

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF ALLEN)	CASE NO.
COUNTY WATER DISTRICT FOR AN)	2020-00296
ALTERNATIVE RATE ADJUSTMENT)	

ORDER

On September 18, 2020, Allen County Water District (Allen District) filed an application with 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 October 13, 2020. Staff issued three rounds of discovery to collect additional information regarding Allen District's financial records.

Using its pro forma test-year operations, Allen District determined that a required revenue increase of \$369,531, or 15.8 percent, over test-year normalized revenues of \$2,343,426 is warranted.¹ The rates requested by Allen District would increase the monthly bill of a typical residential customer purchasing 4,000 gallons per month by \$5.45, from \$34.45 to \$39.90, or approximately 15.8 percent.²

Staff performed a limited financial review of Allen District's operations and, on December 16, 2020, released a report containing Staff's findings (Staff Report). In the Staff Report, Staff found that Allen District's adjusted test-year operations support an

¹ Application, Attachment 5.

² *Id.*, Attachment 1.

overall revenue requirement of \$2,760,639 and that an annual revenue increase of \$267,773, or 11.4 percent,³ is necessary to generate the overall revenue requirement.⁴

On December 22, 2020, Allen District filed with the Commission its comments on Staff's report, wherein it accepted Staff's findings. With its comments, Allen District did not request that an informal conference or formal hearing be held.⁵

WATER LOSS

The Commission notes that in its 2019 Annual Report, Allen District reported a water loss of 30.8998 percent.⁶ 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 Allen District to pursue reasonable actions to reduce its unaccounted-for water loss. Failure by Allen District to make significant process towards reducing unaccounted-for water loss may cause the Commission to pursue additional action with the utility.

³ Staff Report at 17.

⁴ Note that the annual revenue increase stated in the summary of findings of \$2,760,639 was stated in error. The figure on page 17 of the Staff Report is correct.

⁵ Allen District's Response to Commission Staff Report.

⁶ *Annual Report of Allen County Water District to the Public Service Commission for the Calendar Year Ended December 31, 2019* (2019 Annual Report) at 57.

BACKGROUND

Allen 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 5,809 retail customers, and one wholesale customer in Allen County, Kentucky.⁷

TEST PERIOD

The calendar year ended December 31, 2019, was used as the test-year to determine the reasonableness of Allen 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 further Commission adjustments, Allen District's pro forma operational revenue is as follows:⁸

	<u>2019 Annual Report</u>	<u>Rate Study Adjustments</u>	<u>Pro Forma Operations</u>
Total Operating Revenues	\$ 2,526,816	\$ (168,825)	\$ 2,357,991
Utility Operating Expenses	<u>2,641,002</u>	<u>(449,908)</u>	<u>2,191,094</u>
Net Utility Operating Income	<u>(114,186)</u>	<u>281,083</u>	<u>166,897</u>

REVENUE REQUIREMENT ADJUSTMENTS

Billing Analysis Adjustment. In the Staff Report, Staff recommended that the Commission accept Allen District's proposal to decrease its test-year revenues from water sales of \$2,280,366 by \$785 and to increase sales for resale of \$63,846 to reflect the

⁷ *Id.* at 12 and 49.

⁸ See Appendix A for a complete pro forma.

current billing analysis provided by the district. The Commission finds that this adjustment is reasonable as an examination of Allen District's billing register was completed by Staff and a billing analysis was created based on all of the information provided. Staff's billing analysis supported Allen District's proposed sales revenue.

Tap-On Revenues. In the Staff Report, Staff recommended the commission accept Allen District's proposal to decrease miscellaneous service revenue of \$98,520, test-year labor expense by \$29,556, and materials and supplies expense by \$68,964 to reflect the removal of revenues and expenses related to water taps.⁹ The Commission finds that Allen District's adjustment is reasonable and should be accepted.

Nonrecurring Charges. In the Staff Report, Staff recommended a reduction to Allen District's miscellaneous service revenue of \$33,298 to reflect the Commission's recent decisions.¹⁰ 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

⁹ Staff Report at 6, Adjustment B.

