COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF CITIPOWER, LLC FOR RATE ADJUSTMENT FOR SMALL UTILITIES PURSUANT TO 807 KAR 5:076	)))	CASE NO 2008-00392

ORDER

Citipower, LLC ("Citipower") is a local gas distribution company ("LDC") which provides retail natural gas service in Southeastern Kentucky. It serves approximately 400 residential, commercial, industrial and institutional customers in McCreary County.

BACKGROUND

On September 22, 2008, Citipower filed an application for an increase in rates pursuant to 807 KAR 5:076, the Alternative Rate Filing procedure for small utilities. The application was found deficient and was rejected by letter dated September 30, 2008. Citipower submitted additional information in response to the rejection letter, which cured its deficiency, and the application was considered filed October 6, 2008.

There are no intervenors in this matter. Citipower responded to two data requests by Commission Staff ("Staff"). It was also afforded an opportunity to request a public hearing. It filed a response on February 11, 2009, stating (1) that the record was complete; (2) that it had no further comment; and (3) that the matter should stand submitted based on the existing record.

TEST PERIOD

Citipower proposed the 12–month period ending December 31, 2007 as the test period for determining the reasonableness of its proposed increase. The Commission finds using the 12-month period ending December 31, 2007 as the test period in this proceeding to be reasonable. In utilizing a historic test period, the Commission has given full consideration to appropriate known and measurable changes, based on changes occurring both during and subsequent to the test period.

For the test period, Citipower reported operating revenues of $1,241,654, which consisted of $502,265 in revenues from base rates and miscellaneous charges plus $739,389 in gas cost recovery revenues. Citipower requested a rate increase that would raise its base rates by $4.74 per Mcf, which was designed to generate additional annual revenues of approximately $411,500.

TEST-PERIOD REVENUES AND EXPENSES

For the test year, Citipower reported sales of 86,828 Mcf. Based on revenues of $1,241,564 and $1,491,502, total expenses reported in its amended annual report filed with the Commission, Citipower incurred a net loss of $249,848 in 2007. It based its proposed rates on increasing its revenues sufficiently to eliminate its net loss and realize a profit based on a 13 percent return on its total revenue.

ADJUSTMENTS TO TEST YEAR REVENUES AND EXPENSES

The Commission will approve a rate increase for Citipower based on its results of operations for 2007, adjusted as explained and quantified in the following sections. These adjustments reflect standard ratemaking theories and the Commission's long-held ratemaking practices.

Gas Cost Revenues and Expenses

Citipower based its requested increase on its total revenues and expenses for the test year, including the revenues recovered through its Gas Cost Recovery ("GCR") mechanism and the expense it reported for natural gas purchases. Citipower's test year

GCR revenues were $739,389, while its natural gas purchases expense was $832,835, meaning it experienced a gas cost under-recovery of $93,446.

Citipower agreed that under-recoveries by LDCs of their gas costs, which are to be recovered and reconciled via a mechanism such as Citipower's GCR, should not be included in determining the LDC's base rate revenue requirement.[1] The Commission, consistent with its established ratemaking practices, has, therefore, made adjustments to eliminate Citipower's GCR revenues and its natural gas purchases expense from its test-year operating statement.

Salaries and Wages

Citipower reported administrative and general salaries of $86,285 during the test year, which included its manager's salary and a single month's payment of a $10,000 monthly management fee to its parent company, CitiEnergy.[2]

The monthly management fee is described by Citipower as being "for Board of Director costs, accounting staff, legal coordination, regulatory and planning filings and oversight, together with strategic planning duties. These duties are primarily performed in Greensboro, North Carolina."[3] The application stated that the monthly management fee had not been paid since January of 2007.

[1] See Citipower's response to Item 4 of Staff's supplemental data request dated December 9, 2008, response received December 24, 2008.

[2] Citipower proposed an adjustment of $110,000 to increase administrative and general salaries as if the fee had been paid for all 12 months of the test year.

