COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF EAST KENTUCKY UTILITIES, INC. FOR:	)	
1. ORDER AUTHORIZING A RATE INCREASE AND SURCHARGE	)	
2. INTERIM ORDER TO IMMEDIATELY IMPLEMENT ITS PROPOSED RATES ON AN EMERGENCY BASIS PURSUANT TO KRS 278.190	)	CASE NO. 9545
3. INTERIM ORDER GRANTING A SURCHARGE TO PAY KENTUCKY WEST VIRGINIA GAS COMPANY AND SOUTHEASTERN GAS COMPANY FOR DELINQUENT WHOLESALE GAS PURCHASES	)	

O R D E R

Procedural Background

On March 31, 1986, East Kentucky Utilities, Inc., ("EKU") filed its application seeking to increase its rates by $116,774, a surcharge to retire over a 3-year period past due purchased gas costs of $420,419 and authority to charge its proposed rates and surcharge on an interim basis pending the Commission's final Order in this proceeding. On June 4, 1986, the Commission held a hearing at its offices in Frankfort, Kentucky, for the purpose of considering EKU's requests for interim rates and surcharge. Intervenors present and participating at the hearing were the Kentucky-West Virginia Gas Company ("KY-West"), the major supplier of purchased gas to EKU, and the Utility and Rate Intervention Division of the Attorney General's Office ("AG"). On July 8, 1986, the Commission issued its Order denying the proposed interim rates and surcharge. On August 7, 1986, the Commission held a public hearing at its offices to consider EKU's request for general rate relief and a surcharge to retire past due purchased gas costs. Intervening in this proceeding were the AG, KY-West, and Floyd County, Kentucky.

Operational Background

The gas system operated by EKU serves approximately 1,300 customers in Floyd County, Kentucky, and is wholly owned by Floyd County which has entered into a long term lease agreement with David Allen to provide the actual management of the system. Since 1981 EKU has experienced line losses greater than the 5 percent allowed by the Commission peaking at a high of 27.5 percent[1] in 1982. EKU experienced a test period line loss of 14.83 percent.[2]

Since 1984 EKU has fallen approximately $345,240[3] behind in its payments to KY-West for purchased gas. In its final Order in Case No. 9405,[4] the Commission stated that the primary reason for this delinquency was the imprudent management decisions of the system's operators.[5] On July 10, 1986, the Commission issued a

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1 Transcript of Evidence ("T.E."), August 7, 1986, page 7.

2 Application for Rate Increase and Surcharge and Interim Rate and Surcharge Relief ("Application"), page 4.

3 Letter of Notice to file for abandonment of service sent by KY-West to EKU, received by the Commission on August 5, 1986.

4 In the Matter of East Kentucky Utilities, Inc. Delinquent Purchased Gas Account With Kentucky West Virgina Gas Company.

5 Case No. 9405, Order issued July 10, 1986, page 3.

Show Cause Order, Case No. 9478,[6] requiring Floyd County to show cause why the management of the system has not been adequate, why a reasonably priced supply of gas to its customers is threatened and why Floyd County should not terminate its lease with the current operators of the system.

On August 5, 1986, KY-West notified EKU of its intent to file with the Federal Energy Regulatory Commission for permission to abandon service to EKU prior to the 1986-87 heating season.

TEST PERIOD

EKU proposed and the Commission has accepted the 12-month period ending December 31, 1985, as the test period in this proceeding.

REVENUES AND EXPENSES

EKU proposed several adjustments to revenues and expenses in its application. The Commission is of the opinion that the proposed adjustments are generally proper and acceptable for rate-making purposes with the following exceptions:

Purchased Gas

EKU purchased 144,177 MCF of gas from its suppliers during the test period for a cost of $557,081. EKU proposed to reduce this cost by $23,276 to $533,805 to reflect its test period purchases at its December wholesale rate.[7] This calculation did not include an adjustment to reduce the test period purchases to

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6 In the Matter of Kentucky Public Service Commission vs. Floyd County, Kentucky and East Kentucky Utilities, Inc.

