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TENN. REG. AUTH.
BEFORE THE TENNESSEE REGULATORY AUTHORITY

NASHVILLE, TENNESSEE

October 12, 2006

IN RE:)
)
GASCO DISTRIBUTION SYSTEMS, INC.) Docket No. 06-00224
ACTUAL COST ADJUSTMENT (ACA) AUDIT)

NOTICE OF FILING BY THE UTILITIES DIVISION OF THE TENNESSEE
REGULATORY AUTHORITY

Pursuant to Tenn. Code Ann. §§ 65-4-104, 65-4-111 and 65-3-108, the Utilities Division of the Tennessee Regulatory Authority gives notice of its filing of the Gasco Distribution Systems, Inc.'s ACA Audit Report in this docket and would respectfully state as follows:

1. The present docket was opened by the Authority to hear matters arising out of the audit of Gasco Distribution Systems, Inc.'s (the "Company") ACA filing covering the period July 1, 2005 to June 30, 2006.
2. The Company's ACA filing was received on September 1, 2006, and the Staff completed its audit of same on September 29, 2006.
3. The Staff's audit revealed no findings. The Report is attached hereto as Exhibit A and is fully incorporated herein by this reference.

4. The Utilities Division hereby files its Report with the Tennessee Regulatory Authority for deposit as a public record and approval of the Report and the recommendations contained therein.

Respectfully Submitted:

A handwritten signature in black ink, reading "Ron Graham", written over a horizontal line.

Ron Graham, Utility Consultant
Utilities Division of the
Tennessee Regulatory Authority

CERTIFICATE OF SERVICE

I hereby certify that on this 12th day of October 2006, a true and exact copy of the foregoing has been either hand-delivered or delivered via U.S. Mail, postage pre-paid, to the following persons:

Sara Kyle
Chairman
Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, TN 37243

Mr. Fred Steele
President and Chief Executive Officer
Gasco Distribution Systems, Inc.
4435 East Pike
Zanesville, OH 43701
FAX (740) 454-7780



Ron Graham

COMPLIANCE AUDIT
GASCO DISTRIBUTIONS SYSTEMS, INC.

ACTUAL COST ADJUSTMENT

Docket # 06-00224

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EXHIBIT A

COMPLIANCE AUDIT REPORT

OF

GASCO DISTRIBUTIONS SYSTEMS, INC.

ACTUAL COST ADJUSTMENT

Docket # 06-00224

PREPARED BY

TENNESSEE REGULATORY AUTHORITY

UTILITIES DIVISION

OCTOBER 2006

I. INTRODUCTION

The subject of this audit is Gasco Distribution Systems Inc.'s ("Gasco" or the "Company") compliance with the Actual Cost Adjustment ("ACA") and Refund Adjustment ("RA") of the Purchased Gas Adjustment Rule ("PGA Rule") of the Tennessee Regulatory Authority ("TRA" or the "Authority").¹ The objective of the audit was to determine whether the purchased gas adjustments, which are encompassed by the ACA, and approved by the TRA for the twelve (12) months ended June 30, 2006, were calculated correctly and were supported by appropriate source documentation.

II. AUDIT OPINION

The Audit Staff's audit resulted in no findings. The Audit Staff concludes that the Purchased Gas Adjustment mechanism as calculated in the Actual Cost Adjustment appears to be working properly and in accordance with the TRA rules for Gasco Distribution Systems, Inc.

III. BACKGROUND INFORMATION ON COMPANY AND GAS SUPPLIERS

Gasco Distribution Systems, Inc., with its office located in Jellico, Tennessee, is a subsidiary of The Titan Energy Group, Inc., which has its headquarters at 4435 East Pike, Zanesville, Ohio. The Company is a gas distributor, which provides service to the City of Jellico (Campbell County), City of Byrdstown (Pickett County) and a few customers in Fentress County, all of which are located in northeast Tennessee. It has approximately 600 customers and an annual sales volume of approximately 52,000 MCF. In addition to Tennessee, Gasco also operates in Kentucky, Ohio, Pennsylvania, and West Virginia.

Gasco purchases the natural gas used to serve these areas from Delta Natural Gas Company, Inc. and East Tennessee Natural Gas, LLC.

IV. JURISDICTION AND POWER OF THE TENNESSEE REGULATORY AUTHORITY

Tennessee Code Annotated (T.C.A.) §65-4-104 gave jurisdiction and control over public utilities to the Tennessee Public Service Commission. By virtue of Chapter 305 of the Public Acts of 1995, jurisdiction and control over public utilities was transferred from the Tennessee Public Service Commission to the Tennessee Regulatory Authority (the "TRA" or "Authority") on July 01, 1996. T.C.A. §65-4-104 states that:

¹ See TRA Rule 1220-4-7. The ACA is more fully described in Section VI.

