

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF NORTH	)	CASE NO.
MCLEAN COUNTY WATER DISTRICT FOR	)	2020-00238
AN ALTERNATIVE RATE ADJUSTMENT	)	

ORDER

On August 4, 2020, North McLean County Water District (North McLean District) filed an application to the Commission requesting to adjust its water rates pursuant to 807 KAR 5:076. To ensure the orderly review of the application, the Commission established a procedural schedule by Order dated August 20, 2020. North McLean District responded to two requests for information from Staff. In its application, North McLean District requested an overall revenue requirement of \$94,236, which is a 12.36 percent increase over current revenues<sup>1</sup>. The rates requested by North McLean District would increase the monthly bill of a typical residential customer purchasing 4,000 gallons per month by \$3.91, from \$31.84 to \$35.75, or approximately 12.28 percent.<sup>2</sup>

Staff performed a limited financial review of North McLean District's operations and on, November 17, 2020, released a report containing Staff's findings (Staff Report). In the Staff Report, Staff found that North McLean District's adjusted test-year operations support an overall revenue requirement of \$982,954 and that an annual revenue increase

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<sup>1</sup> Application, Attachment 5.

<sup>2</sup> *Id.*, Attachment 1.

of \$117,761, or 14.08 percent,<sup>3</sup> is necessary to generate the overall revenue requirement.<sup>4</sup>

On November 17, 2020, North McLean District filed with the Commission its comments on Staff's Report, wherein it accepted Staff's findings. With its response, North McLean District did not request that an informal conference or formal hearing be held.<sup>5</sup> On December 31, 2020, North McLean District filed a Customer Notice that the rate increase proposed in Staff's report was greater than 10 percent higher than the original requested amount.<sup>6</sup>

### WATER LOSS

The Commission notes that in its data request responses North McLean District reported a water loss of 15.1621 percent.<sup>7</sup> Commission regulation 807 KAR 5:066, Section 6(3), states that for ratemaking purposes a utility's unaccounted-for water loss shall not exceed 15 percent of total water produced and purchased, excluding water consumed by a utility in its own operations.

The Commission is placing greater emphasis on monitoring utilities that consistently exceed the 15 percent unaccounted-for water loss threshold and strongly encourages North McLean District to pursue reasonable actions to reduce its

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<sup>3</sup> Staff Report at 14.

<sup>4</sup> Note that the Overall Revenue Requirement stated in the summary of findings of \$856,524 and the Required Revenue Increase of \$94,236 or 12.93% were stated in error. The figures referenced on page 14 of the Staff Report are correct.

<sup>5</sup> North McLean District's Response to Commission Staff Report.

<sup>6</sup> Customer Notice, December 31, 2020.

<sup>7</sup> *Annual Report of North McLean County District to the Public Service Commission for the Calendar Year Ended December 31, 2019 (2019 Annual Report)* at 57.

unaccounted-for water loss. Failure by North McLean District to make significant process towards reducing unaccounted-for water loss may cause the Commission to pursue additional action with the utility.

### BACKGROUND

North McLean District is a Kentucky water district organized pursuant to KRS Chapter 74. It owns and operates a water distribution system through which it provides water service to approximately 1,307 retail customers in McLean County, Kentucky.<sup>8</sup>

### TEST PERIOD

The calendar year ended December 31, 2019, was used as the test year to determine the reasonableness of North McLean County District’s existing and proposed water rates as required by 807 KAR 5:076, Section 9.

### SUMMARY OF REVENUE AND EXPENSES

Based on the Staff Report and Commission adjustment made herein, North McLean District’s pro forma operational revenue is as follows:<sup>9</sup>

	<u>2019</u> <u>Annual Report</u>	<u>RateStudy</u> <u>Adjustments</u>	<u>Pro Forma</u> <u>Operations</u>
Total Operating Revenues	\$ 792,532	\$ 49,002	\$841,534
Utility Operating Expenses	<u>784,387</u>	<u>80,421</u>	<u>864,807</u>
Net Utility Operating Income	8,145	(31,418)	(23,273)
Gain (Losses) on Disposition of Property	<u>(243)</u>	<u>243</u>	<u>0</u>
Total Utility Operating Income	<u>\$ 7,902</u>	<u>(\$31,175)</u>	<u>\$ (23,273)</u>

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<sup>8</sup> 2019 Annual Report at 12 and 49.

