

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE PETITION OF CUMBERLAND VALLEY)
ENERGY FOR A CERTIFICATE OF)
CONVENIENCE AND NECESSITY TO) CASE NO. 99-139
CONSTRUCT AND OPERATE A NATURAL)
GAS DISTRIBUTION SYSTEM)

O R D E R

On April 6, 1999, Cumberland Valley Energy, Inc. ("Cumberland") filed a petition with the Commission seeking approval for a Certificate of Convenience and Necessity to construct and operate a natural gas distribution system. Cumberland further requested approval of financing and initial rates for the operation of its proposed gas distribution system in Metcalfe, Cumberland, Clinton, and Wayne counties in southern Kentucky. In a July 22, 1999 Order, the Commission required that Cumberland file, within 21 days, additional technical and financial information to support its petition. On August 25, 1999, Cumberland was granted a 30-day extension of time in which to file the required information. On September 27, 1999, Cumberland requested an additional 60 days in which to file the information. By Order dated October 7, 1999, the Commission granted Cumberland a 30-day extension of time to file the required information. On November 8, 1999, Cumberland filed its response to the Commission's July 22, 1999 Order.

After review of the November 8, 1999 filing, the Commission finds that Cumberland has not provided adequate information in support of the financing and rate

components of its application. Cumberland has not adequately demonstrated the manner in which it developed its proposed revenue requirements. The petition appears to have been submitted before Cumberland had prepared all of the information necessary to support its petition for a Certificate of Convenience and Necessity to construct and finance a new natural gas distribution system. Absent adequate information in support of the proposed financing, the Commission cannot properly evaluate Cumberland's request for a Certificate of Convenience and Necessity to construct a gas distribution system. Nor is the Commission able to make an informed decision on Cumberland's requests for approval of financing and rates. Therefore, the Commission has determined that Cumberland's application should be held in abeyance for 30 days from the date of this Order. This will provide Cumberland another opportunity to provide the information necessary for the Commission to determine whether to grant or deny Cumberland a Certificate of Convenience and Necessity to construct the proposed gas distribution system. The appendix to this Order sets out in detail the information that Cumberland must file in order for the Commission to resume processing the request included in Cumberland's original petition.

The Commission is aware of the lack of natural gas service in many areas of southern Kentucky and the desire of many interested individuals, institutions, and governmental bodies to have natural gas service extended to that area of the Commonwealth. Many individuals, parties and agencies have met with the Commission over the years to discuss their plans for extending natural gas service to this area, but very few of the projects considered have been successful. The Commission is

supportive of such efforts and will approve a proposal that is demonstrably feasible and in the best interests of the potential customers in the area.

Prior to approval of such projects, however, the parties proposing them must provide assurances to the Commission on several key points. They must assure the Commission that the individuals and parties proposing such ventures are appropriately qualified, adequately financed, and committed to attaining their goals in a manner consistent with sound regulatory practices so that the Commission can perform its duties in accordance with the statutes that govern its responsibility as a regulatory agency. Unless the parties that apply for approval to establish a new utility can provide such assurances and demonstrate that they are able and willing to comply with the requisite necessities of regulation, the Commission cannot, in good faith, issue Orders of approval. At this point in time, after numerous efforts, the application of Cumberland is inadequate for the Commission to make an informed decision on the feasibility of the proposed project.

We strongly encourage Cumberland to make its very best effort to provide the information that is required by the Commission. Doing so would demonstrate to the Commission, and to the parties interested in having natural gas service brought to their area of the Commonwealth, that Cumberland is capable of providing adequate natural gas service to an area of the Commonwealth where such service currently is non-existent.

IT IS THEREFORE ORDERED that:

1. Cumberland's petition for a Certificate of Convenience and Necessity to construct a gas distribution system and its requests for approval of financing and initial rates shall be placed in abeyance for 30 days from the date of this Order.

2. Cumberland may reactivate this case by providing the information necessary for the Commission to make an informed determination on whether to grant or deny the requests for approval of the construction, financing, and initial rates for Cumberland's proposed natural gas distribution system.

3. The additional information that Cumberland must file to reactivate this case is set out in Appendix A to this Order. That information and all pertinent supporting documents must be filed within 30 days from the date of this Order to reactivate the case.

