

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF DEXTER-ALMO HEIGHTS WATER DISTRICT FOR ALTERNATIVE RATE ADJUSTMENT)
CASE NO. 2017-00191)

NOTICE OF FILING OF STAFF REPORT

Notice is hereby given that, in accordance with the Commission's Order of June 12, 2017, the attached report containing the findings of Commission Staff regarding the Applicant's proposed rate adjustment has been filed in the record of the above-styled proceeding. Pursuant to the Commission's June 12, 2017 Order, Dexter-Almo Heights Water District is required to file written comments regarding the findings of Staff no later than 14 days from the filing of this Report.



John S. Lyons
Acting Executive Director
Public Service Commission
P.O. Box 615
Frankfort, KY 40602

DATE SEP 27 2017

cc: Parties of Record

STAFF REPORT

ON

DEXTER-ALMO HEIGHTS WATER DISTRICT

CASE NO. 2017-00191

Dexter-Almo Heights Water District (“Dexter-Almo”) a water district organized pursuant to KRS Chapter 74, provides water service to approximately 805 residential and commercial customers residing in Calloway County, Kentucky.¹ On May 15, 2017, Dexter-Almo tendered an application (“Application”) to the Commission requesting to adjust its water rates pursuant to 807 KAR 5:076. By letter dated May 19, 2017, the Commission notified Dexter-Almo that its application was rejected as deficient. On May 24, 2017, Dexter-Almo filed its responses to the filing deficiency, and its application was accepted for filing on May 25, 2017. To ensure the orderly review of the Application, the Commission established a procedural schedule by Order dated June 12, 2017.

To comply with the requirements of 807 KAR 5:076, Section 9,² Dexter-Almo used the calendar year ended December 31, 2016, as the basis for its Application. Using its pro forma test-year operations, Dexter-Almo determined that a revenue increase of \$60,304, or 26.28 percent, over test-year normalized revenues of \$229,471 is warranted.³ The rates requested by Dexter-Almo would increase the monthly bill of a typical residential customer

¹ *Annual Report of Dexter-Almo Heights Water District to the Public Service Commission for the Calendar Year Ended December 31, 2016* (“2016 Annual Report”) at 12 and 38.

² The reasonableness of the proposed rates shall be determined using a 12-month historical test period, adjusted for known and measureable changes, that coincides with the reporting period of the applicant’s annual report for the immediate past year.

³ Application, Revenue_Requiremnt_Calculation.pdf, ARF Form 1 – Attachment RR-DC – September 2011, Revenue Requirement Calculation-Debt Service Coverage Method.

using 4,000 gallons per month by \$2.37, from \$23.77 to \$26.17, or approximately 10.00 percent.⁴ A monthly bill for a commercial customer using an average of 3,000 gallons per month will increase by \$1.86, from \$18.64 to \$20.50, or approximately 10.00 percent.⁵

In the Application, Dexter-Almo provided its Pro Forma Income Statement⁶ and Revenue Requirement Determination – Debt Service Coverage Ratio⁷ in support of the Overall Revenue Requirement and Required Revenue Increase as summarized below:

Pro Forma Income Statement			
	2016 Annual Report	Pro Forma Adjustments	Pro Forma Operations
Operating Revenues:			
Revenues from Water Sales:	\$ 219,653	\$ 9,818	\$ 229,471
Other Water Revenues:	1,466	0	1,466
Total Operating Revenues	<u>221,119</u>	<u>9,818</u>	<u>230,937</u>
Operating Expenses:			
Operation & Maintenance:	205,987	19,583	225,570
Depreciation	35,989	0	35,989
Taxes Other Than Income	12,182	0	12,182
Utility Operating Expenses	<u>254,158</u>	<u>19,583</u>	<u>273,741</u>
Net Utility Operating Income	<u>\$ (33,039)</u>	<u>\$ (9,765)</u>	<u>\$ (42,804)</u>

⁴ Application, Rate_Customer_Notice.pdf, Customer Notice of Proposed Rate Adjustment.

⁵ *Id.*

⁶ Application, Schedule_of_Adjusted_Operations.pdf, ARF Form 1 – Attachment SAO-W – September 2011 (“Schedule of Adjusted Operations”).

⁷ Application, Revenue_Requirement_Calculation.pdf, ARF Form 1 – Attachment RR-DC – September 2011.

