

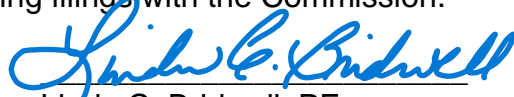
COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF MCKINNEY)	CASE NO.
WATER DISTRICT FOR A RATE ADJUSTMENT)	2022-00400
PURSUANT TO 807 KAR 5:076)	

NOTICE OF FILING OF COMMISSION STAFF'S REPORT

Notice is hereby given that, in accordance with the Commission's Order of December 22, 2022, as amended on January 10, 2023, and February 16, 2023, 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 December 22, 2022, January 10, 2023, and February 16, 2023 Orders, McKinney Water District (McKinney 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 McKinney District to the Commission's July 22, 2021 Order in Case No. 2020-00085¹ regarding filings with the Commission.



Linda C. Bridwell, PE
Executive Director
Public Service Commission
P.O. Box 615
Frankfort, KY 40602

DATED MAY 16 2023

cc: Parties of Record

¹ 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).

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF MCKINNEY)	CASE NO.
WATER DISTRICT FOR AN ADJUSTMENT OF)	2022-00400
ITS WATER RATES PURSUANT TO 807 KAR)	
5:076)	

COMMISSION STAFF'S REPORT
ON MCKINNEY WATER DISTRICT

McKinney Water District (McKinney District) is a water utility organized pursuant to KRS Chapter 74 that owns and operates a water distribution system through which it provides retail water service to approximately 1,841 residential customers and 23 commercial customers that reside in Lincoln and Casey Counties, Kentucky.¹

On November 29, 2022,² McKinney District filed its application with the Commission requesting an adjustment to its water rates pursuant to 807 KAR 5:076. To comply with the requirements of 807 KAR 5:076, Section 9,³ McKinney District used the calendar year ended December 31, 2021, as the basis for its application. The application was filed pursuant to the Commission's Order in Case No. 2022-00048,⁴ which required

¹ *Annual Report of McKinney District to the Public Service Commission for the Calendar Year Ended December 31, 2021* (Annual Report) at 12 and 49.

² McKinney District tendered its application on November 23, 2022. By letter dated November 28, 2022, the Commission rejected the application for filing deficiencies. The deficiencies were subsequently cured, and the application is deemed filed on November 29, 2022.

³ 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.

⁴ Case No. 2022-00048, *Electronic Purchased Water Adjustment of McKinney Water District* (Ky. PSC Mar 3, 2016), at 6, Ordering paragraph 5.

McKinney District to file an application for an adjustment of its base rates by March 16, 2023. McKinney District's last base rate increase pursuant to the alternative rate filing procedure was in Case No. 2015-00331.⁵ Since that matter, McKinney District has only adjusted its rates pursuant to purchased water adjustments

To ensure the orderly review of the application, the Commission established a procedural schedule by Order dated December 22, 2022, which was subsequently amended on January 10, 2023, and February 6, 2023. McKinney District responded to two rounds of discovery. The Commission granted McKinney District's request for an extension of time to respond to the first round of discovery. McKinney District timely filed its response to the second round of discovery.

WATER LOSS

The Commission notes that in its 2021 Annual Report, McKinney District reported a water loss of 31.6879 percent.⁶ Commission regulation 807 KAR 5:066(6)(3) states that for ratemaking purposes a utility's water loss shall not exceed 15 percent of total water produced and purchased, excluding water consumed by a utility in its own operations. The table below shows that the total annual cost of water loss to McKinney District is \$172,159 while the annual cost of water loss in excess of 15.00 percent is \$90,664.

⁵ Case No. 2015-00331, *Alternative Rate Adjustment of McKinney Water District* (Ky. PSC Mar 3, 2016).

⁶ *Annual Report of McKinney District to the Public Service Commission for the Calendar Year Ended December 30, 2021* (Annual Report) at 57.

