expense of \$374,934

³⁵ 16x Employees at \$871 each + General Manager (871 * 81%) + Office Manager (\$871 * 81%) + Customer Service Representative (\$871 * 88%) = \$16,114.

³⁶ 16x Employees at \$28 each + General Manager (28 * 81%) + Office Manager (\$282 * 81%) + CSR (\$28 * 88%) = \$520.

³⁷ Application, Exhibit C, Schedule of Adjusted Operation, Adjustment E.

in the revenues requirement.³⁸ Adair District proposes this gradual increase in rates would give the poorest customers time to adjust to the rate changes.³⁹

Staff agrees with Adair District's initial adjustment methodology for depreciation, by using the NARUC Study; however, Staff disagrees with Adair District's calculation. Staff recalculated the totals when applying the useful lives from the NARUC Study. Staff's adjustment reduced test-year depreciation to \$1,405,589, a reduction of \$39,307 as shown in the table below. Staff also disagrees with the one-third phasing in of Depreciation Expense as proposed by Adair District. Limiting Depreciation Expense to one-third would not allow adequate working capital to fund operations and future plant replacements. Therefore, Staff is including the full amount in depreciation expense into the revenue requirement.

Pro Forma Depreciation Expense	1,388,319
Plus: New Assets added subsequent to Test Year	<u>17,269</u>
Final Pro Forma Adjusted Depreciation	1,405,589
Less: Test Year Depreciation Expense	<u>(1,444,896)</u>
Depreciation Expense Adjustment	<u>\$ (39,307)</u>

(I) Capitalization of Test-Year Water Taps. As explained in adjustment (E) above, the expenses related to the installation of new water connections are capital expenditures that should be capitalized as Utility Plant in Service and depreciated over

³⁸ \$1,124,802 / 3 years = \$374,934.

³⁹ Application, Exhibit C, Schedule of Adjusted Operation, Adjustment E.

their estimated useful lives. Therefore, Staff calculated the annual depreciation amount for the test year and increased depreciation expense by \$1,941 as shown below.

Labor Expense Associated with Tap Ons	\$(24,750)
Materials and Supplies Expense Associated with Tap Ons	<u>(57,750)</u>
Test Year Tap On Expenses	82,500
Divided by: Useful Life of 42.5 Years	<u>42.50</u>
Pro Forma Depreciation Adjustment	<u><u>\$ 1,941</u></u>

(J) Taxes Other Than Income. In its application, Adair District did not include Taxes other Than Income in the Revenue Requirement calculation.⁴⁰ Staff utilized the Salaries and Wages - Employee expense from adjustments (D) and (E) above and the Officer's allocated Salaries from Salaries and Wages - Officers to calculate the FICA tax expense of \$57,568, as shown below. In addition to FICA tax, Taxes Other Than Income included account #10.10.80.667100, PSC Assessment, of \$6,266.⁴¹ Therefore, Staff calculated a net increase to Taxes Other Than Income of \$63,834.

<u>Taxes other Than Income</u>	
Pro Forma Salaries and Wages- Employees	\$ 622,631
Pro Forma Salaries and Wages- Officers	<u>129,887</u>
Total Pro Forma Salaries	752,518
Times: 7.65 Percent FICA Rate	<u>7.65%</u>
FICA Tax Expense	57,568
Plus: PSC Assessment Fee	<u>6,266</u>
Taxes other Than Income adjustment	<u><u>\$ 63,834</u></u>

⁴⁰ Application, Statement of Adjusted Operations.

⁴¹ Response to Staff's First Request, Item 1b.

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

	<u>Adair County Water District</u>	<u>Staff</u>	
Pro Forma Operating Expenses	\$ 2,745,162	\$ 3,655,078	
Plus: Avg. Annual Principal and Interest Payments	1,450,304	1,452,514	(1)
Debt Coverage Requirement	<u>290,061</u>	<u>290,503</u>	(2)
Overall Revenue Requirement	4,485,527	5,398,095	
Less: Other Operating Revenue	(190,641)	(126,278)	
Miscellaneous Service Revenue	-		
Interest Income	<u>(23,050)</u>	<u>(23,050)</u>	
Revenue Required From Water Sales	4,271,836	5,248,767	
Revenue from Sales at Present Rates	<u>(4,055,131)</u>	<u>\$ (4,055,131)</u>	
Required Revenue Increase	<u>216,705</u>	<u>1,193,636</u>	
Percentage Increase	5.34%	29.44%	

⁴² The Kentucky Supreme Court has held that the Commission must permit a water district to recover its depreciation expense through its rates for service to provide internal funds for renewing and replacing assets. See *Public Serv. Comm'n of Kentucky v. Dewitt Water Dist.*, 720 S.W.2d 725, 728 (Ky. 1986). Although a water district's lenders require that a small portion of the depreciation funds be deposited annually into a debt reserve/depreciation fund until the account's balance accumulates to a required threshold, neither the Commission nor the Court requires that revenues collected for depreciation be accounted for separately from the water district's general funds or that depreciation funds be used only for asset renewal and replacement. The Commission has recognized that the working capital provided through recovery of depreciation expense may be used for purposes other than renewal and replacement of assets. See Case No. 2012-00309, *Application of Southern Water and Sewer District for an Adjustment in Rates Pursuant to the Alternative Rate Filing Procedure for Small Utilities* (Ky. PSC Dec. 21, 2012).

