

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

|                                    |   |            |
|------------------------------------|---|------------|
| ELECTRONIC APPLICATION OF GALLATIN | ) | CASE NO.   |
| COUNTY WATER DISTRICT FOR AN       | ) | 2021-00396 |
| ALTERNATIVE RATE ADJUSTMENT        | ) |            |

NOTICE OF FILING OF COMMISSION STAFF REPORT

Notice is hereby given that, in accordance with the Commission's Order of December 7, 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 December 7, 2021 Order, Gallatin County Water District (Gallatin 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 Gallatin District to the Commission's July 22, 2021 Order in Case No. 2020-00085<sup>1</sup> regarding filings with the Commission.



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

DATED MAR 02 2022

cc: Parties of Record

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<sup>1</sup> 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  
GALLATIN COUNTY WATER DISTRICT  
CASE NO. 2021-00396

Gallatin County Utilities District (Gallatin 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 1,945 residential customers and 32 commercial customers that reside in Boone, Gallatin, and Grant counties, Kentucky.<sup>1</sup> As part of the final Order of Case Number 2019-00460, in order to allow Commission Staff (Staff) the opportunity to resolve outstanding questions regarding audit report inconsistencies and high water loss, Gallatin District was ordered to file for an a general adjustment to rates or alternative rate filing within six months of the date of the May 17, 2021 Order.<sup>2</sup> On October 22, 2021, Gallatin District tendered an application, pursuant to 807 KAR 5:076.

The Commission notes that Gallatin District's 2019 Annual Report reported a water loss of 30.85 percent.<sup>3</sup> 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 produced and purchased, excluding water consumed by a utility in its own operations. At

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<sup>1</sup> *Annual Report of Gallatin District to the Public Service Commission (Annual Report) for the Calendar Year Ended December 31, 2019* at 12 and 49.

<sup>2</sup> Case No. 2019-00460, *Electronic Application of Gallatin County Water District to Issue Securities in the Approximate Principal Amount of \$1,633,000 for the Purpose of Refunding Certain Outstanding Obligations of the District Pursuant to the Provisions of KRS 278.300 And 807 KAR 5:001* (Ky. PSC Feb. 28, 2020).

<sup>3</sup> Annual Report at 58.

a 30.85 percent water loss, the annual cost to Gallatin District of water above the allowable 15 percent is \$11,577<sup>4</sup> while the annual cost of total water loss is \$22,533.<sup>5</sup>

To comply with the requirements of 807 KAR 5:076, Section 9,<sup>6</sup> Gallatin District used the calendar year ended December 31, 2019, as the basis for its application. Using its pro forma test-year operations, Gallatin District determined that no revenue increase was warranted as there was a surplus revenue of \$46,252.<sup>7</sup>

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|   | Purchased<br>Water | Purchased<br>Power | Purchased<br>Chemical | Total     |
|---|--------------------|--------------------|-----------------------|-----------|
| 2020 Pro Forma Expenses                           | \$ 7,857           | \$ 58,637          | \$ 6,547              | \$ 73,041 |
| Multiplied by: Water Loss in Excess of 15 Percent | 15.85%             | 15.85%             | 15.85%                | 15.85%    |
| Excess Cost                                       | \$ 1,245           | \$ 9,294           | \$ 1,038              | \$ 11,577 |

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|                                 | Purchased<br>Water | Purchased<br>Power |          | Total     |
|---------------------------------|--------------------|--------------------|----------|-----------|
| 2020 Pro Forma Expenses         | \$ 7,857           | \$ 58,637          | \$ 6,547 | \$ 73,041 |
| Multiplied by: Total Water Loss | 30.85%             | 30.85%             | 30.85%   | 30.85%    |
| Excess Cost                     | \$ 2,424           | \$ 18,090          | \$ 2,020 | \$ 22,533 |

<sup>6</sup> 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.

<sup>7</sup> Application, Attachment 4, Revenue Requirements Calculation.

|   | Gallatin<br>District |
|---|----------------------|
| Operating Expenses                              | \$ 893,161           |
| Add: Average Annual Debt Principal and Interest | 211,697              |
| Additional Working Capital                      | 42,339               |
|   | <hr/>                |
| Overall Revenue Requirement                     | 1,147,197            |
| Less: Other Operating Revenue                   | (52,532)             |
| Interest Income                                 | (21,799)             |
|   | <hr/>                |
| Revenue Requirement - Water Rates               | 1,072,866            |
| Less: Normalized Revenue from Service           | (1,119,119)          |
|   | <hr/>                |
| Required Revenue Increase                       | \$ (46,253)          |
| Percentage Increase                             | <u>-4.13%</u>        |

To determine the reasonableness of the rates currently charged by Gallatin District, Staff performed a limited financial review of Gallatin District's test-year operations. The scope of Staff's review was limited to determining whether operations reported for the test year were representative of normal operations. Known and measurable<sup>8</sup> 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.

