

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF UNION)	CASE NO.
COUNTY WATER DISTRICT FOR AN)	2022-00160
ALTERNATIVE RATE ADJUSTMENT)	

ORDER

This matter arises on Union County Water District's (Union District) submission, pursuant to 807 KAR 5:076, of a request to adjust its water rates under the alternative rate adjustment (ARF) procedures.

On June 3, 2022, Union District tendered its application (Initial Application) using a calendar year 2020 test year. Because Commission regulations require an ARF application test year to be the most recent calendar year period in the utility's annual report, and Union District's most recent annual report was for 2021, the Initial Application was rejected for filing. Union District subsequently filed an amended application (Amended Application) that cured filing deficiencies, and the Amended Application was deemed filed on July 7, 2022.

Union District filed this proceeding in compliance with the final Order in Case No. 2021-00180,¹ which required Union District to file an application by December 7, 2021, for either a traditional adjustment in rates, or for an ARF to ensure that its revenue is

¹ See Case No. 2021-00180, *Electronic Purchased Water Adjustment Filing of Union County Water District* (Ky. PSC June 7, 2021).

sufficient to support adequate and reliable service. Union District was granted two extensions to file the rate adjustment application.

In its Initial Application, Union District calculated its revenue requirement using the Debt Service Coverage (DSC) method. Union District's pro forma operations for the 2020 test year supported an increase in revenues from water rates of \$141,014, or 9.46 percent.² In its Amended Application, Union District determined that its 2021 pro forma operations supported an increase in revenues from water rates of \$224,217,³ or 15.30 percent again based on the DSC method.⁴ Updating the test year financial information from calendar year 2020 to 2021 resulted in the higher requested rates in the Amended Application.

In reviewing the Amended Application Commission Staff discovered that Union District had miscalculated the percentage increase of its proposed increase in revenues by failing to include the revenue from the sales for resale in its calculation.⁵ Even with the error in the calculation of the percentage increase, Union District's total requested revenue requirement from rates of \$1,930,035⁶ was correct.⁷ Commission Staff corrected Union District's calculation to include the revenue from the sales for resale, which resulted

² Initial Application, Attachment 4, Revenue Requirements.

³ Commission Staff's Report at 4–5. Due to rounding the requested revenue increase in the Amended Application column incorrectly states that it is \$224,216. The correct requested revenue increase is \$224,217.

⁴ Amended Application, Attachment 4, Revenue Requirements Using Debt Service Coverage Method.

⁵ Commission Staff's Report at 4.

⁶ Commission Staff's Report at 4–5. Due to rounding the Overall Revenue Requirement in the Amended Application column incorrectly states that it is \$1,930,034. The correct Overall Revenue Requirement is \$1,930,035.

⁷ Commission Staff's Report at 4–5.

in an increase of 14.03 percent rather than the 15.30 percent increase in revenues as originally calculated by Union District in its Amended Application.⁸

As a means of comparison, Union District provided in its Amended Application the calculation of its revenue requirement using the operating ratio method. Union District's calculation showed that an 88 percent operating ratio method would produce an operating revenue increase of \$611,453, or 41.73 percent.⁹ However, in calculating both the revenue increase and the percentage increase, Union District failed to include the sales for resale.¹⁰ Commission Staff corrected Union District's calculation to include the revenue from the sales for resale resulting in an operating revenue impact of \$478,090, for a percentage increase of 29.91 percent.¹¹

The Commission established a procedural schedule by Order dated July 22, 2022, which was subsequently amended on November 22, 2022, and December 6, 2022, to extend the date for filing the Commission Staff Report. The city of Sturgis is an intervenor in this proceeding. Sturgis did not propound discovery requests to Union District and has not actively participated in this proceeding. Union District responded to three rounds of discovery from Commission Staff.¹²

On January 20, 2023, Commission Staff issued its report (Commission Staff's Report) summarizing its findings and recommendations regarding Union District's

⁸ Commission Staff's Report at 4–5.

⁹ Amended Application, Attachment 4, Revenue Requirements Using Operating Ratio Method.

¹⁰ Commission Staff's Report at 5–6.

¹¹ Commission Staff's Report at 5–6.

¹² Commission Staff's First Request for Information (Staff's First Request) (filed Aug. 4, 2022); Commission Staff's Second Request for Information (Staff's Second Request) (filed Sept. 16, 2022); and Commission Staff's Third Request for Information (Staff's Third Request) (filed Oct. 3, 2022).

requested rate adjustment. In the Commission Staff's Report, Commission Staff found that Union District's adjusted test-year operations support an overall revenue requirement of \$1,849,973, and that an annual revenue increase of \$174,035, or 10.78 percent, is necessary to generate the overall revenue requirement. In the absence of a cost of service study (COSS), Commission Staff allocated its recommended revenue increase evenly across the board to calculate its recommended water rates. Commission Staff also recommended that Union District be allowed to assess a monthly water loss reduction surcharge of \$1.72 per active meter for 48 months, which is discussed further below.

Finally, Commission Staff noted that Union District possibly violated the requirements of KRS 278.300¹³ and KRS 278.020(1)¹⁴ when it issued a ten-year \$75,000 promissory note to the United Community Bank of West Kentucky (United Bank) to purchase and renovate Union District's office building located at 409 North Court Street in Morganfield, Kentucky.¹⁵ Union District purchased the office building from the Union County Fiscal Court on August 30, 2021.¹⁶

In its February 2, 2023 response to Commission Staff's Report, Union District disagreed with Commission Staff's removal of labor expenses from its nonrecurring charges and noted that Commission Staff did not make a recommendation regarding its

¹³ KRS 278.300 requires a public utility to obtain authorization from the Commission before issuing any evidence of indebtedness, with certain limited exceptions.

¹⁴ KRS 278.020(1) requires a public utility to seek Commission approval before construction of any plant, equipment, property, or facility for furnishing utility service to the public.

¹⁵ Commission Staff's Report at 14–15.