Total Water Loss	Purchased Water	Power	Total
Pro Forma Purchases	\$ 530,932	\$ 12,364	\$ 543,296
Water Loss Percent	31.6879%	31.6879%	31.6879%
Total Water Loss	\$ 168,241	\$ 3,918	\$ 172,159

Disallowed Water Loss	Purchased Water	Power	Total
Pro Forma Purchases	\$ 530,932	\$ 12,364	\$ 543,296
Water Loss in Excess of 15%	16.6879%	16.6879%	16.6879%
Disallowed Water Loss	\$ 88,601	\$ 2,063	\$ 90,664

DISCUSSION

To comply with the requirements of 807 KAR 5:076, Section 9,⁷ McKinney District used the calendar year ended December 31, 2021, as the basis for its application. Using its pro forma test-year operations, McKinney District determined that a base rate revenue increase of \$63,547 or 6.93 percent was necessary to achieve the revenue requirement as shown in the table below.⁸ McKinney District also proposed a monthly water loss reduction surcharge of \$3.44 per customer.⁹ The rates requested by McKinney District would increase the residential monthly bill of a typical residential customer using 4,000 gallons per month by \$2.92 from \$42.04 to \$44.96, or approximately 6.95 percent.¹⁰ The rates and surcharge requested by McKinney District would increase the residential

⁷ 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.

⁸ Application, Revenue Requirements Using Debt Service Coverage Method, at 16.

⁹ Application, Exhibit 3, Current and Proposed Rates.

¹⁰ Application, Attachment 1, Customer Notice.

monthly bill of a typical residential customer using 4,000 gallons per month by \$6.36, from \$42.04 to \$48.40, or approximately 15.13 percent.¹¹

	McKinney Water District
Pro Forma Operating Expenses	\$ 961,672
Plus: Average Annual Principal and Interest Payments	66,916
Additional Working Capital	13,383
Overall Revenue Requirement	<u>1,041,971</u>
Less: Other Operating Revenue	(59,818)
Interest Income	(1,331)
Revenue Required from Rates	<u>980,822</u>
Less: Pro Forma Present Rate Service Revenues	(917,275)
Required Revenue Increase	<u>\$ 63,547</u>
Percentage Increase	<u>6.93%</u>

To determine the reasonableness of the rates requested by McKinney District, Commission Staff performed a limited financial review of McKinney District's test-year operations. The scope of Commission Staff's review was limited to determining whether operations reported for the test year were representative of normal operations. Known and measurable¹² 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.

¹¹ Application, Attachment 1, Customer Notice.

¹² Commission regulation 807 KAR 5:076, Section 9 sets the standard for the determination of the reasonableness of proposed rates and states, in pertinent part, that the test period shall be "adjusted for known and measurable changes." See also Case No. 2001-00211, *Application of Hardin County Water District No. 1 for (1) Issuance of Certificate of Public Convenience and Necessity; (2) Authorization to Borrow Funds and to Issue its Evidence of Indebtedness Therefore; (3) Authority to Adjust Rates; and (4) Approval to Revise and Adjust Tariff* (Ky. PSC Mar. 1, 2002); Case No. 2002-00105, *Application of Northern Kentucky Water District for (A) an Adjustment of Rates; (B) a Certificate of Public Convenience and Necessity for Improvements to Water Facilities if Necessary; and (C) Issuance of Bonds* (Ky. PSC June 25, 2003); Case No. 2017-00417, *Electronic Proposed Adjustment of the Wholesale Water Service Rates of Lebanon Water Works* (Ky. PSC July 12, 2018).

Commission Staff's findings are summarized in this report. Jeff Abshire and Noah Abner reviewed the calculation of McKinney District's Overall Revenue Requirement and Eddie Beavers reviewed McKinney District's reported revenues and rate design.

SUMMARY OF FINDINGS

1. Overall Revenue Requirement and Required Revenue Increase. By applying the Debt Service Coverage (DSC) method, as generally accepted by the Commission, Commission Staff found that McKinney District's required revenue from water sales is \$1,032,255 to meet the Overall Revenue Requirement of \$1,060,282 and that a \$57,378 revenue increase, or 5.89 percent, to pro forma present rate revenues is necessary to generate the Overall Revenue Requirement.

2. Water Loss Surcharge. In its application, McKinney District requested to implement a water loss reduction surcharge of \$3.44 per customer per month.¹³ McKinney District stated that it had not developed a water loss reduction plan.¹⁴ The monthly amount of the proposed surcharge was based upon the purchased water expense normally disallowed pursuant to 807 KAR 5:066, Section 3. Commission Staff recalculated the amount based on an adjusted water loss cost that is discussed in reference "(G)" of the Pro Forma adjustments later in this report and the inclusion of purchased power for pumping which resulted in a monthly amount of \$4.05 per customer as shown below:

¹³ Application at 8, Attachment #1, Customer Notice.

