COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF CITIPOWER, LLC FOR (1) AN ADJUSTMENT OF RATES PURSUANT TO 807 KAR 5:076; (2) APPROVAL FOR A CERTIFICATE OF PUBLIC CONVENIENCE AND NECESSITY TO PURCHASE PIPELINE AND OTHER RELATED ASSETS; AND (3) APPROVAL OF FINANCING	)))))))	CASE NO. 2019-00109

ORDER

On March 29, 2019, Citipower, LLC (Citipower), tendered an application requesting to adjust its rates pursuant to the procedures set forth in 807 KAR 5:076, for a Certificate of Public Convenience and Necessity (CPCN) to acquire an existing pipeline, and for authority to obtain financing to acquire the existing pipeline (Application). No person requested to intervene in this matter, and the Commission has received no public comments to date regarding the Application. Citipower responded to requests for information from Commission Staff on July 23, 2019, and August 19, 2019. On August 26, 2019, Citipower filed a motion to submit the case for adjudication on the administrative record without a formal hearing. Having reviewed the record and being otherwise sufficiently advised, the Commission finds that Citipower's motion to submit the case for adjudication on the administrative record should be granted with respect to Citipower's request for a CPCN and for financing approval and that Citipower's requests for a CPCN and for financing approval should be granted subject to the conditions discussed below.

However, the Commission declines to take Citipower's application for a rate adjustment under submission at this time for the reasons discussed below.

BACKGROUND

Citipower is a small gas distribution utility with approximately 353 residential customers and 92 commercial and industrial customers.[1] Citipower purchased an average of 64,694 mcf of natural gas per year for distribution over the last five years. Citipower has historically obtained most of its gas from local wells owned by Forexco, LLC (Forexco), and has obtained gas during peaking periods from Citizens Gas Utility District (Citizens), a gas distribution cooperative in Tennessee.[2] For instance, Citipower obtained 5,310 mcf, 2,378 mcf, and 4,623 mcf of natural gas from Citizens in 2018, 2017, and 2016, respectively,[3] and the rest of Citipower's gas in each of those years was obtained from the local wells owned by Forexco.[4] However, Citipower presented evidence that Forexco's wells are reaching the end of their useful lives, and Citipower expects the production of the wells to continue to decrease and to be fully depleted in the next 5 to 10 years.[5]

Citipower proposes to address the expected decrease in production at Forexco's wells by purchasing the Herbert White Pipeline, which currently runs between Citipower and Delta Natural Gas, Inc.'s (Delta) systems.[6] Citipower contended that if it purchased

---

[1] 2018 Annual Report at p. 26.

[2] Reason for Application attachment to Application.

[3] Response to Staff's First Request for Information (Staff's First Request), Item 3.

[4] Response to Staff's Second Request for Information (Staff's Second Request), Item 17.

[5] Response to Staff's First Request, Item 1.

[6] Application.

the pipeline, it would be able to obtain gas from marketers on Delta's system at the monthly NYMEX settlement price plus $1.25 Dekatherm (Dth), which Citipower indicated was consistent with the price at which it obtains gas from Forexco.[7] Citipower proposes to purchase the pipeline for $1.5 million and to fund the purchase with a loan in the same amount, secured by Citipower's property, with an interest rate not to exceed 6.5 percent.[8]

Citipower argued that it would not be viable for it to obtain its base supply from Citizens. First, Citipower noted that Citizens currently charges a significant premium for the gas it supplies such that it currently costs Citipower more than $8.06 per mcf over the cost of gas obtained from Forexco, including all transportation and marketing fees.[9] Further, Citipower's current contract with Citizen's is for peak periods only, and Citipower indicated that Citizen's did not appear interested in providing Citipower's base gas supply.[10] Citipower also indicated that its management did not believe Citizens was a reliable source for its base gas supply, because it is a Tennessee cooperative established to serve local residents and, therefore, providing service to those residents will always be its priority.[11] Finally, Citipower indicated that the current owner of the Herbert White Pipeline uses it as a gathering line to transport gas to Delta's system and is not willing to use it to flow gas to Citipower's system.[12]

---

[7] Response to Staff's Second Request, Item 9.

