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June 8, 2006

Jerome A. Kanney
Cow Creek Gas, Inc.
P. O. Box 3385
Pikeville, KY 41502

CERTIFICATE OF SERVICE

RE: Case No. 2006-00171
Cow Creek Gas, Inc.

I, Beth O'Donnell, Executive Director of the Public Service Commission, hereby certify that the enclosed attested copy of the Commission's Order in the above case was served upon the addressee by U.S. Mail on June 8, 2006.

Executive Director

BOD/jc
Enclosure

Jerome A. Kanney
Cow Creek Gas, Inc.
P. O. Box 3385
Pikeville, KY 41502

Honorable Morris Kennedy
Attorney at Law
2332 Old Hickory Lane
Lexington, KY 40515

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF COW CREEK GAS, INC. FOR AUTHORITY TO ADJUST ITS RATES PURSUANT TO THE ALTERNATIVE RATE FILING PROCEDURE FOR SMALL UTILITIES	))))))	CASE NO. 2006-00171

O R D E R

On April 26, 2006, Cow Creek Gas, Inc. ("Cow Creek") submitted an application pursuant to 807 KAR 5:076 for an increase in rates under the Commission's Alternative Rate Filing ("ARF") procedure. The increase in rates requested by Cow Creek is based on its revenues and expenses for the 12 months ended December 31, 2004, adjusted to reflect its current wholesale cost for natural gas.

In addition to its application, Cow Creek submitted a response to the Commission Staff's May 10, 2006 data request. With that response, the record is complete and the case stands submitted for decision.

BACKGROUND

Cow Creek is a gas distribution company which, at the time of its application, provided gas service to 61 customers in eastern Kentucky. Retail rates were last established for Cow Creek in Case No. 1997-00263.[1] Cow Creek's current rates include a minimum bill of $7.26 which covers the first Mcf of usage, and a rate of $7.26 per Mcf for all additional usage.

REVENUE REQUIREMENTS

Cow Creek reported total operating revenues of $18,377 in its 2004 test year based on Mcf sales of 2,481. Its gas purchases expense was $6,161, which reflected an average cost per Mcf of $2.483. Cow Creek recently entered into a new gas purchase contract under which it pays $10.00 per Mcf for gas purchases.[2] It proposed to pass along the higher wholesale gas price to its customers by increasing its retail rate from $7.26 to $14.66 per Mcf.[3] Cow Creek calculated that this would result in an annual revenue increase of $18,650, or 101.9 percent.

Cow Creek's proposal would result in a pass-through of its higher wholesale gas cost while maintaining its test-year operating income level of $7,043. Under the ARF procedure, the Commission is obligated to review all items of expense and the utility's income level in order to determine the utility's total revenue requirement and the rates

[1] Case No. 1997-00263, The Application of Cow Creek Gas, Inc. for an Adjustment of Rates Pursuant to the Alternative Rate Filing Procedure for Small Utilities, Order dated December 18, 1997.

[2] Per Cow Creek's response to Item 1(b) of the Staff's May 10, 2006 data request and other information available to the Commission, a price of $10.00 per Mcf is consistent with current published market prices as well as the prices being paid by other Kentucky-jurisdictional gas companies.

[3] Cow Creek filed for the proposed increase under the ARF procedure because its tariff does not contain a Gas Cost Adjustment mechanism ("GCA"), which is the process typically used to pass on changes in natural gas purchase costs.

necessary to produce the required revenues. Accordingly, we must determine whether the test-year, non-gas expenses and operating income level are reasonable.

Revenue Normalization

Cow Creek's existing rates, as established in Case No. 1997-00263, were based on a per-Mcf gas cost of $2.60, which is the gas cost recovery portion of its $7.26 per Mcf retail rate. Multiplying this amount to Cow Creek's test-year sales of 2,481 Mcf produces a result of $6,451, which represents Cow Creek's gas cost recovery revenues. The difference between $6,451 and Cow Creek's total revenues of $18,377, which is $11,926, represents the non-gas cost portion of Cow Creek's test-year revenues.

