COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF MIKE LITTLE GAS COMPANY, INC. FOR AN ADJUSTMENT OF RATES PURSUANT TO THE ALTERNATIVE RATE FILING PROCEDURE FOR SMALL UTILITIES	)))))	CASE NO. 2003-00141

O R D E R

On April 24, 2003, Mike Little Gas Company, Inc. (Mike Little) applied for an adjustment of rates pursuant to Administrative Regulation 807 KAR 5:076, the alternative rate filing procedure for small utilities. Having performed a limited financial review of Mike Little s operations, Commission Staff (Staff) has submitted to the Commission a report of its findings and recommendations regarding the proposed rate adjustment. All parties should review the report carefully and submit any written comments on Staff s findings and recommendations or requests for a hearing or informal conference no later than 20 days from the date of this Order.

IT IS THEREFORE ORDERED that all parties shall, no later than 20 days from the date of this Order, submit written comments, if any, regarding the attached Staff Report or request for a hearing or informal conference. If no request for a hearing or informal conference is received by this date, this case shall stand submitted to the Commission for a decision.

Done at Frankfort, Kentucky, this 22nd day of July, 2003.

By the Commission

ATTEST:

Thomas M. Dorman

Executive Director

STAFF REPORT

ON

MIKE LITTLE GAS COMPANY

Case No. 2003-00141

Preface

On April 24, 2003, Mike Little Gas Company, Inc. (Mike Little) filed an application with the Kentucky Public Service Commission (Commission) for a rate adjustment pursuant to Administrative Regulation 807 KAR 5:076, the Alternative Rate Filing Procedure for Small Utilities (ARF). Commission Staff (Staff) has determined that Mike Little is requesting a 25.7 percent increase in rates, resulting in an increase in revenues of $85,000. In order to meet the minimum filing requirements for an ARF, a utility must have less than 500 customers or less than $300,000 in gross annual revenues. Based on its customer level during 2002, Mike Little met the minimum requirements for an ARF application.

The Staff performed a limited financial review of Mike Little s operations for the test year ending December 31, 2002. On May 27, 2003, the Staff issued a letter specifying what information would be needed to assist it during the field review. Andrea Edwards and Dawn McGee of the Commission s Division of Financial Analysis performed the field review on June 2, 2003, at the business office of Mike Little in Melvin, Kentucky. Additional analysis of financial information was performed by the Financial Audit Branch.

Scope

The scope of the review was limited to obtaining information to determine whether test-year operating revenues and expenses, for the period ending December 31, 2002 as reported in Mike Little s application, were representative of normal operations. Mike Little did not propose any pro forma adjustments to the test year. Expenditures charged to test-year operations were reviewed, including any supporting invoices. Insignificant or immaterial discrepancies were not pursued and are not addressed herein.

Accounting and Record-Keeping Procedures

Mike Little s accounting records and procedures are subject to the requirements established by the Uniform System of Accounts (USoA) prescribed for natural gas companies in the Code of Federal Regulations (CFR), Title 18, Chapter 1, Subchapter F, as well as the financial reporting requirements prescribed by the Commission. Several deviations from the USoA and prescribed procedures and reporting requirements were disclosed. For rate-making purposes, the deviations are revenue-neutral. These deviations were previously addressed with the utility by the Financial Audit Branch.

Governing Statutes and Regulations

The operation of a utility in Kentucky is subject to the Kentucky Revised Statutes (KRS) and to the Kentucky Administrative Regulations (KAR). During the field review, Staff discovered that Mike Little was charging a returned check fee of $10, although the charge is not included its tariff as required under 807 KAR 5:011(2). Mike Little requested assistance from Staff in preparing the cost justification to increase its existing non-recurring charges including the returned check fee. The non-recurring charges will be discussed later in this report.

Staff Recommended Accounting and Rate-Making Adjustments

Mike Little presented its test-year operating statement based on its 2002 annual report. Mike Little has proposed no adjustments to its test-year operations. Staff has made adjustments where sufficient information is available from the field review or the public record to make the appropriate adjustment. Staff s evaluation of the adjustments is discussed below. Schedule I contains a pro forma income statement reflecting the allowable adjustments.

Normalized Revenues

Mike Little proposed normalized revenues of $331,019 based on its sales volume and rates for the test year. This amount includes $19,834.23 in surcharges due to a 1990 Federal Energy Regulatory Commission (FERC) case[1] and $214,107.05 in revenues generated by Mike Little s Purchased Gas Adjustment (PGA). It also includes $3,544 in Other Gas Revenues and $566 in Other Income which were actually non-recurring revenues.

