

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)	

ORDER

On November 29, 2022,¹ McKinney Water District (McKinney District) filed its application with the Commission requesting an adjustment to its water rates pursuant to 807 KAR 5:076. McKinney District filed this proceeding in compliance with the final Order in Case No. 2022-00048.² In that proceeding, McKinney District was ordered to file an application by March 16, 2023, for either a general adjustment in rates or for an alternative rate adjustment (ARF) to ensure its revenue is sufficient to support adequate and reliable service.

In its application, McKinney District requested rates that would increase its annual water sale revenues by \$63,547, or a 6.93 percent increase to pro forma present rate water sale revenues.

To ensure the orderly review of the application, the Commission established a procedural schedule by Order dated December 22, 2022, which, among other things, required the Commission Staff to file a report containing its findings regarding McKinney

¹ 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, 2023.

² Case No. 2022-00048, *Electronic Purchased Water Adjustment Filing of McKinney Water District* (Ky. PSC Mar. 16, 2022), Order at 6, ordering paragraph 5.

District's application. McKinney District responded to two requests for information from Commission Staff.

On May 16, 2023, Commission Staff issued its report (Commission Staff's Report) summarizing its recommendations regarding McKinney District's requested rate adjustment. In the Commission Staff's Report, Commission Staff recommended that McKinney District's adjusted test-year operations support an overall revenue requirement of \$1,060,282, and that an annual revenue increase of \$57,378, or 5.89 percent, is necessary to generate the overall revenue requirement. In the absence of a cost of service study (COSS), Commission Staff allocated its recommended revenue increase evenly across the board to calculate its recommended water rates. In its application, McKinney District requested that it be allowed to collect a water loss surcharge of \$3.44 per bill. Commission Staff also recommended an adjusted surcharge of \$4.05 per active meter for 48 months.

On May 22, 2023, McKinney District filed its response to Commission Staff's Report. McKinney District stated that it did not agree with Commission Staff's removal of certain labor expenses from Nonrecurring Charges; however, McKinney District stated that it would not contest the adjustment.³ McKinney District also did not agree with Commission Staff's removal of certain adjustments to materials and contractual services expenses based upon changes in the Producers Price Index; however, McKinney District stated that it would not contest the adjustment.⁴ McKinney District concurs with the

³ McKinney District's Response to Commission Staff's Report (filed May. 22, 2023), Item 1.

⁴ McKinney District's Response to Commission Staff's Report (filed May. 22, 2023), Item 2.

remainder of the recommendations presented in the Commission Staff's Report.⁵ With its response, McKinney District waived its right to request an informal conference or formal hearing in this case.⁶ The case now stands submitted for a decision by the Commission.

LEGAL STANDARD

Alternative rate adjustment proceedings, such as this one, are governed by Commission regulation 807 KAR 5:076, which establishes a simplified process for small utilities to use to request rate adjustments, with the process designed to be less costly to the utility and the utility ratepayers. The Commission's standard review of a utility's request for a rate increase is well established. In accordance with KRS 278.030 and case law, McKinney District is allowed to charge its customers "only fair, just and reasonable rates."⁷ Further, McKinney District bears the burden of proof to show that the proposed rate increase is just and reasonable under KRS 278.190(3).

BACKGROUND

McKinney District is a water utility organized pursuant to KRS Chapter 74. It owns and operates a water distribution system through which it provides water service to approximately 1,841 residential customers and 23 commercial customers in Lincoln and Casey counties, Kentucky.⁸ McKinney District does not produce any of its own water; rather, it purchases its water from the cities of Stanford and Eubank. A review of the

⁵ McKinney District's Response to Commission Staff's Report (filed May 22, 2023), Item 3.

⁶ McKinney District's Response to Commission Staff's Report, Item 4.

⁷ *City of Covington v. Public Service Commission*, 313 S.W.2d 391 (Ky. 1958); and *Public Service Comm'n v. Dewitt Water District*, 720 S.W.2d 725 (Ky. 1986).

