

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF SOUTH SHORE WATER)
WORKS COMPANY FOR AN ADJUSTMENT OF) CASE NO. 2011-00039
RATES)

ORDER

South Shore Water Works Company ("South Shore") has applied for an adjustment of rates to increase its annual operating revenues by \$220,450, or 33.9 percent, over South Shore's normalized revenues from rates of \$650,297.¹ By this Order, we establish rates that will generate annual revenues of \$198,737, or 31.4 percent, over Staff's normalized revenue from rates of \$632,614.²

BACKGROUND

South Shore, a Kentucky corporation, is a utility subject to Commission jurisdiction.³ It owns and operates facilities that treat and distribute water to approximately 2,282 retail customers in Greenup and Lewis counties, Kentucky.⁴ It last applied for a rate adjustment in 2007.⁵

¹ Application, Exhibit 15, Revenue Requirement.

² \$629,080 (Operating Revenue – Water) + \$3,534 (Fire Hydrant Revenue) = \$632,614.

³ KRS 278.010(3)(d).

⁴ *Annual Report of South Shore Water Company to the Public Service Commission of the Commonwealth of Kentucky for the Calendar Year Ended December 31, 2010* at 5 and 30.

⁵ Case No. 2007-00199, *An Adjustment of Rates of South Shore Water Works Co.* (Ky. PSC Mar. 24, 2008).

PROCEDURE

On February 3, 2011, South Shore filed its application for rate adjustment with the Commission. This application is based upon a 12-month historical period ending December 31, 2010. On March 10, 2011, the Commission initiated this proceeding and, pursuant to KRS 278.190(3), suspended the operation of South Shore's proposed rates. On April 7, 2011, the Commission authorized the Attorney General's ("AG") full intervention in this proceeding. On June 27, 2011, following discovery, Commission Staff released a report of its findings and recommendations concerning South Shore's application.

On July 11, 2011, South Shore submitted a written response to Commission Staff's report in which it generally adopted the report's findings and recommendations, with certain exceptions. Acknowledging that "[t]here were not facts in dispute in this proceeding," South Shore requested that this matter be submitted for decision on the basis of the existing record. The AG subsequently advised the Commission of his agreement with the submission of this case on the existing record.

DISCUSSION

In its report, Commission Staff recommended rates for South Shore that would generate \$831,351 in revenues, an increase of \$198,737, or 31.4 percent, over normalized revenues from rates of \$632,614. Commission Staff found that, based upon adjusted test-year operations, South Shore had reasonable operating expenses of \$707,105. It further found that South Shore's revenue requirement should be determined by applying an operating ratio of 88 percent to this expense level.⁶

⁶ In reaching its revenue requirement, Commission Staff also considered non-operating revenues, revenues from nonrecurring charges, interest expense, and an allowance for income tax expense.

While generally agreeing with Commission Staff's findings and recommendations, South Shore stated objections to Commission Staff's recommendations regarding the appropriate level of salaries and wages, depreciation expense, and amortization expenses. As South Shore has adopted all other Commission Staff findings and recommendations and as we find these other findings are reasonable and supported by the evidence of record, we have accepted these findings and the general methodology that Commission Staff used to derive South Shore's total revenue requirement and will focus our attention on the areas of dispute.

Salaries and Wages. South Shore proposed to increase its test-period salaries and wages expense of \$246,764 by \$17,712 to reflect: (1) hiring a new employee on August 4, 2010; (2) increasing an employee's work days from 4 to 5 days per week; (3) the loss of an employee during the test period; and (3) employee wage increases that became effective on January 1, 2011.⁷ During the test period, South Shore paid its president, George Hannah, a salary of \$94,458. As part of its proposed adjustment to test-year salaries and wages, it proposed to increase this salary to \$97,292.⁸

Commission Staff recommended limiting Mr. Hannah's salary to \$63,096. If accepted, this recommendation would result in a pro forma salaries and wages expense of \$227,624, a decrease of \$19,140. Commission Staff's recommendation is based upon a methodology that it has followed since 1996 and which the Commission has consistently accepted. In Case No. 94-188,⁹ Commission Staff and South Shore

⁷ *Id.*, Exhibit 7, Adjustment b.

⁸ *Id.*

⁹ Case No. 94-188, *The Adjustment of Rates of the South Shore Water Works Co.* (Ky. PSC Mar. 8, 1995).

established Mr. Hannah's salary level for ratemaking purposes at \$38,703. Since then, Commission Staff has adjusted this salary level by the annual cost-of-living allowances that South Shore affords to its other employees to determine the appropriate salary level for ratemaking purposes. The Commission has generally accepted this methodology.¹⁰

South Shore objects to Commission Staff's recommendation to limit Mr. Hannah's salary to \$63,096. It asserts that "Mr. Hannah's responsibilities with South Shore cannot be overstated and far exceed the scope of duties customarily performed by utility company officers and executives."¹¹ It states that that evidence in prior Commission proceedings demonstrates "the extent to which Mr. Hannah has been required to perform work that otherwise would have been performed by other employees."¹²

As Mr. Hannah's salary is not the result of an arm's-length transaction, South Shore must demonstrate by substantial evidence that his salary is reasonable. South Shore has failed to make such demonstration.¹³ The record of this proceeding contains virtually no evidence from South Shore on this issue. While South Shore refers to evidence provided in earlier Commission proceedings, it provides no direct

¹⁰ See, e.g., Case No. 2002-00108, *An Adjustment of Rates of The South Shore Water Works Co.* (Ky. PSC Sep. 27, 2002); Case No. 2003-00044, *An Adjustment of Rates of The South Shore Water Works Co.* (Ky. PSC Jul 7, 2003).

