

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

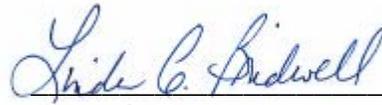
ELECTRONIC APPLICATION OF MARTIN	)	CASE NO.
COUNTY WATER DISTRICT FOR AN	)	2021-00154
ALTERNATIVE RATE ADJUSTMENT	)	

NOTICE OF FILING OF COMMISSION STAFF REPORT

Notice is hereby given that, in accordance with the Commission’s Order of July 16, 2021, 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 July 16, 2021 Order, Martin County Water District (Martin District) is required to file written comments regarding the findings of Commission Staff no later than 14 days from the date of this report. The Commission directs Martin District to the Commission’s July 22, 2021 Order in Case No. 2020-00085<sup>1</sup> regarding filings with the Commission. Electronic documents shall be in portable document format (PDF), shall be searchable, and shall be appropriately bookmarked.

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<sup>1</sup> Case No. 2020-00085, *Electronic Emergency Docket Related to the Novel Coronavirus COVID-19* (Ky. PSC July 22, 2021), Order (in which the Commission ordered that for case filings made on and after March 16, 2020, filers are NOT required to file the original physical copies of the filings required by 807 KAR 5:001, Section 8).



Linda C. Bridwell, PE  
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P.O. Box 615  
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DATED   AUG 11 2021  

cc: Parties of Record

Case No. 2021-00154

STAFF REPORT  
ON  
MARTIN COUNTY WATER DISTRICT  
CASE NO. 2021-00154

Martin County Water District (Martin District) is a water utility company that owns and operates a water distribution and sanitation system through which it provides retail water service to approximately 3,400 retail customers that reside in Martin County, Kentucky.<sup>1</sup> On April 8, 2021, Martin District filed an application, pursuant to the alternative rate adjustment procedure for small utilities as set out in 807 KAR 5:076, requesting to increase its water service rates. To ensure the orderly review of the application, the Commission established a procedural schedule by Order dated April 14, 2021.

The Commission granted Martin County Concerned Citizens, Inc.'s (MCCC) motion to intervene in an Order entered on April 19, 2021. No other parties moved to intervene. Martin District responded to three sets of data requests from Commission Staff (Staff) and two sets from MCCC.

On June 14, 2021, Martin District filed a motion for extension of time to respond to MCCC's second request for information until July 8, 2021. By Order dated July 16, 2021, the Commission granted Martin District's motion and further ordered the procedural schedule be amended to extend the issuance date of the Staff Report to August 5, 2021. Martin District filed additional information requested by Staff on July 27, 2021, and by Order dated August 4, 2021, the Commission ordered the procedural schedule be amended to extend the issuance date of the Staff Report to August 12, 2021.

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<sup>1</sup> Application, ARF Form 1 at 3.

In its application, Martin District requested that emergency rates be permitted, pursuant to KRS 278.190(2), while the Commission completed its review. On May 27, 2021, a public hearing was held at the Commission's offices in Frankfort, Kentucky, for the purpose of addressing Martin District's request for interim emergency rate relief. By Order dated July 9, 2021, the emergency rate increase was granted, subject to refund.

To comply with the requirements of 807 KAR 5:076, Section 9,<sup>2</sup> Martin District based the justification for its requested rates on a historical test period ended December 31, 2020. Using its pro forma test-year operations, Martin District provided evidence that it could justify a revenue increase of up to \$1,204,907, or 56.14 percent, to its retail water customers, as shown in the table below.<sup>3</sup> However, in Martin District's application and corresponding notice to its customers, Martin District requested a total increase to its water service rates of approximately 11 percent.<sup>4</sup> Martin District loosely relied on the previously filed cost of service study (COSS) in Case No. 2018-00017<sup>5</sup> to allocate its requested revenue increase to the rate classes.<sup>6</sup> Martin District explained in Commission Staff's Third Request for Information (Staff's Third Request) that the last COSS was performed in 2017 (using a 2016 base year) and that no material changes had occurred

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

<sup>3</sup> Martin District's Revisions to Rate Request Submittal (filed May 20, 2021) at 2.