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<sup>8</sup> 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 Utilities 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 Utilities 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); and 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. Travis Leach reviewed the calculation of Gallatin District's Overall Revenue Requirement. Jason Green reviewed Gallatin 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 Gallatin District's required revenue from rates is \$1,109,806 to meet the Overall Revenue Requirement of \$1,167,179, and that no revenue increase is necessary to generate the Overall Revenue Requirement given the District's Other Operating Revenue and Interest Income. In addition, Staff was able to resolve its issues regarding the District's audit report inconsistencies and was able to pursue information regarding the District's Water Loss.

2. Monthly Water Service Rates. Gallatin District did not propose an increase of its monthly retail water service rates due to the revenue surplus the district currently has. Staff has verified that no increase is necessary and therefore has not calculated new monthly water service rates.

3. Nonrecurring Charges. Following the Commission's recent decisions,<sup>9</sup> Commission Staff has reviewed Gallatin 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

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<sup>9</sup> 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).

nonrecurring charges should be eliminated from the charges. Gallatin District provided updated cost justification information for the nonrecurring charges that are listed in its tariff.<sup>10</sup> Staff reviewed the cost-justification information provided by Gallatin District and have adjusted these charges by removing Field Labor Costs and Office/Clerical Labor Costs. Gallatin District also proposed to add an after-hours field collection charge and after-hours reconnection charge to its tariff. Such adjustments result in the following revised nonrecurring charges:

| <u>Nonrecurring Charge</u> | <u>Normal Hours</u> | <u>After Hours</u> |
|----------------------------|---------------------|--------------------|
| Connection/Turn-on Charge  | \$9                 | \$105              |
| Disconnect/Reconnect       | \$9                 | \$105              |
| Field Collection Charge    | \$9                 | \$105              |
| Meter Re-Read              | \$9                 |                    |
| Meter Test Charge          | \$58                |                    |
| Returned Check Charge      | \$12                |                    |
| Service Line Inspection    | \$9                 |                    |

The adjustments to the nonrecurring charges result in a decrease to the charges and an increase to the total revenue requirement of \$15,002 as shown below. Staff recommends that Gallatin District should adjust its nonrecurring charges to those found in the Appendix to this report.<sup>11</sup>

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<sup>10</sup> Gallatin District's Responses to Commission Staff's First Request for Information (filed Jan. 5, 2022) (Staff's First Request), Item 2, Cost\_Justifications\_NRC.pdf.

<sup>11</sup> Gallatin District indicated that there were no instances of any after-hours charges made during the test period in Response to Staff's First Request for Information, Item 1, 2019 Nonrecurring Charges.

|                            | Number of Occurrences | Current Charge | Utility Pro Forma | Revised Charge | Adjustment  | Pro Forma |
|----------------------------|-----------------------|----------------|-------------------|----------------|-------------|-----------|
| Connection Turn-On Charge  | 225                   | \$35           | 7,875             | \$9            | (5,850)     | 2,025     |
| Disconnection/Reconnection | 253                   | \$35           | 8,855             | \$9            | (6,578)     | 2,277     |
| Field Collection Charge    | 91                    | \$35           | 3,185             | \$9            | (2,366)     | 819       |
| Late Payment Penalty       | 6555                  | 10%            | 29,740            | N/A            | -           | 29,740    |
| Returned Check Charge      | 16                    | \$25           | 400               | \$12           | (208)       | 192       |
|                            |                       |                | \$ 50,055         |                | \$ (15,002) | \$ 35,053 |

4. Capital Improvement Plan. Although Staff does not recommend a rate increase at this time, Staff does recommend that Gallatin District take steps to improve its historically high levels of water loss. In each of the past five years, Gallatin District has exceeded the allowable 15 percent of total water produced and purchased, shown below

| Year       | 2016   | 2017   | 2018   | 2019   | 2020   |
|------------|--------|--------|--------|--------|--------|
| Water Loss | 22.74% | 24.34% | 25.46% | 30.85% | 24.93% |

Staff recommends that Gallatin District be ordered to file a Capital Improvement plan. Staff notes that the water district currently employs a water loss and leak detection program, and that it should be used as a framework for a capital improvement plan but be altered to include all capital improvements, their estimated cost, approximate location, and estimated date in service that the district has planned to curtail its high water loss.

