

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF SOUTHERN)	CASE NO.
WATER AND SEWER DISTRICT FOR AN)	2022-00099
ALTERNATIVE RATE ADJUSTMENT)	

NOTICE OF FILING OF COMMISSION STAFF'S REPORT

Notice is hereby given that, in accordance with the Commission's Order of May 3, 2022, as amended on June 14, 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 June 14, 2022 Order, Southern Water and Sewer District (Southern 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 Southern 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 AUG 26 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).

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COMMISSION STAFF'S REPORT
ON SOUTHERN WATER AND SEWER DISTRICT

Southern Water and Sewer District (Southern 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 5,224 residential customers, 204 commercial customers, and 2 wholesale customers that reside in Floyd and Knott counties, Kentucky.¹ On March 30, 2022, Southern 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. 2019-00131,² which was later amended by the Commission's Order in Case No. 2020-00121.³ Southern District's last base rate increase pursuant to the alternative rate filing procedure was in Case No. 2019-00131.⁴ To ensure the orderly review of the application, the Commission established a procedural schedule by Order dated May 3, 2022.

¹ *Annual Report of Southern District to the Public Service Commission for the Calendar Year Ended December 31, 2021* (2021 Annual Report) at 12 and 49.

² Case No. 2019-00131, *Application of Southern Water District for an Alternative Rate Adjustment* (Ky. PSC Nov 7, 2019) (November 7, 2019 Order), ordering paragraph 7.

³ Case No. 2020-00121, *Electronic Southern Water & Sewer District Meter Replacement Surcharge Monitoring* (Ky. PSC Oct 1, 2021), ordering paragraph 3.

⁴ Case No. 2019-00131, Nov 7, 2019 Order.

Commission Staff issued its first round of formal discovery (Staff's First Request) on May 10, 2022. On May 31, 2022, Southern District filed a motion for extension of time to file its response to Staff's First Request. The Commission granted Southern District's motion on June 14, 2022, which also amended the procedural schedule to allow Commission Staff additional time to perform discovery and to extend the filing date for Commission Staff's Report. Southern District filed its response to Staff's First Request on June 10, 2022. Commission Staff issued its second round of formal discovery (Staff's Second Request) on July 1, 2022, and Southern District filed its response on July 18, 2022. Staff issued a third round of formal discovery (Staff's Third Request) on July 29, 2022, and Southern District filed its response on August 10, 2022.

WATER LOSS

The Commission Staff notes that in the 2021 Annual Report, Southern District reported a water loss of 54.7978 percent.⁵ 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 a 54.7978 percent water loss, the annual cost of water loss, in excess of

⁵ 2021 Annual Report at 57.

15.00 percent is \$360,558 and the total annual cost of water loss to Southern District is \$519,710.⁶

DISCUSSION

To comply with the requirements of 807 KAR 5:076, Section 9,⁷ Southern District used the calendar year ended December 31, 2021, as the basis for its application. Using its pro forma test-year operations, Southern District determined that a base rate revenue increase of \$275,222, or 8.22 percent was necessary to achieve the revenue requirement as shown in the table below.

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	Water	Power	Chemicals	Total
Purchased Cost (SAO)	\$ 342,556	\$ 428,312	\$ 204,950	\$ 975,818
Exclude Natural Gas		(4,694)		(4,694)
Exclude Telephone	0	(22,709)	0	(22,709)
Adjusted Purchase Costs	\$ 342,556	\$ 400,909	\$ 204,950	\$ 948,415
Water Loss Percent	54.7978%	54.7978%	54.7978%	54.7978%
Total Water Loss	<u>\$ 187,713</u>	<u>\$ 219,689</u>	<u>\$ 112,308</u>	<u>\$ 519,710</u>
Adjusted Purchase Costs	\$ 342,556	\$ 400,909	\$ 204,950	\$ 948,415
Water Cost for Internal Use (5.7082%)	(19,554)	(22,885)	n/a	(42,439)
sub-total	\$ 323,002	\$ 378,024	\$ 204,950	\$ 905,976
Percent of Water Loss Disallowed	39.7978%	39.7978%	39.7978%	
Water Loss in Excess of Allowed Amount	<u>\$ 128,548</u>	<u>\$ 150,445</u>	<u>\$ 81,565</u>	<u>\$ 360,558</u>

⁷ 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.

