

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF NICHOLAS)	CASE NO.
COUNTY WATER DISTRICT FOR A RATE)	2021-00455
ADJUSTMENT PURSUANT TO 807 KAR 5:076)	

NOTICE OF FILING OF COMMISSION STAFF'S REPORT

Notice is hereby given that, in accordance with the Commission's Order of January 18, 2022, 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 January 18, 2022 Order, Nicholas County Water District (Nicholas 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 Nicholas 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 JUN 13 2022

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).

COMMONWEALTH OF KENTUCKY
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ELECTRONIC APPLICATION OF NICHOLAS)	CASE NO.
COUNTY WATER DISTRICT FOR A RATE)	2021-00455
ADJUSTMENT PURSUANT TO 807 KAR 5:076)	

COMMISSION STAFF'S REPORT
ON NICHOLAS COUNTY WATER DISTRICT

Nicholas County Water District (Nicholas 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 1,589 residential customers and 6 commercial customers that reside in Nicholas County, Kentucky.¹ On December 15, 2021, Nicholas 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. 2020-00145.² A review of the Commission's records from 1985 to the present revealed that Nicholas District has never sought a general base rate adjustment prior to the application in this case.

By letter dated December 17, 2021, Nicholas District was notified that the application was rejected for certain filing deficiencies. On January 4, 2022, Nicholas District cured the deficiencies, and the case was considered filed as of that date. To

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

² Case No. 2020-00145, *Electronic Purchased Water Adjustment Filing of Nicholas County Water District* (Ky. PSC May. 11, 2020) at 3, ordering paragraph 5.

ensure the orderly review of the application, the Commission established a procedural schedule by Order dated January 18, 2022. Nicholas District responded to two discovery requests from Commission Staff. On February 8, 2022, Nicholas District filed a motion requesting an additional 14 days to respond to Commission Staff's First Request for Information (Staff's First Request), which was granted by the Commission's Order dated February 21, 2022.

At that time, the procedural schedule was not revised. On May 10, 2022, the Commission amended the procedural schedule with respect to the issuance of the Commission Staff's Report that set a new procedural date of May 20, 2022. On May 20, 2022, the procedural date for the issuance of the Commission Staff's Report was amended a second time to June 15, 2022, to afford Commission Staff an opportunity to conduct additional discovery that was deemed necessary.

The May 20, 2022 amendment included an additional round of discovery requests. Nicholas District responded to Commission Staff's Third Request for Information (Staff's Third Request) on May 31, 2022.

WATER LOSS

Pursuant to 807 KAR 5:066, Section (6)3, water loss is limited to 15 percent for ratemaking purposes. Commission Staff notes that in its 2020 Annual Report, Nicholas District reported a water loss of 24.35 percent.³ At 24.35 percent water loss, the annual

³ 2020 Annual Report at 57.

cost to Nicholas District of water above the allowable 15 percent is \$30,934⁴ while the annual cost to Nicholas District is \$80,561.⁵

DISCUSSION

To comply with the requirements of 807 KAR 5:076, Section 9,⁶ Nicholas District used the calendar year ended December 31, 2020, as the basis for its application. Using the Debt Service Coverage (DSC) method and its pro forma test-year operations, Nicholas District determined that a revenue increase of \$192,735, or 26.52 percent over test-year normalized revenues of \$726,845, is warranted⁷ as shown in the table below. The proposed rates requested by Nicholas District would increase the residential monthly bill of a typical residential customer using 4,000 gallons per month by \$9.45 from \$35.62 to \$45.07, or approximately 26.53 percent.⁸

⁴ Total Cost of Water \$330,848 times 9.35% (percentage of water loss above 15%) = \$30,934.

⁵ Total Cost of Water \$330,848 times 24.35% (percentage of water loss) = \$80,561.

Adjusted Purchased Water Expense	\$	306,831
Purchased Power		24,017
 Total Cost of Water		 330,848
Times: Total Water Loss		24.35%
 Total Cost of Water Loss	 \$	 80,561

⁶ 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.

⁷ Application, Attachment 6.

