COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

IN THE MATTER OF ADJUSTMENT OF RATES OF BELFRY GAS COMPANY, INCORPORATED AND FOR AUTHORITY TO INCUR ADDITIONAL INDEBTEDNESS	)	CASE NO. 93-111

O R D E R

On April 14, 1993, Belfry Gas Company, Inc. ("Belfry") filed an application for adjustment of rates and for authority to incur additional indebtedness. The rates proposed would generate additional revenues of $79,790 annually, an increase of approximately 17.5 percent over normalized test-year revenues of $455,669.

The Commission finds that a revenue increase of $29,930, an increase of 6.57 percent over normalized test-year operating revenues, will provide rates adequate to allow Belfry sufficient cash flow to meet its operating expenses and provide for reasonable equity growth. The Commission finds Belfry's proposed financing should be denied.

On May 25, 1993, the Commission issued an Order extending the deadline for ruling on Belfry's request for financing approval to allow Staff sufficient time to review the financing in conjunction with the rate proceeding. On September 10, 1993, a hearing on the issues was held.

COMMENTARY

Belfry is a privately owned gas corporation engaged in the distribution and sale of natural gas to approximately 670 residential and commercial customers in Belfry and its environs, Pike County, Kentucky. Belfry has no gas production facilities of its own and purchases its gas from Kinhag Development Company, ("Kinhag") and Columbia Gas Transmission. Kinhag is owned by J. W. Kinzer who also owns all of the stock outstanding in Belfry.

TEST PERIOD

Belfry proposed and the Commission has accepted the 12-month period ending December 31, 1992 as the test period for determining the reasonableness of the proposed rates. In utilizing the historical test year, the Commission has considered appropriate known and measurable changes.

VALUATION

Belfry proposed a net investment rate base of $261,243.93 based on the test-year-end value of plant in service and excluding the adjusted accumulated depreciation. Belfry also proposed to include working capital based on one-eighth of adjusted operation and maintenance expenses, exclusive of purchased gas and depreciation expenses. The Commission concurs with this proposal with the exception that working capital has been adjusted to reflect the pro forma adjustments to operation and maintenance expenses found reasonable herein.

Belfry's adjusted net investment rate base for rate-making purposes is as follows:

Utility Plant in Service	$468,856.48
LESS:	
Accumulated Depreciation	228,497.00
Net Utility Plant	$240,359.48
ADD:	
Working Capital	18,749.69
NET INVESTMENT RATE BASE	$259,109.17

REVENUES AND EXPENSES

Belfry proposed to increase its test-period operating expenses of $454,759 by $1,243 to reflect current and anticipated operating expenses. In addition, Belfry requested an additional $30,000 related to the debt service requirements of the financing proposed as a part of this application. Belfry's test-period operating expenses and pro forma adjustments are reasonable with the following exceptions:

Normalized Revenues from Sales

Belfry normalized gas sales to agree with the purchased gas adjustment ("PGA") Case No. 89-068-GGG[1] in effect at the time of filing this case. This created, according to Belfry, a test-year adjustment of $17,584.37. Following data requests to Belfry, the Commission determined that a number used to compute the normalized gas sales was misstated. Belfry explained the error[2] and recomputed the adjustment. The adjustment was understated by $216.53. This results in an increase to test-year revenues of $17,800.90. The adjustment has been recomputed to include Belfry's

1 Case No. 89-068-GGG, The Notice of Purchased Gas Adjustment Filing of Belfry Gas, Inc., Order dated March 26, 1993.

2 Response to Commission Order dated May 19, 1993, Item 18, Sheet 1 of 1.

current PGA Case No. 89-068-MMM.[3] This results in an increase to test-year gas sales of $57,042.44, thus creating normalized gas sales of $455,669.94.

Natural Gas Purchases

Belfry normalized gas purchases to agree with its PGA Case No. 89-068-GGG in effect at the time of filing its application. This created a test-year adjustment of $13,815.54. The Commission agrees with this calculation and has recomputed the adjustment to include Belfry's current PGA Case No. 89-068-MMM, resulting in an increase to test-year gas purchases of $50,806.89, thus creating normalized gas purchases of $287,611.26.

Wages and Salaries

Belfry proposed to decrease its total test-year wage and salary expense of $127,086.33 by $11,539.81 to reflect pay rates in effect at December 31, 1992 plus a 5 percent increase based on a normal work year. The Commission has decreased this expense by $24,581.44. This decrease reflects the removal of one employee's wages totaling $16,375.67 from the test year as his employment was terminated and he was not expected to be replaced. An adjustment of $6,950.50 was made to remove portions of employees' wages who perform work for affiliated companies based on the percentages provided by the company.[4] We have further reduced wages and

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3 Case No. 89-068-MMM, The Notice of Purchased Gas Adjustment Filing of Belfry Gas, Inc., Order dated September 1, 1993.

4 Response to Item 3 of the Commission's August 30, 1993 Order.

salaries by $722.60 to reflect the replacement of one employee and by $532.67 to reflect the reductions of two employees' wages.

The Commission is concerned with the dramatic increase in Belfry's wage and salary expenses, increasing nearly 98 percent in the last 4 years. This is especially troublesome considering sales have remained virtually constant and the proprietary capital of Belfry has continued to decline. This is further exacerbated by the fact that at least some of Belfry's employees perform work for at least one affiliated company, Kinhag Drilling. The Commission encourages Belfry to closely monitor its wage and salary expenses as well as its number of employees in the future to ensure that both the employee level and pay is commensurate with the size and complexity of the Belfry system.

Taxes Other Than Income Taxes

As a result of the adjustments to wages and salaries, test-year payroll tax of $10,489 has been reduced by $2,253.83 to reflect payroll tax on the wages and salaries found reasonable by the Commission. The Commission has also reduced expenses by $106.53 to reflect the removal of the IRS penalty paid by Belfry in 1992 as this is not a recurring expense.

