COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

NOTICE OF ADJUSTMENT IN NATURAL GAS RATES OF THE PUBLIC GAS COMPANY	)))	CASE NO. 8186

O R D E R

PROCEDURAL BACKGROUND

On March 31, 1981, Public Gas Company ("Public") filed its notice with the Commission requesting to increase its rates and charges to produce an increase in gross annual revenues of $178,122, to be effective on April 20, 1981. By Orders entered April 1, and April 9, 1981, the Commission suspended the proposed rates for a period of five months and set a public hearing for May 7, 1981.

Public notified its customers of the proposed rates and date and time of the hearing in accordance with the Commission's regulations, and the hearing was held as scheduled. The Attorney General's Division of Consumer Protection and Joellen Allen, et al., represented by counsel, were allowed to intervene and were present at the hearing. A second hearing was held August 17, 1981.

Briefs were filed by September 11, 1981, and information requested during the hearing has been received.

On September 17, 1981, Public notified the Commission that it would place into effect its proposed rates for gas service rendered on and after September 20, 1981. The Commission entered an Order on September 21, 1981, requiring Public to maintain its records in such a manner that refunds could be made if ordered upon the final determination of this case.

ANALYSIS AND DETERMINATION

Test Period

Public proposed and the Commission has accepted the calendar year ending December 31, 1980, as the test period in this case.

Net Investment

Public proposed a net investment rate base at December 31, 1980, of $234,274.[1/] The Commission has determined that the appropriate net investment rate base is $226,097. This reflects the working capital requirement based on the Commission's determination of adjusted operation and maintenance expenses less the cost of purchased gas and an adjustment to accumulated depreciation and amortization to reflect the end-of-period depreciation expense.

1/ Public's Exhibit 3, page 1.

The composition of the rate base is as follows:

Utility Plant	$ 225,478
Less: Accumulated Depreciation and Amortization	16,960 2/
Net Plant	$ 208,518
Working Capital	$ 13,240 3/
Prepayments	4,339
Net Investment Rate Base	$ 226,097

Although no other valuation methods are included herein, the Commission has given due consideration to all elements of value in its determination of fair, just and reasonable rates.

REVENUES AND EXPENSES

Public proposed several pro forma adjustments to its actual operating revenues and expenses to reflect current operating conditions more clearly. 4/ The Commission has accepted these adjustments but has made the following adjustments to Public's actual test year operation:

Operations Labor

During the hearing of August 17, 1981, witnesses for Public were cross-examined extensively regarding a service corporation, PATS, which Public had employed to perform all

2/ $12,668 + $4,292 = $16,960.

3/ $105,916 x 12.5% = $13,240.

4/ Public's Exhibit 2, page 1.

maintenance work on its plant since June 1, 1980. It was Public's view that it was saving its customers money by subcontracting this labor rather than employing its own personnel.

In response to an information request to which it responded on September 16, 1981, Public demonstrated that the average weekly payroll prior to subcontracting was $823 and after subcontracting was $568. The purpose of the response was to show that PATS was indeed saving the customers money.

Although the Commission is aware that the average weekly payroll of $823 includes well service labor and the $568 does not, it concludes that $568 is reasonable and that future costs will reflect this savings. Therefore, it is necessary for the Commission to adjust the labor charges to reflect this savings by reducing operation labor expenses by $5,610, or $255[5/] for 22 weeks of the test period.

Customer Accounts Expense

During the test year, Public had $15,103[6/] in customer accounts expense. In its response to an information request, Public stated that the expense included $11,000 for one full-time clerk who was responsible for collecting accounts, preparing bills, and answering customer's questions about bills and other services.

5/ $823 - $568 = $255.

6/ Public's Notice Exhibit 2, page 1.

Cross-examination of Public's witnesses concerning a $6,000 charge for centralized managerial services disclosed that this fee included bookkeeping and billing services.[7]

Thus, the Commission concludes that the duties of the office clerk have been reduced which should, therefore, be reflected in his or her salary. The Commission has determined that an appropriate salary commensurate with the remaining responsibilities is $8,000, which results in an adjustment of $3,000.

Purchased Gas Adjustment Losses

Public requested that the Commission allow revenues to reimburse it for past purchased gas adjustment losses. Public claimed that in 1979 and part of 1980, the Commission failed to act on Cases 6728-D and 6728-E, which resulted in losses of $74,444.

The Commission did not act on these adjustments because Public's affiliated suppliers were charging stripper well prices prior to the time these wells were certified under the Natural Gas Policy Act. Until stripper well certification was received the increase in wholesale gas rates was not a proper charge to be paid by Public for gas purchased from its affiliates. The Commission will not in this rate case allow Public to recover alleged losses arising from improper charges paid for natural gas purchased from its affiliated suppliers. Public may seek recovery from its affiliated suppliers through other legal means.

7/ Transcript of Evidence, August 17, 1981, page 24.

