

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ADJUSTMENT OF RATES OF COLUMBIA)
GAS OF KENTUCKY, INC.) CASE NO. 10498

ORDER ON REHEARING

On October 6, 1989, the Commission issued its Order in this proceeding. On October 26, 1989, Columbia Gas of Kentucky, Inc. ("Columbia") petitioned the Commission for rehearing of five issues determined in this proceeding. The five issues were: (1) federal income tax on unbilled revenues; (2) Arrearages of Johnson County Gas and Martin Gas, Inc.; (3) Income tax expense on accelerated depreciation; (4) Depreciation expense on construction work in progress ("CWIP"); and (5) Depreciation expense on post-test-period plant additions.

On the same date, the Attorney General and Lexington-Fayette Urban County Government, ("AG/LFUCG") filed a petition for rehearing on two issues: (1) Columbia's rate base exceeds capitalization; and (2) "The Commission improperly used the unsound formula method to calculate working capital."

By Order dated November 6, 1989, the Commission granted rehearing on all issues except the issue of Martin Gas and Johnson County Gas arrearages. On January 31, 1990, a public hearing was held.

After consideration of the evidence of record and being otherwise sufficiently advised, the Commission finds that Columbia should be allowed to increase its rates to produce additional annual revenues of \$300,063 based upon the following:

REVENUE REQUIREMENT ISSUES

Income Taxes-Unbilled Revenue

In the initial proceeding and on rehearing in this case, Columbia petitioned the Commission to allow recovery of additional tax payments that result from the Tax Reform Act of 1986 ("TRA") and, specifically, its treatment of a utility's unbilled revenues.

Much discussion on this issue has taken place in this case and Case No. 10201,¹ and it has been the Commission's position that Columbia is not entitled to the recovery of the tax payments. Because of Columbia's accounting treatment of unbilled revenues, initiated in 1982, the TRA did not affect Columbia's book tax expense.

Columbia has consistently argued that the change in the tax treatment of unbilled revenues has resulted in additional cost to the company in the form of additional taxes. Columbia has failed on rehearing to provide adequate support of its position. The Commission believes that although Columbia has incurred additional tax payments that may affect the company's cash position, actual tax expense on a book basis remains unaffected. This Commission will not allow Columbia to recover an expense that was incurred in 1982 for two reasons. First, to allow the 1982 expense would

¹ Case No. 10201, An Adjustment of the Rates of Columbia Gas of Kentucky, Inc., Order dated October 21, 1988.

result in retroactive rate-making and second, would result in selective treatment for a nonrecurring expense, both of which are improper.

As an alternative to recovering the tax expense, Columbia proposed it be allowed to earn a return on the additional tax payments to recognize the prospective booking of unbilled revenue under the TRA rules. Columbia states that by allowing such an adjustment to its rate base, the Commission would allow it the same treatment that other utilities received in the TRA cases in late 1987. In those single issue cases in 1987, the Commission did permit a working capital component to include the cash effects of the unbilled revenues. Columbia's situation is unique however, because, unlike the utilities who had single issue TRA cases in 1987, Columbia's TRA rate adjustment was not reviewed by the Commission at that time due to a settlement in Case No. 9554.² If the Commission chose to selectively increase or decrease cash working capital or expenses or revenues in a general rate case as it did in the TRA cases, the matching of earnings to rate base would be distorted. Thus, the Commission views this selective increase to the rate base to be improper and Columbia's alternative proposal should be denied.

Therefore, the Commission reaffirms its initial decision and finds that it would be unreasonable to allow Columbia to increase its expenses or its rate base as a result of the tax payments associated with its unbilled revenues.

² Case No. 9554, Notice of Adjustment of Rates of Columbia Gas of Kentucky, Inc., Order dated June 25, 1987.

