

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF SENTRA CORPORATION )	CASE NO.
FOR RATE ADJUSTMENT PURSUANT TO )	2016-00384
807 KAR 5:076 )	

ORDER

On November 2, 2016, Sentra Corporation ("Sentra") applied for an adjustment of its base gas rates pursuant to 807 KAR 5:076 ("Application"). Sentra is a Kentucky corporation, regulated by the Commission as a utility under KRS 278.010(3)(b) and operating facilities that supply natural gas to approximately 206 customers residing in Monroe County.<sup>1</sup> Sentra applied for Commission approval of its initial operations and rates in 1997.<sup>2</sup> Sentra determined that its pro forma operations support a revenue requirement from base rates of \$382,314.<sup>3</sup> The base rates Sentra proposed produce annual base rate revenues of \$209,819, an increase of \$132,191, or 151.42 percent over normalized test-year base rate revenues of \$77,630.

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<sup>1</sup> *Annual Report of Sentra Corporation to the Public Service Commission for the Calendar Year Ended December 31, 2015* ("2015 Annual Report") at 9 and 31.

<sup>2</sup> Case No. 1997-00429, *In the Matter of a Petition of Sentra Corporation for a Certificate of Convenience and Necessity to Construct and Operate a Natural Gas Distribution System* (Ky. PSC Nov. 17, 1988).

<sup>3</sup> Application, ARF Form 1 – Attachment RR-OR – January 2014, Revenue Requirement Calculation – Operating Ratio Method.

## PROCEDURAL

On November 2, 2016, Sentra tendered its Application to the Commission. In its November 9, 2016 filing, Sentra submitted a correction to Attachment SAO-G, References Section of its Application, Comment 9, to clarify that the loan associated with the proposed truck purchase will have an initial term of no more than 24 months, but may be renewed for a period not to exceed six years. The Commission issued a letter on November 15, 2016 notifying Sentra that its rate application was rejected because the attached customer notice was deficient. On November 16, 2016, Sentra submitted a corrected customer notice. The Commission found that Sentra had cured the noted deficiency and deemed Sentra's Application filed as of November 16, 2016.

To ensure the orderly review of the Application, the Commission established a procedural schedule by Order dated December 7, 2016, which among other things, required Commission Staff ("Staff") to file a report containing its findings regarding Sentra's requested rates by March 29, 2017. At Sentra's request, the field review originally scheduled for February 15, 2017, was rescheduled to April 19, 2017. In order to expedite the processing of Sentra's requested rate increase, the Commission released a revised procedural schedule in its March 3, 2017 Order. In its revised procedural schedule, the Commission found that, pursuant to 807 KAR 5:076, Section 11, a Staff report would not be issued, and that the information needed to process this case would be obtained through the Application and Staff's Requests for Information.

Sentra submitted a motion requesting an extension of time from March 22, 2017,<sup>4</sup> up to and including April 17, 2017, within which to respond to the Staff's First Request for Information ("Staff's First Request"). Sentra explained that it would not be able to meet the deadline due to the unavailability of corporate staff. In a subsequent filing, Sentra stated that it would not place the proposed rates into effect pending the issuance of the final Order in this matter. In its April 5, 2017 Order, the Commission granted Sentra's motion and issued a new procedural schedule that superseded the schedule that was established in the Commission's March 3, 2017 Order.

There are no intervenors in this matter. Sentra responded to three requests for information issued by Staff. The procedural schedule provided Sentra until May 25, 2017, to either request a formal hearing or submit a statement that this case may be submitted for Commission decision based on the existing record. To date, Sentra has neither requested that a hearing be scheduled nor submitted a statement that the case can be submitted for a for Commission decision.

#### TEST PERIOD

The calendar year ended December 31, 2015, is being used as the test year to determine the reasonableness of Sentra's existing and proposed base rates, as required by 807 KAR 5:076, Section 9.

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<sup>4</sup> Although Sentra's motion references a March 22, 2017, due date for its responses to Staff's First Request, Appendix B of the Commission's March 3, 2017, Order set out March 21, 2017, as the date by which responses were required to be filed.