#### PRO FORMA OPERATING STATEMENT

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

|  | Test Year         | Adjustment        | Reference | Pro Forma         |
|--|-------------------|-------------------|-----------|-------------------|
| <b>Operating Revenues</b>                      |                   |                   |           |                   |
| Retail Sales of Water                          | \$ 1,093,070      | \$ 12,124         | A         | \$ 1,105,194      |
| Bulk Sales                                     | 13,925            |                   |           | 13,925            |
| <b>Other Water Revenues</b>                    |                   |                   |           |                   |
| Forfeited Discounts                            | 29,740            |                   |           | 29,740            |
| Misc Service Revenues                          | 19,670            | (14,794)          | B         | 4,876             |
| Other Water Revenues                           | 3,122             | (208)             | B         |                   |
|  |                   | (1,956)           | C         | 958               |
| <b>Total Operating Revenues</b>                | <b>1,159,527</b>  | <b>(4,834)</b>    |           | <b>1,154,693</b>  |
| <b>Operating Expenses</b>                      |                   |                   |           |                   |
| <b>Operation and Maintenance Expenses</b>      |                   |                   |           |                   |
| Salaries and Wages - Employees                 | 258,005           | 1,217             | D         | 259,222           |
| Salaries and Wages - Officers                  | 15,200            | 400               | E         | 15,600            |
| Employee Pensions and Benefits                 | 207,605           | (92,784)          | F         | 114,821           |
| Purchased Water                                | 7,857             | (1,245)           | G         | 6,612             |
| Purchased Power                                | 61,726            | (9,294)           | G         | 52,432            |
| Purchased Chemical                             | 6,547             | (1,038)           | G         | 5,509             |
| Materials and Supplies                         | 59,705            |                   |           | 59,705            |
| Contractual Services                           | 73,326            | 2,833             | H         | 76,159            |
| Transportation Expenses                        | 21,376            |                   |           | 21,376            |
| Insurance - Gen Liability & Other              | 22,144            |                   |           | 22,144            |
| Insurance - Worker's Comp                      | 4,561             |                   |           | 4,561             |
| Advertising Expense                            | 788               |                   |           | 788               |
| Bad Debt                                       | 9,628             |                   |           | 9,628             |
| Miscellaenous Expenses                         | 23,409            |                   |           | 23,409            |
| <b>Total Operation and Mainenance Expenses</b> | <b>771,877</b>    | <b>(99,911)</b>   |           | <b>671,966</b>    |
| Depreciation Expense                           | 254,942           | (33,595)          | I         | 221,347           |
| Taxes Other Than Income                        | 22,316            | (2,486)           | D         | 19,830            |
| <b>Total Operating Expenses</b>                | <b>1,049,135</b>  | <b>(135,992)</b>  |           | <b>913,143</b>    |
| <b>Utility Operating Income(Loss)</b>          | <b>\$ 110,392</b> | <b>\$ 131,158</b> |           | <b>\$ 241,550</b> |

A. Billing Analysis. Gallatin District included test-year service revenues of \$1,093,070. In its application, Gallatin District proposed to increase test-year service revenue by \$12,124 to reflect its current Billing Analysis. Staff agrees that the adjustment proposed by Gallatin District is known and measurable and accurately reflects pro forma revenue and has included it in pro forma calculation.

B. Nonrecurring Charges. As shown above, the adjustments to the nonrecurring charges result in a decrease to Miscellaneous Service Revenues of \$14,794 and Other Water Revenues of \$208.

