

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF LAUREL	)	CASE NO.
COUNTY WATER DISTRICT NO. 2 FOR AN	)	2021-00385
ALTERNATIVE RATE ADJUSTMENT	)	

ORDER

On February 9, 2022,<sup>1</sup> Laurel County Water District No. 2 (Laurel District No. 2) filed its application to the Commission requesting to adjust its water rates pursuant to 807 KAR 5:076. Laurel District No. 2 filed this application in compliance with the final Order in Case No. 2020-00079.<sup>2</sup> In that proceeding Laurel District No. 2 was ordered to file an application by April 8, 2021, for either a traditional adjustment in rates or for an alternative rate adjustment (ARF) to ensure its revenue is sufficient to support adequate and reliable service. In a motion filed on February 10, 2021, Laurel District No. 2 requested a six-month extension to file its ARF application in order to allow the 2020 audit to be completed. By Commission Order dated February 25, 2021, Laurel District No. 2 was granted an extension until October 8, 2021 to submit its ARF application.

Pursuant to a procedural schedule established on February 18, 2022 and amended on May 19, 2022, Laurel District No. 2 responded to four discovery requests

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<sup>1</sup> Laurel District No. 2 tendered its application on October 7, 2021. By letter dated October 18, 2021, the Commission rejected the application for filing deficiencies. The deficiencies were subsequently cured, and the application was deemed filed on February 9, 2022.

<sup>2</sup> See Case No. 2020-00079 *Electronic Application of the Laurel County Water District No. 2 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 Apr. 8, 2020), Order at 7, ordering paragraph 16.

from Commission Staff. The Commission Staff's Report was issued on July 13, 2022, and Laurel District No. 2 filed its comments on the Commission Staff's Report on July 27, 2022.

In the Commission Staff's Report, Commission Staff found that Laurel District No. 2's adjusted test year operations support an Overall Revenue Requirement of \$3,116,164,<sup>3</sup> and an annual revenue decrease of \$184,314, or 5.88 percent to the retail base rates, is necessary.<sup>4</sup> In the absence of a cost of service study (COSS), Commission Staff allocated its recommended revenue decrease evenly across the board to calculate its recommended water rates.<sup>5</sup> Commission Staff also recommended Laurel District No. 2 include in its written responses to the Commission Staff's Report detailed explanations as to why the Commission should not require Laurel District No. 2 to implement Commission Staff's recommended water rate decrease.<sup>6</sup>

In its July 27, 2022 comments, Laurel District No. 2 took exception to Commission Staff's billing analysis adjustment, payroll tax calculation, the removal of labor costs from its nonrecurring charges, and the adjustment to require an employee contribution towards the cost of employee benefit packages (health and dental insurance benefits).<sup>7</sup> In its written comments to the Commission Staff's Report, Laurel District No. 2 included numerous reasons as to why Commission Staff's recommended rate decrease should not

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<sup>3</sup> Commission Staff's Report at 4 and 15.

<sup>4</sup> Commission Staff's Report at 15.

<sup>5</sup> Commission Staff's Report at 4.

<sup>6</sup> Commission Staff's Report at 5.

<sup>7</sup> Laurel District No. 2's Response to Commission Staff's Report (filed July 27, 2022) at unnumbered pages 1, 3, and 4.

be implemented.<sup>8</sup> Laurel District No. 2 waived its right to request an informal conference or a formal hearing, but requested the Commission consider the arguments presented in its response in rendering its decision on the proposed rates.<sup>9</sup>

### LEGAL STANDARD

Alternative rate adjustment proceedings, such as this one, are governed by 807 KAR 5:076, which establishes a simplified process for small utilities to use to request rate adjustments, with the process designed to be less costly to the utility and to its ratepayers. The Commission's standard of review of a utility's request for a rate increase is well established. In accordance with KRS 278.030 and case law, Laurel District No. 2 is allowed to charge its customers, "only 'fair, just and reasonable rates.'"<sup>10</sup> Further, Laurel District No. 2 bears the burden of proof to show that the proposed rates are fair, just and reasonable under KRS 278.190(3).

### UNACCOUNTED FOR WATER LOSS

Pursuant to 807 KAR 5:066, Section 6(3), water loss is limited to 15 percent for ratemaking purposes. Laurel District No. 2 reported a water loss of 11.29 percent in its 2020 Annual Report.<sup>11</sup> At an 11.29 percent water loss, the total annual cost of water loss to Laurel District No. 2 is \$26,081, as calculated in the table below.

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<sup>8</sup> Laurel District No. 2's Response to Commission Staff's Report (filed July 27, 2022) at unnumbered page 2.

<sup>9</sup> Laurel District No. 2's Response to Commission Staff's Report (filed July 27, 2022) at unnumbered page 2.

<sup>10</sup> *City of Covington v. Public Service Commission*, 313 S.W.2d 391 (Ky. 1958); and *Pub. Serv. Comm'n v. Com. of Kentucky v. Dewit Water District*, 720 S.W.2d 725 (Ky. 1986).

