COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN INVESTIGATION OF THE RATES OF JOHNSON COUNTY GAS COMPANY, INC.) CASE NO. 10415

O R D E R

On July 7 and 8, 1988, the Commission Staff ("Staff") performed a field review of Johnson County Gas Company, Inc. ("Johnson County"), to assess its financial condition. Johnson County operated under the protection of federal bankruptcy from September 1984 to July 1987. During that time its rates have not changed to reflect reductions in purchased gas costs or to reflect current operating conditions. The purpose of this investigation is to determine if the rates of Johnson County, which have not been adjusted since March 1983, are reasonable in light of current conditions.

The Staff Report, which is made a part of this Order, Appendix A, details the recommendations the Staff makes for a number of accounting and revenue items. The conclusion of the report is that Johnson County's rates should be reduced by $70,235 annually.

The Commission finds that the Staff Report provides sufficient basis to initiate an investigation into the reasonableness of Johnson County's rates. In order for the Commission to be fully advised as to the appropriateness of the adjustments proposed by Staff, Johnson County should respond to the findings of the Staff Report within 30 days of this Order.

The Commission further finds that a hearing will be necessary to give both Johnson County and the Staff an opportunity to provide additional evidence through direct testimony and cross-examination of their respective witnesses.

A hearing is scheduled for January 10, 1989 at 9:00 a.m., Eastern Standard Time, in the Commission's office in Frankfort, Kentucky.

IT IS THEREFORE ORDERED that:

1. An investigation into the rates of Johnson County is necessary in order to determine the reasonableness of existing rates;

2. Johnson County shall have 30 days from the date of this Order to respond to the recommendations contained in the Staff Report;

3. A hearing shall be held on January 10, 1989 at 9:00 a.m., Eastern Standard Time, in the Commission's offices in Frankfort, Kentucky, for the purpose of direct testimony and cross-examination of witnesses; and

4. At the hearing, Johnson County shall be given the opportunity to demonstrate that its current rates are reasonable, that its rates should remain in effect, and that the recommendations of the Staff Report should not be implemented.

Done at Frankfort, Kentucky, this 9th day of November, 1988.

PUBLIC SERVICE COMMISSION

Chairman

Vice Chairman

Commissioner

ATTEST:

Executive Director

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

STAFF REPORT

ON

REVENUE REQUIREMENTS

JOHNSON COUNTY GAS COMPANY, INC.

CASE NO. 10415

Prepared by:

Steve Gilley, Public Utilities
Financial Analyst Principal
Electric and Gas Revenue
Requirements Branch
Rates and Tariffs Division

and

Leah Faulkner, Public Utility
Rate Analyst Senior
Electric and Gas Rate
Design Branch
Rates and Tariffs Division

STAFF REPORT

ON

JOHNSON COUNTY GAS COMPANY, INC.

Case No. 10415

PREFACE

Johnson County Gas Company, Inc. ("Johnson County") serves approximately 670 customers in and around the community of Van Lear, Kentucky. Johnson County's stock is currently owned by the Kentucky Business Trust ("KBT"), a three-member board composed of representatives from the Commonwealth of Kentucky ("Governor's Office"), the Department of Local Government ("DLG"), and Columbia Gas of Kentucky, Inc. ("Columbia"). This trust was created under a plan of reorganization dated December 31, 1985. In formulating its recommendations, Staff has attempted to comply with the provisions of this plan; a copy of the plan is attached as Appendix A.

On July 7-8, 1988, Staff performed a field review of Johnson County to assess its financial condition in consideration of the fact that Johnson County operated under limited Commission jurisdiction under court ordered receivership during the period of September 1984 to July 1987. Johnson County's rates have not been changed to reflect reductions in purchased gas costs or to reflect current operating conditions since March 1983.

SCOPE

Staff's objective in this review was to determine if rates should be adjusted at this time. The most recent calendar year, 1987, was selected as the test period and various analyses were performed to establish whether revenues and expenses as reported in Johnson County's 1987 Annual Report to the Commission were representative of normal operations. Additionally, information was gathered to evaluate any pro forma rate-making adjustments that should be made to test year operations. Expenditures charged to test year operations were reviewed, including the supporting invoices. Insignificant or immaterial discrepancies were not pursued and are not addressed herein.

This report is divided into two sections. The first section deals with the accounting adjustments necessary to bring Johnson County's financial statements as reported in its 1987 Annual Report to the Commission into compliance with the Uniform System of Accounts for Class C and D Gas Utilities ("USoA"). The second section deals with Staff's recommended pro forma rate-making adjustments and Staff's recommendations concerning whether Johnson County's rates should be adjusted at this time.

PART I - ACCOUNTING ADJUSTMENTS

Johnson County's accounting is done primarily by an outside certified public accounting company, Wells and Company, P.S.C. Consequently, Johnson County's accounting records are very well maintained and accurate. However, a few minor adjustments are necessary to bring Johnson County's 1987 income statement into full compliance with the USoA. Following is a schedule showing

Johnson County's 1987 Income Statement as reported on pages 9-11 of its report to the Commission (Column 2), Staff's accounting adjustments (Column 3), and Staff's adjusted 1987 operations (Column 4). Each adjustment is discussed below the schedule.

