

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

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

ORDER

This matter arises on the motion of the Attorney General of the Commonwealth of Kentucky, by and through the Office of Rate Intervention (Attorney General) requesting that the Commission initiate an investigation into Johnson County Gas Company, Inc. (Johnson County), pursuant to KRS 278.300. On December 28, 2018, Johnson County tendered an application¹ requesting a rate adjustment to, among other things, recover \$144,972 of outstanding debt consisting of three promissory notes, all of which are dated December 28, 2018.² On February 8, 2019, the Attorney General filed the motion requesting that the Commission initiate an investigation into the promissory notes because Johnson County failed to obtain Commission approval prior to entering into the evidences of indebtedness as required by KRS 278.300.

BACKGROUND

Johnson County is a Kentucky corporation whose president, director, and registered agent is Bud Rife. In its application, Johnson County stated that a rate increase

¹ Johnson County's application was rejected due to filing deficiencies, which were subsequently cured and the application was deemed filed on February 4, 2019.

² Application, Unnumbered Attachment of Outstanding Debt Instruments. A fourth promissory note between Johnson County and Goss Samford PLLC has a term of one year and therefore does not require Commission approval under KRS 278.300(8).

was needed to allow Johnson County to pay its expenses without receiving financial assistance from Bud Rife's non-regulated companies. The primary reason for the rate increase is to provide Johnson County with sufficient funds to repay three promissory notes. Of the three promissory notes at issue, all represent funds purportedly borrowed by Johnson County from affiliated entities. The amounts, parties, and terms of the notes are as follows:

- A no-interest loan for \$47,700.00 from Bud Rife, individually, for a term of 20 years, with semiannual payments of \$1,192.50. Mr. Rife is the signatory for both parties on this note.
- A no-interest loan for \$15,198.00 from Bud Rife Construction Company for a term of five years, with semiannual payments of \$1,519.80. Bud Rife Construction Company is a Kentucky corporation whose president and sole officer is Bud Rife. Mr. Rife is the signatory for both parties on this note.
- A no-interest loan for \$82,074.00 from Hall, Stephens, & Hall Gas Company (Hall) for a term of 20 years, with semiannual payments of \$2,051.85. Hall is a partnership whose managing partner is Mr. Rife.³ Mr. Rife is the signatory for both parties on this note.

ATTORNEY GENERAL'S ARGUMENTS

In the motion, the Attorney General explains that, under KRS 278.300, no utility can issue evidences of indebtedness until authorized to do so by the Commission. The exception to that statutory requirement is that, under KRS 278.300(8), notes payable in two years or less, or renewals of such notes, do not require prior Commission approval.

³ Case No.2012-00140, *Alternative Rate Filing Adjustment Application of Johnson County Gas Company*, Responses to Post-Hearing Data Requests (filed May17, 2013) at Item 1, Exhibit 1.

The Attorney General contends that there is no evidence in this proceeding or prior cases that Johnson County sought Commission approval before entering into any of the three promissory notes at issue. The Attorney General emphasizes that none of the three promissory notes are payable in under two years or are renewals of notes payable in under two years, and therefore the exception in KRS 278.300(8) regarding short-term notes is not applicable to the three promissory notes.

The Attorney General argues that the Commission should initiate an investigation into the validity of the three promissory notes before taking substantive action in this proceeding. The Attorney General maintains that heightened scrutiny is necessary because Johnson County issued all three notes on the same date, which is also the date that Johnson County tendered the rate adjustment application. The Attorney General further maintains that the notes lack any indication when the referenced debts were incurred. The Attorney General contends that the alleged debts identified in the three promissory notes at issue are identical to debts identified in a 2011 bankruptcy filing submitted to the Commission in a previous case.⁴ The Attorney General asserts that, based on other records on file with the Commission, the three notes represent payment of questionable amounts: (1) incurred before the test period that may have already been paid; (2) for pre-existing debt for gas purchases that should have been paid through the proceeds of a gas cost adjustment mechanism; and (3) for office space and vehicle leases that benefit Mr. Rife individually at the expense of ratepayers.⁵

⁴ Case No. 2011-00184, *Johnson County Gas Company, Inc. and Bud Rife, Individually and as Sole Officer of the Utility, Alleged Failure to Comply with Commission Orders* (Ky. PSC Feb. 14, 2012).

⁵ Attorney General's Motion at 4.

Because Johnson County requests recovery of debt that the Commission has not investigated or approved, the Attorney General requests that the Commission initiate an investigation into the three promissory notes prior to taking further action in this proceeding and suspend Johnson County's proposed rates until an investigation is completed.

DISCUSSION AND FINDINGS

Legal Standard

The Commission must apply KRS 278.300, the statutory provision for issuing evidences of indebtedness, and 807 KAR 5:076, alternate rate adjustment regulations for small utilities, such as Johnson County. As the Attorney General noted, KRS 278.300 states that no utility shall issue any evidences of indebtedness until authorized to do so by a Commission order. KRS 278.300(8) states that Commission approval is not required for notes "for proper purposes and not in violation of law" that are payable for periods of two years or less, or are renewals of such notes.

Procedures for a rate adjustment for small utilities with \$5,000,000 or less in gross annual revenue in the immediate past calendar year are provided in 807 KAR 5:076. Section 7(1) of 807 KAR 5:076 provides that an applicant cannot place the proposed rates into effect until the Commission issues an order approving those rates or six months from the date of filing the application, whichever occurs first. Section 7(2) of 807 KAR 5:076 states that the applicant may place its proposed rates in effect subject to refund if the Commission has not issued its order within six months from the date of filing of the application. Section 17 of 807 KAR 5:076 provides that the Commission may permit deviations from this regulation upon a showing of good cause.

