COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF ELAM UTILITY COMPANY, INC., MORGAN & WOLFE COUNTY, KENTUCKY, FOR THE AUTHORITY TO BORROW $797,425 FROM THE ECONOMIC DEVELOPMENT ADMINSTRATION THROUGH THE DEPARTMENT FOR LOCAL GOVERNMENT	))))))	CASE NO. 2001-324

O R D E R

On October 4, 2001, Elam Utility Company, Inc. ("Elam") submitted its application seeking Commission approval to borrow $797,425 from the Kentucky Department for Local Government ("DLG"). Elam will execute notes in conjunction with the borrowing from DLG, which will be for a term of 30 years and will bear a fixed interest rate to be determined by DLG at the time of loan closing based on the federal prime rate less four hundred basis points. The proceeds from the loan will be used to pay off delinquent accounts payable and taxes payable, to retire existing short-term debts, and to refinance existing loans with DLG. None of the proceeds of the DLG loan will be used by Elam to acquire property.

Elam requested a waiver of the requirement contained in 807 KAR 5:001, Section 6, that an applicant's financial exhibit be for a period ending not more than 90 days prior to the filing of its application. In place of the required financial exhibit, Elam supplemented its application with financial statements for the 6-month period ending June 30, 2001. By Order dated October 25, 2001, the Commission granted Elam's request for waiver and the case was considered filed.

Elam is delinquent on payments to its gas suppliers, its accounting firm, and to federal, state and local taxing authorities. Elam filed information indicating that it has unpaid invoices from its gas suppliers dating as far back as October 2000. Elam's tax delinquencies began in January 2000. Elam stated that it needs the requested additional financing to pay these outstanding obligations, to retire several short-term notes used to pay other operating expenses and to refinance, at a lower interest rate, long-term notes obtained through DLG.

Elam, within approximately a year and a half, has already received approval of a $180,000 loan from DLG and a rate increase effective April 1, 2001. Despite this relief, Elam is still unable to stay current on essential operating expenses and tax liabilities. The Commission has addressed, in both its Order granting the $180,000 loan and the rate increase, a particular payment that has hampered Elam's ability to pay legitimate operating expenses. Elam's revenues are being used to make a monthly loan payment of $3,514.43 to Mr. and Mrs. B. C. Phillips, the previous owners of Elam, for Wilma and Doug Ison's purchase of Elam. Although the Commission designated this payment a personal liability of the Isons in its Order approving the purchase, the liability is improperly on the utility's books and the payment of principal and interest appears to be the prominent reason for Elam's cash flow problems.

Elam has, in addition to the loan payment to the Phillipses, continued to pay several expenses that were disallowed for rate-making purposes during its most recent rate case. Examples of these are monthly life insurance payments for the Isons totaling approximately $660 per month, unnecessary payments for cable and telephone, and unsupported credit card expenses. Elam has also not re-negotiated its office lease agreement nor found a more reasonable office space as directed in the rate case. Because of these imprudent payments, Elam has used tax funds, collected on behalf of taxing authorities from customers and employees, to pay operating expenses as well as non-utility expenses rather than its tax liabilities.

Having recounted the circumstances that produced the situation Elam has brought before the Commission, we must now determine how to remedy that situation. Ordinarily, Elam's request would be denied on the grounds that long-term financing should not be approved for the purpose of paying prior period operating expenses. Ratepayers should not be required to pay, on a long-term basis, for short-term operating expenses. Rejecting the proposed financing, however, would potentially inure to the long-term detriment of both the utility and its ratepayers by compromising both Elam's financial viability and its ability to provide continued service to its customers. Given Elam's current situation with its creditors and its immediate predicament concerning cash flow, the Commission is persuaded that approving the proposed financing will be in the best long-term interests of both Elam and its ratepayers. Elam will remain viable as a going concern and Elam's ratepayers will continue to receive gas service. In short, this decision is based on the unique circumstances present in this case. Moreover, we herein explicitly prohibit further inappropriate use of utility funds as described herein. Elam is hereby put on notice that further such practices will result in enforcement action and penalties as prescribed in KRS 278.990

In order to monitor the use of the proceeds of the DLG loan and to prevent Elam's financial position from further decline, the Commission's approval is conditioned as follows:

1. Elam may not use any of the proceeds of this DLG financing to make any payments on the Isons' loan from the Phillipses.