Pro Forma Operating Expenses	3,196,378
Plus: Average Annual Principal and Interest Payment:	415,945
Additional Working Capital	83,189
	<hr/>
Overall Revenue Requirement	3,695,512
Less: Other Operating Revenue	(97,107)
Interest Income	23
Other Operating Income	26,301
	<hr/>
Revenue Required from Rates	3,624,729
Less: Pro Forma Present Rate Service Revenues	(3,349,507)
	<hr/>
Required Revenue Increase	<u>\$ 275,222</u>
Percentage Increase	<u>8.22%</u>

Southern District stated that they did not wish to request to increase its retail rates or the bulk loading station rate citing “the many operational changes that have occurred over the past few years and are planned for the near future.”⁸ To determine the reasonableness of Southern District’s request, Commission Staff performed a limited financial review of Southern 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

⁸ Application, Exhibit 2, Reason for Application.

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, *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); and Case No. 2017-00417, *Electronic Proposed Adjustment of the Wholesale Water Service Rates of Lebanon Water Works* (Ky. PSC July 12, 2018).

material. Insignificant and immaterial discrepancies were not necessarily pursued or addressed.

Commission Staff's findings are summarized in this report. Ariel Miller and Jeff Abshire reviewed the calculation of Southern District's Overall Revenue Requirement and Eddie Beavers reviewed Southern 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 Southern District's required revenue from water sales is \$3,648,686 to meet the Overall Revenue Requirement of \$3,741,325 and that a \$299,178 revenue increase, or 8.93 percent, to pro forma present rate revenues is necessary to generate the Overall Revenue Requirement.

2. Monthly Water Service Rates. Southern District found that it needed an increase of approximately 8.22 percent. Southern District stated that it did not wish to request an increase to its monthly retail and wholesale water service rates, asserting that operational changes are expected to have a significant, positive impact on Southern District's financial situation.¹⁰ Southern District has not performed a cost of service study (COSS). Southern District stated that it did not complete a COSS at this time because there have been no material changes in the water system.¹¹

¹⁰ Application, Exhibit 2, Reason for Application. Among the operational changes expected to positively impact Southern District's financial condition include water loss reduction through leak detection and repairs; replacing meters with radio read meters; and changes to employee benefits.

¹¹ Southern District's Response to Staff's First Request, Item 5.

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 has followed the method previously accepted by the Commission and has allocated the \$299,178 revenue increase evenly across the board to Southern District's monthly retail and wholesale water service rates.

The rates set forth in Appendix A 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 \$3,648,686 Revenue Required from Rates, an approximate 8.93 percent increase. These rates will increase a typical residential customer's monthly water bill from \$41.46 to \$45.17, an increase of \$3.71, or approximately 8.95 percent.¹²

Southern District filed a progress report in Case No. 2020-00121, stating that they had completed the installation of the residential meters as of October 5, 2020,¹³ and had converted all residential customers from flat rate billing to the Customer Charge and

¹² The typical residential customer uses approximately 3,000 gallons per month.

¹³ Case No. 2020-00121, *Electronic Southern Water & Sewer District Meter Replacement Surcharge Monitoring* (filed May 7, 2021), Annual Progress Report at unnumbered page 3 of the report.

volumetric billing on October 31, 2020.¹⁴ Commission Staff has eliminated any reference to the flat rate in the Appendix to the Commission Staff Report and would recommend the Commission approve the elimination of the flat rate charge in the future tariff filing.

3. Nonrecurring Charges. Following the Commission's recent decisions,¹⁵ Commission Staff has reviewed Southern 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. Commission Staff has reviewed the most recent cost justification information and made adjustments based on the information provided.¹⁶ Such adjustments result in the following revised nonrecurring charges:

¹⁴ Pursuant to the Commission's June 6, 2019 Order in Case No. 2019-00131, Southern District was ordered to convert all retail customer rates to a flat rate of \$58.82 per month. In its July 17, 2019 Order in Case No. 2019-00131, the rate charge to commercial customers was replaced with a volumetric rate and Southern District tariff was updated shortly thereafter. However, the flat rate charged to residential customers remained in the tariff and was authorized to be charged to any customer that had not yet had its meter replaced pursuant to the Commission's directives in the June 6, 2019 Order. To date, no action has been taken by Southern District or the Commission to remove reference to the flat rate for residential customers from Southern District's tariff. No current Southern District customer is currently being charged the flat rate and therefore the existence of the flat rate in Southern District's tariff is no longer necessary.