<sup>11</sup> *Annual Report of Laurel County Water District No. 2 to the Public Service Commission for the Calendar Year Ended December 31, 2020* (2020 Annual Report) at 57.

	<u>Purchased Water</u>	<u>Purchased Power</u>	<u>Chemicals</u>	<u>Total</u>
Test-Year Reported Expenses	\$ 402	\$ 164,262	\$ 66,342	\$ 231,006
Multiplied by: Test-Year Water Loss %	11.29%	11.29%	11.29%	11.29%
Total Cost of Line Loss	<u>\$ 45</u>	<u>\$ 18,545</u>	<u>\$ 7,490</u>	<u>\$ 26,081</u>

### BACKGROUND

Laurel District No. 2, a water district organized pursuant to KRS Chapter 74, provides water service to approximately 6,251 residential, commercial, and industrial customers in Knox and Laurel counties, Kentucky.<sup>12</sup> A review of the Commission's records indicated Laurel District No. 2 last sought an adjustment of rates through the ARF procedure in Case No. 2015-00341.<sup>13</sup>

### TEST PERIOD

The calendar year ending December 31, 2020, was used as the test year to determine the reasonableness of Laurel District No. 2's existing and proposed water rates as required by 807 KAR 5:076, Section 9.

### SUMMARY OF REVENUES AND EXPENSES

The Commission Staff's Report summarizes Laurel District No. 2's pro forma income statement as follows:<sup>14</sup>

	<u>Test-Year Operations</u>	<u>Commission Staff's Report Pro Forma Adjustments</u>	<u>Pro Forma Operations</u>
Operating Revenues	\$ 3,001,895	\$ 280,314	\$ 3,282,209
Operating Expenses	2,808,711	(383,081)	2,425,630
Net Utility Operating Income	<u>\$ 193,184</u>	<u>\$ 663,395</u>	<u>\$ 856,579</u>

<sup>12</sup> 2020 Annual Report at 12 and 49.

<sup>13</sup> Case No. 2015-00341, *Application of Laurel County Water District No. 2 for Rate Adjustment Pursuant To 807 KAR 5:076* (Ky. PSC Mar. 14, 2016).

<sup>14</sup> See Appendix B for a complete pro forma income statement.

COMMISSION STAFF'S FINDINGS  
AND MODIFICATIONS THEREOF

Laurel District No. 2's proposed adjustments to its revenues and expenses to reflect current and expected operating conditions. In the Commission Staff's Report, Commission Staff proposed additional pro forma adjustments. The Commission accepts the findings contained in the Commission Staff's Report as modified below.

REVENUE REQUIREMENTS

Billing Analysis. In the Commission Staff's Report, Commission Staff recommended that the Commission accept Laurel District No. 2's proposed adjustment to increase Revenue from Water Sales of \$2,851,807 by \$283,109.<sup>15</sup> In its responses to the Commission Staff's Report, Laurel District No. 2 explained that the revenue normalization adjustment is incorrect because the Commission Staff's adjustment is based on the billing analysis filed with the application and not the revised analysis that Laurel District No. 2 filed on February 9, 2022.<sup>16</sup> Laurel District No. 2's February 9, 2022 billing analysis would decrease Commission Staff's normalized revenue from water sales of \$3,134,916 by \$67,574 to a revised level of \$3,067,342.<sup>17</sup>

The Commission has performed a comparative evaluation of the billing analysis in the application to the analysis filed by Laurel District No. 2 on February 9, 2022, and has concluded that the February 9, 2022 billing analysis is correct. Accordingly, the

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<sup>15</sup> Commission Staff's Report at 7–8, Adjustment A.

<sup>16</sup> Laurel District No. 2's Response to Commission Staff's Report (filed July 27, 2022) at unnumbered page 2.

<sup>17</sup> Laurel District No. 2's Response to Commission Staff's Report (filed July 27, 2022) at unnumbered page 2.

Commission is reducing Commission Staff's recommended revenue from water sales by \$67,574.

Miscellaneous Service Revenues – Double Hookup Fees. In the Commission Staff's Report, Commission Staff recommended the Commission accept Laurel District No. 2's Miscellaneous Revenue adjustment of \$4,778.<sup>18</sup> This adjustment reflects the annual impact on Double Hook Fee revenue as a result of the rate increase approved by the Commission in Case No. 2020-00079.<sup>19</sup> When Laurel District No. 2 discovers that a metered customer has extra connections made on its side of the meter, additional minimum bills are charged to that customer.<sup>20</sup> The Commission finds Laurel District No. 2's adjustment to reflect the increased rate for double hookups meets the ratemaking criteria of being known and measurable,<sup>21</sup> is reasonable and is accepted.

Miscellaneous Service Revenues – Nonrecurring Charges. In Commission Staff's Report, Commission Staff discussed Laurel District No. 2's Nonrecurring Charges in which estimated labor costs, previously included in determining the amount of Nonrecurring Charges, were removed. Commission Staff recommended revised

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<sup>18</sup> Commission Staff's Report at 7, Adj. Ref. B.

<sup>19</sup> Commission Staff's Report at 8, Adjustment B.

<sup>20</sup> Commission Staff's Report at 8.

