COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF VALLEY GAS, INC. FOR AN ALTERNATIVE RATE ADJUSTMENT	)))	CASE NO. 2022-00315

NOTICE OF FILING OF COMMISSION STAFF'S REPORT

Notice is hereby given that, in accordance with the Commission's Orders of November 22, 2022, February 17, 2023, and May 10, 2023, the attached report containing the findings of Commission Staff regarding the Applicant's proposed rate adjustment has been filed in the record of the above-styled proceeding. Pursuant to the Commission's November 22, 2022, February 17, 2023, and May 10, 2023 Orders, Valley Gas, Inc. (Valley Gas) is required to file written comments regarding the findings of Commission Staff no later than 14 days from the date of this report. The Commission directs Valley Gas to the Commission's July 22, 2021 Order in Case No. 2020-00085[1] regarding filings with the Commission.

Nancy Vinsel for

Linda C. Bridwell, PE
Executive Director
Public Service Commission
P.O. Box 615
Frankfort, KY 40602

DATED MAY 31 2023

cc: Parties of Record

[1] Case No. 2020-00085, *Electronic Emergency Docket Related to the Novel Coronavirus COVID-19* (Ky. PSC July 22, 2021), Order (in which the Commission ordered that for case filings made on and after March 16, 2020, filers are NOT required to file the original physical copies of the filings required by 807 KAR 5:001, Section 8).

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In the Matter of:

ELECTRONIC APPLICATION OF VALLEY GAS, INC. FOR AN ALTERNATIVE RATE ADJUSTMENT	)))	CASE NO. 2022-00315

COMMISSION STAFF'S REPORT
ON VALLEY GAS, INC.

Valley Gas, Inc. (Valley Gas) is a privately owned local gas distribution company (LDC) that provides retail natural gas in and around the city of Irvington in Breckinridge County, Kentucky. Its two shareholders own a separate business, Irvington Gas, that is not regulated by the Public Service Commission. Irvington Gas provides office and warehousing space, equipment, and staffing for which a portion of costs is allocated to Valley Gas. A detailed discussion of transactions between Irvington Gas and Valley Gas is included in Commission Staff's Supplemental Comments at the end of this staff report. During the 2021 test-year period, Valley served 421 residential customers and 50 commercial customers and one industrial customer.[1] Valley Gas has a single rate class for general service, which includes all residential, commercial, and industrial customers. Valley Gas's last regular rate adjustment was approved by the Commission in Case No. 2013-00150.[2]

[1] *Annual Report of Valley Gas to the Public Service Commission for the Year Ended December 31, 2021* (2021 Annual Report) at 26.

[2] Case No. 2013-00150, *Application of Valley Gas, Inc. for an Alternative Rate Adjustment* (Ky. PSC Nov. 5, 2013).

On September 16, 2022, Valley Gas tendered its application with the Commission requesting an adjustment to its gas service rates pursuant to 807 KAR 5:076. After curing deficiencies, Valley Gas's application was deemed filed as of October 24, 2022. Valley Gas last sought a base rate increase pursuant to the alternative rate filing procedure in Case No. 2013-00150.[3] Since that matter, Valley Gas has only adjusted its rates pursuant to purchased gas adjustments.

DISCUSSION

Using its pro forma test-year operations, Valley Gas determined that a base rate revenue increase of $59,255, or 15.43 percent, was necessary to achieve the revenue requirement shown in the table below.[4] However, Valley Gas's notice to customers reflected proposed rates that would increase bills by approximately 66 percent.[5]

Pro forma Operating Expenses Before Income Taxes	$	248,054
Operating Ratio		88%
Sub-Total		281,880
Less: Pro forma Operating Expenses Before Income Taxes	$	(248,054)
Net Income Allowable		33,826
Add: Provision for State and Federal Income Taxes		
Pro Forma Operating Expenses Before Taxes		248,054
Cost of Natural Gas		170,907
Total Revenue Requirement		452,787
Less: Other Operating Revenue		(9,409)
Total Revenue Required from Rates for Service		443,378
Less: Revenue from Sales at Present Rates		(384,123)
Required Revenue Increase	$	59,255
Required Revenue Increase Percentage		15.43%

[3] Case No. 2013-00150, Mar 6, 2014 Order.

[4] RevenueRequirementCalcualtion-operatingratio.pdf (filed Sept. 30, 2022).