## INCOME STATEMENT

Sentra reported actual test-year operating revenues and expenses of \$511,892 and \$388,129, respectively.<sup>5</sup> Sentra proposes several adjustments to test-year revenues and expenses to reflect current and anticipated operating conditions, resulting in pro forma operating revenues of \$142,505 and pro forma operating expenses of \$283,993.<sup>6</sup> The Commission's review of Sentra's test-year operating revenues and expenses are set forth below.

### Gas Cost Revenues

In order to remove revenues recovered through Sentra's Gas Cost Recovery ("GCR") mechanism, Sentra proposed to reduce its test period operating revenues from gas sales of \$442,209 by \$369,387.<sup>7</sup> The Commission's established ratemaking practice is to exclude gas costs that are recovered through the GCR mechanism from the calculation of utilities' base rates. The Commission finds that Sentra's adjustment is consistent with this established practice and, therefore, is reducing operating revenues from gas sales by \$369,387.

### Other Operating Revenues

Sentra reported other operating revenues of \$69,682 in the test year, which includes miscellaneous service revenues of \$21,589.<sup>8</sup> In response to an interrogatory, Sentra explained that the miscellaneous service revenues are actually "gas recovery

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<sup>5</sup> Application, ARF Form 1 – Attachment SAO-G – September 2011, Schedule of Adjusted Operations – Gas Utility ("Pro Forma Operations").

<sup>6</sup> *Id.*

<sup>7</sup> *Id.*

<sup>8</sup> *Id.*

sales,”<sup>9</sup> which it clarified as being the actual cost of natural gas sold.<sup>10</sup> As previously mentioned, all revenues associated with purchased gas costs are recovered through Sentra’s GCR mechanism and, therefore, should not be included in the calculation of the base rates. For this reason, the Commission finds that Other Operating Revenues should be reduced by \$21,589. The remaining \$48,094 of Other Operating Revenues is attributable to collections from Clay Gas Utility District, which Sentra states is revenue from a recurring activity.<sup>11</sup>

In the test year Sentra reconnected five customers, had one returned check, and recorded 41 customer late payments.<sup>12</sup> According to Sentra, if it had actually charged the tariffed nonrecurring fees it would have recorded additional revenues of \$769, but the resulting administrative costs would have been greater than the amount collected.<sup>13</sup> The Commission finds that Other Operating Revenues should be increased by \$769, to reflect the nonrecurring fees that Sentra should have collected in the test year.

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<sup>9</sup> Response to the Commission’s August 8, 2016 Order, Appendix B, (“August 8, 2016 Order”), Item 2.a.

<sup>10</sup> Response to Staff’s Second Request, Item 2.

<sup>11</sup> Response to the Commission August 8, 2016 Order, Item 2.c.

<sup>12</sup> Response to Staff’s Second Request, Item 3.b.

<sup>13</sup> *Id.*

### Natural Gas Purchases and Transmission Fees

Sentra proposed to reduce its test-year operating expenses by \$176,646<sup>14</sup> to eliminate its gas supply expense.<sup>15</sup> Given that natural gas purchases and transportation cost are recovered through the GCR mechanism, the Commission finds that Sentra's proposed adjustment should be accepted.

### Dump Truck

Sentra proposed to increase its test-year operating expenses by \$10,000<sup>16</sup> to reflect the purchase of a dump truck.<sup>17</sup> Sentra estimates that the dump truck will cost \$50,000.<sup>18</sup> To support its estimated cost, Sentra provided a copy of the "Authority for Expenditure" form dated September 6, 2016, and a price listing for a "2008 GMC Topkick" dump truck that Sentra obtained from the website CARSFORSALE.com.<sup>19</sup> Sentra states that it "expects to purchase the Dump Truck before the end of the year

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<sup>14</sup> Due to Sentra's collection of gas cost revenues in excess of its incurrence of gas cost expenses, the revenue and gas cost adjustments do not match. This issue was addressed by the Commission in Case No. 2016-00139, *An Investigation of the Gas Costs of Sentra Corporation Pursuant to KRS 278.2207, the Wholesale Gas Price It is Charged by Its Affiliate, Magnum Hunter Production, Inc., Pursuant to KRS 278.274, and the Structure of the Purchased Gas Adjustment Clause Contained in Its Filed Tariff* (Ky. PSC Aug. 16, 2016).

