COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF EAST KENTUCKY UTILITIES, INC. FOR APPROVAL OF LONG-TERM FINANCING THROUGH THE KENTUCKY INFRASTRUCTURE AUTHORITY FOR THE PURPOSE OF CONSOLIDATING OUTSTANDING DEBT ASSOCIATED WITH VARIOUS CREDITORS	)	CASE NO. 2004-00510

O R D E R

On December 20, 2004, East Kentucky Utilities, Inc. ("East Kentucky") filed its application for approval of long-term financing in the amount of $550,000 from the Gas System Restoration Board ("GSRB") loan program administered by the Kentucky Infrastructure Authority ("KIA"). As of December 15, 2004, funds were available from the GSRB for a term of 30 years at an annual interest rate of 4 percent. However, those terms are subject to change until the GSRB issues final loan approval. A loan commitment letter from KIA setting out terms and conditions was filed as Appendix A of the application.

East Kentucky seeks approval to consolidate five existing debts, including one owed to KIA, into one new long-term financing. Since almost 60 percent of East Kentucky's existing debt bears interest at rates of 6 percent or greater, the proposed financing at 4 percent will reduce its annual debt cost by $2,000. In addition, since its existing debt is for various terms not exceeding 16 years, the new financing at 30 years will improve its cash flow by approximately $48,000 annually due to payment deferrals.

The new financing should improve East Kentucky's financial condition and help it remain financially viable and continue as a going concern. A summary schedule of the existing debts that East Kentucky proposes to consolidate was included as Appendix B to its application.

This is East Kentucky's second application for approval of long-term financing in recent months. Its first application, Case No. 2004-00276, requested approval to finance approximately $246,000.[1] Most of that amount related to past-due operating expenses, including overdue bills from its gas supplier. In an October 12, 2004 Order in that case, the Commission noted that it was inappropriate to pay for operating expenses by incurring long-term financing, and that typically such financing would be denied. However, an exception was made for a limited number of East Kentucky's debts, including its past-due gas bill, to ensure that East Kentucky could continue operating and serving its customers.

Although East Kentucky was authorized to finance approximately 77 percent of the amount it requested in Case No. 2004-00276, it decided to forego that long-term financing with KIA and negotiated a 7-year loan from the Floyd County Fiscal Court ("Floyd County"). The loan was sufficient to pay its past-due gas bill and some of its other past-due expenses. East Kentucky's existing debt to Floyd County, plus its existing debt to KIA, account for 75 percent of the pending loan consolidation. East

[1]Case No. 2004-00276, Application of East Kentucky Utilities, Inc. For Approval of Long-Term Financing Through the Kentucky Infrastructure Authority for the Purpose of Becoming Current With Various Creditors, Including its Wholesale Natural Gas Supplier, Equitable Energy, LLC.

Kentucky's pending application also requests rescission of the loan approval granted in Case No. 2004-00276.

It appears from this pending application that East Kentucky's current management is attempting to resolve financial problems that have existed for some time. Recognizing that it faces a serious financial crisis, East Kentucky has determined to remedy this situation by executing a financing plan that will not increase its current level of debt. Rather, East Kentucky will maintain its current level of debt under new, more favorable terms.

As discussed in detail in the October 12, 2004 Order in Case No. 2004-00276, a request to pay past-due operating expenses by incurring long-term financing would not typically be approved. Operating expenses are to be paid from the revenues received by the utility for the service it renders. If a utility's revenues are insufficient to pay its operating expenses, the utility is under an obligation to seek timely rate relief to ensure its financial viability. East Kentucky now recognizes that its revenues have been insufficient for some time to pay its legitimate expenses and it has requested assistance from the Commission in preparing a rate application. Under the circumstances presented here, denying East Kentucky's financing request might be detrimental to both the utility and its ratepayers by compromising East Kentucky's financial viability and jeopardizing its ability to provide service to its customers.

Based on the evidence of record and being otherwise sufficiently advised, the Commission finds that approving the financing proposed herein is in the long-term interests of both East Kentucky and its ratepayers. Approving this financing should allow East Kentucky to continue as a going concern and assure that its ratepayers will continue to receive natural gas service. East Kentucky's proposed financing to consolidate $550,000 of existing debts is for a lawful object within its corporate purposes, is appropriate for and consistent with the proper performance of its service to the public and will not impair its ability to perform that service, and is reasonably necessary and appropriate for such purposes. The proceeds of the financing approved herein are to be used only to consolidate the existing debts listed in Appendix B to East Kentucky's application. Further, the Commission finds that since East Kentucky decided not to proceed with the financing approved in Case No. 2004-00276, the approval granted in that case should be revoked.

As discussed in our October 12, 2004 Order in Case No. 2004-00276, it is imperative for East Kentucky to pay when due its current obligations to its vendors, particularly its gas supplier. In the recent past, East Kentucky has been delinquent in paying its vendors and was very close to having its gas supply terminated. Since East Kentucky's rates do include a monthly gas cost recovery charge, customers are paying sufficient revenues to allow East Kentucky to pay its gas supplier and, thereby, avoid interruption of service.

However, it appears that in the past East Kentucky has taken revenues that were intended to pay its gas supplier and utilized them for other purposes. Consequently, the Commission finds it necessary to establish a schedule of payment priorities to be followed by East Kentucky. That schedule, from highest priority to lowest, is as follows:

1. Cost of current gas supply.
2. Debt service payments.
3. Payments to vendors with liens on East Kentucky's assets.

4. Payments to vendors charging late-payment fees.

5. Payment of all other current operating expenses.

6. Payments to any financing escrow accounts or reserve fund accounts.

East Kentucky should adhere to this payment priority schedule until this issue is revisited in its upcoming rate case.

IT IS THEREFORE ORDERED that:

1. East Kentucky is authorized to borrow $550,000 from KIA subject to the terms and conditions set forth in its application and in this Order.

2. The proceeds from the KIA financing authorized herein shall be used only to consolidate the existing debts as listed in Appendix B to East Kentucky's application.

3. Within 10 days of closing the KIA financing approved herein, East Kentucky shall file a written notice with the Commission setting forth the date of closing, the terms of the loan, and the amount of each debt consolidated.

4. The KIA financing approval granted to East Kentucky in Case No. 2004-00276 is revoked.

5. East Kentucky shall adhere to the payment priority schedule set forth in the findings above until this issue is revisited in its upcoming rate case.

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

Done at Frankfort, Kentucky, this 14th day of January, 2005.

By the Commission

ATTEST:

Executive Director