File No. 70-____

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM U-1
JOINT APPLICATION OR DECLARATION
UNDER THE
PUBLIC UTILITY HOLDING COMPANY ACT OF 1935

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Enova Corporation
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(Names of companies filing this statement and addresses of principal executive offices)

None

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The Commission is requested to send copies of all notices, orders and communications in connection with this Application or Declaration to:

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ITEM 1. DESCRIPTION OF PROPOSED TRANSACTION.

1.1. Introduction and Description of Applicants' Business.

Pacific Enterprises ("Pacific") and Enova Corporation ("Enova") are exempt holding companies pursuant to Section 3(a)(1) of the Public Utility Holding Company Act of 1935, as amended (the "Act").(1) Through an indirect, jointly-owned, subsidiary, Frontier Pacific, Inc. ("Frontier Pacific"),(2) Pacific and Enova are proposing to acquire up to 90.1% of the membership interests of Frontier Energy LLC ("Frontier"), a North Carolina limited liability company formed to construct and operate a small gas distribution system in North Carolina. The remaining membership interests in Frontier would be acquired by

Frontier Utilities of North Carolina, Inc. ("Frontier Utilities"), a North Carolina corporation and an indirect, majority-owned subsidiary of ARB, Inc., a closely-held California corporation.(3)

Pacific's predominant subsidiary, Southern California Gas Company ("SoCalGas"), purchases, transports and distributes natural gas in southern California. At December 31, 1997, Pacific reported consolidated total assets of $4.977 billion, of which approximately $3.154 billion consisted of net gas plant. For the year ended December 31, 1997, Pacific reported $2.738 billion in operating revenues (including revenues from transportation-only customers) and $184 million in net income.

1/ Pacific (formerly Pacific Lighting Corporation) is exempt by order issued pursuant to Section 3(a)(1). See Pacific Lighting Corporation, 1 S.E.C. 275 (1936). Enova claims an exemption under Section 3(a)(1) pursuant to Rule 2. See File No. 69-393. In a separate proceeding (File No. 70-9033), Enova and Pacific are seeking SEC approval for a business combination pursuant to which the two companies would become subsidiaries of a new holding company to be called Sempra Energy. Sempra Energy is also requesting an exemption under Section 3(a)(1) in that proceeding.

2/ All of the issued and outstanding common stock of Frontier Pacific is held by Sempra Energy, LLC, a California limited liability company whose membership interests are, in turn, held directly by Pacific and Enova.

3/ ARB, Inc. is not now a "holding company" or an "affiliate" of any "holding company" or "public-utility company," as those terms are defined under Section 2 of the Act.

Enova's principal subsidiary, San Diego Gas & Electric Company ("SDG&E"), provides electric and natural gas service in San Diego and surrounding areas. At December 31, 1997, Enova reported consolidated total assets of $5.2 billion, of which approximately $2.49 billion consists of net electric plant and $449 million consists of net gas plant. For the year ended December 31, 1997, Enova reported operating revenues of $2.2 billion (81.6% from electricity sales and 18.4% from gas sales (including revenues from transportation only customers)), and $252 million in net income.

Pacific and Enova derive substantially all of their gas requirements from sources outside of California. Approximately 58% of their combined system gas requirements are met from production in the Permian Basin, which is located in west Texas, and the San Juan Basin, which is located primarily in New Mexico and Colorado in the "Four Corners" area. Most of the gas produced in these supply basins is delivered to California by El Paso Natural Gas Company ("El Paso") and Transwestern Pipeline Company ("Transwestern") under long-term transportation agreements.

1.2 Description of Frontier and Its Properties.

By order issued January 30, 1996, Frontier Utilities was granted a final certificate of public convenience and necessity (the "Certificate Order") from the North Carolina Utilities Commission ("NCUC") to construct, test, market, own and operate a new natural gas distribution system in a four-county area in northwestern North Carolina comprised of Surrey, Watauga, Wilkes

and Yadkin Counties (the "Four-County Area").(4) Subsequently, by order dated August 16, 1996,(5) the NCUC added Ashe and Allegheny Counties, which are located in the same region, to Frontier Utilities' certificated territory, and by order dated March 27, 1997,(6) granted Frontier Utilities a certificate of convenience and necessity to construct and operate a gas distribution system in Warren County, which is to the east of the Four-County Area. By further order dated March 9, 1998 (the "Financing Order"), the NCUC approved various proposals by Frontier Utilities and Frontier relating to financing of construction of a gas system in the Four-County Area and Warren County, including the participation of Frontier Pacific as an equity investor in Frontier, and the transfer by Frontier Utilities to Frontier of the certificates to serve the Four-County Area, as well as Ashe, Allegheny and Warren Counties.(7) Copies of Frontier Utilities' application to the NCUC and the Financing Order are attached hereto as Exhibits D-1 and D-2, respectively.

4/ In the Matter of Application of Frontier Utilities of North Carolina, Inc. for Certificate of Public Convenience and Necessity, NCUC Docket No. G-38, January 30, 1996 (Order Granting Final Certificate), 166 PUR 4th 565. The order was affirmed on appeal by the Supreme Court of North Carolina on a challenge by Piedmont Natural Gas Company, Inc., whose competing proposal the NCUC had rejected. State of North Carolina v. Piedmont Natural Gas Company, Inc., 488 S.E. 2d 591 (N.C. Sup. Crt. 1997).

5/ In the Matter of Commission Proceeding to Implement G.S. 62-36A(b1), NCUC Docket No. G-100, Sub. 69 (August 16, 1996). This was a generic proceeding in which the NCUC implemented a new law that required that the NCUC grant certificates to provide gas service to all unfranchised areas in North Carolina or, in the absence of any applications for such certificates, that the NCUC assign to the incumbent utilities in the state franchises covering all such uncertificated areas. Because of their proximity to the Four-County Area, the franchises for Ashe and Allegheny Counties were assigned to Frontier Utilities.

6/ In the Matter of Frontier Utilities of North Carolina, Inc. for Certificate of Public Convenience and Necessity, NCUC Docket No. G-38, Sub. 1, March 27, 1997 (Order Awarding Certificate and Approving Rates).

7/ Order Approving Final Financing Plan, Transfer of Certificates, and Security Bond and Preliminarily Approving Debt Financing, NCUC Docket Nos. G-38, Sub 3 and G-40 (March 9, 1998). Although Frontier has indicated that it intends to build out a system in Ashe and Allegheny Counties at such time as it becomes feasible to do so, the financing plan approved by the NCUC does not include the system to be built in those counties.

Frontier commenced construction in the Four-County Area during the second quarter of 1998. Construction in Warren County will commence at a later date, subject to receipt of further NCUC approvals. When complete, the Four-County Area system will consist of approximately 140 miles of transmission mains, including a 40-mile lateral tap off the interstate pipeline facilities of Transcontinental Gas Pipe Line Corp. ("Transco"), and at least 320 miles of distribution mains. Frontier will purchase at least 50% of its gas requirements from production in the San Juan and Permian Basins. Gas will be delivered to Frontier by Transco under a long-term transportation contract. Frontier is projecting that, by the end of the fifth year following commencement of construction, it will serve 13,250 residential, 1,054 small commercial, 300 poultry farm, and 55 large commercial and industrial customers. (Exhibit D-1, p. 10). As a public utility under North Carolina law, Frontier will be subject to regulation by the NCUC as to rates, service, securities issuances and other matters.

The Certificate Order contains various findings and conclusions as to technical issues, the financial feasibility of the Four-County Area system, and the public interest to be served. Two of the central issues in the proceeding concerned the optimum size of the Four-County Area system and the likelihood that customers would convert from propane and heating oil to natural gas. These issues were critical in the NCUC's evaluation of Frontier Utilities' proposal, which assumed that the proposed system could support traditional financing, and of the competing proposal made by Piedmont Natural Gas Company, Inc. ("Piedmont"), an existing franchised gas utility company in North Carolina, which was made contingent upon the availability of

"expansion funds" provided for under North Carolina law.(8) With regard to the financial feasibility of Frontier Utilities' proposed system in the Four-County Area, the NCUC considered a detailed market study prepared by an independent consultant (Heath and Associates) which evaluated the potential customers and loads in the Four-Country Area and the likelihood of converting these customers to gas at the rates and rate designs proposed by Frontier Utilities. During the hearings, witnesses for Heath and Associates and Frontier Utilities were cross-examined at length concerning the data used and assumptions made in the Heath and Associates study and an earlier study prepared by Frontier Utilities. Despite certain discrepancies between the Health and Associates study and Frontier Utilities' initial study as to likely number of customers, the configuration of the system, conversion rates and other matters, the NCUC concluded that "the market study performed by Heath and Associates provides a fair and unbiased assessment of the potential customers and loads resulting from an extensive rural distribution system in the Four-County area at the rates that Frontier proposed to offer." (Certificate Order, p. 19).

1.3 Description of Frontier's Ownership Structure and Management Plan.

It is contemplated that Frontier Pacific and Frontier Utilities will each acquire 50% of the membership interests of Frontier, and that the economic interests of the members will

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8/ See N.C. Gen. Stat. Sections 62-158 (Michie, 1997).equity investments by the members of Frontier, including cash and in-kind contributions of pipeline and other property, totaling approximately $12 million. In addition, the NCUC has given its preliminary approval for $40 million in debt financing by Frontier.

9/ Heath and Associates forecast that the gas system would have 8,553 customers in year 10 and sales of 4 million dekatherms per year. Certificate Order, p. 13. Frontier offered testimony showing that it would be economically feasible to serve an additional 5000 customers outside of the areas included in the Heath and Associates analysis.

equal their membership interests.(10) Under the Financing Order, the NCUC authorized the equity investments by the members of Frontier, including cash and in-kind contributions of pipeline and other property, totaling approximately $12 million. In addition, the NCUC has given its preliminary approval for $40 million in debt financing by Frontier.

Under Frontier's Operating Agreement (attached hereto as Exhibit A-2), the economic interest of a member is defined as that member's interest in the profits and losses of Frontier and right to receive distributions from Frontier. The membership interest of a member means that member's economic interest, plus the right to participate in management of Frontier, including the right to vote. The Operating Agreement specifically contemplates that Frontier Pacific and Frontier Utilities may adjust or change their respective economic and membership interests whenever necessary in order, for example, to limit the percentage of overall voting rights held by a member. Pacific and Enova are seeking approval herein to acquire, indirectly through Frontier Pacific, up to 90.1% of the membership interests of Frontier, representing 90.1% of the voting interests in Frontier. This will enable Frontier Utilities, should it choose to do so, to maintain its percentage interest in Frontier's voting securities at below 10%.

It is anticipated that the day-to-day operations of Frontier will be under the control of its General Manager, who will be located at Frontier's corporate headquarters in Elkin, North Carolina. The General Manager will report to the President, who will be located in San Diego, California. It is also anticipated that Frontier will be staffed by a combination of current employees of the members of Frontier and their respective subsidiaries and new hires from the local community in North Carolina.

10/ An organizational chart showing the ownership structure of Frontier and its members is set forth at page 5 of Frontier Utilities' Application for Approval of Financing Plan (Exhibit D-1 hereto).

The North Carolina and California systems will be coordinated administratively in order to enable Frontier to enter the natural gas business with an experienced management team in place. In addition, Pacific and Enova will be able to provide Frontier with greater financial, operational and technical resources. In accordance with one or more service agreements, administrative and consulting services provided by the members of Frontier and their utility and non-utility affiliates will be directly assigned, distributed or allocated to Frontier by activity, project, program, work order or other appropriate basis. Employees of the members and their affiliates will record transactions utilizing the data capture and accounting systems of Frontier. Costs of the members and their affiliates will be accumulated in their respective accounts and directly assigned, distributed and allocated to Frontier in accordance with the guidelines set forth in the service agreements. Such agreements are required to be filed with the NCUC.

Affiliates of members will provide administrative and consulting services to Frontier as well as other affiliates and third parties. The consulting services will include, among other things, assistance with: project financing, procurement/materials and quality assurance, regulatory and governmental affairs, finance and accounting, human resources, information and technology, technical and design engineering, legal, training and general administrative support.

ITEM 2. FEES, COMMISSIONS AND EXPENSES.

The fees, commissions and expenses to be paid or incurred, directly or indirectly, in connection with the Transaction, inclusive of legal fees and expenses, are estimated at not more than $75,000.

ITEM 3. APPLICABLE STATUTORY PROVISIONS.

3.1 General Overview of Applicable Statutory Provisions.

Because Pacific and Enova are exempt holding companies, each of them will require approval of the SEC under Sections 9(a)(2) and 10 of the Act to acquire, directly or indirectly, 5% or more of the voting securities of Frontier, which will become a "gas-utility company" within the meaning of Section 2(a)(4) of the Act on or after the date on which it commences making residential and commercial sales of gas. Further, following the acquisition of 10% or more of Frontier's voting securities, and the commencement by Frontier of residential and small commercial sales, Frontier will become an additional gas-utility subsidiary company of both Pacific and Enova. However, because neither Pacific nor Enova will derive "any material part of its income" from Frontier, and will each remain "predominantly" a California holding company, their "intrastate" exemptions under Section 3(a)(1) of the Act will not be affected.(11)

The relevant standards for approval of an application under Section 10 are set forth in subsections (b), (c) and (f) thereof.

Section 10(b) provides that, if the requirements of Section 10(f) are satisfied, the Commission shall approve an acquisition under Section 9(a) unless the Commission finds that:

> (1) such acquisition will tend towards interlocking relations or the concentration of control of public-utility companies, of a kind or to an extent detrimental to the public interest or the interest of investors or consumers;
>
> (2) in case of the acquisition of securities or utility assets, the consideration, including all fees, commissions, and other remuneration, to whomsoever paid, to

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11/ Under the Operating Agreement, Pacific and Enova collectively will have a 50% economic interest in Frontier. Based on current projections, the proportionate share of Frontier's income attributable to Pacific and Enova is expected to account for far less than 1% of the consolidated income of Pacific and Enova on a pro forma basis.

be given, directly or indirectly, in connection with such acquisition is not reasonable or does not bear a fair relation to the sums invested in or the earning capacity of the utility assets to be acquired or the utility assets underlying the securities to be acquired; or

> (3) such acquisition will unduly complicate the capital structure of the holding company system of the applicant or will be detrimental to the public interest or the interest of investors or consumers or the proper functioning of such holding company system.

Section 10(f) provides that the Commission:

> shall not approve any acquisition . . . unless it appears to the satisfaction of the Commission that such State laws as may apply in respect of such acquisition have been complied with, except where the Commission finds that compliance with such State laws would be detrimental to the carrying out of the provisions of section 11.

Finally, Section 10(c) of the Act provides that, notwithstanding the provisions of Section 10(b), the Commission shall not approve:

> (1) an acquisition of securities or utility assets, or of any other interest, which is unlawful under the provisions of Section 8 or is detrimental to the carrying out of the provisions of Section 11; or
>
> (2) the acquisition of securities or utility assets of a public-utility or holding company unless the Commission finds that such acquisition will serve the public interest by tending towards the economical and the efficient development of an integrated public-utility system.

An "integrated public-utility system" is defined in Section 2(a)(29)(B), as applied to a gas utility system, to mean:

> . . . a system consisting of one or more gas utility companies which are so located and related that substantial economies may be effectuated by being operated as a single coordinated system confined in its operations to a single area or region, in one or more States, not so large as to impair (considering the state of the art and the area or region affected) the advantages of localized management, efficient operation, and the effectiveness of regulation: Provided, That gas utility companies deriving natural gas from a common source of supply may be deemed to be included in a single area or region.

For the reasons set forth below, Pacific and Enova believe that the requirements of Section 10(f) have been met; that their

acquisition of Frontier's voting securities will satisfy the integration standards under Sections 10(c) and 2(a)(29)(B); and that there is no basis for the Commission to make any of the negative findings enumerated in Section 10(b). As a preliminary matter to the discussion that follows concerning the integration standards of the Act, as applied to this transaction, however, the Applicants believe that it is important to understand the current "state of the art" in the natural gas industry and to review the dramatic changes that have occurred in the gas industry since 1935, and especially in the past decade.

3.2 Historical Perspective on the "State of the Art" in the Natural Gas Industry in the United States.

Although natural gas has been used as a fuel for thousands of years, the growth of the natural gas industry in the United States can be traced in large part to the development of pipeline systems through which large volumes of natural gas could be transported from the wellhead (i.e., the gas producing areas) to distant markets.(12) In the early days of the U.S. natural gas industry (1870-1930), natural gas was seldom transported more than 50 to 75 miles. In some areas, gas produced as an incident to oil drilling operations was simply burned, or "flared," in the oil fields, rather than being piped to nearby cities or towns. Eventually, efforts were made to find commercial uses for this "waste" gas, but the technological difficulties and cost of transporting gas long distances were limiting factors. Thus, in most communities where gas service was available, the source of supply was from locally manufactured gas or from a nearby oil

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12/ A more detailed history and analysis may be found in "Regulation of the Natural Gas Industry," Ed. by American Gas Association (Matthew Bender, 1997), Volume 1.

field. The first iron pipeline was reportedly built in 1872 to transport "waste" gas to Titusville, Pennsylvania, from nearby oil fields, where it was used chiefly for street lighting and some industrial applications. The first long distance, high pressure, gas pipeline, consisting of two parallel 8-inch wrought iron lines approximately 120 miles in length, was constructed in 1891 by Indiana Natural Gas and Oil Company.

A. Developments in the 1920s and 1930s. As indicated, prior to the 1930s, natural gas service to cities and towns was quite often provided from only one local source or field. In many cases, little was known about the extent of gas reserves in a producing area, which tended to limit the willingness of investors to commit the large amounts of capital required to build pipelines to distant markets. By the 1920s, however, technological advances had been made in the manufacture of large diameter pipeline which could withstand high pressures. This made it technologically and economically feasible to construct long-distance gas pipelines which could move gas from the developing oil fields in Texas, Oklahoma and other Southwestern states to the population centers in the Midwest and eastern U.S. This was the first significant change in the "state of the art" in the gas industry.

In the 1930s, the first of what we now know of as the modern-day, long distance, pipelines were constructed to transport the "casinghead" gas that was being produced in the developing Texas oil fields to Midwest markets.(13) By 1934, utilizing improved pipeline and compression technologies, some 150,000 miles of high-pressure transmission lines were in place.

13/ In 1931, Natural Gas Pipeline Company of America ("NGPL") completed a 24-inch line more than one thousand miles long running from the producing areas in Texas to Chicago, and in 1936, Panhandle Eastern Pipeline Company completed a thousand mile pipeline that terminated in Detroit.

Nevertheless, in 1935, when the Act was passed, the natural gas pipeline industry consisted of only two long interstate lines extending to the upper Midwest. For the most part, the pipeline industry in the U.S. still consisted of relatively short lines used to transport gas from local producing areas directly to nearby markets. Natural gas was generally unavailable in the more populous areas on the East Coast and in the Northeast, where local distribution gas companies, or "LDCs," continued to distribute low-Btu gas produced from coal.

For the most part, the interstate pipelines remained free from federal regulation until 1938, when the Natural Gas Act ("NGA") was passed.(14) Under the NGA, the Federal Power Commission ("FPC") was given broad authority to regulate interstate pipelines under a public utility model. This included, importantly, certificate authority over construction of pipelines and authority to set "just and reasonable" rates for sales of gas for resale (i.e., wholesale rates). For almost 50 years following passage of the NGA, there were few if any changes in the basic structure of the natural gas industry or the framework of federal regulation. The Federal Energy Regulatory Commission ("FERC"), the successor to the FPC, has characterized the structure of the natural gas industry regulated under the NGA during this period as "simple:"

> The producers would sell their natural gas in the production area to the interstate pipeline at Commission-determined just and reasonable rates. The pipelines would *transport their purchased gas and their own production to the city gate for sale to local distribution companies (LDCs) at Commission-determined just and reasonable rates which recovered both the pipelines' cost of gas and cost of transmission.* In addition, the pipelines would sell gas to

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14/ 52 Stat. 821-833 (1938), 15 USC Sections 717-717W, as amended. In 1906, Congress had amended the Interstate Commerce Act to specifically exclude pipelines for the transportation of natural gas from the jurisdiction of the Interstate Commerce Commission. 30 Stat. 584 (1906). H.R. 5423, the original House bill introduced in 1935 which contained the Public Utility Holding Company Act and amendments to the Federal Power Act, also included, as Title III, provisions which would have subjected the interstate gas pipelines to federal regulation as common carriers. During the hearings on H.R. 5423, however, Title III was widely criticized as being unworkable, and was not reported out of committee.

end users in non-jurisdictional sales with an appropriate allocation of costs to the non-jurisdictional services. Producer sales to LDCs or end users in the production area, with the pipeline providing only the transportation, were rare. The central features of the NGA-regulated natural gas industry were Commission-determined just and reasonable prices and interstate pipeline sales of gas for resale to LDCs at the city gate at those prices in transactions that combined or bundled into one package the pipelines' gas supply and transmission costs. (Emphasis added.) (Footnotes omitted.)(15)

The "source of supply" of natural gas at the time the Act was passed and for most of the next 50 years must be understood in the context of the relationship that existed between the pipelines and LDCs: the pipelines were in almost all instances the exclusive suppliers to the LDCs, which had little opportunity to contract with producers or other sellers. This was the "state of the art" in the gas industry.

B. Developments After World War II. Although significant changes in the regulation of the industry were still many years away, the natural gas pipeline industry underwent rapid expansion in the decades after 1938, and especially following World War II, when the steel pipe manufacturing capacity in the U.S., which had been diverted to the war effort, was again available for pipeline fabrication. Also in this period, significant new gas discoveries were developed, particularly in West Texas and along the onshore and offshore Gulf Coast areas. Significantly, it was not until after World War II that the market for natural gas developed to the point at which it could support gas exploration and production on a stand-alone basis, separate and apart from the economies associated with oil production.

When World War II ended, the consumption of natural gas was still concentrated within the six principal gas-producing states

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15/ See FERC Order No. 636, FERC Stats. & Regs. Paragraph 30,939, "Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation; and Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol," 57 Fed. Red. 13,267 at 13,270 (April 16, 1992), aff'd in part, United Distribution Cos. v. FERC, 88 F.3d 1105 (D.C. Cir. 1996).

of Texas, Louisiana, California, Oklahoma, West Virginia and Kansas, which, in 1945, produced 87% and consumed 68% of all the natural gas marketed in the United States.(16) In the populous Mid-Atlantic Region, including North Carolina, where there was little or no indigenous supplies, natural gas was either not available or at most mixed with manufactured gas to upgrade its Btu content.

Proven reserves of natural gas in the U.S. totaled about 148 trillion cubic feet (TCF) at the end of 1945 and total annual marketed production was only about four TCF, of which more than half was produced in the four Gulf States. Thus, there were vast reserves, mostly in the Southwest, available to support the expansion of the interstate pipeline system. The primary limiting factor was the lack of the pipeline capacity needed to reach distant markets.

In 1947, Texas Eastern Transmission Corporation purchased and converted to gas the "War Emergency" "Big Inch" and "Little Big Inch" lines that were built during the war to transport oil. During the same period, other companies secured the necessary gas reserves and built large diameter pipelines to waiting markets, while many of those already in existence extended their systems. It was during this period in which the El Paso and Transwestern pipelines were built to transport gas from west Texas to the rapidly growing California market, and in which Transco built a pipeline running from the Gulf Coast along the Eastern Seaboard to New York City.

By 1966, natural gas service was available in all of the 48 contiguous States and the District of Columbia. The gas industry

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16/ See "Regulation of the Natural Gas Industry", supra n. 12, at Section 3.02. Louisiana, Texas, Oklahoma and New Mexico still account for approximately three-quarters of all domestic production. See Energy Information Administration, Natural Gas Annual - 1996, DOE/EIA-0131(96) (Washington, D.C., September 1997), p. 9.

was no longer a local business. The primary forces behind this development were the surplus of reserves in the Southwest, the low prices for such gas, the subsequent discovery and development of additional reserves in the Southwest and elsewhere, and the price advantage that natural gas enjoyed over other competing fuels, such as heating oil and propane, in most uses. Some of the price advantage that natural gas enjoyed over other fuels was inherent in the efficiency of transporting gas in high pressure pipelines with low associated labor costs.

As the LDCs converted from manufactured gas to natural gas, they in effect exited the supply side of the business in favor of becoming customers of the interstate pipelines. The pipelines transported their own gas and gas produced by others, which the pipelines purchased at the well-head, and re-sold such gas to LDCs at the city-gate and to large industrial customers. This development, particularly in the heavily populated areas along the Eastern Seaboard, created a large and significant purchaser group that had a vital interest in keeping the city gate price for gas at levels where retail prices were competitive with other fuels. For LDCs that had historically sold natural gas obtained from local sources, such as in the Appalachian Mountain producing basins and adjacent areas, the growth in demand after World War II quickly outstripped the availability of local supplies. These LDCs were among the first to seek gas from the more plentiful producing areas in the Southwest.

The 25-year period following World War II is sometimes referred to as the "Golden Age of Growth" in the natural gas industry. As indicated, during this period, there was a rapid expansion of the interstate pipelines systems from the Southwest and other producing areas in the West to Midwest and Eastern markets. Also, it was during this period that the FPC extended

its jurisdiction and the comprehensiveness of its regulation in the gas industry, including asserting jurisdiction over gas production.(17) The FPC also developed comprehensive regulations for the certification of pipeline construction and operation pursuant to Section 7(c) of the NGA, as well as for rates and terms and conditions of services provided by interstate pipelines.

C. The 1970s - An Industry in Transition. In the 1970s, the natural gas industry was suddenly faced with the prospect of massive gas shortages, as gas demand in some markets significantly outstripped available production. During this period, the availability of natural gas to the interstate market was so significantly restricted that the principal issue presented to the FPC concerned the curtailment of deliveries by the interstate pipelines. In a sense, the "state of the art" became how to deal with the massive curtailments that threatened the very survival of the industry. The shortages, however, were not due to the unavailability of gas in the ground. Rather, at the artificially constrained well-head price established by the FPC, many producers were simply unwilling to produce gas for sale into the interstate market and to make the capital investment needed to develop new reserves. In response to the gas shortages of the 1970s, Congress, in 1978, enacted a group of statutes jointly referred to as the Natural Energy Acts. Among these acts was the Natural Gas Policy Act of 1978 ("NGPA").(18) The NGPA set in motion the process for gradual de-control of well-head price regulation by the FERC. That process was completed in 1989, when Congress passed the Natural Gas Wellhead Decontrol Act,(19) which eliminated all well-head price and non-price controls.

17/ See Phillips Petroleum Co. v. Wisconsin, 347 U.S. 672 (1954).

18/ 92 Stat. 3350 (1978); 15 USC Section 3301, et. seq.

19/ 103 Stat. 157 (1989).

Of particular importance to the current "state of the art," the NGPA also included provisions (Sections 311 and 312) authorizing certain sales and transportation in intra- and interstate commerce, which, as implemented through FERC regulations, has effectively merged the intra- and interstate transportation markets into a single "seamless" grid without unnecessary jurisdiction or restrictions.