⁸ 2021 Annual Report at 12 and 49.

Commission’s records indicates that this is McKinney District’s first alternative rate adjustment since March 2016.⁹

UNACCOUNTED-FOR WATER LOSS

Pursuant to 807 KAR 5:066, Section (6)3, water loss is limited to 15 percent for ratemaking purposes. The Commission Staff’s Report noted that McKinney District’s reported test-year water loss was 31.6879 percent.¹⁰ At a 31.6879 percent water loss, the annual cost of water loss in excess of 15 percent is \$90,664, and the total annual cost of water loss to McKinney District is \$172,159 as calculated in the table below.

	<u>Purchased Water</u>	<u>Purchased Power</u>	<u>Total</u>
Test-Year Water Purchases and Pumping Costs	\$ 530,930	\$ 12,364	\$ 543,294
Multiplied by: Water Loss In Excess of 15%	16.6879%	16.6879%	16.6879%
Cost of Line loss in Excess of the 15% Limit	<u>\$ 88,601</u>	<u>\$ 2,063</u>	<u>\$ 90,664</u>
Test-Year Water Purchases and Pumping Costs	\$ 530,930	\$ 12,364	\$ 543,294
Multiplied by: Test Year Water Loss Percentage	31.6879%	31.6879%	31.6879%
Total Cost of Line Loss	<u>\$ 168,241</u>	<u>\$ 3,918</u>	<u>\$ 172,159</u>

The Commission is placing greater emphasis on monitoring utilities that consistently exceed the 15 percent unaccounted-for water loss threshold. In recognition of this, McKinney District requested to implement a water loss reduction surcharge in its application. The Commission strongly encourages McKinney District to study its system to identify the sources of unaccounted-for water loss. This is the logical first step toward developing the comprehensive plan to improve McKinney District’s infrastructure and eliminate the identified sources of excessive water loss as discussed in more detail below.

⁹ Case No. 2015-00331, *Alternative Rate Adjustment of McKinney Water District* (Ky. PSC Mar 3, 2016).

¹⁰ *Annual Report of McKinney District to the Public Service Commission for the Calendar Year Ended December 30, 2021* (2021 Annual Report) at 57.

TEST PERIOD

The calendar year ended December 31, 2021, was used as the test year to determine the reasonableness of McKinney District's existing and proposed water rates, as required by 807 KAR 5:076, Section 9.

SUMMARY OF REVENUE AND EXPENSES

The Commission Staff's Report summarizes McKinney District's pro forma income statement as follows:

	<u>Commission Staff's Report</u>		
	<u>Test-Year Operations</u>	<u>Pro Forma Adjustments</u>	<u>Pro Forma Operations</u>
Operating Revenues	\$ 977,093	\$ 24,480	\$ 1,001,573
Operating Expenses	1,049,008	(69,025)	97,9983
Net Utility Operating Income	(71,915)	93,505	21,590
Interest Income	1,331	-	1,331
Total Utility Operating Income	<u>\$(70,584)</u>	<u>\$ 93,505</u>	<u>\$ 22,921</u>

REVIEW OF COMMISSION STAFF'S
RECOMMENDATIONS

McKinney District's proposed adjustments to revenues and expenses reflect current and expected operating conditions. In the Commission Staff's Report, Commission Staff proposed additional adjustments. The Commission accepts the recommendations contained in the Commission Staff's Report. The Commission has no further modifications.

