

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

RECEIVED  
AUG 30 2005  
PUBLIC SERVICE  
COMMISSION

In the Matter of:

**ORIGINAL**

The Application of )  
Kentucky Frontier Gas, LLC )  
for approval of assumption of existing debt ) Case No.  
and financing of new debt ) 2005-00348

**APPLICATION**

Kentucky Frontier Gas, LLC, by counsel, petitions the Commission for an order approving the assumption of debt of several natural gas utilities and the financing of new debt by a combined utility company pursuant to KRS 278.300. A separate application has been filed for approval of the transfer of these utilities under Case No. 2005- , filed jointly with the current owners of the small gas utilities ("Application to Transfer"). Because a number of exhibits are required to be filed in both applications, Kentucky Frontier requests a deviation pursuant to 807 KAR 5:001§14 from filing duplicate copies of exhibits. It requests that it be allowed to reference exhibits attached to the Transfer Application where appropriate. It also requests a deviation from the filing of final financing documents pending approval of such by the Governor's Office of Local Development, which is the primary debt holder for the four utilities to be acquired. Because GOLD has not completed an internal review of the operations of the Gas System Restoration Program and the status of current loans, the nature and form of the specific information needed for Frontier to apply for this refinancing

has not been determined. Whatever filing is ultimately required by GOLD will be submitted to the Commission. However, due to the need for immediate action, Frontier is submitting the available information related to the debt restructuring.

1. Kentucky Frontier Gas, LLC is a Colorado company authorized to do business in Kentucky. Its address is 3760 Vance Street, Wheat Ridge CO 80033. Managing partners are Robert Oxford and Steven Shute. A copy of its articles of organization and its certificate to operate in Kentucky are filed in the Transfer Application as exhibit 1.

2. Kentucky Frontier is an LLC formed for the purpose of acquiring and operating several small natural gas utilities generally located in eastern Kentucky. Frontier has studied about 10 small gas distribution companies in eastern Kentucky. These utilities are all similar: they serve 400 to 1100 customers, mostly small residential and commercial accounts; annual gas volume has not reached a critical mass to achieve profitability; and most have negative equity and large debts. Due to chronic operating losses, these utilities are unable to pay their loans or form capital to market their services or expand systems; they are only marginally able to comply with federal and state regulations for pipeline safety, training and utility reporting; and there is little or no prospect for significant change in their financial outlook.

3. Kentucky Frontier has entered into purchase contracts with the four gas utilities listed below. The contracts are included in the Application to Transfer as exhibit 2 and are incorporated by reference. All purchases are subject to approval by PSC, including approval of proposed financing, capital structure,

tariffs, and transfer of any certificates of public convenience and necessity (CPCN) granted by PSC to any of these entities. Purchase prices are based on the industry standard of \$1000 per meter, plus other factors such as gas volume and growth potential. The resulting purchase prices are about two times Book Value, which is another industry standard for acquiring existing utility systems. The utilities are:

a. **Belfry Gas, Inc.** Incorporated in 1969, Belfry is owned by JW Kinzer and has about 560 customers in eastern Pike County, from Belfry to the border near Williamson, WV. The owner of Belfry Gas will transfer the assets of the gas distribution entity, including the CPCN, but will retain some of the transmission pipelines and the Belfry name.

b. **Floyd County Gas.** Originally incorporated as Ohio-Kentucky Utilities in 1969, the system was bankrupted and assets taken over by Floyd County ca 1979. Since then, the system has been operated by a non-profit entity **Eastern Kentucky Utilities** (EKU) headed by John Allen (now deceased) under contract with the County. It is unclear which entity (if any) holds the CPCN. In April 2005, Floyd County placed the assets up for public bid, and accepted the offer by Frontier partners. The purchase of assets will *not* include EKU. This system serves about 1100 customers in Floyd County from Prestonsburg toward Pikeville.

c. **Elam Utility Company, Inc.** Incorporated in 1936, this gas-only utility is now owned by Wilma Ison. This utility serves about 475 customers, mostly in the West Liberty community in Morgan County.

d. **Mike Little Gas Company** Incorporated in 1964, company is now owned by the heirs of Mike Little. This utility serves about 400 customers, mostly in the Melvin community in southwest Floyd County.