¹⁶ Union District's Response to Staff's Second Request, Item 4.

updated Tap-on Fee.¹⁷ Union District requested that the Commission approve its proposal to increase its Tap-on fee from \$1,100 to \$1,300.¹⁸ Union District agreed with the remainder of Commission Staff's recommendations and waived its right to request an informal conference or hearing.¹⁹

Because Union District did not request a water loss reduction surcharge in its Initial or Amended Application, and thus its customers did not receive notice of the surcharge, the Commission, in its Order dated April 26, 2023, required Union District to publish a one-time notice, following the requirements of 807 KAR 5:076, Section 5, of its amended water rates.

The case now stands submitted for a decision by the Commission.

LEGAL STANDARD

Alternative rate adjustment proceedings, such as this one, are governed by Commission regulation 807 KAR 5:076, which establishes a simplified process for small utilities to use to request rate adjustments, with the process designed to be less costly to the utility and the utility ratepayers. The Commission's standard review of a utility's request for a rate increase is well established. In accordance with KRS 278.030 and case law, Union District is allowed to charge its customers "only fair, just and reasonable rates."²⁰ Further, Union District bears the burden of proof to show that the proposed rate increase is just and reasonable under KRS 278.190(3).

¹⁷ Union District's Response to the January 20, 2023 Commission Staff's Report (Response to Commission Staff's Report) (filed Feb. 2, 2023) at unnumbered page 1.

¹⁸ Union District's Response to Commission Staff's Report at unnumbered page 1.

¹⁹ Union District's Response to Commission Staff's Report at unnumbered page 1.

²⁰ *City of Covington v. Public Service Commission*, 313 S.W.2d 391 (Ky. 1958); and *Public Service Comm'n v. Dewitt Water District*, 720 S.W.2d 725 (Ky. 1986).

UNACCOUNTED-FOR WATER LOSS

Pursuant to 807 KAR 5:066, Section (6)3, water loss is limited to 15 percent for ratemaking purposes. Commission Staff's Report noted that Union District's reported test-year water loss was 19.38 percent.²¹ At a 19.38 percent water loss, the annual cost of water loss in excess of 15 percent is \$45,339, and the total annual cost of water loss to Union District is \$200,610 as calculated in the table below.

	<u>Water</u>	<u>Electricity</u>	<u>Total</u>
Test-Year Water Purchases and Pumping Costs	\$ 952,550	\$ 82,590	\$ 1,035,140
Multiplied by: Water Loss In Excess of 15 Percent	4.38%	4.38%	4.38%
Cost of Line loss in Excess of the 15% Limit	<u>\$ 41,722</u>	<u>\$ 3,617</u>	<u>\$ 45,339</u>
Test-Year Water Purchases and Pumping Costs	\$ 952,550	\$ 82,590	\$ 1,035,140
Multiplied by: Test Year Water Loss Percentage	19.38%	19.38%	19.38%
Total Cost of Line Loss	<u>\$ 184,604</u>	<u>\$ 16,006</u>	<u>\$ 200,610</u>

The Commission is placing greater emphasis on monitoring utilities that consistently exceed the 15 percent unaccounted-for water loss threshold and strongly encourages Union District to pursue reasonable actions to reduce its water loss. Failure by Union District to make significant progress toward reducing unaccounted-for water loss may cause the Commission to pursue additional action with the utility. In recognition of this, in its Response to Commission Staff's Report, Union District amended its application to request that it be allowed to implement a water loss reduction surcharge as the Commission strongly encourages utilities to pursue reasonable actions to reduce its unaccounted-for water loss.

²¹ *Annual Report of Union District to the Public Service Commission for the Calendar Year Ended December 31, 2021* (2021 Annual Report) at 56.

BACKGROUND

Union District is a water utility organized pursuant to KRS Chapter 74, which provides water service to approximately 2,299 residential, commercial, and industrial customers in Union County, Kentucky.²² Union District also provides wholesale water service to the city of Sturgis (Sturgis).²³ Union District does not produce any of its own water; rather, it purchases its water from the city of Morganfield, Kentucky (Morganfield).²⁴ A review of the Commission's records indicates that since 1986, Union District has not sought an adjustment of water rates through a general base rate case or ARF procedure. The only rate cases that were filed by Union District during that period were purchased water pass through cases or rate applications filed pursuant to KRS 278.023.

TEST PERIOD

The calendar year ended December 31, 2021 was used as the test year to determine the reasonableness of Union District's existing and proposed water rates, as required by 807 KAR 5:076, Section 9.

SUMMARY OF REVENUE AND EXPENSES

The Commission Staff's Report summarizes Union District's pro forma income statement as follows:

²² 2021 Annual Report at 12 and 49.

²³ 2021 Annual Report at 56.

²⁴ 2021 Annual Report at 54.

	2021 Test Year Operations	Commission Staff Pro Forma Adjustments	Commission Staff Pro Forma Operations
Operating Revenues	\$ 1,593,700	\$ 80,294	\$ 1,673,994
Operating Expenses	1,928,675	(88,302)	1,840,373
Net Utility Operating Income	<u>\$ (334,975)</u>	<u>\$ 168,596</u>	<u>\$ (166,379)</u>

REVIEW AND MODIFICATIONS TO
COMMISSION STAFF'S RECOMMENDATIONS

Union District's proposed adjustments to revenues and expenses reflect current and expected operating conditions. In the Commission Staff's Report, Commission Staff proposed additional adjustments. The Commission accepts the findings and recommendations contained in the Commission Staff's Report as they represent known and measurable²⁵ levels of revenues and expenses that should be reflected in rates. The Commission has no further modifications.

REVENUE REQUIREMENTS

Billing Analysis. Union District provided usage data by meter size, listing the water usage and water sales revenue for the 12-month test year. Commission Staff calculated the data provided within a normalized billing analysis and determined that annual base rate revenues of \$1,614,943 for all retail customers is an accurate representation of the normalized test-year revenue from water sales. In the Commission Staff's Report,

²⁵ See 807 KAR 5:001E, 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 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); 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).

