

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

PETITION OF STEPP BRANCH)	
GAS COMPANY, INC. TO CEASE)	
OPERATIONS OF ITS NATURAL)	CASE NO. 2002-00182
GAS DISTRIBUTION SYSTEM)	

O R D E R

Stepp Branch Gas Company, Inc. ("Stepp Branch"), a Kentucky corporation that owns and operates facilities used in the distribution, sale, and furnishing of natural gas to the public for compensation in Martin County, Kentucky, is a utility subject to Commission jurisdiction. KRS 278.010(3)(b) and KRS 278.040. Stepp Branch is subject to the safety jurisdiction of the Commission, pursuant to KRS 278.040 and KRS 278.495. Stepp Branch is also subject to Commission jurisdiction under the authority of and in compliance with federal pipeline safety laws, 49 U.S.C. § 60101, et seq., and the regulations of 49 CFR 189-199, pursuant to KRS 278.992(1).

On May 30, 2002, Stepp Branch filed a petition with the Commission requesting approval to terminate gas service as of August 1, 2002. Stepp Branch does not seek to sell its assets or transfer its stock or facilities to any other entity, but to cease operations as a utility by abandoning its natural gas distribution system. KRS 278.020(4) requires Commission approval before any utility may be abandoned.

The Commission is aware of the operational problems of Stepp Branch. In Case No. 2000-00346¹ the Commission required Stepp Branch to appear before it to present evidence on the adequacy of Stepp Branch's current natural gas supply and, if it lacked adequate supplies of natural gas, to show cause why it should not be required to cease providing natural gas service to the public. Stepp Branch, in that case, entered into an agreement with Commission Staff that Stepp Branch would cease operations on or before April 15, 2001. That agreement was incorporated into the Commission's Order of November 1, 2000. However, prior to ceasing operations Stepp Branch was able to obtain a source of supply by entering into a contract for natural gas with Columbia Natural Resources ("CNR"). Stepp Branch was therefore able to demonstrate that it had procured an adequate supply of gas for the winter heating season. Based upon this new evidence the Commission, in effect, modified that part of its Order requiring Stepp Branch to cease operations and allowed Stepp Branch to continue to serve the public.

In the fall of 2001, Stepp Branch requested assistance from the Commission in preparing an Alternative Rate Filing ("ARF") to increase its rates.² Staff began its review of Stepp Branch's records in October 2001. Staff completed, and provided Stepp Branch with, the application on April 10, 2002. On May 4, 2002, before Stepp Branch filed the application, a flood damaged part of its system. Using estimates of the costs to repair the damage and establish a reliable supply of gas, Staff revised its calculations

¹ Case No. 2000-00346, An Investigation Into the Reliability of the Natural Gas Supply for Stepp Branch Gas Company and Alleged Violations of KRS 278.300.

² Case No. 2002-00182 Staff Report, dated July 3, 2002, filed in record.

and issued a Staff Report on July 3, 2002. In that report, Staff determines that Stepp Branch's revenue requirement is \$65,771, resulting in a simple cash flow of \$21,972 annually. Staff noted in its report that the simple cash flow resulting from the required rate increase would not provide sufficient funds to pay for the actions needed to bring Stepp Branch into full operational compliance. Staff also noted that the simple cash flow would not supply adequate debt service if Stepp Branch chose to borrow the money for the required capital investment. As a result of the required capital expenditures, the base rate would have to be increased from \$3.65 per Mcf to \$18.9608 per Mcf, resulting in a 419 percent increase. An average customer bill, not including the gas cost adjustment, would increase from \$38.85 per month to \$195.61 per month.

Stepp Branch is now before the Commission on a petition in which Stepp Branch seeks Commission approval to cease all of its operations as a local distribution company by August 1, 2002. The Commission scheduled a formal hearing on the petition and ordered Stepp Branch to give notice to its customers of the filing of the petition and the time and date of the hearing.³ Accordingly, a formal hearing was held at which Lisa M. Davis, as the vice president of Stepp Branch, appeared. There were no appearances by the customers of Stepp Branch or the general public.