¹¹ South Shore's Comments on Commission Staff Report and Request for Submission for Decision Based on the Existing Record ("South Shores' Comments") at 1.

¹² *Id.*

¹³ See, e.g., Case No. 2007-00436, *Application of Farmdale Development Corporation for an Adjustment in Rates Pursuant to the Alternative Rate Filing Procedure for Small Utilities* (Ky. PSC July 30, 2008).

reference to such evidence, offers no explanation of how such evidence would demonstrate the reasonableness of Mr. Hannah's salary level, or indicates a deficiency in Commission Staff's methodology. In the absence of any evidence to the contrary, we find the appropriate compensation level for Mr. Hannah to be \$63,096.

Depreciation. South Shore reported test-period depreciation expense of \$81,079. Commission Staff proposed to reduce depreciation expense by \$8,532 to remove depreciation for plant that has fully depreciated during 2011.¹⁴ South Shore asserts that this proposed adjustment is inconsistent with Commission holdings in prior rate cases involving South Shore and produces a revenue requirement that does not fully reflect South Shore's expenses.¹⁵ It provides, however, no authority in support of this assertion.

Our review of the utility's application confirms Commission Staff's finding that certain plant for which South Shore incurred depreciation expense during the test period is now fully depreciated. Just as this Commission has allowed adjustments to test-period operations to reflect the addition of new equipment and plant acquired after the close of the test period, we find it reasonable to remove depreciation expense on equipment and plant that have fully depreciated after the end of the test period but before the issue of a final decision. To allow recovery of depreciation on such equipment and plant through rates would effectively require ratepayers to pay an expense that the utility is no longer incurring. Rates should reflect current operating conditions to the fullest extent possible. Accordingly, we concur with Commission Staff's recommendation and have reduced depreciation expense by \$8,532.

¹⁴ Commission Staff Report, App. C at 5.

¹⁵ South Shore's Comments at 2.

Amortization. South Shore proposed to increase its test-period amortization expense of \$35,607 by \$711 to a pro forma level of \$36,318. To support its proposed adjustment, South Shore provided an amortization schedule that included amortizing the \$7,500 cost of this case over three years.¹⁶ Commission Staff proposed to decrease amortization expense by \$9,011 to remove amortization for items that have been fully amortized during 2011 and to reflect amortizing the cost of this case over three years.¹⁷ South Shore asserts that this proposed adjustment is inconsistent with Commission holdings in prior rate cases involving South Shore and produces a revenue requirement that does not fully reflect South Shore's expenses.¹⁸ It provides, however, no authority in support of its assertion.

Our review of the utility's application confirms Commission Staff's finding that certain costs which South Shore amortized during the test period are now fully amortized. For the same reasons that we expressed above in regard to depreciation expense, we concur with Commission Staff's proposed reduction of \$9,011 to amortization expense.

SUMMARY

The Commission, having considered the evidence of record and being otherwise sufficiently advised, finds that:

1. The recommendations and findings contained in the Staff Report are supported by the evidence of record and are reasonable.

¹⁶ Application, Exhibits 5 and 11.

¹⁷ Commission Staff Report, App. C at 5-6.

¹⁸ South Shores' Comments at 2.

2. To meet its reasonable operating expenses and depreciation expense and provide for reasonable equity growth, South Shore requires annual revenues from water sales of \$831,351 based upon its adjusted test-period operations.

3. South Shore's proposed rates will produce revenue in excess of \$831,351 and should be denied.

4. The rates set forth in the Appendix to this Order will produce annual revenues of \$831,351 and should be approved for service South Shore renders on and after the date of this Order.

IT IS THEREFORE ORDERED that:

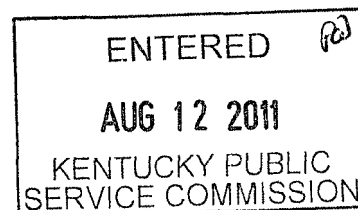
1. The recommendations and findings contained in the Staff Report are adopted and incorporated by reference into this Order as if fully set out herein.

2. South Shore's proposed rates are denied.

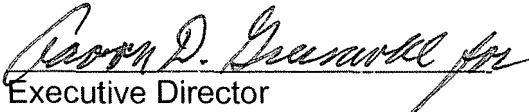
3. The rates set forth in the Appendix to this Order are approved for service that South Shore renders on and after the date of this Order.

4. Within 20 days of the date of this Order, South Shore shall file a revised tariff sheet reflecting the rates approved in this Order.

By the Commission



ATTEST:


Executive Director

APPENDIX

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2011-00039 DATED **AUG 12 2011**

The following rates are prescribed for the customers in the area served by the South Shore Water Works Company. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of the Commission prior to the effective date of this Order.

First	1,000	Gallons	\$	13.07	Minimum Bill
Next	9,000	Gallons	\$	5.59	Per 1,000 Gallons
Over	10,000	Gallons	\$	3.92	Per 1,000 Gallons
Fire Protection			\$	16.12	Per Fire Hydrant

Honorable R. Benjamin Crittenden
Attorney at Law
Stites & Harbison
421 West Main Street
P. O. Box 634
Frankfort, KENTUCKY 40602-0634

Honorable David Edward Spenard
Assistant Attorney General
Office of the Attorney General Utility & Rate
1024 Capital Center Drive
Suite 200
Frankfort, KENTUCKY 40601-8204