Commission Staff recommended an increase to Union District's test-year Water Sales Revenue of \$126,644.²⁶ The Commission finds that this adjustment is reasonable because an examination of Union District's billing analysis was completed by Commission Staff and a normalized revenue was based on the information provided.

Miscellaneous Service Revenues. In the Commission Staff's Report, Commission Staff noted that contrary to Commission precedent estimated labor expense incurred for work during normal business hours was included in Union District's updated cost justification sheets for its nonrecurring charges.²⁷ Commission Staff recommended reducing Union District's nonrecurring charges to reflect the removal of that estimated labor expense which resulted in a reduction to Miscellaneous Service revenues of \$46,350.²⁸ In its response to Commission Staff's Report, Union District disagreed with the removal of the labor expense from its nonrecurring charges but indicated Union District did not wish to contest those adjustments in this case.²⁹

The Commission agrees with the Commission Staff's Report, which is consistent with recent Commission decisions, that labor expenses paid for work during normal business hours should not be recovered through nonrecurring charges.³⁰ The Commission requires that charges be directly related to the actual cost incurred to provide the service. It is unreasonable to allocate an expense already incurred as a day-to-day

²⁶ Commission Staff's Report at 16–17, Adjustment A.

²⁷ Commission Staff's Report at 10–11.

²⁸ Commission Staff's Report at 10–11 and at 17, Adjustment B.

²⁹ Union District's Response to Commission Staff's Report at unnumbered page 1.

³⁰ Case No.2020-00141, *Electronic Application of Hyden-Leslie County Water District for an Alternative Rate Adjustment* (Ky. PSC Nov. 6, 2020), at 19-20.

cost of maintaining a system, such as the salary of a distribution operator, to a nonrecurring service such as the connection and reconnection of a meter during normal working hours. Only the marginal costs related to the service should be recovered through a special nonrecurring charge for service provided during normal working hours. Therefore, the Commission finds that estimated labor expenses previously included in determining the amount of nonrecurring charges should be eliminated from the charges as proposed by Commission Staff and a corresponding reduction to Miscellaneous Service revenues of \$46,350 should be made to reflect the changes in the nonrecurring charges.

Salaries and Wages – Employees. In the Commission Staff’s Report, Commission Staff recommended an increase to Union District’s Salaries and Wages – Employees expense of \$11,989 to reflect Union District’s current staff level of six full-time employees, 2,080 regular work hours, the actual test-year overtime hours worked, and the 2022 employee wage rates.³¹ The Commission finds that Commission Staff’s proposed adjustment meets the ratemaking criteria of being known and measurable, is reasonable, and should be accepted.

Tap-on Fees. Union District correctly recorded its test-year tap-on fee collections of \$20,900³² in Account 425.01, Meter Set Payments from Customers, but incorrectly expensed costs of its meter installations.³³ Union District submitted new cost justification

³¹ Commission Staff’s Report at 17–18, Adjustment C.

³² Commission Staff’s Report at 18–19, Adjustment D. Union District installed 19 meter tap-ons in 2021, which resulted in test-year tap-on collections of \$20,900, rather than the \$25,643 of tap-on collections that were used in Union District’s calculation of its pro forma adjustment.

³³ Commission Staff’s Report at 18–19.

sheets for its 3/4-Inch and 5/8-Inch tap-on charges, which would result in pro forma tap-on collections of \$21,128.³⁴ Applying Union District's proposed allocation factors, Commission Staff proposed to reduce Contractual Services – Other expense by 30 percent of the \$21,128 pro forma tap-on collections or \$6,338 and to deduct the remaining 70 percent or \$14,790 from Materials and Supplies expense.³⁵ The Commission finds that Commission Staff's proposed tap-on fee adjustments meet the ratemaking criteria of being known and measurable, are reasonable, and are accepted.

County Employee Retirement System (CERS). In the Commission Staff's Report, Commission Staff proposed an adjustment to decrease Employee Pensions and Benefits expense by \$33,260 to reflect application of the 26.95 percent employer CERS contribution rate to the pro forma employee salaries and wages expense for full-time employees of \$255,908.³⁶ The Commission finds, based on the evidence of record, that Commission Staff's adjustment is reasonable and should be accepted.

Employee Benefits. To be consistent with Commission precedent regarding premiums paid for employee health benefits, Commission Staff recommended to reduce the employee insurance premiums paid by Union District from 100 percent to 66 percent for family/parent plus/couple health insurance coverage and from 100 percent to 60 percent for dental insurance coverage based on contribution rates reported by the

³⁴ Commission Staff's Report at 18–19.

³⁵ Commission Staff's Report at 18–19.

³⁶ Commission Staff's Report at 19–20, Adjustment E. In the body of Commission Staff's Report there is an incorrect reference to a 26.79 CERS employer contribution rate. The correct employer contribution rate of 26.95% was used in footnote 52 to calculate the pro forma employer CERS contribution of \$68,967.

Bureau of Labor Statistics and The Willis Benchmarking Survey, respectively.³⁷ Following Commission precedent, Commission Staff recommended to decrease Union District's Employee Pensions and Benefits expense by \$30,820.³⁸ The Commission finds that this adjustment is a known and measurable change to Employee Pensions and Benefits, is reasonable, and should be accepted.

Purchased Water. On January 1, 2022, Union District's wholesale water supplier, Morganfield, increased its wholesale water rate from \$0.0025542 per Gallon to \$0.0026924 per Gallon.³⁹ In the Commission's Staff Report, Commission Staff recommended to increase Union District's Purchased Water expense by \$49,657 to reflect the impact the increased wholesale water rate will have on Purchased Water expense.⁴⁰ The Commission finds that Commission Staff's proposed adjustment based on the increased wholesale water rate meets the ratemaking criteria of being known and measurable, is reasonable, and is accepted.