Revenue Requirement Determination - Debt Service Coverage Method

Pro Forma Operating Expenses	\$ 273,741
Plus: Average Annual Debt Principal and Interest Payments	14,000
Debt Coverage Requirement	<u>3,500</u>
Total Revenue Requirement	291,241
Less: Other Operating Revenue	(1,443)
Non- Operating Revenue	
Interest Income	<u>(23)</u>
Revenue Required from Rates	289,775
Less: Normalized Revenues from Water Sales	<u>(229,471)</u>
Required Revenue Increase/(Decrease)	<u><u>\$ 60,304</u></u>

To determine the reasonableness of the rates requested by Dexter-Almo, Staff performed a limited financial review of Dexter-Almo's test-year operations. The scope of Staff's review was limited to determining whether operations reported for the test year were representative of normal operations. Known and measurable changes to test-year operations were identified and adjustments were made when their effects were deemed to be material. Insignificant and immaterial discrepancies were not necessarily pursued or addressed.

Staff's findings are summarized in this report. Mark Frost and Travis Leach reviewed the calculation of Dexter-Almo's Overall Revenue Requirement. Jason Green reviewed Dexter-Almo's reported revenues and rate design.

Summary of Findings

1. Overall Revenue Requirement and Required Revenue Increase. By applying the Debt Service Coverage ("DSC") Method, as generally accepted by the Commission, Staff found that Dexter-Almo's Overall Revenue Requirement to be \$260,543. A revenue increase of \$18,259, or 7.58 percent, is necessary to generate the Overall Revenue Requirement.

2. Monthly Water Service Rates. Dexter-Almo proposed to increase its current water service rates by approximately 10.00 percent evenly across the board. Dexter-Almo has not performed a cost-of-service study (“COSS”). The Commission has previously found that an across-the-board increase is an appropriate and equitable method of cost allocation in the absence of a COSS. With the exception of fire-protection rates, Staff finds that an across-the-board increase to all rate classes is the appropriate means to allocate the increased revenue requirement. The rates set forth in an appendix to this report are based upon the revenue requirement as calculated by Staff and will produce sufficient revenues from water sales to recover the \$18,259 Required Revenue Increase determined by Staff, an approximate 7.58 percent increase. These rates will increase a typical residential customer’s monthly water bill from \$24.89 to \$26.79, an increase of \$1.89, or approximately 7.63 percent.⁸

3. Depreciable Lives. In this report, Staff finds that adjustments are warranted to the depreciable lives assigned to some of Dexter-Almo’s assets and should be revised for ratemaking purposes. Any depreciable lives approved by the Commission in this preceding for ratemaking purposes should be used by Dexter-Almo for all future accounting and reporting purposes. No adjustment to accumulated depreciation or retained earnings should be made to account for the retroactive cumulative effect of this change in accounting estimate.

4. Unauthorized Debt. Dexter-Almo provided a copy of the Promissory Note⁹ between itself and the Murray Bank of Calloway County, Kentucky, (“Murray Bank”) in the

⁸ These rates reflect the current rates as a result from Case No. 2017-00228 *Purchased Water Adjustment Filing of Dexter-Almo Heights Water District* (Ky. PSC June 21, 2017).

⁹ Application, Loan_Documentation_1.pdf, Promissory Note.

principal amount of \$145,988. This Promissory Note has an origination date of December 9, 2009 and a 15-year term. In Case No. 2006-00420 the Commission granted Dexter-Almo a Certificate of Public Convenience and Necessity to construct the "Coles Campground Road Project" and approved the proposed plan of financing, which included a \$47,613 line of credit with the Murray Bank.¹⁰ In its November 23, 2005 letter, the Murray Bank states that Dexter-Almo's total line of credit was for \$150,000 and that the line of credit was renewable on a two-year term.¹¹

According to KRS 278.300, no utility shall issue any form of indebtedness unless it has been authorized to do so by an Order of the Commission.¹² Dexter-Almo currently has an outstanding loan that is payable to the Murray Bank for which Dexter-Almo did not obtain Commission approval as required by KRS 278.300. Dexter-Almo has the responsibility to ensure that it follows the Commission's statutes and regulations and that all statutory and regulatory approvals are obtained. Dexter-Almo should be aware that the Commission may initiate a separate proceeding to more thoroughly investigate the possible violations of Commission statutes and regulations. If a determination is made by the Commission that

¹⁰ Case No. 2006-00420, *Application of Dexter-Almo Heights Water District for (1) Issuance of a Certificate of Public Convenience and Necessity Authorizing the Construction of the Flint & Coles Campground Project No. Wx21035012; and (2) Approval of Its Proposed Plan of Financing the Project* (Ky. PSC Nov. 21, 2006) at 3.

