

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN INVESTIGATION OF THE GAS COSTS)	
OF B & H GAS COMPANY PURSUANT TO)	
KRS 278.2207 AND THE WHOLESALE GAS)	CASE NO.
PRICE IT IS CHARGED BY ITS AFFILIATE,)	2015-00367
B & S OIL AND GAS COMPANY, PURSUANT)	
TO KRS 278.274)	

ORDER

On July 5, 2016, the Attorney General of the Commonwealth of Kentucky, by and through his Office of Rate Intervention (“AG”), filed a motion to compel B&H Gas Company (“B&H”) and B&S Oil and Gas Company (“B&S”), (collectively, “Joint Respondents”), to respond to data requests issued by the AG (“AG’s Motion”). On July 21, 2016, the Joint Respondents filed a motion requesting leave to file a late response to the AG’s Motion. On August 2, 2016, the AG filed a motion requesting leave to late file his reply to the Joint Respondents’ response due to counsel’s illness. Both parties stated that the late filings would not prejudice the parties, and the AG noted that his reply was confined to the issues raised in the response. The Commission finds that the motions to late file the response and the reply will not prejudice the parties and that both motions should be granted.

The AG’s Motion first seeks a “more adequate and complete response” to the AG’s initial data request (“AG’s Initial Request”), Item 6(f). This request questions whether Bud Rife (“Mr. Rife”) “and any individuals related to him by blood or marriage, have received any type or sort of bonus or remuneration during the past five (5) years

from the entities listed below . . . Hall, Stephens, & Hall” (“HSH”).¹ In response, the Joint Respondents stated, “No individuals related to Bud Rife by blood or marriage have received any type of bonus or remuneration from any of the above listed entities. Bud Rife has received no bonus or remuneration from Hall, Stephens, & Hall”² The AG’s Motion notes that Rife is the managing partner of HSH; HSH provides gas to Johnson County Gas Co. (“JCG”); JCG is solely owned by Mr. Rife; and, both HSH and JCG operate from the same business address.³ In addition, the AG references Case No. 2012-00140,⁴ in which Mr. Rife is identified “as a member of the [HSH] partnership with a working interest of 0.126740 and a royalty share of 0.197190, which was the third-highest royalty share of the members therein identified.”⁵ In response, the Joint Respondents state that “[t]he Companies gave an adequate and truthful response to AG 6(f) . . . of the AG’s initial data requests concerning remuneration to Mr. Rife from Hall, Stephens & Hall.”⁶ We find that the Joint Respondents have answered the question presented in the AG’s Initial Request, Item 6(f), and that the AG’s Motion in regard to this item should therefore be denied.

¹ AG’s Initial Request filed Mar. 7, 2016, Item 6(f).

² Joint Respondents response to the AG’s Initial Data Request (“Response to AG’s Initial Request”)(filed Apr.18, 2016), Item 6.

³ AG’s Motion at 4.

⁴ Case No. 2012-00140, *Alternative Rate Filing Adjustment Application of Johnson County Gas*, Johnson County Gas Company’s Response to Post Hearing Data Requests, Exhibit 1, Disbursement Worksheet, (Ky. PSC May 17, 2013).

⁵ *Id.*

⁶ Joint Respondents’ response to AG’s Motion (filed July 21. 2016) at 1.

The AG's Motion next requests that the Commission compel the Joint Respondents to provide a "more adequate and complete response" to the AG's Initial Request, Item 11, to provide "copies of all documents setting forth the costs B&S incurs in obtaining gas for B&H." In response, the Joint Respondents provided copies of invoices from B&S to B&H, dated from January 2015 through February 2016. Joint Respondents also objected to the question and stated that "[t]he costs B&S incurs are not relevant to this proceeding, and would be burdensome to obtain."⁷ The AG requested an explanation of why it would be burdensome to obtain copies of these documents,⁸ to which the Joint Respondents responded, "As previously stated, B&S records were destroyed by two fires making those records impossible to produce. It would be burdensome to obtain copies of these documents given that they are not probative or relevant to this proceeding."⁹

The AG notes that the Joint Respondents confirmed that B&S incurs costs that are "typical of gas production, including labor, repair, management, payment of royalties to mineral owners and material and maintenance costs,"¹⁰ and argues that: "documentation indicating the gas cost that B&S paid to the owners of the seven (7)

⁷ Joint Respondents response to the AG's Initial Request ("Response to AG's Initial Request"), Item 11.

⁸ AG's Supplemental Data Request ("AG's Supplemental Request") (filed Apr.29, 2016), Item 5(b).

⁹ Respondents' response to the AG's Supplemental Request ("Response to AG's Supplemental Request")(filed June 15, 2016), Item 5(b).