Excess Water Loss. Union District's test year water loss was 19.38 percent.⁴¹ 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 the Commission Staff's Report, Commission Staff proposed to reduce Purchased Water expense by \$41,722 and Purchased Power expense by \$3,617 to eliminate the cost of

³⁷ Commission Staff's Report at 20–22, Adjustment F.

³⁸ Commission Staff's Report at 20–22.

³⁹ Commission Staff's Report at 22, Adjustment G.

⁴⁰ Commission Staff's Report at 22.

⁴¹ Commission Staff's Report at 23, Adjustment H.

water loss in excess of the 15 percent limitation.⁴² The Commission finds the proposed adjustments are known and measurable changes to Purchased Water expense and to Purchased Power Expense, are reasonable, and should be accepted. However, the Commission believes that it is in the customers' interest for Union District to correct its water loss, and therefore, is permitting a mechanism to allow it to do so as discussed in detail below.

Materials and Supplies. In the Commission Staff's Report, Commission Staff proposed to reduce Materials and Supplies expense by \$9,741 and to increase depreciation expense by \$496.⁴³ Commission Staff's adjustments reflect removing capital expenditures from test-year operating expenses and depreciating them over their estimated useful lives.⁴⁴ In keeping with Commission precedent, Commission Staff depreciated the capital expenditures over the mid-point of the depreciation live ranges contained in the report published in 1979 by the National Association of Regulatory Utility Commissioners (NARUC) titled Depreciation Practices for Small Water Utilities (NARUC Study).⁴⁵ The Commission finds Commission Staff's adjustments to Materials and Supplies expense and Depreciation expense are reasonable and should be accepted.

⁴² Commission Staff's Report at 23.

⁴³ Commission Staff's Report at 23–24, Adjustment I.

⁴⁴ Commission Staff's Report at 23–24.

⁴⁵ See Case No. 2016-00163, *Alternative Rate Adjustment Filing of Marion County Water District* (Ky. PSC Nov. 10, 2016); Case No. 2020-00141, *Electronic Application of Hyden-Leslie County Water District for an Alternative Rate Adjustment* (Ky. PSC Nov. 6, 2020); and Case No. 2020-00311, *Electronic Application of Cawood Water District for an Alternative Rate Adjustment* (Ky. PSC Apr. 8, 2021).

Office Rent. In the Commission Staff's Report, Commission Staff proposed to reduce pro forma operating expense by \$4,000 to eliminate test year office rent.⁴⁶ The reported office rent was paid by Union District to the Union County Fiscal Court for the building that it purchased on August 20, 2021.⁴⁷ Given that the office rent will not be incurred by Union District as an ongoing expense, the Commission finds Commission Staff's adjustment to be reasonable and should be accepted.

Depreciation. In the Commission Staff's Report, Commission Staff recommended the Commission accept Union District's proposed adjustment to decrease test-year depreciation expense of \$300,719 by \$5,439 to a pro forma level of \$295,280.⁴⁸ Union District's proposed adjustment is consistent with Commission precedent of using the depreciation life ranges contained in the NARUC Study.⁴⁹ When no evidence exists to support a specific life that is inside or outside of the NARUC Study ranges, the Commission has historically used the mid-point of the NARUC Study depreciation ranges to depreciate water assets.⁵⁰

The Commission finds that Union District's proposed depreciation adjustment is reasonable and should be accepted as it is consistent with Commission precedent. The Commission further finds that Union District shall use the mid-point of the depreciable

⁴⁶ Commission Staff's Report at 25, Adjustment J.

⁴⁷ Commission Staff's Report at 25.

⁴⁸ Commission Staff's Report at 25-26, Adjustment K.

⁴⁹ See Case No. 2016-00163, *Alternative Rate Adjustment Filing of Marion County Water District* (Ky. PSC Nov. 10, 2016); Case No. 2020-00141, *Electronic Application of Hyden-Leslie County Water District for an Alternative Rate Adjustment* (Ky. PSC Nov. 6, 2020); and Case No. 2020-00311, *Electronic Application of Cawood Water District for an Alternative Rate Adjustment* (Ky. PSC Apr. 8, 2021).

⁵⁰ See Case No. 2020-00290, *Electronic Application of Bluegrass Water Utility Operating Company, LLC for an Adjustment of Rates and Approval of Construction* (Ky. PSC Sept. 2, 2021).

lives of the NARUC Study ranges to depreciate water plant assets for accounting purposes in all future reporting periods. Union District shall not make an adjustment to accumulated depreciation or retained earnings to account for this change in the accounting estimate.

Taxes Other than Income – FICA. In the Commission Staff's Report, Commission Staff recommended that the Commission decrease Payroll Tax expense by \$717.⁵¹ The Commission finds, based on the evidence of record, Commission Staff's proposed payroll tax adjustment accurately reflects the level of Union District's payroll tax expense using the pro forma Employee Salaries and Wages expense of \$255,908 and the test-year Commissioner Salaries and Wages expense of \$14,400, is reasonable and is accepted.

Based upon the Commission's findings discussed above, the following table summarizes Union District's adjusted pro forma:

⁵¹ Commission Staff's Report at 26–27, Adjustment L.