¹⁵ 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).

¹⁶ TFS 2013-00339, *Tariff Filing of Southern District* (PSC Letter, Jan. 21, 2013) and Southern District's Response to Staff's First Request, Item 10.

Nonrecurring Charges

Connection/Turn On Charge	\$20.00
Connection/Turn On Charge, After Hours	\$88.00
Meter Re-read Charge	\$20.00
Meter Test Charge	\$50.00
Reconnection Charge	\$20.00
Reconnection Charge, After Hours	\$88.00
Returned Check Charge	\$10.00
Service Call/Investigation Charge	\$20.00
Service Call/Investigation Charge, After Hours	\$88.00

The adjustments to the Nonrecurring Charges results in a decrease to the test-year nonrecurring charge revenue and an increase to the total revenue requirement of \$1,239 as shown below.

	Num. ¹⁷	Current Rate	Total	Revised Rate	Adj.	Pro Forma
Other Water Revenues:						
Connection/Turn On Charge	11	\$40.00	\$440	\$20.00	(\$220)	\$220
Reconnection Charge	11	\$40.00	\$440	\$20.00	(\$220)	\$220
Returned Check Charge	41	\$29.00	\$1,189	\$10.00	(\$779)	\$410
Service Call/Investigation Charge	1	\$40.00	\$40	\$20.00	(\$20)	\$20
Total Other Water Revenues			\$2,109		(\$1,239)	\$870

4. Surcharge. Southern District is currently collecting a meter replacement surcharge of \$5.25 per customer per month that was approved in its last base rate case.¹⁸ The purpose of the surcharge is to fund and replace all of Southern District's customer meters and is effective for 60 months or until the cost of new meters had been assessed, whichever occurs first. Southern District reports its surcharge collections and payments

¹⁷ Southern District's Response to Staff's First Request, Item 9.

¹⁸ Case No. 2021-00131, *Application of Southern Water and Sewer District for an Alternative Rate Adjustment* (Ky. PSC Nov 7, 2019).

to Cobank monthly in Case No. 2020-00121.¹⁹ Commission Staff recommends no change to the surcharge at this time.

PRO FORMA OPERATING STATEMENT

Southern District's Pro Forma Operating Statement for the test year ended December 31, 2021, as determined by Commission Staff, appears below.

¹⁹ Case No. 2020-00121 *Electronic Southern Water & Sewer District Meter Replacement Surcharge Monitoring* (Ky. PSC Apr 8, 2020).

	Test Year	Adjustment	(Ref.)	Pro Forma
Operating Revenues				
Sales of Water	\$ 3,472,502	\$ (198,574)	(A)	\$ 3,273,928
Sales for Resale	71,634	3,946	(A)	75,580
Forfeited Discounts	83,003	(20,417)	(B)	62,586
Other Water Revenues				
Meter Service	809	(809)	(D)	
Tap Fees	15,215	(15,215)	(D)	
Other	2,247	(1,377)	(C)	
Wastewater Billing and Collection Fees	11,045	(11,045)	(O)	870
Total Operating Revenues	<u>3,656,455</u>	<u>(243,491)</u>		<u>3,412,964</u>
Operating Expenses				
Operation and Maintenance Expenses				
Salaries and Wages - Employees	721,850	(35,225)	(E)	
		(7,200)	(F)	679,425
Salaries and Wages - Commissioners	18,000	12,000	(G)	30,000
Employee Pensions and Benefits	204,152	(1,867)	(H)	
		(31,853)	(I)	170,432
Purchased Water	342,556	(128,548)	(J)	214,008
Purchased Power for Pumping	428,312	(150,445)	(J)	277,867
Chemicals	204,950	(76,910)	(J)	128,040
Materials and Supplies	206,762	(16,800)	(F)	
		(5,000)	(K)	184,962
Contractual Services - Acctg & Legal	61,531			61,531
Contractual Services - Mgmt Fees	213,438			213,438
Contractual Services - Other	39,745			39,745
Transportation	62,179			62,179
Insurance	106,224			106,224
Advertising	5,059			5,059
Bad Debt	106,691			106,691
Miscellaneous	19,500			19,500
Total Operation and Maintenance Expenses	2,740,949	(441,848)		2,299,101
Taxes Other Than Income	63,345	(2,832)	(L)	60,513
Amortization	2,460			2,460
Depreciation	902,114	(43,000)	(M)	
		250	(N)	859,364
Total Operating Expenses	<u>3,708,868</u>	<u>(487,430)</u>		<u>3,221,438</u>
Net Operating Income	(52,413)	243,939		191,526
Interest Income	23			23
Nonutility Income - Wastewater Billing		2,859	(O)	2,859
Nonutility Income - Garbage Collection Billing	26,301		(O)	26,301
Income Available to Service Debt	<u>\$ (26,089)</u>	<u>\$ 246,798</u>		<u>\$ 220,709</u>