¹⁴ McKinney District's Supplemental Response to Commission Staff's First Request (Staff's First Request) (filed Feb. 20, 2023).

Disallowed Water Loss	\$ 90,664
Customers	1,864
Monthly Surcharge (rounded 00)	<u>\$ 4.05</u>
Annual Surcharge (Monthly x Customers x 12)	<u>\$ 90,590</u>
Total Surcharge (Monthly x Customers x 48)	<u>\$ 362,362</u>

The use of a surcharge is consistent with prior Commission action in cases involving water utilities with excessive unaccounted-for water loss.¹⁵ Further, the Commission has ordered surcharges even when a utility has not specifically requested a surcharge,¹⁶ and recently, the Commission has allowed water utilities with reported water loss above the 15 percent threshold to assess water loss reduction surcharges.¹⁷ Recognizing prior Commission precedent to allow the use of surcharges to assist utilities in obtaining the proper funding needed to combat water loss, Commission Staff recommends that the Commission approve McKinney District’s request and authorize Commission Staff’s recalculated surcharge amount of \$4.05 per bill per month for a temporary period of 48 months, with a review of the necessity to continue the surcharge before the temporary period expires. Commission Staff also recommends that the Commission establish a

¹⁵ 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, 2010); Case No. 2020-00141, *Electronic Application of Hyden-Leslie County Water District for an Alternative Rate Adjustment* (Ky. PSC Nov. 6, 2020) Order at 11-13.

¹⁶ Case No. 2020-00311, *Electronic Application of Cawood Water District for an Alternative Rate Adjustment* (Ky. PSC Apr. 8, 2021) Order at 3.

¹⁷ See Case No. 2021-00094, *Electronic Application of Garrison-Quincy-Ky-O-Heights Water District for a Rate Adjustment Pursuant to 807 KAR 5:076* (Ky. PSC Nov. 24, 2021).

separate proceeding to monitor the surcharge and place strict controls over the use of the funds that will be collected from the surcharge. In addition, Commission Staff recommends that McKinney District be required to develop a long-term plan to address its aging infrastructure and combat water loss within six months of the final order in this proceeding.

3. Monthly Water Service Rates. McKinney District proposed to increase all of its monthly retail and wholesale water service rates by approximately 6.95 percent across the board. McKinney District has not performed a cost-of-service study (COSS). McKinney District stated that it did not complete a COSS at this time as there has been no material changes in the water system.¹⁸

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 into the record demonstrating that this method is unreasonable and in the absence of a COSS. Finding no such evidence in this case, Commission Staff followed the method previously accepted by the Commission and allocated the \$57,378 revenue increase evenly across the board to McKinney District's monthly retail and wholesale water service rates.

The rates set forth in the Appendix to this report are based upon the revenue requirement, as calculated by Commission Staff, and will produce sufficient revenues from water sales to recover the \$1,032,255 Revenue Required from Rates, an approximate 5.89 percent increase. These rates will increase a typical residential customer's monthly water bill from \$42.04 to \$44.52, an increase of \$2.48, or

¹⁸ Response to Staff's First Request (filed Feb. 6, 2023), Item 11a.

approximately 5.90 percent.¹⁹ If the Commission authorizes the assessment of the Water Loss Surcharge as proposed and authorizes the assessment of Commission Staff's recommended Water Loss Surcharge rate of \$4.05 per month, a typical residential customer's monthly water bill will increase from \$42.04 to \$48.57, an increase of \$6.53 or approximately 15.53 percent.²⁰

4. Nonrecurring Charges. Following the Commission's recent decisions,²¹ Commission Staff has reviewed McKinney District's nonrecurring charges. The Commission found that because district personnel are currently paid during normal business hours and those costs are recovered in rates, estimated labor costs previously included in determining the amount of Nonrecurring Charges should be eliminated from the charges to avoid double recovery of the same expense. Commission Staff has reviewed the cost justification information provided by McKinney District and have adjusted these charges by removing Field Labor Costs and Office/Clerical Labor Costs from those charges that occur during normal business hours.²² Such adjustments result in the following revised nonrecurring charges:

¹⁹ The typical residential customer uses approximately 4,000 gallons per month. Application, Attachment 1.

