

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

RECEIVED

In the Matter of:

JAN 19 2006

J. W. KINZER DRILLING COMPANY'S
REQUEST TO INCREASE ITS FARM
TAP GAS RATES

CASE NO. 2005-00478

PUBLIC SERVICE
COMMISSION

**RESPONSES OF J. W. KINZER DRILLING COMPANY TO INTERVENOR'S "FIRST
SET OF INTERROGATORIES AND REQUESTS FOR PRODUCTION OF
DOCUMENTS TO J. W. KINZER DRILLING"**

Set forth below are the Responses of J. W. Kinzer Drilling Company (hereinafter "Applicant") to Interrogatories and Requests for Production of Documents tendered herein by Timothy C. Bates (hereinafter "Intervenor"). These Responses are submitted conditionally, subject to Applicant's pending "Motions to Deny Full Intervenor Status and to Strike", filed contemporaneously herewith.

After being duly sworn, Respondent Patrick G. McNamee responds as follows on behalf of Applicant:

Interrogatory No. 1: Please state the name, position, title, educational background and address of all individuals answering these discovery requests.

Response: Patrick G. McNamee, Controller, J. W. Kinzer Drilling Company, with business address of P. O. Box 155, Allen, Kentucky 41601.

Interrogatory No. 2: Please state in detail Kinzer's basis for requesting an increase in the farm tap rate. Please produce any and all documents supporting Kinzer's position.

Response: Applicant's letter dated November 23, 2005, to the Kentucky Public Service Commission (hereinafter "PSC") which initiated this proceeding sets forth in detail the basis for Applicant's request for rate increase. A copy of this letter is attached hereto as Exhibit "A". Additionally, Applicant is preparing Responses to the PSC's Initial Data Request of January 6, 2006, and will provide copies of those Responses to Intervenor when completed.

Interrogatory No. 3: Please provide in detail an explanation of how an increase in the cost of natural gas in general makes it more expensive for Kinzer to produce and sell the natural gas it currently provides to the 182 farm tap customers in question.

Response: The sale price of Applicant's natural gas into the interstate pipeline market is determined based upon the price of natural gas set on the New York Mercantile Exchange (referred to as "Nymex" in Applicant's letter of November 23, 2005), as adjusted by the Appalachian Basis differential, which is also set on the open market. Therefore, any sale of gas diverted from the interstate market pursuant to KRS 278.485 and sold to farm tap customers at a lesser price than that set out in Applicant's request for rate increase would result in a loss to Applicant.

Interrogatory No. 4: Please explain in detail the "BTU factor" referred to in Patrick G. McNamee's correspondence to the Public Service Commission on November 23, 2005, and how it supports Kinzer's position in the matter at hand.

Response: A BTU, or British Thermal Unit, is a measure of the amount of heat required to raise the temperature of one pound of water by one degree Fahrenheit, divided by 1,000. In the natural gas market, a BTU is generally referred to as a "Decatherm", or "Dth". In the interstate pipeline market, natural gas is priced and sold by the "Dth". An "Mcf" is a volumetric measurement of 1,000 cubic feet of natural gas, regardless of heating content. Natural gas is sold in the local market to farm tap customers based on Mcf delivered. Therefore, in order to adequately compensate a natural gas producer for Mcf sales of gas which would otherwise be sold on a Dth basis, a BTU factor must be applied to all Mcf sold. Applicant's average BTU factor is 1200 BTU/cubic foot, thus a "BTU factor" of 1.2 must be applied to each Mcf of Applicant's gas sold to farm tap customers to adequately compensate Applicant for farm tap sales.

Interrogatory No. 5: Please explain in detail the reference to "NYSEX" [sic] in Patrick G. McNamee's correspondence to the Public Service Commission on November 23, 2005, and how it supports Kinzer's position in the matter at hand.

Response: The apparent reference is to "NYMEX". "NYMEX" refers to the "New York Mercantile Exchange". Futures prices for natural gas are set by open outcry at the NYMEX, and those prices are used as the mechanism for determining prices to be paid for future sales of natural gas. The "12 Month NYMEX Strip" price as of the date of Applicant's rate increase filing is the correct base price to use in determining adequate compensation for any farm tap sales by Applicant.

