

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

ORDER

B&H Gas Company ("B&H") is a local gas distribution company ("LDC") which serves approximately 258 residential, commercial, and industrial customers¹ in Floyd County, Kentucky,² and is subject to the Commission's jurisdiction pursuant to KRS 278.040. Mr. Ulice Bud Rife, Jr. is the president and owner of 100 percent of the stock of B&H, having acquired B&H pursuant to approval granted by the Commission in Case No. 89-018.³ In addition to owning B&H, Mr. Rife owns B&H's primary wholesale gas supplier,

¹ *Annual Report of B&H Gas Company to the Kentucky Public Service Commission for the Year Ended December 31, 2015* at 31.

² *Id.* at 9.

³ Case No. 89-018, *The Joint Application of Ulice Bud Rife, Jr., and John M. Bradley and Debbie L. Bradley for the Approval of the Acquisition of B & H Gas Company, Inc. of Stanville, Floyd County, Kentucky, by Ulice Bud Rife, Jr.* (Ky. PSC May 17, 1989). All annual reports filed with the Commission by B&H since 1989 identify Mr. Rife as president and owner of 100 percent of B&H's stock.

B&S Oil & Gas Company ("B&S").⁴ This proceeding was initiated to investigate B&H's gas costs to its customers, pursuant to KRS 278.2207, and the wholesale gas price B&H is charged by its affiliate, B&S, pursuant to KRS 278.274. This proceeding was also initiated to investigate whether the gas cost component of B&H's retail rate contained in the gas cost adjustment ("GCA") clause in B&H's approved tariff should be reduced, and whether the price of gas sold by B&S to B&H (jointly referred to as the "Companies") should also be reduced, pursuant to KRS 278.274(3)(d).⁵

PROCEDURAL HISTORY

This proceeding was initiated by the Commission's Order of November 24, 2015. On December 14, 2015, the Companies filed responses to the information requests included in Appendix A of the Order initiating this matter. The Companies requested an informal conference ("IC") with Commission Staff ("Staff"),⁶ which was held on January

⁴ The record of Case No. 89-018 indicates that Mr. Rife was the owner of Bradley & Son Oil & Gas Company ("Bradley & Son"), the predecessor of B&S, at the time he was authorized to acquire B&H. At that time, Bradley & Son provided roughly 70 percent of B&H's gas supply. All sales agreements between B&S and B&H filed with the Commission since 2000 show Mr. Rife as the signatory for both parties. B&H's most recent annual reports show B&S supplying between 95 and 100 percent of B&H's gas supply.

⁵ The Order initiating this investigation 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 further ordered B&H to continue collecting the GCA component of its rates subject to refund; to establish an interest-bearing escrow account in which to deposit all GCA revenues above \$4.84 per Mcf collected after June 30, 2016; and to keep all GCA revenues above \$4.84 in the interest-bearing account until further Order of the Commission.

⁶ Companies' motion for an IC (filed Dec. 14, 2015).

14, 2016, at the Commission's offices in Frankfort, Kentucky.⁷ On January 29, 2016, the Companies filed a motion to hold this matter in abeyance ("Companies' Motion for Abeyance") pending the filing of an alternative rate filing ("ARF") application by B&H pursuant to 807 KAR 5:076.

On February 10, 2016, Staff issued its first request for information to the Companies ("Staff's First Request"). On February 15, 2016, the Attorney General of the Commonwealth of Kentucky, by and through his Office of Rate Intervention ("AG"), filed a motion to intervene, which the Commission granted on February 19, 2016. On February 24, 2016, the AG filed a response objecting to the Companies' request to hold this investigation in abeyance ("AG's Response to Companies' Motion for Abeyance"). On March 7, 2016, the AG issued his initial data request to the Companies ("AG's Initial Request"). On March 8, 2016, the Commission ordered the Companies to respond to Staff's First Request (issued February 10, 2016) within ten days or be subject to a show cause proceeding and possible penalties pursuant to KRS 278.990(1).

On March 17, 2016, the AG filed a motion requesting the Commission to set a procedural schedule ("AG's Motion for Procedural Schedule") and to direct the Companies to respond to the AG's Initial Request by April 1, 2016. On March 18, 2016, the Companies filed a response to Staff's First Request, and on April 4, 2016, filed an objection to the AG's request that they respond to the AG's Initial Request by April 1,

⁷ Letter from Jeff Derouen, Executive Director, Public Service Commission, to Parties of Record (filed Jan. 21, 2016).

2016, requesting instead to file a response by April 18, 2016, basing this date in part on B&H's "self-imposed deadline of April 10, 2016, for filing its ARF."⁸ On April 13, 2016, the Companies notified the Commission that B&H's ARF filing had been delayed, as it needed information from its accountant, but that the Companies expected to have the required information no later than April 30, 2016, and that B&H would file an ARF application within ten days thereafter. Also on April 13, 2016, the Commission denied the Companies' request to hold the case in abeyance until the completion of B&H's planned ARF proceeding and established a procedural schedule.