[8] Application.

[9] Reason for Application attachment to Application; Response to Staff's First Request, Item 7.

[10] Response to Staff's First Request, Item 7.

[11] Response to Staff's First Request, Item 4.

[12] Response to Staff's First Request, Item 21.

Citipower asserted that the only alternative to purchasing the Herbert White Pipeline would be to construct a new 20-mile pipeline to connect Citipower's system to Delta's system.[13] However, Citipower estimated that the pipeline would cost approximately $6.28 million to construct based on the cost per mile of a pipeline recently constructed by a Citipower affiliate in Bell County.[14] Thus, Citipower argued that constructing a new pipeline would be too expensive and would place too much of a financial burden on its customers.[15]

Citipower estimated that its purchase of the pipeline under the terms described in the application would increase its interest expense in the first year by $96,658.00.[16] Citipower also estimated that its operating and maintenance expenses for the pipeline would be $190,118 per year and that its purchase of the pipeline would result in an increase in annual depreciation expense of $37,500.[17] However, Citipower expects to be able to obtain the peaking gas it is currently obtaining from Citizens through the Herbert White Pipeline, which it stated would result in a decrease in the cost of that gas.[18] Citipower also estimated that it would earn transportation fees from producers currently using the Herbert White Pipeline in the amount of $27,375.00 per year.[19]

---

[13] *See* Reason for Application attachment to Application (discussing the alternatives).

[14] Reason for Application attachment to Application; Response to Staff's First Request, Item 11; Response to Staff's Second Request, Item 5.

[15] Reason for Application attachment to Application.

[16] Response to Staff's Second Request, Item 21.

[17] ARF Form 1 – Attachment SAO-G.

[18] Reason for Application attachment to Application.

[19] Response to Staff's Second Request, Item 23.

Citipower proposed a rate increase in conjunction with its request for a CPCN and financing approval to recover the increased costs associated with its purchase of the Herbert White Pipeline. Most of the change in Citipower's revenue requirement can be attributed to its proposed purchase of the Herbert White Pipeline.[20] However, Citipower based its revenue requirement on a historical test year ending December 31, 2018, with pro forma adjustments for its purchase of the Herbert White Pipeline.[21] Thus, Citipower's proposed rate increase reflects changes in its costs and revenues between its last rate case in 2017 and the end of the test period in addition to changes arising from its purchase of the Herbert White Pipeline.

DISCUSSION

Citipower's requests for a CPCN, for financing approval, and for a rate adjustment in this matter are interconnected and involve some similar facts. More importantly, as acknowledged by Citipower, neither the financing approval nor the rate increase would be necessary if the CPCN were denied. However, each of Citipower's requests involves separate legal issues and standards to which the facts must be applied. Thus, the Commission addresses each of Citipower's requests separately below.

Citipower's Request for a CPCN

The Commission's standard of review regarding a CPCN is well settled. Under KRS 278.020(1), no utility may construct or acquire any facility to be used in providing utility service to the public until it has obtained a CPCN from this Commission. To obtain

[20] *See* ARF Form 1 – Attachment SAO-G (showing pro forma adjustments related to the purchase of the pipeline that are roughly equal to Citipower's requested revenue increase).

[21] *Id.*

a CPCN, the utility must demonstrate a need for such facilities and an absence of wasteful duplication.[22]

"Need" requires:

> [A] showing of a substantial inadequacy of existing service, involving a consumer market sufficiently large to make it economically feasible for the new system or facility to be constructed or operated.
>
> [T]he inadequacy must be due either to a substantial deficiency of service facilities, beyond what could be supplied by normal improvements in the ordinary course of business; or to indifference, poor management or disregard of the rights of consumers, persisting over such a period of time as to establish an inability or unwillingness to render adequate service.[23]

"Wasteful duplication" is defined as "an excess of capacity over need" and "an excessive investment in relation to productivity or efficiency, and an unnecessary multiplicity of physical properties."[24] To demonstrate that a proposed facility does not result in wasteful duplication, we have held that the applicant must demonstrate that a thorough review of all reasonable alternatives has been performed.[25] Selection of a proposal that ultimately costs more than an alternative does not necessarily result in

---

[22] *Kentucky Utilities Co. v. Pub. Serv. Comm'n*, 252 S.W.2d 885 (Ky. 1952).