Line No.	Acct. No.	Account Name	1987 Reported	Staff Adjustments	Staff 1987 Adjusted
1		Operating Revenues:			
2	480	Residential Sales	$396,874	$ -0-	$396,874
3	481	Commercial/Industrial Sales	11,283	-0-	11,283
4	488	Miscellaneous Service Revenues	7,747	-0-	7,747
5	495	Other Gas Revenues	-0-	3,500	3,500
6		Total Operating Revenues	$415,904	$ 3,500	$419,404
7					
8		Operating Expenses:			
9	730	Purchased Gas	$128,352	$ -0-	$128,352
10	753	Transmission	16,762	-0-	16,762
11	762	Mains and Services Supplies	2,620	-0-	2,620
12	766	Rents	1,712	-0-	1,712
13	901	Meter Reading Labor	31,145	-0-	31,145
14	902	Accounting and Collecting	1,350	-0-	1,350
15	903	Supplies and Expenses	1,891	-0-	1,891
16	904	Uncollectible Accounts	18,304	17,345	35,649
17	920	Administrative & Gen. Salaries	20,908	-0-	20,908
18	921	Office Supplies	5,903	-0-	5,903
19	923	Outside Services	47,425	-0-	47,425
20	924	Property Insurance	2,984	-0-	2,984
21	926	Employee Benefits	2,336	-0-	2,336
22	930.1	Advertising	28	-0-	28
23	930.2	Miscellaneous General	19,366	-0-	19,366
24	931	Rents	3,000	-0-	3,000
25	933	Transportation	3,237	-0-	3,237
26	403	Depreciation	53,131	<8,949>	44,182
27	408.1	Other Taxes	14,425	-0-	14,425
28	409.1	Income Taxes	102	-0-	102
29					
30		Total Operating Expenses	$374,981	$ 8,396	$383,377
31					
32		Net Operating Income	$40,923	$ <4,896>	$ 36,027
33					
34		Other Income/<Deductions>			
35	419	Interest/Dividend Income	6,086	-0-	6,086
36	427	Interest on Long-Term Debt	<2,008>	-0-	<2,008>
37	431	Other Interest Expenses	<557>	-0-	<557>
38					
39		NET INCOME	$ 44,444	$ 4,896	$ 39,548

Uncollectible Accounts, Account No. 904/Other Gas Revenues, Account No. 495

Johnson County reported test-year uncollectible accounts expense of $18,304; however, in arriving at this amount, Johnson County netted certain items against actual write-offs in a manner that does not conform with the reporting requirements of the USoA.

The Tax Reform Act of 1986 ("Tax Reform Act") provides that the balance in any reserve for bad debts account reported as of January 1, 1987 be charged to taxable income ratably over 4 years. This requirement, however, is applicable to IRS Tax Return Income, and no similar amortization should be taken in arriving at book net income under the USoA. The amount which Johnson County netted against uncollectible accounts expense related to the Tax Reform Act bad debt rules was $13,846. Staff therefore has increased uncollectible accounts expense by $13,846.

During 1987, Johnson County was reimbursed by $3,500 by Johnson County Fiscal Court for repairs and lost gas related to a line damage incident which occurred during 1986. This item was netted against uncollectible accounts expense; however, the most appropriate manner in which to account for this reimbursement is by crediting Account No. 495, Other Gas Revenues. Staff has made an adjustment to reflect this accounting treatment.

The total effect of the above adjustments concerning uncollectible accounts expense is to increase this account by $17,345 ($13,846 + $3,500). These recommendations produce an adjusted uncollectible accounts expense of $35,649.

Depreciation Expense

Johnson County reported test-year depreciation expense of \$53,131. A depreciation schedule supporting this level of expense was provided by Johnson County's accountants. There are three adjustments which are necessary to bring Johnson County's 1987 depreciation expense into compliance with the USoA and the Commission's depreciation guidelines.

The first adjustment is related to the 30-year useful life Johnson County has assigned to its mains and lines; Johnson County has used 30 years whereas the Commission's Engineering Staff has determined, based upon its studies, that the minimum expected life for the type of mains and lines installed in the Johnson County system is 35 years. Therefore, an adjustment to extend the useful life by 5 years is necessary. In similar situations where an adjustment of this type has been required, the Commission has arrived at the adjusted expense based on the assets undepreciated value and remaining useful life. The depreciation schedule does not list an in-service date for mains and lines; however, Commission records reflect that the reconstruction of the system was completed in 1981, 7 years ago. The accumulated depreciation balance also reflects that approximately 7 years of straight-line depreciation has been recorded (A/D ÷ depreciation expense = \$289,777 ÷ \$39,805 = 7.3). Therefore, 28 years (35-7) has been determined to be the remaining useful life of mains and lines. The December 31, 1987 undepreciated balance for mains and lines was \$904,384 (Undepreciated balance = original cost - A/D = \$1,194,161 - \$289,777). Therefore, the adjusted annual depreciation expense is $32,299 ($904,384 + 28). The 1987 reported expense was $39,805, which results in a reduction to depreciation expense of $7,506.

The second adjustment is required because tax depreciation rather than straight-line depreciation has been used in the determination of the expense associated with the 1986 Chevrolet truck. Using the same methods described above the undepreciated balance has been determined to be $6,892 ($14,982 - $8,000), and the remaining useful life to be 2 years (5 years - 3 years). Thus, the adjusted expense is $3,446, which when subtracted from the test year expense of $4,800 yields an adjustment of $1,354.

The third adjustment is also required because tax depreciation rather than straight-line depreciation was used to arrive at depreciation expense for meters and regulators. In this instance, Johnson County used 7-year MACRS depreciation. The Commission's Engineering Staff, based upon its studies, has established 20 years as the appropriate basis for depreciating this asset. Again using the methods described above, the undepreciated balance and remaining life have been determined to be $779 ($909 - $130) and 19 years (20 - 1), respectively. Thus, adjusted depreciation on these assets is $41, $89 less than the 1987 actual expense.

It should be noted that tax depreciation was also used in Johnson County's calculation of depreciation on office equipment, but the adjustment associated with this is immaterial and no adjustment has been made herein. However, Johnson County should commence depreciating these assets using straight-line, rather than tax, depreciation.

Based upon the above discussion, the total adjustment to depreciation expense is $8,940. Following is a recap of the depreciation adjustments:

Mains and Lines	$7,506
Truck	1,354
Meters/Regulators	89
TOTAL ADJUSTMENT	$8,949

It should be noted that the above adjustments are based on December 31, 1987 balances and are appropriate for periods going forward from that date. Johnson County should make appropriate adjustments to its depreciation schedule to incorporate the above adjustments on a going-forward basis.