¹¹ Case No. 2006-00420, October 2, 2006 submission of Dexter-Almo.

¹² This requirement does not apply to notes or loans with a two-year term. Those notes or loans can be renewed up to two times for a combined term that does not exceed six years. Dexter-Almo's Promissory Note has a 15-year term, and after seven years it still has an outstanding balance.

there has been a willful violation of any provision of KRS Chapter 278 and 807 KAR Chapter 5, the members of the Board of Commissioners may be held accountable.¹³

Pro Forma Operating Statement

Dexter-Almo's Pro Forma Operating Statement for the test year ended December 31, 2016, as determined by Staff, appears below.

	2016 Annual Report	Pro Forma Adjustments	Adj. Ref.	Pro Forma Operations
Operating Revenues:				
Revenues from Water Sales	\$ 219,653	\$ 21,165	A	\$ 240,818
Other Water Revenues:	1,466			1,466
Total Operating Revenues	<u>221,119</u>	<u>21,165</u>		<u>242,284</u>
Operating Expenses:				
Operation & Maintenance:				
Salaries & Wages - Employees	54,293	(5,699)	B	48,594
Salaries & Wages - Commissioners	7,200	(7,200)	C	0
Employee Pension & Benefits	849	126	D	975
Purchased Water	96,110	24,226	E	120,336
Purchased Power	4,046	(59)	E	3,987
Materials & Supplies	21,973	(7,000)	F	14,973
Contractual Services	11,063			11,063
Water Testing	2,016			2,016
Transportation	2,846			2,846
Insurance	3,974			3,974
Miscellaneous	1,617			1,617
Total Operation & Maintenance	205,987	4,394		210,381
Depreciation	35,989	(10,217)	G	25,772
Taxes Other Than Income	12,182	(5,566)	H	6,616
Utility Operating Expenses	<u>254,158</u>	<u>(11,389)</u>		<u>242,769</u>
Net Utility Operating Income	<u>\$ (33,039)</u>	<u>\$ 32,554</u>		<u>\$ (485)</u>

¹³ KRS 278.990(1). Any officer, agent, or employee of a utility, as defined in KRS 278.010, and any other person who willfully violates any of the provisions of this chapter or any regulation promulgated pursuant to this chapter, or fails to obey any order of the commission from which all rights of appeal have been exhausted, or who procures, aids, or abets a violation by any utility, shall be subject to either a civil penalty to be assessed by the commission not to exceed two thousand five hundred dollars (\$2,500) for each offense or a criminal penalty of imprisonment for not more than six (6) months or both.

(A) Billing Analysis Adjustment. Dexter-Almo proposed to increase its test-year revenues from water sales of \$219,653 by \$9,818 to reflect the impact of the most recent purchased water adjustment (“PWA”) granted by the Commission.¹⁴ Applying the approved PWA rates from Case No. 2017-00228¹⁵ to Dexter-Almo’s billing analysis, Staff calculated a normalized revenue of \$240,818. Accordingly, Staff has increased test year water sales revenue by \$21,165.

(B) Salaries and Wages. Dexter-Almo proposed to decrease its test-year salaries and wages expense of \$54,293 by \$8,543 to reflect the elimination of the salaries paid to part-time employees in the test year.¹⁶ Dexter-Almo does not intend to use part-time employees in the foreseeable future.¹⁷

Staff confirmed that Dexter-Almo had two part-time employees during the test year, but zero at the time of Staff’s review, and discussions with Dexter-Almo’s staff confirm that it does not currently plan to replace the part-time employees. In reviewing the test-year payroll records Staff determined that Dexter-Almo paid its two full-time employees \$48,594 in the test-year, which is \$5,699 less than the reported amount for salaries and wages. Accordingly, Staff is reducing test-year salaries and wages expense by \$5,699 to eliminate the compensation paid to Dexter-Almo’s part-time employees.

