COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

JOHNSON COUNTY GAS COMPANY, INC., VAN LEAR, KENTUCKY 41265 APPLICATION FOR AUTHORITY TO ADJUST RATES ON AN EMERGENCY BASIS	))))	CASE NO. 8235

O R D E R

PROCEDURAL BACKGROUND

On May 5, 1981, Johnson County Gas Company, Inc., ("Johnson County") filed an application with the Commission seeking approval of an increase in rates charged for natural gas service. The proposed rates would produce an increase in gross annual revenues of approximately $224,763 or 77.8 percent above test period revenues.

Primarily, the increase was sought to pay interest on a loan authorized by the Commission on June 6, 1980, in the amount of $1,321,374. The proceeds of the loan, obtained through the Federal Economic Development Administration and the Kentucky Department of Local Government, were to pay for the reconstruction of Johnson County's gas system and to retire other past due debts. The then existing gas system was in a poor state of repair with gas line losses as high as 30 percent.

A hearing was held on this matter on June 8, 1981. The Consumer Protection Division of the Attorney General's Office and a group of concerned citizens, both represented by counsel, were present.

Subsequent to the hearing in this case, both of Johnson County's wholesale gas suppliers, Kentucky West Virginia Gas Company ("Kentucky-West") and Columbia Gas of Kentucky ("Columbia"), filed motions requesting permission to intervene in the case. Kentucky-West and Columbia listed the past due gas bills owed them by Johnson County and requested that the Commission establish a surcharge on Johnson County's ratepayers to be applied exclusively to the past due accounts. The Commission, by Orders dated September 11, 1981, and September 28, 1981, sustained these motions to intervene for the stated purpose of supplementing the record.

All information requested has been filed, and the entire matter is now considered submitted for final determination by the Commission.

ANALYSIS AND DETERMINATION

Test Period

Johnson County proposed and the Commission has accepted the 12-month period ending December 31, 1980, as the test period in this case. As the operating conditions of Johnson County have been altered by the completion of the reconstruction of the system in May 1981, numerous pro forma adjustments to the December 1980 financial statements have been proposed and have been accepted when appropriate to reflect current operating conditions more clearly.

Revenues and Expenses

The Commission has allowed pro forma adjustments reflected in Johnson County's comparative income statement filed June 22, 1981, with the following exceptions:

Accounting and Collecting Labor

Johnson County projected the cost of customer accounting and collecting expense as follows:

Salary - Betty Preston	\$ 7,200 (1)
Salary - Suzanne Wattins	5,400 (1)
Helton Butler & Wells - annual cost of computer billing service	4,200 (2)
Postage - computer billing	1,200 (2)
Printing of computer bills	1,080 (2)
Total	\$19,080

These expenses were included in various operating expense accounts.

Johnson County's accounting witness was cross-examined in the hearing of June 8, 1981, to determine why no cost decreases were projected following the installation of computerized billing.(3) Although the witness maintained that no decrease in the number of employees was expected, the Commission is of the opinion that the duties of the accounting and collection personnel will be reduced and the resulting cost savings should be reflected in rates charged to Johnson County's ratepayers.

(1) Information filed June 22, 1981.
(2) Information filed June 24, 1981.
(3) Transcript of Evidence, June 8, 1981, p. 25.

Based on a review of the annual reports of similar size companies, the Commission has determined that the total cost per month per customer for accounting and collecting expenses should not exceed $1.60, as compared to Johnson County's projected cost of $1.83.[4] Thus the Commission has reduced Johnson County's operating expenses by $2,393.[5]

Uncollectible Accounts

Johnson County, using a list of delinquent accounts which ranged from $30.61 to $325.32,[6] made a pro forma adjustment of $10,000 for the provision of uncollectible accounts. The size of the individual overdue accounts indicates to the Commission that Johnson County has been rather slow in collecting accounts during the test period. The computerized billing system should provide Johnson County's staff with sufficient information to make collections in a more prudent and timely manner. The Commission is of the opinion that an expense of one-percent of gross revenues is adequate and allowable for rate-making purposes and has, therefore, reduced Johnson County's uncollectible accounts by $4,620.[7]

