

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

* * * * *

In the Matter of:

APPLICATION OF SOUTH SHORE WATER)
WORKS COMPANY FOR A GENERAL RATE) CASE NO. 9330
INCREASE)

O R D E R

PROCEDURAL BACKGROUND

On May 1, 1985, South Shore Water Works Company ("South Shore") filed an application with the Commission for an adjustment in its rates and charges which would produce an increase in revenues of approximately \$130,537 annually. On October 3, 1985, South Shore placed the Commission on notice of its intent to place the proposed rates and charges in effect on October 23, 1985.

A hearing was held on October 23, 1985, in the Commission's offices in Frankfort, Kentucky, following notice given pursuant to the Commission's regulations. Witnesses appearing for South Shore were: Mr. Joe Hannah, President of South Shore, and Mr. Ova Kimbleton, CPA. There were no intervenors.

This Order addresses the Commission's findings and determinations on issues presented and disclosed in the hearing and investigation of South Shore's revenue requirements. The Commission has granted rates to produce an annual increase of \$34,870 herein. All requested information has been submitted.

Commentary

South Shore provides water service to approximately 1,900 customers in Greenup County, Kentucky. South Shore first provided water service in the late 1920s and was incorporated in 1954. Throughout South Shore's history, company stock has always been closely held within the Hannah family with Joe Hannah being the sole stockholder today. A review of the Annual Reports on file with the Commission indicates that South Shore has consistently operated efficiently without the need to obtain long-term financing other than when the utility purchased treasury stock. The purchase of treasury stock has now occurred three times and is the primary cause of South Shore's depleted financial condition in this rate application. South Shore initially had 250 shares outstanding which has been reduced by the purchase and retirement of treasury stock to 31 1/2 shares with a reduction to South Shore's earnings and a resultant appropriation to South Shore's past stockholders of an estimated \$500,000 in the last 10-12 years. In every instance treasury stock was purchased, South Shore's accumulated earnings were depleted to zero or below. It should also be noted that at the time of the latest purchase of 63 shares of stock for \$200,000, an offer was made to South Shore of \$1.8 million for its entire operation, but was turned down to maintain the family held ownership.

South Shore also operated sewer facilities for some 62 customers until Spring, 1985, when approval was granted for the transfer of these facilities to the City of South Shore in the

Commission's Order in Case No. 9306¹ entered May 30, 1985. All transactions of the sewer operations were removed by South Shore in its pro forma analysis.

The Commission also notes that in 1979 South Shore began adding chemicals to its water supply and in 1981 began to recover these additional costs through an illegal surcharge of 10 cents per 1000 gallons. This surcharge was discontinued in early 1985 subsequent to Case No. 9205.² After analysing the additional costs incurred and the amounts collected from the surcharge in this case and finding them approximately equal, the Commission is of the opinion that no refunds will be required. However, the Commission is placing South Shore on notice that such action in the future will not be tolerated.

In its application South Shore stated that the additional revenues requested were necessary to make improvements to its water system. Mr. Hannah, in his prefiled testimony, stated that the utility was not in compliance with many of the Commission's rules and regulations, i.e., low pressure and discolored water. Mr. Hannah also stated in his testimony that without a rate adjustment, service would continue to deteriorate beyond the already substandard level.

¹ Application to Transfer Sewer Utility Serving Forest Heights Subdivision From South Shore Water Works Company to the South Shore, Greenup County, Kentucky.

² Kentucky Public Service Commission v. South Shore Water Works, Inc.

In its application South Shore proposed to include the cost of several improvements which it believed would alleviate the service concerns identified in Mr. Hannah's testimony. These improvements were as follows:

Storage Tanks	\$ 30,930
Line Relocation	41,447
3 Service Trucks	27,000
Cash Register	1,057
Replace Old Lines	87,816
Computer	15,435
2 Wells	46,420
Artificial Recharge Pit	18,768
Backhoe	34,000
Total	<u>\$302,873</u>

South Shore proposed to complete these improvements over a 5-year period. In lieu of obtaining financing, South Shore proposed a plan which would generate the funds internally through a rate adjustment based on the amortization of the overall cost over a 10-year period calculated at 12 percent. However, even though specifically requested, South Shore did not see the need to file an application for a certificate of public convenience and necessity or a plan of financing. The Commission is of the opinion that final approval for these improvements cannot be granted until such filings are completed.