<sup>15</sup> Application, Pro Forma Operations and ARF Form 1 – Attachment SAO-G – September 2011, References ("Pro Forma Adjustment References"), Item 3.

<sup>16</sup> *Id.* \$12,000 (Total Proposed Adjustment) - \$2,000 (Pro Forma Training Costs) = \$10,000 (Annual Principal and Interest Dump Truck).

<sup>17</sup> Application, Pro Forma Operations and Pro Forma Adjustment References, Item 9.

<sup>18</sup> *Id.*

<sup>19</sup> Responses to the August 8, 2016 Order, Item 20.b.

2017.”<sup>20</sup> Sentra also states that it has no documentation to support its estimated financing terms.<sup>21</sup>

Administrative Regulation 807 KAR 5:001, Section 16(1), provides that all applications for a general rate adjustment shall be supported by either a “twelve (12) month historical test period that may include adjustments for known and measurable changes” or a “fully forecasted test period.” When an applicant bases its application upon a historical test period, it must provide a “complete description and quantified explanation for all proposed adjustments with *proper support for any proposed changes* in price or activity levels, if applicable, and other factors that may affect the adjustment”<sup>22</sup> or a statement explaining why the required information does not exist and is not applicable. That support should include, at a minimum, some documentary evidence to demonstrate the certainty of some expected change or event.<sup>23</sup>

The Commission finds that the proposed adjustment does not meet the known and measurable criteria for the following reasons: (1) the actual date the dump truck will be purchased is uncertain; (2) Sentra has not secured the financing required to facilitate the purchase of the dump truck, and the financing terms used are only estimates; and (3) Sentra has not provided documentation to show that the dump truck it found in a 2016 web search, is still available. Given that Sentra has not provided the

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<sup>20</sup> *Id.*, Item 20.a.

<sup>21</sup> *Id.*, Item 20.c.

<sup>22</sup> Administrative Regulation 807 KAR 5:001, Section 16(4) (emphasis added).

<sup>23</sup> See Case No. 2001-00211, *The Application of Hardin County Water District No. 1 for (1) Issuance of Certificate of Public Convenience and Necessity; (2) Authorization to Borrow Funds and to Issue its Evidence of Indebtedness Therefor (3) Authority to Adjust Rates; and (4) Approval to Revise and Adjust Tariff* (Ky. PSC Mar. 2002) at 7.

documentary evidence to demonstrate with certainty that the event, purchase of the dump truck, will occur, the Commission finds that Sentra's proposed adjustment should be denied.

Further, the proposed \$10,000 adjustment for the debt service payments includes recovery of both interest and principal. Payments of principal are not included as an expense on the income statement, but rather are recorded on the balance sheet as a reduction to the loan balance. If the adjustment had met the known and measurable criteria, Sentra would have been required to identify separately the interest and the principal payments.

#### Employee Training

Sentra proposed to increase its test-year operating expenses by \$2,000 to reflect the annual cost of employee training.<sup>24</sup> Sentra provided an invoice documenting that the 2016 cost of employee training was \$3,450.<sup>25</sup> The Commission believes that it is important for Sentra to maintain a well trained staff for it to be able operate the natural gas delivery system in a safe and reliable manner. The Commission finds that Sentra's proposed employee training adjustment meets the known and measurable criteria; however, the pro forma adjustment should be \$3,450, the amount invoiced in 2016; rather than Sentra's original estimate of \$2,000. Accordingly, the Commission is increasing operating expenses by \$3,450 to reflect the actual employee training cost Sentra incurred in 2016.

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<sup>24</sup> Application, Pro Forma Operations and Pro Forma Adjustment References, Item 9.

<sup>25</sup> Responses to the August 8, 2016 Order, Item 21.

Office Rent.