	Test Year	Commission Staff's Proposed Adjustments	Final Pro Forma
Operating Revenues			
Sales of Water	\$917,275	\$ 57,602	\$974,877
Late Payment Penalties	22,050	(4,696)	17,354
Other Water Revenues	35,968	(22,050)	
		(6,376)	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)	
		(5,985)	233,539
Salaries and Wages - Commissioners	20,800	(2,800)	18,000
Employee Pensions and Benefits	0	0	0
			0
			0
Purchased Water	464,375	66,555	
		(88,601)	442,329
Purchased Power for Pumping		12,364	
		(2,063)	10,301
Materials and Supplies	76,795	(13,965)	
			62,830
Contractual Services - Accounting	6,590		6,590
Contractual Services - Other	58,531		58,531
Transportation Expense	16,238		16,238
Insurance - General Liability	4,052		4,052
Insurance - Other	7,177		7,177
Bad Debt Expense	7,046		7,046
Miscellaneous Expense	25,065	(12,364)	12,701
Total Operation and Maintenance Expenses	932,874	(53,540)	879,334
Taxes Other Than Income	23,512	(2,686)	20,826
Depreciation	92,622	(12,799)	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

Billing Analysis. McKinney District provided usage data by meter size, listing the water usage and water sales revenue for the 12-month test year. Commission Staff calculated the data provided within a normalized billing analysis and determined that

annual base rate revenues of \$974,877 for all retail customers is an accurate representation of the normalized test-year revenue from water sales. In the Commission Staff's Report, Commission Staff recommended an increase to McKinney District's test-year Water Sales Revenue of \$57,602.¹¹ The Commission finds that this adjustment is reasonable because an examination of McKinney District's billing analysis was completed by Commission Staff and a normalized revenue was based on the information provided.

Late Payment Fees. In the Commission Staff's Report, Commission Staff recommended reducing McKinney District's Late Payment Penalties Revenue by \$4,696¹² to reflect McKinney District's inclusion of Tap fees as late payment fees, and Commission Staff's adjustment of the amount of late payment revenues that were recorded. The Commission finds that this adjustment to Other Water Revenues is reasonable, since the Uniformed System of Accounting required revenues from water taps to not be treated as revenues but treated as Contributions in Aid of Construction, and should be accepted.

Nonrecurring Charges. In the Commission Staff's Report, Commission Staff recommended reducing McKinney District's Other Water Revenues by \$78 to reflect the removal of estimated labor expenses from the nonrecurring charges and revisions to certain nonrecurring charges.¹³ In its response to Commission Staff's Report, McKinney

¹¹ Commission Staff's Report (Ky. PSC May 16, 2023) at 10–11, Adjustment A.

¹² Commission Staff's Report at 11, Adjustment B.

¹³ Commission Staff's Report at 13–14, Adjustment D.

District disagreed with the removal of the labor expense from its nonrecurring charges but also indicated that it did not wish to contest the adjustments.¹⁴

The Commission agrees with the Commission Staff's Report, which is consistent with recent Commission decisions, that labor expenses resulting from work during normal business hours should not be recovered through nonrecurring charges.¹⁵ The Commission requires that charges be directly related to the actual cost incurred to provide the service. It is unreasonable to allocate an expense already incurred and recovered in customer rates as a day-to-day cost of maintaining a system, such as the salary of a distribution operator, to a nonrecurring service such as the connection and reconnection of a meter during normal working hours. Only the marginal costs related to the service should be recovered through a special nonrecurring charge for service provided during normal working hours. For the reasons discussed above, the estimated labor expenses previously included in determining the amount of nonrecurring charges should be eliminated from the charges as proposed by Commission Staff and a corresponding reduction to Other Operating Revenues should be made to reflect the changes in the

¹⁴ McKinney District's Response to Commission Staff's Report, Item 1.

¹⁵ Case No. 2020-00141, *Electronic Application of Hyden-Leslie County Water District for an Alternative Rate Adjustment* (Ky. PSC Nov. 6, 2020), Order at 19–20.

nonrecurring charges. Thus, the Commission finds the revised nonrecurring charges in the Appendix and the decrease of \$78 to Other Water Revenues to be reasonable.¹⁶

Salaries and Wages – Employees. In the Commission Staff’s Report, Commission Staff recommended a decrease to McKinney District’s Salaries and Wages – Employees of \$6,681¹⁷ to reflect changes in employee wages, the retirement of two employees, and post-test year hours worked. The Commission finds that this adjustment is reasonable since McKinney District provided sufficient evidence for the commission to normalize the salaries and Wages subsequent to the test year, and should be accepted.