At the time of the hearing, the initial phase of the line replacement had been substantially completed, the cash register purchased, one service truck purchased and some of the work on the line relocation completed. However, the expenditures generated by these improvements had totally depleted all of South Shore's cash reserves and, as indicated in its letter of October 3, 1985,

placed the utility in an undesirable financial position. South Shore also stated that if the rate adjustment was not granted, service would be severely curtailed. The Commission recognizes that many of the improvements listed are necessary to bring South Shore into compliance with the Commission rules and regulations, but these improvements must be completed in such manner that the best interest of both the utility and the customer are maximized. This maximization requires complete cooperation between and among all parties. The Commission extends its services and the services of its staff to meeting this goal.

ANALYSIS AND DETERMINATION

TEST PERIOD

South Shore proposed the 12-month period ending December 31, 1984, and also January 31, 1985, as test periods in this matter. The billing analysis of South Shore was prepared for the year ended December 31, 1984, and the Commission is of the opinion that the appropriate test period is the 12 months ended December 31, 1984.

VALUATION METHOD

Net Investment

The Commission finds the Net Investment Rate Base determined from South Shore's property devoted to public service as of December 31, 1984, as follows:

Water Utility Plant in Service	\$656,537
Add:	
Allowable Pro Forma Plant Additions	103,268 ³
Water Utility Plant in Service, Adjusted	<u>\$759,805</u>
Add:	
Cash Working Capital	16,520 ⁴
Less:	
Reserve for Depreciation	\$212,854
Contributions in Aid of Construction	231,683
Net Investment Rate Base	<u>\$331,788</u>

REVENUES AND EXPENSES

South Shore showed a net profit for the test period of \$32,610. South Shore proposed several pro forma adjustments to its test period operating revenues and expenses to more accurately reflect current operating conditions. The Commission finds these adjustments reasonable and has accepted them for rate-making purposes with the following exceptions:

Operating Revenues

South Shore showed test period operating revenues of \$185,017 of which \$15,623 represented additional charges to the customers of South Shore during the test period for special chemicals used to prevent discoloration in the water. This

³ Computation of allowable pro forma plant additions:	
Water Utility Plant in Service, September 30, 1985	\$727,951
Water Utility Plant in Service, December 31, 1984	656,537
Increase	<u>\$ 71,414</u>
Capitalized labor - 2 new employees	14,000
Capitalized payroll tax on the new employees	1,595
Waterline relocation previously expensed in 1984	8,209
Chevrolet truck purchased 3/19/85 (not recorded)	8,050
Total	<u>\$103,268</u>
⁴ Computation of cash working capital:	
\$132,161 (operating expenses less depreciation) X 12.5% =	
\$16,520	

special charge was not authorized by the Commission and management discontinued making the charge as of March 1, 1985. Therefore, for rate-making purposes, the Commission has reduced book operating revenues by \$15,623.

Source of Supply Expenses and
Transmission and Distribution Expenses

South Shore made a pro forma adjustment to test period operating expenses of \$10,000 to source of supply expenses and \$10,000 to transmission and distribution expenses which represents the annual salaries of the two additional employees hired in March, 1985. Their primary functions are for new construction and operation and maintenance areas of the water system. During the public hearing, Joe Hannah testified that approximately 70 percent of their time would be devoted to new construction and the remaining 30 percent to meter reading and various maintenance duties.⁵ The Commission has reduced each pro forma salary adjustment of South Shore by \$7,000 which represents the capital portion of the employees salary. Further consideration will be afforded this adjustment in the depreciation expense section of this Order.

The Commission has also made the two following adjustments to test period operating expenses:

1. A reduction in source of supply labor cost of \$6,000 due to Mr. J. Byron Hannah's retirement on March 15, 1985.

⁵ Transcript of Evidence ("T.E."), page 38.

2. A reduction in transmission and distribution expenses of \$8,209 pertaining to waterline relocation cost of highway improvements which was erroneously charged to operating expenses during 1984 by South Shore.⁶ This item will be considered further in the determination of depreciation expense.

Therefore, the adjusted test period expenses related to Source of Supply Expenses is \$6,641 and Transmission and Distribution Expenses is \$17,856, for total reduction of \$28,209.

Purchased Power Expense

South Shore recorded purchased power expense for the test period of \$20,737. In its response to the Commission's request for additional information dated August 7, 1985, South Shore furnished information related to increased power cost for pumping and proposed a pro forma adjustment of \$975. The Commission reviewed the information submitted by South Shore and after annualizing the electric bills for the first 7 months of 1985 arrived at an adjusted purchased power expense of \$21,274.⁷ This results in a reduction of \$438.

Chemical Expense

South Shore had recorded chemical expense for the test period of \$9,296. In its response to the Commission's request for information dated August 7, 1985, South Shore indicated in its answer to question 8c that chemical expense should be reduced by \$566 which would then reflect an average annual cost of chemicals.

