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

IT IS ORDERED that Kentucky Utilities Company ("KU") shall file, no later than 14 days from the date of this Order, an original and 12 copies of the following information with the Commission, with a copy to all parties of record. Each copy of the data requested should be placed in a bound volume with each item tabbed. When numerous sheets are required for an item, each sheet should be appropriately indexed; for example, Item 1(a), Sheet 2 of 6. Include with each response the name of the witness who will respond to questions relating to the information provided. Careful attention shall be given to copied material to ensure its legibility. Where information requested herein has been provided along with the original application, in the format requested herein, reference may be made to the specific location of said information in responding to this information request.

1. Explain whether KU's rate-making proposals for the following accounts in Case No. 8624[1] included the 126 rail cars purchased in 1976. Describe KU's proposals concerning the rail cars and indicate whether the Commission adopted them.

a. Utility Plant in Service.

b. Accumulated Depreciation.

c. Depreciation Expense.

2. During the period from 1976 through 1988:

a. Which KU generating stations could accept coal deliveries using rotary dump cars?

b. Which generating stations were primarily supplied under the Coal Ridge coal contract?

c. For which generating station were the 126 rail cars primarily used to make coal deliveries?

3. In Case No. 10214,[2] KU indicated that, under the terms of the Coal Ridge contract buyout, KU was to purchase 24,000 tons of coal per month for a twelve month period beginning in April 1988.

a. Were the 126 rail cars primarily used to transport the coal purchased from Coal Ridge during the period from April 1988 to March 1989?

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[1] Case No. 8624, General Adjustment of Electric Rates of Kentucky Utilities Company, final Order dated March 18, 1983.

[2] Case No. 10214, Application of Kentucky Utilities Company for an Order Approving Certain Accounting Treatment of Amounts Paid for Coal Contract Release, final Order dated October 7, 1988.

b. After the termination of the Coal Ridge contract in March 1989, what evaluations did KU undertake to determine its need, if any, to keep the 126 rail cars?

4. In response to Item 21 of the Commission's August 5, 1994 Order, KU stated that the buyout of the Coal Ridge contract had no bearing on the ultimate disposition of the rail cars. Did the buyout of the contract have any impact on KU's determination that it needed to keep the rail cars?

5. Does KU admit that:

a. The original cost of the 126 rail cars was $4,238,060?

b. The total scrap salvage value of the 126 rail cars was estimated to be $163,800 (126 cars @ $1,300 per car)?

c. KU recovered total depreciation expenses of $4,074,260 through its fuel adjustment clause, with the expense debited to Account No. 151, Fuel Stock?

d. Depreciation expense was recovered through the clause from 1976 to the end of 1988?

e. From February 1989 through April 1990, KU received rental income from the rail cars totaling $640,000?

f. During 1990, KU received offers to purchase the rail cars, which ranged in price from $2,205,000 (126 cars @ $17,500 per car) to $3,099,600 (126 cars @ $24,600 per car)?

g. KU sold the 126 rail cars in December 1990 for $3,049,200?

6. At page 15 of his direct testimony, Michael D. Robinson states that the shareholders were responsible for any profit or loss on the rail cars and that recovery of depreciation expense was not risk free.

a. Explain how Mr. Robinson's position is consistent with the status of depreciation expense as a component of the fuel adjustment clause billings.

b. From a rate-making perspective, explain the risks to which KU's shareholders were exposed if:

(1) The depreciation expense was recovered in total through the fuel adjustment clause billings.

(2) KU was earning a return on the investment in the rail cars.

c. From a rate-making perspective, explain why KU has not enjoyed an excess recovery of $2,885,400 ($3,049,200 sales price minus $163,800 salvage value) on the fully depreciated rail cars when the depreciation expense was recovered through fuel adjustment clause billings and their sales price exceeded the estimated salvage value.

7. Describe the income tax treatment of the proceeds from the sale of the 126 rail cars.

8. Which of the 126 cars were regularly used during the period from June 1990 through November 1990?

9. In response to Item 15 of the Commission's August 5, 1994 Order, KU stated that service life and net salvage value estimates were based on discussions with railroad industry personnel.

Identify these persons and the positions which they held at the time of these discussions.

10. At page 9 of his testimony, Mr. Robinson takes exception to the statement that "the Company's use of incorrect factors for service life and salvage had resulted in depreciation accruals equal to the original cost of the cars, less the initial 1,300 salvage estimate." He indicates that this statement "mistakenly substitutes the concept of terminal salvage value with fair market value."

a. How does this statement make that substitution?

b. Define "terminal salvage value," "scrap value," and "fair market value" as used in Mr. Robinson's testimony.

c. Is "terminal salvage value" equivalent to "scrap value"?

d. On page 18 of the November 1993 Deloitte & Touche depreciation study, it is stated:

> "This is the first depreciation study in which the distinction between interim and terminal net salvage has been reflected in the Production Plant rate calculations."

