COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF CITIPOWER, LLC FOR A RATE ADJUSTMENT FOR SMALL UTILITIES PURSUANT TO 807 KAR 5:076)	CASE NO. 2017-00160

ORDER

On March 31, 2017, Citipower, LLC ("Citipower") tendered its application ("Application") to adjust its base gas rates pursuant to 807 KAR 5:076. After deficiencies were cured, Citipower's Application was accepted for filing on April 28, 2017. Citipower is a Kentucky corporation regulated by the Commission as a utility under KRS 278.010(3)(b), and operates facilities that supply natural gas to approximately 427 customers residing in McCreary County.[1] Citipower last applied for a rate adjustment in 2008.[2] Citipower determined that its pro forma operations support an increase in revenue requirement from base rates of $244,587.[3] The base rates Citipower proposed produce annual base rate revenues of $758,755, an increase of $245,085, or 47.7 percent over normalized test-year base rate revenues of $513,690.[4]

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[1] *Annual Report of Citipower, LLC to the Public Service Commission for the Calendar Year Ended December 31, 2015* ("2015 Annual Report") at 9 and 31.

[2] Case No. 2008-00392, *Application of Citipower, LLC for Rate Adjustment for Small Utilities Pursuant to 807 KAR 5:076* (Ky. PSC Apr. 3, 2009).

[3] Application, ARF Form 1 – Attachment RR-OR – January 2014, Revenue Requirement Calculation – Operating Ratio Method.

[4] Citipower's April 28, 2017 Response to the Commission's April 11, 2017 Deficiency Letter.

PROCEDURAL

By letter dated April 11, 2017, the Commission Staff notified Citipower that its March 31, 2017 Application was rejected for the following deficiencies: (1) the Application was not signed by applicant or officer under oath as required by 807 KAR 5:076, Section 4(1)(a); and (2) the customer notice did not meet the regulatory requirements that are outlined in 807 KAR 5:076, Section 5(4).[5] Citipower was directed to submit the information necessary to cure the deficiencies by April 22, 2017.

A telephonic Informal Conference ("IC") was held on April 19, 2017, for the purpose of discussing Citipower's filing deficiencies, proposed rates, and customer notification. At the IC, Citipower explained that it had realized that the rates proposed in the application would produce revenues in excess of Citipower's requested revenue requirement. On April 20, 2017, Citipower filed a motion requesting a seven-day extension in which to reply to the Commission's deficiency letter, which the Commission granted by its Order dated April 24, 2017.

On April 28, 2017, Citipower submitted its response to the Commission's deficiency letter. The Commission found that Citipower had cured the noted deficiencies and deemed Citipower's Application filed as of April 28, 2017.

To ensure the orderly review of the Application, the Commission established a procedural schedule by Order dated May 10, 2017. The Commission found that pursuant to 807 KAR 5:076, Section 11, a staff report would not be issued, and that the information needed to process this case would be obtained through the Application and Commission Staff's Requests for Information.

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[5] The average customer bill stated in the notice was incorrect.

There are no intervenors in this matter. Citipower responded to two requests for information issued by Commission Staff. The procedural schedule provided Citipower until July 28, 2017, to either request a formal hearing or submit a statement that this case may be submitted for Commission decision based on the existing record. On July 28, 2017, Citipower filed its motion to submit the case for a decision on the merits of the existing record. Citipower stated that the administrative record was complete and that it waived its right to a hearing so that a decision may be given at the Commission's earliest opportunity.

TEST YEAR

The calendar year ended December 31, 2015, is being used as the test year to determine the reasonableness of Citipower's existing and proposed base rates, as required by 807 KAR 5:076, Section 9.

INCOME STATEMENT

Citipower reported actual test-year operating revenues and expenses of $891,692 and $1,086,661, respectively.[6] The only adjustment proposed by Citipower was to increase test-year operating revenues by $245,085 to reflect the impact of the proposed base gas rates.[7] The Commission's review of Citipower's test-year operating revenues and expenses are set forth below.

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[6] Citipower's Responses to the Commission's April 11, 2017 Deficiency Letter, filed April 28, 2017.

[7] *Id.* at Attachment SAO-Gt.