Classification of Wages and Salaries

Johnson County has three employees whose compensation is charged to wages and salaries expense accounts; following is a recap of test year wages and salaries showing the account to which each employee's compensation was charged:

Employee	Acct. No.	Account Name	Amount
Finetta Mullins	920	Administrative & General Salaries	$20,908
Bobby Goble	901	Meter Reading Labor	23,508
Frelan Bradbury	901	Meter Reading Labor	7,637
TOTAL WAGES AND SALARIES			$52,053

During its review, Staff obtained information relating to the duties of these employees that raises concerns about the accounts to which wages and salaries are allocated. For instance, all of Mrs. Mullins' salary is allocated to Account No. 920, though her duties included labor that should be accounted for in Account No.

902, Accounting and Collecting labor. Similarly, Mr. Goble's and Mr. Bradbury's salaries are classified as 100 percent meter reading labor; however, the duties of these employees, as described to Staff, include labor which should appropriately be included in the various Maintenance Accounts (e.g., Account Nos. 767, 768 and 769), as well as Account No. 760, Supervision; Account No. 761, Mains and Services Labor; Account 763, Meter and House Regulator Expenses; and Account 764, Customer Installations Expense. In addition to the preceding, when appropriate, labor costs should be capitalized to appropriate plan in service accounts.

Staff has not performed the appropriate studies to determine the proper allocations of 1987 wages and salaries as such studies are outside the scope of this Report; however, Staff recommends that Johnson County conduct such studies to more accurately classify wages and salaries in future reports to the Commission. For purposes of this Report, no reclassifications have been made.

PART II - RATE-MAKING ADJUSTMENTS

This section of the Staff Report presents Staff's recommendations on rate-making adjustments. As noted in the Scope Section of this Report, Staff sought to gather information necessary to determine appropriate pro forma rate-making adjustments. Following is a discussion of Staff's recommended rate-making adjustments:

Normalized Revenues from Sales

Using test year sales from Johnson County's 1987 Annual Report and the number Johnson County provided for its number of customer billings, normalized revenues were:

Sales Volumes	$ 43,042	
	x 9.1633/Mcf	
		$394,406.76
Customer Billings	$ 8,043	
Customer Charge	X 3.00	
		24,129.00
TOTAL REVENUES FROM GAS SALES		$418,535.76

After consideration of miscellaneous service revenues of $7,747, total normalized operating revenues are $426,283. (Rates used were in effect for the entire test year.)

Other Gas Revenues

As noted in Part I of this report, Staff has made an adjustment of $3,500 to other gas revenues to reflect proper accounting treatment of a reimbursement from the Johnson County Fiscal Court. As such reimbursements could not reasonably be expected to recur in future periods, Staff has made a rate-making adjustment to eliminate these revenues on the basis that they are non-recurring.

Gas Purchases

Johnson County's 1987 Annual Report showed that the utility purchased 47,668 Mcf in the test year. There are several problems, however, with using this number for normalizing gas purchases expense. First, in October 1987, Johnson County was billed for 6,623 Dth of additional gas volumes delivered from Park-Ohio. The additional volumes were delivered during the months of September 1986 through October 1987. Assuming that a portion of these volumes were actually taken by Johnson County in 1986, it is not appropriate to include the entire amount of additional volumes in 1987 purchases. Secondly, there is an imbalance between the volumes Johnson County purchased from Park-Ohio and the volume of gas Johnson County took from Columbia Transmission, the transporter for Park-Ohio. The bills from Park-Ohio for 1987 show that Johnson County purchased 37,138 Dth (including, for now, the entire 6,623 Dth of additional billings). The bills from TCO, however, show that Johnson County actually took 41,483 Dth. Adding these volumes to 14,878 Dth purchased by Johnson County from Kentucky-West Virginia during 1987 shows that Johnson County actually took for resale approximately 51,700 Mcf (using Kentucky-West Virginia's actual billed volumes and an imputed Park-Ohio conversion factor of 1.09), as opposed to 47,668 Mcf of reported purchases.

The final problem with the use of reported purchases is line loss. The Commission typically allows only 5-percent of line loss to be included in rates. Using reported sales of 43,042 Mcf and reported purchases of 47,668 Mcf, line loss is 9.7 percent.

Because the actual amount of gas taken for resale is different from reported (and invoiced) purchases, and because line loss in any event is higher than the amount typically allowed for rate-making, volumes used in estimating purchased gas expense will be calculated using actual sales volumes. Sales volumes of 43,042 Mcf, adjusted for 5 percent allowed line loss, yields volumes purchased for resale (for rate-making purposes) of 45,194 Mcf. Normalized gas purchase expense can then be calculated using actual billed Mcf purchases from Kentucky-West Virginia, adjusted for 5-percent line loss, with remaining sales volumes allocated to Park-Ohio. The supplier prices for gas and transmission are those effective in December 1987.

Kentucky-West Virginia	Park-Ohio	Total
12,958 Mcf	32,236 Mcf	45,194 Mcf
X $2.8363	X ($2.30 + .4069)(1.09)*	
$ 36,752.78	$ 95,112.32	$131,865.10

*Gas cost per Dth plus transmission charge per Dth converted to a per Mcf charge using a Dth conversion factor imputed from Johnson County's annual report and billings.

Upon substituting total normalized gas purchase expense in place of reported 1987 purchased gas and transmission expense of $145,114, an adjustment to reduce expenses by $13,249 is derived.

Trustee Fee

On September 12, 1984, B. E. Mullins was appointed as the trustee of Johnson County by Bankruptcy Judge, Joe Lee. During Mr. Mullins' tenure as trustee, the administrative operations of

Johnson County have improved substantially. During its review, Staff found the records of Johnson County to be complete and well organized. In comparison, prior to Mr. Mullins' appointment, Johnson County's records were frequently incomplete and unreliable.

