COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION BY KEN-GAS OF KENTUCKY, INC., FOR A CERTIFICATE OF PUBLIC CONVENIENCE AND NECESSITY FOR THE CONSTRUCTION OF A NATURAL GAS SYSTEM, APPROVAL OF FINANCING AND CONSTRUCTION COSTS AND APPROVAL OF APPLICABLE RATES	)	CASE NO. 9586

O R D E R

On May 19, 1986, Ken-Gas of Kentucky, Inc., ("Ken-Gas") filed an application requesting that the Commission issue a certificate of public convenience and necessity for the construction of a natural gas distribution system, approval of the proposed construction and financial costs for the implementation of the project, and approval of rates. The construction will be funded principally through a loan to the corporation. The project will provide natural gas service to approximately 330 residential customers and 21 commercial customers within the corporate limits of Burkesville, Kentucky, after the system's first year of operation.

The proposed construction has been designed to offer service within the corporate limits of Burkesville. Service to customers outside the city limits may occur "when and if there appears to be a need. . .based on the economic feasibility. . . ."[1] Ken-Gas was

1 Application, page 5.

awarded a franchise from the City of Burkesville on September 20, 1985, for the distribution and sale of natural gas within its corporate limits.

An informal conference was held May 15, 1986, and a hearing was conducted October 21, 1986. This Order is based upon these proceedings and additional information filed by Ken-Gas in response to three information requests.

On March 24, 1987, Ken-Gas filed updated financial statements. This information was not solicited by the Commission, and Ken-Gas did not request that these statements be utilized in the determination of its rates. Moreover, pursuant to 807 KAR 5:001, Section 5(4), the Commission considers this information an out-of-time filing. Therefore, these statements have not been utilized in the determinations made herein.

REVENUE REQUIREMENTS

In computing the revenue requirement upon which its initial rate structure proposal is based, Ken-Gas offered a projected operating statement for the 12-month period ending August 31, 1990, (Schedule VIII to the application) with total operating expenses of $205,551. The Commission recognizes that a projected operating statement for a new enterprise can only be a series of estimates. The projected operating statement as determined herein therefore represents only the Commission's best estimate based upon the record established in this proceeding. As Ken-Gas establishes an operating history, it should in the future file revised rates based upon actual operating data.

Following is a discussion of the Commission's findings and decisions with regard to Ken-Gas' projected operating statement:

Purchased Gas

Ken-Gas proposed a purchased gas expense of $123,590. This amount is based upon projected residential customers of 330 with average consumption of 8.36 Mcf per month and 21 commercial customers with average consumption of 64.8 Mcf per month. The projected average cost per Mcf is $2.50.

The Commission finds the foregoing assumptions to be reasonable and has therefore accepted the proposed purchased gas expense.

Wages and Salaries

Ken-Gas projects wages and salaries expense of $35,633. This is based upon the retention of three employees and the following pay scale:[2]

Position	Salary
Operations Manager	$15,435
Service Man	9,173
Bookkeeper	11,025
TOTAL	$35,633

The Commission finds the projected wages and salaries expense to be reasonable for a gas company of this size and will therefore accept Ken-Gas' proposal.

2 Response to Information Requested at October 21, 1986, Hearing, Schedule VIII, Note 5.

Payroll Overhead

Ken-Gas projected payroll overhead expense of 15 percent (rounded) of wages and salaries. This results in a proposed payroll overhead expense of $5,345.

The 15 percent projected level was determined as follows:

FICA Tax	7.15%
State Unemployment	3.00
Federal Unemployment	.80
Workers' Compensation	2.00
Administrative & Contingencies	2.50
	15.45%

The Commission finds the amount for FICA and state and federal unemployment taxes to be correct; Workers' Compensation should appropriately be considered as an insurance expense, but for the present purposes the Commission will treat it as a payroll overhead item and finds the projected amount to be reasonable. The 2.5 percent for "payroll administration and other contingencies," however, has not been supported as a potential expense item; the Commission has therefore allowed $4,614 for payroll overhead expense.[3]

Insurance Expense

Ken-Gas proposed an annual insurance expense of $12,600. In support of this amount, Ken-Gas filed an invoice for the policy period June 1, 1985, through June 1, 1986, in the amount of $14,780. The Commission has therefore allowed $14,780 as the projected insurance expense.

