

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

FAILURE OF SALYERSVILLE GAS COMPANY)
TO COMPLY WITH COMMISSION REGULATIONS)
AND TO FURNISH ADEQUATE, EFFICIENT,) CASE NO. 89-174
AND REASONABLE SERVICE)

ORDER TO SHOW CAUSE

Salyersville Gas Company ("Salyersville") is a natural gas distribution company located in Magoffin County, Kentucky, which owns and operates facilities used in connection with the purchase, sale, and furnishing of natural gas to the public for compensation. Salyersville is a utility as defined by KRS 278.010(3).

Kentucky Revised Statutes ("KRS") Chapter 278 prescribes certain statutory requirements related to the activities of a utility. KRS 278.280 authorizes the Commission to prescribe rules for the performance of any service furnished or supplied by a utility. Pursuant to this authority, the Commission has promulgated rules, codified at 807 Kentucky Administrative Regulations ("KAR") 5:022, which establish minimum safety standards for the operation of natural gas utilities.

On December 5-6, 1988, December 12, 1988, and again on February 6, 1989, Commission Staff ("Staff") was notified by various customers of Salyersville that their gas service had been disrupted. Upon investigation of these incidents, Staff concluded that low pressure on the gas system appeared to be one of the

reasons for the lack of supply to the affected customers. The latter two incidents occurred during periods of cold weather, and the customer demand for gas was greater than Salyersville could temporarily provide. As a result of the December 12, 1989 incident, Staff requested and Inland Gas Company ("Inland") agreed to provide gas on an emergency basis for a 60-day period. Inland later agreed to a one-time extension of its emergency supply which terminated subsequently on April 11, 1989.

Due to this series of service disruptions, Staff initiated a review of Salyersville's operations. During the period December 1988 through March 1989, a series of meetings and telephone discussions took place between Staff and Salyersville's owners, Grady Conley and Barkley Sturgill, and between Staff and both current and potential suppliers of gas to Salyersville. The Commission takes notice that Mr. Conley is the individual who is responsible for the daily operations of Salyersville. He has also been the principal contact since Salyersville began operations and is the person who responds to safety inspection reports and other correspondence from the Commission.

Attached as Appendix A is a copy of the Staff Report which presents the information collected and Staff's assessment and findings regarding Salyersville's gas supply. The scope of the report was limited to reviewing Salyersville's current sources of gas supply; determining how disruptions of service caused by low pressure can be avoided in the future, and whether system design contributed to the low pressures during periods of peak demand; assessing the quality of service Salyersville has provided to its

customers; and determining the extent to which long-term, reliable sources of supply have been secured for future gas needs.

The Commission notes that according to the Staff Report Mr. Conley has stated that he has purchased emergency supplies of gas from Inland during 1986, 1987, twice in 1988, and in 1989. This Commission entered an Order on November 2, 1984,¹ requiring Salyersville to demonstrate that adequate gas supplies were available for the system and that Salyersville had the ability to continue to supply its customers. This show cause proceeding was subsequently dismissed after Salyersville advised the Commission that additional gas wells had been connected to the gas system.

Based upon the recent incidents related to low pressure experienced by Salyersville and the information contained in the Staff Report, the Commission is of the opinion that Salyersville's gas supply is unreliable. The Commission finds from the Staff Report that a prima facie showing has been made that Salyersville has failed to comply with KRS 278.160(1) and 807 KAR 5:022, Section 13, subsections (13)(b), (14)(a), (15)(d), and (16)(a). The Commission is of the opinion that Salyersville may no longer be able to furnish adequate, efficient, and reasonable service pursuant to KRS 278.030(2); and that Salyersville should demonstrate to the Commission that it has a long-term, reliable gas supply for the 1989-90 heating season and thereafter.

¹ Case No. 9200, An Investigation Into the Natural Gas Supply Available to the Salyersville Gas Company.

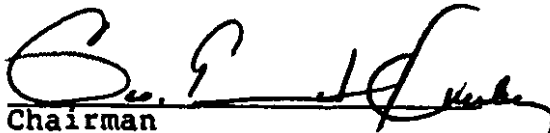
Therefore, the Commission on its own motion HEREBY ORDERS that:

1. Salyersville shall appear before the Commission on August 2, 1989, at 10 a.m., E.D.T., in the Commission's offices at Frankfort, Kentucky, to show cause why Salyersville, and Mr. Conley in his individual capacity as officer and principal stockholder, should not be subject to the penalties prescribed in KRS 278.990 for their failure to comply with the statutes and Commission regulations referenced herein. Furthermore, Salyersville shall be prepared to demonstrate at the above-scheduled hearing that it has long-term, reliable gas supply for the 1989-90 heating season. In the alternative, Salyersville shall be prepared to explain why service should not be discontinued to all customers due to an inadequate and unreliable source of gas supply.