C. Other Income. In the test-year, Gallatin District included \$2,803 related to other income in its Other Water Revenues. Upon examination, Staff determined that most of the revenues do not represent recurring sources of revenue and instead included items such as the sale of scrap meters and aging trucks.<sup>12</sup> However, other income does include amounts paid to the district by local sewer utilities for performing disconnections,<sup>13</sup> which the Commission historically has allowed. In order to adjust Other Water Revenues to allowable pro forma levels, Staff reduced Other Water Revenues to only include amounts tied to Returned Check Charges and revenue tied to disconnections performed for sewer utilities, shown below.

|                                     |    |                       |
|-------------------------------------|----|-----------------------|
| Test Year Sewer Disconnect Revenue  | \$ | 750                   |
| Pro Forma Returned Check Charges    |    | <u>208</u>            |
| Pro Forma Other Water Revenues      |    | 958                   |
| Less: Adjusted Other Water Revenues |    | <u>(2,914)</u>        |
| Pro Forma Adjustment                | \$ | <u><u>(1,956)</u></u> |

D. Salaries and Wages – Employees & FICA. In the test-year, Gallatin District included \$258,005 of Salaries and Wages – Employees Expense. In its application, Gallatin District proposed an adjustment decreasing test-year Salaries and Wages – Employees Expense by \$6,042 citing the retirement and replacement of an experienced

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<sup>12</sup> Gallatin District’s Response to Staff’s First Request, Item 5, 2019 General Ledger Account number 06010-0000.

<sup>13</sup> *Id.*

existing employee. However, upon calculating pro forma salary levels, Staff determined that Salaries and Wages – Employees Expense should be increased by \$1,217 as shown below.

| <u>Employee Title</u>    | <u>Pro Forma Hours Worked</u> | <u>Pro Forma Overtime Hours</u> | <u>Pro Form Hourly Rate</u>     | <u>Pro Forma Wages</u> |
|--------------------------|-------------------------------|---------------------------------|---------------------------------|------------------------|
| Officer Manager          | Salary                        | N/A                             | \$ 47,673                       | \$ 47,673              |
| Superintendent           | Salary                        | N/A                             | 53,352                          | 53,352                 |
| Operator/General Laborer | 1721                          | 104                             | 17.00                           | 31,909                 |
| Operator/Equipment       | 1814                          | 167                             | 21.37                           | 44,118                 |
| Asst. Superintendent     | 1904                          | 208                             | 21.37                           | 47,356                 |
| Asst. Office Manager     | 1921                          | 8                               | 18.01                           | 34,813                 |
|                          |                               |                                 | Pro Forma Salaries and Wages    | 259,222                |
|                          |                               |                                 | Less: Test Year Expense         | <u>258,005</u>         |
|                          |                               |                                 | Increase(Decrease) to Test Year | <u>\$ 1,217</u>        |

As a result of Staff’s increase to Salaries and Wages – Employees, Staff has made an adjustment to reduce FICA Tax Expenses to reflect the adjusted payroll tax costs, as shown below.

|                               |                   |
|-------------------------------|-------------------|
| Pro Forma Salaries and Wages  | \$ 259,222        |
| Multiply by: FICA Rate        | <u>7.65%</u>      |
| Pro Forma FICA Taxes          | 19,830            |
| Less: Test Year Payroll Taxes | <u>(22,316)</u>   |
| Adjustment                    | <u>\$ (2,486)</u> |

E. Salaries and Wages – Officers. In the test-year, Gallatin District included \$15,200 of Salaries and Wages – Officer Expense. Based on pro forma commissioner salaries, Staff notes that the number included by Gallatin District does not reflect a full year of compensation for each commissioner at their current pay and that an adjustment increasing pro forma Salaries and Wages – Officer Expense by \$400 is necessary.

F. Employee Pensions and Benefits. Gallatin District included \$207,605 in its test-year Employee Benefits Expense related to insurance and retirement benefits. As part of its employee compensation, Gallatin District pays approximately 100 percent of its employees' health insurance premiums as well employees' life and short-term disability insurance premiums.

Staff notes that the Commission has consistently made ratemaking adjustments to reduce the cost of employer-sponsored healthcare 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 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.<sup>14</sup>

As Gallatin District's employees currently pay 0 percent of their health insurance premiums, Staff has calculated the total pro forma allowable premiums, shown below.

|   |                  |
|---|------------------|
| Pro Forma Health Insurance Premium          | \$ 4,589         |
| Multiply by: 12 Months                      | <u>12</u>        |
| Annual Premium                              | 55,068           |
| Multiply by: 79% BLS Average                | <u>79%</u>       |
| Allowable Health Insurance Premium          | 43,504           |
| Add: Life Insurance Paid by District        | 465              |
| Add: Short Term Disability Paid by District | <u>992</u>       |
| Total Allowable Insurance Benefits          | <u>\$ 44,961</u> |

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<sup>14</sup> Case 2020-00167, *Electronic Application of Ohio County Utilities District for an Alternative Rate Adjustment* (Ky. PSC Dec. 2, 2020). Case No. 2020-00296, *Electronic Application of Allen County Utilities District for an Alternative Rate Adjustment* (Ky. PSC Feb. 3, 2021).

