COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF MARTIN GAS, INC. FOR RATE ADJUSTMENT FOR SMALL UTILITIES PURSUANT TO 807 KAR 5:076	)))	CASE NO. 2016-00332

ORDER

On September 16, 2016, Martin Gas, Inc. ("Martin") applied for an adjustment of its rates for natural gas service pursuant to 807 KAR 5:076. Martin, a gas distribution company providing service in Floyd, Knott, and Perry counties, owns and operates facilities that supply natural gas to approximately 435 customers. The last adjustment to increase Martin's base rates for natural gas service occurred in May of 2007.[1]

After various filing deficiencies were cured, Martin's application was deemed filed with the Commission on October 10, 2016. While Martin stated that it was proposing an increase of $150,016, it proposed rates that would produce additional annual revenues from natural gas sales of $266,449, an increase of 72.70 percent over its normalized base rate revenues.

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[1] Case No. 2006-00504, *Application of Martin Gas, Inc. for an Adjustment of Rates Pursuant to the Alternative Rate Filing for Small Utilities* (Ky. PSC May 31, 2007).

The Attorney General of the Commonwealth of Kentucky, by and through his Office of Rate Intervention ("AG") is the only intervenor in this proceeding. Martin responded to two sets of data requests from both the AG and Commission Staff ("Staff"). An informal conference ("IC") was held on January 27, 2017, at Martin's request. Martin has since filed further information in response to requests made at the IC. Martin and the AG have both stated that a hearing is not needed in this matter, and that it can be decided based on the existing record.

BACKGROUND

As permitted by 807 KAR 5:056, the Commission's Alternative Rate Filing ("ARF") regulation, Martin used the most recent calendar year for which it had filed an annual report, calendar year 2015, as its test year. As allowed by the ARF regulation, Martin proposed adjustments to its test-year financial operations to reflect current and future conditions. In its application, it reported test-year revenues of $353,408 and test-year expenses of $377,899. Martin proposed adjustments that increased its test-year expenses by $114,669, from $377,899 to $492,568. Using the 88 percent operating ratio that is typically used for determining the revenue requirement for small investor-owned utilities, Martin calculated a needed increase in its annual revenues of $192,875. However, it stated that its requested increase was only $150,016.[2]

ADJUSTMENTS TO TEST YEAR

Adjustments to Revenues

While Martin proposed no revenue adjustments, the Commission has determined that two adjustments are required. The first adjustment corrects Martin's omission of

[2] As stated earlier in this Order, the rates that were proposed by Martin would actually generate additional annual revenues of $266,449.

$17,825 in non-recurring charge revenues from its test-year operating revenues.[3] The second adjustment, based on corrections to Martin's billing analysis,[4] reduces its test-year revenues by $4,477. The net effect of these two revenue adjustments is to increase test-year revenues by $13,348, from $353,408 to $366,756.

Maintenance Expense

Martin proposed an adjustment to increase Maintenance Expense by $15,760.[5] However, the $15,760 is not for maintenance; it is the approximate amount Martin plans to spend yearly for the next three years in a meter-replacement program. The Commission notes that any expenditure for new meters is not an expense item; it would properly be recorded as a capital expenditure which adds to the utility's plant in service. Therefore, no adjustment to increase Maintenance Expense is included in Martin's adjusted test-year operations.

Administrative and General Expenses

Martin proposed an $80,374 adjustment to increase Administrative and General ("A&G") Expenses which included adjustments to several items that fall within the category of A&G Expenses, including advertising expense of $6,000, which Martin intends to incur in order to attract new customers. Based on Martin's description of the types of advertising it intends to use as a means of attracting customers, the Commission concludes that none of the planned advertising cost is allowed to be

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[3] Supplemental Response to Commission Staff's Initial Request for Information, Item 4.

[4] Response to IC Request Item 2, page 2.

[5] Application, ARF Form 1, Attachment SAO-G.

included in rates under the provisions of 807 KAR 5:016. As such, $6,000 of the proposed adjustment of $80,374 will not be allowed.

Interest Expense

Martin included $6,028 in interest in A&G expenses as part of its proposed $80,374 adjustment. However, Martin also stated that it intended to recover no interest expense in its new rates.[6] With confirmation that Martin, in fact, intended to recover no interest expense in its new rates, the Commission has made an adjustment to reduce Martin's proposed adjustment by $6,028.

Rate Case Expense

Martin included estimated rate case expense of $25,000 as part of its $80,374 adjustment to increase A&G expenses. Through responses to requests for information, Martin acknowledged the Commission's practice of amortizing rate case expenses over a period of three years. In a February 10, 2017 response to a request made at the IC, Martin provided an update to its actual rate case expense showing the amount to be $21,198. Amortized over three years, this amount results in an adjustment of $7,066, or $17,934 less than the $25,000 included in Martin's proposed adjustment of $80,374. Accordingly, we have reduced the amount of rate case expense included in Martin's adjusted test year by $17,934, from $25,000 to $7,066.

