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August 14, 2008

CERTIFICATE OF SERVICE

RE: Case No. 2008-00096
GASCO Distribution Systems, Inc.

I, Stephanie Stumbo, 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 August 14, 2008.

Executive Director

SS/tw
Enclosure

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN INVESTIGATION INTO THE)
REASONABLENESS OF THE GAS COST) CASE NO. 2008-00096
RECOVERY FILING OF GASCO DISTRIBUTION)
SYSTEMS, INC.)

ORDER

This matter involves the review of the quarterly report of Gasco Distribution Systems, Inc. ("Gasco") to update its Gas Cost Recovery ("GCR") rate for the calendar quarter beginning April 1, 2008. In calculating its updated GCR rate, Gasco includes in the Actual Cost Adjustment ("ACA") component the difference between its actual gas costs and its recovered gas costs for the 2-year period ending June 30, 2007. At issue is whether the provisions of Gasco's GCR Rate Schedule permit the recovery of these costs. Finding in the negative, we deny Gasco's proposed GCR rate and establish a different GCR rate and a limited surcharge for the recovery of previously unrecovered gas costs.

BACKGROUND

Gasco, a corporation organized under the laws of Ohio, owns and operates facilities that distribute and furnish natural gas to approximately 134 customers in Albany, Kentucky.¹ It is authorized to operate within the Commonwealth of Kentucky and is a utility subject to Commission jurisdiction.²

¹ Report of Gasco Distribution Systems, Inc. to the Public Service Commission of Kentucky for the Year Ended December 31, 2007 at 11.

² KRS 278.010(3)(b); KRS 278.040(1).

Following Commission approval of its acquisition of the Albany Gas System from Royal Energy Company, Inc. in February 1995,³ Gasco filed with the Commission a tariff that included its GCR Rate Schedule. The GCR Rate Schedule established a mechanism for Gasco to pass through to its customers changes in Gasco's cost of purchased natural gas. It established an initial GCR rate of \$2.40 per Mcf and required Gasco to file with the Commission at least 30 days prior to the beginning of each calendar quarter⁴ a report setting forth an updated GCR rate based upon Gasco's current cost of gas.

The updated GCR rate is the sum of four components: Expected Gas Cost ("EGC"); Supplier Refund Adjustment ("RA"); Actual Cost Adjustment ("ACA"); and Balancing Adjustment ("BA").⁵ The EGC represents the average expected cost of gas. It is determined by applying Gasco's current wholesale cost of gas (including transportation and storage costs) to the total volume purchased for the 12-month period ending approximately 90 days before the start of the calendar quarter to which the GCR will apply and dividing by total sales volume for the same period.

The RA represents refunds received from suppliers during the 3-month period ending 90 days before the start of the calendar quarter to which the GCR will apply, plus

³ Case No. 1994-00427, The Application of Gasco Distribution Systems, Inc. for a Certificate of Public Convenience and Necessity to Provide Local Gas Distribution Service to Albany, Ky. and for Transfer of Albany Gas Utility Company (Ky. PSC Feb. 16, 1995).

⁴ A "calendar quarter" consisted of one of the four 3-month periods of "(1) August, September and October; (2) November, December and January; (3) February, March and April; and (4) May, June and July." Tariff of Gasco Distribution Systems, Inc., PSCKY No. 1, Original Sheet No. 24.

⁵ $GCR = EGC + RA + ACA + BA$.

interest. The ACA represents “the difference between the previous quarter’s expected gas cost and the actual cost of gas during that quarter.”⁶ The BA represents “any under or over collections which have occurred as a result of prior adjustments.”⁷

Despite the GCR Rate Schedule’s requirement for the filing of quarterly reports, Gasco failed to file a quarterly report or update its GCR rate for more than six years. On September 28, 2000, Gasco filed its first quarterly report in which it sought to update its GCR rate to recover expected increases in its wholesale natural gas costs and to collect \$237,038 of under-recovered gas costs from January 1994 through June 2000. Upon review of this report, the Commission recalculated the GCR rate to permit recovery of \$219,527 of such costs.⁸ During the next six years, Gasco filed the required quarterly reports on only four occasions.⁹ Prior to September 2007, it last updated its GCR in December 2002.¹⁰

⁶ Tariff of Gasco Distribution Systems, Inc., PSCKY No. 1, Original Sheet No. 23.

⁷ *Id.* As with the EGC, the amounts of the other components are divided by total sales volume for the 12-month period ending approximately 90 days before the start of the calendar quarter to which the GCR will apply to convert the component into a dollar per Mcf basis.