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3 $35,633 X 12.95% = $4,614

Rent

Ken-Gas proposed an annual rental expense of $2,400. This amount represents a $200 per month rental expense for office space and equipment.[4] The Commission finds $200 per month to be a reasonable amount for rent expense and has therefore allowed this amount for rate-making purposes.

Utilities

Ken-Gas proposed that $218 per month be recognized for electricity, water, garbage, and telephone. The proposed amounts were derived solely by estimation. Following is a breakdown of the specific monthly amounts proposed by Ken-Gas:

	Monthly Amount Proposed by Ken-Gas
Electricity	$100
Water	10
Garbage	8
Telephone	100
TOTAL	$218

Though not well documented, the Commission believes the expense proposed by Ken-Gas to be reasonable and has therefore allowed the expense.

Transportation Expense

Ken-Gas proposed a transportation expense of $6,000 for utilization in determining revenue requirements. No specific

4 Response to Information Requested at October 21, 1986, Hearing, Item No. 2b.

documentation or calculation supporting this amount has been provided.

In consideration that the system consists of only 4 1/2 miles of pipeline,[5] the Commission finds the proposed level of $500 per month to be greatly excessive. Even under the assumption that two complete circuits around the system daily are necessary, this would result in monthly travel of only about 270 miles per month. At $.21 per mile, the monthly transportation expense would only be about $57 per month or $680 annually. However, realizing that transportation for other purposes will be necessary from time to time, the Commission has allowed $1,000 annually for transportation expense.

Bad Debts Expense

Ken-Gas proposed bad debts expense of $18,883, based upon 5 percent of the projected sales of $377,669. As justification for this, Ken-Gas stated that its management had experienced losses of between 2 and 3 percent with other businesses, but since Ken-Gas is a new company, losses are expected to be greater.

The Commission's experience with uncollectible accounts among residential and small commercial users is that the percentage of uncollectibles compared to revenues from gas sales is small relative to competitive markets where alternative suppliers are available. The Commission's experience is that uncollectibles would vary in a normal range of .27 percent to .91 percent for residential and small commercial customers when considering the

5 Hearing Transcript, October 21, 1986, page 9.

customer deposit and the necessity of natural gas service. Large commercial and industrial uncollectibles, as well as sales for resale, are typically considered by this Commission on a case-by-case basis, as these accounts tend to be few in number, large in amount, and lack predictability.

The Commission notes that in a recent case, Case No. 9329, involving Albany Gas Utility Company ("Albany"),[6] the Commission allowed a bad debts expense of .59 percent. Albany is located near Burkesville. In consideration of this and all other factors, as an approximation the Commission will allow 1 percent of Ken-Gas' projected sales as bad debts expense. This amount is $3,777.

Advertising

Ken-Gas proposed that advertising expense of $3,600 be considered in determination of its rates. Ken-Gas requests these funds to advertise the benefits of natural gas over competitive forms of energy, promote the company, and encourage new customers to tap-on to the system.[7]

The Advertising Regulation, 807 KAR 5:016, expressly disallows advertising expenditures for the above purposes from

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6 Case No. 9329, The Application of Albany Gas Utility Company, of Clinton County, Kentucky, for (1) A Certification of Public Convenience and Necessity to Construct and Operate a New Natural Gas Distribution System at Albany, Kentucky, (2) Approval of the Proposed Plan of Financing of Said Project and (3) Approval of Proposed Gas Rates to be Charged by the Company to the Natural Gas Customer, Final Order dated November 15, 1985.

7 Response to Information Requested at October 21, 1986, Hearing, Item No. 2d.

being considered as cost-of-service expenses for rate-making purposes. The Commission has therefore disallowed the $3,600 amount proposed for advertising.

Licenses and Dues

Ken-Gas proposed that $1,000 be allowed for licenses and dues expense. This appears to be reasonable for a system of this size. The Commission has therefore allowed this projected expense.

Professional Services

Ken-Gas proposes an annual expense of $6,000 for professional services. Ken-Gas' testimony reflects that these funds will be used for bookkeeping and accounting services.