2. Elam will remove the Isons' loan from the Phillipses from its books and discontinue using company funds to make payments on this loan. The loan to the Isons was initially placed on the books by a debit to Reacquired Capital Stock and a credit to Other Long-Term Debt. When removing the liability from the company's books, the utility shall make the following journal entry:

Acct. No.	Account Title	Debit	Credit
224	Other Long-Term Debt	XXX	
439	Adjustments to Retained Earnings	XXX	
217	Reacquired Capital Stock		$346,500

Other Long-Term Debt shall be debited for the current outstanding balance of the loan. The difference between that balance and the $346,500 represents the principal payments already made with company funds and shall be debited to Adjustments to Retained Earnings. In essence, this treats these payments as dividends paid to the Isons. It should be noted that the company has paid and expensed interest on this loan since its inception. This has had the effect of further reducing Retained Earnings. These interest payments are also considered to be dividend payments. However, given the utility's unstable financial condition, the payments were profoundly inappropriate. The Commission's Financial Audit Branch will meet with Elam to provide assistance on this and other bookkeeping matters.

3. Elam will distribute the loan proceeds for only the items listed in Appendix A. Elam will provide supporting documentation, such as cancelled checks or receipts showing totals paid in full, in order to verify that this requirement has been met.

4. Elam will meet with Commission staff within 60 days of the date of this Order to discuss the steps the utility needs to take to improve its financial condition.

5. Because of the concerns expressed above, the Commission believes it is essential for Elam to establish and follow a payment priority for certain payables and expenses in lieu of deferral. The first priority shall be Elam's gas supplier. Elam's second priority shall be its tax liabilities. The next priority shall be any and all expenses that the Commission approved in Elam's last rate case. The Commission will require periodical reports from Elam indicating what payments Elam is making from the utility account.

6. The Commission will initiate a general rate review no later than May 1, 2002 in order to pass on to the customers any reduction in expenses as a result of the refinancing.

IT IS THEREFORE ORDERED that:

1. Elam is authorized to borrow $797,425 from DLG subject to the provisions and terms contained within its application.

2. The proceeds from the transaction authorized herein shall be used only for the items listed in Appendix A. Elam shall file with the Commission, by the tenth day of every month, a general ledger and copy of the bank statement for the preceding month.

3. Elam shall not use the proceeds from the transaction authorized herein to make payment on the loan from Mr. and Mrs. B.C. Phillips to Doug and Wilma Ison to fund the Isons' purchase of the utility.

4. Elam shall remove the Isons' loan from the Phillipses from its books and shall discontinue using company funds to make payments on the loan.

5. Elam shall meet with Commission staff within 60 days of the date of this Order to discuss the steps the utility needs to take to improve its financial condition.

6. Elam shall adhere to the following payment priority: (1) Gas Suppliers; (2) Tax liabilities; and (3) Expenses approved in Elam's last rate case.

7. The Commission will initiate a general rate review no later than May 1, 2002. Nothing herein shall be deemed to guarantee rate recovery of the entire interest expense associated with this loan in future rate cases.

Nothing contained herein shall be deemed a warranty or finding of value of securities or financing authorized herein on the part of the Commonwealth of Kentucky or any agency thereof.

Done at Frankfort, Kentucky, this 3rd day of December, 2001.

By the Commission

ATTEST:

Thomas M. Dorman

Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2001-324 DATED DECEMBER 3, 2001

Gasco	$ 21,434.28
Columbia Gas	$ 18,814.65
Jefferson Gas	$ 8,401.79
Commercial Bank, line of credit balance	$ 18,516.99
Commercial Bank, 10% Note	$ 20,309.19
Harrod & Associates	$ 15,207.50
IRS 941 Taxes through 6/30/01	$ 41,635.00
Ky State Treasurer Sales Tax through 6/01	$ 12,476.98
Ky State Treasurer State Withholding to 6/01	$ 5,194.31
Utility Taxes for 2000 through 6/01	$ 23,460.62
Existing DLG Loans	$607,424.97
Accounting Fees	$ 4,548.72
TOTAL	**$797,425.00**