COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF MT. OLIVET NATURAL)
GAS CO., INC. FOR A RATE ADJUSTMENT)
PURSUANT TO THE ALTERNATIVE RATE) CASE NO. 97-389
FILING PROCEDURE FOR SMALL UTILITIES)

O R D E R

On December 5, 1997, Mt. Olivet Natural Gas Co., Inc. ("Mt. Olivet") filed its application for Commission approval of proposed gas rates. Commission Staff, having performed a limited financial review of Mt. Olivet's operations, has prepared the attached Staff Report containing Staff's findings and recommendations regarding the proposed rates. All parties should review the report carefully and provide any written comments or requests for a hearing or informal conference no later than 10 days from the date of this Order.

IT IS THEREFORE ORDERED that all parties shall have no more than 10 days from the date of this Order, or 90 days after the date the application was filed, whichever is later, to provide written comments regarding the attached Staff Report or requests for a hearing or informal conference. If no request for a hearing or informal conference is received, this case will be submitted to the Commission for a decision.

Done at Frankfort, Kentucky, this 2nd day of April, 1998.

ATTEST:

Helen C. Helton
Executive Director

PUBLIC SERVICE COMMISSION

B. J. Helton
For the Commission

STAFF REPORT

ON

MT. OLIVET NATURAL GAS CO., INC.

Case No. 97-389

A. Preface

On December 5, 1997, Mt. Olivet Natural Gas Co., Inc. ("Mt. Olivet") filed an application for a rate adjustment pursuant to 807 KAR 5:076, the Alternative Rate Filing Procedure for Small Utilities ("ARF"). The rates proposed by Mt. Olivet would generate $47,000 in additional annual revenues or approximately 2.8 percent based on normalized test-year sales. In order to meet the minimum filing requirements for an ARF, a utility must have less than 500 customers and less than $300,000 in gross annual revenues. Mt. Olivet met the minimum requirements for an ARF filing.

The Commission Staff performed a limited financial review of Mt. Olivet's operations for the test year ending December 31, 1996. The Commission's objective was to reduce or eliminate the need for written data requests, decrease the time necessary to examine the application and, therefore, decrease the expense to the utility. Tammy Page and Marvin Goff of the Commission's Division of Financial Analysis performed the staff review on January 8, 1998 at the home of Ana Mae Brooks in Cynthiana, Kentucky. Staff also had two telephone conferences with Don Gravett, C.P.A. at Ms. Brooks home. With the exception of the sections dealing with Normalized Revenues, Purchased Gas Expense, and Retail Rates, which were prepared by Mr. Goff, this report was prepared by Ms. Page.

Scope

The scope of the review was limited to obtaining information to determine that the operating expenses as reported in Mt. Olivet's application for the period ending December 31, 1996 were representative of normal operations, and to gather information to evaluate the pro forma adjustments proposed in Mt. Olivet's filing. Expenditures charged to test-year operations were reviewed, including any supporting invoices. Insignificant or immaterial discrepancies were not pursued and are not addressed herein.

B. Recommended Rate-Making Adjustments

Normalized Revenues

Mt. Olivet proposed normalized revenue of $239,681.00. It calculated this amount based on September 1997 rates. Normalized revenue should be calculated on rates in effect on December 5, 1997, the date this case was accepted as filed. Normalized test year revenues should be calculated as follows:

	MCF	RATE	REVENUE
1st 1000 Cu. Ft.	3,725	$7.58	$28,235.50
Next 4000 Cu. Ft.	10,189	5.8617	59,724.86
Next 5000 Cu. Ft.	9,592	5.6617	54,307.03
Next 10,000 Cu. Ft.	11,228	5.5117	61,885.37
Next 10,000 Cu. Ft.	11,195	5.3117	59,464.48
	45,929		$263,617.24

Purchased Gas Expense

Test year gas purchases for Mt. Olivet are $199,276.00, based on 47,861 MCF. When adjusted for the expected gas costs in Case No. 9918-U4[1]. Mt. Olivet's normalized

1 Case No. 9918-U4, The Notice of Purchased Gas Adjustment of Mt. Olivet Natural Gas Company, Inc., Order dated December 5, 1997.

gas costs are $220,179.74.

Operating Expenses

Mt. Olivet did not propose any adjustments to its operating expenses. Upon review of the records, Staff determined that two adjustments were required.