7 Application, page 17.

the 5 percent maximum line loss allowed by the Commission for rate-making purposes. Using the mix established in this proceeding and $3.50 per MCF from Southeastern Gas Company, another primary supplier of gas to EKU, and $2.9496 per decatherm from KY-West,[8] the Commission has determined the allowable test period purchased gas cost to be $478,155 based on test period gas volumes sold. This reduces the proposed purchased gas cost by an additional $55,650.

Wages

EKU had test period salary and wage expense of $100,270.[9] During the test period EKU was engaged in replacing distribution lines and upgrading its system utilizing its own labor force; however none of the labor associated with this construction was capitalized.[10] David Allen, President and General Manager of EKU, stated that approximately 25 percent of EKU's full-time labor force time and all of its part-time labor force time were spent in this construction.[11] Utilizing the salary breakdown provided by EKU in response to a Commission information request, the amount of wages which should have been capitalized during the test period has been calculated to be $16,711. Therefore, EKU's test period wage expense has been reduced by this amount.

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8 Case No. 9236-C, Purchased Gas Adjustment Filing of East Kentucky Utilities, Inc.

9 Response to Commission information request dated May 19, 1986, Item 7.

10 T.E., August 7, 1986, page 54.

11 Ibid., pages 19 & 54.

Employee Benefits

The wages capitalized above represent 16.67 percent of EKU's total test period wages; therefore the Commission will capitalize 16.67 percent of EKU's test period employee benefits; the test period expense was $14,370, resulting in a capitalization adjustment of $2,395. When further reduced by the $2,153 adjustment proposed by EKU in response to the Commission's Order in Case No. 9236,[12] this results in an adjusted employee benefits expense allowable for rate-making purposes of $9,822.

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

	Proposed Adjusted Test Period	Commission Adjustments	Adjusted Test Period
Gas Service Revenues	$689,359	$ -0-	$689,359
Other Operating Revenues	8,954	-0-	8,954
Gas Operating Expenses	707,972	<$74,756>	633,216
Net Operating Income	<$ 9,659>	$74,756	$ 65,097

REVENUE REQUIREMENTS

EKU proposed to base its revenue requirement on the fund requirements of its bond ordinance. This requires transfering to a bond sinking fund the annual principal and interest requirements on its outstanding bond indebtedness plus an additional 20 percent

12 Application of East Kentucky Utilities, Inc. for (1) Order Authorizing a Rate Increase, (2) Interim Order to Immediately Implement Its Proposed Rates on Emergency Basis Pursuant to KRS 278.190, (3) Interim Order Granting Permission to Borrow $134,009.92 as an Emergency to Pay Kentucky West Virginia Gas Company Wholesale Gas Purchases and Fix a Surcharge to Pay Same, (4) Order Approving PGA Filings as Filed July 17, 1984, Under Case No. 8114, (5) Order Approving Bond Ordinance as Approved and Adopted by County of Floyd.

coverage and 10 percent of gross operating revenues after the sinking fund requirement being placed in a depreciation fund. EKU also has an additional debt service of $13,008 on a loan used to purchase a Ditch-Witch. Using the adjusted test period operations and including $11,548 of interest income this methodology would result in a required increase of operating revenues of $30,918, calculated as follows:

Total Gas Operating Expenses	$633,216
Debt Service on Ditch-Witch	13,008
	$646,224
Adjusted for Depreciation Fund Requirement (÷ 90%)	718,027
Sinking Fund Requirment	23,650
Total Revenue Requirement	$741,677
Present Gas Service Revenues	690,257
Miscellaneous Service Revenues	8,954
Interest Income	11,548
Required Increase	$ 30,918

Traditionally the Commission has allowed a 1.5X debt service coverage, excluding depreciation which will satisfy most bond ordinances. The methodology proposed by EKU in this proceeding, and utilized by the Commission in Case No. 9236, will result in a debt service on outstanding bonds and other long-term debt of 3.32X.

