COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN EXAMINATION BY THE PUBLIC SERVICE COMMISSION OF THE APPLICATION OF THE FUEL ADJUSTMENT CLAUSE OF KENTUCKY UTILITIES COMPANY FROM NOVEMBER 1, 1993 TO APRIL 30, 1994	)	CASE NO. 92-493-C

O R D E R

Commission Regulation 807 KAR 5:056, Section 1(11), requires the Commission every six months to conduct public hearings on an electric utility's past fuel adjustments and to charge off and amortize any adjustments due to improper calculation or application of the fuel charge or improper fuel procurement practices.

In its most recent reviews of the fuel adjustments of Kentucky Utilities Company ("KU"),[1] the Commission has ordered each docket to remain open pending the outcome of proceedings before the Federal Energy Regulatory Commission ("FERC") involving certain of its depreciation practices.

In September 1976, KU purchased 126 rail cars to transport coal from the Coal Ridge Mine to KU's Ghent Generating Station. KU

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[1] Case No. 92-493, An Examination by the Public Service Commission of the Application of the Fuel Adjustment Clause of Kentucky Utilities Company from November 1, 1990 to October 31, 1992 (Apr. 5, 1993); Case No. 92-493-A, An Examination by the Public Service Commission of the Application of the Fuel Adjustment Clause of Kentucky Utilities Company from November 1, 1992 to April 30, 1993 (Oct. 27, 1993); Case No. 92-493-B, An Examination by the Public Service Commission of the Application of the Fuel Adjustment Clause of Kentucky Utilities Company from May 1, 1993 to October 31, 1993 (June 28, 1994).

used a 12-year service life to determine the depreciation rate and the amount to accrue as depreciation expense. KU recorded this depreciation expense as a fuel cost and passed this expense through its FAC. In 1988 when the rail cars' useful life had ended, KU ceased computing depreciation expense on them. At the same time, KU filed requests with this Commission and FERC to recover from its customers the $14.5 million buyout cost related to the Coal Ridge coal contract through its FAC. Both regulatory commissions granted their approval.[2]

With the termination of the Coal Ridge coal contract, KU ceased using the rail cars. Between February 1989 and April 1990 it leased the rail cars and recorded $640,000 as lease income. In December 1990 it sold the rail cars for $3,049,200.

FERC Staff audited KU's books and records in 1991 and found that KU had failed to make timely adjustments to its estimates of service life and salvage for accruing depreciation expense on the rail cars. It further found that, after failing to adjust properly its depreciation accruals, KU incorrectly accounted for the proceeds from the subsequent rental and sale of the rail cars. FERC Staff noted:

> The rental and subsequent sale of the coal cars was directly linked to the buyout of the Coal Ridge coal supply contract. The Company deferred the buyout costs in Account 186, and subsequently allocated those costs to future periods. The Company's termination of

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[2] Case No. 10214, Application of Kentucky Utilities Company for an Order Approving Certain Accounting Treatment of Amounts Paid for Coal Contract Release (Oct. 7, 1988); Kentucky Utilities Co., 49 F.E.R.C. ¶61,008 (Oct. 5, 1989).

> the Coal Ridge contract and rental and sale of the coal cars resulted from the same event, namely shedding contracts and assets that no longer resulted in acquisition of fuel supply at the lowest economic cost to the utility. Therefore, the buyout cost and the proceeds from the rental and sale of the coal cars should have been similarly accounted for. This is of particular important [sic] here since the Company had received permission from regulatory authorities to defer the buyout costs in Account 186, and recover such amounts in future billings to customers.
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> . . . .
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> The cars became available for rental and subsequent sale as a result of the coal buyout. Therefore, the Company should have reduced the buyout costs properly chargeable to the wholesale customers by the net proceeds from both the rental and the sale of the cars.
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> The failure to similarly account for the related transactions resulted in passing on the buyout costs to its customers through FAC billings while retaining the proceeds from the rental and sale of the coal cars for the benefit of stockholders.

Division of Audits, FERC, Results of the Examination of the Books and Records of Kentucky Utilities Co., (FERC Docket No. FA91-65-000) at 5 - 8.

FERC Staff recommended that KU revise its current depreciation practices, perform certain correcting entries to account for the rental and sales proceeds properly, recompute its FAC billings for each period in which buyout costs were included as a cost of fuel, and make refunds to customers for any overcollected amounts.

KU contested the report's findings and requested a hearing before FERC. FERC granted KU's request and held hearings on the report. The matter currently stands submitted for decision.

The transactions raise serious questions about the level of the buyout costs which KU should have been permitted to recover through its FAC. If, as FERC Staff has alleged, the rental and sales transactions are related to the buyout of the Coal Ridge coal contract, the proceeds of those transactions reduced KU's buyout costs and permitted KU to recover in excess of its actual buyout costs through its FAC.

