

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN INVESTIGATION OF THE GAS COSTS OF SENTRA)
CORPORATION PURSUANT TO KRS 278.2207, THE)
WHOLESALE GAS PRICE IT IS CHARGED BY ITS) CASE NO.
AFFILIATE, MAGNUM HUNTER PRODUCTION, INC.) 2016-00139
PURSUANT TO KRS 278.274, AND THE STRUCTURE)
OF THE PURCHASED GAS ADJUSTMENT CLAUSE)
CONTAINED IN ITS FILED TARIFF)

O R D E R

Sentra Corporation (“Sentra”) is a local gas distribution company (“LDC”) subject to Commission jurisdiction pursuant to KRS 278.040. Its 2014 annual report filed with the Commission identifies Magnum Hunter Production, Inc. (“MHP”) as Sentra’s sole owner and gas supplier.¹ Sentra’s tariff contains a Purchased Gas Adjustment (“PGA”) clause which requires that it file certain information with the Commission in order to receive approval to revise its retail rates to reflect an increase in wholesale gas cost.² Sentra’s PGA clause is unique among Kentucky LDCs in that Sentra is required to file for approval to revise its rates only to reflect increases in wholesale gas costs.

¹ The annual report shows MHP having a 100 percent ownership interest in Sentra, although in Case No. 2014-00043, *Joint Application of Magnum Hunter Resources Corporation, NGAS Hunter, LLC, Magnum Hunter Production, Inc. and Sentra Corporation for Approval of Proposed Reorganization* (Ky. PSC May 20, 2014), the Commission approved the transfer of Sentra’s ownership from MHP to Magnum Hunter Resources Corporation, which is the ultimate parent of both Sentra and MHP.

² The issue date of Sentra’s tariffed PGA clause, December 1, 1998, reflects the Commission’s approval of Sentra’s initial construction, rates, and tariffs in Case No. 1997-00429, *The Petition of Sentra Corporation for a Certificate of Convenience and Necessity to Construct Facilities, Approval of Financing, Approval of Initial Rates and Operation of a Natural Gas Distribution System for the City of Fountain Run, Kentucky* (Ky. PSC Nov. 17, 1998).

GAS COST CONSIDERATIONS

Since its PGA clause was approved, Sentra has made one PGA filing with the Commission, and as a result was permitted to increase its PGA from \$3.9764 to \$12.5306 per Mcf³ during a period in which market prices for natural gas caused many Kentucky LDCs to increase their PGAs to levels of \$10.00 or more per Mcf. Market prices have declined since Sentra's current PGA of \$12.5306 became effective in 2007 to the extent that the 11 small LDCs that file quarterly PGAs with the Commission currently have gas cost rate components of \$5.70 per Mcf or less, excluding pipeline transportation costs.⁴ These 11 LDCs have reported gas costs averaging \$4.84 per Mcf in their 2012, 2013, and 2014 annual reports.⁵

Sentra's PGA clause does not require that it seek Commission approval to revise its rates to reflect a decrease in its wholesale gas costs. However, given that (1) such revision would cause its revenue to merely track the reduction in its purchased gas cost and (2) the language in its PGA clause does not prohibit a filing to revise rates to reflect a decrease in its gas costs, the Commission is concerned as to Sentra's attitude toward, and relationship with, its customers. Sentra's annual reports reflect that its gas costs were between \$9.50 and \$10.30 per Mcf in 2005-2008. Since 2010, however, Sentra's gas costs have been much lower, ranging from \$4.40 to \$6.70 per Mcf.

³ Case No. 2007-00120, *The Notice of Purchased Gas Adjustment Filing of Sentra Corporation* (Ky. PSC Apr. 19, 2007).

⁴ Two LDCs, Burkesville Gas Company, Inc. and Navitas KY NG, LLC, have PGAs of \$6.92 and \$5.73 per Mcf, which include pipeline charges of approximately \$2.50 and \$1.50 per Mcf, respectively.

⁵ Additionally, of the 11 small LDCs that file quarterly PGAs with the Commission, none reported annual gas costs greater than \$6.76 per Mcf in any year from 2012 through 2014.

While the Commission recognizes that Sentra's base rates are among the lowest of the small LDCs under its jurisdiction, the total rates charged its customers are among the highest of those same LDCs because of the magnitude of its PGA. Sentra appears to be charging its customers more through its PGA than the level of gas cost it has incurred in recent years. While the Commission is unable to draw a conclusion at this time, Sentra's annual reports suggest that its base rates may not be sufficient to recover its non-gas costs.

