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BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

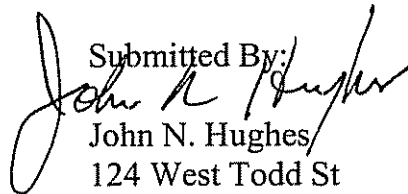
THE APPLICATION OF KENTUCKY FRONTIER  
GAS, LLC FOR APPROVAL OF FINANCING AND  
TRANSFER OF CONTROL

)  
)CASE  
)2008-00349

RESPONSE TO FIRST DATA REQUEST OF COMMISSION STAFF

Kentucky Frontier Gas, LLC ("Kentucky Frontier"), by counsel, submits for filing the attached responses to the Commission's first data request.

Submitted By:

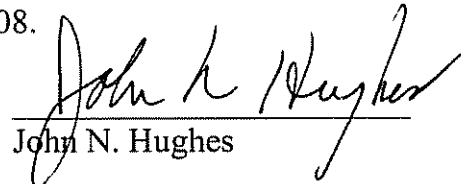


John N. Hughes  
124 West Todd St  
Frankfort, KY 40601  
502 227 7270

Attorney for Kentucky Frontier Gas LLC

Certificate of Service:

I certify that a copy of this response was mailed to the Attorney General, 1024 Capital Center Drive, Frankfort, KY 40601 and Kim Gevedon, Box 216, West Liberty, KY 41472 by first class mail the 7<sup>th</sup> day of November, 2008.

  
John N. Hughes



1. Refer to paragraph 4.a. on page 2 and paragraph 16.a. on page 5 of Kentucky Frontier's application concerning the farm tap customers which Kentucky Frontier is negotiating to take over.

a. How many farm tap customers are involved and are they all served by the Alert Gas System ("Alert")?

b. Is the Alert system physically connected to Belfry Gas, Inc. ("Belfry"), which has the same ownership as Alert? If no, describe where the Alert system is located in relation to the Belfry system.

c. Describe the physical assets involved in serving the customers on the Alert system that will be acquired by Kentucky Frontier under the proposed acquisition.

d. Under Kentucky Frontier, will the customers presently being served by Alert be considered farm tap customers or distribution customers?

WITNESS: Oxford, Shute

RESPONSE:

a. There are about 300 residential farm tap customers served by Alert. See Application exhibit 4

b. The Alert farm taps are located along gathering systems controlled by Alert, mostly near Pikeville. The Alert systems are not inter-connected with Belfry Gas facilities, which are located 20-25 miles northeast from Belfry, KY to near Williamson, WV).

c. The physical assets are the farm tap regulator and meter sets.

d. The Alert customers will be treated as farm taps.



2. Refer to paragraph 16.b. on page 5 of Kentucky Frontier's application.

- a. What is the amount of Floyd County Gas's ("Floyd County") debt to the Governor's Office of Local Development ("GOLD")?
- b. Kentucky Frontier has placed \$700,000 in escrow for the benefit of Floyd County as payment for its assets. What is the total amount Kentucky Frontier will pay to acquire the Floyd County assets?

WITNESS: Oxford

RESPONSE: a. The principal amount is \$265,576.81, plus accrued interest since about January 2005.

b. \$1,075,000. For purposes of setting the purchase price, the Asset Agreement with Floyd County assumes a GOLD debt on September 15, 2008 of \$300,000. It will pay Floyd County \$700,000. The remaining \$75,000 is an amount agreed to by the parties to reflect Frontier's previous management of the gas system. See page 2 of the Floyd County Asset Purchase Agreement, exhibit 1 of the Amended Application. Because the total payment to GOLD of \$800,000 is not based on the actual debt of any company and has not been allocated by Frontier to any company based on actual debt, the total amount actually paid to Floyd County is \$700,000. A portion of the \$800,000 paid to GOLD will release the Floyd County debt in its entirety.



3. Refer to paragraph 24 on page 7 of Kentucky Frontier's application. Describe in detail the reasons Gilmer Mickey and Don Silversmith, each of whom was to have a 23 percent ownership interest in Kentucky Frontier as shown in its application in Case No. 2005-00348, no longer have an ownership interest in Kentucky Frontier.

WITNESS: Oxford, Shute

RESPONSE: At the time of the 2005 application, Mr. Mickey and Mr. Silversmith were prospective partners in Frontier. Neither had done any of the development work in assembling the gas utilities. Mr. Mickey shares co-ownership in Pinedale Natural Gas with Steven Shute and planned to invest and work on the billing-accounting-financial functions of Frontier. Mr. Silversmith is a banker and planned to assist Frontier with debt financing. Due to the long delay caused by GOLD, both individuals moved on to other projects and will not participate in Frontier.