On April 18, 2016, the Companies filed a joint response to the AG's Initial Request, and on April 20, 2016, filed a supplement to the joint response. On April 29, 2016, Staff issued its second request for information ("Staff's Second Request") to the Companies, and the AG issued a supplemental data request ("AG's Supplemental Request"), with the Companies' responses to both due no later than May 12, 2016. On May 27, 2016, the Commission ordered the Companies to respond to Staff's Second Request and to the AG's Supplemental Request within seven days. On June 1, 2016, the Companies filed a motion for an extension of time until June 6, 2016, to respond to Staff's Second Request, and for an extension of time until June 14, 2016, to respond to the AG's Supplemental Request. On June 8, 2016, the Commission granted the Companies an extension until June 6, 2016, to respond to Staff's Second Request and

⁸ Companies' response to the AG's Motion to Set a Procedural Schedule (filed Apr. 4, 2016) at 2.

until June 13, 2016, to respond to the AG's Supplemental Request. The Commission also put the Companies on notice that failure to file their responses as directed could result in a show cause proceeding and possible penalties, pursuant to KRS 278.990(1).

Contrary to the Commission's June 8, 2016 Order, the Companies did not file responses to the AG's Supplemental Request by June 13, 2016, but instead filed responses on June 15, 2016. On June 17, 2016, the Commission initiated a separate show cause proceeding against the Companies and Mr. Rife for their failure to comply with the Commission's June 8, 2016 Order.⁹

On July 5, 2016, the AG filed a motion to compel the Companies to file "adequate and complete" responses to several of his previously issued data requests ("AG's Motion to Compel"), which the Commission granted, in part, on October 20, 2016. On October 31, 2016, the Companies filed supplemental responses to three prior AG data requests,

⁹ Case No. 2016-00204, *B&H Gas Company, B&S Oil and Gas Company, and Mr. Bud Rife, Individually and as an Officer of B&H Gas Company and B&S Oil and Gas Company, Alleged Violation of a Commission Order* (Ky. PSC June 17, 2016). Following an evidentiary hearing on July 5, 2016, the Commission assessed penalties of \$500 each against B&H, B&S and Bud Rife for willful violations of the Commission's June 8, 2016 Order. The Companies' failure to comply with the Commission's June 8, 2016 Order was the third such failure during this proceeding. First, the Companies failed to respond to Staff's First Request within the prescribed time period, which led to the Commission's March 8, 2016 Order in which the Companies were ordered to file responses within ten days. At that time, the Companies were also put on notice that a show cause proceeding could be initiated if they failed to comply. Next, information requests were issued to the Companies by Staff and the AG on April 29, 2016, to which the established procedural schedule directed the Companies to respond by May 12, 2016, which the Companies failed to do. On May 27, 2016, the Commission ordered the Companies to file their responses within seven days, again putting them on notice that a show cause proceeding could be initiated if they failed to comply.

as directed by the Commission's October 20, 2016 Order.¹⁰ On December 5, 2016,¹¹ the Commission held an evidentiary hearing at which Mr. Rife testified on behalf of B&H and B&S. The AG did not file testimony in this matter and did not sponsor a witness at the hearing. On January 17, 2017, the Companies filed responses to Staff's post-hearing data request, which was issued on December 8, 2016.¹² This case now stands submitted for a decision.

BACKGROUND

As a utility subject to the Commission's jurisdiction, B&H's rates and conditions of service are subject to the Commission's regulations, and as stated in its approved, filed tariff. B&H's tariff includes a GCA clause which allows B&H to revise its rates to reflect changes in its wholesale gas cost. Pursuant to its GCA, B&H is required to file certain information with the Commission¹³ in order to revise its rates, including "[a] copy of the contract or wholesale supplier notification effecting the change in rate and a statement

¹⁰ The AG's Motion to Compel was filed on July 5, 2016, and the Companies filed a response on July 21, 2016. On August 2, 2016, the AG filed a reply to the Companies' Response. On October 31, 2016, the Companies filed supplemental responses to the AG's Initial Request, Item 11, and to the AG's Supplemental Request, Items 4.c. and 5.b.

¹¹ On November 3, 2016, the Commission scheduled an evidentiary hearing for November 21, 2016. On November 9, 2016, the Companies filed a motion to reschedule the hearing, and on November 16, 2016, the Commission granted the motion and rescheduled the hearing to December 5, 2016.

¹² Letter from Talina R. Mathews, Executive Director, Public Service Commission, to Parties of Record (Dec. 8, 2016).