<sup>21</sup> See, 807 KAR 5:001, Section 16.1.(a),1.; 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 Therefore; (3) Authority to Adjust Rates; and (4) Approval to Revise and Adjust Tariff* (Ky. PSC Mar. 1, 2002) at 6-8; 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 April 30, 2003) at 8-10; Case No. 2017-00417, *Electronic Proposed Adjustment of the Wholesale Water Service Rates of Lebanon Water Works* (Ky. PSC July 12, 2018) at 8-10; and Case No. 2019-00080, *Electronic Proposed Adjustment of the Wholesale Water Service Rates of the City of Pikeville to Mountain Water District* (Ky. PSC Dec. 19, 2019) at 31.

Nonrecurring Charges, which resulted in a reduction to Miscellaneous Service Revenue of \$41,581.<sup>22</sup>

In its response to Commission Staff's Report, Laurel District No. 2 disagreed with the removal of labor costs related to its nonrecurring charges.<sup>23</sup> According to Laurel District No. 2, its nonrecurring charges comply with 807 KAR 5:006, Section 9, which provides that a utility may "make special nonrecurring charges to recover customer-specific costs incurred that would otherwise result in monetary loss to the utility or increased rates to other customers to whom no benefits accrue from the service provided or action taken."<sup>24</sup> Laurel District No. 2 argued that by removing the direct labor cost from its nonrecurring charges it is essentially passing this cost to the customers that do not receive these services.<sup>25</sup>

The Commission continues to follow its previous decisions regarding Nonrecurring Charges: personnel are paid during normal business hours and their salaries are recovered through base rates.<sup>26</sup> Allowing a utility to recover the same labor expense twice is not fair, just, or reasonable. Therefore, estimated labor costs previously included in determining the amount of Nonrecurring Charges shall be eliminated from the charges. The Commission finds that the calculation of Nonrecurring Charges shall be revised and

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<sup>22</sup> Commission Staff's Report Nonrecurring Charges at 5-6 and at 8, Adjustment C.

<sup>23</sup> Laurel District No. 2's Response to Commission Staff's Report (filed July 27, 2022) at unnumbered page 3.

<sup>24</sup> Laurel District No. 2's Response to Commission Staff's Report (filed July 27, 2022) at unnumbered page 3.

<sup>25</sup> Laurel District No. 2's Response to Commission Staff's Report (filed July 27, 2022) at unnumbered page 3.

<sup>26</sup> Case No. 2020-00141, *Electronic Application of Hyden-Leslie County Water District for an Alternative Rate Adjustment* (Ky. PSC Nov. 6, 2020).

only the marginal costs related to the service should be recovered through a special nonrecurring charge for service provided during normal working hours. The Commission requires that charges be directly related to the actual cost incurred to provide the service. It is unreasonable to allocate an expense already incurred as a day-to-day cost of maintaining a system, such as the salary of a distribution operator, to a nonrecurring service such as the connection and reconnection of a meter during normal working hours.

This approach to ratemaking is entirely consistent with the Commission's history of ensuring that rates reflect, to a reasonable degree, the principle of cost causation while simultaneously considering the health of the utility and the ability of the utility to provide the adequate, efficient, and reasonable provision of service. The implementation of rates that significantly deviate from the actions and expenses underlying the service provided can create material issues with a utility's ability to meet its approved revenue requirement, particularly a utility with razor thin margins.

Laurel District No. 2 argued that, if the Commission's ultimate decision is to allow it to recover only vehicle expenses in the Nonrecurring Charges, then the increased costs (i.e.; gas and other operational costs) occurring since 2020 to operate its service trucks should be factored into the allowable Nonrecurring Charges.<sup>27</sup> Laurel District No. 2 explained that since the 2020 test-year the price of its gasoline increased from \$1.91 per gallon to \$3.80 per gallon, an approximate 99 percent increase.<sup>28</sup>

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<sup>27</sup> Laurel District No. 2's Response to Commission Staff's Report (filed July 27, 2022) at unnumbered page 3.

<sup>28</sup> Laurel District No. 2's Response to Commission Staff's Report (filed July 27, 2022) at unnumbered page 3.

In its responses to Commission Staff's Report, Laurel District No. 2 did not include any detailed documentation to support any increase in the transportation costs included in Commission Staff's recommended Nonrecurring Charges. Additionally, Laurel District No. 2 has the ability to file the required documentary evidence and request an adjustment to its Nonrecurring Charges through a Tariff Filing. For these reasons, and in keeping with precedent, the Commission finds Commission Staff's recommended adjustment to Miscellaneous Service Revenue to reflect the recommended Nonrecurring Charges to be reasonable and is accepted. The Commission also finds the revised nonrecurring charges set out in Appendix B are reasonable.

Forfeited Discounts. In the Commission Staff's Report, Commission Staff recommended an increase of \$34,008 to Laurel District No. 2's test year Forfeited Discounts of \$11,707 to normalize late payment penalties to \$45,715, or the three-year average from 2017 through 2019, to account for the moratorium regarding the collection of late fee payments due to the COVID-19 pandemic.<sup>29</sup> The Commission finds that Commission Staff's adjustment meets the ratemaking criteria of being known and measurable, is reasonable and is accepted.