²⁰ The typical residential customer uses approximately 4,000 gallons per month. Application, Attachment 1.

²¹ 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).

²² McKinney District's Response to Commission Staff's Second Request (Staff's Second Request), Item 2(b) (filed Mar. 20, 2023).

Delinquent Charge	\$22.50
Meter Reread Charge	\$22.50
Paycall	\$24.00
Returned Check Charge	\$10.00
Reconnect Charge	\$34.50
Service Investigation Charge	\$22.50
<u>Tap Fees</u>	
5/8- x 3/4-Inch Meter	\$1,421.33
1-Inch Meter	\$1,960.85

The revised nonrecurring charges result in a decrease to test year Other Water Revenues and an increase to the total revenue requirement of \$78.00 as explained in adjustment (C) below.

Description	Occurrences	Current Rate	Total	Revised Rate	Adjustment	Pro Forma
Delinquent Charge	0	\$ -	\$ -	\$ 22.50	\$ -	\$ -
Meter Reread	0	\$ 35.00	0	\$ 22.50	0	0
Paycall	2	\$ 10.00	20	\$ 24.00	28	48
Returned Check	18	\$ 10.00	180	\$ 10.00	0	180
Reconnect	212	\$ 35.00	7,420	\$ 34.50	(106)	7,314
Service Investigation	0	\$ 35.00	0	\$ 22.50	0	0
Totals			<u>\$ 7,620</u>		<u>\$ (78)</u>	<u>\$ 7,542</u>

PRO FORMA OPERATING STATEMENT

McKinney District's Pro Forma Operating Statement for the test year ended December 31, 2021, as determined by Staff, appears below.

	Test Year	Adjustment	(Ref.)	Pro Forma
Operating Revenues				
Sales of Water	\$ 917,275	\$ 57,602	(A)	\$ 974,877
Late Payment Penalties	22,050	(4,696)	(B)	17,354
Other Water Revenues	35,968	(22,050)	(C)	
		(6,376)	(C)	7,542
Misc. Service Revenues	1,800			1,800
Total Operating Revenues	977,093	24,480		1,001,573
Operating Expenses				
Operation and Maintenance Expenses				
Salaries and Wages - Employees	246,205	(6,681)	(D)	
		(5,985)	(E)	233,539
Salaries and Wages - Commissioners	20,800	(2,800)	(F)	18,000
Purchased Water	464,375	66,555	(G)	
		(88,601)	(H)	442,329
Purchased Power for Pumping		12,364	(I)	
		(2,063)	(H)	10,301
Materials and Supplies	76,795	(13,965)	(E)	
			(L)	62,830
Contractual Services - Accounting	6,590		(L)	6,590
Contractual Services - Other	58,531		(L)	58,531
Transportation Expense	16,238		(L)	16,238
Insurance - General Liability	4,052		(L)	4,052
Insurance - Other	7,177		(L)	7,177
Bad Debt Expense	7,046			7,046
Miscellaneous Expense	25,065	(12,364)	(I)	
			(L)	12,701
Total Operation and Maintenance Expenses	932,874	(53,540)		879,334
Taxes Other Than Income	23,512	(2,686)	(J)	20,826
Depreciation	92,622	(12,799)	(K)	79,823
Total Operating Expenses	1,049,008	(69,025)		979,983
Net Operating Income	(71,915)	93,505		21,590
Interest Income	1,331			1,331
Income Available to Service Debt	\$ (70,584)	\$ 93,505		\$ 22,921

(A) Billing Analysis Adjustment. McKinney District did not propose any adjustments to its test-year revenues from water sales of \$917,275. McKinney District stated that a current and projected billing analysis could not be prepared using standard

reporting from the McKinney District's billing software²³, McKinney District went on to state that the revenue from water sales was calculated correctly by the billing software.²⁴ Commission Staff calculated an increase of \$57,602 in water sales as a result of the rate adjustment effected by a purchased water adjustment that was approved during 2022, and thus made an adjustment to the Billing Analysis.²⁵ Commission Staff recommends that the Commission approve the adjustment proposed by Commission Staff. Commission Staff also recommends that McKinney District issue a request for purchase for a new billing and usage software to obtain accurate data consistent with information that is required to be filed in support of rate adjustment applications by Commission regulations.