The Commission has never addressed the issues surrounding the rental and sale of the rail cars. KU never advised it of the rental or sale of the rail cars. Because approximately $6 million of the buyout costs were passed through KU's FAC to KU's retail customers between November 1, 1990 and October 31, 1992, the Commission finds that these issues should be addressed in this proceeding.

In addition to those issues, the Commission finds that KU's <u>current</u> depreciation practices for rail cars should be reviewed. KU recently submitted to the Commission a Book Depreciation Study of its property as of December 31, 1992. This study recommends the use of a 20-year service life for KU rail cars. KU currently uses a 15-year service life. If the Book Depreciation Study is correct, then KU has been recovering through its FAC charges in excess of its actual fuel costs.

IT IS HEREBY ORDERED that:

1. KU shall appear on November 9, 1994, at 9:00 a.m., Eastern Standard Time, in Hearing Room 1 of the Commission's offices at 730 Schenkel Lane, Frankfort, Kentucky, to submit itself

to examination on the application of its FAC from November 1, 1993 to April 30, 1994.

2. At the scheduled hearing, KU shall show cause why it should not be required to charge off and amortize, by means of a temporary decrease of rates, the proceeds which KU received from the rental and sale of the 126 rail cars which were used to transport coal from the Coal Ridge Mine to KU's Ghent Generating Station.

3. At the scheduled hearing, KU shall also present evidence on its current depreciation practices for rail cars, and shall show cause why it should not be required to charge off and amortize, by means of a temporary decrease of rates, any excessive fuel costs related to these depreciation practices.

4. KU shall, on or before August 22, 1994, file in verified prepared form the testimony of each witness who will testify on its behalf at the scheduled hearing.

5. Intervenors may, on or before September 1, 1994, serve upon KU a request for production of documents and written interrogatories to be answered by KU no later than September 14, 1994.

6. Intervenors presenting witnesses at the scheduled hearing shall, on or before September 26, 1994, file in verified prepared form the testimony of those witnesses.

7. KU may, on or before October 10, 1994, serve upon intervenors a request for production of documents and written interrogatories to be answered no later than October 24, 1994.

8. Case Nos. 92-493, 92-493-A, and 92-493-B are consolidated with this case.

9. KU's Book Depreciation Study of its property as of December 31, 1992 is made a part of the record of these proceedings.

10. KU shall notify its customers in writing of the date, time, place, and purpose of the hearing or shall publish such notice in accordance with 807 KAR 5:011, Section 8(5).

11. KU shall, on or before August 22, 1994, file with the Commission an original and 10 copies of the information requested in Appendix A. Each copy shall be placed in a bound volume with each item tabbed. When a number of sheets are required for an item, each sheet should be appropriately indexed; for example, Item 1(a), Sheet 2 of 6. KU shall furnish with each response the name of the witness who will be available at the public hearing to respond to questions concerning each area of information requested. Careful attention shall be given to copied material to ensure its legibility.

Done at Frankfort, Kentucky, this 5th day of August, 1994.

PUBLIC SERVICE COMMISSION

Chairman

Vice Chairman

Commissioner

ATTEST:

Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 92-493-C DATED August 5, 1994.

1. Provide the following information for the six-month review period.

a. A listing of all written solicitations for coal supply. For each solicitation, provide its date, type (contract or spot), quantities, a general description of the quality of coal solicited, the time period over which deliveries were requested, and the generating unit(s) for which the coal was intended.

b. For each solicitation identified in response to part (a) above, the number of vendors to which it was sent, the number of vendors which responded, the bid tabulation sheet or corresponding document which ranked the proposals (identifying all vendors which made proposals), the vendor selected, and a brief explanation for the selection.

c. A listing of any verbal solicitations for coal supply. For each such solicitation, explain why the solicitation was not written and provide its date(s), quantities, a general description of the quality of coal sought, the time period over which deliveries were requested, and the generating unit(s) for which the coal was intended.

d. For each solicitation identified in response to part (c) above, the vendors contacted, the tabulation sheet or other document which ranked the proposals (identifying all vendors which made proposals), the vendor selected, and a brief explanation for the selection.

2. Provide the following information for the six-month review period.

a. List each vendor from which coal was purchased and the quantities purchased, identified as either spot or contract purchases.

b. The number of solicitations issued to each vendor above, identified as contract or spot solicitations, and the number of proposals made by each vendor in response to the solicitations.

3. Provide the following information for the six-month review period.

a. For each station or unit for which a separate coal inventory is maintained, the actual coal burn in tons, actual coal deliveries in tons, total KWH generated, and actual capacity factor at which the plant operated.

b. For the stations or units identified above, contract deliveries in tons, estimated KWH generation if coal burn were equal to contract deliveries, and estimated capacity factor at this estimated generation level.

