COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

| | | |
|---|---|---|
| THE PETITION OF SENTRA CORPORATION FOR A CERTIFICATE OF CONVENIENCE AND NECESSITY TO CONSTRUCT FACILITIES, APPROVAL OF FINANCING, APPROVAL OF INITIAL RATES AND OPERATION OF A NATURAL GAS DISTRIBUTION SYSTEM FOR THE CITY OF FOUNTAIN RUN, KENTUCKY | ) | CASE NO. 97-429 |

ORDER

Sentra Corporation ("Sentra"), a Kentucky corporation, has applied for a Certificate of Public Convenience and Necessity to construct a natural gas distribution system for Fountain Run, Kentucky and portions of Monroe County, Kentucky. Sentra also seeks Commission approval of its proposed rates for the proposed natural gas distribution system. By this Order, the Commission grants a Certificate of Public Convenience and Necessity to Sentra and establishes initial rates for its natural gas service.

## PROCEDURE

Sentra filed its application with the Commission on October 20, 1997. On November 6, 1997, the Commission deemed the application deficient and rejected it. On November 21, 1997, Sentra cured these deficiencies. On January 22, 1998, the Commission, after ascertaining that Sentra was not a corporation in good standing in Kentucky and finding that Sentra lacked standing to bring its application, dismissed the application. Sentra subsequently moved for rehearing and presented evidence that it had taken the necessary actions to become a corporation. On February 17, 1998, the Commission granted rehearing and ordered that Sentra's application be accepted for filing.

There are no intervenors in this proceeding. No request for public hearing on the application has been made. The Commission's decision is based upon evidence contained in Sentra's application and its responses to Commission's Orders and Commission Staff's requests for information.

## DISCUSSION

### Operating Revenues and Expenses

Sentra's proposed rates are based upon its projections for its initial three years of operation. Having reviewed these projections and the supporting documents, the Commission finds, with the exceptions noted below, that these projections are reasonable and should be accepted.

Sentra projects a residential/commercial customer base of 75 customers in its first year of operation, 103 customers in the second year, and 133 in the third year. It projects 2 industrial customers in its first year of operation and three industrial customers in the following two years. The Commission finds these projections and the projected gas usage of these customers are reasonable. The Commission further finds that, because Sentra's third year of operation represents the first year that Sentra will operate with a full complement of customers and with its proposed natural gas distribution system completely constructed and fully operational, Sentra's rates should be established based upon projected sales and operating expenses for that year of operation.

The Commission has determined that Sentra's rate should be based upon a commodity cost of natural gas of $3.9764 per 1,000 cubic feet ("Mcf"). This rate reflects Sentra's projected commodity cost and includes the estimated delivered cost of gas of $3.95 per Mcf and annual meter charge of $600. It is also adjusted for a one percent line loss.

The Commission finds that projected administrative/clerical expense should be reduced by $140 and field and installation expense should be eliminated. Sentra proposed an administrative/clerical expense of $3,600, but the number of employee hours attributed to administrative/clerical functions and projected wage rates reflect total expense of only $3,460.

Sentra also projected field and installation labor expense of $1,620 to connect additional customers to the completed distribution system. Such costs are normally capitalized costs and are reflected in plant increases shown in Sentra's projected depreciation schedule for its third year of operation. Field and installation labor expense has been reduced to zero.

Sentra originally proposed an annual telephone expense of $1,200, but subsequently submitted evidence reflecting a monthly expense of $127.64 or $1,532 annually. The Commission finds that $1,532 is the appropriate level of expense and has increased telephone expense by $332.

Sentra projected printing expenses of $600 in its first year of operation and $200 in each of the following years. It provided invoices supporting the first year projections and stated that a lower level of expense would occur in the next 2 years as some printing supplies purchased in the first year would be available for use. The Commission finds that printing expense should be on an average of the first 3 years of operation and has increased the projected expense level by $133 to an annual expense level of $333.

In its application, Sentra proposed an expense of $2,000 for Commission fees, filings, and records. This expense category is intended to cover the annual assessment for maintenance of the Commission, and expenses incurred to prepare and submit various reports and filings to the Commission. Sentra provided no supporting evidence for its proposed level of expense. Given the projected size of the proposed natural gas system and the amounts included previously in administrative/clerical expense, the Commission finds that $1,000 is a reasonable level of expense attributable to the preparation and filing of required reports. Provision for the PSC assessment is discussed below.

Sentra projects miscellaneous expense of $1,600 calculated as one percent of its projected gross sales. The company has not demonstrated any relationship between miscellaneous expenses and its gross sales nor has it identified any specific items that will be included in this account. Recognizing that Sentra is likely to incur such miscellaneous expenses as bank charges and that such charges are not reflected in other expense accounts, the Commission finds that a monthly miscellaneous expense of $50, or $600 annually, is a reasonable level of expense for such incidental items. Miscellaneous expense has been reduced by $1,000.

