COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF PUBLIC GAS COMPANY FOR RATE ADJUSTMENT FOR SMALL UTILITIES PURSUANT TO 807 KAR 5:076	)))	CASE NO 2012-00431

ORDER

Public Gas Company ("Public") is a local gas distribution company ("LDC") which provides retail natural gas service in several Eastern Kentucky counties. It serves approximately 1,600 customers in Breathitt, Johnson, Lawrence, Lee, Magoffin, Morgan and Wolfe counties.[1]

BACKGROUND

On September 28, 2012, Public filed an application for an increase in its base rate revenues of $349,573 pursuant to 807 KAR 5:076, the Alternative Rate Filing procedure for small utilities. There are no intervenors in this matter. Public responded to two data requests from Commission Staff ("Staff"). At Public's request, an informal telephonic conference was held on January 3, 2013, so that Public could clarify certain responses to data requests and for discussion of procedural matters. Public stated during the conference that it did not believe a formal hearing was necessary and that it would not request a hearing. Staff concurred with Public, stating that it also did not believe a hearing was needed. With no intervenors, and with both Public and the Staff having indicated there is no need for a hearing, the case now stands submitted for a decision.

[1] The transfer of Public from Kentucky Energy Development LLC to Gas Natural, Inc. was approved in Case No. 2012-00029, Joint Application of Gas Natural, Inc. and Kentucky Energy Development, LLC for an Order Approving a Transfer and Acquisition of Ownership and Control of Public Gas Company, Inc. (Ky. PSC Mar. 9, 2012).

TEST PERIOD

Public proposed the 12-month period ending December 31, 2011 as the test period for determining the reasonableness of its proposed increase. The Commission finds using the 12-month period ending December 31, 2011 as the test period in this proceeding to be reasonable. In utilizing a historic test period, the Commission has given full consideration to appropriate known and measurable changes, based on changes occurring both during and subsequent to the test period.

For the test period, Public reported operating revenues of $994,708, which consisted of $290,293 in revenues from base rates and miscellaneous charges plus $704,415 in gas cost recovery revenues. Public requested an increase in rates that would generate additional annual revenues of approximately $349,573.

TEST-PERIOD REVENUES AND EXPENSES

Public reported sales of 109,621 Mcf in the test year. Based on revenues of $994,708 and total expenses of $1,016,981 as reported in its annual report filed with the Commission, Public incurred a net loss of $22,273 in 2011. It based its proposed rates on increasing its revenues sufficiently to eliminate its net loss, cover increases in expenses, and realize a profit based on an operating ratio of .88 percent on its non-gas operating expenses.

ADJUSTMENTS TO TEST-YEAR REVENUES AND EXPENSES

We will approve a rate increase for Public of $268,147 based on its results of operations for its 2011 test year, the adjustments proposed by Public which we have accepted, and adjustments made by the Commission as described below. These adjustments reflect standard ratemaking theories and the Commission's long-held ratemaking practices.

Corporate Overhead Expenses

Public proposed an adjustment of $108,000 to reflect its share of the corporate overhead expenses incurred by its parent company, Gas Natural, Inc. ("Gas Natural"). This adjustment was based on Pubic's being allocated 3 percent of Gas Natural's total corporate overhead expenses.

In response to a Staff data request, Public revised its proposed adjustment based on an allocation percentage of 1.76842.[2] This resulted in an adjustment of only $78,785, or $29,215 less than what Public had originally proposed. The Commission will accept this revision as the correct adjustment, which we find to be reasonable for ratemaking purposes.

Insurance Costs

Public initially proposed an adjustment of $14,160 to reflect increased costs associated with (1) employee health insurance; (2) property insurance; (3) auto insurance; (4) general liability insurance; and (5) worker's compensation insurance. However, when preparing its response to a Staff data request, Public determined that this amount applied only to employee insurance, and that the amount of the adjustment should have been increased by $8,880[3] in order to include the other forms of insurance, resulting in a total amount of $23,040. We will accept this revision as the correct adjustment, which we find to be reasonable for ratemaking purposes.