<sup>4</sup> Application, Attachment 3, Reasons for Rate Increase. See also Application, Attachment 1, Customer Notice.

<sup>5</sup> Case No. 2018-00017, *Electronic Application of Martin County Water District for an Alternative Rate Adjustment* (Ky. PSC July 22, 2020).

<sup>6</sup> See *Id.*, Martin County's Responses to Commission Staff's First Request for Information (Staff's First Request), Item 1.

that would require a new COSS and ultimately alter the overall rate design.<sup>7</sup> After performing several “what-if” scenarios, Martin District proposed (1) an 11 percent “across-the-board” increase to usage based rates, and (2) a percentage increase to minimum bills proportional to meter size and the per-month gallon allotment.<sup>8</sup> The proposed changes to Martin District’s water rates amount to a \$5.86, or an 11.7 percent increase,<sup>9</sup> on a typical residential customer using 4,000 gallons per month.

Pro Forma Operating Expenses	\$3,328,164
Plus: Average Annual Principal and Interest Payments	207,376
Additional Working Capital	<u>42,491</u>
Overall Revenue Requirement	3,578,031
Less: Other Operating Revenue	(33,560)
Interest Income	-
Surcharge Income	<u>(193,180)</u>
Revenue Required from Rates	3,351,291
Less: Pro Forma Present Rate Service Revenues	<u>(2,146,384)</u>
Required Revenue Increase	<u>\$ 1,204,907</u>
Percentage Increase	<u>56.14%</u>

To determine the reasonableness of the revenue requirement above and the sufficiency of the rates requested by Martin District, Staff performed a limited financial review of Martin District’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 made when their effects were deemed material. Insignificant and immaterial discrepancies were not necessarily pursued or addressed.

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<sup>7</sup> Martin County’s Responses to Staff’s Third Request, Item 1.

<sup>8</sup> *Id.*, Item 8.

<sup>9</sup> Application, Attachment 1 at 1.

This report summarizes Staff’s findings. Ariel Miller reviewed the calculation of Martin District’s Overall Revenue Requirement. Jason Green reviewed Martin District’s reported revenues and rate design.

### SUMMARY OF FINDINGS

1. Overall Revenue Requirement and Required Revenue Increase. By applying a Debt Service Coverage (DSC) method, as generally accepted by the Commission, Staff found that Martin District’s Overall Revenue Requirement is \$3,031,705, and that a \$550,980 revenue increase, or 24.31 percent, to pro forma present rate revenues is necessary to generate the Overall Revenue Requirement.

2. Water Service Rates. Martin District proposed (1) an 11 percent “across-the-board” increase to usage based rates, and (2) a percentage increase to minimum bills proportional to meter size and the per-month gallon allotment. As discussed above, Martin District did not prepare an updated COSS for this proceeding, but generally adhered to the existing rate design studies and recommendations.<sup>10</sup> Martin District processed several “what-if” scenarios in order to meet its calculated revenue requirement increase. Minimizing impact to end users (affordability) and equity in its rate design were considerations of Martin District throughout the process.<sup>11</sup>

Martin District’s proposed method of increasing its service rates is not an appropriate method for ratemaking purposes. In the absence of a COSS, the Commission has previously found 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

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<sup>10</sup> Martin District’s Response to Staff’s First Request for Information, Item 5.

