

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN ADJUSTMENT OF RATES OF THE)
SOUTH SHORE WATER WORKS) CASE NO. 2007-00199
COMPANY)

O R D E R

On May 17, 2007, South Shore Water Works Company ("South Shore") applied to the Commission for an adjustment of its rates. Commission Staff has performed a limited financial review of South Shore's operations and prepared a report of its findings and recommendations regarding the proposed rates. All parties should review carefully the report, a copy of which is attached, and submit to the Commission any written comments on this report or requests for a hearing or informal conference no later than 10 days from the date of this Order.

IT IS THEREFORE ORDERED that all parties shall have 10 days from the date of this Order to submit to the Commission written comments regarding the Staff Report or to request a hearing or informal conference in this matter. If no request for a hearing or informal conference is received within this period, this case shall stand submitted to the Commission for a decision.

Done at Frankfort, Kentucky, this 1st day of November, 2007.

By the Commission

ATTEST:


Executive Director

STAFF REPORT
SOUTH SHORE WATER WORKS CO.
CASE NO. 2007-00199

On May 17, 2007, South Shore Water Works Company ("South Shore") applied for an increase in its water rates. It proposes a revenue increase of \$134,407, or 24.7 percent over test year revenue of \$543,014. This proposal would increase the water bill for a residential customer using 4,000 gallons from \$18.09 to \$22.70, an increase of 25.4 percent.

To evaluate the requested increase, Commission Staff ("Staff") performed a limited financial review of South Shore's test period operations for the 12 months ending April 30, 2007. Jack Kaninberg of the Commission's Water and Sewer Revenue Requirements Branch performed the limited review with a field visit on July 25, 2007. The scope of Staff's review was limited to obtaining information as to whether the test period operating revenues and expenses were representative of normal operations. Insignificant or immaterial discrepancies were not pursued and are not addressed herein.

Jason Green is responsible for all revenue adjustments, the rate design, and the calculation of the recommended rates. South Shore proposed in its application to increase its current rates by an across the board percentage amount. The percentage amount is based on the additional revenue requirement over normalized revenues requested in the application. Commission Staff previously prepared a cost-of-service

study for South Shore in Case No. 2003-00044¹. This study was prepared using the commodity demand methodology set forth in American Water Works Association Manual M-1 and recognized that a utility must be prepared to meet peak demand requirements as well as average water use needs. South Shore's current rate design adequately meets those needs and requirements. Therefore, Staff recommends that the proposed across the board percentage increase in South Shore's current rate design be approved.

Jack Kaninberg is responsible for the determination of the revenue requirement. Based on Staff's recommended pro forma operations as shown in Attachment A, Staff recommends that South Shore's requested increase be denied, and that a recommended increase in revenues of \$83,307 should be granted. This increase will allow South Shore sufficient funds to meet its reasonable operating expenses and provide for adequate equity growth. Based on the recommendations herein, Staff is of the opinion that the rates as shown in Attachment A of this report are reasonable and should be approved by this Commission.

Signatures

Prepared by: Jack Kaninberg
Financial Analyst, Water and Sewer
Revenue Requirements Branch
Division of Financial Analysis

Prepared by: Jason Green
Rate Analyst, Communications, Water,
and Sewer Rate Design Branch
Division of Financial Analysis

¹ Case No. 2003-00044, An Adjustment of Rates of the South Shore Water Works Company.