(A) Billing Analysis Adjustment. Southern District proposed to decrease its test-year revenues from retail water sales of \$3,472,502 by \$198,574 and to increase its test-year revenues from wholesale water sales of \$71,634 by \$3,946 to reflect required

adjustments due to the billing analysis.²⁰ Southern District's adjustment meets the ratemaking criteria of being known and measurable and Commission Staff recommends acceptance of the proposed adjustment and therefore included the amounts in Pro Forma operations.

(B) Forfeited Discounts. In its application, Southern District included \$83,003 for Forfeited Discounts.²¹ Southern District provided the late payment penalties collected during the years, 2017 through 2021.²² Commission Staff adjusted Southern District's test year Forfeited Discounts as the 2021 Forfeited Discount Revenue may be overstated due to the lifting of the 2020 moratorium regarding the collection of late payment penalties due to the COVID-19 pandemic. Therefore, Commission Staff applied the three-year average of 2017 through 2019, or \$62,586, which is consistent with Commission precedent.²³ As a result, Commission Staff decreased test year Forfeited Discounts by \$20,417.

(C) Nonrecurring Charges. Southern District reported test year nonrecurring charge revenues of \$29,319.²⁴ In its application, Southern District proposed to decrease Other Water Revenues by \$15,215 to remove amounts collected for tap fees, as discussed in adjustment (D) below, but made no adjustment regarding Wastewater Billing

²⁰ Application, Exhibit 4, Statement of Adjusted Operations, Adjustment A.

²¹ Application, Exhibit 4, Statement of Adjusted Operations.

²² Southern District's Response to Staff's First Request, Item 8.

²³ Case No. 2021-00475, *Electronic Application of Carroll County Water District, No. 1 for an Adjustment of Rates* Pursuant to 807 KAR 5:076 (Ky. PSC Jun. 28, 2022).

²⁴ Application, Exhibit 4, Statement of Adjusted Operations. The breakdown of Other Water Revenues includes Meter Service \$809 + Tap Fees \$15,218 + Other \$2,247 + Wastewater Billing and Collection Fees \$11,045 = \$29,319.

and Collection Fees,²⁵ nor any adjustment to nonrecurring charges. Regarding the nonrecurring charges, Commission Staff decreased Other Water Revenues by \$1,377 which was the combined result of Commission Staff's recommendations on nonrecurring charges discussed above of \$(1,239),²⁶ as well as misclassified revenues of \$138 that were identified upon Commission Staff's review of the 2021 general ledger.²⁷

(D) Tap Fee Revenue. In the application, Southern District proposed pro forma adjustments to decrease Other Water Revenues by \$15,215 to reclassify tap on fees as contributed capital.²⁸ Upon review of the general ledger, Commission Staff determined that an additional decrease of \$809²⁹ was necessary due to a misclassification of revenues for Meter Services, which should be included as contributed capital along with the test period tap fees. Accordingly, Commission Staff decreased Other Water Revenues \$809 and \$15,215 to reflect the capitalization of these items.

(E) Salaries and Wages - Employees. In its application, Southern District proposed a decrease of \$35,225 to Salaries and Wages – Employees expense to reflect the net effect of vacancies, new hires and authorized wage increases subsequent to the test year.³⁰ Commission Staff reviewed Southern District's calculations and determined the proposed adjustments are an accurate representation of the decrease in the annual

²⁵ Commission Staff addresses the reclassification of this revenue in Adjustment (O).