In a previous section of this Order, the Commission approved the inclusion of $11,025 in wages for a bookkeeper. With such in-house accounting capability, the Commission does not agree with Ken-Gas' projection that it will require an additional $500 per month for outside accounting help.

The Commission has, however, allowed $1,200 annually for outside professional services for preparation of tax returns, legal fees, and other contingencies that may not be accomplished by the permanent staff.

Office Expense

Ken-Gas proposed an office expense of $5,400. This amount was based upon an estimate of costs for services, supplies and other items provided to the company.[8]

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8 Ibid., Item No. 6a.

Recognizing that many items of a miscellaneous nature fall into this general expense category, the Commission will allow the proposed level for office expense.

Repairs and Maintenance Expense

Ken-Gas proposed repairs and maintenance expense of $11,330. This amount is based on 3 percent of sales. Ken-Gas advances the argument that this amount is reasonable because similar results have been experienced by its management in the liquid propane industry.

The Commission finds the amount proposed by Ken-Gas for repairs and maintenance expense to be excessive. A newly constructed plastic pipe gas system may be expected to require minimal repairs and maintenance. In fact, repairs should be necessary primarily in instances where third-party negligence is involved. Also, routine maintenance activities should be of little cost for a new system of this type.

The Commission has observed that other gas systems of similar size and construction under its jurisdiction have experienced repairs and maintenance expense of about $1,500 annually. For example, Elam Utility Company has incurred this level on its new plastic pipeline system. Accordingly, this amount has been used herein for rate-making purposes.

Miscellaneous

Ken-Gas proposed a provision for miscellaneous expenses of $7,553. This amount is based upon 2 percent of projected sales.

The Commission has adequately allowed for all projectable expenses in other sections of this Order. However, the Commission recognizes that a reasonable allowance for contingencies and unforeseeable costs should be considered. The level of miscellaneous expense proposed by Ken-Gas is $629 per month; this level, in the Commission's opinion, is excessive. The Commission has allowed herein $250 per month, or $3,000 annually, for miscellaneous expenses.

Depreciation and Amortization

Ken-Gas proposed depreciation expense of $33,286 (rounded). This amount may be derived based upon the schedule contained in Note 6, page 10, of the information requested at the hearing on October 21, 1986. Requested amortization expense is $4,000; this amount represents $20,000 in organization costs amortized over 5 years.

A myriad of factors, including late revisions, have made it necessary to recalculate depreciation and amortization expense. Following is the Commission's calculation formulated as in the aforementioned schedule; exceptions to Ken-Gas' proposals are explained thereafter:

Classification	Cost	Life Years	Depreciation/ Amortization Expense
Building	$ 35,000	35	$ 1,000
Trencher	33,500	5	6,700
Backhoe	10,500	Disallowed	-0-
Service Truck	10,500	5	2,100
Radio Equipment	6,500	Disallowed	-0-
Fusing Machine	19,200	5	3,840
Transmission System	277,420	35	7,926
Meters	29,705	20	1,485
Organization Cost	20,000	40	500
	$442,325		$23,551

The Commission disallowed the $10,500 cost of the backhoe because of the apparent duplication of function with the trencher. Ken-Gas explained that the ownership of a trencher was necessary because of the difficulty in renting one in Burkesville; granting that to be the case, the Commission has allowed the cost of the trencher, but disallowed the cost of the backhoe. A backhoe is a common piece of equipment, and Ken-Gas should be able to easily rent one as needed rather than incurring the high expense of purchasing one.

The Commission has also disallowed the $6,500 proposed for radio equipment. The Ken-Gas system is to consist of only 4.5 miles of pipeline. A system of this small size does not need an expensive communication system such as this. The Commission has therefore excluded this cost from its determination of depreciation expense.

The costs of the transmission system and meters have undergone late revisions. The costs assigned to these assets in the above referenced schedule were $325,000 and $34,800, respectively. The latest cost estimate, however, reflects a revised cost of $875 per customer.[9] The pro forma operating statement is based upon 330 residential customers and 21 commercial customers.[10] The Commission has therefore determined the total

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9 Response to the Commission's Order dated February 6, 1987, Item No. 2.