Sentra proposed to increase its operating expenses by \$18,000 to reflect payment to Magnum Hunter Resources (“MHR”) of \$1,500 per month for the use of its office.<sup>26</sup> The office building is owned by Magnum Hunter Production, Inc., but is managed by MKS Commercial Real Estate Services.<sup>27</sup> NGAS Production Co.<sup>28</sup> is currently leasing 9,127 square feet of office space and is sharing this space with Sentra, although there is no formal agreement between the two affiliates.<sup>29</sup> Sentra explained that “[t]he pro forma office rent of \$1,500 implies approximately 973 square feet of space in use by Sentra Corporation at the same rate per square foot paid by NGAS Production Co.”<sup>30</sup>

For transactions between a utility and its parent or affiliate, the Commission has historically held that:

[t]he burden of proof is on the utility to demonstrate that the outcome of the transaction is fair, just and reasonable, and is substantially the equivalent of an arms-length transaction. Moreover, if this burden of proof is not met, the Commission will not allow proposed adjustments resulting from such transactions for rate-making purposes.<sup>31</sup>

The evidence provided by Sentra confirms that the proposed monthly rent of \$1,500 has no basis. MHR decided to charge Sentra \$1,500 of its base rental expense

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<sup>26</sup> Application, Pro Forma Adjustment References, Item 7.

<sup>27</sup> Responses to the August 8, 2016 Order, Item 19.b.

<sup>28</sup> Sentra refers to the same affiliate as either Magnum Hunter Production, Inc. or NGAS Production Co without giving an explanation for the use of both names.

<sup>29</sup> Responses to the August 8, 2016 Order, Item 19.e.

<sup>30</sup> *Id.*

<sup>31</sup> See Case No. 9269, *The Application of Public Service Utilities, Inc., - Boone Creeke for a Rate Adjustment Pursuant to the Alternative Rate Filling for Small Utilities* (Ky. PSC Oct. 2, 1985) at 3.

without any regard to the amount of office space that is actually dedicated to Sentra's operations. Sentra did not perform an analysis or study to show that \$18,000 is reasonable rent for a privately owned gas utility of comparable size to Sentra or that \$1,500 monthly office rent is in line with the office rent being charged in Sentra's service territory. For any cost allocation between affiliates KRS 278.2207(1)(b) provides, in pertinent part:

Services and products provided to the utility by an affiliate shall be priced at the affiliate's fully distributed cost but in no event greater than market or in compliance with the utility's existing USDA, SEC, or FERC approved cost allocation methodology.

Sentra has not provided evidence that its proposed office rent complies with KRS 278.2207(1)(b). Therefore, based on the evidence of record, the Commission finds that Sentra has not met its burden to show that the allocation of office rent is fair, just and reasonable, and therefore Sentra's proposed office rent adjustment of \$18,000 should be denied.

#### Administrative Expenses

Sentra proposed to increase its operating expenses by \$18,000 to reflect reimbursements to MHR for administrative expenses.<sup>32</sup> Sentra states that, it "utilizes two of MHR employees on a part-time basis, and this fee will recoup a portion of their salaries to MHR."<sup>33</sup> Based on interviews that were conducted with the two MHR employees, Sentra determined that on average, each employee spent one day per

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<sup>32</sup> Application, Pro Forma Adjustment References, Item 4.

<sup>33</sup> *Id.*

week providing services to Sentra, which equates to a 20 percent employee salary allocation factor.<sup>34</sup>

Sentra described MHR as “a holding company that provides administrative services to all of its operating subsidiaries, including human resources, in-house legal, financial and tax accounting, accounts payable, treasury and information technology services.”<sup>35</sup> According to Sentra, MHR does not formally allocate administrative or overhead costs to its operating subsidiaries because MHR believes that such allocations are unnecessary.<sup>36</sup> Sentra stated that since MHR’s financial statements are prepared on a consolidated basis, the allocations would be eliminated in the consolidation and “that management does not believe that such allocations are necessary to analyze the performance of MHR’s operating subsidiaries.”<sup>37</sup> Sentra claims that because it is a regulated entity, the proper allocation of MHR’s administrative and overhead costs is necessary because those costs affect the calculation of Sentra’s base rates.<sup>38</sup>

Sentra did not submit a time study or any other type of analysis to support its 20 percent allocation factor, but stated that it conducted interviews with the two MHR employees and concluded that each spends approximately one day per week providing

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<sup>34</sup> Responses to Commission Staff’s Second Request for Information, (“Staff’s Second Request”) Item 6.a.