General Advertising Expenses

Johnson County proposed to include in its test year operations $500 in advertising expenses for the following purposes:

a) Advertisement of the new computer billing system

b) Advertisement of the proposed rates

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(4) $19,080 ÷ 867 customers ÷ 12 months = $1.83.
(5) 867 customers X $.23 X 12 months = $2,393.
(6) Information filed June 24, 1981.
(7) Uncollectibles are calculated on revenues normalized through PGA 7059-DD.

The first item of advertising is non-recurring, and the second item does not frequently occur. Therefore, the Commission is of the opinion that advertising expense should be amortized over a 3-year period and has reduced operating expenses by $333.

Office Supplies and Expenses

Johnson County provided an analysis of its actual and projected office supplies and expenses. The Commission has evaluated each expense and has made the following adjustments:

	Actual (8)	Proposed (9)	Allowed
Postage - General	$ 55	$ 300	$ 73
Uniform Rental	159	780	159
Cleaning Supplies	173	600	173
Soft Drinks for Employees	541	600	-0-

The Commission has allowed only the 33 percent increase in postage stamps, as Johnson County provided no support for additional postage costs.

Uniform rental and cleaning supplies were estimated using an inflation factor. Johnson County provided no documentation to support the expected increases. The increases were speculative, did not meet the known and measurable standard and have, therefore, been denied.

The expense for soft drinks for employees has been denied in its entirety. The Commission considers this to be an unnecessary expense in the provision of gas service which should not be borne by Johnson County's ratepayers.

(8) Information filed June 22, 1981.
(9) Information filed June 24, 1981.

Outside Services Employed

Johnson County estimates that its annual recurring cost for legal services will be $7,000.[10] The Commission, based on its experience with other public utilities of this size, considers this amount to be excessive. The Commission is of the opinion that $300 per month or $3,600 per year is an adequate allowance for legal services for Johnson County's operations and has allowed this amount.

Injuries and Damages

Johnson County made a pro forma adjustment of $5,000 per year to operating expenses for customer claims resulting from the reconstruction of the gas system. Johnson County indicated that claims would relate to damages such as driveway cracks, pavement settling and sewer line breaks.[11]

There is no evidence of record to substantiate this adjustment. It is neither known nor measurable. Therefore, the Commission has denied this adjustment in its entirety.

Transportation Expense

Johnson County proposed an annual transportation cost of $10,000 for the operation of its three maintenance trucks purchased in September of the test year. The Commission has given due consideration to the following factors in determining an allowable transportation expense:

a. A completely renovated gas system should experience reduced operating maintenance for a period of approximately 3 years from renovation.

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(10) Information filed June 24, 1981.
(11) Information filed September 1, 1981.

b. Johnson County has stated that each of the maintenance trucks is getting a minimum of 20 miles per gallon.

c. Based on Johnson County's service territory, the Commission estimates that each truck will operate a maximum of 25,000 miles per year.

In view of the above-mentioned facts, the Commission has determined the following expense to be allowable:

Mileage per year	25,000
Average miles per gallon	÷ 20
Gallons used per year	1,250
Average cost of gasoline per gallon	X $ 1.25
Annual cost per truck	$1,562.50
Number of trucks	X 3
Total allowance	$4,688.00 (12)

Depreciation Expense

Johnson County included a pro forma adjustment for depreciation expense of $42,900 per year based on the reconstructed cost of its gas system. A depreciation schedule was submitted by Johnson County in support of its computation.(13) The Commission has reviewed each unit of depreciable plant on the schedule and is of the opinion that depreciation expense of $7,519(14) applicable to retired plant of $182,493 should be deleted in computing pro forma depreciation expense. The Commission has allowed $35,381 in depreciation expense for rate-making purposes.

