

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF BIG RIVERS )  
ELECTRIC CORPORATION, LG&E )  
ENERGY MARKETING, INC., )  
WESTERN KENTUCKY ENERGY ) CASE NO. 2002-00195  
CORPORATION, WKE STATION TWO, )  
INC., AND WKE CORPORATION FOR )  
APPROVAL OF AMENDMENTS TO )  
TRANSACTION DOCUMENTS )

O R D E R

On June 10, 2002, Big Rivers Electric Corporation ( Big Rivers ) and the LG&E Parties<sup>1</sup> filed an application seeking expedited approval of proposed amendments to the agreements governing Big Rivers lease of its generating units to the LG&E Parties. The purpose of the amendments is to implement a proposal by WKEC to construct, install, operate, and maintain a flue-gas desulfurization system ( scrubber ) on the three generating units at Big Rivers Coleman Generating Station ( Coleman ). The amendments make changes and clarifications in the contractual relationships between and among Big Rivers, one or more of its principal creditors, and one or more

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<sup>1</sup> The LG&E Parties are wholly-owned subsidiaries of LG&E Energy Corp. The subsidiaries that are co-applicants with Big Rivers are LG&E Energy Marketing, Inc. ( LEM ), Western Kentucky Energy Corporation ( WKEC ), WKE Station Two, Inc. ( Station Two ), and WKE Corporation.

subsidiaries of LG&E Energy Corp. The lease agreements were originally approved by the Commission in Case Nos. 1997-00204<sup>2</sup> and 1998-00267.<sup>3</sup>

Coleman is a 455 MW coal-fired plant located in Hancock County, Kentucky and is the only plant in the Big Rivers system that is not scrubbed for sulfur dioxide, except for a relatively small 65 MW coal-fired unit known as Reid 1. Consequently, Coleman is now required to burn medium sulfur coal. WKEC will pay all the costs of constructing, installing, operating, and maintaining the scrubber during the term of the lease transaction approved in Case Nos. 1997-00204 and 1998-00267, including Big Rivers out-of-pocket transaction costs for negotiating and obtaining approval of the proposed amendments.

WKEC's decision to construct the Coleman scrubber is entirely voluntary<sup>4</sup> and will allow the units to be run on high sulfur coal which costs less than medium sulfur coal. WKEC wants to install the Coleman scrubber to save fuel costs; to sell gypsum, which is a by-product of the scrubber process; and to improve the existing air quality to facilitate additional economic development in the surrounding area.

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<sup>2</sup> Case No. 1997-00204, The Application of Big Rivers Electric Corporation, Louisville Gas and Electric Company, Western Kentucky Energy Corp., Western Kentucky Leasing Corp., and LG&E Station Two, Inc. for Approval of Wholesale Rate Adjustment for Big Rivers Electric Corporation and for Approval of Transaction, final Order dated June 11, 1998.

<sup>3</sup> Case No. 1998-00267, The Application of Big Rivers Electric Corporation for Approval of the 1998 Amendments to Station Two Contracts Between Big Rivers Electric Corporation and the City of Henderson, Kentucky and the Utility Commission of the City of Henderson, final Order dated July 14, 1998.

<sup>4</sup> Under the current terms of the lease transaction, if WKEC were required to construct the Coleman scrubber to meet the requirements of environmental laws and regulations, Big Rivers would be responsible for a portion of the construction, operation, and maintenance costs.

The proposed amendments are contained in three documents: the Fifth Amendment to New Participation Agreement and Second Amendment to Lease and Operating Agreement ( Fifth Amendment ); the First Amendment to Mortgage and Security Agreement (LEM Mortgage) ( LEM Mortgage Amendment ); and the First Amendment to Third Amended and Restated Subordination, Nondisturbance, Attornment and Intercreditor Agreement ( Nondisturbance Agreement Amendment ). The following summarizes the changes resulting from the proposed amendments:<sup>5</sup>

1. Fifth Amendment. This amendment includes amendments to the New Participation Agreement<sup>6</sup> and the Lease and Operating Agreement<sup>7</sup> to recognize the Coleman scrubber as part of the lease transaction; Big Rivers approval of the Coleman scrubber; WKEC s commitment to fund 100 percent of the capital costs, maintenance, and operations costs of the scrubber during the term of the lease. The amendment also establishes that the scrubber will be titled in Big Rivers name; characterizes the scrubber under the lease transaction documents; and explains the treatment of the scrubber for purposes of the LG&E Parties Residual Value Payment ( RVP ), which may be payable by Big Rivers to the LG&E Parties upon the expiration or termination of the lease arrangement. The Coleman scrubber is to be considered a Major Capital Improvement having a 20-year useful life for purposes of determining whether and to

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<sup>5</sup> A detailed summary of all changes and the lease transaction documents affected are contained in the Application, paragraphs 10 through 13.