Staff recommends that normalized revenues exclude the revenues generated from the FERC surcharge and the non-recurring amounts reported as Other Gas Revenues and Other Income. Staff recommends including $1,165 in Service Charge Revenue and $3,919 in Forfeited Discounts as determined in the course of its field review. In addition, Staff recommends that PGA revenues reflect the PGA rate

[1] FERC Docket TQ89-1-46-000, effective January 1, 1991.

proposed by Mike Little in Case No. 2003-00242,[2] which is to be effective August 1, 2003, resulting in PGA revenues of $257,975. Based on the adjusted amounts, Staff calculated normalized revenues in the amount of $356,026.

Purchased Gas Expense

Mike Little proposed normalized purchased gas expense of $226,481 based on purchased volumes of 34,749 Mcf and an average gas cost of $6.52 during 2002. Staff recommends normalizing Mike Little s purchased gas expense using the recently proposed PGA of $7.2721 per Mcf from Case No. 2003-00242 and the volumes used to determine the PGA revenues, resulting in a purchased gas expense of $257,975.

Meter Reading Labor

During the test year, Mike Little included an expense of $160 in Account No. 902, Meter Reading Labor. According to the supporting invoice, the expense was for repair to a furnace located in an adjacent portion of the building that is rented to the Post Office. It is not reasonable to include this expense for rate-making purposes because Mike Little does not own the building. Staff has removed the expense of $160 from the pro forma operating expenses.

Uncollectible Accounts

Although Mike Little did not report any Uncollectible Account expense for the test year, Staff has adjusted Account No. 904, Uncollectible Accounts, based on an analysis of Mike Little s 2002 inactive past due accounts of $2,416. Based on its

[2] Case No. 2003-00242, Purchased Gas Adjustment of Mike Little Gas Company, Inc.

analysis, Staff recommends an increase to the Uncollectible Account expense of $2,416.

Office Supplies and Expense

Mike Little reported $5,143 in Account No. 921, Office Supplies and Expenses, including $77 for garbage service. Mike Little states it was only billed for garbage service 3 months during the test year, had been billed for the wrong amount during the test year and the monthly bill frequently contained errors. Mike Little has corrected the billing problems and submitted copies of its current billing for garbage service which indicates an expense of $186 annually. Staff believes it is reasonable to use the corrected annual level of expense for rate-making purposes. Therefore, Staff has increased the garbage service expense by $109.

Property Insurance

In its 2002 annual report, Mike Little reported a balance of $13,032 in Account No. 924, Property Insurance. According to Mike Little s most recent invoices, it s current annual premiums for general liability and umbrella insurance policies total $14,108, an increase of $1,076. However, the commercial property policy, with a premium of $1,062, includes coverage for the building occupied by Mike Little, which it does not own. Using the loss limitation of the commercial property policy as a basis for allocation, 82.6 percent of the premium, or $877, would be the amount allocated to the building. Deducting this amount from the normalized premium of $14,108 leaves an expense of $13,231. This results in an increase to test year property insurance expense of $199 ($14,108 - $877 = $13,231 - $13,032 = $199). Accordingly, Staff has increased test year property insurance expense by $199.

Regulatory Commission Expense

During the test year, Mike Little reported $2,294 in Account No. 928, Regulatory Commission Expenses. This expense includes $868 of prior year PSC Assessment costs and $500 of penalties for late payment of the PSC Assessment. It is not reasonable to include these prior year expenses for rate-making purposes. The penalties do not represent recurring annual expenses to Mike Little and the test year PSC Assessment is properly recorded in Account No. 408, Taxes Other than Income Taxes. Therefore, Staff has decreased the expense by $1,368.

General Advertising Expense

During the test year, Mike Little reported $306 in Account No. 930.1, General Advertising Expense. This account includes an expense for $198 for t-shirts sponsoring the local high school. This type of advertising is promotional in nature and is not an allowable expense for rate-making purposes under 807 KAR 5:016 Section 4. Accordingly, Staff has decreased the expense by $198.

Miscellaneous General Expense

In its 2002 annual report, Mike Little reported an expense of $726 in Account No. 930.2, Miscellaneous General Expense. A summary of the major items in this account follows.