Outside Services Employed

During the test year, Mt. Olivet was a member of the Columbia Small Customer Group. This group consisted of small gas companies banding together to obtain a contract on gas at a cheaper price. Mt. Olivet incurred $500 in lawyer fees. Since then, Mt. Olivet decided not to renew the contract. Therefore, since the expense is considered non-recurring, Staff recommends that the $500 not be included in revenue requirements for rate-making purposes.

Miscellaneous General Expenses

Mt. Olivet included $60 in donations in miscellaneous general expense. Donations should be recorded as a stockholder expense and not charged to the ratepayers, therefore, it should be a below the line expense. Staff proposes to exclude donations in the amount of $60. Miscellaneous general expenses should have a balance of $198.

Based on the recommendations proposed in this Staff Report, Mt. Olivet's adjusted operations are as follows:

Accounts	Mt. Olivet's Test-Year	Staff Proposed Adjustment	Staff Adjusted Balances
Operating Revenues	$215,516	$48,101	$263,617
Operating Expenses:			
Natural Gas Purchases	$199,276	$20,904	$220,180
Distribution Expense	10,181	0	10,181
Labor	13,129	0	13,129
A&G Expense	13,060	(560)	12,500
Total O&M Expenses	$235,646	$20,344	$255,990
Depreciation	5,259	0	5,259
Taxes other than Income Taxes	3,224	0	3,224
Total Operating Expenses	$244,129	$20,344	$264,473
Net Operating Income	(28,613)	27,757	(856)
Other Income	6,819	0	6,819
NET INCOME	$(21,794)	$27,757	$ 5,963

C. Revenue Requirements

Mt. Olivet did not propose a rate of return on capital and/or rate base method or the operating ratio method.

Staff has determined the net investment rate base for Mt. Olivet to be $32,090, calculated as follows:

Utility Plant		$196,193
ADD:	Working Capital	4,476[2]
Subtotal		$200,669
LESS:	Accumulated Depreciation	168,579
NET INVESTMENT RATE BASE		$ 32,090

The operating ratio method is used primarily when there is no sound basis for a rate of return determination using the required return on capital and/or rate base method. In order for the rate of return on equity to be conceptually valid, capitalization must be closely supported by rate base. Mt. Olivet's proprietary capital consists of common stock of $100,000 and unappropriated retained earnings of $(15,300). Net investment rate base for Mt. Olivet is $32,090. Therefore, since the capitalization is not a valid basis to determine the appropriate level of earnings, Staff believes that the operating ratio method should be used to determine revenue requirements in this case.

The Commission employs an .88 percent operating ratio. Applying the operating ratio to the Staff adjusted operating expenses, less purchased gas expense, results in a total revenue requirement of $270,513 which will require an increase in annual revenues

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[2]

O&M	$255,990
Less: Gas Purchases	$220,180
Subtotal	$ 35,810
Cash Working Capital Allowance	x 1/8
Working Capital	$ 4,476

of $6,896 before adjustments for the Public Service Commission assessment. Mt. Olivet did not propose an adjustment for the annual assessment; however, Staff has calculated this expense by applying the 1998 assessment rate of .0014720 to the recommended increase of $6,896 and determined that an additional $101 of expense should be recorded in Taxes Other than Income Taxes.

This additional adjustment results in a total recommended revenue increase of $6,997. This increase should allow Mt. Olivet to meet its operating expenses, and provide for reasonable equity growth. Therefore, Staff recommends an increase in operating revenue of $6,997.

The calculation of the total increase is shown below:

Total Operating Expenses	$264,473
Less: Purchased Gas	220,180
Subtotal	$ 44,293
Operating Ratio	.88
Subtotal	$ 50,333
Add: Purchased Gas	$220,180
Revenue Requirement	$270,513
PSC Assessment	101
Total Revenue Requirement	$270,614
Normalized Revenues	263,617
Increase Required	$ 6,997

Rates

Based on the recommended revenue requirement of $270,614, the following rates are recommended:

First 1000 Cu. Ft. or less (Minimum Bill)	$7.80
Next 4000 Cu. Ft. per 1000 Cu. Ft.	6.0147
Next 5000 Cu. Ft. per 1000 Cu. Ft.	5.8099
Next 10,000 Cu. Ft. per 1000 Cu. Ft.	5.6582
Next 20,000 Cu. Ft. per 1000 Cu. Ft.	5.4505

D. Signatures

Prepared By: Tammy Page
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