[23] *Id.* at 890.

[24] *Id.*

[25] Case No. 2005-00142, *Joint Application of Louisville Gas and Electric Company and Kentucky Utilities Company for the Construction of Transmission Facilities in Jefferson, Bullitt, Meade, and Hardin Counties, Kentucky* (Ky. PSC Sept. 8, 2005).

wasteful duplication.[26] All relevant factors must be balanced.[27] The statutory touchstone for ratemaking in Kentucky is the requirement that rates set by the Commission must be fair, just, and reasonable.[28]

Here, Citipower has established a need for an alternative gas supply. The production at the local wells that currently supply most of Citipower's gas is decreasing, and the wells are expected to be depleted in the next 5 to 10 years. Further, gas purchased from Citizens is too expensive at the peaking load rate, and there is no evidence that Citizens would be willing to commit to selling Citipower its base load supply. Finally, while Citipower is currently connected to Delta's system through the Herbert White Pipeline, which it is proposing to purchase, the evidence indicates that the current owner of the Herbert White Pipeline uses it as a gathering line to transport gas to Delta's system and is not willing to transport gas from Delta's system for sale to Citipower.[29] Thus, the evidence indicates that Citipower needs an alternative gas supply to meet its base demand.

The Commission also finds that the evidence presented in this case supports Citipower's assessment regarding the viability of constructing a new pipeline. First, Citipower estimated the overall cost of constructing a new pipeline to be $6.28 million,

---

[26] *See* Kentucky Utilities Co. v. Pub. Serv. Comm'n, 390 S.W.2d 168, 175 (Ky. 1965). *See also* Case No. 2005-00089, *The Application of East Kentucky Power Cooperative, Inc. for a Certificate of Public Convenience and Necessity to Construct a 138 kV Electric Transmission Line in Rowan County, Kentucky* (Ky. PSC Aug. 19, 2005).

[27] Case No. 2005-00089, *East Kentucky Power Cooperative, Inc.* (Ky. PSC Aug. 19, 2005), Final Order at 6.

[28] KRS 278.190(3).

[29] *See* Response to Staff's First Request, Item 21.

which is more than four times the cost of the Herbert White Pipeline, and Citipower's estimate appears to be reasonable. Citipower based the estimated cost per mile of a new pipeline on the costs incurred by one of its affiliates to construct a similar pipeline in nearby Bell County.[30] Further, while costs will vary based on circumstances and size of the pipeline, Citipower's estimated cost per mile is actually lower than the cost per mile of other recent pipelines. Thus, the Commission finds that the construction costs of a new pipeline would be higher than the purchase price of the Herbert Walker Pipeline.

The higher upfront costs of a new pipeline would significantly increase the costs to Citipower's customers. For instance, assuming an interest rate of 6.5 percent per year and similar repayment terms, the interest expense on the loan for a new pipeline alone would exceed all of the expected cost increases of the purchase of the Herbert White Pipeline.[31] On top of the significant increase in interest expense, the annual depreciation expense for a new pipeline would be significantly higher than the depreciation expense on the Herbert White Pipeline.[32] Citipower would also be unable to earn alternative revenue from the new pipeline by transporting gas for producers currently connected to the Herbert White Pipeline, which Citipower estimated would currently offset the increase

---

[30] *See* Response to Staff's First Request, Item 11; Response to Staff's Second Request, Item 5.

