COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF JOHNSON COUNTY GAS COMPANY, INC. FOR A RATE ADJUSTMENT PURSUANT TO THE ALTERNATIVE RATE FILING PROCEDURE FOR SMALL UTILITIES	) CASE NO. 99-155

O R D E R

On May 6, 1999, Johnson County Gas Company, Inc. (Johnson County) applied for Commission approval of proposed gas rates. Commission Staff has performed a limited financial review of Johnson County s operations and prepared the attached Staff Report containing its findings and recommendations regarding the proposed rates. Johnson County should carefully review the report 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 Johnson County shall have no more than 10 days from the date of this Order to provide written comments regarding the attached Staff Report or to request 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 6th day of August, 1999.

ATTEST:

By the Commission

Executive Director

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF JOHNSON COUNTY GAS	)	
COMPANY, INC. FOR A RATE ADJUSTMENT	)	CASE NO. 99-155
PURSUANT TO THE ALTERNATIVE RATE	)	
FILING PROCEDURE FOR SMALL UTILITIES	)	

STAFF REPORT

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STAFF REPORT

ON

JOHNSON COUNTY GAS COMPANY, INC.

Case No. 99-155

A. Preface

On May 6, 1999, Johnson County Gas Company, Inc. (Johnson County) filed an application for a rate adjustment pursuant to 807 KAR 5:076, the Alternative Rate Filing Procedure for Small Utilities (ARF). The application stated the proposed rates would produce a $30,908 increase; however, this reflects Johnson County s incorrect calculation of normalized test period revenues. When compared to properly normalized test period revenues, the proposed increase is $78,639 which is a 43% increase.

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. Johnson County met the minimum requirements for an ARF filing. The Commission Staff performed a limited financial review of Johnson County s operations for the test year ending December 31, 1998. 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. Beverly Davis and Chris Whelan of the Commission s Division of Financial Analysis performed the staff review on May 20-21, 1999 at Johnson County s office in Harold, Kentucky. This report was prepared by Beverly Davis with the exception of the sections dealing with Normalized Revenues, Purchased Gas Expense, and Rates, which were prepared by Dawn McGee.

Scope

The scope of the review was limited to obtaining information to determine that the operating expenses as reported in Johnson County s application for the period ending December 31, 1998 were representative of normal operations, and to gather information to evaluate the pro forma adjustments proposed in Johnson County s filing. Insignificant or immaterial discrepancies were not pursued and are not addressed herein.

B. FERC Surcharge

Johnson County is required to pay a surcharge to Kentucky West Virginia Gas Company (Kentucky West) in the amount of 61.4 cents per Dth. The surcharge was approved by the Federal Energy Regulatory Commission (FERC) as part of a settlement in Docket Nos. TQ89-1-46-000, et. al. between Kentucky West and this Commission. Johnson County collects a surcharge from its customers in the amount of 41.55 cents per Mcf for the purpose of payment of the Kentucky West billings.

According to its application, Johnson County reported $11,132 in surcharge revenue for the test period. The rate at which Johnson County is collecting the surcharge from its customers greatly exceeds the amounts billed by Kentucky West. The total amount invoiced by Kentucky West during the test period was $3,207 although Johnson County s actual payments totaled $5,354, which apparently included some past due amounts. This imbalance has existed for several years. The amounts that were collected in excess of the amount remitted were not escrowed into an account to be used to pay future billings from Kentucky West Virginia. As a result, the surcharge revenues have been used in part to help fund current operations.

The surcharge approved by the Commission to be collected from Johnson County s customers was intended for the purpose of paying the debt to Kentucky West Virginia. The surcharge revenue was not intended and should not be used to pay current operating expenses. The amount of surcharge revenue not currently used to pay surcharge billings to Kentucky West Virginia should be escrowed in an account to be used solely for the purpose of payment of the surcharge obligation. Staff recommends that the Commission direct Johnson County to establish a separate interest-bearing bank account for surcharge revenues. Johnson County should deposit all surcharge revenues into the account and pay surcharge billings from the account so that any unused revenues will be available to pay future billings.

