

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF KENTUCKY FRONTIER)	
GAS COMPANY, LLC FOR APPROVAL OF)	CASE NO.
TRANSFER OF AUXIER ROAD)	2009-00442
CORPORATION STOCK)	

O R D E R

Kentucky Frontier Gas Company, LLC ("Kentucky Frontier") has applied for authorization to acquire certain shares of stock of Auxier Road Gas Company ("Auxier"), a natural gas utility, and for authorization of financing of the acquisition. Finding that the statutory prerequisites have been met for the acquisition and associated financing, we authorize the transfer of Auxier stock to Kentucky Frontier and approve the proposed financing.

PROCEDURE

On November 13, 2009, Kentucky Frontier applied for Commission authorization to acquire 94.29 percent of the stock of Auxier. On December 22, 2009, Kentucky Frontier amended its Petition to also request approval of financing for the stock purchase. Staff issued one data request to which Kentucky Frontier has responded. An informal conference was held on December 18, 2009. There are no other parties to the case and no party requested intervention.

DISCUSSION

According to the agreement submitted with its application, Kentucky Frontier will acquire 94.29 percent of the Auxier stock for \$1,550,000 and assume Auxier's existing

note with Community Trust Bank, Inc. in Pikeville, Kentucky (“Community Trust Bank”) at the current balance as of the date of the agreement, not to exceed \$88,000. Kentucky Frontier will continue to negotiate to purchase the remaining 5.71 percent of Auxier’s outstanding stock.

Kentucky Frontier will finance its acquisition of Auxier with a commercial bank loan from Community Trust Bank, consisting of two notes in the total amount of \$1,746,400 and with an equity contribution of \$484,000 from Kentucky Frontier. The equity and the majority of the loan proceeds will be used to acquire the Auxier stock and to extinguish the \$88,000 note between Auxier and Community Trust Bank. Kentucky Frontier will use approximately \$550,000 of the debt for other planned acquisitions of gas facilities. The portion of the \$484,000 total equity contribution to be allocated to Auxier has not been determined at this time but the debt to equity ratio is intended to be approximately 80 percent debt and 20 percent equity once the purchase is completed.¹

At the informal conference, Kentucky Frontier discussed its financing plan and disclosed that \$550,000 of the loan will not be used for the acquisition of Auxier but for future acquisition of other gas utility assets. In its amended application, Kentucky Frontier stated that it will file a separate application for the acquisition and financing of the other gas utility assets.² By this Order, the Commission is approving the portion of the loan that applies to the acquisition of Auxier. Kentucky Frontier will be required to

¹ Kentucky Frontier’s response to Staff’s December 4, 2009 data request, Item 14, dated December 11, 2009.

² Amended petition for transfer of stock and approval of financing, dated December 22, 2009, at paragraph 13.

seek Commission approval of any future acquisitions of gas utility assets, as well as for the financing of those assets.

GAS PLANT ACQUISITION ADJUSTMENT/STOCK PREMIUM

Kentucky Frontier is purchasing Auxier's stock at a purchase price in excess of the stock's book value. When the sale of a utility's assets results in a purchase price greater than the original cost less accumulated depreciation (net book value), the difference between the purchase price and the net book value is accounted for as a plant acquisition adjustment.

In response to Commission Staff's data request, Kentucky Frontier provided the journal entries it proposed to make to record the Auxier transfer. With a cash payment of \$1,663,000 and a net book value of \$448,384, Kentucky Frontier indicated that it would record a Gas Plant Acquisition Adjustment ("GPAA") of \$1,214,616.³ Kentucky Frontier's proposed journal entries are not the proper entries for a stock acquisition. The entries proposed by Kentucky Frontier are for an "asset" purchase, similar to Kentucky Frontier's recent purchase of several other small gas utilities. Since this is a "stock" purchase and not an "asset" purchase, Kentucky Frontier should record its investment in Auxier in Account 123.1, Investments in Subsidiary Companies. Kentucky Frontier should contact Commission Staff if it has any questions regarding the journal entries to record its acquisition of Auxier.

In any case, Kentucky Frontier must request Commission authorization if it wishes to recover through rates any of the purchase price of Auxier stock in excess of

³ Kentucky Frontier's response to Staff's December 4, 2009 data request, item 11, dated December 11, 2009.

the book value of the stock. The Commission will treat such a request in a manner similar to that of a GPAA.