4. No rate adjustment is being proposed at this time and no acquisition adjustment is being requested at this time. Frontier proposes to adopt the currently approved General Rates and tariffs used by each respective certificated gas utility. Adoption notices have been included in the Transfer Application. Kentucky Frontier anticipates these rates will stay in effect for 1 to 2 years. Kentucky Frontier plans to eventually file a consolidated rate case and serve all customers through a single utility brand with a single rate structure.

5. The consolidation of these utilities is expected to create a critical mass which is much more viable. Many utility functions - billing, accounting, customer calls, emergency response, operator training and regulatory compliance - would be enhanced by a common, central organization.

6. Kentucky Frontier expects to significantly reduce operating costs with the combined utility. This reduction in annual obligations will benefit the customers by providing additional funds for operations, stable financial operations and potential for reduced rates or less frequent rate increases. These operational savings are reflected in the pro forma statement filed as exhibit 6 of the Transfer Application.

7. Elam and Mike Little customers will continue to be served under those operating names, rates and tariffs. Customers of East Kentucky Utilities

and Belfry Gas will be served under the “Frontier Gas” brand, but at the current rates and tariffs of those companies.

8. Kentucky Frontier will hold all assets and liabilities of all companies acquired.

9. Kentucky Frontier is a limited liability company formed to acquire Kentucky gas utilities. Information on members is contained in exhibit 4 of the Transfer Application and details of the transactions are contained in the Application for Transfer.

10. Kentucky Frontier has no historical financial statements due to its recent formation. A current financial statement for partner Industrial Gas Services, Inc. is included in the Application to Transfer as exhibit 5.

11. The most recent PSC Annual Reports for Belfry, Elam and Mike Little are incorporated by reference. No annual report is available for East Kentucky Utilities, but the 2004 financial statements prepared for the Floyd County gas system bid package are included in the Application to Transfer as exhibit 2

12. The capital structure of Kentucky Frontier will consist of \$1,020,000 or 30% in cash equity contributed toward the acquisition, along with 70% long-term debt.

Most of the existing long-term debt is through Gas System Restoration and Development Project (GSRP) and Kentucky Infrastructure Agency (KIA) programs administered by the Governor’s Office of Local Development (GOLD). For simplicity, all such loans are referred here as GOLD loans. Frontier has

proposed to GOLD that approximately 50% of the acquisition and improvement cost would be funded with long-term, low-interest debt. The remaining 20% will be funded with long-term corporate debt from commercial sources, arranged and possibly guaranteed by the partners.

13. The utility acquisitions are subject to approval by the GOLD loan agency. A copy of the financing application and proposal to GOLD (or "GOLD Application") is attached as exhibit 1. Kentucky Frontier anticipates it will assume existing GOLD debt or incur new debt in the following amounts.

- |    |                     |             |
|----|---------------------|-------------|
| a. | Assumed GOLD debt   | \$1,135,000 |
| b. | New GOLD debt       | \$ 465,000  |
| c. | New Commercial debt | \$ 640,000  |

14. Each utility will cease to be a separate corporate entity under Kentucky Frontier ownership. The proposed debt structure of Kentucky Frontier is attributable to the original utility systems as follows:

a. **Belfry Gas.** Belfry has no external debt, except for amounts payable to owner JW Kinzer. This acquisition will leave this entity without debt. The acquisition cost of \$750,000 includes farm tap customers controlled by Kinzer but not currently included in the Belfry system.

*Frontier proposes to fund \$350,000 with a new GOLD loan, about half the acquisition cost. Commercial bank debt will be \$175,000.*

b. **Floyd County Gas.** This system has substantial debt to GOLD, to Floyd County and to a commercial bank. Under the terms of the public bid, the acquisition price of \$1,075,000 will be paid to Floyd County, which

will discharge all debts. The Floyd County / ECU loan is a recent debt consolidation loan, and is currently about \$550,000 for 30 years at 4% APR. *Frontier proposes to assume or renew the existing \$550,000 Floyd County loan through GOLD. Commercial bank debt will be \$200,000.*

c. **Elam Utility.** This system has substantial debt to GOLD of about \$775,000 for 27 years at 2.9% APR. The current owner has a debt to the previous owner, which will be paid out of sales proceeds. *Frontier proposes to reduce the GOLD debt to \$450,000 under the same terms of the existing loan. Commercial bank debt will be \$110,000.*

d. **Mike Little.** Company has a small GOLD loan, and 2 small commercial bank loans. The GOLD loan is approved up to \$135,000. *Frontier proposes to assume or renew the existing Mike Little loan through GOLD, and to increase the approved amount to \$250,000. Commercial bank debt will be \$85,000.*

15. Floyd County Gas currently has a bond payable to the county. This bond will be redeemed at closing and will not be assumed by Frontier. There are no other current bonds. Kentucky Frontier does not anticipate issuing bonds.