The affiliated nature of Sentra's gas supply falls within the scope of KRS 278.2207(1)(b), which governs the pricing requirements of transactions between utilities and affiliates. This statute requires that:

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.⁶

The affiliated nature of Sentra's gas supply also falls within the scope of KRS 278.274, which, as Sections (3)(c) and (3)(d), indicate below, allows the Commission to reduce the utility's rates by the portion of its purchased gas costs found to be unjust or unreasonable and reduce the affiliated supplier's rate to the utility by the same amount.

KRS 278.274(3)(c):

If the commission determines that the rates charged by the utility are not just and reasonable in that the cost of natural gas purchased from the affiliated company is unjust and unreasonable, the commission may reduce the purchased

⁶ There is nothing in the Commission's records indicating that Sentra utilizes a cost allocation methodology approved by the United States Department of Agriculture, the Securities and Exchange Commission, or the Federal Energy Regulatory Commission.

gas component of the utility's rates by the amount deemed to be unjust or unreasonable.

KRS 278.274(3)(d):

The commission may also reduce the rate charged by the affiliated company by the same amount.

Based on the facts that Sentra (1) has made no PGA filings since 2007 to reflect decreases in wholesale cost for gas purchased from an affiliate after having previously made a filing to increase its PGA by over 200 percent,⁷ and (2) has reported gas costs in its annual reports for the years 2010 through 2014 which, on average, have been less than \$6.00 per Mcf, the Commission finds that Sentra's gas procurement activities may be in violation of the provisions of KRS 278.2207(1)(b).

TARIFF CONSIDERATIONS

As stated earlier, Sentra's PGA clause is unique among the LDCs jurisdictional to the Commission. It may have been acceptable, during an era of tight gas supplies that typically put upward pressure on prices, for a PGA clause to require that an LDC file to revise rates only when the LDC's gas cost increased. However, market conditions have changed in recent years, largely because of increases in gas supplies from shale gas reserves. The Commission therefore finds that Sentra should provide justification to continue operating under a PGA clause that does not provide for decreases in gas costs.

FINDINGS AND ORDERS

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

⁷ This is based on the increase from \$3.9764 to \$12.5306 per Mcf mentioned earlier in this Order.

1. Sentra's gas supply is provided by its affiliated gas supplier, MHP.
2. Sentra's PGA clause requires that it file for Commission approval to revise its rates to reflect increases in its cost of gas, but does not require rate revisions when gas prices fall.
3. Sentra has not made a PGA filing since March 2007 when, based on current market conditions at the time, it was authorized to implement a PGA of \$12.5306 per Mcf.
4. Market conditions in the gas industry have changed since 2007 such that gas costs reported in the annual reports filed by the small LDCs that file quarterly PGAs averaged \$4.84 per Mcf from 2012 through 2014.
5. Sentra's cost of gas purchased from MHP, as shown in its annual reports filed with the Commission, has been less than \$6.70 per Mcf in each of the years from 2010 through 2014, with the average cost in those years being less than \$6.00 per Mcf.
6. Sentra's gas purchases from its affiliate fall under KRS 278.2207, which governs the pricing of transactions between a utility and a non-regulated affiliate and which requires that services or products provided to a utility by an affiliate be priced at no greater than the market price or in a manner that complies with the utility's existing allocation methodology approved by the United States Department of Agriculture, the Securities and Exchange Commission, or Federal Energy Regulatory Commission.
7. Sentra's purchases from its affiliate are governed by KRS 278.274, under which the Commission is authorized to exert jurisdiction over an intrastate affiliate gas supplier as though it were a utility subject to the Commission's jurisdiction.

8. Pursuant to KRS 278.274(3)(b) and (c), when a utility purchases natural gas from an affiliate, the Commission is required to ensure that the rates charged the utility and ultimately, the consumers, are just and reasonable, and the Commission may reduce the purchased gas component of the utility's rates by the amount deemed unjust and unreasonable.

9. Based on the evidence in this record, a *prima facie* showing has been made that: (a) the price charged for gas by MHP to its affiliate Sentra may not be equal to or less than market price, as required by KRS 278.2207(1)(b), which governs the pricing of transactions between a regulated utility and a non-regulated affiliate; (b) the gas cost component of the rates Sentra charges its customers appears to be significantly above market and may not be just and reasonable as required by KRS 278.274; and (c) the one-sided nature of Sentra's PGA clause does not appear to result in rates that are fair, just, and reasonable.

