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PUBLIC SERVICE COMMISSION

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

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| APPLICATION OF KENTUCKY FRONTIER GAS, LLC FOR APPROVAL OF CONSOLIDATION OF AND ADJUSTMENT OF RATES, APPROVAL OF AMR EQUIPMENT AND A CERTIFICATE OF CONVENIENCE AND NECESSITY FOR INSTALLATION OF AMR, PIPELINE REPLACEMENT PROGRAM, REVISION OF NON-RECURRING FEES AND REVISION OF TARIFFS | CASE NO. 2011-00443 |

## KENTUCKY FRONTIER GAS, LLC's MOTION FOR REHEARING

Kentucky Frontier Gas, LLC, (Frontier) by counsel, moves for rehearing of the final order issued on April 30, 2013.

Frontier seeks clarification of the description of the net investment and acquisition adjustment related to Cow Creek Gas Company and DLR Enterprises on page six of the order. This request for clarification is for purposes of correctly reflecting the financial terms of the transactions. Frontier is not seeking any adjustment of rates in this rehearing as a result of the correction to the description of the transactions. The proposed changes to the final order will merely establish the correct baseline valuation going forward, which will allow Frontier ultimately to recognize the appropriate ratemaking treatment of the acquisition.

On page six, the order states:

> Frontier reported a net investment of $105,707 in Cow Creek after completing the aforementioned acquisitions. However, it paid $550,000 for 100 percent of Cow Creek's stock (when the net book value of the Cow Creek system was $420,153), and for 75 percent (by linear length of pipe) of the DLR system (when 75 percent of the net book value of that system was $325,414).9 This produces a combined net-book value of $745,567 for the Cow Creek (Sigma Gas) and DLR acquisitions. Based on a combined purchase price of $550,000, the result is a negative acquisition adjustment of $195,567.

Frontier believes the correct description of the transactions is:

- Frontier paid $320,000 for the stock of Cow Creek Gas
- Frontier injected $230,000 of additional cash into Cow Creek Gas
- With the cash, Cow Creek paid $230,000 for 32.56 miles of the former Sigma system held by DLR
- Frontier paid $550,000 for the entire purchase from the owners
- $10,000 was allocated to Dema and $10,000 to farm taps.
- Frontier booked a net investment of $530,000 in the Cow Creek and Sigma utility systems
- For the last Data Request in this case, Frontier reported $424,293 for Cow Creek net book value (NBV) as of 12/31/09, which is slightly different than a schedule filed in Case 2010-00076 with $417,353. Frontier has not yet determined the source of this discrepancy
- Frontier calculated an Acquisition Adjustment of $105,707, which is the difference of $530,000 paid less Cow Creek's depreciable basis of $424,293.
- For PSC ratemaking purposes, Frontier did not carry any of the depreciable basis from the DLR books for the purchased segments
- Frontier used the amount actually paid for Cow Creek and remaining Cow Creek NBV as the bases for Depreciation & Amortization

Attached are four responses filed on April 7, 2010 in Case No. 2010-0076, which explain the transactions. Also attached is a response dated March 1, 2013 in this case, which also specifies the cost allocations of the transactions.

It appears that the order reduces the total acquisition adjustment by $300,000, which is very significant to Frontier. This change would only be appropriate with a concomitant increase in depreciation basis using DLR's figures. Frontier's figures are slightly different than those in the Order: DLR's NBV was $386,919 in May, 2010 and the portion sold to Cow Creek is a 64% allocation by inch-miles of pipeline. With these assumptions, the adjusted order calculations would be:

- Total NBV is Cow Creek $424,293 plus DLR $278,000 = $702,293
- Total acquisition adjustment is $702,293 NBV compared to $530,000 paid resulting in a ($172,293) negative adjustment.

The net effect on the balance sheet simply slides $278,000 from acquisition adjustment (amortized over 20 years) to depreciation base or NBV (depreciated over 30 years). The net effect on revenue is about $4600 per year less D&A, which is about 1.5c per MCF and not material to ratemaking.

The significance of the corrected values of the transaction to Frontier relates to the establishment of the correct accounting of the transactions for ratemaking, consistency of information submitted to the financial institutions that loaned the funds to acquire Cow Creek and the value of the property for tax purposes. To avoid potential problems with verification of the information previously submitted or future questions about the transaction in any subsequent proceeding, Frontier needs to have this issue clarified.

