

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF JOHNSON COUNTY	)	CASE NO.
GAS COMPANY, INC. FOR AN	)	2018-00434
ALTERNATIVE RATE ADJUSTMENT	)	

ORDER

On February 4, 2019, Johnson County Gas Company, Inc. (Johnson County), filed an application (Application) with the Commission, pursuant to 807 KAR 5:076, requesting to adjust its rates for natural gas service.<sup>1</sup> Johnson County requested rates that would increase its annual natural gas sales revenues by approximately \$153,608, a 107 percent increase to pro forma present rate natural gas sales revenues of \$143,666.<sup>2</sup> Among other things, Johnson County sought to recover \$144,972 of outstanding debt consisting of three promissory notes, all of which are dated December 28, 2018 (Promissory Notes).<sup>3</sup>

On February 8, 2019, the Attorney General of the Commonwealth of Kentucky, by and through his Office of Rate Intervention (Attorney General), the only intervenor in this matter, requested that the Commission initiate an investigation pursuant to KRS 278.300

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<sup>1</sup> Johnson County tendered its Application on December 28, 2018. It was rejected due to filing deficiencies. Johnson County cured the filing deficiencies and the Application was deemed filed on February 4, 2019.

<sup>2</sup> See Application, ARF Form 1 - Attachment Revenue Requirement Calculation (Attachment RRC) and ARF Form 1 - Attachment Schedule of Adjusted Operations (Attachment SAO) at 1. Attachment RRC states that the requested increase is a 107 percent increase from present revenues of \$143,666, which corresponds to the present revenues reported on Attachment SAO. See also Johnson County's Second Response to Filing Deficiencies, which calculates operating revenues from current and proposed rates as \$139,934 and \$238,359, respectively, a requested increase of 70 percent.

<sup>3</sup> Application, Unnumbered Attachment of Outstanding Debt Instruments.

regarding Johnson County's failure to obtain Commission approval prior to the issuance of the Promissory Notes and suspend Johnson County's proposed rates until such investigation is complete. On February 27, 2019, the Commission entered an Order granting the Attorney General's motion and holding this case in abeyance pending the outcome of the investigation initiated in Case No. 2019-00056.<sup>4</sup> On March 21, 2019, Johnson County and Bud Rife, individually and as an officer of Johnson County, filed undated documents revoking the three Promissory Notes.<sup>5</sup> This matter stands submitted for a decision based on the case record.

### BACKGROUND

In its Application, Johnson County included adjustments that together increase its test-year operating expenses by \$49,576.<sup>6</sup> Johnson County included adjustments to increase the amortization expense by \$9,528 to repay the Promissory Notes with the intent to recover past-due operating expenses incurred from affiliates.<sup>7</sup> Johnson County included adjustments totaling \$22,381 to correct the annual report for the improper

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<sup>4</sup> Case No. 2019-00056, *Electronic Investigation of Johnson County Gas Company, Inc. and Bud Rife, Individually and as an Officer of Johnson County Gas Company, Inc. Alleged Violation of KRS 278.300, a Commission Order, and a Tariff* (Ky. PSC Feb. 27, 2019).

<sup>5</sup> See Case No. 2019-00056, Response to Order Initiating Investigation, Exhibit A.

<sup>6</sup> Application, Attachment SAO at 1. This amount is exclusive of adjustments to remove gas costs and related revenues. Consistent with Johnson County's Gas Cost Recovery (GCR) tariff, gas costs are recovered through the GCR and are therefore removed from base rates through adjustments to test-year revenues and expenses.