While Mr. Mullins has done much to improve the status of Johnson County, Staff is concerned with the appropriateness of including Mr. Mullins' compensation in the establishment of Johnson County's rates. With the exception of purchased gas, Mr. Mullins' $30,000 annual fee is the largest single cash expense incurred by the company during 1987. Yet, based on conversations with Mr. Mullins and other staff of Johnson County, Mr. Mullins currently has limited involvement with the day-to-day operations of the company. The office manager, Mrs. Mullins, attends to the day-to-day administrative requirements while the two field men, Mr. Goble and Mr. Bradbury, operate the system. Furthermore, Johnson County acquires the services of a professional accountant to perform accounting functions for the company. In view of this, Staff has no apparent justification for recommending that the current $30,000 trustee fee be included as an operating expense for rate-making purposes.

Moreover, Staff believes such inclusion would be unfair due to the circumstances that caused a trustee to be appointed. Prior management was inefficient and evidently misused the revenues provided by the ratepayers. As a result the company was forced into bankruptcy and is now burdened by a substantial trustee fee. Inasmuch as inefficient management was the direct cause of the bankruptcy action, traditional rate-making treatment would favor that the burden of the trustee's fee not be borne by the ratepayers. Staff believes that the ratepayers would be unfairly penalized if they are required to fund an expense that resulted from mismanagement of the company.

Therefore, in consideration of the above discussion, Staff recommends that the trustee fee be reduced from $30,000 to $3,600 for rate-making purposes. While this recommendation will still charge a portion of the trustee fee to the ratepayers, Staff believes this is appropriate in view of the substantial improvements in record keeping and general administration that has occurred under the trustee. Staff's recommendation of $3,600 is based upon the provisions of KRS 74.020 which establishes $3,600 as the maximum salary for water district commissioners. Mr. Mullins' function is analogous to that of a water district commissioner; however, if Johnson County is able to establish that a greater allowance for this expense is justified, Staff will modify its recommendations accordingly.

Miscellaneous General Expenses

Johnson County reported test year charges to Account No. 930.2, Miscellaneous General Expenses, of $19,366. Of this amount, $17,856 was related to payments of administrative expenses to Columbia and DLG pursuant to Orders of the Bankruptcy Court, and $1,509 related to the write-off of a bank account balance that was created on the books of Johnson County during the time that Jupiter Gas operated the company.

It is Staff's opinion that the above expenditures should be excluded from operations for rate-making purposes. Rates are set prospectively, and as these expenses could not reasonably be expected to occur in future periods, their inclusion for rate-making purposes would be improper.

Uncollectible Accounts

As noted in Part I of this Report, the adjusted 1987 uncollectible accounts expense is $35,649. This represents 8.7 percent of 1987 gas sales of $408,157. Staff believes this level of uncollectible accounts indicates a very serious problem and recommends that Johnson County explore all possible methods of reducing this expense. This level is substantially greater than the levels being experienced by other small gas companies under the Commission's jurisdiction. Following is a representative example of the 1987 uncollectible accounts expense incurred by small gas companies:

COMPARISON OF 1987
UNCOLLECTIBLE/SALES

Company	Uncollectible Accounts Expense	Gas Sales	Percent
Auxier Road	$2,759	$406,537	0.68
Mountain	7,268	268,386	2.70
Mt. Olivet	-0-	189,005	-0-
Elam	3,245	308,100	1.10
B & H	-0-	125,487	-0-
Valley	-0-	220,152	-0-
Public	-0-	425,050	-0-
Martin	3,112	244,991	1.30
Johnson County	35,649	408,157	8.70

As reflected in the above schedule, the uncollectible accounts expense level of Johnson County is notably high. What normally is a relatively minor expense is in the case of Johnson

County a major expense. Also the potential burden on the ratepayers is of major significance. If the full test year expense were allowed for rate-making purposes, this expense's contribution to the retail rate would be $.83 per Mcf; the average customers would incur a cost of $4.64 per month. Staff believes it is improper for the ratepayers of Johnson County to have to be responsible for this level of uncollectible accounts expense.

Staff recommends that this expense be reduced to provide for an uncollectible accounts expense of 2.7 percent. This provides an expense at the same level as Mountain Utilities, the small gas company with the highest uncollectible rate excluding Johnson County. Based upon normalized gas sales of $418,536, Staff recommends an uncollectible accounts expense allowance of $11,300 ($418,536 X 2.7 percent) which results in a reduction to expenses of $24,349.

Accounting Fees

Johnson County incurred outside accounting expenses during the test year of $15,373. While Johnson County's accounting records are in exemplary condition, Staff is concerned about this level of expense because many of the services being acquired from outside accountants could be performed in-house. Johnson County has on its payroll an employee, Mrs. Mullins, who has approximately 30 years of experience as a utility accountant. Staff is of the opinion that Johnson County has failed to take advantage of this. With Mrs. Mullins' experience, Johnson County should require outside services for only the more complicated accounting requirements, such as annual report and tax return preparation.

Staff also is of the opinion that its recommended salary allowance of $20,800 for an office manager is sufficient to attract and retain someone with the skills necessary to do the routine bookkeeping and billing. The ratepayers are funding this salary at a level such that routine bookkeeping and billing should be expected to be performed in-house. Viewed in this manner the ratepayers are funding the costs for routine billing and accounting service twice: once for the salary of the office manager and again for the outside accountants. Therefore, Staff recommends that the rate-making allowance for outside accounting be reduced to $6,000, which should provide sufficient funds to acquire outside services for accounting requirements that cannot be performed in-house. The recommended level for this expense is based upon a review of the accounting expenses of three small gas utilities similar in size to Johnson County. These companies, Western Lewis-Rectorville Gas District (517 customers), Belfry Gas, Inc. (708 customers), and Public Gas Company, Inc. (533 customers) incurred 1986 outside accounting expenses of $3,000, $6,700, and $5,400, respectively, according to the audit records of the Commission's Financial Audit Staff. The average expense for outside accounting services for these three companies is $5,033; however, since this data relates to 1986, Staff believes a $6,000 allowance for outside accounting services is reasonable. If Johnson County is able to sufficiently establish that a greater allowance for this expense is needed, Staff will modify its recommendations accordingly.