In addition to health and life insurance, Gallatin District employees participate in Kentucky’s County Employee Retirement System (CERS). As part of CERS, Gallatin District makes contributions to employee’s retirement account based on annual salaries and wages. Using the pro forma Salaries and Wages – Employees Expense discussed above, Staff normalized annual contributions using the CERS rate effective July 1, 2021, of 26.95 percent as shown below.

|   |                         |
|---|-------------------------|
| Pro Forma Applicable Salaries and Wages       | \$ 259,222              |
| Multiply By: Pro Forma CERS Contribution Rate | <u>26.95%</u>           |
| Pro Forma CERS Contributions                  | <u>\$ 69,860</u>        |
| Less: Test-year CERS Contributions            | <u>(58,718)</u>         |
| Pro Forma Adjustment                          | <u><u>\$ 11,142</u></u> |

Considering both adjustments discussed above, Staff calculates a pro forma for Employee Benefits Expense should be a decrease of \$92,784 as shown below.

|  |                        |
|--|------------------------|
| Pro Forma Insurance Benefits           | \$ 44,961              |
| Pro Forma CERS Contributions           | <u>69,860</u>          |
| Pro Forma Pension and Benefits Expense | 114,821                |
| Less: Test Year Pensions and Benefits  | <u>(207,605)</u>       |
| Adjustment                             | <u><u>(92,784)</u></u> |

G. Water Loss. In its application, Gallatin District proposed adjustments to Purchased Water, Purchased Power, and Purchased Chemicals Expense of \$1,245, \$9,784, and \$1,038, respectively, to account for the district’s unaccounted for water loss in excess of 15 percent. Staff agrees that such adjustments are appropriate, but also notes that the reduction to purchased power expense should be limited to power related

to pumping. Therefore, Staff reduced Purchased Water Expense by \$9,294, as shown below.

|   | Purchased<br>Water | Purchased<br>Power | Purchased<br>Chemical | Total     |
|---|--------------------|--------------------|-----------------------|-----------|
| 2020 Pro Forma Expenses                           | \$ 7,857           | \$ 58,637          | \$ 6,547              | \$ 73,041 |
| Multiplied by: Water Loss in Excess of 15 Percent | 15.85%             | 15.85%             | 15.85%                | 15.85%    |
| Excess Cost                                       | \$ 1,245           | \$ 9,294           | \$ 1,038              | \$ 11,577 |

H. Copper & Lead Testing. In its application, Gallatin District proposed to include costs incurred during 2020 related to required lead and copper tests throughout its system. The tests cost \$8,500 and must be performed every three years. Therefore, Gallatin District proposed amortizing the cost of the test over three years, for a total pro forma adjustment increasing contractual services by \$2,833, shown below. Staff agrees this adjustment appropriate as it represents known and measurable changes and has included it in pro forma calculations.

|                               |                 |
|-------------------------------|-----------------|
| Lead & Copper Testing Expense | \$ 8,500        |
| Divide by: 3 Years            | <u>3</u>        |
| Pro Forma Testing Expense     | <u>\$ 2,833</u> |

I. Depreciation Expense. In its application, Gallatin District included \$254,942 in Depreciation Expense and proposed to reduce test-year Depreciation Expense by \$33,595 citing Commission precedent of evaluating the reasonableness of the depreciation practices of small water utilities using the National Association of Regulatory Utility Commissioners' (NARUC) report titled *Depreciation Practices for Small Utilities* (NARUC Study) published in 1979. When no evidence exists to support a specific life that is outside the NARUC ranges, the Commission has historically used the midpoint of the NARUC ranges to depreciate the utility plant.

Upon examination, Staff agrees that the adjustment proposed by Gallatin District is known and measurable and accurately reflects adjusting Gallatin District's assets' useful life to the midpoint of the life's found in the NARUC Study and has included it in pro forma operations.