C. Recommended Rate-Making Adjustments

Johnson County proposed numerous adjustments to its test-year operations. Johnson County requested and is using a historical test period normalized for changes that occurred during the test year. During the test period, the utility was owned by the Kentucky Municipal Gas Utility Investment Trust and Mr. Rife served as operator under a management contract. Subsequent to the end of the test period, the Commission approved the transfer of the stock of the utility to Mr. Rife so he is now owns all outstanding shares of the stock of Johnson County. Most of the adjustments contained in Johnson County s application concerned the proposal to hire employees and discontinue the practice of providing services through a management contract. Normally changes to operating expenses that occur outside the test year would not be accepted when a historical test period is used. However, due to the change in ownership that occurred subsequent to the end of the test period, Staff has considered the proposed changes related to the discontinuance of the management contract. Staff s evaluation of the proposed adjustments and test period operations follows.

Affiliated Companies

Mr. Bud Rife owns 100 percent of the shares of Johnson County. In addition, he owns Bud Rife Construction Company, Inc. (Bud Rife Construction), B & S Oil and Gas Company (B & S), and B & H Gas Company, Inc. (B & H). All four companies share office space in a building owned by Mr. Rife in Harold, Kentucky.

During the field review, Mr. Rife reported that B & H has two employees, Bud Rife Construction has two employees, and B & S has two employees. Although, Staff takes note that the general information sections of the 1997 and 1998 annual reports stated that B & H had five full-time employees. Johnson County does not have any employees; its operation has been conducted through a management contract.

Mr. Rife reported that expenses for pager service, cellular telephone service, electric service from AEP, and building rent are allocated equally between Johnson County and two of the other affiliated companies. He said that office supplies are allocated equally between Johnson County and two other companies unless the item is used exclusively by one company. He reported that the gasoline expense for his vehicle is distributed to all the companies by rotating the charge to the different companies credit cards.

As discussed throughout this report, Staff agrees with Johnson County s request to hire its own employees and discontinue operation under a management contract. However, Johnson County must ensure that there is no cross-subsidization between the affiliated companies. Johnson County has assured Staff that any employees hired will work exclusively for Johnson County. If for any reason this is found not to be the case, Johnson County should allocate salary, payroll taxes, workers compensation insurance, and health insurance to the other companies as appropriate. Additionally, any other joint costs should be allocated to all the affiliated companies that benefit from the expense.

Normalized Revenues

Johnson County proposed normalized revenues of $240,390. This amount, reported in Attachment IV of the application, consisted of sales revenues of $206,684, customer charge revenues of $17,460, and other revenues of $16,246. The sales revenues were based on Johnson County s retail rate in effect from January 21 through May 7, 1998, which was $7.68 per Mcf. To correctly calculate Johnson County s normalized revenues, Staff used $6.40 per Mcf which was the rate in effect at the time of filing. A second problem is that the sales volume used by Johnson County included free gas that it supplies in exchange for easements. A third problem with Johnson County s normalized revenues is the amount of other revenues. The $16,246 included $11,132 collected pursuant to the FERC approved surcharge discussed earlier in this report. This surcharge is designated to repay Kentucky West and is not to be used to pay operating expenses; therefore, it should not be included in the calculation of normalized revenues for the purpose of setting rates. Based on these adjustments, Johnson County s normalized test year revenues are calculated as follows:

Reported 1998 Sales Volume-in Mcf	26,912
Less: Free Gas	(966)
Adjusted 1998 Sales Volume	25,946
Current Rate per Mcf	x $6.4005
Normalized Sales Revenues	$166,067

Plus:	
Customer Charge Revenues	$ 17,460
Other Revenues:	
Penalties	4,764
Non-recurring charges	350
TOTAL NORMALIZED REVENUES	$188,641

Purchased Gas Expense

Johnson County proposed normalized purchased gas expense of $98,229 based on volume sold during 1998 of 26,912 Mcf and a purchased gas cost of $3.65 per Mcf. This expense level was based on Johnson County s existing contract with Interstate Natural Gas Company which sets out a gas cost of $3.65 per Mcf.

Staff calculated Johnson County s normalized purchased gas expense by using the actual volumes of 27,649 Mcf purchased in 1998 as reported in Johnson County s annual report and the most recent gas cost adjustment (GCA) approved by the Commission at the time of filing. Using the most recent GCA of $3.5458 per Mcf results in an adjusted level of purchased gas expense of $98,038.

Operation Supervision and Labor

Johnson County proposed elimination of contract labor in the amount of $4,575 included in this account and indicated it plans to hire employees to perform those services. The costs attributable to the proposal to hire employees are included in other accounts. Johnson County s pro forma adjustment to this account also included an increase of $2,580 which is half the annual lease cost for a 1997 4 wheel drive Chevrolet S-10 extended cab truck. The proposal regarding the truck lease will be addressed in the section of the report that discusses transportation expenses.