(C) Commissioner Fees. Dexter-Almo reported paying its commissioners \$7,200 in the test year. Staff requested that Dexter-Almo provide a copy of the fiscal court minutes

¹⁴ Schedule of Adjusted Operations, References, Item A.

¹⁵ Case No. 2017-00228, *Purchased Water Adjustment Filing of Dexter-Almo Heights Water District* (Ky. PSC June 21, 2017).

¹⁶ Schedule of Adjusted Operations, References, Item C.

¹⁷ *Id.*

authorizing the payment of the commissioner fees. According to KRS 74.020(6) the commissioner fees:

... shall be fixed by the county judges/executive with the approval of the fiscal court; in multicounty districts, it shall be fixed by the agreement between the county judges/executive with the approval of their fiscal courts.

Dexter-Almo was unable to provide the required approval from the judge/executive and the fiscal court in Calloway County, Kentucky. For this reason, Staff is reducing operating expenses by \$7,200 to eliminate the commissioner fees.

(D) Employee Individual Retirement Account ("IRA"). In May 2016 Dexter-Almo began offering retirement benefits to its employees.¹⁸ Dexter-Almo provides matching contributions up to 3 percent of the employee's gross salary into an IRA account. In the test year, Dexter-Almo contributed \$849 into the system operator's IRA. Using the operator's annual salary and the 3 percent matching IRA contribution rate, Dexter-Almo arrived at its pro forma adjustment of \$126.¹⁹ Staff finds that Dexter-Almo's adjustment meets the ratemaking criteria of being known and measurable and accepts it in pro forma operations.

(E) Purchased Water. Dexter-Almo proposed to increase its test-year purchased water expense of \$96,110 by \$10,000 to reflect the impact of the increased wholesale water rate that occurred in the middle of 2016.²⁰ Staff determined that Dexter-Almo's test-year purchased water expense should be increased by 24,226,²¹ and purchased power expense decreased by \$59, as explained below.

¹⁸ *Id.*, Item C.

¹⁹ *Id.*

²⁰ *Id.*, Item A.

²¹ \$25,997 (Wholesale Water Rate Increase) - \$1,771 (Water Loss Adjustment) = \$24,226.

Changes to Wholesale Purchase Water Rate. Murray Municipal Utilities

(“Murray”) increased its wholesale water rate in the test year,²² and twice in 2017.²³ Staff is increasing test-year purchased water expense by \$25,997 to account for the wholesale rate of \$2.67 per thousand gallons that became effective on June 1, 2017.

Test-Year Water Purchases	45,733,000
Wholesale Rate per Gallon	<u>\$ 0.00267</u>
Pro Forma Purchased Water	122,107
Less: Reported Test-Year Expense	<u>(96,110)</u>
Pro Forma Adjustment	<u>\$ 25,997</u>

Excess Water Loss. 807 KAR 5:066, Section 6(3),²⁴ limits water loss to 15 percent for ratemaking purposes unless an alternative level is found reasonable by the Commission. In the below table, Staff determines Dexter-Almo’s test-year water loss was 16.45 percent, or 1.45 percent above the 15 percent allowable limit.

²² Case No. 2016-00196, *Purchased Water Adjustment Filing of Dexter-Almo Heights Water District* (Ky. PSC June 30, 2016). Effective July 1, 2016, Murray increased its wholesale water rate from \$2.01 per 1,000 gallons to \$2.21 per 1,000 gallons.

²³ Case No. 2016-00433, *Purchased Water Adjustment Filing of Dexter-Almo Heights Water District* (Ky. PSC Jan. 10, 2017). Effective January 1, 2017, Murray increased its wholesale water rate from \$2.21 per 1,000 gallons to \$2.43 per 1,000 gallons. Case No. 2017-00228, *Purchased Water Adjustment Filing of Dexter-Almo Heights Water District* (Ky. PSC June 21, 2017). Effective July 1, 2017, Murray increased its wholesale water rate from \$2.43 per thousand gallons to \$2.67 per thousand gallons.

²⁴ 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 rate making 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.