Merrill Lynch. Mike Little included an annual account fee of $300 paid to Merrill Lynch. Mike Little subsequently closed the account in January 2003. Therefore the expense is non-recurring and the Staff has decreased the expense by $300.

Bank Service Charge. Mike Little included bank service charges for 7 months totaling $101. The fees vary depending on the number of deposits made, the number of checks written, and the number of checks deposited each month. Based on the banking activity during the test year, Staff determined that the annualized bank service charge should be $180. Using the annualized amount, Staff has increased the expense by $79.

Customer Deposits. Mike Little returned customer deposits totaling $186 and recorded it as miscellaneous expense. The return of customer deposits should be reflected in the appropriate balance sheet accounts, and not as an operating expense. Staff has excluded the returned customer deposits from the operating expenses, resulting in a decrease of $186.

The net effect of the above adjustments is a decrease to Miscellaneous General Expense of $407.

Rent

Mike Little rents office and storage space in Melvin, Kentucky from its owners. The monthly rent expense is $1,500, or $18,000 annually. Staff has included this annual amount for rate-making purposes.

During the field review, Mike Little disclosed that there is no written rental agreement with the owners. The lack of a written rental agreement gives rise to the need for closer scrutiny as to whether the arrangement reflects an arms-length transaction. In addition, a review of Mike Little s records reveals that it has paid for repairs to the furnace, property insurance on the building, and property taxes on the building. As Mike Little rents its office space, it should not be responsible for such building expenses in addition to the monthly rent.

Staff recommends that Mike Little enter into a written agreement with the building owners for the office and storage space. The written rental agreement should specifically identify the rights and responsibilities of each party. The written rental agreement should be structured in a manner to demonstrate that the rent charged reflects an arms-length transaction. Concerning the expenses related to the building, as discussed in other sections of this Staff Report, those expenses have been excluded for rate-making purposes.

The Post Office rents space in the same building as Mike Little and pays its rent directly to Mike Little instead of to the owners. The Post Office rent is recorded in Mike Little s general ledger in Account No. 931, as is the remittance of the Post Office rent to the owners. Although this approach results in the Post Office rent not impacting operating expenses of Mike Little, the receipt and remittance of the Post Office rent should not be recorded on the books of Mike Little. Staff recommends that Mike Little no longer accept the Post Office rent payments for processing and that the building owners be informed they will have to make other arrangements to collect the rent from the Post Office.

Taxes Other Than Income Taxes

A review of the expenses included by Mike Little in Account No. 408.1, Taxes Other than Income Taxes revealed amounts that should not be included in the operating expenses. Property taxes of $1,032 for the building rented by Mike Little were included in the account. Since Mike Little rents its office and storage space, it should not also be responsible for the property taxes. Mike Little included $287 for Kentucky sales tax, which it collects on behalf of the Commonwealth and forwards to the Kentucky Revenue

Cabinet. The collection and remittance of the Kentucky sales tax should not be recorded as income or expense for Mike Little. Consequently, Staff has excluded these expenses for rate-making purposes.

Mike Little did not propose an adjustment to normalize its PSC Assessment. The PSC Assessment paid by Mike Little in the test year was based on gross operating revenues for calendar year 2001. Staff has recalculated the PSC Assessment to reflect the normalized revenues as determined in this report and to reflect the PSC Assessment rate currently in effect. The adjustment for the PSC Assessment is as follows:

Retail Revenues subject to PSC Assessment	$ 356,027
Rate of 1.823 per $1,000 revenue	(x) .001823
PSC Assessment computed	$ 649
Test Year PSC Assessment	$ (925)
Staff adjustment to PSC Assessment	$ (276)

The combined impact of these three adjustments is a reduction in expense of $1,596. Accordingly, Staff has reduced Taxes Other Than Income Taxes by $1,596.

Revenue Requirements

Mike Little did not explain how it determined the amount of increase it proposed in its application. Typically, a utility proposes a rate of return on a rate base or an operating ratio approach to determine its total revenue requirements. An operating ratio is used primarily when there is no sound basis for a rate of return determination using the required return on rate base method.

The Commission generally uses an 88 percent operating ratio to determine a reasonable level of earnings for small privately-owned utilities. For gas utilities, purchased gas expense is excluded from the operating ratio calculation since it is recovered through the PGA. Applying an 88 percent operating ratio to Staff s adjusted operating expenses results in a total revenue requirement of $417,280. As stated previously, Staff s adjustments result in adjusted test-year revenues of $356,027. Therefore, Staff recommends an increase in operating revenue of $61,253. This should provide adequate revenue to cover Mike Little s operating expenses and provide a reasonable rate of return.

