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November 7, 2005

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Suite 200
Frankfort, KY 40601-8204

CERTIFICATE OF SERVICE

RE: Case No. 2005-00424
Zebulon Gas Association

I, Beth O'Donnell, Executive Director of the Public Service Commission, hereby certify that the enclosed attested copy of the Commission's Order in the above case was served upon the addressee by U.S. Mail on November 7, 2005.

A handwritten signature in black ink, appearing to read "Beth O'Donnell", written over a horizontal line.

Executive Director

BOD/sh
Enclosure



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Hatler Slone
Treasurer
Zebulon Gas Association
c/o Jefferson Gas, LLC
P. O. Box 24032
Lexington, KY 40524-4032

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COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN INVESTIGATION INTO THE CONDITION)
AND MANAGEMENT OF ZEBULON GAS) CASE NO. 2005-00424
ASSOCIATION, INC.)

ORDER

This case involves an investigation of the management of natural gas distribution facilities that Zebulon Gas Association, Inc. ("Zebulon Gas") owns. At issue is whether Zebulon Gas has abandoned these facilities. Finding in the affirmative, we direct the Commission's Executive Director to seek the appointment of a receiver to operate these facilities or, in the event that no person or entity willing and capable of serving as a receiver is located, to take all actions that the Natural Gas Pipeline Safety Act requires to terminate the operation of these facilities.

PROCEDURE

Finding prima facie evidence of the abandonment of Zebulon Gas's natural gas distribution system, the Commission, on October 11, 2005, ordered Zebulon Gas, its directors, and members to show cause why its natural gas distribution facilities should not be declared abandoned and why these facilities should not be placed under the control and responsibility of a receiver. The Commission served by mail a copy of this Order on all known members and customers of Zebulon Gas and published notice of the scheduled hearing in the Appalachian News-Express.¹

¹ The Appalachian News-Express is the newspaper of general circulation for Pike County, Kentucky.

On October 13, 2005, the Commission held a public meeting in Zebulon, Kentucky for the purpose of informing Zebulon Gas's members and customers of the nature of this proceeding, its possible outcomes, and Commission Staff's efforts to ensure the continued operation of Zebulon Gas's natural gas distribution system.²

The Attorney General ("AG") is the only person to request intervention in this proceeding. On October 14, 2005, he moved for leave to intervene in this proceeding. The Commission granted his motion on October 17, 2005.

On October 18, 2005, the Commission held an evidentiary hearing in this matter at our offices in Frankfort, Kentucky. The AG was the only party to appear at this hearing. No representative of Zebulon Gas appeared nor did any director, member, or customer of Zebulon Gas appear. At this hearing, the Commission heard testimony from the following persons: Bert Layne, Treasurer of Jefferson Gas, LLC; Jeffrey Shaw, Assistant Director, Financial Analysis Division, Kentucky Public Service Commission; Aaron Greenwell, Manager, Financial Audits Branch, Kentucky Public Service Commission; and Jason Brangers, Manager, Gas Pipeline Safety Branch, Kentucky Public Service Commission.

STATEMENT OF THE CASE

Zebulon Gas is a non-profit corporation organized pursuant to KRS Chapter 273. It owns facilities that, as of December 31, 2004, distributed natural gas to approximately 52 households in Pike County, Kentucky.³ These facilities consist of approximately

² See Transcript of Hearing ("TR"), Commission Staff Exhibit 4, for an agenda of this public meeting and a list of the persons who attended.

³ Annual Report of Zebulon Gas Association to the Public Service Commission of Kentucky for the Calendar Year Ended December 31, 2004 at 9.

15,480 linear feet of 2-inch polyvinyl chloride pipe, 7,000 linear feet of 1-inch polyvinyl pipe, and 3,000 linear feet of 2-inch steel pipe. In 2004, Zebulon Gas had annual sales of \$39,935.⁴

Zebulon Gas was incorporated in 1956 for the purpose of purchasing and distributing natural gas for domestic and industrial purposes for its members.⁵ Commission records do not reveal any significant activity before the Commission for the utility until 1994.⁶ The utility apparently did not have a tariff on file with the Commission until 1999.⁷ Except for three years in the early 1990s, Zebulon Gas did not file an annual report on its operations as Administrative Regulation 807 KAR 5:006, Section 3, requires until 2002.

In October 2000, Columbia Gas Transmission Company (“CGT”)⁸ notified the Commission that Zebulon Gas had a negative imbalance of 60,408 dekatherms valued at about \$379,000. At the Commission’s direction, Commission Staff held a series of meetings with representatives of Zebulon Gas, CGT, and Jefferson Gas Transmission

⁴ Id.

⁵ TR, Commission Staff Exhibit 1.