<sup>35</sup> *Id.*, Item 6.e.

<sup>36</sup> *Id.*

<sup>37</sup> *Id.*

<sup>38</sup> *Id.*

services to Sentra.<sup>39</sup> Although, Sentra claims that MHR is allocating “20 percent of those employees’ salaries, bonuses, payroll taxes, and benefits including health and life insurance,”<sup>40</sup> it did not produce a detailed calculation showing a breakdown of the compensation into its major components. Sentra provided a calculation showing that the \$18,000 allocation “equates to an annual salary of \$45,000 per employee.”<sup>41</sup>

Since MHR does not allocate its administrative and overhead costs to the other operating subsidiaries, the Commission is unable to perform a comparative analysis to determine whether Sentra’s 20 percent allocation factor is reasonable. Further, without separate financial statements and cost allocations for each of MHR’s operating subsidiaries, the Commission is unable to confirm that Sentra’s regulated operations are not subsidizing the nonregulated affiliates.

For the aforementioned reasons, the Commission has determined that Sentra has not met its burden of proof that its allocation of administrative expenses is equivalent to an arm’s-length transaction that results in fair, just and reasonable rates and is compliant with KRS 278.2207(1)(b). The Commission finds that Sentra’s proposed administrative expense adjustment of \$18,000 should be denied.

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<sup>39</sup> *Id.*, Item 6.e.

<sup>40</sup> *Id.*, Item 6.c.

<sup>41</sup> *Id.*, Item 6.b.  $\$18,000 \text{ (Allocation)} \div 20\% = \$90,000 \text{ (Estimated Employee Compensation)} \div 2 \text{ (Number of Employees)} = \$45,000.$

### General and Administrative

Sentra proposed to increase its operating expenses by \$12,000 to reflect the reimbursement to MHR for general and administrative expenses.<sup>42</sup> According to Sentra the general and administrative expenses are related to day-to-day accounting services,<sup>43</sup> but Sentra later expanded it to include human resources, in-house legal, accounts payable, treasury and information technology services.<sup>44</sup> Sentra acknowledged that it does not have an itemized list of the general and administrative services that would be recovered through this allocation.<sup>45</sup> After interviewing MHR corporate personnel, Sentra concluded that they devote 20 hours per month providing services to Sentra and the \$50 hourly rate is a blended effective rate.<sup>46</sup>

Sentra relied upon identical reasons and arguments that it used to justify the proposed allocation of administrative expenses. As with the administrative expense allocation, the Commission has determined that Sentra has not met its burden of proof that allocation of general and administrative expenses is equivalent to an arm's-length transaction that results in fair, just and reasonable rates and is compliant with KRS 278.2207(1)(b). The Commission finds that Sentra's proposed general and administrative expense adjustment of \$12,000 should be denied.

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<sup>42</sup> Application, Pro Forma Adjustment References, Item 4.

<sup>43</sup> Responses to the August 8, 2016 Order, Item 17.a.

<sup>44</sup> Responses to Staff's Second Request, Item 7.d.

<sup>45</sup> Responses to the August 8, 2016 Order, Item 17.b.

<sup>46</sup> Responses to Staff's Second Request, Item 7.a.

## Insurance

Sentra proposed to increase its operating expenses by \$18,411 to “include the insurance expense that MHR now charges Sentra for insurance on vehicles, pipelines, employees, etc.”<sup>47</sup> To support its proposed insurance adjustment, Sentra provided an October 21, 2016 e-mail from Aon Risk Solutions explaining that the annual insurance premium for Sentra would be \$18,411. The Commission has determined that the e-mail is sufficient documentation to support Sentra’s pro forma adjustment. Accordingly, operating expenses have been increased by \$18,411.