#### OVERALL REVENUE REQUIREMENT AND REQUIRED REVENUE INCREASE

The Commission has historically applied a DSC method to calculate the Overall Revenue Requirement of Utilities Districts and water associations. This method allows for recovery of (1) cash-related pro forma operating expenses; (2) recovery of depreciation expense, a noncash item, to provide working capital;<sup>15</sup> (3) the average annual principal and interest payments on all long-term debts, and (4) working capital that is in addition to depreciation expense.

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<sup>15</sup> The Kentucky Supreme Court has held that the Commission must permit a Utilities 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 Utilities 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 Utilities 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).

|   | Gallatin<br>District | Staff              |
|---|----------------------|--------------------|
| Operating Expenses                              | \$ 893,161           | \$ 913,143         |
| Add: Average Annual Debt Principal and Interest | 211,697              | 211,696            |
| Additional Working Capital                      | <u>42,339</u>        | <u>42,339</u>      |
| Overall Revenue Requirement                     | 1,147,197            | 1,167,179          |
| Less: Other Operating Revenue                   | (52,532)             | (35,574)           |
| Interest Income                                 | <u>(21,799)</u>      | <u>(21,799)</u>    |
| Revenue Requirement - Water Rates               | 1,072,866            | 1,109,806          |
| Less: Normalized Revenue from Service           | <u>(1,119,119)</u>   | <u>(1,119,119)</u> |
| Required Revenue Increase                       | <u>\$ (46,253)</u>   | <u>\$ (9,313)</u>  |
| Percentage Increase                             | <u>-4.13%</u>        | <u>-0.83%</u>      |

1. Average Annual Principal and Interest Payments. At the time of Staff's review, Gallatin District had one outstanding debt obligation to Kentucky Infrastructure Authority and two to Kentucky Rural Water Finance Corporation. In its application, Gallatin 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 2021 through 2025.<sup>16</sup> Staff agrees with the methodology Gallatin District proposes. As shown in below, Staff calculated an Average Principal and Interest Payment of \$211,696.

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<sup>16</sup> Application, Attachment 4, Revenue Requirement Calculation.

| Year                          | Principal  | Interest  | Fees     | Total             |
|-------------------------------|------------|-----------|----------|-------------------|
| 2021                          | \$ 121,322 | \$ 86,465 | \$ 3,495 | \$ 211,282        |
| 2022                          | 131,666    | 81,671    | 3,317    | 216,654           |
| 2023                          | 132,014    | 76,644    | 3,134    | 211,792           |
| 2024                          | 132,366    | 71,611    | 2,950    | 206,927           |
| 2025                          | 142,723    | 66,344    | 2,760    | 211,827           |
| 5-Year Total                  |            |           |          | 1,058,482         |
| Divide By: 5 Years            |            |           |          | <u>5</u>          |
| Average Debt Service Coverage |            |           |          | <u>\$ 211,696</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. In its application, Gallatin District requested recovery of an allowance for working capital that is equal to 120 percent of its average annual debt payments for its long-term debt with the KIA at the time of its application.

KIA requires that Gallatin 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, \$42,339 is included it in the revenue requirement.

|                               |     |                  |
|-------------------------------|-----|------------------|
| Annual Debt Service Payments  |     | \$ 211,696       |
| Multplied by:                 | 20% | <u>1.20</u>      |
| Required Net Revenues         |     | 254,036          |
| Less: Annual Debt Service     |     | <u>(211,696)</u> |
| Allowance for Working Capital |     | <u>\$ 42,339</u> |

Signatures

/s/Travis Leach

Prepared by: Travis Leach  
Revenue Requirements Branch  
Division of Financial Analysis

/s/Jason Green

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

APPENDIX

APPENDIX TO A STAFF REPORT OF THE KENTUCKY PUBLIC SERVICE  
COMMISSION IN CASE NO. 2021-00396 DATED MAR 02 2022

Nonrecurring Charges

|   |        |
|---|--------|
| Connection/Turn-on Charge                 | \$9.00 |
| Connection / Turn-on Charge (After Hours) | 105.00 |
| Disconnect/Reconnect Charge               | 9.00   |
| Disconnect/Reconnect Charge (After Hours) | 105.00 |
| Field Collection Charge                   | 9.00   |
| Field Collection Charge (After Hours)     | 105.00 |
| Meter Re-Read Charge                      | 9.00   |
| Meter Test Charge                         | 58.00  |
| Returned Check Charge                     | 12.00  |
| Service Line Inspection                   | 9.00   |

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\*Tammy Hendren  
Secretary  
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