16. Belfry Gas holds a note to owner J.W. Kinzer. Elam Utility, Floyd County Gas and Mike Little Gas each hold one or more commercial bank notes. These debts will be assumed or paid by the current owners and not by Kentucky Frontier.

17. The remaining Kentucky Frontier debt will be secured through a commercial bank loan arranged by partner Don Silversmith. The terms are

expected to be \$650,000 at 9% APR amortized over 20 years. This loan may require personal guarantees from the partners.

18. The proceeds of equity and debt financing will be used to finance the acquisition of these utilities. The total acquisition cost is expected to be \$3.1 million. The cost of regulatory approvals and initial system upgrades is expected to increase the total initial project cost to \$3.4 million.

19. The proceeds of the financing are not being used to refund any outstanding obligations.

20. Kentucky Frontier's business plan is generally reflected in the proposed pro forma financial statements, description of proposed operations and other information provided in the Application to Transfer.

21. A description of the original cost of the property to be acquired by Frontier can be found in the PSC Annual Reports of Belfry Gas, Inc., Elam Utility Company, Inc., and Mike Little Company, which are incorporated by reference. The assets of Floyd County Gas are included in the Application to Transfer, exhibit 2. The cost to Kentucky Frontier of each property is described above.

22. Kentucky Frontier is an LLC and has no stock. Upon funding of equity and debt, and after closing on the purchase of the utilities named herein, Frontier partners will hold the following ownership (percentages will vary slightly):

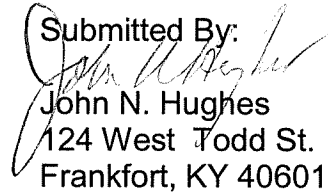
- a. **Industrial Gas Services, Inc.** (20%)
- b. **Gilmer Mickey** (23%)
- c. **Larry Rich** (10%)
- d. **Steven Shute** (24%)



e. **Don Silversmith (23%)**

23. No stock is to be issued in conjunction with this financing.
24. The other debt to be issued, amount, interest rate and security are described in the application to GOLD, which is attached as exhibit 1. The proposed loans from commercial banks are described in paragraphs 14 -17.
25. The proceeds of the financing are to be used to finance the acquisition of the utilities named above.
26. The use of the proceeds of the financing are described more fully in the Transfer Application.
27. The proceeds of the financing are not being used to refund any outstanding obligations.
28. There is no preferred stock issued.
29. The current KIA (GOLD) mortgages, including the name of the mortgagee, secured debt, and other provisions of the utilities to be acquired are discussed in paragraphs 14-18.
30. There are no bonds.
31. Notes are described in paragraphs 14-18.
32. Other debts are discussed in paragraphs 14-18.
33. No dividends have been paid by Kentucky Frontier in the last five years.
34. A detailed balance sheet and income statement is attached as exhibit 7 to the Transfer Application.

Based on this information, the Applicant believes the financing is in the public interest, for a lawful purpose, is necessary for the proper performance of the utility to serve its customers and is reasonably necessary. Because KRS 147.200 requires any applicant for GOLD financing to obtain Commission approval for such financing prior to GOLD consideration of the proposed financing, Kentucky Frontier requests that the Commission authorize it to apply to GOLD for the proposed financing and authorize the assumption of the proposed debt and its terms by Kentucky Frontier as being consistent with KRS 278.300. At the time of the approval by GOLD of the specific terms and conditions, they will be filed with the Commission.

Submitted By:  
  
John N. Hughes  
124 West Todd St.  
Frankfort, KY 40601

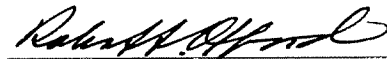
Attorney for  
Kentucky Frontier Gas, LLC

COLORADO

JEFFERSON COUNTY

Robert J. Oxford, being first duly sworn, deposes and says:

That he is a Member, to wit, Manager of Kentucky Frontier Gas, LLC, Petitioner, named in the above entitled matter; that he has read the foregoing Application and knows the contents thereof and that the same is true of his own knowledge except as to those matters and things therein alleged upon information and belief, and as to those matters and things he believes them to be true.