⁶ Zebulon Gas Association, Inc. – Alleged Failure to Comply with KRS 278.140 and KRS 278.230(3), Case No. 1994-00369 (Ky. PSC Feb. 9, 1995).

⁷ See An Investigation Into The Source of Supply and Gas Cost Arrearage of Zebulon Gas Association, Inc., Case No. 1997-00163 (Ky. PSC Apr. 5, 1999). As a result of this proceeding, the Commission directed Zebulon Gas to file a schedule of its rates with the Commission. Zebulon Gas filed this schedule on June 22, 1999.

⁸ CGT, a Delaware Corporation, is an interstate transmission pipeline company that operates pipelines in the Commonwealth of Kentucky. It is not subject to Commission jurisdiction.

Company ("Jefferson Gas")⁹ to discuss this imbalance and the continued operations of the Zebulon Gas system.

In June 2002, as a result of these discussions, CGT and Zebulon agreed to place a value of \$175,203 on Zebulon Gas's gas imbalance. They further agreed that Zebulon Gas would pay this amount over a 20-year period. The Term Note, which the two corporations executed, required Zebulon Gas to make monthly payments of \$730 for this 20-year period.¹⁰ CGT subsequently agreed to reduce the value of the imbalance to approximately \$152,500 with Zebulon Gas paying approximately \$635 a month for 20 years.¹¹

Similarly, on October 9, 2001, Jefferson Gas and Zebulon Gas entered into an operating agreement.¹² Under the terms of this agreement, Jefferson Gas agreed to operate Zebulon Gas's facilities, reconstruct these facilities, and provide Zebulon Gas with appropriate administrative services to collect system revenues, pay system debts, and perform system accounting, reporting and regulatory requirements.¹³ The Agreement provided that Jefferson Gas would be compensated for its services from gas

⁹ Jefferson Gas Transmission Company was a Kentucky corporation organized pursuant to KRS Chapter 271B. On December 11, 2002 it was reorganized as Jefferson Gas, LLC, a Kentucky Limited Liability Company. See <http://apps.sos.ky.gov/business/obdb/> (enter "Jefferson Gas Transmission Company"). All references in this Order to "Jefferson Gas" refer to Jefferson Gas, LLC.

¹⁰ See Zebulon Gas Association, Inc., Case No. 2001-00358 (Ky. PSC Nov. 16, 2001).

¹¹ See Zebulon Gas Association, Inc., Case No. 2002-00285 (Ky. PSC Aug. 20, 2002).

¹² Operating Agreement between Jefferson Gas Transmission Company, Inc. and Zebulon Gas Association, Inc. (Oct. 9, 2001) (Commission Staff Exhibit 5).

¹³ Id. at § 1.

sale revenues that remained after the payment of all expenses. This Agreement provided for an initial term of operation of 3 years and for automatic renewal for a one-year term unless one of the parties provided 30 days' prior written notice.

Since October 9, 2001, Jefferson Gas has operated Zebulon Gas's gas facilities. It arranges for the procurement of natural gas supplies, reads customer meters, bills customers for service, maintains the utility's records and accounts, inspects, operates and maintains the utility's distribution system, and submits all required reports and filings to the appropriate regulatory or taxing agencies. Neither Zebulon Gas nor its directors played any role in the operations of its natural gas facilities since that time.¹⁴

On or about July 1, 2004, Jefferson Gas decided to terminate its operating agreement with Zebulon Gas. Given the small customer base, it was not earning sufficient revenues to cover operating expenses.¹⁵ Moreover, the ownership and business strategy of Jefferson Gas had changed since the execution of the operating agreement with Zebulon Gas. No other Jefferson Gas operation is within the general vicinity of the Zebulon Gas system.¹⁶

¹⁴ Since December 2002 Bert Layne has served as the Jefferson Gas official responsible for the operation of the Zebulon Gas system and served as the contact person for any inquiries from Zebulon Gas. He testified that since that time no official of Zebulon Gas had contacted him or made any request for information regarding the operation of the Zebulon Gas system. He further testified that he was not aware of any discussions between any Jefferson Gas employee and any representative of Zebulon Gas on any subject during this period. TR at 18 - 20.

¹⁵ Mr. Layne testified that Jefferson Gas has been required to use from \$500 to \$1,000 per month of its own funds to operate the Zebulon Gas system. For the calendar year ending December 31, 2004, Zebulon Gas had total operating revenues of \$39,985 and total operating expenses of \$46,493. See Annual Report of Zebulon Gas Association to the Public Service Commission of Kentucky for the Calendar Year Ended December 31, 2004 at 9.

¹⁶ TR at 25.