¹³ B&H's tariffed GCA clause was issued June 1, 1995, with an effective date of July 1, 1995.

relative to the effective date of such proposed change.”¹⁴ From October 2004 to March 2008, B&H entered into a series of four gas-purchase agreements with B&S, each of which reflected an increase in the wholesale price charged by B&S.¹⁵ B&H’s last GCA application which proposed raising the gas cost component of its rates from \$7.00 to \$9.38 was filed on March 19, 2008.¹⁶

B&S’s wholesale price of gas to B&H, as well as the gas cost component of B&H’s rates charged to its customers, has remained unchanged at \$9.38 Mcf since 2008. The Companies state that the 2008 agreement between B&H and B&S has not expired and does not require the parties to renegotiate,¹⁷ and that “[n]o subsequent agreements have been reached because B&H and B&S agreed that the price established in 2008 of \$9.38 remained acceptable.”¹⁸ B&H avers that it evaluates the appropriateness of its contract price with B&S on an annual basis, and that it considers “whether B&H is able to currently

¹⁴ *Id.*

¹⁵ While four agreements were filed with the Commission, only the 2004 and 2008 agreements were implemented and resulted in an actual increase in B&H’s wholesale cost of gas. Those increases were approved in Case No. 2004-00449, *The Notice of Purchased Gas Adjustment Filing of B & H Gas Company, Inc.* (Ky. PSC Dec. 6, 2004) and Case No. 2008-00101, *The Notice of Purchased Gas Adjustment Filing of B&H Gas Company, Inc.* (Ky. PSC Apr. 15, 2008).

¹⁶ Case No. 2008-00101, *The Notice of Purchased Gas Adjustment Filing of B&H Gas Company, Inc.* (Ky. PSC Apr. 15, 2008).

¹⁷ Companies joint response to the Commission’s November 24, 2015 Order, Appendix A (filed Dec. 14, 2015), Item 4.

¹⁸ *Id.*

meet its obligations to B&S and whether B&H customers are able to pay their bills to B&H at the current rate.”¹⁹

B&H initially claimed that “[f]rom 2008 through 2015, B&H and its customers have been consistently *unable* to pay for gas at the current rate.”²⁰ B&H later changed this assertion, stating that:

It was a misstatement to say that B&H customers are ‘consistently unable to pay for gas at the current rate.’ Customers have been largely able to pay for gas at the current rate. However, B&H’s ability to operate profitably has been diminished by the fact that B&H’s overhead and maintenance costs have increased over the last several years, resulting in insufficient funds to meet revenue requirements of B&H. B&H has the lowest rates in the area.”²¹

The Companies also contend that although the gas cost component of B&H’s rates has not decreased since 2008, the utility’s “base rates are so low that B&H’s customers’ bills are very reasonable and appear to be lower than other utilities’ customer bills, and that there have been no complaints from B&H’s customers regarding their bills.”²²

The Companies state that B&H’s ability—and inability—to pay B&S for its gas is a real problem, and that:

It has often been the case that B&H has been unable to pay B&S the amount owed on a monthly basis. In such instances, B&S has permitted B&H to make payments on a delayed basis, and it is not uncommon that payments owed by B&H

¹⁹ *Id.*, Item 5.

²⁰ *Id.*

²¹ Companies’ joint response to Staff’s First Request, (filed Mar. 18, 2016), Item 2.a.

²² Letter from Jeff Derouen, Executive Director, Public Service Commission, to Parties of Record (filed Jan. 21, 2016).

are paid in successive years. These later payments made in successive years do not evidence fluctuating average wholesale costs, because B&H has at all times paid the established \$9.38 per Mcf.²³

The Companies argue that the \$9.38 per Mcf contract price for the gas that B&H purchases from B&S is reflective of market price. In support of this position, B&H notes that: (1) the gas provided to B&H customers has a high heat content with a BTU ratio of 1350; (2) the gas is delivered at a higher pressure than is typical for gas companies; and (3) B&S is the only gas provider serving the B&H customer area that can provide gas at each delivery point necessary to service B&H's customers.²⁴

The Companies also contend that: "[n]o other gas provider is willing to operate the lines maintained and operated by B&S, due to the maintenance and upkeep costs required to provide service to these rural customers. The overhead for service to B&H customers is greater than other service providers in other areas, and B&S rates are competitive and reflective of market price for gas for similarly situated producers."²⁵

DISCUSSION

The primary issues before the Commission in this case are whether the gas cost component of B&H's rates and the cost of gas B&H purchases from its affiliate, B&S, are just and reasonable, and in compliance with the affiliate transaction requirements of KRS

²³ Companies' joint response to the Commission's November 24, 2015 Order, Appendix A (filed Dec. 14, 2015), Item 3.

²⁴ Companies' joint response to Staff's First Request, (filed Mar. 18, 2016), Item 3.

²⁵ Companies' joint response to Staff's Second Request, (filed June 6, 2016), Item 1.b.

278.2207 and KRS 278.274; and, if they are not in compliance, whether B&H's gas cost component of its rates and the cost of gas purchased from B&S should be reduced.

Pursuant to KRS 278.274, in determining whether B&H's rates are just and reasonable, the Commission is required to review B&H's purchasing practices and may disallow any costs or rates which are deemed to result from imprudent purchasing practices. B&H's GCA clause allows B&H to pass on to its customers, on a dollar-for-dollar basis, the price it pays for natural gas; however, due to Mr. Rife's common ownership of B&H and B&S, an affiliate relationship exists. Because of this affiliate relationship,²⁶ KRS 278.2207 provides that certain restrictions apply to the transactions between B&H and B&S. KRS 278.2207(1)(b) requires that:

Services 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 methodology.

