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 PRICE IT IS CHARGED BY ITS AFFILIATE, B&S OIL AND GAS COMPANY, PURSUANT TO KRS 278.274	)))))	CASE NO. 2015-00367

ORDER

On May 24, 2017, B&H Gas Company ("B&H") and B&S Oil and Gas Company ("B&S") (collectively the "Companies") filed a motion for rehearing of the Commission's May 4, 2017 Order. Specifically, the Companies argue that the Commission is without authority to require B&H or B&S to issue refunds to customers and that the rate established as B&H's gas cost adjustment ("GCA") component of its rates and the price that B&S can charge B&H are not reasonable rates. On June 8, 2017, the Attorney General of the Commonwealth of Kentucky, by and through his Office of Rate Intervention ("AG"), filed a motion to set a procedural schedule on the Companies' motion for rehearing.

This proceeding was initiated by the Commission's Order of November 24, 2015, to investigate the gas cost component of B&H's rates. The November 24, 2015 Order specifically required that B&H collect the gas cost component of its rates *subject to refund*

for bills rendered after the date of the Order until further Order of the Commission. On June 30, 2016, the Commission reiterated that B&H was to continue collecting the gas cost component of its rates *subject to refund.* The Commission further ordered that B&H establish an interest-bearing escrow account and deposit all GCA revenues collected after June 30, 2016, above $4.84 per Mcf, into this account. The Commission's May 4, 2017 Order disallowed a portion of B&H's GCA revenues collected since November 24, 2015, and ordered B&H and B&S to issue, over a two-year period, refunds of the amount disallowed.

In support of its motion for rehearing regarding the required refunds, the Companies assert that the gas cost component of B&H's retail rates was the rate on file with the Commission; that B&H's tariff did not require it to file quarterly GCAs, but only required it to file for an adjustment in its GCA when the cost of gas from its wholesale providers changed, which rate B&H states has not changed. The Companies state that the Commission is without authority to order B&H and B&S to issue refunds as this constitutes "retroactive ratemaking" and would violate the "filed rate doctrine," citing the Court of Appeals decision in *Cincinnati Bell Telephone Company vs. Kentucky Public Service Commission*, 223 S.W. 3d, 829 (Ky. Ct. App., 2007) ("Cincinnati Bell"). The Cincinnati Bell case involved a complex combination of directives issued by the Federal Communications Commission ("FCC") pursuant to the Telecommunications Act of 1996. The FCC stated that a period of transition would be necessary as a competitive payphone market developed and that the telecommunication companies were entitled to await a

prospective decision of the Commission. The Court of Appeals held that the Commission could not retroactively impose terms of FCC's order on telecommunications companies that were not subject to federal jurisdiction, and the companies were entitled to await a prospective decision of the Commission as to how it would regulate the companies as no policy had been articulated as a matter of fact at the time of the Commission's Order. The Court of Appeals stated that although the Commission is granted sweeping authority to regulate public utilities pursuant to the provisions of KRS Chapter 278, it is nonetheless a creature of statute and has only such powers as granted by the General Assembly.

The issues presented in the current matter are distinguishable from those in the Cincinnati Bell case relied upon by the Companies. In this case, there is an established process that allows jurisdictional natural gas utilities to recover the reasonable cost, but not to earn a profit on, the cost of the commodity it provides to its customers. The Commission has extensive experience reviewing the reasonableness of the gas cost component of local distribution companies' ("LDC") rates and has, in the past, ordered LDC's to collect the gas cost component of their rates *subject to refund*. In Case No. 8528-I,[1] for example, Delta Natural Gas Company, Inc. ("Delta") filed for its quarterly gas cost adjustment to become effective February 1, 1984, and to remain in effect until May 1, 1984. On February 1, 1984, the Commission approved Delta's rates to be effective on and after February 1, 1984, *subject to refund*. Delta filed a motion for reconsideration, asking the Commission to remove the "subject to refund" clause from its Order. At that

[1] Case No. 8528-I, *Notice of Purchased Gas Adjustment Filing of Delta Natural Gas Company, Inc.* (Ky. PSC Mar. 12, 1984).

time, the Commission was investigating the inclusion of gas storage and the seasonal fluctuation of the actual adjustment, and denied Delta's motion and ordered that Delta's rates approved February 1, 1984, should remain in effect *subject to refund* pending the outcome of its investigation.