This began an extremely rapid change in the "state of the art" which culminated in a revolutionary change in the previous paradigm: the "common source of supply" for LDCs was no longer purchasing gas from the pipeline at the city-gate at "just and reasonable" rates established by the FERC. LDCs and other purchasers could now contract directly with producers. The pipelines were becoming nothing more than transporters of gas owned by others.

D. The 1980s - the Move Towards Competition. The implementation of Sections 311 and 312 of the NGPA began a move to a more market-driven transportation sector for the natural gas industry. Building upon the market-responsive goals of Section 311, the FERC issued a series of orders, beginning with Order No. 436 in 1985(20) and culminating in Order No. 636 in 1992, that mandated "open access" transportation. This shift in regulatory policy sought to encourage competition within the natural gas industry. Under revised regulations, most recently promulgated in Order No. 636, many gas transactions that once required prior approval from the FERC now can begin as soon as the pipeline and shipper reach agreement. Transportation of natural gas in interstate commerce still requires FERC authorization, but that authorization usually takes the form of "blanket" certificate

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20/ FERC Stats. & Regs. Paragraph 30,665, "Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol," 50 Fed. Reg. 42,408 (October 18, 1985).

approvals under the terms and conditions established in Order No. 636.(21)

With the issuance of Order No. 636, the FERC completed the process of transforming the supply end of the natural gas industry into a fully competitive industry. The FERC's stated policy goal was to promote competition among all natural gas suppliers, including interstate pipelines to the extent that they still act in a gas sales (or merchant) capacity. The FERC's primary objectives were two-fold: to enhance competition in the natural gas industry and to maintain an adequate and reliable supply.

Under Order No. 636, pipelines were required to "unbundle," or separate, their merchant function from their transportation function. The order requires that this unbundling take place at an upstream point, near the production area. Pipelines are now obligated to provide all transportation service on a basis that is equal in quality for all gas supplies, whether purchased from the pipeline or from another gas supplier.(22) To assure comparability in the quality of service, pipelines are required to provide a variety of essential, or ancillary, transportation services, such as storage, on a non-discriminatory basis, and to

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21/ Under the FERC's regulations, there are two distinct types of self-implementing transportation service. The first is commonly referred to as "Section 311 Transportation." Under this authority, interstate pipelines are authorized to commence transportation service on behalf of any intrastate pipeline or any LDC without any specific prior approval. The second type of self-implementing transportation is referred to as a Section 7 "blanket" certificate service. " Blanket" certificates are issued under Section 7 of the NGA and are available to interstate pipelines and end-users. Regulations governing both sets of transportation are included in Part 284 of the FERC's regulations (18 CFR Part 284). The FERC's regulations define "transportation" to include both storage and exchanges of natural gas.

22/ Although Order No. 436, issued in 1985, provided for open-access, non-discriminatory, transportation service to enable LDCs and others to purchase gas directly from producers at the wellhead, the FERC subsequently concluded that firm transportation made available by the pipelines to LDCs and others was "inferior in quality to the firm transportation embedded within the pipelines' bundled, city-gate, firm sales service," in that there was no obligation on the pipelines' part to provide transportation-only customers with other essential services and facilities, such as storage, on a non-discriminatory basis. Order No. 636, 57 Fed. Reg. at 13,272. In Order No. 636, FERC mandated various changes in the terms and conditions that must be offered by an open-access pipeline in order to assure that all gas purchasers would receive comparable transportation service.

implement capacity release programs so that firm shippers can release their firm capacity on a short or long term basis.(23)

E. The Development of Market Centers, Hubs and Pooling Areas. Another important feature of Order No. 636 was FERC's pronouncement that it would not allow actions that would inhibit the natural development of market centers, hubs, and pooling areas.(24) In a study issued by the FERC's Office of Economic Policy in 1991,(25) which was cited in Order No. 636, the staff of the FERC had reported on the growing importance of market centers and recommended that there was a need to foster their development. The FERC staff believed that market centers were necessary to facilitate market-driven transactions between buyers and sellers while at the same time making unnecessary the construction of additional high-cost facilities. In the view of the FERC staff, the organization of market centers would (i) help

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23/ Traditionally, LDCs and other shippers were required to reserve, on a long-term basis, enough "firm" capacity on the supplying pipeline to meet their maximum requirements. Pipeline capacity utilization was inefficient because there was no mechanism in place to allow for the shifting of reserved "firm" capacity from one pipeline customer to another at times when it was in excess of current needs. The capacity release mechanism contemplated by Order No. 636 was intended to correct this situation. It allows an LDC or other shipper (the "primary shipper") to permanently or temporarily release and sell some or all of its reserved "firm" capacity, which the pipeline must then offer to others. Conversely, it provides a prospective purchaser (the "replacement shipper") with access to "firm" capacity that would otherwise not be available to it. Although the primary shipper remains liable on its contract with the pipeline, it is entitled to a credit to the extent released capacity is resold to a replacement shipper. See Order No. 636, 57 Fed. Reg. at 13,284 - 13,286. The capacity release program has had a significant impact on the contracting practices of LDCs and other purchasers since 1993. It is estimated that, based on full utilization of released capacity by replacement shippers, 36% of all gas delivered to consumers in the U.S. could have moved under released capacity. See Energy Information Administration, "Deliverability on the Interstate Natural Gas Pipeline System," DOE/EIA-0618(98) (Washington, D.C., May 1998), pp. 83 - 85.

24/ Market centers, hubs and pooling areas all serve a similar purpose, namely, to facilitate transactions between gas buyers and sellers through information exchanges, physical exchanges of gas, providing transportation related services (e.g., storage, parking), the aggregation of supplies by all merchants, etc. Market centers may or may not be associated with any physical facilities, but are situated so as to be easily accessed from many parts of the country. They can be used to arrange storage or transportation or other ancillary services. Hubs, in contrast, operate as the physical transfer points where several different pipelines are interconnected. At a hub, gas can be physically rerouted from one pipeline to another. Pooling areas, most often located in production areas, facilitate the aggregation of supplies from many producers. Title to gas frequently passes from the producers to the shippers (i.e., LDCs or other purchasers) in the pooling areas.

25/ "Importance of Market Centers," Office of Economic Policy, FERC (Washington, DC), August 21, 1991.

to eliminate the traditional receipt point inflexibility of the interstate pipelines by allowing shippers (i.e., buyers and sellers) to receive and deliver gas at any point on the pipeline where the receipt and delivery of gas is possible, (ii) provide better responses to supply disruption, (iii) eliminate difficulties in reselling long-term contracted gas, and (iv) foster the development of market intermediaries (brokers and traders), such as exist in other commodities markets, who would facilitate transactions among buyers and sellers in the market. Thus, the development, evolution and operation of market centers and hubs is at the very heart of the current, and radically different, "state of the art."

Of particular interest, the FERC staff identified several natural market centers and hubs which will be instrumental in the coordination of gas supply between SoCalGas and Frontier. These include (i) the Blanco, New Mexico, market center near the San Juan Basin; (ii) the Waha Hubs, near Midland, Texas, formed at the point where the Transwestern and El Paso pipelines interconnect with NGPL and numerous intrastate pipelines; (iii) the Katy Hub, in east Texas; and (iv) the Henry Hub, located in southern Louisiana.(26) At these market centers and hubs, gas can be bought, sold, exchanged for gas at another location, or stored. Services are provided by independent brokers at such points to arrange deals, and producers or owners of gas at these centers often have significant marketing staffs to maximize the value and liquidity of the commodity.

26/ The FERC staff noted that the Waha hub is located at a point that is within 70 miles of 2.74 Bcf per day of deliverable gas production and nearly 1 Bcf per day of peak storage deliverability. The staff noted that, at the Katy Hub alone, 23 pipelines (including Transco) are interconnected within a radius if 70 miles of over 12 Bcf per day of deliverable gas production, and that there is nearly 17 Bcf per day of working storage capacity at the hub. Finally, at the Henry Hub in South Louisiana, the staff noted that a total of 28 pipelines interconnect within 50 miles of more than 19 Bcf per day of deliverable gas production. See also "North American Gas Market Centers 1994," produced by Hart's Gas Transactions Report.

Pooling areas facilitate the transfer of title to gas at both production and market points. Transco, El Paso, and Transwestern all operate pooling areas on their systems. In addition to the operation of pooling areas by interstate pipelines, several marketing companies provide services by which interested buyers and sellers can exchange gas at such pooling points for a fee. At some market centers, hub services, such as parking, loaning, wheeling, and, in some instances, title transfer, are also available.(27)

Why are market centers, hubs and pooling areas so vital to the current "state of the art?" The importance of these creative market mechanisms is clear. A producer in one producing basin may, through such mechanisms, sell gas to a buyer several pipeline systems away without the payment of additional transportation costs, thus making gas produced in one basin more competitive with gas produced in a geographically closer locale. This represents a significant change from the days throughout most of the last 50 years when LDCs typically bought all of their gas at the city-gate from the interconnecting pipeline. As an example, low cost San Juan Basin gas, combined with its tax incentives and creative transactional mechanisms, can be priced cheaper to a market in North Carolina than gas produced in the Gulf Coast or the Alabama Black Warrior Basin, which are both physically closer to North Carolina. Such creative arrangements, however, are dependent upon the existence of significant physical interconnections and market centers between the production area and ultimate delivery point. While these conditions may not

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27/ "Parking" is essentially a short-term interruptible storage service. "Loaning" is a service by which a party with gas will provide the gas to another party with a specific date for the return of such gas at either that location or another location under mutually agreeable terms and conditions (in effect, the inverse of parking). "Wheeling" is the provision of transportation by a hub operator from one system to another system. Finally, title transfer services allow parties to exchange title to gas that is already within a pipeline system for gas that is at a different point on the same pipeline system or for gas that is on another pipeline system. No physical movement occurs.

currently exist throughout all of the contiguous 48 States, they do exist throughout the southern tier of States, both west and east, all of which depend for a large percentage of their total gas supplies upon production in the Southwest producing basins.

F. The Development of "High Deliverability" Storage.

Another important development in the gas industry is in storage technology and the development of a market for "un-bundled" storage services. The ability to store gas has always been critical to the economic and efficient operation of a gas system because of the seasonal nature of demand, particularly by residential customers. Most "seasonal" storage is in depleted oil and gas fields, such as exist in the Appalachian region. In the last five years, however, there has been significant new development of so-called "high deliverability," or salt-dome, storage caverns, which in some cases are owned and operated independent of the pipelines. The importance of "high deliverability" storage is not so much in the absolute volume of the working storage capacity that they represent, but rather in their operational characteristics, which allow for rapid injection and withdrawals of gas ("cycling"). This provides LDCs with considerably more flexibility in responding to changes in demand without the need to maintain high inventory levels and enables LDCs to take advantage of price volatility.(28)

G. New Pipeline Construction. The nation's interstate pipeline system, which experienced such dramatic growth in the decades immediately following World War II, continues to expand at a significant rate, in terms of both long-haul capacity and

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28/ See Energy Information Administration, Natural Gas 1996: Issues and Trends, DOE/EIA-0560(96) (Washington, D.C., December 1996), p. 15; Energy Information Administration, Natural Gas Annual - 1996, DOE/EIA-0131(96) (Washington, D.C., September 1997), p. 21.

interregional interconnections. Between 1990 and the end of 1997, capacity additions on the long-haul pipeline systems (viz. the pipelines running from the production areas to end markets) totaled 12.4 billion cubic feet (Bcf) per day, an increase of about 17%, while interregional capacity additions totaled 11.4 Bcf per day, or about 15%, in the same period. More than 40 projects were completed in 1997 alone.(29) Several new expansion projects have been announced to alleviate capacity constraints in those few areas of the country where they still exist. Moreover, as previously described, market centers and storage capacity are becoming increasingly integrated into the pipeline network. In summing up the current state of the nation's pipeline delivery system, taking into account completion by the end of the year 2000 of projects that will expand transportation capacity from the Rocky Mountain, New Mexico, and West Texas producing areas to Midwest and Northeast markets, the Department of Energy has observed that "*the interstate natural gas pipeline network will come closer to being a national grid where production from almost any part of the country can find a route to customers in almost any area.*" (Emphasis added).(30)

3.3 *The Standards for Approval under Section 10(c).*

A. *Section 10(c)(1).* Section 10(c)(1) provides that the Commission may not approve an acquisition that "is unlawful under the provisions of Section 8 or is detrimental to the carrying out of the provisions of Section 11." In this case, the transaction will not be unlawful under Section 8, as it will not lead to common ownership of gas and electric properties serving the same

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29/ See Energy Information Agency, "Deliverability on the Interstate Natural Gas Pipeline System," DOE/EIA-0618(98) (Washington, D.C., May 1998), pp. 32 -34.

30/ Id. at p. 34.

area in North Carolina. Nor will approval of the transaction be detrimental to the carrying out of the provisions of Section 11, which provides, in subsection (b)(1) thereof, that every registered holding company and its subsidiaries shall limit their operations "to a single integrated public-utility system . . . ." As indicated above, Pacific and Enova are both exempt holding companies and will continue to be entitled to their current exemptions even following the acquisition of Frontier's voting securities. In this regard, the Commission has held on several occasions that, because Section 11 by its terms applies only to registered holding companies, Section10(c)(1) does not preclude *registered* an acquisition by an *exempt* holding company of the securities of another public-utility company, even though the existing properties of the exempt holding company and those of the company to be acquired together would not constitute a *single* integrated system, provided that the acquisition is not unlawful under Section 8 and would have the integrating tendencies required by Section 10(c)(2). See Union Electric Company, 44 SEC 489, 501 (1974), aff'd without opinion sub nom., City of Cape Girardeau v. SEC, 521 F.2d 324 (D.C. Cir. 1975); WPL Holdings, Inc., 40 SEC Docket 491 at 497 (February 26, 1988), aff'd in part and rev'd in part sub nom., Wisconsin's Environmental Decade, Inc. v. SEC, 882 F.2d 523 (D.C. Cir. 1989), reaffirmed 49 SEC Docket 1255 (September 18, 1991); Gaz Metropolitan, Inc., et al., 58 SEC Docket 190 at 192 (November 23, 1994); TUC Holding Company, et al., 65 SEC Docket 301 at 305 (August 1, 1997); and BL Holding Corp., Holding Co. Act Rel. No. 26875 (May 15, 1998). Accordingly, as long as the acquisition of Frontier by Pacific and Enova would have the integrating tendencies required by Section 10(c)(2), discussed below, it is of no consequence that other existing properties of Pacific and Enova (e.g., San Diego's electric system) would not form a part of the same integrated system as Frontier's gas properties.

B. Section 10(c)(2).

Under Section 10(c)(2), the Commission must affirmatively find that the acquisition of the voting securities of Frontier by Pacific and Enova "will serve the public interest by tending towards the economical and the efficient development of an integrated public-utility system . . ., " which, as applied to a gas system, is defined in Section 2(a)(29)(B). The acquisition of Frontier by Pacific and Enova will satisfy the integration standards of Sections 10(c)(2) and 2(a)(29)(B) for all of the following reasons:

- () The indirect investment by Pacific and Enova in Frontier, and their ongoing involvement with Frontier's operations, will be instrumental to the development of a gas utility system in an area in which natural gas service is not now available.

- () Frontier and the operating utility subsidiaries of Pacific and Enova will share a "common source of supply" (the San Juan and Permian Basins) and will be operated as a "single coordinated system."

- () Frontier will achieve "substantial economies" in gas supply through the increased buying power that it will attain by being part of the larger Pacific and Enova systems; Frontier and its customers will also benefit by gaining access to Pacific's and Enova's expertise in such areas as procurement/materials management; finance and accounting; and gas system engineering and construction management.

- () Taking into account the current "state of the art": the area or region served by Pacific and Enova's subsidiaries in California and Frontier will not be "so large as to impair . . . the advantages of localized management, efficient operation, and the effectiveness of regulation." To the contrary, the day-to-day operations of Frontier will be under the direction of its General Manager. The management of Frontier will be independent of, but coordinated with (in order to promote efficient operation), Pacific and Enova, and will be subject to effective local regulation by the NCUC. This project enjoys the strong support of the NCUC.

- () Because of Frontier's size, Pacific and Enova will continue to qualify for exemption under Section 3(a)(1) as "intrastate" holding companies even after acquiring Frontier's voting securities. Under these circumstances, and because the acquisition of Frontier will have the integrating features required by Sections 10(c)(2) and 2(a)(29)(B), the Commission should approve the transaction.

1. <u>Given the Existence of a Common Source of Supply and Changes in the State of the Art in the Gas Industry, the Commission Should Find that the Pacific and Enova Systems and Frontier's System Together Will Constitute an Integrated Gas System.</u>

Although the retail gas service areas of Frontier in North Carolina and of SoCalGas and SDG&E in California are separated by a substantial distance and are located in non-contiguous States, such factors, by themselves, are not determinative. On the contrary, it is clear that Section 2(a)(29)(B), which defines an "integrated" gas-utility system, does not require that the States comprising the "single area or region" even adjoin each other. In MCN Corporation, 62 SEC Docket 2379 (September 17, 1996), for example, the Commission approved an acquisition of an interest in a gas-utility company in Missouri by an exempt gas-utility holding company whose service area is located more than 500 miles distant in Michigan, a non-adjoining State. Moreover, Section 2(a)(29)(B) specifically contemplates that "gas utility companies deriving natural gas from a common source of supply <u>may be deemed to be included in a single area or region</u>." (Emphasis added). Thus, the Commission was given broad discretion to interpret the "single area or region" standard in a flexible manner that should take into account the tremendous changes that have occurred since 1935 in the production and transportation of natural gas. Likewise, in considering whether an "area or region" is so large as to impair "the advantages of localized management, efficient operation, and the effectiveness of regulation . . .," the Commission is called upon to consider the "state of the art" in the industry.

Because of the dramatic changes in the "state of the art" in the gas industry that have taken place in recent years, the distance between two LDCs has become much less relevant, particularly when compared to the days when LDCs depended for

their supplies upon essentially local sources or upon the same interconnecting pipeline, in its merchant capacity. Thus, based on all of the facts and circumstances of this case, as more fully developed below, the Commission should conclude that the gas utility operations of SoCalGas and SDG&E in southern California and those of Frontier in western North Carolina together will be "confined to a single area or region in one or more States," and that such area or region will not be "so large as to impair the advantages of localized management, efficient operation and the effectiveness of regulation." It is important to underscore that such a conclusion is consistent with the literal terms of Section 2(a)(29)(B).

Moreover, in order to make the findings required by Sections 10(c)(2) and 2(a)(29)(B), as applied to the specific facts of this case, the Commission need not address or decide the broader question of whether an integrated gas market now exists throughout all of the 48 contiguous States or even whether all LDCs purchasing gas in the same supply basins could be part of one integrated gas system.

Common Source of Supply: Historically, in determining whether two gas companies share a "common source of supply," the Commission has attached greatest importance to whether the gas supply of the two companies is derived from the same gas producing areas (or basins), recognizing that the most significant economies and efficiencies that two entities can achieve is through the coordination and management of gas supply. The Commission has also considered whether the two entities receive gas deliveries from a common pipeline. However, the Commission has properly found an integrated gas system to exist where two entities take delivery from different pipelines which originate in the same gas producing area and/or interconnect at various points along the transportation route. See MCN

Corporation, supra, 62 SEC Docket at 2383-2384; American Natural Gas Company, et al., 43 S.E.C. 203 at 205-207 n. 5 (1966); Central Power Company, et al., 8 S.E.C. 425 at 431 (1941). These decisions, and especially MCN Corporation, reflect the fact that an LDC's gas supply is no longer purchased at the city-gate from the interconnecting pipeline. The key factor to be considered by the Commission, given the current "state of the art," is the "common source of supply."

As indicated, SoCalGas and SDG&E currently derive approximately 58% of their combined gas requirements from the Permian and San Juan Basins, and it is expected that Frontier will purchase at least 50% of its gas supplies from production in the same two supply basins. Further, although SoCalGas and SDG&E and Frontier will take delivery from different interstate pipelines (Transco in the case of Frontier and El Paso and Transwestern in the case of SoCalGas and SDG&E), those pipelines all transport gas that originates in the Permian and San Juan Basins. The "common source of supply" is therefore in the Permian and San Juan Basins. In one case, the method of transportation is Transco, and, in the other case, El Paso and Transwestern.

The El Paso and Transwestern pipelines transport gas out of the Permian and San Juan Basins for ultimate consumption in both California and eastern U.S. markets.(31) Transco's interstate pipeline does not itself extend into either such basin. However, it intersects at various points in Texas with intrastate

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31/ In recent years, although production in the San Juan area has increased significantly, the demand for both San Juan and Permian Basin gas at the California border has declined due, in part, to the increased availability in California of cheaper gas from western Canada and the Rocky Mountain region. However, the decline in demand for Permian and San Juan Basin gas in the California market, which has led to significant capacity "turn-backs" on the El Paso and Transwestern systems, has been largely offset by growing demand elsewhere, primarily in eastern U.S. markets. To meet this demand, El Paso and Transwestern have both sought and received certificate authority from the FERC under Section 7 of the NGA for expansions in the San Juan area that now provide much better access from the eastern ends of their respective systems to various market centers and hubs in Texas, from which gas can be shipped to eastern U.S. markets. See El Paso Natural Gas Company, 70 FERC Paragraph 61,295 (1995); Transwestern Pipeline Company, 75 FERC Paragraph 61,107 (1996).

pipelines (including the Oasis, Valero-TECO and Valero-Lone Star pipelines), which transport gas from those basins for consumption by Transco's ultimate customers. San Juan and Permian Basin gas also moves through the Henry Hub, on the Louisiana Gulf Coast, as well as the Katy Hub in Texas, where Transco and other pipelines transport it to Mid-Atlantic and East Coast markets. (See Exhibit E - Map of Gas Pipelines and Producing Areas). Accordingly, there is substantial evidence that SoCalGas, SDG&E and Frontier will share a "common source of supply," roughly equidistant from each of them.

It should be recognized that the concept of a "common source of supply" has a very different meaning today than it did in 1935. In 1935 and for most of the 50 years that followed, LDCs generally purchased natural gas at the city-gate directly from the interstate pipeline that served them at FERC (and earlier FPC) approved wholesale rates that reflected both the cost of the commodity and the related cost of transportation. Hence, two LDCs serving non-contiguous areas could in most instances demonstrate that they shared a "common source of supply" only if they purchased their gas from the same pipeline, in its capacity as both gas merchant and transporter. LDCs did not, and in most instances could not, purchase their gas in upstream markets and arrange separately with the pipeline for transportation. The "single area or region" served was therefore defined in terms of the pipeline delivery points (i.e., the city-gate), where the LDCs purchased their gas, rather than in terms of the upstream gas production areas or pipeline receipt points.

In contrast, today, most LDCs do not purchase their gas supply from the pipeline serving them. Instead, LDCs, and many industrial customers as well, purchase gas directly from producers (or independent marketers or other middlemen), and

contract separately for transportation on the pipeline that serves them, as well as on other upstream pipelines that transport gas out of the producing basins.(32) Although transportation costs and pipeline capacity constraints are economic factors which may limit an LDC's ability to contract for gas produced in any particular supply basin, the legal impediments no longer exist, and LDCs, no matter where they are located, are entitled to non-discriminatory transportation service. The transportation arrangements entered into by two different LDCs are unimportant for purposes of determining whether or not they share a "common source of supply," inasmuch as the pipelines that serve them are no longer the suppliers in any event. The relevant inquiry should instead be whether the two LDCs purchase substantial quantities of gas produced in the same supply basins, and whether that gas is "deliverable" (i.e., whether there is sufficient transportation capacity available in the marketplace to assure delivery on an economic and reliable basis).(33)

State of the Art in the Gas Industry: As previously described, the natural gas industry has undergone fundamental changes, with the pronounced trend in the past decade towards increased competition in gas supply and the development of a seamless natural gas delivery system throughout most of the United States.(34) This trend is the direct result of several

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32/ By 1995, the Department of Energy could report that interstate pipeline gas sales were "virtually non-existent," and that transportation (as opposed to sales) accounted for 74% of all deliveries to industrial customers by local companies (LDCs and intrastate pipelines). See Energy Information Administration, Natural Gas 1996: Issues and Trends, DOE/EIA-0560(96) (Washington, D.C., December 1996), p. 17.

33/ "Deliverability" may be defined in terms of the physical capacity of the U.S. natural gas pipeline network, as well as of the contractual structure governing the transportation of gas on that system, which is largely the product of Order No. 636. See Energy Information Administration, "Deliverability on the Interstate Natural Gas Pipeline System," DOE/EIA-0618(98) (Washington, D.C., May 1998), p. 79.

34/ As previously indicated, although there is substantial evidence that a fully integrated natural gas market now exists throughout most of the United States, that is not a question that this Commission would need to address in order to make the findings required by Sections 10(c)(2) and 2(a)(29)(B), as applied to the specific facts of this case.

developments, including, most importantly, de-control of gas prices at the well-head; the "un-bundling" of the commodity and transportation functions of interstate pipelines; the construction of significant new pipeline capacity, which has eliminated transportation bottlenecks in most parts of the country; the emergence of gas brokers and marketers and development of an efficient gas futures market, which now enable LDCs and other large gas purchasers to manage price volatility and secure gas supplies without regard to its physical source; and increased inter-basin competition for sales to the market, due in part to the effects of imports into the U.S. of low-cost Canadian gas.(35) It is important to stress that the paradigm for the gas industry today is fundamentally and irreversibly different than earlier this century.

The Commission has already taken notice of these and other regulatory and technological changes that have reshaped the natural gas industry. See "The Regulation of Public-Utility Holding Companies," Report of the Division of Investment Management (June 1995), pp. 29 - 31. In light of such changes, the Division of Investment Management has recommended that the Commission continue to interpret the "single area or region" requirement of Section 2(a)(29) flexibly to take into account technological advances, and that the focus of the SEC's inquiry under Section 10(c)(2) should be on whether a proposed acquisition would promote the economic and efficient development of a utility system and on whether the resulting system would be subject to effective regulation. Id. at 72 -74.

As discussed above, the traditional source of supply for both California and the Mid-Atlantic states is in the producing

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35/ Canadian production, as a percentage of total U.S. consumption, increased in each of the ten years prior to 1996. In 1995, net imports of gas (mostly from Canada) accounted for 13% of all U.S. consumption. The western region of the U.S. received by far the largest share (41%) of all Canadian imports. See Energy Information Administration, Natural Gas Monthly, DOE/EIA-0130(96/10) (Washington, D.C., November 1996).

basins in the Southwest. The primary producing basins in the Southwest that can be accessed by both the Mid-Atlantic region and California include the Permian and San Juan Basins. Today, because LDCs in most States (including California and North Carolina) can purchase gas in these Southwest producing basins (or purchase gas pegged to production in those areas) from a producer or marketer at the city-gate off of the interstate pipeline system, there is significant competition for markets between producers in the San Juan and Permian Basins and producers in other U.S. and Canadian basins. For the California market, for example, gas produced in western Canada and the Overthrust producing areas in the Rocky Mountain region now provides stiff competition for the Southwest basin supplies. This basin-to-basin competition and the development of additional interstate pipeline capacity through the construction of the Kern River pipeline and the expansion of Pacific Gas Transmission Company and Northwest Pipeline Corporation from Canada have, in fact, caused 2 Bcf/day of excess pipeline capacity to the California market.