Interest on Long Term Debt

Johnson County proposed adjusted interest expense of $70,000 per year. The major portion of this interest is related

(12) Depreciation expense on the three trucks is included in the depreciation account.
(13) Information filed June 24, 1981.
(14) Ibid.

to the reconstruction loan from the Federal Economic Development Administration through the Department of Local Government in the sum of $1,321,374 at an interest rate of 5.125 percent.

The Commission, in its consolidated Order in Cases Numbers 7576, 7743 and 7875 entered October 6, 1980, considered and granted the proposal of Johnson County to purchase and record on its books 994 shares of its common stock as treasury stock. The debt incurred to purchase the treasury stock was to be recorded on the books as a long-term debt. However, the Commission, after due consideration of this matter, advised Johnson County and its stockholders, that neither the interest cost nor the excess of the purchase price over the net original cost would be recognized for rate-making purposes.

The Commission is, therefore, of the opinion that the interest cost attributable to the purchase of treasury stock by Johnson County in the amount of $164,702 (15) should be deleted from the requested interest on long-term debt. Allowable interest has been computed as follows:

Johnson County's Proposed Adjusted Interest Expense	$ 70,000
Less:	
Interest on debt supporting treasury stock ($164,702 X 5.125%)	8,441
Allowable Interest Expense	$ 61,559

Employee Concessions

During the test period, Johnson County supplied free gas service to four employees. (16) The Commission is of the opinion

(15) 1980 Annual Report, page 3, line 11.
(16) Transcript of Evidence, June 8, 1981, p. 100.

that Johnson County's ratepayers should not bear this cost, and therefore, has made an adjustment to increase revenues by $1,802. This adjustment is based on average gas usage of 12 MCF per month per employee at the latest PGA rates.

Therefore, Johnson County's adjusted operating revenues and expenses are as follows:

	Johnson County's Pro Forma	Commission Adjustments	Adjusted
Operating Revenues	$ 289,037	$ 1,802	$ 290,839
Operating Expenses	417,000	(30,452)	386,548
Operating Loss	$ (127,963)	$ 32,254	$ (95,709)
Interest Expense	70,000	(8,441)	61,559
Net Loss	$ (197,963)	$ 40,695	$(157,268)

Interest Coverage

Johnson County's investment in its utility plant and equipment devoted to public service is entirely financed by debt. As stated above, the majority of this debt is held by the Federal Economic Development Administration through the Department of Local Government and was incurred to reconstruct the gas system. Since the entire investment is financed by debt, a return on net investment is not appropriate.

The Commission is of the opinion that the most reasonable method of determining the required level of operating revenue is to use an interest coverage measure. The Commission is, moreover, of the opinion that the fair, just and reasonable interest coverage in this case is 1.5 times interest in that it will provide an adequate margin for equity growth and the repayment of existing obligations. Therefore, the Commission concludes that Johnson County is entitled to increase its rates and charges to produce an increase in annual operating revenues of $188,048, calculated as follows:

Adjusted Operating Expenses	$386,548
1.5 X Interest Expense	92,339
Subtotal	$478,887
Less:	
Adjusted Operating Revenue	290,839
Increase	$188,048

The Commission stresses to Johnson County that the provision of the margin above operating costs and interests payments is not for the purpose of payment of dividends or for additional increases in salaries to the stockholders employed in the company operations. This margin should compensate for ordinary business risks and facilitate the payment of past due accounts to Kentucky-West and Columbia.

The Commission will not assess a surcharge on Johnson County's ratepayers. It is the Commission's opinion that with prudent management of its cash flow during the winter heating season of 1981/1982, Johnson County can pay both its current wholesale gas bills and its past due gas bills. The Commission will require Johnson County to provide monthly statements of payments to Columbia and Kentucky-West.