Submitted by:
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Certification:

I certify that a copy of this response was mailed to Robin Simpson Smith, Box 216 Prestonsburg, KY 41653 and to Joe and Gloria Conley, 231 Mine Fork Rd., Salyersville, KY 41465 the 20th day of May, 2013.

1. Refer to the Petition for Transfer of Stock and Pipeline Facilities, Purchase of Farm Tap Customers, and Approval of Financing ("Petition") filed February 22, 2010. In Item 3, Kentucky Frontier proposes to acquire the stock of Cow Creek Gas, Inc. ("Cow Creek"), a regulated utility. Item 4 proposes that 32.6 miles of a 42.7-mile pipeline become part of the Cow Creek system, with the remaining 10.1 miles retained by DLR Enterprises ("DLR"), the current owner of the pipeline. Item 7 states that DLR is to be purchased by Industrial Gas Services, Inc. ("IGS"), a company related to Kentucky Frontier and not regulated by the Commission. Explain why the 10.1 miles of pipeline is not to become part of Cow Creek and why it is, instead, to be owned by IGS. Also explain what impact, if any, this will have on rates of regulated utility customers.

Witness: Shute

Response:

The former Sigma Gas system was split up in bankruptcy. As approved by the Commission, the portion of the system within the community of Salyersville was placed under the name of Cow Creek Gas, a tiny existing regulated utility. The remainder was placed into an unregulated gathering and pipeline company named DLR Enterprises. The Salyersville-Sigma segment had only about 150 meters attached to it. The DLR segment had about 350 customers attached, yet all those meters were allowed to stay as Sigma-Cow Creek.

As Frontier analyzed the purchase of the Sigma-Cow Creek customers, it realized that Frontier could not completely "un-ring the bell". The existing rates for Sigma could justify a $550k purchase price of Sigma-Cow Creek and the peripheral Cow Creek, Dema and Interstate farm tap customers. But the combined entities had about $800k in debt and the sellers were unable to sell at a loss.

The extra $250k debt attributed to Sigma-DLR pipelines made the project untenable at existing Sigma rates for Frontier. To maintain control over the entire system and guarantee the integrity of the system and service, IGS will purchase a 10.1 mile segment of the DLR pipeline.

A segment of DLR will remain as DLR, with IGS ownership and separate financing from Frontier. IGS will pay up to $250,000 for this portion of the pipeline. This segment has about 52 Sigma customers attached to it, which will stay distribution customers. DLR (IGS) will charge producers and transporters a pipeline charge. This change will have no effect on current customers, who already pay the charges to DLR within their gas cost.

Frontier will eventually file a General Rate case to consolidate all customers served by its Eastern Kentucky entities. But filing such a case now would unnecessarily delay by a year the pending acquisitions, and would have to be done *prospectively* without a true Test Year, since Frontier does not yet have history on the true cost of operating all these consolidated entities.

RESPONSE 1
CASE NO. 2010-00076
FILED APRIL 7, 2010

5. Refer to page 4 of Exhibit 1, the Stock Purchase Agreement with Cow Creek ("Cow Creek Agreement"). Article 3.10 discusses negotiations surrounding the sale of certain gas production properties belonging to Interstate. Is Kentucky Frontier or IGS involved in these negotiations as a potential purchaser? If not, what will be the disposition of the current Interstate farm tap customers that Kentucky Frontier is proposing to acquire?

Witness: Shute

Response:

No. If the production properties are sold prior to the closing of the agreement reflected in Exhibit 1, then the purchaser could chose to retain the farm tap customers and that portion of the agreement could change. However, if those properties are sold after the execution of Exhibit 1, that purchaser would be subject to the terms of the agreement reflected in Exhibit 1. No Frontier partner nor affiliate is working to purchase any other Interstate-related production properties. The agreement to acquire the farm taps contemplates that Frontier would keep the customers regardless of ownership of the wells and pipelines.

