Commonwealth of Kentucky
Public Service Commission
211 Sower Blvd.
P.O. Box 615
Frankfort, Kentucky 40602-0615
Telephone: (502) 564-3940
Fax: (502) 564-3460
psc.ky.gov

December 21, 2007

Brenda Everette
Manager
Apache Gas Transmission Co., Inc.
5005 Live Oak Street
Greenville, TX 75402

CERTIFICATE OF SERVICE

RE: Case No. 2007-00354
Apache Gas Transmission Co., 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 December 21, 2007.

Executive Director

BOD/rs
Enclosure

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF APACHE GAS TRANSMISSION COMPANY, INC. FOR AN INCREASE IN RATES	))	CASE NO 2007-00354

O R D E R

Apache Gas Transmission Company, Inc. ("Apache") is a Kentucky corporation which operates approximately 21 miles of intrastate pipeline facilities in the south central portion of Kentucky. The sole function of Apache's pipeline system is to transport natural gas to Burkesville Gas Company, Inc. ("Burkesville"), a small gas distribution system providing natural gas service in Cumberland County, Kentucky.

BACKGROUND

On August 6, 2007, Apache submitted an application requesting an increase in rates pursuant to 807 KAR 5:076, the Commission's Alternative Rate Filing procedure for small utilities. The application was found to be deficient and was rejected by letter dated August 14, 2007. Apache submitted additional information in response to the rejection letter, which cured the deficiencies, and the application was considered filed August 29, 2007.

Apache transports natural gas from a tap on an interstate gas pipeline owned by Texas Eastern Transmission, LP to the city gate of Burkesville, which is its sole customer. Apache requested a rate adjustment that would increase its transportation rate from $1.74 to $2.94 per Mcf and generate additional annual revenues of $42,452, which represents an increase of approximately 69 percent.

TEST PERIOD

Apache proposed the 12–month period ending December 31, 2006 as the test period for determining the reasonableness of its proposed increase. The Commission finds that using the 12-month period ending December 31, 2006 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.

TEST-PERIOD REVENUES AND EXPENSES

For the test period, Apache reported operating revenues of $61,556 and operating expenses of $52,239. It reported net other income and deductions of ($6,601), resulting in net income of $2,715. Including income tax expense, Apache proposed eight expense adjustments to its test-year results.[1] The net effect of Apache's proposed adjustments, based on an increase in operating expenses of $41,364 and a decrease in interest expense of $3,820, is a reduction in net income of $37,544.

The Commission will accept Apache's proposed adjustments to property taxes, accounting fees, and interest expense; therefore, those adjustments will not be addressed individually. Discussion of the remainder of Apache's proposed adjustments and the Commission's modifications thereto is set forth in the following paragraphs.

Legal Fees

During the test year, Apache incurred legal expenses of $183. It proposed an adjustment to increase legal expenses by $3,230, to a total of $3,413. The proposed

[1] The adjustment to income tax expense reflects the impact on income taxes of all other adjustments proposed by Apache.

adjustment was based on the level of legal expenses Apache incurred in the first half of 2007 annualized to reflect the impact as if that level of expense continued for a full year.

Apache's legal expenses have fluctuated greatly over the period 2004 to 2007, with extremely low levels of expense in 2004 and 2006 (less that $500) and much higher levels in 2005 and 2007. Apache indicated that the majority of its legal expenses pertain to an easement lawsuit that has been pending for more than 10 years. In years in which there is substantial activity in the lawsuit proceeding, Apache's legal fees escalate; in other years, it incurs relatively small levels of legal fees. Greater activity in the lawsuit proceeding in 2005 and 2007 accounts for the much higher levels of legal expenses in those years ($2,383 in 2005 and $4,137 in the first 9 months of 2007) compared to the respective amounts, $410 and $183, incurred in 2004 and 2006.