Following is Staff s calculation of the revenue requirement:

Total Gas Operating Expenses		$402,638
Less:	Purchased Gas Expense	$(257,975)
	Subtotal	$144,663
Operating Ratio		88%
	Subtotal	$164,389
Add:	Purchased Gas Expense	$257,975
Less:	Other Gas Revenues	$(5,084)
Total Revenue Requirement		$417,280
Normalized Revenues		$356,027
Increase Required		$61,253

Rates and Charges

Non-Recurring Charges

During the field review, Mike Little indicated that it would like to increase its non-recurring charges and requested assistance with preparing the cost justification. Staff gathered the pertinent cost information and performed the required analysis. Based on the amount of time, travel and labor, Staff recommends the following increases in non-recurring charges:

	Currently Authorized	Staff Recommended	Resulting Increase
Returned Check Charge	-0-	$12.50	$12.50
Reconnection Charge	$25.00	$50.00	$25.00
Connection Charge	$25.00	$65.00	$40.00
Service Charge	$15.00	$35.00	$20.00

Mike Little did not propose to increase its non-recurring charges in its application, and, therefore, did not notice its customers of any increase for these charges. As required under 807 KAR 5:011 Section 9(2). Mike Little will need to give its customers a 30-day notice of these increases and provide proof of such notice to the Commission before it can place the Staff recommended non-recurring charges into effect.

Rates

Mike Little s current and proposed base rates are as follows:

	Current	Proposed
Residential/Commercial		
Melvin and Langley		
Minimum Bill 0 1 Mcf	$2.8211	$5.5138
Over 1 Mcf	$2.6040	$4.8616

Goble Roberts

Minimum Bill 0	1 Mcf	$3.4984	$5.5138
Over 1 Mcf		$2.4658	$4.8616

Mike Little s current tariff contains separate rates for the Melvin/Langley and Goble Roberts service areas. Mike Little proposes to apply only one rate to its service areas. Staff agrees with this approach in order to create rate equality between all of Mike Little s customers and simplify the billing process for Mike Little.

Based on its recommended revenues of $417,280, Staff recommends the following rates for Mike Little:

Residential/Commercial

Minimum Bill 0	1 Mcf	$5.50
Over 1 Mcf		$4.3271

Signatures:

Prepared By: Andrea Edwards
Public Utility Financial Analyst
Electric and Gas Revenue
Requirements Branch
Division of Financial Analysis

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

Schedule I
Mike Little Gas Company
Operating Statement

Acct. No.	Account Title	Test Year End Balance per Annual Report	Staff Adjustments	Staff Recommended Test Year Balance
	Operating Revenue			
481,482	Retail Sales	112,802	(19,834)	92,968
495.0	Other Gas Revenue	3,544	1,540	5,084
	Purchase Gas Revenue	214,107	43,868	257,975
	Total Operating Revenue	330,453	25,574	356,027
	Operation and Maintenance Expenses:			
804.0	Natural Gas Citygate Purchases	226,481	31,494	257,975
902.0	Meter Reading Labor	55,639	(160)	55,479
904.0	Uncollectible Accounts	0	2,416	2,416
920.0	Administrative and General Salaries	21,333		21,333
921.0	Office Supplies and Expenses	5,143	109	5,252
923.0	Outside Services Employed	9,761		9,761
924.0	Property Insurance	13,032	199	13,231
926.0	Employee Pensions and Benefits	2,418		2,418
928.0	Regulatory Commission Expenses	2,294	(1,368)	926
930.1	General Advertising Expenses	306	(198)	108
930.2	Miscellaneous General Expenses	726	(407)	319
931.0	Rents	17,996	4	18,000
	Total Operation and Maintenance Expenses	355,129	32,089	387,218
403.0	Depreciation	8,652		8,652
406.0	Amortization of Plant Acquisition Adjustment	689		689
408.1	Taxes Other Than Income	7,675	(1,596)	6,079
	Total Operating Expenses Before Income Taxes	372,145	30,493	402,638
	Net Operating Income (Loss) Before Income Taxes	(41,692)	(4,919)	(46,611)
	Other Income (Deductions)			
419.0	Interest and Dividend Income	202		202
421.0	Miscellaneous Non-operating Income	364		364
	Total Other Income (Deductions)	566		566
	NET INCOME	(41,126)	(4,919)	(46,045)