The Authority shall have general supervision and regulation of, jurisdiction, and control over, all public utilities...

T.C.A. states further in §65-4-111 that the public utilities are to maintain a Uniform System of Accounts:

The Authority shall have the power after hearing, upon notice, by order in writing to require every public utility... to keep its books, records, and accounts so as to afford an intelligent understanding of the conduct of its business, and to that end to require every public utility of the same class to adopt a uniform system of accounting. Such system shall conform, where applicable to any system adopted or approved by the Interstate Commerce Commission of the United States. And to furnish annually, or at other times as the Authority may require, a detailed report of finances and operations as shown by said system of accounts.

The TRA responded to T.C.A. §65-4-111 by establishing its own rule 1220-4-1-.11 regarding the uniform system of accounts which public utilities should maintain. The TRA's rule provides:

The following uniform system of accounting will be followed by utilities and other companies making periodic reports to the Authority:

1. For Classes A and B gas companies - Uniform System of Accounts as adopted by the National Association of Regulatory Utility Commissioners as revised June 30, 1972, and any amendments or revisions pertaining thereto.

The TRA received its authority to examine the books and records of public utilities from T.C.A. §65-4-105 which states that the TRA would possess all the other powers conferred on the TRA. T.C.A. §65-3-108 gives the TRA:

full power to examine the books and papers of the said companies, and to examine, under oath, the officers, agents, and employees of said companies...to procure the necessary information to intelligently and justly discharge their duties and carry out the provisions of this chapter and chapter 5 of this title.

V. PURPOSE OF COMPLIANCE AUDITS

The two basic reasons for compliance audits are to assure compliance with the Uniform System of Accounts (USOA) and to assure that the utility is following all rules, regulations and directives adopted by the TRA.

Compliance audits provide the foundation of assurance underlying the basic objective of regulatory accounting, which is to provide a uniform method of recording transactions among similar companies. This uniform record keeping is accomplished through the adoption of the USOA and ensures the integrity, reliability, and comparability of the financial data contained in financial reports filed with the TRA, which provides the TRA with one of its most useful regulatory tools for establishing just and reasonable rates.

VI. DESCRIPTION OF PURCHASED GAS ADJUSTMENT (PGA) RULE

The Tennessee Public Service Commission issued an Order in Docket No. G-86-1, which adopted a new PGA rule beginning July 1, 1992. This PGA Rider is intended to permit the Company to recover, in a timely fashion, the total cost of gas purchased for delivery to its customers and to assure that the Company does not over-collect or under-collect gas costs from its customers. This PGA consists of three major components:

- 1) **The Actual Cost Adjustment (ACA)**
- 2) **The Gas Charge Adjustment (GCA)**
- 3) **The Refund Adjustment (RA)**

The ACA is the difference between the revenues billed customers by means of the GCA and the cost of gas invoiced the Company by suppliers plus margin loss (if allowed by order of the TRA in another docket) as reflected in the Deferred Gas Cost account. The ACA then "true-up" the difference between the actual gas costs and the gas costs recovered from the customer through a surcharge or a refund. The RA refunds the "true-up" along with other supplier refunds. For a more complete definition of the GCA and RA, please see the PGA Formula in Appendix A.

Section 1220-4-7-.03(2) of the PGA Rule requires:

Each year, the Company shall file with the [Authority] an annual report reflecting the transactions in the Deferred Gas Cost Account. Unless the [Authority] provides written notification to the Company within one hundred eighty (180) days from the date of filing the report, the Deferred Gas Cost Adjustment Account shall be deemed in compliance with the provisions of these Rules. This 180-day notification period may be extended

by mutual consent of the Company and the [Authority] Staff or
by order of the [Authority].

VII. AUDIT TEAM

The TRA's Utilities Division is responsible for conducting ACA audits. Ron Graham conducted this audit of Gasco Distribution Systems, Inc. under the supervision of Pat Murphy.

VIII. SCOPE OF AUDIT

To accomplish the audit objective, the Audit Staff conducted in-house audit work, during which the Company's calculations of gas costs incurred and gas costs recovered were tested. The Audit Staff also audited a sample of customer bills to determine if the proper PGA rates and ACA rates were being applied in the Company's calculation of the customers' bills. These bills were selected to be representative of the residential, commercial and industrial customers in each of the Company's service areas. The sample was selected from all twelve months of the audit period. After recalculating each sample bill, Audit Staff is satisfied that customers were billed appropriately.