(B) Late Payment Penalties. McKinney District did not propose any adjustments to its reported test-year late payment penalties of \$22,050. However, Commission Staff determined that the amount reported was for tap fees and not late fees, and thus was inaccurate. Staff made an adjustment to reduce the reported amount by \$4,696 to reflect the correct test year amount of \$17,354.²⁶

(C) Other Water Revenues. In its application, McKinney District reported test year Other Water Revenues was \$35,968. Commission Staff reduced the misclassified tap fees of \$22,050, that should not be included in other water revenues. Other Water Revenues were reduced further by \$2,943 for the Billing and Collection of Fees related

²³ Application at 17, References.

²⁴ Response to Staff's Second Request, Item 1.

²⁵ Case No. 2022-00048, *Electronic Purchased Water Adjustment Filing of McKinney Water District* (KY PSC Mar 16, 2022). Gallons sold 97,631,000 times Purchased Water Factor \$0.59 = \$57,602.

²⁶ Response to Staff's Second Request, Item 3. Reported in the Application's SAO of \$22,050 – the stated Forfeited Discounts in the response of \$17,354 = an adjustment of the reported amount of \$4,696.

to the 911 Service which is not water revenues and should not be included in Other Water Revenues. An adjustment was made for the changes in the nonrecurring charges of a reduction of \$78 and a balancing adjustment of \$3,355 for items that will not recur. The combined reductions leave a balance of \$7,542²⁷ which represents non-recurring charges. As discussed previously, McKinney District's nonrecurring charges were revised and updated by McKinney District²⁸ and Commission Staff has removed the Field Labor Costs and Office/Clerical Labor Costs from those charges that occur during normal business hours the to the recent decisions of the Commission.²⁹

(D) Salaries and Wages - Employees. In its application, McKinney District proposed an increase of \$10,976 to Salaries and Wages – Employees expense to reflect increased wage rates after the test year.³⁰ McKinney District's calculations included two employees who left in July and November 2021.³¹ McKinney District also submitted employee hours and wage information for 2022 which totaled \$239,524 or \$6,681 less than the test year.³² Commission Staff reviewed McKinney District's submittals and concluded that the 2022 employee count, hours, and wage rates more accurately

²⁷ Response to Staff's Second Request, Item 2. Reported in the Application's SAO of \$35,968 – Misclassified Tap Fees of \$22,050 - Billing/Collection Fees for BG911 of \$2,943 – Nonrecurring Charges adjustment of \$78 – Balancing Adjustment of \$3,355 = \$7,542.

²⁸ Response to Staff's First Request, Item 10.

²⁹ Case No. 2020-00141, *Electronic Application of Hyden-Leslie County Water District for an Alternative Rate Adjustment* (Ky. PSC Nov. 6, 2020).

³⁰ Application, Attachment 4, References, Adjustment A.

³¹ Response to Staff's First Request, Item 2a Rate Study.xlsx.

³² Response to Staff's First Request, Item 1f, Hours and Wages.pdf.

represents McKinney District's current staffing and wage structure and reduced the Pro Forma wage amount by \$6,681 based on the information provided for 2022.

(E) Capitalization of Cost of Customer Taps. During the test year McKinney District installed 19 regular meter connections.³³ McKinney District reduced labor expense by \$5,985 and materials expense by \$13,965 for capitalization of the costs of the meter connections. The Uniform System of Accounts for Class A/B Water Systems (USoA) requires that these costs be capitalized as Utility Plant in Service and depreciated over their estimated useful lives.³⁴ Commission Staff agrees with McKinney District's proposed adjustments and decreased labor expense by \$5,985 and materials expense by \$13,965.

(F) Salaries and Wages – Officers. In the test year, McKinney District reported \$20,800 for Salaries and Wages – Officer Expense. McKinney District did not propose an adjustment. McKinney District further stated that it was unable to identify any training records for commissioners during 2020, 2021, or 2022.³⁵ McKinney District pays commissioners a salary³⁶ along with a per meeting or occurrence amount,³⁷ but was not able to provide documentation that authorized the payment structure or the amounts.³⁸ Based on five commissioners and a maximum allowed pay of \$3,600 under KRS

³³ Response to Staff's First Request, Item 8, 2021 Nonrecurring Charges.pdf.

