COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF VALLEY GAS, INC. FOR AN ADJUSTMENT OF RATES PURSUANT TO THE ALTERNATIVE RATE FILING PROCEDURE FOR SMALL UTILITIES	))))	CASE NO. 2006-00012

O R D E R

On January 12, 2006, Valley Gas, Inc. ("Valley Gas") applied to the Commission for an adjustment of rates pursuant to 807 KAR 5:076, the alternative rate filing procedure for small utilities. Having performed a limited financial review of Valley Gas's operations, Commission Staff ("Staff") has submitted to the Commission a report of its findings and recommendations regarding the proposed rate adjustment. All parties should review the report carefully and submit any written comments on Staff's findings and recommendations 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, no later than 10 days from the date of this Order, submit written comments, if any, regarding the attached Staff Report or request for a hearing or informal conference. If no request for a hearing or informal conference is received by this date, this case shall stand submitted to the Commission for a decision.

Done at Frankfort, Kentucky, this 21st day of February, 2006.

By the Commission

ATTEST:

Executive Director

STAFF REPORT

ON

VALLEY GAS, INC

CASE NO. 2006-00012

Pursuant to a request by Valley Gas, Inc. ("Valley Gas") for assistance with the preparation of a rate application, Commission Staff performed a limited financial review of Valley Gas's test period operations, the calendar year ending December 31, 2004. 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 operations. Insignificant or immaterial discrepancies were not pursued and are not addressed herein.

Upon completion of its limited review, Staff assisted Valley Gas in the development and preparation of its rate application, which Valley Gas filed with the Commission on January 12, 2006. Staff hereby adopts the contents of Valley Gas's application as its recommendation in this report as if fully set out herein. Dawn McGee of the Commission's Division of Financial Analysis is responsible for all pro forma revenue adjustments and the billing analysis. Andrea Edwards of the same division is responsible for all pro forma expense adjustments and the revenue requirement determination.

Attachment A of the application, attached hereto as Appendix A, is the adjusted pro forma operating income statement wherein adjustments were made to test period operating revenues and expenses that were known and measurable and deemed to be reasonable. The revenue requirement determination, also shown on Attachment A of the application and Appendix A of Staff's Report, shows that Valley Gas's pro forma operations support a revenue requirement from rates of $496,212, an increase of $44,365 or 9.82 percent above the normalized revenue from rates of $451,847. The rates proposed by Valley Gas will increase the average residential bill from $122.24 to $129.91, an increase of $7.67 or 6.27 percent.

Valley Gas used an 88 percent operating ratio to determine the amount of increase it proposed in its application. An operating ratio is used primarily when there is no sound basis for a rate of return determination using the required return on rate base method. For gas utilities, purchased gas expense is excluded from the operating ratio calculation since it is recovered through the PGA. Applying an 88 percent operating ratio to Staff's adjusted operating expenses results in a total revenue requirement of $496,212, an increase in operating revenue of $44,365

Upon its review of the documents upon which the application is based, Staff finds that the proposed revenue requirement of $496,212 will allow Valley Gas to pay its adjusted operating expenses and provide a reasonable rate of return. Based on its recommended revenues of $496,212, Staff recommends the following rates for Valley Gas:

All Mcf

	Base Rate	Gas Cost Recovery Rate	Total
Minimum Bill	$ 8.50	$ 9.02	$ 17.52
> 1 Mcf	$ 3.1272	$ 9.02	$ 12.1472

During the preparation of the application, Valley Gas indicated that it would like to increase its non-recurring charges and requested assistance with preparing the cost justification. Staff gathered the pertinent cost information and performed the required analysis. Based on the amount of time, travel and labor, Staff recommends the following increases in non-recurring charges:

	Currently Authorized	Staff Recommended	Resulting Increase
Returned Check Charge		$25.00	$25.00
Collection Fee	$7.50	$15.00	$ 7.50

Signatures

Prepared by: Andrea Edwards
Financial Analyst, Electric and Gas
Revenue Requirements Branch
Division of Financial Analysis