IX. SUMMARY OF COMPANY FILINGS

The Company submitted its ACA filings on September 1, 2006, covering the period July 1, 2005, to June 30, 2006. There were separate filings for the Jellico Division and the Byrdstown/Fentress Division. The Jellico Division filing reflected a net balance in its ACA account at June 30, 2006, of **positive \$265,095.25**, which represents an **under-collection** of gas costs from customers. The Byrdstown/Fentress Divisions filing reflected a net balance in its ACA account at June 30, 2006, of **positive \$9,430.96**, which represents an **under-collection** of gas costs from customers. The tables on the following page provide a summary of each ACA account as submitted by the Company.²

² The positive balances on line 9 of both the Jellico and Byrdstown/Fentress tables indicates that the Company has under-collected these amounts from its customers as of June 30, 2006. The ACA factors derived by dividing these amounts by the projected sales volumes for the next twelve (12) months will attempt to surcharge these amounts over a twelve month period. However, there are timing differences between the close of the audit period (6/30/06) and the effective date of a new factor (November 2006). When the next audit period (12 months ended 6/30/07) is audited, the factor will have been in effect for only eight (8) months. There is always regulatory lag inherent in the true-up process. Larger companies are capable of calculating ACA factors and implementing them immediately, prior to audit. However, the smaller companies are encouraged to await the results of the Staff's audit before implementing an ACA factor.

Jellico Division

Line No.		<u>Amount</u>
1	Cost of gas purchased (7/1/05 to 6/30/06)	\$ 681,518.19
2	Cost of gas recovered from customers through PGA rates	<u>424,980.46</u>
3	Under/(Over) Recovery of gas costs (Line 1-Line 2)	\$ 256,537.73
4		
5	ACA surcharges/(refunds) (7/1/05 – 6/30/06)	104,824.45
6	Interest calculated on average monthly balance in account	13,934.94
7	Beginning ACA balance at 7/1/05	<u>99,447.03</u>
8		
9	Balance in ACA account at 6/30/06 (Line 3-Line 5+Line 6+Line 7)	<u>\$ 265,095.25</u>

Byrdstown/Fentress Division

Line No.		<u>Amount</u>
1	Cost of gas purchased (7/1/05 to 6/30/06)	\$ 48,226.76
2	Cost of gas recovered from customers through PGA rates	<u>38,162.12</u>
3	Under/(Over) Recovery of gas costs (Line 1-Line 2)	\$ 10,064.64
4		
5	ACA surcharges/(refunds) (7/1/05 – 6/30/06)	335.30
6	Interest calculated on average monthly balance in account	380.85
7	Beginning ACA balance at 7/1/05	<u>(679.24)</u>
8		
9	Balance in ACA account at 6/30/06 (Line 3-Line 5+Line 6+Line 7)	<u>\$ 9,430.96</u>
Total Company ACA Account Balance at 6/30/06		<u>\$274,526.21</u>

X. ACA AUDIT FINDINGS

Audit Staff agrees with the ACA Account Balance as calculated by the Company (see Section IX). Therefore, there are no findings.

XI. CONCLUSIONS AND RECOMMENDATIONS

Audit Conclusions:

Audit Staff reviewed the gas costs and recoveries of Gasco Distribution Systems, Inc. for the 12-month period ended June 30, 2006. Based on the filing provided in Section IX, the **net balance** in the refund due customers account (ACA Account) as of June 30, 2006 should be a **positive \$274,526.21**. This means that as of June 30, 2006 the Company had under-collected this amount from its customers. The net balance is composed of an **under-collection from Jellico customers of \$265,095.25** and an **under-collection from Byrdstown/Fentress customers of \$9,430.96**. In order to surcharge the Jellico balance and Byrdstown/Fentress balance accordingly, the correct ACA adjustment factor to be applied to customer bills in the **Jellico Division** is a **positive \$5.5964 per MCF** (see Attachment 1). The correct ACA adjustment factor to be applied to customer bills in the **Byrdstown/Fentress Division** is a **positive \$2.2030 per MCF** (see Attachment 2). Staff recommends that these factors be implemented beginning with the Company's **November 2006** billing and should remain in effect until the Staff's next audit, at which time new factors will be calculated. The next audit of Gasco will cover the period July 2006 through June 2007.

Gasco's ACA Account Balance in its Jellico Division has risen significantly during this audit period, a 167% increase. An analysis of this account (see Section X) shows that the level of purchased Gas Adjustment (PGA) for the Jellico Division was too low recovering only 62% of actual costs during the period. Gasco has not filed to adjust the level of PGA since October 2004.

As Audit Staff has stated in prior audits, it is important for Gasco to monitor its ACA balance on a monthly basis. As actual data is gathered at the end of each month, the ACA schedule can be updated to the latest balance. This balance, along with gas cost increases and decreases in the market, should be a factor in the Company's decision whether a PGA filing to adjust the PGA adjustment factor is needed.

APPENDIX A

PGA FORMULA

The computation of the GCA can be broken down into the following formulas:

$$\text{Firm GCA} = \frac{D + \text{DACA}}{\text{SF}} - \text{DB} + \frac{P + T + \text{SR} + \text{CACA}}{\text{ST}} - \text{CB}$$

$$\text{Non-Firm GCA} = \frac{P + T + \text{SR} + \text{CACA}}{\text{ST}} - \text{CB}$$

where

GCA = The Gas Charge Adjustment in dollars per Ccf/Therm, rounded to no more than five decimal places.