Sentra provided a depreciation schedule that reflects depreciation expense of $18,929 in its third year of operation. This expense includes depreciation of a backhoe and two fusing machines over a 7-year useful service life. Sentra states that this equipment will be used primarily for the construction of the natural gas system and may be sold upon completion of construction. The Commission finds that, given the strong likelihood that this equipment will be sold and, if kept, rarely used, the useful lives of these items should be extended to 10 years for rate-making purposes. Accordingly, the Commission has decreased depreciation expense by $2,915.

Sentra carries long-term debt of $125,000 on its books to William Daugherty, a related party. This loan is to be paid off with 10 equal payments over 10 years and carries a 6 percent interest rate. In its revised operating expenses, Sentra projects interest expense in its third year of operation of $4,800. However, at that time, the company's outstanding debt will be $100,000 and will result in interest expense of $6,000. The Commission therefore finds that interest expense should be increased by $1,200.

Capitalization

After considering the level of debt existing in its third year of operation, the Commission finds that Sentra's capitalization will consist of $100,000 in long-term debt and $50,550 in common stock. This results in a total capitalization of $150,550, calculated as follows:

| | Year 3 Balance | Percentage of Total |
|---|---|---|
| Debt | $100,000 | 66.4 |
| Common Equity | 50,550 | 33.6 |
| | $150,550 | 100.0 |

In determining a reasonable rate of return on common equity, the Commission has given consideration to the nature of Sentra's operations and its economic circumstances. The Commission finds that an 11.6 percent rate of return on common equity is reasonable for Sentra under present economic conditions. This rate of return on common equity results in an overall rate of return on capitalization of 7.9 percent, shown as follows:

| | Percentage | Cost | Overall Rate of Return |
|---|---|---|---|
| Debt | 66.4 | 6.0% | 4.0% |
| Common Equity | 33.6 | 11.6% | 3.9% |
| Overall Return on Capitalization | | | 7.9% |

Revenue Requirements

The Commission finds that Sentra's revenue requirements should be based on the allowed return on capital. Applying a 7.9 percent rate of return on Sentra's capitalization yields an operating income of $11,893. This approach, including an allowance of $1,329 for state and federal income taxes and $254 for the PSC assessment as shown in Appendix A, will require $139,006 in total revenues. This level of revenues should allow Sentra to meet its operating expenses and provide for reasonable equity growth when the company is fully operational.

Based on the company's projections of its operations, and modifications approved herein, the utility's pro forma operating statement is as follows:

| | | |
|---|---|---|
| Revenues | | $139,006 |
| Expenses: | | |
| Natural Gas Purchases | $90,403 | |
| Office Rent | 2,400 | |
| Office Supplies | 600 | |
| Administrative/Clerical | 3,460 | |
| Telephone | 1,532 | |
| Repairs | 700 | |
| Bad Debts | 700 | |
| Product & Liability Insurance | 1,800 | |
| Meter Reading & Billing | 4,788 | |
| Printing Costs | 333 | |
| Training & Travel | 1,200 | |
| KPSC Fees, Filing & Records | 1,000 | |
| Miscellaneous | 600 | |
| Income Taxes | 1,329 | |
| PSC Assessment | 254 | |
| Depreciation | 16,014 | |
| Total Operating Expenses | | 127,113 |
| Net Operating Income | | 11,893 |
| Interest Expense | | 6,000 |
| Net Income | | $ 5,893 |

Rate Design

Sentra proposes monthly volumetric rates of $7.50 per Mcf for residential and commercial customers and $6.50 per Mcf for industrial customers. It also proposes a monthly residential and commercial customer charge of $5 and a $10 monthly customer charge for industrial customers. Based on the revenue requirements found reasonable herein, the Commission has applied Sentra's proposed rate design and the revenue allocations inherent in Sentra's proposed rates to its projected third year sales of 14,110 Mcf for residential and commercial service and 8,400 Mcf per year for industrial service. This application yields rates of $6.1204 per Mcf for residential and commercial customers and $5.2961 per Mcf for industrial customers. The proposed $5 and $10 customer charges should be approved as proposed.

CONCLUSION

The Commission, having considered the evidence of record and being otherwise sufficiently advised, finds that:

1. Sentra proposes to construct a natural gas distribution system to serve Fountain Run, Kentucky and a portion of Monroe County, Kentucky. The proposed natural gas system consists of approximately 45,000 feet of 3-inch polyethylene pipeline, 12,500 feet of 2-inch polyethylene pipeline, and related facilities. The proposed system will connect at Monroe County, Kentucky, to an 8-inch polyethylene pipeline that Clay Gas Utility District ("Clay") owns and operates. The Clay pipeline is tapped into a Texas Eastern Transmission Corporation pipeline.

2. The estimated cost of the proposed distribution system is $216,875.

3. No entity currently provides natural gas service to Fountain Run, Kentucky or its surrounding area.

4. Sentra estimates that, after the initial year of operation, the proposed natural gas distribution system will serve approximately 75 customers. It estimates that the proposed natural gas distribution system will serve approximately 133 customers within 3 years of operation.

5. The maximum operating pressure of the proposed natural gas distribution system's pipeline will be 100 pounds per square inch ("psig") and will be tested by air up to 150 psig.