¹⁰ 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), Case No. 2020-00196, *Electronic Application of West Daviess County Water District for an Alternative Rate Adjustment* (Ky. PSC Dec. 30, 2020), and Case No. 2020-00195 *Electronic Application of Southeast Daviess County Water District for an Alternative Rate Adjustment*, (Ky. PSC Dec. 30, 2020).

in special nonrecurring service charges, Allen 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 Allen 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 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. Allen 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.¹¹ 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.¹² 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.¹³

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 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.

¹¹ See Case No. 2020-00085, *Electronic Emergency Docket Related to the Novel Coronavirus COVID-19* (Ky. PSC March 16, 2020), Hyden-Leslie District's Response to Commission Staff's Initial Request for Information (filed July 23, 2020).

¹² *Id.*

¹³ *Id. at 3.*

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,”¹⁴ which allows the Commission discretion to determine whether the fee is fair, just and reasonable. For Allen 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 estimated at \$50,093 to have been collected by Allen District in the test-year late to the revenue requirement so that the utility can receive the income through its base rates. This allows Allen District to have a secure revenue stream related to service rendered.

Based upon the evidence of record, the Commission finds that it is reasonable to remove Allen District’s Late Payment Fee.

Other Water Revenues. In the Staff Report, Staff recommended the Commission accept Allen District’s proposal to reduce Other Water Revenues by \$49,975.¹⁵ The adjustment is to reflect the both the reclassification of water sold to the city of Scottsville for \$16,845; as well as the reclassification of Line Extension Revenues for \$33,130¹⁶ as a capital contribution.¹⁷ The Commission finds that Allen District’s adjustment is reasonable and should be accepted.

¹⁴ 807 KAR 5:006, Section 9(3)(h).

¹⁵ Staff Report at 8, Adjustment D.

¹⁶ Staff Report reported this figure as \$33,129 in error due to a rounding issue.

¹⁷ Staff Report at 8, Adjustment D.

Salaries and Wages-Employees. In the Staff Report, Staff recommended a decrease in pro forma Salaries and Wages Expense of \$68,530 to reflect a 3 percent increase in the wage rate for Allen District's employees, and a decrease in the number of full time employees currently employed with Allen District.¹⁸ The Commission finds that this adjustment is a known and measurable change to salaries and wages, is reasonable, and should be accepted.

Employee Pensions and Benefits. In the Staff Report, Staff recommended an increase to Employee Pension and Benefit expense of \$221. This adjustment incorporates the employees who contribute to the 457(b) retirement account and the increase in Salaries and Wages expense as explained above.¹⁹ The Commission finds that this adjustment is reasonable and should be accepted.

Wages and Salaries-1099 Back Pay. In the Staff Report, Staff recommended a reduction to Allen District's test-year Wages and Salaries expense totaling \$9,715²⁰ to reflect back pay paid to two employees who received raises in 2018 but inadvertently did not receive the pay increase from the raise. The Commission agrees with the 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.

Employee Health Insurance. In the Staff Report, Staff recommended a reduction to Allen District's test-year Employee Health Insurance expense totaling \$32,087 to reflect

¹⁸ *Id.* at 9, Adjustment E.

¹⁹ *Id.* at 9, Adjustment F.

²⁰ *Id.* at 10, Adjustment G.

Commission policy of reducing benefit expenses for utilities that pay 100 percent of its employees' health insurance coverage. The total adjustment reflects a reduction of 21 percent, the national average employee contribution rate.²¹ This adjustment is consistent with past Commission precedent²² in which the Commission has reduced benefits expenses for utilities that pay 100 percent of an employee's health insurance coverage, and the Commission finds that this adjustment is reasonable should be accepted.

Purchased Water–Excess Water Loss. In the Staff Report, Staff recommended a reduction in test-year purchased water expense of \$112,842 and purchased power expense of \$10,488 for a total adjustment of \$123,330 based on water loss in excess of 15 percent.²³ The Commission finds that this adjustment is known and measurable and reasonable and should be accepted.