## Forecasted Expenses

Sentra proposed to increase its operating expenses by \$9,000 to reflect anticipated legal fees of \$5,000 and expected increases in-office supply expenses of \$4,000.<sup>48</sup> Sentra did not provide detailed descriptions for either proposed adjustment.

In Case No. 2001-00211,<sup>49</sup> Hardin County Water District failed to provide documentary evidence to support its proposed adjustments that were based upon budgetary projections. In that proceeding the Commission made the following finding:

While such projections may be acceptable when an applicant bases its application upon a forecasted test period, they are not when the basis for the proposed rate adjustment is a historical test period. Assuming arguendo that the projections were permissible support for Hardin District’s application, the utility’s failure to produce the calculations and assumptions used to develop these projections makes it impossible for the Commission to assess the validity and reasonableness of such projections.<sup>50</sup>

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<sup>47</sup> Application, Pro Forma Adjustment References, Item 10.

<sup>48</sup> Application, Pro Forma Operations and Pro Forma Adjustment References, Item 4 and Item 8.

<sup>49</sup> See final Order in Case No. 2001-00211, Hardin County Water District.

<sup>50</sup> *Id.* at 8.

Sentra has not presented any evidence in this proceeding that would persuade the Commission to reverse its prior finding that pro forma adjustments based on budgetary projections in a historical test period should be disallowed. Accordingly, we find that the pro forma adjustments for legal fees of \$5,000 and office supplies of \$4,000 should be denied.

#### Gas Consultant

In the test year, the regulatory compliance officer (“Gas Consultant”) was employed on a contract basis with MHR.<sup>51</sup> The adjustment of \$13,480 is the difference between the original contract amount of \$26,520<sup>52</sup> and the current salary being paid by Sentra.<sup>53</sup> Sentra stated that effective April 8, 2017, the part-time Gas Consultant was no longer employed by Sentra, and that it was seeking a replacement.<sup>54</sup> According to Sentra, effective April 26, 2017, the Gas Consultant services are being performed by an existing MHR employee and that it is estimated that the MHR employee will spend approximately 10 percent of his time providing these services.<sup>55</sup>

As with its administrative expense adjustment, Sentra did not submit any type of study or analysis to support its proposed 10 percent allocation factor. The Commission concludes that Sentra has not met its burden of proof that allocation of Gas Consultant expenses is fair, just and reasonable and is compliant with KRS 278.2207(1)(b). The

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<sup>51</sup> Application, Pro Forma Adjustment References, Item 4.

<sup>52</sup> Responses to Staff's Second Request, Item 8.a.

<sup>53</sup> Application, Pro Forma Adjustment References, Item 4.

<sup>54</sup> Responses to Staff's Second Request, Item 8.c.

<sup>55</sup> Responses to the Commission Staff's Third Request for Information, (“Staff's Third Request”), Item 2.a.

Commission finds that Sentra's proposed Gas Consultant expense adjustment should be denied and operating expenses decreased by \$26,520, which is the test-year Gas Consultant payment.

#### Employee Health and Dental Insurance

In the test year, Sentra reported paying \$17,110<sup>56</sup> in employee health and dental insurance premiums. Sentra paid 88 percent of the premium for employee plus health insurance coverage, 93 percent of the premium for employee single health insurance coverage, and 70 percent for employee dental insurance.<sup>57</sup> The Commission expects Sentra to increase its efforts to control employee benefits expenses by establishing a policy of reasonably limiting Sentra's contribution to health insurance premiums and requiring that all employees pay an increased percentage of those premiums. The Commission finds that Sentra should limit its contributions to its employees' health plans to percentages representative of other businesses in order to reduce its expenses. Accordingly, the Commission will, for ratemaking purposes, adjust test-year health for all employees based on national average employee contribution rates.<sup>58</sup>

The Commission has reduced health insurance cost by \$3,222, based on a 32 percent employee contribution rate for employee plus coverage and a 21 percent employee contribution rate for single coverage.

