

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ADJUSTMENT OF THE RATES OF ELZIE )  
NEELEY GAS COMPANY, INC., PURSUANT )  
TO THE ALTERNATIVE RATE ADJUSTMENT ) CASE NO. 9521  
PROCEDURE FOR SMALL UTILITIES )

O R D E R

On March 6, 1986, Elzie Neeley Gas Company, Inc., ("Elzie Neeley") filed an application with the Commission requesting authority to increase its gas rates. This application was filed pursuant to 807 KAR 5:076, Alternative Rate Adjustment Procedure for Small Utilities ("ARF"). Elzie Neeley stated that the requested increase was necessary because the operating margins over the past years have declined and customer usage has declined. The amount of increased revenue requested by Elzie Neeley was \$4,496, an increase of approximately 6.6 percent over normalized operating revenues as determined herein. Based upon the determination herein, Elzie Neeley's operating revenue will increase by \$738 annually, an increase of 1.1 percent.

A hearing was not requested in this matter, and in accordance with the provisions of the ARF, no hearing was conducted. The decision of the Commission is based upon information contained in the application, written submissions, annual reports, staff reports and other documents on file in the Commission's offices.

### COMMENTARY

Elzie Neeley operates as a public utility providing gas service to 80 residential customers in the town of Prestonsburg, Kentucky.

### TEST PERIOD

Elzie Neeley proposed and the Commission has accepted the 12-month period ending December 31, 1985, as the test period for determining the reasonableness of the proposed rates. In using the historical test period, the Commission has given full consideration to appropriate known and measurable changes.

### Staff Audit Report Adjustments

In the course of its investigation in this case, the Commission staff performed a limited audit to verify reported test-year expenses and determine what accounting or classification changes might be appropriate. The Commission's objective was to substantially reduce the need for written data requests, thus reducing the expense to Elzie Neeley. The staff audit report of Elzie Neeley's financial operations for the calendar year 1985 was filed as a part of the record in this case on June 9, 1986.

Elzie Neeley filed no comments regarding the staff audit report. The Commission hereby adopts the findings of that report to be used for rate-making purposes herein.

The Commission has made additional adjustments to the test year, as determined in the audit report, based upon the following findings of fact to reflect more normal and current operating conditions:

## VALUATION

### Net Investment

Elzie Neeley proposed a net investment rate base of \$21,439. The Commission has adopted Elzie Neeley's proposed net investment rate base with the following modifications:

Net investment rate base has been increased by \$812 to reflect the findings in the audit report of the capitalization of an odormeter at \$326, and a relief valve costing \$486.

Working capital of 1/8 of operation and maintenance expenses, exclusive of depreciation, taxes and other deductions, has been calculated based upon the adjusted pro forma operation and maintenance expenses found reasonable herein.

With these adjustments, Elzie Neeley's net investment rate base for rate-making purposes is as follows:

Gas Utility Plant in Service	\$37,137
Add:	
Capitalized Items	812
Cash Working Capital	2,039
Less:	
Reserve for Depreciation	<u>18,385</u>
Net Investment Rate Base	<u>\$21,603</u>

### Normalized Sales Revenues

Elzie Neeley's normalized sales revenue for the test year, based on its most recent Purchased Gas Adjustment 8546-U, was \$66,652.

### Gas Purchases

Elzie Neeley proposed that its purchased gas expense be based on a 3 percent line loss. According to Elzie Neeley's Annual Reports of 1983 and 1984, Elzie Neeley experienced a line loss of approximately .2 percent in 1983 and a net line gain of .4 percent in 1984. The staff audit report of the 1985 test year in this case shows adjusted gas purchases of 10,909 Mcf which compares to sales of 10,863 Mcf for a line loss of .4 percent during the test period.

The Commission is of the opinion that the facts in this case do not support a 3 percent line loss allowance for rate-making purposes. Therefore, the Commission has determined purchased gas expense based on the actual test-period line loss and the blended cost of gas. Consequently, the Commission has reduced test-period purchased gas expense by \$1,822 to \$48,043 annually.

### Rate Case Expenses

Elzie Neeley proposed \$1,000 annually in rate case expenses. Elzie Neeley's most recent rate case was concluded in November 1982. From the interval between rate cases it appears that Elzie Neeley's revenues and costs are relatively stable. Additionally, it appears unreasonable to allow full cost recovery of rate case expenses based on a single year's amortization. Instead, the Commission has determined, based on a 3-year amortization period, that \$333 is a reasonable annual expense for rate case expenses in this instance. Therefore, the Commission has increased test-period rate case expense by \$333 annually.