Gas Cost Revenues and Expenses

Citipower based its requested rate increase on its total gas service revenues and operating expenses of $883,162 and $1,086,661, respectively. Included in the gas service revenues are $369,472[8] of revenues that were recovered through Citipower's Gas Cost Recovery ("GCR") mechanism, and operating expenses included natural gas purchases of $352,299.[9]

The Commission's established ratemaking practice is to exclude gas costs that are recovered through the GCR mechanism from the calculation of a gas utility's base rates. Consistent with this established ratemaking practice, the Commission is reducing operating revenues and expenses by $369,472 and $352,299, respectively.

Uncollectible expenses

In the test year, Citipower reported uncollectible expense of $36,747.[10] Upon review of the *Annual Report of Citipower, LLC to the Public Service Commission* for the calendar years ended December 31, 2013 through 2016, the Commission notes that the only year Citipower reported an uncollectible expense was in calendar year 2015. In response to a Commission Staff interrogatory, Citipower explained:

> The write–off amount had been left off of the books of Citipower. During the yearly audit, our auditor suggested that this amount be included. Citipower took the auditor's suggestion and included the write-off amount.[11]

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[8] $883,161 (Reported Revenues from Gas Sales) - $513,690 (Citipower's Billing Analysis) = $369,472.

[9] Application, Pro Forma Operations

[10] *Id.*

[11] Responses to the Commission Staff's First Request for Information ("Staff's First Request"), Item 26.a.

Uncollectible/bad debt expense represents the amount of uncollectible accounts receivable that occurs in a given period.[12] The amount expensed in any given period is derived from, and is entirely dependent upon, the amount of the revenue reported for the same period. If accounts receivable are not written off in the year they are earned, there is a resulting mismatch of revenue and expenses. There are also large fluctuations from year to year in the amounts that are reported as uncollectible expenses. Citipower did not report an uncollectible expense in the three years immediately preceding the test year or the year following the test year, but reported an uncollectible expense of $35,748 in the test year.

In reviewing the auditor's calculation of the test-year uncollectible expense of $35,478,[13] the Commission was unable to determine the years in which the receivables were billed and the amount of uncollectible expense attributable to the test year. Generally, a utility with effective customer deposit and collection policies will realize uncollectible expenses that range from 0.5 to 1 percent of utility service revenues.[14] By applying the mid-point of this range to Citipower's pro forma present rate revenues from gas sales of $813,441,[15] the Commission has determined that $6,101[16] is a

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[12] http://www.investopedia.com/terms/b/bad-debt-expense.asp

[13] Responses to the Staff's First Request, Item 26.b.

[14] Case No. 2012-00433, *Application of West Carroll Water District for an Adjustment in Rates Pursuant to the Alternative Rate Filing Procedure for Small Utilities*, Staff Report on West Carroll Water District (Ky. PSC Jan 29, 2013).

[15] 73,450 Mcf (Test Year Gas Sales) x $4.0810 (Current Tariffed PGA Rate = $299,751 (PGA Revenues) + $513,690 (Base Gas Rate Revenues) = $813,441.

[16] $813,441 (Present Rate Revenues from Gas Sales) x 0.75% (Uncollectible Rate) = $6,101.

reasonable level of uncollectible expense to be recognized for ratemaking purposes. Accordingly, test-year uncollectible expense is being reduced by $29,377.[17]

Administrative Expenses

Citipower reported a test-year administrative and general salaries expense of $189,051,[18] which included an $84,000 management fee paid to its parent CitiEnergy and a $101,136 management consulting expense paid to Paddock Oil and Gas.[19] Citipower pays a monthly management fee of $6,000 to CitiEnergy, but there are 14 monthly payments or $84,000 recorded in the test-year operating expenses.[20]

The services provided by CitiEnergy for the management fee are described as follows: "CitiEnergy manages the administrative tasks of Citipower such as bookkeeping, GCA and other PSC filings, executive managing and strategic planning."[21] The following are the duties performed by Paddock Oil and Gas:

> Manage and oversee the day to day operations of the company; work directly with the Office Manager to ensure the daily office functions are carried out and the necessary records are kept, filed, and stored; work with the field staff to ensure the daily operations of the company are performed in a safe and competent manner; provide cross training of the staff so each of them can perform all necessary field jobs as needed.[22]

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[17] $6,101 (Pro Forma Uncollectibles) - $35,478 (Test-Year Uncollectibles) = $29,377.

[18] *Annual Report of Citipower, LLC to the Public Service Commission for the Calendar Year Ended December 31, 2015* ("2015 Annual Report") at 29.

[19] Response to Staff's First Request, Item 25.c.

[20] *Id.*

[21] Response to Commission Staff's Second Request for Information ("Staff's Second Request"), Item 13.a.