The competition for the California market by other producing basins and pipelines was directly responsible for significant "turn-backs" on the El Paso and Transwestern systems in the mid-1990s.(36) It was in response to this competition and the need

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36/ Under Order No. 636, the "restructuring rule," the "firm" sales contracts between a pipeline and its customers were converted into the rights to receive "firm" transportation. As these "firm" transportation contracts expire, however, some LDCs will elect to reduce or release that "firm" capacity that they previously reserved. Such capacity "turn-backs" have led to the situation in some parts of the country where available "firm" pipeline capacity exceeds customer commitments. Unless a pipeline can remarket "turned-back" capacity, it faces a potential loss of revenues. Following the adoption of Order No. 636, two of the largest capacity "turn-backs" were on the El Paso and Transwestern systems. As indicated, those companies responded to this situation by altering the utilization of existing pipeline capacity to move gas out of the Southwest producing areas to eastern markets, where such gas would be competitive with other available supplies. For a more detailed of discussion of the impact of pipeline capacity releases and the industry's response, see Energy Information Administration, Natural Gas 1996: Issues and Trends, DOE/EIA-0560(96) (Washington, D.C., December 1996), ch. 2.

to find new customers for the "turned-back" capacity that El Paso and Transwestern have both expanded their systems out of the San Juan Basin in order to move gas to eastern markets, such that, today, there are periods when the net flow of gas out of the San Juan Basin is to the east rather than to the west. These actions were also driven by certain operational characteristics of San Juan Basin production which require producers to maintain high production levels without regard to demand in the California market.(37) Further, El Paso and Transwestern have incentives to discount transportation for gas transported to new markets in the east, thus limiting delivery costs. As a result, San Juan Basin gas can be priced at a rate below its competitors in most other basins even with additional delivery costs.

The Attorney General of the State of California addressed the integrated pipeline market from an economic perspective in its Opinion on Competitive Effects of Proposed Merger between Pacific Enterprises and Enova Corporation, submitted to the California Public Utilities Commission ("CPUC") on November 20, 1997.(38) The Attorney General used a correlation and co-integration analysis to determine that FERC actions have created a network of transmission suppliers connecting purchasers at the wholesale level with middlemen and well operators at the production level. The Attorney General concluded that, from an economic perspective, markets are integrated where the price of supplies remain closely linked (taking into account transportation and other transaction costs) and that there is "direct" evidence that prices at delivery points within the four basin area (including the Permian and San Juan Basins) remain

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37/ San Juan Basin gas is produced from coal seam formations. The technology used to produce gas from coal seam formations requires maintaining a steady state of production. The significant tax benefits granted to coal seam gas is a further incentive for maintaining high production levels.

38/ The Attorney General's Opinion has been filed as Exhibit D-9 in File No. 70-9033.

co-integrated within arbitrage bounds on a nearly national grid basis.

Due to the restructured natural gas transportation market, gas can be moved from the San Juan and Permian Basins to both California and North Carolina physically as well as contractually in a variety of ways. As discussed above, both Transwestern and El Paso access the Permian and San Juan Basins and have traditionally moved their gas west to California. SoCalGas is the largest holder of capacity on both of those systems and purchases a significant portion of its supply portfolio from those two basins. However, as indicated, natural gas from the San Juan and Permian Basins also moves east and north to serve Midwest and Mid-Atlantic markets.

Both El Paso and Transwestern interconnect at numerous points in West Texas with major intrastate Texas pipelines including the Valero, Oasis, and other pipelines. Through these intrastate pipelines, gas is physically transported to the eastern half of the State of Texas where the intrastate pipelines connect with, among others, Transco. Thus, gas can and does physically flow from the Southwest producing basins which provide the principal supply of gas to SoCalGas and to the developing North Carolina market represented by Frontier.(39)

While physical delivery is possible from the common supply basins to both SoCalGas and Frontier, more flexible and efficient transactions are available utilizing marketing tools created by the FERC in Order No. 636. As previously indicated, one of the more important outgrowths of FERC Order No. 636 has been the development of market centers, hubs and pooling points, which

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39/ Further, El Paso and Transwestern interconnect with NGPL, the first major interstate pipeline company constructed in the United States, in west Texas through NGPL's major western trunkline. NGPL also accesses Gulf Coast reserves through its eastern trunkline which is connected by a major crossover through Oklahoma and north Texas to its western trunkline. On its eastern trunkline, NGPL interconnects at two points with Transco.

allows LDCs operating in a much larger area or region of the country to realize the operating economies and efficiencies from coordinated gas supply that were once thought to be achievable only by contiguous or nearly contiguous gas companies supplied by the same interstate pipelines. In fact, the opportunities to achieve operating economies may be even greater where the two companies seeking to combine have significantly different load profiles (e.g., non-coincident seasonal peaks, substantially different customer mix, different projected growth patterns, etc.).

2. Frontier will Realize Significant Economies and Efficiencies from its Affiliation with the Much Larger Pacific and Enova Systems.

Section 10(c)(2) requires that the Commission find that a proposed acquisition will produce economies and efficiencies. Although some of the anticipated economies and efficiencies will be fully realized in the longer term, they are properly considered in determining whether the standards of Section 10(c)(2) are met. See American Electric Power Co., 46 SEC 1299, 1320-21 (1978). Further, although some potential benefits cannot be precisely estimated, they too are entitled to consideration. As the Commission has stated, "[s]pecific dollar forecasts of future savings are not necessarily required; a demonstrated potential for economies will suffice even when these are not precisely quantifiable." Centerior Energy Corp., 35 SEC Docket 769 at 775 (April 29, 1986). Finally, there is no requirement in Section 10(c)(2) that the specific dollar estimates of future savings be large in relation to the gross revenues of the companies involved. See American Natural Gas Company, supra, 43 S.E.C. at 206-207.

In this case, there can be little doubt that significant benefits will be realized by Frontier as a result of becoming a part of the much larger Pacific and Enova systems, particularly

in the areas of gas supply, increased purchasing power, and the ability to utilize the expertise and resources available from Pacific and Enova. Exhibit I hereto outlines specific areas in which the affiliation of Frontier with Pacific and Enova is likely to produce substantial economies and efficiencies over time, and dollar estimates of such savings. Pacific and Enova have estimated that Frontier will realize total start-up cost savings of $1.8 million due to its integration into the Pacific and Enova systems and ongoing annual operating cost savings of at least $300,000 per year. On a yearly basis, Pacific and Enova estimate that Frontier will save approximately 19% on its operating costs due to the affiliation. The total estimated savings are quite significant relative to the size of the transaction. Projected annual operating savings appear to be greater than those in the SEC's MCN Corporation decision, which involved an investment in a gas system of roughly comparable size to the Frontier system.

It should be emphasized that the savings that will be realized by Frontier will not be at the expense of California utility customers of SoCalGas and SDG&E. In this connection, the CPUC recently adopted affiliate transaction rules that permit corporate support services provided both to a California utility and to its affiliates, including affiliates outside California. See Opinion Adopting Standards of Conduct Governing Relationships Between Utilities and Their Affiliates, CPUC Decision No. 97-12-088, 1997 Cal. PUC LEXIS 1139 (December 16, 1997). For example, the CPUC rule permits such shared services as: payroll, taxes, shareholder services, insurance, financial reporting, financial planning and analysis, corporate accounting, corporate security, human resources (compensation, benefits, employment policies), employee records, regulatory affairs, lobbying, legal, and pension management. Decision No. 97-12-088, App. A, mimeo, p. 11. All of the services described on Exhibit I are permitted

under the CPUC's rules. To ensure that the use of shared services does not result in cross-subsidization, the CPUC specifically required that "[a]ny shared support shall be priced, reported and conducted in accordance with the Separation and Information Standards set forth herein, as well as other applicable Commission Pricing and Reporting requirements." Id. In the same decision, the CPUC adopted extensive accounting rules to prevent cross-subsidization. Id. at 14.

3. The System Formed by the Affiliation of Pacific and Enova and Frontier will not be So Large as to Impair the Advantages of Localized Management, Efficient Operation, and the Effectiveness of Regulation.

The resulting integrated gas system to be formed by adding Frontier's gas system to the substantially larger SoCalGas and SDG&E systems will not be "so large as to impair (considering the state of the art and the area or region affected) the advantages of localized management, efficient operation, and the effectiveness of regulation." As in MCN Corporation, this case involves the development and financing of a small, start-up, gas distribution system designed to serve a predominantly rural population. As described in greater detail in Item 1.3, the day-to-day operations of Frontier will be under the direct supervision of its General Manager. Its operations, however, will be coordinated with those of SoCalGas and SDG&E in order to provide operating efficiencies and savings. Local regulation is and will continue to be effective. In fact, every aspect of Frontier's development and financing has been or will be specifically considered by the NCUC, beginning with the NCUC's selection of Frontier's proposal for the new gas system over a competing proposal submitted by an existing North Carolina gas company. While Pacific and Enova will bring to the table much needed skills and expertise in the areas of construction and gas supply management, pipeline technology and maintenance,

procurement, operating expertise, and marketing, among others, Frontier will maintain its separate corporate identity and local presence and have its own management and work force.

4. The Acquisition of Frontier's Voting Securities Will Have No Effect on Pacific's and Enova's Current Exemptions under Section 3(a)(1).

Frontier will be a small utility compared to Pacific and Enova. (see fn. 11, above). The acquisition and ownership of its voting securities by Pacific and Enova will therefore have no impact on the continuing entitlement of Pacific and Enova to their exemptions under Section 3(a)(1) of the Act. Given that there is substantial evidence that the acquisition will have integrating features (e.g., common source of supply, local management, realization of substantial economies and efficiencies through coordinated operation, strong local support and effective local regulation) and that exempt holding companies, like Pacific and Enova, are not subject to the strict integration standards of Section 11(b)(1), the Commission should have little reason to interpret the integration standards of Section 10(c)(2) and Section 2(a)(29)(B), as applied to this transaction, in a narrow or restrictive manner. In other recent cases involving acquisitions by exempt holding companies, such as Gaz Metropolitan, Inc., et al., TUC Holding, et al., and MCN Corporation, the Commission has exhibited a willingness to interpret the integration standards of Section 10(c)(2) flexibly, focusing instead on the demonstrated benefits of the transaction from the perspectives of both investors and consumers. It should do the same here.

3.4 Section 10(b).

Section 10(b) provides that, if the requirements of Section 10(f) are met, then the Commission shall approve a proposed acquisition unless it finds that the transaction would have any one of several enumerated adverse effects. In this case, there

is no basis for the Commission to make any adverse findings under Section 10(b).

A. Section 10(b)(1). Section 10(b)(1) was intended to avoid "an excess of concentration and bigness" in the utility industry at the expense of competition while preserving the "opportunities for economies of scale, the elimination of duplicative facilities and activities, the sharing of production capacity and reserves and generally more efficient operations" afforded by certain acquisitions. See American Electric Power Co., Inc., 46 S.E.C. 1299, 1309 (1978). The transaction proposed herein will not add meaningfully to the size of Pacific and Enova, both of which are much larger companies than Frontier and will derive only a de minimis part of their income from Frontier's operations. The approximately 15,000 residential, industrial and commercial customers that Frontier projects having at the end of its fifth year of operation represents about one-quarter of 1% of the approximately 6 million retail and industrial gas customers (including transportation-only customers) that SoCalGas and SDG&E now serve in California. On the other hand, the transaction will benefit Frontier's customers and create a modestly larger and more diverse asset and customer base, which will create opportunities for operating efficiencies.

Further, although the transaction proposed herein will result in creating a link between Pacific and Enova, on the one hand, and Frontier, on the other, it will not lead to the type of concentration of control over utilities, unrelated to operating efficiencies, that Section 10(b)(1) was intended to prevent.(40) In fact, far from limiting or restricting competition, the

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40/ See Section 1(b)(4) of the Act (finding that the public interest and interests of consumers and investors are adversely affected "when the growth and extension of holding companies bears no relation to economy of management and operation or the integration and coordination of related operating properties . . . ").

transaction proposed herein is the outgrowth of proceedings in North Carolina in which the NCUC carefully evaluated competing proposals to construct and operate a gas system in the Four-County Area. Finally, although the management interlocks that will be created are necessary and desirable in order to integrate Frontier fully into Pacific's and Enova's systems, Frontier will have its own local management team and work force.

B. Section 10(b)(2). The Commission may not approve the proposed transaction if it determines pursuant to Section 10(b)(2) that the consideration (including fees and expenses of the transaction) to be paid, indirectly, by Pacific and Enova in connection with the transaction is not reasonable or does not bear a fair relation to investment in and earning capacity of the utility assets underlying the securities being acquired. In this case, the equity investments by Frontier Pacific and Frontier Utilities in Frontier, a newly-formed entity with no preexisting business, have been expressly approved by the NCUC, which has also conducted extensive hearings on the overall economic feasibility of Frontier at the rates and rate design proposed by Frontier. The amounts to be invested were the result of direct, arms'-length, negotiations between private investors, and no fees to outside investment bankers will be paid.

C. Section 10(b)(3). Section 10(b)(3) requires the Commission to determine whether the transaction will unduly complicate the capital structure of Pacific and Enova or will be detrimental to the public interest, the interest of investors or consumers or the proper functioning of the Pacific and Enova holding company systems. The intent of these requirements is to assure the financial soundness of the holding company system, which particular regard to the proper balance of debt and equity.

The transaction proposed herein will have a virtually undetectable impact on the capitalization and earnings of Pacific

and Enova, and will not introduce any complexity into the capital structure of either holding company system. With regard to the latter, the debt and other obligations incurred or to be incurred by Frontier will not be recourse, directly or indirectly, to either SoCalGas or SDG&E.

Moreover, as set forth more fully in the discussion of the standards of Section 10(c)(2), supra, and elsewhere in this Application or Declaration, the transaction will create opportunities for Frontier to achieve substantial savings, chiefly in the areas of coordinated gas supply and economies associated with greater buying power and the availability of managerial and technical expertise that will be needed by Frontier. The transaction will therefore be in the public interest and the interest of investors and consumers, and will not be detrimental to the proper functioning of the resulting holding company system.

3.5 Section 10(f).

Frontier has obtained the required NCUC approvals for the equity investment by Pacific and Enova, through Frontier Pacific, in Frontier. The requirements of Section 10(f) have therefore been satisfied.

ITEM 4. REGULATORY APPROVALS.

The construction and financing of Frontier's gas distribution system is subject to the jurisdiction of the NCUC, which has issued various approvals referred to in Item 1. No other State or Federal commission has jurisdiction over any aspect of the transaction.

ITEM 5. PROCEDURE.

The Commission is requested to publish a notice under Rule 23 with respect to the filing of this Application or Declaration as soon as practicable. Pacific and Enova request that the Commission's Order be issued as soon as practicable, and that there should not be a 30-day waiting period between issuance of the Commission's order and the date on which the order is to become effective. Pacific and Enova hereby waive a recommended decision by a hearing officer or any other responsible officer of the Commission and consent that the Division of Investment Management may assist in the preparation of the Commission's decision and/or order, unless the Division opposes the Transaction.

ITEM 6. EXHIBITS AND FINANCIAL STATEMENTS.

A - EXHIBITS.

A-1 Articles of Organization of Frontier Energy LLC.

A-2 Operating Agreement of Frontier Energy LLC.

D-1 Application of Frontier Utilities of North Carolina and Frontier Energy LLC for Approval of Final Financing Plan, to Transfer Certificates, and for Approval of Waiver of Security Bond (NCUC Docket Nos. G-38, Sub. 3 and G-40).

D-2 Order of the NCUC in Docket Nos. 38, Sub. 3, and G-40, dated March 9, 1998.

E Map of natural gas service areas of SoCalGas, SDG&E and Frontier, common supply basins, major interstate pipelines and market centers and hubs. (To be filed by amendment - paper format filing).

F-1 Preliminary opinion of Reid & Priest LLP, special counsel to Pacific and Enova. (To be filed by amendment).

F-2 Past-tense opinion of Reid & Priest LLP, special counsel to Pacific and Enova. (To be filed by amendment).

H Proposed form of Federal Register notice.

I Description of Economies and Efficiencies and Estimated Dollar Savings.

B. FINANCIAL STATEMENTS.

FS-1: Pacific Enterprises Consolidated Balance Sheet as of March 31, 1998 (incorporated by reference to the Quarterly Report on Form 10-Q of Pacific Enterprises for the fiscal quarter ended March 31, 1998, in File No. 1-0040).

FS-2: Enova Corporation Consolidated Balance Sheet as of March 31, 1998 (incorporated by reference to the Quarterly Report on Form 10-Q of Enova Corporation for the fiscal quarter ended March 31, 1998, in File No. 1-11439).

FS-3: Pacific Enterprises Consolidated Statement of Income for the quarter ended March 31, 1998 (incorporated by reference to the Quarterly Report on Form 10-Q of Pacific Enterprises for the fiscal quarter ended March 31, 1998, in File No. 1-0040).

FS-4: Enova Corporation Consolidated Statement of Income for the quarter ended March 31, 1998 (incorporated by reference to the Quarterly Report on Form 10-Q of Enova Corporation for the fiscal quarter ended March 31, 1998, in File No. 1-11439).

ITEM 7. INFORMATION AS TO ENVIRONMENTAL EFFECTS.

The transaction does not involve a "major federal action" nor will it "significantly affect the quality of the human environment" as those terms are used in section 102(2)(C) of the National Environmental Policy Act. The transaction that is the subject of this Application or Declaration will not result in changes in the operation of the Applicants or their respective subsidiaries that will have an impact on the environment. The Applicants are not aware of any federal agency that has prepared or is preparing an environmental impact statement with respect to the transaction.

SIGNATURE

Pursuant to the requirements of the Public Utility Holding Company Act of 1935, as amended, the undersigned companies have duly caused this Application or Declaration filed herein to be signed on their behalf by the undersigned thereunto duly authorized.

PACIFIC ENTERPRISES

By: /s/ Warren I. Mitchell
Name: Warren I. Mitchell
Title: Executive Vice President

ENOVA CORPORATION

By: /s/ Donald E. Felsinger
Name: Donald E. Felsinger
Title: President and Chief Operating Officer

Date: June 15, 1998

EXHIBIT INDEX

	Exhibit	Description
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	F-2	Past-tense opinion of Reid & Priest LLP, special counsel to Pacific and Enova. (To be filed by amendment).
	H	Proposed form of Federal Register notice.
	I	Description of Economies and Efficiencies and Estimated Dollar Savings.

C-0445838

FILED
1:56 PM
EFFECTIVE DEC 29, 1997

ELAINE F. MARSHALL
SECRETARY OF STATE
NORTH CAROLINA

ARTICLES OF ORGANIZATION

97 363 9082

OF

FRONTIER ENERGY, LLC

Pursuant to Section 57C-2-20 of the General Statutes of North Carolina, the undersigned do hereby submit these Articles of Organization for the purpose of forming a limited liability company.

1. The name of the limited liability company is Frontier Energy, LLC.

2. The latest date on which the limited liability company is to dissolve is December 31, 2047.

3. The name and address of each organizer executing these Articles of Organization is as follows:

   Frontier Pacific, Inc.
   633 West Fifth Street, Suite 5200
   Los Angeles, California 90071

   Frontier Utilities of North Carolina, Inc.
   1919 North Bridge Street
   Elkin, North Carolina 28621

4. The street address, which is also the mailing address, and county of the initial registered office of the limited liability company is 225 Hillsborough Street, Raleigh, Wake County, North Carolina 27603.

5. The name of the initial registered agent is C T Corporation System.

6. All of the members by virtue of their status as members shall be managers of this limited liability company.

7. These Articles will be effective upon filing.

This the 29th day of December, 1997.

FRONTIER PACIFIC, INC., Organizer

By: /s/ Donald C. Liddell

Name: Donald C. Liddell

Title: Secretary

FRONTIER UTILITIES OF NORTH CAROLINA, INC., Organizer

By: /s/ Robert J. Oxford

Name: Robert J. Oxford

Title: President

FRONTIER ENERGY LLC
OPERATING AGREEMENT

THIS FRONTIER ENERGY LLC OPERATING AGREEMENT (this "Agreement") is made and entered into as of December 15, 1997 (the "Effective Date"), by and among Frontier Utilities of North Carolina, a North Carolina corporation ("FUNC"), and Frontier Pacific, Inc., a Delaware corporation ("Pacific"). Capitalized terms used herein and not otherwise defined shall be used with the meanings given them in Exhibit A to this Operating Agreement.

WHEREAS, the Frontier Energy LLC (the "Company") was formed for the purpose of designing, engineering, financing, constructing, testing, managing, marketing, owning and operating a local gas distribution company in the certificated area in North Carolina (the "Project" or the "System");

WHEREAS, FUNC is a wholly-owned subsidiary of Frontier Utilities, Inc., a Colorado corporation ("Frontier Colorado"), a majority owned subsidiary of ARB, Inc., a California corporation ("ARB"). As a condition to its execution of this Operating Agreement, Energy Pacific required Frontier Colorado to execute and deliver to it a Funding Agreement, and to be bound under certain other obligations under this Operating Agreement;

WHEREAS, Pacific is a wholly-owned subsidiary of Energy Pacific LLC, a California limited liability company ("Energy Pacific"), which is owned 50-50 by subsidiaries of each of Pacific Enterprises and Enova Corporation. As a condition to its execution of this Operating Agreement, Frontier Colorado required Energy Pacific to execute and deliver to it an Agreement to Fund Certain Obligations, and to be bound under certain other obligations under this Operating Agreement;

NOW, THEREFORE, for good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the Members agree as follows:

SECTION 1 - DEFINITIONS

For the purposes of this Agreement, the definitions shall be as set forth in Exhibit A attached hereto and incorporated herein by reference.

SECTION 2 - FORMATION OF COMPANY

2.1. Formation. Pacific and FUNC constitute themselves as Members under the North Carolina Limited Liability Company Act for the purpose of designing, engineering, financing, constructing, testing, managing, marketing and operating the System.

2.2. Name. The Company shall operate under the name "Frontier Energy LLC", or such other name as the Board of Directors may select. Either Member shall execute any assumed or fictitious name certificate or certificates required by law to be filed in connection with the formation of the Company and shall cause such certificate or certificates to be filed in the appropriate offices as required by law.

2.3. Place of Business. The principal place of business for the Company is Elkin, North Carolina or such other place or places as shall be unanimously agreed upon by the Members.

2.4. Company Property. All Company Property shall be deemed owned by the Company as an entity, and no Member, individually, shall have any ownership of such property. The Members hereby expressly covenant and agree to waive any and all rights to partition the Company Property or cause a dissolution of the Company except to the extent provided in Section 5.10(c), below. A Member who breaches this covenant shall be liable to the non-breaching Member for damages, including, without limitation, reasonable costs and attorneys' fees. A Member's interest in the Company shall be considered personal property for all purposes.

2.5. No Other Agreement Or Restriction. Except as expressly provided herein, this Agreement does not limit the power or rights of any Member hereto to carry on its business for its own sole benefit.

SECTION 3 - MEMBERSHIP AND ECONOMIC INTERESTS; CAPITAL

CONTRIBUTIONS;
ADDITIONAL CAPITAL CONTRIBUTIONS

3.1. Membership and Economic Interests. (a) Each Member's "Economic Interest" shall be that Member's ownership share in the Company's Profits and Losses, and the Member's interest in and right to receive distributions of the Company's assets pursuant to this Agreement and the Act, but shall not include any right of the Member to participate in the management or affairs of the Company. Each Member's "Membership Interest" shall mean that Member's Economic Interest and any and all right of that Member to participate in the management or affairs of the Company, including without limitation all of the Member's voting rights. Each Member's Economic Interest and Membership Interest shall be as set forth on Schedule 3.1, as it may be amended from time to time to reflect changes in such interests.

(b) The Members agree to amend Schedule 3.1 whenever necessary. Membership Interests and Economic Interests may be changed only by amendment of Schedule 3.1. Until agreed otherwise by all of the Members, each Member's Economic Interest shall be a percentage determined by dividing such Member's aggregate Capital Contributions by the aggregate Capital Contributions contributed by all Members. Notwithstanding the foregoing, with respect to capital contributions made following the funding of the first $12,000,000 of capital contributions by the Members, such additional capital contributions shall, to the extent they are made in any manner disproportionate with the Members' Economic Interests immediately prior to such contribution, impact the percentage Economic Interests of the Members in the manner set forth in Section 3.4(b).

3.2. Initial Capital Contributions; Conditions Precedent to Capital Contributions. As of the date hereof, Pacific and FUNC have made the Capital Contributions shown on Schedule 3.1. Pacific's Capital Contribution shall be made in cash. FUNC's Capital Contribution shall be made by contribution of the Certificates of Public Convenience and Necessity (the "Certificates") issued to FUNC with respect to the construction and operation of a System for local natural gas distribution in the certificated area in North Carolina counties by the North Carolina Utilities Commission (the "NCUC"). The Members have reviewed the Certificates, the conditions to which they are subject, the efforts undertaken and financial resources expended to obtain the Certificates and the market conditions for the System and have determined that the Certificates have a fair value to the Company in monetary terms equal to the initial Capital Contribution as shown on Schedule 3.1.

3.3. Further Budgeted Capital Contributions. (a) In addition to the initial Capital Contributions referenced in Section 3.2, the Members agree that they shall make, in the aggregate, additional Capital Contributions ("Further Contributions") in the aggregate amount set forth with respect thereto on Schedule 3.1. Of such Further Contributions, FUNC shall contribute not less than $2,000,000 to the Company and FUNC may at its election make additional capital contributions in an amount that, when aggregated with Further Contributions required to be made in accordance with the foregoing, equal one-half of all Further Contributions. Pacific shall contribute, in the aggregate, one-half of all Further Contributions plus the amount, if any, of the Further Contributions that FUNC is entitled to contribute but fails to contribute.

(b) Further Contributions shall be made from time to time at such times as determined by the Board of Directors for purposes of funding the construction and development of the System as found necessary and approved by the Board of Directors.

(c) The parties Capital Contributions and Further Contributions have been determined with reference to the construction and development budget for the Project, the general outline of which is set forth as Appendix 3.3, which construction budget shall be finalized by the Board of Directors within 30 days following the Effective Date ("Construction Budget"). On approval by the Board of Directors, the Construction Budget as approved shall be and supersede Appendix 3.3 and shall provide the general timing for making Further Contributions.

3.4. Capital Calls. (a) If the Board of Directors shall determine that

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(i) additional equity capital is needed immediately for the activities of the Company, beyond that which had been contemplated for Further Contributions, (ii) the Company would incur material liabilities or otherwise suffer serious harm if the capital were not made available, (iii) the capital is not reasonably available from any other source, and (iv) all Further Contributions have been made in accordance with the terms herein, then the Board of Directors shall give each Member a written notice (the "Call Notice") setting forth (1) the aggregate amount of Additional Capital needed (the "Additional Capital"), (2) each Member's proportionate share of such Additional Capital and (3) the due date (the "Due Date") of such contribution, such Due Date to be not less than 15 days after the deemed delivery date of such Call Notice; provided however, that the amount of any such capital call made pursuant to this Section shall not exceed the amounts set forth in the Construction Budget approved by the Board of Directors. Not later than the Due Date, each Member shall contribute cash in an amount equal to the product of Additional Capital called times such Member's Economic Interest.