Taxes Other than Income Taxes

Martin proposed an adjustment to increase Taxes Other than Income Taxes by $18,535 based on its proposed increase.[7] The amounts recorded by Martin as Taxes

[6] Response to Commission Staff's Initial Request for Information ("Staff's Initial Request"), Item 1.b.

[7] Application, ARF Form 1, Attachment SAO-G and response to Staff's Initial Request, Item 4.d.

Other than Income Taxes includes sales tax and school tax it collects from customers and remits to the applicable taxing authority. The Uniform System of Accounts ("USoA") does not permit this accounting for taxes collected by a utility.

According to the USoA, these taxes are not to be recorded as revenues or expenses by a utility as they are not taxes imposed on a utility, but are taxes imposed on a utility's customers for which the utility serves as the tax collector. For serving in this role, utilities are permitted to retain 2 percent of the amounts they collect. The amounts retained are to be recorded as Other Income. Accordingly, there will be no adjustment to increase Taxes Other than Income Taxes in Martin's adjusted test year. In addition, the Commission is making adjustments to eliminate the amount of $10,585 recorded by Martin in the test year and to add $212, the test year retainage amount, to Other Income.

Depreciation Expense

In addition to a meter-replacement program, Martin plans a project to replace a portion of its pipeline distribution system. Its current cost estimate for the meter and pipeline programs combined is $77,280. While the Commission cannot treat these proposed capital expenditures as operating expenses, we will recognize the planned expenditures and, based on a 25-year life for both meters and pipeline, allow a $3,091 adjustment to increase Martin's annual depreciation expense.

Existing Liabilities

Martin identified two liabilities it intends to pay subsequent to this proceeding for which it did not seek rate recovery as part of this case. The first liability, in the amount of $51,245[8] dating to 2005, is for natural gas purchased from an affiliate, Heritage Gas LLC. The second liability, in the amount of $12,200, is for a loan from shareholders which was booked in April of 2015.[9] The gas cost should have been recovered through Martin's Purchased Gas Adjustment ("PGA") mechanism. Including it for recovery through base rates at this time would constitute double recovery, which is not permissible. Conversely, the loan from shareholders was made by Martin's prior primary shareholders in order to pay expenses incurred by Martin during the test year. As such, no recovery of this amount has been sought by Martin previously. In this instance, the Commission will amortize the amount of the loan for three years for ratemaking purposes and allow amortization expense in an annual amount of $4,067 as part of Martin's adjusted test year.[10]

REVENUE REQUIREMENT DETERMINATION

All adjustments to the test year, both those of Martin accepted by the Commission and the Commission's adjustments result in annual revenues of $366,756 and annual operating expenses of $424,884, including $189,124 in gas costs and $235,760 in non-gas costs. With adjusted non-gas costs in this amount, the Commission has determined that Martin has a revenue requirement of $446,738, and that in order to achieve its revenue requirement, Martin will require an annual revenue increase of $97,748, which is a 26.65 percent increase over the $366,756 base rate revenues. The

[8] Application, ARF Form 1, Attachment SAO-G.

[9] Response to Staff's Initial Request, Item 15.b.

[10] Any of Martin's proposed adjustments not addressed in the ADJUSTMENTS TO TEST YEAR portion of this Order are acceptable to the Commission.

derivation of the revenue requirement and the revenue increase are shown in Appendix A, attached hereto and incorporated herein.

RATES AND RATE DESIGN

Martin proposes to replace its current minimum bill rate design with one that consists of a monthly customer charge and a single volumetric rate for all Mcf sold. Martin proposes a $15.00 monthly customer charge. We find that the proposed rate design and customer charge is reasonable, and are similar to recent rate designs and customer charges approved for other small gas utilities to provide stability to revenue collection, especially during summer months when low sales volumes are experienced. The Commission also finds, based on the increase found reasonable herein, that Martin's proposed $9.690 per Mcf volumetric base rate should be denied. Based on the revenues projected to be collected by the $15.00 monthly customer charge, a volumetric base rate of $4.9946 per Mcf is reasonable and should be charged for service rendered on and after the date of this Order.

VIOLATIONS OF STATUTE AND ORDERS

In providing reasons for why it needed a rate increase, Martin included in its application a copy of a 60-month, $40,000 promissory note it entered into in April of 2016 to pay its outstanding obligations to two gas suppliers: EQT and Basin Energy. Under KRS 278.300, a utility must receive Commission approval prior to issuing any evidence of indebtedness with a term longer than 24 months. In response to a data request, Martin stated that it "made an error by not requesting Commission approval prior to obtaining the line of credit[11]."

[11] Response to Commission Staff's Supplemental Request for Information, Item 4.

