COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF BURKESVILLE GAS COMPANY, INC. FOR A RATE ADJUSTMENT PURSUANT TO THE ALTERNATIVE RATE FILING PROCEDURE FOR SMALL UTILITIES	))))	CASE NO. 2000-158

O R D E R

On April 27, 2000, Burkesville Gas Company, Inc. ("Burkesville") filed its application for Commission approval of proposed base gas rates. Commission Staff, having performed a limited financial review of Burkesville's operations, has prepared the attached Staff Report containing Staff's findings and recommendations regarding the proposed rates. All parties should review the report carefully and provide any written comments or requests for a hearing or informal conference no later than 10 days from the date of this Order.

IT IS THEREFORE ORDERED that all parties shall have no more than 10 days from the date of this Order to provide written comments regarding the attached Staff Report or requests for hearing or informal conference. If no request for a hearing or informal conference is received, this case will be submitted to the Commission for a decision.

Done at Frankfort, Kentucky, this 30th day of October, 2000.

By the Commission

ATTEST:

Thomas M. Dorman

Executive Director

STAFF REPORT

ON

BURKESVILLE GAS COMPANY, INC.

CASE NO. 2000-158

On April 27, 2000, Burkesville Gas Company, Inc. ("Burkesville") filed an application with the Public Service Commission ("Commission") to increase its base gas rates. The proposed base rates would increase annual operating revenue by $53,286 or 40.37 percent. The proposed base rates will increase the average monthly residential bill by $7.30 or 20.74 percent.

In order to review the requested rates Commission Staff ("Staff") performed a limited financial review of Burkesville's test year operations. The scope of Staff's review was limited to obtaining information as to whether the test period operating revenues and expenses were representative of normal operation. Insignificant or immaterial discrepancies were not pursued and are not addressed herein. Burkesville used the twelve months ending December 31, 1999, as the test year in its application.

Burkesville's pro forma operating income statement is included in this report as Attachment A. It shows normalized operating revenues from base rates to be $131,996. Using test year Mcf sales, Burkesville's proposed base rates would increase normalized operating revenues by $53,285 to $185,282.

Staff's pro forma operating income statement and explanation of adjustments thereto are shown in Attachment B of this report. Staff used on 88 percent operating ratio to determine Burkesville's revenue requirement. Based on Staff's calculations, Burkesville's actual revenue requirement from base rates is $206,813. This exceeds the requested requirement by $21,531. Staff recommends that the requested base rates be approved in this case as they will not result in Burkesville over earning.

A comparison of Burkesville's and Staff's revenue requirement calculations is shown in Attachment C. The rates listed in Attachment D will produce additional annual revenue from base rates of $53,285 and should be approved by this Commission. Attachment E includes discussion of Burkesville's proposed rate structure.

Daryl Newby is responsible for all revenue adjustments and calculation of the recommended rates. Scott Lawless is responsible for the determination of the revenue requirement.

Signatures

Prepared by: Jack Scott Lawless, CPA
Financial Analyst, Water and Sewer
Revenue Requirements Branch
Division of Financial Analysis

Prepared by: Daryl Newby
Rate Analyst, Electric and Gas Rate
Rate Design Branch
Division of Financial Analysis

ATTACHMENT A
STAFF REPORT CASE NO. 2000-158
BURKESVILLE'S REQUESTED OPERATIONS

	Test Year	Adjustments	Pro forma
Service Revenues			
Base Rate Revenue	131,996		131,996
Gas Cost Recovery Revenue	206,746	59,174	265,920
Total Service Revenues	338,742	59,174	397,916
Operating Expenses			
Operation and Maintenance Expenses			
Cost of Gas:			
Natural Gas Purchases	142,241	37,759	180,000
Transmission	52,385	33,535	85,920
Total Cost of Gas	194,626	71,294	265,920
Mains and Services Labor	32,672	1,634	34,306
Mains and Services Supplies and Expenses	2,404		2,404
Rents	1,254		1,254
Maintenance of Lines	1,408	71	1,479
Maintenance of Meters and House Regulators	412	21	433
Meter Reading Labor	1,260	63	1,323
Accounting and Collecting Labor	15,971	799	16,770
Supplies and Expenses	1,037		1,037
Office Supplies and Expenses	4,711		4,711
Outside Services Employed	40,514	1,894	42,408
Property Insurance	15,878	1,153	17,031
General Advertising Expenses	145	456	601
Miscellaneous General Expenses	10,818	2,409	13,227
Transportation Expenses	2,706		2,706
Total Operation and Maintenance Expenses	325,816	79,794	405,610
Depreciation Expense	40,849	(40,849)	-
Amortization Expense	(30,016)	30,016	-
Taxes Other Than Income Taxes	14,687		14,687
Total Operating Expenses	351,336	68,961	420,297
Net Operating Income	(12,594)	(9,787)	(22,381)

