

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC TARIFF FILING OF HAY)	
EXPLORATION, INC. FOR INITIAL RULES,)	CASE NO.
REGULATIONS, AND RATES FOR FURNISHING)	2023-00152
GAS SERVICE PURSUANT TO KRS 278.485)	

ORDER

On April 19, 2023, Hay Exploration, Inc. (Hay Exploration) filed a proposed tariff to establish initial rules, regulations, and rates to serve farm tap customers, pursuant to KRS 278.485 and Commission regulation 807 KAR 5:026, which govern natural gas gathering systems that provide services to retail customers who connect to such systems. Hay Exploration did not propose an effective date; however, pursuant to KRS 278.180(1), the earliest the proposed tariff could be effective is May 19, 2023, which is 30 days after the filing of the proposed tariff. On May 15, 2023, the tariff filing was suspended pursuant to KRS 278.190(2) for five months up to and including October 18, 2023, to investigate the reasonableness of the proposed tariff.

The May 15, 2023 Order also established a procedural schedule for the timely processing of the case. Hay Exploration responded to three rounds of discovery from Commission Staff and was granted a motion for an extension of time for responses to Commission Staff's Second Request for Information (Staff's Second Request) to be filed 30 days after the deadline.¹ On August 31, 2023, the Commission, upon granting Hay

¹ Staff's Second Request had a procedural schedule deadline of July 14, 2023. Hay Exploration did not respond to the request for information until August 9, 2023.

Exploration's motion for an extension of time, issued an amended procedural schedule. Hay Exploration had up to and including October 6, 2023, to request a hearing or a request that this matter be decided on the evidentiary record. Hay Exploration filed neither. There are no intervenors in this proceeding. By the Commission's own motion this matter now stands submitted for a decision on the written record.

LEGAL STANDARD

The Commission has exclusive jurisdiction over the regulation of rates and services of utilities in Kentucky,² including natural gas distribution companies. KRS 278.190 permits the Commission to investigation any schedule of new rates to determine its reasonableness.

The Commission also has jurisdiction to regulate the retail rates of gas pipeline companies that do not meet the definition of a utility but provide limited retail gas service pursuant to KRS 278.485. This statute requires every company obtaining natural gas from producing wells located within the state to furnish retail gas service to owners of property located within one-half air mile of one of the company's wells or gathering lines by direct tap, known as a farm tap, on the company's piping. A gas producer or gathering line operator that provides only farm tap service is not a utility as that term is defined in KRS 278.010 because service is not furnished to the public but is restricted to owners of property near the production or gathering facilities.

As to the rates that gas pipeline companies providing farm tap service may charge, KRS 278.485 in pertinent part provides only that "[t]he gas service shall be furnished at rates and minimum monthly charges determined by the Public Service Commission."

² KRS 278.040(2).

Commission regulation 807 KAR 5:026, Section 1(4) defines “gas company” as the owner of any producing gas well or gathering line.

KRS 278.485 does not prescribe a method of review for initial farm tap rates. Commission regulation 807 KAR 5:026, Section 9, in pertinent part, provides that “[e]ach gas company shall charge rates filed with and approved by the Commission in accordance with KRS Chapter 278 and 807 KAR Chapter 5.”³ This regulation also prescribes a procedure for a gas company that offers service pursuant to KRS 278.485 to request an adjustment of existing rates through a proposed tariff submitted at least 60 days prior to its proposed effective date.⁴

BACKGROUND

This case arises out of Case No. 2021-00390,⁵ a proceeding in which Natural Gas Services, LLC (Natural Gas Services) requested approval of initial rates and terms of service to serve farm tap customers. In its March 23, 2022 final Order in that case, the Commission denied Natural Gas Services’ proposed tariff finding that while Natural Gas Services and Hay Exploration share common ownership, based upon the case record, Hay Exploration, not Natural Gas Service, owned the production facilities—specifically, the natural gas wells and gathering lines.⁶ Thus, pursuant to KRS 278.485, Hay Exploration, not Natural Gas Services, had a statutory obligation to serve its farm tap customers and the right to charge rates for gas service upon receiving Commission

³ 807 KAR 5:026, Section 9(1).