Capitalization of Cost of Customer Taps. In the Commission Staff’s Report, Commission Staff recommended the Commission accept McKinney District’s proposed adjustment to decrease test-year Salaries and Wages – Employees by \$5,985, and Materials and Supplies by \$13,965¹⁸ to reflect the capitalization of costs incurred in installation of 19 new water connections. The Commission finds that these adjustments are reasonable since 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, and should be accepted.

¹⁶ See 807 KAR 5:001, Section 16.1.(a); Case No. 2001-00211, *The 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); and Case No. 2019-00080, *Electronic Proposed Adjustment of the Wholesale Water Service Rates of the City of Pikeville to Mountain Water District* (Ky. PSC Dec. 19, 2019).

¹⁷ Commission Staff’s Report at 12–13, Adjustment D.

¹⁸ Commission Staff’s Report at 13, Adjustment E.

Salaries and Wages – Officers. In the Commission Staff's Report, Commission Staff recommended a decrease to McKinney District's Salaries and Wages – Officers of \$2,800¹⁹ to reflect the normalization of the test-year commissioner's salaries restricted to \$3,600 annually per commissioner. The Commission finds that this adjustment is a known and measurable change to Salaries and Wages – Officers, is reasonable since it is the normalization of officer salaries, and should be accepted.

Purchased Water Expense. In Commission Staff's Report, Commission Staff recommended an increase to McKinney District's Purchased Water Expense of \$66,555²⁰ to reflect the normalization of Purchased Water Expense. The Commission finds that this adjustment is reasonable, since McKinney District provided sufficient evidence for the Commission to normalize Purchased Water Expense, and should be accepted.

Excess Water Loss. McKinney District's test year water loss was 31.6879 percent. 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. In the Commission Staff's Report, Commission Staff recommended a decrease to McKinney District's Purchased Water Expense of \$88,601 and Purchased Power Expense of \$2,063²¹ to reflect the costs associated with the production of water in excess of 15 percent water loss. The Commission finds that this adjustment to Purchased Water Expense and Purchased Power Expense is reasonable, because of 807 KAR 5:066 limits water loss recovery to 15 percent, and should be accepted.

¹⁹ Commission Staff's Report at 13–14, Adjustment F.

²⁰ Commission Staff's Report at 14–15, Adjustment G.

²¹ Commission Staff's Report at 15, Adjustment H.

Purchased Power for Pumping – Reclassification. In Commission Staff's Report, Commission Staff recommended an increase to Purchased Power for Pumping of \$12,364 and decreased miscellaneous Expense of \$12,364²² to reflect the correction of the misclassification of purchased power into the correct account. The Commission finds that this adjustment is a known and measurable change to Purchased Power for Pumping, is reasonable in order to properly record expenses in the correct category, and should be accepted.

Taxes Other than Income – FICA. In Commission Staff's Report, Commission Staff recommended a decrease to McKinney District's Taxes Other than Income Expense of \$2,686²³ to account for the decreased contribution amount of pro forma Salaries and Wages Expense adjustment multiplied by the FICA percentage rate of 7.65 percent. The Commission finds that this adjustment is reasonable since it is a result of changes to Salaries and Wages – Employees; and should be accepted.

Depreciation. In the Commission Staff's Report, Commission Staff recommended the Commission accept McKinney District's proposed adjustment to decrease test-year depreciation expense of \$96,622 by \$12,799 to a pro forma level of \$79,823.²⁴ McKinney District's proposed adjustment is consistent with Commission precedent of using the depreciation life ranges contained in the report published in 1979 by the National Association of Regulatory Utility Commissioners (NARUC) titled *Depreciation Practices for Small Water Utilities* (NARUC Study) to evaluate the depreciation lives used by the

²² Commission Staff's Report at 15–16, Adjustment I.