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[2] See Response to Item 3 of Staff's First Request for Information filed Nov. 21, 2012 ("Staff's First Request").

[3] See Response to Item 1 of Staff's Second Request for Information filed Dec. 20, 2012 ("Staff's Second Request").

Rate Case Expenses

In its application, Public included an estimate of rate-case expenses of $12,000. Consistent with the Commission's historical practice, Public proposed to amortize its estimated rate-case expenses over a period of three years for ratemaking purposes, resulting in an adjustment of $4,000. In response to discovery, Public provided its actual rate-case expenses to date and provided two new estimates: one based on having a one-day hearing and one with no hearing.[4]

As there was no hearing in this case, the Commission has modified Public's rate-case expense adjustment. The information provided in the aforementioned response supports an expense level of $9,976. Amortizing this amount over three years results in an annual expense of $3,325, which is the amount we will allow as the adjustment for Public's rate-case expenses.

Summary Impact of Adjustments

After considering Public's actual revenues and expenses for the calendar year 2011 test year and the adjustments we have found reasonable herein, the Commission has determined that the financial results of Public's adjusted test-year operations would be as shown in Table 1.

[4] See response to Item 2 of Staff's Second Request.

Table 1

Account Titles	Test-Period Operations	Accepted Adjustments	Adjusted Operations
Operating Revenues	$ 994,708	$ (704,415)	$ 290,293
Operating Expenses	1,012,125	(546,444)	465,689
Net Operating Income	$ (17,417)	$ (157,979)	($ 175,396)
Other Income & Deductions	(4,856)	0	(4,856)
Net Income	$ (22,273)	$ (157,979)	$ (180,252)

REVENUE REQUIREMENT DETERMINATION

Public developed its revenue requirement based on an operating ratio of .88 ("88 percent"), consistent with the Commission's typical practice in rate cases involving small investor-owned utilities. However, there are three errors in Public's derivation which cause both its revenue requirement and proposed increase to be overstated.

The first error relates to Public's treatment of interest expense. While it added interest expense to adjusted operating expenses and its provision for income taxes in calculating its total revenue requirement, Public incorrectly included interest expense in determining its adjusted operating expenses of $491,552 and divided this amount by 88 percent to derive its allowable net income.

The second error relates to the state and federal income tax rates used by Public to derive its tax gross-up factor. Public used the maximum state corporate income tax rate of 6.0 percent and the maximum federal corporate income tax rate of 35.0 percent when only a portion of its income – over $50,000 for state taxes and over $75,000 for federal taxes – would be taxed at the maximum rates.[5] With its income, Public would be subject to a blended state income tax rate of 5.25 percent and a blended federal income rate of 22.5 percent. Those blended rates produce a 1.3841 gross-up factor, whereas Public had calculated a 1.6367 factor based on the maximum tax rates.

The final error is Public's omission of Other Operating Revenues of $33,754 in determining its Total Revenue Requirement from its Rates for Service. The omission of $33,754 in such revenues results in its proposed increase being overstated by that same amount.

Based on Public's adjusted test-year operating results and correct application of the 88 percent operating ratio, the Commission has determined, as shown in Table 2, that Public requires an increase in base rate revenues of $268,147.

Table 2

Adjusted Operating Expenses	$ 465,689
Divided by : 0.88	88%
Revenue to Cover Expenses and Operating Ratio	$ 529,192
Less: Adjusted Operating Expenses	465,689
Required Net Operating Income	$ 63,503
Multiply by Tax Gross-up Factor of 1.3841	$ 87,895
Add: Adjusted Operating Expenses	465,689
Other Interest Expense	4,856
Total Base Rate Revenue Requirement	$ 558,440
Less: Other Operating Revenues	33,754
Revenue Required from Rates for Service	$ 524,686
Less: Adjusted Test Year Base Rate Revenues	$ 256,539
Required Increase in Base Rate Revenues	$ 268,147

[5] Kentucky tax rates are: 4% for first $25,000, 5% for second $25,000 and 6% for amounts over $50,000. Federal rates are: 15% for first $50,000; 25% for next $25,000 and 35% for amounts over $75,000

Based on Public's most recent gas cost adjustment ("GCA"),[6] this base rate revenue increase will result in total annual revenues of $1,045,638. This reflects GCA revenues of $520,952, compared to Public's test year GCA revenues of $704,415.