10. Based on the findings above, a proceeding should be initiated to investigate these issues.

11. A procedural schedule should be established for the proceeding.

The Commission, on its own motion, HEREBY ORDERS that:

1. This investigation is opened to provide Sentra an opportunity to present evidence to demonstrate: (a) that its cost of gas from its affiliate is no greater than market as required by KRS 278.2207(1)(b); (b) that the PGA component of Sentra's rates and the wholesale rates charged to Sentra are just and reasonable as required by KRS 278.274 for natural gas purchased from an affiliate; (c) why the PGA component of Sentra's rates should not be reduced to market with a corresponding reduction to the

cost of gas sold to Sentra under KRS 278.274; and (d) why Sentra's PGA clause should not be revised to provide a better match of its gas cost and its gas cost revenue.

2. Sentra and its affiliate supplier, MHP, shall be parties to this case.
3. Sentra shall collect the PGA component of its rates subject to refund effective for bills rendered after the date of this Order until further Commission Order.
4. The procedural schedule set forth in Appendix A shall be followed.
5. Sentra and MHP shall individually or jointly file, within 14 days of the date of this Order, responses to the requests for information attached hereto as Appendix B, along with any other information relevant to Sentra's cost of gas purchased from MHP.
 - a. Responses to requests for information in paper medium shall be appropriately bound, tabbed and indexed, and shall include the name of the witness responsible for responding to questions related to the information provided, with an original in paper medium and an electronic version to the Commission.
 - b. Each response shall be answered under oath or, for representatives of a public or private corporation or a partnership or an association or a governmental agency, be accompanied by a signed certification of the preparer or person supervising the preparation of the response on behalf of the entity that the response is true and accurate to the best of that person's knowledge, information, and belief formed after a reasonable inquiry.
 - c. Any party shall make timely amendment to any prior response if it obtains information which indicates that the response was incorrect when made or, though correct when made, is now incorrect in any material respect.

d. For any request to which a party fails or refuses to furnish all or part of the requested information, that party shall provide a written explanation of the specific grounds for its failure to completely and precisely respond.

e. A party filing a paper containing personal information shall, in accordance with 807 KAR 5:001, Section 4(10), encrypt or redact the paper so that the personal information cannot be read.

6. The April 19, 2007 final Order in Case No. 2007-00120 is attached hereto as Appendix C.

7. KRS 278.2207 and 278.274 are attached hereto as Appendix D.

8. The case number and Order date of the other jurisdictional LDCs' currently approved PGAs are attached hereto as Appendix E.

9. The annual gas costs reported by the smaller jurisdictional LDCs are attached hereto as Appendix F.

10. Any motion requesting an informal conference with Commission Staff to consider any matter that would aid in the handling or disposition of this proceeding shall be filed with the Commission no later than 20 days from the date of this Order.

11. A person who submits a motion to intervene after April 22, 2016, and upon a showing of good cause is granted leave to intervene, shall accept and abide by the existing procedural schedule.

12. Pursuant to KRS 278.360 and 807 KAR 5:001, Section 9(9)(a), the record of any formal hearing in this matter shall be by digital video recording.

By the Commission

ENTERED

APR 08 2016

KENTUCKY PUBLIC
SERVICE COMMISSION

ATTEST:

Lawson D. Grunwald
Acting Executive Director *for*

Case No. 2016-00139

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2016-00139 DATED **APR 08 2016**

Requests for intervention shall be filed by 04/22/16

Initial requests for information to Sentra from Commission Staff
and intervening parties shall be filed no later than 05/10/16

Sentra shall file responses to initial requests for
information no later than 05/20/16

Supplemental requests for information to Sentra
shall be filed no later than 06/02/16

Sentra shall file responses to supplemental requests
for information no later than 06/14/16

Any party's request for a formal evidentiary hearing
shall be filed no later than 06/24/16

APPENDIX B

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2016-00139 DATED

APR 08 2016

1. Confirm that MHP is Sentra's current wholesale gas supplier. If this cannot be confirmed, provide the name of the current supplier, the date it became Sentra's wholesale gas supplier, and state whether it is affiliated with Sentra.
2. State whether, as shown in Sentra's 2014 annual report, MHP remains its owner, or if that has changed pursuant to the approval granted in Case No. 2014-00043 of the transfer of Sentra's stock to Magnum Hunter Resources Corporation.
3. Provide the number of connection points between the system of Sentra's wholesale natural gas supplier and the Sentra distribution system.
4. Identify the source (interstate or intrastate pipeline, local wells, etc.) of the gas sold to Sentra by its wholesale natural gas supplier.
5. Provide the written contract or agreement that governs the terms of sales to Sentra by its wholesale gas supplier.
6. Identify and describe the mechanism, index, forward curve, etc., under which the price of the natural gas sold to Sentra is charged.
7. Provide copies of invoices for the gas sold to Sentra by month in calendar years 2013, 2014, 2015, and the available months of 2016.
8. State whether Sentra's price for its natural gas purchases reflects current market price conditions. If so, provide support for why Sentra believes this price reflects current market prices. If not, indicate an appropriate price based on current market conditions and provide support for the indicated amount.