²³ Commission Staff's Report at 16, Adjustment J.

²⁴ Commission Staff's Report at 16–17, Adjustment K.

water utilities under its jurisdiction.²⁵ When no evidence exists to support a specific life that is inside or outside of the NARUC Study ranges, the Commission has historically used the midpoint of the NARUC Study depreciation ranges to depreciate water assets.²⁶ The Commission agrees that the adjustment to Depreciation expense is reasonable and should be accepted.

Proposed Index Adjustments. In Commission Staff's Report, Commission Staff disagreed with McKinney District's proposed adjustments to several expense accounts based upon the September 2022 Producer Price Index year-to-year change in Final Demand Goods and Final Demand Services.²⁷ In an ARF rate case, adjustments must be based upon a historic test period and known and measurable changes that are supported by substantial evidence. The Commission finds that McKinney District's proposed adjustments are based on an index and not based on known and measurable changes to actual expenses incurred by McKinney District, and thus are not supported by substantial evidence. For this reason, the Commission finds that the adjustments proposed by McKinney District should be denied, and the recommendation made in the Commission Staff's Report should be accepted.

Based upon the Commission's findings discussed above, the following table summarizes McKinney District's adjusted pro forma:

²⁵ Case No. 2016-00163, *Alternative Rate Adjustment Filing of Marion County Water District* (Ky. PSC Nov. 10, 2016); 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. 2020-00311, *Electronic Application of Cawood Water District for an Alternative Rate Adjustment* (Ky. PSC Apr. 8, 2021).

²⁶ Case No. 2020-00290, *Electronic Application of Bluegrass Water Utility Operating Company, LLC for an Adjustment of Rates and Approval of Construction* (Ky. PSC Sept. 2, 2021).

²⁷ Commission Staff's Report at 17–18, Adjustment L.

	<u>Commission Staff's Pro Forma</u>	<u>Commission Adjustments</u>	<u>Final Pro Forma</u>
Total Operating Revenues	\$ 1,001,573	-	\$1,001,573
Utility Operating Expenses	<u>979,983</u>	<u>-</u>	<u>979,983</u>
Net Utility Operating Income	21,590	-	21,590
Interest and Dividend Income	<u>1,331</u>	<u>-</u>	<u>1,331</u>
Total Utility Operating Income	<u>\$22,921</u>	<u>-</u>	<u>\$22,921</u>

OVERALL REVENUE REQUIREMENT

Commission Staff's Report recommended using the Debt Service Coverage (DSC) method to calculate the Overall Revenue Requirement. 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; (3) the average annual principal and interest payments on all long-term debts; and (4) working capital that is in addition to depreciation expense. The Commission agrees with using the DCS methodology since McKinney District has four long-term debts.

Based upon the Commission determinations herein, McKinney District requires an increase in revenues from water sales of \$57,378, or 5.89 percent above the pro forma present water rate revenues as calculated below. This increase is required for McKinney District to remain operationally and financially sound and have an opportunity to provide adequate, efficient and reasonable service to its customers.

Pro Forma Operating Expenses	\$ 979,983
Plus: Average Annual Principal and Interest Payments	66,916
Additional Working Capital	<u>13,383</u>
Overall Revenue Requirement	1,060,282
Less: Other Operating Revenue	(26,696)
Interest Income	<u>(1,331)</u>

Revenue Required from Rates	1,032,255
Less: Pro Forma Present Rate Service Revenues	<u>(974,877)</u>
Required Revenue Increase	<u>\$ 57,378</u>
Percentage Increase	<u>5.89%</u>

WATER LOSS SURCHARGE

In the Commission Staff's Report, Commission Staff recommended the Commission approve McKinney District's Water Loss Reduction Surcharge at the recalculated amount of \$4.05 per customer per month for 48 months to help lower system losses to more acceptable levels.²⁸ The surcharge would produce approximately \$90,590²⁹ annually, and \$362,362 in total collections over the 48-year period

The annual surcharge collection reflects the 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.³⁰ In establishing water-loss surcharges, the Commission recognized that the adjustments required to comply with the 15 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

²⁸ Commission Staff's Report at 5, Summary of Findings paragraph 2.