**COW CREEK GAS, INC.**
**Balance Sheet**
**December 31, 2009**

| | | |
|---|---|---|
| **ASSETS** | | |
| Current Assets: | | |
| Cash | $ | 28,692 |
| Accounts Receivable | | 37,050 |
| Prepaid Insurance | | 3,042 |
| Total Current Assets | | 68,784 |
| Fixed Assets: | | |
| Shop Building | | 15,876 |
| Meters | | 106,463 |
| House Regulators | | 33,833 |
| Mains | | 759,707 |
| Less: Accumulated Depreciation | | (498,527) |
| Total Fixed Assets | | 417,353 |
| TOTAL ASSETS | $ | 486,137 |
| **LIABILITIES** | | |
| Accounts Payable | $ | 218,359 |
| Interest Payable | | 1,714 |
| Customer Deposits | | 11,537 |
| Loans from Shareholders | | 8,000 |
| Notes Payable-CNB 25763 | | 317,510 |
| Total Liabilities | | 557,121 |
| **STOCKHOLDERS' EQUITY (DEFICIT)** | | |
| Capital Stock | | 1,000 |
| Retained Earnings (DEFICIT) | | (71,985) |
| Total Stockholders' Equity (DEFICIT) | | (70,985) |
| TOTAL LIABILITIES & STOCKHOLDERS' EQUITY (DEFICIT) | $ | 486,136 |

RESPONSE 33
CASE NO. 2010-00076
FILED APRIL 7, 2010

# 33

36. Refer to Exhibit 5, Article 1.02. Confirm that IGS is agreeing to pay or assume the entire balance of the loan with Citizens National Bank even if the balance at closing exceeds $250,000. What is the current balance of the loan from Citizens National Bank?

Witness; Oxford

Response: IGS will pay an amount not to exceed $250,000. The current balance is approximately $230,000. DLR has a loan with Citizens with the stated loan balance at that date. IGS has agreed to pay the balance up to and including $250,000. If the loan balance at closing exceeds this amount, the present owners of DLR must pay down the balance or retain a loan for the difference.

37. Refer to Exhibit 5, Exhibit B, of DLR's balance sheet as of November 30, 2009. Provide a detailed analysis of what comprises the line item for Notes Payable – Citizens National Bank in the amount of $483,867.

Witness: Shute

Response: DLR has a loan with Citizens with the stated loan balance at that date. The current Citizens Bank statements show loan balances as of 3/31:

| | |
|---|---|
| Cow Creek | $314,137 |
| DLR | $468,687 |

Frontier will pay $320k to Cow Creek, which will pay off this CC loan.

Then Frontier will pay $230k to Cow Creek to pay DLR for pipelines.

IGS will purchase remaining DLR stock and pipeline for the remaining DLR loan balance, not to exceed $250k.

5. PSC #1 tab 22, p. 14 Explain Cow Creek $530,000 vs $550,000. Does PSC #1 tab 12 Cow Creek entry include DLR; how has DLR been accounted for/allocated among CC, Sigma, Dema and farm taps?

Exhibit C is a Petition for Transfer of Stock and Pipeline Facilities in Case No. 2010-0076, filed 2/22/10. Paragraphs 3 and 4 describe exactly what happened at closing of the transactions with Interstate Natural Gas in April and May, 2010:

- Frontier paid $320,000 for the stock of Cow Creek Gas, Inc.
- Cow Creek (under the control of Frontier) paid $230,000 to DLR Enterprises for 32.6 miles of pipeline, to mostly restore the system in Magoffin County formerly operated as Salyersville Gas then Sigma Gas.
- Dema Gas and the Interstate Farm Taps were thrown into the $320k Cow Creek purchase for no specific value.
- After all transactions were finalized Frontier allocated the $550,000 total purchase cost as follows:
    - $530k Cow Creek Gas, Inc. (original system + Sigma)
    - $10k Dema Gas, Inc.
    - $10k Interstate farm taps

The correct basis for Cow Creek is shown on the revised Depreciation schedule.

In a *transaction separate from the* $550k utility purchases, the individual partners of Frontier purchased the stock of DLR and paid off the remaining debt. After the Cow Creek pipeline sale, the greatly reduced DLR is an unregulated, intrastate pipeline that gathers wells and supplies gas to Sigma. DLR has about 10 miles of pipeline, mostly in Floyd County. Frontier has no ownership in this DLR remnant. No part of the final DLR purchase transaction is included in the Frontier purchase price of Cow Creek etal.