	Commission Staff Test Year Operations	Commission Staff Pro Forma Adjustments	Commission Staff Pro Forma Operations	Commission Pro Forma Adjustments	Commission Pro Forma Operations
Operating Revenues:					
Total Metered Sales	\$ 1,488,299	\$ 126,644	\$ 1,614,943		1,614,943
Other Water Revenues:					
Forfeited Discounts	19,012	0	19,012		19,012
Miscellaneous Service Revenues	86,389	(46,350)	40,039		40,039
Total Other Operating Revenues	105,401	(46,350)	59,051	0	59,051
Total Operating Revenues	1,593,700	80,294	1,673,994	0	1,673,994
Operating Expenses:					
Operation and Maintenance:					
Salaries and Wages - Employees	243,919	11,989			
		(6,338)	249,570		249,570
Salaries and Wages - Officers	14,400		14,400		14,400
Employee Pensions and Benefits	194,564	(33,260)			
		(30,820)	130,484		130,484
Purchased Water	902,893	49,657			
		(41,722)	910,828		910,828
Purchased Power	82,590	(3,617)	78,973		78,973
Materials and Supplies	56,212	(14,790)			
		(9,741)	31,681		31,681
Contractual Services	23,895		23,895		23,895
Rent - Building	4,000	(4,000)	0		0
Transportation Expenses	26,029		26,029		26,029
Insurance - Gen. Liab. & Workers Comp.	23,721		23,721		23,721
Insurance - Other	2,287		2,287		2,287
Miscellaneous Expenses	32,050		32,050		32,050
Total Operation and Maint. Expenses	1,606,560	(82,642)	1,523,918	0	1,523,918
Depreciation Expense	300,719	496			
		(5,439)	295,776		295,776
Taxes Other Than Income	21,396	(717)	20,679		20,679
Total Operating Expenses	1,928,675	(88,302)	1,840,373	0	1,840,373
Net Utility Operating Income	\$ (334,975)	\$ 168,596	\$ (166,379)	\$ -	\$ (166,379)

OVERALL REVENUE REQUIREMENT

In its application, Union District's used the DSC method to calculate its requested revenue requirement.⁵² However, for comparative purposes Union District provided the calculation of its revenue requirement using the Operating Method and briefly discussed the impact this method would ultimately have on Union District's working capital.⁵³ Union District discussed, in general terms, the benefits that a larger working capital would have on its ability to fund future capital projects but failed to provide specific uses of any

⁵² Amended Application (filed June 23, 2022), cover letter, unnumbered page 1.

⁵³ Amended Application (filed June 23, 2022), cover letter, unnumbered page 1.

additional funds that would be generated if the Commission were to calculate its revenue requirement utilizing the operating ratio method.⁵⁴

Historically, the Commission has applied a DSC method to calculate the revenue requirement of water districts and water associations.⁵⁵ This method allows for recovery of (1) cash-related pro forma operating expenses; (2) depreciation expense, a non-cash item, to provide working capital; (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 the Commission Staff's Report, Commission Staff provided a schedule comparing Union District's revenue requirements and working capital using operating ratios ranging from 88 percent to 92 percent.⁵⁶ The comparison shows that the operating ratios produced levels of working capital far in excess of the amount requested by Union District.⁵⁷ The Commission Staff concluded that a DSC produced a level of operating revenues that will allow Union District to pay its cash-related pro forma operating expenses and to cover its annual debt service payments, while providing a sufficient level of working capital to allow Union District to operate and to maintain its system.⁵⁸ Based upon its review of the case record, the Commission finds that Commission Staff's recommendation to use the DSC method is reasonable and should be accepted.

⁵⁴ Amended Application (filed June 23, 2022), cover letter, unnumbered page 1.

⁵⁵ See Case No. 2019-00424, *Electronic Application of Grant County Sanitary Sewer District for an Alternate Rate Adjustment* (Ky. PSC May 6, 2020); see also Case No. 2019-00268, *Application of Knott County Water and Sewer District for an Alternative Rate Adjustment* (Ky. PSC Jan. 31, 2020).

⁵⁶ Commission Staff Report at Appendix B.

⁵⁷ Commission Staff Report at 7–9.

⁵⁸ Commission Staff Report at 7–9.

Based upon the Commission findings and determinations made in this Order, Union District requires an increase in revenues from water sales of \$174,035, or 10.78 percent above the pro forma present water rate revenues as calculated below. This level of increase is required for Union District to remain operationally and financially sound and have an opportunity to provide adequate, efficient and reasonable service to its customers.

Pro Forma Operating Expenses	\$ 1,840,373
Plus: Average Annual Debt Service	9,600
Debt Service Coverage Requirement	<hr/>
Overall Revenue Requirement	1,849,973
Less: Other Operating Revenue	(59,051)
Nonutility Income	(1,944)
Revenue Required from Water Sales	<hr/> 1,788,978
Less: Normalized Revenues from Water Sales	(1,614,943)
Required Revenue Increase	<hr/> <hr/> \$ 174,035
Percentage Increase	<hr/> <hr/> 10.78%

WATER LOSS SURCHARGE

In the Commission Staff's Report, Commission Staff recommended that the Commission approve a Water Loss Reduction Surcharge of \$1.72 per active meter per month for 48 months to help lower system unaccounted-for water losses to levels closer to the regulatory standard of 15 percent.⁵⁹ The surcharge would produce approximately \$45,463 annually, and \$181,852 in total collections over the four-year period.⁶⁰ The

⁵⁹ Commission Staff's Report at 11–13.

⁶⁰ \$1.72 (Monthly Water Loss Reduction Surcharge) x 26,432 (Annual Number of Bills) = \$45,463 (Annual Water Loss Reduction Surcharge Collections) x 4 (Four Year Collection Period) = \$181,852. The difference between the calculated annual surcharge collections of \$45,463 and the annual cost of line loss in excess of 15 percent of \$45,339 is due to rounding the monthly surcharge to two decimal places.

annual surcharge collection reflects the amount disallowed for excessive water loss pursuant to 807 KAR 5:066, Section 6(3).

The use of a surcharge is consistent with prior Commission action in cases involving water utilities with excessive unaccounted-for water loss.⁶¹ In establishing water-loss surcharges, the Commission recognized that the adjustments required to be made to comply with the 15 percent line-loss limitation in 807 KAR 5:066, Section 6(3), could severely restrict cash flow and could impair a water district's ability to take the necessary action to focus on its leak detection and repair. Using a surcharge to fund a water utility's water loss reduction efforts allows the Commission to place strict controls governing the surcharge proceeds to ensure their effective use, public acceptance of the surcharge and public confidence in the water utility's use of those funds.