⁴ 807 KAR 5:026, Section 9(1)(a), through 807 KAR 5:026, Section 9(4).

⁵ Case No. 2021-00390, *Electronic Tariff Filing of Natural Gas Services, LLC for Initial Rules, Regulations and Rates for Furnishing Gas Service Pursuant to KRS 278.485* (Ky. PSC Mar. 23, 2022).

⁶ Case No. 2021-00390, *Electronic Tariff Filing of Natural Gas Services, LLC for Initial Rules, Regulations and Rates for Furnishing Gas Service Pursuant to KRS 278.485* (Ky. PSC Mar. 23, 2022) at 10.

approval. Hay Exploration and Natural Gas Services failed to furnish a formal agreement. Thus, Natural Gas Service has no operations and is not currently involved in the service or management of Hay Exploration's farm taps.⁷

Hay Exploration is a Kentucky Corporation that owns and operates natural gas production facilities, specifically natural gas wells and gathering lines located in Elliott, Morgan, Lawrence, and Johnson counties, Kentucky. The gas wells involved in servicing the farm tap customers are 263 wells located in Lawrence and Johnson counties with four separate pipeline systems.⁸ The heat content of the gas that is delivered across the system averages 1,050 Btu but can vary based on the location.⁹ Hay Exploration has never established rates for its farm tap customers and does not currently charge any user connected to its system.¹⁰

DISCUSSION AND ANALYSIS

The total number of expected farm tap customers served by Hay Exploration, pursuant to KRS 278.485, is about 110, which includes mostly residential, commercial or public entities.¹¹ Of the 110 customers, approximately 78 are "free-gas" customers with pre-existing right-of-way lease agreements that allow up to 200 Mcf per year of free gas. Any amount in excess of the allotted 200 Mcf per year of free gas will be charged Commission-approved rates. Hay Exploration provides some information that appears to

⁷ Hay Exploration's Response to Commission Staff's First Request for Information (Staff's First Request), Items 35 and 36.

⁸ Hay Exploration's Response to Staff's First Request, Item 11.

⁹ Hay Exploration's Response to Commission Staff's First Request, Items 16a, 16b, and 16c.

¹⁰ Hay Exploration's Response to Staff's First Request, Item 22.

¹¹ Hay Exploration's Response to Staff's First Request, Item 19b.

be contradictory, by first stating that “[a]lmost all customers exceed the 200 Mcf,”¹² while later stating only 16 of 78 free-gas customers are expected to exceed 200 Mcf per year.¹³

Hay Exploration estimates that annual gas volumes sold to all farm taps will be around 152 Mcf per customer, which is approximately 12.5 Mcf per month. Hay Exploration states that the estimate is based on actual meter readings for a very small subset of its expected customer count and that it did not perform any additional meter reading outside of the sample conducted as it would not be economically viable for Hay Exploration to do so.¹⁴ Hay Exploration reports that the total annual usage for the system, including free gas, based on estimates using the differential between meters at the well and the sales meter to be an average of 16,720 Mcf. The estimated average annual usage for free gas is 11,856 Mcf.¹⁵

Hay Exploration states that its farm tap customers use gas for a variety of reasons, which include home heating, appliances, or operation of machinery.¹⁶ Once rates are placed into effect, Hay Exploration does not believe that legitimate usage will decrease, but that incidents of unauthorized connections or use other than household will decline.¹⁷ Hay Exploration also plans to disconnect any farm tap customers that utilize gas outside of the agreement.¹⁸ The Commission notes that Hay Exploration claimed to have

¹² Hay Exploration’s Response to Staff’s First Request, Item 19c.

¹³ Hay Exploration’s Response to Staff’s Second Request, Item 5b.

¹⁴ Hay Exploration’s Response to Staff’s First Request, Item 20a and Hay Explorations’ Response to Staff’s Second Request, Item 17.