ATTACHMENT B
STAFF REPORT CASE NO. 2000-158
STAFF'S RECOMMENDED OPERATIONS

	Test Year	Adjustments		Pro forma
Service Revenues				
Base Rate Revenue	131,996			131,996
Gas Cost Recovery Revenue	206,746	23,950	A	230,696
Total Service Revenues	338,742	23,950		362,692
Operating Expenses				
Operation and Maintenance Expenses				
Cost of Gas:				
Natural Gas Purchases	142,241	36,172	A	178,413
Transmission	52,385	(2,429)	A	49,956
Total Cost of Gas	194,626			228,369
Mains and Services Labor	32,672	1,140	B	33,812
Mains and Services Supplies and Expenses	2,404			2,404
Rents	1,254			1,254
Maintenance of Lines	1,408		C	1,408
Maintenance of Meters and House Regulators	412		C	412
Meter Reading Labor	1,260	44	B	1,304
Accounting and Collecting Labor	15,971	557	B	16,528
Supplies and Expenses	1,037			1,037
Office Supplies and Expenses	4,711			4,711
Outside Services Employed	40,514	(19,528)	D	20,986
Property Insurance	15,878	1,216	E	17,094
General Advertising Expenses	145		F	145
Miscellaneous General Expenses	10,818	(457)	G	10,361
Transportation Expenses	2,706			2,706
Total Operation and Maintenance Expenses	325,816	(17,028)		342,532
Depreciation Expense	40,849	6,109	H	46,958
Amortization Expense	(30,016)	19,399	I	(10,617)
Taxes Other Than Income Taxes	14,687	(658)	J	14,029
Total Operating Expenses	351,336	7,823		392,902
Net Operating Income Before Taxes	(12,594)	16,127		(30,211)

ATTACHMENT B
STAFF REPORT CASE NO. 2000-158
STAFF'S RECOMMENDED OPERATIONS

A) Gas Cost Recovery Revenue and Cost of Gas. Burkesville proposed to increase Gas Cost Recovery Revenue, Natural Gas Purchases, and Transmission Costs by $59,174, $37,759, and $33,535, respectively. Staff calculated the adjustments to be $23,950, $36,172, and ($2,429), respectively. The primary difference in the adjustments is attributed to Burkesville using a transmission cost from its transporter of $1.75 per Mcf. That rate had not been approved by the Commission prior to the issuance of this report and has therefore not been reflected in Staff's adjustment. Staff used the current transport rate of $1.05 per Mcf. These adjustments were made to show pro forma operations of Burkesville and have no impact on the calculation of base rates. Any change in the cost of gas is accounted for through the quarterly gas cost recovery filing of Burkesville.

B) Payroll. Burkesville proposed to increase test year operating expenses by a total of $2,496 for increased payroll. A detail of this adjustment was not provided. It was calculated by subtracting test year expenses from Burkesville's operating budget for the year 2000.

Staff calculated a total adjustment of $1,741 by applying employee pay rates at the time of Staff's fieldwork to test year hours worked. Then, total pro forma payroll was allocated to each expense account based on the percentage allocations used during the test year. Total payroll allocated to operating expenses was $51,644 while $1,396 was allocated to Jobbing Labor.

C) Maintenance of Lines, Meters, and House Regulators. Burkesville proposed to increase each of these expenses by 5 percent. Burkesville's adjustments do not meet the rate-making criteria of known and measurable. Staff recommends that they be denied.