In its report titled *Confronting the Problems Plaguing Kentucky's Water Utilities: An Investigative Report by the Kentucky Public Service Commission November 2019* that was fully incorporated in the final Order in Case No. 2019-00041, Appendix L, the Commission recommended more frequent rate cases and pursuing qualified infrastructure improvement surcharges, the proceeds of which will be devoted exclusively to infrastructure improvement and replacement.⁶²

⁶¹ See Case No. 96-126, *An Investigation into the Operations and Management of Mountain 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); and 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, 2020).

⁶² Case No. 2019-00041, *Electronic Investigation into Excessive Water Loss by Kentucky's Jurisdictional Water Utilities* (Ky. PSC Nov. 22, 2019), Appendix L, *Confronting the Problems Plaguing Kentucky's Water Utilities: An Investigative Report by the Kentucky Public Service Commission November 2019* at 24–25.

Therefore, the Commission finds that a monthly surcharge is a reasonable means for Union District to recover the cost for its water leak detection efforts and repairs in order to reduce the increased expense and lost revenue from unaccounted-for water loss. The Commission finds that a monthly water loss reduction surcharge of \$1.72 per active meter for 48 months should be approved. Union District should be restricted to expending any funds collected under the surcharge subject to authorization by the Commission. Union District should file a qualified infrastructure improvement plan, including a comprehensive unaccounted-for water loss reduction plan that establishes priorities, a time schedule for eliminating each source of unaccounted-for water loss, and provides a detailed spending plan for the proceeds of the requested surcharge. The proceeds from the surcharge shall be kept in a separate, interest-bearing account.

The proceeds of Union District's Water Loss Reduction Surcharge should be used solely to fund Union District's unaccounted-for water loss reduction efforts as set forth in the Commission Staff's Report.

UNAUTHORIZED LONG-TERM DEBT

Commission Staff discovered that Union District had not obtained prior Commission authorization before it entered into the August 30, 2021 Union Bank ten-year \$75,000 promissory note and that it used the loan proceeds to purchase its office building located at 409 North Court Street in Morganfield, Kentucky from the Union County Fiscal Court.⁶³ Union District's action to enter into the ten-year promissory note before obtaining prior Commission approval could be construed as a violation of KRS 278.300.⁶⁴ Further,

⁶³ Commission Staff's Report at 14–15.

⁶⁴ Commission Staff's Report at 14–15.

the Commission has previously required utilities to follow the requirements of KRS 278.020(1) by obtaining a CPCN before purchasing an existing building and performing any minimal construction to retrofit the building for use as a water utility headquarters or to remodel existing facilities already in use by a utility.⁶⁵

The Commission Staff has provided sufficient evidence to support the Commission in its decision to initiate an investigation into Union District's possible violations of Commission statutes and regulations, including KRS 278.020(1) and KRS 278.300. Also, given that Union District's Board of Commissioners have a statutory duty and responsibility to ensure that Union District follows the Commission's statutes and regulations the Commission's investigation will look into the possibility that Union District commissioners willfully violated provisions of KRS Chapter 278 and 807 KAR Chapter 005

RATE DESIGN

Union District proposed to increase all of its monthly retail water service rates evenly across the board by approximately 15.30 percent. Union District has not performed a cost of service study (COSS). Union District stated that it did not consider filing a COSS because there have not been any material changes in customer usage patterns to warrant it.

⁶⁵ See Case No. 2016-00392, *Application of North Mercer Water District for a Certificate of Public Convenience and Necessity to Acquire a Building and Make Minimal Adaptions Thereto* (Ky. PSC Dec. 22, 2016); Case No. 2005-00277, *Application of Fleming-Mason Energy Cooperative Corporation for an Order and Certificate of Public Convenience and Necessity Authorizing Applicant to Construct a Garage, Warehouse, fieldhouse, and Remodeling at Flemingsburg, Kentucky* (Ky. PSC Oct. 14, 2005); and Case No. 2016-00181, *Electronic Application of Columbia Gas of Kentucky, Inc. for a Declaratory Order that the Construction of Proposed Gas Safety Training Facilities is in the Ordinary Course of Business and Does Not Require a Certificate of Public Convenience* (Ky. PSC Sept. 9, 2016) (the Commission required a CPCN for the remodeling necessary to retro-fit a portion of an existing building to accommodate a training facility).

In the Commission Staff's Report, Commission Staff followed the method proposed by Union District and allocated Commission Staff's calculated revenue increase across the board to Union District's monthly retail water service rates. The Commission finds that in the absence of a COSS, the proposed across-the-board method is an appropriate and equitable method to allocate the increased cost to Union District's customers.

The rates set forth in Appendix A to this Order are based upon the revenue requirement the Commission has found to be fair, just and reasonable, and will produce sufficient revenues to recover the required revenue of \$1,788,978 from water sales—an approximate 10.78 percent over normalized test-year water sales of \$1,614,943. The monthly bill of a typical residential customer using 4,000 gallons of water will increase from \$27.57 to \$32.16, an increase of \$4.59 or approximately 16.65 percent.⁶⁶ The monthly bill of typical wholesale customer using 2,640,026 gallons of water will increase from \$11,466.68 to \$12,709.53, an increase of \$1,242.85, or approximately 10.83 percent.

RATE CASE FREQUENCY

In Case No. 2019-00041 and the resulting investigative report, the Commission discussed the problems that can occur when utilities avoid a review of their financial records.⁶⁷ A key recommendation from that investigative report was that water utilities should monitor the sufficiency of their base rates closely and, in general, apply for base rate adjustments on a more frequent basis.⁶⁸

⁶⁶ The average monthly bill also includes the water loss surcharge of \$1.72 per month.

⁶⁷ Case No. 2019-00041, *Electronic Investigation into Excessive Water Loss by Kentucky's Jurisdictional Water Utilities* (Ky. PSC. Nov. 22, 2019), Order.

⁶⁸ Case No. 2019-00041, Nov. 22, 2019 Order.