Depreciation. In the Staff Report, Staff recommended an adjustment reducing test-year depreciation by \$115,022²⁴ in keeping with Commission precedent²⁵ of using National Association of Regulatory Utility Commissioners (NARUC) Study depreciable life midpoint when no evidence exists to support a specific life that is outside the NARUC

²¹ *Id.* at 11, Adjustment H.

²² See, Case No. 2019-00053, *Electronic Application of Jackson Purchase Energy Corporation for a General Adjustment in Existing Rates*, (Ky. PSC June 20, 2019) at 8–12.

²³ Staff Report at 12, Adjustment I.

²⁴ *Id.* at 15, Adjustment J.

²⁵ See *e.g.*, Case No. 2016-00163 *Alternative Rate Adjustment Filing of Marion County Water District* (Ky. PSC Nov. 10. 2016).

ranges.²⁶ 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 Allen District’s test-year payroll tax expense of \$5,243 to reflect changes in Payroll taxes due to the prior adjustment to Salaries and Wages Expense discussed above.²⁷ The Commission finds that this adjustment is reasonable and should be accepted.

Nonutility Income. In the Staff Report, Staff recommended a decrease to Allen District’s Nonutility Income of \$77,816 to reflect unrealized gain on temporary investments.²⁸ The Commission finds that this adjustment is reasonable and should be accepted.

REVENUE REQUIREMENT

Based upon the Commission’s findings and determinations herein, Allen District requires an increase in revenues of \$317,866, or 13.56 percent above pro forma present rate revenues as shown below.

²⁶ Staff Report at 15, Adjustment J.

²⁷ *Id.* at 16, Adjustment K.

²⁸ *Id.* at 16, Adjustment L.

Pro Forma Operating Expenses	\$ 2,191,094
Plus: Average Annual Principal and Interest Payments	474,621
Additional Working Capital	<u>94,924</u>
Overall Revenue Requirement	2,760,639
Less: Other Operating Revenue	(14,564)
Interest Income	(75,875)
Net nonutility Income	<u>(8,907)</u>
Revenue Required from Rates	2,661,293
Less: Pro Forma Present Rate Service Revenues	<u>(2,343,427)</u>
Required Revenue Increase	<u>\$ 317,866</u>
Percentage Increase	<u>13.56%</u>

RATE DESIGN

Allen District proposed to increase all of its monthly retail water service rates evenly across the board by approximately 15.80 percent. Allen District has not performed a cost of service study (COSS). Allen District stated that they did not complete a COSS at this time as there has not been any material change in the water system to warrant a COSS.²⁹

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 Allen District and allocated Staff's calculated revenue increase across the board to Allen District's monthly retail water service rates.

²⁹ Staff's First Request for Information (filed Aug. 14, 2020), Item 3.

The rates set forth in the Appendix 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 \$2,661,293 Revenue Required from Rates, an approximate 13.56 percent increase. These rates will increase a typical residential customer's monthly water bill from \$34.45 to \$39.13, an increase of \$4.68, or approximately 13.58 percent.³⁰

Water Loss Surcharge. The Commission discussed above an adjustment to Purchased Water and Purchased Power expense of \$123,330, related to that adjustment, the Commission finds that it should establish Water Loss Surcharge for the \$123,330 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.³¹ In establishing water loss surcharges, the Commission recognized that the adjustments required to be made to comply with the 15.00 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,

³⁰ The typical residential customer uses approximately 4,000 gallons per month.

³¹ 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).

and public confidence in the water district's use of those funds. In its report entitled, "*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.³²

Therefore, the Commission finds that a monthly surcharge is a reasonable means for Allen District to recover the cost of its efforts in water leak detection and repair in order to reduce the increased expense and lost revenue from unaccounted-for water loss. Accordingly, the Commission finds that a monthly water loss reduction surcharge of \$1.77³³ per active meter over 48 months should be approved. Allen District should be restricted to expending any funds collected under the surcharge subject to authorization by the Commission. Allen 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.