6. The city of Fountain Run, Kentucky has granted a franchise to Sentra to operate a natural gas distribution system within its corporate limits.

7. Construction of the proposed natural gas distribution system will not result in the wasteful duplication of facilities.

8. The public convenience and necessity require the construction of the proposed natural gas distribution system.

9. The rates set forth in Appendix B will, based upon Sentra's projected sales for its third year of operation, generate total annual revenues of $139,006. These rates will allow Sentra sufficient revenues to meet its operating expenses, and provide for future equity growth, including provisions for servicing its debt.

10. The rates proposed in Sentra's application will produce revenues in excess of those found reasonable herein and should be denied.

IT IS THEREFORE ORDERED that:

1. Sentra is granted a Certificate of Public Convenience and Necessity to construct the proposed natural gas distribution system and related facilities as set forth in the drawings and specifications contained in its application to serve Fountain Run, Kentucky and portions of Monroe County, Kentucky.

2. Sentra shall obtain approval from the Commission prior to performing any additional construction not expressly authorized by this Order.

3. Any deviation from the construction approved shall be undertaken only with the prior approval of the Commission.

4. At least 7 days prior to the commencement of construction of the proposed facilities, Sentra shall file a copy of its construction schedule with the Commission.

5. Sentra shall furnish to the Commission documentation of the total costs of this project including the cost of construction and all other capitalized costs (engineering, legal, administrative, etc.) within 90 days of the date that construction is substantially completed. Construction costs shall be classified into appropriate plant accounts in accordance with the Uniform System of Accounts for natural gas utilities prescribed by the Commission.

6. Within 90 days of substantial completion of the project, Sentra shall file with the Commission "as built" drawings of the proposed facilities approved herein.

7. Sentra is authorized to furnish and lay at its own expense up to 100 feet of customer service lines. Sentra shall own this portion of the service line and shall keep it in good repair and in accordance with the requirements of its own rules and the Commission's regulations.

8. Sentra's proposed rates are denied.

9. The rates set forth in Appendix B are approved for service rendered by Sentra on and after the date of this Order.

10. Within 30 days of the date of this Order, Sentra shall file with the Commission its proposed tariffs setting out the rates approved herein and all terms and conditions of service. The proposed tariffs shall conform with Administrative Regulation 807 KAR 5:011.

11. Sentra shall include in its proposed tariffs a gas cost adjustment mechanism that permits automatic adjustments to its retail rates to reflect changes in the utility's cost of gas.

Done at Frankfort, Kentucky, this 17th day of November, 1998.

PUBLIC SERVICE COMMISSION

B. J. Helton
Chairman

Vice Chairman

Commissioner

ATTEST:

Helen C. Helton
Executive Director

## APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 97-429 DATED November 17, 1998.

| | | |
|---|---|---|
| TOTAL OPERATING EXPENSES BEFORE TAXES, INTEREST, AND PSC ASSESSMENT | | $125,530 |
| TOTAL CAPITALIZATION | $150,550 | |
| RATE OF RETURN | 7.9% | |
| REQUIRED OPERATING INCOME | 11,893 | |
| LESS: INTEREST EXPENSE | 6,000 | |
| TAXABLE INCOME | 5,893 | |
| ADD: TAX EXPENSE | 1,329[1] | |
| PRETAX INCOME AVAILABLE FOR COMMON | | 7,222 |
| INTEREST EXPENSE | | 6,000 |
| PSC ASSESSMENT | | 254 |
| TOTAL REVENUE REQUIREMENT | | $139,006 |

[1] TAX EXPENSE = (TAXABLE INCOME * GROSS-UP FACTOR) - TAXABLE INCOME

TAX EXPENSE = ($5,893 * 1.2254902) – $5,893 = $1,329

| | |
|---|---|
| GROSS-UP FACTOR: | |
| OPERATING REVENUES | 1000.000000 |
| LESS: PSC ASSESSMENT OF .001828 | 1.828000 |
| NET INCOME BEFORE FED. AND STATE INCOME TAX | 998.172000 |
| LESS STATE INCOME TAXES @ 4% | 39.926880 |
| NET INCOME BEFORE FED. INCOME TAX | 958.245120 |
| LESS: FEDERAL INCOME TAX @ 15% | 143.736768 |
| NET INCOME | 814.508352 |
| GROSS-UP FACTOR | 1.2254902 |
| COMPOSITE TAX RATE | 18.4% |

APPENDIX B

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 97-429 DATED November 17, 1998.

The following rates and charges are prescribed for the customers in the area served by Sentra Corporation on and after the date of the Order.

Residential and Commercial

Customer Charge $5.00 per month

| | Base Rate | Gas Cost Recovery Rate | Total |
|---|---|---|---|
| All Mcf | $2.1440 | $3.9764 | $6.1204 |

Industrial

Customer Charge $10.00 per month

| | Base Rate | Gas Cost Recovery Rate | Total |
|---|---|---|---|
| All Mcf | $1.3197 | $3.9764 | $5.2961 |