  
\_\_\_\_\_  
Robert J. Oxford

Sworn to and subscribed before me this 19<sup>th</sup> day of August, 2005.

  
\_\_\_\_\_  
Notary Public

My Commission Expires: 10/31/06

List of Exhibits

- 1) Financing proposal to GOLD (or "GOLD Application").



COMMONWEALTH OF KENTUCKY  
GOVERNOR'S OFFICE FOR LOCAL DEVELOPMENT

In the Matter of:

The Application of )  
Kentucky Frontier Gas, LLC )  
for approval of assumption of existing debt )  
and financing of new debt )

**APPLICATION**

Kentucky Frontier Gas, LLC, by counsel, petitions the Governor's Office for Local Development ("GOLD") and the Gas System Restoration and Development Project ("GSRP") board for approval of the assumption of debt of several natural gas utilities and the financing of new debt by a combined utility company.

Two related applications are filed contemporaneously with the Kentucky Public Service Commission ("PSC"). The first PSC filing addresses the transfer of four small gas utility operations into Frontier ("Application to Transfer"), which is attached as exhibit 1; this application was prepared jointly with the owners of those utilities. The second PSC filing addresses debt financing of the combined Frontier system ("Application to Finance"), which is attached as exhibit 2.

1. Kentucky Frontier Gas, LLC ("Frontier") is a Colorado company authorized to do business in Kentucky. Its address is 3760 Vance Street, Wheat Ridge CO 80033. Managing partners are Robert Oxford and Steven Shute

2. Frontier is an LLC formed for the purpose of acquiring and operating several small natural gas utilities generally located in eastern

Kentucky. Frontier has studied about 10 small gas distribution companies in eastern Kentucky. These utilities are all similar: they serve 400 to 1100 customers, mostly small residential and commercial accounts; annual gas volume has not reached a critical mass to achieve profitability; and most have negative equity and large debts. Due to chronic operating losses, these utilities are unable to pay their loans or form capital to market their services or expand systems; they are only marginally able to comply with federal and state regulations for pipeline safety, training and utility reporting; and there is little or no prospect for significant change in their financial outlook.

3. Frontier has entered into purchase contracts with the four gas utilities listed below. The contracts are attached to exhibit 1. All purchases are subject to approval by the Public Service Commission, including approval of proposed capital structure, financing, tariffs, and transfer of any certificates of public convenience and necessity (CPCN) granted by the PSC to any of these entities. Purchase prices are based on the industry standard of \$1000 per meter, plus other factors such as gas volume and growth potential. The resulting purchase prices are about two times Book Value, which is another industry standard for acquiring existing utility systems. The utilities are:

a. **Belfry Gas, Inc.** Incorporated in 1969, Belfry is owned by JW Kinzer and has about 560 customers in eastern Pike County, from Belfry to the border near Williamson, WV. The owner of Belfry Gas will transfer the assets of the gas distribution entity, including the CPCN, but will retain some of the transmission pipelines and the Belfry name.

b. **Floyd County Gas.** Originally incorporated as Ohio-Kentucky Utilities in 1969, the system was bankrupted and assets taken over by Floyd County ca 1979. Since then, the system has been operated by a non-profit entity **Eastern Kentucky Utilities** (EKU) headed by John Allen (now deceased) under contract with the County. It is unclear which entity (if any) holds the CPCN. In April 2005, Floyd County placed the assets up for public bid, and accepted the offer by Frontier partners. The purchase of assets will *not* include EKU. This system serves about 1100 customers in Floyd County from Prestonsburg toward Pikeville.

c. **Elam Utility Company, Inc.** Incorporated in 1936, this gas-only utility is now owned by Wilma Ison. This utility serves about 475 customers, mostly in the West Liberty community in Morgan County.

d. **Mike Little Gas Company** Incorporated in 1964, company is now owned by the heirs of Mike Little. This utility serves about 400 customers, mostly in the Melvin community in southwest Floyd County.

4. No rate adjustment is being proposed at this time with the PSC and no acquisition adjustment is being requested at this time. Frontier proposes to adopt the currently approved General Rates and tariffs used by each respective certificated gas utility. Frontier anticipates these rates will stay in effect for 1 to 2 years. Frontier plans to eventually file a consolidated rate case and serve all customers through a single utility brand with a single rate structure.

