

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF KENTUCKY)
FRONTIER GAS, LLC FOR) CASE NO. 2017-00263
ALTERNATIVE RATE ADJUSTMENT)

ATTORNEY GENERAL’S POST-HEARING BRIEF

Comes now the intervenor, the Attorney General of the Commonwealth of Kentucky, by and through his Office of Rate Intervention, and hereby submits his post-hearing brief in the above-styled matter.

STATEMENT OF THE CASE

Kentucky Frontier Gas, LLC (“Frontier”) filed an application for Alternative Rate Filing on June 30, 2017. Frontier stated that the reason for the Application is twofold—to consolidate the rates and tariffs of all current customers, and to continue and accelerate the Pipeline Replacement Program (“PRP”).¹ At the time of filing, Frontier served 5050 customers.² Frontier requested additional revenues totaling \$603,810.³ The proposed rates would produce additional annual revenue of \$373,000, and would unify the rates of the existing Frontier customers and the former customers of Public Gas Company, which Frontier acquired in 2015.⁴ Frontier also proposed raising the customer charge 60% for Residential and Commercial classes, from \$10.00 to \$16.00, while the Large Commercial charge had no proposed change from \$50.00. Finally, Frontier proposed an increase of \$0.75 to the PRP surcharge, raising it from \$1.25/month to \$2.00/month per customer.⁵

¹ *Kentucky Frontier Gas, LLC Application*, Case No. 2017-00263, at 15 (Ky. P.S.C. June 30, 2017).
² *Kentucky Frontier Gas, LLC Application*, Case No. 2017-00263, at 8 (Ky. P.S.C. June 30, 2017).
³ *Id.*
⁴ *Id.* at 12, 15; *PSC Order*, Case No. 2015-00299 (Ky. P.S.C. November 24, 2015).
⁵ *Id.* at 13.

The Attorney General filed a motion requesting intervention on July 14, 2017, and was granted the same on July 25, 2017.⁶ Frontier gave notice of its intent to waive its right to a hearing and agreed to have the matter submitted on the record.⁷ The Attorney General filed a motion to waive a formal hearing and for leave to file comments instead.⁸ Frontier filed a response objecting to the filing of comments, however the Commission upon its own Motion ordered a hearing, rendering the Attorney General's motion and Frontier's response moot.⁹ A hearing was subsequently held on November 27, 2017.¹⁰

ARGUMENT

I. AFFILIATE TRANSACTIONS

Steve Shute is the majority owner and a Managing Member of Frontier.¹¹ Mr. Shute is also the sole owner of Pipeline Solutions Inc. ("PSI"),¹² and the owner of Pinedale Natural Gas Co. ("Pinedale") in Pinedale, Wyoming.¹³ Robert Oxford is a minority owner of Frontier, and the sole owner of Industrial Gas Services, Inc. ("IGS").¹⁴ IGS is also a minority owner of Frontier.¹⁵ Frontier is the sole owner of Auxier Road Gas Company, which it operates under contract.¹⁶ Finally, the four Frontier owners own DLR Enterprises, Inc., which is in turn operated under contract by Frontier.¹⁷ PSI and IGS perform consulting services for Frontier.¹⁸

⁶ *AG Motion to Intervene*, Case No. 2017-00263 (Ky. P.S.C. July 14, 2017); *PSC Order*, Case No. 2017-00263 (Ky. P.S.C. July 25, 2017).

⁷ *Kentucky Frontier Gas LLC Letter of Agreement to Submit*, Case No. 2017-00263 (Ky. P.S.C. October 9, 2017).

⁸ *AG Motion to Waive Formal Hearing and For Leave to Submit Comments*, Case No. 2017-00263 (Ky. P.S.C. October 20, 2017).

⁹ *PSC Order*, Case No. 2017-00263 (Ky. P.S.C. October 26, 2017).

¹⁰ *PSC Notice of Filing Hearing Documents*, Case No. 2017-00263 (Ky. P.S.C. November 29, 2017).

¹¹ *Kentucky Frontier Gas LLC Response to Request for Information – Part 1*, Case No. 2017-00263, at 41–42 (Ky. P.S.C. August 11, 2017).