³⁴ USoA, Accounting Instruction 19 and 33.

³⁵ Supplemental Response to Staff's First Request, Item 1j.

³⁶ Response to Staff's First request, 1i_Commissioners_Compensation.pdf.

³⁷ Response to Staff's First request, 2b_Commissioners_Fees.pdf.

³⁸ Response to Staff's Second Request, Items 4a and 4b

74.020(6) for a commissioner who has not had training, the maximum amount that McKinney District could expend for ratemaking purposes for officer salaries is \$18,000.

KRS 74.020(6) states that “[e]ach commissioner shall receive an annual salary of not more than thirty-six hundred dollars (\$3,600)...” and that

[A]ny such amount the salary shall be fixed by the county judges/executive with the approval of the fiscal court; in multicounty districts, it shall be fixed by the agreement between the county judges/executive with the approval of their fiscal courts. In fixing and approving the salary of the commissioners, the county judge/executive and the fiscal court shall take into consideration the financial condition of the district and its ability to meet its obligations as they mature.

Commission Staff notes the required fixed salary is to be set by the fiscal court. Paying Commissioners per meeting or occurrence creates the possibility that a commissioner could be paid more than the statutorily allowable amount in the event the utility must hold more meetings than expected, or the commissioners have more frequent occurrences where they are needed to attend to utility business. Therefore, Commission Staff proposes a reduction of \$2,800 as shown below.

Description	Pro Forma Salaries
Five Commissioners at \$3,600 Each	\$ 18,000
Test year Commissioner Salaries ()	(20,800)
Adjustment	<u>\$ (2,800)</u>

In addition, Commission Staff recommends that McKinney District request the Lincoln County Fiscal Court to incorporate authorization of compensation of McKinney District Commissioners in the Fiscal Court minutes upon the appointment or reappointment of each future McKinney District commissioner.

(G) Purchased Water. McKinney District purchases water from the Cities of Stanford and Eubank. McKinney District did not propose an adjustment to purchased

water cost. During 2022 McKinney District the tariff for water purchased from the City of Stanford increased by \$0.54 per thousand gallons of water purchased.³⁹ Commission Staff increased Purchased Water cost by \$66,555 for the effect on 2021 test year purchases as shown below.

	Stanford	Eubank	Total
Gallons	117,343,200	28,396,300	145,739,500
Current Tariff	\$ 3.53	\$ 4.11	\$ 3.643
Pro Forma Cost	<u>\$ 414,221</u>	<u>\$ 116,709</u>	\$ 530,930
Test Year Cost			(464,375)
Pro Forma Adjustment (rounded)			<u>\$ 66,555</u>

(H) Water Loss. In its application, McKinney District proposed a reduction to Purchased Water Expense of \$77,495 to account for the district's water loss in excess of 15 percent.⁴⁰ Commission Staff recalculated water loss including the purchased water adjustment discussed above and reduced purchased water by \$88,601. Commission Staff also reduced purchased power for pumping by \$2,063, which was omitted by McKinney District.

Disallowed Water Loss	Purchased Water	Power	Total
Pro Forma Purchases	\$ 530,932	\$ 12,364	\$ 543,296
Water Loss in Excess of 15%	16.6879%	16.6879%	16.6879%
Disallowed Water Loss	<u>\$ 88,601</u>	<u>\$ 2,063</u>	<u>\$ 90,664</u>
Pro Forma Amounts	<u>\$ 442,331</u>	<u>\$ 10,301</u>	

(I) Purchased Power for Pumping - Reclassification. McKinney District did not report Purchased Power for Pumping in its application. In its Response to Staff's First

³⁹ Case No. 2022-00048, *Electronic Purchased Water Adjustment Filing of McKinney Water District* (KY PSC Mar 16, 2022).

⁴⁰ Application at 17, References.

Request, it noted that \$12,364 was misclassified as Miscellaneous Expense in its 2021 Annual Report.⁴¹ Commission Staff reclassified \$12,364 from Miscellaneous Expense to Purchased Power Expense in the Pro Forma.

(J) Taxes other than Income - FICA. In its application, McKinney District proposed to decrease Taxes Other than Income by \$3,838 in order to account for decreases in payroll taxes due to the proposed changes in Salaries and Wages Expense.⁴² However, as explained in Adjustment (D) above, Commission Staff calculated pro forma Salaries and Wages – Employees of \$239,524. Therefore, Commission Staff calculated FICA on wages and decreased Taxes Other Than Income by \$2,686.