With this degree of fluctuation, it is unreasonable to establish an amount of legal expenses for rate-making purposes based on the activity of a single year. Therefore, using the level of actual expense for the years 2004, 2005, 2006, and annualizing the expense incurred in the first 9 months of 2007, the Commission will allow Apache an average annual level of legal expenses to be included for rate-making purposes. The annual average, based on those time periods, is $2,123, resulting in an adjustment of $1,940 ($2,123 - $183).

Property Insurance

Apache's test-year expense for property insurance was $3,042. It proposed an adjustment to increase its property insurance expense by $4,034, to $7,076, annually. Apache explained that it and its sister company, Burkesville, had been covered under a joint policy for a number of years, but beginning in October 2006 coverage was provided under separate policies.

Apache's proposed adjustment was based on its annual premium, as of October 2006, plus an expected increase of 10 percent beginning in October of 2007. In a data response, Apache indicated that its new premium, beginning in October of 2007, was actually lower than the premium it had been charged for the period October 2006 to October 2007. The annual cost of Apache's property insurance, based on its new premium, is $6,287. The Commission will allow this amount for rate-making purposes, which results in an adjustment of $3,245.

Maintenance of Lines

During the test year, Apache incurred $15,424 in expense for maintenance of lines. It proposed an adjustment to increase its expense by $16,986, to a total of $32,410. Apache based its adjustment on its belief that roughly $30,000 to $35,000 per year would be an adequate amount to repair and maintain the system. As support for its proposed adjustment, Apache calculated the average of its repair and maintenance costs, including costs that it capitalized as well as those that it expensed, for the 10 years from 1997 to 2006. This calculation produced an annual average of $19,065,[2] which, in order to arrive at an amount within its proposed range of $30,000 to $35,000, Apache increased by 70 percent, resulting in its proposed expense level of $32,410.

Apache has not provided adequate justification for the level of $30,000 to $35,000 annually, which it believes is needed to adequately maintain the system. It did state that, in addition to normal repairs and maintenance, it had need for funds to pay for line relocation that would be necessitated by a state highway project and to replace

[2] When it calculated its 10-year average, Apache did not include $46,000 in expense recorded as maintenance of lines during 2004. Apache stated that this amount represented supervision and management in connection with repairs and maintenance and, while it was recorded on Apache's books, the amount was never paid.

existing 3-inch line with 6-inch line. While there may be need for such funds, these are capital projects, not repair and maintenance items which should be charged to expense.

There is a clear distinction between maintenance expenses and capital costs incurred to add, replace, or relocate long-lived physical assets which make up a utility's plant. The costs of such assets are to be recovered ratably over the lives of the assets through a utility's depreciation expense, not as if the one-time cost is an ongoing, annually recurring expense.

The Commission acknowledges the need for some adjustment to recognize the increased level of maintenance expense incurred as a system ages. Therefore, we will allow an adjustment using an averaging approach, but one based solely on amounts charged to expense and for a 4-year period of time, which is consistent with the adjustment being allowed for legal expenses. Although the $46,000 incurred for supervision and management of maintenance work was not included in Apache's average calculation, the Commission will include this amount in calculating the 4-year average.[3] Including it, along with the other amounts charged to maintenance of lines expense for the period 2003 to 2006, results in an average annual expense of $21,235. This level of expense results in an adjustment of $5,811 ($21,235 - $15,424), which is the amount that will be recognized for rate-making purposes.

---

[3] Although the $46,000 was for supervision of maintenance work and was not paid, it was properly recorded as repairs and maintenance expense, and should be included in the average calculation.

Management Fees

Apache's test-year expense for management fees was $6,211. It proposed an adjustment to increase this amount by $19,754 to a total annual expense of $25,965. The adjustment was based on the reclassification of some items as management expenses that had been recorded as accounting expenses. It also reflected a monthly fee of $1,800 for Tom Shirey, the president of Apache, for management and supervisory services.[4] After Apache's loan from the Shirey Family Trust for the original purchase of the Apache system was fully paid in August 2006, Apache resumed paying Mr. Shirey a monthly fee of $1,500 for management and supervisory services.