¹² *Id.*

¹³ *Id.*

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ *Id.*

¹⁷ *Id.*

¹⁸ *Id.*

In responses to the Attorney General's data requests, Frontier stated,

Neither Pipeline Solutions Inc. (PSI) or Pinedale Natural Gas (Pinedale) are affiliated in any way with Kentucky Frontier Gas LLC. Steven Shute is the sole owner of PSI and Pinedale, and majority owner of Frontier, but they are in no way legally bound nor share facilities or employees¹⁹

Under KRS Chapter 278, affiliate "means a person that controls or that is controlled by, or is under common control with, a utility."²⁰ Likewise, control "means the power to direct the management or policies of a person through ownership, by contract, or otherwise."²¹ Under the plain meaning of these definitions, PSI, IGS, Pinedale, and DLR are all affiliated companies with Frontier.

The statutes governing affiliate transactions are clear:

(b) 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

KRS 278.2207.

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

KRS 278.2209.

As such, the companies listed prior are subject to the pricing requirement as described in KRS 278.2207. Frontier was and continues to be subject to a legal duty to document its affiliate transactions, of any and all services and products provided by affiliates to Frontier, and to make a showing that those transactions are consistent with the requirements of KRS 278. To date, Frontier has taken no affirmative steps to do so. At the hearing, Mr. Shute said that Frontier does not have

¹⁹ *Kentucky Frontier Gas, LLCs Responses to PSC and AG Request for Information*, Case No. 2017-00263 (September 8, 2017).

²⁰ KRS 278.010 (18).

²¹ KRS 278.010 (19).

a Cost Allocation Manual,²² and that Frontier did not have any affiliate companies.²³ However, aside from his testimony under cross examination, Mr. Shute acknowledged a number of affiliated companies in Frontier’s response to Staff’s first request for information, question 12.²⁴

Under KRS 278.2211, if a utility has failed to comply with these provisions, the Commission may access the books and records of the utility and the utility’s nonregulated affiliate and may in turn order that costs attached to any transactions be disallowed.²⁵ Further, after inspecting the records of the utility and nonregulated affiliate, if the Commission finds that the utility has not complied with any provision of 278.010 to 278.450, the Commission may perform a financial audit of the utility’s affiliate in order to ensure compliance.²⁶

Under KRS 278.2219, Frontier is free to file for a waiver or deviation from the requirements of KRS 278.2201 through 278.2213, if it believes compliance with these provisions is impracticable or unreasonable. Here, they did neither, and took no other action to address affiliate transactions. Thus, the Commission should require Frontier to demonstrate its compliance with these provisions, and to document the transactions using proper cost allocation in the future.

II. PIPELINE REPLACEMENT PROGRAM ACCELERATION

Frontier has proposed an increase in its PRP surcharge in order to accelerate the program, although it appears that this may indicate simply returning Frontier to its originally estimated pace

²² KRS 278.010 (20) (“‘CAM’ means a cost allocation manual which is an indexed compilation and documentation of a company’s cost allocation policies and related procedures”).

²³ Video Transcript Evidence (“VTE”), *Kentucky Frontier Gas, LLC Application*, Case No. 2017-00263, at ... 10:11:51–10:15:00 (Ky. P.S.C. November 27, 2017) (Mr. Shute testified that “we don’t really have any affiliated companies with Frontier. The only affiliation from Frontier to any company is through its owners. I’m a majority owner of Frontier, and I have other entities in Wyoming, in Colorado, Nevada, and California, but they’re not really legally—they’re not at all affiliated with Frontier other than the fact that they share ownership through me. Bob Oxford has a similar situation where he has other companies—they are not actually affiliates of Frontier other than their association with him as owner”).

²⁴ *Kentucky Frontier Gas LLC Response to Request for Information – Part 1*, Case No. 2017-00263, at 41–42 (Ky. P.S.C. August 11, 2017).

²⁵ KRS 278.2211 (1) (a)-(b).

