COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

RATE ADJUSTMENT OF WESTERN KENTUCKY GAS COMPANY	))	CASE NO. 90-013

O R D E R

On October 22, 1990, the Commission granted rehearing on various issues contained in the September 13, 1990 Order which granted an increase in the revenues of Western Kentucky Gas Company ("Western") of $1,018,455 annually. Testimony was filed by the parties, a hearing was conducted on January 29 and 30, 1991 and all parties were permitted to file briefs and reply briefs. After reviewing the evidence of record and being otherwise sufficiently advised, the Commission finds as follows:

PLANT ACQUISITION ADJUSTMENT/DEFERRED INCOME TAXES

The transfer of Western to Atmos in 1987 created an approximate $17 million increase in net investment due to the loss of accumulated deferred income taxes and the purchase price in excess of net book value which resulted in a plant acquisition adjustment. The consideration of these two items is the basis for determining whether or not the transfer results in an economic benefit to the ratepayers.

The Commission has determined that the findings contained in the original Order with regard to the rate-making treatment of the transfer-related deferred tax losses are valid, theoretically sound, and would fairly reflect and account for the sources of funds used for investment in utility assets if not for the rulings of the Internal Revenue Service. The uncontested testimony in the rehearing reflects that if the Commission applies this rate-making treatment in this instance, the utility will be subject to rulings of the Internal Revenue Service which would preclude it from utilizing accelerated depreciation for tax purposes. Accelerated depreciation provides, through the normalization process in rate-making, funds for capital investment. The risk of loss of such tax benefits would not be in the best interests of the utility or the ratepayers. Due to the violation of normalization requirements, the Commission finds it appropriate to remove the adjustment for Transfer Related Deferred Tax Losses and increase rate base by $12,030,269, which is the amount of $12,783,597 originally deducted from rate base less Western's actual test-year-end accumulated deferred taxes. This adjustment will result in an increase in revenue requirements of $2,225,068. In addition, the Commission reinstates the income tax expense of $233,330 for amortization of the investment tax credits and $131,081 for amortization of the excess deferred taxes. These tax adjustments result in an increase in revenue requirements of $601,785.

The Commission's initial determination on the plant acquisition adjustment was that cost savings would result from the change in ownership; that ratepayers and stockholders would both benefit; and that the benefits should be shared in the rate-making process by allowing Western to amortize the adjusted plant acquisition adjustment in operating costs, but to exclude the acquisition adjustment from the rate base. However, as indicated above, the Commission cannot restore any portion of the benefits of the pre-transfer deferred taxes to the ratepayers. As a result, the ratepayers will realize a substantial economic loss. Had the transfer been structured differently, the loss of deferred taxes might not have occurred, and the ratepayers could have been kept "whole." The Commission believes that the ratepayers' interests were not adequately considered by the buyer and the seller in structuring the 1987 transfer of Western. Given these circumstances, the Commission finds it unreasonable to require those same ratepayers to also bear the expense for the amortization of the plant acquisition adjustment which resulted from the transfer. The Commission therefore reverses its previous decision and finds that the amortization of the plant acquisition adjustment should not be included for rate-making purposes. The exclusion of this item results in a decrease in revenue requirements of $280,204.

OTHER REHEARING ISSUES

Valuation of Working Gas

The Commission granted rehearing on this issue at the request of the Kentucky Legal Services intervenor, Martha Sue Holmes ("KLS"). KLS requested the Commission rehear this issue, since according to KLS, the Commission's original determination of the appropriate valuation of working gas was not based upon a known and measurable adjustment. After consideration of this issue, the Commission finds the use of an average rather than end-of-test-period valuation to be reasonable and supported by the record in this proceeding. The Commission thus affirms its original decision on this issue.

Merchandising Sales and Jobbing/Demonstration and Selling

Based on the evidence presented by Western on rehearing, the Commission has been able to identify and segregate the costs which should be recorded below the line for rate-making purposes. Western provided an analysis which showed that $305,713 of the $721,223 in Demonstration and Selling expenses should be recorded above the line. Western has not presented substantial evidence that its costs relating to the "Affordable Gas Home" and "On The Mains" programs are not promotional in nature, and of benefit to the ratepayers of Western. Therefore, the Commission will reduce the amount of expense proposed by Western by $82,362 for rate-making purposes resulting in an increase of $223,351 to revenue requirements. The $322,784 in Merchandise Sales and Jobbing Income which was moved above the line in the original Order will be reinstated as a below the line income item which will result in a total increase in revenue requirements of $546,135.