APPENDIX C

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2016-00139 DATED

APR 08 2016

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE NOTICE OF PURCHASED GAS)	
ADJUSTMENT FILING OF SENTRA)	CASE NO. 2007-00120
CORPORATION)	

O R D E R

On November 17, 1998, in Case No. 1997-00429,¹ the Commission approved rates for Sentra Corporation ("Sentra") and provided for their further adjustment in accordance with Sentra's gas cost adjustment ("GCA") clause.

On March 22, 2007, Sentra filed its proposed GCA to be effective May 1, 2007.

After reviewing the record in this case and being otherwise sufficiently advised, the Commission finds that:

1. Sentra's notice includes revised rates designed to pass on to its customers its expected change in wholesale gas costs.
2. Sentra's proposed expected gas cost ("EGC") is \$10.3850 per Mcf, which is an increase of \$6.4086 per Mcf from the previous EGC of \$3.9764.
3. Sentra's notice sets out no current quarter refund adjustment.
4. Sentra's notice sets out a current quarter actual adjustment ("AA") of \$2.1456 per Mcf. Sentra's notice sets out a total AA of \$2.1456 per Mcf, which is an increase of \$2.1456 per Mcf from the previous total AA.

¹ Case No. 1997-00429, The Petition of Sentra Corporation for a Certificate of Convenience and Necessity to Construct Facilities, Approval of Financing, Approval of Initial Rates and Operation of a Natural Gas Distribution System for the City of Fountain Run, Kentucky.

5. Sentra's GCA is \$12.5306 per Mcf, which is \$8.5542 per Mcf more than the previous GCA of \$3.9764.

6. The rates in the Appendix to this Order are fair, just, and reasonable, and should be approved for billing for service rendered by Sentra on and after May 1, 2007.

IT IS THEREFORE ORDERED that:

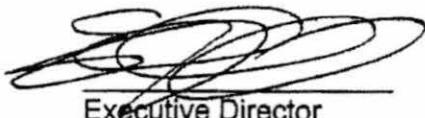
1. The rates in the Appendix, attached hereto and incorporated herein, are approved for billing for service rendered on and after May 1, 2007.

2. Within 20 days of the date of this Order, Sentra shall file with this Commission its revised tariffs setting out the rates authorized herein.

Done at Frankfort, Kentucky, this 19th day of April, 2007.

By the Commission

ATTEST:



Executive Director

APPENDIX

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2007-00120 DATED April 19, 2007

The following rates and charges are prescribed for the customers served by Sentra Corporation. 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:

Residential and Commercial

	<u>Base Rate</u>	<u>Gas Cost</u>	<u>Total Rate</u>
Customer Charge	\$5.00 per Month		
All Mcf	\$2.1440	\$12.5306	\$14.6746

Industrial

	<u>Base Rate</u>	<u>Gas Cost</u>	<u>Total Rate</u>
Customer Charge	\$10.00 per Month		
All Mcf	\$1.3197	\$12.5306	\$13.8503

APPENDIX D

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2016-00139 DATED

APR 08 2016

278.2207 Transactions between utility and affiliate -- Pricing requirements -- Request for deviation.

- (1) The terms for transactions between a utility and its affiliates shall be in accordance with the following:
 - (a) Services and products provided to an affiliate by the utility pursuant to a tariff shall be at the tariffed rate, with nontariffed items priced at the utility's fully distributed cost but in no event less than market, or in compliance with the utility's existing USDA, SEC, or FERC approved cost allocation methodology.
 - (b) 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.
- (2) A utility may file an application with the commission requesting a deviation from the requirements of this section for a particular transaction or class of transactions. The utility shall have the burden of demonstrating that the requested pricing is reasonable. The commission may grant the deviation if it determines the deviation is in the public interest.
- (3) Nothing in this section shall be construed to interfere with the commission's requirement to ensure fair, just, and reasonable rates for utility services.