[3] See Citipower's response to Item 2.a. of Staff's supplemental data request dated December 9, 2008, received December 24, 2008.

Citipower's last general rate case was Case No. 1999-00225,[4] which, according to Citipower, predates the manager position and implementation of the CitiEnergy management fee.[5] In that case, $124,217 was allowed for salaries and wages based on four full-time employees and a part-time office assistant. During the test year in the current case, Citipower had five employees, which include its manager, an office manager, and three outside employees whose wages were reported as meter reading costs. The manager's salary and the office manager's and outside employees' calculated wages, including overtime, totaled $180,854 for the 2007 test year.

When small utilities have gone several years between rate cases, as is the case for Citipower, the Commission has, on occasion, used the Consumer Price Index ("CPI") as a guide in considering the reasonableness of the increases in salaries and wages over the time between cases.[6] In this instance, the growth in the CPI from the 1997 test year used in the prior case through 2008 was 34.15 percent. Recognizing the change in Citipower's workforce since the prior case and applying the CPI growth rate to the $124,217 allowed therein as salaries and wages results in an adjusted, updated amount of $180,629, which is nearly equal to and provides support for the actual test year salaries and wages, excluding the monthly management fee.

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[4] Case No. 1999-00225, The Application of Citipower LLC, for an Adjustment of Rates Pursuant to the Alternative Rate Filing Procedure for Small Utilities (Ky. PSC Mar. 31, 2000).

[5] Citipower stated in its data responses that the manager position and monthly management fee arrangement had been in place since 2002.

[6] _See_ Case No. 2003-00171, A Review Of the Rates of Elam Utility Company, Inc. Pursuant to the Decision to Approve the Financing Requested in Case No. 2001-00324 (Ky. PSC Sept. 18, 2003).

By including $120,000 for the management fee in its rate request, Citipower proposes to recover administrative and general salaries (management expenses) of nearly $200,000 for the operation and management of a gas system with only slightly more than 400 customers. The fact that the fee was not paid for nearly 20 months prior to Citipower filing its rate request raises questions about its necessity. In addition, 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. Total administrative and general expenses reported by Citipower for 2007 are nearly $350,000. These expense levels represent a per customer cost of nearly $500 annually for the salaries and more than $850 for all functions considered part of administrative and general expenses. Both the totals and the amounts per customer greatly exceed what is typical among the other LDCs regulated by the Commission that are comparable in size to Citipower.[7]

While recognizing that Citipower's costs for outside services and property insurance, the two items which make up the majority of its "non-salary" administrative and general expenses, are greater than is typical for the smaller LDCs operating under our jurisdiction, those costs are incurred in return for goods or services provided by an outside party to fulfill a need which Citipower cannot fulfill on its own. Salaries and/or management fees, conversely, along with how a utility sets up its management structure, are totally within the utility's judgment and discretion. Having thoroughly considered this issue, the Commission finds Citipower's proposed level of administrative

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[7] Twelve small jurisdictional LDCs have customer levels that make them comparable to Citipower. Among the 12, which had an average of 466 customers at the end of 2007, administrative and general salaries in 2007 ranged from zero to $90,400 while their total administrative and general expenses ranged from $48,500 to $156,500.

and general salaries to be excessive. For the reasons set forth herein, we will limit Citipower's salaries and wages to $180,854 for ratemaking purposes, the actual amount of test-year salaries and wages of Citipower, excluding the CitiEnergy management fee.

Compressor-related Expenses

During the test year, Citipower undertook a number of cost-cutting measures, which included eliminating a compressor it deemed no longer needed for its operations. One item of expense incurred in connection with discontinuing its use of the compressor was the cost of moving the compressor and, apparently, returning it to the vendor from which it was acquired. Citipower has agreed that the $3,857 cost of removing the compressor was a nonrecurring expense, which should not be included in determining its revenue requirements. Accordingly, this amount will be removed from Citipower's annual operating expenses for ratemaking purposes.

