

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF SOUTH)	CASE NO.
HOPKINS WATER DISTRICT FOR AN)	2022-00122
ALTERNATIVE RATE ADJUSTMENT)	

NOTICE OF FILING OF COMMISSION STAFF'S REPORT

Notice is hereby given that, in accordance with the Commission's Order of August 12, 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 August 12, 2022 Order, South Hopkins Water District (South Hopkins 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 South Hopkins 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 SEP 23 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
SOUTH HOPKINS WATER DISTRICT

South Hopkins District, a water district organized pursuant to KRS Chapter 74, provides water service to approximately 3,009 residential, commercial, industrial, and public authorities in Caldwell and Hopkins counties, Kentucky.¹ South Hopkins District also provides wholesale water service to the city of Mortons Gap, the city of Earlington, and to Caldwell County Water District.²

On April 29, 2022,³ South Hopkins District filed its application to the Commission requesting an adjustment to its water rates pursuant to 807 KAR 5:076. To ensure an orderly review of the application, the Commission established a procedural schedule by Order dated May 19, 2022. On August 12, 2022, the Commission, upon its own motion, extended the date the Commission Staff should schedule and conduct its limited financial

¹ *Annual Report of South Hopkins District to the Public Service Commission for the Calendar Year Ended December 31, 2020* (2020 Annual Report) at 12 and 51.

² 2020 Annual Report at 58.

³ South Hopkins District tendered its application on April 26, 2022. By letter dated April 26, 2022, the Commission rejected the application for filing deficiencies. The deficiencies were cured and the application was deemed filed on April 29, 2022.

review to August 19, 2022 and the date the Commission Staff's Report should be issued to September 23, 2022.

WATER LOSS

Pursuant to 807 KAR 5:066, Section (6)(3), water loss is limited to 15 percent for ratemaking purposes. The Commission Staff notes that South Hopkins District reported a water loss of 28.99 percent in its 2020 Annual Report.⁴ At a 28.99 percent water loss, the annual cost of water loss in excess of 15 percent is \$125,345 and the total annual cost of water loss to South Hopkins District is \$259,734, as calculated in the table below.

	Purchased Water	Purchased Power	Total
Test-Year Purchased Water and Purchased Power expenses	\$ 822,528	\$ 73,416	\$ 895,944
Multiplied by: Water Loss in Excess of 15 Percent	<u>-13.99%</u>	<u>-13.99%</u>	<u>-13.99%</u>
Cost of Water loss in Excess of the 15% Limitation	<u>\$ (115,073)</u>	<u>\$ (10,272)</u>	<u>\$ (125,345)</u>
Test-Year Purchased Water and Purchased Power expenses	\$ 822,528	\$ 73,416	\$ 895,944
Multiplied by: Test-Year Water Loss	<u>-28.99%</u>	<u>-28.99%</u>	<u>-28.99%</u>
Total Cost of Water Loss	<u>\$ (238,451)</u>	<u>\$ (21,283)</u>	<u>\$ (259,734)</u>

DISCUSSION

To comply with the requirements of 807 KAR 5:076, Section 9,⁵ South Hopkins District used the calendar year ended December 31, 2020, as the basis for its application.⁶ South Hopkins District explained that in its last rate case filed in 2018,⁷ the Commission

⁴ 2020 Annual Report at 59.

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

⁶ Application at 3.

⁷ Case No. 2018-00387, *Application of South Hopkins Water District for an Alternative Rate Adjustment* (Ky. PSC Apr. 16, 2019).

used the Debt Service Coverage (DSC) method to calculate its revenue requirement.⁸ However, South Hopkins District claimed that the DSC method only produces additional working capital of \$13,735, which is inadequate because it will not strengthen South Hopkins District's cash flow position.⁹ For this reason South Hopkins District proposed to use the operating ratio method to calculate its revenue requirement.¹⁰ Using the operating ratio method¹¹ and its pro forma test-year operations, South Hopkins District determined it could justify an Overall Revenue Requirement of \$1,820,452.¹² Although it did not include the calculation of its requested revenue increase in its revenue requirement schedule, Commission Staff determined that by using the reported Other Operating Revenues of \$30,941¹³ and Revenues from Water Sales of \$1,645,684¹⁴ that South Hopkins District is requesting an increase in revenues of \$143,828, or 8.74 percent, as shown in the table below. South Hopkins District did not request rates that reflect the full revenue requirement. The rates requested by South Hopkins District would increase

⁸ Application, Reasons for Application.