<sup>9</sup> See Appendix A for a complete pro forma.

## REVENUE REQUIREMENT ADJUSTMENTS

Billing Analysis Adjustment. In the Staff Report, Staff recommended that the Commission accept North McLean District's proposed increase of \$7,106 to test-year revenues based on its revised billing analysis.<sup>10</sup> The Commission finds that this adjustment is reasonable as an examination of North McLean District's revised billing analysis supported North McLean District's proposed sales revenue.

Purchase Water Adjustment. Subsequent to the test year, the Commission, pursuant to 807 KAR 5:068, authorized North McLean District to increase its water rates in order to pass through the wholesale water rate increase of its supplier.<sup>11</sup> By applying the current retail rates authorized by the Commission to the applicable water sales shown in the billing analysis provided by North McLean District's application, Staff determined that pro forma present-rate revenues from retail sales should be stated at \$836,387 and an adjustment of \$66,993 was made. The Commission finds that this adjustment is known, measurable and reasonable, and should be accepted.

Nonrecurring Charges. In the Staff Report, Staff recommended a reduction to North McLean District's miscellaneous service revenue of \$8,145<sup>12</sup> to reflect the Commission's recent decision set out in the final Order issued in Hyden-Leslie Water District's (Hyden-Leslie District) and Ohio County Water District (Ohio District) recent

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<sup>10</sup> Staff Report at 5, Adjustment A.

<sup>11</sup> Case No. 2020-00320, *Electronic Purchased Water Adjustment Filing of North McLean Water District* (Ky. PSC Oct. 21, 2020).

<sup>12</sup> The narrative on page 6 of the Staff Report stated that the adjustment was an increase to the revenue requirement of \$25,097; however, the tables on pages 4 and 6 reflected the corrected adjustment of a decrease of \$8,145.

Alternative Rate Filings (ARF).<sup>13</sup> The Commission finds that as personnel are paid during normal business hours, estimated labor costs previously included in determining the amount of nonrecurring charges should be eliminated from the charges. Staff updated the nonrecurring charges to reflect the Commission's precedent as well as an update to the mileage costs. For After Hours Nonrecurring Charges, Staff removed office/clerical labor costs and updated the mileage rate, assuming office/clerical labor expenses are not incurred after hours for after-hours activities, but instead those in office activities are performed during ordinary business hours. By reflecting only the marginal costs incurred in special nonrecurring service charges, North McLean District's rates will be more in line with the principle of cost causation. Merely allocating a fixed expense of ordinary labor costs in special nonrecurring charges like disconnect or reconnect fees creates a mismatch between how a utility incurs expenses and how it recovers those expenses from customers. Instead of reflecting fixed costs in special nonrecurring charges that a utility incurs regardless of the number or timing of those nonrecurring services, including those fixed costs in rates for water service more closely aligns those expenses with the actions that drive them. For a publicly owned, nonprofit utility such as North McLean District that operates on thin margins, the Commission finds it is reasonable and necessary to provide appropriate rates to help ensure the health of the utility's operations. This approach to ratemaking is entirely consistent with the Commission's history of ensuring that rates reflect, to a reasonable degree, the principle of cost causation while simultaneously taking into account the health of the utility and the ability of the utility to

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<sup>13</sup> Case No. 2020-00141, *Electronic Application of Hyden-Leslie County Water District for an Alternative Rate Adjustment* (Ky. PSC Nov. 6, 2020). See also Case No. 2020-00167, *Electronic Application of Ohio County Water District for an Alternative Rate Adjustment* (Ky. PSC Dec. 3, 2020).

provide the adequate, efficient and reasonable provision of service. The implementation of rates that significantly deviate from the actions and expenses underlying the service provided can create material issues with a utility's ability to meet its approved revenue requirement, particularly a utility with razor thin margins. In keeping with precedent, the Commission finds this adjustment to be reasonable.