Ms. Davis began her testimony by summarizing the prior history of Stepp Branch and the issues previously before the Commission as to Stepp Branch's gas supply problem. She stated that her father, Michael Davis, had spent approximately \$45,000 of his own money to rework the G.W. Stepp well, one of two gas wells used to produce

³ Appendix A to Commission Order dated June 17, 2002, Case No. 2002-00182.

gas for the Stepp Branch system, the other being the Lydia Kirk (“Kirk”) well.⁴ The G. W. Stepp well has failed to produce despite the efforts of Mr. Davis to rehabilitate the well. Ms. Davis testified that, subsequent to the hearing in Case No. 2000-00346 and with the assistance of local political leaders, Stepp Branch was able to enter into a contract with CNR for a supply of natural gas. She stated that this supply was only intended to augment the production from the Kirk well during the winter heating season. It was Ms. Davis’s testimony that this supplemental supply appeared to ensure that Stepp Branch had an adequate supply of gas year round for its customers.

However, on May 4, 2002, a flood precipitated a landslide, which in turn carried away part of the Stepp Branch distribution system and uncovered part of its gas mains.⁵ This resulted in the severance of the distribution system just south of the Kirk well.⁶ The Kirk well previously produced gas to serve the entire distribution system. It now serves only 6 customers.⁷ The tap with CNR, which was originally intended only for the purpose of supplementing the gas supply of the Stepp Branch system during the winter heating season, now supplies the remaining customers.⁸ Ms. Davis further stated that while Stepp Branch had not received a recent bill from CNR, any such bill will have an adverse

⁴ Stepp Branch Hearing Exhibit A.

⁵ See Appendix A of Order dated June 13, 2002, which contains an inspection report prepared by Commission Staff that relates a chronological history of the events related to the damage to the Stepp Branch system.

⁶ Stepp Branch Hearing Exhibit A.

⁷ Response of Stepp Branch dated June 26, 2002 (sheet 3 of 6) to question 7-A of the Staff Data Request.

⁸ Response of Stepp Branch dated June 26, 2002 (sheet 3 of 6) to question 7-B of the Staff Data Request.

effect on the company in that there will be no funds to pay the supplier.⁹ Ms. Davis testified that due to the cost of repairs, the declining customer base, and increasing account collection problems, Stepp Branch will not have the ability to pay the CNR bill. Ms. Davis testified that under the present circumstances Stepp Branch cannot provide its customers with an adequate gas supply.

Ms. Davis testified it is she who prepares the customer bills, keeps the accounts records and collects for gas service, but that she now has a full time position elsewhere and can no longer attend to these administrative duties. She further stated that her father, Michael Davis, has family medical problems that require more of his time than he can devote to Stepp Branch. She stated that neither she nor her father believes they can continue operating the company.

Ms. Davis stated that Stepp Branch has no employees and cannot afford to hire a qualified person to maintain the system. She stated that there is a customer familiar with the system who serves as an emergency contact. She further testified that this person is not an employee of Stepp Branch or a trained operator.

In response to a question as to the possibility of a sale or transfer of the distribution system, Ms. Davis testified that there is no one interested in the Stepp Branch distribution system and that there is no reason to think it could be sold or transferred.

Ms. Davis testified that Stepp Branch had recorded losses for the last two years as reported in the annual reports filed with the Commission for 2000 and 2001. She stated that due to the declining customer base, unpaid customer accounts and system repair

⁹ Stepp Branch Hearing Exhibit B. The contract with CNR establishes the price for all gas delivered equal to the Index price of spot gas delivered to Columbia Gas Transmission Corporation, Appalachia.

costs, these losses would continue to increase. She testified that due to these cash flow problems Stepp Branch is unable to purchase any liability insurance to cover its operations.¹⁰ She testified that repairing the immediate damage to the system, and correcting outstanding safety violations, is too costly for Stepp Branch.¹¹ She further testified that although she had intended to remain in business she has been unable to obtain any local, state or federal financial assistance to continue to operate the system.