<sup>7</sup> Application, Attachment SAO at 2. Contrary to the provided explanation of the adjustment, this amount does not include recovery of a fourth promissory note between Johnson County and Goss Samford PLLC. Additionally, the amortization period was incorrectly identified as 5 years for the notes to Bud Rife and Hall, Stephens, & Hall Gas Company. See Application, Unnumbered Attachment of Outstanding Debt Instruments.

accounting<sup>8</sup> of distribution expenses incurred from affiliates, including office rent, truck leases, and maintenance.<sup>9</sup> Adjustments were also included to increase administrative and general expenses by \$17,667, comprised of \$6,000 for budgeted legal expenses, \$1,667 for the three-year amortization of ongoing training, and \$10,000 for an unspecified purpose.<sup>10</sup>

Johnson County has made conflicting statements regarding the level of recurring expenses;<sup>11</sup> whether services are provided to Johnson County through Mr. Rife's management contract or from an affiliate;<sup>12</sup> and the affiliates that operated out of the same office as Johnson County.<sup>13</sup> As stated above, Johnson County also revoked the three

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<sup>8</sup> See Application, 2017 Federal Corporate Tax Return, Form 1120, Schedule K, and Attachment SAO at 2. Johnson County uses accrual accounting; however, it failed to record expenses that were incurred in the test year because they were not also paid in the test year.

<sup>9</sup> Application, Attachment SAO at 2.

<sup>10</sup> Application, Attachment SAO at 1 and 2.

<sup>11</sup> See Case No. 2019-00056, Johnson County's responses to Commission Staff's First Request for Information (Staff's First Request), Item 1, Exhibit 1 and the Attorney General's Initial Request for Information (Attorney General's Initial Request), Item 15.d, Exhibit 6 at unnumbered page 1 of 7. Johnson County states that office rent was increased from \$1,000 per month to \$2,000 per month in January 2018 due to the recalculation of expenses; however, the attached expenses include a late payment penalty for property taxes and do not fully justify rent expense of \$2,000 per month. Also, invoices show that Johnson County's office rent was increased to \$1,500 per month starting in October 2017 with no explanation.

<sup>12</sup> See Case No. 2019-00056, Johnson County's responses to the Attorney General's Initial Request, Item 9.c. and Staff's First Request, Item 2.b. Exhibit 3, unnumbered pages 7–91. Johnson County states that Mr. Rife's management contract includes meter reading and leak surveys. Johnson County is also invoiced for these services by Bud Rife Construction Co., Inc. (Rife Construction). Further Exhibit 3 contains numerous Rife Construction invoices for services which, in conjunction with the \$0 reported for Miscellaneous Service Revenues in Johnson County's 2015, 2016, and 2017 annual reports, suggest that Johnson County is not collecting the special charges in its tariff.

<sup>13</sup> See Case No. 2019-00056, Johnson County's responses to the Attorney General's Initial Request, Item 2, Exhibit 1, and Item 15. Johnson County stated that Johnson County and B & H Gas Company are the only entities operated from 497 George Road, Betsy Lane, Ky. However, this is the same address listed as the principal office of Rife Construction with the Kentucky Secretary of State and West Virginia Secretary of State.

Promissory Notes filed with the Application; however, Johnson County subsequently stated that payments had been made on the Promissory Notes.<sup>14</sup>

### DISCUSSION

Administrative Regulation 807 KAR 5:001, Section 16(1), provides that all applications for a general rate adjustment shall be supported by either a “twelve (12) month historical test period which may include adjustments for known and measurable changes” or a “fully forecasted test period.” When an applicant bases its application upon a historical test period, it must provide a “complete description and quantified explanation for all proposed adjustments with *proper support for any proposed changes* in price or activity levels, and any other factors which may affect the adjustment.”<sup>15</sup> (emphasis added). That support should include, at a minimum, some documentary evidence to demonstrate the certainty of some expected change or event.