¹⁰ Id., Item 5(a).

wells identified in response to AG 1-8 lies at the very heart of this inquiry and is far more relevant than invoices B&S sent to B&H.”¹¹

While the Commission could adjust B&H's rate to a market-based rate and apply the resulting dollar amount to B&S's sales to B&H, without B&S's cost we have only the “market” and no cost to which it can be compared, which makes the costs incurred by B&S in obtaining gas for B&H relevant to our inquiry in this investigation. Mr. Rife's sole ownership and control of both B&S and B&H create an affiliate relationship between B&S and B&H pursuant to KRS 278.010(18),¹² and make B&S's transactions with B&H in supplying B&H gas subject to the conditions of KRS 278.2207(1)(b), which provides that “[s]ervices and products provided to the utility by an affiliate shall be priced at the affiliate's fully distributed cost but in no event greater than market or in compliance with the utility's existing USDA, SEC, or FERC approved cost allocation method.”

KRS 278.274(3) provides that: “[i]t shall be presumed that natural gas purchases from affiliated companies are not conducted at arm's length” In instances in which a utility purchases natural gas from an intrastate affiliate, the Commission “shall assume jurisdiction of the affiliated company as though it were a utility as defined in KRS 278.010 . . . to that extent necessary to ensure that the rates charged the utility and ultimately to the consumer are just and reasonable.”¹³ If the Commission determines that the rates charged by the utility are not just and reasonable because the cost of natural gas purchased from the affiliated company is unjust and unreasonable, the

¹¹ AG's Motion at 5.

¹² KRS 278.010(18) defines an “affiliate” as a person that controls or that is controlled by, or is under common control with, a utility. KRS 278.010(19) defines “Control” as “the power to direct the management or policies of a person through ownership, by contract, or otherwise.”

¹³ KRS 278.274(3)(b)

Commission may “reduce the purchased gas component of the utility’s rates by the amount deemed to be unjust or unreasonable¹⁴ . . . and may also “reduce the rate charged by the affiliated company by the same amount.”¹⁵

The Joint Respondents claim that the records requested cannot be provided because “B&S records were destroyed by two fires making those records impossible to produce.”¹⁶ Several statements made by the Joint Respondents in this proceeding, however, contradict this claim and imply that the requested B&S records *do exist* and are physically housed elsewhere. In response to an AG request regarding the amount of profit and loss incurred by B&S for the past five years, Joint Respondents provided this information for the years 2010–2015.¹⁷ When asked to confirm that JCG continues to maintain offices in the same location as B&H and/or B&S, Joint Respondents replied that “B&H shares physical office space with Johnson County Gas and both entities pay a monthly rent to Mr. Rife. *B&S does not, and has never, maintained an office at this location . . . Johnson County Gas and B&H are the only entities operating out of this office space*” (Emphasis added.)¹⁸ Finally, when asked to confirm whether B&H and B&S planned to obtain a new building to house their operations, the Joint

¹⁴ KRS 278.274(3)(c)

¹⁵ KRS 278.274(3)(d)

¹⁶ Joint response to the AG’s Supplemental Request, Item 5(b).

¹⁷ *Id.*, Item 3.

¹⁸ Joint response to the AG’s Initial Data Requests (“Joint Response to the AG’s Initial Request”) (filed Apr. 18, 2016), Item 19.

Respondents responded that “B&S operates out of Mr. Rife’s home, and he only stored *certain records* at the building which burned.” (Emphasis added.)¹⁹

Based on the record in this matter, we find that the costs B&S incurs in providing gas to B&H are relevant to this proceeding and that the AG’s Motion in regard to responses to the AG’s Initial Request, Item 11, and the AG’s Supplemental Request, Item 5(b), should be granted.

The AG’s Motion next requests that the Commission compel the Joint Respondents to respond to the AG’s Initial Request, Items 21 and 22, regarding whether B&H and B&S are contemplating or planning to file bankruptcy. The AG contends that the financial stability of both B&H and B&S are crucial to their ongoing ability to provide gas service, which includes acquisition of gas supply. The Joint Respondents object to both requests, based on the confidentiality of trade secrets and that these inquiries are “designed to harass and annoy” B&H and B&S. The AG suggests that both B&H and B&S have the option to file responses to these questions under a petition of confidentiality. Although the Commission agrees with the AG that the financial stability of both B&H & B&S could be important factors in their continuing ability to provide gas service to customers, whether either company is “contemplating” or “planning” to file bankruptcy is speculative and not relevant to the current issues in this matter, which are limited to B&H’s costs for gas purchased and rates for gas sold. Thus, we find that the AG’s Motion in regard to Items 21 and 22 of the AG’s Initial Request should be denied.