⁹ Application, Reasons for Application.

¹⁰ Application, Reasons for Application.

¹¹ Operating Ratio is defined as the ratio of expenses, including depreciation and taxes, to gross revenues. It is illustrated by the following equation:

$$\text{Operating Ratio} = \frac{\text{Operating Expenses} + \text{Depreciation} + \text{Taxes}}{\text{Gross Revenues}}$$

¹² Application, Revenue Requirement.

¹³ Application, Schedule of Adjusted Operations at 1.

¹⁴ Application, Schedule of Adjusted Operations at 1.

the monthly bill of a typical residential customer using 4,000 gallons per month by \$2.24, from \$33.90 to \$36.14, or approximately 6.50 percent.¹⁵

Pro Forma Operating Expenses	\$ 1,601,998
Divided by: Operating Ratio	88%
Total Revenue Requirement	<u>1,820,452</u>
Less: Other Operating Revenue	(30,941)
Revenue Requirement from Water Rates	<u>1,789,511</u>
Less: Revenues from Water Sales	(1,645,684)
Requested Revenue Increase	<u>\$ 143,828</u>
Percentage Increase	<u>8.74%</u>

To determine the reasonableness of the rates requested by South Hopkins District, Commission Staff performed a limited financial review of South Hopkins 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 measurable¹⁶ changes to test-year operations were identified, and adjustments were made when their effects were deemed material. Insignificant and immaterial discrepancies were not necessarily pursued or addressed.

Commission Staff's recommendations are summarized in this report. Mark Frost reviewed South Hopkins District's Pro Forma Operating Expenses and its Overall Revenue Requirement. Elizabeth Stefanski reviewed South Hopkins District's reported revenues and rate design.

SUMMARY OF FINDINGS

1. Overall Revenue Requirement and Required Revenue Increase. By applying the Operating Ratio method, as generally accepted by the Commission,

¹⁵ Application, Customer Notice.

¹⁶ 807 KAR 5:076, Section 9, Test Period.

Commission Staff determined that South Hopkins District requires a revenue from water rates of \$1,691,882 to meet the Overall Revenue Requirement of \$1,732,484. To meet the Overall Revenue Requirement, South Hopkins District requires a \$74,843, or 4.63 percent, revenue increase to Pro Forma present rate revenues.

2. Monthly Water Service Rates. In the application, South Hopkins District proposed to increase its monthly retail water service rates evenly across the board by approximately 6.65 percent.¹⁷ South Hopkins District has not performed a cost of service study (COSS). South Hopkins District stated that it did not consider filing a COSS with the current rate application because there were no material changes in its system, but also stated that it would consider preparing a new COSS if material changes in customer usage patterns occurred.¹⁸

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 South Hopkins District and allocated the \$74,843 revenue increase across the board to South Hopkins District's monthly retail service rates.

The rates set forth in the Appendix to this report are based upon the revenue requirement calculated by Commission Staff and will produce sufficient revenues from water sales to recover the \$1,691,882 Revenue Required from Rates, an approximate 4.63 percent increase. These rates, including the water loss recovery surcharge as

¹⁷ Application, Proposed Rates.

¹⁸ South Hopkins District's Response to Commission Staff's First Request for Information (Staff's First Request) (filed June 16, 2022), Item 13.

recommended by Commission Staff, will increase a typical residential customer’s monthly water bill from \$33.90 to \$38.97, an increase of \$5.07, or approximately 14.96 percent. The increase, before the water loss recovery surcharge is added, would increase a typical customer’s monthly water bill from \$33.90 to \$35.47, an increase of \$1.57 or 4.63 percent.

3. Nonrecurring Charges. Following the Commission’s recent decisions,¹⁹ Commission Staff reviewed South Hopkins 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. South Hopkins District provided the cost justification information for the nonrecurring charges.²⁰ Commission Staff reviewed the cost justification information provided by South Hopkins District and adjusted the charges performed by utility personnel by removing Field Labor Costs and Office/Clerical Labor Costs from those charges that occur during normal business hours. Such adjustments result in the following revised Nonrecurring Charges:

Nonrecurring Charge	Current Charge	Revised Charge
Late Payment Charge	10%	10%
Connection Turn-On Charge	\$ 50.00	\$ 13.00
Reconnection Charge	\$ 50.00	\$ 13.00
Reconnection Charge - After Hours	\$100.00	\$ 96.00
Returned Payment Charge	\$ 25.00	\$ 0.00
Service Call/Investigation	\$ 50.00	\$ 13.00
Service Call/Investigation - After Hours	\$100.00	\$ 96.00
Meter Test Request	\$100.00	\$ 13.00

¹⁹ 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).