The Commission has set forth its position on GPAA's in several prior Orders. A primary source of information regarding the Commission's past position regarding GPAA's is Case No. 1998-00613.⁴ The decision in that case generally held that the issue of recovery of a GPAA should be considered on a case-by-case basis. The Order set out five criteria to be considered by the Commission regarding recovery of a GPAA. Those criteria can be identified as follows:

- (1) The purchase price was established upon arm's-length negotiations;
- (2) The initial investment plus the cost of restoring facilities to required standards will not adversely impact the overall costs of existing or new customers;
- (3) Operational economies can be achieved through the acquisition;
- (4) The purchase price of utility property and non-utility property, if any, can be clearly identified; and
- (5) The purchase will result in overall benefits in the financial and service aspects of the utility's operations.

While the matter of recovery of the stock premium created by Kentucky Frontier's acquisition of control of Auxier is not being decided in this case, these criteria will need to be addressed by Kentucky Frontier if it seeks to recover any portion of the stock premium in a future rate proceeding. The Commission finds that the stock premium/

⁴ Case No. 1998-00613, In the Matter of the Application of Delta Natural Gas Company, Inc. for an Order Authorizing the Purchase of the Assets of Mt. Olivet Natural Gas Company (Ky. PSC Sept. 7, 1999).

acquisition adjustment should be approved for accounting purposes only and a decision on rate-making treatment deferred until a future rate proceeding.

FINDINGS OF FACT

The Commission, based on the evidence of record and being otherwise sufficiently advised, finds that:

1. The Commission has previously approved the acquisition of three natural gas utilities by Kentucky Frontier in Case No. 2008-00394.⁵

2. Auxier, a privately held Kentucky corporation, owns and operates facilities that distribute and furnish natural gas to approximately 500 customers in and around Prestonsburg, Kentucky.

3. Kentucky Frontier is a limited liability company formed under the laws of Colorado and is authorized to conduct business in Kentucky.

4. Kentucky Frontier has entered into an agreement for the transfer of 94.29 percent of Auxier stock from Sallye Branham.

5. The term sheet for the acquisition of Auxier stock provides for the purchase of stock for \$1,550,000 and the assumption of an \$88,000 bank note held by Community Trust Bank. Kentucky Frontier will enter into a five-year consulting contract with Sallye Branham for \$10,000 per year. The Auxier office building, shop, and storage area will be leased from Sallye Branham for \$1,800 per month. Sallye Branham will receive gas at her current residence at no charge for up to 15 years at a volume not

⁵ Case No 2008-00394, Application of Kentucky Frontier Gas, LLC for Approval of Financing and Transfer of Control (Ky. PSC Nov. 25, 2008).

to exceed 80 dekatherms per year. Employment will be offered full-time to Kimberly Crisp and part-time to Susan Crum.

6. To finance this acquisition, Kentucky Frontier has obtained a commercial loan commitment from Community Trust Bank. The Auxier stock purchase will be funded with approximately 80 percent debt and 20 percent equity. There are to be two notes for a total of \$1,746,400. The terms of the \$1,746,400 commercial loan include an interest rate at the Wall Street Journal ("WSJ") prime rate plus one percent Annual Percentage Rate ("APR"), with a floor of six percent, amortized over 15 years. According to the amortization schedule, the monthly principal and interest payment will total \$15,000.

7. Kentucky Frontier will use approximately \$550,000 of the debt for other planned acquisitions of gas facilities. Kentucky Frontier will be required to seek Commission approval of any future acquisitions of gas utility assets, as well as for the financing of those assets.

8. Upon completion of the proposed transaction, Kentucky Frontier, LLC will own 94.29 percent of the stock of Auxier.

9. Kentucky Frontier does not propose any immediate changes to the rates, regulations, or conditions of service of Auxier. Kentucky Frontier anticipates that Auxier's current rates will remain in effect until consolidated with the other gas utilities under its ownership and control. It has stated its intention to establish a single Gas Cost Recovery methodology for all the gas utilities under its ownership and control at a later date.

10. Kentucky Frontier's management has extensive experience in the operation and management of gas pipeline and distribution systems.