10 Response to Information Requested at the October 21, 1986, Hearing, Schedule VIII, page 9.

cost of the system to be $307,125.[11] This amount has been prorated between the transmission system, depreciable over 35 years, and meters, depreciable over 20 years, in the same ratio as in the above referenced schedule. Thus, 90.3 percent,[12] or $277,420, was assigned to the transmission system, and the remaining $29,705 was assigned to meters.

Ken-Gas proposed to amortize organizational costs over 5 years. While this amortization period may be appropriate for accounting purposes as prescribed by Generally Accepted Accounting Principles for nonregulated businesses, for rate-making purposes these costs should be amortized over the life of the system. This is because current and future ratepayers should share equally in this cost because they will share equally in the benefits. Forty years represents the term that the Commission considers to be the most reasonable estimate of the system's life. To facilitate future rate proceedings, Ken-Gas should adopt this to be its amortization period for organizational costs and is hereby directed to do so in accordance with Financial Accounting Standards Board Statement 71.

The foregoing results in allowable depreciation and amortization expense of $23,551 for rate-making purposes.

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11 351 customers X $875 per customer = $307,125

12 $325,000 ÷ $359,800 = 90.3%

Interest Expense

As explained in a subsequent section of this Order, financing of $395,248 has been approved herein. The resulting interest of this financing is $36,054. This amount has been used herein for rate-making purposes.

Taxes

Based upon the revenues and expenses determined to be reasonable herein, state and federal income taxes reflecting the composite rate of 38.785 percent effective July 1, 1987, of $3,334 have been allowed for rate-making purposes.

Based upon the foregoing adjustments, following is a schedule showing the projected expense levels allowed by the Commission:

Expense	Ken-Gas Proposed	Commission Adjustments	Commission Allowed
Purchased Gas	$123,590	$ -0-	$123,590
Salaries	35,633	-0-	35,633
Payroll Overhead	5,345	<731>	4,614
Insurance	12,600	2,180	14,780
Rent	2,400	-0-	2,400
Utilities	2,616	-0-	2,616
Transportation	6,000	<5,000>	1,000
Depreciation and Amortization	37,278	<13,727>	23,551
Advertising	3,600	<3,600>	-0-
Bad Debts	18,883	<15,106>	3,777
Licenses and Dues	1,000	-0-	1,000
Outside Services	6,000	<4,800>	1,200
Office Expense	5,400	-0-	5,400
Repairs	11,330	<9,830>	1,500
Miscellaneous	7,553	<4,553>	3,000
Taxes	7,985	<4,651>	3,334
Total Operating Exp.	$287,213	$ <59,818>	$227,395
Interest	49,913	<13,859>	36,054
TOTAL EXPENSES	$337,126	$ <73,677>	$263,449

Revenue Requirements Determination

Ken-Gas did not specifically request an acceptable method for determination of its revenue requirement. The Commission finds that in this instance return on invested equity should be used for this purpose. As previously mentioned, the record reflects stockholder equity of $35,077. The Commission finds that a 15 percent return on the invested equity is appropriate in this instance. Thus, based upon operating expenses of $227,395 and interest of $36,054, Ken-Gas' revenue requirement has been determined to be $268,710, and is summarized as follows:

Revenue Granted	$268,710
Operating Expense	227,395
Operating Income	$ 41,315
Interest	36,054
NET INCOME	$ 5,261

NET INVESTMENT RATE BASE

Ken-Gas did not propose a rate base. Based upon the cost of the gas system as discussed herein and the allowance of 1/8 of operation and maintenance expense exclusive of purchased gas, the Commission has determined Ken-Gas' investment rate base to be as follows:

Plant in Service	$425,325
Working Capital	12,559
Investment Rate Base	$437,884

The revenues allowed herein produce a return on rate base of 9.44 percent. Ken-Gas should note that $425,325 is the level of investment that the Commission has approved in this application. Construction expenditures that exceed the amounts approved herein will not be considered for rate-making purposes in future applications.

FINANCING

As a part of its request, Ken-Gas is requesting that financing be approved for the construction of the proposed gas system; however, despite repeated requests, Ken-Gas has not provided a specific financing plan for the Commission's approval. Therefore, as explained herein, the Commission has found it necessary to authorize financing based upon the applicable facts as contained in the record. Ken-Gas should take notice that in future financing proceedings before the Commission it should have its financing arrangements completed prior to coming to the Commission for approval.