This account includes the cost of cell phone service and pager service. One-third of the cost of both services was allocated to Johnson County. The remainder of the cost was allocated to B & H and Bud Rife Construction. Apparently none of the cell phone service or pager service was allocated to B & S. As previously indicated, Mr. Rife reported that B & S has two employees. Based on this information, Staff recommends that B & S be allocated a portion of the cell phone and pager services. The cell phone service is for five lines. Mr. Rife reported that one cell phone is kept in each vehicle used by the affiliated companies and he carries one at all times. There is a pager for each employee of the affiliated companies. Test period expenses were reduced by $173 to account for redistribution of the cell phone expense equally to four companies and by $67 to account for redistribution of the pager expense to four companies.

One-half the cost of the lease payments made during the test period for a 1996 Chevrolet Blazer was also included in this account. Mr. Rife said the previous manager of Johnson County leased the vehicle. The lease expires on September 26, 1999 and the lease purchase option will not be exercised according to Mr. Rife. Because this expense will not be incurred after September 26, 1999, Staff recommends it be removed from test period expenses. This is a reduction of $2,039 to this account.

Staff agrees with the elimination of contract labor in the amount of $4,575. The total reduction to this account recommended by Staff is $6,854.

<u>Mains and Services Labor</u>

Johnson County proposed to reduce the contractual services for Bud Rife Construction recorded in this account by $15,131 leaving $5,600 in contractual services.

No analysis was provided to justify or explain the computation of the amount retained. Johnson County s adjustment to this account also included an increase of $28,080, which is 75 percent of the cost it proposed to hire two field employees. The remaining portion of the field employees salaries is addressed in Meter Reading Labor. Mr. Rife reported that the employees hired to work for Johnson County would not perform work for any of the other affiliated companies. The company proposed to hire a supervisor at a rate of $10 per hour for an annual wage of $20,800 (40 hours per week X 52 weeks X $10 per hour). A general laborer would also be hired at a rate of $8 per hour for an annual wage of $16,640 (40 hours per week X 52 weeks X $8). Mr. Rife said he established the hourly rates by informal discussions with other local utilities to determine the local pay rates. Mr. Rife plans to transfer one of the employees currently employed by B & H to the supervisory position for Johnson County. That individual is currently paid $7 per hour. Mr. Rife reported that all six individuals employed by B & H, Bud Rife Construction, and B & S currently earn around $7 per hour.

Since no justification was provided to retain $5,600 for contractual services, Staff recommends that the entire amount of $20,731 be removed. Staff takes note of the fact that all other companies owned by Mr. Rife pay employees less than the proposed levels for Johnson County. However, the proposed levels are not unreasonable and are in line with pay levels for other small utilities. Staff recommends acceptance of Johnson County s proposed adjustment for adding field employees. The net increase to this account is $7,349.

Mains and Services Supplies and Expenses

Johnson County proposed no adjustments to this account. Staff recommends reduction of the account by a total of $3,175 to remove from expense the cost of a flame pack and a calibrator kit. These items will benefit more than one period and should be capitalized. Provision for depreciation will be discussed under Depreciation Expense.

Rents

The $1,916 recorded in this account was to recognize the free gas provided to the estate of the previous owner of the gas system and to a landowner as compensation for locating a meter house on his property. According to the billing analysis, these entities used 966 Mcfs of gas. Since no recognition of the 966 Mcfs of gas provided was included in the gas sales computations, no offsetting expense should be recognized.

Meter Reading Labor

Johnson County proposed reducing this account by $4,575 for contractual services provided by Bud Rife Construction due to the proposal to add two field employees. Johnson County s pro forma adjustment also included an increase of $8,320 for 25 percent of the proposed wages for two employees. The proposal to hire field employees was discussed under Mains and Services Labor.

Staff agrees with the proposal to remove the allowance for contractual services from test period expenses. The company made an error in computing the increase for the addition of employees. Twenty-five percent of the proposed wages at the levels requested is $9,360 for a net increase to the account of $4,785.

Accounting and Collecting Labor

Test period expenses did not include provision for accounting and collecting labor since this function was provided under the management contract with Bud Rife. Johnson County proposed that a bookkeeping and billing clerk be hired at a pay level of $10 per hour for an annual wage of $20,800. Mr. Rife said the current office employee for B & H will probably be transferred to Johnson County. Her current salary from B & H is $7.50. He said she would not perform work for any of the other affiliated companies.