The Commission finds that Union District should conduct internal financial reviews on an annual basis to ensure that its water rates are sufficient. If Union District needs assistance in conducting its annual internal rate reviews to ensure the sufficiency of its rates, Union District can request the Commission to allow its Financial Analysis Staff to assist with the annual rate analysis. Further, the Commission recommends that Union District develop and implement a written policy requiring an annual internal rate review, and the filing of a rate case every three to five years to maintain a regular review of the utility's finances. These are good practices to ensure that there is not an excessive gap between base rate cases in the future.

In the Commission Staff's Report, Commission Staff recommended that the Commission direct Union District to file a rate case in three years unless its annual financial review indicates that a rate case should be filed sooner.⁶⁹ Commission Staff also recommended that in its next rate case filing, Union District should be directed to calculate its revenue requirement using either the DSC method as commonly accepted by the Commission or the operating ratio method. Union District should be prepared to show that the revenue requirement method chosen will produce an adequate level of working capital.⁷⁰

SUMMARY

After consideration of the evidence of record and being otherwise sufficiently advised, the Commission finds that the recommendations contained in the Commission Staff's Report are supported by the evidence of record and are reasonable. The

⁶⁹ Commission Staff's Report at 8.

⁷⁰ Commission Staff's Report at 8–9.

Commission has historically used a DSC method to calculate the revenue requirement for water districts or associations with outstanding long-term debt. Therefore, applying the DSC method to Union District's pro forma operations results in an Overall Revenue Requirement of \$1,840,373, a required revenue from water sales of \$1,788,978, and an increase in revenue from water sales of \$174,035, or 10.78 percent.

The Commission finds Union District will file a rate case in three years unless its annual financial review indicates that a rate case is required to be filed sooner. In its next rate case filing, Union District will calculate its revenue requirement using either the DSC method as commonly accepted by the Commission or the operating ratio method. Union District will show that the revenue requirement method chosen will produce an adequate level of working capital. To ensure continued rate sufficiency over time, the Commission also recommends that Union District's board of commissioners consider filing periodic rate cases with the Commission regularly every three to five years.

The Commission finds that allocating the calculated revenue increase across the board to Union District's monthly water service rates.

The Commission shall open a separate case to investigate the possibility that Union District violated any Commission regulation and/or statute. The Commission's investigation will also look into the possibility that Union District commissioners willfully violated provisions of KRS Chapter 278 and 807 KAR Chapter 005

The Commission further finds that Union District should be authorized to assess a Water Loss Reduction Surcharge of \$1.72 per active meter per month for 48 months, or until \$181,852 has been assessed, whichever occurs first. The Commission shall open

a separate case to monitor the surcharge collection and expenses with the following conditions:

1. Within 120 days of the date of service of this Order, Union District shall file with the Commission a qualified infrastructure improvement plan, including a comprehensive unaccounted-for water loss reduction plan that establishes priorities and a time schedule for eliminating each source of unaccounted-for water loss, and provide a detailed spending plan for the proceeds of a surcharge;

2. Union District shall deposit surcharge collection in a separate inter-bearing account;

3. Union District shall file monthly activity reports with the Commission that include a statement of monthly surcharge billings and collections, a monthly surcharge bank statement, a list of each payment from the account, its payee, and a description of the purpose, and invoice supporting each payment;

4. Union District shall file monthly water-loss reports with the Commission;

5. Surcharge proceeds shall not be used to reimburse Union District for unaccounted-for water loss reduction expense incurred prior to the date of this Order;

6. Union District's surcharge and water loss detection and repair program is subject to annual Commission reviews that will examine the progress of the water loss detection and repair program and expenditures made with surcharge proceeds and consider adjustments to the program and the surcharge amount;

7. Union District's failure to comply with any conditions attached to the assessment of the surcharge will result in termination of the surcharge and the refund of

collected surcharge proceeds disbursed on expenses or projects outside the scope of the expenses and projects approved by the Commission.

IT IS THEREFORE ORDERED that:

1. The recommendations contained in the Commission Staff's Report are adopted and incorporated by reference into this Order as if fully set out herein.
2. The water service rates proposed by Union District are denied.
3. The rates forth in the Appendix to this Order are approved for service rendered by Union District on and after the date of this Order.
4. The Commission shall open a separate proceeding to investigate the possibility that Union District has violated any Commission regulation and/or statute. The Commission's investigation will also look into the possibility that Union District commissioners willfully violated provisions of KRS Chapter 278 and 807 KAR Chapter.
5. Within 20 days of the date of service of this Order, Union District shall file with this Commission, using the Commission's electronic Tariff Filing System, new tariff sheets setting forth the rates and charges approved by this Order and their effective date, and also stating that the rates and charges were authorized by this Order.
6. Union District shall use the midpoint of the depreciable lives of the NARUC Study ranges, as recommended by Commission Staff, to depreciate water plant assets for accounting purposes in all future reporting periods. Union District shall not make adjustments to accumulated depreciation or retained earnings to account for this change in the accounting estimate.
7. Any documents filed in the future pursuant to ordering paragraph 9 shall reference this case number and shall be retained in the post-case correspondence file.

8. Union District is authorized to assess a monthly Water Loss Reduction Surcharge of \$1.72 per meter per month for 48 months, or until \$181,852 has been assessed, whichever occurs first, to fund its unaccounted-for water loss reduction efforts as set forth in the Commission Staff's Report, subject to the conditions set forth in ordering paragraph 9.

9. The Commission shall open a separate proceeding, Case No. 2023-00119⁷¹ to monitor the surcharge proceeds collection and expenses, subject to the following conditions:

a. Within 120 days of the date of service of this Order, Union District shall file with the Commission a qualified infrastructure improvement plan, including a comprehensive unaccounted-for water loss reduction plan that establishes priorities and a time schedule for eliminating each source of unaccounted-for water loss and provides a detailed spending plan for the proceeds of a surcharge.

b. Union District shall deposit surcharge collections in a separate interest-bearing account. On the 15th day of each month for 48 months from the date of this Order or until all surcharge proceeds are expended, Union District shall file with the Commission a monthly activity report that includes a statement of monthly surcharge billings and collections; a monthly surcharge bank statement; a list of each payment from the account, its payee, a description of the purpose; and invoices supporting each payment.