²⁰ South Hopkins District’s Response to Staff’s First Request, Item 11a.

South Hopkins District provided additional information regarding the number of occurrences in the test year,²¹ and an itemized list of Miscellaneous Service Revenue reported for 2020.²² South Hopkins District's Miscellaneous Service Revenue for 2020 included credit card fees totaling \$11,304,²³ charged by its bank to customers paying the utility with a credit card. The revenue collected for credit card fees is offset by an expense for the bank fees to South Hopkins District, from its bank. The total reported Miscellaneous Service Revenue for 2020 was \$25,029.²⁴ The adjustments to the nonrecurring charges result in a decrease to Miscellaneous Service Revenue of \$10,111 from the total nonrecurring charges amount of \$13,725,²⁵ as shown below. Commission Staff recommends that the Commission order South Hopkins District to adjust its nonrecurring charges to those found in the Appendix to this report.

	Occur- rences	Other Water Revenue	Adjustment	Pro Forma
Connection Turn-On Charge	-	-	-	-
Reconnection Charge	87	\$ 5,825	(\$ 4,694)	\$ 1,131
Reconnection Charge After Hours	-	-	-	-
Returned Payment Charge	1	\$ 25	(\$25)	-
Service Call/Investigation	191	\$ 7,875	(\$5,392)	\$ 2,483
Service Call/Investigation After Hours	-	-	-	-
Meter Test Request	-	-	-	-
		\$ 13,725	(\$10,111)	\$ 3,614

²¹ South Hopkins District's Response to Staff's First Request, Item 11c.

²² South Hopkins District's additional filing of itemized 2020 miscellaneous service revenue (filed Sept. 7, 2022).

²³ South Hopkins District's additional filing of itemized 2020 miscellaneous service revenue .

²⁴ 2020 Annual Report at 51.

²⁵ \$25,029 total Miscellaneous Service Revenue less credit card fees of \$11,304 = \$13,725.

4. Water Loss Reduction Surcharge. Upon its review of South Hopkins District's Annual Reports on file with the Commission for the calendar years 2018 through 2021,²⁶ the Commission Staff notes that South Hopkins District's reported water loss consistently exceeded the 15 percent limitation established in 807 KAR 5:066, Section (6)(3). The table below is a comparison of South Hopkins reported water loss percentages, cost to purchase and pump water, cost of water loss in excess of the 15 percent limitation, and the total cost of water lost.

Year	Reported Percentage Water Loss	Purchased Water and Power	Cost of Water Loss in Excess of 15%	Total Cost of Water Loss
2017	17.68%	\$ 768,662	\$ 20,600	\$ 135,899
2018	25.94%	866,989	94,849	224,897
2019	36.11%	944,494	199,383	341,057
2020	28.99%	895,944	125,345	259,734
2021	37.77%	896,078	204,037	338,449

While South Hopkins District did not specifically request a surcharge to fund its efforts to correct the chronic water loss problem in its application, the use of a surcharge is consistent with prior Commission action in cases involving water utilities with excessive unaccounted-for water loss.²⁷ The Commission has ordered surcharges even when a

²⁶ See *Annual Report of South Hopkins District to the Public Service Commission for the Calendar Year Ended December 31, 2017* at 51 and 58; *Annual Report of South Hopkins District to the Public Service Commission for the Calendar Year Ended December 31, 2018* at 52 and 59; *Annual Report of South Hopkins District to the Public Service Commission for the Calendar Year Ended December 31, 2019* at 52 and 59; *2020 Annual Report* at 52 and 59; and *Annual Report of South Hopkins District to the Public Service Commission for the Calendar Year Ended December 31, 2021* at 52 and 59.