Non-gas Expenses

Cow Creek's non-gas expenses for the test year totaled $5,173. However, this amount included ($1,763) as the amortization of a negative plant acquisition adjustment. It is the Commission's normal rate-making practice to exclude the impact of a utility's plant acquisition adjustments from the determination of its revenue requirement. Such adjustments are typically positive, rather than negative as is the case for Cow Creek. However, in order to be consistent we must adhere to our normal practice and exclude the amortization of the negative plant acquisition adjustment. The resulting non-gas expense amount to be recognized for rate-making purposes is $6,936.

Operating Income

In the case of an investor-owned utility, the appropriate level of operating income is typically determined based on establishing an appropriate rate of return on the utility's capital investment. However, in order for the rate of return method to be valid, a utility's capitalization must be supported by its net investment rate base. At the end of the test year, Cow Creek's capitalization was $18,932 while its net investment rate base, which consisted of its net utility plant and an allowance for cash working capital, was $28,880.[4] With such a disparity between these amounts, it would be inappropriate to employ a rate of return approach to determine Cow Creek's revenue requirement. Therefore, we find that the revenue requirements methodology typically used when a rate of return approach is not appropriate, the 88 percent operating ratio method, should be used in this instance.[5]

Revenue Requirement Calculation

Cow Creek's non-gas expenses for rate-making purposes are $6,936. Dividing this amount by .88 produces a non-gas revenue requirement of $7,882.[6] Dividing this amount by Cow Creek's test-year sales of 2,481 Mcf results in a per Mcf rate of $3.177, which will be established, prospectively, as the non-gas component of Cow Creek's retail rate. The gas cost recovery component of Cow Creek's retail rate will be $10.00 per Mcf, which reflects the recovery of its gas cost pursuant to its new wholesale gas purchase contract. The resulting total rate is $13.177 per Mcf.

FUTURE GAS COST RECOVERY

In response to Staff's May 10, 2006 data request, Cow Creek stated that it agreed that future adjustments in its natural gas costs could be efficiently addressed

[4] This included net plant in service of $28,013 (which excludes the impact of both the negative plant acquisition adjustment and the amortization thereof) and a cash working capital allowance equal to one-eighth its non-gas operating expenses.

[5] The 88 percent operating ratio methodology was also used in Cow Creek's most recent rate case, Case No. 1997-00263.

[6] As Cow Creek is a subchapter S corporation, it has no income tax liability. Therefore, no provision for income taxes is included in its revenue requirement.

through a GCA mechanism. It also requested that we approve, for inclusion in its tariff, a GCA clause with terms identical to those contained in the GCA clause of its sister company, Dema Gas Company, Inc.

Cow Creek's request to establish a GCA clause as part of its tariff appears to be reasonable, and should provide an efficient means of implementing future rate changes based on changes in its wholesale natural gas costs. Accordingly, we will approve a GCA mechanism for Cow Creek, for inclusion and filing with the Commission as part of its tariff.

FINDINGS AND ORDERS

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

1. Cow Creek's proposed rate and minimum monthly charge should be denied.

2. The rate and minimum monthly charge in the Appendix to this Order are fair, just, and reasonable and should be approved for service rendered by Cow Creek on and after the date of this Order.

3. Cow Creek should implement a GCA mechanism and file a GCA clause, as described herein, with the Commission as part of its filed tariff.

IT IS THEREFORE ORDERED that:

1. Cow Creek's proposed rate and minimum monthly charge are denied.

2. The rate and minimum monthly charge in the Appendix, attached hereto and incorporated herein, are approved for service rendered by Cow Creek on and after the date of this Order.

3. Cow Creek shall implement a GCA mechanism with terms identical to those of its sister company, Dema Gas Company, Inc.

4. Within 20 days of the date of this Order, Cow Creek shall file with this Commission its revised tariff containing the rate and minimum monthly charge and GCA clause approved herein. The tariff shall show its effective date, the date of issue, and that it is issued pursuant to this Order.

Done at Frankfort, Kentucky, this 8th day of June, 2006.

By the Commission

ATTEST:

Executive Director

APPENDIX

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2006-00171 DATED June 8, 2006.

The following rates and charges are prescribed for the customers served by Cow Creek Gas, Inc. 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.

Minimum Monthly Charge (Covers first Mcf)	$ 13.177
All Additional Mcf	$ 13.177

The gas cost component of these rates is $10.00 per Mcf.