Test-Year Water Purchases	45,733,000
Volume Sold During the Test Year	(38,111,300)
Utility/Water Treatment Plant	(2,900)
System Flushing	(83,925)
Fire Department Usage	(10,000)
	<hr/>
Water Loss	7,524,875
Divide by: Total Water Purchased	45,733,000
	<hr/>
Percent Lost	16.45%
Allowable Water Loss	-15.00%
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Excess Water Loss Percentage	1.45%
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With the adjustments in the table below, Staff is removing from Dexter-Almo's test-year operations the cost of purchasing and pumping the excess water loss.

	Purchased Water	Purchased Power
Pro Forma Subject to Water Loss Adjustment	122,107	\$ 4,046
Times: Water Loss in Excess of 15 Percent	-1.45%	-1.45%
	<hr/>	<hr/>
Pro Forma Water Loss Adjustments	\$ (1,771)	\$ (59)
	<hr/> <hr/>	<hr/> <hr/>

(F) Materials and Supplies. Dexter-Almo reported test-year materials and supplies expense of \$21,973.

Forecasted Adjustments. Dexter-Almo proposed to increase its test-year materials and supplies expense by \$15,000 to reflect the additional cost for the purchase of radio-read meters.²⁵ It is also proposed to increase its test-year transportation expense by \$3,000 to accrue the necessary funds over a seven-year period to purchase a new vehicle that is estimated to be \$20,000.²⁶

Administrative Regulation 807 KAR 5:001, Section 16(1), provides that all applications for a general rate adjustment shall be supported by either a "twelve (12) month historical test

²⁵ Schedule of Adjusted Operations, References, Item E.

²⁶ *Id.*, Item F.

period that may include adjustments for known and measurable changes” or a “fully forecasted test period.” When an applicant bases its application upon a historical test period, it must provide a “complete description and quantified explanation for all proposed adjustments with *proper support for any proposed changes* in price or activity levels, if applicable, and other factors that may affect the adjustment,”²⁷ or a statement explaining why the required information does not exist and is not applicable. That support should include, at a minimum, some documentary evidence to demonstrate the certainty of some expected change or event.²⁸

Further, in a prior decision the Commission made the following finding regarding budgetary adjustments in a historical rate case:

While such projections may be acceptable when an applicant bases its application upon a forecasted test period, they are not when the basis for the proposed rate adjustment is a historical test period. Assuming arguendo that the projections were permissible support for Hardin District’s application, the utility’s failure to produce the calculations and assumptions used to develop these projections makes it impossible for the Commission to assess the validity and reasonableness of such projections.²⁹

The proposed adjustments to materials and supplies and transportation do not comply with 807 KAR 5:001, Section 16(1). Dexter-Almo has not provided the minimum evidence required by the Commission to demonstrate with certainty that the radio-read meters will be

²⁷ 807 KAR 5:001, Section 16(4) (emphasis added).

²⁸ See 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) at 7.

²⁹ *Id.* at 8.

installed or the vehicle will be purchased. The actual price that Dexter-Almo will pay for the radio-read meters and the vehicle is unknown. Further, Dexter-Almo has not presented any evidence in this proceeding that would persuade Staff that the pro forma adjustments based on budgetary projections in a historical test period should be allowed. For these reasons, Staff finds that Dexter-Almo's proposed budgetary adjustments to reflect the \$15,000 annual cost of the radio-read meters and the \$3,000 annual funding of the vehicle purchase should be denied.

The purchase of a truck is a capital expenditure that typically would be funded by a district with short-term financing. The district would be able to recover its capital investment by depreciating the truck over its estimated useful life and would also be allowed a dollar-for-dollar recovery of the interest paid on the short-term financing.

Capital Costs. In reviewing the 2016 general ledger, Staff notes that Dexter-Almo collected customer tap-on fees of \$7,000 in the test year. Dexter-Almo correctly recognized that tap-on fees are a form of cost-free capital that are reported as a Contribution in Aid of Construction. Likewise tap-on fees pay for the installation of new meters and services, which are capital expenditures that should be depreciated rather than recorded as an expense. Accordingly, Staff is reducing the materials and supplies expense by \$7,000 to remove the cost of the new meter installations that were funded with tap-on fees. The associated depreciation is discussed in the next section.