The salary level proposed for the bookkeeping and billing clerk is the same as that proposed for the field supervisor; however, the bookkeeping and billing clerk will not be supervising any other employees. Because of the difference in the level of responsibility, a slightly lower rate of pay would be appropriate. Staff has included provision for this employee at a rate of $8.75 per hour, or an annual wage of $18,200. This is half the difference between the current pay rate of $7.50 and the requested rate of $10.

Administrative and General Salaries

Test period expense included no provision for administrative and general salaries because the operation of Johnson County was handled through a management contract during 1998. Mr. Rife purchased the gas system in early 1999. Johnson County proposed a salary of $2,500 per month or $30,000 annually for Mr. Rife. During the field review, Mr. Rife reported that 35-40 percent of his time is devoted to Johnson County. He reports receiving the following salaries from his other companies:

B & H Gas	$15,000
B & S	15,000
Bud Rife Construction	35-40,000

The 1997 annual report for B & H Gas reports an $11,705 salary for Mr. Rife. The 1998 annual report listed a salary of $9,805. The 1997 financial statements for B & S provided in Case No. 98-523[1] gave no indication of a salary but showed a $14,000 withdrawal. The 1997 financial statements for Bud Rife Construction, also included in the case file for Case No. 98-523, reported payroll expense of $15,262 although it cannot be determined whether this salary was for Mr. Rife or another employee. It appears Mr. Rife may not have a set salary from any of the other affiliated companies and his compensation may depend on the companies financial results for the year.

The owner/manager salaries for small gas companies vary widely. The following were noted in the 1998 annual reports:

Elam Utility, Inc.	$49,350
Mike Little Gas Co.	21,333
Mountain Utilities, Inc.	32,300
Sigma Gas Co.	18,000
Gasco Distribution Systems, Inc.	15,428

Considering that Johnson County is still struggling to become financially stable, the $30,000 salary level suggested in the application appears excessive. Staff recommends a salary level of $15,000.

<u>Office Supplies and Expenses</u>

Johnson County did not propose any adjustments to this account. Staff reduced the account by $465 to adjust for a payment made to Mr. Rife for management services that was accounted for in Outside Services Employed. Test period expenses were

[1] Case No. 98-523, Application of Mr. Bud Rife and the Kentucky Municipal Gas Utility Investment Trust for the Approval of the Acquisition of the Stock of Johnson County Gas Company, Inc. of Paintsville, Johnson County, Kentucky, by Mr. Bud Rife and the Issuance of Two Promissory Notes Evidencing Certain Indebtedness of the JCGC.

reduced by $173 to account for redistribution of the cell phone expense equally to four companies as previously discussed under Operation Supervision and Labor. The total reduction recommended for this account is $638.

It was noted that some office supply expenses were allocated between two or three companies while others were paid entirely by Johnson County. General use office supplies should be allocated between all four companies that share office space using a reasonable allocation factor. No adjustment was made to test period expenses because it would be necessary to examine each invoice to determine whether it was for a specialized item that could be directly identified with a specific company and because any possible adjustment would not have had an impact on the final recommendation. However, for future financial reporting and future rate cases, Johnson County should take care to allocate these expenses in a reasonable and consistent manner to all companies that benefit from the expenses and keep adequate records to document the allocation.

Office utilities were also included in this account. Those items examined were allocated to Johnson County and two other companies. This expense should be allocated to all the companies that benefit from the expense. No adjustment was made because test period expenses did not include twelve months of utility expense so were somewhat understated. However, for future financial reporting and future rate cases, Johnson County should allocate office utilities to all the companies that share office space.

Outside Services Employed

Johnson County proposed reducing this account for the $60,000 management fee paid to Mr. Rife during the test period since the company has proposed hiring employees to provide services rather continuing the management service contract. The company also proposed increasing accounting services by $1,080 for preparation of quarterly financial statements required by the final order in Case No. 98-523. This represents ten hours at $54 per hour for two quarters. During the field review, the company s CPA said this adjustment should be doubled to include the preparation of financial statements for the remaining two quarters. Johnson County also requested $270, five hours at $54 per hour, for tax research. An addition of $1,350 for 25 hours of accounting services at $54 per hour was added for preparation of the rate case.