²⁶ Commission Staff recommends a decrease to Other Water Revenues of \$1,599 that is a direct result of the changes to the nonrecurring charges.

²⁷ Southern District's Response to Staff's First Request, Item 1a, SWS1_1.a-General_Ledger_2021.xlsx.

²⁸ Application, Exhibit 4, Statement of Adjusted Operations, Adjustment B.

²⁹ Southern District's Response to Staff's First Request, Item 1a, SWS1_1.a-General_Ledger_2021.xlsx.

³⁰ Application, Exhibit 4, Statement of Adjusted Operations, References, Adjustment C.

labor expense to Southern District. Accordingly, Commission Staff decreased Salaries and Wages \$35,225.

(F) Capitalization of Cost of Customer Taps. During the test year Southern District installed 32 regular meter connections.³¹ Southern District proposed to reduce Salaries and Wages expense by \$7,200 and Materials and Supplies expense by \$16,800 and included the depreciation amount on the total capitalized amount of \$24,000 in Depreciation Expense Adjustments to reflect the capitalization of its customer taps.³² Commission Staff agrees that Southern District's proposed adjustment is an accurate estimation of the total cost to install meter connections in the test period and therefore decreased Salaries and Wages expense and Materials and Supplies expense by \$7,200 and \$16,800, respectively. Depreciation on the capitalized amount is included as part of adjustment (M) as described below.

(G) Salaries and Wages – Commissioners. In the test year, Southern District reported \$18,000 for Salaries and Wages – Commissioner Expense. In its application, Southern District did not propose an adjustment to increase test year Salaries and Wages – Commissioner Expense. Commission Staff determined that all five of Southern District's Commissioners completed the mandatory training in September 2021.³³ Commission Staff increased Salaries and Wages – Commissioner Expense by \$12,000 to \$30,000, to compensate for the completed training and for vacancies during the test period.

³¹ Southern District's Response to Staff's First Request, Item 6.

³² Application, Exhibit 4, Statement of Adjusted Operations, References, Adjustment D.

³³ Southern District's Response to Staff's Second Request, Item 2.

(H) Employee Retirement (401k). In its application, Southern District proposed a decrease of \$1,867 to Employee Retirement (401k) expense to reflect the net effect of vacancies, new hires and authorized wage increases after the test year.³⁴ Commission Staff reviewed Southern District's calculations and determined the proposed adjustments are an accurate representation of the reduction in retirement expense due to the decrease in the annual labor expense proposed in adjustment (E) to Southern District. Accordingly, Commission Staff decreased Employee Retirement (401k) by \$1,867.

(I) Employee Benefits. In its application, Southern District proposed a decrease of \$31,853 to Employee Benefits expense.³⁵ Southern District pays 100 percent of its full-time employees' health, dental, and vision insurance premiums. Southern District adjusted the level of employer-funded premiums to be consistent with the Bureau of Labor Statistics' national average for an employer's share of health insurance premiums. Southern District adjusted the premium cost to reflect a 79 percent employer contribution for single coverage and 66 percent for family coverage. Southern District also adjusted the employer contribution for dental coverage to 60 percent.³⁶ Commission Staff reviewed Southern District's calculations and determined the proposed adjustments are an accurate representation of the decrease in the annual labor expense to Southern District. Accordingly, Commission Staff decreased Employee Benefits by \$31,853.

(J) Water Loss. In its application, Southern District proposed decreases of \$136,330, \$159,553, and \$81,565 to Purchased Water expense, Purchased Power

³⁴ Application, Exhibit 4, Statement of Adjusted Operations, References, Adjustment E.

³⁵ Application, Exhibit 4, Statement of Adjusted Operations, References, Adjustment F.

³⁶ Application, Exhibit 4, Statement of Adjusted Operations, References, Adjustment F.

expense, and Chemicals, respectively, to account for water loss in excess of 15 percent.³⁷ Commission Staff discovered in its review of the calculations that Southern District did not exclude 43.088 million gallons,³⁸ or 5.7082 percent, of water used in its own operations in the calculation of excess water used and, thus overstated the amount of water loss that should be excluded. Commission Staff corrected the Purchased Water, Purchased Power, and Chemical amounts by adding \$7,782, \$9,108, and \$4,655 respectively, to the pro forma amounts as shown in the calculation below. Accordingly, Commission Staff decreased Purchased Water, Purchased Power, and Chemicals by \$128,548, \$150,445, and \$76,910.