⁶ T.E., October 23, 1985, page 51.

⁷ $\$12,410.08 \div 7 = \$1,772.87 \times 12 = \$21,274.$

Therefore, the Commission has reduced the chemical expense by \$566.

Depreciation Expense

South Shore recorded depreciation expense of \$12,114 for the test period. The depreciation schedule for the year ended December 31, 1984, filed with the application of South Shore and identified as Kimbleton Exhibit No. 2, listed several capital items on which depreciation expense was computed using an accelerated method of depreciation. The Commission advised South Shore through its information Order dated August 7, 1985, that it recognizes only depreciation expense computed on the straight-line method for rate-making purposes. South Shore filed its response to the information Order on September 3, 1985, which included a revised depreciation schedule on which South Shore indicated an increase in depreciation expense of \$598 by recomputing all depreciation to the straight-line method.

The Commission in its disallowance of capital items of \$7,000 included in Source of Supply Expenses, \$15,209 in Transmission and Distribution Expenses, \$1,595 in payroll taxes, unrecorded purchase of a Chevrolet pick-up truck of \$8,050 and pro forma capital additions from December 31, 1984, through September 30, 1985, of \$71,414 has allowed a pro forma depreciation expense

adjustment of \$2,709 computed on the basis of South Shore's expected lives for the property being installed.⁸

The Commission has also reduced depreciation expense by \$4,298 in accordance with its established precedent for rate-making purposes that depreciation expense should be computed on the basis of original cost of the plant in service less contributions in aid of construction. The Commission is of the opinion that it is unfair to require ratepayers to provide recovery on that portion of the plant provided free of cost.

Thus, the Commission finds that the appropriate adjusted test period depreciation expense is \$11,123, a reduction of \$1,001.

Payroll Taxes

At the end of the test period, South Shore had payroll taxes of \$8,269. In response to the Commission's request for information which was filed on September 3, 1985, an analysis of payroll taxes indicated that the account included Sales and Use Taxes of \$523. Since South Shore only collects the sales tax on its commercial sales and remits the tax to the Commonwealth of Kentucky, it cannot be considered an expense of the water company and, thus, the Commission has reduced payroll taxes by \$523. The Commission has also made an adjustment of \$683 to payroll taxes based on the expense portion of payroll taxes on the salaries of

⁸ Response to hearing requests filed October 30, 1985, Attachment B.

the two new employees hired in March 1985. Therefore, payroll taxes for the test period have been increased by \$160 to \$8,429.⁹

Rate Case Expense

South Shore proposed a pro forma adjustment of \$1,400 to test period expenses to reflect a 3-year amortization of the \$4,200 estimated cost of this case as shown on Exhibit No. 3 of the application. During the public hearing, South Shore was directed to furnish the Commission with the actual cost of each service performed and included in the rate case expense. After reviewing the information filed October 30, 1985, the Commission bases its computation on the amounts contained in Attachment A of the letter: attorney fees \$1,459, accounting fees \$3,000, administrative costs \$227, totalling \$4,686, or an adjusted annual amortization of \$1,562 over a 3-year period. Thus, the Commission has increased rate case amortization by \$162.

Income From Non-utility Operations

South Shore showed test period income from non-utility operations of \$13,435. In its response to the Commission's request for information, which it filed September 3, 1985, South Shore indicated in Item No. 6b of the response that \$515

⁹ Computation of payroll taxes:

Payroll taxes, per books, December 31, 1985	\$8,269
Add:	
Pro forma payroll tax on salaries of 2 new employees	683
Less:	
Sales and use taxes	(523)
Adjusted payroll taxes	<u>\$8,429</u>

represented rental income of a residential apartment which South Shore had discontinued renting as of February 1985. Also Item 6c of the response stated that the \$2,500 represented a one-time gift from the James E. Hannah Realty Company to help the cash flow of South Shore. These items have been excluded from income from non-utility operations.

As discussed earlier, South Shore transferred its sewer operations to the City of South Shore and agreed to do the monthly billing for the negotiated amount of \$700 per month. During the test period, South Shore received \$7,400 for these services and the Commission has annualized this fee which would add an additional \$1,000 to test period income.¹⁰

Therefore, the adjusted income from non-utility operations is \$11,420. South Shore failed to identify any costs associated with the generation of these non-utility revenues and thus the Commission finds it appropriate to include these revenues in the overall determination of revenue requirements.