[5] Valley Gas's Notice for Newspaper (filed Oct. 24, 2022) (October 24, 2022 Customer Notice).

To determine the reasonableness of the rates requested by Valley Gas, Commission Staff performed a limited financial review of Valley Gas's test-year operations. Additionally, Commission Staff conducted a field review on March 1, 2023, that included a review of documents and interviews with representatives of Valley Gas. Subsequent additional discovery took place between Valley Gas and Commission Staff via email correspondence and telephone discussion. On April 10, 2023, in accordance with 807 KAR 5:001E, Section 4(5), Commission Staff held an informal conference (IC) with Valley Gas. Commission Staff's memorandum summarizing the IC was filed on April 17, 2023.

The scope of Commission Staff's review was limited to determining whether operations reported for the test year were representative of normal operations. Known and measurable[6] changes to test-year operations were identified and adjustments made when their effects were deemed material. Insignificant and immaterial discrepancies were not necessarily pursued or addressed.

Commission Staff's findings are summarized in this report. Jeff Abshire and Noah Abner reviewed the calculation of Valley Gas's Overall Revenue Requirement and Sarah Jankowski and William Coston reviewed Valley Gas's reported revenues and rate design.

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[6] Commission regulation 807 KAR 5:076, Section 9, sets the standard for the determination of the reasonableness of proposed rates and states, in pertinent part, that the test period shall be "adjusted for known and measurable changes." *See also* Case No. 2001-00211, *Application of Hardin County Water District No. 1 for (1) Issuance of Certificate of Public Convenience and Necessity; (2) Authorization to Borrow Funds and to Issue its Evidence of Indebtedness Therefore; (3) Authority to Adjust Rates; and (4) Approval to Revise and Adjust Tariff* (Ky. PSC Mar. 1, 2002); Case No. 2002-00105, *Application of Northern Kentucky Water District for (A) an Adjustment of Rates; (B) a Certificate of Public Convenience and Necessity for Improvements to Water Facilities if Necessary; and (C) Issuance of Bonds* (Ky. PSC June 25, 2003); and Case No. 2017-00417, *Electronic Proposed Adjustment of the Wholesale Water Service Rates of Lebanon Water Works* (Ky. PSC July 12, 2018).

Purchased gas costs and gas transmission fees are excluded when determining base rate revenue.

SUMMARY OF FINDINGS

1. Overall Revenue Requirement and Required Revenue Increase. The Operating Ratio methodology is used when there is no basis for a rate of return determination, the cost of the utility has fully or largely been funded through contributions, or there is little or no outstanding long-term debt. Commission Staff finds the Operating Ratio method more appropriate because, at the time of Commission Staff's review, Valley Gas did not have any outstanding debt. Commission Staff is of the opinion that an operating ratio of 88 percent will allow Valley Gas sufficient revenues to cover its reasonable operating expenses and provide for reasonable equity growth. By applying the Operating Ratio method, as generally accepted by the Commission, Commission Staff found that Valley Gas's required revenue from gas sales is $225,337 to meet the Overall Revenue Requirement of $231,859 and that a $12,311 revenue increase, or 5.78 percent, to pro forma present base rate revenues is necessary to generate the Overall Revenue Requirement.

2. Gas Service Rates. Valley Gas currently provides retail gas sales to all customers under one general service rate schedule. Valley Gas did not propose any changes to its rate structure. The proposed rate schedule includes a monthly customer charge, a monthly gas base rate, and a gas cost recovery (GCR) rate. Valley Gas proposed to increase the monthly customer charge from $15.00 to $25.00, or 66.66 percent. Valley Gas proposed to increase the gas base rate from $3.0061 per Mcf to $5.0000 per Mcf, or 66.32 percent. The GCR rate is outside the scope of this rate filing

and is addressed in each quarterly purchased gas adjustment filing of Valley Gas. During the review process Valley Gas's representatives stated that they had not performed a cost of service study (COSS). In the absence of a COSS, Commission Staff recommends, that the allocation of revenues between fixed and volumetric charges remain the same. Commission Staff calculated a customer charge for the general service class by applying the percent of revenue that is currently recovered from the customer charge to the Commission Staff calculated revenue requirement. The rates found in the Appendix to this Commission Staff's Report are based on the $12,311 revenue increase that Commission Staff found to be warranted.