<sup>11</sup> *Id.*, Item 5.

into the record demonstrating that this method is unreasonable. Martin District argues that while an across-the-board increase may be a more equitable way of increasing rates, their proposal to increase the usage rates by 11 percent and the monthly minimums by a slightly higher percentage will provide a more predictable stream of revenue.<sup>12</sup>

Staff also notes that Martin District did not increase the monthly minimum bills of the larger size meters in an appropriate manner. While monthly minimum bills for Martin District's 5/8- by 3/4-inch size meters were increased by 12.00 percent, Martin District increased the larger size meters by \$2.00 per 1,000 gallons until the gallons included in the minimum bill were met.<sup>13</sup>

Staff increased Martin District's water service rates evenly across the board and allocated the \$550,980 revenue increase to Martin District's monthly base and per gallon usage rates. The rates set forth in the 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 \$2,817,443 Revenue Required from Rates, an approximate 24.31 percent increase. Staff's recommended increase will cause the rates to increase a typical residential customer's monthly water bill for the Martin District Service Area from \$57.53 to \$69.73, an increase of \$12.20, or approximately 21.21 percent.<sup>14</sup>

3. Rate Case Expense. Staff notes that Martin District did not make a pro forma adjustment to amortize any costs attributable to the preparation of its application

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<sup>12</sup> Martin District's Response to Staff's Third Request for Information, Item 9.

<sup>13</sup> *Id.*, Item 8.

<sup>14</sup> Average customer uses 4,000 gallons and is assessed a debt service surcharge of \$2.63 per month and a management/infrastructure surcharge of \$4.72 per month.

for rate adjustment. In its response to the Staff Report, Martin District should identify any additional costs that were incurred in preparation for this case.

### PRO FORMA OPERATING STATEMENT

Martin District's Pro Forma Income Statement for the test year ended December 31, 2020, as determined by Staff, appears below. The middle column shows Staff's adjustments to the test-year income and expenses.

	Test Year	Adjustment	(Ref.)	Pro Forma
Operating Revenues				
Sales of Water	\$ 2,146,384	\$ 288,184	(A)	
		(168,105)	(A)	\$ 2,266,463
Surcharge Revenue	300,616			
		(107,436)	(B)	193,180
Other Operating Revenue	70,743	(22,872)	(C)	
		(14,311)	(D)	
		(12,864)	(E)	20,696
	<u>2,517,743</u>	<u>(37,404)</u>		<u>2,480,339</u>
Total Operating Revenues				
Operating Expenses				
Operation and Maintenance Expenses				
Salaries and Wages - Employees	-			-
Salaries and Wages - Commissioners	-			-
Employee Pensions and Benefits	(119,701)	119,701	(F)	-
Purchased Water	-			-
Purchased Power for Pumping	320,969	(160,485)	(G)	160,485
Chemicals	-			-
Materials and Supplies	6,511			6,511
Contractual Services	2,017,014	(17,500)	(H)	
		(56,788)	(G)	
		(26,000)	(I)	1,916,727
Water Testing	6,831			6,831
Rent	9,053	260	(J)	9,313
Insurance	48,400			48,400
Regulatory Commission Expense	5,983			5,983
Bad Debt Expense	118,530	(55,749)	(K)	62,781
Miscellaneous Expense	8,132			8,132
	<u>2,421,722</u>	<u>(196,560)</u>		<u>2,225,162</u>
Taxes Other Than Income	-			-
	786,741	743	(I)	
		(102,991)	(L)	
Depreciation		(125,000)	(M)	559,493
Total Operating Expenses	<u>3,208,463</u>	<u>(423,808)</u>		<u>2,784,655</u>
Net Operating Income	(690,720)	386,404		(304,316)
Interest Income	386			386
Loss on Sale of Assets	(5,237)	5,237	(N)	-
Income Available to Service Debt	<u>\$ (695,571)</u>	<u>\$ 391,641</u>		<u>\$ (303,930)</u>

(A) Billing Analysis Adjustment. Martin District provided a billing analysis showing the gallons of water billed to retail customers during the test year and made an adjustment in test-period revenues. Martin District was only able to provide 6 months of billing data from their new Incode billing software (July through December of 2020). The data was then annualized to generate 12 months of customer usage. Martin District stated that the usage data for January through June 2020 was produced using Martin District's Bill Xpress software, but Martin District was unable to rely on this data due to accuracy concerns.<sup>15</sup> As further support for the proposed annualization, Martin District stated that the Bill Xpress data was not secure and customer usage could be manipulated by office staff or deleted without leaving an audit trail. Martin District further stated that there is only a single firm or person to support the software with no other backup support.<sup>16</sup> Due to the concerns with the accuracy and reliability of data of the previously used software, Staff finds that Martin District's proposed annualization of the Incode billing software data is appropriate and recommends the proposed adjustment to test-year revenues be accepted.