(b) If either Member fails to make any contribution of Additional Capital within 10 days after the Due Date, the other Member shall be given the opportunity to make the needed Capital Contribution and upon any such Capital Contribution the Economic Interests of the Members shall be adjusted to the percentages determined with respect to each Member by calculating (i) such Member's Economic Interest expressed as a percentage multiplied by the Market Value of the Company determined immediately prior to and without giving effect to the additional contribution, plus (ii) the amount of the additional contributions actually made that are represented by such Member's contribution, and dividing such sum by (iii) the aggregate of the Market Value (as determined in (i) above), plus the amount of contributions actually made.

3.5. Withdrawal Election. Notwithstanding the foregoing, each Member,
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respectively, may, upon written notice to the other, elect to be excused from making any Further Contributions or contributions of Additional Capital as otherwise provided herein or, at its election, may immediately terminate this Agreement upon the occurrence of any of the events set forth below (each, a "Withdrawal Event"). Such election may be exercised only by written notice given by the electing Member to the other Member and to the Company within 15 days of the occurrence of the Withdrawal Event. The following shall constitute Withdrawal Events:

i. with respect only to Pacific, assertion by the SEC that Pacific's ownership interest in the System could affect the exemption from PUHCA of Pacific Enterprises (or its successor in interest as a result of a merger which is pending as of the date hereof) or result in initiation of an enforcement action by the SEC; and

ii. with respect only to FUNC, assertion by the SEC that FUNC's ownership interest in the System could affect the exemption of FUNC or any of its affiliate corporations from PUHCA or result in initiation of an enforcement action by the SEC.

Upon exercise by a Member of such withdrawal election, such Member's interests shall be subject to the provisions of Sections 10.1 and 13.4 below.

SECTION 4 - ALLOCATIONS AND DISTRIBUTIONS

4.1 Profits. Profits for any fiscal year shall be allocated to
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the Members in proportion to their Economic Interests.

4.2 Losses. Losses for any fiscal year shall be allocated to the
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Members in proportion to their Economic Interests.

4.3 Special Allocations. The special allocations under Regulations
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Section 1.704-2(f) under the Code shall be made in the order set forth in Exhibit B attached hereto and specifically incorporated by reference as if
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separately set forth herein.

4.4 Tax Allocations: Code Section 704(c). If there is any variance
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between the adjusted basis (for federal income tax purposes) of any property contributed to the Capital of the Company and its initial Gross Asset Value, then income, gain, loss, and deductions with respect to such property shall, solely for tax purposes, be allocated among the Members in the manner which is most equitable to both Members, in accordance with Code Section 704(c) and the Regulations thereunder.

In the event the Gross Asset Value of any Company Asset is adjusted pursuant to the definition of Gross Asset Value, and such adjustment results in a variance between the adjusted basis of such asset for federal income tax purposes and its Gross Asset Value, then subsequent allocations of income, gain, loss, and deduction with respect to such asset shall similarly be made in the manner which is most equitable to both Members, in accordance with Code Section 704(c) and the Regulations thereunder.

Any elections or other decisions relating to such allocations shall be made by the CFO, subject to the limitations in Section 6.5 and following the receipt of advice from the Company's accountants, in any manner that reasonably reflects the purpose and intention of this Agreement and is consistent with the requirements of law.

4.5 Tax Distributions. During the first ten (10) days of each month during which a quarterly estimated tax payment is due under the Code, the Board of Directors shall, subject to any limitations or covenants of any loan or credit agreements of the Company, cause to be distributed to the Members, in proportion with their Economic Interests, forty-two percent (42%) of the Company's pre-tax income (determined in accordance with generally accepted accounting principles applied on a consistent basis).

4.6 Distributions - Net Cash From Operations. Except as otherwise provided in Section 10 hereof, Net Cash From Operations, if any, and all other distributions other than those made in connection with a liquidation of the Company shall be distributed, at such times as the Board of Directors may determine, to the Members in proportion to their Economic Interests.

4.7 Distributions - Net Cash From Sale, etc.. Net cash from the sale, condemnation, casualty loss adjustment or other disposition of all or a substantial part of the Property following the occurrence of a Liquidating Event shall be distributed as provided in Section 10.2 hereof.

4.8 Allocation of Profits and Losses from Sale, etc..

(a) The Profits arising from the sale, condemnation, casualty loss adjustment or other disposition of all or a substantial part of the Property or upon a termination of the Company shall be allocated among the Members as follows:

First, if any Members have an Adjusted Capital Account Deficit, Profits shall be credited to the Capital Accounts of such Members in proportion to such deficits until such time as the Adjusted Capital Account Deficits of all such Members equal zero;

Second, Profits shall be allocated pro rata to the Members until the balance in each Member's Capital Account equals the amount of such Member's Capital Contribution; and

Third, the balance of such Profits shall be allocated to the Members pro rata in accordance with their respective Economic Interests.

(b) The Losses arising from the sale, condemnation, casualty loss or other disposition of all or a substantial part of the Company's assets or upon a termination of the Company shall be allocated among the Members as follows:

First, if the Capital Accounts of any Members have a positive balance, Losses shall be allocated to the Capital Accounts of such Members in proportion to such positive balances, until such time as the Capital Accounts of all such Members equal zero; and

Second, the balance of such Losses shall be allocated to the Members pro rata in accordance with their respective Economic Interests.

4.9. Amounts Withheld. All amounts withheld pursuant to the Code or any provision of any state or local tax law with respect to any payment or distribution to the Company or the Members shall be treated as amounts distributed to the Members pursuant to Section 4.5 for all purposes under this Agreement. The CFO, subject to the limitations in Section 6.5, may allocate any such amounts among the Members in any manner that is in accordance with applicable law.

SECTION 5 - MEMBERS; BOARD OF DIRECTORS

5.1 Voting Rights. All Members who have not Dissociated shall be entitled to vote on any matter submitted to a vote of the Members. There shall be one hundred (100) voting points, and each Member shall have one point for each percentage point of Economic Interest held by such Member from time to time with changes in voting points effective at the same time as the corresponding changes in the parties' Economic Interests.

5.2 Management by Board of Directors. The business and affairs of the Company shall be managed under the direction and control of a Board of Directors, consisting of three directors appointed by Pacific and three appointed by FUNC; provided that if the Restructuring occurs and is not rescinded (a) Pacific shall only appoint one Director and (b) management of the Company shall be vested in a Manager. Any Member, at any time and from time to time, may remove any Director appointed by it and may designate an individual to replace a Director previously serving as appointee of such Member. Neither Member may take any action on behalf of the Company, other than voting as a Member and appointing its Directors, without the approval of the Board of Directors, as provided below. Each Member delegates to the Board of Directors the exclusive authority to manage the Company's business except as to those matters as to which (a) the approval of the Members is expressly required by this Agreement or by the Act, (b) the Board of Directors fails or refuses to act, or (c) the Board of Directors submits the matter for approval to the Members. The authority of the Board of Directors shall be delegated to officers to the extent provided in Section 6, subject to the limitations provided therein. Decisions of the Board of Directors within the scope of its authority shall be binding on the Company and each Member. Any Member who takes any action or binds the Company in violation of this Section 5.2 shall be solely responsible for any loss and expense incurred as a result of the unauthorized action and shall indemnify and hold the Company and the other Member harmless with respect to the loss or expense arising out of or relating thereto.

5.3 Chair. The Directors shall elect a chair for a one-year term. The chair shall alternate each year between Pacific and FUNC. The chair shall preside at all meetings of the Board, and shall have the power to call meetings, but no other authority as chair.

5.4 Meetings; Minutes.

(a) Members. Meetings of the Members for any purpose may be called by the President appointed pursuant to Section 6 or by any Member.

(b) Board of Directors. Meetings of the Board of Directors may be called by the President appointed pursuant to Section 6, the Chairman or any Director, provided that the Board of Directors as a group shall have the authority to establish a regular meeting schedule.

Attendance at meetings of either the Members or the Board of Directors may be by speaker telephone or other communications device whereby all those participating in the meeting may hear each other. The Board of Directors shall keep written minutes of all meetings, and the minutes of each meeting shall be signed by the Directors attending or participating by conference call. The minutes shall be included in the records of the Company.

5.5 Place of Meetings; Notice. The call for each meeting shall specify the location for the meeting, which may be either within or outside the State of North Carolina. If no designation is made, the place of meeting shall be the principal executive office of the Company. Written Notice stating the place, day and hour of the meeting and the purpose or purposes for which the meeting is called shall be sent not less than three (3) nor more than sixty (60) days before the date of the meeting, by or at the direction of the President or person calling the meeting, to each Member or Director entitled to vote at such meeting. In lieu thereof, special meetings may be called on telephonic notice given not less than 48 hours prior to the time for the meeting.

5.6 Meeting of All Members or Directors. If all of the Members or Directors shall meet at any time and place and consent to the holding of a meeting at such time and place, such meeting shall be valid without call or notice, and at such meeting lawful action may be taken.

5.7 Rules and Guidelines; Project Implementation Plan. The Board of

Directors may adopt such rules and guidelines governing the operation of the Company and the construction of the System ("Rules and Guidelines") as it deems appropriate. The Board of Directors shall finalize a Project Implementation Plan within ninety (90) days of the Effective Date. Any amendment to the Project Implementation Plan or material deviation therefrom shall require approval of the Board of Directors as provided in Section 6.4(p), below.

5.8 Record Date. For the purpose of determining Members entitled to notice of or to vote at any meeting of Members or any adjournment thereof, or Members entitled to receive payment of any distribution, or in order to make a determination of Members for any other purpose, the record date for the determination of Members shall be the date on which notice of the meeting is mailed or the date on which the resolution declaring such distribution is adopted, as the case may be. When a determination of Members entitled to vote at any meeting of Members has been made as provided in this Section, such determination shall apply to any adjournment thereof.

5.9 Quorum. (a) Members. Attendance by all Members shall constitute a quorum at any meeting of Members.

(b) Directors. Attendance by at least one Director appointed by each Member shall constitute a quorum at any meeting of the Board of Directors.

5.10 Manner of Acting. (a) Members. If a quorum is present, the affirmative vote of Members holding 51% of the Economic Interests represented in person or by proxy shall be the act of the Members, unless the vote of a greater or lesser proportion or number is otherwise required by the Act, by the Certificate or by this Agreement. In no event shall the percentage of Economic Interests required to be voted in favor of an issue be less than the percentage of Director votes that would be required if the same matter were submitted to the Board of Directors.

(b) Directors. The Directors shall vote as representatives of the Members, in the same proportion as the Members' Economic Interests. If three (3) Directors representing a Member are present at a meeting, each Director shall vote one-third of the voting points allocated to such Member. If two (2) Directors representing a Member are present at a meeting, each Director shall vote one-half of the voting points allocated to such Member. If only one such Director is present, that Director shall vote all of the points allocated to such Member. The affirmative vote of Directors voting 51 points shall be the act of the Board.

(c) Deadlocks. A deadlock shall be deemed to exist if, with respect to any material issue submitted to either the Members or the Board of Directors concerning the Company's affairs or management, both Members are represented and there are not sufficient votes for resolving the issue as a result of each Member or its Director(s) voting differently from the other Member or its Director(s) on such issue. If a deadlock occurs and is not resolved, then the issue shall promptly, and in no event any later than thirty (30) days after the first occurrence of such deadlock, be submitted for resolution to a panel of the chief executive officers of the second tier parent entities of each Member (as of the date of this Agreement, ARB and Energy Pacific). In the case of any issue referred to such a panel, representatives of each Member shall be given an opportunity to make a presentation concerning the issue to the chief executive officer with respect to the other Member. If they are unable to resolve the matter within thirty (30) days of submission, they shall try to agree on a neutral third party to whom the matter may be submitted for resolution. If they are unable to agree on the selection of the neutral third party within sixty (60) days after the date on which the matter was originally referred to them, (i) either party may submit the matter to Arbitration, or (ii) the Company shall be dissolved and its assets sold, as provided in Section 10.2, below. Any decision of either the chief executives jointly or of the neutral third party or pursuant to an Arbitration, shall be final and binding on the Members. The Members agree that neither they nor any of their Affiliates nor any entities in which they have an ownership or controlling interest shall purchase, lease or otherwise acquire the assets of the Company in any sale resulting from the dissolution of the Company pursuant to option (ii) above in this subsection (c). Notwithstanding the foregoing, either Member or any of its Affiliates may purchase the assets of the Company or all of the Membership Interests of the other Member, on terms agreed to with such other Member, at any time before option (ii) is reached.

For the purposes hereof, "Arbitration" shall mean the following procedures: the dispute shall first be submitted to non-binding mediation in accordance with the rules established by the American Arbitration Association.

If mediation does not result in the resolution of such dispute within thirty (30) days, the matter shall be submitted to binding arbitration administered by the American Arbitration Association under its Commercial Arbitration Rules, as further provided in Section 21 hereof. Both the mediation and the arbitration shall be held in Los Angeles, California. Judgment on any award rendered by either the neutral third party referenced in the fourth sentence of this subsection (c) or the arbitrator(s) may be entered in any court having jurisdiction.

(d) Votes by Interested Member or Director. Unless otherwise expressly provided herein or required under applicable law, a Member, or Directors appointed by a Member who has or have an interest (economic or otherwise) in the outcome of any particular matter upon which the Members or Directors, respectively, vote or consent, may vote or consent upon any such matter, without regard to such interest.

5.11 Proxies. At all meetings of Members, a Member may vote in person or by proxy executed in writing by the Member or by a duly authorized attorney-in-fact. Such proxy shall be filed with the President before or at the time of the meeting.

5.12 Action Without a Meeting. Action required or permitted to be taken at a meeting of Members or Directors may be taken without a meeting if the action is evidenced by one or more written consents describing the action taken, signed by each Member or Director, as the case may be, entitled to vote and delivered to the President for inclusion in the minutes or for filing with the Company records. Action taken under this Section is effective when all Members or Directors, as the case may be, entitled to vote have signed the consent, unless the consent specifies a different effective date. The record date for determining Members entitled to take action without a meeting shall be the date the first Member signs a written consent.

5.13 Waiver of Notice. When any notice is required to be given to any Member or Director, a waiver thereof in writing signed by the person entitled to such notice, whether before, at, or after the time stated therein, shall be equivalent to the giving of such notice.

5.14 Liability of Members. No Member shall be liable as such for the liabilities of the Company. The failure of the Company to observe any formalities or requirements relating to the exercise of its powers or management of its business or affairs under this Agreement or the Act shall not be grounds for imposing personal liability on the Members for liabilities of the Company.

5.15 (a) Indemnification of Parties. The Company shall indemnify a Person who was or is a party or is threatened to be made a party to a threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative, because that Person is or was a Member, Director, employee or agent of the Company or is or was serving at the request of the Company as a director, officer, trustee, partner, fiduciary, employee or agent of another corporation, partnership, joint venture, trust, or other enterprise, against expenses, including reasonable attorneys' fees (subject to Section 5.15(e) below), judgments, fines and amounts paid in settlement actually and reasonably incurred by that Person in connection with such an action, suit or proceeding; provided that no indemnification may be provided for a Person with respect to a matter for which that Person is finally adjudicated:

i. Not to have acted honestly or in the reasonable belief that that Person's action was in, or not opposed to, the best interests of the Company or its Members;

ii. With respect to a criminal action or proceeding, to have had reasonable cause to believe that that Person's conduct was unlawful; or

iii. To have acted in a grossly negligent or fraudulent manner, or to have engaged in willful misconduct.

A final adjudication as to any one of items i, ii or iii above shall be sufficient to relieve the Company from any obligation to indemnify. The termination of an action, suit or proceeding by judgment, order or conviction adverse to that Person, or by settlement or plea of nolo contendere or its equivalent, does not of itself create a presumption that that Person did not act honestly or in the reasonable belief that that Person's action was in or not opposed to the best interests of the Company or its Members and, with respect to

a criminal action or proceeding, had reasonable cause to believe that that Person's conduct was unlawful.

(b) Indemnification Prohibited if Party Liable to Company; Exception. Notwithstanding any provision of subsection (a), the Company shall not indemnify a Person with respect to a claim, issue or matter asserted by or in the right of the Company for which that Person is finally adjudicated to be liable to the Company unless the court in which the action, suit or proceeding was brought determines that, in view of all the circumstances of the case, that Person is fairly and reasonably entitled to indemnity for such amounts as the court determines reasonable.

(c) Indemnification Proper and in the Best Interests of the Company. Any indemnification under subsection (a), may be made by the Company only as authorized in the specific case upon a determination by the Board of Directors or Members that indemnification of the Member, Director, employee or agent is proper in the circumstances and in the best interests of the Company.

(d) Payment of Expenses in Advance. Expenses incurred in defending a civil, criminal, administrative or investigative action, suit or proceeding shall be paid by the Company in advance of the final disposition of that action, suit or proceeding upon a determination made in accordance with the procedure established in subsection (c) that, based solely on the facts then known to those making the determination and without further investigation, the Person seeking indemnification satisfied the standard of conduct prescribed by subsection (a), and upon receipt by the Company of: (i) a written undertaking by or on behalf of the Member, Director, employee or agent to repay that amount if that Person is finally adjudicated not to be entitled to indemnification under this Agreement, and (ii) a written affirmation by the Member, Director, employee or agent that the Person has met the standard of conduct necessary for indemnification by the Company as authorized in this section. The undertaking required by subsection (i) must be an unlimited general obligation of the Person seeking the advance but need not be secured and may be accepted without reference to financial ability to make the repayment.

(e) Restrictions on Payment for Separate Counsel. The Company shall not pay for counsel for any Person when such counsel is not also counsel for the Company in the proceeding unless expressly approved in advance.

(f) Intent; Amendments. It is not the intent of the foregoing to provide for indemnification outside the scope of what is permitted under applicable law, including the Act, as it may be amended from time to time. If any future amendment to the Act or other applicable law reduces the scope of permitted indemnification, this Section 5.15 shall be deemed to be amended to eliminate any provision which is not thereafter permitted. The right to indemnification under this Section 5.15 shall be fully vested with respect to any matter occurring while this Section 5.15 was in effect in its current form.

5.16 Conflicts of Interest. A Member, a Director, or an Affiliate of either Member, does not violate a duty or obligation to the Company merely because the Member's or the Director's or such Affiliate's conduct -- which conduct may include lending money to, or transacting other business with, the Company -- furthers the Member's or the Director's or such Affiliate's own interest. A Member, Director or Affiliate of either Member may enter into agreements, transactions, contracts, instruments or other transactions with the Company so long as any agreement, contract, instrument or other transaction between the Company and the Member, Director or such Affiliate is either (i) entered into pursuant to FUNC's preferential bidding rights, as provided for in Section 5.20, or (ii) at no greater than market rates, on commercially reasonable terms and conditions such as are no less favorable to the Company than would be available in a bona fide arm's length transaction with a Person which is not an Affiliate, and has been approved by the Board of Directors or the Members (such approval not to be unreasonably withheld if it has been determined that the proposed transaction meets the other conditions of this subsection (ii)).

The rights and obligations of a Member or a Director who thus lends money to or transacts business with the Company are the same as those of a person who is not a Member or Director, subject to other applicable law and the terms of this Agreement. No transaction with the Company shall be voidable solely because a Member, a Director or an Affiliate of either Member has a direct or indirect interest in the transaction if either the transaction is fair to the Company, or the Board of Directors or the Members, in either case knowing the material facts of the transaction and the Member's or Director's or Affiliate's interest, authorize, approve, or ratify the transaction.

5.17 Pacific Responsibilities and Rights.

(a) Responsibilities. Pacific will provide at its expense, from its own resources or that of its Affiliates, the services of its Directors and, at any time before Restructuring or after rescission of Restructuring, its Officers. All other support provided by Pacific or its Affiliates to the Company shall be provided pursuant to a Support Services Agreement.

(b) Matters to be Undertaken by Pacific at the Company's Expense. Pacific shall provide, by itself or through its Affiliates, certain services pursuant to a Support Services Agreement, at the Company's expense. The following areas are areas of primary and not exclusive authority. FUNC shall be allowed reasonable participation in and shall have an obligation to cooperate with Pacific in connection with the implementation of the business objectives of the Company. Pacific's areas of primary responsibility are as follows:

i. Through its Affiliate Energy Pacific, will provide primary system design and system planning activities in consultation with FUNC's Affiliate, ARB. All work completed by Pacific, or its Affiliates, will be undertaken pursuant to a separate support services agreement that will define each activity and the cost for the work to be completed prior to work beginning.

ii. Responsibility for system engineering will be shared by Energy Pacific and ARB to ensure construction flexibility yet maintain proper controls for the Company.

iii. Responsibility for marketing, sales and customer service, as well as regulatory compliance and local franchise agreements and government relations.

iv. Responsibility for negotiation of gas supply and transportation agreements, for development of operating manuals and procedures.

v. Each Member agrees that neither it nor any of its Affiliates will provide any Gas Distribution Service in or to any community in the Selected Market or to any entity providing such service without first receiving the approval of the other Member.

5.18 FUNC's Responsibilities and Rights.

(a) Matters to be Undertaken at FUNC Expense; Name. FUNC will provide at its expense, from its own resources or that of its Affiliates, the services of its Directors and, at any time before Restructuring or after recission of Restructuring, its Officers. All other support provided by FUNC or its Affiliates to the Company shall be provided pursuant to a Support Services Agreement. In addition, FUNC hereby permits and licenses the Company to use as part of its name the word "Frontier". Such permit and license shall continue after the transfer provided for in Section 3.2.

(b) Matters to be Undertaken by FUNC at the Company's Expense. FUNC shall provide, by itself or through its Affiliates, certain services pursuant to a Support Services Agreement, at the Company's expense. The following areas are areas of primary and not exclusive authority. Pacific shall be allowed reasonable participation in and shall have an obligation to cooperate with FUNC in connection with the implementation of the business objectives of the Company. FUNC's areas of primary responsibility are as follows:

i. An Affiliate of FUNC, ARB, will contract with the Company for the construction of the gas transmission and distribution system. The contract will be on a fixed price or cost plus a fixed fee basis for completion of the work and will provide for quality and safety inspections by the Company. In addition, ARB will provide system design and system planning activities in support of Energy Pacific activities. The foregoing activities are not expected to be the exclusive responsibilities of ARB as Pacific may participate as appropriate. All work completed by ARB, or its affiliates, will be undertaken pursuant to a separate support services agreement that will define each activity and the cost for the work to be completed prior to work beginning. The cost of the work is expected to be consistent with market value.

ii. Responsibility for system engineering will be shared by Energy Pacific and ARB to ensure construction flexibility yet maintain

proper controls for the Company.

iii. Each Member agrees that neither it nor any of its Affiliates will provide any Gas Distribution Service in or to any community in the Selected Market or to any entity providing such service without first receiving the approval of the other Member.

5.19 Procurement of Goods and Services. FUNC may elect to make available any of its assets and services, or those of its Affiliates to the Company. Except as provided herein for specific items, all goods and services acquired by the Company shall, whenever practical, be acquired on a competitive bid basis. Notwithstanding any other provision of this Agreement, any services of either Member used by the Company whose pricing is not explicitly provided for elsewhere in this Agreement or in a Support Services Agreement will be purchased at Market Value.

SECTION 6 - OFFICERS

6.1. Appointment of Officers.

(a) President. The day-to-day affairs of the Company shall be managed by a President and such other officers, appointed to such positions and on such terms as the Board of Directors determines; provided that no officer shall have a title that includes the word "manager", it being the intent that no person shall be a manager for purposes of the Act. Whenever in this Agreement the word "President" is used, it shall also mean such other duly authorized officer as is appointed by the Board of Directors to act in the absence of the President. The President shall be jointly selected by the Members.

(b) Chief Financial Officer. The Chief Financial Officer ("CFO") shall be jointly selected by the Members. The CFO shall have such duties as are provided by the Board of Directors and in this Agreement.

6.2. Annual Budget. No later than forty-five (45) days before the end of each fiscal year, the President shall prepare and send to the Board of Directors proposed annual budgets of operations, maintenance, administrative and marketing expenses, capital expenditures, revenues and cash flows for the next fiscal year. Such budgets shall be acted on by the Board of Directors prior to the end of the fiscal year; provided that should the Board of Directors fail to approve any budget prior to the end of the fiscal year, then the budget for the following year shall be based on the budget presented by the President, subject to the following limitations (i) no line item in the budget shall be increased year to year over the amount for such line item in the previous year's budget by in excess of 15% and (ii) the aggregate budgeted amounts for operations, maintenance, administrative and marketing expenses for the budget year shall not exceed 110% of the budgeted expenses for the previous year and (iii) capital expenditures shall be based on the Project Implementation Plan. The budget proposed by the President as adjusted as provided above or by agreement of the Board of Directors shall remain in effect for the balance of the next fiscal year unless modified by action of the Board of Directors. The President shall manage the business of the Company in accordance with such budget and shall not take any action that materially varies from a budgeted item without the approval of the Board of Directors except upon compliance with the provisions of Section 6.4(g).

6.3. Authority and Duties of President.

(a) Authority. The President shall manage the Company under the supervision of the Board of Directors. Subject to the specific limitations on the authority of the President set forth in Section 5 and Section 6.4 hereof, the President shall have the power, on behalf of the Company, to do all things necessary or convenient to carry out the business and affairs of the Company and implement the decisions of the Board of Directors, including, without limitation:

i. The institution, prosecution and defense of any Proceeding in the Company's name;

ii. The purchase, receipt, lease or other acquisition, ownership, holding, improvement, use and other dealing with, Property, wherever located;

iii. The sale, conveyance, mortgage, pledge, lease, exchange, and other disposition of Property;

iv. Entering into contracts and guaranties; incurring of liabilities; borrowing money, issuance of notes, bonds, and other obligations; and the securing of any of its obligations by mortgage or pledge of any of its Property or income;

v. The lending of money, investment and reinvestment of the Company's funds, and receipt and holding of Property as security for repayment, including, without limitation, the lending of money to, and otherwise helping officers, employees and agents;

vi. The conduct of the Company's business, the establishment of Company offices, and the exercise of the powers of the Company within or without the State;

vii. The appointment of employees and agents of the Company, the defining of their duties and authority, the establishment of their compensation;

viii. The payment of compensation, or additional compensation to any or all employees on account of services rendered to the Company, whether or not an agreement to pay such compensation was made before such services were rendered; and

ix. The taking of any other action that furthers the business and affairs of the Company.

(b) Duties. The President, either individually or together with such other officers as are appointed by the Board of Directors, will have the following duties:

i. evaluation, selection and purchase of System equipment subject to prior Board of Directors approval of all capital expenditures in excess of $100,000, individually, or in excess of $300,000, in the aggregate, in any six month period;

ii. supervision of System design, engineering and buildout within the design approved by the Board of Directors;

iii. construction management;

iv. timeline and budget management;

v. reporting (at scheduled or noticed meetings) to the Board of Directors on the construction and operation of the System;

vii. all the work to be performed under the Project Implementation Plan to build the System and all matters relating thereto;

viii. responsibility for the compliance by the Company with all applicable North Carolina and federal laws, rules and regulations relating to the construction, maintenance and operation of the System, including, without limitation, all laws, rules, regulations and licensing requirements relating to the provision of engineering advice and services in the State of North Carolina;

ix. coordinating the activities undertaken by the Members and their Affiliates pursuant to Sections 5.17 and 5.18 with the other activities of the Company; and

x. such other duties as the Board of Directors may, from time to time, designate.