Therefore, South Shore's adjusted operations at the end of the test period were as follows:

	<u>South Shore Adjusted</u>	<u>Commission Adjustments</u>	<u>Commission Adjusted</u>
Operating Revenues	\$ 169,394	\$	\$ 169,394
Operating Expenses	184,553	(29,882)	154,671
Net Operating Income	\$ (15,159)	\$ 29,882	\$ 14,723
Other Income	13,444	(2,015)	11,429
Interest Expense	<u>73</u>	<u>30,000</u>	<u>30,073</u>
Net Income (Loss)	<u>\$ (1,788)</u>	<u>\$ (2,133)</u>	<u>\$ (3,921)</u>

¹⁰ \$700 X 12 = \$8,400 - \$7,400 = \$1,000.

RATE OF RETURN

The Commission is of the opinion that South Shore's adjusted operating loss is unfair, unjust and unreasonable. Further, the Commission is of the opinion that a rate of return on net investment of 13.25 percent is fair, just and reasonable for South Shore to earn in that it will allow South Shore to meet its expenses and provide a reasonable surplus for equity growth. Therefore, the Commission finds that South Shore should be permitted to increase its rates to produce an increase in annual revenue of \$34,870¹¹ which includes state and federal income taxes of \$5,631.

NON-RECURRING CHARGES

South Shore has been charging various non-recurring charges that have not been approved by the Commission. The Commission requested and received a description of the work performed and cost justification supporting each item in order that the charges could be considered in the instant case.

South Shore is hereby informed that all its rates and charges must be approved by the Commission, and failure to seek Commission approval is in direct violation of the Kentucky Revised Statutes, Chapter 278 and the Rules and Regulations of the Commission.

¹¹ \$154,671 (adjusted operating expenses) + \$43,962 (13.25 percent allowed return) + \$5,631 (Federal and state income taxes) - \$169,394 (adjusted per books gross revenues) = \$34,870.

Returned Check Fee

South Shore has been charging a returned check fee in the amount of \$6. South Shore provided cost justification for this charge and the Commission has found the charge to be reasonable and that it should be approved.

Reconnect Fee

South Shore has been charging a reconnection fee in the amount of \$10. The cost justification provided by South Shore in support of this fee shows that it is reasonable and should be approved.

New Account Charge

South Shore provided cost justification in support of its new account charge of \$3. The charge is reasonable and should be approved.

Meter Test Fee

The meter test fee in the amount of \$11.50 is reasonable and should be approved. However, this charge can only be applied when a customer requests a meter test and after testing, the meter is found to register within the acceptable range as set out in 807 KAR 5:006, Section 20, Complaint Tests and has been tested within the periodic test interval required by 807 KAR 5:066 (17).

Trailer Guarantee

South Shore currently charges a trailer guarantee charge of \$75 because it considers trailer taps temporary services. This guarantee of \$75 is held by South Shore for a period of 2 years and then refunded without interest.

The Commission is of the opinion that this guarantee should not be approved since it results in an unreasonable prejudice and disadvantage to South Shore's trailer occupants. Furthermore, any trailer customer guarantees held by South Shore at this time should be refunded within 30 days of the date of this Order.

Road Cut and Road Bore

South Shore presently charges \$25 for a gravel road cut and \$80 for a road bore. South Shore has requested a rate of \$20 for a gravel road cut and \$80 for a road bore. The purpose of this work in the installation of service connections for new customers and a charge for this work would be a violation of Section 14(3)(a) of 807 KAR 5:066 which states: "No utility shall charge for the installation or the use of its portion of the service line or of any device for metering service to a customer, except for temporary service...." The propose of charges of \$20 and \$80 should, therefore, be denied.

Late Penalty

South Shore currently charges a late penalty in the amount of 10 percent of the bill owed. South Shore has proposed to continue this penalty to ensure the payment of bills. This penalty is reasonable and should be approved.

Transit Charge

South Shore currently charges a transit charge to move equipment from its storage area to a job site to perform work requested by a customer. South Shore filed cost justification requesting approval of a transit charge in the amount of \$35.

The Commission is of the opinion that any work requested to be performed by a customer such as repairs to the line between the meter and house is between South Shore and the customer. It is the customer's responsibility to maintain that portion of his line and the customer is free to find the lowest price for which the work can be performed. Therefore, the Commission finds that this price is negotiable between South Shore and its customers, but should cover the cost of performing the repairs.

However, the Commission reminds South Shore that it is responsible for its portion of the line and no charges can be made for repairs made on South Shore's side of the meter.

Meter Transfer Charge

South Shore has proposed to continue charging its meter transfer fee in the amount of \$10 which is applicable when a customer moves to a new location. This charge is reasonable and should be approved.

