

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION OF KENTUCKY

In the Matter of:

PROPOSED ADJUSTMENT OF THE WHOLESALE)
WATER SERVICE RATES OF CENTRAL CITY) Case No. 2019-00260
MUNICIPAL WATER & SEWER)

TESTIMONY OF DAVID RHOADES

1 **Q. Please state your name and business address.**

2 A. My name is David Rhoades. My business address is 214 N. 1st St., Central City,
3 Kentucky 42330.

4 **Q. By whom are you employed?**

5 A. I am employed as City Administrator by the City of Central City. I have served in this
6 position since March 1999.

7 **Q. Please describe the Central City's water operations.**

8 A. The City operates a waterworks system and provides water service to customers in
9 Central City and surrounding areas. The water works system is operated through a Water
10 Commission, pursuant to KRS 96.320. In addition to water service to retail customers, the City
11 provides wholesale water service to Muhlenberg County Water District and Muhlenberg County
12 Water District No. 3. Accordingly, Central City's water treatment plant is a regional facility that
13 provides potable water to the majority of Muhlenberg County.

14 **Q. In general terms, why is additional revenue needed from the Central City's**
15 **wholesale water customers?**

1 A. Several factors have prompted the need for a rate increase. Generally speaking, the costs
2 of operating Central City's water system have increased over time and consumption has
3 declined. Notably, the City of Sacramento is now purchasing water from McClean County
4 Water District instead of Muhlenberg County Water District No. 3. Previously, McClean County
5 Water District purchased approximately 55 million gallons per year from District No. 3. These
6 two factors lead to the need for higher utility rates.

7 In addition to simply needing additional revenue to ensure that Central City can continue
8 to provide safe, reliable water service, the City has received conditional approval from
9 U.S.D.A's Rural Development ("RD") to receive a \$150,000 grant and an \$850,000 loan. This
10 favorable funding will be jeopardized if Central City's wholesale rate is not set at \$3.31 or
11 above.

12 **Q. Can you provide more details on why additional revenue is needed from the Central**
13 **City's wholesale water customers?**

14 Central City's wholesale rates were last adjusted in March 2013 shortly after completing
15 a major renovation of its water treatment plant. The treatment plant's capacity was increased
16 from four to seven million gallons per day in order to meet the needs of the vast majority of
17 customers in Muhlenberg County. At that time, the initial rate agreed upon by Central City and
18 the two water districts was based on the anticipated costs of operating the larger treatment
19 facility. The contract authorized Central City to increase rates on or after July 1, 2014, but the
20 City has not proposed an increase until now.

21 Over the course of the past five years, the City has realized increases in operating
22 expenses, when compared with the projected expenses on which the current wholesale rates were

1 based. Current operating expenses for the water system are significantly greater than what the
2 projected expenses on which the current rates are based.

3 In addition, consumption has declined. Both water districts have attempted to reduce line
4 loss. Muhlenberg County Water District recently implemented upgrades to its telemetry
5 monitoring system and installed new leak prevention and detection controls. Muhlenberg
6 County Water District No. 3 has also seen a reduced percentage of water loss since Central
7 City's last rate increase, particularly because the City of Sacramento has started to purchase from
8 McClean County Water District.

9 **Q. What steps did Central City take in determining the proposed rate increase to its**
10 **wholesale customers?**

11 A. Central City requested \$1,000,000 in funding from RD for a variety of projects that will
12 benefit all City customers, including the Districts. As a part of that process, RD has
13 conditionally approved a \$150,000 grant and \$850,000 low-interest loan. In order for the City to
14 qualify for the loan and grant funding, Rural Development evaluated financial information
15 submitted by the City (thorough McGhee Engineering) and determined the minimum rates that
16 Central City must charge.

17 **Q. What is the specific proposed rate increase to Central City's wholesale customers?**

18 A. Central City is proposing to increase its wholesale rates from \$2.63 per 1,000 gallons to
19 \$3.31 per 1,000 gallons. Because RD did not consider rate case expense in its calculation of the
20 \$3.31-per-1,000-gallon minimum rate and because Central City may incur significant expenses
21 in defending its proposed rate with the Commission, Central City is requesting a 36-month
22 surcharge to cover its rate case expenses.

1 **Q. Are the proposed rates to Muhlenberg County Water District and Muhlenberg**
2 **County Water District No. 3 the same?**

3 A. Yes. Pursuant to the Water Purchase Contracts, the parties agreed that the City would
4 charge the same rate to both water districts.

5 **Q. Has Central City increased rates to its in-city customers?**

6 A. The City Council has approved a second reading of the ordinance increasing the
7 volumetric rate to its in-city customers.

8 **Q. Does Central City operate other utilities?**

9 A. Yes. Central City also provides wastewater services.

10 **Q. Are water rates increased to offset losses in other departments?**

11 A. No. The rates collected for water service are based solely upon the revenues and
12 expenses of the water department and have no relationship to the revenues and expenses of other
13 utilities or departments.

14 **Q. Does this conclude your testimony?**

15 A. Yes, it does.

AFFIDAVIT

The undersigned, David Rhoades, being duly sworn, deposes and says that he is the City Administrator of the City of Central City, that he is authorized to submit this testimony on behalf of City of Central City, and that the information contained in the testimony is true and accurate to the best of his knowledge, information and belief, after reasonable inquiry, and as to those matters that are based on information provided to him, he believes to be true and correct.



David Rhoades, Affiant

NOTARY CERTIFICATE

COMMONWEALTH OF KENTUCKY

COUNTY OF Muhlenberg

Subscribed, acknowledged and sworn to before me by David Rhoades on this 27th day
of August 2019.

My commission expires: 12-8-21.