²⁷ See Case No. 96-126, *An Investigation into the Operations and Management of South Hopkins Water District* (Ky. PSC Aug. 11, 1997); Case No. 2011-00217, *Application of Cannonsburg Water District for (1) Approval of Emergency Rate Relief and (2) Approval of the Increase in Nonrecurring Charges*, (Ky. PSC June 4, 2012); Case No. 2018-00017, *Application of Martin County Water District for an Alternative Rate Adjustment* (Ky. PSC Nov. 5, 2018); Case No. 2018-00429, *Application of Graves County Water District for an Alternative Rate Adjustment* (Ky. PSC Sept. 30, 2019); Case No. 2019-00119, *Electronic Application of Estill County Water District No. 1 for a Surcharge to Finance Water Loss Control Efforts* (Ky. PSC Mar. 24, 2010); and Case No. 2020-00141, *Electronic Application of Hyden-Leslie County Water District for an Alternative Rate Adjustment* (Ky. PSC Nov. 6, 2020), Order at 11-13.

utility has not specifically requested a surcharge,²⁸ and recently, the Commission has allowed water utilities with reported water loss above the 15 percent threshold to assess water loss reduction surcharges.²⁹

Recognizing Commission precedent to allow the use of surcharges to assist utilities in obtaining the proper funding needed to combat water loss, Commission Staff recommends the Commission to authorize South Hopkins District to assess a monthly water loss reduction surcharge of \$3.50³⁰ per active meter for 48 months, with a review of the necessity to continue the surcharge before the 48-month period expires. Commission Staff also recommends that the Commission establish a separate proceeding to monitor the surcharge and place strict controls over the use of the funds that will be collected from the surcharge and require South Hopkins District to develop a long-term plan to address its aging infrastructure and combat water loss within six months of the final order in this proceeding.

PRO FORMA OPERATING STATEMENT

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

²⁸ Case No. 2020-00311, *Electronic Application of Cawood Water District for an Alternative Rate Adjustment* (Ky. PSC Apr. 8, 2021), Order at 3.

²⁹ See Case No. 2021-00094, *Electronic Application of Garrison-Quincy-Ky-O-Heights Water District for a Rate Adjustment Pursuant to 807 KAR 5:076* (Ky. PSC Nov. 24, 2021).

³⁰ \$125,345 (Cost of Water Loss in Excess of 15% limit) ÷ 35,762 (Number of Test-Year Bills) = \$3.50.

	Test Year Operations	Pro Forma Adjustments	Adj Ref.	Pro Forma Operations
Operating Revenues:				
Operating Revenues- Water Sales	\$ 1,645,684	\$ (28,645)	A	\$ 1,617,039
Other Water Revenues:				
Forfeited Discounts	5,838	19,772	B	25,610
Misc. Service Revenues	25,029	(10,111)	C	14,918
Other Water Revenue	74			74
Total Other Water Revenues	30,941	9,661		40,602
Total Operating Revenues	1,676,625	(18,984)		1,657,641
Operating Expenses:				
Operation and Maintenance:				
Salaries and Wages - Employees	289,819	(16,967)	D	272,852
Salaries and Wages - Officers	18,200			18,200
Employee Pensions and Benefits	226,107	(42,522)	E	
		(45,595)	F	137,990
Purchased Water	822,528	(115,073)	G	707,455
Purchased Power	73,416	(10,272)	G	63,144
Materials and Supplies	79,299			79,299
Contractual Services	11,100			11,100
Water Testing	10,022			10,022
Transportation Expenses	21,570			21,570
Insurance - Gen. Liab. & Workers Comp.	24,908			24,908
Bad Debt	5,112			5,112
Miscellaneous Expenses	19,917			19,917
Total Operation and Mnt. Expenses	1,601,998	(230,429)		1,371,569
Depreciation Expense	112,314			112,314
Taxes Other Than Income	24,267	(2,002)	H	22,265
Total Operating Expenses	1,738,579	(232,431)		1,506,148
Net Utility Operating Income	\$ (61,954)	\$ 213,447		\$ 151,493

(A) Billing Analysis. South Hopkins District provided billing data³¹ listing water usage and water sales revenue for the 12-month test year of 2020. Commission Staff reviewed the South Hopkins District's billing analysis and discovered that the formulas for all tiers, other than the minimum bill tiers, used incorrect formulas to calculate revenue numbers, resulting in incorrect revenue totals for every rate tier. Further, South Hopkins District did not create a billing analysis for the proposed increase, nor were the amounts calculated for the billing analysis³² used as the Pro Forma Metered Water Sales amount in the Schedule of Adjusted Operations.³³ South Hopkins made no adjustments to the Operating Revenues as reported in the 2020 Annual Report, with total metered water sales revenue reported as \$1,645,684.³⁴ According to South Hopkins District's 2020 Annual Report, the total metered water sales revenue reported for the test year was also \$1,645,684,³⁵ total Other Water Revenues reported as \$30,941,³⁶ and Total Operating Revenues reported for the test year as \$1,676,625.³⁷ Commission Staff used the billing and usage data provided by South Hopkins to create an accurate billing analysis and to calculate a normalized revenue amount based on the statistics compiled in the table below for an amount of \$1,617,039. Accordingly, Commission Staff decreased test year water sales by \$28,645.

