COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF BLAZER ENERGY CORP., INC., A WHOLLY OWNED SUBSIDIARY OF EASTERN STATES OIL AND GAS, INC. TO ADJUST RATES	))))	CASE NO. 98-489

O R D E R

On September 9, 1998, Blazer Energy Corp., Inc. (Blazer) applied for an increase in its rate to its domestic end-use (farm tap) customers. Blazer serves its customers pursuant to KRS 278.485 and lease or right-of-way contracts. It filed its application pursuant to 807 KAR 5:026, Section 9, which sets out the process of rate adjustment for gas gathering systems which serve farm tap customers. In its initial application, Blazer requested an increase in its farm tap rate from $3.463 per Mcf to $5.77 per Mcf. In its post-hearing brief, Blazer re-calculated its proposed rate as being $5.65 per Mcf.

The Commission granted motions for full intervention filed by Loren Miller, David B. Thacker, Clifford Belcher, Donna S. Biliter, and A. B. Patrick, and granted limited intervention to Kenneth Reffitt. The Commission also granted a joint motion for full intervention filed by counsel for Pike County Citizens United for Justice, Randall Ratliff, Jonah May, Marquette Deskins, and Linda McCoy (intervenors).

A public hearing was conducted January 20, 1999, and all information requested during the hearing has been submitted. Post-hearing briefs were submitted by Blazer and the intervenors, and Blazer submitted a rebuttal brief.

In the post-hearing brief for intervenors filed February 22, 1999, the intervenors stated that the proposed adjustment in rates should be denied because of Blazer s failure to comply with the requirements of the regulations to include its cost to provide service during each of the two previous years. Blazer stated in its initial application that although it recognized the Commission s requirement for two years data, some of the information was located in Texas among voluminous records and not readily available, and Blazer s own employees were not located in that area. Blazer s position was that the undertaking would have been unduly burdensome. The Commission finds Blazer s method of using cost data to determine an annual revenue requirement to be an acceptable alternative to the incremental increase method contemplated by 807 KAR 5:026, Section 9(1).

As stated previously, Blazer proposed a rate of $5.77 per Mcf in its application. In support of its rate, Blazer filed a cost analysis which was comprised of two components: a gas cost which was based on a market-adjusted NYMEX strip average, adjusted for heat content; and a nongas cost which consisted of expenses Blazer asserts it incurs in the provision of farm tap service. In its post-hearing brief of February 22, 1999, the company filed an Appendix A to update its gas and nongas costs for the period ending June 30, 1998. This appendix sets out a rate of $5.65 per Mcf as opposed to the $5.77 proposed rate in Blazer's application.

In determining a fair, just, and reasonable rate for farm tap service, Blazer should be allowed to recover its cost of gas, plus those costs directly related to providing service to its farm tap customers. The Commission has analyzed the operating expenses filed in Blazer's application as well as in Appendix A to its brief. At issue during the hearing was whether gathering, compression, and line loss expenses are

included in Blazer's cost of gas. At the hearing, Blazer failed to demonstrate that these expenses are not included in its cost of gas, but provided conflicting testimony. The Commission finds that gathering, compression, and line loss expenses should not be allowed as they are included in Blazer's cost of gas. To include such costs in the farm tap rate would constitute double recovery. The Commission has accepted the cost of gas of $2.90 per Mcf contained in Appendix A of Blazer s February 22, 1999 post hearing brief as reasonable for its cost of gas. Expenses included by Blazer in its proposed rate that were derived through cost allocations were disallowed. Blazer failed to show that these expenses are not already recovered in its $2.90 per Mcf cost of gas.

The Commission has included the salary and benefits for the Pikeville office filed in Blazer's application, but has not included the regional offices' salaries and benefits. A rate case expense of $30,000 has been included but is amortized over three years in accordance with usual Commission practice. Contract landman expense and property taxes have not been included. That portion of other district expenses identified as domestic customer expenses has been incorporated in the approved rate. Blazer's depreciation calculation has been disallowed; however, depreciation based on the cost of a meter for each customer has been included, assuming a 25-year useful life. Pipeline depreciation should already be included in Blazer's cost of gas. An allowance for bad debts has been included as well as a gross up for federal and state income taxes.

In addition to the operating costs, Blazer should be allowed a reasonable return for providing this service. An approach used by the Commission in determining a reasonable return is the "Operating Ratio Method." This method is used primarily when there is no sound basis for a rate of return on investment or capital devoted to providing

utility service as is the situation in this case. The operating ratio generally used by the Commission to provide for equity growth is 88 percent on allowed operating costs, exclusive of gas costs. This methodology has been used to determine a fair return to Blazer.

Based on the operating costs and return found reasonable, the Commission has determined that the total revenue requirement for Blazer is $735,077. The Commission finds that Blazer's rate to its farm tap customers should be $4.364 per Mcf.

In calculating Blazer s approved rate for farm tap service, the Commission excluded volumes and expenses related to the 367 customers served pursuant to right-of-way contracts. These contracts provide for gas to be supplied at a rate of 35 cents. Because the interpretation of these contracts is pending in federal court, the Commission finds that the $4.364 rate should not apply to the contract or right-of-way or lease customers whose agreements refer to a rate of 35 cents per Mcf. The Commission, upon request, will review this issue upon the conclusion of the federal litigation.

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

1. The rate proposed by Blazer would produce revenues in excess of that found reasonable herein and should be denied.

2. The rate set forth in Appendix A is the fair, just and reasonable rate for Blazer to charge for service rendered on and after the date of this Order.

3. The operating ratio granted herein is fair, just, and reasonable.

IT IS THEREFORE ORDERED that:

1. The rate in Appendix A is approved for service rendered by Blazer to its KRS 278.485 customers on and after the date of this Order.

2. The rates proposed by Blazer are denied.

3. Within 30 days of the date of this Order, Blazer shall file its tariff sheets setting out the rate authorized herein.

Done at Frankfort, Kentucky, this 8th day of April, 1999.

By the Commission

ATTEST:

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Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 98-489 DATED APRIL 8, 1999

The following rates and charges are prescribed for the customers in the area served by Blazer Energy Corporation, 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 effective date of this Order.

The rate for gas service is $4.364 per Mcf for KRS 278.485 customers.