COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

THE APPLICATION OF MARTIN GAS, INC.,) CASE NO. 9291
FOR AN ADJUSTMENT OF RATES)

O R D E R

On March 31, 1985, Martin Gas, Inc., ("Martin") filed an application with the Public Service Commission ("Commission") seeking $32,301 in additional annual revenues. Martin cited the poor condition of its plant which is requiring additional revenues to effect repairs to the system to reduce excessive line loss. The requested rates would result in approximately an 11.6 percent increase in annual revenues.

On July 23, 1985, a hearing was conducted on the general issue of Martin's requested increase in annual revenues. The Attorney General of the Commonwealth of Kentucky, through its Utility and Rate Intervention Division, and the City of Martin, Kentucky, intervened in the proceedings.

This Order addresses the Commission's findings and determinations with regard to its investigation of Martin's revenue requirements. This Order grants additional annual revenues of approximately $15,306, or a 5.5 percent increase in revenues.

COMMENTARY

Martin is currently being operated by Columbia Gas of Kentucky as court-appointed receiver. The Commission received a letter on November 8, 1985, from C. Ronald Tilley, president of Columbia Gas of Kentucky, indicating that Columbia is resigning as receiver of Martin Gas. At this time, the Commission has not received notice of the appointment of a new receiver. Martin serves approximately 404 customers in Martin, Kentucky.

TEST PERIOD

Martin proposed and the Commission has accepted the 12-month period ended December 31, 1983, as the test period in this case. In utilizing the historic test period, the Commission has given recognition to all known and measurable changes found reasonable herein.

REVENUES AND EXPENSES

Martin made several adjustments to the test period based on the data of the preliminary 1984 Annual Report by adjusting each line item to agree with the preliminary report. Since Martin's application was filed, the final 1984 Annual Report has been filed and is identical to the preliminary report. Consequently, with a few exceptions noted elsewhere in this Order, Martin updated the 1983 test period to agree with the reported 1984 results of operations.

The results of Martin's operations were the cumulative effect of three different managements operating the Martin system. The Martin system was operated by Mr. David Allen from January 1, 1984, to April 9, 1984; by a court-appointed receiver, Mr. Patton, from April 10, 1984, to September 30, 1984; and by Columbia Gas of Kentucky, the current court-appointed receiver, from October 1, 1984, to the present.[1] For comparable monthly data, the average monthly cost of service during 1984 varied from $2,972 under Mr. Patton's receivership to $5,551 under Mr. Allen's management; while under the guidance of Columbia Gas of Kentucky, the cost of service averaged $4,266 monthly.[2] The Commission is of the opinion that, although the changes in Martin's management are not technically changes in accounting entity, the changes of management have had a profound affect on Martin's cost of service. More specifically, the Commission is of the opinion in this case that those costs most affected by the changes in Martin's management would be those costs in which management has discretionary power. The Commission feels in this case that the only line item where management does not have discretionary power is gas purchases, since management is committed by contract to price and is committed through obligation of service to quantity. Consequently, the Commission feels that the discretionary cost of service data contained in the 9-month period ended June 30, 1985, extended to 12 month, is more representative of on-going cost of service under the management of Columbia Gas of Kentucky.

Gas Purchases

The Commission typically does not allow for rate-making purposes line losses in excess of 5 percent of total purchased

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1 Data requested at Hearing No. 4, filed August 7, 1984.

2 Ibid.

volumes; however, to provide a sufficient cash inflow to Martin to effectuate necessary repairs to Martin's system, the Commission will allow for rate-making purposes full recovery of all gas purchases in excess of the typical 5 percent line loss with the following caveat. The Commission is of the opinion that purchased gas costs recovered in excess of the 5 percent maximum line loss allowable for rate-making purposes should be accounted for as customer advances for construction to offset the capitalization of extraordinary repairs. To the extent that the amounts accrued to customer advances for construction are not absorbed by extraordinary repairs by December 31, 1988, the Commission will determine a reasonable amortization period over which the balance in customer advances for construction will be refunded to the Martin customers.

The intent of allowing full recovery of excessive line loss is to provide Martin with sufficient cash inflows to effectuate repairs and replacements of the Martin system to reduce the excessive line loss. The intent of accounting for the cost recovery of the excessive line loss as customer advances for construction is to recognize the source of the monies and accrue benefits rightfully due that source, Martin's customers. To facilitate these intents, the Commission feels it is necessary that Martin should file monthly statements for each monthly period disclosing excess gas costs recovered above the 5 percent allowable for rate-making purposes and all expenditures qualifying as extraordinary repairs to reduce excessive line loss.

Subject to the previous discussion, the Commission is of the opinion that it is necessary for Martin to recover excess purchased gas costs and it is fair to Martin's customers to account for this recovery as customer advances for construction. Therefore, based on test-period adjusted purchases of 54,362 Mcf and the average price per Mcf of $4.313, the Commission has determined $234,483 in annual purchased gas expense to be fair and reasonable for rate-making purposes.

Discretionary Costs of Service

For the 9-month period ended June 30, 1985, Martin reported $40,460[3] in discretionary expenditures under the management of Columbia Gas of Kentucky. Based on the previous discussion under Revenues and Expenses, the Commission has determined discretionary cost of service to be $53,947 annually.