³¹ Application, BILLING.xlsx.

³² Application, BILLING.xlsx.

³³ Application, Schedule of Adjusted Operations at 1.

³⁵ 2020 Annual Report at 51.

³⁵ 2020 Annual Report at 51.

³⁶ 2020 Annual Report at 51, and Application, Schedule of Operations at 1.

³⁷ 2020 Annual Report at 51, and Application, Schedule of Operations at 1.

Meter Size	Bills	Gallons Sold	Revenue
5/8 inch	35,156	127,759,931	1,120,567
5-8 Rate2	192	1,286,673	9,980
1 inch	270	13,090,050	83,707
2 inch	132	10,933,963	66,403
3 inch	12	2,074,600	11,753
Wholesale	36	108,121,435	341,664
			\$1,634,075
Less: Billing Adjustments			(17,036)
Normalized Revenue			\$1,617,039

(B) Forfeited Discounts. During the test year, South Hopkins District recorded \$5,838 in late payment charges, or forfeited discounts. Given that the test year occurred during the moratorium regarding the collection of late payment fees due to the COVID-19 pandemic, Commission Staff normalized the revenue from Forfeited Discounts using a three-year average of the reported income from late fees in the years 2017, 2018, and 2019.³⁸ Based upon a three-year average of \$25,610, Commission Staff increased Miscellaneous Service Revenues by \$19,772.

YEAR	Amount
2019	26,497
2018	25,382
2017	24,950
Three-year Average	\$ 25,610
Less: Test Year Late Fees	(5,838)
Pro Forma Adjustment	\$ 19,772

³⁸ Annual Report of South Hopkins District to the Public Service Commission for the Calendar Year Ended December 31, 2017 at 50, Annual Report of South Hopkins District to the Public Service Commission for the Calendar Year Ended December 31, 2018 at 51, and the Annual Report of South Hopkins District to the Public Service Commission for the Calendar Year Ended December 31, 2019 at 51.

(C) Miscellaneous Service Revenues. In its application, South Hopkins District reported test year Other Water Revenues of \$30,941, which included \$5,838 of Forfeited Discounts, \$25,029 of Miscellaneous Service Revenues, and \$74 of Other Water Revenues.³⁹ South Hopkins District made no adjustments for nonrecurring charges in its application. South Hopkins District provided information about the nonrecurring charges revenue,⁴⁰ and Commission Staff calculated an adjustment to Other Water Revenue, removing labor costs, as discussed above. South Hopkins District's Miscellaneous Service Revenue for 2020 included credit card fees totaling \$11,304,⁴¹ charged by its bank to customers paying the utility with a credit card. The adjustment is the difference between the reported nonrecurring charges amount of \$13,725, and the Pro Forma Revenue amount of \$3,614 from the nonrecurring charges for Reconnection Charges, Returned Check charges and Service Call/Investigation charges. The adjustment to Nonrecurring Charges results in a decrease to Miscellaneous Service Revenue of \$10,111 as discussed above in the Nonrecurring Charges section.

(D) Employee Salaries and Wages. South Hopkins District reported test-year Employee Salaries and Wages expense of \$289,819.⁴² Since the test-year, South Hopkins District has experienced a high level of employee turnover. An adjustment to reflect the actual 2022 wage rates, and the current staff level would meet the ratemaking

³⁹ Application, Schedule of Adjusted Operations at 1.

⁴⁰ South Hopkins District's Additional filing of itemized 2020 miscellaneous service revenue.

⁴¹ South Hopkins District's Additional filing of itemized 2020 miscellaneous service revenue.

⁴² Application, Schedule of Adjusted Operations at 1.

criteria of being known and measurable.⁴³ Using South Hopkins District’s current staff level of 7 full-time employees, 2,080 regular annual work hours, the actual test-year overtime hours worked, and the 2022 employee wage rates, Commission Staff calculates a pro forma Employee Salaries and Wages expense of \$272,852, which is \$16,967, below the reported expense level. Commission Staff’s calculation is in the table below. Commission Staff recommends the Commission decrease Employee Salaries and Wages expense by \$16,967.