4. Refer to the top of page 3 of Kentucky Frontier's amended application, which was filed with the Commission on October 23, 2008.

a. Describe the efforts Kentucky Frontier has made to date to contact either Johnson County Gas Company, Inc. ("Johnson County") or B & H Gas Company, Inc. ("B & H") for the purpose of attempting to negotiate purchase agreements to acquire those systems and/or their assets.

b. The next-to-last sentence in the paragraph discussing Johnson County and B & H states that "[lit expects to either negotiate a mutually satisfactory agreement or to leverage the acquisition through the rights acquired with the security agreements from GOLD." Explain what Kentucky Frontier means by leveraging the acquisition through the rights acquired with the security agreements from GOLD.

c. Explain why it is appropriate for the Commission to consider Kentucky Frontier's request for approval of transfer of B & H and Johnson County at this time, since no agreement has been reached for said transfer and B & H and Johnson County are not parties to this proceeding.

WITNESS: Oxford

RESPONSE: a. Representatives of Frontier have met or talked with the owner of both Johnson Co. Gas and B&H Gas on numerous occasions since 2004. In response to the owner's statement that the companies were for sale, Frontier made a written offer to purchase B&H and JCG in January 2005. The parties talked frequently in early 2005 on details of an agreement and due diligence. The owner removed B&H from consideration and no final agreement was made on JCG. Frontier applied in late 2005 for PSC approval of purchases of 4 utilities, not including B&H or JCG. For the next 18 months, Frontier worked through the purchase of GOLD loans, including those of B&H and JCG. After the GOLD loan purchase details were set, Frontier made an updated offer to purchase both companies in August 2007. The offer was rejected. Numerous attempts to contact the owner since then have not been successful

b. Frontier will acquire the notes Johnson County and B&H executed with GOLD. Because each company has failed to make payments as required by the notes, each is in default. Frontier will acquire all legal rights and remedies associated with the notes, including claims against the assets. Frontier believes it can utilize these legal remedies to encourage the owners of the companies to negotiate in good faith a reasonable purchase agreement. The alternative to such negotiation is the probability of legal action to exercise the rights to the assets Frontier acquires from GOLD. This is the leverage that is referenced in the application.

c. Frontier will be able to assert a legal claim against the assets of these companies. It will acquire ownership either through a negotiated agreement or through legal proceedings. In either situation, Frontier expects to acquire these companies. To avoid another proceeding before the Commission and the associated expense and time for both Frontier and the Commission, it is reasonable to acknowledge that the acquisition is in the public interest. KRS 278.020 merely requires proof of financial, technical and managerial ability to own and operate the utility. Frontier has proven those qualifications. The public interest will be served because two financially fragile companies will be merged with a larger company with much stronger financial stability and long term prospects. The only unknown is the amount of the payment for the assets. The GOLD loans exceed the value of the companies, so Frontier's purchase of the notes for less than face value assures that the cost of acquisition will be no more than and probably much less than the value of the assets.



5. Elam Utility Company, Inc. ("Elam"), one of the joint applicants in Case No. 2005-00348, has intervened in this case and opposes the acquisition of its customers and assets by Kentucky Frontier.

a. Does Kentucky Frontier believe its agreement to acquire the stock of Elam, dated June 23, 2005, which is in the record of Case No. 2005-00348, is a valid and enforceable contract? Explain the response.

b. Does Kentucky Frontier have the same ability to leverage the acquisition of Elam through the rights acquired with the security agreements from GOLD that it asserts it has in the case of Johnson County and B & H? If no, explain why.

c. Explain whether Kentucky Frontier plans to go forward with its agreement with GOLD if it is unable to reach a satisfactory arrangement with Elam at this time.

WITNESS: Oxford

RESPONSE: a. Yes. That letter agreement was executed in anticipation of further review of the condition of Elam and more detailed negotiations. As stated in the first paragraph of that letter, the agreement is subject to due diligence and the execution of a "detailed Purchase and Sales Agreement". Frontier has attempted to resolve certain issues, for example, conflicting GCR and revenue data and payments to Columbia Transmission for gas purchases, which have come to light during its due diligence review. Because of the difficulty in developing the necessary information from Elam's records, there have been unexpected delays in finalizing the agreement.

b. Yes

c. Yes. Frontier will proceed with the GOLD acquisition. If unable to reach a mutually agreeable resolution of the outstanding issues, Frontier will have the option to exercise its legal rights acquired from GOLD to proceed with the acquisition of Elam.