	Purchased Water	Purchased Power	Chemicals	Total
Test Year Costs of Water	\$342,556	\$400,909	204,950	\$948,415
Times: Water Cost for Internal Use	5.7082%	5.7082%	5.7082%	5.7082%
Less: Water Cost for Internal Use	(19,554)	(22,885)	(11,699)	(54,137)
Subtotal	323,002	378,024	193,251	894,277
Percent of Water Loss Disallowed	39.7978%	39.7978%	39.7978%	39.7978%
Water Loss in Excess of Allowed Amount	(128,548)	(150,445)	(76,910)	(355,903)
Southern District Proposed Adjustment	136,330	159,553	81,565	377,448
Proposed Increase	\$7,782	\$9,108	\$4,655	\$21,545

(K) Capital Expenditures. Commission Staff reviewed Southern District's 2021 general ledger and identified one purchase for \$5,000 that was charged to Materials and Supplies that should have been capitalized.³⁹ Commission Staff reduced Materials and Supplies expense \$5,000 and included corresponding depreciation on the item as discussed in adjustment (N) below.

³⁷ Application, Exhibit 4, Statement of Adjusted Operations, References, Adjustment G.

³⁸ 2021 Annual Report at 57.

³⁹ Southern District's Response to Staff's First Request, Item 1a, SWS1_1.a-General_Ledger_2021.xlsx.

(L) Taxes Other than Income. In its application, Southern District proposed a decrease of \$2,832 to Taxes Other Than Income to reduce FICA match due to the decrease in salaries in wages noted in adjustment (E) above.⁴⁰ Commission Staff agrees that the proposed decrease accurately reflects the effect of the previously discussed payroll reductions and therefore decreased Taxes Other Than Income by \$2,832.

(M) Depreciation Expense. In its application, Southern District reported test year Depreciation Expense of \$902,114.⁴¹ Southern District decreased its test year depreciation by \$43,000 to reflect additions to plant in service since December 31, 2021, as well as adjustments of asset service lives to the mid-point of service life range set forth in National Association of Regulatory Utility Commissioners (NARUC) Publication *Depreciation Practices for Small Water Utilities* (NARUC Study). To evaluate the reasonableness of the depreciation practices of small water utilities, the Commission has historically relied upon the NARUC Study. 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. In this proceeding, Commission Staff found no evidence to support depreciable lives that vary significantly from the midpoint of the NARUC ranges. Therefore, Commission Staff agrees with Southern District's proposed adjustment and decreased pro forma Depreciation Expense \$43,000 accordingly.

(N) Depreciation – Adjustment for Capitalized Amounts. Commission Staff identified one capital item described in adjustment (K) above which are summarized in

⁴⁰ Application, Exhibit 4, Statement of Adjusted Operations, References, Adjustment C.

⁴¹ Application, ARF-SAO.pdf

the table below. Commission Staff calculated depreciation expense related to these items totaling \$250 and increased Depreciation Expense accordingly.

Asset	Original Cost	Commission Staff Life	Adjusted Depreciation
Raw Water Pump	\$5,000	20 Years	\$250

(O) Non-Utility Income. Southern District performs billing services for garbage and sewer for the Prestonsburg City Utilities Commission (PCUC). Southern District charges PCUC three percent of the revenues collected to perform this service. In the test period, Southern District reported \$11,045 as Other Water Revenues that was directly related to this service.⁴² In addition, Southern District included in the revenue requirement \$26,301 for Nonutility Income that was also attributable to its billing services.⁴³ Commission Staff was able to determine that the net of its garbage billing results in \$26,301, however an additional \$2,859 is attributable to the wastewater billing. Commission Staff removed \$11,045 from Other Water Revenue and reclassified the appropriate pro forma amounts for its billing service below Net Operating Income. Accordingly, Commission Staff included pro forma Nonutility Income of \$26,301 for Garbage Collection Billing and \$2,859 for Wastewater Billing.

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

⁴² Application, Exhibit 4, Statement of Adjusted Operations; Southern District's Response to Staff's First Request, Item 1a, "SWS1_1.a-General_Ledger_2021.xlsx."