When its attempts to contact the directors of Zebulon Gas proved unsuccessful,¹⁷ Jefferson Gas met with Commission Staff to advise of its pending action. On September 8, 2004, Jefferson Gas notified the Commission and the members of Zebulon Gas's Board of Directors in writing of its intent to terminate its operating agreement with Zebulon Gas.¹⁸ After discussions between representatives of Jefferson Gas and Commission Staff, Jefferson Gas agreed to continue operating Zebulon Gas's facilities on a short-term basis until another operator could be found.¹⁹

On June 1, 2005, Mr. Layne, on behalf of Jefferson Gas, advised the Commission in writing of Jefferson Gas's intent to discontinue its operation of the Zebulon Gas system. In his letter, Mr. Layne noted that Jefferson Gas had been unable to collect any operating fee, recover its losses on gas purchases, or obtain reimbursement for its expenses. He stated that Jefferson Gas was still unable to locate any active member of Zebulon Gas's Board of Directors. Mr. Layne further advised that written notice of Jefferson Gas's intention to discontinue operation of the gas system as of August 31, 2005 had been sent to all Zebulon Gas customers. Despite its planned termination of operations on August 31, 2005, Jefferson Gas continued to operate the

¹⁷ Mr. Layne testified that Jefferson Gas was able to locate only one member of Zebulon Gas's Board of Directors – Hatler Slone. When Jack Banks, Jefferson Gas Vice President of Operations, attempted to contact Mr. Slone by telephone, Mr. Slone's spouse informed him that Mr. Slone was physically unable to address any matters related to Zebulon Gas and requested that he not speak with Mr. Slone. TR at 24.

¹⁸ Letter from Gene Mapes, Sr., Chairman, Jefferson Gas Company, to Jeff Shaw, Assistant Director, Financial Analysis Division, Kentucky Public Service Commission (Sep. 8, 2004). Jefferson Gas also mailed a copy of this notice to Hatler Slone. TR at 23.

¹⁹ TR at 25.

system after this date on a short-term basis to allow Commission Staff an opportunity to locate another system operator.

On October 3, 2005, Jefferson Gas notified the Commission in writing that, effective October 18, 2005, it would cease operating or otherwise serving Zebulon Gas's facilities.²⁰ In its notification, it advised of its unsuccessful efforts to obtain a replacement operator and to locate any active members of Zebulon Gas's Board of Directors. It further advised the Commission that it had foregone several attempts to cease operating Zebulon Gas's facilities to permit Commission Staff the opportunity to locate another operator.²¹

The operating agreement between Zebulon Gas and Jefferson Gas allows for Jefferson Gas's proposed termination of operations. The agreement provides an initial term of operation of three years and for automatic renewal for a one-year term unless one of the parties provides 30 days' prior written notice of proposed termination. It further provides that Jefferson Gas may terminate the agreement immediately when the Zebulon Gas customer level falls below 50 customers. Jefferson Gas has provided the required notice for termination. Moreover, the Zebulon Gas system currently has only 45 customers.²²

²⁰ Letter from Bert R. Layne, Treasurer, Jefferson Gas Company, to Beth O'Donnell, Executive Director, Kentucky Public Service Commission (Oct. 3, 2004) (Commission Staff Exhibit10). See also TR at 30.

²¹ As of the date of this Order, Jefferson Gas was still operating the Zebulon Gas system. Mr. Layne testified at the hearing that Jefferson Gas would delay the cessation of operations pending the outcome of this proceeding. TR at 32.

²² TR at 21.

If Jefferson Gas ceases to operate the Zebulon Gas system, there is no entity to whom to transfer the operations of the gas system. The Kentucky Secretary of State administratively dissolved Zebulon Gas on November 1, 2003.²³ Of the six persons named as officers and directors of Zebulon Gas in the corporation's last filing with the Kentucky Secretary of State, two are deceased,²⁴ one is physically unable to serve,²⁵ and three disclaim any connection with the corporation.²⁶ There is no evidence that the corporation has engaged in any of the actions necessary for the corporation to maintain its corporate identity and existence.

Commission Staff members Shaw and Greenwell noted in their testimony the lack of participation of Zebulon Gas's members in efforts to find a replacement for Jefferson Gas. Mr. Shaw testified that, although he has served as the action officer on Zebulon Gas, he has not had any contact or communications with any officer or director of Zebulon Gas since 2002.²⁷ He further testified that, while the Commission has received three customer inquiries regarding the status of Zebulon Gas immediately

²³ TR, Commission Staff Exhibit 2.

²⁴ Mr. Shaw testified that he was advised at the public meeting held on October 13, 2005, that Mr. Thadus Blackburn and Mr. Truman Thompson have died. TR at 50. See also Affidavit of Gerald E. Wuetcher (Commission Staff Exhibit 11) at ¶ 5. For a list of the officers and directors listed on Zebulon Gas's last filed annual report, see TR, Commission Staff Exhibit 3.

²⁵ Mr. Shaw testified that Mrs. Hatler Slone informed him at the public meeting held on October 13, 2005, that her husband was not physically able to attend to any duties as a director of Zebulon Gas. TR at 49.