Based on the above, B&H's purchase of gas from B&S must be priced at B&S's *fully distributed cost, but no greater than market* (emphasis added). KRS 278.2209 further requires that in any formal Commission proceeding in which cost allocation is at issue, a "utility shall provide sufficient information to document that its cost allocation procedures and *affiliate transaction pricing* are consistent with the provisions of this chapter" (emphasis added).

²⁶ KRS 278.010(18) defines "affiliate" as a person that controls or that is controlled by, or is under common control with, a utility.

KRS 278.274(3) states that “[i]t shall be presumed that natural gas purchases from affiliated companies [defined as ‘those in which one (1) or more of the owners control or have the right to control the business affairs of all affected companies,’²⁷] are not conducted at arm’s length.”²⁸ “Arm’s length” describes the standard of conduct under which “unrelated parties, each acting in its own best interest, would negotiate and carry out a particular transaction.”²⁹ Based on the above and given Mr. Rife’s sole ownership and control of both B&H and its affiliate gas supplier, B&S, B&H’s gas purchases from B&S are presumed not to be conducted at “arm’s length,” and the Commission shall assume jurisdiction of B&S “as though it were a utility as defined in KRS 278.010.”³⁰

In addition, if the Commission determines that rates B&H charges its customers are not just and reasonable because its affiliate gas cost is unjust or unreasonable, the Commission may reduce the purchased gas component of B&H’s rates by the amount deemed unjust or unreasonable.³¹ The Commission may also reduce the rate charged by B&S by the same amount that it reduces the rate(s) charged by B&H to its customers.³²

²⁷ KRS 278.274(3)(a).

²⁸ KRS 278. 274(3).

²⁹ KRS 278.010(25).

³⁰ KRS 278.274(3)(b)

³¹ KRS 278.274(3)(c).

³² KRS 278.274(3)(d).

Gas Cost Component

KRS 278.2207(1)(b) requires that the cost of gas B&H purchases from its affiliate, B&S, shall be priced at B&S's fully distributed cost but in no event greater than market. The Commission will consider B&H's longstanding practice of purchasing its gas supply almost exclusively from B&S in accordance with the affiliate pricing requirements of KRS 278.2207 and KRS 278.274.

Efforts to determine B&S's fully distributed cost, however, have been resisted by the Companies during this proceeding. For example, when the Companies were first requested to provide documentation of the costs B&S incurs in providing gas to B&H, the Companies objected, maintaining that "[t]he costs B&S incurs are not relevant to this proceeding, and would be burdensome to obtain. Without waiving this objection, please see the documents from January, 2015 through February, 2016, consisting of invoices from B&S to B&H" ³³ The invoices provided were simply B&S's monthly charges for gas it sold to B&H, and were not responsive to the actual request made. No information was provided regarding the cost B&S incurs in providing gas to B&H.

When asked to provide a list of the different types of costs B&S incurs to obtain gas for B&H, the Companies stated: "B&S incurs costs typical of gas production, including labor, repair, management, payment of royalties to mineral owners, and material and

³³ Response to the AG's Initial Request (filed Apr. 18, 2016), Item 11.

maintenance costs.”³⁴ When asked to explain why it was “burdensome” to provide the documentation that had been requested earlier, the Companies responded:

As previously stated, B&S records were destroyed by two fires making it impossible to produce. It would be burdensome to obtain copies of these documents given that they are not probative or relevant to this proceeding. B&S has provided its invoices to B&H, which are sufficient for the purposes of this proceeding.³⁵

The above claim that B&S’s records had been destroyed, or had been housed in the building that burned, is contradicted by the Companies elsewhere throughout this proceeding. For example, when requested to provide profit and loss information for B&S, the Companies were able to do so and even stated specific dollar amounts of profit and loss experienced by B&S for each of the years from 2010 to 2015.³⁶ In another instance, when asked whether Johnson County Gas (another LDC solely owned and operated by Mr. Rife) continues to maintain offices in the same location as B&H or B&S, the Companies responded 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 continue to share this office space, however since the building burned in January, 2015 neither entity has paid rent to Bud Rife. Johnson County Gas and B&H are the only entities operating out of this office space

³⁴ Response to the AG’s Supplemental Request (filed June 15, 2016), Item 5.a.

³⁵ *Id.*, Item 5.b.

³⁶ *Id.*, Item 3.a.

. . . . (emphasis added.)³⁷

In another example, when asked whether B&H or B&S planned to obtain a new building to house their operations, and if so whether the Companies would seek recovery for such expenses in an ARF case, the Companies state: “No. B&S operates out of Mr. Rife’s home, and he only stored *certain records* at the building which burned” (emphasis added.)³⁸

On July 5, 2016, following several attempts to obtain information and documentation from the Companies showing the actual costs B&S incurs in providing gas to B&H, the AG filed a motion to compel the Companies to provide the information and documentation.³⁹ On October 20, 2016, the Commission specifically granted the AG’s motion.⁴⁰

On October 31, 2016, in response to the Commission’s October 20, 2016 Order, the Companies produced approximately 670 unbound pages of assorted documents which were neither tabbed nor indexed. These pages included miscellaneous invoices,

³⁷ Response to the AG’s Initial Request (filed Apr. 18, 2016), Item 19.