Was this distinction applied to other accounts in previous depreciation studies? If so, identify the studies and the accounts.

11. a. On page 21 of his testimony, Mr. Robinson states that:

> "When depreciation is under-accrued in relation to fair market value, FERC properly took the position that the loss should fall on shareholders."

If the term "scrap value" were substituted for "fair market value," would FERC's position still be proper?

b. If not:

(1) What criteria does KU apply to determine if proceeds from the sale of an asset are "scrap value" or "fair market value"?

(2) If the determination is based upon the age of the asset compared to estimated service life, explain why proceeds from the sale of 14-year old cars which had an estimated service life of 12 years was considered to be "fair market value" rather than "scrap value."

(3) If the determination is based upon the expected use of the asset after it is sold, how can the Commission monitor the use of an asset after sale considering the sharp rate-making distinctions between assets sold at "fair market value" which KU advocates?

(4) If the determination is based upon other subjective criteria, explain how the Commission can monitor the consistent application of these criteria.

c. If yes, would requiring shareholders to absorb the loss from insufficient depreciation accruals be a radical departure from traditional ratemaking and depreciation practices?

12. When is it proper for shareholders to absorb the loss when insufficient depreciation is accrued or to receive the gain when excess depreciation is accrued?

13. KU's response to Item 24 of the Commission's August 5, 1994 Order indicates that the rail cars originally cost $4,238,060 in 1976 and were sold for $3,049,200 in 1990.

a. Was this data known and considered when determining the current depreciation rate for Account 312, Coal Cars, or other account in which the depreciation was recorded?

b. If not, explain the statement made on page 6 of KU's November 1993 depreciation study that "it is salvage that will actually be received and the cost of removal that will actually be incurred, both measured at the price level at the time of receipt of incurrence, that are required to be recognized in the depreciation rates of the Company."

14. Provide the underlying study, including calculations and charts, developed to support service-life and future net-salvage estimates of the plant account which currently reflects KU's investment in rail cars.

15. KU's response to Item 24 of the Commission's August 5, 1994 Order states in part:

> "The $4,238,060 original purchase price of the 126 rail cars was closed to Electric Plant in Service (Account 101) in September 1976 and was further detailed to Account 316, Steam Plant - Miscellaneous. This amount was allocated to Kentucky retail operations in Case No. 8624 for the purpose of developing base rates, based on a month end rate base of June 1982."

a. Was a subsequent adjustment made to remove the effect of the rail cars from base rates?

b. If not, explain why double recovery did not occur when rail car expenses were claimed through the fuel adjustment clause.

16. a. Were rail car expenses ever included in base rates through the two year reviews of the fuel clause?

b. If yes, was the fuel charge reduced at the time of the sale of the rail cars?

17. On page 10 of his testimony, Mr. De Cleene states that:

> "In my opinion, given the historical cost framework underpinning the current accounting model and the related necessity to recover the historical cost of an asset, revising a terminal salvage value estimate based on current resale market value or the effects of inflation is inconsistent with that historical cost model."

a. Explain how adjusting removal costs to reflect changes in inflation is consistent with this statement.

b. Explain how adjusting removal costs to reflect changes in inflation is consistent with not adjusting removal costs by salvage value.

c. Should actual data on salvage value be ignored when estimating a salvage value?

18. Provide the data used to develop the graphs in Mr. Heller's testimony, Exhibits 1, 4, and 5.

19. Provide all data available for the years 1970 through 1978 on the price of used steel gondolas.

20. Provide all data available for the years 1970 through the present on the average age of used steel gondolas when sold.

21. Provide all data available for the years 1970 through the present on the use of the used steel gondolas after their sale, i.e., were they sold for scrap metal or did they continue in service.

22. At page 5 of his testimony, Mr. Heller indicates that the lowest average sale price of used steel gondolas was between $2000 and $2500 per car, and Exhibit 1 to his testimony indicates that the average price was approximately $5000 in 1978. Explain how the 1976 estimate of salvage value of $1300 per car for 12 year old cars is consistent with the data shown in Mr. Heller's testimony.

23. Provide all internal documents, memoranda and correspondence in which KU's efforts to sell or lease the 126 rail cars in question are discussed.

24. Describe all efforts made by KU between 1976 and 1991 to market for sale or lease the 126 rail cars in question.

Done at Frankfort, Kentucky, this 4th day of October, 1994.

PUBLIC SERVICE COMMISSION

For the Commission

ATTEST:

Executive Director