²⁶ Affidavit of Gerald E. Wuetcher at ¶ 5.

²⁷ TR at 46 - 51.

following the publication of the Jefferson Gas notice to cease operations, none of the officers or directors of Zebulon Gas contacted the Commission.²⁸

Mr. Greenwell testified that, at a public meeting of customers/members of Zebulon Gas in Pike County in 2001, Zebulon Gas's officers and legal counsel advised the members of the corporation that the current officers wished to relinquish their duties and that new officers were needed. Mr. Greenwell further testified that he was not aware of any action being taken on this announcement.

DISCUSSION

The facts before us clearly demonstrate that an abandonment of a utility has or is about to occur. Jefferson Gas, the entity with whom Zebulon Gas contracted to operate its utility facilities, has announced its intention to cease operating these facilities. We find no basis under the operating agreement between Zebulon Gas and Jefferson Gas that requires Jefferson Gas's continued operation of the facilities.²⁹ Moreover, the record demonstrates that Jefferson Gas has provided adequate notice to Zebulon Gas and its members of its intention to discontinue operating the facilities and that Jefferson Gas has exercised remarkable restraint and patience in not discontinuing operations until this time.

Upon Jefferson Gas's cessation of operations, there is no person or entity to assume responsibility for the utility facilities. Zebulon Gas, the owner of the utility, has effectively ceased to operate. The Kentucky Secretary of State has administratively

²⁸ Id. at 50.

²⁹ We do not address in this Order the Commission's authority to order a non-owner operator's obligation to operate utility facilities or continue operating such facilities when its contractual responsibilities have expired.

dissolved it. It has no officers or directors who can or are willing to perform the corporation's official business. There is no evidence that its members, despite having a strong interest in the continuation of natural gas service, have or are willing to take the necessary actions to restore the corporation to an active status.

Assuming that another person or entity was willing to step into Jefferson Gas's place, Zebulon Gas could not confer authority upon that person or entity to assume responsibility for the gas system's operations. It lacks the corporate status to enter any contract for the operation or transfer of the facilities. It lacks a board of directors who could vote to authorize an operating or purchase agreement and corporate officers who could execute such an agreement.

KRS 278.021(1) provides:

If the commission determines, after notice and hearing, that any utility is abandoned, the commission may petition the Franklin Circuit Court for an order attaching the assets of the utility and placing it under the sole control and responsibility of a receiver.

The Commission finds that Zebulon Gas has abandoned its natural gas distribution system and that the appointment of a receiver to operate the Zebulon Gas system is in the best interest of the public. The appointment of a receiver would allow for the continued operation of the Zebulon Gas system during the upcoming winter heating season and thus provide a heating source for those customers who currently lack the time or means to arrange for an alternative heating source. It would also provide the legal framework to transfer the utility's assets to a party that is more financially and technically competent to provide utility service.

Accordingly, we today direct our General Counsel to take all actions necessary to obtain an Order from Franklin Circuit Court attaching Zebulon Gas's assets and placing

them under the sole control and responsibility of a receiver. In the event that the Commission's efforts in this regard prove unsuccessful and Jefferson Gas ceases its operation of the Zebulon Gas system, we find that Jefferson Gas must take all actions that federal safety regulations require before its cessation of operations.³⁰

SUMMARY

Based upon the findings set forth, the Commission HEREBY ORDERS that:

1. The natural gas distribution system that Zebulon Gas owns is declared abandoned.
2. The Commission's Executive Director shall take all actions necessary to locate persons who are qualified and willing to serve as receiver of the Zebulon Gas natural gas distribution system.
3. The Commission's General Counsel shall take all actions necessary to obtain, pursuant to KRS 278.021(1), an order from Franklin Circuit Court attaching the assets of Zebulon Gas and placing them under the sole control and responsibility of a receiver.
4. If Jefferson Gas ceases operation of Zebulon Gas's natural gas distribution system and is unable to transfer operations to another party, it shall comply with Administrative Regulation 807 KAR 5:022, Section 14(15), and 49 C.F.R. § 192.727.

³⁰ Administrative Regulation 807 KAR 5:022, Section 14(15), and 49 C.F.R. § 192.727 require the operator of a natural gas distribution system to take certain actions when he ceases to operate that system and is unable to transfer the operations to another certified operator. See also TR at 64 – 65.

5. The Executive Director shall serve by mail a copy of this Order on the AG, the Governor's Office of Local Development, CGT, and all current customers of Zebulon Gas. She shall further cause notice of the issuance of this Order to be published in a newspaper of general circulation in the area in which Zebulon Gas provides natural gas service.

Done at Frankfort, Kentucky, this 7th day of November, 2005.

By the Commission

ATTEST:

Executive Director

Case No. 2005-00424