³⁸ Supplemental response to the AG’s Initial Request (filed Apr. 20, 2016), Item 34. Transcript 10:46:49

³⁹ AG’s Motion to Compel, Item 2.

⁴⁰ Order at 5–6 (Ky. PSC Oct. 20, 2016).

receipts, cancelled checks, correspondence, etc.⁴¹ Documents provided included the following:

- Invoices from Kentucky Power Company and other utilities for service to various locations, including several residences;
- Invoices from Coalfields Telephone and Broadband and Gearheart Communications for telephone and cable television service, including line item charges for premium movie channels, with service also provided to several locations;
- Correspondence from Darrell Madden, CPA, along with payment vouchers for Mr. Rife's 2014 Federal Individual Income Tax return and 2014 Kentucky Individual Income Tax Return;
- Documentation from several insurance companies for flood insurance, as well as invoices for Mr. Rife's insurance for various vehicles, including a "classic auto policy" for a Corvette and a policy for two Harley Davidson motorcycles;
- Several non-identified receipts from other vendors, again with no explanation included as to the reason for the claimed expenditure;⁴² and
- Copies of documents from Bud Rife Construction Co., Inc., ("Bud Rife Construction") (another company solely owned and operated by Mr. Rife and thus another

⁴¹ B&H and B&S's Supplement to the Joint Response to the AG's Initial Data Requests and Supplemental Data Requests, Consistent with the Commission's October 20, 2016 Order ("Supplemental Response") (filed Oct. 31, 2016).

⁴² *Id.*

affiliate of B&H), also indicating transactions between B&H and Bud Rife Construction, which are subject to the affiliate pricing requirements.⁴³

Establishing the Market Price for B&H's Gas Cost Component

While KRS 278.2207(1)(b) requires that the gas B&S provides B&H be at its fully distributed cost, it also requires that its wholesale cost of gas furnished to B&H be “no greater than market.” Since April 2008, B&H has made no GCA filings to reflect decreases in its wholesale price from B&S, although for the last few years market prices for natural gas around the country have been and continue to be significantly lower than in 2008.⁴⁴

At the time this case was initiated, the 11 small LDCs that file quarterly GCAs with the Commission had gas cost rate components no greater than \$5.31 per Mcf, excluding pipeline transportation costs.⁴⁵ At present, two of the 11 small LDCs' gas cost components are approximately \$6.50 per Mcf; another is approximately \$5.25 per Mcf, with the other eight at \$4.65 or less. Moreover, the Intrastate Utility Service (“IUS”) rate of Columbia Gas of Kentucky (“Columbia”) and the Expected Gas Cost (“EGC”) rate of

⁴³ *Id.* See also Response to the AG's Initial Request (filed Apr. 18, 2016), Item 1.e. Bud Rife Construction Co., Inc., is a for-profit corporation, Incorporated on September 18, 1984.

⁴⁴ B&H's annual reports filed with the Commission reflect a wholesale gas cost on its purchases from B&S of at least \$9.30 per Mcf each year from 2008 through 2015, except in 2012, when the cost was reported as \$8.67 per Mcf. The highest cost of \$9.85 per Mcf was reported in 2010. The average cost of B&H's purchases from B&S during the period from 2008 through 2014 was \$9.34 per Mcf.

⁴⁵ Two of the 11 LDCs, Burkesville Gas Company, Inc. and Navitas KY NG, LLC, currently have approved GCAs of \$7.26 and \$5.725 per Mcf, which include, respectively, pipeline charges of approximately \$2.50 and \$1.50 per Mcf.

Peoples Gas KY, LLC (“Peoples”), formerly Equitable Gas Company, both of which were used for comparison purposes in B&H’s 2008 GCA filing, were \$3.5340 and \$4.9390 per Mcf, respectively, when this proceeding was initiated. They are now \$7.1771 and \$4.3879, respectively. As support for its last GCA application to increase its gas cost rate from \$7.00 Mcf to \$9.38 Mcf in Case No. 2008-00101, B&H relied upon the following, in part:

The increased rate reflects the significantly higher market price conditions for natural gas around the country. The rate is lower than the current NYMEX natural gas futures prices (attached). NYMEX prices are prone to wide fluctuations from week to week. B&H Gas is aware that Columbia Gas of Kentucky’s IUS rate is currently \$13.47 per MCF and that Equitable Gas Company’s most current expected gas cost is \$12.00. B&H believes B&S contract rate to be very reasonable in comparison.