Staff agrees with the proposal to eliminate the management fee. Test period expenses included $1,000 for accounting services related to Case No. 98-523. Since this is a nonrecurring item, it should be removed from expenses. Staff recommends increasing expenses for accounting services by $2,160 to provide for the preparation of quarterly financial statements; however, there should be an offsetting reduction to the expense for the preparation of the annual report and tax returns since much of the work required will have been done in connection with the preparation of the quarterly statements. Staff recommends the annual report and tax preparation fee be reduced by $1,415. This leaves $4,106 in test period expenses for the preparation of quarterly statements, the annual report, and tax returns. Staff disagrees with the request to increase accounting services by $270 for tax research. According to the CPA, this research is related to the tax treatment of the debt restructuring and is a nonrecurring item. The requested rate case expense of $1,350 is not included here, but is addressed under Regulatory Commission Expenses. The total adjustment recommended to Outside Services Employed is a reduction of $60,255.

Property Insurance

No adjustments to test period expense were proposed by Johnson County. Staff recommends disallowing the expense for commercial property insurance for the office building since this is an expense normally paid by the property owner. This will reduce expenses by $183. Health insurance expense of $738 should also be eliminated from this account since it is provided for in Employee Benefits. A total adjustment of $921 is recommended for this account.

Injuries and Damages

The test period included no expenses in this account. Johnson County proposed increasing expenses by $4,259 for workers compensation coverage for the employees it intends to hire. A letter from Kentucky Farm Bureau Insurance Companies dated March 19, 1999 was provided as verification. The letter indicated the quote of $4,259 was based on an annual payroll of $87,000. Johnson County addressed this expense in Employee Benefits; however, the proper Uniform System of Accounts classification is Injuries and Damages.

Since Staff recommends reducing the annual payroll to a total of $70,640 (field supervisor - $20,800, general laborer - $16,640, bookkeeping & billing clerk - $18,200, owner/manager - $15,000), the cost of workers compensation coverage should be reduced proportionately. The quote of $4,258.74 divided by the payroll used for the estimate of $87,000 computes to a rate of $0.048951 per payroll dollar. Applying this rate to the recommended payroll of $70,640 results in an expense of $3,458 for workers compensation coverage.

Employee Benefits

Johnson County proposed increasing expenses by $5,905 to provide health insurance coverage for the three employees it plans to hire and for Mr. Rife. The cost per employee of $123 per month was based on the amount paid during 1998 for single coverage through Blue Cross/Blue Shield. Johnson County did not propose to allocate any of the expense for Mr. Rife s coverage to any of the other affiliated companies.

The cost per employee appears reasonable; however, staff recommends allocating the cost of Mr. Rife s coverage equally between the four affiliated companies. The recommended increase for health insurance coverage is $4,798 (($123.03 X 12 months X 3 employees) + ($123.03 X 12 months / 4)).

Regulatory Commission Expenses

The only expense reported for the preparation of this rate case is $1,350 for 25 hours of accounting services. Johnson County included the entire amount in pro forma expenses; however, it is normal ratemaking treatment to spread this type cost over several periods. Staff recommends that rate case expenses be amortized over three years for an increase to test period expenses of $450.

Miscellaneous General Expenses

No adjustments to this account were proposed by Johnson County. The test period expenses included $497 that could not be specifically identified. Staff reduced the account for this amount but recommends including membership dues to the Kentucky Gas Association in the amount of $264 and drug testing in the amount of $113 since these items are not included elsewhere. The net change recommended for this account is a decrease of $120.

Rents (Office)

Test period expenses included rent expense for office space for two months at $350 per month. Johnson County proposed to normalize this by increasing the expense by $3,500 ($350 X 10 months).

Mr. Rife owns the office building. According to the information provided by him, the monthly mortgage payment for the building is $998. Mr. Rife said Johnson County, B & H, and Bud Rife Construction each pay $350 per month for office rent (excluding utilities) for a total of $1,050. Staff recommends that office rent be allocated equally to all four companies instead of three. This would mean a monthly rent payment of $262.50 for each company ($1,050 / 4 companies). An increase of $2,450 is recommended for this account (262.50 X 12 months = $3,150 - $700 test period expense).

Transportation Expenses

Johnson County s pro forma adjustment to this account of $2,580 represented half the total annual lease cost of $5,160 ($430 per month X 12 months) for a 1997 4 WD Chevrolet S-10 extended cab truck. The truck was leased by Mr. Rife in June 1997. Mr. Rife said the truck is currently being used for Johnson County and he proposed that Johnson County assume the lease payments.