6.4. Restrictions on Authority of the President. Notwithstanding anything to the contrary in Sections 6.2, 6.3 or elsewhere in this Agreement, neither the President nor any other officer shall have any authority to take any of the following actions without first obtaining the consent of the Board of Directors as provided in Section 5, above; for all matters listed below, the vote required shall be 51 voting points:

(a) Contracts with Members or Affiliates. Approval, pursuant to Section 5.16, of the terms of any material agreement, contract, instrument or other transaction between the Company and any Member or any Affiliate of a Member, except as explicitly provided for elsewhere herein.

(b) Merger, Sale of Assets. Authorization of the merger or

consolidation of the Company with any Person, any liquidation or dissolution of the Company, any change to the form of the organization of the Company or any sale, lease, exchange, transfer of all or substantially all of the assets of the Company (disagreement on such vote can trigger the "put" rights in Section 13.5).

(c) Indebtedness, Including System Loan and Bonds. Authorization of the incurrence, assumption or guaranty by the Company of, or suffering the existence by the Company of, the System Loan, the Bonds, and any other indebtedness except for (A) not more than two hundred and fifty thousand dollars ($250,000) in the aggregate during any one fiscal year and at any one time outstanding, (B) indebtedness secured by Permitted Liens and (C) any other indebtedness in an operating budget previously approved by the Board of Directors or otherwise permitted under subsection (g) below.

(d) Material Agreements.

(i) Approval of the terms of a "Material Agreement" (as defined below),

(ii) Any material amendment or modification of any Material Agreement,

(iii) Waiver of compliance with any material provision of a Material Agreement,

(iv) Termination, assignment of any material rights the Company may have under, or consenting to or permitting the assignment by any other Person of any material right such Person may have under a Material Agreement, or

(v) Giving consents or exercising any other material rights under a Material Agreement.

"Material Agreement" shall mean any agreement for the construction, installation, operation, maintenance or provision of other services to the System with a value of over two hundred fifty thousand dollars ($250,000), or the purchase of equipment with a value of over two hundred fifty thousand dollars ($250,000), or any other material agreement to which the Company is a party.

(e) Contracts; Borrowing; Guaranties. Entering into contracts (i) relating to matters other than those specifically enumerated within the definition of "Material Agreement" above that call for the payment by the Company in excess of $100,000, or (ii) with respect to the guaranty by the Company of the obligations of any other Person.

(f) Liens. Creating or otherwise allowing any Lien to be imposed on, or otherwise to affect, any of the Company's Property, except Permitted Liens.

(g) Litigation. Instituting, prosecuting and defending the Company in any Proceeding in the Company's name, except with the approval and direction of the Board of Directors.

(h) Settlements. Confessing a judgment or entering into any settlement of any dispute, where the amount of the resulting liability of the Company is greater than fifty thousand dollars ($50,000).

(i) Budget and Capital Improvements. Approval of the annual budgets as provided in Section 6.2, and of capital expenditures exceeding the limits therein or as otherwise approved hereunder. Notwithstanding the foregoing, the President may authorize capital expenditures or indebtedness arising out of an emergency which requires immediate action, so long as the President gives notice to the Directors as soon as possible of the incurrence of such expenditures and obtains any requisite consent to the continuation of any such expenditures after the immediate emergency has passed.

(j) Charges. Annual approval (at the same time as the budget is approved as per paragraph (i) above) of all charges under the agreements or contracts referenced in paragraphs (a), (d) or (i) above, and any exercise of any material rights or elections under such agreements or contracts.

(k) Bankruptcy Filing. (i) Commencing, or causing the Company to

commence any case, proceeding or other action (A) under any existing or future law of any jurisdiction, domestic or foreign, relating to bankruptcy, insolvency, reorganization or relief of debtors, seeking to have an order for relief entered with respect to it, or seeking to adjudicate it a bankrupt or insolvent, or seeking reorganization, arrangement, adjustment, winding-up, liquidation, dissolution, composition or other relief with respect to it or its debts, or (B) seeking appointment of a receiver, trustee, custodian or other similar official for it or for all or any substantial part of its assets, or making a general assignment for the benefit of its creditors; or (ii) if there shall be commenced against the Company any case, proceeding or other action of a nature referred to in clause (i) above, taking any action in furtherance of, or indicating its consent to, approval of, or acquiescence, therein, or (iii) admitting in writing its inability to pay its debts as they become due.

(l) Sale of Valuable Assets. The sale, assignment or other transfer of title to any asset, or any group of assets in the same transaction, or in related transactions, having an aggregate value in excess of fifty thousand dollars ($50,000).

(m) Acts in Contravention of This Agreement. Knowingly do any act in contravention of this Agreement.

(n) Thwarting Ordinary Business. Knowingly do any act which would make it impossible, or materially more difficult, to carry on the ordinary business of the Company, except as otherwise provided in this Agreement.

(o) Possessing Property for Non-Company Purpose. Possess property, or assign rights in specific property, for other than a Company purpose.

(p) Jeopardizing Tax Treatment. Knowingly take any steps that could jeopardize the treatment of the Company as a partnership under the Code.

(q) Deviating from Project Implementation Plan. Taking any action which materially deviates from the Project Implementation Plan, or making any amendment to the Project Implementation Plan.

(r) Usurpation of Board Function. Taking any step within the realm normally governed by boards of directors of corporations, including but not limited to the setting of basic policies and the setting of the President's compensation and benefits.

6.5. Limitations on Authority of CFO. Any delegation of authority to the CFO in this Agreement with regard to tax matters shall be subject to the requirement that the CFO determine if any proposed action is likely to have a material adverse effect on either Member, and if it does, to obtain the approval of the Board of Directors or such Member before taking any such action.

6.6. Liability for Certain Acts. The President and other officers shall exercise their powers and discharge their duties in good faith with a view to the interests of the Company and its Members with that degree of diligence, care and skill that ordinarily prudent persons would exercise under similar circumstances in like positions. No officer shall be liable, responsible or accountable in damages or otherwise to the Company or to any Member for any action taken or any failure to act on behalf of the Company within the scope of the authority conferred on the officer by this Agreement or by law; provided that the officer shall be liable if it is reasonably determined by the Board of Directors that the relevant action or failure to act would disqualify the officer for indemnification under the provisions of Section 5.15.

6.7. Bank Accounts. The President or CFO may from time to time open bank accounts in the name of the Company. The manual signatures of two (2) officers shall be required for all disbursements over a level to be determined by the Board of Directors; in the absence of such determination, such level shall be five thousand dollars ($5,000). Any withdrawal of funds in excess of one hundred fifty thousand dollars ($150,000.00), other than transfers between Company accounts, shall require approval of the Board of Directors if the expenditure is not contemplated by the Project Implementation Plan or a budget approved as provided in Section 6.2.

6.8. Removal. At a Board of Directors meeting called expressly for that

purpose, any officer may be removed at any time, with or without cause, if the votes for removal are not less than 49 voting points.

SECTION 7 - BOOKS AND RECORDS; TAX RETURNS; INSURANCE

7.1. Books and Records. All books, records and financial accounts of the Company shall be kept by the President and the CFO at the principal place of business of the Company (as provided in Section 2.3, above), or at such other location as is determined by the Board of Directors.

7.2. Audit. A periodic audit (or, if agreed upon, review) of the books and records of the Company shall be made by an independent firm of certified public accountants or by such individuals and at such intervals as may be selected by the Board of Directors, and a like audit or review shall be made upon completion of the System. The cost of any audits or reviews shall be borne by the Company. Upon the completion of the System, a true and correct accounting shall be rendered to the Members of all costs, expenses, and other data relating to the performance and affairs of the Company.

7.3. Inspection of Records. Each Member shall have the right at all reasonable times, during usual business hours, to have its independent accountant or any other agent or employee audit, examine and, at such Member's expense, make confidential copies of or extracts from the books and records maintained in connection with the Company. Such Member shall bear all expenses incurred in its examination.

7.4. Maintenance of Records after Winding-up. To the extent that the books and records of the Company are required to be kept subsequent to its winding-up, they shall be kept at such place or places as the President or other Person responsible for such winding-up may from time to time determine. The cost of maintaining and storing the books and records after the winding-up of the Company shall be paid from the funds set aside pursuant to subsection (iii) of Section 10.2, below.

7.5. Fiscal Year. The fiscal year of the Company shall be the calendar year, except as otherwise required by the Code.

7.6. Income Tax Returns.

i. All income tax returns of the Company shall be prepared by accountants selected by the Board of Directors.

ii. Any provision hereof to the contrary notwithstanding, for federal income tax purposes, the Members hereby recognize and agree that the Company will be treated as a partnership in accordance with the provisions of the Code, as the same may from time to time be amended; provided, however, that the filing of partnership tax returns shall not be construed to extend the purposes of the Company or expand the obligations or liabilities of the Members.

iii. The CFO shall cause to be prepared all tax returns and statements, if any, which are required to be filed on behalf of the Company with the appropriate taxing authorities. Such returns and statements shall be submitted by the CFO to the Members in draft, in time for the approval of the Board of Directors to be made by May 1 of each year, and in final form prior to filing, and when approved by the Board of Directors, shall be filed promptly.

iv. Pacific shall serve as the tax matters Member of the Company for purposes of the Internal Revenue Code.

7.7. Insurance. The Company shall maintain such insurance as the Board of Directors deems appropriate.

SECTION 8 - INVESTMENT OF FUNDS

All cash Capital Contributions made to the Company by the Members and all revenues received by the Company shall be deposited in an account or accounts in the name of the Company at such bank or other financial institution as the Board of Directors may select, or shall be invested in such short-term, investment quality investments as shall be selected by the Board of Directors. Such funds shall be withdrawn on such signatures as the Board of Directors shall determine as provided in Section 6.7, above.

SECTION 9 - DISSOCIATION OF A MEMBER

9.1. Dissociation. A Person shall cease to be a Member ("Dissociate") upon the happening of any of the following events:

(a) an Insolvency Event occurs with respect to the Member or any Affiliate which directly or indirectly owns more than 50% of the Member's voting equity, as provided in Section 9.2 below;

(b) in the case of a Member who is a natural person, the death of the Member or the entry of an order by a court of competent jurisdiction adjudicating the Member incompetent to manage the Member's personal estate;

(c) in the case of a Member who is acting as a Member by virtue of being a trustee of a trust, the termination of the trust (but not merely the substitution of a new trustee);

(d) in the case of a Member that is a separate entity other than a corporation, the dissolution and commencement of winding up of the separate entity;

(e) in the case of a Member that is a corporation, the filing of a certificate of dissolution, or its equivalent, for the corporation or the revocation of its charter;

(f) in the case of an estate, the distribution by the fiduciary of the estate's entire interest in the Company; or

(g) a change of control of a Member, or of any Affiliate (other than ARB) which directly or indirectly owns more than 50% of the Member's voting equity, other than transfers to Affiliates of the transferring Affiliate (For purposes of this paragraph, a change of control shall mean the transfer of greater than 50 percent of the voting equity of a party; provided, however, that with respect to Pacific Enterprises, a change of control shall mean that Pacific Enterprises is acquired in a transaction or series of transactions in which Pacific Enterprises or its successor ceases to be a publicly traded company, and with respect to Frontier Colorado shall mean that ARB shall cease to own, directly or indirectly, at least 50% of Frontier Colorado's voting equity.

9.2. Effect of Insolvency Event and Other Acts of Dissociation on Membership Interest.

(a) Effective at the time when an Insolvency Event occurs with respect to a Member or an Affiliate described in Section 9.1(a), such Member's voting rights and rights to participate in the management of the affairs of the Company shall cease and such Member's Membership Interest shall thereafter consist solely of such Member's Economic Interest.

(b) The Membership Interest of any Dissociating Member shall be subject to Sections 13.4 (offer to the other Members) and 13.6 (sale of voting rights to the Company).

SECTION 10 - DISSOLUTION AND WINDING UP

10.1. Liquidating Events. (a) The Company shall dissolve and commence winding up and liquidating upon the first to occur of any of the following (each, a "Liquidating Event"):

i. The sale of all or substantially all of the Company's Property.

ii. The vote by the Members to dissolve, wind up, and liquidate the Company.

iii. Either Member elects not to make further Capital Contributions under Section 3.5, and within 180 days thereafter, neither of the following occurs -- (A) the other Member buys all interests of the electing Member under Section 13.4, or (B) the electing Member sells all of its interests to another party who agrees to continue making Capital Contributions at the agreed-upon schedule, including making any Capital Contributions previously due.

iv. A deadlock is reached, pursuant to the procedures described in Section 5.10(c) above, and the parties are unable to reach any resolution of the deadlock and agree not to submit the matter to arbitration.

(b) The Members hereby agree that, notwithstanding any provision of the Act, the Company shall not dissolve prior to the occurrence of a Liquidating Event. If it is determined by a court of competent jurisdiction that the Company has dissolved prior to the occurrence of a Liquidating Event, the Members hereby agree to continue the business of the Company without a winding up or liquidation.

10.2. Winding Up. Upon the occurrence of a Liquidating Event, the Company shall continue solely for the purposes of winding up its affairs in an orderly manner, liquidating its assets, and satisfying the claims of its creditors and Members. No Member shall take any action that is inconsistent with, or not necessary to or appropriate for, the winding up of the Company's business and affairs. The President (or, in the event that at the time of such Liquidating Event, there is no President, any Member elected by the Members) shall be responsible for overseeing the winding up and dissolution of the Company and shall take full account of the Company's liabilities and Company Property and the Company Property shall be liquidated as promptly as is consistent with obtaining the fair value thereof, and the proceeds therefrom, to the extent sufficient therefor, shall be applied and distributed in the following order:

i. First, to the payment and discharge of all of the Company's debts and liabilities to creditors other than Members;

ii. Second, to the payment and discharge of all of the Company's debts and liabilities to Members;

iii. Third, the Company shall fund reserves for contingent liabilities to the extent deemed reasonable by the Board of Directors or other Person responsible for the winding up;

iv. Fourth, to each Member with a positive balance in its Capital Account (determined after taking into account all applicable allocations, including but not limited to those in Section 4.8), in proportion to such balances until such balances are reduced to zero; and

v. Fifth, the balance, if any, to the Members in proportion to their Membership Interests.

Except upon the specific approval of the Board of Directors, no Member shall receive any additional compensation for any services performed pursuant to this Section 10.

10.3. Compliance With Timing Requirements of Regulations. If any Member has a deficit balance in its Capital Account (after giving effect to all contributions, distributions and allocations for all taxable years, including those made pursuant to Section 10.2, above, and other distributions made in the year during which such liquidation occurs), such Member shall have no obligation to make any contribution to the capital of the Company with respect to such deficit, and such deficit shall not be considered a debt owed to the Company or to any other Member for any purpose whatsoever. In the discretion of the Board of Directors, subject to the limitations in Section 6.5, a pro rata portion of the distributions that would otherwise be made to the Members pursuant to this Section 10 may be:

i. distributed to a trust established for the benefit of the Members for the purposes of liquidating Company assets, collecting amounts owed to the Company, and paying any contingent or unforeseen liabilities or obligations of the Company or of the Members arising out of or in connection with the Company. The assets of any such trust shall be distributed to the Members, in the same proportions as the amount distributed to such trust by the Company would otherwise have been distributed to the Members pursuant to this Agreement; or

ii. withheld to provide a reasonable reserve for Company liabilities (contingent or otherwise) and to reflect the unrealized portion of any installment obligations owed to the Company, provided that such withhold amounts shall be distributed to the Members as soon as practicable.

10.4. Rights of Members. Except as otherwise provided in this Agreement, (a) each Member shall look solely to the assets of the Company for the return of its Capital Contribution and shall have no right or power to demand or receive property other than cash from the Company, and (b) no Member shall have priority over any other Member as to the return of its Capital Contributions, distributions, or allocations.

10.5. Notice of Dissolution. In the event a Liquidating Event occurs or an event occurs that would, but for provisions of Section 10.1, above, result in a dissolution of the Company, the President shall, within thirty (30) days thereafter, provide written notice thereof to each of the Members and to all other parties with whom the Company regularly conducts business (as determined in the discretion of the President) and shall publish notice thereof in a newspaper of general circulation in each place in which the Company regularly conducts business (as determined in the discretion of the President).

SECTION 11 - CROSS-INDEMNIFICATION BY MEMBERS

11.1. Cross-Indemnification by Members. Each Member (the "Indemnifying Party") agrees to hold harmless, indemnify, protect and defend each other Member (the "Indemnified Party") and its officers, directors, employees, shareholders and agents, against any and all liabilities, damages, claims, costs, decrees, judgments, suit, actions, and expenses suffered or incurred by the Indemnified Party (collectively, the "Liabilities"), including reasonable attorneys' fees and court costs, arising out of or in connection with (a) the failure by the Indemnifying Party or its personnel to perform the Indemnifying Party's obligations, representations or covenants under this Agreement, or (b) any business conducted or operated by the Indemnifying Party or any Affiliate of such Indemnifying Party other than the business affairs of the Company. Notwithstanding the foregoing, neither Pacific nor FUNC shall have any liability hereunder arising from or in connection with the sale, production, or delivery of electrical power by FUNC, or the maintenance and operation of its systems and equipment used therefor.

11.2. Other Provisions. Nothing contained in this Agreement with regard to the sharing of the losses and liabilities of the Company shall in any way limit the Indemnifying Party's liability to the Indemnified Party for liabilities arising out of (i) the intentional breach by the Indemnifying Party or its personnel of (x) this Agreement or (y) the obligations assigned to the Indemnifying Party under this Agreement or (ii) actions taken by the Indemnifying Party or its personnel in bad faith or constituting willful misconduct.

SECTION 12 - PRIOR COSTS

Each party shall bear all costs incurred by it prior to October 1, 1997 except for costs specifically permitted in this Agreement to be recovered by a Member from the Company after October 1, 1997, or as otherwise agreed by the Board of Directors.

SECTION 13 - TRANSFER OF INTERESTS

13.1. Limitation on Transfers; Pacific. Except to the extent provided in 13.3(iv) hereof and except for transfers to Affiliates, no Member shall transfer, sell, assign, or convey all or any portion of its Membership Interests (the "Offered Interest") unless such Member (the "Seller") (a) first offers to sell the Offered Interest pursuant to the terms of this Section 13 and (b) obtains the prior written consent of the other Members to a transfer of the Offered Interest. Any purported transfer of Membership Interests that is not effected pursuant to the terms of this Section 13 shall be null and void and of no effect whatever.

13.2. Right of First Refusal. No transfer may be made under this Section unless the Seller has received a bona fide written offer (the "Purchase Offer") from a Person (the "Purchaser") to purchase the Offered Interest for a purchase price (the "Offer Price") denominated and payable in United States dollars at closing or according to specified terms, with or without interest, which offer shall be in writing signed by the Purchaser and shall be irrevocable for a period ending no sooner than the day following the end of the Offer Period, as hereinafter defined.

13.3. Offer Notice. Prior to making any transfer that is subject to the terms of this Section 13, the Seller shall give to the Company and each other Member written notice (the "Offer Notice") which shall include a copy of the Purchase Offer and an offer (the "First Offer") to sell the Offered Interest to the other Members (the "Offerees") for the Offer Price, payable according to the same terms as (or more favorable terms than) those contained in the Purchase Offer, provided that the First Offer shall be made without regard to the requirement of any earnest money or similar deposit required of the Purchaser prior to closing, and without regard to any security (other than the Offered Interest) to be provided by the Purchaser for any deferred portion of the Offer

Price.

i. Offer Period. The First Offer shall be irrevocable for a period (the "Offer Period") ending at 11:59 p.m., local time at the Company's principal office, on the ninetieth day following the day of the Offer Notice.

ii. Acceptance of First Offer. At any time during the first 60 days of the Offer Period, any Member may accept the First Offer as to that portion of the Offered Interest that corresponds to the ratio of its Membership Interests to the total Membership Interests held by all Members, by giving written notice of such acceptance to the Seller and the other Members. In the event that Offerees ("Accepting Offerees"), in the aggregate, accept the First Offer with respect to all of the Offered Interest, the First Offer shall be deemed to be accepted. If Accepting Offerees do not accept the First Offer as to all of the Offered Interest during the Offer Period, the First Offer shall be deemed to be rejected in its entirety.

iii. Closing of Purchase Pursuant to First Offer. In the event that the First Offer is accepted, the closing of the sale of the Offered Interest shall take place within thirty (30) days after the First Offer is accepted or, if later, the date of closing set forth in the Purchase Offer. The Seller and all Accepting Offerees shall execute such documents and instruments as may be necessary or appropriate to effect the sale of the Offered Interest pursuant to the terms of the First Offer and this Section 13.

iv. Sale Pursuant to Purchase Offer If First Offer Rejected. If the First Offer is not accepted in the manner herein above provided, the Seller may sell the Offered Interest to the Purchaser at any time within 60 days after the last day of the Offer Period, provided that such sale shall be made on terms no more favorable to the Purchaser than the terms contained in the Purchase Offer, and provided that if the Seller has not received the prior written consent of the other Members to transfer the Offered Interest as provided in Section 13.1, only an Economic Interest may be sold to the Purchaser. In the event that the Offered Interest is not sold in accordance with the terms of the preceding sentence, the Offered Interest shall again become subject to all of the conditions and restrictions of this Section 13. The transferee of any Economic Interest or Membership Interest in the Company shall take such interest subject to the provisions of this Agreement, and all restrictions and limitations in this Agreement with respect to a Members actions or transactions in the Membership Interests or Economic Interests in the Company shall apply to such interests as if the transferee were a party hereto.

13.4. Option to Purchase on Certain Events. Upon the occurrence of any of the following (each, a "Triggering Event"): (i) the death of any Member or the owner of an Economic Interest, (ii) any inter vivos gift of an Economic Interest or a Membership Interest, (iii) any event described in Section 9.1(a) or 9.1(g) (certain Insolvency Events and changes of control), or (iv) a Member electing not to make further Capital Contributions under Section 3.5, the other Members shall have an option to purchase all of the Membership Interest or Economic Interest owned by such Person or such Person's predecessor in interest (or, in the case of the debtor in possession, owned by such Person), for a period of one year after such Triggering Event. If the Company does not receive a notice of such Triggering Event, the rights of the other Member shall accrue upon the receipt of actual notice by the Company of the Triggering Event. The Company shall send the other Member a notice of their rights hereunder within sixty (60) days after the Company receives actual notice of a Triggering Event. Except as set forth below, the purchase price for such interest shall be fair market value, as agreed to by the purchasing Member and the holder of such Membership Interest or Economic Interest being sold; if they are unable to agree to such value or to an independent appraiser to determine such value within thirty (30) days of submission, such value shall be determined in accordance with the provisions of Section 21 hereof. If the Triggering Event is a Member's election to cease making Captial Contribution in the manner permitted in Section under Section 3.5, the purchase price for such Member's Membership Interest shall be the balance of such Member's Capital Account as of the date of the Triggering Event. The provisions of Section 13.1 above shall also govern in the event that the options under this Section 13.4 are not fully exercised. Payment shall be, at the option of the purchasing Member, in cash or by promissory note. Any promissory note shall be dated as of the effective date of the purchase, shall mature in not more than four (4) years, shall be payable in equal installments of principal and interest that come due monthly, shall bear

interest at the Prime Rate, plus two (2) percentage points per annum. Any such promissory note shall be due on sale by the purchasing Member or the Company to any third party of equity interests in the Company representing ownership of, or the right to acquire, fifty percent (50%) or more of the voting equity interests in the Company. The selling Member shall retain a security interest in such interest until pay-off.

13.5. Option to Sell on Certain Events: Upon a vote described in Section 6.4(b) (merger, dissolution, etc.) (each, a "Triggering Vote") any Member disagreeing with the vote and having an Economic Interest of 49% or less, and any non-Member holder of Economic Interests (either, a "Minority Member") shall have an option to sell to the other Member, and the other Member shall have the obligation to buy, all of the Membership Interest or Economic Interest owned by such Minority Member or such Minority Member's predecessor in interest (or, in the case of the debtor in possession, owned by such Person), by sending notice to the other Member within fifteen (15) days after such Triggering Vote. The purchase price for such Membership Interest or Economic Interest shall be fair market value, as agreed to by the Members. If they are unable to agree to such value or to an independent appraiser to determine such value within thirty (30) days of submission, such value shall be determined in accordance with the provisions of Section 21 hereof. Closing on such sale shall take place within sixty (60) days after determination of the price. Payment shall be, at the option of the purchasing Member, in cash or partly in cash and partly by note, but in any event not less than one-fourth in cash. Any promissory note shall be dated as of the effective date of the purchase, shall mature in not more than three (3) years, shall be payable in equal installments of principal and interest that come due monthly, shall bear interest at the Prime Rate, plus two (2) percentage points per annum. The Minority Member shall retain a security interest in such interest until pay-off.

13.6. Sale of Remaining Membership Rights to the Company. Upon and contemporaneously with any sale or other disposition (including a sale or disposition resulting from a Dissociation) of a Member's Economic Interest in the Company which does not at the same time transfer the balance of the rights associated with the Economic Interest transferred by the Member (including, without limitation, the rights of the Member to participate in the management of the business and affairs of the Company or to acquire rights transforming the Economic Interest into a full Membership Interest), the Company shall have an option, which shall remain effective for the maximum period under applicable law, to purchase from such Member or the executor or other successor in interest to such Member, and such Member or the executor or other successor in interest to such Member shall, upon exercise of such option, sell to the Company for a purchase price of one hundred dollars ($100.00), all remaining rights and interests retained by such Member or the executor or other successor in interest to such Member which immediately prior to such sale or other transfer were associated with the transferred Economic Interest. No other writing, in addition to this Agreement, shall be necessary to evidence such option.

SECTION 14 - ADMISSION OF ADDITIONAL PARTIES

The Board of Directors may determine to issue Membership Interests in the Company in return for cash or in-kind capital contributions, and on such other terms as the Board of Directors may approve, provided, however, that no such issuance of Membership Interests shall have the effect of reducing Pacific's or FUNC's Membership Interests (except to the extent diluted by the issuance of additional interests; and provided further that no Membership Interests will be issued to any Member or any Affiliate of such Member who, directly or indirectly, sells energy on a wholesale or retail basis into the Selected Market, without the written consent of FUNC or Pacific.

SECTION 15 - CHOICE OF LAW

This Agreement shall be governed by and interpreted in accordance with the laws of the State of North Carolina.

SECTION 16 - INTEGRATION

This Agreement is the complete and final agreement of the parties and supersedes any prior agreements or understandings with respect to the subject matter hereof.

SECTION 17 - OWNERSHIP OF DESIGNS, PLANS AND SPECIFICATIONS

Notwithstanding any other provision of this Agreement, all Designs that have been developed by or for a party hereto shall be the property of the Company, except that if the Company has not paid in full therefor, the Designs shall remain the property of the party that developed the Designs and shall be deemed Confidential Information of the party that developed such Designs for

purposes of Section 18, below. At all times during the term of the Company, each party hereto shall have full and complete right and license, free of charge, to use the Designs owned by the Company in connection with the construction and operation of the System. Upon and after the termination of the Company pursuant to Section 10, above, the Designs owned by the Company shall be an asset of the Company that shall be sold to the purchaser of the System or distributed to either or both Members as part of a liquidating distribution.