Miscellaneous Adjustments

In addition to the expense adjustments discussed individually, Staff noted several other relatively minor test year expenditures of the type normally disallowed by the Commission in rate proceedings. Following is a brief discussion of these:

Johnson County paid Christmas bonuses totaling $214. In recent proceedings, the Commission has denied such bonuses on the basis that ratepayers should not bear the burden of discretionary bonuses declared by management.

Johnson County incurs a monthly fee for the lease of radio equipment. During the test year, 13 months was included for this expense. An adjustment of $164 has been made to annualize this expense to 12 months.

During 1987, Johnson County incurred a $400 expense paid to Bo Cook Engineering, Inc. for services to digitize, dimension, and compile gas line site sheets. Based upon advice of the Commission's Engineering Division, an adjustment has been made to eliminate this expense on the basis that this is a non-recurring cost.

Johnson County incurred a $1,095 expense paid to Southern Cross Corporation for a flame pack gas detector survey. Based upon advice of the Commission's Engineering Division, Staff is of the opinion that this expense should be amortized over 3 years for rate-making purposes on the basis that this is the frequency that the expense associated with such surveys should be incurred. Therefore, expenses have been reduced by $730.

Johnson County incurred a $360 expense for 6 $60 hams during 1987. Staff is of the opinion that this expense should be excluded on the basis that this is an expense unassociated with providing gas service.

The total of the above miscellaneous Staff recommendations is $1,868.

Debt Service

Johnson County's largest outstanding obligation is its debt to DLG. DLG loaned Johnson County $1,321,374 at an interest rate of 5 1/8 percent in 1981, the proceeds of which were used to rebuild the system. In the 7 years since this loan was acquired by Johnson County, no payments toward retiring the debt have been made. The debt service on this obligation is considerable, but Staff believes full consideration to this must be given in the Commission's determination of Johnson County's rates in order to provide for the financial integrity of the company. The $87,186 annual debt service produces per Mcf a rate requirement of approximately $2.03 ($87,186 + 43,048 Mcf). The monthly burden on the average customer for this debt service is $11.34.

In this report, Staff has utilized the year 1 principal and interest requirements of the DLG amortized mortgage table. These amounts are $67,720 for interest and $19,466 for principal.

Article II of the Plan of Reorganization ("Plan") requires that "the [unsecured] claims of DLG and Columbia Gas. . . shall be paid together pro rata (i.e., as each claim bears a percentage to the two combined claims). . . ." The Plan further identifies the amounts of these claims as $1,321,374 (89 percent) payable to DLG and $156,682 (11 percent) to Columbia. Staff interprets the Plan to mean that the Columbia arrearage does not bear interest and the DLG obligation is to be retired according to the original terms of the mortgage.

In accordance with its interpretation of the Plan, Staff has calculated the Columbia arrearage debt service to be $10,776 (11 percent + 89 percent X $87,186). Staff has fully considered this obligation in its rate recommendation.

Johnson County's remaining obligation is a 6 5/8 percent Small Business Administration loan bearing a debt service obligation of $217 per month ($2,604 per year). The test year-end balance was $7,022; therefore, Staff has imputed an annual interest obligation of $465 ($7,022 X 6 5/8 percent) and an annual principal obligation of $2,139 ($2,604 - $465). The above recommendations produce an adjustment to interest expense of $66,177 ($67,720 + $465 - $2,008).

Adjustments Recap

Following is a recap of the rate-making adjustments proposed by Staff:

Staff Recommendation	Staff Adjustment
Operating Revenues:	
Gas Sales	$ 10,379
Other	<3,500>
Total Operating Revenues	$6,879
Operating Expenses:	
Purchased Gas	<13,249>
Trustee Fee	<26,400>
Miscellaneous General Expenses	<19,366>
Uncollectible Accounts	<24,349>
Accounting Fees	<9,373>
Miscellaneous Adjustments	<1,868>
TOTAL	$<94,605>
Other Income/Deductions:	
INTEREST ON LONG-TERM DEBT	$ 66,177

Summary

Based upon the above recommended rate-making adjustments, following is the proposed operations upon which Staff recommends Johnson County's revenue requirements be based:

	Staff Adjusted Test Year	Rate-Making Adjustments	Adjusted Test Year
Operating Revenues	$419,404	$ 6,879	$426,283
Operating Expenses	383,377	<94,605>	288,772
Operating Income	36,027	101,484	137,511
Other Income/<Deductions> - Net	3,521	<66,177>	<62,656>
NET INCOME	$ 39,548	$ 35,307	$ 74,855

Revenue Requirements

Staff recommends that Johnson County's revenue requirements be determined based on the return on net investment rate base method. Under this method, the utility's allowed return is applied to rate base to determine required operating income.

At this time, there is no net stockholder investment in Johnson County. All utility plant is supported by a subsidized loan bearing an interest rate of 5.125 percent. Under present circumstances, the need for cash reserves is minimal. With a newly built system, extraordinary maintenance should be low and there are no indications that Johnson County plans major construction.

Absent the need for an equity return; a low interest, subsidized loan; and low cash flow requirements, Staff recommends that Johnson County's rates be based upon a rate of return of 7 percent, which is 1 3/4 percent greater than its cost of capital.

Based upon this recommendation, Johnson County's rates should be lowered by $70,235. Following is a schedule showing the derivation of this amount.