Based on the 5.78 percent increase recommended above, Commission Staff finds reasonable a monthly customer charge of $15.85 and a volumetric charge of $3.1821 per Mcf.

Valley Gas did not distinguish the average monthly residential usage from nonresidential usage in its application. Based on Valley Gas's 2021 Annual Report, its average monthly residential usage is 4.95 Mcf.[7] The average residential customer bill impact would be an increase of $1.72, from $29.88 to $31.60.

	Current	Proposed	Increase / (Decrease)	Percent
Tariffed Customer Charge	$ 15.00	$ 15.85	$ 0.85	5.67%
Average Monthly Customer Use Mcf	4.95	4.95		
Base Rate Per Mcf	$ 3.0061	$ 3.1821	$ 0.1760	5.85%
Total at Base Rate	$ 14.88	$ 15.75	$ 0.87	5.85%
Average Customer Bill	$ 29.88	$ 31.60	$ 1.72	5.76%

[7] 2021 Annual Report at 26. 24,998 Mcf / 421 customers / 12 months = $4.95 Mcf/customer/month.

3. Nonrecurring Charges. Valley Gas proposed to increase its Collection Charge from \$43.00[8] to \$75.00 and Reconnect Charge from \$18.00 to \$25.00.[9] Valley Gas did not propose any changes to its Returned Check Charges. Following the Commission's recent decisions,[10] Commission Staff reviewed all of Valley Gas's Nonrecurring Charges. The Commission found that because personnel are currently paid during normal business hours and wages are already recovered in rates, estimated labor costs previously included in determining the amount of Nonrecurring Charges should be eliminated from the charges to avoid double recovery of the same expense. Commission Staff reviewed the most recent cost justification information provided by Valley Gas and has adjusted those charges by removing Field Labor Costs and Office/Clerical Labor Costs from those charges as follows:

Description	Current	Revised
Collection Charge	\$18	\$6
Returned Check Charge	\$25	\$0
Reconnection Charge	\$43	\$25

[8] Valley Gas misreported its Collection Charge as \$40.00 in its customer notice. Valley Gas's Tariff shows a Collection Charge of \$43.00 in KY PSC No. 1, Original Sheet No. 1.1.

[9] October 24, 2022 Customer Notice.

[10] Case No. 2020-00141, *Electronic Application of Hyden-Leslie County Water District for an Alternative Rate Adjustment* (Ky. PSC Nov. 6, 2020); Case No. 2020-00167, *Electronic Application of Ohio County Water District for an Alternative Rate Adjustment* (Ky. PSC Dec. 3, 2020); Case No. 2020-00196, *Electronic Application of West Daviess County Water District for an Alternative Rate Adjustment* (Ky. PSC Dec. 30, 2020); and Case No. 2020-00195, *Electronic Application of Southeast Daviess County Water District for an Alternative Rate Adjustment* (Ky. PSC Dec. 30, 2020).

PRO FORMA OPERATING STATEMENT

Valley Gas's Pro Forma Operating Statement for the test year ended December 31, 2021, as determined by Commission Staff, appears below. Valley Gas did not propose any adjustments to its pro forma operating statement.

	Test Year	Adjustment	(Ref)	Staff Pro Forma
Operating Revenues				
Sales of Gas				
Gas Revenues (Customer Charge and Base Rate)	$ 384,123	$ (171,097)	(A)	$ 213,026
Other Operating Revenues				
Forfeited Discounts	4,819	0		4,819
Miscellaneous Service Revenues	4,590	(2,912)	(B)	
		25	(B)	1,703
Total Operating Revenues	393,532	(173,984)		219,548
Operating Expenses				
Operation and Maintenance Expenses				
Other Gas Supply Expenses	170,907	(170,907)	(C)	0
Distribution Expenses	77,509	(5,260)	(D)	72,249
Customer Accounts Expenses	16	0		16
Administrative and General Expenses	154,527	(9,843)	(E)	
		(7,491)	(F)	
		(3,544)	(G)	
		(30,000)	(H)	103,649
Total Operation and Maintenance Expenses	402,959	(227,045)		175,914
Depreciation	8,585	6,391	(I)	
		1,498	(F)	16,474
Taxes Other Than Income	7,417	(1,277)	(J)	
		5,508	(K)	11,648
Total Operating Expenses	418,961	(214,925)		204,036
Utility Operating Income	$ (25,429)	$ 40,941		$ 15,512

(A) Billing Analysis Adjustment. Valley Gas reported total test period operating revenues from gas sales of $384,123. However, included in this amount are purchased gas costs and gas transmission fees. These costs are recovered by Valley Gas through its purchased gas adjustment and are excluded when determining base rate revenue.