Interrogatory No. 6: Please state with specifically [sic] when Kinzer began using the NYSEX [sic] to base its rate to its 182 farm tap customers.

Response: OBJECTION. This question seeks information which is irrelevant to the question of whether Applicant's requested rate increase is just and reasonable.

Interrogatory No. 7: Please admit that all or some of the 182 farm tap customers have granted Kinzer easements to use their property in exchange for a low gas rate.

Response: OBJECTION. See Response to Interrogatory No. 6.

Interrogatory No. 8: Please produce all documentation of the “labor cost” referred to in Patrick G. McNamee’s November 23, 2005, letter to the Public Service Commission for the years 2000 through 2005. Be sure to provide copies of all wages, taxes, health insurance costs, etc. referred to in said letter.

Response: The PSC has requested labor cost information in its “Initial Data Request of Commission Staff to J. W. Kinzer Drilling Company”. Intervenor will be served a copy of Applicant’s response to said request. Applicant OBJECTS to Intervenor’s request for any additional information as such request seeks information which is irrelevant to the question of whether Applicant’s requested rate increase is just and reasonable.

Interrogatory No. 9: Please provide a detailed explanation as to why “vehicle costs” referred to in Patrick G. McNamee’s letter of November 23, 2005, to Public Service Commission should be used to justify a rate increase.

Response: All costs associated with providing farm tap service are allowable additions to the commodity components when calculating a just and reasonable rate.

Interrogatory No. 10: Admit or deny that the “labor costs” referred to in Patrick G. McNamee’s letter of November 23, 2005, to the Public Service Commission, is a cost Kinzer would have to bear in order to monitor and maintain [sic] gas wells which currently exist on or near properties possessed by some or all of the 182 farm tap customers in question regardless of whether gas is sold to these farm tap customers or not.

Response: Deny. The labor cost component of the farm tap rate is only that portion of total labor costs allocable to farm tap operations. See also Response to Interrogatory No. 8.

Interrogatory No. 11: Admit or deny that the “vehicle costs” referred to in Patrick G. McNamee’s letter of November 23, 2005, to the Public Service Commission, is a cost Kinzer would have to bear in order to maintain and monitor gas wells which currently exist on or near properties possessed by farm tap customers, regardless of whether gas is sold to these farm tap customers or not.

Response: Deny. The vehicle cost component of the farm tap rate is only that portion of total vehicle costs allocable to farm tap operations.

Interrogatory No. 12: Admit or deny that the “tool cost” referred to in Patrick G. McNamee’s letter of November 23, 2005, to the Public Service Commission, is a cost Kinzer would have to bear in order to monitor and maintain gas wells which exist on or near properties possessed farm tap customers, regardless of whether gas is sold to these farm tap customers or not.

Response: Deny. The tool cost component of the farm tap rate is only that portion of total tool costs allocable to farm tap operations.

Interrogatory No. 13: Admit or deny that the “rent costs” referred to in Patrick G. McNamee’s letter of November 23, 2005, is a cost Kinzer would have to bear in order to drill, maintain and produce gas wells on the properties in question regardless if gas is sold to farm tap customers or not.

Response: Deny. The rent cost component of the farm tap rate is only that portion of total rent costs allocable to farm tap operations.

Interrogatory No. 14: Explain in detail why an increase in the cost of natural gas makes an increase in the farm tap rate necessary. Please provide copies of all documents in support of Kinzer’s position.

Response: See Response to Interrogatory No. 2.

Interrogatory No. 15: Please provide a copy of all reports associated with any audits conducted by or on behalf of Kinzer Drilling Company or any of its parent or subsidiary companies during the last five (5) years. Be sure to include any and all governmental audits.

Response: OBJECTION. This question seeks information which is irrelevant to the question of whether Applicant’s requested rate increase is just and reasonable.

Interrogatory No. 16: Please indicate whether Kinzer utilizes financial statement budgets and/or forecasts developed and relied upon by Kinzer and produce copies of any such documents for the last five (5) years.