Rate Design

Public proposed to change its rate design from one composed of a minimum bill including one Mcf and a flat volumetric rate for all additional volumes, which has been traditional for small gas utilities, to a rate design composed of a monthly customer charge and a single volumetric rate for all Mcf sold. Public proposed to establish a monthly customer charge of $13 per customer. We find that Public's proposed rate design is reasonable and similar to rate designs approved for other small gas utilities in recent years to provide revenue stability, especially during summer months when sales are at their lowest. As this is a change in rate design, and because the revenue increase being granted is approximately one-fourth less than the proposed increase, the Commission finds that a $10 customer charge is appropriate and will introduce the rate-design change to Public's customers more gradually. This is also the customer charge approved for Valley Gas, Inc.[7] and Bluegrass Gas Sales, Inc.[8] in the most recent small gas utility rate cases decided by the Commission. Revenues produced by the customer charge, which is calculated by applying the charge to test year 2011 bills, should be subtracted from the approved revenue requirement and divided by test year 2011 sales volumes in order to calculate the approved volumetric rate set out in the Appendix to this Order.

[6] Case No. 2013-0014, Purchased Gas Adjustment Filing of Public Gas Company (Ky. PSC Jan. 22, 2013).

[7] Case No. 2011-00010, Application of Valley Gas, Inc. for Alternative Rate Filing Adjustment (Ky. PSC July 5, 2011).

[8] Case No. 2011-00364, Alternative Rate Filing Adjustment of Bluegrass Gas Sales, Inc. (Ky. PSC July 17, 2012).

Public proposed to increase in its reconnect charge from $35.00 to $40.00 and to establish a $20.00 returned-check charge. Public provided the supporting costs for both the higher reconnect charge and the returned check charge. The Commission finds that these charges are reasonable and should be approved.

Public also proposed an increase in its customer deposit from $100 to $110,[9] based on its calculation of an average customer bill for two months. Performing the same calculation using the approved rates, the customer deposit would be $101.90. The Commission, therefore, finds that no increase in the customer deposit is necessary.

SUMMARY

Having considered the evidence of record and being otherwise sufficiently advised, the Commission finds that:

1. Based upon the adjusted test-period operations reflected herein, Public's annual base rate revenue requirement is $524,686.

2. Public's proposed rates will produce approximately $603,113 in annual base rate revenues.

3. The rates proposed by Public would produce revenues in excess of those found reasonable herein and should be denied.

IT IS THEREFORE ORDERED that:

1. The rates proposed by Public are denied.

2. The rates found reasonable herein and set forth in the appendix to this Order are approved for service rendered by Public on and after the date of this Order.

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[9] See Response to Item 8 of Staff's First Request.

3. Within 20 days of the date of this Order, Public shall file with the Commission revised tariffs setting out the rates approved herein which states that they were approved pursuant to this Order.

By the Commission

ENTERED

MAR 27 2013

KENTUCKY PUBLIC SERVICE COMMISSION

ATTEST:

Executive Director

APPENDIX

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2012-00431 DATED MAR 27 2013

The following rates and charges are prescribed for the customers served by Public Gas Company. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of the Commission prior to the effective date of this Order.

	Base Rate	Gas Cost Recovery Rate	Total
Customer Charge	$10.00		
All Mcf	$ 3.0914	$4.7523	$ 7.8437
Returned-Check Charge	$20.00		
Reconnect Charge	$40.00		
Customer Deposit	$100.00		

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