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<sup>56</sup> Responses to Staff's Second Request, Item 5, and Staff's Third Request, Item 1.a. 2015 Insurance Premiums: \$9,769 (Emp. Plus) + \$6,716 (Single) + \$435 (Dental) = \$17,110.

<sup>57</sup> \$9,769 (Sentra Contribution Emp. Plus Coverage) ÷ \$11,111 (Total Premium) = 88%; \$6,716 (Sentra Contribution Single Coverage) ÷ \$7,225 (Total Premium) = 93%; and \$435 (Sentra Contribution Dental) ÷ \$625 (Total Premium) = 70%.

<sup>58</sup> Bureau of Labor Statistics, Healthcare Benefits, March 2016, Table 10, private industry workers. (<https://www.bls.gov/ncs/ebs/benefits/2016/ownership/private/table10a.pdf>)

### Depreciation

Sentra proposed reducing test-year operating expenses by \$30,381 to reflect that its utility plant is fully depreciated.<sup>59</sup> The Commission has reviewed Sentra's depreciation schedule attached to its Application and finds that Sentra has recovered 100 percent of its utility plant investment and accepts Sentra's adjustment to eliminate depreciation from pro forma operating expenses.

### Summary Impact of Adjustments

After considering the test-year operating revenues and expenses, including appropriate adjustments found reasonable herein, the Commission has determined that the financial results of Sentra's pro forma test-year operations would be as follows:

	Test-Year Operations	Pro Forma Adjustments	Pro Forma Operations
Operating Revenues	\$ 511,892	\$ (385,399)	\$ 126,493
Operating Expenses	388,129	(214,908)	173,220
Net Operating Income	<u>\$ 123,763</u>	<u>\$ (170,491)</u>	<u>\$ (46,727)</u>

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<sup>59</sup> Application, Pro Forma Adjustment References, Item 4.

## REVENUE REQUIREMENT DETERMINATION

The Commission has historically used an operating ratio approach to determine revenue requirements for small, privately owned utilities.<sup>60</sup> This approach is used because no basis for rate-of-return determination exists or the cost of the utility has fully or largely been recovered through the receipt of contributions. Given that Sentra is a small gas distribution system, the Commission finds that this method should be used to determine Sentra's revenue requirement.

As shown in the table below, Sentra's pro forma operations, an allowance for income taxes, and an 88 percent operating ratio, result in a revenue requirement from base rates of \$145,421, which is an increase of 87.33 percent, or \$67,791, over normalized revenues from existing base rates of \$77,630.

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<sup>60</sup> An operating ratio measures the difference between operating revenues and operating expenses. It is defined by the following equation.

$$\text{Operating ratio} = \frac{\text{Operation \& Maintenance Exp. + Depreciation + Taxes}}{\text{Gross Revenues}}$$

The Commission has found that the operating ratio is a reasonable and necessary alternative to the rate of return method for calculating the allowable NOI for small investor owned utilities. Specifically, it has found that the rate of return method cannot be used because there is "no basis" upon which to determine a rate of return for these utilities, Case No. 95-236, *Application of Thelma Waste Control, Inc. for a Rate Adjustment Pursuant to the Alternative Rate Filing Procedure for Small Utilities* (Ky. PSC Apr. 15, 1996) at 6. Further, it has found that the operating ratio method is appropriate when plant investment is low and operating expenses are high, Case No. 7982, *Notice of Application of Fern Lake Company* (Ky. PSC Aug. 27, 1981) at 3.