⁴³ Application, Exhibit 4, Revenue Requirements calculation.

expense, a non-cash item, to provide working capital;⁴⁴ (3) the average annual principal and interest payments on all long-term debts; and (4) working capital that is in addition to depreciation expense. Commission Staff notes a concern that Southern District is not able to maintain liquidity and cannot adequately manage its system absent the recommended increase as calculated below.

Cash Management. Southern District's general ledger as of December 31, 2020, reported a negative balance of \$(40,373.91) in its general account and a balance of \$18,006.41 in its general savings account.⁴⁵ These accounts are reported as being held at different banks which presumes no direct offset. As of December 31, 2021, Southern District reported a negative balance of \$(35,311.18) in its general account and a balance of \$39,656.52 in its general savings account.⁴⁶ Commission Staff did not determine whether other designated or restricted cash accounts are being used to offset the negative balances.

Garbage collection billing and remittance to Floyd County Solid Waste. Southern District bills customers for garbage collection and remits the collections to Floyd County

⁴⁴ The Kentucky Supreme Court has held that the Commission must permit a water district to recover its depreciation expense through its rates for service to provide internal funds for renewing and replacing assets. See *Public Serv. Comm'n of Kentucky v. Dewitt Water Dist.*, 720 S.W.2d 725, 728 (Ky. 1986). Although a water district's lenders require that a small portion of the depreciation funds be deposited annually into a debt reserve/depreciation fund until the account's balance accumulates to a required threshold, neither the Commission nor the Court requires that revenues collected for depreciation be accounted for separately from the water district's general funds or that depreciation funds be used only for asset renewal and replacement. The Commission has recognized that the working capital provided through recovery of depreciation expense may be used for purposes other than renewal and replacement of assets. See Case No. 2012-00309, *Application of Southern Water and Sewer District for an Adjustment in Rates Pursuant to the Alternative Rate Filing Procedure for Small Utilities* (Ky. PSC Dec. 21, 2012).

⁴⁵ Southern District's Response to Staff's First Request, Item 1a, "SWS1_1.a-General_Ledger_2020.xlsx."

⁴⁶ Southern District's Response to Staff's First Request, Item 1a, "SWS1_1.a-General_Ledger_2021.xlsx."

Solid Waste. Southern District retains three percent of amounts collected for providing the service. Southern District could not provide a copy of the contract with Floyd County Solid Waste and noted that the procedure for collecting solid waste revenue and remitting to Floyd County Solid Waste is a decades-long process.⁴⁷ Commission Staff is concerned about the absence of documentation that would establish the rights and responsibilities of the parties and any recourse that would be afforded to either party as a result of uncollected billings.

Receivables Management and Records Management. Southern District's two largest receivables balances are for water revenues (including surcharge) and garbage fee collection. Southern District's days sales outstanding in accounts receivable for water revenues is 150.09.⁴⁸ Southern District's days sales outstanding in accounts receivable for garbage billings is 292.81.⁴⁹ A typical revenue cycle for a water customer would be approximately 60 days, which would constitute 30 days of usage, 5 to 10 days for bill processing, and 20 days to collect or disconnect service. Southern District identified a component of the receivables balance of \$1,284,848.11 as "Old Delinquent" and stated that the balance represented inactive customers that the balances did not get transferred to their new accounts receivable system,⁵⁰ and that the entire balance was for water accounts.⁵¹ Southern District also stated that "[t]he District is currently analyzing the

⁴⁷ Southern District's Response to Staff's Third Request, Item 1a.

⁴⁸ 2021 Water Revenue \$3,979,558 / Gross Accounts Receivable \$1,636,395 / 365 Days = 150.09 Days Sales in Receivables.

⁴⁹ 2021 Garbage Revenue \$876,690 / Gross Accounts Receivable \$703,305 / 365 Days = 292.81 Days Sales in Receivables.

⁵⁰ Southern District's Response to Staff's Third Request, Item 2a.

⁵¹ Southern District's Response to Staff's Third Request, Item 2b.

collectability of those accounts to decide if they will be written off as uncollectible and believes that the remaining balance of \$884,682.53 will be uncollectible.”⁵² Southern District’s Tariff states that Southern District may terminate service after five days’ written notice of termination after 20 days have elapsed since the mailing date of the original unpaid bill.⁵³ Commission Staff is concerned with the apparent disparity between its delinquent accounts receivable and the collection policy outlined in its tariff.