ATTACHMENT A
STAFF REPORT CASE NO. 2007-00199
SOUTH SHORE WATER WORKS COMPANY

South Shore Proforma	YE 4/30/07	Adjstmts.	Adjusted	Staff Adjstmts.	Ref.	Staff Adjusted
Water Sales	\$526,533		\$526,533	(\$1,290)		\$525,243
Penalty Revenue	\$9,902		\$9,902	0		\$9,902
Nonrecurring Revenue	\$6,580		\$6,580	0		\$6,580
Total Income	\$543,015	0	\$543,015	(\$1,290)	A	\$541,725
Employee Wages	\$115,917	\$22,509	\$138,426	0		\$138,426
Employee Salaries	\$81,885	(\$6,745)	\$75,140	(\$17,398)	B	\$57,742
Health Insurance	\$62,251	(\$2,303)	\$59,948	0		\$59,948
Pensions/Benefits	\$3,891	0	\$3,891	(\$1,008)	C	\$2,883
Purchased Water	\$502	\$103	\$605	0		\$605
Purchased Power	\$45,510	0	\$45,510	0		\$45,510
Chemicals	\$13,775	0	\$13,775	0		\$13,775
Materials/Supplies	\$40,636	\$3,909	\$44,545	\$506 (\$2,910) (\$300)	D	\$41,841
Contract Services-Acct	\$2,400	0	\$2,400	0		\$2,400
Rental Expenses	\$17,326	(\$422)	\$16,904	0		\$16,904
Transportation Expense	\$10,702		\$10,702	0		\$10,702
Insurance Expense	\$12,828	0	\$12,828	0		\$12,828
Reg. Com Expense	\$875		\$875	0		\$875
Tot. Water Util. Exp.	\$408,498	\$17,051	\$425,549	(\$21,110)		\$404,439
Depreciation Expense	\$62,260	0	\$62,260	\$838 (\$4,929)	E	\$58,169
Amortization Expense	\$26,766	\$1,750	\$28,516	(\$2,195) \$970	F	\$27,291
Taxes OT Income	\$15,035		\$15,035	0	G	\$15,035
	15,132	\$1,206	16,338	(\$1,331)		\$15,007
	806		806	0		806
	4,081	1,172	5,253	0		5,253
	\$35,054	\$2,378	\$37,432	(\$1,331)		Total - \$36,101
Total Op. Expenses	\$532,578	\$21,179	\$553,757	(\$27,757)		\$526,000
<i>Total Op. Income</i>	<i>\$10,437</i>	<i>(\$21,179)</i>	<i>(\$10,742)</i>	<i>\$26,467</i>		<i>\$15,725</i>
Other Income	\$10,351	(\$5,175)	\$5,176	0		\$5,176
	383		383			383
Interest Income	\$1,236	0	\$1,236	0		\$1,236
Interest Expense	(\$8,754)	\$8	(\$8,747)	0		(\$8,747)
Tot. Other Inc./Ded.	\$3,216	(\$5,167)	(\$1,951)	0		(\$1,951)
Income Before Inc. Tax	\$13,654	(\$26,346)	(\$12,692)	\$26,467		\$13,775

Calculation of Recommended Revenue Requirement:

Revenue Requirement Determination	Proposed	Recommended
Pro forma Operating Expenses	\$553,755.88	\$526,000
Divided by Operating Ratio	88%	88%
Subtotal	\$629,268.05	\$597,727
Less: Pro Forma Operating Expenses	(\$553,755.88)	(\$526,000)
Operating Margin allowed in Revenue Req.	\$75,512.17	\$71,727
Add: Pro Forma Operating Expenses excluding Income Taxes	\$553,755.88	\$526,000
Income Taxes		23,403
Operating Margin Allowed		\$71,727
Other Income & Deductions (Net)	\$1,950.72	\$1,951
Total Revenue Requirement	\$677,421.90	\$623,081
Less: Other Operating Revenues		(\$16,482)
Revenue Requirement from Rates		\$606,599
Less: Normalized Operating Rev. from Rates	(\$543,014.44)	(\$525,243)
Recommended Increase	\$134,407.46	\$81,356
Non-Operating Expense (Net)		\$1,951
Required Increase in Revenues		\$83,307

Reference Notes:

A. Normalized Revenues as determined by Commission Staff's billing analysis.

B. Employee Salaries Expense was adjusted in conformity with past Commission rate case precedents involving South Shore. George J. Hannah is South Shore's president and majority stockholder, and is responsible for overseeing its daily operations. Staff in past South Shore cases has recommended adjustments to Mr. Hannah's salary for ratemaking purposes. For instance, in Case No. 2002-108, Commission Staff stated the following:

"Mr. Hannah dedicates an extraordinary amount of time owning and operating South Shore. However, it has not been demonstrated how Mr. Hannah's duties and responsibilities have substantially changed since cases 94-188 and 97-321 or that \$79,500 is reasonable compensation for the work performed. Therefore, Staff recommends that Mr. Hannah's salary be set in this case using the base salaries established in those cases as adjusted for the same three percent cost of living allowances given to all other South Shore employees since 1997...

In South Shore's most recent rate case, Case No. 2003-00044, the President's allowable salary of \$51,303 for ratemaking purposes was again based upon the historical cost-of-living adjustments (COLAs) granted to other employees of the water utility.