1. Average Annual Principal and Interest Payments. At the time of Staff's review, Adair District had seven outstanding loans from the Kentucky Infrastructure Authority (KIA), four bonds with RD, and two loans with Kentucky Rural Water Finance Corporation (KRWFC). In its application, Adair District requested recovery of the average annual principal and interest on its indebtedness based on a five-year average of the annual principal, and interest and fee payments for the years 2022 through 2026.⁴³ Staff agrees with the methodology Adair District proposes, but calculated a different amount. As shown in Appendix B, Staff calculated an Average Principal and Interest.

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. In its application, Adair District requested recovery of an allowance for working capital that is equal to 120 percent of its average annual debt payments for its loan payable to KIA at the time of its application.

USDA/RD requires that Adair 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 Adair District's revised methodology. Therefore, \$290,503 is included it in the revenue requirement.

⁴³ Application, Exhibit D.1, and Debt_Details.xlsx.

Average Annual Principal and Interest	\$	1,452,514
Times: DSC Coverage Ratio		<u>120%</u>
Total Net Revenues Required		1,743,017
Less: Average Annual Principal and Interest		<u>(1,452,514)</u>
Additional Working Capital	\$	<u><u>290,503</u></u>

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Signatures

/s/ William Foley

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

/s/ Sam Reid

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

APPENDIX A

APPENDIX TO A STAFF REPORT OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2021-00315 DATED DEC 16 2021

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

Monthly Water Rates

5/8- x 3/4-Inch Meter

First 1,000 Gallons	\$ 25.76 Minimum Bill
Next 4,000 Gallons	0.00906 Per gallon
Next 5,000 Gallons	0.00809 Per gallon
Next 15,000 Gallons	0.00673 Per gallon
Over 25,000 Gallons	0.00576 Per gallon

1-Inch Meter

First 5,000 Gallons	\$ 62.00 Minimum Bill
Next 5,000 Gallons	0.00809 Per gallon
Next 15,000 Gallons	0.00673 Per gallon
Over 25,000 Gallons	0.00576 Per gallon

1 1/2-Inch Meter

First 10,000 Gallons	\$ 102.46 Minimum Bill
Next 15,000 Gallons	0.00673 Per gallon
Over 10,000 Gallons	0.00576 Per gallon

2-Inch Meter

First 16,000 Gallons	\$ 142.84 Minimum Bill
Next 9,000 Gallons	0.00673 Per gallon
Over 25,000 Gallons	0.00576 Per gallon

Wholesale Rate

City of Edmonton	0.00292 Per gallon
Green Taylor WD	0.00324 Per gallon
East Casey WD	0.00324 Per gallon

Nonrecurring Charges

Connection/Turn-On Charge	\$ 12.88
Connection/Turn-On Charge (After Hours)	30.98
Meter Re-read Charge	12.88
Meter Re-read Charge (After Hours)	30.98
Meter Test Charge	12.88
Reconnection Charge	12.88
Reconnection Charge (After Hours)	30.98
Return Check Charge	6.60
Service Call/ Investigation Charge	12.88
Service Call/ Investigation Charge (After Hours)	30.98
Meter Reading Re-Check Charge	12.88
Meter Reading Re-Check Charge (After Hours)	30.98