Late Payment Fee. North McLean District assesses customers who pay their bill after the date in which the bill is due a 10.00 percent late payment fee. This fee is presumably intended to elicit customer behavior, is not cost based, and creates an additional expense for customers who have already failed to timely make payment. The evidence collected in Case No. 2020-00085, and the portion of which related to Hyden-Leslie District was discussed at the hearing in Case No. 2020-00141, has challenged the efficiency of late fees.<sup>14</sup> In response to the Commission's Request for Information in Case No. 2020-00085, the data provided by many utilities demonstrated that the moratorium on late payment fees had no material effect on the percentage of customers paying on time.<sup>15</sup> The Commission, in its September 21, 2020 Order in Case No. 2020-00085, also discussed the fact that most late fees are not calculated based upon actual costs or the time value of money.<sup>16</sup>

Commission regulation 807 KAR 5:006, Section 9(2) states: "A charge shall relate directly to the service performed or action taken and shall yield only enough revenue to

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<sup>14</sup> See Case No. 2020-00085, *Electronic Emergency Docket Related to the Novel Coronavirus COVID-19*, Hyden-Leslie District's Response to Commission Staff's Initial Request for Information (filed July 23, 2020).

<sup>15</sup> *Id.*

<sup>16</sup> *Id. at 3.*

pay the expenses incurred in rendering the service.” The evidence provided in Case No. 2020-00085, and the record in Case No. 2020-00141, shows that utilities rely on these fees as a significant portion of their income and the process disproportionately affects those customers who have already evidenced an inability to timely pay, thus making it unreasonable to continue to collect late fees that do not have the intended impact on customer’s behavior. Furthermore, the addition of late fees, disconnect charges, and reconnect charges to a bill for water service makes it less likely customers who have already failed to timely pay will be able to do so at all. Customers being unable to pay at all increases the utility’s bad debt expense, reduces the utility’s income and cash flow in that period, and ultimately increases the cost of service for the remainder of customers. Commission regulation 807 KAR 5:006, Section 9(3)(h), states that “[a] late payment charge may be assessed if a customer fails to pay a bill for services by the due date shown on the customer’s bill,”<sup>17</sup> which allows the Commission discretion to determine whether the fee is fair, just and reasonable. For North McLean District the collection of late fees is not recovering an actual cost that the utility incurs, it is purely a punitive exercise that disproportionately affects those customers already unable to pay for service rendered, and the uncontroverted evidence indicates it has little-to-no effect on a customer’s timeliness of payment. Therefore, the Commission has included the amount of \$16,951<sup>18</sup> collected by North McLean District in the test-year to the revenue requirement so that the utility can receive the income through its base rates. This allows North McLean District to have a secure revenue stream related to service rendered.

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<sup>17</sup> 807 KAR 5:006, Section 9(3)(h).

<sup>18</sup> Response to Staff’s second request for information, (filed Oct. 30, 2020), Item 2.

Based upon the evidence of record, the Commission finds that it is reasonable to remove North McLean District's Late Payment Fee of \$16,951 from other water revenues.

Salaries and Wages - Employees. In the Staff Report, Staff recommended an increase on Pro Forma Salaries and Wages of \$400 to reflect the calculated amount of salaries paid to water district employees.<sup>19</sup> The Commission finds that this adjustment is a known and measurable change to salaries and wages, is reasonable, and should be accepted.

Salaries and Wages. In the Staff Report, Staff recommended an increase in Pro Forma Salaries and Wages Expense of \$12,193 to reflect a 3 to 6 percent increase in the wage rate for North McLean District's employees and a reduction of one part time employee.<sup>20</sup> The Commission finds that this adjustment is a known and measurable change to salaries and wages, is reasonable, and should be accepted.

Salaries and Wages - Officers. In the Staff Report, Staff recommended a decrease in Wages and Salaries-Commissioners of \$400 to reflect the calculated amount of salaries paid to water district commissioners.<sup>21</sup> The Commission finds that this adjustment is a known and measurable change to salaries and wages, is reasonable and should be accepted.

Purchased Water. In the Staff Report, Staff recommended an increase to Purchased Water expense of \$66,254.<sup>22</sup> This adjustment is a result of Staff recalculating

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<sup>19</sup> Staff Report at 7, Adjustment D.