In this case, Staff asked South Shore to explain its current position relative to the salary adjustments recommended by Staff in past cases. Mr. Hannah responded that he works 7 days a week and is on call 24 hours a day, and has dealt with increasing

regulation in recent years. Absent greater justification, Staff recommends adjusting Mr. Hannah's salary consistent with past precedents, as follows:

\$51,303 - Pro Forma Salary allowed in 2003
 1.030 COLA for 2004 = \$52,842
 1.030 COLA for 2005 = \$54,427
 1.030 COLA for 2006 = \$56,060
 1.030 COLA for 2007 = **\$57,742 recommended**

C. Pensions Expense was determined based upon a rate of 1.75% times \$164,720 (the recommended salaries for the five employees covered by the plan), or \$2,883.

D. Materials and Supplies Expense was adjusted for three items. First, Staff included a \$506 increase to recognize increased postal rates (from 39 to 41 cents) effective in May 2007. Second, Staff removed a \$2,910 expense from McCoy and McCoy in the test year that is normally required once every three years, and recommends allowing a three-year recovery in amortization expense. Third, Staff removed a \$300 donation to the Stan Spence Little League.

E. Depreciation Expense was adjusted for two items. First, Staff recommends allowance of depreciation expense associated with plant additions that have occurred subsequent to the end of the test period. Second, Staff has adjusted depreciation expense to remove the expense associated with plant items that were fully depreciated during or subsequent to the test period, as follows:

Plant Fully Depreciated	Life	Test yr. Depreciation
Wells 5/5/92	15	213.40
Wells 8/14/92	15	106.70
Pump Unit W6 8/02	5	483.80
Elec. Pump. Equip. 6/87	20	24.25
Pump Filter 5/97	10	271.47
Pump 3 Recon 5/97	10	46.10
Pump 10/97	10	97.79
Trtmt. Equip 3/87	20	130.75
Trtmt. Equip 5/87	20	95.43
Chlorinator 2/97	10	616.75
Chem. Pump 11/97	10	70.03
Chem. Pump 12/97	10	86.20
Reservoir 1/57	50	143.73
Clean Clearwell 11/97	10	555.00
Distrib. Main 1/57	50	75.53
Service 7/92	15	54.98
Hydrants 9/92	15	21.32
Muriatic Acid 1/01	5	1.78
Muriatic Acid 8/02	5	123.30
Well 4 - 8/02	5	527.85
Well 5 - 8/02	5	590.55
Well 6 - 8/02	5	533.67
Tools (p. 13)	10	59.06
Adjustment		4,929.44

F. Amortization Expense was adjusted for two items. First, Staff recommends removal of \$2,195 of amortization expense associated with items that were fully amortized during or subsequent to the test period, as follows:

Expenses Fully Amortized	Date	Original Amount	Life (Yrs.)	Adjustment
Accounting – PSC #2003-044	2/04	\$300.00	3	\$100.00
Legal – PSC #2003-003	7/04	\$207.46	3	\$69.15
Legal – PSC #2003-003	8/04	\$537.90	3	\$179.30
Legal – PSC #2003-003	10/04	\$160.00	3	\$53.33
Legal – PSC #2003-003	12/04	\$48.00	3	\$16.00
Muriatic Acid	1/01	\$777.58	5	\$1.78
Muriatic Acid	8/02	\$616.52	5	\$123.30
Well 4	8/02	\$2,639.25	5	\$527.85
Well 5	8/02	\$2,952.75	5	\$590.55
Well 6	8/02	\$2,668.37	5	\$533.67
			Adjustment	\$2,194.93

Second, Staff recommends a three-year recovery for the \$2,910 McCoy and McCoy expenditure removed from Materials and Supplies Expense, an adjustment of \$970.

G. Taxes Other Than Income Expense was adjusted to allow FICA tax expense of \$15,007, based on the recommended wages and salaries expense of \$196,168 times a FICA rate of 7.65%.

ATTACHMENT B
STAFF REPORT CASE NO. 2007-00199
SOUTH SHORE WATER WORKS COMPANY

RECOMMENDED RATES

		BILLS	GALLONS	RATE	REVENUE
FIRST	1,000 GALLONS	26,722	22,640,000	\$9.15	244,506.30
NEXT	9,000 GALLONS		70,810,000	3.92	277,575.20
OVER	10,000 GALLONS		30,907,000	2.74	84,685.18
ACTUAL COMMODITY SALES			124,357,000		
REVENUE REQUIREMENT					\$606,766.68