Job Description	Status	2020 Hours Worked		2022 Wage Rates	Emp. Salaries And Wages
		Regular	Overtime		
Superintendent	Salary	0.00	0.00	1,269.23	\$ 66,000
Office Manager	Salary	0.00	0.00	875.00	45,500
Laborer	Hourly	2,080.00	0.00	16.00	33,280
Laborer	Hourly	2,080.00	0.00	16.00	33,280
Office Clerk	Hourly	2,080.00	0.00	14.50	30,160
Office Clerk	Hourly	2,080.00	47.00	14.50	31,182
Laborer	Hourly	2,080.00	100.00	15.00	33,450
Pro Forma Employee Salaries & Wages					272,852
Less: Pro Forma Employee Salaries & Wages - Staff Report					<u>(289,819)</u>
Pro Forma Adjustment					<u>\$ (16,967)</u>
Gross Wages for Full Time Employees CERS Eligible					<u>\$ 272,852</u>

(E) County Employee Retirement System (CERS). South Hopkins District reported a test-year employee pension expense of \$115,619.⁴⁴ In Case No. 2016-

⁴³ See 807 KAR 5:001, Section 16.1.(a).; Case No. 2001-00211, *The Application of Hardin County Water District No. 1 for (1) Issuance of Certificate of Public Convenience and Necessity; (2) Authorization to Borrow Funds and to Issue Its Evidence of Indebtedness Therefor; (3) Authority to Adjust Rates; and (4) Approval to Revise and Adjust Tariff* (Ky. PSC Mar. 1, 2002); Case No. 2002-00105, *Application of Northern Kentucky Water District for (A) an Adjustment of Rates; (B) a Certificate of Public Convenience and Necessity for Improvements to Water Facilities if Necessary; and (C) Issuance of Bonds* (Ky. PSC June 25, 2003); Case No. 2017-00417, *Electronic Proposed Adjustment of the Wholesale Water Service Rates of Lebanon Water Works* (Ky. PSC July 12, 2018); and Case No. 2019-00080, *Electronic Proposed Adjustment of the Wholesale Water Service Rates of the City of Pikeville to Mountain Water District* (Ky. PSC Dec. 19, 2019).

⁴⁴ South Hopkins District’s Responses to Staff’s First Request, Item 8, 2020 Trial Balance with Net Journal Transactions. Account No. 604.1, Pension expense.

00163,⁴⁵ the Commission discussed in great detail the reporting requirements of General Accounting Standards Board (GASB) 68, and how those requirements would impact a utility's income statement and balance sheet. In that proceeding, the Commission found the annual pension expense should be equal to the amount of a district's contributions to CERS, which historically have been "fairly constant." In the fiscal year, beginning July 1, 2022, the CERS employer contribution rate is 26.79 percent.⁴⁶ Based on the above, Commission Staff determined that South Hopkins District's pro forma CERS employer contributions are \$73,097,⁴⁷ resulting in a decrease to Employee Pensions and Benefits expense of \$42,522.⁴⁸

(F) Employee Benefits. South Hopkins District reported paying test-year employee insurance premiums of \$110,488.⁴⁹ South Hopkins District currently pays 100 percent of the monthly premiums for single health coverage, vision, dental, and life insurance for its eligible full-time employees.⁵⁰

Commission Staff notes that the Commission has consistently made ratemaking adjustments to reduce the cost of employee benefit packages paid by some utilities when certain aspects of those benefit packages were found to be unreasonable based on a

⁴⁵ Case No. 2016-00163, *Alternative Rate Adjustment filing of Marion County Water District* (Ky. PSC Nov. 10, 2016).

⁴⁶ <https://kyret.ky.gov/Employers/Pages/Contribution-Rates.aspx>. Employer CERS Contribution Rate for the Fiscal Year 2023 beginning July 1, 2022 is 26.79%.

⁴⁷ \$272,852 (Pro Forma Employee Salaries and Wages) x 26.79% (July 1, 2020 CERS Employer Contribution Rate) = \$73,097.

⁴⁸ \$73,097 (Pro Forma CERS Contribution) - \$115,619 (Test-Year CERS Contribution) = (\$42,522).