⁸ Application, Attachment 1, Customer Notice.

Pro Forma Operating Expenses	\$ 745,381
Plus: Average Annual Principal and Interest Payments	145,853
Additional Working Capital	<u>29,171</u>
Overall Revenue Requirement	920,405
Less: Other Operating Revenue	
Interest Income	<u>(825)</u>
Revenue Required from Rates	919,580
Less: Pro Forma Present Rate Service Revenues	<u>(726,845)</u>
Required Revenue Increase	<u>\$ 192,735</u>
Percentage Increase	<u>26.52%</u>

To determine the reasonableness of the rates requested by Nicholas District, Commission Staff performed a limited financial review of Nicholas District's test-year operations. The scope of Commission Staff's review was limited to determining whether operations reported for the test year were representative of normal operations. Known and measurable⁹ 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.

⁹ 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 Therefore; (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).

Commission Staff's recommendations are summarized in this report. Ariel Miller reviewed the calculation of Nicholas District's Overall Revenue Requirement. Elizabeth Stefanski reviewed Nicholas 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, Commission Staff found that Nicholas District's required revenue from water sales is \$934,181 to meet the Overall Revenue Requirement of \$951,673 and that a \$161,340 revenue increase, or 20.88 percent, to pro forma present rate revenues of \$772,841 is necessary to generate the Overall Revenue Requirement.

2. Monthly Water Service Rates. In the Application, Nicholas District proposed to increase all of its monthly retail water service rates, evenly across the board by approximately 26.52 percent. Nicholas District has not performed a cost of service study (COSS). Nicholas District stated that it did not consider filing a COSS with the current rate application as there were no material changes in its system and that Nicholas District would consider preparing a new COSS if material changes in customer usage patterns were to occur.¹⁰ Nicholas District has filed three applications for purchased water adjustments in the past seven years due to increases in wholesale rates from their suppliers.¹¹ Nicholas District purchases water from four separate suppliers; the city of Carlisle, Western Fleming County Water District, Kentucky-American Water Company,

¹⁰ Nicholas District's Response to Staff's First Request (filed Feb. 22, 2022), Item 4.

¹¹ Case No. 2015-00276, *Purchased Water Adjustment Filing of Nicholas County Water District* (Ky. PSC Sept. 8, 2015); Case No. 2020-00145, *Electronic Purchased Water Adjustment Filing of Nicholas County Water District* (Ky. PSC April 19, 2020); and Case No. 2022-00132, *Electronic Purchased Water Adjustment Filing of Nicholas County Water District* (Ky. PSC April 29, 2022).

and Buffalo Trail Water Association. Each of its suppliers has not increased their wholesale rates to Nicholas District by the same amount or percentage when they have decided to increase its rates. There is concern that these increases, although passed through on a one-to-one base, may have resulted in rates that have diverged from the actual cost to serve. Therefore, to ensure that there is no subsidization between retail and wholesale customers, Commission Staff recommends the Commission order Nicholas District to perform a full COSS that incorporates its retail and wholesale rates within three years to determine if a change in rate design is necessary.

The Commission has previously found that the allocation of a revenue increase evenly across the board to a utility's rate design is appropriate when there has been no evidence entered into the record demonstrating that this method is unreasonable and in the absence of a COSS. Finding no such evidence in this case, Commission Staff followed the method proposed by Nicholas District and allocated the \$161,340 revenue increase across the board to Nicholas 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 Commission Staff, and will produce sufficient revenues from water sales to recover the \$934,181 Revenue Required from Rates, an approximate 20.88 percent increase. These rates will increase a typical residential customer's monthly water bill from \$37.26¹² to \$45.00, an increase of \$7.74, or approximately 22.77 percent.

¹² This is updated based upon Case No. 2022-00132, *Electronic Purchased Water Adjustment Filing of Nicholas County Water District* (filed on Apr. 29, 2022), Appendix B and an average usage of 4,000 gallons.