Martin proposed an adjustment to its discretionary expenses of $18,000 annually, intended to pay for liability insurance of $2,500 and repairs and maintenance of $15,500 annually. The Commission is of the opinion that the $2,500 annually for liability insurance is a legitimate expense for rate-making purposes. However, the Commission is also of the opinion that the requested additional $15,500 annually for repairs and maintenance lacks sufficient detailed support of the intended application of these funds, and completely lacks any cost or service benefit which should result from the $15,500 increase in annual expenditures for repairs and maintenance. Furthermore, the Commission feels that

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3 Data requested at Hearing No. 2 filed August 6, 1985.

the $3,528 and $5,297 annually for mains and services and maintenance of lines previously included in Martin's discretionary cost of service, and the additional cash inflow resulting from complete recovery of all excessive line loss, will provide sufficient funds to effectuate repairs to Martin's system.

Therefore, the Commission has determined the cost of service above gas purchases to be $56,447 annually under the management of Columbia Gas of Kentucky.

Consequently, test-period operations have been adjusted to produce the following results:

	Test Period Reported	Adjustments to Test Period	Adjusted Test Period
Total Operating Revenues	$ 321,422	$< 36,183>	$285,239
Total Operating Expenses	<365,930>	75,000	<290,930>
Operating Income	$< 44,508>	$ 38,817	$< 5,691>

REVENUE REQUIREMENTS

For the test period, Martin had no long-term debt and a negative proprietary capital of $66,269.[4] The Commission is of the opinion that it is not fair and reasonable to determine Martin's revenue requirements on the basis of a return on rate base since it is obvious that Martin has no collateral long-term funds invested. However, it is also obvious that the adjusted test-period operating loss of $5,691 annually cannot continue indefinitely and is not in the interest of either Martin or its customers. Therefore, the Commission has determined Martin's

[4] 1983 Annual Report.

revenue requirement based on an 88 percent operating ratio, modified for income taxes, applied to the added distribution costs above natural gas as follows:

Distribution Costs	$ 56,447
Income Taxes	1,688
Total Distribution Costs	$ 58,135
Operating Ratio	÷ .88
	$ 66,062
Gas Purchases	234,483
Revenue Requirements	$300,545
Normalized Revenues	<285,239>
Additional Revenues Required	$ 15,306

The Commission is of the opinion that additional annual revenues of $15,306 will produce net operating income of $7,927 annually, after income taxes of $1,688, and is sufficient income to provide for equity growth, a reasonable return, and to ensure the long-run survival of Martin.

FINDINGS AND ORDERS

The Commission, after examining the evidence of record, is of the opinion and finds that:

1. Martin's proposed rates are unfair, unjust and unreasonable in that they produce revenues in excess of those found reasonable herein.

2. The rates and charges in Appendix A will produce operating revenues of $300,545 annually and are fair, just and reasonable rates in that they will produce revenues sufficient to permit Martin to repair its system, earn a reasonable profit and provide for equity growth.

3. Gas purchase costs recovered in excess of the 5 percent maximum line loss allowable for rate-making purposes should be accounted for as customer advances for construction.

4. Extraordinary repairs to reduce excessive line loss should be charged against customer advances for construction to the extent of the credit balance in that account.

5. Martin should file monthly reports to the Commission within 30 days of the close of the monthly period accounting for monies received from recovery of line loss in excess of 5 percent and monies expended for extraordinary repairs to reduce line loss.

6. Martin should place monies collected from the recovery of line loss in excess of 5 percent in a separate escrow account.

7. Only capital expenditures intended to reduce excessive line loss should be made from the escrow account.

IT IS THEREFORE ORDERED that:

1. The rates and charges proposed by Martin be and they hereby are denied.

2. The rates and charges in Appendix A be and they hereby are fair, just and reasonable rates to be charged by Martin for service rendered on and after , 1985.

3. Martin shall account for gas purchases recovered in excess of 5 percent line loss as customer advances for construction.

4. The cost of extraordinary repairs to reduce line loss in excess of 5 percent shall be charged against customer advances for construction to the extent of the credit balance in that account.

5. Martin shall file monthly reports to the Commission within 30 days of the close of each monthly period accounting for monies received from recovery of line loss in excess of 5 percent and monies expended for extraordinary repairs to reduce line loss.

6. Martin shall place monies collected from the recovery of line loss in excess of 5 percent in a separate escrow account.

7. Martin shall make only capital expenditures intended to reduce excessive line loss from the escrow account.

8. Martin shall file with the Commission within 30 days from the date of this Order its revised tariff sheets setting out the rates and charges approved herein.

Done at Frankfort, Kentucky, this 20th day of December, 1985.

PUBLIC SERVICE COMMISSION

Richard D. Heman Jr.

Chairman

Vice Chairman

Commissioner

ATTEST:

Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 9291 DATED 12/20/85

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 this Commission prior to the effective date of this Order.

The following rates and charges have incorporated all increases and decreases in purchase gas adjustment clause cases from 8730-K through 8730-P.

<u>RATES</u>: Monthly

First 1 Mcf	\$6.2080 Per Mcf (Minimum Bill)
Over 1 Mcf	\$6.1080 Per Mcf

The base rate for the future application of the purchased gas adjustment clause of Martin Gas, Inc., shall be:

	<u>Commodity</u>
Columbia Gas of Kentucky, Inc.	\$4.551 per Mcf
Southeastern Gas Company	\$0.140 per Mcf