SECTION 18 - CONFIDENTIALITY AGREEMENT

18.1. Confidential Information. With respect to a party hereto (the "Disclosing Party"), "Confidential Information" shall mean technical, business and financial information including, where appropriate and without limitation, any information, business and financial data, software, structures, models, techniques, processes, compositions, formulas, inventions, schematics, and apparatus relating to the same disclosed by the Disclosing Party to another party hereto (the "Receiving Party") or obtained by the Receiving Party through observation or examination of information, but only to the extent that such information is maintained as confidential by the Disclosing Party and is marked or otherwise identified as confidential or proprietary when disclosed to the Receiving Party or, in the case of information given verbally, is identified as confidential or proprietary to the Receiving Party at the time of such verbal disclosure to the Receiving Party. Confidential Information shall not be deemed to be or include promotional materials prepared and approved by the Board of Directors.

18.2. Receiving Party. Each of the Members agrees that the Disclosing Party is the owner or licensee of the Confidential Information. The Receiving Party shall not use any of the Confidential Information of the Disclosing Party at any time except for the purposes of constructing and operating the System and evaluating the desirability of a mutually beneficial business relationship. The Receiving Party shall not disclose any of the Confidential Information other than on a need-to-know basis, as reasonably necessary for such evaluation, to his or its directors, officers, employees, attorneys, accountants, bankers, financial advisors or consultants who are bound by written agreements with the Receiving Party to maintain the Confidential Information in confidence or who are otherwise under obligations of confidentiality to the Receiving Party. Each of the Members agrees to hold the Confidential Information disclosed to it by the Disclosing Party in strict confidence and to take reasonable precautions to protect such Confidential Information (including, without limitation, all precautions the Receiving Party employs with respect to its own Confidential Information).

18.3. Liability. Notwithstanding anything to the contrary in this Agreement, the Receiving Party shall have no liability to the Disclosing Party for the use or disclosure of (1) such information as required by applicable law or regulation, provided that the Receiving Party shall give the Disclosing Party prompt written notice and sufficient opportunity to object to such use or disclosure, or to request confidential treatment to the Confidential Information; or (2) such information as the Receiving Party can establish by written documentation to:

i. have been publicly known prior to disclosure by the Disclosing Party of such information to the Receiving Party;

ii. have become publicly known without fault on the part of the Receiving Party, subsequent to disclosure to the Disclosing Party of such information to the Receiving Party;

iii. have been received by the Receiving Party at any time from a source, other than the Disclosing Party, lawfully having possession of and the right to disclose such information;

iv. have been otherwise known by the Receiving Party without any obligation of confidentiality directly or indirectly for the benefit of the Disclosing Party prior to disclosure by the Disclosing Party to the Receiving Party of such information; or

v. have been independently developed by the Receiving Party without use of such Confidential Information.

18.4. No Adequate Remedy at Law. Each of the Members acknowledges and agrees that due to the unique nature of the Disclosing Party's Confidential Information, there can be no adequate remedy at law for any breach of its obligations hereunder, that any such breach may allow the Receiving Party or third parties to unfairly compete with the Disclosing Party, and therefore, that upon any such breach or any threat thereof, the Disclosing Party shall be

entitled to appropriate equitable relief in addition to whatever remedies it might have at law. The Receiving Party will notify the Disclosing Party in writing immediately upon the occurrence of any such unauthorized release or other breach of which it is aware.

SECTION 19 - NO RECOURSE

Neither party hereto shall have any recourse under this Agreement for any breach hereof by the other party against any officer, employee, director, shareholder or agent of such other party or against any party related to or affiliated with such other party, recourse of each party hereunder for breach of this Agreement being strictly limited to recourse against the other party that is a signatory hereto and to any successors or permitted assigns of such party.

SECTION 20 - SURVIVAL; BENEFIT

Notwithstanding the occurrence of a Liquidating Event or dissolution of the Company, this Agreement shall continue in effect during the winding up of the Company. Thereafter, the provisions of Sections 5.10(c), 5.14, 5.15, 11, 17, 18, 19 and 21 of this Agreement shall survive any termination hereof. This Agreement is solely for the benefit of the parties hereto and their successors and permitted assigns. No third party is granted or shall have any rights hereunder.

SECTION 21 - DISPUTE RESOLUTION

21.1. Arbitration. Except for matters covered under Section 5.10(c), all claims, disputes and other matters in question arising out of or pertaining to this Agreement or the breach thereof shall be decided by arbitration in accordance with the Arbitration Rules of the American Arbitration Association, to be conducted in Los Angeles, California. Arbitration shall be before a single arbitrator if the parties can agree on such an arbitrator within five (5) business days of a Member's call for arbitration. If the parties cannot so agree within such period, then each party shall choose a single arbitrator, and the two arbitrators thus chosen shall choose the third arbitrator. If the first two arbitrators cannot agree on the third arbitrator within ten (10) business days of submission, such arbitrator shall be chosen by the American Arbitration Association. Should the arbitrator find the non-prevailing party's claim(s) or defense(s) to be frivolous, the arbitrator may compel as part of the award the non-prevailing party to pay all fees and costs of arbitration, including but not limited to the reasonable attorneys' fees of the prevailing party. This Agreement to arbitrate shall be specifically enforceable. The award rendered by the arbitrators shall be final, and judgment may be entered upon it in accordance with applicable law.

21.2. Demand for Arbitration. Written demand for arbitration shall be filed by a party hereto requesting the same with the American Arbitration Association in Los Angeles, California, with notice to all other parties. The demand for arbitration must be filed within a reasonable period of time after the claim, dispute or other matter in question has arisen, and in no event shall it be made after institution or legal or equitable proceedings based on such a claim, dispute or other matter in question would be barred by the applicable statute of limitations.

SECTION 22 - POTENTIAL RESTRUCTURING

22.1 Legislative Monitoring. Pacific agrees to monitor closely the progress of legislation to repeal or amend PUHCA, and to keep FUNC apprised of material developments from time to time.

22.2. Construction Monitoring. The Company agrees to deliver a report to Pacific and FUNC at least once per month that will describe the progress of construction and development of the System (the "Construction Report"). Each Construction Report shall contain an estimate of the amount of time remaining before the System commences operations as a utility within the meaning of PUHCA (the "Completion Date"). If the Company is unable to deliver the Construction Report to FUNC and Pacific, FUNC shall prepare and deliver the Construction Report to Pacific.

22.3. Financing Schedule. The Company agrees to deliver a report to Pacific and FUNC no less frequently than once a month that will describe the progress made with respect to obtaining the System Loan (the "Financing Report"). Each Financing Report shall contain an estimate of the amount of time remaining before the Completion Date. If the Company is unable to deliver the Financing Report to FUNC and Pacific, Pacific shall prepare and deliver the Financing Report to FUNC.

22.4 PUHCA. The Members acknowledge that it may be necessary to restructure the Company in the future, taking into account all relevant factors affecting the Company's operations, including, without limitation, PUHCA, the NCUC, financing for the System, and the mutual interest of the parties in developing the optimal capital structure for the Company. If PUHCA has not been repealed as of the date that either Member or the Board of Directors determines it must seek approval of a restructuring of the Company by the Securities and Exchange Commission in order to have a reasonable opportunity to obtain SEC approval of the manner of restructuring prior to the Completion Date, the Board of Directors shall meet to determine what manner of restructuring to pursue. The Members have reviewed the restructuring options described as "Structure B", "Structure C" and "Structure D" set forth below and the Members each acknowledge that each of such alternatives is generally acceptable to such Member. The manner of restructuring the Company determined in accordance with Section 22.5 is referred to as the "Restructuring." The Board of Directors shall make such amendments to this Operating Agreement as are reasonably necessary to implement the Restructuring.

22.5 Decision as to Which Structure to Pursue. (a) The Board of Directors shall first consider and undertake reasonable good faith efforts to pursue any mutually acceptable alternative for restructuring the Company that retains the relative economic benefits and interests of the parties as in effect prior to such restructuring and provides each reasonable protection of their investment. The parties business intent being to retain such economic interests and benefits to the extent possible while structuring control of the Company in such a manner that neither Member nor any of its Affiliates will be required to register as a public utility holding company under PUHCA or to obtain SEC approval for its acquisition of an interest in the Company.

(b) If the Board of Directors is unable to agree on a mutually acceptable restructuring concept, the Board will then consider and undertake reasonable good faith efforts to pursue a restructuring in the manner of Structure B. The Board of Directors may by mutual agreement determine not to pursue Structure B for, among other reasons, the Board's inability to identify a prospective Managing Member otherwise meeting the qualifications described below that is willing and able to make a financial contribution commensurate with the interest to be acquired by such prospect. In exercising good faith efforts in order to achieve Structure B, either party may object to such structure on the grounds that such structure is subject of regulatory or statutory prohibitions affecting such Member or its Affilates, or that such structure exposes the Member or its Affiliates to regulatory or statutory burdens that are materially more burdensome to such party than those applicable if the Member were to have only a non-controlling investment in the Company yielding substantially the economic benefits as such Member holds in the Company (either such grounds, "Regulatory Objections"). In considering Structure B, each Member acknowledges that it will not object to such structure on the basis that it has inadequate investment protections or management input so long as it has investment protections and management input in form and effect reasonably consistent with those protections and voting rights set forth in Structure B below ("Reasonable Rights and Protections").

(c) If the Board of Directors is unable to reach agreement on Structure B, the Board will then adopt a restructuring in the manner of Structure C; provided that the Board of Directors may by mutual agreement determine not to pursue Structure C and FUNC may, in its sole discretion, elect not to pursue Structure C due to Regulatory Objections. Each Member shall be entitled to have Reasonable Rights and Protections in any Restructuring. The Members acknowledge that FUNC and its Affiliates may not ultimately desire to become a registered PUHCA holding company.

(d) If the Board of Directors mutually determines not to pursue Structure C or FUNC elects not to pursue Structure C, the Board will then adopt a restructuring in the manner of Structure D.

22.6 Submissions to the SEC. As soon as possible after the Restructuring is determined pursuant to Section 22.5, the Members shall prepare and submit to the SEC all applications or "no action letters" necessary to own and operate the System as a utility under PUHCA. Each Member agrees to cooperate to the fullest extent reasonable to assist the other Member with such submissions upon request.

22.7 Suspension of Rights to Withdraw or Withhold Capital Contributions. So long as both Members are complying with the foregoing provisions of this Section 22 in all material respects, neither Member shall invoke the provisions of subsections 3.2 (d)(iii) and (d)(iv) hereof.

22.8 No Commencement of Utility Operations Before Receiving All Necessary SEC Approvals. The Company will not commence operations of the System as a utility within the meaning of PUHCA unless and until the Board of Directors determines that any and all SEC approvals have been obtained or no-action letters have been received to the effect that such approvals will not be required or the Board has determined that no further such approvals or no-action letters are required; such commencement is expressly conditioned on necessary approvals and no-action letters having been obtained.

22.9 Rescission of Restructuring. If PUHCA is repealed, and unless FUNC and Pacific agree otherwise in writing, any and all steps theretofore taken to effect the Restructuring shall be rescinded as quickly as is reasonably possible, and the structure of the Company shall be returned to what it was before such Restructuring, without affecting any changes made which are not related to the Restructuring. The Company and the Members shall cooperate to obtain all required governmental approvals to implement this Section.

22.10 Structure B. The restructuring described in this Section 22.10 shall be referred to as "Structure B". If PUHCA is not repealed before the Completion Date, and Structure B is adopted by the Board of Directors pursuant to Section 22. 5, the Company may be restructured as follows, and the Operating Agreement amended accordingly:

(a) Admission of New Member. A new Member (the "Managing Member") reasonably acceptable to FUNC and Pacific, with the experience, resources and ability to perform the duties and obligations of the Managing Member set forth herein, shall be admitted as a Member of the Company in exchange for a Capital Contribution to be determined by the Board of Directors. In no event shall the Managing Member be an Affiliate of either FUNC or Pacific.

(b) Adjustment of Economic and Membership Interests. Upon admission of the Managing Member, the Membership Interests of FUNC, Pacific and the Managing Member shall be adjusted to 4.9%, 4.9% and 90.2%, respectively. The Economic Interests of FUNC, Pacific and the Managing Member shall be adjusted in accordance with the Capital Contribution made by the Managing Member; provided, however, that in no event shall the Managing Member's Economic Interest in the Company initially exceed 20%, and provided that such amount shall be the lowest amount the Members reasonably agree will achieve the intended purpose. Schedule 3.1 of the Agreement shall be amended to reflect the adjustment in Economic and Membership Interests of the Members.

(c) Voting By Members. All Members who have not Disassociated shall be entitled to vote on any matter submitted to a vote of the Members. There shall be one hundred (100) voting points, and each Member shall have one point for each percentage point of Membership Interest held by such Member from time to time, with changes in voting points effective at the same time as the corresponding changes in the Membership Interests of the Members. Attendance by two thirds of the Members shall constitute a quorum at any meeting of Members. If a quorum is present, the affirmative vote of Members holding at least 51% of the Membership Interests represented in person or by proxy shall be an act of the Members, unless the vote of a greater or lesser proportion or number is otherwise required by the Act, by the Certificate or by this Agreement. In no event shall the percentage of Membership Interests required to be voted in favor of an issue be less than the percentage of Director votes that would be required if the same matter were submitted to the Board of Directors.

(d) Board of Directors. The Board of Directors shall consist of three directors appointed by Pacific, three directors appointed by FUNC and three directors appointed by the Managing Member. The Directors shall vote as representatives of the Members, in the same proportion as the Members' Membership Interests and in the manner provided in Section 5.10(b). Attendance by at least one Director appointed by each Member shall constitute a quorum at any meeting of the Board of Directors. The affirmative vote of Directors voting 51 points shall be an act of the Board. The Managing Member shall elect the Chair of the Board of Directors.

(e) Deadlocks. The provisions contained in Sections 5.10(c) and 10.1(iv) of the Operating Agreement shall be deleted and shall be replaced with provisions that are comparable and reasonably reflective of the economic interests of the parties.

(f) Selection of President. The Board of Directors shall select the President.

(g) Selection of CFO and Limitation on Authority of CFO. The Board of Directors shall select the CFO. If the CFO determines that any proposed action of the Company is likely to have a material adverse effect on the Company, the CFO must obtain the approval of FUNC and Pacific before taking such action.

(h) Removal of Managing Member for Cause. FUNC and Pacific may, by mutual agreement, remove the Managing Member for cause. "Cause" will be defined in the Operating Agreement to include, but will not be limited to:

(1) Failure to Make Capital Contribution. The failure of the Managing Member to make timely a required Capital Contribution.

(2) Failure to Seek Approval of Major Matters. The failure of the Managing Member to seek approval of major matters materially affecting the business of the Company in the manner provided in subsection (i) below.

(3) Bankruptcy/Insolvency. The commencement of bankruptcy or insolvency proceedings against the Managing Member or its Affiliates.

(4) Breach of Operating Agreement. The Managing Member's breach of any provision of the Operating Agreement which has or may have a material adverse effect on the construction, operation or maintenance of the operations of the System or on the equity investments of FUNC or Pacific in the Company.

(5) Breach of Fiduciary Duty. The Managing Member's breach of fiduciary duty to either FUNC or Pacific, which duties shall not be less than those imposed upon a corporate director with respect to a corporation's shareholders.

(6) Change in Ownership. A 45% (provided that such percentage shall be reduced if the Members reasonably agree that such reduction shall not have an adverse regulatory effect) or greater change in the equity ownership of the Managing Member.

The Operating Agreement shall also provide that if the Managing Member is removed for cause, FUNC and Pacific may select another Person as the successor Managing Member. In no event shall the successor Managing Member be an Affiliate of FUNC or Pacific.

(i) Approval of Major Matters. Approval of major matters materially affecting the business of the Company shall require the affirmative vote of a majority of the voting points of FUNC and Pacific. Such matters shall include, but not be limited to, the following:

(1) Merger, Sale of Assets. Authorization of the merger or consolidation of the Company with any Person or any sale, lease, exchange, mortgage or other disposition of 25% or more of the fair market value of the assets of the Company (other than the sale of natural gas in the ordinary course of business).

(2) Dissolution, Liquidation. Dissolving or liquidating the Company.

(3) Indebtedness. Incurring or prepaying indebtedness (or providing guaranties of another entity's indebtedness) other than in the ordinary course of business, or, if in

the ordinary course of business, in an amount in excess of $1,000,000, provided that such amount shall be reduced if the Members reasonably agree that such reduction shall not have an adverse regulatory effect.

(4) Material Agreements.

Approval of the terms of a "Material Agreement" (as defined below),

Any material amendment or modification of any Material Agreement,

Waiver of compliance with any material provision of a Material Agreement,

Termination, assignment of any material rights the Company may have under, or consenting to or permitting the assignment by any other Person of any material right such Person may have under a Material Agreement, or

Giving consents or exercising any other material rights under a Material Agreement.

"Material Agreement" shall mean any agreement for the construction, installation, operation, maintenance or provision of other services to the System with a value of over $250,000, or the purchase of equipment with a value of over $100,000, or any other material agreement to which the Company is a party.

(5) Liens. Creating or otherwise allowing any Lien to be imposed on, or otherwise to affect, any of the Company's Property, except Permitted Liens.

(6) Settlements. Confessing a judgment or entering into any settlement of any dispute that would materially adversely affect the Company or require payment by the Company of more than $1,000,000, provided that such amount shall be reduced if the Members reasonably agree that such reduction shall not have an adverse regulatory effect.

(7) Form of Organization. Any change to the form of the organization of the Company, including, without limitation, the admission of any additional Member.

(8) Adoption of Budget. Adopting a budget that causes an increase of 15% or more for any category of expenses over the amount included in the prior year's budget, or an aggregate increase of 10%.

(9) Modification of Budget. Modifying a budget to result in a material increase for any category or expense, or an aggregate increase of 10%.

(10) Capital Expenditures. Making any capital expenditure in excess of $500,000, provided that such amount shall be reduced if the Members reasonably agree that such reduction shall not have an adverse regulatory effect.

(11) Governmental Action. Amending any material government permit, amending any filing with any governmental body, or seeking any governmental action other than is ordinarily required in the ordinary conduct of business.

(12) Insurance Proceeds. Making a determination with respect to the disposition of insurance proceeds in excess of $500,000, provided that such amount shall be reduced if the Members reasonably agree that such reduction shall not have an adverse regulatory effect, or the repair or rebuilding of any material portion of the System in the event of substantial damage or destruction.

(13) Bankruptcy Filing. (i) Commencing, or causing the Company to commence any case, proceeding or other action (A) under any existing or future law of any jurisdiction, domestic or foreign, relating to bankruptcy, to have an order for relief entered with respect to it, or seeking to adjudicate it a bankrupt or insolvent, or seeking reorganization, arrangement, adjustment, winding-up, liquidation, dissolution, composition or other relief with respect to it or its debts, or (B) seeking appointment of a receiver, trustee, custodian or other similar official for it or for all or any substantial part of its assets, or making a general assignment for the benefit of its creditors; or (ii) if there shall be commenced against the Company any case, proceeding or other action of a nature referred to in clause (i) above, taking any action in furtherance of, or indicating its consent to, approval of, or acquiescence, therein, or (iii) admitting in writing its inability to pay its debts as they become due.

(14) Transfer of Membership Interest by Managing Member. A sale, assignment, exchange, mortgage or other disposition of all or any part of the Managing Member's Membership Interest or Economic Interest in the Company.

(15) Capital Calls. The determination of Additional Capital required from the Members pursuant to Section 3.4 hereof.

(16) Distributions. The determination of Distributions pursuant to Sections 4.6, 4.7 or 4.8 hereof.

(j) Transactions with the Company. A Member, Director or Affiliate of any Member may enter into agreements, contracts, instruments or other transactions with the Company so long as any agreement, contract, instrument or other transaction between the Company and the Member, Director or such Affiliate is at no greater than market rates, on commercially reasonable terms and conditions such as are no less favorable to the Company than would be available in a bona fide arm's length transaction with a Person that is not an Affiliate, and has been approved by the Board of Directors (such approval not to be unreasonably withheld if it has been determined that the proposed transaction meets the other conditions set forth herein). A Director appointed by a Member who has an interest (economic or otherwise) in the outcome of any such agreement, contract, instrument or other transaction with the Company may not vote or consent upon any such matter.

(k) Support Services Agreement. Pacific or an Affiliate with equal or greater experience and expertise in the business of operating a local gas distribution company and FUNC or an Affiliate with equal or greater experience and expertise in the business of operating a local gas distribution company (collectively, the "Service Providers") shall at all times be parties to a Support Services Agreement with the Company pursuant to which the Service Providers make available to the Company, at commercially reasonable rates, the services of their employees on matters involving the day-to-day operations of the Company. Services provided by the Service Providers shall be provided as agent for the Board of Directors and shall be subject to the exclusive direction and control of the Board of Directors and the officers of the Company.

(l) Change in Control. The provisions of Section 9.1(g) shall not apply to transfers of interests in FUNC by ARB.

22.11 Structure C. The restructuring described in this Section 22.11 shall be referred to as "Structure C". If PUHCA is not repealed before the Completion Date, and Structure C is adopted by the Board of Directors pursuant to Section 22. 5, the Company may be restructured as follows, and the Operating Agreement amended accordingly:

(a) Adjustment of Economic and Membership Interests. The Economic and Membership Interests of FUNC and Pacific shall be adjusted as set forth in "Structure C" on Schedule 3.1 of this Agreement, and FUNC shall become the Managing Member.

(b) Voting By Members. All Members who have not Disassociated shall be entitled to vote on any matter submitted to a vote of the Members. There shall be one hundred (100) voting points, and each Member shall have one point for each percentage point of Membership Interest held by such Member from time to time, with changes in voting points effective at the same time as the corresponding changes in the Membership Interests of the Members. Attendance by both Members shall constitute a quorum at any meeting of Members. If a quorum is present, the affirmative vote of Members holding at least 51% of the Membership Interests represented in person or by proxy shall be an act of the Members, unless the vote of a greater or lesser proportion or number is otherwise required by the Act, by the Certificate or by this Agreement. In no event shall the percentage of Membership Interests required to be voted in favor of an issue be less than the percentage of Director votes that would be required if the same matter were submitted to the Board of Directors.

(c) Board of Directors. The Board of Directors shall consist of three directors appointed by Pacific and three directors appointed by FUNC. The Directors shall vote as representatives of the Members, in the same proportion as the Members' Membership Interests and in the manner provided in Section 5.10(b). Attendance by at one Director appointed by each Member shall constitute a quorum at any meeting of the Board of Directors. The affirmative vote of Directors voting 51 points shall be an act of the Board. FUNC shall elect the Chair of the Board of Directors.

(d) Deadlocks. The provisions contained in Sections 5.10(c) and 10.1(iv) of the Operating Agreement shall be deleted and shall be replaced with provisions that are comparable and reasonably reflective of the economic interests of the parties.

(e) Selection of President. The Board of Directors shall select the President.

(f) Selection of CFO and Limitation on Authority of CFO. The Board of Directors shall select the CFO. If the CFO determines that any proposed action of the Company is likely to have a material adverse effect on the Company, the CFO must obtain the approval of Pacific before taking such action.

(g) Removal of Managing Member for Cause. Pacific may remove the Managing Member for cause. "Cause" will be defined in the Operating Agreement to include, but will not be limited to:

(1) Failure to Seek Approval of Major Matters. The failure of the Managing Member to seek approval of major matters materially affecting the business of the Company in the manner provided in subsection (h) below.

(2) Bankruptcy/Insolvency. The commencement of bankruptcy or insolvency proceedings against the Managing Member or its Affiliates.

(3) Breach of Operating Agreement. The Managing Member's breach of any provision of the Operating Agreement which has or may have a material adverse effect on the construction, operation or maintenance of the operations of the System or on the equity investments of Pacific in the Company.

(4) Breach of Fiduciary Duty. The Managing Member's breach of fiduciary duty to Pacific, which duties shall not be less than those imposed upon a corporate director with respect to a corporation's

shareholders.

The Operating Agreement shall also provide that if the Managing Member is removed for cause, FUNC and Pacific shall agree upon a successor Manager. If FUNC is removed as Managing Member, FUNC's Economic Interest in the Company shall not be altered.

(h) Approval of Major Matters. Approval of major matters materially affecting the business of the Company shall require the affirmative vote of Directors voting 96 voting points or of Members holding 96% of all Membership Interests. Such matters shall include, but not be limited to, the following:

(1) Merger, Sale of Assets. Authorization of the merger or consolidation of the Company with any Person or any sale, lease, exchange, mortgage or other disposition of 25% or more of the fair market value of the assets of the Company (other than the sale of natural gas in the ordinary course of business).

(2) Dissolution, Liquidation. Dissolving or liquidating the Company.

(3) Indebtedness. Incurring or prepaying indebtedness (or providing guaranties of another entity's indebtedness) other than in the ordinary course of business, or, if in the ordinary course of business, in an amount in excess of $1,000,000, provided that such amount shall be reduced if the Members reasonably agree that such reduction shall not have an adverse regulatory effect.

(4) Material Agreements.

Approval of the terms of a "Material Agreement" (as defined below),

Any material amendment or modification of any Material Agreement,

Waiver of compliance with any material provision of a Material Agreement,

Termination, assignment of any material rights the Company may have under, or consenting to or permitting the assignment by any other Person of any material right such Person may have under a Material Agreement, or

Giving consents or exercising any other material rights under a Material Agreement.

"Material Agreement" shall mean any agreement for the construction, installation, operation, maintenance or provision of other services to the System with a value of over $250,000, or the purchase of equipment with a value of over $100,000, or any other material agreement to which the Company is a party.

(5) Liens. Creating or otherwise allowing any Lien to be imposed otherwise to affect, any of the Company's Property, except Permitted Liens.

(6) Settlements. Confessing a judgment or entering into any settlement of any dispute that would materially adversely affect the Company or require payment by the Company of more than $1,000,000, provided that such amount shall be reduced if the Members reasonably agree that such reduction shall not have an adverse regulatory effect.

(7) Form of Organization. Any change to the form of the

organization of the Company, including, without limitation, the admission of any additional Member.

(8) Adoption of Budget. Adopting a budget that causes an increase of 15% or more for any category of expenses over the amount included in the prior year's budget, or an aggregate increase of 10%.

(9) Modification of Budget. Modifying a budget to result in a material increase for any category or expense, or an aggregate increase of 10%. 6.

(10) Capital Expenditures. Making any capital expenditure in excess of $500,000, provided that such amount shall be reduced if the Members reasonably agree that such reduction shall not have an adverse regulatory effect.

(11) Governmental Action. Amending any material government permit, amending an filing with any governmental body, or seeking any governmental action other than is ordinarily required in the ordinary conduct of business.

(12) Insurance Proceeds. Making a determination with respect to the disposition of insurance proceeds in excess of $500,000, provided that such amount shall be reduced if the Members reasonably agree that such reduction shall not have an adverse regulatory effect, or the repair or rebuilding of any material portion of the System in the event of substantial damage or destruction.