Attorney General's Motion to Initiate an Investigation

Based upon a review of the motion and the case record, and being otherwise sufficiently advised, the Commission finds that the Attorney General established good cause for the Commission to investigate whether Johnson County violated KRS 278.300 by issuing three promissory notes without the Commission's prior approval. As the Attorney General noted, Johnson County did not provide evidence of Commission approval of the notes in this case or in previous cases. Commission records reflect that Johnson County has not requested authority to enter into an evidence of indebtedness between 1981 and this proceeding.⁶

Johnson County has the burden of proof to show that the proposed rate increase is fair, just and reasonable under KRS 278.190(3). The primary reason for the proposed rate increase is to reduce Johnson County's alleged financial reliance on affiliated companies. Placing Johnson County on sound financial footing to repay the purported loans represents a significant portion of the requested rate increase. Given that, the Commission concurs that an investigation into the three promissory notes is necessary. This is especially so because Mr. Rife is a signatory for both parties on all three notes, all the notes were issued on the same date, and the underlying basis for the loan is not set forth with sufficient clarity.

In addition to the validity of the notes, the Commission should investigate whether the notes are necessary for or consistent with the proper performance of Johnson County, will not impair Johnson County's ability to perform that service, and are reasonably necessary and appropriate to provide service. Because there is an alleged violation of

⁶ Listing of all cases filed by Johnson County Gas Company, Inc., https://psc.ky.gov/PSC_WebNet/SearchCases.aspx (accessed Feb. 19, 2019).

KRS 278.300, and Johnson County and Mr. Rife could be assessed a civil penalty if the Commission determines there was a violation, the investigation should be conducted in a separate proceeding from this case.

Effective date of Rates

The Attorney General also requested that the Commission suspend Johnson County's proposed rates until an investigation of the alleged violation of KRS 278.300 is completed. As noted above, under 807 KAR 5:076, Section 7(2) provides that Johnson County's rates could be placed into effect six months after the application was filed if the Commission has not issued an order. Johnson County's application was deemed filed as of February 4, 2019. Thus, the earliest date that Johnson County could place its proposed rates into effect, without a Commission order approving the rates, is August 4, 2019.

In the alternative, pursuant to 807 KAR 5:076, Section 17, the Commission could deviate from the regulation upon good cause and hold this proceeding in abeyance for a reasonable period to conduct an investigation into the promissory notes. Section 3 of 807 KAR 5:076 sets forth the record on which a decision about a rate increase should be made, which includes the application filed by the utility. As a trier of fact, there must be sufficient evidence of record for the Commission to weigh in order to reach a decision whether the proposed rate increase is fair, just, and reasonable. Additionally, the Commission has disallowed rate recovery when the proceeds of an unauthorized loan were used to pay current operating expenses because such action would constitute retroactive ratemaking.⁷ Because the three promissory notes serve as a primary

⁷ See Case No. 8690, *Application of Glengarry Utilities, Inc., Glengarry Sewage Treatment Plant for an Adjustment of Rates Pursuant to the Alternative Procedure for Small Utilities* (Ky. PSC July 8, 1983) at 7; and Case No. 9303, *Application of Fordhaven, Inc. for an Adjustment of Rates Pursuant to the Alternative Procedure for Small Utilities* (Ky. PSC Aug. 8, 1985) at 8.

reason that Johnson County requested a rate increase, the Commission finds that, unless we investigate the validity of those notes, we cannot reasonably rely on the evidence contained in the application, and therefore cannot render a decision whether the proposed rate increase is fair, just, and reasonable.

For the above reasons, the Commission finds that good cause exists to deviate from the regulations set forth in 807 KAR 5:076 and hold this proceeding in abeyance until the separate show cause proceeding is completed. The separate show cause proceeding will be initiated on the same date as this order is issued. The Commission will use its best efforts to timely complete the show cause investigation, but the need to conduct a thorough investigation may result in a decision after August 2019. The Commission cautions that its ability to timely complete the show cause investigation is dependent upon Johnson County's and Mr. Rife's submitting timely and complete filings in response to Commission orders and requests for information.

SUMMARY OF FINDINGS

A summary of the Commission findings is as follows:

1. Because the three promissory notes at issue are the primary reason that Johnson County requested a rate increase, unless the Commission investigates the validity of those notes, we cannot reasonably rely on the evidence contained in the application, and therefore cannot render a decision whether the proposed rate increase is fair, just, and reasonable.

2. Good cause exists to grant the Attorney General's request that the Commission initiate a separate show cause proceeding to investigate the validity of the

three promissory notes issued by Johnson County allegedly without Commission approval in violation of KRS 278.300.

3. Good cause exists to deviate from the procedural time set forth in 807 KAR 5:076.

4. This proceeding is held in abeyance pending the completion of an investigation into the three promissory notes issued by Johnson County.

IT IS THEREFORE ORDERED that:

1. The Attorney General's motion requesting the Commission to initiate an investigation pursuant to KRS 278.300 regarding Johnson County's evidences of indebtedness is granted.

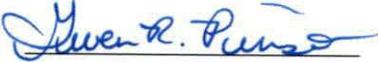
2. This proceeding is held in abeyance until further order of the Commission.

3. Johnson County shall not put its proposed rate increase into effect until further order of the Commission is issued.

By the Commission

ENTERED
FEB 27 2019
KENTUCKY PUBLIC
SERVICE COMMISSION

ATTEST:


Executive Director

Case No. 2018-00434

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