²⁶ KRS 278.2211(2).

of completion. In response to a question from the Staff's Fourth data request regarding the feasibility of accelerating the PRP and completing it by 2023, Frontier expressed a preference to keep the surcharge as proposed in the application, while expanding the timeline for completion.²⁷ During the hearing, the Chairman indicated that the Commission would like to see the PRP accelerated, even if an increased surcharge would be necessary.²⁸

The Attorney General recognizes that Pipeline Replacement Programs are rooted in safety and reliability concerns, and that pipeline infrastructure is vital to the long-term health of natural gas systems. While the Attorney General understands the Commission's desire to see Frontier's PRP completed, he believes that the principle of gradualism requires that such costs should not be set at a level which would be detrimental to Frontier's customers. The Attorney General would also submit that the Commission require Frontier to be more diligent in the oversight of its PRP costs, as well as provide more data for future cost estimations and timelines.

Frontier's current PRP was established in 2013.²⁹ In that case, Frontier estimated that the cost to replace pipe would be \$4.00 per foot, with Frontier performing the work replacing 12,500 feet per year, and with an average annual expenditure level of \$50,000.³⁰ In the application and responses to data requests, Frontier stated that it "has done most PRP work to date with internal forces at very low costs of \$5 to \$10 per foot."³¹ Also, the company "has intended to replace about

²⁷ *Kentucky Frontier Gas, LLC Information Response*, Case No. 2017-00263, at 8 (Ky. P.S.C. October 20, 2017) ("If the work is mostly complicated and mostly done by contractors, the current 23.2 miles at \$15 per ft would cost \$1.84 million. At 5050 average payers per month, the PRP surcharge would be \$5.05 to finish in 6 more seasons for the original 2023 target. As discussed, the proposed \$2.00 surcharge and expanded timeline are more likely to succeed than pushing too hard").

²⁸ VTE at 11:47:27—11:48:55.

²⁹ *PSC Order*, Case No. 2011-00443, at 12–14 (Ky. P.S.C. April 30, 2013).

³⁰ *Id.* at 13.

³¹ *Kentucky Frontier Gas LLC Response to Request for Information – Part 1*, Case No. 2017-00263, at 10 (Ky. P.S.C. August 11, 2017).

2.5 miles of pipe every year, but have not met that target mostly due to limitations of company forces.”³²

Frontier now says that,

[t]he cost estimate of \$4 /ft is ok for rural areas if in dirt and not under pavement, but we don’t have many of those projects ... [o]ur target is still 12,500 ft per year in PRP. As discussed herein, much of that work will need to be by contractors at higher cost³³

While estimates are always subject to some change, Frontier’s 2011 estimate should have been much more accurate. The costs for which it originally estimated \$4/foot are actually much higher, with Frontier further stating “[t]he actual cost for recent projects was more like \$8 to \$10 /ft with company forces, and \$12-15 /ft by contractors.”³⁴ Additionally, projected costs rise to \$20 to \$30 per foot if a contractor is needed to operate a horizontal directional drill.³⁵

Frontier should have been more proactive in managing costs and in finding ways to complete more of the PRP work in house, in keeping with the original estimate. If the PRP in this instance is based on safety concerns, then Frontier is certainly not moving fast enough. If the timeline issue goes more to costs, then Frontier could have included more of the PRP costs in base rates, to allow for better control of expenses moving forward. The question should be asked: did Frontier acquire small systems simply because the costs to run them would be fully recoverable through rates?

Before and upon acquiring these smaller gas systems, Frontier should have performed better due diligence on the integrity of the pipeline system. Frontier’s use of GIS/CAD to update

³² *Id.*

³³ *Id.* at 12.

³⁴ *Id.*

³⁵ *Id.* at 9.

its map of the current system, is a step in the right direction—as long as it remains a one-time cost—since it would provide more clarity on Frontier’s PRP priorities going forward.³⁶

Historically, the Commission has favored the principle of gradualism.³⁷ In Frontier’s last rate case, the Commission made it clear that it preferred gradual increases to certain charges, as opposed to significant increases in order to lessen the financial burden on customers.³⁸ Here, the Commission should adhere to the same principle when considering the increase of the PRP surcharge, especially if it considers setting the charge higher than Frontier’s request.

III. RATE CASE EXPENSE

Finally, the rate case expense in this matter totaled \$113,462.16 through December 7, 2017.³⁹ The Attorney General would simply point out that the total additional revenue request in this matter is \$603,810.⁴⁰ Furthermore, approximately 51.75% of the rate case expense is being directly billed to affiliated entities,⁴¹ rendering the establishment of proper procedures toward and documentation of affiliate transactions all the more necessary. It should also be noted that despite Frontier’s Response to Staff’s First Request for Information which stated that “[t]here is no

³⁶ *Id.* at 11.