²⁹ \$4.05 x 1,864 customers x 12 months = \$90,590.

³⁰ 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).

Commission to place strict controls governing the surcharge proceeds to ensure their effective use, public acceptance of the surcharge and public confidence in the water utility's use of those funds. In its report titled *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.³¹

Therefore, the Commission finds that a monthly surcharge is a reasonable means for McKinney District to recover the cost for its water leak detection efforts and repairs in order to reduce the increased expense and lost revenue from unaccounted-for water loss. The Commission finds that a monthly water loss reduction surcharge of \$4.05 per customer over 48 months should be approved. The proceeds of McKinney District's Water Loss Reduction Surcharge should be used solely to fund McKinney District's unaccounted-for water loss reduction efforts as set forth in the Commission Staff's Report. McKinney District should be restricted to expending any funds collected under the surcharge subject to authorization by the Commission. McKinney 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

³¹ 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.

proceeds of the requested surcharge. The proceeds from the surcharge should be kept in a separate, interest-bearing account. McKinney District should file an annual report of surcharge activity and water loss improvement progress no later than April 30 of each year. The report should be based on the preceding year ended December 31 with reported surcharge billings and expenditures reflecting the amounts reported for surcharge activity in the financial and statistical Annual Report filed with the Commission and McKinney District's audited financial statements.

RATE DESIGN

The rates and surcharge requested by McKinney District would increase the residential 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. McKinney District proposed to increase its monthly retail water service rates evenly across the board by approximately 6.95 percent. McKinney District has not performed a cost of service study (COSS). McKinney District stated that it did not consider filing a COSS because there have not been any material changes in customer usage patterns to warrant it.

In the Commission Staff's Report, Commission Staff followed the method proposed by McKinney District and allocated Commission Staff's calculated revenue increase across the board to McKinney District's monthly retail water service rates. The Commission finds that in the absence of a COSS, the proposed across-the-board method is an appropriate and equitable method to allocate the increased cost to McKinney District's customers.

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 to recover the required revenue of \$1,032,255 from water sales—an approximate 5.89 percent over normalized test-year water sales of \$974,877.

RATE CASE FREQUENCY

In Case No. 2019-00041 and the resulting investigative report, the Commission discussed the problems that can occur when utilities avoid a review of their financial records.³² A key recommendation from that investigative report 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.³³ In light of its findings in Case No. 2019-00041, the Commission noted, in Case No. 2022-00048,³⁴ that McKinney District had not sought a base rate adjustment since 2015.³⁵ It was noted that McKinney District's net income before any capital contributions was negative for the calendar years 2018 through 2020 and there are concerns that McKinney District's cash flows may not be sufficient; therefore, the Commission ordered McKinney District to file an application for general or an alternative rate adjustment within one year of the date of filing of the Order in Case No. 2022-00048.³⁶

The Commission recommends that McKinney District conduct internal financial reviews on an annual basis to ensure that its water rates are sufficient. The Commission also recommends that McKinney District's board of commissioners consider filing periodic

³² Case No. 2019-00041, *Electronic Investigation into Excessive Water Loss by Kentucky's Jurisdictional Water Utilities* (Ky. PSC. Nov. 22, 2019), Order.

³³ Case No. 2019-00041, Nov. 22, 2019 Order.

³⁴ Case No. 2022-00048, Mar. 16, 2022 Order.