In order to establish the market price of the gas cost component of B&H’s retail rates consistent with the requirements of KRS 278.2207(1)(b), and to establish the wholesale rate that its affiliate B&S is authorized to charge B&H, a combination of the factors referenced by B&H in Case No. 2008-00101 will be used. Specifically, the market price for gas should be calculated using Columbia’s most recent IUS rate averaged with Peoples’ most recent EGC multiplied by two (once as a substitute for the NYMEX rate, since Peoples uses the NYMEX in calculating its EGC). In this manner, B&H can calculate the market price from information that is readily available on the Commission’s website and has been approved by the Commission in the most recent Columbia and Peoples PGA cases. The prices used in the average should be adjusted for the

percentage difference in heating content between B&H⁴⁶ and the other two companies⁴⁷ to arrive at an average market rate per Mcf. With this formula, B&H's revised gas cost rate will be \$5.9855, as shown below:

	CKY IUS	Peoples	Peoples	Market rate
	\$7.1771	\$4.3879	\$4.3879	
Heat rate differential	1.158	1.0991	1.0991	
	\$8.3111	\$4.8227	\$4.8227	\$5.9855

Determination of GCA Over-Collections/Amount of Refund Owed to B&H's Customers

B&H has been on notice since our November 24, 2015 Order initiating this proceeding that its continued collection of \$9.38 per Mcf for the gas cost component of its rates was subject to refund. The same factors used above to determine the market price for gas B&S provides to B&H going forward can also be used to establish the historical market rate to use in the calculation of the refund that B&H owes its customers. The historical market rate includes an average of:

- Columbia's average IUS rates beginning November 30, 2015 in Case No. 2015-00359, through Columbia's latest PGA case, Case No. 2017-00057. This would result in

⁴⁶ Based on reports from Southern Hydrocarbon Corporation provided by the Companies on October 31, 2016, the average heat content of gas supplied to B&H by B&S is 1275.

⁴⁷ Based on Columbia's most recent PGA application in Case No. 2017-00057, Purchased Gas Adjustment Filing of Columbia Gas of Kentucky, Inc. (Ky. PSC Feb. 20, 2017), Columbia's average BTU factor used to convert Dth rates to Mcf rates reflects a heat content of 1101. Based on Peoples' most recent PGA application in Case No. 2017-00152, Purchased Gas Adjustment Filing of Peoples Gas KY, LLC. (Ky. PSC Apr. 21, 2017), Peoples' average BTU factor used to convert Dth rates to Mcf rates reflects a heat content of 1160.

a rate of \$ \$4.6192 per Mcf, multiplied by 1.158 to reflect the difference in heat content between B&H and Columbia, resulting in a heat content-adjusted average of \$5.3490.

- Peoples' average EGC as established starting with Case No. 2015-00307 (effective date of November 1, 2015) through Case No. 2016-00436 (effective date of February 1, 2017). These six PGA's produce a simple average of \$4.0938 multiplied by 1.0991 to reflect the difference in heat content between B&H and Peoples, resulting in a heat content-adjusted average of \$4.4995. This rate would be included in the average twice.

An average of Columbia's \$5.3490 per Mcf IUS rate and twice the Peoples \$4.4995 per Mcf EGC results in a historical market average price of \$4.7827 per Mcf. Subtracting this market price from B&H's \$9.38 per Mcf gas cost results in a difference or "over collection" of \$4.5973 per Mcf. The monthly sales data provided by B&H showed that, for the 12 months ended November 2016, sales were 13,175 Mcf. Estimating the sales for December 2016 through March 2017 produces a sales estimate for the 16-month period ended March 2017 of 22,160 Mcf. Multiplying this sales volume by the \$4.5973 over collection results in an amount to be refunded of approximately \$101,876. Using B&H's typical annual sales level of approximately 17,000 Mcf and a 24-month refund period, results in a refund factor of \$3.0000 per Mcf

Having reviewed the evidence of record and being otherwise sufficiently advised, the Commission finds that:

1. Market conditions in the natural gas industry have changed greatly since 2008 such that, as stated in the Order opening this proceeding, the gas costs reported in the annual reports of the small LDCs that file quarterly GCAs averaged \$4.84 per Mcf from 2012 through 2014. With the addition of data contained in these small LDCs' 2015

annual reports and removal of the data in their 2012 annual reports, the three-year average of the gas costs they reported for 2013 through 2015 is \$4.68 per Mcf.

2. The Companies have not provided sufficient evidence to support B&S's charge of \$9.38 per Mcf for gas sold to B&H as reflective of B&S's fully distributed cost of providing gas to B&H "but in no event greater than market."

3. The Companies have not provided sufficient evidence to support B&H's \$9.38 per Mcf GCA component of its rates as being B&S's fully distributed cost to provide gas to B&H "but in no event greater than market."

4. Since the Order of November 24, 2015, opening this proceeding, B&H has collected the GCA component of its rates subject to refund.

5. Since our Order of June 30, 2016, B&H has continued to collect the GCA component of its rates subject to refund, and should have deposited all GCA revenues collected above \$4.84 in an interest-bearing account, until further Commission Order.

6. B&H should begin quarterly GCA filings with the Commission, with B&H's first GCA filing no later than September 1, 2017, with new GCA rates to be effective October 1, 2017. The EGC shall be based on the application that Columbia is required to file on or around August 1, 2017, and the application that Peoples is required to file on or around July 1, 2017, both of which will be accessible through the Commission's website.