Rate Design

Johnson County's current tariffs include a rate schedule for the area supplied by Columbia and a rate schedule for the area supplied by Kentucky-West. A separate rate schedule was established for each area because the area supplied by Kentucky-West and the area supplied by Columbia are not physically connected and the cost of gas purchased from Columbia has been and currently is significantly higher than the cost of gas purchased from Kentucky-West.

Johnson County proposed a customer charge and one rate schedule for both service areas. Johnson County's witness, Mr. Abrams, testified that the cost of construction per customer was greater in the Kentucky-West area and the allocation of expenses based on the cost per customer would offset the difference in the suppliers' cost of gas. After the hearing, Johnson County submitted a letter from Heath and Associates to support the construction cost per customer in the two areas.

The Commission is of the opinion that the allocation of expenses and return based on the average investment per customer would tend to offset the differential in the cost of gas of the two areas. Therefore, the Commission concludes that Johnson County's proposed rate design should be approved.

SUMMARY

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

1. The rates in Appendix A, attached hereto and made a part hereof, are the fair, just and reasonable rates to be charged by Johnson County for gas service rendered to its customers and should produce an increase of gross annual revenues of approximately $188,048.

2. The rates proposed by Johnson County would produce revenues in excess of the revenues found reasonable herein and should be denied upon application of KRS 278.030.

3. Johnson County should be required to submit monthly statements showing payments to its wholesale gas suppliers with copies of the suppliers' invoices and cancelled checks.

4. The rates and charges in Appendix A have been normalized to include the most recent PGA rates (Case No. 7059-FF) and therefore, effective with the date of this Order, Johnson County should have a zero purchased gas adjustment.

IT IS THEREFORE ORDERED that the proposed rates and charges as set forth in Johnson County Gas Company's application of May 5, 1981, be and the same are hereby denied.

IT IS FURTHER ORDERED that effective on the date of this Order, Johnson County Gas Company is hereby authorized to place in effect the rates and charges in Appendix A, attached hereto and made a part hereof.

IT IS FURTHER ORDERED that Johnson County Gas Company shall submit monthly statements to the Commission showing payments to its wholesale gas suppliers, Columbia Gas of Kentucky and Kentucky-West Virginia Gas Company. These monthly statements should include a copy of the suppliers' invoices and cancelled checks.

IT IS FURTHER ORDERED that within 20 days of the date of this Order Johnson County Gas Company shall file its tariffs setting out the rates approved in Appendix A.

Done at Frankfort, Kentucky, this 29th day of October, 1981.

PUBLIC SERVICE COMMISSION

Marlin M. Volz
Chairman

Katherine Randall
Vice Chairman

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Commissioner

ATTEST:

Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE PUBLIC
SERVICE COMMISSION IN CASE NO.
8235 DATED OCTOBER 29, 1981

The following rates are prescribed for the customers in the area served by Johnson County Gas Company, 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 date of this Order.

RATES:

Customer charge	$ 3.00 per month
All MCF	$ 6.8734 per MCF

Minimum charge is the customer charge.

For the purpose of the future application of the purchased gas adjustment clause of Johnson County, the base rate for purchased gas shall be:

	Commodity
Columbia Gas Company of Kentucky	$ 4.0930 per MCF
Kentucky West Virginia Gas Company	$ 1.4317 per DTH
BASE RATE	$ 3.2582 per MCF

PGA increases will be computed as follows:

1. Multiply the total MCF purchased for the most recent 12 month-period times the current price per MCF for each supplier.

2. Total the MCF purchased and total the cost for all suppliers.

3. Divide the total cost by the total MCF purchased for the average cost of gas.

4. From the average cost of gas subtract the Base Rate ($3.2582) for the increase or decrease per MCF.

5. Add or subtract the increase or decrease (as computed in Step 4) to the charge per MCF ($6.8734) to obtain new charge per MCF.