¹⁵ Hay Exploration’s Response to Commission Staff’s Third Request for Information (Staff’s Third Request), Items 2a and 2b.

¹⁶ Hay Exploration’s Response to Staff’s First Request, Item 20b.

¹⁷ Hay Exploration’s Response to Staff’s First Request, Item 20c.

¹⁸ Hay Exploration’s Response to Staff’s First Request, Item 26.

discovered unauthorized connections and believes that some users have installed a branch tee or other connection to serve users other than the customer without the prior written consent required by 807 KAR 5:026, Section 6(2), but provided no proof of these claims. If these claims are accurate, the legitimate annual usage of farm tap customers should be lower than the estimated 152 Mcf.

Revenue Requirement

Hay Exploration does not currently charge customers, read meters, or track its farm tap expenses. Hay Exploration estimated its cost of service by creating assumptions for labor and miscellaneous expenses for various activities. The Commission accepts these estimated expenses for establishing initial rates. Based on the expected revenues from nonrecurring charges of \$1,053, Hay Exploration's base rates need to recover \$64,712 annually. Hay Exploration explicitly stated that it did not request an operating margin because "the sale of gas to customers in accordance with KRS 278.485 is a requirement of operations in the industry, but not intended as a profit center for Hay Exploration."¹⁹

Rate Design

Hay Explorations is proposing a \$30.00 monthly minimum customer charge plus a volumetric charge. Hay Exploration states that its monthly minimum customer charge is based on fixed expenses such as labor associated with maintenance and administrative functions. A \$30.00 monthly charge is higher than all active Kentucky local distribution companies with Delta Natural Gas Company, Inc.'s base rate monthly customer charge

¹⁹ Hay Exploration's Response to Staff's Third Request, Item 4a.

of \$24.00 being the closest to Hay Exploration's proposed charge.²⁰ Through responses to Staff Requests for Information, it was determined that Hay Exploration intends the monthly charge to function more as a minimum bill than simply a monthly customer charge to recover fixed costs to serve customers. Hay Exploration elaborated on the proposed charge, stating that the \$30.00 will apply to the first 3.6 Mcf of usage and any usage above 3.6 Mcf will be charged the proposed volumetric charge of \$8.35 per Mcf.²¹ The 3.6 Mcf included in the minimum bill is not included in Hay Exploration's proposed tariff and Hay Exploration did not provide justification for why 3.6 Mcf should be included in the minimum bill nor an explanation for why this usage level was not provided in the initial filing.

For the reasons discussed above, the Commission finds that there is not sufficient evidence in the record to precisely determine the most appropriate revenue requirement and farm tap rates that would be fair, just and reasonable for Hay Exploration's future operations. This appears to be due primarily because Hay Exploration has not historically maintained the records necessary to determine the costs associated with operating and maintaining the farm tap system in regard to service provided within a one-half air mile of its gathering line and wells pursuant to KRS 278.485. 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. However, the Commission also finds that requiring Hay Exploration to incur undue expenses related to meter reading and service without being able to recover those costs for the sole purpose of tracking expenses would not be fair, just and reasonable. There is simply not sufficient evidence in the record to

²⁰ Delta Natural Gas Company, Inc.'s most recent customer charge was approved by the Commission in Case No. 2021-00185, *Electronic Application of Delta Natural Gas Company, Inc. for an Adjustment of Its Rates and a Certificate of Public Convenience and Necessity* (Ky. PSC June 7, 2022).

²¹ Hay Exploration's Response to Staff's Second Request, Item 1.

determine the most appropriate rates, and Hay Exploration is unable to provide such information without first providing and tracking the services provided to its customers served pursuant to KRS 278.485.

Because there is no language in KRS 278.485 prescribing a method of review for initial farm tap rates, the Commission finds Hay Exploration's proposed farm tap rates and charges to be fair, just and reasonable to be charged until Hay Exploration establishes record keeping sufficient to provide evidence in support of its rates. This will allow Hay Exploration to collect revenue to cover its expenses related to the operation and maintenance of its farm tap system at rates that are consistent with rates approved for other farm tap systems that are subject to the Commission's regulation pursuant to KRS 278.485. A review of farm tap supplier rates reflects rates that are both lower and higher than the \$8.35 per Mcf commodity rate reflected in the proposed minimum bill and the base rate proposed by Hay Exploration.