D) Outside Services Employed.

Contracted Accounting Services. During the test year Burkesville incurred $4,716 in accounting fees. Burkesville proposed an increase of $7,200 to reflect a new contract wherein a CPA would perform monthly processing of account payable checks, record deposits and sales, process payroll checks, and prepare and file applicable payroll tax forms. Staff recommends that this adjustment be disallowed. These tasks are bookkeeping in nature and do not require a CPA. Staff has included office payroll of $16,000 for an employee to manage the office. This amount is adequate for all duties proposed to be done by the CPA for a utility the size of Burkesville. Burkesville has 325 customers, three employees, and writes approximately 600 checks per year of which 156 are payroll.

Staff proposes to reduce test year accounting fees by $2,400 for bookkeeping services provided by a CPA during the test year. Again, the office payroll is adequate to cover all bookkeeping costs. Staff has allowed accounting fees of $2,316 to remain in pro forma operations that was incurred for the preparation of income tax forms and financial statement compilation.

Legal Fees. During the test year Burkesville incurred legal fees of $15,029. It proposed to reduce that amount by $9,029 stating that $6,000 was expected to be incurred annually for normal legal fees.

Staff recommends that Burkesville's adjustment be denied. Normal recurring legal fees of $6,000 for a utility with 325 customers is unreasonable.

After reviewing test year legal fees Staff determined that the majority were related to prudent but nonrecurring items. Therefore, Staff has amortized the total amount over 5 years to allow for their recovery. This results in a decrease to test year expenses of $12,023[1].

Legal fees for a utility the size of Burkesville should be minimal. The fees should be substantially less than $6,000 per year. Staff considered the unusual circumstances surrounding Burkesville's change in ownership, debt history, and operations when recommending its adjustment to allow for the recovery of test year legal fees. However, it appears that Burkesville's operations are becoming more traditional and should therefore result in more efficient operations. Legal fees should become an insignificant part of Burkesville's operating expenses in the future.

Contracted Management Fee. Burkesville proposed a pro forma management fee of $12,000 to be paid to Summit Holding Company, an affiliated entity. No evidence has been provided to substantiate the reasonableness of this adjustment. It is Staff's opinion that the amount is excessive given the size of Burkesville. Staff believes that Summit should be paid a reasonable amount for management services. Staff recommends that a $3,600 annual management fee be approved in this case. The Commission commonly uses this amount when setting rates for small water and sewer

---

1 $15,029 test year / 5 years = $3,006 annual recovery
$3,006 annual recovery - $15,029 test year = $12,023 decrease

utilities filing under 807 KAR 5:076. Staff has decreased test year expenses by $5,105 ($3,600 recommended amount - $8,705 test year expense = $5,105 decrease) to reflect this adjustment.

The total decrease to test year outside services employed is $19,528 and is summarized as follows:

Accounting	$2,400
Legal	12,023
Management	5,105
Total decrease	$19,528

E) Property Insurance. Burkesville reported health insurance premiums paid on behalf of its employees in the property insurance account in the amount of $6,432. Burkesville proposed to increase that amount by $1,153. Staff calculated an increase of $1,216[2] by annualizing the monthly premium paid at the time of the fieldwork. Staff recommends that test year operating expenses be increased by $1,216.

F) General Advertising Expenses. Burkesville reported test year advertising expense of $145 that it proposed to increase by $456. Burkesville did not provide support for the increase. Burkesville did submit evidence showing that the year 2000 expense through October 13, totaled $235 or $90 more than test year. This is not a significant increase that warrants adjustment. Staff recommends that no adjustment be made to test year advertising expenses.

[2] $637 monthly premium x 12 months = $7,644 pro forma
$7,644 pro forma - $6,432 test year = $1,216 increase

G) Miscellaneous General Expenses. Burkesville proposed to increase test year miscellaneous expenses by $2,409. The adjustment was supported by the following:

Rerock and grade drive	$100
Termite inspection	150
Front door	350
Carpet cleaning	75
Lawn care equipment	300
Total Maintenance	$975
Meter head software training	$350
Gas advantage training system	195
Locating underground piping	95
Advanced	615
Minimum skills	240
Total Training	$1,495
Total Increase	$2,470

Staff considers the items included as miscellaneous maintenance expenses to be general to the operations of Burkesville. Although these specific costs may only occur once every two or three years, there are similar types of expenses already included in test year operation. Staff recommends that this portion of the adjustment be rejected.