Employee Salaries and Wages. In the Commission Staff's Report, Commission Staff recommended that Employee Salaries and Wages expense be decreased by \$12,331.<sup>30</sup> Commission Staff's pro forma Employee Salaries and Wages expense of

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<sup>29</sup> Commission Staff's Report at 8-9, Adjustment D.

<sup>30</sup> Commission Staff's Report at 9-10, Adjustment E.

\$792,428 is based on Laurel District No. 2's current staff level of 17 full-time employees, and the 2021 employee wage rates.<sup>31</sup>

In its July 27, 2022 response to the Commission Staff's Report, Laurel District No. 2 informed the Commission that on January 2, 2022, its employees were given a 5.9 percent Cost-of-Living Adjustment (COLA) wage increase.<sup>32</sup> Laurel District No. 2 proposed to increase Commission Staff's pro forma Employee Salaries and Wages expense by \$59,812 to reflect its 2022 COLA employee wage increases.<sup>33</sup> Applying the 5.9 percent COLA wage increase to Commission Staff's recommended pro forma Employee Salaries and Wages expense results in an increase of \$46,739 as calculated in the table below.

Position	Pay Type	Test-Year Hours			Wage Rates 12/31/2021	Commission Staff Pro Forma Salaries	Commission Order	
		Regular	Overtime	Holiday			Wage Rates 1/2/2022	Salaries 5.9% COLA Wage Rates
Cust.Serv./Admin	H	2,080	0	80	\$ 20.00	\$ 43,200	\$ 21.18	\$ 45,749
Superintendent	S	0	0	0	\$ 87,514.00	87,514	\$ 92,677.33	92,677
Cust. Serv./Admin	H	2,080	5	80	\$ 17.39	37,687	\$ 18.42	39,919
Off.Mgr./Asst.Supt./Accountant	S	0	0	0	\$ 73,582.00	73,582	\$ 77,923.34	77,923
Customer Service Clerk	H	2,080	7	80	\$ 15.65	33,962	\$ 16.57	35,958
Customer Service Clerk	H	2,080	0	0	\$ 15.30	31,824	\$ 16.20	33,696
Distribution Supervisor	S	0	0	0	\$ 51,688.00	51,688	\$ 54,737.59	54,738
Distribution Operator	H	2,080	116	80	\$ 19.14	44,659	\$ 20.27	47,296
Distribution Operator/Mapping	H	2,080	89	80	\$ 19.07	43,727	\$ 20.20	46,318
Distribution Operator	H	2,080	0	0	\$ 14.68	30,534	\$ 15.55	32,344
Meter Technician	H	2,080	39	80	\$ 16.07	35,640	\$ 17.02	37,747
Plant Mgr./Asst. Supt.	S	0	0	0	\$ 60,823.00	60,823	\$ 64,411.56	64,412
Plant Operator/Safety/Mapping	H	2,080	44	80	\$ 21.41	47,673	\$ 22.67	50,478
Plant Operator	H	2,080	1	80	\$ 18.22	39,383	\$ 19.29	41,696
Plant Operator/Equip Maint	H	2,080	2	80	\$ 21.21	45,878	\$ 22.46	48,582
Plant Operator	H	2,080	2	80	\$ 19.06	41,231	\$ 20.18	43,654
Plant Operator	H	2,080	5	80	\$ 20.04	43,423	\$ 21.22	45,980
Pro Forma Employee Salaries and Wages						792,428		839,167
Less: Test-Year Employee Salaries and Wages						(804,759)		(792,428)
Pro Forma Adjustment						\$ (12,331)		\$ 46,739

<sup>31</sup> Commission Staff's Report at 9-10.

<sup>32</sup> Laurel District No. 2's Response to Commission Staff's Report (filed July 27, 2022) at unnumbered page 2.

<sup>33</sup> Laurel District No. 2's Response to Commission Staff's Report (filed July 27, 2022) at Exhibit A, Adjustment Reference D. \$852,240 (Laurel District No. 2's Pro Forma Employee Salaries and Wages expense) - \$792,428 (Commission Staff's Report at 9-10, Pro Forma Employee Salaries and Wages Expense) = \$59,812.

The Commission finds that an adjustment to include the 2022 COLA employee wage increase meets the ratemaking criteria of being known and measurable. Therefore, the Commission is increasing Commission Staff's pro forma Employee Salaries and Wages expense of \$792,428 by \$46,739 using the percentage increase of 5.9 percent as presented by Laurel District No. 2.