[31] Citipower calculated the interest expense on the $1.5 million loan to be $96,658.00 a year in the first year. *See* Response to Staff's Second Request, Item 21. With the same interest rate and payment schedule, the interest expense on a $6.28 million loan would be approximately $404,674.00 in the first year. Conversely, Citipower is requesting an increase in operating and maintenance expenses in the amount of $190,118.00; an increase in depreciation expense in the amount of $37,500.00; and an increase in interest expense in the amount of $96,658.00 arising from its purchase of the Herbert White pipeline. *See* ARF Form 1 – Attachment SAO-G (showing pro forma adjustments related to the purchase of the pipeline).

[32] Citipower has effectively proposed to depreciate the Herbert Walker Pipeline based on about a 65 to 70 year useful life, because it was mostly completed by the mid-1990s and Citipower proposes to depreciate its expected $1.5 million cost over 40 years from the date of purchase. Assuming a similar 70-year useful life for the new pipeline, the annual straight-line depreciation expense of the original cost basis would be $89,714, more than double the depreciation expense for the Herbert White Pipeline.

in expense in the case of the Herbert White Pipeline by $27,375. Thus, the evidence supports Citipower's conclusion that the purchase of the Herbert White Pipeline is more economical than constructing a new pipeline.

To be clear, there would be advantages to constructing a new 20-mile pipeline. For instance, despite Citipower's assertions to the contrary, the annual operation and maintenance costs for a new 20-mile pipeline would be lower, because it would be shorter and presumably in better condition. Citipower would also likely have more knowledge regarding the condition and the location of a new pipeline, which would reduce the risk of certain unexpected costs. However, Citipower has indicated that it does not expect the pipeline to require any significant work in the next ten years and that it would perform a pressure test on the pipeline before it completes its purchase to test its integrity. There is also a risk of unexpected costs in construction projects, particularly where it would be necessary to obtain easement rights for nearly 20 miles. Thus, while a material change in the facts might tilt the balance toward the construction of a new 20-mile pipeline, the Commission finds, based on the recorded, that the purchase of the Herbert Walker Pipeline is the most reasonable alternative to satisfy Citipower's need for an additional fuel source and that Citipower's request for a CPCN should be granted.

In granting Citipower's request for a CPCN, the Commission recognizes that Citipower's purchase of the Herbert White Pipeline is not final and that Citipower has not completed its due diligence. However, the Commission is approving Citipower's CPCN based on the facts and the expected terms of purchase expressed in the record of this case and with the expectation that Citipower will perform its due diligence to confirm the condition of the pipeline. If Citipower determines that there is a material difference in the facts or expected terms of purchase as compared to the representations it made in support of its CPCN, including any material change in the condition of the pipeline and any material increase in the expected costs,[33] Citipower should not proceed with the purchase until the Commission has approved an amended application for a CPCN.

The Commission's approval of the CPCN is also conditioned on Citipower performing any due diligence that is reasonably necessary before it finalizes the purchase. Such due diligence should, at minimum, include the performance of the pressure test Citipower indicated it would perform to assess the condition of the pipeline. Citipower will bear the risk of any failure to perform its due diligence reasonably in completing the purchase of the Herbert Walker Pipeline.

Citipower's Request for Financing Approval

KRS 278.300(1) provides that "[n]o utility shall issue any securities or evidences of indebtedness . . . until it has been authorized so to do by order of the commission." The Commission is prohibited from approving the issue of securities or evidences of indebtedness unless it finds that the issue "is necessary or appropriate for or consistent with the proper performance by the utility of its service to the public and will not impair its ability to perform that service, and is reasonably necessary and appropriate for such purpose."[34] The Commission may grant approval for the issuance of securities or evidences of indebtedness "with such modifications and upon such terms and conditions as [it] deems necessary and appropriate."[35]

[33] The Commission would not consider a decrease in any expected cost, in and of itself, to be a material change under the circumstances.

[34] KRS 278.300(3).

[35] KRS 278.300(4).