Mr. Rife said he leased the truck instead of purchasing to make sure he liked the vehicle. He expressed the intention to exercise the purchase option at the end of the lease. According to the lease agreement, the purchase price at the end of the lease term will be $14,250 plus taxes. Assuming Johnson County cannot pay cash, it would have to finance the purchase price and related taxes. Financing $15,075 (purchase price plus sales tax) over 36 months at 9% interest would require monthly payments of $479.38. The total paid for this truck over six years under this scenario would equal $32,743 (36 months X 430.14 monthly lease expense plus 36 months X 479.38 monthly cost to finance purchase option).

Based on information obtained from the internet site autoweb.com, it appears a new 2-door Chevrolet S-10 with long wheel base, 4 wheel drive, air conditioning, and automatic transmission can be purchased for approximately $20,179 including destination charge, title and license, and sales tax. Financing this amount over 60 months at the average rate for new car loans in Kentucky of 8.39% would require monthly payments of $413. The total payments under this scenario would be $24,780 (60 months X $413). The difference between this and the total cost paid under the previous scenario would be over $7,000 even after reducing the lease/purchase option cost by $569 in property taxes paid during the lease period.

Staff recommends that the requested amount of $5,160 be allowed for a vehicle because it is not materially different from the amount required to purchase a suitable truck when provision for property tax is included. This amount would be allowed in place of the cost of the lease for the 1996 Blazer. As explained under Operation Supervision and Labor, Staff recommends that the expense for the Blazer be eliminated from test period expense. Including this reduction of $2,039, the net change to the account is an increase of $3,121.

Johnson County should carefully analyze the costs of leasing versus purchasing future vehicles and be able to justify any decision from an economic standpoint in future rate cases. It should be noted that the lease agreement signed by Mr. Rife indicates the truck was leased with the understanding it would be used for personal, family or household use and the agreement indicates that there is a prohibition of transfer of the lessee s interest.

As previously noted, Mr. Rife said he spreads the expense for gasoline for the vehicle he uses to all the affiliated companies. He said he accomplishes this by randomly rotating the charge to the companies. This is not a systematic method of fairly allocating this expense. Assuming the vehicle is used exclusively for business, the time Mr. Rife devotes to each company would be a more appropriate allocation factor. This factor should be based on a time study covering several months at least. No adjustment was made for the amount of gasoline expense included in test period expenses. However, for future financial reporting and future rate cases, Johnson County should use a reasonable allocation factor to consistently distribute this expense to all the companies that benefit from the expense.

<u>Depreciation Expense</u>

Johnson County proposed a program to replace ten percent of its meters per year at a cost of $100 per replacement. Assuming approximately 500 meters in the system, this would entail replacing 50 meters each year with an increase to plant of $5,000 annually. Johnson County used a seven-year depreciable life for an annual increase to depreciation expense of $716.

In reviewing the depreciation schedule Johnson County provided in its application, the Commission s Engineering Staff determined a number of the depreciable lives used by Johnson County were not within the range normally considered acceptable by the Commission. Depreciation expense was recalculated using the undepreciated book balance and remaining useful life at 12/31/98, determined by considering the original in-service date and the useful life assigned by the Engineering Staff. Staff s calculation of depreciation expense is shown in Attachment 1. The change to depreciation expense due to the change in the depreciable lives is a reduction of $3,279 ($38,791 test period expense minus $35,512 staff computed expense).

Staff recommends that the proposal to increase depreciation expense for a plan to replace meters be disallowed. Johnson County has not initiated this program so it is not included in the historic test period. Additionally, it may not be necessary to replace all meters. It may be feasible to test and repair the meters rather than replacing them all. Test period expenses already include $2,680 for meter testing and repairing which should be adequate.

Staff recommended capitalizing a flame pack and a calibrator kit that were expensed during the test period. This is an increase to plant of $3,175. Depreciating this equipment over seven years will increase depreciation expense by $453. Staff recommends a net reduction to the depreciation expense account of $2,826.

<u>Taxes Other Than Income Taxes</u>

Johnson County proposed a reduction of $12,573 to remove 1994 and 1995 county property taxes and 1995 state property taxes from test period expenses. It also proposed an increase of $7,390 for payment of payroll taxes using an anticipated payroll of $88,240.