Applying the water service rates that were in effect during the test year to the water sales shown in the billing analysis, Staff determined that Martin District's adjustment is appropriate, and test-year revenues from retail customers should be increased by \$288,184. In addition, Martin District stated that billing adjustments were made to its test-year billing analysis, but were not noted in the table that was provided in the application.<sup>17</sup>

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<sup>15</sup> Application, Attachments 5 and 6, Current and Proposed Billing Analysis.

<sup>16</sup> Martin District's Response to Staff's First Request, Item 9(b).

<sup>17</sup> *Id.*, Item 9(c).

Martin District subsequently provided the billing adjustments that were made during the test period, further reducing test-year revenues by (\$168,105),<sup>18</sup> resulting in pro forma test-period revenues of \$2,266,462.

(B) Debt Service Surcharge. In its application, Martin District proposed to reduce Operating Revenues by \$107,436 to remove, for ratemaking purposes, the amounts collected from customers from the Debt Service Surcharge.<sup>19</sup> When the surcharge was established by the Commission's March 16, 2018 Order, the intent was for Martin District to use the proceeds from the surcharge collections to pay its accounts payable or secure a loan to pay existing past-due accounts.<sup>20</sup> The amounts collected from the Debt Service Surcharge are not intended to pay for current operating expenses and should be excluded from calculation of the revenue requirement from base rates. Accordingly, Staff reduced Surcharge Revenue by \$107,436 to remove the Debt Service Surcharge collections from pro forma operations.

(C) Tap Fees. In its application, Martin District proposed to reduce Other Water Revenues by \$22,872 for amounts collected to install customer taps.<sup>21</sup> Staff examined Martin District's 2020 audit and confirmed the amounts received to install customer taps were included on the income statement and were therefore included in Other Water Revenues.<sup>22</sup> As tap fees are considered contributed capital, it is not proper to recognize

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<sup>18</sup> *Id.*

<sup>19</sup> Application, Attachment 4, Schedule of Adjusted Operations, References, Item B.

<sup>20</sup> Case No. 2018-00017, *Electronic Application of Martin County Water District for an Alternative Rate Adjustment* (Ky. PSC Mar. 16, 2018) at 10.

<sup>21</sup> Application, Attachment 4, Schedule of Adjusted Operations, References, Item A.

<sup>22</sup> Application, Attachment 4(e) at 10.

the collections of tap fees as annual revenue. Therefore, Staff concurs with Martin District's proposed adjustment to eliminate the tap fee collections from test-year revenues and reduced Other Operating Revenues by \$22,872.

(D) Vacation Payment Liability. When Alliance assumed operations on January 1, 2020, all employees of Martin District at the time of the transfer became employees of Alliance. During the test period, Martin District recognized a payment from Alliance in the amount of \$14,311 to reimburse Martin District for outstanding vacation balances owed to Martin District employees at the time of the transfer. As this is a one-time nonrecurring item, Staff reduced Other Operating Revenue by \$14,311.

(E) Nonrecurring Charges. Following the Commission's recent decisions,<sup>23</sup> Staff has reviewed Martin District's Nonrecurring Charges. The Commission found that as district personnel are currently paid during normal business hours, estimated labor costs previously included in determining the amount of Nonrecurring Charges should be eliminated from the charges. Staff has reviewed the most recent cost justification information provided in Martin District's 2014 tariff filing and has adjusted these charges by removing Field Labor Costs and Office/Clerical Labor Costs. Such adjustments result in the following revised Nonrecurring Charges:

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<sup>23</sup> Case No. 2020-00141, *Electronic Application of Hyden-Leslie County Water District for an Alternative Rate Adjustment* (Ky. PSC Nov. 6, 2020), and 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).