[22] *Id.* at Item 13.b.(2).

In Case No. 2008-00392, the Commission determined "there is no evidence of record to show that the arrangement between Citipower and its parent company was conducted at arms-length, which raises further questions about its necessity as well as its reasonableness."[23] The Commission noted that Citipower's proposed administrative and general salaries, and total administrative and general expenses greatly exceeded what was typically incurred by the other regulated Local Distribution Company of comparable size to Citipower.[24] The Commission ultimately found that Citipower's proposed level of administrative and general salaries was excessive and did not allow rate recovery of the CitiEnergy management fee.[25]

For transactions between a utility and its parent or affiliate, the Commission has historically held that:

> [t]he burden of proof is on the utility to demonstrate that the outcome of the transaction is fair, just and reasonable, and is substantially the equivalent of an arms-length transaction. Moreover, if this burden of proof is not met, the Commission will not allow proposed adjustments resulting from such transactions for rate-making purposes.[26]

Citipower did not perform a time study or other type of analysis to show that an annual management fee of $72,000 is reasonable for a privately owned gas utility of comparable size to Citipower. Although Citipower states that CitiEnergy's $6,000 monthly management fee was "developed by approximating the amount of CitiEnergy-employee time and expense consumed to facilitate the various required needs of

[23] April 3, 2009 Order at 5.

[24] *Id.*

[25] *Id.* at 6.

[26] *See* Case No. 9269, *The Application of Public Service Utilities, Inc., - Boone Creeke for a Rate Adjustment Pursuant to the Alternative Rate Filling for Small Utilities* (Ky. PSC Oct. 2, 1985) at 3.

Citipower,"[27] it did not produce any supporting calculations or assumptions that were relied on by CitiEnergy in developing its management fee. For any cost allocation between affiliates: KRS 278.2207(1)(b) provides, in pertinent part:

> Services and products provided to the utility by an affiliate shall be priced at the affiliate's fully distributed cost but in no event greater than market or in compliance with the utility's existing USDA, SEC, or FERC approved cost allocation methodology.[28]

Citipower has not provided evidence that its proposed management fee allocation complies with KRS 278.2207(1)(b). Further, Citipower has not provided any new evidence in this proceeding to persuade the Commission to deviate from its findings in Case No. 2008-00392 regarding the CitiEnergy management fee. Therefore, based on the evidence of record, the Commission finds that Citipower has not met its burden to show that the management fee is fair, just, and reasonable, and therefore is reducing administrative and general salaries expense by $84,000, the amount reported in the test year.

Outside Services Employed

Citipower reported a test-year expense for outside services employed of $86,025.[29] Citipower recorded in this expense account $31,225 in payments to Noah Patton for mapping services.[30] At the request of the Commission's Inspection Division, the Whitley City Fire Department, and the Whitley County Emergency Medical Services, Citipower hired Mr. Patton to prepare maps of the distribution pipelines and

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[27] Response to Staff's Second Request, Item 13.a.

[28] KRS 278.2207 (1)(b)

[29] 2015 Annual Report at 29.

[30] Response to Staff's First Request, Item 25.d.

the customer service lines.[31] Citipower admitted that the costs incurred to map its system are nonrecurring, but explained:

> Because these expenditures were forced upon the utility by outside entities, and because these expenditures did not improve the operations of the utility, Citipower believes these costs to be relevant in the determination of the new rates.[32]

The Commission is in agreement with Citipower that the cost to map the gas delivery system is a nonrecurring expenditure, but disagrees with Citipower's assessment of its operational significance. An accurate and up-to-date map of Citipower's gas-delivery system will improve its ability to provide safe and dependable gas service to its customers. Furthermore, as shown below, Kentucky regulation, require all utilities under the Commission's jurisdiction to have maps of their systems.

> System Maps and Records. (1) Each utility shall have on file at its principal office located within the state and shall file upon request with the commission a map or maps of suitable scale of the general territory it serves or holds itself ready to serve.[33]

For these reasons, the Commission finds that the cost incurred by Citipower to prepare the system maps is a nonrecurring expenditure that should be amortized rather than recorded as an expense. The Commission is reducing operating expenses by $31,225 and is establishing a regulatory asset for the mapping costs. The amortization of the regulatory mapping asset is discussed in the Amortization section below.

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[31] Response to Staff's Second Request, Item 9.b.