³⁵ Case No. 2022-00048, Mar. 16, 2022 Order at 3.

³⁶ Case No. 2022-00048, (Mar. 16, 2022) Order at 6, ordering paragraph 5.

rate cases with the Commission every three to five years and implement a written policy to that effect to maintain a regular review of McKinney District's finances.

SUMMARY

After consideration of the evidence of record and being otherwise sufficiently advised, the Commission finds that the recommendations contained in the Commission Staff's Report are supported by the evidence of record and are reasonable. The Commission has historically used a DSC method to calculate the revenue requirement for water districts or associations with outstanding long-term debt. Therefore, applying the DSC method to McKinney District's pro forma operations results in an Overall Revenue Requirement of \$1,060,282, a required revenue from water sales of \$1,032,255, and an increase in revenue from water sales of \$57,378, or 5.89 percent.

McKinney District responded to Commission Staff's First Request that the most appropriate effective date for any increase in monthly or nonrecurring charges should be effective on the 15th of the month. The Commission agrees that McKinney District's request is reasonable and therefore the effective date for the monthly water service rates and the nonrecurring charges will be September 15, 2023.³⁷

The Commission further finds that McKinney District should be authorized to assess a Water Loss Reduction Surcharge of \$4.05 per active meter per month for 48 months, or until \$362,362 has been assessed, whichever occurs first. The Commission shall open a separate case to monitor the surcharge collection and expenses with the following conditions:

³⁷ McKinney District's Response to Commission Staff's First Request for Information (filed Feb. 6, 2023), Item 9.

1. Within 120 days of the date of this Order, McKinney District should file with the Commission a qualified infrastructure improvement plan, including a comprehensive unaccounted-for water loss reduction plan that establishes priorities and a time schedule for eliminating each source of unaccounted-for water loss, and provide a detailed spending plan for the proceeds of a surcharge.

2. McKinney District should deposit surcharge collection in a separate interest-bearing account.

3. On the 15th day of each month for 48 months from the date of service of this Order or until all surcharge proceeds are expended, McKinney District should file a monthly activity report with the Commission that includes a statement of monthly surcharge billings and collections; a monthly surcharge bank statement; and a list of all payments made for the month from the surcharge account that includes the following for each payment: the payee, a description of the purpose, and the supporting invoice.

4. McKinney District should file monthly water loss reports with the Commission.

5. McKinney District should not use any surcharge proceeds for reimbursement of unaccounted-for water loss reduction expenses without prior Commission authorization. .

6. McKinney District's surcharge and water loss detection and repair program should be subject to annual Commission reviews that will examine the progress of the water loss detection and repair program and expenditures made with surcharge proceeds and consider adjustments to the program and the surcharge amount.

7. McKinney District's failure to comply with any conditions attached to the assessment of the surcharge will result in termination of the surcharge and the refund of collected surcharge proceeds disbursed on expenses or projects outside the scope of the expenses and projects approved by the Commission.

IT IS THEREFORE ORDERED that:

1. The recommendations contained in the Commission Staff's Report are adopted and incorporated by reference into this Order as if fully set out herein.

2. The water service rates proposed by McKinney District are denied.

3. The rates set forth in the Appendix to this Order are approved for service rendered by McKinney District on and after September 15, 2023.

4. The Nonrecurring Charges set forth in the Appendix to this Order are approved for service rendered by McKinney District on and after September 15, 2023.

5. Within 20 days of the date of service of this Order, McKinney District shall file with this Commission, using the Commission's electronic Tariff Filing System, new tariff sheets setting forth the rates and charges approved by this Order and the effective date of September 15, 2023, and stating that the rates and charges were authorized by this Order.

6. McKinney District shall use the midpoint of the depreciable lives of the NARUC Study ranges, as recommended by Commission Staff, to depreciate water plant assets for accounting purposes in all future reporting periods. McKinney District shall not make adjustments to accumulated depreciation or retained earnings to account for this change in the accounting estimate.