Amortization Expense

Citipower reported $13,188 as test-year amortization expense, which it stated represented the amortization of Gas Plant Acquisition Adjustments.[8] In Case No. 1999-00225, the amortization expense reported by Citipower was identified as being the amortization of organizational costs, which, in response to a data request in this proceeding, Citipower stated would normally be amortized over a period of 60 months.[9] It also stated that it could not find an answer to whether the amortization was, in fact, for organizational costs rather than an acquisition adjustment. The available evidence

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[8] See Citipower's response to Item 7.a. of Staff's supplemental data request dated December 9, 2008, received December 24, 2008.

[9] See Citipower's response to Item 7.b. of Staff's supplemental data request dated December 9, 2008, received December 24, 2008.

points more strongly to the expense being for the amortization of Gas Plant Acquisition Adjustments. Except in unusual circumstances, which the Commission does not find to exist in this case, this type of expense is not allowed for ratemaking purposes. Accordingly, we will make an adjustment to eliminate this item of expense from the determination of Citipower's revenue requirements

Summary Impact of Adjustments

After considering the test-year expenses, including appropriate adjustments found reasonable herein, the Commission has determined that the financial results of Citipower's adjusted test-year operations would be as shown in Table 1.

Table 1

Account Titles	Test-Period Operations	Accepted Adjustments	Adjusted Operations
Operating Revenues	$ 1,241,654	$ (739,389)	$ 502,265
Operating Expenses	1,344,971	(846,092)	498,879
Net Operating Income	$ (103,317)	$ 106,703	$ 3,386
Other Income & Deductions	(36,531)	13,188	(23,343)
Net Income	$ (139,848)	$ 119,891	$ (19,957)

REVENUE REQUIREMENT DETERMINATION

Citipower explained that it derived its requested revenue increase based on a 13 percent profit return on its total revenues. Typically, for small investor-owned utilities, the Commission will use either a rate of return approach or an operating ratio method to determine the revenue requirement. An operating ratio method is used primarily when there is not a sound basis for a rate of return determination using the return on rate base method. The Commission generally uses an 88 percent operating ratio to determine a reasonable level of earnings for small investor-owned utilities.

Given that it is a small distribution system, the Commission finds it reasonable to use an operating ratio to determine Citipower's revenue requirement, which is the same method used in its previous case. Applying an 88 percent operating ratio to the adjusted operating expenses results in a total base rate revenue requirement of $605,591. The Commission has accepted Citipower's test-year base rate revenues based on its actual test year Mcf sales of 86,828. Based on the following calculation, the Commission finds that Citipower should receive an increase in annual operating revenue of $103,326.

Table 2

Adjusted Operating Expenses Before Income Taxes	$ 498,879
Divided by : 0.88	88%
Sub-total	$ 566,908
Plus: Other Income and Deductions	23,343
Revenue Requirement Before Income Taxes	$ 590,251
Plus: Provision for Income Taxes	15,341
Total Base Rate Revenue Requirement	$ 605,592

In order to meet this revenue requirement, Citipower will require a revenue increase of $103,327. This amount of additional revenue, based on 86,828 in test-year Mcf sales volumes, will require raising Citipower's rates by $1.1900 per Mcf. This will result in an increase from $6.4692 to $7.6492 per Mcf for residential and commercial rates, and an increase from $5.4692 to $6.6492 per Mcf for industrial and institutional rates. The Commission finds these to be the fair, just and reasonable rates for Citipower.

SUMMARY

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

1. Based upon the adjusted test-period operations reflected herein, Citipower's total annual base rate revenue requirement is $605,592.

2. Citipower's proposed rates will produce approximately $913,800 in annual base rate revenues.

3. The rates proposed by Citipower would produce revenues in excess of those found reasonable herein and should be denied.

IT IS THEREFORE ORDERED that:

1. The rates proposed by Citipower are denied.

2. The rates found reasonable herein 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 the Commission revised tariffs setting out the rates approved herein and stating that they were approved pursuant to this Order.

By the Commission

ENTERED
APR 03 2009
KENTUCKY PUBLIC
SERVICE COMMISSION

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