Staff agrees with the proposal to eliminate $12,573 in prior period taxes from the test period; however, an additional $1,436 should be eliminated for 1996 state property taxes and $410 for penalties and interest assessed due to the late payment of property taxes. Expenses should be increased by $4,814 for 1997 county property taxes that were not included in test period expenses. Staff recommends an increase of $6,044 for payroll taxes based on the payroll recommended for ratemaking purposes of $70,640. Staff also recommends normalizing the amount included in test year expenses for the PSC assessment. Using the Staff adjusted test year operating revenues and the PSC assessment rate for 1999, the normalized assessment is $333 ($199,773.37 normalized operating revenues X .001667). Test period expense of $527 would be reduced by $194 to reflect the normalized PSC assessment. The total adjustment recommended for this account is a decrease of $3,755.

Based on the recommendations proposed in this Staff Report, Johnson County s adjusted operations are as shown in Attachment 2.

Corporate income taxes have not been addressed. Given the increase requested by Johnson County compared to the pro forma operating expenses, the company would not be expected to have any taxable income and would not be expected to be liable for any income tax expense.

D. Revenue Requirements

In its application, Johnson County included a worksheet computing a revenue requirement using the operating ratio method. Using an 88 percent ratio, Johnson

County determined its revenue requirement to be $341,672; however, the company requested an amount smaller than it determined necessary to satisfy its revenue requirements due to the likelihood of losing customers if the entire requirement was recovered. Johnson County requested rates designed to produce total revenues of $267,280. It should be noted that Johnson County used unadjusted test period numbers in the revenue requirement calculation so none of its requested pro forma changes were reflected.

Staff has determined the net investment rate base for Johnson County to be $653,809 calculated as follows:

	12/31/98	Staff Adjustments	Staff Adjusted 12/31/98
Gas Plant in Service	$1,310,148	$3,175	$1,313,323
Accumulated Depreciaton	(673,975)	(222)	(674,197)
Working Capital		14,666	14,666
Total Rate Base	$636,173	$17,619	$653,793

Working Capital Allowance:	
Total Operating & Maintenance Expenses	$215,368
Less: Gas Purchases	(98,038)
Subtotal	117,330
Multipy by 1/8	0.125
Working Capital Allowance	$14,666

In Johnson County s past several rate cases, the Commission has calculated revenue requirements based on the return on net investment rate base method. Under this method, the utility s allowed return is applied to rate base to determine required operating income.

At this time, there is no net stockholder investment in Johnson County. Virtually all plant is supported by a government-subsidized loan bearing an interest rate of four percent. Using a six percent return, which is two percent greater than the cost of the capital supporting rate base, the required operating income would be $39,228. Considering the staff adjusted test period operating deficit of $75,308, the increase in revenues required using the rate of return on net investment rate base would be $114,674. This exceeds the requested increase of $78,639[2]. The calculation would be as follows:

Net Investment Rate Base	$653,792
Recommended Return	6%
Required Operating Income	39,228
Adjusted Operating Income	(75,308)
Revenue Deficit	$114,536

Considering Johnson County s concern that too large of an increase may result in a loss of customers, staff recommends that the rate increase be limited to the amount requested by the company. The increase of $78,639 should provide sufficient cash flow to allow Johnson County to meet its operating expenses.

Rate Design and Rates

Johnson County s current and proposed rates are as follows:

	Current	Proposed
Residential		
Customer Charge	$3.00	
All Mcf	$6.40	
Minimum Bill:0 2 Mcf		$17.50
All Additional Mcf		$ 8.85
Commercial		
Customer Charge	$3.00	
All Mcf	$6.40	
All Mcf		$ 9.85

[2] Total revenues at Johnson County s proposed rates $267,280

Total revenues at Johnson County s proposed rates		$267,280
Normalized revenue:		
Gas sales revenues	$166,067	
Customer charge revenues	17,460	
Other revenues	5,114	188,641
Increase requested		$ 78,639

In informal discussions with Staff prior to filing its application, Johnson County indicated that it proposed changing its residential rate design in order to produce greater revenues during the non-heating season to cover fixed costs. Staff recognizes the need to generate more revenue during the non-heating season but believes the proposed minimum bill is excessive and would be unfair to customers using less than 2 Mcf. All gas distribution companies have the same concerns about generating revenues in the off-season but only 2 of more than 30 distribution companies regulated by the Commission have a minimum bill that covers usage from 0 to 2 Mcf. All others have minimum bills that cover zero usage or 0 to 1 Mcf. Staff believes a significant increase in Johnson County s minimum bill is warranted, but that it should only cover usage of 0 to 1 Mcf. Due to the larger volumes consumed by Johnson County s commercial customers Staff accepts the proposed rate design for that customer class.