Leah Ann Gossett # 591193
NOTARY PUBLIC

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION OF KENTUCKY

In the Matter of:

PROPOSED ADJUSTMENT OF THE WHOLESALE)
WATER SERVICE RATES OF CENTRAL CITY) Case No. 2019-00260
MUNICIPAL WATER & SEWER)

TESTIMONY OF MICHAEL W. McGHEE

1 **Q. Please state your name and business address.**

2 A. My name is Michael W. McGhee. My business address is 202 South Ewing Street,
3 Guthrie, KY 42234.

4 **Q. By whom are you employed?**

5 A. I am the President of McGhee Engineering, Inc.

6 **Q. Please provide a summary of your work experience.**

7 A. I have been involved in the water industry for approximately 35 years. In addition, I have
8 significant experience in the design and management of site development, highway, airport,
9 water, wastewater, and drainage projects, as well as a number of engineering reports and analysis
10 projects throughout the southeastern United States.

11 **Q. Please describe your educational background.**

12 A. I have a Bachelor of Science degree in Civil Engineering from the University of
13 Kentucky and a Masters of Business Administration with a specialization in finance from the
14 University of Houston.

1 **Q. Do you hold a professional license?**

2 A. Yes, I am a licensed engineer in Kentucky, Tennessee, and Pennsylvania.

3 **Q. Are you affiliated with any professional organizations?**

4 A. Yes, I am a member of the Kentucky Rural Water Association, the American Water
5 Works Association, and the Kentucky Society of Professional Engineers.

6 **Q. Have you provided assistance to clients in developing rates?**

7 A. Yes, I have assisted dozens of clients in developing rates. In planning water projects, I
8 am often required to provide guidance on how a utility will pay for the project. Frequently, a
9 utility's financing will require an upward adjustment in rates to ensure that the utility can
10 maintain an appropriate level of debt service coverage. I have frequently been asked to perform
11 those calculations.

12 **Q. What is the purpose of your testimony in this proceeding?**

13 A. The purpose of my testimony is to support the proposed wholesale rate of Central City.

14 **Q. Briefly describe your task in developing proposed rates for Central City.**

15 A. In providing assistance to the City to acquire federal funding, I provided financial
16 analysis and information to Rural Development ("RD"), who reviews the financial information
17 to ensure that a utility has the ability to repay any RD loans.

18 **Q. How did you accomplish your task?**

19 A. Initially, I began by reviewing the revenues and expenses for Central City's water system
20 in its audit for the 2016 fiscal year because it was the most current end-of-fiscal-year
21 information. Knowing that the project would not be started until 2019 and recognizing that
22 revenues and expenses would change from 2016 to 2019, I made pro forma adjustments to the
23 2016 financials. For example, we anticipated increased O&M expenses, as well as a decline in

1 consumption. This methodology is consistent with my assistance on all projects on which we
2 seek Rural Development funding. The recommended rate was \$3.31 per 1,000 gallons.

3 Rural Development reviewed this financial information, performed their underwriting,
4 and concurred that the minimum wholesale rate should be \$3.31 per 1,000 gallons as a minimum
5 in order to ensure that the federal government could get paid.

6 We have since conducted additional analysis using actual expenses from 2019. This
7 analysis suggested that the rate should be \$3.33 per 1,000 gallons. This is a significant factor for
8 two reasons. First, it shows that our estimates and pro forma changes conducted in 2017 to the
9 2016 financials were reasonable. Second, and more importantly, it demonstrates that the Water
10 Districts will not be overcharged at a rate of \$3.31 per 1,000 gallons.

11 **Q. Are those calculations in the record?**

12 A. The City is filing those calculations as an Excel file attachment to Item 22 in response to
13 the Commission's initial request for information.

14 **Q. How did you determine the depreciation expense to include in your rate analysis?**

15 A. We provided a very conservative estimate for Central City's depreciation. In reviewing
16 the depreciation schedule that is provided by Central City in response to Item 9 of the
17 Commission's Initial Request for Information, Central City's depreciation expense appears to be
18 \$100,000 greater than the amount we used in our rate analysis.

19 **Q. What factor did you use for debt service coverage?**

20 A. We used a conservative 10% or 1.1x factor for debt service coverage. Section 501 of the
21 2012 Series A and Series B Bond Ordinance requires revenues that "are equal to not less than
22 120% of the average annual debt service requirements for principal and interest on all of the then

1 Outstanding Bonds payable from the revenues of the System.” If a 20% or 1.2x factor was used,
2 Central City could justify a higher wholesale water rate.

3 **Q. Did any financial information that you submitted to RD include anticipated rate**
4 **case expense?**

5 A. None of the proposed rates reflect any expenses incurred in litigating proposed rates
6 before the Public Service Commission. Reasonable expenses incurred in litigating rate cases are
7 generally accepted to be amortized and included in rates.

8 **Q. Can you describe the projects that Central City proposes to fund through RD?**

9 A. Yes. I have prepared a summary of the projects, which also explains how those projects
10 assist in providing service to the two wholesale customers. That document is being attached as
11 Exhibit 1.

12 **Q. Does this conclude your testimony?**

13 A. Yes.

AFFIDAVIT

The undersigned, Michael W. McGhee, being duly sworn, deposes and says that he is the President of McGhee Engineering and that he is authorized to submit this testimony on behalf of City of Central City, and that the information contained in the testimony is true and accurate to the best of his knowledge, information and belief, after reasonable inquiry, and as to those matters that are based on information provided to his, he believes to be true and correct.



Michael W. McGhee, Affiant

NOTARY CERTIFICATE


COMMONWEALTH OF KENTUCKY

COUNTY OF Fayette

Subscribed, acknowledged and sworn to before me by Michael W. McGhee on this

27 day of August, 2019.

My commission expires: April 17, 2021



NOTARY PUBLIC 577668