<u>Nonrecurring Charge</u>	<u>Normal Hours</u>	<u>After Hours</u>
Service Disconnection	\$20	
Meter Re-read	\$20	
Meter Test	\$53	
Meter Turn-On	\$20	\$55
Service Reconnection	\$20	\$55
Returned Check Fee	\$25	
Service Call/Investigation	\$20	\$55

The adjustments to the Nonrecurring Charges results in a decrease to other operating revenue and an increase to the total revenue requirement of \$12,864 as shown below:<sup>24</sup>

<u>Charge</u>	<u>No. of Occurances</u>	<u>Adjusted NRC</u>	<u>Pro Forma</u>
Service Disconnection	155	\$20	\$3,100
Meter Test	20	\$53	\$1,060
Meter Turn-On	30	\$20	\$600
Service Reconnect	101	\$20	\$2,020
Returned Check Fee	20	\$25	\$500
			<hr/>
Pro Forma Test Year NRC Revenue			\$7,280
Less: Test Year NRC Revenue			(\$20,144)
Adjustment			<hr/> -\$12,864

(F) Net Pension Liability. In its Application, Martin District proposed to increase test-year expenses by \$119,701 for a “one-time payment to the Kentucky Retirement System.”<sup>25</sup> In response to Staff’s First Request, Item 3.c., Martin District clarified that the reduction to expenses of \$119,701 was the result of an audit adjustment to reduce Martin District’s net pension liability to the County Employee Retirement System. As this adjustment was a noncash transaction made to reduce the total net pension liability on

<sup>24</sup> Martin District’s Response to Staff’s First Request, Item 4.

<sup>25</sup> Application, Attachment 4, Schedule of Adjusted Operations, References, Item C.

Martin District's balance sheet, it should not be included in pro forma expenses for ratemaking purposes. Accordingly, Staff increased pro forma operating expenses by \$119,701 to remove the effects of the audit adjustment.

(G) Water Loss (Purchased Power and Chemical Costs). Martin District's test-year water loss average was 65 percent.<sup>26</sup> Commission regulation 807 KAR 5:066, Section 6(3), limits water loss to 15 percent for ratemaking purposes unless the Commission finds an alternative level is reasonable. Consequently, the expenses associated with water loss in excess of 15 percent cannot be recovered through base rates. Martin District did not propose any pro forma adjustments to its purchased power expenses. Staff finds that Martin District's test-year purchased power expenses must be reduced by \$160,485 to reflect the limitation set forth in the regulation.<sup>27</sup>

As discussed in the Commission's July 9, 2021 Order, Martin District is falling behind on its payments for its management contract with Alliance.<sup>28</sup> Alliance is now bearing the burden of the expenses incurred by the District, which include, but are not limited to, audit expenses, employee benefits, chemical costs, and any repair costs or capital expenditures that Martin District may require. Some of these expenses are recorded under contractual services in Martin District's submitted schedule of adjusted operations.<sup>29</sup> Therefore, pro forma adjustments must be made to abide by the regulations set forth by 807 KAR 5:066, Section 6(3), as explained above, for chemical expenses paid on behalf of Martin District in excess of the 15 percent water loss limit. Martin

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<sup>26</sup> Application, Attachment 4(g) at 1.

<sup>27</sup>  $(65\% - 15\%) * \$320,969 = \$160,485$

<sup>28</sup> Order (Ky. PSC July 9, 2021) at 8.

<sup>29</sup> Application, Attachment 4.