2. Salyersville shall respond to the findings of the Staff Report (Appendix A) no later than 20 days from the date of this Order.

Done at Frankfort, Kentucky, this 10th day of July, 1989.

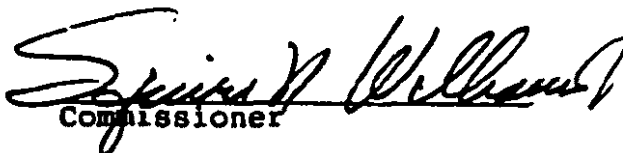
PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman

ATTEST:

Executive Director


Commissioner

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

STAFF REPORT
OF
STATUS OF GAS SUPPLY TO
SALYERSVILLE GAS COMPANY
CASE NO. 89-174

Prepared by:
Ralph E. Dennis
Manager, Gas Branch
Division of Engineering and
Consumer Services

Staff Report
of
Status of Gas Supply to
Salyersville Gas Company

PREFACE

During December 1988, two separate incidents occurred on the Salyersville Gas Company's (Salyersville) system which caused a temporary loss of service to various customers. In each instance, low pressure on the system appeared to be the reason for the lack of supply to the affected customers. The first incident, reported December 5-6, 1988, was resolved when additional gas supply was made available to Salyersville from two new local wells. However, on December 12, 1988 a second incident was reported which; based upon comments from the Mayor of Salyersville, the local fire department, and the County Rescue Squad; placed several people in a life-threatening situation. This low pressure problem was resolved when Commission Staff (Staff) requested and Inland Gas Company (Inland) agreed to provide gas on an emergency basis. Inland is an interstate gas pipeline company jurisdictional to the Federal Energy Regulatory Commission. Section 284, Subpart I, of the FERC's rules and regulations allows gas to be supplied on an emergency basis for a 60-day period.

On February 6, 1989, low pressure once again occurred which temporarily disrupted gas service to several customers. By late afternoon, system pressure was back to normal, and no subsequent telephone calls were received the following day. Prior to expiration of its 60-day emergency supply on February 11, 1989, Inland agreed to another 60-day emergency supply, a one-time

extension allowed under the FERC's regulations. This supply, which terminated April 11, 1989, in addition to an increase in production from local producers and warmer than normal weather, allowed Salyersville to provide gas to its customers for the remainder of the 1988-89 heating season without any disruptions of service. However, it should be noted that notification to the Commission (through Staff) of the interruptions which occurred during the 1988-89 heating season was made by the affected customers and not by Salyersville, a violation of 807 KAR 5:022, Section 13(16)(a). Also, according to some of the customers who called, their disruption in service had occurred a day or two prior to the time they called.

Staff also reviewed Salyersville's pressure charts from one of its two purchase points for the period November 2, 1988 through February 27, 1989. The information on these charts depicts frequent pressure fluctuations below 20 pounds per square inch gage (psig). Some of these pressure drops apparently lasted 2-3 days during this period, and at certain times a pressure at or near 0 psig was recorded.

Salyersville's tariff states in part that it ". . . shall supply gas continuously and without interruption and adopts and shall maintain . . . a standard pressure of 6" as measured at the outlet side of the customer meters." (6" of water column represents approximately 3 ounces of gas pressure.) Based upon the disruptions of service reported by customers, and to the extent incoming pressure at one purchase point was at or near 0 psig on certain occasions, it would appear Salyersville has at

times violated its tariff and failed to comply with 807 KAR 5:022, Section 13(14)(a) and (15)(d).

SCOPE

The scope of this report is limited to reviewing the current sources of gas supply to Salyersville, making determinations as to how Salyersville can avoid future disruptions of service caused by low pressure, and analyzing the low pressure problems which have occurred on the system to determine if system design is a contributing factor. Staff has also attempted to determine the quality of service Salyersville has provided to its customers and the extent to which long-term, reliable sources of supply have been secured for the system's future gas needs.