(G) Depreciation. Dexter-Almo reported test-year depreciation expense of \$35,988. It calculated this amount using the whole-life, straight-line method, pursuant to which an asset's depreciable basis is divided by its estimated useful life. Staff finds that the test-year amount should be decreased by \$10,217 to: (1) reflect modifying the depreciable

lives currently assigned to Transmission and Distribution Mains (“Mains”) from 25 and 50 years to 62.5 years; (2) reflect modifying the depreciable lives currently assigned to Meters from 25 and 50 years to 42.5 years; and (3) account for the additional depreciation resulting from the new meters/services capitalized by Staff above in Ref. Item (F). The calculation of Staffs adjustment is shown below, followed by a discussion of Staffs adjustment to the depreciable lives assigned to Mains and Meters.

Depreciable Basis in Mains as Stated in 12/31/2016 Plant Ledger	\$ 930,445	
Divide by: Estimated Useful Life	<u>62.50</u>	
Pro forma Depreciation Expense - Mains		\$ 14,887
Depreciable Basis in Meters as Stated in 12/31/2016 Plant Ledger	\$ 263,625	
Divide by: Estimated Useful Life	<u>42.50</u>	
Pro forma Depreciation Expense - Meters		6,203
Meters/Services Test Year	\$ 7,000	
Divide by: Estimated Useful Life	<u>42.50</u>	
Pro forma Depreciation Expense - Test-Year Meters/Services		<u>165</u>
Pro Forma Depreciation Mains and Meters		21,255
Less: Test-Year Depreciation - Mains and Meters		<u>(31,472)</u>
Pro Forma Depreciation Adjustment		<u><u>\$ (10,217)</u></u>

Generally, the Commission requires a “large” utility to perform a depreciation study to determine the appropriate depreciable lives to be assigned to each of its utility plant account groups. Detailed property records specific to historic plant additions, plant retirements, and salvage practices are required to complete a depreciation study. Generally, “small” water utilities, such as Dexter-Almo, do not maintain property records with enough detail to properly complete a formal study. Even if adequate records were maintained, small utilities do not have the financial resources to fund a formal study. Therefore, to evaluate the reasonableness of the depreciation practices of small water utilities, the Commission has

historically relied upon the report published in 1979 by the National Association of Regulatory Utility Commissioners (“NARUC”) titled Depreciation Practices for Small Water Utilities (“NARUC Study”).

The NARUC Study provides a range of average service lives that are assigned to water plant account groups by water utilities across the county that design, install, and maintain their systems in accordance with good engineering practices. It concludes that the ranges are intended to be used as a guide by state regulatory commissions and other water utilities when developing the depreciable lives to be assigned to water plant account groups. For example, the NARUC Study found that the Mains are depreciated between 50 and 75 years. Lives outside the NARUC ranges are acceptable when conditions warrant alternative lives.

When no evidence exists to support a specific life that is inside or outside the NARUC ranges, the Commission has used the mid-point of the NARUC ranges to depreciate utility plant. In Case No. 2013-00154, the Commission found that Henderson County Water District (“Henderson District”) was depreciating the cost of some Mains using a 40-year life and others using a 50-year life. Even though the 50-year life is within the NARUC range, the Commission found that the depreciable life assigned to all of Henderson District's Mains should be 62.5 years, the mid-point of the NARUC range, since no evidence was presented to support a 50-year life.³⁰

In this proceeding, Staff found no evidence to suggest that any of Dexter-Almo's asset account groups should be depreciated using lives that vary significantly from the mid-point

³⁰ Case No. 2013-00154, *Application of Henderson County Water District for an Alternative Rate Filing* (Ky. PSC Nov. 14, 2013), final Order, Appendix B

of the NARUC ranges. Generally, the lives that Dexter-Almo has assigned to each asset account group, except for Mains and Meters, are close enough to the mid-point that adjustments to the mid-point would not have a material effect on Dexter-Almo's test-year depreciation expense. During the test year, Dexter-Almo depreciated some Mains and Meters using 25 years and others using 50 years. Adjusting these lives to the NARUC mid-point has a material effect on test-year depreciation and is reasonable.

(H) Sales/School Tax. Dexter-Almo reported test-year taxes other than income tax expense in the amount of \$12,182, which includes sales/school tax remitted of \$5,566. Dexter-Almo merely acts as a collection agent. Inasmuch as the collected tax is not revenue generated through Dexter-Almo's water service rates, it should not be reported as such, and, therefore, should not be reported as expense to be recovered through the water service rates. Accordingly, Staff is reducing taxes other than income tax expense by \$5,566 to eliminate the reported sales/school tax.