County Employee Retirement System (CERS). In the Commission Staff's Report, Commission Staff recommended that Laurel District No. 2's CERS expense be decreased by \$534,412 to reflect applying the 26.95 percent employer CERS contribution rate to the pro forma employee salaries and wages expense for full-time employees of \$792,428.<sup>34</sup> The Commission finds that the methodology employed by Commission Staff to calculate the allowable CERS expense meets prior precedent regarding CERS employer contributions,<sup>35</sup> and is reasonable. Applying the CERS employer contribution rate of 26.95 percent to the COLA wage rate adjustment of \$46,739 results in an increase to Commission Staff's pro forma Employee Pensions and Benefits expense of \$12,596.<sup>36</sup>

Employee Benefits. In the Commission's Staff Report, Commission Staff recommended a decrease to Laurel District No. 2's Employee Pensions and Benefits expense of \$105,425.<sup>37</sup> Commission Staff's recommended adjustment reflects reducing

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<sup>34</sup> Commission Staff's Report at 10-11, Adjustment F.

<sup>35</sup> See Case No. 2021-00013, *Electronic Application of Edmonson County Water District for a Rate Adjustment Pursuant to 807 KAR 5:076* (Ky. PSC Aug. 4, 2021); Case No. 2021-00241, *Electronic Application of West Shelby Water District for a Rate Adjustment Pursuant to 807 KAR 5:076* (Ky. PSC Feb. 24, 2022); Case No. 2021-00301, *Electronic Application of McCreary County Water District for an Alternative Rate Adjustment* (Ky. PSC Jul 27, 2022); and Case No. 2021-00369, *Electronic Application of Christian County Water District for a Rate Adjustment Pursuant to 807 KAR 5:076* (Ky. PSC March 17, 2022).

<sup>36</sup> \$46,739 (Cola Wage Rate Increase) x 26.95% (CERS Employer Contribution Rate) = \$12,596.

<sup>37</sup> Commission Staff's Report at 11-13, Adjustment G.

the employee insurance premiums paid by Laurel District No. 2 from 100 percent to 79 percent for single health insurance coverage and from 100 percent to 66 percent for dental insurance coverage.<sup>38</sup>

Laurel District No. 2 explained that it is aware of the Commission's recent decisions that require utility employees to contribute toward the cost of their employee benefit packages (health and dental insurance benefits).<sup>39</sup> Laurel District No. 2 claimed that the current job market is making it difficult to attract experienced employees and its search would become more difficult if its employees were required to contribute towards their insurance benefit package.<sup>40</sup> Furthermore, Laurel District No. 2 argued that if its current employees are required to make a contribution towards their health insurance premiums, the employees would choose to either retire or to begin job searches.<sup>41</sup> In order to retain its experienced employees, Laurel District No. 2 claimed it will be required to increase employee wage rates to compensate for any cost reduction in benefits.<sup>42</sup> Laurel District No. 2 respectfully requested the Commission reconsider its position on this issue.<sup>43</sup>

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<sup>38</sup> Commission Staff's Report at 11-13.

<sup>39</sup> Laurel District No. 2's Response to Commission Staff's Report (filed July 27, 2022) at unnumbered pages 3 and 4.

<sup>40</sup> Laurel District No. 2's Response to Commission Staff's Report (filed July 27, 2022) at unnumbered pages 3 and 4.

<sup>41</sup> Laurel District No. 2's Response to Commission Staff's Report (filed July 27, 2022) at unnumbered pages 3 and 4.

<sup>42</sup> Laurel District No. 2's Response to Commission Staff's Report (filed July 27, 2022) at unnumbered pages 3 and 4.

<sup>43</sup> Laurel District No. 2's Response to Commission Staff's Report (filed July 27, 2022) at unnumbered pages 3 and 4.

The Commission originally adopted its approach in an attempt to reign in employee benefit expenses by requiring all utility employees to pay an established portion of their premiums.<sup>44</sup> The Commission found that utilities subject to its regulatory oversight should limit their contributions to its employees' health plans to percentages that were more in line with those of other businesses in order to reduce its expenses.<sup>45</sup>

Since Case No. 2016-00174, the Commission has consistently made ratemaking adjustments to reduce the cost of employee benefit packages paid by utilities when certain aspects of those benefit packages were found to be unreasonable based on a review of total salaries and fringe benefits.<sup>46</sup> The Commission evaluates the 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. Nothing presented by Laurel District No. 2 convinces the Commission that Laurel District No. 2's policy of providing 100 percent of their employer-funded health benefits meets the established ratemaking criteria.

Accordingly, the Commission will, for ratemaking purposes, accept Commission Staff's recommendation to adjust test-year Employee Benefits expense to limit the insurance benefits provided to all Laurel District No. 2's employees based on national average employee contribution rates.

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<sup>44</sup> See Case No. 2016-00174 *Electronic Application of Licking Valley Rural Electric Cooperative Corporation for a General Rate Increase* (Ky. PSC Mar. 1, 2017) at 10.

<sup>45</sup> See Case No. 2016-00174 *Electronic Application of Licking Valley Rural Electric Cooperative Corporation for a General Rate Increase* (Ky. PSC Mar. 1, 2017) at 10.

<sup>46</sup> See Case No. 2021-00241, *Electronic Application of Christian County Water District for a Rate Adjustment Pursuant to 807 KAR 5:076* (Ky. PSC Feb 24, 2022) at 7-8; Case No. 2021-00369, *Electronic Application of Christian County Water District for a Rate Adjustment Pursuant to 807 KAR 5:076* (Ky. PSC Mar. 17, 2022) at 11-12; and Case No. 2021-00406, *Electronic Application of Western Fleming County Water District for a Rate Adjustment Pursuant to 807 KAR 5:076* (Ky. PSC Sept. 19, 2022) at 9-10.