District's test-year chemical expenses totaled \$113,575.<sup>30</sup> Martin District did not propose any pro forma adjustments for its chemical expenses; however, Staff finds that a reduction of \$56,788 should be made to contractual services expense to adhere to the regulation.<sup>31</sup>

(H) Expenses to Perform Prior Year Audits. In the test period, Martin District paid \$25,000 for accounting services to complete its 2017, 2018, and 2019 audit.<sup>32</sup> It is typical for a water utility to perform a regular annual audit in order to meet its debt covenants for its long-term indebtedness. Staff believes that because audits would be performed under normal circumstances on an annual basis, that it is inappropriate to include in base rates the expenses associated with three years of audits. Martin District estimated the total cost to perform the 2021 audit would be between \$7,985 and \$10,710.<sup>33</sup> Staff examined the general ledger and determined Martin District paid \$7,500 per audit for the calendar years 2018 and 2019.<sup>34</sup> Based on the estimates and the expenses associated with the prior year audits, Staff believes \$7,500 is reasonable to perform a single audit and reduced pro forma expenses by \$17,500, the total cost in the test period to perform the prior year audits.

(I) Capitalization of Meter Installations. On July 27, 2021, Martin District filed a response to Staff's telephone inquiry regarding the number of installed taps during the

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<sup>30</sup> *Id.*, Attachment 4(g) at 5.

<sup>31</sup>  $(65\% - 15\%) * \$113,575 = \$56,788$

<sup>32</sup> Application, Attachment 4 at 3.

<sup>33</sup> Martin District's Response to Staff's Third Request, Item 2.

<sup>34</sup> Martin District's response to Staff's First Request, Item 1.a.1, Excel attachment entitled 05.18.21\_Excel\_1a1\_2020\_MCW\_Detail\_GL\_(2020).xlsx.

test period. Martin District stated that it installed a total of 26 customer taps during 2020.<sup>35</sup> Staff reviewed Martin District’s general ledger and determined that Martin District did not make any adjustment to capitalize the installation of these taps. Because the installation of a customer meter is a capital item, the expenses associated with the installation of these items should be removed from the Income Statement and depreciated on Martin District’s depreciation schedule. Pursuant to Martin District’s tariff, the cost collected from the customer, which should be in line with the actual cost to install a new customer meter, is \$1,000. Staff believes that absent empirical evidence of the actual cost to install customer taps, it would be appropriate to remove from expenses the total cost billed for 26 meter installations and include in depreciation expense this amount over the expected life of the installations. Accordingly, Staff reduced operating expenses by \$26,000, and included in depreciation expense \$743,<sup>36</sup> based on the 35-year depreciation rate for meter installations approved in Case No. 2018-00017.<sup>37</sup>

(J) Office Rent. In the response to Staff’s Third Request, Item 3, Martin District provided its rental agreement to maintain its billing office in the Roy F. Collier Community Center.<sup>38</sup> According to the rental agreement, Martin District will see a 3 percent increase

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<sup>35</sup> Martin District’s Response to Staff’s Question Regarding Tap Installations (filed Jul. 27, 2021).

<sup>36</sup>

Total Cost to Install 26 Meter Taps	\$ 26,000
Divide by: 35 Years	<u>35</u>
Annual Depreciation Expense	<u>\$ 743</u>

<sup>37</sup> Case No. 2018-00017, *Electronic Application of Martin County Water District for an Alternative Rate Adjustment* (Ky. PSC July 22, 2020).

<sup>38</sup> Martin County’s Response to Staff’s Third Request, Item 3, Attachment 3.

in rental costs beginning August 1, 2021.<sup>39</sup> Martin District did not propose any pro forma adjustments to its test-year rental costs. Staff finds pro forma expenses should be increased by \$260 to reflect the increase included in the rental agreement.<sup>40</sup> Due to the timing of discovery, the Order establishing the final revenue requirement for this case will not be in effect until after the rental cost increase has occurred, and that the adjustment above is therefore reasonable.

(K) Bad Debt Expense. Martin District proposed no adjustments to their bad debt expense. In the response to Staff's Third Request, Alliance officials explained that the current level of bad debt is atypical compared to Alliance's other clients. Where Martin District's 5-year bad debt average is 2.77 percent, the 5-year average for Alliance's clients is only 0.17 percent.<sup>41</sup> In its response, Martin District stated the level of bad debt is expected to fluctuate depending upon current local economic conditions.<sup>42</sup> Due to the extreme and dire situation that Martin District finds itself in and the unprecedented levels of water loss and suspected water theft, allowing Martin District to recover its 5-year average bad debt expense in base rates is justifiable, reasonable, and prudent to ensure the financial health of Martin District. Allowing for the 5-year average of 2.77 percent, Staff reduced test-year bad debt expense \$55,749.