Prepared by: S. Dawn McGee
Rate Analyst, Electric and Gas
Rate Design Branch
Division of Financial Analysis

APPENDIX A
STAFF REPORT CASE NO. 2006-00012
PRO FORMA INCOME STATEMENT

	Test-Period Operations	Pro Forma Adjustments	Adj. Ref	Pro Forma Operations
Operating Revenue:				
Retail Sales	$ 374,267	$ 77,579	(A)	$ 451,847
Forfeited Discounts	6,559			6,559
Miscellaneous Service Revenues	2,822			2,822
Total Operating Revenue	$ 383,649	$ 77,579		$ 461,228
Total Operating Expenses:				
Operation & Maintenance:				
Natural Gas Citygate Purchases	$ 352,765	$		$ 352,765
Gas Withdrawn from Storage	(43,371)			(43,371)
Mains and Services Expense	33,871			33,871
Uncollectible Accounts	950			950
Administrative and General Salaries	26,400			26,400
Office Supplies and Expenses	8,951	1,308	(B)	10,258
Outside Services Employed	57,587	255	(C)	57,842
Property Insurance	9,156	2,835	(D)	11,991
Employee Pensions and Benefits	9,720	6,156	(E)	15,875
General Advertising Expenses	488	(488)	(F)	0
Miscellaneous General Expenses	3,362			3,362
Rent	6,000			6,000
Total Operation & Maint. Expense	$ 465,880	$ 10,065		$ 475,945
Depreciation Expense	$ 1,648	$		$ 1,648
Taxes Other than Income	4,411	45	(G)	4,457
Total Operating Expenses	$ 471,939	$ 10,110		$ 482,050
Net Operating Income (Loss)	$ (88,290)	$ 67,469		$ (20,821)
Other Income & Deductions:				
Other Nonutility Income – Net	$ 29,786	$		$ 29,786
Interest and Dividend Income	281			281
Other Nonutility Deductions	(100)	100	(H)	0
Other Interest Expense	(1,988)			(1,988)
Total Other income (Deductions)	$ 27,978	$ 100		$ 28,078
NET INCOME	$ (60,312)	$ 67,569		$ 7,256

Adj. Ref.	Descriptions of Pro Forma Adjustments
(A)	**Revenue from Gas Sales**: This adjustment reconciles the gas cost adjustment revenues and the gas cost expense.
(B)	**Mains & Services Labor**: This adjustment reflects the current staff level and current wage rates.
(C)	**Maintenance of Lines**: This adjustment reflects the elimination of repair work to an employee's home, a floral arrangement, and a grocery gift card.
(D)	**Accounting & Collection Labor**: This adjustment reflects the elimination of the management firm, and the current staff level and wage rate.
(E)	**Administrative and General Salaries**: This adjustment reflects the current staff level and current wage rates.
(F)	**Office Supplies & Expenses**: This adjustment reflects the elimination of a cellular phone contract that was not renewed and corrects misclassified expense.
(G)	**Outside Services:** This adjustment removes the management consulting fees.
(H)	**Insurance**: This adjustment reflects an expected increase in liability insurance
(I)	**Employee Benefits**: This adjustment reflects the current health and retirement expenses.
(J)	**Equipment Rental**: This adjustment removes the non-recurring equipment rental.
(K)	**Transportation Expense**: This adjustment reflects the elimination of non-field personnel fuel expenses and corrects misclassified expenses.
(L)	**Interest Expense**: This adjustment reflects the increase in interest expense due to the debt refinancing.
(M)	**Taxes Other than Income**: This adjustment reflects the payroll taxes at the current wage rates.

REVENUE REQUIREMENTS DETERMINATION

Revenue Requirement Calculation/Based on an 88% Operating Ratio	
Pro Forma Operating Expenses	482,050
Less: Natural Gas Purchases	309,394
Subtotal	172,656
Divided by: 88%	88%
Subtotal	196,200
Add: Natural Gas Purchases	309,394
Less: Other Gas Revenues	9,381
Revenue Requirement from Rates	496,212
Normalized Revenues	451,847
Increase (Decrease) Required	44,365