Water Deposit

South Shore currently charges a deposit in the amount of \$15 for residential customers and \$25 for commercial customers. South Shore has proposed to continue its present deposit policy. South Shore's proposed water deposit charges are reasonable and should be approved.

Service Call Charge

South Shore currently charges \$5 for a service call. South Shore has proposed to increase this charge to \$7.50 to cover the costs associated with preparing a service work order including gasoline and time spent at the customer's premises. The

Commission finds that this charge is reasonable unless the service work order is made to correct a problem with South Shore's meter or water lines. With this exception the charge is reasonable and should be approved.

SUMMARY

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

1. The rates proposed by South Shore would produce revenues in excess of the revenues found reasonable herein and should be denied pursuant to KRS 278.030.

2. The rates in Appendix A are the fair, just and reasonable rates to charge for water service rendered to South Shore's customers and should produce annual revenues from water sales of approximately \$196,349.

3. South Shore should file with the Commission an application for a certificate of public convenience and necessity and permanent financing of its anticipated capital improvements as soon as feasible.

4. South Shore's proposed returned check fee is reasonable and should be approved.

5. South Shore's proposed reconnect fee and new account charge is reasonable and should be approved.

6. South Shore's proposed meter test fee is reasonable and should be approved as modified herein.

7. South Shore's proposed trailer guarantee charge is unfair, unjust and should be denied.

8. South Shore should refund any trailer guarantees held at this time within 30 days of the date of this Order.

9. South Shore's proposed charges for a road cut and road bore should be denied.

10. South Shore's proposed late payment penalty is reasonable and should be approved.

11. South Shore's proposed transit charge for work performed on the customer's side of the meter should be negotiated between South Shore and its customer.

12. The proposed meter transfer charge is reasonable and should be approved.

13. South Shore's proposed water deposit charges are reasonable and should be approved.

14. South Shore's proposed service call charge should be approved as modified herein.

IT IS THEREFORE ORDERED THAT:

1. The rates in Appendix A be and they hereby are approved as the fair, just and reasonable rates to be charged by South Shore for water service rendered on and after the date of this Order.

2. The rates proposed by South Shore be and they hereby are denied.

3. South Shore's proposed return check fee be and it hereby is approved.

4. South Shore's proposed reconnect fee and new account charge be and they are approved.

5. South Shore's proposed meter test fee be and it hereby is approved as modified herein.

6. South Shore's proposed trailer guarantee be and it hereby is denied.

7. South Shore shall refund all trailer guarantees held at this time within 30 days of the date of this Order.

8. South Shore's proposed charges for a road cut and road bore be and they hereby are denied.

9. South Shore's proposed late payment penalty be and it hereby is approved.

10. South Shore's proposed transit charge shall cover the cost of work performed and shall be negotiated between South Shore and its customer.

11. The proposed meter transfer charge be and it hereby is approved.

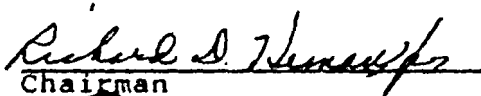
12. South Shore's proposed water deposit charges be and they hereby are approved.

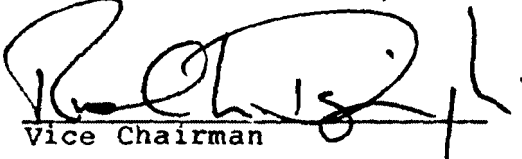
13. South Shore's proposed service call charge be and it hereby is approved as modified herein.

14. Within 30 days of the date of this Order South Shore shall file with this Commission its tariff sheets setting forth the rates approved herein and a copy of its rules and regulations for providing water service.

Done at Frankfort, Kentucky, this 13th day of January, 1986.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:

Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 9330 DATED JANUARY 13, 1986

The following rates and charges 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 this Commission prior to the effective date of this Order.

RATES: Monthly

First 1,000 gallons	\$2.60 Minimum Bill
Next 9,000 gallons	1.30 per 1,000 gallons
Next 20,000 gallons	1.00 per 1,000 gallons
Next 20,000 gallons	.90 per 1,000 gallons
Over 50,000 gallons	.85 per 1,000 gallons

Fire Hydrant Charge \$5.50 per month

Nonrecurring Charges

Return Check Fee	\$ 6.00
Reconnect Fee	10.00
New Account Charge	3.00
Meter Test Fee	11.50
Meter Transfer Charge	10.00
Water Deposit	
Residential	15.00
Commercial	25.00
Service Call	7.50
Late Penalty	10% of amount owed