⁷¹ Case No. 2023-00119, *Electronic Union County Water District Unaccounted-for Water Loss Reduction Plan, Surcharge and Monitoring* (Ky. PSC May 5, 2023).

c. On the 15th day of each month for 48 months from the date of service of this Order or until all surcharge proceeds are expended, Union District shall file a monthly water loss report with the Commission.

d. Union District shall not use any surcharge proceeds for reimbursement of unaccounted-for water loss reduction expenses without prior Commission authorization.

e. Union District shall consider all surcharge collections as contributions and shall account for them in the manner that the Uniform System of Accounts for Class A and B Water Districts and Associations prescribes.

f. When Union District collects the surcharge from the customers, it shall debit special funds and credit the customer account.

g. One year after the date of service of this Order and annually thereafter, Union District shall file in Case No. 2023-00119 a schedule of the estimated and actual progress of the water loss detection and repair program, and estimated and actual expenditures made with surcharge proceeds, for the purpose of evaluating whether adjustments to the program or to the surcharge amount are required.

10. Union District's failure to comply with the conditions set forth in ordering paragraph 9 shall result in termination of the surcharge and the refund of collected surcharge proceeds disbursed on expenses or projects outside the scope of expenses and projects approved by the Commission.

11. Union District shall file a rate case in three years unless its annual financial review indicates that a rate case is required to be filed sooner. In its next rate case filing, Union District will calculate its revenue requirement using either the DSC method as

commonly accepted by the Commission or the operating ratio method. Union District will show that the revenue requirement method chosen will produce an adequate level of working capital.

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

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PUBLIC SERVICE COMMISSION



Chairman



Vice Chairman



Commissioner

ENTERED
MAY 05 2023
rCS
KENTUCKY PUBLIC
SERVICE COMMISSION

ATTEST:



Executive Director

APPENDIX

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2022-00160 DATED MAY 05 2023

The following rates and charges are prescribed for the customers in the area served by Union 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-Inch Meter

First	2,000 Gallons	\$ 15.18	Minimum Bill
Next	3,000 Gallons	0.00763	Per Gallon
Next	5,000 Gallons	0.00719	Per Gallon
Next	15,000 Gallons	0.00680	Per Gallon
Next	25,000 Gallons	0.00647	Per Gallon
Next	50,000 Gallons	0.00603	Per Gallon
Next	100,000 Gallons	0.00558	Per Gallon
Next	100,000 Gallons	0.00514	Per Gallon
Over	300,000 Gallons	0.00470	Per Gallon

3/4-Inch Meter

First	5,000 Gallons	\$ 38.06	Minimum Bill
Next	5,000 Gallons	0.00719	Per Gallon
Next	15,000 Gallons	0.00680	Per Gallon
Next	25,000 Gallons	0.00647	Per Gallon
Next	50,000 Gallons	0.00603	Per Gallon
Next	100,000 Gallons	0.00558	Per Gallon
Next	100,000 Gallons	0.00514	Per Gallon
Over	300,000 Gallons	0.00470	Per Gallon

1-Inch Meter

First	10,000 Gallons	\$ 74.01	Minimum Bill
Next	15,000 Gallons	0.00680	Per Gallon
Next	25,000 Gallons	0.00647	Per Gallon
Next	50,000 Gallons	0.00603	Per Gallon
Next	100,000 Gallons	0.00558	Per Gallon
Next	100,000 Gallons	0.00514	Per Gallon
Over	300,000 Gallons	0.00470	Per Gallon

1 1/2-Inch Meter

First	25,000 Gallons	\$ 176.04	Minimum Bill
Next	25,000 Gallons	0.00680	Per Gallon
Next	50,000 Gallons	0.00647	Per Gallon
Next	100,000 Gallons	0.00603	Per Gallon
Next	100,000 Gallons	0.00514	Per Gallon
Over	300,000 Gallons	0.00470	Per Gallon

2-Inch Meter

First	50,000 Gallons	\$ 337.78	Minimum Bill
Next	50,000 Gallons	0.00647	Per Gallon
Next	100,000 Gallons	0.00603	Per Gallon
Next	100,000 Gallons	0.00514	Per Gallon
Over	300,000 Gallons	0.00470	Per Gallon

2 1/2-Inch Meter

First	75,000 Gallons	\$ 488.43	Minimum Bill
Next	25,000 Gallons	0.00647	Per Gallon
Next	100,000 Gallons	0.00603	Per Gallon
Next	100,000 Gallons	0.00514	Per Gallon
Over	300,000 Gallons	0.00470	Per Gallon

3-Inch Meter

First	100,000 Gallons	\$ 639.09	Minimum Bill
Next	100,000 Gallons	0.00603	Per Gallon
Next	100,000 Gallons	0.00514	Per Gallon
Over	300,000 Gallons	0.00470	Per Gallon

4-Inch Meter

First	200,000 Gallons	\$ 1,197.41	Minimum Bill
Next	100,000 Gallons	0.00514	Per Gallon
Over	300,000 Gallons	0.00470	Per Gallon

6-Inch Meter

First	300,000 Gallons	\$ 1,711.42	Minimum Bill
Over	300,000 Gallons	0.00470	Per Gallon

Monthly Water Loss Reduction Surcharge

\$ 1.72 per customer

To be collected over 48 months or until \$181,852 has been assessed, whichever occurs first.

Nonrecurring Charges

Returned Check Charge	\$	0.00
Meter Read Charge	\$	13.00
Reconnection Charge	\$	13.00
Meter Test Charge	\$	55.00
3/4-Inch and 5/8-Inch tap-on charges	\$	1,300.00

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