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<sup>39</sup> *Id.* at 2.

<sup>40</sup>  $(\$776 * 12) - \$9,053 = \$260$

<sup>41</sup> Martin County's Response to Staff's Third Request, Item 6.

<sup>42</sup> *Id.*

(L) Depreciation. In its last rate adjustment in Case No. 2018-00017,<sup>43</sup> Martin District proposed an annual depreciation expense of \$683,750, which reflected numerous revisions to the service lives of Martin District's assets. The revisions were made to conform to the ranges recommended by the National Association of Regulatory Utility Commissioners (NARUC) in its report published in 1979 titled *Depreciation Practices for Small Water Utilities* (NARUC Study). In the staff report in that case, Commission Staff recommended the Commission approve Martin District's proposal, and by Order dated November 5, 2018, the Commission approved a revenue requirement that was reflective of the proposed modifications. Subsequent to that case, Martin District has continued to record annual depreciation expense that is not in line with the amounts proposed and subsequently approved. Staff believes that absent any evidence to support a specific life that is outside the NARUC ranges, Martin District should be required to implement the depreciable lives approved by the Commission in that case, which are in line with the NARUC Study ranges historically relied upon by the Commission. Consistent with this belief, Staff reduced depreciation expense \$102,991 to reflect the amount approved in Case No. 2018-00017.<sup>44</sup>

(M) Alliance Contract Repair Limit. Alliance and Martin District entered into a professional operating and management agreement for water service on November 20, 2019, and Alliance began formally operating the system on January 1, 2020. Pursuant to the contract, Alliance is responsible for repairs of the system up to a repair limit of \$125,000 annually. Because the repair limit is designed to handle replacements and

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<sup>43</sup> Case No. 2018-00017, *Electronic Application of Martin County Water District for an Alternative Rate Adjustment* (Ky. PSC July 22, 2020).

<sup>44</sup> *Id.*

repairs of Martin District's assets throughout the year, the associated expenses would normally be recovered by a water utility through the inclusion of its depreciation expense in a base rate case. If Martin District is permitted recovery of its full depreciation expense and the amount of the contract associated with the repair limit, it is Staff's opinion that a double recovery of expenses has occurred. Accordingly, Staff reduced test-year depreciation expense by \$125,000, the amount of the repair limit in the contract.

(N) Loss on Sale of Assets. In its application, Martin District reported a loss on the sale of assets of \$5,237.<sup>45</sup> Upon review of Martin District's general ledger and depreciation schedule, Staff found that the amounts recorded were associated with the disposal of two chart recorders and a submersible pump.<sup>46</sup> The recognition of the loss was a balancing entry performed by Martin District's auditor to remove the assets from its books. As this balancing entry would be nonrecurring and is not actually an expense to Martin District, Staff reduced Martin District's pro forma operations by \$5,237 to remove the effects of the entry.

#### OVERALL REVENUE REQUIREMENT AND REQUIRED REVENUE INCREASE

By applying a DSC method, Staff determined Martin District's Overall Revenue Requirement to be \$3,031,705. Staff calculated a revenue increase of \$550,980, or 24.31 percent, is necessary to generate the Overall Revenue Requirement. A comparison of Martin District's and Staff's calculation of the Overall Revenue Requirement and the Required Revenue Increase using a DSC method is shown below.

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<sup>45</sup> Application, Management's Discussion and Analysis at 16.

<sup>46</sup> Application, Attachment 7 at 2, 6, and 7.