Gas Plant in Service	$1,237,833
Materials and Supplies	886
Cash Working Capital = 1/8 (Operating and Maintenance - Purchased Gas)	12,276
Subtotal	$1,250,995
LESS: Accumulated Depreciation	289,907
Net Investment Rate Base	$ 961,088
Recommended Return	7.0%
Required Operating Income	$ 67,276
Adjusted Operating Income	137,511
REVENUE SUFFICIENCY	$ 70,235

The above recommendations will provide for annual positive cash flow of $16,421. Following is Staff's calculation of this:

Net Income	$74,855
Reduction	70,235
Net Income After Reduction	$4,620
ADD: Depreciation	44,182
	$48,802
LESS: DLG Principle	<19,466>
Columbia Payment	<10,776>
SBA Principle	<2,139>
NET CASH FLOW	$16,421

Staff is of the opinion that the implementation of its recommendations will provide sufficient revenues to allow Johnson County to meet its operating expenses, service its debt, provide for reasonable equity growth and meet the requirements of the Bankruptcy Reorganization Plan.

OTHER ISSUES

During its review, Staff noted that Johnson County is not currently complying with the Commission's request that it file monthly operations statements. According to the Staff's review of Commission files, the last such filing was June 3, 1988. Staff recommends that Johnson County update its past-due filings and begin complying with this Commission request on a current basis.

Johnson County reported test-year line loss of 9.73 percent during 1987. Staff is concerned with this level of line loss, because Johnson County has a newly rebuilt system. Staff recommends that Johnson County file a report addressing the current status of its line loss situation.

Prepared by:

Steve Gilley

Steve Gilley, Public Utilities
Financial Analyst Principal
Electric and Gas Revenue
Requirements Branch
Rates and Tariffs Division

and

Leah Faulkner

Leah Faulkner, Public Utility
Rate Analyst Senior
Electric and Gas Rate
Design Branch
Rates and Tariffs Division

Appendix A

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF KENTUCKY
PIKEVILLE

IN THE MATTER OF: CHAPTER 11

JOHNSON COUNTY GAS COMPANY

DEBTOR NO. 83-2

PLAN OF REORGANIZATION

This Plan of Reorganization, dated ~~September~~ December 3, 1985, is filed by Kentucky Department of Local Governments and Columbia Gas of Kentucky, Inc., creditors herein.

DEFINITIONS

The following terms, when used in this plan, shall, unless the context otherwise requires, have the following meanings respectively;

DEBTOR: Johnson County Gas Co., a Kentucky corporation now pending in this Court as a Debtor with a Reorganization Trustee operating the business.

CHAPTER 11: Chapter 11 of the United States Bankruptcy Code.

REORGANIZATION CASE: The case for the reorganization of the Debtor commenced by involuntary petition under Chapter 11 of the United States Bankruptcy Code on January 18, 1983 styled: IN THE MATTER OF: JOHNSON COUNTY GAS CO., Bankruptcy Case No. 83-2.

COLUMBIA GAS: Columbia Gas of Kentucky, Inc., a creditor herein.

COURT: The United States Bankruptcy Court for the Eastern District of Kentucky, Pikeville Division, acting in this case.

CONFIRMATION OF THE PLAN: The entry by this Court of an order confirming the plan in accordance with Chapter 11 of the United States Bankruptcy Code.

CONSUMMATION OF THE PLAN: The accomplishment of all things contained or provided for in this Plan in the

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF KENTUCKY
PIKEVILLE

IN THE MATTER OF: CHAPTER 11

JOHNSON COUNTY GAS COMPANY

DEBTOR NO. 83-2

PLAN OF REORGANIZATION

This Plan of Reorganization, dated ~~September~~ December 3, 1985, is filed by Kentucky Department of Local Governments and Columbia Gas of Kentucky, Inc., creditors herein.

DEFINITIONS

The following terms, when used in this plan, shall, unless the context otherwise requires, have the following meanings respectively:

DEBTOR: Johnson County Gas Co., a Kentucky corporation now pending in this Court as a Debtor with a Reorganization Trustee operating the business.

CHAPTER 11: Chapter 11 of the United States Bankruptcy Code.

REORGANIZATION CASE: The case for the reorganization of the Debtor commenced by involuntary petition under Chapter 11 of the United States Bankruptcy Code on January 18, 1983 styled: IN THE MATTER OF: JOHNSON COUNTY GAS CO., Bankruptcy Case No. 83-2.

COLUMBIA GAS: Columbia Gas of Kentucky, Inc., a creditor herein.

COURT: The United States Bankruptcy Court for the Eastern District of Kentucky, Pikeville Division, acting in this case.

CONFIRMATION OF THE PLAN: The entry by this Court of an order confirming the plan in accordance with Chapter 11 of the United States Bankruptcy Code.

CONSUMMATION OF THE PLAN: The accomplishment of all things contained or provided for in this Plan in the pending proceedings as shown by and the entry of an Order of Consummation finally dismissing the case.

CORPORATION OR REORGANIZED CORPORATION: The Debtor, in its corporate status, after consummation of the Plan as a reorganized corporation, except as otherwise noted from the context herein contained.

DLG: The Commonwealth of Kentucky Department of Local Government, a creditor herein.

PLAN: This Plan of Reorganization.

STOCK: The common stock of the Debtor, both issued and unissued.

TRUST: A Kentucky business trust created by certain creditors of the Debtor and known as The Kentucky Municipal Gas Utility Investment Trust, which will become the ultimate and sole stockholder of the corporation.

TRUSTEE: B. E. Mullins, currently acting under appointment by this Court as reorganization trustee in this reorganization case.

ARTICLE I
CLASSIFICATION OF CLAIM OR INTEREST

CLASS 1.