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

³² See 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.

³³ $\$112,842$ (Purchased Water) + $\$10,488$ (Purchased Power) = $\$123,330$ (Annual Surcharge Collections) \div 5,810 (Number of Active Meters as of December 31, 2019) = $\$21.23$ (Annual Surcharge Collections per Active Meter) \div 12 (Months) = $\$1.77$.

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 Allen District would produce inadequate revenues and should be denied.

3. The water service rates set forth in 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 water service rates proposed by Allen District are denied.

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

4. The Water Loss Surcharge Rate set forth in Appendix B of \$1.77 per meter is approved for and shall be collected by Allen District on and after the date of this Order. This Surcharge shall be collected for four years and Allen District shall abide by the conditions outlined elsewhere in this Order as if these conditions were stated here.

5. Within 20 days of the date of this Order, Allen 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:



Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2020-00296 DATED FEB 03 2021

	<u>Test-Year</u>	<u>Adjustment</u>	<u>Pro Forma</u>
Operating Revenues			
Total Retail Meter Sales	2,280,366	(785)	2,279,581
Sales for Resale	0	63,846	63,846
Other Water Revenues			
Forfeited Discounts	50,093	(50,093)	0
Misc. Service Revenues	146,382	(98,520)	
		(33,298)	14,564
Other Water Revenues	49,975	(49,975)	0
Total Operating Revenues	<u>2,526,816</u>	<u>(168,825)</u>	<u>2,357,991</u>
Operating Expenses			
Operation and Maintenance Expenses			
Salaries and Wages - Employees	529,451	(68,530)	
		(29,556)	431,365
Salaries and Wages - Officers	39,715	(9,715)	30,000
Employee Pensions and Benefits	277,930	221	
		(32,087)	246,064
Purchase Water	709,705	(112,842)	596,863
Purchased Power	65,964	(10,488)	55,476
Materials and Supplies	152,847	(68,964)	83,883
Contractual Services	167,929		167,929
Rental of Bldg/Property & Equipment	4,682		4,682
Transportation Expense	51,052		51,052
Insurance- Gen. Liability	17,038		17,038
Insurance- Workers Comp.	8,581		8,581
Insurance- Other	7,546		7,546
Miscellaneous Expense	23,104		23,104
Total Operation and Maintenance Expenses	2,055,544	(331,961)	1,723,583
Depreciation	546,044	(115,022)	
		2,318	433,340
Taxes Other Than Income	39,414	(5,243)	34,171
Total Operating Expenses	<u>2,641,002</u>	<u>(449,908)</u>	<u>2,191,094</u>
Net Utility Operating Income	<u>(114,186)</u>	<u>281,083</u>	<u>166,897</u>
Non Utility Income	86,723	(77,816)	8,907

APPENDIX B

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2020-00296 DATED FEB 03 2021

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

General Customers

First 2,000 Gallons	\$21.91	Minimum Bill
Next 3,000 Gallons	0.00861	Per Gallon
Next 5,000 Gallons	0.00729	Per Gallon
Next 60,000 Gallons	0.00665	Per Gallon
Over 70,000 Gallons	0.00610	Per Gallon

U.S. Corp of Engineers

First 55,000 Gallons	\$414.79	Minimum Bill
Next 15,000 Gallons	0.00665	Per Gallon
Over 70,000 Gallons	0.00610	Per Gallon

Mobile Home Parks

First 10,000 Gallons	\$76.80	Minimum Bill
Next 60,000 Gallons	0.00665	Per Gallon
Over 70,000 Gallons	0.00610	Per Gallon

Wholesale Rate	.00376	Per Gallon
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Nonrecurring Charges

Connection/Reconnection Charge	42.50
Connection/Reconnection Charge After Hours	88.50
Meter Reread Charge	25.50
Meter Test Charge	39.00
Returned Check Charge	10.25
Security Deposit	76.75
Service Investigation Charge	25.50
Service Investigation Charge After Hours	71.50
Water Loss Surcharge Rate	1.77 per meter for 4 years

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