<sup>20</sup> Staff Report at 7 and 8, Adjustment E.

<sup>21</sup> *Id.* at 8 and 9, Adjustment F.

<sup>22</sup> *Id.* at 9 and 10, Adjustment G.

the amount of water purchased by North McLean District during the test year at higher rates due to an increase in the cost of water supplied by its vendors. The Commission finds that this adjustment is known, measurable, and reasonable and should be accepted.

Excess Water Loss. In the Staff Report, Staff recommended a reduction in test-year purchased water expense of \$541 and test-year purchase power expense of \$17 based on water loss in excess of 15 percent.<sup>23</sup> The Commission finds that this adjustment is known, measurable, and reasonable and should be accepted.

Depreciation. In the Staff Report, Staff recommended an adjustment reducing test-year depreciation by \$376 in keeping with Commission precedent<sup>24</sup> of using NARUC Study depreciable life midpoint when no evidence exists to support a specific life that is outside the NARUC ranges.<sup>25</sup> The Commission finds that this adjustment is reasonable and should be accepted, as it is consistent with Commission precedent.

Taxes Other Than Income – Payroll Taxes. In the Staff Report, Staff recommended an increase to North McLean District’s test-year payroll tax expense of \$933 to reflect the prior adjustment to Salaries and Wages Expense discussed above.<sup>26</sup> The Commission finds that this adjustment is reasonable and should be accepted.

Losses on Disposition of Property. In the Staff Report, Staff recommended a decrease to North McLean District’s test-year Gains on the disposition of Property of \$243

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<sup>23</sup> *Id.* at 11, Adjustment H.

<sup>24</sup> See Case No. 2016-00163 *Alternative Rate Adjustment Filing of Marion County Water District* (Ky. PSC Nov. 10, 2016).

<sup>25</sup> Staff Report at 12, Adjustment I.

<sup>26</sup> Staff Report at 13, Adjustment J.

to reflect the effects of the extraordinary item.<sup>27</sup> The Commission agrees with Staff that an extraordinary item is not a routine transaction in the normal course of business, and therefore finds the removal from the test year is reasonable.

### REVENUE REQUIREMENT

Based upon the Commission's findings and determinations herein, North McLean District requires an increase in revenues of \$139,860, or 16.62 percent above pro forma present rate revenues as shown below this increase is required for North McLean District to remain operational and financially sound and have an opportunity to provide adequate, efficient, and reasonable service to its customers.<sup>28</sup>

Pro Forma Operating Expenses Before Income Taxes	\$ 864,807
Divided by: Operating Ratio	<u>0.88</u>
Sub-Total	982,736
Less: Pro Forma Operating Expenses Before Income Taxes	<u>(864,807)</u>
Net Income Allowable	117,929
Add: Interest Expense	218
Pro Forma Operating Expenses Before Taxes	<u>864,807</u>
Total Revenue Requirement	982,954
Less: Other Operating Revenue	5,147
Non-operating Revenue	0
Interest Income	<u>(6,707)</u>
Total Revenue Required from Rates for Service	981,394
Less: Revenue from Sales at Present Rates	<u>(841,534)</u>
Required Revenue Increase	<u>\$ 139,860</u>
Percentage Increase	<u>16.62%</u>

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<sup>27</sup> *Id.* at 12 and 13, Adjustment K.

<sup>28</sup> KRS 278.030(2).

## RATE DESIGN

North McLean District proposed to increase all of its monthly retail water service rates evenly across the board by approximately 12.36 percent. North McLean District has not performed a cost of service study (COSS). North McLean District stated that they did not complete a COSS at this time and it is unknown when the last COSS for North McLean District was completed.<sup>29</sup>

The Commission finds that the allocation of a revenue increase evenly across the board to a utility's rate design is appropriate when there has been no evidence entered into the record demonstrating that this method is unreasonable and in the absence of a COSS. In the Staff Report, Staff followed the method proposed by North McLean District and allocated Staff's calculated revenue increase across the board to North McLean's monthly retail water service rates.