3. Nonrecurring Charges. Following the Commission’s recent decisions,¹³ Commission Staff has reviewed Nicholas District’s Nonrecurring Charges. The Commission found that because 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. Nicholas District provided the cost justification information for the nonrecurring charges.¹⁴ Commission Staff reviewed the cost justification information provided by Nicholas District and have adjusted these charges by removing Field Labor Costs and Office/Clerical Labor Costs from those charges that occur during normal business hours. Nicholas District also provided information about the Returned Payment Charge,¹⁵ to which Commission Staff adjusted the charge to zero, as Nicholas District’s bank no longer charges it a fee for a returned check.¹⁶ Such adjustments result in the following revised Nonrecurring Charges:

<u>Nonrecurring Charge</u>	<u>Current Charge</u>	<u>Revised Charge</u>
Late Payment Charge	10%	10%
Disconnection Charge	\$55.00	\$8.00
Reconnect Charge	\$55.00	\$8.00
Returned Payment Charge	\$20.00	\$0.00
Service Call/Investigation	\$55.00	\$8.00
Service Call/Investigation After Hours	\$70.00	\$57.00
Meter Test Request	\$70.00	\$23.00
Lock Replacement	\$15.00	\$15.00

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 Nicholas District’s Response to Staff’s First Request, Item 7.

¹⁵ Nicholas District’s Response to Staff’s Third Request, Item 3.

¹⁶ Nicholas District’s Response to Staff’s Third Request, Item 3.

The adjustments to the Nonrecurring Charges results in an increase to Other Water Revenue of \$655 and a decrease to Retail Sales of Water of \$4,655 as shown below.¹⁷

	No. of Occurrences	Current NRC	Other Water	Adjusted NRC	Pro Forma
Disconnection Charge	43	\$55	2,365	8	344
Reconnection Fee	37	55	2,035	8	296
Returned Payment Charge	12	20	240	-	-
Lock Replacement Charge	1	15	15	15	15
			<u>\$ 4,655</u>		<u>\$ 655</u>

4. Rate Case Expense. Commission Staff notes that Nicholas District did not make a pro forma adjustment to amortize any costs attributable to the preparation of its application for rate adjustment. In its response to Commission Staff’s Report, Nicholas District should identify any additional costs that were incurred in preparation for this case.

PRO FORMA OPERATING STATEMENT

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

¹⁷ Nicholas District’s Response to Staff’s First Request, Item 7.

	Test Year	Adjustment	(Ref.)	Pro Forma
Operating Revenues				
Sales of Water	\$ 715,847	\$ (7,180)	(A)	
		64,174	(B)	\$ 772,841
Late Payment Penalties		16,012	(C)	16,012
Other Water Revenues		655	(A)	655
	<u>715,847</u>	<u>73,661</u>		<u>789,508</u>
Operating Expenses				
Operation and Maintenance Expenses				
Salaries and Wages - Employees	153,331	(9,400)	(D)	143,931
Salaries and Wages - Commissioners	2,400	7,000	(D)	9,400
Employee Pensions and Benefits	94,517	(34,838)	(E)	59,679
Purchased Water	257,522	49,309	(F)	
		(28,689)	(G)	278,142
Purchased Power for Pumping	24,017	(2,246)	(G)	21,771
Chemicals				-
Materials and Supplies	33,244			33,244
Contractual Services	36,164			36,164
Water Testing	7,715			7,715
Transportation Expense				-
Insurance	15,344			15,344
Regulatory Commission Expense				-
Bad Debt Expense				-
Miscellaneous Expense	26,177			26,177
	<u>650,431</u>	<u>(18,863)</u>		<u>631,568</u>
Total Operation and Maintenance Expenses	650,431	(18,863)		631,568
Taxes Other Than Income	1,460			1,460
Depreciation	202,493	(58,871)	(H)	143,622
	<u>854,384</u>	<u>(77,734)</u>		<u>776,650</u>
Total Operating Expenses	854,384	(77,734)		776,650
Net Operating Income	(138,537)	151,395		12,858
Interest Income	825			825
	<u>\$ (137,712)</u>	<u>\$ 151,395</u>		<u>\$ 13,683</u>
Income Available to Service Debt	\$ (137,712)	\$ 151,395		\$ 13,683