Transportation Expenses

The Commission has reduced test-year transportation expenses by $1,820.89 to reflect the disallowance of certain repairs based on a review of the invoices provided by the company. Included in this amount was an invoice dated December 1991 totalling $481.51. Since this repair occurred in 1991, it should not be included in the expenses for the test year. There were two additional invoices excluded from the allowable expenses of the utility for $406.96 and $525.38 for which no vehicle identification was given. No support was provided for including these expenses and no documentation was provided indicating that Belfry owned or leased these vehicles. The invoice for $407.04 for repair made to a vehicle not owned or leased by Belfry was also excluded from allowable expenses.

The Commission is concerned over the apparent practice of allowing non-employees to sign credit card receipts for gasoline purchases even if the non-employee is performing work for Belfry. Belfry should be billed for its use of employees, equipment and any other costs it incurs in the provision of gas service to its customers even if the work is performed by affiliated companies. Sound accounting practice requires that these transactions be well documented and supported so that the reasonableness of the actions of the utility can be clearly shown.

Rate Case Expenses

Belfry proposed that it be allowed to recover rate case expenses anticipated to cost $3,808.91 over a 3 year period for an annual expense of $1,269.64. Belfry has provided updates of its actual expenses which show that Belfry has incurred $6,311.45 in rate case expense. The Commission accepts this actual level of expense and agrees with the proposed 3 year amortization of this costs resulting in a $2,103.82 increase in test year expenses to reflect this cost.

Debt Service Requirements

Belfry proposed to decrease interest expense by $2,523.53 to reflect a normalization of test-year-end long-term debt totalling $166,935.13 with the test-year-end interest rate of 3.75 percent. Belfry further proposed to increase test-year interest expense by $312.54 to reflect the inclusion of a 10 year average of the interest costs related to the proposed borrowing of $300,000. The purpose of this borrowing was to refinance current outstanding debt to First National Bank, to repay certain 1992 gas purchases totalling $95,000 and to repay an affiliate, Kinhag Drilling for gas purchases outstanding since 1989.

There is no showing in the record of any benefit to Belfry, or its customers, to refinancing the existing loan with First National Bank as the interest rate will not change. Additionally, the record reflects Kinhag Drilling was paid for all gas purchases, except the December 1992 gas purchases, in early 1993. As these expenses have been paid, additional financing to cover this expense is not necessary. The Commission has previously denied recovery of the $108,266.18 past due gas purchases owed to Kinhag Drilling.[5] In that Order, the Commission adopted the Staff Report, as did Belfry. The Staff Report recommended that this cost be borne by the investor. Belfry presented no new evidence regarding this debt.

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[5] Case No. 89-068, The Application Of Belfry Gas, Incorporated For An Application For Adjustment Of Rates And For Authority To Incur Additional Indebtedness.

Belfry's test-year interest expense has been reduced by $2,099 to reflect a normalization of the test-year-end debt of $166,935.13 at the test-year-end interest rate of 3.75 percent.

The effect of the pro forma adjustments on Belfry's net income is as follows:

	Actual Test Period	Pro Forma Adjustments	Adjusted Test Period
Operating Revenues	$432,078	$32,220	$464,298
Operating Expenses	445,506	22,768	468,274
Net Operating Income	(13,428)	9,452	(3,976)
Interest on Long-Term Debt	9,253	(2,099)	7,154
NET INCOME	$(22,681)	$ 11,551	$(11,130)

REVENUE REQUIREMENTS DETERMINATION

Belfry requested an approximate 17.5 percent increase in revenues. Based on Belfry's current cost of debt and its cash flow, the Commission finds that the 10 percent rate of return on rate base proposed by Belfry is fair, just and reasonable. To achieve a return of 10 percent, Belfry needs additional annual revenues of $29,930 determined as follows:

Net Investment Rate Base	$259,109.17
Rate of Return granted	10%
Required Operating Income	25,910.92
Net Operating Loss	3,976.01
Subtotal	$ 29,886.93
Additional PSC Assessment	43.00
Revenue Increase Required	$ 29,929.93

SURCHARGE

Belfry requested numerous times that the Commission consider continuing its current surcharge established in Case No. 89-068.[6] The purpose of the continuance of the surcharge according to Belfry would be to pay off outstanding gas purchases for which recovery was previously denied in Case No. 89-068. As no new evidence was presented to justify this request, it is denied.

SUMMARY

The Commission, after consideration of the evidence of record and being otherwise sufficiently advised, finds that:

1. The rates in Appendix A, attached hereto and incorporated herein, are the fair, just, and reasonable rates for Belfry to charge for service rendered on and after the date of this Order.

2. The rates proposed by Belfry would produce revenue in excess of that found reasonable and should be denied.

3. The financing proposed by Belfry should be denied.

IT IS THEREFORE ORDERED that:

1. The rates in Appendix A are approved for service rendered by Belfry on and after the date of this Order.

2. The rates proposed by Belfry are denied.

3. The financing proposed by Belfry is denied.

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[6] Id.

4. Within 30 days from the date of this Order, Belfry shall file with this Commission its revised tariff sheets setting out the rates approved herein.

Done at Frankfort, Kentucky, this 11th day of October, 1993.

PUBLIC SERVICE COMMISSION

Chairman

Vice Chairman

Commissioner

ATTEST:

Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 93-111 DATED OCTOBER 11, 1993

The following rates are prescribed for the customers served by Belfry Gas, Inc. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of this Commission prior to the date of this Order.

Monthly Rates:

	Rate Per Unit	
First 1,000 cu. ft.	Minimum Bill	$8.6270
Over 1,000 cu. ft.		7.0785