Valley Gas has a single industrial customer that is served by Valley Gas under a Special Contract approved by the Commission in Case No. 2014-00368.[11] The terms of the special contract allow the industrial customer to establish a separate gas procurement contract with Valley Gas's gas supplier, Constellation Energy (Constellation), and transport the gas through Valley Gas's system at a reduced transportation fee that is less than the base rate paid by other customers. Should the industrial customer procure its gas from Constellation, then any gas supply related costs for the industrial customer would be excluded from Valley Gas's GCR rate calculation.[12] A provision is included in the special contract that allows the industrial customer an option to purchase gas directly from Valley Gas and revert to Valley Gas's tariffed rates, including the GCR rate.

In the April 11, 2023 IC, Commission Staff met with representatives of Valley Gas to discuss the terms of the special contract. During the IC, Commission Staff was informed that the industrial customer did not enter into a separate contract with Constellation and that the industrial customer has been purchasing its natural gas directly from Valley Gas. Under the terms of the special contract, the industrial customer should pay Valley Gas the tariffed rates, which would be the monthly \$15 customer charge, the quarterly GCR rate, and the current \$3.0061 per Mcf usage rate. However, Valley Gas informed Commission Staff that it has been charging the industrial customer a monthly \$489 meter charge rate in lieu of the monthly \$15 customer charge tariff rate.[13] Valley

[11] Case No. 2014-00368, *Valley Gas, Inc. Request for Approval of a Special Contract With Mago Construction Company and a Deviation from the Gas Cost Adjustment Clause* (Ky. PSC Oct. 28, 2014).

[12] Because the industrial customer with a special contract is excluded from Valley Gas's GCR rate calculation, that industrial customer would not be charged Valley Gas's quarterly GCR rate. The GCR rate for Valley Gas should only be charged to end use customers that purchase the gas procured by Valley Gas.

[13] April 11, 2023 IC Memo (Ky. PSC Apr. 17, 2023).

Gas was unable to provide a cost justification for the monthly $489 meter charge at the time of the IC. Commission Staff recommends that the Commission base the revenues from base gas rates of the industrial customer on the tariffed rates and exclude the monthly $489 meter charge from revenues. A utility can only bill its customers rates and charges approved by the Commission pursuant to KRS 278.160. Commission Staff's recommendation is based on the fact that neither the current tariff nor the special contract includes a Commission-approved $489 meter charge. Additionally, due to the unauthorized charging of a non-Commission approved rate, Commission Staff recommends that the Commission open an investigation into the special contract between Valley Gas and the industrial customer approved by the Commission in Case No. 2014-00368.

In 2021, Valley Gas reported gas sales of 42,662 Mcfs to 471 customers.[14] By applying the gas deliveries to the current rate of $3.0061 per Mcf and the test-period customer level to the monthly customer charge of $15.00, Commission Staff calculated the revenues from base gas rates of $213,026 as show below.

		Current
Tariffed Customer Charge	$	15.00
Number of Customers		471
Monthly Customer Charge Revenues	$	7,065
		12
Annual Customer Charge Revenues	$	84,780
Base Rate Per Mcf	$	3.0061
Mcf Deliveries		42,662
Volumetric Revenues	$	128,246
2021 Normalized Base Rate Revenues	$	213,026
Reported Gas Revenues ( )		(384,123)
Net Adjustment	$	(171,097)

[14] 2021 Annual Report at 26 and 37.

Commission Staff recommends that the Commission decrease operating revenues from gas sales by $171,097 to eliminate both the purchased gas costs and gas transmission fees, and to adjust the billing analysis as calculated above.