³⁷ Case No. 2014-00396, *In the Matter of Application of Kentucky Power Company for: (1) A General Adjustment of its Rates for Electric Service; (2) An Order Approving its 2014 Environmental Compliance Plan; (3) An Order Approving its Tariffs and Riders; and (4) An Order Granting All Other Required Approvals and Relief*, Order (Ky. PSC June 22, 2014) (“...the Commission has long employed the principle of gradualism....”); *See also*, Case No. 2000-080, *In the Matter of: The Application of Louisville Gas & Electric Company to Adjust its Gas Rates and to Increase its Charges for Disconnecting Service, Reconnecting Service and Returned Checks*, Order (Ky. PSC September 27, 2000) (“... the Commission is adhering to the rate-making concepts of continuity and gradualism in order to lessen the impact of these increases on the customers that incur these charges.”).

³⁸ *PSC Order*, Case No. 2011-00443, at 2 (Ky. P.S.C. June 21, 2013) (“With regard to the four \$100 charges for Turn on, Reconnection, Service Trips, and Special Meter Reading, the Commission is not persuaded that Frontier has sufficient experience with its combined system to rely on its estimates of the time involved to perform the activities associated with these functions. In the interest of applying a more gradual increase to these charges for the benefit of Frontier’s customers, many of whom were paying significantly lower fees for these activities to some of the utilities acquired by Frontier, the Commission finds that each of these fees should be established at \$50”).

³⁹ *Kentucky Frontier Gas, LLC Response to Post Hearing Request for Information*, Case No. 2017-00263, 20–39 (Ky. P.S.C. December 11, 2017).

⁴⁰ *Kentucky Frontier Gas, LLC Application*, Case No. 2017-00263, at 8 (Ky. P.S.C. June 30, 2017).

⁴¹ *Kentucky Frontier Gas, LLC Response to Post Hearing Request for Information*, Case No. 2017-00263, at 21 (Ky. P.S.C. December 11, 2017) (Expenses billed to PSI totaled \$38,763.50, to PNG \$18,438.50, and to IGS \$1,515.00).

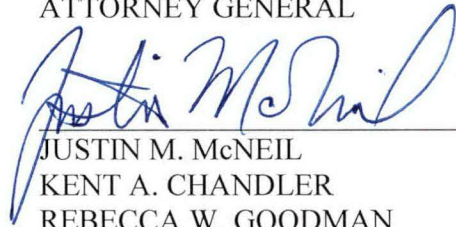
relationship between Frontier and PNG,” PNG billed significant rate case expense to Frontier, including for the attendance of Dustin Braeger, a rate analyst, at the hearing.⁴²

CONCLUSION

The Attorney General recommends that the Commission require Frontier to provide evidence of compliance with the affiliate transaction statutes in KRS 278 *et seq.*, as well as requiring proper documentation and allocation of those transactions moving forward. Further, the Commission should place higher scrutiny on Frontier’s PRP, both in terms of overall cost estimation and timeline. Such oversight would require Frontier to be more diligent in its formulation of estimated PRP costs and time of completion, especially when acquiring small and potentially outdated systems in need of significant upgrades. If the Commission proposes to accelerate the PRP beyond Frontier’s projections, any increase to the PRP surcharge should be done in accordance with the principals of gradualism.

Respectfully submitted,

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⁴² *Kentucky Frontier Gas LLC Response to Request for Information – Part 1*, Case No. 2017-00263, at 41–42 (Ky. P.S.C. August 11, 2017).

Certificate of Service and Filing

Counsel certifies that an original and ten (10) photocopies of the foregoing were served and filed by hand delivery to Ms. Gwen R. Pinson, Executive Director, Public Service Commission, 211 Sower Boulevard, Frankfort, Kentucky 40601; counsel further states that true and accurate copies of the foregoing were emailed to jnhughes@johnnhughespsc.com, and mailed via First Class U.S. Mail, postage pre-paid, to:

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This 18th day of December, 2017



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