Income Taxes-Accelerated Depreciation

In its petition for rehearing, Columbia argued that the Commission wrongfully denied \$155,172 of federal and state income tax expense incurred when tax depreciation on an accelerated basis became less than book depreciation calculated on a straight line basis. The Commission found that "if Columbia had fully normalized, there should be no impact on the ratepayer because adequate tax reserves should remain on the books to offset any deficiency that would occur."³ However, it has been determined on rehearing that in Case No. 3196,⁴ a 1968 proceeding, the Commission allowed Columbia to flow through the excess accelerated tax depreciation as opposed to normalization. Therefore, beginning January 1, 1968, Columbia ceased normalization of the depreciation amounts in excess of straight line.

The Commission believes that it would be unfair to require normalization for rate-making now after allowing Columbia to utilize flow through all these years. Columbia's ratepayers shared in the benefit of accelerated tax depreciation and must share in the additional cost now that the "turnaround" has begun.

The Commission therefore finds that the additional income tax expense should be allowed. This action will increase Columbia's revenue requirements by \$253,487.

³ Order dated October 6, 1989, page 34.

⁴ Case No. 3196, Application of Columbia Gas of Kentucky, Inc., For Authority For a Change in the Accounting Procedure Provided For At Case No. 3196, October 23, 1968.

Working Capital Allowance

On rehearing, as in the initial proceeding, the AG/LFUCG argues that the formula method of determining a working capital allowance should be replaced by the balance sheet approach. This approach would require that the working capital component of Columbia's rate base be determined based on the accounting definitions of working capital; current assets less current liabilities. In this proceeding, this has been narrowed to require that only the current assets deserving of a return less the "cost free" current liabilities be considered.

In addition, the AG/LFUCG concluded that the formula method was inaccurate and that the balance sheet method should be adopted by this Commission as it has been accepted in many jurisdictions.⁵

The AG/LFUCG has failed, on rehearing, to persuade the Commission that it is appropriate in this instance to replace the formula method with the balance sheet approach. In most instances where the formula method has been abandoned, it has been replaced by the lead-lag method. This Commission has in the past required lead-lag studies; however, such studies are very time consuming and expensive to undertake and the Commission has been reluctant to require them in all rate proceedings. Therefore, the Commission affirms its use of the formula method for the determination of working capital in this matter.

⁵ DeWard Supplemental Testimony, page 2.

Capital vs. Rate Base

The AG/LFUCG, in attempting to persuade the Commission to abandon the formula method in favor of the balance sheet approach to working capital, argued that Columbia's net investment rate base exceeded its level of capitalization by approximately \$12.8 million,⁶ and further that the formula method resulted in an excessive working capital requirement, thus causing rate base to greatly exceed capital. In its petition, the AG/LFUCG implies that the Commission should determine Columbia's revenue requirement based on capital of \$55,252,327 as determined by the AG/LFUCG.⁷

This Commission has always attempted to achieve a reconciliation between a company's rate base and its level of capital. In this proceeding, the AG/LFUCG gave much consideration to this issue. However, there is not sufficient evidence in the record explaining the reason for the disparity. The Commission believes that there could be several reasons for the disparity. One cause could be that many of Columbia's deferred tax credits are not being recognized as a reduction to the rate base. Another reason could be Columbia's large nominated gas balances. A change to reflect the AG/LFUCG's proposed levels of capital without evidence regarding the reason of disparity would be unreasonable. Therefore, the AG/LFUCG's petition for rehearing on this issue is denied.

⁶ AG/LFUCG Petition for Rehearing, page 2.

⁷ Ibid, pages 2-4.

However, since this issue is very complex and Columbia has filed its notice of intent to file a new rate case, Case No. 90-063, this issue will be closely scrutinized therein. Columbia is hereby placed on notice that in the upcoming rate case it is required to reconcile the differences in investor supplied capital in utility operations and net investment in utility operations.