(13) Bankruptcy Filing. (i) Commencing, or causing the Company to commence any case, proceeding or other action (A) under any existing or future law of any jurisdiction, domestic or foreign, relating to bankruptcy, insolvency, reorganization or relief of debtors, seeking to have an order for relief entered with respect to it, or seeking to adjudicate it a bankrupt or insolvent, or seeking reorganization, arrangement, adjustment, winding-up, liquidation, dissolution, composition or other relief with respect to it or its debts, or (B) seeking appointment of a receiver, trustee, custodian or other similar official for it or for all or any substantial part of its assets, or making a general assignment for the benefit of its creditors; or (ii) if there shall be commenced against the Company any case, proceeding or other action of a nature referred to in clause (i) above, taking any action in furtherance of, or indicating its consent to, approval of, or acquiescence, therein, or (iii) admitting in writing its inability to pay its debts as they become due.

(14) Capital Calls. The determination of Additional Capital required from the Members pursuant to Section 3.4 hereof.

(15) Distributions. The determination of Distributions pursuant to Sections 4.6, 4.7 or 4.8 hereof.

22.12 Structure D. The restructuring described in this Section 22.12 shall be referred to as "Structure D". If PUHCA is not repealed before the Completion Date, and Structure D is adopted by the Board of Directors pursuant to Section 22. 5, the Company may be merged into and become a division of Southern California Gas Company (the "Gas Company"). Such a merger would be carried out in a manner that would preserve the balance of economic benefits and burdens and management control set forth in this Operating Agreement. If Structure D is adopted, the Members shall negotiate in good faith to determine

an economic adjustment that recognizes any tax burden impacting only one Member and that is directly attributable to the Restructuring. Such tax burden shall include taxable events impacting only one Member at the time of implementation of the Restructuring as well as any change in the nature of taxes (i.e ordinary income vs. capital gain) thereafter imposed on the Member with respect to the Company (without regard to the Member's specific tax situation). Following such merger, the provisions of Section 9.1(g) shall not apply to transfers of interests in FUNC by ARB. Notwithstanding the foregoing, at the sole election of FUNC, FUNC's influence on the resulting division of the Gas Company may be limited to reasonable rights and protections that may be as limited as the Reasonable Rights and Protections.

SECTION 23 - GENERAL

23.1. Project Finance: Limitation on Obligations of FUNC and Pacific. With respect to the terms and conditions of the System Loan, or any other debt of the Company, the Members agree that (a) neither FUNC nor Pacific will provide any guarantee or other financial accommodation to or in favor of the Company or to any lender, nor will it provide any pledge, mortgage or other security interests in its assets, and (b) that parties holding security interests in FUNC's assets will not be requested to enter into non-disturbance agreements regarding the use by the Company of any of FUNC's assets. The parties further covenant with respect to obtaining the System Loan as follows:

(a) Pacific and FUNC, acting jointly, each shall use its good faith best efforts to cause the Company to obtain the System Loan reflecting a ratio of seventy-five percent debt financing and twenty-five percent equity financing, represented by the Capital Contributions provided for herein. Any System Loan shall be on commercially reasonable terms and conditions, including interest rate and maturity, for projects of similar size and scope that are not subject of guaranties by the parents of the members of the Company. The target amount of System Loan is, therefore, equal to seventy-five percent of the Total Capital Need.

(b) If the Company is unable to raise at least seventy percent of the Total Capital Need through the System Loan, Pacific's affiliate, Energy Pacific, shall provide up to $4,000,000 in incremental financing for the Company in the form of a Capital Contribution by Pacific (the "Incremental Equity"). The final amount of the Incremental Equity shall be an amount equal to seventy percent of the Total Capital Need minus the amount of the System Loan, but in no event shall be greater than $4,000,000.

(c) The Incremental Equity shall be a part of the capital of the Company and shall be included in determining the Economic Interests of the Members in the Company. The Incremental Equity, however, will not be included for purposes of determining the Membership Interests or voting interests of the Members in the Company before the fourth anniversary of the funding of the Incremental Equity. After such date no distinction shall be drawn between Capital Contributions otherwise provided for in this Operating Agreement and Incremental Equity.

(d) The Company shall use its best efforts to redeem and repurchase such Incremental Equity (in whole or in part) from time to time as feasible in light of its financial position, and as permitted under the covenants in favor of its lenders and any applicable law prior to and on the fourth anniversary of the funding of the Incremental Equity. FUNC shall have the right at any time on or before the fourth anniversary of the funding of the Incremental Equity, upon written notice to Pacific, to purchase up to one-half of the Incremental Equity then outstanding. The purchase price to be paid by the Company or FUNC shall be paid in cash at the amount of the Incremental Equity purchased.

23.2. Further Cooperation. The Parties agree to execute and furnish any and all papers and documents which may reasonably be necessary to carry out the terms of this Agreement and to further the interests of the Company, including, without limitation, any financial statements, corporate resolutions, and other documentation and information as may be required by bonding companies, insurers, depositories of funds of the Company, construction and permanent lenders and public agencies involved in the funding of the Project Implementation Plan and to permit granting authorities relative to permits required for the performance of the Project Implementation Plan.

23.3. Counterparts. This Agreement may be executed in any number of counterparts, each of which shall be deemed to be an original as against any party whose signature appears thereon, and all of which shall together constitute one and the same instrument. This Agreement shall become binding when one or more counterparts hereof, individually or taken together, shall bear the signatures of all of the parties reflected hereon as the signatories.

23.4. Notices. All notices, request, demands and other communications required hereunder shall be in writing and shall be deemed to have been duly given or made if delivered personally, sent by facsimile transmission or telex confirmed in writing within two (2) business days, or sent by registered or certified mail, postage prepaid, as follows:

In the event of notice to Pacific:

Frontier Pacific
c/o Energy Pacific
633 W. Fifth Street, Suite 5200
Los Angeles, CA 90071-2071
Attention: President
Fax: 213-629-9651

and in the event of a notice to FUNC:

Frontier Utilities of North Carolina
c/o ARB, Inc.
14409 Paramount Boulevard
Paramount, CA 90723
Attention: President
Fax: (562) 601-4604

Any Party may change the address to which such communications are to be sent to it by giving written notice of change of address to the other party in the manner provided above for giving notice.

23.5. Attorneys Fees. The prevailing party shall be entitled to reasonable attorneys' fees and expenses in the event of any litigation arising out of or related to this Agreement or the System.

23.6. Authorization; Enforceability. This Agreement has been duly authorized by all corporate and other action required by Pacific and FUNC, respectively, and constitutes the valid, binding and enforceable obligation of such party.

23.7. Amendments. The provisions of this Agreement may not be amended, modified or waived except by a written instrument executed by each Member.

23.8. Severability. Any provision of this Agreement which is prohibited or unenforceable in any jurisdiction shall not invalidate the remaining provisions hereof, and any such prohibition or unenforceability in any jurisdiction shall not invalidate or render unenforceable such provision in any other jurisdiction.

23.9. Counterparts. This Agreement may be signed in any number of counterparts with the same effect as if the signatures thereto and hereto were upon the same instrument.

IN WITNESS WHEREOF the parties have entered this Operating Agreement as of the first date set forth above.

FRONTIER UTILITIES OF NORTH CAROLINA	FRONTIER PACIFIC, INC.
By: /s/ John P. Schauerman	By: /s/ Andrew R. Rea
Name: John P. Schauerman	Name: Andrew R. Rea
Title: President	Title: Vice President

SCHEDULE 3.1
TO OPERATING AGREEMENT OF
FRONTIER UTILITIES OF NORTH CAROLINA LLC

Situation A: As of the date hereof

Name and address of Member	Capital Contribution	Economic Interest	Membership Interest
Frontier Pacific	$3,272,500	50%	50%
Frontier Utilities of North Carolina	$3,272,500	50%	50%

Structure C: If the structure is changed to Structure C as provided in Section 22.5

Name and address of Member	Capital Contribution	Economic Interest	Membership Interest
Frontier Pacific	$3,272,500	50%	4.9%
Frontier Utilities of North Carolina	$3,272,500	50%	95.1%

FURTHER CONTRIBUTIONS

The Members' Further Contributions (as defined in Section 3.3) shall equal $5,455,000, in the aggregate.

APPENDIX 3.3

OUTLINE AND GENERAL PARAMETERS OF CONSTRUCTION BUDGET

STATE OF NORTH CAROLINA
UTILITIES COMMISSION
RALEIGH

DOCKET NOS. G-38, SUB 3 and G-40

BEFORE THE NORTH CAROLINA UTILITIES COMMISSION:

In the Matter of Application of Frontier Utilities of North Carolina, Inc. and Frontier Energy LLC for Approval of Final Financing Plan, to Transfer Certificates, and for Approval or Waiver of Security Bond,	)	Application

NOW COMES APPLICANTS FRONTIER UTILITIES OF NORTH CAROLINA ("Frontier Utilities") AND FRONTIER ENERGY, LLC ("Frontier Energy") and hereby respectfully make application to the North Carolina Utilities Commission ("Commission"), pursuant to Commission Rules R1-4, R1-5, R1-16 and N.C. Gen. Stat. Sections 62-111, 62-153, 62-161 et seq. (a) for approval of final financing plan, including the participation of Frontier Pacific, Inc. as an equity partner and the formation of Frontier Energy, LLC; (b) for approval of approximately $12,000,000 in equity investment, including $3,250,000 in cash deposited on January 21, 1997 in Frontier Energy's account with NationsBank in Elkin, North Carolina, $5,000,000 in transmission pipe that has already been ordered, and $3,250,000 in capital and in-kind contributions by Frontier Utilities; (c) for preliminary approval to borrow up to $40,000,000 principal amount in debt; (d) to transfer certificates; and (e) for approval or waiver of security bond. In support thereof, the Applicants show the Commission as follows:

The names, addresses and telephone numbers of persons to whom any notices or other communications with respect to this Application are to be sent are as follows:

Frontier Energy, LLC
1919 North Bridge Street
Elkin, North Carolina 28621
tele: 910-526-2690

Donald Liddell, Esq.
Energy Pacific, LLC.
633 West Fifth Street, Suite 56K
Los Angeles, CA 90071-2006
tele: 213-895-5166

Mr. John Schauerman
ARB, Inc.
2600 Commercenter Driver
Los Angeles, CA 92630
tele: 714-454-7103

Mr. Andrew Rea
Energy Pacific, LLC.
633 West Fifth Street, Suite 56K
Los Angeles, CA 90071-2006
tele: 213-895-5734

M. Gray Styers, Jr., Esq.
James P. Cain, Esq.
Kilpatrick Stockton LLP
4101 Lake Boone Trail, Suite 400
Raleigh, NC 27607
tele: 919-420-1700

Mr. Robert J. Oxford
Frontier Utilities of North Carolina, Inc.
4501 Wadsworth Blvd.
Wheat Ridge, CO 80033
tele: 303-422-3400

II. BACKGROUND INFORMATION

Frontier Utilities is. a corporation duly organized and existing under the taws of the State of North Carolina for the purpose of providing natural gas service in certain areas of North Carolina pursuant to Certificates of Public Convenience and Necessity heretofore issued by the Commission. Frontier Utilities is a public utility under the laws of this State, and its efforts to commence public utility operations in North Carolina are subject to the jurisdiction of this Commission.

Frontier Utilities received a Certificate of Public Convenience and Necessity to construct a natural gas transmission and local distribution systems in Surrey, Wilkes, Watauga, and Yadkin Counties in consolidated Docket Nos. G-38 and G-9, Sub 357, on January 30, 1996. The order granting this Certificate was affirmed by the North Carolina Supreme Court on July 24,

1997. The time in which a petition for writ of certiorari to the United States Supreme Court could have been filed to challenge this decision expired on November 11, 1997. Ashe and Allegheny Counties were added to Frontier Utilities' certificated territory, pursuant to N.C. Gen. Stat. Section 62-36A(b1), by Order of the Commission in Docket No. G-100, Sub 69, issued on August 16, 1996. Frontier Utilities received a Certificate of Public Convenience and Necessity to construct and operate a natural gas transmission and distribution system in Warren County in Docket G-38, Sub 1, on March 27, 1997. Collectively, the transmission and distribution system to be built in the Four-County area and in Warren County, financed as explained in greater detail below, is hereinafter referred to as "the System."(1)

Both the Certificates in consolidated Docket Nos. G-38 and G-9, Sub 357, and in Docket No. G-38, Sub 1, require Frontier Utilities to file for approval of its final financing plan within nine months of the date that the Order in Docket Nos. G-38 and G-9, Sub 357 becomes final by the expiration of any period during which that Order may be appealed (i.e. November 11, 1997). A purpose of this current application is to request approval of this financing plan for the System, pursuant to these Certificates and the requirements of N.C. Gen. Stat. Sections 62-161 et seq.

Since the issuance of the Supreme Court decision, Frontier Utilities has been actively talking and meeting with potential investors and partners who had previously expressed their interest in the project. These potential investors and partners

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1 Although Frontier Energy plans to serve both Ashe and Allegheny Counties as soon as possible and feasible, the financing plan set forth herein does not include the system to be fuilt in those counties. To the extent that Commission approval will be reuqied fore additional financing for the extension of the System into those two counties, that financing plan will be tghe subject of a future docket.

have been performing their own studies of the natural gas markets in Frontier's certificated territories and the transmission and distribution systems that will be needed to serve those markets. After considerable investigation and deliberation, Frontier Utilities has chosen a partner that brings significant natural gas distribution and energy related experience and skills and substantial resources to serve the industries, businesses, and residents in its territories.

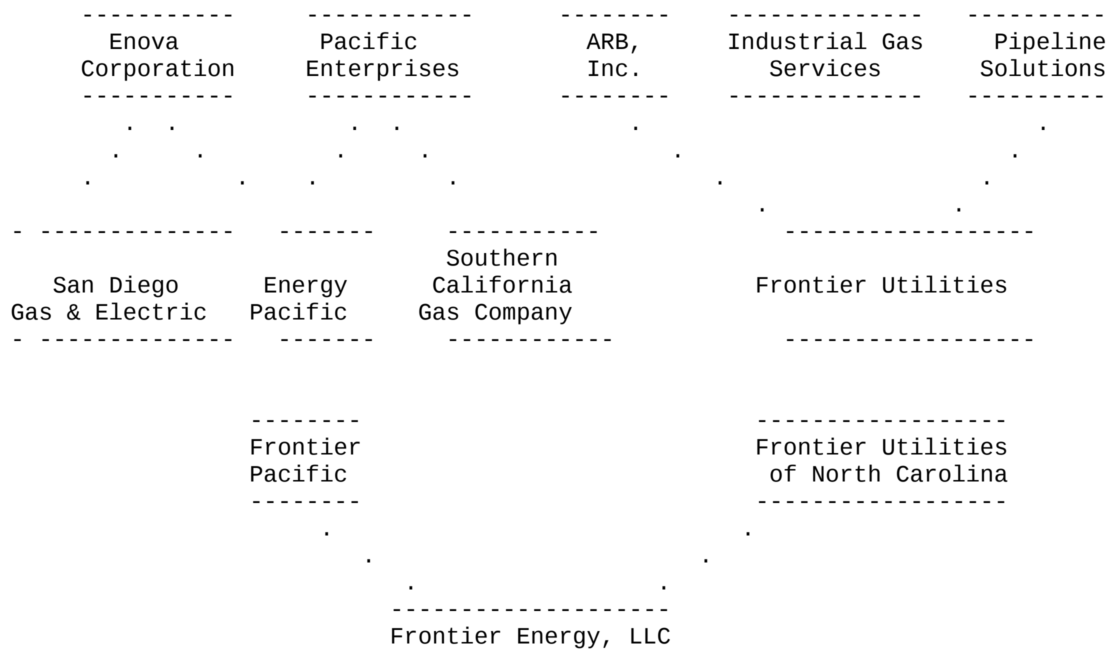
III. FINANCING PLAN: EQUITY PARTNER - FRONTIER PACIFIC, INC. FORMATION OF FRONTIER ENERGY, LLC

Frontier Utilities' proposed equity partner is Frontier Pacific, Inc. ("Frontier Pacific"), a wholly-owned subsidiary of Energy Pacific, LLC, a joint venture of subsidiaries of pacific Enterprises and Enova Corporation. Frontier Utilities and Frontier Pacific will each be fifty-percent (50%) members of a newly formed entity, Frontier Energy, LLC ("Frontier Energy"). Frontier Energy is a limited liability company organized under the laws of the State of North Carolina. The Articles of Organization of Frontier Energy are attached hereto behind Tab A. If approved in this docket, Frontier Energy will be a public utility under the laws of this State, and its public utility operations in North Carolina will be subject to the jurisdiction of this Commission. The formation of Frontier Energy provides an organizational structure for all parties to contribute the necessary capital for construction and operations, to share in the management responsibility and ownership, to allocate appropriately the inherent risks and potential rewards, and to minimize administrative, tax, and other burdens that might otherwise be present with alternative structures.

As a partner in this venture, Frontier Pacific, through its affiliated companies, brings not only financial resources, but

also a proven track record and extensive technical expertise and experience. Moreover, this project is consistent with the objectives of Energy Pacific (Frontier Pacific's parent) to invest and participate in energy business opportunities in unserved or underserved areas and that arise from changes in energy markets. Exhibit B shown below and attached hereto behind Tab B contains a chart indicating the relationship of Frontier Utilities, Frontier Pacific, Frontier Energy, and some of their affiliated companies.

Exhibit B
Organization Chart



As shown on Exhibit B, Pacific Enterprises and Enova Corporation, who are currently merging with one another, are the parent companies of Southern California Gas Company and San Diego Gas & Electric, respectively. Together, they serve over six million energy customers and are the nation's largest natural gas distributor. The most recent annual reports for Pacific Enterprises and Enova Corporation are attached as behind Tabs C and D, respectively

Specifically, Frontier Energy will have access to the engineering, legal, financial, and administrative resources of Pacific Enterprises and Enova Corporation. Frontier Energy's officers involved in the building and initial operations of the Frontier system include the following persons: John Schauerman, President; Andrew Rea, Senior Vice President; Robert Oxford, Vice President of Public Affairs; Rodger Schwecke, Vice President of Marketing; Kenneth Teague, Vice President of Operations; Robert Salvaria, Treasurer; and Donald Liddell, Secretary. Other key personnel include Steve Shute; Larry Rich; David Schiller; and Antonio Prietto. Biographical profiles for all of these persons are attached behind Tab E.

IV. EQUITY CAPITALIZATION

The capitalization of Frontier Energy will total approximately $12,000,000 in equity, including a cash contribution of approximately $3,250,000 by Frontier Pacific, which has already been deposited with NationsBank in Elkin, North Carolina, almost $5,000,000 in pipe that has been ordered for delivery on or about March 1, 1998, and $3,250,000 in cash and in-kind contributions (start-up efforts, investigations and studies, and certificates, etc.) contributed by Frontier Utilities. Upon information and belief, this represents the largest equity capitalization of a new public utility ever in North Carolina. The amount of this investment also demonstrates the resources and the commitment of Frontier Energy and its members to ensure high quality, safe, and reliable natural gas service to its customers.

Frontier Energy will borrow additional funds for the construction of the system, as described in more detail below,

not to exceed 75% of the total financing. Contributions by Frontier Pacific, as equity, will constitute the balance of the unfinanced portion, if necessary. Both Frontier Pacific and Frontier Utilities intend to retain their respective 50% membership interest in Frontier Energy, at least through and until the system construction, as proposed and projected, is completed.

V. DEBT FINANCING

Frontier Utilities and Frontier Energy have determined that, under present market conditions, an agreement for the borrowing of funds to be received at the times needed to meet the cash needs of the ongoing construction of the System will provide Frontier Energy with the maximum flexibility for debt financing on reasonable and favorable terms.

Frontier Energy intends to enter into an agreement for the debt containing the following terms and subject to the following limitations:

Maximum Debt:	$40 million
Minimum Maturity:	3 years
Maximum Maturity:	10 years
Interest Rates:	Not to exceed LIBOR (London inter-bank offered rate) + 3.50% or 9.50% at today's rates.
Fees:	Not to exceed 2.5% of total debt
Collateral:	To be negotiated, but may include the pledge of the company's assets and/or the members' equity interest
Covenants and Other Limitations:	To be negotiated with banks but will include financial covenants, such as: - total debt-total capital not to exceed 75% - restrictions on dividends/distributions

Frontier Energy has talked with a number of lenders regarding the arrangement of a debt facility consistent with these terms. At present, the negotiations have progressed the farthest with NationsBank and Societe Generale, although other banks that are considering the project include Bank of America, ABN AMRO, and Union Bank of California. Letters of interest by NationsBank and Societe Generale are attached hereto behind Tabs F and G respectively.

In order to. facilitate and expedite the debt financing, Frontier Utilities and Frontier Energy requests approval of this financing in two stages. First would be preliminary, general approval of borrowing of up to $40,000,000, as part of the final financing plan, consistent with the terms outlined above. Second would be final approval of the definite terms of the financing with the specific lending institution(s) from whom Frontier Energy decides to borrow these funds, as set forth in a firm Commitment Letter and Term Sheet with the institution(s).

Frontier Energy anticipates filing the Commitment Letter and Term Sheet before, or very shortly after, the initial approval of this proposed financing plan, as requested herein, and that this second approval may occur in a subsequent Order in this docket, following that filing. Because of the exigencies of the process of closing financing of this type and the need for funds to continue construction, which will already have begun, Frontier Energy would respectfully request that this final approval occur as soon as practical following the filing of the Commitment Letter and Term Sheet of the financing.

In addition, as noted above, it may be necessary for the debt to be secured by the system assets of Frontier Energy or its members' equity interest. Therefore, pursuant to the requirements of N.C. Gen. Stat. Section 62-160, Frontier

Utilities and Frontier Energy also requests permission to pledge the assets of the company if necessary to obtain financing, to be approved at the time of the final approval of the terms of the financing as set forth in the commitment letter and term sheet.

As soon as possible after the Commission's final approval of the financing, Frontier Energy will proceed with the closing of the debt financing. As soon as the financing documentation is executed, Frontier Energy will file all of this documentation with the Commission, so that its compliance with the terms of the Commitment Letter and Term Sheet can be confirmed

In summary, Frontier Utilities and Frontier Energy request authorization and permission to receive equity investments and preliminary approval to borrow debt and pledge assets as outlined above for the construction and initial operations of a natural gas transmission and distribution system in Surrey, Watauga, Wilkes, Yadkin, and Warren Counties, consistent with the evidence that was presented in Docket Nos. G-38 and G-9, Sub 357 and Docket No. G-38, Sub 1. These transactions are necessary and essential for Frontier Utilities/Frontier Energy to construct the System and provide service in these counties as authorized by certificates issued by the Commission in those dockets, and Frontier's ability to provide that utility service in a timely manner will be impaired in the absence of permission and authorization to undertake the transactions contemplated and to borrow debt as described above.

VI. TRANSFER OF CERTIFICATES

Because of the organizational structure of this financing plan, Frontier Utilities also needs to transfer its Certificates of Public Convenience and Necessity for the Four-County area (Surrey, Watauga, Wilkes, and Yadkin Counties), for Ashe and Allegheny Counties, and for Warren County to Frontier Energy and for Frontier Energy to own and operate the System in these areas. The System will be designed, constructed, and operated in substantial conformity with the evidence presented by Frontier Utilities in consolidated Docket Nos. G-38 and G-9, Sub 357 and Docket No. G-38, Sub 1. During the first five years of construction, Frontier Energy projects installing 146 miles of steel transmission pipe and distribution pipe to serve 13,250 residential, 1,054 small commercial, 300 poultry, and 55 large commercial and industrial customers by the end of the fifth year.

Additional distribution pipe will be installed after Year-5 as needed and feasible to serve more customers. The exhibit attached behind Tab H contains a more detailed breakdown of Frontier Energy's projections of the volumes of gas it plans to provide and the number of customers it hopes to serve over next five years

As a successor to Frontier Utilities, Frontier Energy agrees to accept all of the obligations and commitments of Frontier Utilities, pursuant to the terms of the certificates and the rules and regulations of the North Carolina Utilities Commission. In addition to the transmission and local distribution systems to be built in northwestern North Carolina, it intends to construct a system in Warren County. At the present time, Frontier Energy has already ordered 55 miles of 10-inch, 76 miles of 6-inch, and 15-miles of 4 inch steel transmission pipe at a cost of almost $5,000,000 and intends to begin construction in the Four-County area by the second quarter of 1998 if the necessary approvals are granted. Assuming no unanticipated delays, gas should be delivered to Frontier's first key industrial customers in the summer of this year. Construction of the system in Warren County will not begin as soon as in northwestern North Carolina, because Frontier Pacific had not completed its final investigation and verification of the economics of the system in Warren County at the time of its commitment to invest as an equity partner. Frontier Energy, however, plans to build the Warren County system from the equity invested by its members and does not anticipate the need for any additional financing beyond what is outlined above. Frontier Energy will file for approval of its plans to build the Warren County system, along with its agreement for interstate pipeline capacity for this system, on or before August 11, 1998.

VII. APPROVAL OR WAIVER OF SECURITY

In addition to approval of the final financing plan, the

certificate issued by the Commission in Docket Nos. G-38 and G-9, Sub 357 required Frontier to file for approval of security in the form of a bond in the amount of $4 million payable if (1) Frontier abandons the system so that the Commission has to appoint an emergency operator and (2) the funds are needed for the emergency operator to reliably operate the system. Likewise, in Docket No. G-38, Sub 1, the Commission's final Order required approval of security in the amount of $500,000 for the Warren County project for the same purpose. The need for such security was discussed in the context of concerns raised because Frontier Utilities was a new utility company. The Orders in both dockets stated, "The Order need not be executed at th[e] time [of approval], but must be ready to be executed." Accordingly, attached hereto as Exhibit I is such security, ready to be executed.

Although Frontier Energy stands ready, willing, and able to fulfill these requirements, it believes that the track record, reputation, experience, and financial strength of Energy Pacific and its corporate parents obviate the need for such security. For example, the $12,000,000 equity contribution demonstrates that a separate security of $4,500,000 is totally unnecessary The Certificate in Docket Nos. G-38 and G-9, Sub 357 expressly stated, "It is the Commission's intention that the required security should eventually be eliminated," and requested that the Public Staff annually "evaluate the current and prospective risks of the project and recommend to the Commission whether. . the bond should continue to be required." Under the present circumstance, the "current and prospective risks of the project" render a bond a bond unnecessary, and therefore one should not be required.(2) There is no practical, realistic scenario in which such a bond would be needed to ensure the continued operation of the System. Therefore, Frontier Utilities and Frontier Energy respectfully request that this requirement be waived.

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2 Even without a performance bond, the construction and operation of the System will be assured in other ways (e.g. construction bond of the Contractor, business and liability insurance, compliance inspections by the Commission's pipeline safety staff, etc.) as the Commission observed in its Order granting the certificate to Frontier (Order of January 30, 1996, in Docket Nos. G-38 and G-9, Sub 357, pp. 29-30).