Due to these three issues, Commission Staff recommends the Commission order the full amount of the recommended increase as shown in the calculation below.

	Southern District	Commission Staff	
Pro Forma Operating Expenses	3,196,378	\$ 3,221,438	
Plus: Average Annual Principal and Interest Payments	415,945	436,698	(1)
Additional Working Capital	83,189	83,189	(2)
Overall Revenue Requirement	3,695,512	3,741,325	
Less: Other Operating Revenue	(97,107)	(63,456)	
Interest Income	23	(23)	
Nonutility Income	26,301	(29,160)	
Revenue Required from Rates	3,624,729	3,648,686	
Less: Pro Forma Present Rate Service Revenues	(3,349,507)	(3,349,508)	
Required Revenue Increase	<u>\$ 275,222</u>	<u>\$ 299,178</u>	
Percentage Increase	<u>8.22%</u>	<u>8.93%</u>	

1. Average Annual Principal and Interest Payments. At the time of the Commission Staff’s review, Southern District had two outstanding loans from the

⁵² Southern District’s Response to Staff’s Third Request, Item 2e.

⁵³ Southern District Tariff at 24, paragraph 4.

Kentucky Infrastructure Authority (KIA), one bond issuance from the United States Department of Agriculture Rural Development (RD), one loan from Citizen's Bank, one loan from Community Trust Bank (CTB), and two loans outstanding from Cobank for a total of eight loans that are secured by the revenues of Southern District. A separate loan from Cobank is excluded from the analysis because it is secured by surcharge revenues. Additionally, Southern District has an installment balance payable to PCUC in relation to Southern District's transfer of ownership of its wastewater system to PCUC.⁵⁴ Southern District Requested recovery of the average annual principal and interest on its current indebtedness excluding the Cobank note secured by the surcharge revenue based on a five-year average of the annual principal, and interest and fee payments for the years 2022 through 2026.⁵⁵ Commission Staff is concerned about Southern District's liquidity as discussed above. Because the installment balance payable to PCUC is well known and was established during the transfer of assets approved in Case No. 2020-00228, Commission Staff concludes that the installment payments should be included in the average principal and interest payments as part of the calculation of the revenue requirement. Commission Staff did not include any allowance for additional working capital on these payments, because a debt service coverage would not be required pursuant to the agreement. Commission Staff agrees with the methodology Southern District proposed regarding its current indebtedness and included \$436,698 in the

⁵⁴ Case No. 2020-00228, Southern District's August 10, 2020 Response to the Order of July 20, 2020 and First Amendment to Asset Purchase Agreement.

⁵⁵ Application, Exhibit 4, Statement of Adjusted Operations, References, Adjustment I and Table B; Southern District's Response to Staff's Third Request , Item 3c.

calculation of the revenue requirement which includes both its proposed average principal and interest payments and the installment payments to PCUC.

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, Southern District requested recovery of an allowance for working capital that is equal to 120 percent of its average annual debt payments. Following the Commission's historic practice of including additional working capital, \$83,189 is included in the revenue requirement.

Signatures

 /s/ Ariel Miller

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Revenue Requirement Branch
Division of Financial Analysis

 /s/ Jeff Abshire

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 /s/ Eddie Beavers

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APPENDIX

APPENDIX TO COMMISSION STAFF'S REPORT OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2022-00099 DATED AUG 26 2022

The following rates and charges are prescribed for the customers in the area served by Southern Water and Sewer 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

All Meter Sizes

Customer Charge	\$11.39	Minimum Bill
First 2,000 Gallons	0.01220	Per Gallon
Over 2,000 Gallons	0.00938	Per Gallon
Wholesale Water	0.00483	Per Gallon

Nonrecurring Charges

Connection/Turn On Charge	\$20.00
Connection/Turn On Charge, After Hours	\$88.00
Meter Re-read Charge	\$20.00
Meter Test Charge	\$50.00
Reconnection Charge	\$20.00
Reconnection Charge, After Hours	\$88.00
Returned Check Charge	\$10.00
Service Call/Investigation Charge	\$20.00
Service Call/Investigation Charge, After Hours	\$88.00

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