The AG’s Motion further requests that the Commission compel the Joint Respondents to respond to the AG’s Supplemental Request, Item 2(c), and provide the

¹⁹ Supplement to the Joint Response to the AG’s Initial Request (filed Apr. 20, 2016), Item 34.

sums which: (i) B&H; (ii) B&S; (iii) JCG; and (iv) Hall, Stephens & Hall (“HSH”) have paid to Bud Rife Construction Co. for each of the past five years.²⁰ The AG argues that each of these entities is an affiliate and that this affiliate relationship demonstrates a “clear pattern of self-dealing . . . which has contributed to B&H’s unduly high gas supply cost.”²¹ The Joint Respondents claim that “[d]ue to the office fires disclosed in previous responsive pleadings, respondent can only provide the requested information for the past two (2) years.”²² Respondents also object to providing any of the information requested for JCG or HSH based on the information not being relevant and not being in the Joint Respondents’ possession and control.

As earlier discussed, Mr. Rife is the sole owner of B&S, B&H, JCG and Bud Rife Construction Co. (“Rife Construction”) and he is a partial owner of HSH. Rife solely controls the management and policies of B&S, B&H, JCG, and Rife Construction, and is the managing partner of HSH. As such, affiliate relationships exist among and between each entity and Mr. Rife individually. While these affiliate relationships are unambiguous, we find that the AG has not established a direct connection between either JCG or HSH and Rife Construction relevant to the issues in this matter and find that the AG’s Motion in regard to the specified items should be denied.

The AG’s Motion next requests that the Commission compel the Joint Respondents to respond to his Supplemental Request, Item 3(b), and provide “the amount of profit or loss for Hall, Stephens & Hall for each of the past five (5) years.” For

²⁰ Response to AG’s Supplemental Request, Item 2(c) (filed Jun 15, 2016).

²¹ AG’s Motion to Compel at 6.

²² Response to AG’s Supplemental Request, Item 2(c) (filed Jun 15, 2016).

the reasons stated directly above, we find that the AG has not demonstrated that the amount of profit or loss HSH has incurred for the past five years is relevant to the issues in this case and find that the AG's Motion in regard to this item should be denied.

The AG's Motion next requests that the Commission compel the Joint Respondents to provide "documentation authorizing the amount of the management fee Mr. Rife earns from both B&H and Johnson County Gas," as requested in the AG's Supplemental Request, Item 3(e). The Joint Respondents have stated that no documentation exists authorizing the amount of the management fees B&H pays to Mr. Rife and we therefore find that the request has been answered. We also find that any documentation regarding the fees that JCG pays to Mr. Rife are beyond the scope of this case and find that the AG's Motion in regard to this item should be denied.

The AG's Motion next requests that the Commission compel the Joint Respondents to respond to the AG's Supplemental Request, Item 4(c), and to "[s]tate whether Mr. Rife, and/or any of the officers, directors or partners of: (i) B&H; (ii) B&S; (iii) Johnson County Gas; and (iv) Hall, Stephens & Hall, have any ownership interest of any type or sort, including but not limited to royalties, in these seven (7) gas wells." The Joint Respondents failed to provide any response to this request regarding Mr. Rife and objected and refused to provide any of the information requested regarding both JCG and HSH, asserting that "[t]his request is irrelevant to this proceeding; the information is not in the Respondents' possession and control; the request is unduly burdensome; and the request is designed to harass or annoy the Respondents."²³ The Joint Respondents

²³ Respondents response to the AG's Supplemental Request (filed June 15, 2016), Item 4(c).

further maintain that this information is “confidential, and is not likely to lead to admissible evidence.”²⁴

In support of his motion to compel, the AG maintains that JCG and HSH are affiliated with the two Joint Respondents in the current case, and that “[t]he financial stability of any one, or combination of these affiliates can and will directly affect the financial stability of Joint Respondents.”²⁵ The AG further asserts, “the record in the instant case, and in prior Commission dockets, has amply demonstrated a clear pattern of self-dealing between all of these entities which has contributed to B&H’s unduly high gas supply cost, thus harming B&H’s ratepayers.”²⁶ The Joint Respondents acknowledge that these seven gas wells are the sole source of B&S’s gas supply;²⁷ that B&H’s gas is supplied almost entirely by B&S;²⁸ and that B&H is B&S’s only customer.²⁹

As previously stated, the Commission recognizes that an affiliate relationship exists between the Joint Respondents, JCG, and HSH. In addition to being the sole proprietor of B&S, the sole owner of B&H and JCG, and a partial owner of HSH, Mr. Rife also solely operates, manages and controls B&H, B&S, and JCG, and is the managing partner of HSH. Due to these affiliate relationships and Mr. Rife’s ownership and control over each entity, we find that the information sought by the AG as to whether, and to what extent, JCG and HSH have ownership interests in the seven gas

²⁴ Respondents response to the AG’s Motion to Compel (filed July 21, 2016) at 3.