This report is the product of a series of meetings and telephone discussions between Staff and Salyersville's owners, and between Staff and both current and potential suppliers of gas to Salyersville. While such meetings and discussions are continuing, those from which this report are principally derived occurred during the period December 1988-March 1989. Staff participating in these meetings and discussions and development of this report were: Scott Smith, Larry Amburgey, Mark Hostetter, and Ralph Dennis.

BACKGROUND

Salyersville is a Kentucky corporation whose sole stockholders are William Grady Conley and Barkley Sturgill. Mr. Conley is the individual who is responsible for the daily operations of the company. He has been the principal contact since Salyersville began operations and is the person who responds to safety

inspection reports and other correspondence from the Commission. Based upon its most recent Annual Report filed with the Commission, Salyersville sold 22,699 Mcf to 257 customers in 1988. The sources of supply and the amount purchased from each were:

Cobra Oil and Gas	17,176 Mcf
R. C. Energies	801 Mcf
Tricor	2,282 Mcf
Inland	1,427 Mcf
AEI-KAARS	1,013 Mcf

In Case No. 8652,¹ an Order was entered in November 1982 granting Salyersville a Certificate of Public Convenience and Necessity to construct a natural gas system. In its review of Salyersville's application for a certificate and related documents, Staff determined that the proposed design and subsequent construction of the system complied with Commission regulations. Based upon this review and numerous inspections since the initial construction, Engineering is unaware of any system design under the current operating scenario which would contribute to low pressure problems.

During the October 8, 1982 hearing, Mr. Conley estimated that 410 customers would be receiving gas service at the end of the first year of operations. Salyersville began operations during the 1983-84 heating season and in that first season of operations had to arrange for emergency purchases of gas to be transported

¹ Case No. 8652, The Application of Salyersville Gas Company, of Magoffin County, Kentucky, for (1) A Certificate of Public Convenience and Necessity to Construct and Operate a New Natural Gas Distribution System at Salyersville, Kentucky, (2) Approval of the Proposed Plan of Financing of Said Project and (3) Approval of Proposed Gas Rates to be Charged by the Company to the Natural Gas Customer.

through Inland's system. Based upon its Annual Report, Salyersville had 141 customers connected to its system in 1984. According to Inland, these purchases came from local producers, and Inland received a "temporary assignment" from the FERC which permitted Inland to transport gas to Salyersville. Since that initial operating season, Mr. Conley stated that he has had to purchase gas from Inland to supplement his system supply for periods from approximately 2 to 4 months during 1986, 1987, twice during 1988, and 1989.

On November 2, 1984, an Order was entered (Case No. 9200)² requiring Salyersville to demonstrate that adequate gas supplies were available for the system and that it had the ability to continue to supply its customers. During this proceeding, Mr. Conley explained that some of the problems which had caused supply interruptions related to storm damage or third party activity. He also provided reports which stated that eight wells were supplying gas to Salyersville. In July 1985 Mr. Conley advised Staff that three additional wells were interconnected with the system. After reviewing this information, the Commission concluded that an adequate supply of natural gas was available to Salyersville to provide service to its customers, and an Order was entered August 8, 1985 dismissing the show cause proceeding.

² Case No. 9200, An Investigation into the Natural Gas Supply Available to the Salyersville Gas Company.

PAST/PRESENT GAS SUPPLY

During review of its applications for approval to bid on a franchise and a certificate for construction of its system, Case Nos. 8557³ and 8652 respectively, Mr. Conley advised the Commission that six gas wells were currently available to supply Salyersville. A total of 21 wells would likely be accessible to Salyersville in the near future. Cobra either owned these wells or had access to the supply through contracts with the producers.

Based upon its Annual Reports through 1988, most of Salyersville's gas has been provided by Cobra. However, in 1986 a small portion was purchased directly from R. C. Energies; in 1987 almost 40 percent of its supply came from R. C. Energies and Tricor Corporation; and in 1988, 18 percent of its total supply was supplied from R. C. Energies, Tricor, and AEI-KAARS. (These figures do not include any emergency purchases from Inland during the periods stated.)