6. Refer to the last paragraph in the body of Kentucky Frontier's amended application in which Kentucky Frontier requests expedited review and approval prior to November 28, 2008. Identify and describe the specific terms of any agreements, contracts, etc. with GOLD, Community Trust Bank, Inc., Floyd County, or any other party involved in the proposed acquisitions and transfers of control which bear on the importance of the November 28, 2008 requested approval date.

WITNESS: Oxford, Shute

RESPONSE: Article X of the Agreement with Floyd County, filed as exhibit 1 of the Amended Application, states that the Agreement may be terminated if closing has not occurred by November 1, 2008. The Floyd County attorney represented to the Commission at the conference held in this matter on October 16<sup>th</sup> that the County would defer the termination date to November 28<sup>th</sup> based on the commitment at the conference that an order would be issued by that date.

On September 15, 2008, Community Trust Bank made a loan commitment to finance the debt of Frontier. In the commitment letter, §19 lists a loan closing deadline of December 1.

The cash flow of gas utilities is vitally dependent upon the winter months of December to March. The utility has 56% of gas sales during this 25% of the year, and accumulates cash with which to survive the summer. If the closing is delayed for more than a few days past November 28, the significant reduction in cash flow would impair Frontier's cash position for summer.



7. In Case No. 2005-00428 the Commission found that the requirements of KRS 278.300 were not applicable to Kentucky Frontier as it was not a utility. It also found that those requirements would become applicable to Kentucky Frontier after it had acquired ownership or control of facilities used to provide utility service. Explain whether Kentucky Frontier has acquired ownership or control of such facilities.

WITNESS: Oxford

RESPONSE: Frontier has acquired control over the operation of the assets of both Mike Little Gas Company and Floyd County Gas as reflected in the operations agreement filed with the application. It is managing the assets and operations as defined by those agreements. It is engaged in a "regulated activity" as defined by KRS 278.010(23).

KRS 278.020 requires a "person", not a utility, to seek approval for a transfer. One of the conditions for approval of the transfer is proof of financial ability to acquire the utility. The method proposed to finance the acquisition seems to be an integral part of the transfer review. It would be an odd situation if a "person" could acquire a utility without any oversight of the financing of the acquisition. Once it has acquired that utility, that "person" is now a "utility". It is possible that the financing of the initial acquisition, which was not jurisdictional under KRS 278.300 because the acquirer was only a person and not a utility, was so onerous that the utility cannot operate with "reasonable" rates. The acquisition becomes financially problematic in that initial financing cannot be serviced with existing rates. Such a situation seems contrary to the regulatory scheme. The purpose of Frontier's request for approval of the transfer and the financing is to assure the Commission that it has the financial ability to acquire these companies and that the projected revenues from rates will provide sufficient operating funds.

Whether the financing is approved pursuant to KRS 278.300 or KRS 278.020, it is an essential part of the acquisition. The transfer cannot occur without the financing and the financing is meaningless without approval to acquire.





8. In Case No. 2007-00107 the Commission ordered Mike Little Gas Company, Inc. ("Mike Little") to replace its non-corrosion controlled steel distribution pipe. Mike Little chose to comply with the Commission's Order by inserting plastic pipe inside existing steel distribution pipe.

a. State whether Kentucky Frontier is aware of the method that Mike Little has chosen to comply with the Commission's Order. Describe Kentucky Frontier's familiarity with gas systems that faced similar situations and used the same method chosen by Mike Little.

b. State whether Kentucky Frontier is of the opinion that connecting a customer to plastic pipe inserted in a steel distribution pipe would present greater technical challenges than just connecting a customer to plastic pipe. Explain the response.

c. State whether Kentucky Frontier is of the opinion that connecting a customer to plastic pipe inserted in a steel distribution pipe would be more costly than a typical connection to a non-corrosive line. Explain the response.

WITNESS: Oxford, Rich, Shute

RESPONSE:

a. Frontier is aware of the replacement of the pipe and the method used. The ECU / Floyd County system also has some PE inserts. These segments seem to run in the less-populated areas where service lines were not close together then, and where new taps would be less common. Frontier principals have worked with virtually every type of gas pipe (cast iron, bare steel, coated CP steel, aluminum, steel or copper tubing, PVC, ABS, PE of all flavors)..

b. The use of inserted plastic pipe is fairly common in the gas industry. Connections take longer to expose the PE carrier pipe inside the steel pipe, but require no unusual technical prowess by Frontier.

c. The cost of connection will vary with complexity, ground conditions, location and geometry of the connection and relative sizes of steel and inserted PE lines. Frontier expects that the average cost would increase by an hour or so of extra labor, but little other added cost. Compared with running an extra 100-500 ft of pipe to a gap in the steel, the modestly extra time is justified to cut a window or cylinder in the steel casing to expose the PE main.