VIII. EXHIBITS

The following exhibits are filed along with this Application behind the corresponding lettered tabs and are incorporated herein by reference . :

Exhibit A - Articles of Organization of Frontier Energy

Exhibit B - Organization Chart of Frontier Energy and some of their affiliated companies

Exhibit C - Annual Report of Pacific Enterprises

Exhibit D - Annual Report of Enova Corporation

Exhibit E - Biographical Profiles of Officers, Directors, and Key Personnel

Exhibit F - Letter of Interest from NationsBank

Exhibit G - Letters of Interest from Societe Generale

Exhibit H- Projections - Numbers of Customers and Volumes

Exhibit I - Bond letter and unexecuted Bond

IX. CONCLUSION

Frontier Utilities and Frontier Energy represent that the formation of the limited liability corporation, the investment of equity and borrowing of debt, and the transfer of certificates are for a lawful object within their corporate purposes, compatible with the public interest, necessary and appropriate for and consistent with the proper performance by them of their service to the public, and that these measures will not impair their ability to perform that service and are reasonably necessary and appropriate for such purposes.

WHEREFORE, Frontier Utilities and Frontier Energy respectfully request that the Commission enter an order (a) approving the final financing plan, including the formation of Frontier Energy, LLC, its investment of equity, and the plan for borrowing debt, as discussed above; (b) granting preliminary approval of the terms of the debt financing within the parameters set forth above and the pledging of assets of the company to secure such debt, and empowering and permitting Frontier Energy to negotiate the appropriate agreements with underwriters or agents for the borrowing of debt consistent with these terms, (c) bifurcating this proceeding so that final approval of the debt financing shall occur in a subsequent Order of the Commission following the filing of the Commitment Letter and Term Sheet with specific lending institution(s); (d) transferring to Frontier Energy the certificates of public convenience and necessity currently issued to Frontier Utilities, and (e) concluding that a security, as contemplated by orders in Docket Nos. G38 and G-9, Sub 357 and Docket No. G-38, Sub 1, is no longer needed, and that such requirements are hereby waived.

Respectfully submitted, this the 23rd day of January, 1998.

KILPATRICK STOCKTON LLP

By: /s/ M. Gray Styers, Jr.

M. Gray Styers, Jr.
James P. Cain
4101 Lake Boone Trail, Suite 400
Raleigh, North Carolina 27607
Telephone: 919/420-1700
Attorneys for Frontier Utilities of North Carolina, Inc. and Frontier Energy, LLC

STATE OF Colorado)

) VERIFICATION
COUNTY OF Jefferson)

Robert J. Oxford, as President of Frontier Utilities of North Carolina, being first duly sworn, deposes and says:

That he has read the foregoing Application and knows the contents thereof; that the same is true of this own knowledge, except as to those matters therein alleged upon information and belief, and as to those matters, he believes them to be true.

/s/ Robert J. Oxford

Robert J. Oxford

SWORN TO AND SUBSCRIBED
before me this 22nd day of
January , 1998

/s/ Peggy C. Oxford

Notary Public

My Commission Expires:

10-31-98

STATE OF California)

) VERIFICATION

COUNTY OF Los Angeles)

Andrew Rea, on behalf of Frontier Energy, LLC, being duly sworn, deposes and says that he is the Senior Vice President of Frontier Energy, LLC; that as such he has read the foregoing Application and knows the contents thereof; that the same are true of his own knowledge except as to those matters stated on information and belief and as to those matters he believes them to be true.

/s/ Andrew Rea

Andrew Rea, Senior Vice President
Frontier Energy, LLC

SWORN TO AND SUBSCRIBED
before me this 22nd day of
January , 1998

/s/ Louise Trammel

Notary Public

My Commission Expires:

3-17-2000

CERTIFICATE OF SERVICE

I, M. Gray Styers, Jr., hereby certify that on this date I served the foregoing APPLICATION OF FRONTIER UTILITIES OF NORTH CAROLINA, INC. AND FRONTIER ENERGY, LLC upon counsel of record by depositing a copy thereof in the United States mail, postage prepaid and addressed as follows:

Mr. Robert P. Gruber
Executive Director, Public Staff
North Carolina Utilities Commission
Post Office Box 29520
Raleigh. North Carolina 27626-0520

Mark Payne, Esq.
Attorney General's Office
Department of Justice
P.O. Box 629
Raleigh, NC 27602

This the 23rd day of January, 1998.

/s/ M. Gray Styers

M. Gray Styers,

KILPATRICK STOCKTON LLP
4101 Lake Boone Trail, Suite 400
Raleigh, North Carolina 27607
Telephone: (919) 420-1700

STATE OF NORTH CAROLINA
UTILITIES COMMISSION
RALEIGH

DOCKET NO. G-38, SUB 3
DOCKET NO. G-40

BEFORE THE NORTH CAROLINA UTILITIES COMMISSION

In the Matter of	
Application of Frontier Utilities of North Carolina, Inc., and Frontier Energy, LLC, for Approval of Final Financing Plan, to Transfer Certificates, and for Approval or Waiver of Security Bond	) ORDER APPROVING FINAL) FINANCING PLAN, TRANSFER) OF CERTIFICATES, AND) SECURITY BOND AND) PRELIMINARILY APPROVING) DEBT FINANCING

BY THE COMMISSION: Frontier Utilities of North Carolina, Inc. (Frontier Utilities), was granted a certificate of public convenience and necessity by this Commission to serve the Four-County area of Surry, Watauga, Wilkes, and Yadkin Counties by Order dated January 30, 1996, in Docket Nos. G-38 and G-9, Sub 357. The North Carolina Supreme Court affirmed this Order by opinion filed July 24, 1997, which became final on November 11, 1997, by the expiration of the deadline to file for review by the United States Supreme Court. Ashe and Allegheny Counties were added to Frontier Utilities' territory pursuant to G.S. 62-36A(b1) by Order dated August 16, 1996, in Docket No. G-100, Sub 69. The certificate to serve Warren County was awarded to Frontier Utilities by Order dated March 27, 1997. The Orders awarding the Four-County area and Warren County to Frontier Utilities required it to file its final financing plan within nine months of the date the Four-County Order became final.

On January 23, 1998, Frontier Utilities and Frontier Energy, LLC (Frontier Energy), filed an application (a) for approval of their final financing plan, including the participation of Frontier Pacific, Inc., as an equity partner and the formation of Frontier Energy; (b) for approval of approximately $12 million in equity investment, including $3.25 million in cash deposited on January 21, 1997, in Frontier Energy's account with NationsBank in Elkin, North Carolina, $5 million in transmission pipe that has already been ordered, and $3.25 million in capital and in-kind contributions by Frontier Utilities; (c) for preliminary approval to borrow up to $40 million principal in debt; (d) to transfer the certificates of public convenience and necessity awarded to Frontier Utilities to serve Surry, Watauga, Wilkes, and Yadkin Counties (the Four-County area), Ashe and Allegheny Counties, and Warren County to Frontier Energy; and (e) for approval or waiver of a security bond.

Under the proposed financing plan as filed, Frontier Utilities and Frontier Pacific, Inc., will be fifty-percent (50%) members of a newly formed entity, Frontier Energy, LLC. Frontier Pacific, Inc., is a wholly-owned subsidiary of Energy Pacific, LLC, which is a joint venture of two companies that have extensive experience in natural gas distribution.

By Order dated February 3, 1998, the Commission established a deadline of February 24, 1998, for petitions to intervene and the filing of written comments. The Public Staff and the Attorney General filed comments. One letter dated February 20, 1998, was filed on behalf of the Warren County Economic Development Commission, and it raised concerns about the timing of service to Warren County.

The Public Staff's comments indicated that its investigation of Frontier Energy's market studies revealed that the Four-County project as proposed by Frontier Energy is comparable in scope and size to the project as originally proposed in 1994. Frontier Energy has already ordered transmission pipe and begun the process of right-of-way selection and acquisition. Construction will begin as soon as financing is closed.

In response to a Public Staff data request about its plans with respect to Warren County, Frontier Energy indicated that it had focused its resources on the Four-County area initially and that because of the substantial lead time involved in due diligence and the planning process, its plans for Warren County

could not be implemented as soon as its plans in the Four-County area. Frontier Energy further indicated that it expects to file plans to build the Warren County system no later than August 11, 1998. In addition, it indicated that it had received a formal proposal for interstate pipeline capacity from Public Service Company of North Carolina, Inc., on February 20, 1998. Finally, it indicated that it intends to build the system substantially in conformance with Frontier Utilities' proposal as filed in 1996, and that based on (1) the assumption that a reasonable agreement for interstate pipeline capacity can be finalized and (2) weather conditions and other variables beyond its control, it expects to begin construction during the latter part of 1998, with completion during the first half of 1999.

With respect to Ashe and Alleghany Counties, Frontier Energy has indicated that it intends to serve Ashe County soon after it completes its Warren County project. Alleghany County will receive service as soon thereafter as possible.

With respect to the financing issues, the Public Staff's comments indicated that it is reasonable to grant approval of the debt financing in two stages as proposed by Frontier Energy, subject to certain specific requirements for information being imposed on the second stage of the approval process. In addition, the comments indicated that, with the Public Staff's recommended wording change, the equity financing should be approved.

Frontier Energy filed an executable security bond as required by the Commission in its Orders granting the certificates to Frontier Utilities for the Four-County area and for Warren County, but requested that the security requirement be waived. The purpose of the bond, as explained in those orders, is to provide funds if an emergency operator is appointed by the Commission and the funds are needed for the emergency operator to reliably run the system. Frontier Energy requested that the bond requirement be waived because the reputation, experience, financial strength, and other resources of Energy Pacific and its corporate parents obviate the need for such security. In its comments, the Public Staff did not make a recommendation as to the security requirement and stated that it would not object to the Commission waiving the security requirement

Finally, the only outstanding issue at the time the Public Staff filed its comments was whether Frontier Energy could be considered to be part of a registered holding company under the Public Utility Holding Company Act of 1935 (PUHCA). The Attorney General's comments also stated concerns about the potential PUHCA issue and about the books and records of Frontier Energy and its affiliates being subject to full disclosure. A stipulation between the Public Staff and Frontier Energy, Frontier Pacific, its ultimate parent companies, and Frontier Utilities on both of these issues was filed on Monday, March 9, 1998.

The Public Staff presented this matter to the Commission at its Staff Conference on Monday, March 9, 1998. Allen Kimball of the Warren County Economic Development Commission made a statement along the lines of his February 20, 1998 letter.

Based on Frontier Energy's agreement to the changes and conditions recommended by the Public Staff and the stipulation, the Public Staff recommended that the Commission (a) approve Frontier Utilities' and Frontier Energy's final financing plan, including the participation of Frontier Pacific, Inc., as an equity partner and the formation of Frontier Energy; (b) approve $11.5 million in equity investment; (c) preliminarily approve up to $40 million in debt financing that is consistent with the terms outlined in its application; and (d) approve the transfer of the certificates of public convenience and necessity awarded to Frontier Utilities to serve Surry, Watauga, Wilkes, and Yadkin Counties (the Four-County area), Ashe and Allegheny Counties, and Warren County to Frontier Energy. The Public Staff further recommended that if the Commission grants preliminary approval of the debt financing as proposed, it should be subject to Frontier Energy (1) filing the Commitment Letter(s) and Term Sheet(s) of the final debt financing and (2) providing all requested additional information with respect thereto. Finally, the Public Staff recommended that, if the Commission decided to continue the requirement for the security bond, a security bond of a short-term nature should be all that is required. The Public Staff therefore recommended that, if the Commission requires a

security bond, it be set up so that it expires (i.e., has a sunset provision) two years from the date the first customer is served unless the Commission takes affirmative action to require that it be renewed.

Based on the foregoing, the Commission concludes that the January 23, 1998, application should be approved as recommended by the Public Staff and as discussed herein. With respect to the security requirement, the Commission concludes that the requirement of a security bond should not be waived. However, given the experience and financial strength of Energy Pacific and its parents, the security bond required in this case should be of a short-term nature. Frontier Energy should file an executable bond within 30 days of this Order that is set up so that it expires (i.e., has a sunset provision) two years from the date the first customer is served unless the Commission takes affirmative action to require that it be renewed. Frontier Energy is required to execute the bond by the date on which its first natural gas utility customer is served and to file copies of such executed security within ten (10) days of such execution.

IT IS THEREFORE ORDERED as follows:

1. That Frontier Utilities' and Frontier Energy's final financing plan, including the participation of Frontier Pacific, Inc., as an equity partner and the formation of Frontier Energy, and the stipulation between the Public Staff and Frontier Energy with respect to PUHCA and access to utility-related books and records are approved;

2. That the capitalization of Frontier Energy with an equity investment of $11.5 million is approved;

3. That $40 million in debt financing that is consistent with the terms outlined in the January 23, 1998, application is preliminarily approved;

4. That the transfer of the certificates of public convenience and necessity awarded to Frontier Utilities to serve Surry, Watauga, Wilkes, and Yadkin Counties (the Four-County area), Ashe and Allegheny Counties, and Warren County to Frontier Energy is approved;

5. That the debt financing as approved herein is subject to Frontier Energy (1) filing the Commitment Letter(s) and Term Sheet(s) of the final debt financing and (2) providing all requested additional information with respect thereto within 60 days of the date of this Order;

6. That the financing is required to be closed as soon as possible after the Commission grants approval of Frontier Energy's final debt financing, but no later than 60 days following the date such approval becomes final; and

7. That Frontier Energy shall file an executable bond within 30 days of this Order that is set up so that it expires (i.e., has a sunset provision) two years from the date the first customer is served unless the Commission takes affirmative action to require that it be renewed. Frontier Energy is required to execute the bond by the date on which its first natural gas utility customer is served and to file copies of such executed security within ten (10) days of its execution.

This the 9th day of March, 1998.

NORTH CAROLINA UTILITIES COMMISSION

/s/ Geneva S. Thigpen

Geneva S. Thigpen, Chief Clerk

Federal Register Notice

Pacific Enterprises, 555 West Fifth Street, Suite 2900, Los Angeles, California 90013-1001 ("Pacific") and Enova Corporation, 101 Ash Street, San Diego, California 92101 ("Enova"), both of which are exempt holding companies pursuant to Section 3(a)(1) of the Public Utility Holding Company Act of 1935, as amended (the "Act"),(1) have filed a joint Application or Declaration pursuant to Sections 9(a)(2) and 10 of the Act in which they request authority to acquire, indirectly, up to 90.1% of the membership interests of Frontier Energy LLC ("Frontier"), a North Carolina limited liability company.(2) Frontier has been formed to construct and operate a small gas distribution system in North Carolina.

Pacific's predominant subsidiary, Southern California Gas Company ("SoCalGas"), purchases, transports and distributes natural gas in southern California. At December 31, 1997, Pacific reported consolidated total assets of $4.977 billion, of which approximately $3.154 billion consisted of net gas plant. For the year ended December 31, 1997, Pacific reported $2.738 billion in operating revenues (including revenues from transportation-only customers) and $184 million in net income.

1/ In a separate proceeding (File No. 70-9033), Pacific and Enova are seeking authority for a business combination pursuant to which they would become subsidiaries of a new holding company to be called Sempra Energy.

2/ The remaining membership interests in Frontier would be acquired by Frontier Utilities of North Carolina, Inc., a North Carolina corporation and an indirect, majority-owned subsidiary of ARB, Inc., a closely-held California corporation.

Enova's predominant subsidiary, San Diego Gas & Electric Company ("SDG&E"), provides electric and natural gas service in San Diego and surrounding areas. At December 31, 1997, Enova reported consolidated total assets of $5.2 billion, of which approximately $2.49 billion consists of net electric plant and $449 million consists of net gas plant. For the year ended December 31, 1997, Enova reported operating revenues of $2.2 billion (81.6% from electricity sales and 18.4% from gas sales) (including revenues from transportation only customers), and $252 million in net income.

Pacific and Enova derive substantially all of their gas requirements from sources outside of California. Approximately 58% of their combined system gas requirements are met from production in the Permian Basin, which is located in west Texas, and the San Juan Basin, which is located primarily in New Mexico and Colorado in the "Four Corners" area. Most of the gas produced in these gas producing basins is delivered to California by El Paso Natural Gas Company and Transwestern Pipeline Company under long-term transportation agreements.

Frontier (as assignee of Frontier Utilities of North Carolina, Inc.) has been granted certificates of public convenience and necessity by the North Carolina Utilities Commission ("NCUC") to construct, test, market, own and operate a new natural gas distribution system in a four-county area in northwestern North Carolina comprised of Surrey, Watauga, Wilkes and Yadkin Counties (the "Four-County Area"), and in Warren County, which is to the east of the Four-County Area. Frontier commenced construction in the Four-County Area during the second quarter of 1998. Construction in Warren County will commence at a later date, subject to receipt of further NCUC approvals. When complete, the Four-County Area system will consist of

approximately 140 miles of transmission mains, including a 40-mile lateral tap off the interstate pipeline facilities of Transcontinental Gas Pipe Line Corp. ("Transco"), and at least 320 miles of distribution mains. Frontier will purchase at least 50% of its gas requirements from production in the San Juan and Permian Basins. Gas will be delivered to Frontier by Transco under a long-term transportation contract. Frontier is projecting that, by the end of the fifth year following commencement of construction, it will serve 13,250 residential, 1,054 small commercial, 300 poultry farm, and 55 large commercial and industrial customers. As a public utility under North Carolina law, Frontier will be subject to regulation by the NCUC as to rates, service, securities issuances and other matters.

It is currently contemplated that Pacific and Enova together and Frontier Utilities will each acquire, directly or indirectly, 50% of the membership interests of Frontier, and that the economic interests of the members will equal their membership interests. The NCUC has authorized the equity investments by the members of Frontier, including cash and in-kind contributions of pipeline and other property, totaling approximately $12 million. In addition, the NCUC has given its preliminary approval for $40 million in debt financing by Frontier.

Under Frontier's Operating Agreement, the economic interest of a member is defined as that member's interest in the profits and losses of Frontier and right to receive distributions from Frontier. The membership interest of a member means that member's economic interest, plus the right to participate in management of Frontier, including the right to vote. The Operating Agreement specifically contemplates that the members may adjust or change their respective economic and membership interests whenever necessary in order, for example, to limit the percentage of overall voting rights held by a member. Pacific and Enova are seeking approval in this proceeding to acquire, indirectly through Frontier Pacific, Inc., up to 90.1% of the membership interests of Frontier, representing 90.1% of the voting interests in Frontier. This will enable Frontier Utilities, should it choose to do so, to maintain its percentage interest in Frontier's voting securities at below 10%.

It is stated that the day-to-day operations of Frontier will be under the control of its General Manager, who will be located at Frontier's corporate headquarters in Elkin, North Carolina. The General Manager will report to the President, who will be located in San Diego, California. It is also anticipated that Frontier will be staffed by a combination of current employees of the members of Frontier and their respective subsidiaries and new hires from the local community in North Carolina. The applicants state that the operations of Frontier in North Carolina and those of Pacific and Enova in California systems will be coordinated administratively in order to enable Frontier to enter the natural gas business with an experienced management team in place. In addition, Pacific and Enova state that they will be able to provide Frontier with greater financial, operational and technical resources.

The applicants state that their acquisition of Frontier's voting securities will satisfy all of the requirements of Section 10, including Section 10(c)(2), which provides that the Commission shall not approve "the acquisition of securities or utility assets of a public-utility or holding company unless the Commission finds that such acquisition will serve the public interest by tending towards the economical and the efficient development of an integrated public-utility system." Specifically, the applicants state that the gas distribution areas of Pacific and Enova and Frontier together will constitute an "integrated" gas-utility system, as defined in Section 2(a)(29)(B), in that the companies will share a "common source of supply" (the San Juan and Permian Basins) and will be operated as a "single coordinated system." Such coordinated operation will enable Frontier to achieve "substantial economies" in gas supply through the increased buying power that it will attain by being part of the larger Pacific and Enova systems, and by gaining access to Pacific's and Enova's expertise in such areas as procurement/materials management, finance and accounting, and gas system engineering and construction management.

Furthermore, the applicants assert that their indirect investment in Frontier, as well as their ongoing involvement with Frontier's operations, will be instrumental to the development of

a gas utility system in an area in which natural gas service is not now available and that the development of this gas system enjoys strong support from the NCUC.

Finally, the applicants state that, taking into account the current "state of the art" in the natural gas industry, the area or region served by Pacific and Enova's subsidiaries in California and by Frontier in North Carolina will not be "so large as to impair . . . the advantages of localized management, efficient operation, and the effectiveness of regulation." On the contrary, the applicants note that the day-to-day operations of Frontier will be under the direction of its General Manager, who will be locally based, and that Frontier will be subject to effective local regulation by the NCUC.

Pacific and Enova state that they will continue to qualify for exemption under Section 3(a)(1) as "intrastate" holding companies even after acquiring Frontier's voting securities because they will derive no material part of their income from Frontier. In this regard, the applicants estimate that Frontier will account for far less than 1% of the consolidated income of Pacific and Enova on a pro forma basis.

EXHIBIT I - Description of Economies and Efficiencies and Estimated Dollar Savings

INTEGRATION & SYNERGY EXAMPLES	START-UP COST SAVINGS	ANNUAL OPERATING COST SAVINGS
COMMON SOURCE OF SUPPLY: Approximately 58% of SoCalGas' and SDG&E's combined gas supplies originate from the SanJuan and Permian basins located in the Southwestern United States (approximately 272,000 MMMBTU's were purchased from these basins in the 1996 -1997 timeframe). At least 50% of Frontier Energy's gas purchases will consist of gas supplies originating from the same two basins (ranging from 600 MMMBTU's in 1998 to 1,800 MMMBTU's in 2000).	NA	Frontier will be able to procure the best supply prices available in the market from reputable suppliers because of its affiliation with SoCalGas and SDG&E, the collectively largest public utilityin the United States.
PROJECT FINANCING COSTS: Because of its association with PE/ENOVA, Frontier will be able to secure better terms on its approximate $40 million in financing than it would have been able to secure otherwise. These terms include interest rate spread, up-front fees, commitment fee, and required equity. Frontier will also secure more flexible terms and less restrictive covenants than it would have obtained otherwise.		Estimated financing cost savings for a $40,000,000 revolver over a 5-year period are approximately $1,030,000.
PROCUREMENT/MATERIALS MANAGEMENT AND QUALITY ASSURANCE: Frontier has and will continue to realize significant efficiencies and savings by utilizing PE/ENOVA's corporate "Procurement/Materials Management" staff. Procuring service enables SoCalGas, SDG&E materials though this corporate and Frontier to attain increased buyer power and volume discounts on items ranging from natural gas pipe to computer software and hardware and other office equipment. By being affiliated with PE/ENOVA, Frontier is able to secure prices and payment terms on construction materials that are more competitive than it would have obtained otherwise. In addition, the expertise available from these staffs enables Frontier to negotiate/ bid very favorable supply arrangements. Frontier will also benefit from the Quality Assurance services these staffs provide. For example, rather than having to hire outside consulting services to monitor and QA the manufacture of the natural gas pipe to be used in the Frontier project, resources from these staffs were utilized. Frontier also benefits from the years of expertise and R&D these staffs have accumulated regarding materials specifications.	These staffs are being used to procure the majority of construction materials for the Frontier project, including 146 miles of natural gas pipe. A total ofapproximately $533,000 was saved on the cost of the pipe.	Frontier will continue to benefit from the use of corporate procurement and quality assurance staff expertise, precluding it from contracting for outside resources at costs that would likely be at least double (due to higher hourly rates and slower turnaround).

REGULATORY AND GOVERNMENTAL AFFAIRS: Frontier will continue to utilize support from PE/ENOVA's regulatory and governmental affairs corporat staffs on federal, national, state and local regulatory and public policy issues and proceedings. In addition, Frontier will be able to utilize corporate communication staffs to assist in its public communication and outreach efforts.	An estimated $37,500 will be saved on initial start-up costs by using corporate resources and expertise vs. hiring outside consultants.	By utilizing corporate regulatory and governmental affairs support, Frontier can forego hiring and/ or contracting for outside expertise at costs that would likely be at least double. Estimated annual savings are $42,500/ year.
FINANCE AND ACCOUNTING: Frontier will be able to utilize corporate financial and accounting staff services. These services include areas such as finance, budgeting and planning, financial reporting, regulatory compliance, cost accounting, accounts payable, treasury, cash management, financial risk management, insurance/claims, payroll accounting, internal auditing, taxes, accounting systems, and pension management. Frontier will be able to avoid hiring its own staffs to perform these functions, as well as being able to use corporate accounting and finance information systems rather than purchasing and setting up completely new systems.	An estimated $150,000 in up front costs will be saved by utilizing existing corporate accounting and financial reporting computer software systems.	Frontier will save an estimated $68,500/year due to its ability to utilize corporate finance & accounting staff instead of hiring on-site staff.
HUMAN RESOURCES: Frontier will be able to utilize PE/ENOVA's corporate human resources staff services, including compensation and benefits, employee communications, labor relations, personnel administration, employee development, and human resources systems.		By utilizing corporate human resources staff, Frontier can forego hiring an on-site human resources manager. Estimated savings are $22,500 per year.
INFORMATION & TECHNOLOGY SERVICES: Frontier will be able to utilize PE/ENOVA's corporate Information & Technology services and systems, such as telecommunications, computer operations, computer infrastructure support, data security, and user support.	An estimated $50,000 in up frontcosts will be saved by utilizing portions of existing corporate planning, customer information and human resources software systems.	By utilizing corporate IT services, Frontier can forego hiring two on-site IT support staff. Estimated savings are $76,138 per year.
ENGINEERING, TECHNICAL & DESIGN SERVICES: Frontier will continue to realize efficiencies from utilizing SoCalGas/SDG&E engineering, technical & design services. These services include pipeline system component design, pipeline construction, mapping/GIS technology, measurement, instrumentation and controls design, laboratory services, and cathodic protection system design. SoCalGas and SDG&E possess state of the art systems to support these services, as well as the expertise that comes from being industry leaders.	By utilizing SoCalGas engineering services and expertise on initial engineering and design, Frontier saved approximately $67,500.	By utilizing SoCalGas/SDG&E engineering services and expertise, Frontier will save an estimated $22,500/year.
CORPORATE AND SUPPORT SERVICES:		By utilizing

Frontier will be able to utilize various corporate services, such as the services of Building and Real Estate, Transportation Fleet Management, Facilities Maintenance, Security, and Claims & Administration, rather than procuring services from outside agencies. It will also realize increased leverage in the negotiation of insurance rates, terms, and conditions.		PE/ENOVA corporate services, Frontier will be able to forego hiring outside agencies to perform these functions and will save an estimated $31,200 per year.
LEGAL: Frontier will be able to utilize corporate legal staffs to support its legal and regulatory processes, rather than its own counsel. It can also combine forces with SoCalGas & SDG&E on certain proceedings, such as FERC and other Federal proceedings, thus lowering overall costs for the three utilities.		By utilizing PE/ENOVA corporate legal services, Frontier can forego hiring full-time staff to supervise and perform legal functions and will save an estimated $24,209 per year.
TRAINING: Frontier will be able to use PE/ENOVA in-house training expertise to train its general management, marketing and service personnel.		Frontier benefits from the use of existing corporate expertise, precluding it from contracting for outside resources at costs that would likely be at least double. Estimated savings are $12,000 per year.