Since Salyersville has been in operation, virtually all of its gas has been provided from Weir oil formations. Such wells are shallow (1,200 feet) and drilled for oil, but usually produce modest amounts of sweet natural gas as the oil is produced. Producers generally burn off the gas when there is no market for it. During the late 1940s, drilling for gas wells in Big Six sand (2,400 feet) took place with some initial production up to 20,000

³ Case No. 8557, In the Matter of Application of Salyersville Gas Company for a Certificate Authorizing it to Bid on Franchise Established and to be Offered For Sale by the City of Salyersville, Magoffin County, Kentucky.

Mcf/day. These wells were produced fast and have been abandoned except for the owners' own domestic use. According to Mr. Conley, Cobra has drilled some Big Six wells, but abandoned them due to sulphur content or cave-ins; in addition, many Weir oil wells have been shut down in the past 3-5 years due to EPA regulations for treatment of waste water.

Inland and Kentucky West Virginia Gas Company (Kentucky West Virginia) are the only interstate pipelines in the area. Inland has gathering and transmission pipelines in south central Magoffin County, but the direction of flow in this part of its system is east. In addition, since the existing production connected to these lines is extremely low, Inland is trying to sell this portion of the system for \$150,000. A question also exists about the costs required to upgrade the pipelines in this area if subjected to higher pressures, as would occur if connected to increased production for supply to Salyersville. Inland has also told Staff that if no sale is made the pipelines and production tied to them will be abandoned in 1989. Kentucky West Virginia has pipelines in eastern and southern areas of the county, although the closest one is 12 miles away. Kentucky West Virginia has estimated it would cost approximately \$1,000,000 to construct a pipeline from its closest line to the Salyersville system.

For these reasons, neither Inland nor Kentucky West Virginia can be a transporter of gas for Salyersville. Therefore, based upon the information available, local production seems to be the only present source of supply for Salyersville.

However, there does appear to be the potential for production of more gas in Magoffin County, generally in the areas south of Salyersville. Ashland Exploration, Inc. is preparing to start drilling about 100 gas wells in the area of the Breathitt-Magoffin county line, and AEI-KAARS intends to start drilling exploratory gas wells this summer southeast of Salyersville. Still unresolved, though, is the inability to get the gas out of the area for resale. This is necessary, if any serious gas production occurs, since the Salyersville gas system's load is not large enough to utilize that amount of gas. Ashland Exploration may renovate an abandoned liquids pipeline. Inland's existing lines could be used if they were upgraded; however, the purchase price and additional costs related to upgrading these lines probably makes ownership prohibitive to Salyersville. Some of Salyersville's other suppliers may also expand production, although probably limited to Weir oil wells.

CURRENT EFFORTS

Mr. Conley is presently notifying his current suppliers of his need for additional gas. He also feels that none of them have performed according to the requirements of the contracts. However, he also recognizes that they represent his only present source of gas. According to Mr. Conley; James Joice, an out-of-state contractor/producer; will soon be drilling gas wells in Magoffin County and has expressed interest in purchasing the gas system. Mr. Conley has also stated that other sources have expressed some interest in purchasing Salyersville as well. The sale of at least Mr. Conley's portion of ownership may occur since

he has been advised by his doctor "to get out of the gas business." Mr. Conley owns approximately 80 percent of Salyersville.

Mr. Conley has recently stated that he does not intend to depend solely on gas from Weir oil wells in the future. He has concluded that additional gas wells to the depth of a Big Six need to be drilled. He will talk to Ashland Exploration about accessing its system and will investigate how he, individually or as Salyersville Gas, can pursue drilling his own Big Six wells.

Salyersville has also indicated that it intends to install additional metering equipment at each of its purchase points to more accurately measure the amount of gas purchased. Since AEI-KAARS and Hunsaker Oil Company began supplying gas from its Weir oil production, Salyersville has had disagreements with each regarding the amount of gas delivered. Staff visited each purchase point with Mr. Conley and his consultants, and the consultants have recommended that equipment should be installed which allows the meter to record volume at the time purchased and also compensate for the pressure in the supplier's line. Once installed, there should be no basis for any additional discrepancies in gas purchased.

Mr. Conley has stated to Staff that he recognizes Salyersville has the potential for expansion beyond its current 257 customers. At least three potential large volume end-users are not on the system, in part due to Salyersville's history of supply interruptions. He also feels that many additional residential customers could be added if adequate supplies of gas could be assured. Some already have service lines installed.

Salyersville does not appear to have information which demonstrates that the wells connected to the system have the capability to provide the peak demands of the system. Information is also apparently lacking which demonstrates that Salyersville can provide the daily demands of the system without disruption.