The Commission finds that Hay Exploration should file an application for an adjustment of its farm tap rates with the Commission no later than 18 months following the date of service of this Order with a complete record and evidence to support its proposed rates. The subsequent filing should comply with KRS 278.485 and 807 KAR 5:026, the statute and regulation governing gathering systems that provide service to retail customers who have connected to such systems.²² Hay Exploration should provide a proposed revenue requirement based on a 12-month historical period along with justification.

²² 807 KAR 5:026, Section 9(1)(e), erroneously references 807 KAR 5:001, Section 10, the proper reference is 807 KAR 5:001, Section 16.

The Commission further finds that Hay Exploration should separately track and differentiate the expenses and meter readings for its typical Farm Tap customers and its “free gas” farm tap customers. All nonrecurring charges collected should be tracked with all occurrences noted of the activity for which the fee is charged. Hay Exploration, in its next rate application, should include cost justification for its nonrecurring charges and be able to show that the charges are directly related to the actual cost incurred to provide the service. Hay Exploration should be able to explicitly describe how expenses are allocated. Additionally, Hay Exploration should review its application before filing to ensure that the information it provides is accurate and does not provide contradictory information. Hay Exploration should use and file with its application the forms attached as an Appendix to this Order to assist in the timely processing of its case.²³

PROPOSED TARIFF

Hay Exploration filed a proposed tariff containing its proposed rates, rules, and regulations. An Application for Gas Service was also filed containing additional rules and regulations. Except as modified herein, the Commission finds that the proposed tariff is reasonable and that it should be accepted as filed.

1. Billing Errors. Hay Exploration’s proposed tariff indicated that if billing errors occur, Hay Exploration would refund customers the amount of any overcharge and have the right to collect from customers the amount of any undercharge resulting from the billing error.²⁴ The tariff did not however explain how far back Hay Exploration would

²³ Versions of the form that are in XFDL or XML format and can be filled out electronically are available on the Commission’s Website at www.psc.ky.gov under Utility Information > Utility Forms > All Utilities > Alternative Rate Filing Forms.
File Name: “ARF Form 1 - Attachment SAO-G - Schedule of Adjusted Operations - Gas Utility”
File Name: “ARF Form 1 - Attachment RR-OR - Revenue Requirement Calculation Form - Operating Ratio Method”

²⁴ Hay Exploration’s proposed tariff at unnumbered pdf pages 9–10 of 23.

go in collecting any undercharge and refunding any overcharge. Hay Exploration stated that it would operate in accordance with KRS 413.120 regarding collecting any undercharges and refunding any overcharges.²⁵ KRS 413.120(2) requires that an action upon a liability created by statute be commenced within five years after the cause of the action when no other time is fixed by the statute creating the liability. While KRS 413.120 is the correct statute to follow regarding overcharges, KRS 278.225 would be the correct statute to follow regarding undercharges. KRS 278.225 states that no customer shall be liable for unbilled service after two years from the date of service unless the service was obtained through fraud, theft, or deception. The Commission finds that Hay Exploration should revise its tariff to clarify that overcharges will be refunded in accordance with KRS 413.120 while undercharges will be collected in accordance with KRS 278.225.

2. Application for Service. Hay Exploration's application for service has a request for a spouse's name, if applicable.²⁶ Hay Exploration stated that having the spouse's name allows Hay Exploration to know who may or may not have authority over the property since the spouse most likely has a dower interest in the property.²⁷ The Commission finds that the request for the spouse's name is unnecessary for the provision of service to potential customers and should be stricken from the Application for Service. In the alternative, Hay Exploration could include a field on the Application for Service for any co-applicants.

²⁵ Hay Exploration's Response to Commission Staff's First Request for Information, Item 6b.