4. Provide a list of all firm power commitments for KU from November 1, 1993 to April 30, 1994. Include the utility's name, size of commitment and purpose; for example, peaking, emergency, etc. for (a) purchase and (b) sales.

5. Provide a monthly billing summary for sales to all electric utilities for the period November 1, 1993 to April 30, 1994.

6. Provide a copy of KU's scheduled, actual, and forced outages for the 6-month period November 1, 1993 to April 30, 1994.

7. Provide an updated list of all existing fuel contracts categorized as long-term (i.e., more than 1 year in length) and include the following information for each:

a. Name and address of supplier.

b. Name and location of production facility.

c. Date contract signed.

d. Duration of contract.

e. Date(s) of each contract revision, modification or amendment.

f. Annual tonnage requirements.

g. Actual annual tonnage received since the inception of the contract.

h. Percent of annual requirements received.

i. Base price.

j. Total amount of price escalations to date.

k. Current price paid for coal under the contract (i + j).

8. a. State whether KU regularly performs any type of coal price comparison with other electric utilities on coal purchases.

b. If yes, state:

(1) how KU compares with others.

(2) the utilities which are included in this comparison and the geographical region of each.

9. State the percentage of KU's coal, as of the date of this Order, which is delivered by:

a. barge

b. rail

c. truck

10. a. What was KU's actual coal inventory level in tons and in number of days' supply as of May 1, 1994?

b. Describe the criteria used to determine days' supply.

c. What was KU's coal inventory target for May 1, 1994?

d. If actual coal inventory exceeded the inventory target by 10 or more days' supply, state the reasons for excess.

e. (1) Does KU expect any significant changes in its current coal inventory target within the next 12 months?

(2) If yes, state the expected change and the reasons for this change.

11. a. Has KU audited any of its coal contracts during the period under review?

b. If yes, for each:

(1) identify the contract.

(2) identify the auditor.

(3) state the results of the audit.

(4) describe the actions which KU took as a result of the audit.

12. a. Has KU received any customer complaints regarding its fuel adjustment clause during the period under review?

b. If yes, for each complaint, state:

(1) the nature of the complaint

(2) KU's response

13. a. Is KU currently involved in any litigation with its current or former coal suppliers?

b. If yes, for each litigation:

(1) provide a copy of the complaint or other legal pleading which initiated the litigation.

(2) identify the coal supplier.

(3) identify the coal contract involved.

(4) state the amount of recovery sought by each party.

(5) list the issues being litigated.

(6) state its current status.

14. a. Provide the accounting entries made on KU's books to record the purchase of the 126 rail cars which transported coal from the Coal Ridge Mine to the Ghent Generating Station.

b. When was this entry recorded?

15. How did KU determined the service life and the salvage value of these 126 rail cars?

16. a. Describe the depreciation treatment which KU used for tax purposes for these rail cars between 1976 and 1988.

b. When were the rail cars fully depreciated for income tax purposes?

17. When it terminated the Coal Ridge coal contract in 1988 and ceased using the cars, did KU consider reclassifying these rail cars on its books (for example, using Account No. 118, Other Utility Plant)? Explain.

18. Why did KU not reclassify the rail cars to Account No. 104 when it leased the cars to Tradewater Railroad Company?

19. a. How did KU incorporate the rail cars in its analysis of the costs and benefits of the Coal Ridge contract buyout?

b. Did KU model the possible lease or sale of the rail cars in its analysis? Explain.

20. a. Did KU inform the Commission of the lease and subsequent sale of the 126 rail cars used to transport coal from the Coal Ridge Mine to the Ghent Generating Station?

b. If yes, when? Provide copy of such notice.

c. If no, why not?

21. a. Did KU consider revenues from the lease and sale of the 126 rail cars as offsets to the Coal Ridge contract buyout costs?

b. If yes, why was no action taken to offset buyout costs which were being recovered through KU's FAC?

c. If no, why not?

22. a. Provide the accounting entries made on KU's books to record KU's purchase of 150 railroad cars in 1991.

b. How did KU determine the service life and the salvage value of these 150 cars?

23. a. Describe the tax depreciation treatment which KU is using for the 150 rail cars purchased in 1991.

b. When are the cars expected to be depreciated fully for income tax purposes?

24. Provide the amount allocated to KU's Kentucky retail operations for:

a. $4,238,060 purchase price of 126 rail cars in 1976.

b. $1,300 per car salvage value.

c. $600,000 revenues from the lease of the rail cars which had transported coal from the Coal Ridge Mine to the Ghent Generating Station.

d. $3,049,200 sale proceeds for these 126 cars in 1990.