FINDINGS

1. There appears to be nothing inherent in the current design of the system which should cause low pressure problems. Adequate system pressure to maintain service to all customers during the coldest day should be present if adequate supplies of gas are available.

2. Based upon information provided in CN 9200 and by Mr. Conley, some of the previous service disruptions on the Salyersville system have been for reasons other than supply problems.

3. It appears that Salyersville is restricted at the present to acquiring its gas supply solely from local production. Most of the current local producers seem interested in expanding their production. To some extent only additional Weir oil wells will be drilled, which will probably not add substantially to Salyersville's system needs. However, greater gas well drilling is also occurring which could represent access to a longer term supply of gas for Salyersville.

4. Based upon discussions with geologists and the activity of producers in the area, there may be additional gas reserves in Magoffin County. However, Staff's gas production figures for gas wells in this area is very old. Therefore, Staff is of the

opinion that Salyersville should hire an independent consultant to conduct a feasibility study to determine the options available to Salyersville for additional gas supply. The scope of the study should include, but not necessarily be limited to: an assessment of the feasibility of obtaining adequate sources of gas from drilling new gas wells; connecting additional Weir well production and connecting to existing transmission companies; a flow study of the distribution system; and recommended courses of action for Salyersville.

5. Salyersville's principal supplier is Cobra who supplied over 75 percent of Salyersville's gas in 1988. While Cobra's headquarters is located in California, Mr. Conley is president of Cobra in Kentucky. Cobra also sells gas directly to Inland. While Mr. Conley has stated that Cobra has two separate leases, one contract with Salyersville and the other with Inland, it is still unclear why Cobra's gas sold directly to Inland cannot be sold to Salyersville.

6. Staff agrees with Mr. Conley's assessment that gas from Weir oil wells should not be relied upon as a primary supply source. Production available from such wells is limited by their nature; in addition, their reliability and longevity may be questionable due to compliance requirements with EPA regulations for oil production. Numerous oil wells have been shut down in recent years because of EPA.

7. Salyersville's most realistic possibilities for a long-term source of gas supply would appear to be Ashland Exploration, James Joice, and Cobra. While Inland's lines south of

Salyersville offer a route to another market for gas, the costs to upgrade the lines would be prohibitive to Salyersville.

8. If Inland does not sell its lines in Southern Magoffin County and abandons them in 1989 as it has stated, Salyersville will no longer have access to emergency gas supplies from Inland.

9. Given the number of supply interruptions that have occurred since operations began and the number of times Inland has had to make emergency sales to Salyersville to prevent disruptions of service to customers, Mr. Conley may no longer be able to furnish adequate, efficient, and reasonable service pursuant to KRS 278.030(2).

10. As service to its customers has been disrupted, Salyersville has failed to comply with Commission regulations 807 KAR 5:022, Section 13, subsections (13)(b), (14)(a); (15)(d); and (16)(a).

11. To the extent disruptions of service have occurred, Salyersville has failed to comply with KRS 278.160(1) by violating its own tariff.


12. Salyersville should pursue contact with Ashland Exploration, AEI-KAARS, and James Joice to determine their prospective schedule for drilling gas wells. All have expressed intentions to drill in Magoffin County. Staff should monitor these efforts and reevaluate Salyersville's efforts prior to the 1989-90 heating season to determine the status of its gas supply.

13. Salyersville should contact Cobra in California to determine its interest in additional drilling activity in Magoffin County. Salyersville should also discuss with Inland and Cobra

the possibility of diverting Inland's purchases from Cobra to the Salyersville system on a permanent basis.

14. Due to the uncertainty regarding its source(s) of gas supply for the 1989-90 heating season, Salyersville should have an independent consultant conduct a study on the potential for gas supply to Salyersville. The scope of the study should include but not necessarily be limited to those issues described in Finding 4 of this report. The report should be completed no later than August 15, 1989, and a copy should be submitted to the Commission when completed.

15. A proceeding should be established requiring Salyersville and Mr. Conley, in his individual capacity as officer and principal stockholder, to show cause why they should not be penalized for failure to comply with 807 KAR 5:022, Section 13, subsections (13)(b), (14)(a), (15)(d), and (16)(a), respectively. This proceeding should also address whether Salyersville is able to furnish adequate, efficient, and reasonable service to the customers of Salyersville pursuant to KRS 278.030(2).


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