

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF LEVEE ROAD)	
WATER ASSOCIATION, INC. FOR A)	
CERTIFICATE OF PUBLIC CONVENIENCE)	
AND NECESSITY TO CONSTRUCT A SYSTEM)	CASE NO.
IMPROVEMENTS PROJECT AND AN ORDER)	2021-00015
APPROVING A CHANGE IN RATES AND)	
AUTHORIZING THE ISSUANCE OF)	
SECURITIES PURSUANT TO KRS 278.023)	

ORDER

On January 25, 2021, Levee Road Water Association, Inc. (Levee Road Water) filed an application, pursuant to KRS 278.023, requesting a Certificate of Public Convenience and Necessity (CPCN) to construct a water system improvements project. The Commission is required, pursuant to KRS 278.023, to accept agreements between water utilities and the United States Department of Agriculture, Rural Development (USDA/RD), regarding construction projects, and to issue the necessary orders to implement the terms of such agreements no later than 30 days after filing the application with the Commission.

To comply with the requirements of KRS 278.023, the Commission issued its Order on February 22, 2021, granting Levee Road Water a CPCN to construct its proposed project, authorizing Levee Road Water to obtain the \$1,050,000 USDA/RD loan, and approving the increase in base rates. The case remained open in order for Commission Staff to issue further Requests for Information, for Levee Road Water to submit its responses to the Commission Staff's Second Request for Information, to allow the

Commission ample time to review Levee Road Water's responses, and evaluate Levee Road Water's financial information.

The Commission notes that Levee Road Water reported in its annual report a water loss of 17.78 percent.¹ 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 Levee Road Water to pursue reasonable actions to reduce its unaccounted-for water loss. Failure by Levee Road Water to make significant progress toward reducing unaccounted-for water loss may cause the Commission to pursue additional action with the utility.

The Commission notes that its records indicate Levee Road Water has not sought a general adjustment in base rates since its last rate case in 1992.² Since 1992, the only cases involving base rate increases filed by Levee Road Water has been purchased water adjustments. The Commission's review of records in a financing/rate case, filed pursuant to KRS 278.023, is limited and very different from the comprehensive review of a utility's total financial stability and operational viability that takes place in a traditional rate adjustment case or an alternative rate adjustment. The Commission recently noted that some utilities file applications to increase rates pursuant to KRS 278.023 to

¹ *Annual Report of Levee Road Water Association, Inc. to the Public Service Commission for the Calendar Year Ended December 31, 2019* at 57.

² Case No. 1992-00007, *Application of Levee Road Water Association, Inc. for an Adjustment of Rates Pursuant to the Alternative Rate Filing Procedure for Small Utilities* (Ky. PSC July 10, 1992).

intentionally avoid a review of its financial records.³ A key general recommendation that resulted from the investigation in Commission Case No. 2019-00041 was that water utilities should monitor the sufficiency of their base rates closely and, in general, apply for base rate adjustments on a more frequent basis.⁴

Levee Road Water stated in a response to a Staff interrogatory that the United States Department of Agriculture Rural Development (RD) requires it to maintain a 1.1 Debt Service Coverage (DSC).⁵ However, Levee Road Water was not able to produce a RD loan document to support its claim, but did explain that a 1.1 DSC is monitored by RD to determine sustainability.⁶ Levee Road Water later admitted that a 1.1 DSC is not specifically required by RD as part of a loan agreement.⁷ In reviewing the Staff Report and Order issued in Case No. 1992-00007, a 1.2 DSC was used by the Commission to calculate Levee Road Water's revenue requirement. In the RD loan documents, RD has consistently required a 1.2 DSC. Accordingly, the Commission is using a 1.2 DSC to evaluate Levee Road Water's financial performance.

Attached hereto in the Appendix is the Commission's analysis of Levee Road Water's Excel spreadsheets submitted in its responses to Staff's Requests for

³ See Case No. 2019-00041, *Electronic Investigation into Excessive Water Loss by Kentucky's Jurisdictional Water Utilities* (Ky. PSC Nov. 22, 2019).

⁴ *Id.*

⁵ Levee Road Water's Responses to Commission Staff's First Request for Information (Staff's First Request) (filed Feb. 2, 2021), Item 2.

⁶ Levee Road Water's Responses to Commission Staff's Second Request for Information (Staff's Second Request) (filed Apr. 15, 2021), Item 2.a.

⁷ *Id.*

Information.⁸ The Commission's analysis of Levee Road Water's audited financial records shows that for the calendar years 2017 through 2019, Levee Road Water did not meet the DSC requirements of its lenders. Based upon Levee Road Water's projections, and using a three-average debt service payment, Levee Road Water will be in compliance with the DSC requirements of its lenders for the 2022 through 2024 calendar years. However, unlike Levee Road Water's lenders, the Commission includes noncash items such as depreciation expense in the DSC calculation supporting the revenue requirement of water districts and associations.⁹ For the projected calendar years 2022 through 2024, Levee Road Water's DSC falls below the 1.2 threshold.

A key general recommendation that resulted from the investigation of Commission Case No. 2019-00041 was that water utilities should monitor the sufficiency of their base rates closely and, in general, apply for general rate adjustments on a more frequent basis.¹⁰ Staff is able to review rate sufficiency during a base rate case, and review financial policies that affect debt service and funding for infrastructure maintenance. The Commission can recommend better business practices to help fortify a water utility's finances like reviewing the depreciation schedule to ensure that a utility is maintaining its funds for infrastructure repair and not using operational funds. The Commission can also provide guidance on other factors that affect the financial and operational health of the

⁸ Levee Road Water's Responses to Staff's First Request (filed Feb. 2, 2021), Items 2 through 4 and Levee Road Water's Responses to Staff's Second Request (filed Apr. 15, 2021), Item 2.b.