Based upon the allowed portion of this project, the total cost is as follows:

Building	$ 35,000
Trencher	33,500
Service Truck	10,500
Fusing Machine	19,200
Transmission System	277,420
Meters	29,705
Organization Costs	20,000
	$425,325

Of this, $35,077 is to be financed by stockholders' equity. In addition, while the initial cost of the trencher may have been $33,150, the record reflects that the financial note on the trencher at the time of the filing amounted to $28,150. Therefore, the amount of financing approved for the trencher is reduced from $33,150 to $28,150. The amount of financing the

Commission approves herein is therefore $384,898.[13] Of this amount, the $28,150 related to the purchase of the trencher is to be financed over 4 years at 13 percent; the remainder is to be financed over 20 years at 9.25 percent. The Commission therefore approves financing as follows:

Amount	Interest Rate	Amortization Period	First Year Interest
$356,748	9.25%	20 years	$32,729
28,150	13.00%	4 years	3,325
$384,898			$36,054

If upon finalizing its financing arrangements, Ken-Gas determines that its loans differ from the terms as approved herein, Ken-Gas should reapply to the Commission for approval of the finalized financing plan.

Regulatory Issues

Throughout this proceeding, Ken-Gas has demonstrated itself to be unknowledgeable of the regulatory environment in which a public utility functions. Coincident with the receipt of its certificate, Ken-Gas must become aware that for entities subject to Commission jurisdiction there are specific regulatory principles under which rates are set, unique accounting methods prescribed, high standards of cost-justification, and a need for consistent and clear presentation of the facts during pending applications.

[13] $425,325 - $35,077 - $5,350 = $384,898

Among the unacceptable procedures introduced by Ken-Gas into this proceeding have been long delays in responding to Commission requests, failure to compile coherent and adequate construction cost information, failure to provide a firm financing plan, numerous revisions of projected financial statements, and numerous revisions of construction costs.

In order that Ken-Gas will in the future conduct its operations in accordance with Commission law and regulation, the Commission will advise Ken-Gas on certain requirements. The expense and asset classifications used within this Order are for illustrative purposes only and are presented with the objective of providing simpler comparison to Ken-Gas' filing. Account titles and amounts includable in these accounts may vary depending upon actual construction cost records as the system is completed. Ken-Gas, from the initiation of its operations and throughout its existence as a public utility subject to the Commission's jurisdiction, must maintain its accounting records as prescribed by the Uniform System of Accounts for Class C and D Gas Utilities.

The amount approved for construction in this Order is $307,125. This amount does not include a provision for the cost of service installations related to the connection from the curb stop to the place of consumption in accordance with 807 KAR 5:022, which requires the customers to bear the responsibility for such costs. During this proceeding, Ken-Gas has indicated that it seeks to include such costs in its construction estimates. Ken-Gas is hereby advised that no amounts approved herein should be used for such purposes, and if they are, such investment will not be considered for rate-making purposes in future applications.

RATE DESIGN

The rates for Ken-Gas' customers have been determined based on projected residential customers of 330 with average consumption of 8.36 Mcf per month and 21 commercial customers with average consumption of 64.8 Mcf per month, and the amount of revenue granted of $268,710. The rates are shown in the Appendix to this Order.

OTHER CONSIDERATIONS

Engineering/Construction

Subsequent to the hearing, Ken-Gas filed a revised construction estimate of $325,000,[14] approximately $940 per customer to construct, less than half of the original estimate of $703,613.[15] In the most recent information filed by Ken-Gas, the "current estimated cost. . .[is] in the range of $875 per customer,"[16] which, based upon 351 customers, results in a total cost of $307,125. The Commission notes that the construction estimate includes costs for the installation of customer service lines. However, 807 KAR 5:022, Section 9(17)2, makes the customer responsible for furnishing the service line. The Commission accepts the most recent estimate as a reasonable amount for the

14 Response to Information Requested at October 21, 1986, Hearing, Schedule VI.

15 Application of Ken-Gas of Kentucky, Exhibit L.

16 Response to the Commission's Order dated February 6, 1987, Item No. 2.

construction of the transmission and company's portion of the distribution system, but approval of $307,125 excludes any company costs for installation of customer service lines. Although the Commission has disallowed service line costs, no related adjustment has been made to the amount of the construction estimate. The Commission is of the opinion that $307,125 is a reasonable estimate of what the cost will be, less service lines, as proposed by Ken-Gas. The Commission advises that Ken-Gas shall not accept a construction bid in excess of $307,125.