(A) Nonrecurring Charges. In its application, Nicholas District included nonrecurring charges revenue and late payment penalties in its retail sales revenue. Nicholas District provided information about the nonrecurring charges revenue,¹⁸ and Commission Staff calculated an adjustment to Other Water Revenue, removing labor

¹⁸ Nicholas District's Response to Staff's First Request, Item 6, and Nicholas District's Response to Commission Staff's Second Request for Information (Staff Second Request) (filed Apr. 5, 2022), Item 5.

costs as discussed above. The adjustments to Nonrecurring Charges results in an increase to Other Water Revenue of \$655 and a decrease to Retail Sales of Water of \$7,180 as shown below.

	No. of Occurrences	Current NRC	Other Water Revenue	Adjusted NRC	Pro Forma
Late Payment Charge	586	10%	\$ 2,525		
Disconnection Charge	43	\$55	2,365	\$8	344
Reconnection Fee	37	55	2,035	8	296
Returned Payment Charge	12	20	240	\$0	\$0
Lock Replacement Charge	1	15	15	15	15
			\$ 7,180		\$ 655

(B) Billing Analysis Adjustment. In its application, Nicholas District made an adjustment of \$10,998 to Metered Water Sales and provided a billing analysis listing the water usage and water sales revenue for the 12-month test year in its application, with total metered water sales revenue reported as \$726,845.¹⁹ According to Nicholas District’s 2020 Annual Report, the total metered water sales revenue reported for the test year is \$715,847.²⁰ During the test year, Nicholas District increased its service rates through a purchase water adjustment (PWA), due to an increase from its supplier.²¹ In addition, on April 29, 2022, Nicholas District submitted a PWA to increase its service rates

¹⁹ Application, Attachment 5, Schedule of Adjusted Operations.

²⁰ 2020 Annual Report at 49.

²¹ Case No. 2020-00185, *Electronic Purchased Water Adjustment Filing of Nicholas County Water District* (Ky. PSC May 11, 2020).

effectively on March 29, 2022.²² Commission Staff has adjusted the normalized revenue to include this recent increase. Nicholas District provided usage data,²³ and billing adjustment information²⁴ which Nicholas District later revised.²⁵ Nicholas District revised the net billing adjustment amount from \$5,209, to \$2,966²⁶ for Meter Mis-reads and \$764²⁷ for Water Leak Adjustments, totalling \$3,730. Commission Staff calculated a normalized revenue amount based on the statistics compiled in the table below, which include two PWA increases and net billing adjustments²⁸ for a normalized revenue of \$772,841. Accordingly, Commission Staff increased test-year water sales revenue by \$64,174 to reflect the increase in rates.

²² Case No. 2022-00132, *Electronic Purchased Water Adjustment Filing of Nicholas County Water District* (Ky. PSC May 18, 2022).

²³ Nicholas District's Response to Staff's First Request, Item 9a–9d.

²⁴ Nicholas District's Response to Staff's First Request, Item 9a, and Nicholas District's Response to Staff's Second Request, Item 5 and Item 7.

²⁵ Nicholas District's Response to Staff's Second Request, Item 7. Note that the amount listed in the response is a transposition of the actual amount included in response to Staff's Second Request, Item 5, for Meter Mis-reads and Water Leak Adjustments of \$3,730.

²⁶ Nicholas District's Response to Staff's First Request, Item 6, and Nicholas District's Response to Staff's Second Request, Item 5.

²⁷ Nicholas District's Response to Staff's First Request, Item 6, and Nicholas District's Response to Staff's Second Request, Item 5.

²⁸ Nicholas District's Response to Staff's First Request, Item 6, and Nicholas District's Response to Staff's Second Request, Item 5.