	Martin District	Staff	
Pro Forma Operating Expenses	\$3,328,164	\$ 2,784,655	
Plus: Average Annual Principal and Interest Payments	207,376	205,875	(1)
Additional Working Capital	<u>42,491</u>	<u>41,175</u>	(2)
Overall Revenue Requirement	3,578,031	3,031,705	
Less: Other Operating Revenue	(33,560)	(20,696)	
Interest Income	-	(386)	
Surcharge Income	<u>(193,180)</u>	<u>(193,180)</u>	
Revenue Required from Rates	3,351,291	2,817,443	
Less: Pro Forma Present Rate Service Revenues	<u>(2,146,384)</u>	<u>(2,266,463)</u>	
Required Revenue Increase	<u>\$ 1,204,907</u>	<u>\$ 550,980</u>	
Percentage Increase	<u>56.14%</u>	<u>24.31%</u>	

(1) In its application, Martin District proposed to include in its revenue requirement the three-year average of its annual principal and interest payments on its loan payable to Kentucky Rural Water Finance Corporation (KRWFC), for a loan payable to the Kentucky Infrastructure Authority (KIA), and a Kentucky Association of Counties Equipment Lease.<sup>47</sup> Staff examined Martin District's supporting documentation in its application<sup>48</sup> and the amounts reported for principal and interest due in the 2020 audit<sup>49</sup> and recalculated the five-year average of Martin District's bonds and loan payable summarized in the table below:

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<sup>47</sup> Martin District's Response to Staff's First Request, Item 10.

<sup>48</sup> Application, Attachment 9.

<sup>49</sup> *Id.*, Attachment 4(e) at 15.

Year	Annual Debt Payment
2021	\$ 210,110
2022	207,375
2023	204,644
2024	206,795
2025	<u>200,451</u>
Total	1,029,375
Divide by: 5 years	<u>5</u>
Average Annual Principal and Interest Payment	<u><u>\$ 205,875</u></u>

(2) Martin District included in its calculation of the revenue requirement \$42,491 for an additional working capital component that it states is required by Martin District's KIA Covenants.<sup>50</sup> 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. KRWFC requires that Martin District charge rates that produce net revenues that are at least 120 percent of its average annual debt payments. Following the Commission's historic practice, Staff agrees with Martin District's proposal to include additional working capital on its current indebtedness but has recalculated the amount based on the average annual principal and interest payments calculated by Staff above. The calculation of Martin District's additional working capital is summarized below:

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<sup>50</sup> *Id.*

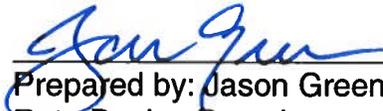
Average Annual Principal and Interest	\$ 205,875
Times: DSC Coverage Ratio	<u>120%</u>
Total Net Revenues Required	247,050
Less: Average Annual Principal and Interest Payments	<u>(205,875)</u>
Additional Working Capital	<u>\$ 41,175</u>

Signatures



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Revenue Requirements Branch  
Division of Financial Analysis



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Rate Design Branch  
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APPENDIX

APPENDIX TO A STAFF REPORT OF THE KENTUCKY PUBLIC SERVICE  
COMMISSION IN CASE NO. 2021-00154 DATED AUG 11 2021

Monthly Water Rates

5/8- x 3/4-Inch Meter

First	2,000 Gallons	\$41.42	Minimum Bill
Over	2,000 Gallons	0.01049	per Gallon

1-Inch Meter

First	5,000 Gallons	\$72.83	Minimum Bill
Over	5,000 Gallons	0.01049	per Gallon

1 1/2-Inch Meter

First	10,000 Gallons	\$125.18	Minimum Bill
Over	10,000 Gallons	0.01049	per Gallon

2-Inch Meter

First	20,000 Gallons	\$229.89	Minimum Bill
Over	20,000 Gallons	0.01049	per Gallon

3-Inch Meter

First	30,000 Gallons	\$334.61	Minimum Bill
Over	30,000 Gallons	0.01049	per Gallon

4-Inch Meter

First	50,000 Gallons	\$544.02	Minimum Bill
Over	50,000 Gallons	0.01049	per Gallon

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