Tax on ESOP Dividends

Western has provided additional information after the hearing which indicates that $11,067 in tax savings on ESOP dividends should be reflected in Western's adjusted operating statement for rate-making purposes. The Commission accepts this adjustment and therefore has decreased revenue requirements by $18,276.

Pension Expense

No additional evidence was presented on this issue by the Attorney General. Therefore, the Commission affirms its original decision on this issue.

Outside Services

Western argued that the temporary services expense of $132,133 proposed by the Attorney General and disallowed in the original Order was an incorrect amount and was inappropriately disallowed. Western stated that the actual amount was $117,068 but no explanation or supporting documentation for the amount was provided. The Commission finds that Western has not adequately supported the necessity for this expense and hereby affirms its original decision on this issue.

Working Capital

The increase in operation and maintenance expenses resulting from the adjustments for merchandising and jobbing and demonstration and selling expenses creates an increase in cash working capital of $68,267 which results in an increase in revenue requirements of $12,626.

Interest Synchronization Adjustment

The net increase in rate base of $12,098,536 to reflect the adjustments contained herein results in a decrease in revenue requirements of $473,168 resulting from the tax savings created by the additional interest costs allowed for rate-making purposes.

Return on Equity

The Commission allowed additional evidence to be presented as to how the Commission's treatment of deferred taxes and the acquisition adjustment affected Western's riskiness and hence its cost of equity. Based on the decisions herein with regard to the rate-making treatment of the pre-acquisition deferred taxes and the plant acquisition adjustment, the Commission finds that there is not sufficient evidence to determine that any additional risk or increased cost of equity will occur. Therefore, the original decision on this issue is affirmed.

Remedial Surcharge

Western requested the Commission establish a remedial surcharge and to set rates on rehearing effective as of the date of the Commission's original Order in this proceeding, September 13, 1990.

The Commission has fully complied with its legislative mandate to afford due process through evidentiary hearings and rehearings. The fair, just, and reasonable rates could not have been determined prior to the fulfillment of this entire process and, consequently, the rates are not subject to an effective date prior to the issuance of this final Order. To allow the rates to be collected for service rendered on and after the date of the original Order would constitute retroactive rate-making which cannot be allowed. Therefore, the request is denied.

REVENUE REQUIREMENTS

Based on the decisions on the issues contained herein, Western is entitled to increase its revenues by $2,613,966 above the amount allowed in the Commission's original Order, which results in a total combined revenue increase of $3,632,421.

IT IS THEREFORE ORDERED that:

1. The rates in the Appendix, attached hereto and incorporated herein, are approved for service rendered by Western on and after the date of this Order.

2. Within 30 days of the date of this Order, Western shall file with the Commission revised tariff sheets setting out the rates approved herein.

Done at Frankfort, Kentucky, this 29th day of May, 1991.

PUBLIC SERVICE COMMISSION

Chairman

Vice Chairman

Commissioner

ATTEST:

Executive Director

APPENDIX

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 90-013 DATED 5/29/91

The following rates and charges are prescribed for the customers in the area served by Western Kentucky Gas Company. 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. These rates reflect all gas cost adjustments through Case No. 90-013-C.

General Sales Service Rate G-1

Base Charge:	\$ 4.35	per meter per month for residential service
	\$11.60	per meter per month for non-residential service
Commodity Charge:		
First 300 Mcf per month	\$4.3763	per 1,000 cubic feet
Next 14,700 Mcf per month	\$4.2263	per 1,000 cubic feet
Over 15,000 Mcf per month	\$4.0763	per 1,000 cubic feet

Transportation Service Rate T-2

Includes standby sales service under corresponding sales rates.

General Service Rate G-1:

	Simple Margin	+	Non-Commodity Components	=	Gross Margin Transportation Rate Per 1,000 Cu. Ft.
First 300 Mcf/mo.	\$0.9419		\$0.3464		\$1.2883
Next 14,700 Mcf/mo.	0.7919		0.3464		1.1383
All over 15,000 Mcf/mo.	0.6419		0.3464		0.9883