7. The GCA component of B&H's rates should be adjusted quarterly based on the average of the heat-adjusted IUS rate included in Columbia's GCA application filed

one month previously, combined with two times Peoples' heat-adjusted EGC included in its GCA application filed two months previously, as directed herein.

8. As of the date of this Order, the EGC component of B&H's GCA rates should be revised and established at \$5.9885 per Mcf, using the formula identified above, including recognition of the differences in the heat content of gas supplied by B&S relative to the heat content of the gas supplied by Columbia and Peoples.

9. B&H should be required to refund to its customers, over a period of approximately 24 months, the GCA component of its rates that it over-collected since November 24, 2015, in the total amount of \$101,876. In order to accomplish this, \$3.0000 per Mcf should be included as the Refund Adjustment ("RA") Factor of B&H's GCA rates beginning with the first monthly billing by B&H subsequent to the date of this Order. B&H's total GCA rate should be \$2.9885 per Mcf. The refund Factor should remain in the GCA rate until all over-collections of gas cost have been refunded.

10. For the first bill B&S renders to B&H after the date of this Order, the gas B&S provides to B&H should be priced at \$5.9885 per MCF, consistent with the revised GCA component of B&H's rates, and should be adjusted quarterly to correspond with the GCA component of B&H's rates charged to its customers.

11. By way of a credit of \$3.0000 per MCF, commencing with the first bill B&S renders to B&H after the date of this Order for gas B&S provides to B&H, B&S shall credit any portion of the \$101,876 that it has been paid by B&H over a period of 24 months.

IT IS THEREFORE ORDERED that:

1. On and after the date of this Order, the GCA component of B&H's rates shall be \$2.9885 per Mcf, reflecting an EGC of \$5.9885 per Mcf and an RA of \$3.0000 per Mcf.

2. B&H shall file quarterly GCA applications with the Commission, with the first filing made no later than September 1, 2017, for GCA rates effective October 1, 2017, using the format attached as Appendix A.

3. B&H's GCA application for rates effective October 1, 2017, shall include monthly sales volumes for December 2016 through March 2017 so that the refund amount owed to B&H's customers can be adjusted for actual sales volumes.

4. Each quarterly GCA application filed by B&H shall contain rates calculated as directed herein.

5. Within 20 days of the date of this Order, B&H shall file with this Commission, using the Commission's electronic Tariff Filing System, a quarterly Purchased Gas Adjustment Clause using the format attached as Appendix B.

6. Over-collections of \$101,876 shall be refunded to B&H's customers over 24 months through the GCA at an initial rate of \$3.0000 per Mcf, to be adjusted when actual sales volumes and over-collections from December 2016 through March 2017 are known.

7. B&S shall reduce the cost of gas sold to B&H to \$5.9885 per Mcf, effective for all gas sold on and after the date of this Order, with B&S's rate to be adjusted quarterly to conform to the GCA component of B&H's rates, as adjusted.

8. B&S shall refund or credit to B&H any portion of the \$101,876 remitted to it by B&H at an initial rate of \$3.0000 per Mcf, to be adjusted when actual over-collections from December 2016 through March 2017 are known.

By the Commission

ENTERED
MAY 04 2017
KENTUCKY PUBLIC
SERVICE COMMISSION

ATTEST:



Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2015-00367 DATED **MAY 04 2017**

Company Name

Quarterly Report of Gas Cost
Recovery Rate Calculation

Date Filed:

Date Rates to be Effective:

Reporting Period is Calendar Quarter Ended:

SCHEDULE I

GAS COST RECOVERY RATE SUMMARY

<u>Component</u>	<u>Unit</u>	<u>Amount</u>
Expected Gas Cost (EGC)	\$/Mcf	
+ Refund Adjustment (RA)	\$/Mcf	(3.0000)
+ Actual Adjustment (AA)	\$/Mcf	
+ Balance Adjustment (BA)	\$/Mcf	
= Gas Cost Recovery Rate (GCR)		
GCR to be effective for service rendered from _____	to	_____

A.	<u>EXPECTED GAS COST CALCULATION</u>	<u>Unit</u>	<u>Amount</u>
	Total Expected Gas Cost (Schedule II)	\$	
÷	Sales for the 12 months ended _____	Mcf	
=	Expected Gas Cost (EGC)	\$/Mcf	
B.	<u>REFUND ADJUSTMENT CALCULATION</u>	Unit	<u>Amount</u>
	Supplier Refund Adjustment for Reporting Period (Sch.III)		
+	Previous Quarter Supplier Refund Adjustment	\$/Mcf	
+	Second Previous Quarter Supplier Refund Adjustment	\$/Mcf	
+	Third Previous Quarter Supplier Refund Adjustment	\$/Mcf	
=	Refund Adjustment (RA)	\$/Mcf	(3.0000)

SCHEDULE II

EXPECTED GAS COST

Actual * MCF Purchases for 12 months ended _____

(1)	(2)	(3)	(4)	(5)**	(6)
Supplier	Dth	BTU Conversion Factor	Mcf	Rate	(4) X (5) Cost

Totals _____

Line loss for 12 months ended _____ is _____ % based on purchases of _____ Mcf and sales of _____ Mcf.