Based on the recommended level of revenues of $267,280, staff recommends the following rates for Johnson County:

	Residential	Commercial
Minimum Bill:		
0 1 Mcf	$10.50	
All Additional Mcf	$ 9.50	
All Mcf		$9.85

E. Signatures

Prepared By: Beverly B. Davis
Manager, Financial Audit Branch
Division of Financial Analysis

Prepared By: Dawn McGee
Public Utility Rate Analyst I
Electric and Gas Rate Design Branch
Division of Financial Analysis

ATTACHMENT 1 TO THE STAFF REPORT ON

JOHNSON COUNTY GAS COMPANY, INC., CASE NO. 99-155

Proforma Depreciation
12/31/99

Date	Description	Depr Life per JCGC	Depr Life per Staff	Depr Life Remaining	Cost	Accum Depr 12/31/98	Cost Not Yet Depr	Annl Exp Per Staff
09/15/89	Furniture	MACRS 5	fd		5,140	5,140	0	0
10/15/89	Mains	MACRS 15	35	25.78	1,546	1,064	482	19
02/05/90	Regulator	20	25	16.09	3,256	1,453	1,803	112
04/13/90	Safety Equipment	MACRS 7	fd		1,048	1,048	0	0
09/01/91	1991 Mains Relocate	30	35	27.66	4,388	1,071	3,317	120
01/01/81	Mains & Lines	35	nc		1,148,416	621,391	527,025	31,002
02/06/87	1" by 1" Regulator	20	25	13.09	712	494	218	17
03/12/87	1 A Meter	20	25	13.19	197	137	60	5
08/06/90	Mains Additions	30	35	26.59	1,479	413	1,066	40
06/14/91	Mains Additions 1991	30	35	27.45	10,058	2,541	7,517	274
08/09/91	Telephones	7	fd		424	424	0	0
12/01/91	Meter 1991	20	25	17.91	478	170	308	17
04/09/91	Equipment	7	fd		505	505	0	0
06/05/91	Equipment	7	fd		716	716	0	0
06/10/92	1992 Mains Addition	30	35	28.44	71,000	15,385	55,615	1,956
06/30/93	1993 Mains	15	35	29.49	49,417	18,117	31,300	1,061
05/10/94	1994 Mains	15	35	30.35	2,271	755	1,516	50
09/12/94	1994 Mains	15	35	30.70	625	210	415	14
11/09/94	1994 Mains	15	35	30.85	1,731	575	1,156	37
05/17/95	Odometer	7	15	11.37	1,723	904	819	72
09/15/95	Electric Generator	7	nc		615	293	322	88
03/14/97	Computer/Printer	7	nc		3,488	913	2,575	498
10/12/98	Copier	7	nc		917	33	884	131
					1,310,149	673,752	636,397	35,512

fd Fully Depreciated
nc No Change

ATTACHMENT 2 TO THE STAFF REPORT ON
JOHNSON COUNTY GAS COMPANY, INC., CASE NO. 99-155

Acct. Title	Test Year Amount	Staff Adjustments	Staff Adjusted Test Year
Total Gas Operating Revenues	$236,808	($48,167)	$188,641
Operating Expenses			
Natural Gas Purchased	127,566	(29,528)	98,038
Operations Supervision Labor	9,269	(6,854)	2,415
Mains & Services Labor	20,731	7,349	28,080
Mains & Services Supplies & Exp	9,552	(3,175)	6,377
Rents	1,916	(1,916)	0
Meter Reading Labor	4,575	4,785	9,360
Accounting & Collecting Labor	0	18,200	18,200
Supplies & Expenses	3,000	0	3,000
Administrative & General Salaries	0	15,000	15,000
Office Supplies & Expenses	3,259	(638)	2,621
Outside Services Employed	64,361	(60,255)	4,106
Property Insurance	5,669	(921)	4,748
Injuries and Damages	0	3,458	3,458
Employee Benefits	0	4,798	4,798
Regulatory Commission Expenses	0	450	450
Miscellaneous General Expense	3,237	(120)	3,117
Rents	700	2,450	3,150
Transportation Expense	5,328	3,121	8,449
Total Operation & Maint Expenses	259,163	(43,795)	215,368
Depreciaton Expense	38,791	(2,826)	35,965
Taxes Other Than Income	16,371	(3,755)	12,616
Total Gas Operating Expenses	314,325	(50,376)	263,949
Net Operating Income	(77,517)	2,209	(75,308)
Interest Expense		29,124	29,124
Net Income	($77,517)	($26,915)	($104,432)