Meter Size	Bills	Gallons Sold	Revenue
5/8 inch	18721	75,403,830	\$ 663,197
Wholesale	731	26,815,100	91,976
1 inch	204	1,923,750	13,699
1.5 inch	12	582,000	3,011
2 inch	50	563,500	4,689
Totals	19,718	105,288,180	776,571
Less: Billing Adjustments			(3,730)
			\$ 772,841

(C) Late Payment Charges. In its application, Nicholas District included Forfeited Discount revenue within the total retail sales revenue. Nicholas District provided information about the test year late payment charges totaling \$2,525.²⁹ Commission Staff reduced Retail Water Sales by \$2,525 as part of its \$7,180 adjustment discussed in adjustment (A) above. Due to the fact that Nicholas District's test year of 2020 occurred during the moratorium regarding the collection of late payment fees due to the COVID-19 pandemic, the Late Payment revenue from the test year is not representative of amounts that would normally be collected in an annual period. Nicholas District provided Commission Staff with the total annual late payment revenue from each of the three years prior to 2020.³⁰ Commission Staff relied upon this information and calculated a three-year average of reported late payment fee revenue of \$16,012³¹ in order to normalize the adjustment needed for this revenue stream. Commission Staff increased Other Water Revenue by the adjusted amount of \$16,012.

²⁹ Nicholas District's Response to Staff's First Request, Item 6.

³⁰ Nicholas District's Response to Staff's Third Request, Item 1.

³¹ \$17,641 (2019); \$20,104 (2018); \$10,291 (2017); divided by 3 equals \$16,012.

(D) Salaries and Wages - Commissioners. In its application, Nicholas District made a reclassification adjustment to move Salaries and Wages – Commissioners to the proper category in the pro forma which reduced Salaries and Wages – Employees by \$9,400. As part of the reclassification, Nicholas District increased Salaries and Wages – Commissioners by \$7,000. The net effect of the two adjustments, a reduction of \$2,400 was to reflect its board chairman no longer accepting payment for being a board member.³² Nicholas District stated that it was unable to locate any fiscal court minutes approving any commissioner appointments or minutes setting commissioner compensation.³³ Commission Staff believes that the amounts paid to Nicholas District's board of commissioners is reasonable and is consistent with the limitations set by KRS 74.020 Section 6, but is concerned that neither Nicholas District, nor the fiscal court is able to locate any documentation regarding board appointments or commissioner salaries. Therefore, Commission Staff recommends the Commission order Nicholas District to ensure that the fiscal court address these discrepancies at its next available fiscal court meeting. Accordingly, Commission Staff implemented Nicholas District's proposed reclassification adjustment and additionally reduced Salaries and Wages – Commissioners by \$2,400.

(E) Governmental Accounting Standards Board Statement No. 68. In its application, Nicholas District proposed to decrease Employee Pensions and Benefits \$34,838 to remove the effects of journal entries made by Nicholas District's auditor to

³² Application, Attachment 5, Adjustment B.

³³ Nicholas District's Response to Staff's First Request, Item 1.h. and Nicholas District's Response to Staff's Second Request, Item 3.

conform to the requirements of the Governmental Accounting Standards Board Statement No. 68 and No. 75 (GASB 68 and 75).³⁴

In Case No. 2016-00163,³⁵ Commission Staff discussed in great detail how reporting requirements for GASB 68 and 75 would affect a utility's income statement and balance sheet. In that proceeding, Commission Staff found that the annual pension expense should be equal to the amount of a district's contribution to CERS, which historically have been very constant.³⁶ Consistent with Commission Staff's previous practice, Commission Staff agrees with the proposal to reduce expenses related to GASB 68 and 75 and reduced Employee Pensions and Benefits by \$34,838.

(F) Purchased Water Adjustment. In its application, Nicholas District proposed to increase Purchased Water expense \$13,444 to reflect a purchased water adjustment that occurred during the test period.³⁷ Commission Staff agrees that the proposed \$13,444 is reasonable and should be accepted to reflect the purchased water adjustment that occurred in the test period, but recommends an additional \$35,865 increase to Purchased Water expense to reflect the impact of the purchased water adjustment filed in Case No. 2022-00132.³⁸ Accordingly, Commission Staff increased Purchased Water expense \$49,309.