No training expenses were reported during the test year. The training included in this adjustment was to be completed by the fall of 2000. It was not. Staff recommends that the proposed adjustment be denied.

Staff is of the opinion that Burkesville's employees should be adequately trained and that related costs should be reflected in rates. To formulate an adjustment Staff reviewed training that was completed during the last 12 months and determined that test year operating expenses should be increased by $501. During the last 12 months

Burkesville incurred $1,294 for meter head software training and $242 for a Commission sponsored seminar. Staff considers the software training to be nonrecurring and proposes to amortize it over 5 years. The Commission seminar is general in nature and should be allowed annually. The adjustment was calculated as follows:

Nonrecurring training	$1,294
Divide by: 5 years	5
Annual recovery	259
Add: Recurring training	242
Increase	$501

Staff decreased test year Miscellaneous General Expenses by $958. This amount represents payment made for the use of a Texas based cell phone while a Summit Holding Company executive was in Kentucky for 3 consecutive weeks tending to business of Burkesville. The calls were not directly related to Burkesville's gas operations and have therefore been removed from test year operations.

Staff's recommended net adjustment to the Miscellaneous General Expense account is a decrease of $457 ($501 increase for training - $958 decrease for executive cell phone = $457 net decrease).

H. Depreciation Expense. Test year depreciation expense was reported at $40,849. However, it was not included as a revenue requirement in Attachment 1 of Burkesville's application. Staff is of the opinion that the original cost of plant in service may be recovered through rates. Staff has included depreciation in its determination of revenue requirements in this case.

Upon review of Attachment 6 of Burkesville's application, Staff determined that test year depreciation expense was calculated using tax depreciation rates. Instead of using that amount for rate-making purposes, Staff chose to formulate a pro forma depreciation expense consistent with the Commission's audit of Burkesville's 1996 financial statements that was completed on October 3, 1997. Staff adjusted the plant schedule used in that audit for additions made to plant as noted in Burkesville's 1997, 1998, and 1999 Annual Reports on file with the Commission. Straight line depreciation was taken on Utility Plant in Service over the estimated useful life of each asset. The resulting adjustment is an increase of $6,109 over reported test year depreciation. Staff recommends that its adjustment be accepted in this case.

I. Amortization Expense. Burkesville reported test year amortization expense with a credit (revenue) entry of $30,016. The amount has two components. The first is a debit entry of $1,984 that was erroneously charged to account 404, amortization expense, instead of account 403, depreciation expense. The second is a $32,000 credit entry for the complete write-off of a prior period acquisition adjustment.

Staff proposes to eliminate the $1,984 debit entry to this account. Staff has accounted for this entry in its adjustment to test year depreciation expense.

The $32,000 write-off stems from the Commission's audit of 1996 wherein Burkesville was instructed to record an acquisition adjustment of $43,053 as a result of the 1992 capital lease with Ken Gas. The adjustment was to be amortized over 27 years. The annual amortization expense was $1,595. In 1999, the unamortized balance was $32,000 when it was written-off entirely. Staff is of the opinion that the amount should be placed back on the books of Burkesville and amortized accordingly. Staff has made the adjustment for rate-making purposes.

Staff further proposes to adjust test year amortization expense for a gain on debt restructuring. During the test year Burkesville recognized a $180,449 write down of long-term debt. The gain was erroneously recorded as a decrease to Utility Plant in Service. It should have been recorded as an Unamortized Gain and amortized over the life of the loan, 20 years. The inclusion of this gain is necessary to be consistent with other recommendations in this report where Staff included legal fees and interest costs related to this debt. The annual recognition of this gain will be $9,022 ($180,449 / 20).