[32] *Id.*

[33] 807 KAR 5:006, Section 23

Employee Health and Dental Insurance

In the test year, Citipower reported paying $24,204[34] in employee health and dental insurance premiums. Citipower paid 100 percent of the premium for employee health insurance coverage, and for the employee dental insurance.[35] The Commission is placing greater emphasis on evaluating employee total compensation packages, including both salary and benefits programs, for market and geographic competitiveness to ensure fair rate development and has determined that in most cases, 100 percent employer-funded health and dental care does not meet that criteria. Citipower should establish a policy of reasonably limiting its employer contributions to health and dental insurance costs by requiring that all employees pay a portion of those premiums. Accordingly, for ratemaking purposes, the Commission will adjust test-year health and dental expenses for all employees based on the national average of employee contribution rates.

The Commission has reduced health insurance cost by $5,700,[36] based on a 21 percent employee contribution rate for single health insurance coverage[37] and a 60 percent employee contribution rate for dental coverage.[38]

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[34] Responses to Staff's Second Request, Item 11. Insurance Premiums: $22,620 (Single Employee Health Insurance) + $1,584 (Dental Insurance) = $24,204.

[35] Responses to Staff's First Request, Item 22.

[36]

$22,620 (Health Insurance) x 21%(Emp. Contribution Rate) =	$	4,750
$1,584 (Dental Insurance) x 60% (Emp. Contribution Rate) =	+	950
Total Adjustment	$	5,700

[37] Bureau of Labor Statistics, Healthcare Benefits, March 2017, Table 10, private industry workers. (https://www.bls.gov/ncs/ebs/benefits/2017/ownership/private/table10a.pdf)

[38] The Willis Benchmarking Survey, 2015, at 62–63. (https://www.willis.com/Documents/publications/Services/Employee_Benefits/20151230_2015WillisBenefitsBenchmarkingSurveyReport.pdf)

Depreciation

Citipower reported a test-year depreciation expense of $90,627.[39] During the test year, Citipower recorded the purchase of $24,327 of power-operated equipment. Because the date the asset was placed into service was during the test year, Citipower recorded only one-half year of depreciation for this asset. Accordingly, the Commission is increasing test-year depreciation expense by $2,432[40] to reflect a full year of depreciation.

Amortization

Citipower reported a test-year amortization expense of $13,188,[41] which was identified in Case No. 2008-00392 as the amortization of a Gas Plant Acquisition Adjustment.[42] The Commission eliminated this expense item from the determination of Citipower's revenue requirement, finding that "[e]xcept in unusual circumstances, which the Commission does not find to exist in this case, this type of expense is not allowed for ratemaking purposes."[43] Citipower has not presented any new evidence to persuade the Commission to deviate from its prior finding, and therefore, the Commission is reducing amortization expense by $13,188. The Commission is increasing amortization expense by $6,753[44] to reflect amortizing the $33,765 cost

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[39] 2015 Annual Report at 26.

[40] $24,327 ÷ 5-Years = $4,865 - $2,433 (Test-Year Depreciation Expense) = $2,432.

[41] 2015 Annual Report at 26.

[42] *See* Case No. 2008-00392 final Order at 7.

[43] *Id.*

[44] $33,765 (Regulatory Asset – Mapping) ÷ 5 Years (Amortization Period) = $6,753.

incurred by Citipower to map its system over five years. The net decrease to amortization expense is $6,435.

Summary Impact of Adjustments

After considering the test-year operating revenues and expenses, including appropriate adjustments found reasonable herein, the Commission has determined that the financial results of Citipower's pro forma test-year operations are as follows:

	Test Year Operations	Pro Forma Adjustments	Pro Forma Operations
Operating Revenues	$ 891,692	$ (369,472)	$ 522,220
Operating Expenses	1,086,662	(509,144)	577,518
Net Operating Income	$ (194,970)	$ 139,672	$ (55,298)

REVENUE REQUIREMENT DETERMINATION

The Commission has historically used an operating-ratio approach to determine revenue requirements for small, privately owned utilities.[45] This approach is used because either no basis for rate-of-return determination exists or the cost of the utility has fully or largely been recovered through the receipt of contributions. Given that Citipower is a small gas distribution system, the Commission finds that this method should be used to determine Citipower's revenue requirement.