³⁴ Application, Attachment 5, Adjustment C.

³⁵ Case No. 2016-00163, *Alternative Rate Adjustment Filing of Marion County Water District* (Ky. PSC Aug 11, 2016), Commission Staff's Report on Marion County Water District at 11–27.

³⁶ Case No. 2016-00163, *Alternative Rate Adjustment Filing of Marion County Water District* (Ky. PSC Aug 11, 2016), Commission Staff's Report on Marion County Water District at 26.

³⁷ Case No. 2020-00145, *Electronic Purchased Water Adjustment Filing of Nicholas County Water District* (Ky. PSC May 11, 2020).

³⁸ Case No. 2022-00132, *Electronic Purchased Water Adjustment Filing of Nicholas County Water District* (filed on Apr. 29, 2022), Application, Exhibit B.

(G) Water Loss. Nicholas District's test year water loss was 24.35 percent.³⁹ Commission regulation 807 KAR 5:066, Section 6(3), limits water loss to 15 percent for ratemaking purposes unless the Commission finds an alternative level is reasonable. In its application, Nicholas District proposed to reduce Purchased Water and Purchased Power expenses by \$10,647 and \$2,247, respectively, to reflect the limitation stated in the regulation.⁴⁰ Commission Staff agrees that the regulation has been properly applied by Nicholas District but disagrees with the amount of Purchased Water expense Nicholas District applied in its adjustment. Commission Staff believes the amount of pro forma Purchased Water is the correct amount to apply in the calculation of disallowed water loss. Therefore, Commission Staff adjusted Purchased Water expense by the pro forma expense calculated in Adjustment (F) as described above, to reflect the true impact of water loss in excess of 15 percent to Nicholas District's Purchased Water Expense. Therefore, Commission Staff reduced Pro Forma Purchased Water and Purchased Power by \$28,689 and \$2,246, respectively, for a total reduction of \$30,934 as shown in the calculation below.

Adjusted Purchased Water Expense	\$	306,831
Test Year Purchased Power		<u>24,017</u>
Total Cost of Water		330,848
Times: Excess Water Loss Percentage		<u>9.35%</u>
Expenses Disallowed for Ratemaking Purposes	\$	<u><u>30,934</u></u>

³⁹ Application, Attachment 5, Adjustment E.

⁴⁰ Application, Attachment 5, Adjustment E.

(H) Depreciation Expense. In its application, Nicholas District reported a test-year Depreciation expense of \$202,493. To evaluate the reasonableness of the depreciation practices of small water utilities, the Commission has historically relied upon the report published in 1979 by the National Association of Regulatory Utility Commissioners (NARUC) titled *Depreciation Practices for Small Water Utilities* (NARUC Study). When no evidence exists to support a specific life that is outside the NARUC Study ranges, the Commission has historically used the midpoint of the NARUC ranges to depreciate water utility plant.

In its application, Nicholas District proposed to decrease Depreciation Expense \$58,871 to adjust the lives of assets on its depreciation schedule to bring them to the midpoint of the NARUC recommended ranges.⁴¹ Commission Staff agrees with Nicholas District's proposed adjustments and decreased pro forma Depreciation Expense \$58,871 accordingly.

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

⁴¹ Application, Attachment 5, Adjustment F.

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

and interest payments on all long-term debts; and (4) working capital that is in addition to depreciation expense. A comparison of Nicholas District's and Commission Staff's calculation of the Overall Revenue Requirement and Required Revenue Increase using a DSC method is shown below. Commission Staff notes that Nicholas District did not include any Other Operating Revenues recorded for the test period, or in its proposed Pro Forma in its calculation of the Revenue Requirement. Therefore, Commission Staff included this information in its calculation.