Overall Revenue Requirement and Required Revenue Increase

The Commission has historically applied a DSC method to calculate the Overall Revenue Requirement of water districts and water associations. This method allows for recovery of: 1) cash related pro forma operating expenses; 2) recovery of depreciation expense, a non-cash item, to provide working capital;³¹ 3) the average annual principal and

³¹ 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).

interest payments on all long-term debts, and 4) working capital that is in addition to depreciation expense.

A comparison of Dexter-Almo's and Staff's calculations of the Overall Revenue Requirement and Required Revenue Increase using the DSC method is shown below:

	<u>Dexter-Almo</u>	<u>Staff</u>
Pro Forma Operating Expenses	\$ 273,741	\$ 242,769
Plus: Average Annual Debt Principal and Interest Payments	14,000	14,219
Debt Coverage Requirement	<u>3,500</u>	<u>3,555</u>
Total Revenue Requirement	291,241	260,543
Less: Other Operating Revenue	(1,443)	(1,443)
Non- Operating Revenue		
Interest Income	<u>(23)</u>	<u>(23)</u>
Revenue Required from Rates	289,775	259,077
Less: Normalized Revenues from Water Sales	<u>(229,471)</u>	<u>(240,818)</u>
Required Revenue Increase/(Decrease)	<u>\$ 60,304</u>	<u>\$ 18,259</u>
Percentage Increase	<u>26.280%</u>	<u>7.582%</u>


(1) Average Annual Principal and Interest Payments. As previously discussed, Dexter-Almo has an outstanding loan with the Murray Bank that was not authorized by the Commission. KRS 278.300(1) states that no utility shall issue any securities or evidences of indebtedness, or assume any obligation or liability in respect to the securities or evidences of indebtedness of any other person until it has been authorized so to do by order of the commission. In instances in which it is shown that the proceeds of an unauthorized loan were used to pay for current operating expenses, the Commission has disallowed rate recovery, finding that such action would constitute retroactive ratemaking. Staff has determined that Dexter-Almo used the proceeds of the Murray Loan to fund capital projects, and therefore, finds that Dexter-Almo should be allowed rate recovery of the associated debt service.

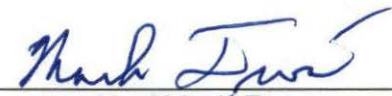
In calculating its revenue requirement, Dexter-Almo used an annual debt service of \$14,000. According to Dexter-Almo's loan amortization schedule the annual debt service for each of the 15-years is \$14,219.


(2) Additional Working Capital. The DSC method, as historically applied by the Commission, includes an allowance for additional working capital that is equal to the minimum net revenues required by a district's lenders that are above its average annual debt payments. Dexter-Almo's additional working capital is calculated below:

<u>Additional Working Capital</u>	
Annual Debt Service Payments	\$ 14,219
Multiplied by: DSC Coverage Ratio	<u>1.25</u>
Required Net Revenues	17,774
Less: Annual Debt Service	<u>(14,219)</u>
Allowance for Additional Working Capital	<u>\$ 3,555</u>

Signatures:


Prepared by: Travis Leach
Financial Analyst, Water and Sewer
Revenue Requirements Branch
Division of Financial Analysis


Prepared by: Mark Frost
Financial Analyst, Water and Sewer
Revenue Requirements Branch
Division of Financial Analysis


Prepared by: Jason Green
Rate Analyst, Water and Sewer
Rate Design Branch
Division of Financial Analysis

APPENDIX TO A COMMISSION STAFF REPORT,
CASE NO. 2017-00191
RATE CALCULATED BY STAFF DATED **SEP 27 2017**

Monthly Water Rates

First 2,000 Gallons	\$15.14 Minimum Bill
Next 1,000 Gallons	5.82 per 1,000 Gallons
Next 2,000 Gallons	5.07 per 1,000 Gallons
Next 45,000 Gallons	4.74 per 1,000 Gallons
Over 50,000 Gallons	3.67 per 1,000 Gallons

*Dexter-Almo Heights Water District
351 Almo Road
Almo, KY 42020

*Kathy Wyatt
Office Manager
Dexter-Almo Heights Water District
351 Almo Road
Almo, KY 42020