Depreciation. In the Commission Staff's Report, Commission Staff recommended the Commission increase Laurel District No. 2's test-year Depreciation expense by \$59,009.<sup>47</sup> In Case No. 2020-00079,<sup>48</sup> the Commission granted Laurel District No. 2 a Certificate of Public Convenience and Necessity (CPCN) to construct a 14-inch water main and a water storage tank.<sup>49</sup> Using the depreciation life ranges for the appropriate asset categories contained in the 1979 National Association of Regulatory Utility Commissioners (NARUC) report titled *Depreciation Practices for Small Water Utilities* (NARUC Study), Commission Staff calculated its proposed Depreciation adjustment.<sup>50</sup>

The Commission has historically relied upon the NARUC Study to evaluate the reasonableness of the depreciation practices of small water utilities when no evidence exists to support a specific life that is inside or outside the NARUC Study ranges.<sup>51</sup> The Commission finds that Commission Staff's adjustment to Depreciation expense to reflect depreciating the new plant constructed in 2022 over the NARUC depreciation lives meets the ratemaking criteria of being known and measurable, is reasonable and is accepted.

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<sup>47</sup> Commission Staff's Report at 7, Pro Forma Operating Statement, Adjustment Reference H and at 13-14, Adjustment H. Commission Staff incorrectly stated that Laurel District No. 2 proposed to decrease depreciation expense by \$61,483. The referenced adjustment was not proposed by Laurel District No. 2, it is not included in Commission Staff's pro forma income statement or included in its revenue requirement calculation.

<sup>48</sup> Case No. 2020-00079 *Electronic Application of the Laurel County Water District No. 2 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 Apr. 8, 2020).

<sup>49</sup> Commission Staff's Report at 13-14.

<sup>50</sup> Commission Staff's Report at 13-14.

<sup>51</sup> See Case No. 2016-00163, *Alternative Rate Adjustment Filing of Marion County Water District* (Ky. PSC Nov. 10, 2016); 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. 2020-00311, *Electronic Application of Cawood Water District for an Alternative Rate Adjustment* (Ky. PSC Apr. 8, 2021).

Payroll Tax. In the Commission Staff's Report, Commission Staff recommended that Laurel District No. 2's test-year Taxes Other than Income Tax expense of \$66,397 be decreased by \$3,481 based on applying Federal Insurance Contributions Act (FICA) tax rate of 7.65 percent to pro forma Employee Salaries and Wages expense.<sup>52</sup>

Laurel District No. 2 claimed that Commission Staff's FICA Tax adjustment is based on the incorrect assumption that reported test-year Taxes Other than Income Tax expense only included payroll taxes.<sup>53</sup> According to Laurel District No. 2, test-year Taxes Other than Income Tax expense also included PSC Assessment of \$4,875, Permits of \$474, and Kentucky Unemployment Tax of \$1,176.<sup>54</sup> By eliminating the non FICA taxes from Commission Staff's FICA Tax calculation, Laurel District No. 2 determined that Commission Staff's recommended Taxes Other than Income Tax expense should be increased by \$6,525.<sup>55</sup>

The Commission finds, based on the evidence of record, the methodology used by Commission Staff to calculate Laurel District No. 2's pro forma FICA expense modified to include the 2022 COLA wage increases and to eliminate the non-FICA Taxes, is correct. Applying the FICA Tax rate of 7.65 percent to the total Salaries and Wages expense of

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<sup>52</sup> Commission Staff's Report at 14, Adjustment I.

<sup>53</sup> Laurel District No. 2's Response to Commission Staff's Report (filed July 27, 2022) at unnumbered page 1.

<sup>54</sup> Laurel District No. 2's Response to Commission Staff's Report (filed July 27, 2022) at unnumbered page 1.

<sup>55</sup> Laurel District No. 2's Response to Commission Staff's Report (filed July 27, 20022) at unnumbered page 1.

\$869,167,<sup>56</sup> the Commission is increasing Commission Staff's pro forma Payroll Tax expense of \$62,916 by \$10,100.<sup>57</sup>

Based on the Commission's findings discussed above, the following table summarizes Laurel District No. 2's adjusted Pro Forma operations:<sup>58</sup>

	Commission Staff's		Commission Order			
	Pro Forma Operations		Pro Forma Adjustments			
Operating Revenues	\$	3,282,209	\$	(67,574)	\$	3,214,635
Operating Expenses		2,425,630		69,435		2,495,065
Net Operating Income	\$	856,579	\$	(137,009)	\$	719,570

### REVENUE REQUIREMENT

Based upon the Commission's findings and determinations herein, Laurel District No. 2 would require a decrease in its water revenues of \$47,305, or 1.54 percent as calculated below.