4. Should Cumberland fail adequately to supply the information set forth in Appendix A hereto within 30 days from the date of this Order, the Commission will reject Cumberland's petition and deny its requests for approval of the proposed construction, financing, and initial rates for its proposed natural gas distribution system.

Done at Frankfort, Kentucky, this 22nd day of December, 1999.

By the Commission

ATTEST:

Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 99-139 DATED DECEMBER 22, 1999

The following are additional items that must be provided in order for the Commission to remove the petition of Cumberland Valley Energy, Inc. (Cumberland) from abeyance and continue processing the case. These questions are intended to

facilitate and assist the utility in developing its support for the proposed construction, financing and initial rates. Some of the questions have been asked in previous data requests and some arise from the information that has been filed. Cumberland should review each request carefully and provide a full and complete response to each question, including the subparts.

Additional Information Required, Cumberland Valley Energy, Inc., Case No. 99-139

1. 807 KAR 5:001, Section 9(2)(e). *The manner in detail in which it is proposed to finance the new construction or extension.* In Attachment I, Note XI of the November 8, 1999 response, Cumberland stated that its proposed indebtedness is \$5.8 million at 6.5 percent for 20 years. However, in its response to the original deficiency letter of the above regulation filed on May 27, 1999, Cumberland stated the terms of its proposed indebtedness were \$7.87 million at 8 percent for 20 years.

a. Explain the change in the amount to be financed, the interest rate, and any other changes in the terms of the financing.

b. Provide a schedule that lists all sources of funds that will be used to finance this project. The schedule will include the names of the investors or lenders, the number of bonds to be issued, the face value of the bonds, the term of the bonds, the interest rate, the number of shares of capital stock to be issued, the amount of investment in capital stock, and any other equity investments with their terms and conditions.

c. Provide the Use of Funds report that was prepared by Cumberland Securities and referenced in the response dated November 8, 1999, Attachment I, Note XI.

d. Explain any differences between the amounts contained in the Use of Funds report and the proposed construction costs contained in the Nesbitt Engineering study and elsewhere in the data response.

2. 807 KAR 5:001, Section 10(6)(h). *A summary of the utility's determination of its revenue requirements based on return on net investment rate base, return on capitalization, interest coverage, debt service coverage, or operating ratio, with supporting schedules.* While the response to Item 20 of the Order dated November 8, 1999 included a brief discussion of the return on investment of 18 percent, there was no information in the form of supporting calculations and underlying operating income and investment used to determine the rate of return. Provide the information.

3. For the Five Year Financial Pro Forma (pro forma) in Attachment I, provide the rate of return on rate base and the return on capital structure. The information used in these calculations should be in agreement with the information contained in the response to question 4 below.

4. 807 KAR 5:001, Section 10(6)(l). *A reconciliation of the rate base and capital used to determine its revenue requirements.* This response should identify all sources of capital funding required to support the capital construction, reserves, etc. The rate base should consist of net utility plant, materials and supplies, prepayments, cash working capital, and other utility assets. The capital should consist of the various sources of funding, including long-term debt and equity, used to support items contained in the rate base. Explain any differences between the two.

5. Refer to Attachment I, Note I, page 1 of 10 of the data response dated November 8, 1999 to answer the following: Explain the caption Feasibility Analysis performed in-house by professional gas marketing consultants using public and private data. Provide the qualifications of the consultants and explain whether the term in-house means that Cumberland principals performed any of the study. If the term means something else, explain.

6. Refer to Attachment I, Note V of the data response dated November 8, 1999 to answer the following:

a. Identify any of the cost associated with the installation of new facilities including distribution lines, meters, service lines, etc. Explain why their costs should not be capitalized under the Uniform System of Accounts (USoA), or why they should be included as operating expenses. Provide reference to the appropriate USoA account numbers and titles in the explanation.

b. Explain the duties and responsibilities of the two employees identified as sales reps. Explain why it is necessary to incur this level of expense for this function.

7. Refer to Item 19. i. (4) of the data response dated November 8, 1999 to answer the following: Provide a detailed explanation of how the 15 percent for payroll-related expenses was determined. Include the items contained and their cost and basis for the estimated amounts. Also include the supporting calculations used to determine the 15 percent, as well as the determination of the dollar amount contained in the pro forma.

8. Refer to Attachment I, Note VII of the data response dated November 8, 1999 to answer the following: The data contained in the pro forma calculates to be .5 percent instead of .005 percent as shown in Note VII. Explain how the estimated level of bad debt expense was determined.