Here, Citipower requests authority to obtain a loan in the amount of $1.5 million with an interest rate not to exceed 6.5 percent per annum for the sole purpose of purchasing the Herbert White Pipeline. As noted above, the Commission finds that Citipower's purchase of the Herbert White Pipeline is necessary and will not result in wasteful duplication. Thus, subject to the conditions discussed below, the Commission finds that the loan for which Citipower requests approval is for a lawful object within the corporate purposes of Citipower's utility operations, is necessary and appropriate for and consistent with the proper performance of Citipower's service to the public, will not impair Citipower's ability to perform that service, and is reasonably necessary and appropriate for such purposes.

However, the lender for the loan at issue herein proposed that it include a term requiring that it be cross-collateralized and cross-defaulted with any future loan obtained by Citipower or its affiliates from the lender. Such a term, or one like it, would effectively make Citipower the guarantor and its property the collateral for any future loans from the lender to Citipower's affiliates because Citipower would have to pay to keep its affiliates' debts current to ensure that the lender did not hold it in default with respect to its loan or attempt to seize Citipower's property to satisfy the debts of its affiliates. Permitting Citipower to effectively act as guarantor in that way for unknown or future loans to its affiliates would not be necessary or appropriate for or consistent with the proper performance of Citipower's service to the public and would potentially impair its ability to perform that service. Thus, as a condition of its approval of Citipower's application to issue the debt, the Commission finds that the loan agreement and any related agreement shall not include any term that requires the loan to be cross-collateralized or cross-defaulted with any current or future loans to Citipower's affiliates.[36]

The Commission also notes that its approval herein is based upon statements made by Citipower in its Application and its responses to Commission Staff's requests for information. The Commission expects the final terms of the loan for which approval is requested in this matter to be consistent with representations made in this matter in all material respects except as specified above. Moreover, the Commission expects that Citipower identified all material terms as to the costs of the loan, the security being offered for the loan, and the circumstances under which the loan could go into default. Thus, the Commission's approval of Citipower's loan is also conditioned on the final loan agreement being consistent with representations made in this matter in all material respects, except as otherwise stated in this Order, and on the final loan agreement containing no additional terms that materially increase costs, or materially change the security for the loan or the circumstances under which the loan could go into default.[37]

Citipower's Request for a Rate Increase

Citipower indicated that its requested rate increase would only be necessary to the extent that the Commission grants its request for a CPCN and authorizes its requested financing because it argued that the rate increase was intended to recover increased

---

[36] *See* KRS 278.300(2)(indicating that the Commission shall not grant approval to a utility to assume the debts of another unless the Commission finds, among other things, that it is necessary or appropriate for or consistent with the proper performance by the utility of its service to the public and will not impair its ability to perform that service); *see also* KRS 278.2201 ("A utility shall not subsidize a nonregulated activity provided by an affiliate or by the utility itself.").

[37] The Commission observes that decreases in fees and costs, reductions in the security interest the lender would take in Citipower's property, and the removal of conditions under which the loan could go into default, even if significant, would not be material under the circumstances.

costs associated with its operation of the Herbert White Pipeline.[38] The Commission agreed that the Citipower's rate increase depended in large part on whether the Commission approved Citipower's CPCN and financing and permitted Citipower to file its request for a rate increase with its request for a CPCN and financing approval for the sake of efficiency.[39] Citipower has now requested that the Commission take its entire application under submission for a decision on the written record.[40]

While the Commission is granting Citipower's CPCN and request for financing approval in this order as discussed above, Citipower's purchase of the Herbert Walker Pipeline and the terms of its financing are still contingent. Specifically, Citipower has no binding contract to purchase the pipeline and indicated that it was waiting to perform its due diligence regarding the condition of the pipeline until it received approval from the Commission, so it is currently not even clear that Citipower will purchase the pipeline despite having approval to do so. Further, the terms of Citipower's financing, including the interest rate, are not final and the Federal Reserve has decreased interest rates since Citipower filed this application, so it appears likely that Citipower will be able to obtain a more favorable interest rate than the rate it used to calculate rates. Thus, the increased costs and expenses arising from the Herbert White Pipeline, which are the primary basis for Citipower's request for a rate increase, are currently too speculative to establish rates

[38] Citipower's Motion for Deviation from Filing Requirements (filed Mar. 29, 2019).