Wages	\$	239,524
FICA		0.07650
Total		<u>18,324</u>
Other Misc Taxes		2,502
Pro Forma		<u>20,826</u>
Test Year ()		(23,512)
Decrease ()	\$	<u><u>(2,686)</u></u>

(K) Depreciation Expense. In its application McKinney District reported Depreciation Expense of \$96,622.⁴³ McKinney District decreased its test year depreciation by \$12,799 to reflect adjustments of asset service lives to the midpoint of service life range set forth in the National Association of Regulatory Utility Commissioners' (NARUC) 1979 publication entitled Depreciation Practices for Small Water Utilities (NARUC Study). To evaluate the reasonableness of the depreciation

⁴¹ Response to Staff's First Request, Item 2c.

⁴² Application, Attachment 4, Adjustment B.

⁴³ Application, SAO.

practices of small water utilities, the Commission has historically relied upon NARUC Study. When no evidence exists to support a specific life that is outside the NARUC ranges, the Commission has historically used the midpoint of the NARUC ranges to depreciate the utility plant. In this proceeding, Commission Staff found no evidence to support depreciable lives that vary significantly from the midpoint of the NARUC ranges. Therefore, Commission Staff agrees with McKinney District’s proposed adjustment and decreased pro forma Depreciation Expense \$12,799 accordingly.

(L) Proposed Index Adjustments. In its application, McKinney District proposed \$15,770 in expense increases, as shown below, based on the September 2022 Producer Price Index year-to-year change in Final Demand Goods and the September 2022 Producer Price Index year-to-year change in Final Demand Services.

Expense Category	Amount	Index
Materials and Supplies	\$ 8,678	Goods (11.3%)
Contractual Services - Accounting	448	Services (6.8%)
Contractual Services - Other	3,980	Services (6.8%)
Transportation Expense	1,104	Services (6.8%)
Insurance - General Liability	276	Services (6.8%)
Insurance - Other	488	Services (6.8%)
Miscellaneous Expense	796	Services (6.8%)
Total	\$ 15,770	

Commission Staff disagreed with McKinney District’s methodology. The Commission previously determined that “while such projections may be acceptable when an applicant bases its application upon a forecasted test period, they are not when the basis for the proposed rate adjustment is a historical test period.”⁴⁴ Since McKinney

⁴⁴ Case No. 2008-00563, *Application of Water Service Corporation of Kentucky for an Adjustment of Rates* (Ky. PSC Nov. 9, 2009), at 9–13.

District filed an Alternative Rate Case (ARF), Commission regulation 807 KAR 5:076, Section 9 requires the usage of a historical test period. Pro forma adjustments in a historical test year must be known and measurable changes from the test year amount. Therefore, Commission Staff does not recommend an adjustment to account for the increase in prices due to inflation and recommends the proposed adjustment be denied.

OVERALL REVENUE REQUIREMENT AND REQUIRED REVENUE INCREASE

The Commission has historically applied a Debt Service Coverage (DSC) method to calculate the Overall Revenue Requirement of water districts and water associations. This method allows for recovery of (1) cash-related pro forma operating expenses; (2) recovery of depreciation expense, a non-cash item, to provide working capital;⁴⁵ (3) the average annual principal and interest payments on all long-term debts; and (4) working capital that is in addition to depreciation expense.

⁴⁵ The Kentucky Supreme Court has held that the Commission must permit a water district to recover its depreciation expense through its rates for service to provide internal funds for renewing and replacing assets. See *Public Serv. Comm'n of Kentucky v. Dewitt Water Dist.*, 720 S.W.2d 725, 728 (Ky. 1986). Although a water district's lenders require that a small portion of the depreciation funds be deposited annually into a debt reserve/depreciation fund until the account's balance accumulates to a required threshold, neither the Commission nor the Court requires that revenues collected for depreciation be accounted for separately from the water district's general funds or that depreciation funds be used only for asset renewal and replacement. The Commission has recognized that the working capital provided through recovery of depreciation expense may be used for purposes other than renewal and replacement of assets. See Case No. 2012-00309, *Application of Southern Water and Sewer District for an Adjustment in Rates Pursuant to the Alternative Rate Filing Procedure for Small Utilities* (Ky. PSC Dec. 21, 2012).