Effective: July 14, 2000

History: Created 2000 Ky. Acts ch. 511, sec. 5, effective July 14, 2000.

278.274 Review of natural gas utility's purchasing practices in determining reasonableness of proposed rates -- Reduction of rates by commission.

- (1) In determining whether proposed natural gas utility rates are just and reasonable, the commission shall review the utility's gas purchasing practices. The commission may disallow any costs or rates which are deemed to result from imprudent purchasing practices on the part of the utility.
- (2) When proposing new rates, the utility shall be required to prove that the proposal is just and reasonable in accordance with the requirements of this section.
- (3) It shall be presumed that natural gas purchases from affiliated companies are not conducted at arm's length.
 - (a) For purposes of this subsection, affiliated companies shall be defined as those in which one (1) or more of the owners control or have the right to control the business affairs of all affected companies.
 - (b) In instances in which a utility purchases natural gas from an intrastate affiliate, the commission shall assume jurisdiction of the affiliated company as though it were a utility as defined in KRS 278.010. The commission's jurisdiction shall extend to that extent necessary to ensure that the rates charged the utility and ultimately to the consumer are just and reasonable.
 - (c) If the commission determines that the rates charged by the utility are not just and reasonable in that the cost of natural gas purchased from the affiliated company is unjust or unreasonable, the commission may reduce the purchased gas component of the utility's rates by the amount deemed to be unjust or unreasonable.
 - (d) The commission may also reduce the rate charged by the affiliated company by the same amount.

Effective: July 13, 1984

History: Created 1984 Ky. Acts ch. 40, sec. 1, effective July 13, 1984.

APPENDIX E

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2016-00139 DATED **APR 08 2016**

Bluegrass Gas Sales, Inc., *Case No. 2016-00094* – Order dated March 18, 2016

Burkesville Gas Company, Inc., *Case No. 2016-00090* – Order dated March 18, 2016

Citipower, LLC, *Case No. 2016-00102* – Order dated March 16, 2016

Kentucky Frontier Gas, LLC, *Case No. 2016-00135* – Order dated April 7, 2016

Martin Gas, Inc., *Case No. 2016-00093* – Order dated March 11, 2016

Millennium Energy, Inc., *Case No. 2016-00097* – Order dated March 18, 2016

Natural Energy Utility Corporation, *Case No. 2016-00095* – Order dated March 18, 2016

Navitas KY NG, LLC, *Case No. 2015-00427* – Order dated January 26, 2016

Public Gas Company, *Case No. 2016-00136* – Order dated April 8, 2016

Valley Gas, Inc., *Case No. 2016-00105* – Order dated March 18, 2016

Western Lewis-Rectorville, *Case No. 2016-00085* – Order dated March 11, 2016

APPENDIX F

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2016-00139 DATED

APR 08 2016

Annual Gas Cost (\$ per Mcf) as
Reported in Smaller LDC Annual Reports*

<u>LDC Name</u>	<u>2008</u> [♦]	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>3-yr ave.^</u>
Bluegrass	9.00				3.59	4.62	6.00	5.14
Burkesville	9.51				4.81	5.66	6.72	5.98
Citipower	11.48				4.12	4.69	6.36	5.41
Ky. Frontier	9.67 [#]				4.10	3.93	6.45	5.11
Martin Gas	5.02				5.00	5.02	5.11	5.06
Millennium	10.08				3.49	4.04	5.93	4.82
NEUC	7.45				2.86	3.71	4.43	3.98
Navitas	10.61				3.90	5.02	6.36	5.67
Public Gas	9.00				4.47	5.32	5.76	5.50
Valley Gas	9.57				4.69	4.55	5.16	4.88
W-L-R	<u>9.62</u>				<u>4.55</u>	<u>4.36</u>	<u>5.75</u>	<u>5.09</u>
Average	9.18				4.14	4.63	5.75	4.84
Sentra	<u>9.55</u>	<u>7.75</u>	<u>6.45</u>	<u>4.47</u>	<u>6.42</u>	<u>6.64</u>	<u>5.36</u>	<u>6.14</u>

* Includes smaller LDCs that file quarterly PGAs with the Commission. Amounts were calculated based on purchased volumes and costs reported on Gas Purchases Schedule (Accts. 804,805).

♦ 2008 is the first full year at the \$12.5306 PGA approved for Sentra in Case No. 2007-00120.

^ Three-year average of 2012–2014, three most recent years reported to Commission by all small LDCs.

Ky. Frontier did not file a 2008 annual report. \$9.67 is the average of the LDCs it later acquired.

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