11. The proposed debt and equity financing for the purchase of Auxier stock is for lawful objects within the corporate purposes of Kentucky Frontier, is necessary and appropriate for and 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 purposes.

CONCLUSIONS OF LAW

Based upon the above findings of fact, the Commission makes the following conclusions of law:

1. Auxier and Kentucky Frontier are utilities subject to Commission jurisdiction.⁶

2. Both Kentucky Frontier and Auxier are “persons” for purposes of KRS Chapter 278.⁷

3. KRS 278.020(5) provides that “[n]o person shall acquire or transfer ownership of, or control, or the right to control, any utility under the jurisdiction of the commission . . . without prior approval by the commission.” As Kentucky Frontier is a person and proposes to acquire ownership of Auxier, this statute is applicable to and requires Commission approval of the proposed transfer.

4. KRS 278.020(6) provides that “[n]o individual, group, syndicate, general or limited partnership, association, corporation, joint stock company, trust, or other entity (an ‘acquirer’), whether or not organized under the laws of this state, shall acquire

⁶ KRS 278.010(3)(b).

⁷ KRS 278.010(2).

control, either directly or indirectly, of any utility furnishing utility service in this state, without having first obtained the approval of the commission.”

5. KRS 278.300 provides that no utility shall issue or incur an evidence of indebtedness until it has been authorized to do so by the Commission.

6. Kentucky Frontier has the financial, technical, and managerial abilities to provide reasonable service to the present customers of Auxier.

7. The proposed transfer of stock is in accordance with law, for a proper purpose, and consistent with the public interest.

8. The financing proposed by Kentucky Frontier should be approved.

IT IS THEREFORE ORDERED that:

1. Kentucky Frontier’s proposed acquisition of Auxier stock is approved.

2. Commission authorization of the proposed acquisition of the stock of Auxier is effective for one year from the date of this Order and shall lapse if the acquisition is not completed within this time period.

3. Within 10 days of completion of the transfer of stock as approved, Kentucky Frontier shall notify the Commission in writing of the completion thereof.

4. Within 20 days of the completion of the proposed transfer, Kentucky Frontier shall file the journal entries it proposes to record the approved acquisition. The acquisition shall be recorded in accordance with the Uniform System of Accounts.

5. Nothing in this Order shall be construed as authorizing rate-making treatment for the recovery through rates of any cost or expense in excess of book value associated with the proposed acquisition of control of Auxier. The issue of rate recovery is deferred until a future rate case proceeding.

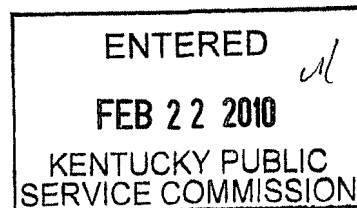
6. Kentucky Frontier is authorized to borrow \$1,746,400 at an interest rate equivalent to the WSJ prime rate plus one percent APR, with a floor of six percent over 15 years, subject to the provisions and terms contained within its application.

7. The proceeds from the transaction authorized herein shall be used only for the lawful purposes set out in the application.

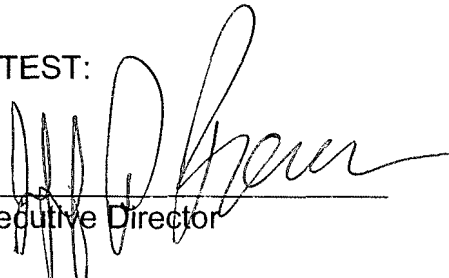
8. Kentucky Frontier shall be required to seek Commission approval of any future acquisition of gas utility assets and for the financing of those assets.

9. Nothing contained herein shall be deemed a warranty or finding of value of securities or financing authorized herein on the part of the Commonwealth of Kentucky or any agency thereof.

By the Commission



ATTEST:



Executive Director

Sallye Branham
President
Auxier Road Gas Company, Inc.
P. O. Box 785
Prestonsburg, KY 41653

Honorable John N Hughes
Attorney at Law
124 West Todd Street
Frankfort, KY 40601

Robert Oxford
Managing Partner
Kentucky Frontier Gas, LLC
4891 Independence Street, Suite 200
Wheat Ridge, CO 80033