(B) Miscellaneous Service Revenues. As discussed above, Commission Staff followed Commission precedent and made adjustments to the Nonrecurring Charges which results in a decrease to the charges and an increase to total revenue requirement of $2,912 as shown below.[15]

Description	Occurrences	Current Rate	Reported Revenue	Calculated Revenue	Increase / (Decrease) Revenue	Revised Rate	Pro Forma Revenue	Increase / (Decrease) Revenue
Collection Charge	213	$18	3,834	3,834	0	$6	1,278	(2,556)
Returned Check Charge	2	$25	40	50	10	$0	0	(50)
Reconnection Charge	17	$43	680	731	51	$25	425	(306)
Not Identified			36		(36)			0
Totals	232		$ 4,590	$ 4,615	**$ 25**		$ 1,703	**$ (2,912)**
Reference					(B)			(B)

Commission Staff notes that in one occurrence, Valley Gas charged $15 rather than the approved tariff amount of $25 for a returned check charge. In all 17 occurrences, Valley Gas charged $40 rather than the approved tariff amount of $43 for Reconnection Charges. KRS 278.160(2) states that "[n]o utility shall charge, demand, collect, or receive from any person a greater or less compensation for any service rendered or to be rendered than that prescribed in its filed schedules, and no person shall receive any service from any utility for a compensation greater or less than that prescribed in such schedules." All utilities regulated by the Commission are responsible for ensuring that the rates and charges it bills customers match its approved rates and charges and that the tariffs on file with the Commission reflect those rates and charges. While the forgone

[15] Case No. 2020-00141, November 6, 2020 Order.

revenue to Valley Gas of $51 was minimal, Commission Staff notes that Valley Gas's failure to charge the correct tariff rate was also noted in a prior case.[16] Commission Staff recommends that the Commission initiate an investigation regarding Valley Gas's compliance with approved tariff rates, pursuant to KRS 278.160, KRS 278.250, KRS 278.260, and KRS 278.270; and, upon a finding of a willful violation of a provision of KRS Chapter 278, Commission regulation, Commission Order, or tariff provision, that Valley Gas and its officers, agents, and employees may be assessed a civil penalty up to $2,500 per occurrence and per person.

(C) Gas Supply Expenses. Valley Gas reported net natural gas purchases and transmission fees of $170,907.[17] Given that the natural gas purchases and transmission fees are recovered through Valley Gas's purchased gas adjustment, Commission Staff proposes that operating expenses by reduced by $170,907 to exclude these costs from the determination of Valley's revenue requirement.

(D) Distribution Expenses – Mains and Services. Commission Staff identified a $5,260.26 payment to Discover Card that Valley Gas stated was erroneously paid from Valley Gas's cash account rather than Irvington Gas's account. Commission Staff removed the charge from Distribution Expenses.

(E) Administrative and General Expenses - Adjustment. Commission Staff identified two expenditures totaling $14,764.20 that will recur periodically, but not annually. Based on discussions with Valley Gas representatives, Commission Staff recommends amortizing the expenditures for ratemaking purposes over a three-year

[16] Case No. 2013-00150, November 5, 2013 Order at 7.

[17] 2021 Annual Report at 28.

period as shown below. Commission Staff proposes a reduction of $9,843 for this adjustment.

Date	Supplier	Description	Invoice Amount	Estimated Frequency of Recurrence (Years)	Adjustment (Years)	Adjustment
12/10/2021	USDI	Training	6,372.20	3	2	4,248.00
08/06/2021	USDI	Audit / Manual	8,392.00	3	2	5,595.00
Total			$ 14,764.20			$ 9,843.00

(F) Administrative and General Expenses – Reclassified to Fixed Assets. Commission Staff identified two expenditures totaling $7,491.73 that should be capitalized and depreciated over five years. The expenditures were removed from Administrative and General Expenses and 20 percent of the cost, or $1,498, was added to depreciation expense.

Date	Supplier	Description	Invoice Amount	Depreciation Life	Depreciation Adjustment
08/25/21	Rural Computer	MS Surface Pro	1,081.96	5	216.39
08/25/21	Rural Computer	Mobile Office On the Go (software)	6,409.77	5	1,281.95
Total			$ 7,491.73		$ 1,498.34

(G) Administrative and General Expenses – Vehicle Expenses. Commission Staff recommends three expenses totaling $3,544.29 be disallowed. The amounts were paid to American Express and charged to "Vehicle Expense – 874." The President of Valley Gas, Kerry Kasey, explained that because Valley Gas does not own a vehicle, he paid the fuel bill for three months out of Valley Gas's cash rather than Irvington Gas. Commission Staff cannot conclude that the amounts paid are either directly attributable to Valley Gas's activities or proportionate to its share of cost and Valley Gas failed to provide sufficient evidence to support this request. The financial information provided cannot be relied upon as sufficient evidence to support the requested increase. Under KRS 278.190(3), a utility requesting a rate increase has the burden of proof to show that the rates it seeks are just and reasonable.[18] In reaching a decision on whether rates are fair, just and reasonable, there must be sufficient evidence of record for the Commission, as the trier of fact, to weigh. Commission Staff cannot reasonably rely on the information provided by Valley Gas for Vehicle Expenses.