The refund issue raised by the Companies should also be reviewed in light of the Supreme Court of Kentucky's subsequent opinion in the case *Kentucky Pub. Serv. Comm'n v. Com. ex rel. Conway*, 324 S.W.3d 373 (Ky.2010), in which the Supreme Court reversed a Court of Appeals' decision, and affirmed the Commission's Order approving Duke Energy Kentucky, Inc.'s ("Duke") implementation of an accelerated main replacement program ("AMRP") rider. The Supreme Court held that:

> The broad role of the PSC in regulating and investigating utilities to ensure that utilities comply with state law is set forth in KRS 278.040 . . . .
> (3) The commission may . . . *investigate the methods and practices of utilities to require them to conform to the laws of this state,* and to all reasonable rules, regulations and orders of the commission not contrary to law.
>
> Because utilities are allowed to charge consumers only "fair, just, and reasonable rates" under KRS 278.030(1), the PSC must ensure that utility rates are fair, just and reasonable to discharge its duty under KRS 278.040 to ensure that utilities comply with state law.

The Supreme Court further concluded "[w]hile the power . . . at issue may not have been expressly granted by statute . . . . we, nonetheless, conclude that the PSC has the power . . . . upon (1) its *plenary ratemaking authority* derived from KRS 278.030 and KRS 278.040, to require that the PSC act to ensure that rates are fair, just and reasonable. The Supreme Court added, "the [Commission] has broad ratemaking power . . . even in

the absence of a statute specifically authorizing . . . ." The Supreme Court held that the Commission has *plenary authority* to regulate and investigate utilities and a duty to establish *fair just and reasonable rates* without necessarily requiring a particular procedure to deal with specific ratemaking issues.

In the case at hand, the Commission's November 24, 2015 Order, specifically directed B&H to collect the gas cost component of its rates *subject to refund* on a *prospective basis* – from the date of the Order. The Commission repeated this directive in its June 30, 2016 Order, and further ordered that B&H establish an interest-bearing account and to deposit into this account all gas cost component revenues collected by B&H above $4.84, from the date of that Order – again on a prospective basis. The Commission put the Companies on specific, advance notice, in both the November 24, 2015 Order and the June 30, 2016 Order, that the future collection of the gas cost component of B&H's rates and the rate B&S charged B&H for gas in the future were subject to refund. The Companies raised no objection or challenge in response to either of those Orders. The Commission's authority in establishing the fair, just and reasonable cost of gas provided by B&H and B&S is well within the Commission's *plenary ratemaking authority* as defined by the Supreme Court in the Duke AMRP decision, and the Commission finds that the Companies' motion for rehearing regarding the ordered refunds should be denied.

The Companies' motion for rehearing also asserts that B&S's *actual cost* to provide gas to B&H is higher than the rate it has been charging B&H since 2008, and bases this position on a list of invoices for services from Bud Rife Construction. Based on the affiliate

relationship that exists between B&H, B&S and Bud Rife Construction, however, this argument is irrelevant based on the statutory requirements applicable to affiliate transactions.

Mr. Bud Rife is the president and owner of 100 percent of the stock of B&H. In addition, Mr. Rife owns B&H's primary wholesale gas supplier, B&S, as well as Bud Rife Construction, which provides services and products to both B&H and B&S, creating an affiliate relationship among them.[2] B&H's purchase of gas from B&S is subject to the affiliate transactions provisions of both KRS 278.2207 and KRS 278.274.