[39] Order (Ky. PSC May 14, 2019).

[40] Citipower's Motion to Submit Case for Adjudication on the Administrative Record and Waiver of Right to Hearing (filed Aug. 23, 2019).

based on Citipower's projections.[41]

Citipower indicated that if its requests for a CPCN and financing were approved by the Commission on or before September 27, 2019, that Citipower expects to know whether it will be able to reach an agreement with the current owner of the Herbert White Pipeline by October 31, 2019; to finalize the financing by December 31, 2019; and to begin transporting natural gas through the Herbert White Pipeline by mid-to-late January 2020.[42] The statutory deadline by which the Commission must address Citipower's request for a rate increase is March 26, 2020. Further, it would be more efficient to address Citipower's request for a rate increase as part of this case, given the extent of the investigation that has taken place. Thus, assuming Citipower does not intend to place its proposed rates into effect at the end of the suspension period, the Commission finds that the most reasonable course would be to deny Citipower's motion to submit with respect to its request for a rate increase; keep the record open while Citipower determines whether it will finalize its purchase of the Herbert White Pipeline; and issue a final order on the proposed rate increase based on updated information provided upon Citipower's purchase of the Herbert White Pipeline or after it determines it will not purchase the pipeline.

---

[41] The Commission acknowledges that it has established rates based on projected capital projects and projected interest rates. However, this case is different from those cases, because Citipower bases its need for a rate increase almost exclusively on its purchase of the Herbert White Pipeline; the costs and expenses associated with Citipower's purchase and operation of the Herbert White Pipeline would constitute a significant portion of Citipower's overall operating expenses and a significant portion of the rates collected from its small customer base; and the purchase of the Herbert White Pipeline is still contingent on Citipower performing its due diligence and coming to terms with a third party.

[42] Response to Staff's Second Request, Item 26.

IT IS THEREFORE ORDER THAT:

1. Citipower's motion to submit is granted with respect to its request for a CPCN to purchase the Herbert White Pipeline and for financing approval and is denied with respect to Citipower's request for a rate increase.

2. Citipower is granted a CPCN to purchase the Herbert White Pipeline as set forth in its application.

3. If Citipower determines that there is a material difference in the facts or expected terms of purchase as compared to those represented in its Application and in response to requests for information, Citipower shall apply for an amendment of the CPCN granted herein.

4. Citipower is authorized to issue the evidences of debt in a principal amount not to exceed $1.5 million subject to the conditions discussed above.

5. The proceeds from the issue of the evidences of debt authorized shall be used only for the lawful purposes set out in the application.

6. Immediately upon entering into an agreement for the purchase of the Herbert White Pipeline, whether conditional or not, Citipower shall notify the Commission by filing a notice of filing in this case; providing a copy of any written agreement; and describing any material terms of the agreement not included in the written agreement.

7. Immediately upon finalizing the terms and conditions of the debt approved, Citipower shall notify the Commission by filing a notice of filing in this case; providing a copy of any note and written agreement; and describing any material terms not included in the note or written agreement.

8. Within 30 days from the date of entry of this Order, Citipower shall notify the Commission by filing a notice of filing as to whether it intends to place its proposed rates into effect subject to refund upon the end of the suspension period if the Commission has not entered a final order by that date.

9. This matter shall remain open for further proceedings regarding Citipower's request for a rate increase.

[REMAINDER OF PAGE INTENTIONALLY LEFT BLANK]

By the Commission

ENTERED

SEP 27 2019

KENTUCKY PUBLIC
SERVICE COMMISSION

ATTEST:

Gwen R. Pinson

Executive Director

*CitiPower, L.L.C.
37 Court Street
P. O. Box 1309
Whitley City, KY 42653

*L Allyson Honaker
Goss Samford, PLLC
2365 Harrodsburg Road, Suite B325
Lexington, KENTUCKY 40504

*David S Samford
Goss Samford, PLLC
2365 Harrodsburg Road, Suite B325
Lexington, KENTUCKY 40504