The construction estimate includes 2" and 4" plastic pipe for mains; 3/4" plastic pipe for services; meter, meter riser and stop, regulator and fittings for 330 small customer services and 21 large customer services; main line valves; meter and regulator for the town border station; and telemetry and recording gauges. A contingency cost and engineering fee are also included.

The design and construction of the gas system must comply with the Commission's pipeline safety regulations, 807 KAR 5:022. Since the construction estimate denotes that only plastic pipe will be used for mains and services, Ken-Gas should specifically review and follow the requirements in Section 6, subsections (7), (8), and (9), which relate to qualifying joining procedures, qualifying persons to make joints, and the inspection of joints on plastic pipe. Also relating to plastic pipe is Section 7, subsection (12), Installation of Plastic Pipe. Prior to construction, Ken-Gas should also review Section 4, Design of Pipeline Components, to assure that the design of the system and its various components are in compliance. Particular attention should also be directed to Section 9, Customer Meters, Service Regulators and Service Lines; and Section 11, Test Requirements. Section 8, subsection (2)(d), requires that a standard method of meter and service line installation be adopted to the extent practicable. This regulation also requires that a copy of the installation method be provided to the Commission once it is established and that copies be made available to prospective customers and contractors.

Ken-Gas has stated that no construction on the gas system will begin until the Commission has issued a certificate of public convenience and necessity.[17] During the hearing, Ken-Gas stated that once a certificate is issued it will provide the Commission with a copy of the bid notice and copies of the bids for construction submitted, the name of the contractor selected to install the system, and a copy of the construction schedule 30 days prior to the start of construction.[18] Ken-Gas has also agreed to review with the Commission for its approval, prior to construction, the construction specifications and plans to be used to install the gas system.[19]

Gas Supply

In its initial application, Ken-Gas proposed that its primary supplier of gas would be East Tennessee Natural Gas Company ("East

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17 Response to the Commission's Order dated July 31, 1986, Item No. 19.

18 Hearing Transcript, October 21, 1986, pages 23 and 24.

19 Ibid., page 24.

Tennessee"), through a transmission line owned by Kentucky Energy Transmission, Inc. ("K.E.T.").[20] Ken-Gas filed additional information later which stated that the primary source of supply would be from local gas wells, and East Tennessee would be the supplemental source.[21] Still later, in response to questions asked at the hearing, Ken-Gas stated that it will receive 100 percent of its gas from local wells, if the reserves are adequate, through gathering lines owned by K.E.T.[22] Ken-Gas further stated, "If additional gas is needed. . .Ken-Gas of Kentucky has the right to purchase from Texas Eastern Gas Transmission Company ["Texas Eastern"] which [K.E.T.] lines are tapped into."[23] East Tennessee is no longer available as a supplier.[24]

Copies of various easement/right-of-way agreements have been filed by Ken-Gas. Copies of eight gas lease agreements which include 1,420 acres have also been submitted. According to this information, an additional 3,547 acres are available through "various joint venture leases."[25] Ken-Gas also provided copies of gas analyses and open flow tests performed on three wells, each

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20 Application, page 5.