⁸ Case No. 1994-00427-A, The Notice of the Gas Cost Recovery Filing of Gasco Distribution Systems, Inc. (Ky. PSC Dec. 12, 2000).

⁹ Case No. 1994-00427-B, The Notice of the Gas Cost Recovery Filing of Gasco Distribution Systems, Inc. (Ky. PSC April 27, 2001); Case No. 1994-00427-C, The Notice of the Gas Cost Recovery Filing of Gasco Distribution Systems, Inc. (Ky. PSC July 30, 2001); Case No. 2002-00279, The Notice of the Gas Cost Recovery Filing of Gasco Distribution Systems, Inc. (Ky. PSC July 24, 2002); Case No. 2002-00426, The Notice of the Gas Cost Recovery Filing of Gasco Distribution Systems, Inc. (Ky. PSC Dec. 27, 2002).

¹⁰ In one instance, Gasco sought and was permitted to return over-recovered cost of gas for a 1-year period in which it had failed to file quarterly reports. See Case No. 2002-00279, *supra*, at 2.

On September 26, 2007, Gasco submitted a GCR quarterly report to update its GCR rate for the calendar quarter beginning November 1, 2007. Gasco proposed an updated GCR rate that would allow recovery of \$494,941 of under-recovered gas costs related to Gasco's failure to bill the correct GCR rate. Despite being authorized in December 2002 to assess a GCR of \$7.5766 per Mcf, Gasco had billed customers a GCR rate of \$4.4427 per Mcf. Gasco proposed to increase its ACA component by \$4.8755 per Mcf for a 60-month period.

Finding that further investigation into the reasonableness of the proposed updated GCR rate was necessary, the Commission suspended the proposed updated GCR rate and established Case No. 2007-00421.¹¹ While this proceeding was pending, Gasco submitted on December 14, 2007 a GCR quarterly report to update its GCR rate for the calendar quarter beginning February 1, 2008. In this report, Gasco again proposed an updated GCR rate that included recovery of the under-recovered gas costs since 2002. The Commission suspended this proposed updated GCR rate and initiated Case No. 2007-00519 to investigate its reasonableness.¹²

In response to the Attorney General's ("AG") opposition to its initial proposal, Gasco subsequently revised its proposal to recover only \$275,635.97 of under-recovered gas costs and to recover these costs over a 3-year period. Under its proposal, Gasco's ACA component would increase by \$4.5686 per Mcf for 36 months.

¹¹ Case No. 2007-00421, The Notice of Gas Cost Recovery Filing of Gasco Distribution Systems, Inc. (Ky. PSC filed Sept. 26, 2007).

¹² Case No. 2007-00519, The Notice of Gas Cost Recovery Filing of Gasco Distribution Systems, Inc. (Ky. PSC filed Dec. 14, 2007). On March 31, 2008, the Commission approved an updated GCR rate for service rendered on and after April 1, 2008. This updated GCR did not include any gas costs related to the under-recovery that Gasco experienced between 2002 and 2007.

Gasco also moved for dismissal of Case No. 2007-00421 and submitted a GCR quarterly report to update its GCR rate for the calendar quarter beginning April 1, 2008 to implement its revised proposal. The Commission dismissed Case No. 2007-00421, suspended the proposed GCR rate and opened this proceeding to review and investigate the reasonableness of the proposed updated GCR and the proposed recovery of two years' gas cost.

PROCEDURE

On March 31, 2008, we established this proceeding to review the quarterly report that Gasco submitted on February 25, 2008 and to examine the reasonableness of the proposed updated GCR. We directed that the scope of this proceeding include the "lawfulness and reasonableness of recovering the unrecovered gas costs through Gasco's GCR Rate Schedule and the appropriateness of using another rate mechanism, such as a surcharge, to recover such costs."¹³ We further directed Gasco to publish notice of its proposed updated GCR and the possible use of other recovery mechanisms, including a surcharge, to recover previously unrecovered gas costs.

The AG is the only intervenor in this proceeding. When establishing this proceeding, the Commission directed that the AG be made a party to this proceeding due to his participation in Case Nos. 2007-00421 and 2007-00519.

All parties have been afforded the opportunity to conduct discovery, comment upon Gasco's proposal, and request a hearing in this matter. To ensure a complete record, the Commission has directed that the record of Case Nos. 2007-00421 and 2007-00519 be incorporated by reference into the record of this proceeding. As of June 5, 2008, this matter stood submitted for decision.