Administrative Expense Claims. Each claim as described in Section 503(a)(2) and 507(a)(1) upon application and allowance by the court pursuant to Section 330(a) of the Code, and court costs, if any, for attorney's fees for B.E. Mullins, Reorganization Trustee, and the claims due Columbia Gas pursuant to Section 507(a)(3) and (4) in the amounts of $118,133.16 (gap expenses) and $30,724.83 (attorney's fees of Petitioning Creditors), or a total to Columbia Gas of $146,676.29, and Columbia Gas of Kentucky and Commonwealth of Kentucky Department of Local Governments for reimbursement of GRW Engineers appraisal, equally, not to exceed $15,000.00.

CLASS 2.

Current Operating Expenses. All operating expenses, including taxes, on the books of the debtors, or accrued, and due and owing currently in the ordinary course of the debtor's operations, as are in existence as of the date of the Consummation of this Plan.

CLASS 3.

Secured Claim - Small Business Administration. The secured debt of the United States of America Small Business

Administration in the approximate amount of $13,887.54, bearing interest at the rate of 6-5/8% per annum, which debt was and is being paid currently by way of monthly installments and is not in default, which constitutes a first mortgage upon the assets of the debtor.

CLASS 4.

Secured Claim - Columbia Gas. The claim secured by real property collateral in favor of Columbia Gas, which claim is hereby allowed as secured to the extent of $65,085.00, plus interest at the rate of 8% per annum from August 19, 1981, until paid, and which constitutes a fully secured but second lien on the real property of the debtor, subject only to the secured claim of the Class 3 creditor mentioned above.

CLASS 5.

DLG's Claims. The secured claim of the Kentucky Department of Local Governments in the amount of $1,321,374.00, plus contract interest thereon at the rate of 5.125%, secured by all of the assets of the debtor, subject only to the secured claims of the Class 3 and 4 creditors, which debt is in default and which claim is allowed herein in the amount previously mentioned, including interest thereon.

CLASS 6.

Unsecured Claim. The unsecured claim of Columbia Gas of Kentucky, Inc. in the amount of $156,682.21, not secured by any collateral, being the amount of the unsecured pre-petition debt of said creditor.

CLASS 7.

Stockholders. The existing stockholders of the Debtor, being Mr. and Mrs. Danny Preston, who hold five shares more or less of the authorized 1,000 shares of the Debtor.

ARTICLE II
TREATMENT OF CLASSIFIED CLAIMS

CLASS 1 - Administrative Expense Claims.

The administrative expense claims described in Class 1 shall be paid in full in cash on or before the Consummation of the Plan, provided, however, that the claim of B.E. Mullins shall be based upon an allowance of his commissions and fees by the court upon proper application, notice and a hearing thereon, and the claims of Columbia Gas shall be paid in the amounts set forth in Article I hereinbefore. Thereafter, the claims of Columbia Gas and DLG for reimbursement of the GRW appraisal fee will be paid equally to each creditor. Any shortages in cash at time of payment shall be paid out of the Corporation, in cash, as soon as practicable after Confirmation, and shall have first priority as to all other Classes herein except the Class 2 operating expenses and the Class 3 SBA monthly payment. If payments are made, the Trustee shall receive his allowance first; then the amounts due Columbia Gas, then the amounts due Columbia Gas and DLG equally.

CLASS 2 - Current Operating Expenses.

The claims of creditors for all operating expenses, including taxes, existing as of the Consummation of the Plan, and as defined in Article I, shall be assumed by the Corporation and paid according to their terms and in the ordinary course of the business of the Corporation.

CLASS 3 - Secured Claim - Small Business Administration

The secured claim of the United States of America Small Business Administration shall be assumed by the Corporation and paid according to its terms in the ordinary course of the business of the Corporation.

CLASS 4 - Secured Claim - Columbia Gas

The secured claim of Columbia Gas shall be paid in monthly cash installments of 1/12th of its claim for twelve consecutive months, with interest at the rate of 8% thereon to be paid in succeeding months thereafter, beginning in the first month following Consummation of the Plan.

CLASS 5 AND 6 - Other Claims and Unsecured Claim

The claims of DLG and Columbia Gas in Classes 5 and 6 respectively shall be paid together pro rata (i.e. as each claim bears a percentage to the two combined claims), in full, by quarterly cash payments decreed by the Corporation out of profits, surplus cash or unused cash, after taking into consideration adequate reserves for future operating needs, maintenance, repairs, replacement and retirement of Class 1 and 4 claims; after the Class 3 and 4 claims have been paid in full, the sums previously available to the Class 3 and 4 creditors shall be applied to the Class 5 and 6 creditors until said debts (including DLG interest according to its debt instruments) have been paid in full.

CLASS 7 - Stockholders

The interests of the stockholders, being stock in a corporation that is both insolvent and bankrupt, shall, upon consummation, be cancelled and voided, and thereafter be of no legal effect, and said interestholders shall cease being stockholders in the corporation.

ARTICLE III
CLAIMS OR INTEREST IMPAIRED BY THE PLAN

The claims of creditors in Class 1 are being paid in full at or immediately following Consummation and therefore are not impaired and shall be deemed to have accepted the Plan;

The claims of creditors in Classes 2 and 3 are current and are being assumed by the reorganized corporation and are not impaired and shall be deemed to have accepted the Plan;

The claim of the creditor in Class 4 will retain its collateral, which value is in excess of its claim, and will be paid out by monthly payments by the reorganized corporation, and therefore is not impaired and shall be deemed to have accepted the Plan;

The claims of the creditors in Classes 5 and 6 will be paid by deferred payment, but since such payments are deferred, their claims are impaired and they must accept the Plan as a class; and

The claim of the stockholders has no value via equity in the Debtor and is therefore not impaired, and shall be deemed to have accepted the Plan.

ARTICLE IV
EXECUTORY CONTRACTS

Any executory contracts or unexpired leases in effect in the within action as of the date of Consummation shall be assumed by the reorganized corporation, if not in default thereto. If in default, the curing of same shall be accomplished by a grant of a §507(a)(1) priority, and will be paid at Consummation immediately prior to payments to creditors in Class 1.