⁴⁹ South Hopkins District's Response to Staff's First Request, Item 8, 2020 Trial Balance with Net Journal Transactions. \$295 (Account No. 604.0, Employee Benefits) + \$109,553 (Account No. 604.2, Medical Insurance expense) + \$640 (Account No. 604.3, Life Insurance expense) = \$110,488.

⁵⁰ South Hopkins District's Response to Staff's First Request, Item 4.

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

Consistent with past precedent, in which the Commission has reduced benefit expenses for utilities that pay 100 percent of an employee's health insurance coverage; Commission Staff reduced South Hopkins District's employee health insurance premiums by 21 percent for individual health insurance coverage,⁵¹ and by 60 percent for dental insurance coverage, the national average employee contribution rate.⁵² Factoring in the preceding, Commission Staff decreased employee pensions and benefits by \$45,595, as shown in the calculation below.

	2022 Monthly Premium	District Contribution Percentage	Annual Premium	Allowable Employer Share	Allowable Employer Premium
Medical - Single	\$ 6,440	100%	\$ 77,280	79%	\$ 61,051
Vision - Invoice	154	100%	1,848	100%	1,848
Dental - Invoice	328	100%	3,936	40%	1,574
Life	35	100%	420	100%	420
Total	\$ 6,957		\$ 83,484		\$ 64,893
Allowable Employer Premium					64,893
Less: Test-Year Employee Benefits					(110,488)
Medical Adjustment					\$ (45,595)

⁵¹ Bureau of Labor Statistics, Healthcare Benefits, March 2020, Table 3, private industry workers. (<https://www.bls.gov/news.release/pdf/ebs2.pdf>)

⁵² The Willis Benchmarking Survey, 2015, at 62–63. (https://www.willis.com/Documents/publications/Services/Employee_Benefits/20151230_2015WillisBenefitsBenchmarkingSurveyReport.pdf).

(G) Excess Water Loss. South Hopkins District reported test-year Purchased Water expense and Purchased Power expense of \$822,528 and \$73,416, respectively.⁵³ Commission regulation 807 KAR 5:066, Section 6(3),⁵⁴ limits water loss to 15 percent for ratemaking purposes unless the Commission finds an alternative level reasonable. South Hopkins District reported a test year water loss of 28.99 percent, or 13.99 percentage points above the 15 percent allowable limit.⁵⁵

To conform to the Commission’s current practice to eliminate the cost to purchase, produce, and pump water over the 15 percent allowable limit, Commission Staff is decreasing Purchased Water expense and Purchased Power expense by \$115,073, and \$10,272, respectively.⁵⁶

(H) Payroll Taxes. South Hopkins District reported test-year Payroll Tax expense of \$24,267.⁵⁷ Using the pro forma Salaries and Wages expense subject to the Federal Insurance Contributions Act (FICA) tax withholdings of \$290,012⁵⁸ and the

⁵³ Application, Schedule of Adjusted Operations at 1.

⁵⁴ “Unaccounted-for water loss. Except for purchased water rate adjustments for water districts and water associations, and rate adjustments pursuant to KRS 278.023(4), for ratemaking purposes a utility’s unaccounted-for water loss shall not exceed fifteen (15) percent of total water produced and purchased, excluding water used by a utility in its own operations. Upon application by a utility in a rate case filing or by separate filing, or upon motion by the commission, an alternative level of reasonable unaccounted-for water loss may be established by the commission. A utility proposing an alternative level shall have the burden of demonstrating that the alternative level is more reasonable than the level prescribed in this section.”

⁵⁵ 2020 Annual Report at 59.

⁵⁶

	<u>Purchased Water</u>	<u>Purchased Power</u>	<u>Total</u>
Test-Year Purchased Water and Purchased Power expenses	\$ 822,528	\$ 73,416	\$ 895,944
Multiplied by: Water Loss in Excess of 15 Percent	-13.99%	-13.99%	-13.99%
Cost of Water loss in Excess of the 15% Limitation	<u>\$ (115,073)</u>	<u>\$ (10,272)</u>	<u>\$ (125,345)</u>

⁵⁷ Application, Schedule of Adjusted Operations at 2.

⁵⁸ \$271,812 (Employee Salaries and Wages expense) + \$18,200 (Commissioner Salaries and Wages expense) = \$290,012 (Salaries and Wages expense subject to FICA).

current FICA tax rate of 7.65 percent, Commission Staff calculated a pro forma FICA tax expense of \$22,265.⁵⁹ Accordingly, Commission Staff decreased South Hopkins District's payroll tax expense by \$2,002.⁶⁰

OVERALL REVENUE REQUIREMENT AND REQUIRED REVENUE INCREASE

Debt Service Coverage (DSC) method that has been historically used by the Commission 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;⁶¹ (3) the average annual principal and interest payments on all long-term debts; and (4) working capital that is in addition to depreciation expense.