The net adjustment to test year amortization expense is calculated as follows, numbers in parenthesis (###) represents a credit entry:

Amortization of Acquisition Adjustment	$(1,595)
Amortization of Gain on Debt Restructuring	(9,022)
Pro forma Amortization Expense	(10,617)
Less: Test year	30,016
Decrease	$19,339

Taxes Other Than Income Taxes. Test year FICA taxes were reported at $4,608. FICA taxes calculated on pro forma payroll is $3,951 ($51,644 pro forma payroll in operating expenses x 7.65% FICA rate). Therefore, Staff has decreased test year expenses by $658 ($4,608 - $3,951).

ATTACHMENT C
STAFF REPORT CASE NO. 2000-158
COMPARISON OF BURKESVILLE'S AND STAFF'S REVENUE REQUIREMENT CALCULATIONS

	Burkesville Requested	Staff Recommended
Total Operating Expenses	420,297	392,902
Less: Cost of Gas	(265,920)	(228,369)
Operating Expenses to be Recovered in Base Rates	154,377	164,533
Adjust for:		
Revenue from Merchandising and Jobbing	(7,442)	
Expense from Merchandising and Jobbing	6,054	
Nonutility Deductions	6,210	
Divide by: Operating Ratio		88%
Revenue to cover operating ratio		186,970
Plus: Interest on Long-Term Debt (See Note 1)	32,528	14,495
Income Taxes on Net Operating Income (See Note 2)		5,349
Total Revenue Required from Base Rates	191,727	206,813
Less: Revenue Requested/Recommended from Base Rates	(185,282)	(185,282)
Revenue Deficit/(Surplus)	6,445	21,532

Note 1: Burkesville requested interest on long-term debt of $32,528. Interest of $15,528 relates to loans owed to the Bank of Clinton County and the Small Business Administration ("SBA"). The remaining $17,000 is from a loan owed to Summit Holding Co. Burkesville assumed the notes owed to the Bank of Clinton and SBA through the transfer of ownership from Ken Gas. Staff has calculated a five-year average interest payment for these two loans to be included in revenue requirements. The amount owed to Summit was accrued on the books of Burkesville when Summit was financing a portion of Burkesville's daily operations. To allow interest costs on loans used to fund prior period operations would constitute retroactive rate-making. Staff recommends this portion of the interest ($17,000) be disallowed.

ATTACHMENT C
STAFF REPORT CASE NO. 2000-158
COMPARISON OF BURKESVILLE'S AND STAFF'S REVENUE
REQUIREMENT CALCULATIONS

Calculation of Five-Year Average Interest Payment.

Year	Bank of Clinton	SBA	Total
2001	4,475	12,598	17,073
2002	3,570	12,598	16,168
2003	2,555	12,412	14,967
2004	1,417	11,691	13,108
2005	239	10,920	11,159
Total Paid	12,256	60,219	72,475
Divide by: 5 years	5	5	5
Average	2,451	12,044	14,495

Note 2:
Calculation of Income Tax Allowance

Revenue for operating ratio coverage	186,970
Less: Operating expenses before taxes	(164,533)
Net Operating Income Allowed	22,436
Times: Gross-up factor	1.23839009
Net Operating Income Before Taxes	27,785
Less: Net Operating Income Allowed	(22,436)
Income Tax Expense	5,349

Calculation of Gross-up Factor

Revenues	1
Less: State tax	0.05
Sub-total	0.95
Less: Federal tax (15 percent of sub-total)	-0.1425
Percent change in Net Operating Income	0.8075
Gross-Up Factor (Revenue of 1 divided by percent change in NOI)	1.23839009

ATTACHMENT D
STAFF REPORT CASE NO. 2000-158
STAFF'S RECOMMENDED RATES

	Base Rate
Residential	$4.25 per Mcf
Commercial	3.90 per Mcf

Burkesville has no minimum bill or customer charge. Burkesville might want to consider such a charge to assist in recovering its fixed costs. Staff also notes that Burkesville has no reconnect charge. With the significant variance of customers it experiences on a seasonal basis, it may be to Burkesville's advantage to consider such a charge to recover expenses caused by customers going on and off the system. Staff recommends that Burkesville evaluate a reconnection charge, and if desired, submit it to the Commission for consideration in a revised tariff.