As in its previous case, the Commission is of the opinion that EKU's depreciation fund requirement is extraordinary in requiring 10 percent of gross revenues to be deposited without placing a limit on the total funding required. Given the level of line loss being experienced by EKU and the extensive line replacement project being undertaken to upgrade the system and thus lower line loss and provide safer, more efficient service to its customers the Commission will continue to compute EKU's revenue requirement as proposed in this proceeding and utilized by the Commission previously. Therefore, the Commission will allow EKU to increase its operating revenues by $30,918 on an annual basis. However, as soon as the extensive line replacement and system upgrading has been essentially completed the Commission will require EKU to provide justification why its customers should continue to fund the bond ordinance requirements at these levels.

SURCHARGE

In addition to an increase in its on-going operating revenues, EKU requested a surcharge to recover its past due purchased gas costs. This arrearage is the result of EKU's excessive line loss, a condition which had not substantially improved until recently, and management's insistence of paying all other operating expenses prior to its purchased gas cost, including at least $44,370 in related party salaries. Therefore, the Commission will deny EKU's request for a surcharge. This position is consistent with that adopted by the Commission in Case No. 9236.

MOTION TO ISSUE BONDS

In its motion to intervene filed on August 6, 1986, Floyd County also requested that the Commission enter an Order authorizing the Floyd County Fiscal Court to issue bonds on behalf of the system. The revenue from these bonds is to be used to retire EKU's currently outstanding bond indebtness, pay all delinquent gas accounts and upgrade the system to eliminate the line loss of 14.83 percent.

Floyd County's motion did not include the minimum requirements necessary for the Commission to adequately consider its request, as stated in 807 KAR 5:001, Section 11, nor did EKU amend its application requesting authority from the Commission to include this financing in its current proceeding. Therefore, the Commission is not in a position to rule on the appropriateness of this proposal or to consider its potential effects on the operations of EKU. Should EKU wish the Commission to make the above considerations it should file its application with the Commission in accordance with 807 KAR 5:001, Section 11.

FINDING AND ORDERS

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

1. The rates and charges proposed by EKU should be denied upon application of KRS 278.030.

2. The rates and charges in Appendix A are the fair, just and reasonable rates and charges to be charged by EKU in that they will produce revenues sufficient, when considering other available income, to permit EKU to pay its operating expenses, service its debt and provide a reasonable surplus.

3. The delinquent purchased gas costs are a direct result of EKU's excessive line loss and management decisions and the surcharge to pay the delinquency should be denied.

4. EKU should file with the Commission its application for authority to incur bond indebtedness in accordance with 807 KAR 5:001, Section 11, in order to have the financing proposed by Floyd County considered for rate-making purposes.

5. EKU should continue to file monthly financial reports as directed by the Commission in Case No. 9236.

IT IS THEREFORE ORDERED that:

1. The rates proposed by EKU in its application be and they hereby are denied.

2. The rates and charges in Appendix A are the fair, just and reasonable rates and charges for gas service rendered on and after the date of this Order.

3. The surcharge proposed by EKU is hereby denied.

4. EKU shall continue to file monthly financial reports as directed in Case No. 9236.

5. EKU shall file its revised tariffs setting out the rates authorized herein within 30 days of the date of this Order.

Done at Frankfort, Kentucky, this 25th day of September, 1986.

PUBLIC SERVICE COMMISSION

Richard D. Heman Jr.
Chairman

Vice Chairman

George N. Williams
Commissioner

ATTEST:

Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 9545 DATED September 25, 1986.

The following rates and charges are prescribed for the customers served by East Kentucky Utilities, 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	$7.92 Per Mcf
Over 1 Mcf	5.12 Per Mcf

Minimum Bill: $7.92 for less than 1 Mcf.

The base rate for the future application of the purchased gas adjustment clause of East Kentucky Utilities, Inc., shall be:

	Commodity
Kentucky West Virginia Gas Company	$2.6062/dth*
Southeastern Gas Company	$3.50/Mcf

The above rates and charges have incorporated all increases and decreases in PGA filings from 9236-C through 9236-G.

*Includes $0.0125 per Dth - Gas Research Institute Funding Charge