Additionally, for transactions between a utility and its parent or affiliate, the Commission has historically held that:

[t]he burden of proof is on the utility to demonstrate that the outcome of the transaction is fair, just and reasonable, and is substantially the equivalent of an arms-length transaction. Moreover, if this burden of proof is not met, the Commission will not allow proposed adjustments resulting from such transactions for rate-making purposes.<sup>16</sup>

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<sup>14</sup> See Case No. 2019-00056, Response to Order Initiating Investigation, Exhibit A; Johnson County’s response to Staff’s First Request, Items 1.g., 2.g., and 3.j.; and Johnson County’s response to Commission Staff’s Post-Hearing Request for Information, Item 4. When revoking the Promissory Notes, Johnson County specified that no payments had been made. Johnson County then stated that the amounts of the Promissory Notes were rolling balances and later clarified that payments were applied to the oldest past-due balances.

<sup>15</sup> Administrative Regulation 807 KAR 5:001, Section 16(4).

<sup>16</sup> See Case No. 9269, *The Application of Public Service Utilities, Inc., - Boone Creeke for a Rate Adjustment Pursuant to the Alternative Rate Filling for Small Utilities* (Ky. PSC Oct. 2, 1985) at 3.

Lastly, the Commission does not allow prior period expenses to be borne by current and future ratepayers. To do so would constitute retroactive ratemaking and would not be consistent with previous decisions by the Commission in this regard. Johnson County failed to request rate relief as it should have when it became apparent that its rates were deficient. Instead, Johnson County chose alternative arrangements to handle its expenses and attempted to delay recovery. The Commission strongly advises Johnson County to seek rate relief when it becomes necessary. When a utility begins to defer payment of its expenses from affiliates, it may not be construed to be an arms-length transaction and may be denied by the Commission.

Based upon the evidence of record and being otherwise sufficiently advised, the Commission finds that Johnson County failed to provide sufficient evidence to support its request, and therefore its request is denied. Due to the withdrawal of the Promissory Notes and the inaccuracies in the annual report and data responses, the financial information provided cannot be relied upon as sufficient evidence to support the requested increase in base rates. A utility requesting a rate increase has the burden of proof to show that the rates it seeks are just and reasonable.<sup>17</sup> In reaching a decision whether rates are fair, just, and reasonable, there must be sufficient evidence of record for the Commission, as the trier of fact, to weigh. The Commission finds that it cannot reasonably rely on the information contained in the Application provided by Johnson County and, therefore, cannot make a determination of the reasonableness of the test-year expenses, adjustments, and resulting revenue requirement as stated therein.

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<sup>17</sup> “[T]he burden of proof of showing that an increase of rate or charge is just and reasonable [is] upon the applicant utility.” *Kentucky American Natural gas Co. v. Commonwealth ex rel. Cowan*, 847 S.W.2d 737, 741 (Ky. 1993).

The Commission further finds that this matter should be dismissed without prejudice, which permits Johnson County leave to submit a new alternative rate adjustment filing. Additionally, in compliance with 807 KAR 5:076, Section 9, which requires that the test period for alternative rate adjustment filings coincide with the annual report of the immediate past year; Johnson County's Application was based on its 2017 annual report. Johnson County has since filed its 2018 annual report with the Commission and, as such, an application based on its 2017 annual report is no longer based on its most recent annual report. Further, Johnson County should include sufficient information to establish cost justification for transactions with affiliates in any future base rate applications.

#### SUMMARY

After consideration of the evidence of record and being otherwise sufficiently advised, the Commission finds that:

1. Based on the foregoing, test-year expenses, adjustments, and resulting revenue requirement as calculated by Johnson County cannot be reasonably relied upon and should not be accepted.

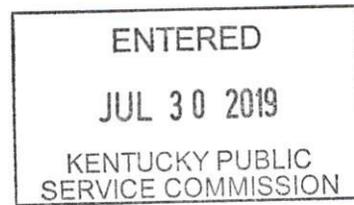
2. The natural gas service rates proposed by Johnson County should be denied.

IT IS THEREFORE ORDERED that:

1. The rates proposed by Johnson County are denied.

2. This case is dismissed without prejudice and removed from the Commission's docket.

By the Commission



ATTEST:

  
Executive Director

Case No. 2018-00434

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