²⁶ Hay Exploration's Response to Commission Staff's Second Request for Information, Item 38, Attachment.

²⁷ Hay Exploration's Response to Commission Staff's Second Request for Information, Item 37.

3. Terms and Conditions for Service. Hay Exploration included the terms and conditions for service with its application for service.²⁸ There were numerous discrepancies between the proposed tariff and the terms and conditions for service included with the application for service. For example, the terms and conditions for service contain monthly charges that differ from the proposed tariff and contain references to Natural Gas Services instead of Hay Exploration. There are also other discrepancies amongst the two documents, including but not limited to the Budget Billing Plan being included in the proposed tariff but not the terms and conditions included with the application for service and a meter relocate fee being included in the terms and conditions included with the application for service but not being included in the proposed tariff. The Commission finds that Hay Exploration should update its terms and conditions for service included with the Application for Service to match the information in Hay Exploration's tariff.

4. Nonrecurring Charges – Free Gas Customers. Hay Exploration states that nonrecurring charges would not be charged to free gas customers pursuant to the terms of the applicable agreements.²⁹ However, this is not indicated in the proposed tariff. The Commission finds that Hay Exploration's tariff should be revised to include a statement that nonrecurring charges will not be charged to free gas customers pursuant to the applicable agreements.

5. Monthly Minimum Customer Charge. As previously discussed, Hay Exploration did not include in its proposed tariff the 3.6 Mcf of usage to be included in its

²⁸ Hay Exploration's Response to Commission Staff's Second Request for Information, Item 38, Attachment.

²⁹ Hay Exploration's Response to Commission Staff's Third Request for Information, Item 5c.

monthly minimum customer charge. The Commission finds that Hay Exploration's tariff should be revised to include the 3.6 Mcf usage in its monthly minimum customer charge, and to clarify that \$8.35 per Mcf will only be charged for monthly usage exceeding 3.6 Mcf.

Having considered the evidence of record and being otherwise sufficiently advised, the Commission finds that the rates, charges, and terms as discussed herein to this Order are fair, just and reasonable, in the public interest, and should be approved effective with the date of service of this Order.

IT IS THEREFORE ORDERED that:

1. The rates and charges as proposed and clarified by Hay Exploration are approved for service rendered on and after the date of service of this Order.

2. Except for the tariff provisions that have been modified herein, Hay Exploration's proposed tariff is approved as filed.

3. Within 20 days of the date of service of this Order, Hay Exploration shall file with the Commission, using the Commission's electronic Tariff Filing System, new tariff sheets setting forth the rates, charges, and modifications approved or as required herein and reflecting their effective date and that they were authorized by this Order.

4. Upon placing the rate and charges into effect, Hay Exploration shall separately track and differentiate the expenses and meter readings for its Farm Tap customers that will be charged for all their usage and its "free gas" farm tap customers. All nonrecurring charges collected shall be tracked with all occurrences noted. Hay Exploration shall include cost justification for its nonrecurring charges as required herein.

5. Within 18 months of the date of service of this Order, Hay Exploration shall file with the Commission revised proposed tariff sheets including the information required

to complete the forms attached as an Appendix to this Order. Hay Exploration shall also include the nonrecurring charge information required in ordering paragraph 4.

6. This case is closed and removed from the Commission's Docket.

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PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ENTERED
FEB 16 2024 rcs
KENTUCKY PUBLIC
SERVICE COMMISSION

ATTEST:


Executive Director

APPENDIX

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2023-00152 DATED FEB 16 2024

FIVE PAGES TO FOLLOW

REVENUE REQUIREMENT CALCULATION - OPERATING RATIO METHOD

(Method commonly used by investor owned utilities and/or non-profit entities that do not have long-term debt outstanding.)