Response: OBJECTION. This question seeks information which is irrelevant to the question of whether Applicant’s requested rate increase is just and reasonable.

Interrogatory No. 17: Please describe whether Kinzer’s budgets or financial statements include any assumptions regarding rate increases or decreases. If so, please describe the basis for which the amounts for increases or decreases are included.

Response: OBJECTION. This question seeks information which is irrelevant to the question of whether Applicant’s requested rate increase is just and reasonable.

Interrogatory No. 18: Please indicate whether Kinzer utilizes budgets or financial statements to evaluate whether it should file for a rate increase, to decide on a time frame for such a filing, and to decide on the general amount of such request. If so, explain in detail.

Response: Applicant’s reasons for requesting a rate increase for farm tap customers are set out in November 23, 2005, letter to the PSC.

Interrogatory No. 19: Please provide a copy of Kinzer Drilling’s earnings report for 2002, 2003, 2004 and 2005.

Response: OBJECTION. This question seeks information which is irrelevant to the question of whether Applicant's requested rate increase is just and reasonable.

Interrogatory No. 20: Please provide a copy of all tax returns for Kinzer Drilling for the last five (5) years.

Response: OBJECTION. This question seeks information which is irrelevant to the question of whether Applicant's requested rate increase is just and reasonable.

Interrogatory No. 21: Please provide a copy of any and all documents used by Kinzer to determine the "cost" Kinzer bears to provide farmtap services to the 182 farm tap customers referred to in Patrick G. McNamee's November 23, 2005, letter. Please provide copies of all documents for the last five (5) years.

Response: See Response to Interrogatory No. 2.

Interrogatory No. 22: For the years 2000 through 2005 please provide all the following information for Kinzer Drilling:

- a. Gas volumes (mcf) rates to retail customers.
- b. Gas volumes (mcf) produced.
- c. Gas volumes (mcf) purchased.
- e. Gas volumes (mcf) rates to farm tap customers.
- f. Gas volumes (mcf) produced for each gas well on any farm tap customer's property.

Response: OBJECTION. This question seeks information which is irrelevant to the question of whether Applicant's requested rate increase is just and reasonable.

Interrogatory No. 23: Please provide the percentage of gas Kinzer Drilling anticipates it will purchase, rather than produce to supply its 182 farm tap customers with gas from 2006 through 2016.

Response: 0%.

Interrogatory No. 24: State what percentage of gas, if any, is currently purchased by Kinzer in order to provide gas to its 182 farm tap customers.

Response: 0%.

Interrogatory No. 25: Please provide the names of all current third party gas suppliers Kinzer uses. Please provide a copy of any and all contracts relating to such.

Response: None.

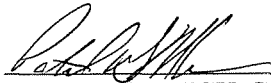
Interrogatory No. 26: Please provide a copy of any and all index or indices that Kinzer uses to determine the rate to charge its farm tap customers.

Response: See Responses to Interrogatories Nos. 2, 3 and 5.

Interrogatory No. 27: Please give a detailed account of how the decision to seek a rate increase was made. Be specific as to the individuals involved in the decision making process, their position and title, what information they used in reaching their decision, as well as the time frame involved.

Response: See Response to Interrogatory No. 2. Applicant OBJECTS to Intervenor's request for any additional information as such request seeks information which is irrelevant to the question of whether Applicant's requested rate increase is just and reasonable.

Subscribed and sworn to this 17th day of January, 2006, by Patrick G. McNamee.



PATRICK G. MCNAMEE

COMMONWEALTH OF KENTUCKY
COUNTY OF FLOYD

Subscribed and sworn to before me this 17th day of January, 2006, by Patrick G. McNamee.