In this instance, Commission Staff agrees with the methodology used by South Hopkins District to calculate its revenue requirement and required increase. Historically, the Commission has used the operating ratio methodology when there is no basis for a rate of return determination, the cost of the utility has been fully or largely funded through contributions, or there is little or no outstanding long-term debt. South Hopkins District's

⁵⁹ \$291,052 (Salaries and Wages expense subject to FICA) x 7.65% (FICA Rate) = \$22,265.

⁶⁰ \$22,265 (Pro Forma Payroll Tax) - \$24,267 (Reported Test-Year Payroll Tax) = (\$2,002).

⁶¹ 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).

five-year debt service payment of \$69,665⁶² fails to produce a revenue requirement sufficient to support South Hopkins District's financial operations or to provide for an adequate level of working capital. It is Commission Staff's opinion that an operating ratio of 88 percent is reasonable in this instance and will allow South Hopkins District sufficient revenues to cover its reasonable operating expenses and provide for reasonable equity growth.

Shown below are Commission Staff's calculations of South Hopkins District's revenue requirement and required revenue increase using the Operating Ratio method.

Pro Forma Operating Expenses	\$ 1,506,148
Divided by: Operating Ratio	88%
Subtotal	<u>1,711,532</u>
Add: Interest Expense	<u>20,952</u>
Total Revenue Requirement	1,732,484
Less: Other Operating Revenue	<u>(40,602)</u>
Revenue Requirement from Water Sales	1,691,882
Less: Revenues from Water Sales	<u>(1,617,039)</u>
Requested Revenue Increase	<u>\$ 74,843</u>
Percentage Increase	<u>4.63%</u>

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	<u>2022</u>	<u>2023</u>	<u>2024</u>	<u>2025</u>	<u>2026</u>	<u>Totals</u>
KIA Loan No. B17-011	\$ 35,292	\$ 35,134	\$ 35,192	\$ 35,143	\$ 35,091	\$ 175,852
RD 1	28,820	29,370	29,898	30,403	31,885	150,376
RD 2	<u>4,280</u>	<u>4,313</u>	<u>4,443</u>	<u>4,469</u>	<u>4,592</u>	<u>22,097</u>
Totals	<u>\$ 68,392</u>	<u>\$ 68,817</u>	<u>\$ 69,533</u>	<u>\$ 70,015</u>	<u>\$ 71,568</u>	<u>\$ 348,325</u>
Five-Year Average Debt Service						<u>\$ 69,665</u>

Signatures

/S/ Mark Frost

Prepared by: Mark C. Frost
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. 2022-00122 DATED SEP 23 2022

The following rates and charges are prescribed for the customers in the area served by South Hopkins 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	\$13.36	Minimum Bill
Next	9,000 Gallons	0.00737	Per Gallon
Next	10,000 Gallons	0.00688	Per Gallon
Next	30,000 Gallons	0.00639	Per Gallon
Over	50,000 Gallons	0.00548	Per Gallon

1-Inch Meter

First	10,000 Gallons	\$79.66	Minimum Bill
Next	10,000 Gallons	0.00688	Per Gallon
Next	30,000 Gallons	0.00639	Per Gallon
Over	50,000 Gallons	0.00548	Per Gallon

2-Inch Meter

First	20,000 Gallons	\$148.38	Minimum Bill
Next	30,000 Gallons	0.00639	Per Gallon
Over	50,000 Gallons	0.00548	Per Gallon

3-Inch Meter

First	50,000 Gallons	\$340.13	Minimum Bill
Over	50,000 Gallons	0.00548	Per Gallon

Wholesale Rates

All	0.00330	Per Gallon
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Water Loss Reduction Surcharge \$3.50 per customer
To be collected over 48 months

Nonrecurring Charges

Late Payment Charge	10%
Connection Turn-On Charge	\$ 13.00
Reconnection Charge	\$ 13.00
Reconnection Charge After-Hours	\$ 96.00
Returned Payment Charge	\$ 0.00
Service Call / Investigation	\$ 13.00
Service Call / Investigation After-Hours	\$ 96.00
Meter Test Request	\$ 13.00

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