¹³ Order of March 31, 2008 at 1.

DISCUSSION

Recovery under GCR Rate Schedule

Any recovery of unrecovered gas costs through the GCR Rate Schedule must be consistent with the provisions of that schedule. We find no support for such recovery within that schedule. The GCR Rate Schedule limits recovery to four components.¹⁴ None of the under-recovered gas costs for which Gasco seeks recovery fall within these components.¹⁵ Moreover, virtually all of the costs in question were incurred well outside the time period established in the GCR Rate Schedule.

To allow recovery of the costs in question would require the Commission to deviate from the clear and specific terms of the GCR Rate Schedule. Kentucky law does not permit such deviation from a utility's filed rate schedule. KRS 278.160(1) provides:

No utility shall charge, demand, collect, or receive from any person a greater or less compensation for any service rendered or to be rendered than that prescribed in its filed schedules, and no person shall receive any service from any utility for a compensation greater or less than that prescribed in such schedules.

In Case No. 1991-00108,¹⁶ the Commission noted the effect of this statute on a utility's authority to deviate from a filed rate:

¹⁴ For a discussion of these components, see text accompanying footnotes 4 through 6.

¹⁵ Gasco suggests that the under-recovered costs may be included in the ACA component. This component is limited to the "difference between the previous quarter's expected gas cost and the actual cost of gas during that quarter." Tariff of Gasco Distribution Systems, Inc., PSCKY No. 1, Original Sheet No. 23. The component does not allow any consideration of gas costs incurred for the 3-month period ending 90 days before the start of the calendar quarter to which the present quarterly report applies.

¹⁶ Case No. 1991-00108, Americoal Corporation v. Boone County Water and Sewer District (Ky. PSC April 24, 1992) at 6.

The primary effect of KRS 278.160 is to bestow upon a utility's filed rate schedule the status of law. 'The rate when published becomes established by law. It can be varied only by law, and not by act of the parties. The regulation . . . of . . . rates takes that subject out of the realm of ordinary contract in some respects, and places it upon the rigidity of a quasi-statutory enactment.' *New York N.H. & H.R. Co. v. York and Whitney*, 102 N.E. 366, 368 (Mass. 1913). While a utility may file or publish new rate schedules to change its rates pursuant to KRS 278.180, it lacks the legal authority to deviate from its filed rate schedule. It 'can claim no rate as a legal right that is other than the filed rate.'

The Commission recognizes that our decision this day conflicts with prior decisions involving the recovery of under-recovered gas costs through Gasco's GCR Rate Schedule. To the extent that those decisions conflict with the holding in this Order, they are overruled. Recovery of under-recovered gas costs incurred in any 3-month period that ends more than 90 days before the start of the calendar quarter to which the present quarterly report applies is not authorized by Gasco's GCR Rate Schedule and is contrary to KRS 278.160.

By our Order today, the Commission places all natural gas utilities on notice that they must strictly comply with the terms of their gas cost recovery rate schedules to be eligible for full recovery of their gas costs. For several years, the Commission has applied a liberal interpretation of such schedules to prevent serious economic harm to natural gas utilities and to avoid potential service disruptions to their customers. In some cases, this interpretation has served only to foster a disregard of the provisions within filed rate schedules and to encourage imprudent management practices. Sound public policy requires us to return to a stricter and exact interpretation and enforcement of GCR rate schedules.

The Commission places Gasco and its management on notice that failure to comply with the provisions of Gasco's GCR Rate Schedule, including the timely filing of

quarterly reports, will result in significant consequences. These consequences may include the loss of its right to update the GCR rate for the affected calendar quarter, termination of the GCR Rate Schedule, and the assessment of civil penalties against the utility and utility management.

Use of Alternative Recovery Mechanism

The Commission recognizes that Gasco's failure to comply with the provisions of its GCR Rate Schedule has resulted in a significant financial burden to the utility and a significant windfall to its customers. By its own calculations, Gasco has failed to recover \$494,941 of natural gas costs over a 5-year period and \$275,635.97 over a 2-year period. It has advised the Commission that failure to recover these costs may seriously threaten its financial integrity.¹⁷ Apparently in light of these arguments, the AG has advised the Commission that he has no objections to recovery of \$275,635.97 of the unrecovered gas costs.¹⁸

While the gas costs in question cannot lawfully be recovered through Gasco's GCR Rate Schedule, we recognize that other means exist to permit the recovery of such costs. The Commission has long taken the position that surcharges are an appropriate rate-making methodology available under KRS Chapter 278. Where extraordinary costs pose a threat to a utility's financial integrity, the imposition of a

¹⁷ See Case No. 2006-00421, Gasco's Response to AG's Supplemental Requests for Information, Item 12; Case No. 2006-00421, Gasco's Response to AG's Initial Requests for Information, Item 12; Case No. 2006-00421, Gasco's Response to the Commission's Order of October 17, 2007, Item 3.