	Nicholas District	Commission Staff	
Pro Forma Operating Expenses	\$ 745,381	\$ 776,650	
Plus: Average Annual Principal and Interest Payments	145,853	145,853	(1)
Additional Working Capital	29,171	29,171	(2)
	<hr/>	<hr/>	
Overall Revenue Requirement	920,405	951,673	
Less: Other Operating Revenue		(16,667)	
Interest Income	(825)	(825)	
	<hr/>	<hr/>	
Revenue Required from Rates	919,580	934,181	
Less: Pro Forma Present Rate Service Revenues	(726,845)	(772,841)	
	<hr/>	<hr/>	
Required Revenue Increase	<u>\$ 192,735</u>	<u>\$ 161,340</u>	
Percentage Increase	<u>26.52%</u>	<u>20.88%</u>	

1. Average Annual Principal and Interest Payments. At the time of Commission Staff's review, Nicholas District has two bonds payable to the United States Department of Agriculture Rural Development (RD), and one loan payable to the Kentucky Rural Water Finance Corporation (KRWFC). In its application, Nicholas District

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).

requested recovery of the average annual principal and interest on its indebtedness based on a three-year average of the annual principal, and interest and fee payments for the years 2022 through 2024. Commission Staff agrees with the methodology and calculation that Nicholas District proposed and therefore included principal and interest payments of \$145,853 in the calculation of the revenue requirement.

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, Nicholas 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 RD and KRWFC at the time of its application. RD requires that Nicholas 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 of including additional working capital, \$29,171 is included in the revenue requirement.

Signatures

/s/ Ariel Miller

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

/s/Elizabeth Stefanski

Prepared by: Elizabeth Stefanski
Rate Design Branch
Division of Financial Analysis

APPENDIX

APPENDIX TO COMMISSION STAFF'S REPORT OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2021-00455 DATED JUN 13 2022

The following rates and charges are prescribed for the customers in the area served by Nicholas 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	\$18.56	Minimum Bill
Next	2,000 Gallons	0.00927	Per Gallon
Next	2,000 Gallons	0.00777	Per Gallon
Next	5,000 Gallons	0.00638	Per Gallon
Next	15,000 Gallons	0.00584	Per Gallon
Over	25,000 Gallons	0.00555	Per Gallon

1-Inch Meter

First	3,000 Gallons	\$37.20	Minimum Bill
Next	2,000 Gallons	0.00777	Per Gallon
Next	5,000 Gallons	0.00638	Per Gallon
Next	15,000 Gallons	0.00584	Per Gallon
Over	25,000 Gallons	0.00555	Per Gallon

1 1/2-Inch Meter

First	5,000 Gallons	\$52.81	Minimum Bill
Next	5,000 Gallons	0.00638	Per Gallon
Next	15,000 Gallons	0.00584	Per Gallon
Over	25,000 Gallons	0.00555	Per Gallon

2-Inch Meter

First	10,000 Gallons	\$84.91	Minimum Bill
Next	15,000 Gallons	0.00584	Per Gallon
Over	25,000 Gallons	0.00555	Per Gallon

3-Inch Meter

First	15,000 Gallons	\$114.28	Minimum Bill
Next	10,000 Gallons	0.00584	Per Gallon

Over 25,000 Gallons 0.00555 Per Gallon

4-Inch Meter

First 25,000 Gallons \$173.03 Minimum Bill

Over 25,000 Gallons 0.00555 Per Gallon

Wholesale Rates

Harrison County Water Association \$0.00410 Per Gallon

Nonrecurring Charges

5/8- x 3/4 Inch Water Tap On \$1,000.00

Late Payment Charge 10%

Disconnection Charge \$ 8.00

Reconnection Charge \$ 8.00

Returned Payment Charge \$ 0.00

Service Call/Investigation \$ 8.00

Service Call/Investigation After Hours \$ 57.00

Meter Test Request \$ 23.00

Lock Replacement \$ 15.00

Damage to Meter, Meter Setting or Lid Actual Cost

Meter Relocation Actual Cost

*David P. Foster
Rural Community Assistance Partnership
101 Burch Court
Frankfort, KENTUCKY 40601

*Nicholas County Water District
1639 Old Paris Road
Carlisle, KY 40311

*Monica Pryor
Office Manager
Nicholas County Water District
1639 Old Paris Road
Carlisle, KY 40311