21 Response to the Commission's Order dated July 31, 1986, Item No. 9.

22 Response to Information Requested at October 21, 1986, Hearing, Item No. 14b.

23 Ibid.

24 Ibid., Item 14c.

25 Ibid., Schedule VII.

located in three of the leases already signed. During the hearing, Ken-Gas testified that there are currently 50 shut-in gas wells located on the acreage of the leases available to them for supply.[26] Ken-Gas further testified that additional tests are planned to produce gas reserves analysis information.[27]

The acreage on which the local gas wells are located, which is intended to be the principal source of supply to Burkesville, is leased to K.E.T. or other parties. Ken-Gas has submitted a letter-of-intent from K.E.T. which grants permission to Ken-Gas to use K.E.T.'s rights-of-way for the transmission of natural gas from these gas leases; and further, that "K.E.T. will work for and assist. . .Ken-Gas in utilizing the natural gas production. . .available from the underground reserves. . . ."[28] In each of the gas leases submitted, it is stated that "this lease is being granted for the purpose of gas going into the Burkesville Gas Line only and. . .shall not be sold to any other parties other than Burkesville Gas Line."[29]

The Commission notes that Ken-Gas has two potential sources of supply, local production and interstate pipeline gas (Texas Eastern). While many local wells, and acreage with additional wells, are leased, Ken-Gas has testified that gas reserves

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26 Hearing Transcript, October 21, 1986, page 47.

27 Ibid., pages 17 and 18.

28 Response to Information Requested at October 21, 1986, Hearing, Schedule VII.

29 Ibid.

analysis must still be done. On the other hand, Ken-Gas has access to gas through K.E.T.'s lines which are tapped into Texas Eastern's interstate pipeline, but apparently no contract has been signed.

This case has been before the Commission for over a year, principally due to the difficulty in obtaining adequate information from Ken-Gas. Ordinarily, the Commission would not issue a certificate of public convenience and necessity without a more substantive assurance of a long-term gas supply. While Ken-Gas has two legitimate sources of supply though, neither has been consummated as a firm, long-term source. However, the Commission recognizes that the prime construction season is at hand and does not desire to unnecessarily delay the start of construction of the Burkesville system, thereby delaying the availability of natural gas to Burkesville for the 1987-88 heating season. Given the access to Texas Eastern for gas once a contract is signed, and the likelihood such a contract is available given the excess gas supply in the national market, the Commission recognizes that a source of supply exists other than local production if needed. Therefore, the Commission is of the opinion that construction should be allowed to begin. However, within 120 days of the date of this Order, Ken-Gas should submit to the Commission gas reserves analysis information on a minimum of five of the local wells it intends to use as its primary source of supply. With that information available, Ken-Gas can determine whether supply from Texas Eastern will be necessary to supplement the local supply.

The gas reserves analysis information should provide an estimate of gas deliverable to a pipeline under pressure, the type and date of the tests(s) performed, and an estimate of the gas reserves in each well's reservoir. (So-called "open-flow potential" tests do not provide such information since the test is only conducted under atmospheric pressure.)

Regarding K.E.T., Ken-Gas has testified that certain officers of K.E.T. are related to the shareholders of Ken-Gas.[30] Since K.E.T. will own the lines through which the gas supply will be delivered to the Ken-Gas system, and K.E.T. is lessee of some of the potential gas wells, it represents a significant link in the chain of supply to the Burkesville customers. Consequently, K.E.T. will have an impact on the cost of gas to these customers. The Commission will monitor the relationship between Ken-Gas and K.E.T. to the extent of Ken-Gas' costs for gas delivered to its town border station. If necessary, a future proceeding may be initiated regarding K.E.T. pursuant to KRS 278.274(3)(b).

SUMMARY

The Commission, having considered the evidence of record and being advised, is of the opinion and finds that:

1. Ken-Gas filed an application on May 19, 1986, requesting that the Commission issue a certificate of public convenience and necessity for the construction of a natural gas system, the approval of construction and financing costs, and the approval of requested rates.

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30 Hearing Transcript, October 21, 1986, page 12.

2. Ken-Gas was awarded a franchise from the City of Burkesville on September 20, 1985, for the distribution and sale of natural gas.

3. Public convenience and necessity require that the construction proposed in the application and record be performed and that a certificate of public convenience and necessity be granted. However, the issuance of a certificate should be made only when the accepted bid for construction does not exceed the construction costs approved herein.

4. Any deviations from the approved construction which could adversely affect service to any customers should be subject to prior approval of the Commission.

5. Ken-Gas should comply with 807 KAR 5:022 regarding the design and construction of the gas system and direct specific attention to those regulations referenced herein relating to the use of plastic pipe.

6. Ken-Gas should provide the Commission with a copy of the bid notice when advertised, copies of the bids submitted for construction within 10 days of receipt, and the name of the contractor selected to install the system within 10 days of selection.