¹⁸ Case No. 2006-00421, AG's Response to Petitioner's Motion to Dismiss at 1.

surcharge to recover those costs may be particularly appropriate.¹⁹ We find that, given Gasco's present circumstances, it should be authorized to assess a separate surcharge of \$4.9284 per Mcf for a 3-year period to recover \$275,635.97 of the unrecovered gas costs.

EGC Based on Current Gas Prices

Gasco's proposed EGC is \$13.2335 based on national commodity price estimates and its recurring pipeline demand charges as of February 25, 2008. Recent natural gas prices, as reported on the physical and futures markets, are in a range of \$9.00 to \$9.50 per dekatherm.²⁰ The estimates in Gasco's GCR quarterly report are not current and should be updated to reflect current market conditions. As Gasco has not filed a quarterly report for the calendar quarter that began August 1, 2008, the Commission has revised Gasco's proposed EGC to reflect more current estimates of wholesale gas prices for the months of August, September and October 2008.

Proposed Revisions to GCR Rate Schedule Changes

In response to Commission Staff interrogatories, Gasco has proposed to amend its GCR Rate Schedule to permit the recovery of actual unbilled gas costs through its ACA for periods other than the previous calendar quarter.²¹ As Gasco has not

¹⁹ See, e.g., Case No. 9484, The Application of Verna Hills, Ltd. for an Emergency and Permanent Rate Increase (Ky. PSC May 9, 1986) (stating that the imposition of a surcharge was necessary to avoid potential bankruptcy of the utility); Case No. 8826, Motion by Louisville Gas and Electric Company to Recognize a New Element in Its Fuel Adjustment Clause (Ky. PSC May 23, 1983) (noting the need for a special surcharge if an electric utility's financial integrity is threatened by a contingent expense).

²⁰ See, e.g., http://www.nymex.com/ng_fut_cso.aspx (last visited Aug. 7, 2008).

²¹ Case No. 2008-00096, Gasco's Response to the Commission's Order of March 31, 2008, Item 4.

submitted its proposed revision in accordance with the procedures set forth in KRS 278.180 or 807 KAR 5:011, we take no action upon this proposal in this Order.

The Commission questions the need for the proposed revision. Gasco's GCR Rate Schedule did not create the current situation. Its language is clear; its procedures are simple and relatively straightforward. The present under-recovery of gas costs is the direct result of the failure of Gasco's management to comply with the GCR Rate Schedule. Had Gasco submitted quarterly reports over the course of the last 12 years, the existing problem would not have occurred. The proposed revision will not remedy that problem, but it is likely to encourage greater management inattention by reducing the consequences of non-compliance with the provisions of the GCR Rate Schedule.

The Commission recognizes that regulatory procedures must be flexible and accommodate changing conditions. To that end, we have directed Commission Staff to review existing gas cost recovery mechanisms for possible revisions to reduce excessive regulatory burdens, ensure a quicker regulatory response, and afford greater flexibility for utility management without weakening protections for the ratepayer.

SUMMARY

After reviewing the evidence of record in this case and being otherwise sufficiently advised, the Commission finds that:

1. Gasco's quarterly report sets out an EGC of \$13.2335 per Mcf. As significant changes have occurred in the wholesale gas market since Gasco's filing, Gasco's EGC should be updated to reflect these changes based on the New York Mercantile Exchange ("NYMEX") futures price for the months of August, September and October 2008, as of July 25, 2008, to revise the calculation. The NYMEX futures prices per dekatherm for these months are \$9.084, \$9.126, and \$9.232, respectively.

Updating the wholesale price of natural gas in Gasco's quarterly report, based on an average of these prices plus its pipeline demand charges, produces an EGC of \$10.9064, which is an increase of \$0.1373 per Mcf from its previous EGC of \$10.7691.