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[45] An operating ratio measures the difference between operating revenues and operating expenses. It is defined by the following equation.

$$\text{Operating ratio} \quad \frac{\text{Operation \& Maintenance Exp.} + \text{Depreciation} + \text{Taxes}}{\text{Gross Revenues}}$$

The Commission has found that the operating ratio is a reasonable and necessary alternative to the rate of return method for calculating the allowable net operating income for small investor owned utilities. Specifically, it has found that the rate of return method cannot be used because there is "no basis" upon which to determine a rate of return for these utilities, Case No. 95-236, *Application of Thelma Waste Control, Inc. for a Rate Adjustment Pursuant to the Alternative Rate Filing Procedure for Small Utilities* (Ky. PSC Apr. 15, 1996) at 6. Further, it has found that the operating-ratio method is appropriate when plant investment is low and operating expenses are high, Case No. 7982, *Notice of Application of Fern Lake Company* (Ky. PSC Aug. 27, 1981) at 3.

As shown in the table below, Citipower's pro forma operations combined with an 88 percent operating ratio results in a revenue requirement from base rates of \$647,741, which is an increase of 26.096 percent, or \$134,051, over normalized revenues from existing base rates of \$513,690.

Pro Forma Operating Expenses (Net of Purchased Gas Costs)		577,518
Divide by: Operating Ratio		88%
Total Revenue Requirement - Base Gas Rates		656,271
Less: Other Operating Revenues		(8,530)
Total Revenue Requirement Base Rates		647,741
Less: Operating Revenues (Net of PGA)		(513,690)
Revenue Increase	\$	134,051
% Increase		26.096%

RATES AND RATE DESIGN

Citipower proposed a change in rate design to separate its customers into four rate classes designated individually as Residential, Commercial, Industrial, and Institutional. Citipower's current two rate classes are Residential and Commercial and Industrial and Institutional. Citipower also proposed increases in base rates that allocated more revenue responsibility to the Institutional class. Citipower states the Institutional class's volumes represent the majority its annual sales volumes, and that it spends the most resources to serve Institutional customers.[46] Citipower presented conflicting information with regard to the use of a minimum-bill versus customer-charge format for its proposed rates. Since Citipower's initial application included a proposed tariff setting out a customer charge format with all Mcf billed at a single rate, the

[46] Response to Staff's First Request, Item 4.

Commission finds that such rate design is the expectation of Citipower's customers, is most straightforward, and would still ensure that Citipower collects the proposed monthly amounts if customers have zero usage. The Commission finds Citipower's proposed monthly fixed customer charges of $8.00 for Residential; $15.00 for Commercial and Industrial; and $20.00 for Institutional customers to be reasonable. Volumetric charges for all Mcf sold for each class as set out in the Appendix to this Order are $7.76 per Mcf for Residential; $7.80 per Mcf for Commercial and Industrial; and $8.30 per Mcf for Institutional customers.

SUMMARY

The Commission, after consideration of the evidence of record and being sufficiently advised, finds that:

1. The rates proposed by Citipower would produce revenues in excess of the amount found reasonable herein and should be denied.

2. The rates set forth in the Appendix to this Order are fair, just, and reasonable and should be approved.

IT IS THEREFORE ORDERED that:

1. The rates proposed by Citipower are denied.

2. The rates and charges found reasonable herein and set forth in the Appendix to this Order are approved for service rendered by Citipower on and after the date of this Order.

3. Within 20 days of the date of this Order, Citipower shall file with this Commission, using the Commission's electronic Tariff Filling System, revised tariff

sheets setting out the rates approved herein and reflecting that they were approved pursuant to this Order.

By the Commission

ENTERED

OCT 27 2017

KENTUCKY PUBLIC SERVICE COMMISSION

ATTEST:

Gwen R. Pinson

Executive Director

APPENDIX

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2017-00160 DATED OCT 27 2017

The following rates and charges are prescribed for the customers served by Citipower Corporation. All other rates and charges not specifically mentioned in this Order shall remain the same as those in effect under authority of this Commission prior to the effective date of this Order.

RESIDENTIAL

	Base Rate	Gas Cost Recovery Rate*	Total
Customer Charge	$8.00		
All Mcf	$7.7600	$3.6992	$11.4592

COMMERCIAL AND INDUSTRIAL

	Base Rate	Gas Cost Recovery Rate	Total
Customer Charge	$15.00		
All Mcf	$7.8000	$3.6992	$11.4992

INSTITUTIONAL

	Base Rate	Gas Cost Recovery Rate	Total
Customer Charge	$20.00		
All Mcf	$8.3000	$3.6992	$11.9992

Gas Cost Recovery Rate approved in Case No. 2017-00362 effective October 1, 2017

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