²⁵ AG’s Motion to Compel (filed July 5, 2016) at 8.

²⁶ *Id.*

²⁷ Respondents’ response to the AG’s Initial Request (filed Apr. 18, 2016), Item 8.

²⁸ *Id.*, Item 13.

²⁹ *Id.*, Item 9.

wells supplying B&S is relevant to this proceeding and that this information is readily available and maintained by Mr. Rife. We find, therefore, that the AG's Motion in regard to this material should be granted.

In our discussion of the portion of the AG's Motion seeking to compel a response to the AG's Initial Request, Item 11, we also discussed the portion of the AG's Motion seeking to compel "an adequate and complete response" to Item 5(b) of the AG's Supplemental Request and for an explanation of why it would be burdensome to obtain copies of documents setting forth the costs B&S incurs in obtaining gas for B&H." As stated above, we disagree with the Joint Respondents' assertion that the requested documents are not probative or relevant to this proceeding, and find that the AG's Motion in regard to this item should be granted.

Finally, the AG's Motion seeks to compel requests responses to the AG's Supplemental Request, Item 8 (c)–(e), regarding the gas prices per mcf and the quantities of gas (in mcf) provided by HSH to JCG over periods of years. As the price of the gas that JCG purchases from HSH, as well as the quantities of this gas, is beyond the scope of this proceeding, we find that the AG's Motion in regard to this item should be denied. We note, however, that JCG, as a public utility under the jurisdiction of the Commission, is required to provide information regarding its gas purchases in its annual reports filed with the Commission and that these annual reports are available for review by the public on the Commission's website.

The Commission HEREBY ORDERS that:

1. The Joint Respondents' motion requesting leave to late file their Response to the AG's Motion is granted.

2. The AG's motion requesting leave to late file his reply to the Joint Respondents' response to the AG's Motion is granted.

3. The AG's Motion for a more adequate and complete response to the AG's Initial Request, Item 6(f), concerning remuneration during the past five years from HSH to Mr. Rife and any individuals related to him by blood or marriage, is denied as having been answered.

4. The AG's Motion for a more adequate and complete response to the AG's Initial Request, Item 11, concerning copies of all documents setting forth the costs B&S incurs in obtaining gas for B&H, is granted.

5. The AG's Motion for an adequate and complete response to the AG's Initial Request, Item 21, concerning whether B&H is contemplating or plans to file bankruptcy, is denied.

6. The AG's Motion for an adequate and complete response to the AG's Initial Request, Item 22, concerning whether B&S is contemplating or plans to file bankruptcy, is denied.

7. The AG's Motion for an adequate and complete response to the AG's Supplemental Request, Item 2(c), concerning sums paid by JCG and HSH to Rife Construction, is denied.

8. The AG's Motion for an adequate and complete response to the AG's Supplemental Request, Item 3(b), concerning the amount of profit or loss of HSH, is denied.

9. The AG's Motion for a response to the AG's Supplemental Request, Item 3(e), concerning documentation authorizing the amount of the management fee Mr. Rife earns from B&H, is denied as having been answered.

10. The AG's Motion for a response to the AG's Supplemental Request, Item 3(e), concerning documentation authorizing the amount of the management fee Mr. Rife earns from JCG, is denied.

11. The AG's Motion for an adequate and complete response to the AG's Supplemental Request, Item 4(c), concerning whether Mr. Rife, and/or any of the officers, directors or partners of (i) B&H; (ii) B&S; (iii) JCG; and (iv) HSH, have any ownership interest of any type or sort, including but not limited to royalties, in the seven gas wells, is granted.

12. The AG's Motion for an adequate and complete response to the AG's Supplemental Request, Item 5(b), concerning why it would be burdensome to obtain copies of documents setting forth the costs B&S incurs in obtaining gas for B&H, is granted.

13. The AG's Motion for an adequate and complete response to the AG's Supplemental Request, Items 8(c)–(e), concerning JCG's gas purchases from HSH, is denied.

14. The Joint Respondents shall provide adequate and complete responses to the AG's Initial Request, Item 11, the AG's Supplemental Request, Item 4(c), and the AG's Supplemental Request, Item 5(b), within ten days of the date of this Order.

By the Commission

ENTERED
OCT 20 2016
KENTUCKY PUBLIC
SERVICE COMMISSION

ATTEST:



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