Apache indicated that Mr. Shirey devotes an average of 18 hours per month for the services he provides. It also indicated that the hourly rate of $100 is Mr. Shirey's billing rate for services that he provides to any company in which he is an acting officer.[5] Apache provided a list of some of the services provided by Mr. Shirey; however, it did not provide adequate support for the proposed monthly fee of $1,800.

Mr. Shirey has provided service to Apache for a number of years, although for a period of time he was not compensated for those services. When Apache resumed paying compensation in September 2006, the monthly amount was $1,500. Evidence that Mr. Shirey's hourly billing rate for other companies is $100 is insufficient to support the proposed adjustment. Without additional evidence for the proposed $1,800 fee, the

---

[4] Although management and supervisory services have consistently been provided to Apache, for a period of time from 2004 through August of 2006, Apache had not recorded the expense on its books. This was because of a management decision to not accrue/record any management fees that Apache was unable to pay.

[5] The companies include Burkesville, Consolidated Financial Resources, Inc., and Summit National Holding Corporation.

the Commission finds that only $1,500 per month, the amount of the fee during the test year, should be allowed.

After considering the adjustments found reasonable herein, and their related income tax effects, the Commission has determined that the financial results of Apache's adjusted test-year operations would be as shown in Table 1.

Table 1

Account Titles	Test-Period Operations	Accepted Adjustments	Adjusted Operations
Operating Revenues	$ 61,556	$ 0	$ 61,556
Operating Expenses	52,239	19,744	71,983
Net Operating Income	$ 9,317	$ (19,744)	$ (10,427)
Other Income & Deductions	(6,602)	3,820	(2,782)
Net Income	$ 2,715	$ (15,924)	$ (13,209)

REVENUE REQUIREMENT DETERMINATION

Apache did not explain how it determined the amount of revenue increase it proposed in its application. Typically, small investor-owned utilities will use a rate of return approach or an operating ratio method to determine its revenue requirement. An operating ratio method is used primarily when there is not a sound basis for a rate of return determination using the return on rate base method. The Commission generally uses an 88 percent operating ratio to determine a reasonable level of earnings for small investor-owned utilities.

Given that Apache is a small intrastate gas pipeline, the Commission concludes that it is reasonable to use an operating ratio approach to determine Apache's revenue requirement. Applying an 88 percent operating ratio to the adjusted operating expenses results in a total revenue requirement of $90,270. The Commission has accepted

Apache's test-year revenues based on the actual test-year Mcf volumes of 35,377. Based on the following calculation, the Commission finds that Apache should receive an increase in annual operating revenue of $28,709:

Table 2

Adjusted Operating Expenses Before Income Taxes	$74,961
Divided by : .0.88	88%
Sub-total	$85,183
Plus: Other Income and Deductions	2,782
Revenue Requirement Before Income Taxes	$87,965
Plus: Provision for Income Taxes	2,305
Total Revenue Requirement	$90,270

In order to meet this revenue requirement, Apache requires an increase of $28,709. An increase of this amount, based on test-year Mcf volumes, will require an increase in Apache's per Mcf transportation rate of $0.812, from $1.74 to $2.552 per Mcf. The Commission finds this to be the fair, just and reasonable rate for Apache.

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, Apache's total annual revenue requirement is $90,270.

2. Apache's proposed rates will produce $104,008 in annual revenue.

3. The rate proposed by Apache would produce revenues in excess of that found reasonable herein and should be denied.

IT IS THEREFORE ORDERED that:

1. The rate of $2.552 per Mcf found reasonable herein is approved for service rendered by Apache on and after January 1, 2008.

2. The rate proposed by Apache is denied.

3. Within 20 days of the date of this Order, Apache shall file with the Commission its revised tariff setting out the rate approved herein.

Done at Frankfort, Kentucky, this 21st day of December, 2007.

By the Commission

ATTEST:

Robert A. Amato for the

Executive Director