5. The consolidation of these utilities is expected to create a critical mass which is much more viable. Many utility functions - billing, accounting,



customer calls, emergency response, operator training and regulatory compliance - would be enhanced by a common, central organization.

6. Frontier expects to significantly reduce operating costs with the combined utility. This reduction in annual obligations will benefit the customers by providing additional funds for operations, stable financial operations and potential for reduced rates or less frequent rate increases.

7. Elam and Mike Little customers will continue to be served under those operating names, rates and tariffs. Customers of East Kentucky Utilities and Belfry Gas will be served under the "Frontier Gas" brand, but at the current rates and tariffs of those companies.

8. Frontier will hold all assets and liabilities of all companies acquired.

9. Frontier is a limited liability company formed to acquire Kentucky gas utilities. Information on members and details of the transactions are contained in exhibit 1.

10. Frontier has no historical financial statements due to its recent formation. A current financial statement for partner Industrial Gas Services, Inc. is included in exhibit 1.

11. The most recent PSC Annual Reports for Belfry, Elam and Mike Little are incorporated by reference. No annual report is available for East Kentucky Utilities, but the 2004 financial statements prepared for the Floyd County gas system bid package are included in exhibit 1.

12. The capital structure of Frontier will consist of \$1,020,000 or 30% in cash equity contributed toward the acquisition, along with 70% long-term debt.

Most of the existing long-term debt is through Gas System Restoration and Development Project (GSRP) and Kentucky Infrastructure Agency (KIA) programs administered by the Governor's Office of Local Development (GOLD). For simplicity, all such agency loans are referenced here as GOLD loans.

Frontier proposes to GOLD that approximately 47% of the acquisition and improvement cost would be funded with long-term, low-interest GOLD debt. The remaining 23% will be funded with long-term corporate debt from commercial sources, arranged and possibly guaranteed by the partners.

13. The utility acquisitions are contingent upon approval by GOLD of the renewal or assumption of certain existing GOLD loans. Less critical, but still important to the economic strength of the combined utility, is the need by Frontier of new loans from GOLD for two systems. Frontier anticipates assuming existing GOLD debt or incurring new GOLD debt in the following amounts.

a.	Assumed GOLD debt	\$1,135,000
b.	New GOLD debt	\$ 465,000
c.	New Commercial debt	\$ 640,000

14. Each utility will cease to be a separate corporate entity under Frontier ownership. The proposed debt structure of Frontier is attributable to the original utility systems as follows:

a. **Belfry Gas.** Belfry has no external debt, except for amounts payable to owner JW Kinzer. This acquisition will leave this entity without debt. The acquisition cost of \$750,000 includes farm tap customers controlled by Kinzer but not currently included in the Belfry system.

*Frontier proposes to fund \$350,000 with a new GOLD loan, about half the acquisition cost. Commercial bank debt will be \$175,000.*

b. **Floyd County Gas.** This system has substantial debt to GOLD, to Floyd County and to a commercial bank. Under the terms of the public bid, the acquisition price of \$1,075,000 will be paid to Floyd County, which will discharge all debts. The Floyd County / ECU loan is a recent debt consolidation loan, and is currently about \$550,000 for 30 years at 4% APR. *Frontier proposes to assume or renew the existing \$550,000 Floyd County loan through GOLD. Commercial bank debt will be \$200,000.*

c. **Elam Utility.** This system has substantial debt to GOLD of about \$775,000 for 27 years at 2.9% APR. The current owner has a debt to the previous owner, which will be paid out of sales proceeds. *Frontier proposes to reduce the GOLD debt to \$450,000 under the same terms of the existing loan. Commercial bank debt will be \$110,000.*

d. **Mike Little.** Company has a small GOLD loan, and 2 small commercial bank loans. The GOLD loan is approved up to \$135,000. *Frontier proposes to assume or renew the existing Mike Little loan through GOLD, and to increase the approved amount by \$115,000 to a total of \$250,000. Commercial bank debt will be \$85,000.*

15. Floyd County Gas currently has a bond payable to the county. This bond will be redeemed at closing and will not be assumed by Frontier. There are no other current bonds. Frontier does not anticipate issuing bonds.

16. Belfry Gas holds a note to owner J.W. Kinzer. Elam Utility, Floyd County Gas and Mike Little Gas each hold one or more commercial bank notes. These debts will be assumed or paid by the current owners and not by Frontier.