D = The sum of all fixed Gas Costs.

DACA = The demand portion of the ACA.

P = The sum of all commodity/gas charges.

T = The sum of all transportation charges.

SR = The sum of all FERC approved surcharges.

CACA = The commodity portion of the ACA.

DB = The per unit rate of demand costs or other fixed charges included in base rates in the most recently completed general rate case (which may be zero if the Company so elects and the Commission so approves).

CB = The per unit rate of variable gas costs included in base rates in the most recently completed general rate case (which may be zero if the Company so elects and the Commission so approves).

SF = Firm Sales.

ST = Total Sales.

The computation of the RA can be computed using the following formulas:

$$\text{Firm RA} = \frac{\text{DR1} - \text{DR2}}{\text{SFR}} + \frac{\text{CR1} - \text{CR2} + \text{CR3} + i}{\text{STR}}$$

$$\text{Non-Firm RA} = \frac{\text{CR1} - \text{CR2} + \text{CR3} + i}{\text{STR}}$$

where

- RA = The Refund Adjustment in dollars per Ccf/Therm, rounded to no more than five decimal places.
- DR1 = Demand refund not included in a currently effective Refund Adjustment, and received from suppliers by check, wire transfer, or credit memo.
- DR2 = A demand surcharge from a supplier not includable in the GCA, and not included in a currently effective Refund Adjustment.
- CR1 = Commodity refund not included in a currently effective Refund Adjustment, and received from suppliers by check, wire transfer, or credit memo.
- CR2 = A commodity surcharge from a supplier not includable in the GCA, and not included in a currently effective Refund Adjustment.
- CR3 = The residual balance of an expired Refund Adjustment.

i =	Interest on the "Refund Due Customers" account, using the average monthly balances based on the beginning and ending monthly balances. The interest rates for each calendar quarter used to compute such interest shall be the arithmetic mean (to the nearest one-hundredth of one percent) of the prime rate value published in the "Federal Reserve Bulletin" or in the Federal Reserve's "Selected Interest Rates" for the 4th, 3rd, and 2nd months preceding the 1st month of the calendar quarter.
SFR =	Firm sales as defined in the GCA computation, less sales under a transportation or negotiated rate schedule.
STR =	Total sales as defined in the GCA computation, less sales under a transportation or negotiated rate schedule.

ATTACHMENT 1

Gasco Distribution Systems, Inc.

Calculation of the ACA Factor

(for Jellico customers)

Line No.	Factor to be applied to residential, commercial and industrial customers:		
1	Cost of Gas purchased (7/1/05 - 6/30/06)	\$ 681,518.19	
2	Cost of Gas recovered from customers through PGA rates	<u>424,980.46</u>	
3	Under/(Over) Collection (Line 1 - Line 2)	\$ 256,537.73	
4	ACA surcharges/(refunds) (7/1/05 - 6/30/06)	104,824.45	
5	Interest calculated on average monthly balance in account	13,934.94	
6	Beginning balance at 6/30/05	<u>99,447.03</u>	
7	Balance in ACA account at 6/30/05 (Line 3 - Line 4 + Line 5 + Line 6)	\$ <u>265,095.25</u>	Under-Collection
8	Sales Volumes **	47,369	MCF
9	ACA Factor - surcharge/(refund) (Line 7 divided by Line 8)	\$ <u>5.5964</u>	Per MCF

** Historical sales volumes for 12 months ending 6/30/06.

ATTACHMENT 2

Gasco Distribution Systems, Inc.

Calculation of the ACA Factor (for Byrdstown/Fentress customers)

Line No.	Factor to be applied to residential, commercial and industrial customers:		
1	Cost of Gas purchased (7/1/05 - 6/30/06)	\$ 48,226.76	
2	Cost of Gas recovered from customers through PGA rates	<u>38,162.12</u>	
3	Under/(Over) Collection (Line 1 - Line 2)	\$ 10,064.64	
4	ACA surcharges/(refunds) (7/1/05 - 6/30/06)	335.30	
5	Interest calculated on average monthly balance in account	380.85	
6	Beginning balance at 6/30/05	(679.24)	
7	Balance in ACA account at 6/30/06 (Line 3 - Line 4 + Line 5 + Line 6)	<u><u>\$ 9,430.95</u></u>	Over-Collection
8	Sales Volumes **	4,281	MCF
9	ACA Factor - surcharge/(refund) (Line 7 divided by Line 8)	<u><u>\$ 2.2030</u></u>	Per MCF

** Historical sales volumes for 12 months ending 6/30/06.