	Laurel	Commission Staff	Commission Order	
	District No. 2	Report	Adjustments	Rev. Requirement
Pro Forma Operating Expenses	\$ 2,477,196	\$ 2,425,630	\$ 69,435	\$ 2,495,065
Plus: Average Annual Debt Service	450,927	575,445		575,445
Debt Service Coverage Requirement	90,185	115,089		115,089
Overall Revenue Requirement	3,018,308	3,116,164	69,435	3,185,599
Less: Other Operating Revenue	(216,963)	(147,293)		(147,293)
Non-Operating Income	(15,129)	(15,129)		(15,129)
Interest Income	(3,140)	(3,140)		(3,140)
Revenue Required from Water Sales	2,783,076	2,950,602	69,435	3,020,037
Less: Normalized Revenues from Water Sales	(3,134,916)	(3,134,916)	67,574	(3,067,342)
Required Revenue Increase/(Decrease)	\$ (351,840)	\$ (184,314)	\$ 137,009	\$ (47,305)
Percentage Increase	-11.22%	-5.88%		-1.54%

<sup>56</sup> \$839,167(Employee Salaries and Wages expense) + \$30,000 (Commissioner Salaries and Wages expense) = \$869,167.

<sup>57</sup> \$869,167 (Total Salaries and Wages expense) x 7.65% (FICA Tax rate) = \$66,491 - \$59,872 (Test-Year FICA Tax) = \$6,619 + \$3,481 (Commission Staff Original FICA Adjustment) = \$10,100.

<sup>58</sup> See Appendix A for a complete pro forma income statement.

## REVENUE DECREASE

In its application, Laurel District No. 2 calculated a required decrease to revenues from water sales of \$351,840.<sup>59</sup> Laurel District No. 2 claimed that its revenue requirement calculation using the Debt Service Coverage (DSC) method indicated that a water service rate increase was not necessary.<sup>60</sup> After adjusting the Commission Staff's recommendations, the Commission has recalculated the required decrease in Laurel District No. 2's revenue from water sales to a decrease of \$47,305.

In its July 27, 2022 comments in response to Commission Staff's Report, Laurel District No. 2 gave the following reasons as to why the Commission should not require it to decrease its water service rates: (1) its current tariffed water rates were a requirement of the August 8, 2018 Letter of Conditions of the USDA Rural Development and were approved by the Commission in Case No. 2020-00079; (2) Laurel District No. 2 expects to hire three additional employees in the near future;<sup>61</sup> and (3) operational cost increases have occurred since the 2020 test year.<sup>62</sup>

The issues raised by Laurel District No. 2 could have a significant impact on Laurel District No. 2's revenue requirement. However, with the limited information provided by Laurel District No. 2, the Commission is unable to quantify certain adjustments. For

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<sup>59</sup> Application, "Revenue Requirements Calculation" Attachment, at unnumbered page 1.

<sup>60</sup> Application, "Reasons for Application" Attachment, at unnumbered page 1.

<sup>61</sup> A new Distribution Department employee will be hired as a result of the increased workload Laurel District No. 2 will replace an office staff employee that left May 26, 2020. Due to EPA Lead and Copper Rule Revisions that occurred on December 16, 2021, Laurel District No. 2 will either hire an additional outside employee or will require increased employee overtime.

<sup>62</sup> Bad debt expense increased from \$10,557 in 2020 to \$39,736 in 2021. A 30% increase in commercial insurance package premiums. An 87% increase in chemical costs. The increased cost of electricity and the price of gasoline.

example, Laurel District No. 2 failed to provide projected hire dates or salaries for its proposed new employees. Therefore, adjustments for any new employee would not meet the ratemaking criteria of being known and measurable. The Commission is concerned that Laurel District No. 2 has not adequately planned for appropriate staffing levels, which is a critical component of maintaining safe and reliable water service. Laurel District No. 2 was provided an opportunity to quantify and substantiate any increases in gas or chemical costs in its written responses to the Commission Staff's Report. Laurel District No. 2 failed to provide thorough information meeting the standards for known and measurable adjustments.

Although the Commission is unable to quantify the cost increases noted by Laurel District No. 2, it does acknowledge that utilities have experienced operational cost increases since calendar year 2020 due to the Covid pandemic, the recent supply chain issues, and the current rate of inflation. Therefore, the Commission finds that it would be unreasonable to require Laurel District No. 2 to reduce its water rates under the current market conditions.

However, it is important for Laurel District No. 2 to establish a policy to perform an annual review of its rate sufficiency to verify that an increase in rates is not required. Laurel District No. 2 should submit a rate case or rate study within three years from the date this Order is issued unless the annual rate sufficiency analysis indicates a rate case should be filed sooner. The Commission encourages Laurel District No. 2 to particularly review staffing levels and include any anticipated staffing changes within the annual rate sufficiency analysis. The Laurel District No. 2 initial rate sufficiency analysis should be submitted to the Commission to allow for Commission Staff review.