Date	Supplier	Invoice Amount
05/27/21	American Express	561.61
10/01/21	American Express	1,110.07
12/04/21	American Express	1,872.61
Total		$ 3,544.29

(H) Administrative and General Expenses – Management Fee. Valley Gas recorded a charge of $30,000 from Irvington Gas that was classified as "Mgmt Fees – 923" in its test-year general ledger. Valley Gas did not provide documentation or justification in support of the charge for ratemaking purposes. In Case No. 2011-00010, the Commission excluded the management fee from expenses.[19] In Case No. 2011-00010, the Commission Staff report, for which recommendations were adopted in the final order, referred to Case No. 2007-00436, stating, "In its decision in Case No. 2007-00436, the Commission stated that 'the reasonableness of the [owner-manager] fee will depend on the circumstances of the particular utility, to include its owner's responsibilities and duties and the size and complexity of the sewer utility's operations.'" It further stated that

[18] *See also Kentucky American Natural Gas Co. v. Commonwealth ex rel.* Cowan, 847 S.W.2d 737. 741 (Ky. 1993) (stating that burden of proof for a rate increase is on the applicant requesting the rate increase).

[19] Case No. 2011-00010, *Application of Valley Gas, Inc. for an Alternative Rate Adjustment* (Ky. PSC Jul 5, 2011).

"as payment of an owner-manager fee is not an arm's-length transaction, the utility must demonstrate by substantial evidence that the fee is reasonable." The Commission has previously disallowed recovery of management fees for the same reason.[20] Valley Gas did not demonstrate that the fee being reported is reasonable. It did not provide evidence of a contractual arm's-length transaction given that Valley Gas and Irvington Gas have shared ownership. In addition, Valley Gas did not provide documentation of activities that support a management fee.

(I) Depreciation Expense – Capital Expenditures Subsequent to Test Year. During the year ended December 31, 2022, Valley Gas purchased two capital equipment items totaling $77,835.41. Pro forma depreciation expense was increased by $6,391 as shown in the table below.

Item	Description	Cap Date	Cost	Book Depreciation Life	NARUC Life	Full Year Depreciation
118	RT45 Trencher (Ditch Witch)	10/12/22	69,636.68	7.00	12.50	5,571.00
119	Meters	11/18/22	8,198.73	7.00	10.00	820.00
	Adjustment		$ 77,835.41			$ 6,391.00

(J) Taxes Other Than Income – Property Taxes. Irvington Gas recorded $1,276.72 as paid to the city of Irvington on September 10, 2021, and provided documentation that the payment was for 2018 taxes due in 2019. Commission Staff reduced Other Taxes for $1,276.72 because the expenditure does not represent 2021 expenses.

[20] Case No. 2019-00109, *Electronic Application of Citipower, LLC for (1) an Adjustment of Rates Pursuant to 807 KAR 5:076; (2) Approval for a Certificate of Public Convenience and Necessity to Purchase Pipeline and Other Related Assets; and (3) Approval of Financing* (Ky. PSC Mar. 25, 2020); Case No. 2017-00160, *Application of Citipower, LLC for a Rate Adjustment for Small Utilities Pursuant to 807 KAR 5:076* (Ky. PSC Oct. 27, 2017); and Case No. 2008-00392, *Application of Citipower, LLC for a Rate Adjustment for Small Utilities Pursuant to 807 KAR 5:076* (Ky. PSC Apr. 3, 2009).

(K) Taxes Other Than Income – FICA. Valley Gas reported $72,000 in salary compensation but did not report any FICA on the salaries. Commission Staff calculated taxes of $5,508 based on a contribution rate of 7.65 percent and increased Taxes Other Than Income accordingly.