The Commission, having heard the testimony of Lisa Davis, Vice President of Stepp Branch, having considered the responses filed by Stepp Branch to the Staff data request on July 5, 2002, and the entire record, finds that:

1. On or about May 4, 2002, the Stepp Branch natural gas distribution system was seriously damaged by a landslide, which destroyed part of the gas mains and effectively severed the system.
2. The Kirk well served all customers system-wide prior to the damage.
3. The primary purpose of the CNR tap and contract was to provide a supplemental gas supply for the winter heating season.
4. Based on cost estimates to repair the system, Stepp Branch does not currently have funds to make the repairs and does not have access to additional funds.
5. Stepp Branch's customer base is declining and that it is unable to collect its accounts receivables.

¹⁰ Response to question 6 of the Staff Data Request dated June 26, 2002, Item 6 (sheet 6 of 6) in which Stepp Branch stated a premium quote of \$3,800 for liability insurance.

¹¹ Appendix B of Commission Order dated June 13, 2002, in which a Comprehensive Inspection Report list 35 separate safety deficiencies for the Stepp Branch system.

6. Even without including debt service for necessary repairs, in order to meet its cost of service, a rate increase would place an undue financial hardship on Stepp Branch's already declining customer base.

7. Stepp Branch will not have an adequate supply of natural gas for its customers because its current gas supply contract with CNR expires in 2004 and because Stepp Branch lacks funds to meet its present obligations for gas purchases.

8. The management of Stepp Branch does not possess the present ability or the inclination to operate the distribution system.

9. There is no present prospect of the sale or transfer of the system to any qualified entity.

10. There is no qualified operator or employee with the necessary training to continue the operation of the system.

11. Staff inspectors have found that Stepp Branch is currently in violation of at least 35 safety regulations and that, without the necessary funds to correct those violations, Stepp Branch will be unable to serve its customers in a safe, reliable manner.

12. Stepp Branch does not have the financial, technical and managerial ability to provide adequate, efficient or reasonable service pursuant to KRS 278.030 and therefore should cease operations as a local distribution company.

IT IS THEREFORE ORDERED that:

1. The request of Stepp Branch to cease operations of its natural gas distribution system is granted.

2. The request of Stepp Branch to cease operations on or before August 1, 2002 is denied.

3. Stepp Branch is authorized to abandon and cease operations of its natural gas distribution system as of August 31, 2002.

4. Stepp Branch shall perform the following prior to abandoning its natural gas distribution system:

a. The pipeline connection between Stepp Branch and CNR shall be terminated, disconnected, locked and sealed. The exposed connection pipeline itself shall be removed and all remaining connections sealed.

b. Any connector valve and any pipe located between the source of Stepp Branch's existing wells and the main gas line shall be locked and sealed closed.

c. Stepp Branch shall remove its gas meters and seal its service lines prior to September 1, 2002.

5. On or before August 1, 2002, Stepp Branch shall give notice to its customers and the general public that it will cease operations as a local distribution company on August 31, 2002 and that it will remove its gas meters and seal its service lines by mailing to each customer and publishing notice in a newspaper of general circulation in the area served by Stepp Branch, with proof of publication to be filed with the Commission.

6. On or before September 15, 2002, Stepp Branch shall certify to the Commission that its operations as a natural gas distribution company have been terminated, pursuant to Administrative Regulation 807 KAR 5:022, Section 14(15), and in compliance with this Order.

Done at Frankfort, Kentucky, this 23rd day of July, 2002.

By the Commission

ATTEST:

A handwritten signature in black ink, appearing to read "Thomas H. Dixon", written over a horizontal line.

Executive Director