## SUMMARY

After consideration of the evidence of record and being otherwise sufficiently advised, the Commission finds that the recommendations contained in the Commission Staff Report and discussed above are supported by the evidence of record and are reasonable. The Commission has historically used a DSC method to calculate the revenue requirement for water districts or associations with outstanding long-term debt. Therefore, applying the DSC method to Laurel District No. 2's pro forma operations results in an Overall Revenue Requirement of \$3,185,599 and, a revenue decrease of \$47,305. The Commission agrees with Laurel District No. 2 and finds that a rate decrease is not warranted at this time. The Commission further finds that Laurel District No. 2 establish a policy to perform an annual review of its rate sufficiency and to submit the initial rate sufficiency analysis completed in 2023 within 60 days of the completion of the 2022 Financial Audit. Unless Laurel District No. 2's annual rate sufficiency review(s) indicates a need for a rate case sooner, Laurel District No. 2 shall submit a rate case or rate study within three years from the issuance date of this Order.

IT IS THEREFORE ORDERED, that:

1. The findings contained in the Commission Staff's Report, are adopted, and are incorporated by reference into this Order.
2. Laurel District No. 2 is not required to decrease its base water rates.
3. The Nonrecurring Charges in Appendix B are approved for services rendered on and after the entry of this Order.

4. Within 20 days of the date of service of this Order, Laurel District No. 2 shall file with this Commission, using the Commission's electronic Tariff Filing System, new tariff sheets setting forth the Nonrecurring charges approved in this Order.

5. Laurel District No. 2 shall establish a policy to perform an annual review of its rate sufficiency and to submit the initial rate sufficiency analysis that will be completed in 2023. The analysis shall be filed within 60 days of the completion of the 2022 Financial Audit.

6. Any documents filed in the future pursuant to ordering paragraph 5 shall reference this case number and shall be retained in the post-case correspondence file.

7. Unless Laurel District No. 2's annual rate sufficiency review(s) indicates a need for a rate case sooner, Laurel District No. 2 shall submit a rate case or rate study within three years from the issuance date of this Order.

8. This case is closed and removed from the Commission's docket.

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PUBLIC SERVICE COMMISSION

  
\_\_\_\_\_  
Chairman

\_\_\_\_\_  
Vice Chairman

  
\_\_\_\_\_  
Commissioner



ATTEST:

  
\_\_\_\_\_  
Executive Director

## APPENDIX A

### APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2021-00385 DATED NOV 01 2022

#### Pro Forma Detailed Income Statement

	Test Year Operations	Commission Staff Report		Commission Order	
		Pro Forma Adjustments	Pro Forma Operations	Pro Forma Adjustments	Pro Forma Operations
<b>Operating Revenues:</b>					
Total Metered Sales	\$ 2,851,807	\$ 283,109	\$ 3,134,916	\$ (67,574)	\$ 3,067,342
Other Water Revenues:					
	150,088	4,778			
		(41,581)			
		34,008	147,293		147,293
<b>Total Operating Revenues</b>	<b>3,001,895</b>	<b>280,314</b>	<b>3,282,209</b>	<b>(67,574)</b>	<b>3,214,635</b>
<b>Operating Expenses:</b>					
Operation and Maintenance:					
Salaries and Wages - Employees	804,759	(12,331)	792,428	46,739	839,167
Salaries and Wages - Officers	30,000		30,000		30,000
Employee Pensions and Benefits	870,667	(320,853)	444,389	12,596	456,985
		(105,425)			
Purchased Water	402		402		402
Purchased Power	164,262		164,262		164,262
Chemicals	66,342		66,342		66,342
Materials and Supplies	97,252		97,252		97,252
Contractual Services	22,986		22,986		22,986
Water Testing	14,403		14,403		14,403
Rent - Equipment	70		70		70
Transportation Expenses	23,191		23,191		23,191
Insurance - Vehicle	25,958		25,958		25,958
Bad Debt	10,557		10,557		10,557
Miscellaneous Expenses	65,922		65,922		65,922
<b>Total Operation and Maint. Expenses</b>	<b>2,196,771</b>	<b>(438,609)</b>	<b>1,758,162</b>	<b>59,335</b>	<b>1,817,497</b>
Depreciation Expense	539,451	59,009	598,460		598,460
Amortization Expense	6,092		6,092		6,092
Taxes Other Than Income	66,397	(3,481)	62,916	10,100	73,016
<b>Total Operating Expenses</b>	<b>2,808,711</b>	<b>(383,081)</b>	<b>2,425,630</b>	<b>69,435</b>	<b>2,495,065</b>
<b>Net Utility Operating Income</b>	<b>\$ 193,184</b>	<b>\$ 663,395</b>	<b>\$ 856,579</b>	<b>\$ (137,009)</b>	<b>\$ 719,570</b>

APPENDIX B

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE  
COMMISSION IN CASE NO. 2021-00385 DATED NOV 01 2022

The following rates and charges are prescribed for the customers in the area served by Laurel County Water District No. 2. 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.

Nonrecurring Charges	
Additional Trip Charge	\$13.00
Meter Reread Charge	\$13.00
Meter Test Charge	\$27.00
Return Check Charge	\$13.00
Service Reconnection Charge	\$25.00
Service Reconnection Charge, After Hours	\$80.00
5/8-Inch x 3/4-Inch Meter	\$1,007.00

\*Kenneth Fisher  
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\*Wanda Smith  
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