2. Gasco's quarterly report sets out no current quarter refund adjustment.

3. Gasco's quarterly report sets out a current quarter ACA of \$1.3403 per Mcf. Gasco's quarterly report sets out a total ACA of \$7.3055, which includes the costs that will now be recovered through a separate surcharge. Removing these costs produces a total ACA of \$2.7369 per Mcf, which is an increase of \$1.3403 per Mcf from Gasco's previous total ACA.

4. Gasco's quarterly report sets out no current quarter BA. Gasco's total BA is \$0 per Mcf, which is no change from its previous total BA.

5. Gasco's GCR is \$13.6433 per Mcf, which is an increase of \$1.4776 per Mcf from its previous GCR of \$12.1657.

6. Gasco should be authorized to assess a separate surcharge of \$4.9284 per Mcf for a period of three years or until it has billed a total of \$275,635.97 through this surcharge, whichever occurs first.

7. The authorized surcharge is intended to recover unrecovered gas costs incurred for the 2-year period ending June 30, 2007.

8. Gasco's authorization to assess the surcharge is conditioned upon the following:

a. Gasco shall submit with its GCR quarterly reports to the Commission a written report stating the amount of the surcharge billed for the reporting period and the amount billed since the surcharge's initial assessment;

b. Gasco shall list the surcharge as a separate line item on customer bills;

c. Gasco shall timely and promptly file its GCR quarterly reports with the Commission in accordance with the provisions of its GCR Rate Schedule; and

d. Gasco shall terminate any present efforts and shall not commence any new efforts to collect from present or former customers any GCR charges for which it failed to properly bill during the 5-year period ending June 30, 2007.

9. The rates in Appendix A to this Order are fair, just, and reasonable, and should be approved for billing for service rendered by Gasco on and after the effective date of this Order, which will be August 1, 2008.

10. Pursuant to the provisions of its GCR Rate Schedule, Gasco must submit its next GCR quarterly update on or before October 1, 2008 with rates to be effective November 1, 2008.

IT IS THEREFORE ORDERED that:

1. Gasco's proposed updated GCR rate is denied.

2. Pursuant to the conditions set forth in Ordering Paragraphs 3 through 6 of this Order, Gasco is authorized to assess a separate surcharge of \$4.9284 per Mcf for a period of three years or until it has billed a total of \$275,635.97 through this surcharge, whichever occurs first.

3. Gasco shall submit with its GCR quarterly reports to the Commission a written report stating the amount of the surcharge billed for the reporting period and the amount billed since the surcharge's initial assessment.

4. Gasco shall list the surcharge as a separate line item on customer bills.

5. Gasco shall terminate any present efforts and shall not commence any new efforts to collect from present or former customers any GCR charges for which it failed to properly bill during the 5-year period ending June 30, 2007.

6. Gasco shall timely and promptly file its GCR quarterly reports with the Commission in accordance with the provisions of its GCR Rate Schedule.

7. Gasco's authorization to assess a separate surcharge shall immediately terminate and Gasco shall refund all surcharge proceeds collected if it fails to comply with any of the provisions set forth in Ordering Paragraphs 3 through 6 of this Order during the 3-year period in which the surcharge is in effect.

8. The rates in Appendix A are approved for billing for service rendered on and after August 1, 2008.

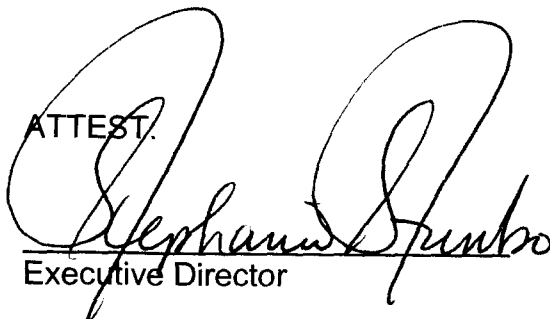
9. Within 20 days of the date of this Order, Gasco shall file with the Commission revised tariff sheets setting out the rates approved herein.

10. Gasco shall file its next GCR, pursuant to the provisions of its GCR tariff, on or before October 1, 2008 with rates to be effective November 1, 2008.

Done at Frankfort, Kentucky, this 14th day of August, 2008.

By the Commission

ATTEST.


Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2008-00096 DATED AUGUST 14, 2008

The following rates and charges are prescribed for the customers served by Gasco Distribution Systems, 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.

RATES:

	<u>Base Rate</u>	<u>Gas Cost Recovery Rate</u>	<u>Total</u>
Residential	\$4.62	\$13.6433	\$18.2633
Commercial	\$3.62	\$13.6433	\$17.2633
3-Year Surcharge			\$ 4.9284