7. McKinney District is authorized to assess a monthly Water Loss Reduction Surcharge of \$4.05 per meter per month for 48 months, or until \$362,362 has been assessed, whichever occurs first, to fund its unaccounted-for water loss reduction efforts as set forth in the Commission Staff's Report, subject to the conditions set forth in ordering paragraph 8.

8. The Commission shall open a separate proceeding, Case No. 2023-00194, to monitor the surcharge proceeds collection and expenses, subject to the following conditions:

a. Within 120 days of the date of service of this Order, McKinney District shall file with the Commission a qualified infrastructure improvement plan, including a comprehensive unaccounted-for water loss reduction plan that establishes priorities and a time schedule for eliminating each source of unaccounted-for water loss and provides a detailed spending plan for the proceeds of a surcharge.

b. McKinney District shall deposit surcharge collections in a separate interest-bearing account.

c. On the 15th day of each month for 48 months from the date of this Order or until all surcharge proceeds are expended, McKinney District shall file with the Commission a monthly activity report that includes a statement of monthly surcharge billings and collections using the format in the Surcharge Reporting form³⁸; a monthly surcharge bank statement; and a list of all payments made for the month from the

³⁸ The Surcharge Reporting form can be found at <https://psc.ky.gov/Home/UtilForms> under the Water tab.

surcharge account that includes the following for each payment: the payee, a description of the purpose, and the supporting invoice.

d. On the 15th day of each month for 48 months from the date of service of this Order or until all surcharge proceeds are expended, McKinney District shall file a monthly water loss report, using the format in the Water Use & Loss Calculations form, with the Commission.³⁹

e. McKinney District shall not use any surcharge proceeds for reimbursement of unaccounted-for water loss reduction expenses without prior Commission authorization.

f. McKinney District shall consider all surcharge collections as contributions and shall account for them in the manner that the Uniform System of Accounts for Class A and B Water Districts and Associations prescribes.

g. McKinney District shall debit monthly billings for the surcharge to customers' accounts received and credit the contribution account.

h. When McKinney District collects the surcharge from the customers, it shall debit special funds and credit the customer account.

i. No later than April 30 of each year, McKinney District shall file in Case No. 2023-00194 a report of surcharge activity and water loss improvement progress based on the preceding year ended December 31 with reported annual surcharge billings collections, and deposits, as well as expenditures reflecting the amounts reported for surcharge activity in the financial and statistical Annual Report filed with the Commission and McKinney District's audited financial statements. Cumulative surcharge billings and

³⁹ The Water Use & Loss Calculations form can be found at <https://psc.ky.gov/Home/UtilForms> under the Water tab.


expenditures over the life of the surcharge shall also be included, as well as a schedule of the estimated and actual progress of the water loss detection and repair program. This report shall include encumbered amounts of future surcharge proceeds for the purpose of evaluating whether adjustments to the program or to the surcharge amount shall be provided.

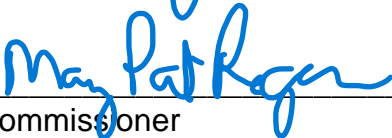
9. McKinney District's failure to comply with the conditions set forth in ordering paragraph 8 shall result in termination of the surcharge and the refund of collected surcharge proceeds disbursed on expenses or projects outside the scope of expenses and projects approved by the Commission.

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

PUBLIC SERVICE COMMISSION

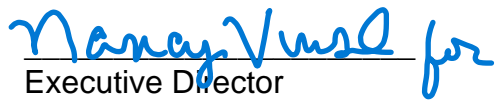

Chairman


Vice Chairman


Commissioner

ENTERED
SEP 01 2023 rcs
KENTUCKY PUBLIC
SERVICE COMMISSION

ATTEST:


Executive Director

APPENDIX

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2022-00400 DATED SEP 01 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
Pay-call Charge	\$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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