APPENDIX B
APPENDIX TO A STAFF REPORT OF THE KENTUCKY PUBLIC SERVICE COMMISSION
IN CASE NO. 2021-00315 DATED DEC 16 2021

Year	F06-01 ¹		F07-01 ²		F10-01 ³		F10-02 ⁴		F11-10 ⁵		F12-04 ⁶		F20-009 ⁷	
	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest
2022	234,949	15,113	51,691	3,600	198,676	22,488	84,560	9,103	26,845	6,839	76,051	16,861	12,460	2,014
2023	237,304	12,758	52,209	3,082	200,668	20,496	85,408	8,255	27,114	6,569	76,623	16,290	25,014	3,934
2024	239,683	10,379	52,733	2,559	202,680	18,485	86,264	7,399	27,386	6,298	77,198	15,714	25,139	3,809
2025	242,086	7,976	53,261	2,030	204,711	16,453	87,129	6,534	27,660	6,023	77,779	15,134	25,265	3,683
2026	244,513	5,549	53,795	1,496	206,764	14,400	88,002	5,661	27,938	5,746	78,363	14,549	25,392	3,557
Totals	1,198,534	51,775	263,689	12,766	1,013,499	92,322	431,363	36,952	136,942	31,474	386,014	78,547	113,271	16,996
	91-22 ⁸		91-24 ⁹		91-45 ¹⁰		93-51 ¹¹		2013 D ¹¹		2020G ¹²		Total	
	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest		
	21,400	21,613	28,500	30,726	24,000	30,420	37,500	13,372	144,050	55,854	156,800	137,519		\$ 1,463,003
	22,000	21,351	29,000	30,663	24,500	29,693	38,000	13,118	140,700	49,660	156,800	133,991		1,465,198
	22,600	20,822	29,500	30,599	25,000	28,950	38,500	12,860	144,050	43,609	161,700	130,463		1,464,376
	23,200	20,278	30,500	30,535	25,500	28,193	39,000	12,598	150,750	37,415	161,700	126,824		1,462,216
	23,900	19,718	31,000	30,470	26,500	27,413	39,500	12,334	100,500	30,933	166,600	123,186		1,407,777
	113,100	103,782	148,500	152,993	125,500	144,668	192,500	64,280	680,050	217,471	803,600	651,982		7,262,570
											Divide by: 5 years			5
											Average Annual Interest Payment			<u>\$ 1,452,514</u>

¹ Case No. 2010-00361, *Application of Adair County Water District to Assume Certain Securities in the Outstanding Principal Amount of \$2,236,343 Pursuant to the Provisions of KRS 278.300 and 807 KAR 5:001* (Ky. PSC Oct. 7, 2010).

² Case No. 2007-00473, *Petition of Adair County Water District for approval of Loan to District from the Kentucky Infrastructure Authority* (Ky. PSC Dec. 12, 2007).

³ Case No. 2017-00127, *807 KAR 5:006, Section 14(b)(1)* (Ky. PSC Oct. 12, 2017).

⁴ Case No. 2010-00361, *Application of Adair County Water District to Assume Certain Securities in the Outstanding Principal Amount of \$2,236,343 Pursuant to the Provisions of KRS 278.300 and 807 KAR 5:001* (Ky. PSC Oct. 7, 2010).

⁵ Case No. 2013-00095, *Application of Adair County Water District for a Certificate of Public Convenience and Necessity to Construct a Water Improvements Project Pursuant to KRS 278.020 and 807 KAR 5:001* (Ky. PSC May 14, 2013).

⁶ Case 2014-00020, *Application of the Adair County Water District for a Certificate of Public Convenience and Necessity to Construct a Water Improvements Project and to Issue Securities in the Approximate Amount of \$1,085,000 to Finance Said Project Pursuant to KRS 278.020 and 278.300*, (Ky. PSC March 4, 2014).

⁷ Case 2021-00176, *Electronic Application of the Adair County Water District For The Issuance of a Certificate of Public Convenience and Necessity to Construct a Water System Improvements Project and an order Authorizing the Issuance of Securities Pursuant To The Provisions of KRS 278.020, KRS 278.300 and 807 KAR 5:001*, (Ky. PSC June 10, 2021).

⁸ Case 2009-00320, *The Application of Adair County Water District for a Certificate of Public Convenience and Necessity to Construct Water Distribution System Improvements and the Approval of the Proposed Plan of Financing Improvements* (Ky. PSC August 28, 2009).

⁹ Case 2012-00018, *Application of the Adair County Water District, a Water District Organized Pursuant To Chapter 74 of the Kentucky Revised Statutes in Adair County, Kentucky for (1) A Certificate of Public Convenience and Necessity Authorizing and Permitting Said Water District to Construct Water Distribution System Improvements, (2) Approval of the District's Plan of Financing Said Improvements Through the Issuance of the District's Water Revenue Bonds, and (3) The Approval of Increases in the District's Rates and Charges for Water Service* (Ky. PSC Feb. 3, 2012).

¹⁰ Case 2010-00361, *Application of Adair County Water District to Assume Certain Securities in the Outstanding Principal Amount of \$2,236,343 Pursuant to the Provisions of KRS 278.300 and 807 KAR 5:001* (Ky. PSC Oct. 7, 2010).

¹¹ Case 2020-00308, *Electronic Application of the Adair County Water District for a Certificate of Public Convenience and Necessity to Construct a System Improvements Project and an Order Approving a Change In Rates and Authorizing the Issuance of Securities Pursuant to KRS 278.023* (Ky. PSC Oct. 27, 2020).

¹² Case 2013-00169, *Application of Adair County Water District to Issue Securities in the Approximate Principal Amount of \$4,025,000 for the Purpose of Refunding Certain Outstanding Revenue Bonds of the District Pursuant to the Provisions of KRS 278.300 and 807 KAR 5:001* (Ky. PSC June 3, 2013).

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