Depreciation Expense on Construction Work In Progress ("CWIP")

In its October 6, 1989 Order, the Commission excluded \$28,682 of depreciation expense on \$907,644 of CWIP. Columbia requested rehearing on this issue. This decision was based upon testimony provided by a Columbia witness that Columbia's calculation of depreciation expense did include CWIP. However on rehearing, it was determined that Columbia had properly excluded CWIP from its calculation. The Commission, therefore, will allow the previously excluded depreciation expense of \$28,682.

Depreciation Expense on Post-Test-Period Construction

In its October 6, 1989 Order, the Commission adjusted the depreciation reserve by \$17,894 to reflect depreciation on post-test-period plant additions. The Commission did not, however, adjust depreciation expense for the property additions. The basis for the decision was that revenues were not adjusted for the plant additions and, consequently, there should be no adjustment to expenses. After rehearing of this issue, the Commission believes that in order to properly match the income statement and balance sheet and to be consistent with past Orders in which the Commission has allowed post-test-period construction, the

Commission should allow the additional depreciation expense of \$17,894.

SUMMARY

As a result of the actions taken by this Commission on rehearing, Columbia is authorized to increase its rates to produce additional annual revenues of \$300,063 above those revenues granted in our Order dated October 6, 1989 in this case.

IT IS THEREFORE ORDERED that:

1. Columbia shall not be allowed to increase its expenses or its rate base as a result of the tax payments associated with unbilled revenues.

2. Columbia shall be allowed \$253,487 in additional revenues for increased income tax expense.

3. The formula method shall be used in determining Columbia's working capital.

4. In its next rate case, Columbia shall reconcile the differences in investor supplied capital in utility operations and net investment in utility operations.

5. Columbia shall be allowed to increase its depreciation expense in the amount of \$28,682 for CWIP.

6. Columbia shall be allowed to increase its depreciation expense in the amount of \$17,894 for post-test-period plant additions.


7. Columbia shall be allowed to increase its rates and charges to produce additional annual revenues of \$300,063 above those granted in the Commission's Order dated October 6, 1989 in this proceeding.

8. The rates in Appendix A, attached hereto and incorporated herein, are fair, just and reasonable and are approved for service rendered on and after the date of this Order.

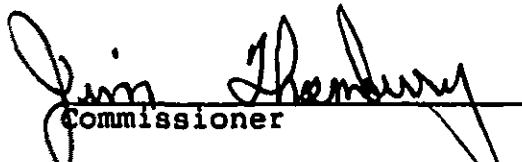
9. Within 20 days of the date of this Order, Columbia shall file with this Commission its revised tariffs setting out the rates authorized herein.

Done at Frankfort, Kentucky, this 11th day of June, 1990.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:


Executive Director

APPENDIX

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 10498 DATED 6/11/90

The following rates and charges are prescribed for the customers served by Columbia Gas of Kentucky, Inc. 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 date of this Order.

CURRENTLY EFFECTIVE BILLING RATES

	Base Rate Charge <u> \$ </u>	Gas Cost Adjustment <u> \$ </u>	Total Billing Rate <u> \$ </u>
RATE SCHEDULE GS			
Volumetric:			
First 2 Mcf/Month	1.4472	3.5697	5.0169
Next 48 Mcf/Month	1.4072	3.5697	4.9769
Next 150 Mcf/Month	1.3672	3.5697	4.9369
All Over 200 Mcf/Month	1.3272	3.5697	4.8969
Delivery Service:			
Firm	1.3272	.0561	1.3833
 RATE SCHEDULE FI			
Commodity Charge:	0.4514	3.5697	4.0211
Delivery Service:			
Interruptible	0.4421	.0561	.4982
 RATE SCHEDULE IS			
Commodity Charge	0.4514	3.5697	4.0211
Delivery Service:			
Interruptible	0.4421	.0561	0.4982
 RATE SCHEDULE IUS			
For all Volumes			
Delivered each Month	0.1411	3.5697	3.7108
Delivery Service	0.1411	0.7643	0.9054