Therefore, following the above adjustments, Public's test year operating statement is adjusted as follows:

	Per Books[8]	Adjustments	Adjusted
Operating Revenue	$ 338,267	$ 85,486	$ 423,753
Operating Expense	415,170	101,126	516,296
Operating Income (Loss)	$ (76,903)	$ (15,640)	$ (92,543)

Return

At December 31, 1980, Public had a negative equity position and was financed entirely by notes and accounts payable. The notes payable, which by June 30, 1981, had increased from the $200,000[9] balance at the end of the test year to $256,000[10] were all short-term with a composite interest rate of 17.8 percent.[11] It is inappropriate for a utility with long-term assets to be financed entirely by short-term notes. As stated before, Public filed its case on March 31, 1981, or past the period of high volume sales. It is equally inappropriate for a gas utility to sustain operating losses through the winter heating season and finance these losses with short-term notes at 18 percent to 19 percent interest.

Public has asked the Commission to grant a return of 24.45 percent[12] on its net investment rate base. This return is based

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8/ Public's Notice Exhibit 2, page 1.

9/ Public's Notice, Exhibit 1, page 2.

10/ Public's Brief, page 2.

11/ Ibid.

12/ $57,546 ÷ $226,097 = 25.45%.

on a hypothetical capitalization of $100,000 equity and $200,000 debt. As the Attorney General pointed out, this $300,000 base is in excess of the investment in used and useful property.

The Commission will accept the hypothetical capital structure of 33.3 percent equity and 66.7 percent debt and apply this capital structure to the net investment rate base. Moreover, the Commission will accept Public's cost of debt of 17.8 percent at June 30, 1981. The 15.5 percent[13/] return on equity requested by Public in its notice is found to be fair, just and reasonable. This results in operating income required of $38,574, and a return on net investment of 17.6 percent, the return found fair, just and reasonable. To achieve this return, Public requires an increase in rates to produce additional annual revenues of $133,942.[14/]

The Commission cautions Public that it must immediately take steps to correct its financial instability by seeking long-term debt financing to replace the existing short-term notes.

RATE DESIGN

Public requested a change in rate design. Public has been charging a seasonal rate per Mcf to the Prestolite Wire Division of ELTRA Corporation ("Eltra") for interruptible service. A five-step declining block rate structure is used for all other

13/ Public's Notice, Exhibit 3, page 1.

14/ Income taxes are based on interest expense of $26,904.

customers. Public proposed to bill all customers, including Eltra, on a two-step declining block rate structure. Eltra would still receive interruptible service. It is the opinion of the Commission that the proposed rate design changes are reasonable and should be approved.

SUMMARY

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

(1) The rates proposed by Public would produce revenues in excess of the revenues found reasonable herein and should be denied upon application of KRS 278.030.

(2) The rates and charges in Appendix A, attached hereto and made a part hereof, are the fair, just and reasonable rates for Public to charge its customers in rendering gas service on and after September 20, 1981.

(3) A refund to Public's customers for service rendered on and after September 20, 1981, billed in excess of the rates in Appendix A is necessary.

(4) This refund should include interest at a rate equal to the average of the "3-Month Commercial Paper Rates" for the immediately preceding 12-month period less 1/2 of 1 percent to cover the cost of refunding. These monthly rates are reported in both the Federal Reserve Bulletin and the Federal Reserve Statistical Release.

IT IS THEREFORE ORDERED that the proposed rates and charges in Public Gas Company's notice of March 31, 1981, be and the same are hereby denied.

IT IS FURTHER ORDERED that effective with service rendered on September 20, 1981, Public Gas Company be and it hereby is authorized to place into effect the rates and charges in Appendix A, attached hereto and made a part hereof.

IT IS FURTHER ORDERED that Public Gas Company be and it hereby is directed to refund to its customers all rates and charges collected in excess of those approved herein for the period September 20, 1981, through the effective date of this Order.

IT IS FURTHER ORDERED that Public Gas Company shall within 30 days of the date of this Order submit a refund plan to this Commission for approval.

IT IS FURTHER ORDERED that within 20 days of the date of this Order, Public Gas Company shall file its tariffs setting out the rates and charges approved herein.

Done at Frankfort, Kentucky, this 13th day of November 1981.

PUBLIC SERVICE COMMISSION

Marlin M. Volz
Chairman

Katherine Randall
Vice Chairman

[illegible]
Commissioner

ATTEST:

Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 8186 DATED NOVEMBER 13, 1981.

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

First 1 MCF, Minimum Bill	$ 6.00
All Over 1 MCF, per MCF	4.88

For the purpose of the future application of the Purchased Gas Adjustment Clause of Public Gas the Base Rate for purchased gas shall be:

	Demand	Commodity
Capital Producing Company	-	$ 3.30
Pan Bowl Production	-	3.30
Edna Smith	-	3.30
All Other Wells	-	3.30