	<u>Unit</u>	<u>Amount</u>
Total Expected Cost of Purchases (6)	\$	_____
÷ Mcf Purchases (4)	Mcf	_____
= Average Expected Cost Per Mcf Purchased	\$/Mcf	_____
x Allowable Mcf Purchases (must not exceed Mcf sales ÷ .95)	Mcf	_____
= Total Expected Gas Cost (to Schedule IA)	\$	_____

*Or adjusted pursuant to Gas Cost Adjustment Clause and explained herein.

**Based on the most recent Purchased Gas Adjustment filings of Columbia Gas of Kentucky and Peoples Gas KY, LLC as found on the Public Service Commission Web site at www.psc.ky.gov.

SCHEDULE III
SUPPLIER REFUND ADJUSTMENT

Details for the 3 months ended _____ (reporting period) _____

<u>Particulars</u>	<u>Unit</u>	<u>Amount</u>
Total supplier refunds received	\$	
+ Interest	\$	
= Refund Adjustment including interest	\$	
÷ Sales for 12 months ended	Mcf	
= Supplier Refund Adjustment for the Reporting Period (to Schedule IB.)	\$/Mcf	

APPENDIX B

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2015-00367 DATED **MAY 04 2017**

PURCHASED GAS COST ADJUSTMENT CLAUSE

Determination of GCR

The Company shall file a quarterly report with the PSC which shall contain an updated Gas Cost Recovery Rate (GCR) and shall be filed at least thirty (30) days prior to the beginning of each calendar quarter. The GCR shall become effective for billing for service rendered on or after the first day of each calendar quarter.

The Gas Cost Recovery Rate is composed of:

1. The expected gas cost component (EGC) on a dollar-per-Mcf basis, which represents the average expected cost of purchased gas, based on the most recent Purchased Gas Adjustment applications of Columbia Gas of Kentucky, Inc. ("Columbia") for its Intrastate Utility Service ("IUS") rate, adjusted for heat content, and Peoples Gas KY, LLC ("Peoples") for its EGC, adjusted for heat content.
2. The supplier refund adjustment (RA) on a dollar-per-Mcf basis, which reflects the refunds received from suppliers during the reporting period plus interest at a rate equal to 1/2 of one percent below the average ninety-day commercial paper rate for the twelve month period. In the event of any large or unusual refunds, the Company may apply to the Public Service Commission for the right to depart from the refund procedure herein set forth.

Billing

The gas cost recovery rate to be applied to bills of customers shall equal the sum of the following components:

$$\text{GCR} = \text{EGC} + \text{RA}$$

The GCR will be added to or subtracted from the tariff rates prescribed by the Commission Order on the Company's latest general rate case or last legally effective rate and will be included in the tariff rates stated on each applicable rate sheet within this tariff.

Definitions

For the purpose of this tariff:

- a. "Average Expected Cost" is the cost of purchased gas which results from the application of the most recent Purchased Gas Adjustment applications of Columbia Gas of Kentucky, Inc. for its Intrastate Utility Service rate, adjusted for heat content, and Peoples Gas KY, LLC for its EGC, adjusted for heat contents, on purchased volumes for the most recently available twelve-month period, divided by the corresponding sales volume.

The Average Expected Cost shall be calculated using the following formula:

$$\frac{[(\text{Columbia IUS rate} \times \text{heat adjustment}) + 2(\text{Peoples' EGC} \times \text{heat adjustment})]}{3}$$

In the event that line loss exceeds 5%, purchased volumes for the twelve-month period shall be calculated as: sales volumes divided by 0.95. Where the calculations require the use of volumes used during a given period, and those volumes did not exist for a particular source for the entire period, or the Company expects the volumes to change substantially, the Company may make appropriate adjustments to its calculations. Any adjustments of this type shall be described in the quarterly Gas Cost Recovery Report.

- b. "GCR" means the quarterly updated gas cost recovery rate and is the sum of the expected gas cost component plus the supplier refund adjustment plus the actual cost adjustment plus the balance adjustment; i.e., $\text{GCR} = \text{EGC} + \text{RA}$.

- c. "Calendar quarters" means each of the four three-month periods of (1) January, February, and March; (2) April, May, and June; (3) July, August, and September; (4) October, November, and December.
- d. "Reporting Period" means the three-month accounting period that ended approximately sixty (60) days prior to the filing date of the updated gas cost recovery rates, i.e., the calendar quarters ended March 31, June 30, September 30, and December 31 of each year.

Interim Gas Cost Adjustment

The company may apply to the Public Service Commission for an interim PGA in addition to the quarterly GCA should any significant change in nationwide market prices for natural gas occur that is not reflected in the Columbia IUS rate and the Peoples EGC rate.

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