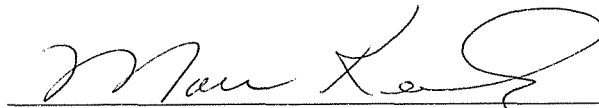


NOTARY PUBLIC

My Commission Expires: October 20th 2007

CERTIFICATE OF SERVICE

This certifies that the foregoing "Responses of J. W. Kinzer Drilling Company to Intervenor's First Set of Interrogatories and Requests for Production of Documents to J. W. Kinzer Drilling Company" has been filed with the Kentucky Public Service Commission by mailing to Beth O'Donnell, Executive Director, Kentucky Public Service Commission, P.O. Box 615, Frankfort, Kentucky 40602-0615, with true copy served upon Intervenor Timothy C. Bates, P.O. Box 787, Hindman, Kentucky 41822 by first class mail, this 18th day of January, 2006.



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PUBLIC SERVICE
COMMISSION

November 23, 2005

Beth O'Donnell
Kentucky Public Service Commission
PO Box 615
Frankfort, KY 40602

RE: Cost Justification/ Rate increase

Case No. 2005-00478

Dear Mrs. O'Donnell:

Due to the increase in the cost of natural gas our company must increase our farm tap gas rates. We currently have 182 customers on various gathering lines throughout eastern Kentucky that consume an average of 7.65 Mcf per month per customer (91.8 Mcf annually).

We have itemized the different components of the rate below. Please note that there is no profit built into this rate. We only want to recoup what the gas cost us to deliver to the customer. We realize that the rates will vary throughout the year and there may be a gain or loss to us since we are producing the gas.

Gas Rate - \$15.31/Mcf

12 Month NYMEX Strip (as of 11/2/2005 close)	\$10.68/dth
Appalachian Basis (Differential based on 2 year history)	+ .36/dth
	\$11.04/dth
BTU factor (average Kinzer BTU factor 1200 btu/cf)	1.20
Gas Price/Mcf	<u>\$13.25/Mcf</u>
Labor costs (Operator & Administrative) ¹	\$ 1.731/Mcf
Vehicle costs ²	\$.196/Mcf
Postage (\$.23/customer/month) ³	\$.030/Mcf
Tools ⁴	\$.014/Mcf
Supplies/Overhead (Bill cards, ink, paper, telephone,etc) ⁵	\$.014/Mcf
Rent (\$100 per month) ⁶	<u>\$.072/Mcf</u>
Company Costs/Mcf	<u>\$ 2.057/Mcf</u>
Gas rate	<u>\$ 15.31/Mcf</u>

We feel this is a very reasonable rate considering the current market conditions. We respectfully request your approval of this rate.

Sincerely,



Patrick G. McNamee
Controller
J.W. Kinzer Drilling Company

¹ Labor Costs – We have ten employee well operators, two contract meter readers and one administrative employee that are involved in the farm tap readings, maintenance, callouts and billing. These employees have other responsibilities in the company so we only charged the cost of each employee to each customer for twenty minutes per customer per month. The total cost of each employee includes the following: Wages, Employer FICA, Employer Medicare, SUTA, FUTA, Health Insurance, Pension, Life Insurance and Vacation. The average hourly cost per employee is \$24.25. The average cost per customer (18 customers) per month for the contract meter readers is \$15.56.

² We normally charge \$65/day/pickup truck to a job. We are only charging \$50/day/pickup (\$5/hr – 10 hour day) for this gas rate. The rate per mcf is computed as follows: 164 customers (182 less the 18 customers read by contract meter readers) X \$5/hr (\$50 / day divided by 10 hours) X .333333 (20 minutes per customer) = \$273.33 truck cost per month related to farm tap readings. Divide 273.33 by 1,392 (average mcf per month) = \$.196/mcf.

³ Postage is calculated as follows: \$.23 X 182 (# of customers) / 1392 (average mcf per month) = .03

⁴ We recently purchased 4 gas detectors for use with our domestic customers. They cost \$300 each. The rate was computed as follows: 4 X 300 / 60 (five year life) = \$20/month divided by 1392 = .014/mcf.

⁵ Miscellaneous supplies/overhead was estimated to cost \$20/month. \$20 divided by 1392 mcf = .014/mcf.

⁶ Rent is estimated to be \$100/month. J.W. Kinzer pays rent for the land used by the drilling company. This amount represents 1.67 percent of the total cost of rent.