In addition, a review of sample bills produced by Martin in discovery reflected that some of the bills did not reflect the rates that were approved for Martin at the times the bills were rendered. Further discovery determined that Martin regularly reflected a lag of several months between the date when, by Commission Order, new rates were to be effective and the date when Martin actually implemented the new rates. This occurred following the issuance of Orders in several PGA cases in 2015 and 2016. Martin disclosed that its failure to correctly bill its approved rates was due to errors of a former employee and that it is now changing rates in its billing system as the Commission approves changes in its gas cost and total billing rates. Martin has verified that it has charged the rates approved by the Commission since the beginning of 2017.

In its response to an IC data request, Martin indicated that it had over-charged its customers for gas cost by $15,601 during the period from April 2015 through December 2016 by not timely implementing the changes in rates that had been approved in the PGA cases applicable to that period. It also provided three options for returning the over-collected gas cost to its customers. Martin's preference is to refund $3.01 per customer per month for 12 months. It provided a refunding alternative using a monthly bill credit for nine months, which would result in a monthly credit of $4.02. The second option identified by Martin is to determine which customers were over-charged and by how much, and to refund specifically to those customers using a bill credit over a period of six months. The third option is to refund to customers in one month, which Martin stated is its least favored option due to its financial condition.

The Commission finds that refunding equal amounts to customers using a 12-month bill credit should be implemented. This method would avoid the expense and work hours that would be involved in determining which current customers were overbilled and the overbilled amounts, and it would have the least immediate impact on Martin's financial condition.

Based on Martin's having entered the aforementioned promissory note and having not charged the rates approved by the Commission, the Commission finds that it should open a proceeding to permit Martin to show cause why it should not be penalized for (1) violating KRS 278.300; and (2) violating prior Commission orders.

FINDINGS AND ORDERS

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

1. Based on the adjusted test-period operations reflected herein, Martin's annual revenue requirement, including $189,124 test-year gas cost, is $446,738.

2. The rates and charges proposed by Martin would produce revenues in excess of those found reasonable herein and should be denied.

3. The rates and charges set forth in Appendix B to this Order are found reasonable and should be approved for Martin for service rendered on after the date of this Order.

4. A proceeding should be initiated to permit Martin to show cause why it should not be penalized for (1) violating KRS 278.300; and (2) violating prior Commission Orders.

IT IS THEREFORE ORDERED that:

1. The rates and charges proposed by Martin are denied.

2. The rates and charges found reasonable herein and set forth in Appendix B to this Order are approved for service rendered by Martin with service rendered on and after the date of this Order.

3. Within 20 days of the date of this Order, Martin shall file with this Commission, using the Commission's electronic Tariff Filing System, revised tariff sheets setting out the rates approved herein and reflecting that they were approved pursuant to this Order.

4. An investigation shall be opened to provide Martin an opportunity to present evidence to demonstrate that it should not be penalized for (1) violating KRS 278.300; and (2) violating prior Commission orders with respect to failure to charge authorized rates.

By the Commission

ENTERED
APR 06 2017
KENTUCKY PUBLIC
SERVICE COMMISSION

ATTEST:

Richard G. Raff for
Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2016-00332 DATED APR 0 6 2017

Martin Gas, Inc.
Case No 2016-00332 - Adjustment of Rates
Revenue Requirement - Operating Ratio Method
ARF Form 1 - Attachment RR-OR

Pro Forma Operating Expenses Before Income Taxes	$235,760
Operating Ratio	0.88
Subtotal	$267,909
Less: Pro Forma Operating Expenses Before Income Taxes	$235,760
Net Income Allowable	$32,149
Add: Provision for Income Taxes	$7,741
Interest Expense	$0
Pro Forma Operating Expenses Before Income Taxes	$235,760
Cost of Natural Gas	$189,124
Total Revenue Requirement	$464,775
Less: Other Operating Revenue	$17,825
Non-Operating Revenue	$212
Interest Income	$0
Total Revenue Required from Rates	$446,738
Less: Revenue from Sales at Present Rates	$348,931
Required Revenue Increase	$97,807
Less: Increase in school tax retainage	$59
Required Increase from Rates	**$97,748**

Provision for Income Taxes - Calculation of Tax Gross-Up Factor

Revenue	100.00%
Less: PSC Assessment	0.19%
Subtotal	99.81%
Less: State Income Tax, 5% of Subtotal	4.99%
Subtotal	94.82%
Less: Federal Income Tax, 15% of Subtotal	14.22%
Subtotal	80.60%
Factor (Revenue of 100.00% / Change in NOI)	1.2408
Times: Allowable Net Income	$32,149
Net Income Before Taxes	$39,891
Difference Equals Provision for income Taxes	$7,741

APPENDIX B

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2016-00332 DATED APR 06 2017

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

RETAIL RATES:

	Base Rate	Gas Cost Recovery Rate	Total
Customer Charge	\$15.00		
All Mcf	\$4.9946	\$4.5805[12]	\$9.5751

[12] Gas cost approved effective Apr. 1, 2017, in Case No. 2017-00108, *Purchased Gas Adjustment Filing of Martin Gas, Inc.* (Ky. PSC Mar. 20, 2017).

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