Pro Forma Operating Expenses before Income Taxes	\$ 166,215
Divide by: Operating Ratio	<u>88%</u>
Overall Revenue Requirement before Income Taxes	188,881
Less: Pro Forma Operating Expenses before Income Taxes	<u>(166,215)</u>
Net Operating Income After Income Taxes	22,666
Multiplied by: Gross-up Factor	<u>1.2383901</u>
Net Operating Income Before Income Taxes	28,069
Add: Pro Forma Operating Expenses before Income Taxes	<u>166,215</u>
Overall Revenue Requirement	194,284
Less: Other Operating Revenues	<u>(48,863)</u>
Revenue Requirement Base Gas Rates	145,421
Less: Actual Test-Year Base Gas Rate Revenues	<u>(77,630)</u>
Bas Gas Revenue Increase	<u>\$ 67,791</u>
Percentage Increase	<u>87.33%</u>

### RATES AND RATE DESIGN

Sentra proposes no change in its rate design. It proposes to continue charging its \$5.00 monthly customer charge to all customers, and to apply 100 percent of its revenue increase to its single volumetric rate for all Mcf sold. We find that the proposed rate design and customer charge is reasonable, and that, based on the increase found reasonable herein, Sentra's proposed \$6.4862 per Mcf volumetric base rate should be denied. Based on the revenues projected to be collected by the \$5 monthly customer charge, a volumetric rate of \$4.3709 per Mcf is reasonable and should be charged for service rendered on and after the date of this Order.

## INTEREST ON DEPOSITS TARIFF REVISION

In response to a Staff Request for Information,<sup>61</sup> Sentra stated that it would provide a revised tariff sheet to reflect the current language of KRS 278.460 regarding the requirement for utilities to pay interest on deposits at a rate calculated annually by the Commission. Sentra provided the following language that it will use when it revises its tariff:

Interest will accrue on all deposits at the rate prescribed by law beginning on the date of the deposit, interest accrued will be refunded to the customer or credited to the customer's bill on an annual basis. If interest is paid or credited to the customer's bill prior to twelve (12) months from the date of deposit or the last interest payment date, the payment or credit shall be on a prorated basis.<sup>62</sup>

### SUMMARY

The Commission, after consideration of the evidence of record and being sufficiently advised, finds that:

1. The rates proposed by Sentra would produce revenues in excess of the amount found reasonable herein and should be denied.
2. The rates set forth in the Appendix to this Order are fair, just, and reasonable and should be approved.
3. Sentra should revise its tariff sheet to reflect the current language required by KRS 278.460 regarding the requirement for utilities to pay interest on deposits at a rate calculated annually by the Commission.

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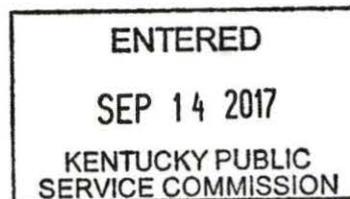
<sup>61</sup> Responses to the August 8 2016 Order, Item 3.c.

<sup>62</sup> *Id.*

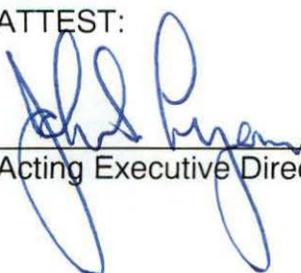
IT IS THEREFORE ORDERED that:

1. The rates proposed by Sentra are denied.
2. The rates and charges found reasonable herein and set forth in the Appendix to this Order are approved for service rendered by Sentra on and after the date of this Order.
3. Sentra shall revise its tariff sheet to reflect the current language required by KRS 278.460 as described herein.
4. Within 20 days of the date of this Order, Sentra 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.

By the Commission



ATTEST:

  
\_\_\_\_\_  
Acting Executive Director

Case No. 2016-00384

APPENDIX

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE  
COMMISSION IN CASE NO. 2016-00384 DATED **SEP 14 2017**

The following rates and charges are prescribed for the customers served by Sentra Corporation. All other rates and charges not specifically mentioned in this Order shall remain the same as those in effect under authority of this Commission prior to the effective date of this Order.

RETAIL RATES:

	<u>Base Rate</u>	<u>Gas Cost Recovery Rate</u>	<u>Total</u>
Customer Charge	\$5.00		
All Mcf	\$4.3709	\$4.4917 <sup>63</sup>	\$8.8554

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<sup>63</sup> Gas cost approved effective Aug. 1, 2017, in Case No. 2017-00258, *Purchased Gas Adjustment Filing of Sentra Corporation* (Ky. PSC Jul. 26, 2017).

\*Honorable John N Hughes  
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