⁹ See Case No. 2019-00424, *Electronic Application of Grant County Sanitary Sewer District for an Alternate Rate Adjustment* (Ky. PSC May 6, 2020); see Case No. 2020-00020, *Alternative Rate Adjustment Filing of Knox County Utility Commission* (Ky. PSC July 22, 2020); and see Case No. 2020-00141, *Electronic Application of Hyden-Leslie County Water District for an Alternative Rate Adjustment* (Ky. PSC Nov. 6, 2020).

¹⁰ See Case No. 2019-00041, *Electronic Investigation into Excessive Water Loss by Kentucky's Jurisdictional Water Utilities* (Ky. PSC. Nov. 22, 2019).

utility.¹¹ Pursuant to the Commission's recommendation in Case No. 2019-0004¹² and the results of the financial analysis performed in this proceeding, the Commission finds that Levee Road Water should be ordered to file an application for a general rate adjustment pursuant to 807 KAR 5:001, Section 16, or an application for an alternative rate adjustment pursuant to 807 KAR 5:076 within one year of the date of the issuance of this Order to ensure its revenue is sufficient to support adequate and reliable service.

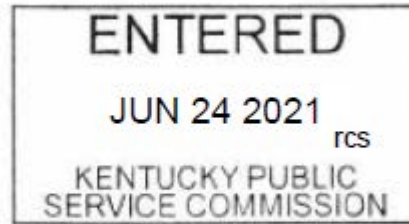
IT IS THEREFORE ORDERED that:

1. Levee Road Water shall file an application for a general rate adjustment pursuant to 807 KAR 5:001, Section 16, or an application for an alternative rate adjustment pursuant to 807 KAR 5:076 within one year of the date of service of this Order.
2. This case is closed and removed from the Commission's Docket.

¹¹ *Id.*

¹² *Id.*

By the Commission



ATTEST:


Executive Director

APPENDIX

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2021-00015 DATED JUN 24 2021

Commission Analysis of Levee Road Water's Audited Financial Information

	Actual DSC - Lenders		
	2017	2018	2019
Operating Revenues	\$ 262,130	\$ 281,334	\$ 264,980
Operating Expenses	317,972	337,996	330,835
Operating Income (Loss)	(55,842)	(56,662)	(65,855)
Add back: Depreciation Expense	65,860	65,572	64,992
Cash Available for Debt Service	10,018	8,910	(863)
Average Annual Debt Service	10,504	10,504	23,904
DSC	0.95	0.85	(0.04)

	Projected DSC - Commission				
	2020	2021	2022	2023	2024
Operating Revenues	\$ 412,512	\$ 420,748	\$ 429,149	\$ 437,718	\$ 446,458
Less: Operating Exp. Net of Depreciation	(335,073)	(344,019)	(353,204)	(362,635)	(372,317)
Less: Depreciation Expense	(65,000)	(65,000)	(85,800)	(85,800)	(85,800)
Net Available for Debt Service	12,439	11,729	(9,855)	(10,717)	(11,659)
Divide by: 3-Year Avg Debt Service	37,304	50,704	50,704	50,704	48,101
Debt Service Coverage Ratio	0.33	0.23	-0.19	-0.21	-0.24

	Projected DSC - Lenders				
	2020	2021	2022	2023	2024
Net Available for Debt Service	\$ 12,439	\$ 11,729	\$ (9,855)	\$ (10,717)	\$ (11,659)
Add: Depreciation Expense	65,000	65,000	85,800	85,800	85,800
Cash Available for Debt Service	77,439	76,729	75,945	75,083	74,141
Divide by: 3-Year Avg Debt Service	37,304	50,704	50,704	50,704	48,101
Debt Service Coverage Ratio	2.08	1.51	1.50	1.48	1.54

a) Assumes a 2% Annual Cost Pass Through:

	Operating Revenues		
	Water Sales	Other	Totals
2020	411,792	720	412,512
2%	8,236		
2021	420,028	720	420,748
2%	8,401		
2022	428,429	720	429,149
2%	8,569		
2023	436,998	720	437,718
2%	8,740		
2024	445,738	720	446,458

b) Assumes a 2.67% Expense Inflation Factor.

	Operating Expenses Net of Dep.
2020	335,073
2.67%	8,946
2021	344,019
2.67%	9,185
2022	353,204
2.67%	9,431
2023	362,635
2.67%	9,682
2024	372,317

c) Depreciation.

Depreciation Existing Plant	65,000
Add: Depreciation New Plant	20,800
Forecasted Depreciation	<u>85,800</u>

	2017	2018	2019	2020	2021	2022	2023	2024
2017	\$ 10,504							
2018	10,504	\$ 10,504						
2019	10,504	10,504	\$ 10,504					
2020		10,504	10,504	\$ 10,504				
2021			50,704	50,704	\$ 50,704			
2022				50,704	50,704	\$ 50,704		
2023					50,704	50,704	\$ 50,704	
2024						50,704	50,704	\$ 50,704
2025							50,704	50,704
2026								42,896
Totals	<u>31,512</u>	<u>31,512</u>	<u>71,712</u>	<u>111,912</u>	<u>152,112</u>	<u>152,112</u>	<u>152,112</u>	<u>144,304</u>
3-Year Avg.	<u>\$ 10,504</u>	<u>\$ 10,504</u>	<u>\$ 23,904</u>	<u>\$ 37,304</u>	<u>\$ 50,704</u>	<u>\$ 50,704</u>	<u>\$ 50,704</u>	<u>\$ 48,101</u>

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