OVERALL REVENUE REQUIREMENT AND REQUIRED REVENUE INCREASE

By applying the operating ratio method, Commission Staff determined Valley Gas's Overall Revenue Requirement to be $231,859. Commission Staff calculated a revenue increase of $12,311, or 5.78 percent, is necessary to generate the Overall Revenue Requirement. Commission Staff's calculation of the Overall Revenue Requirement and the Required Revenue Increase using the Operating Ratio method is shown below.

	Valley Gas	Commission Staff
Pro forma Operating Expenses Before Income Taxes	$ 248,054	$ 204,036
Operating Ratio	88%	88%
Sub-Total	281,880	231,859
Less: Pro forma Operating Expenses Before Income Taxes	(248,054)	(204,036)
Net Income Allowable	33,826	27,823
Add: Provision for State and Federal Income Taxes		
Pro Forma Operating Expenses Before Taxes	248,054	204,036
Cost of Natural Gas	170,907	0
Total Revenue Requirement	452,787	231,859
Less: Other Operating Revenue	(9,409)	(6,522)
Total Revenue Required from Rates for Service	443,378	225,337
Less: Revenue from Sales at Present Rates	(384,123)	(213,026)
Required Revenue Increase	$ 59,255	$ 12,311
Required Revenue Increase Percentage	15.43%	5.78%

COMMISSION STAFF'S SUPPLEMENTAL COMMENTS

Commission Staff identified one information item and three items of concern that warrant further comment during the review.

1. Information Technology (IT) Expense Impacts Valley Gas incurred higher information technology expenses during 2020, 2021, and 2022 for outside services that do not have an offsetting cost reduction at this time. Valley Gas specifically noted the utilization of one supplier for technical training, safety audit, and documentation manuals that recur periodically but not annually. Additionally, many information technology functions were shifted to fee-based cloud systems. Neither of these activities resulted in corresponding expense reductions but may improve Valley Gas's ability to meet compliance and to manage its administrative and financial activities. This is noted because the net cost increase to Valley Gas's operations is a trend, not an anomaly. Valley Gas should ensure that future IT expenditures are designated as either recurring annually or, if periodic in nature, it should specify the frequency of recurrence to ensure that the cost is properly reflected in its rates.

2. Non-Arm's-Length Transactions / Documentation Issues. Irvington Gas charged Valley Gas for expenses displayed in the table below. Mr. Kerry Kasey, shareholder, stated that he could not find the agreement between Irvington Gas and Valley Gas for the annual billing of utilities and rent, and asserted that the Commission received a copy of the agreement in the past.

Utilities	$ 4,490.00
Labor	9,360.00
Management Fees	30,000.00
Insurance	6,847.76
Rent	6,000.00
Salaries	36,000.00
Total	$ 92,697.76

Commission Staff requested an estimation of hours spent managing Valley Gas, but Valley Gas did not provide any supporting information. Commission Staff recommends that all the charges, with the exception of the management fees, be accepted as they appear reasonable and have historically been accepted in prior cases. Commission Staff recommends that the management fee be disallowed because the expense is not supported by evidence. Additionally, both Valley Gas owners are paid a salary, which is allocated from Irvington Gas. Valley Gas did not provide evidence justifying payment of a management fee in addition to a salary. Further, Commission Staff determined that Irvington Gas expenses are improperly intermingled with expenses attributed to Valley Gas, which creates a question regarding the corporate relationship between the two entities that share common ownership and interests.

For transactions between a utility and its parent or affiliate, the Commission has historically held that:

> [t]he burden of proof is on the utility to demonstrate that the outcome of the transaction is fair, just and reasonable, and is substantially the equivalent of an arm's-length transaction. Moreover, if this burden of proof is not met, the Commission will not allow proposed adjustments resulting from such transactions for rate-making purposes.[21]

Further Commission Staff recommends Valley Gas be required to submit, and annually update, a formalized cost-sharing agreement with Irvington Gas to the Commission by

[21] Case No. 2018-00433, *Application of B & H Gas Company for an Alternative Rate Adjustment* (Ky. PSC July 30, 2019) at 4 (quoting Case No. 9269, *Application of Public Service Utilities, Inc., - Boone Creek for a Rate Adjustment Pursuant to the Alternative Rate Filling for Small Utilities* (Ky. PSC Oct. 2, 1985) at 3).

December 31, 2023, to be effective for the 2023 reporting year and going forward. This will provide Valley Gas with appropriate documentation to support its future rate requests.