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 from water sales to recover the \$981,394 Revenue Required from Rates, an approximate 16.62 percent increase. These rates will increase a typical residential customer's monthly water bill from \$34.28 to \$39.97, an increase of \$5.69, or approximately 16.60 percent.<sup>30</sup>

After consideration of the evidence of record and being otherwise sufficiently advised, the Commission finds that:

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<sup>29</sup> Response to Staff's First Request for Information (filed Oct. 31, 2020), Item 4.

<sup>30</sup> The typical residential customer uses approximately 4,000 gallons per month.

1. The recommendations contained in the Staff Report are supported by the evidence of record, are reasonable, and, as revised above, are adopted.

2. The water service rates proposed by North McLean District would produce inadequate revenues and should be denied.

3. The water service rates set forth in the Appendix B to this Order are fair, just and reasonable and should be approved for service rendered on and after the date of this Order.

IT IS THEREFORE ORDERED that:

1. The adjustments and recommendations contained in this Order are adopted.

2. The rates originally proposed by North McLean District are denied.

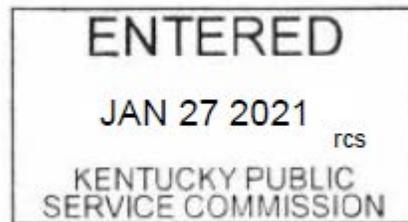
3. The rates set forth in the Appendix B to this Order are approved for services rendered by North McLean District on and after the date of this Order.

4. North McLean District shall discontinue charging a Late Payment Fee.

5. Within 20 days of the date of this Order, North McLean District shall file with this Commission, using the Commission's electronic Tariff Filing System, new tariff sheets setting forth the rates and charges approved herein and their effective date, and stating that the rates and charges were authorized by this Order.

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

By the Commission



ATTEST:

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Executive Director

Case No. 2020-00238

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE  
COMMISSION IN CASE NO. 2020-00238 DATED JAN 27 2021

	2019 <u>Audit Report</u>	Pro Forma <u>Adjustment</u>	Pro Forma <u>Operations</u>
Operating Revenues			
Sales of Water			
Metered Water Sales	\$ 762,288	7,106	
		66,993	\$ 836,387
Other Water Revenues			
Total Other Water Revenues	<u>30,244</u>	<u>(25,097)</u>	<u>5,147</u>
Total Operating Revenues	<u>\$ 792,532</u>	<u>49,002</u>	<u>\$ 841,534</u>
Operating Expenses			
Operation and Maintenance Expenses			
Salaries and Wages - Employees	219,807	400	
		12,193	232,400
Salaries and Wages - Officers	16,200	(400)	15,800
Employee Pensions and Benefits	9,179		9,179
Purchased Water	333,674	66,254	
		648	400,576
Purchased Power	10,587	17	10,604
Materials and Supplies	39,291		39,291
Contractual Services	14,566		14,566
Rents	2,040		2,040
Transportation Expenses	14,584		14,584
Insurance	13,385		13,385
Miscellaneous Expense	<u>19,122</u>		<u>19,122</u>
Total Operation and Maintenance Expenses	692,435	79,111	771,546
Depreciation	71,067	376	71,443
Taxes Other Than Income	<u>20,885</u>	<u>933</u>	<u>21,818</u>
Utility Operating Expenses	<u>784,387</u>	<u>80,421</u>	<u>864,807</u>
Net Operating Income	8,145	(31,418)	(23,273)
Gain on Disposition of Property	(243)	243	-
Utility Operating Income	<u>\$ 7,902</u>	<u>\$ (31,175)</u>	<u>\$ (23,273)</u>

APPENDIX B

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE  
COMMISSION IN CASE NO. 2020-00238 DATED JAN 27 2021

The following rates and charges are prescribed for the customers in the area served by North McLean 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

First	2,000	Gallons	\$22.93	Minimum bill
Next	8,000	Gallons	0.00852	per Gallons
Next	30,000	Gallons	0.00780	per Gallons
Over	40,000	Gallons	0.00711	per Gallons

Nonrecurring Charges

Service Call	\$8.64
Service Call (After Hours)	\$48.42
Disconnect Fee	\$17.25
Disconnect Fee (After Hours)	\$54.06
Reconnect Fee	\$17.25
Reconnect Fee (After Hours)	\$54.06
Cut-Lock Charge	\$48.63

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