9. Refer to Attachment I, Note VIII of the data response dated November 8, 1999 to answer the following: The data contained in the pro forma calculates to be .5 percent instead of .005 percent as shown in Note VIII. Explain how the estimated level of repair expense was determined.

10. Refer to Attachment I, Note IX of the data response dated November 8, 1999 to answer the following: Provide a detailed explanation of how the 30 percent corporate income tax rate was determined. Include the state, federal and local tax rates used in the determination of the total amount of corporate income tax expense.

11. Cumberland's response dated November 8, 1999 to Item 15 of the Commission's July 22, 1999 Order indicates that there is no written documentation to support the contention that Clinton County will authorize the sale of the proposed Industrial Building Gross Revenue Bonds.

a. Explain why the documents are not available.

- b. Explain when this information will be available.
- c. Provide a copy as soon as it becomes available.

12. Cumberland's answer dated November 8, 1999 to Item 16 of the Commission's July 22, 1999 Order was inadequate.

- a. Explain why the documents are not available.
- b. Explain when this information will be available.
- c. Provide a copy as soon as it becomes available.

13. Refer to Item 17 of the data response filed November 8, 1999.

a. Is the pro forma provided the Commission the same as that provided to the bond investment adviser?

b. Submit an approval letter from the bond investment advisor accepting projections from Cumberland. If this is not available, explain when this will be available.

c. Provide a copy of the bond insurance policy and explain what it covers.

14. Provide a copy of the debt service amortization schedule that was referred to in the November 8, 1999 data response, Item 17(1).

15. Provide a breakdown of projected insurance expenses in accounts 924 and 925. The response dated November 8, 1999 indicates that some of these insurance costs are related to payroll expense.

a. Did Cumberland receive a written quotation from Bituminous General Liability? If so, provide a copy of the quotation. If not, explain how the amount was

determined and provide a breakdown of the \$12,000 estimate into various forms of coverage.

b. Are these costs in addition to any insurance costs included in the 15 percent of payroll for employee-related costs included in Account 926? If so, state the salaries to which these costs relate, and provide all underlying calculations supporting the proposed amount.

16. Provide the specific items along with projected costs to support the \$6,000 amount included on the pro forma in office expense, account 921.

17. Provide support for the professional services, such as legal, accounting and auditing, and engineering, that will be acquired for the amount included in account 923.

a. Provide a schedule listing the type of service to be acquired, the estimated cost, and the purpose of the service acquired.

b. Are any of the costs associated with the proposed or future construction? If so, provide the amount for each year and an explanation of the construction that will be undertaken. (The total amount for each year should correspond to the amount contained in the pro forma.)

c. Are any of the costs nonrecurring? If so, identify the amounts for each year and explain why the cost is nonrecurring.

18. Explain how the inflation rate of 3 percent that is used to project some of the operating expenses in the November 8, 1999 response was determined.

19. Refer to the pro forma in Attachment I in the November 8, 1999 response. Account 920 is broken down into three categories: Equipment Rental, Utilities, and

Telephone Expense. According to the USoA chart of accounts, account 920 is the administrative and general salaries account. Reclassify the three categories previously mentioned into their proper USoA accounts.

20. Cumberland's answer to item 19.viii in the data response dated November 5, 1999 was non-responsive. *Give a thorough explanation of the basis or source documentation used to project any expense not previously mentioned.* Several of the items on the pro forma financial projections are not explained. Provide a detailed explanation, including supporting calculations and all underlying assumptions, used to determine these projected expenses:

- a. 930.1 Advertising Expense
- b. 927 Licenses
- c. 930.2 Miscellaneous
- d. 403 Depreciation
- e. 427 Interest

21. Refer to Attachment I, page 5 of 10. The projected number of residential customers and usage is presented as zero for each year of the 5-year period. Provide a projection for the number of residential customers and their usage for this time period.

22. Refer to Attachment I, pages 4, 6-10 and Attachment IV, Tariff, page 1. The monthly service charges presented for each customer class in Attachment I are \$5.00 per class less than the monthly service charges proposed in Attachment IV, Tariff. Provide the correct monthly service charges proposed per class and a cost justification for each customer class service charge.

23. Provide a billing analysis, by customer class, showing the revenues generated by the proposed rates at the projected usage.

24. Provide a copy of the letter of intent between El Paso and Cumberland.