Pro forma Operating Expenses Before Income Taxes	
Operating Ratio	
Sub-Total	
Less: Pro forma Operating Expenses Before Income Taxes	
Net Income Allowable	
Add: Provision for State and Federal Income Taxes, if Applicable (see footnote)	
Interest Expense	
Pro forma Operating Expenses Before Taxes	
Cost of Natural Gas (water utilities should leave this blank)	
Total Revenue Requirement	
Less: Other Operating Revenue	
Non-operating Revenue	
Interest Income	
Total Revenue Required from Rates for Service	
Less: Revenue from Sales at Present Rates	
Required Revenue Increase	

Required Revenue Increase stated as a Percentage of Revenue at Present Rates

Provision for Income Taxes - Calculation of Tax Gross-Up Factor

Revenue	
Less: 5% State Tax	
Sub-Total	
Less: Federal Tax, 15% of Sub-Total	
Percent Change in NOI	
Factor (Revenue of 1 divided by change in NOI)	
Times: Allowable Net Income	
Net Income Before Taxes	
Difference Equals Provision for State and Federal Income Taxes	

Notes: (1) Natural gas utilities should deduct their cost of natural gas from pro forma operating expenses before performing the operating ratio calculation. The cost of natural gas should be added back and included in pro forma operating expenses when determining the total revenue requirement. (2) A provision for state and federal income taxes should only be included in the calculation of revenue requirements for utilities that file income tax returns and are liable for the payment of state and federal income taxes. Utilities whose income flows through to its owner's income tax returns for tax purposes should not include a provision for income taxes. (3) The conversion factor above is calculated using the minimum federal tax rate. Adjustment may be warranted where the actual federal tax rate exceeds the minimum federal tax rate.

SCHEDULE OF ADJUSTED OPERATIONS - GAS UTILITY

TYE 12/31/20

	Test Year	Adjustment	Ref.	Pro Forma
Operating Revenues				
Sales of Gas				
Residential				
Commercial & Industrial				
Interdepartmental				
Sales for Resale				
Total Sales of Gas				
Other Operating Revenues				
Forfeited Discounts				
Miscellaneous Service Revenues				
Rent from Gas Property				
Other Gas Revenues				
Total Operating Revenues				
Operating Expenses				
Operation and Maintenance Expenses				
Manufactured Gas Production Expenses				
Natural Gas Production Expenses				
Exploration and Development Expenses				
Storage Expenses				
Other Gas Supply Expenses				
Transmission Expenses				
Distribution Expenses				
Customer Accounts Expenses				
Customer Service and Informational Expenses				
Administrative and General Expenses				
Total Operation and Maintenance Expenses				
Depreciation Expense				
Amortization Expense				
Taxes Other Than Income				
Income Tax Expense				
Total Operating Expenses				
Utility Operating Income				

References

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Provide a completed version of the table below for the 12-month period ended: _____

Revenue Requirement Calculation	
Gross Wages	
Employee Benefits/Expenses:	
Health Insurance	
Workers Compensation	
Payroll Taxes	
Natural Gas Costs ¹	
Vehicle Gas/Maintenance	
Billing	
Administration	
Postage and Office Expenses	
Well and Road Repairs	
Income Tax Provision	
Depreciation	
Revenue Requirement (Sum of All Above)	

¹ Natural Gas Cost should be based on the average of NYMEX futures prices for 12 months along with a two-year average Appalachian Differential.

	Customer Count	Total Annual Usage	Annual Revenue
'Free Gas' Farm Tap Customers			
Typical Farm Tap Customers			
Number of Total Customers			

This form should be completed for each individual nonrecurring charge

NONRECURRING CHARGE COST JUSTIFICATION

Type of Charge: _____

1. Field Expense:

A. Materials (Itemize)

_____	\$ _____
_____	_____
_____	_____

B. Labor (Time and Wage)

_____	_____
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Total Field Expense \$ _____

2. Clerical and Office Expense

A. Supplies \$ _____

B. Labor _____

Total Clerical and Office Expense \$ _____

3. Miscellaneous Expense

A. Transportation \$ _____

B. Other (Itemize)

_____	_____
_____	_____
_____	_____

Total Miscellaneous Expense \$ _____

Total Nonrecurring Charge Expense \$ _____

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