3. Forfeited Discounts. Commission Staff did not recommend any adjustments to Valley Gas's test-year Forfeited Discounts. However, during its historical review of Forfeited Discounts, Commission Staff noted that the amount reported for 2020 exceeded the amounts reported for each of 2019 and 2021 as shown below.

Year	Amount
2019	$ 4,316
2020	$ 5,773
2021	$ 4,819

Commission Staff reviewed the 2020 general ledger activity and identified approximately $2,721.66 (50 percent of March 2020 and 100 percent of April through December 2020) in residential forfeited discounts that were billed during the late fee moratorium period of March 16, 2020, through December 31, 2020, that was established in Case No. 2020-00085.[22] During the field review, Mr. Kasey stated that Valley Gas likely billed the amounts and that if they were in error or contrary to the order, that Valley Gas would reimburse the customers. Commission Staff recommends that, pursuant to KRS 278.160, KRS 278.250, KRS 278.260, and KRS 278.270, the Commission open an investigation into the alleged violation of a Commission Order and, upon a finding of a willful violation of a Commission Order, that Valley Gas and its officers, agents, and employees may be assessed a civil penalty up to $2,500 per occurrence per person penalties pursuant to KRS 278.990.

[22] Case No. 2020-00085, Sept. 21, 2020 Order at 7 (finding that late fees shall not be assessed on any past due residential amounts accrued between March 16, 2020, and December 31, 2020, following the December 31, 2020 deadline).

4. Gas Cost Recovery Rate. In Case No. 2014-00368, the Commission approved the special contract between Valley Gas and the industrial customer while also granting a deviation that would allow the industrial customer's gas supply cost to be excluded from Valley Gas's GCR rate mechanism in accordance with the terms of the special contract.[23] In Case No. 2018-00089, Valley Gas's GCR rate report began to explicitly depict the removal of the industrial customer's volumes and gas supply costs from the calculation of the Expected Gas Cost and current quarter Actual Adjustment component.[24] It is unknown if prior GCR rate report filings removed the industrial customer's volumes and gas supply costs in its calculations based on the record of those cases. Commission Staff recommends the Commission open an investigation pursuant to KRS 278.160, KRS 278.250, KRS 278.260, and KRS 278.270, into Valley Gas' GCR rate report to determine the amount of purchased gas cost revenue that has been under- or overcollected since the industrial customer's gas supply cost have been removed from the GCR rate calculation, yet the customer has been charged the GCR rate.

[23] Case No. 2014-00368, Oct. 28, 2014 Order at 5.

[24] Case No. 2018-00089, *Purchased Gas Adjustment Filing of Valley Gas, Inc.* (filed. Mar. 5, 2018).

Signatures

__/s/ Jeff Abshire______________________
Prepared by: Jeff Abshire
Revenue Requirement Branch
Division of Financial Analysis

__/s/ Noah Abner______________________
Prepared by: Noah Abner
Revenue Requirement Branch
Division of Financial Analysis

/s/ Sarah Jankowski with permission by William Coston
Prepared by: Sarah Jankowski
Rate Design Branch
Division of Financial Analysis

/s/ William Coston______________________
Prepared by: William Coston
Director of Financial Analysis
Division of Financial Analysis

APPENDIX

APPENDIX TO COMMISSION STAFF'S REPORT OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2022-00315 DATED MAY 31 2023

The following rates and charges are prescribed for the customers in the area served by Valley Gas, Inc. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under the authority of the Commission prior to the effective date of this Order.

Commission Staff Calculated Monthly Gas Rates:

General Service

	Base Rate	Gas Cost Recovery Rate *	Total
Customer Charge	$15.85		
All Mcf	3.1821	$3.4612	$6.6433

*Gas Cost Recovery Rate approved in Case No. 2023-00065 effective April 1, 2023.

Nonrecurring Charges

Collection Charge	$ 6.00
Returned Check Charge	$ 0.00
Reconnection Charge	$25.00

*Cova Haynes
Valley Gas, Inc.
401 S First Street
P. O. Box 366
Irvington, KY 40146

*Kerry R Kasey
President
Valley Gas, Inc.
401 S First Street
P. O. Box 366
Irvington, KY 40146

*Valley Gas, Inc.
401 S First Street
P. O. Box 366
Irvington, KY 40146