7. Ken-Gas should submit to the Commission within 10 days a copy of the accepted bid which should not exceed the construction costs approved herein.

8. Ken-Gas should submit to the Commission a copy of the construction schedule 30 days prior to the start of construction.

9. Prior to the start of construction, Ken-Gas should submit to the Commission for review and approval the construction specifications and plans to be used.

10. Within 120 days of the date of this Order, Ken-Gas should submit to the Commission gas reserves analysis information on a minimum of five of the local wells it intends to use as the primary source of supply. This information should include an estimate of gas deliverable to a pipeline under pressure, the type and date of the test(s) performed, and an estimate of the gas reserves in each well's reservoir. (So-called "open flow potential" tests do not provide such information since the test is only conducted under atmospheric pressure.)

11. Ken-Gas should file with the Commission duly verified documentation of the total cost of this project, including the cost of construction and all other capitalized costs (engineering, legal, administrative, etc.) within 60 days of the date that construction is substantially completed. Said construction costs should be classified into appropriate plant accounts in accordance with the Uniform System of Accounts for gas utilities prescribed by the Commission.

12. Ken-Gas should require the contractor to furnish a copy of the "as built" drawings and a signed statement that the construction has been satisfactorily completed in accordance with the contract plans and specifications within 60 days of the date of substantial completion of the construction.

13. Regarding any intrastate pipeline with which Ken-Gas interconnects, Ken-Gas should determine that such pipeline has

been designed, installed, constructed, initially inspected, and tested in accordance with 807 KAR 5:022. Ken-Gas should submit such determination with supporting information to the Commission prior to any such interconnection.

14. Financing should be approved for the amounts, interest rates and amortization periods as determined herein.

15. Costs of $307,325 should be approved for construction, start-up, and other necessary capital outlays as referenced herein. Pursuant to 807 KAR 5:022, Section 9(17)2, the construction costs herein approved should not include any customer service lines.

16. The rates proposed by Ken-Gas would produce revenue in excess of that found reasonable herein and should be denied upon application of KRS 278.030.

17. The rates in Appendix A are fair, just, and reasonable rates for Ken-Gas in that they will produce gross annual revenues from gas sales of approximately $268,710 which should provide for Ken-Gas' operating expenses and provide a sufficient return to its investors.

18. Ken-Gas should file with the Commission a tariff sheet setting out the rates approved herein and a copy of its operation rules and regulations, within 90 days of the date of this Order.

19. Ken-Gas should maintain its accounting records in accordance with the methods prescribed by the Uniform System of Accounts for Class C and D Gas Utilities.

IT IS THEREFORE ORDERED THAT:

1. A certificate of public convenience and necessity be and it hereby is granted to Ken-Gas for the proposed construction as set forth in its application. Issuance of this certificate is subject to the accepted bid for construction not exceeding the construction costs approved herein.

2. Financing be and it hereby is approved for the amounts, interest rates, and amortization periods as determined herein.

3. Costs of $307,125 be and they hereby are approved for construction, start-up, and other necessary capital outlays as determined herein. Pursuant to 807 KAR 5:022, Section 9(17)2, the construction costs shall not include any customer service lines.

4. The rates proposed by Ken-Gas be and they hereby are denied.

5. The rates in Appendix A be and they hereby are approved for service rendered by Ken-Gas on and after the date of this Order.

6. Ken-Gas shall comply with all matters set forth in Findings 4 through 13 and 18 through 19 as if the same were individually ordered.

Nothing contained herein shall be deemed a warranty of the Commonwealth of Kentucky, or any agency thereof, of the financing herein authorized.

Done at Frankfort, Kentucky, this 22nd day of May, 1987.

PUBLIC SERVICE COMMISSION

Chairman

Vice Chairman

Commissioner

ATTEST:

Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE PUBLIC SERVICE COMMISSION IN CASE NO. 9586 DATED 5/22/87

The following rates are prescribed for customers of Ken-Gas of Kentucky, Inc.

Base Rates:	0 to 1 Mcf	$5.80	per Mcf
	All over 1 Mcf	5.4227	per Mcf
Minimum Bill		$5.80	per Mcf