### Depreciation Expense

The audit report of June 9, 1986, calculated depreciation on certain assets as of their in-service dates. This calculation for accounting purposes understated depreciation expense since depreciation on some assets was not based on a full year's depreciation. The Commission has redetermined depreciation expense based on a complete year's normally expected depreciation and has increased depreciation expense by \$598 annually.

### Income Taxes

Elzie Neeley proposed \$536 annually in income tax expense for rate-making purposes based upon the proposed amount of return on net investment rate base. Elzie Neeley made no adjustments to net investment rate base for deferred tax credits, nor did it account for the deductibility of interest expense. Elzie Neeley also made no determination of investment tax credits. Elzie Neeley is a Sub-Chapter S corporation for income taxes purposes.

The reason for allowing income tax expense for rate-making purposes is to provide an adequate after-tax rate of return to the corporation because it is this return which investors evaluate according to their own economic circumstances to include tax considerations. Therefore, income taxes are allowed for rate-making purposes to provide an after tax return available for dividend distribution to the shareholder. The shareholder pays income taxes based upon individual tax circumstances. Since income taxes are not levied at the corporate level in the case of a Sub-Chapter S corporation, the return on net investment rate base is available to be distributed on an after tax basis.

Therefore, the Commission has disallowed the proposed income tax expense for rate-making purposes.

The Commission, after consideration of all pro forma adjustments and applicable income tax effects, has determined Elzie Neeley's adjusted operating results to be as follows:

	<u>Test Year Per Audit</u>	<u>Adjustments</u>	<u>Test Year Adjusted</u>
Operating Revenues	\$73,745	\$<4,769>	\$68,976
Operating Expenses	<u>71,217</u>	<u>&lt;3,663&gt;</u>	<u>67,554</u>
Operating Income	2,528	<1,106>	1,422
Interest Expense	<u>-0-</u>	<u>440</u>	<u>440</u>
Net Income	<u>\$ 2,528</u>	<u>\$&lt;1,546&gt;</u>	<u>\$ 982</u>

#### RATE OF RETURN

Elzie Neeley requested a rate of return on net investment rate base of 10 percent. In its most recent case, Elzie Neeley was allowed a return of 13 percent. The requested return is consistent with the lowered returns allowed by the Commission since Elzie Neeley's last case in 1982 and, therefore, the Commission is of the opinion that the requested return of 10 percent is a fair, just and reasonable rate of return on net investment rate base in that it will allow Elzie Neeley to pay its operating expenses, service its debt, and provide a reasonable surplus for equity growth.

#### REVENUE REQUIREMENTS

The Commission has determined that Elzie Neeley needs additional annual operating income of \$738 to produce an overall return on net investment rate base of 10 percent. To achieve this level of operating income, Elzie Neeley is entitled to increase

its annual revenues by \$738 over normalized operating revenues as determined herein.

The rates and charges in Appendix A are designed to produce gross operating revenue, based upon the adjusted test year, of \$69,714.

#### FINDINGS AND ORDERS

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

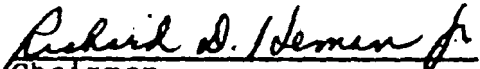
1. The proposed rates and charges are excessive and unreasonable and should be reduced.
2. The rates and charges in Appendix A are the fair, just and reasonable rates to be charged by Elzie Neeley.

IT IS THEREFORE ORDERED that:

1. The rates in Appendix A be and they hereby are approved for service rendered by Elzie Neeley on and after the date of this Order.
2. The rates proposed by Elzie Neeley be and they hereby are denied.
3. Within 30 days from the date of this Order Elzie Neeley shall file with the Commission its revised tariff sheets setting out the rates approved herein.

Done at Frankfort, Kentucky, this 28th day of July, 1986.

PUBLIC SERVICE COMMISSION

  
Chairman

  
Vice Chairman

  
Commissioner

ATTEST:

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Executive Director



APPENDIX

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE  
COMMISSION IN CASE NO. 9521 DATED 7/28/86

The following rates and charges are prescribed for the customers served by Elzie Neeley Gas Company, 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.

RATES: Monthly

First 1 Mcf	\$7.10 Per Mcf
Over 1 Mcf	\$6.13 Per Mcf

Minimum Bill

The minimum bill shall be \$7.10

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

Commodity

Columbia Gas of Kentucky, Inc.	\$4.404 per Mcf
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