KRS 278.2207(1)(b) 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* (emphasis added) . . . ." KRS 278.2207(3) also provides that "[n]othing in this section shall be construed to interfere with the [C]ommission's requirement to ensure fair, just, and reasonable rates for utility services." Assuming for the sake of argument that the referenced invoices can be relied upon and that the cost for B&S to serve B&H would produce a rate that is higher than the market-based rate found reasonable by the Commission, the clear language of the statute requires that the lower market-based gas cost be used for the simple reason that it *is* lower.

In the current matter, KRS 278.274(1) provides that in determining whether B&H's rates are just and reasonable, the Commission shall review B&H's gas purchasing practices, and if found to be imprudent, permits the Commission to "disallow any costs or

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[2] KRS 278.020(18) defines an "affiliate" as a person that controls or that is controlled by, or is under common control with, a utility.

rates" deemed to result from imprudent purchasing practices. This prudency review by the Commission, and the Commission's authority to disallow costs deemed to result from imprudent purchasing practices, is critical to the Commission's decision in this matter, both in determining the reasonableness of B&S's cost to B&H for providing gas and in the Commission's disallowance of a portion of that cost and the ordered refund. It is statutorily presumed that natural gas purchases from affiliated companies are not conducted at arm's length,[3] and the Commission shall "assume jurisdiction of the affiliated company as though it were a utility as defined in KRS 278.010."[4] KRS 278.274(3)(c) provides that "[i]f the [C]ommission determines that the rates charged by the utility are not just and reasonable in that the cost of natural gas purchased from the affiliated company is unjust or unreasonable, the [C]ommission may reduce the purchased gas component of the utility's rates by the amount deemed to be unjust or unreasonable." The Commission may also reduce the rate charged by the affiliated company by the same amount.[5]

Between October 2004 and March 2008, as the price of natural gas across the country was increasing, the Companies were vigilant about raising the price that B&S charged B&H for providing gas and increasing the gas cost component of B&H's rates. These increases were done through a series of four revised gas-purchase agreements,

[3] KRS 278.274(3)

[4] KRS 278.274(3)(b).

[5] KRS 278(3)(d).

with each reflecting an increase in the wholesale price charged B&H by B&S. B&H's last GCA application to raise its gas cost component from $7.00 to $9.38 per Mcf was filed on March 19, 2008. Since 2008, the market price for natural gas nationwide has declined. Yet, the Companies have not revised the 2008 gas-purchase agreement between B&H and B&S.[6]

Using a combination of the same factors referenced by B&H as support for its 2008 GCA application increasing its gas cost rate from $7.00 Mcf to $9.38 Mcf in Case No. 2008-00101, the Commission's May 4, 2017 Order established $5.9855 as the market price of gas.[7] Finding that $5.9855 per Mcf is the market price for the gas B&S provides to B&H and that it is consistent with the requirements of KRS 278.2207(1)(b), the Commission finds that the Companies' motion for rehearing on this issue should be denied.

Finally, in finding that rehearing should be denied regarding both of the issues presented by the Companies in their motion for rehearing, the Commission finds that the AG's motion to set a procedural should also be denied as moot.

IT IS HEREBY ORDERED that:

1. The Companies' motion for rehearing regarding the ordered refunds is denied.

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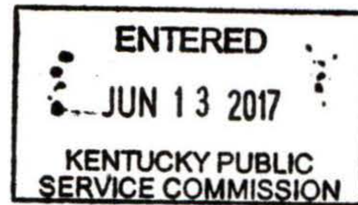
[6] See May 4, 2017 Order at 16.

[7] Specifically, the Commission used a combination of Columbia Gas of Kentucky's most recent Intrastate Utility Service rate averaged with Peoples Gas KY, LLC's expected gas cost ("EGC") multiplied by two (once as a substitute for the NYMEX rate, since Peoples uses the NYMEX in calculating its EGC), as adjusted for B&H's heating content.

2. The Companies' motion for rehearing regarding the rate charged to B&H by B&S is denied.

3. The AG's motion to set a procedural schedule is denied as moot.

By the Commission



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