17. The remaining Frontier debt will be secured through a commercial bank loan arranged by partner Don Silversmith. The terms are expected to be \$650,000 at 9% APR amortized over 20 years. This loan may require personal guarantees from the partners.

18. The proceeds of equity and debt financing will be used to finance the acquisition of these utilities. The total acquisition cost is expected to be \$3.1 million. The cost of regulatory approvals and initial system upgrades is expected to increase the total initial project cost to \$3.4 million.

19. The proceeds of the financing are not being used to refund any outstanding obligations.

20. Frontier's business plan is generally reflected in the proposed pro forma financial statements, description of proposed operations and other information provided in exhibit 1.

21. A description of the original cost of the property to be acquired by Frontier can be found in the PSC Annual Reports of Belfry Gas, Inc., Elam Utility Company, Inc., and Mike Little Company, which are incorporated by reference. The assets of Floyd County Gas are included in the attached bid proposal, which is included in exhibit 1. The cost to Frontier of each property is described herein.

22. Upon funding of equity and debt, and after closing on the purchase of the utilities, Frontier partners will hold the following ownership (percentages will vary slightly):

- a. **Industrial Gas Services, Inc.** (20%)
- b. **Gilmer Mickey** (23%)
- c. **Larry Rich** (10%)
- d. **Steven Shute** (24%)
- e. **Don Silversmith** (23%)

23. Based on this information, the Applicant believes the GOLD financing is in the public interest and requests approval by GOLD of the financing necessary to acquire and operate the combined facilities. Frontier requests these specific actions by GOLD:

A. Approve the assumption by Frontier of the GOLD loan to Floyd County Gas System. This loan would be transferred to Frontier at the existing repayment terms, which are approximately \$550,000 for 30 years at 4% APR.

B. Approve the assumption by Frontier of the GOLD loan to Mike Little Gas Company. The loan would be transferred to Frontier at the existing repayment terms, which are approximately \$135,000 for 24 years at 4% APR.

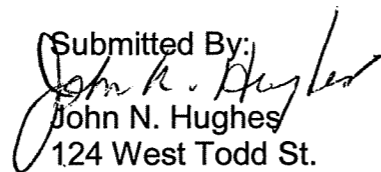
C. Approve the assumption by Frontier of a portion of the GOLD loan to Elam Utility Company. The loan balance would be reduced

from approximately \$775,000 to \$450,000, and Frontier would pay the reduced balance at the existing terms of 27 years at 2.9% APR.

D. Approve new financing to Frontier for the purchase of Belfry Gas assets. Frontier requests a GOLD loan for \$350,000 which is about half of the purchase price, with repayment terms of 30 years at 4% APR.

E. Approve increased financing to Frontier for the purchase of Mike Little assets. Frontier requests an increase of about \$115,000 to the existing loan to reach a balance of \$250,000, with repayment terms of 24 years at 4% APR.

24. Time is of the essence for these transactions. Because of the seasonal nature of gas utility sales, it is highly important that Frontier take over operation of each of these utilities before winter. To achieve that deadline, Frontier requests expedited approval by GOLD of the necessary actions herein described on or before November 1, 2005.

Submitted By:  
  
John N. Hughes  
124 West Todd St.  
Frankfort, KY 40601

Attorney for  
Kentucky Frontier Gas, LLC

#### List of Exhibits

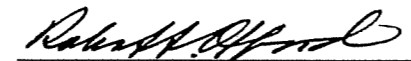
- 1) "Application to Transfer" filing to PSC to consolidate ownership of 4 small gas utilities
- 2) "Application to Finance" filing to PSC for debt financing of the combined Frontier system.

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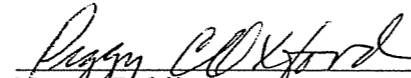
JEFFERSON COUNTY

Robert J. Oxford, being first duly sworn, deposes and says:

That he is a Member, to wit, Manager of Kentucky Frontier Gas, LLC, Petitioner, named in the above entitled matter; that he has read the foregoing Application and knows the contents thereof and that the same is true of his own knowledge except as to those matters and things therein alleged upon information and belief, and as to those matters and things he believes them to be true.

  
\_\_\_\_\_  
Robert J. Oxford

Sworn to and subscribed before me this 19<sup>th</sup> day of August, 2005.

  
\_\_\_\_\_  
Notary Public

My Commission Expires: 10/31/06