	McKinney Water District	Commission Staff	
Pro Forma Operating Expenses	\$ 961,672	\$ 979,983	
Plus: Average Annual Principal and Interest Payments	66,916	66,916	(1)
Additional Working Capital	13,383	13,383	(2)
Overall Revenue Requirement	1,041,971	1,060,282	
Less: Other Operating Revenue	(59,818)	(26,696)	
Interest Income	(1,331)	(1,331)	
Revenue Required from Rates	980,822	1,032,255	
Less: Pro Forma Present Rate Service Revenues	(917,275)	(974,877)	
Required Revenue Increase	<u>\$ 63,547</u>	<u>\$ 57,378</u>	
Percentage Increase	<u>6.93%</u>	<u>5.89%</u>	

1. Average Annual Principal and Interest Payments. At the time of Commission Staff's review, McKinney District had four outstanding loans from the United States Department of Agriculture Rural Development (RD).⁴⁶ McKinney District requested recovery of the average annual principal and interest on its indebtedness based on a five-year average of the annual principal, and interest and fee payments for the years 2023 through 2027.⁴⁷ Commission Staff agrees with the methodology McKinney District proposed and included \$66,916 in the calculation of the revenue requirement.

2. Additional Working Capital. The DSC method, as historically applied by the Commission, includes an allowance for additional working capital that is equal to the minimum net revenues required by a district's lenders that are above its average annual debt payments. In its exhibits, McKinney District requested recovery of an allowance for working capital that is equal to 120 percent of its average annual debt payments, or

⁴⁶ Application, Table B, Debt Service Schedule.

⁴⁷ Application, Table B, Debt Service Schedule.

\$13,383.⁴⁸ RD requires that McKinney 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 of including additional working capital, Commission Staff agrees with McKinney District's proposed \$13,383 working capital adjustment and included it in the revenue requirement.

SUPPLEMENTAL COMMISSION STAFF COMMENTS

McKinney District stated that none of its employees receive benefits.⁴⁹ Commission Staff notes that a substantial majority of entities that are under Commission jurisdiction reflect in their annual reports and rate cases that they pay medical benefits and many pay retirement benefits. McKinney District reported six employees during 2022, three of which have been employed by McKinney District between 18 to 21 years, and three of which were hired during 2021. Commission Staff recommends that McKinney District either consider providing employee medical and retirement benefits to be more competitive long term in the labor market or consider pursuing a merger partner to both leverage cost structures and to provide facilitate providing better opportunities for its employees.

⁴⁸ Application, Table B, Debt Service Schedule.

⁴⁹ Response to Staff's First Request, Item 1.e.

Signatures

/s/ Jeff Abshire

Prepared by: Jeff Abshire
Revenue Requirement Branch
Division of Financial Analysis

/s/ Noah Abner

Prepared by: Noah Abner
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/s/Eddie Beavers

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Rate Design Branch
Division of Financial Analysis

APPENDIX

APPENDIX TO COMMISSION STAFF'S REPORT OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2022-00400 DATED MAY 16 2023

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

5/8- x 3/4-Inch Meter

First	1,000 Gallons	\$15.89	Minimum Bill
Next	2,000 Gallons	0.01004	Per Gallon
Next	7,000 Gallons	0.00855	Per Gallon
Over	10,000 Gallons	0.00783	Per Gallon

1-Inch Meter

First	5,000 Gallons	\$53.06	Minimum Bill
Next	5,000 Gallons	0.00855	Per Gallon
Over	10,000 Gallons	0.00783	Per Gallon

2-Inch Meter

First	20,000 Gallons	\$167.31	Minimum Bill
Over	20,000 Gallons	0.00783	Per Gallon

Water Loss Surcharge

\$4.05 Per Meter

To be collected for 48 months or until a total amount of \$362,362 is collected for water loss reduction.

Nonrecurring charges

Delinquent Charge	\$22.50
Meter Reread Charge	\$22.50
Paycall	\$24.00
Returned Check Charge	\$10.00
Reconnect Charge	\$34.50
Service Investigation Charge	\$22.50
TAP FEES	

5/8- x 3/4-Inch Meter

\$1,421.33

1-Inch Meter

\$1,960.85

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