ARTICLE V
GENERAL PROVISIONS

Until the case is closed, the court shall retain jurisdiction to insure that the purposes and intent of this Plan are carried out, to hear and determine all claims against the Debtor, and to enforce all causes of action which may exist on behalf of the Debtor. Nothing herein contained shall preclude the reorganized corporation from taking such action as may be necessary in the enforcement of any cause of action which may exist on behalf of the Debtor and which have not been enforced or prosecuted by the Trustee.

ARTICLE VI
EFFECT OF CONFIRMATION

Notwithstanding provisions in the United States Bankruptcy Code to the contrary, the confirmation of this plan shall vest all of the property of the estate of the Debtor in the reorganized corporation, free and clear of all claims and interest of any creditors, equity security holders and stockholders, and shall discharge the Debtor from any debts (other than those specifically treated under this Plan) that arose before the date of such confirmation, any debt of a kind specified in Sections 502(g), (h) and (i) of the United States Bankruptcy Code, whether or not a proof of claim based upon said debt was filed or deemed filed under Section 501 of United States Bankruptcy Code, whether or not such claim is allowed under Section 502 of United States Bankruptcy Code and whether or not the holder of such claim has accepted the plan, and confirmation shall terminate all rights and interests of equity security holders and the stockholders, as provided for by the Plan, and that the provisions of subsections 2 of Section 1141 of the United States Bankruptcy Code are not controlling.

ARTICLE VII
RETENTION OF ASSETS AND LIENS

The Corporation shall retain all of the assets held by it as of the effective date of the Plan, but said assets shall continue to remain liened in favor of the creditors in Classes 3, 4 and 5, which liens shall remain in effect until the conclusion of the payments of all sums due and owing said creditors. Any assets to be disposed of or liquidated pending payment of Class 4 creditors shall be only with the permission of said creditor and the proceeds thereof shall be used to pay such Class 4 creditors and the proceeds then remaining of any such sale be paid over to Classes 5 and 6 creditors to the extent provided for in Article II.

ARTICLE VIII
CANCELLATION AND REISSUE OF STOCK

Upon consummation of the Plan, the stock held by the interestholders in Class 7 shall be cancelled and voided and shall be of no legal effect, and said stockholders shall cease being stockholders in the corporation, and all of the stock of the Debtor shall be issued and delivered to the Trust.

ARTICLE IX
PROVISIONS FOR CONTINUATION OF CORPORATE OPERATIONS

The following provisions shall apply to the reorganized corporation until the provisions of this Plan have been fully complied with, except to the extent as limited therein:

1. Immediately prior to or at Consummation, the Trustee shall cause to be voided and cancelled on the Debtor's books and records all of the stock issued and held by the Class 7 Stockholders.

2. At Consummation and prior to the Trustee's termination as Trustee, he shall cause to be issued all shares of the Debtor's stock to the Trust, same to be fully paid-up capital stock of the Corporation.

3. Immediately following the responsibilities set forth in 1 and 2 above, the Trustee shall cease all activities as Trustee, and his appointment shall terminate without further court order.

4. Immediately upon Consummation, the ownership of all of the issued outstanding stock of the Debtor, as vested in the Trust, shall authorize control of the reorganized corporation in the board of directors of the Corporation.

5. The Board of Directors of the reorganized corporation shall be the trusteos of the Trust.

6. Immediately following termination of the Trustee's appointment, B.E. Mullins shall assume control of the reorganized corporation's business, and shall, subject to the direction of the board of directors, be president, general manager and secretary-treasurer of the reorganized corporation.

7. The trustees of the Trust, as directors of the reorganized corporation, shall exercise their sound business discretion and best efforts to operate the corporation profitably and to pay the claims of creditors in all classes herein, provided however, the board shall be required to pay the claims of creditors in Classes 1 through 4 inclusive, except for extraordinary circumstances preventing same, and then only upon full disclosure, accounting and explanation to said creditors, and provided further that the priorities set forth in this Plan and the other terms contained herein, are specifically assumed by the Trustees and cannot be altered by the board of directors or the Trust, unless consent is made in writing by the affected party specifically setting forth its consent with reference to this section herein.

ARTICLE X
MISCELLANEOUS PAYMENT PROVISIONS

1. The Corporation shall have sole authority to determine the amount(s) of the distribution to the Class 5 and 6 claimants, but shall make payment of all amounts equal

to the Class 3 and 4 claimants' amounts after the Class 3 and 4 claims have been paid in full.

2. The Corporation shall have the authority, at any time after (but not before) the Class 4 claimant has been paid in full to sell the Corporation by stock transfer from the Trust or to sell the assets of the Corporation for any sum believed by the Trust to be the fair value of the stock or assets, and pay the cash proceeds of the sale to the Class 5 and 6 claimants pro rata.

PEDLEY, ROSS, ZIELKE & GORDINIER

BY: Lawrence L. Pedley
LAWRENCE L. PEDLEY
1705 Meidinger Tower
Louisville Galleria
Louisville, KY 40202
ATTORNEYS FOR KENTUCKY
DEPARTMENT OF LOCAL GOVERNMENT

12-31-85

BUNCH & BROCK

BY: WTBunch
W. THOMAS BUNCH
P. O. Box 2086
805 Security Trust Building
271 West Short Street
Lexington, KY 40594
Telephone: 606-254-5522
THOMAS E. MORGAN, General
Counsel, JAMES L. FULLIN,
Asst. General Counsel, and
STEPHEN B. SEIPLE, Attorney,
Columbia Gas of Kentucky,
Inc., P. O. Box 117,
Columbus, OH 43216-0117
Telephone: 614-460-4648
ATTORNEYS FOR COLUMBIA
GAS OF KENTUCKY, INC.