<sup>6</sup> Dated April 6, 1998, as amended, between Big Rivers, LEM, Western Kentucky Leasing Corp., Station Two, and WKEC.

<sup>7</sup> Dated July 15, 1998, between WKEC and Big Rivers.

what extent an RVP will be owed to WKEC.<sup>8</sup> The Fifth Amendment also contains provisions dealing with the RVP if the lease transaction does not run the full 25 years. Among those provisions is a requirement that if, during the scrubber's first 10 years of commercial operation, Big Rivers terminates the lease transaction on the basis of a breach or default by an LG&E Party under any Operative Document, an RVP would be owing on the scrubber, and this amount will be secured by the LG&E Parties subordinated mortgage and not the senior LEM Mortgage.

2. LEM Mortgage Amendment. This amendment amends the Mortgage and Security Agreement (LEM Mortgage)<sup>9</sup> to implement the terms of the Fifth Amendment respecting the securitization of the RVP under certain circumstances.

3. Nondisturbance Agreement Amendment. This amendment contains the consents of the parties to the Third Amended and Restated Subordination, Non-Disturbance, Attornment and Intercreditor Agreement (Nondisturbance Agreement)<sup>10</sup> to the lease transaction amendments proposed by Big Rivers. The consents include

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<sup>8</sup> As with other Major Capital Improvements, no RVP would be owing on the scrubber costs if the lease runs for its full 25-year term and title to the scrubber is not sold by Big Rivers during the lease term.

<sup>9</sup> Dated July 15, 1998, between Big Rivers and WKEC, LEM, and Station Two.

<sup>10</sup> Dated August 1, 2001, by and among Big Rivers, WKEC, LEM, Station Two, WKE Corp., the United States of America, Ambac Assurance Corporation (Ambac Assurance), Credit Suisse First Boston (Credit Suisse), U.S. Bank Trust National Association (U.S. Bank TNA), National Rural Utilities Cooperative Finance Corporation (CFC), PBR-1 Statutory Trust (PBR-1), PBR-2 Statutory Trust (PBR-2), PBR-3 Statutory Trust (PBR-3), FBR-1 Statutory Trust (FBR-1), FBR-2 Statutory Trust (FBR-2), PBR-10P Statutory Trust, PBR-20P Statutory Trust, PBR-30P Statutory Trust, FBR-10P Statutory Trust, FBR-20P Statutory Trust, FBR-30P Statutory Trust, Bluegrass Leasing, Fleet Real Estate, Inc., AME Investments, LLC, CoBank, ACB, and Ambac Credit Products, LLC (Ambac Credit).

those of the parties to the Nondisturbance Agreement that are also Mortgagees under the Big Rivers Third Restated Mortgage and Security Agreement.<sup>11</sup> The Nondisturbance Agreement Amendment also provides for the implementation of certain terms of the Fifth Amendment.

Big Rivers will sign the three documents upon receipt of approval from the Commission.

On June 4, 2002, the proposed amendments were sent to the other parties to the Nondisturbance Agreement with a request for their review and approval on or before July 1, 2002. As of June 27, 2002, Big Rivers had received the approval of CoBank, and based on conversations with the other parties, expects all approvals will be received by July 1, 2002 or shortly thereafter.<sup>12</sup> Big Rivers and the LG&E Parties have requested expedited review and approval of these amendments by the Commission, noting the critical nature of the scrubber project. The target completion date for the Coleman scrubber is December 31, 2003, with a construction cycle of 18 months. The completion date coincides with the expiration of various coal contracts WKEC has for Coleman.<sup>13</sup> Big Rivers and the LG&E Parties also cite potential escalation in construction costs, changes in sulfur dioxide allowance values, risk concerning

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<sup>11</sup> Dated August 1, 2001, with the Mortgagees being United States of America, Ambac Assurance, Credit Suisse, U.S. Bank TNA, Trustee, CFC, PBR-1, PBR-2, PBR-3, FBR-1, FBR-2, and Ambac Credit.

<sup>12</sup> Response to the Commission Staff's First Data Request dated June 21, 2002, Item 6.

<sup>13</sup> Id.

favorable cost differentials between low and high sulfur fuels, and the risk that air regulations may change as factors requiring expedited approval.<sup>14</sup>

Based on our review of the application, the Commission finds that the proposed amendments to the three documents are reasonable. Big Rivers will incur none of the costs to construct, install, operate, or maintain the Coleman scrubber during the term of the lease transaction. There is no cash flow impact from the scrubber on Big Rivers, and there should be no effect on its rates. WKEC is required to maintain the scrubber in accordance with prudent utility practice, so that when Big Rivers takes over the scrubber, it should be in the best possible operating condition. Therefore, the Commission will approve the amendments as proposed in total.

The Commission notes that while Big Rivers will have title to the Coleman scrubber, Big Rivers has not determined how it will record the scrubber on its books, how annual depreciation expense will be recorded, or whether an accounting entry for the initial investment will be made. Big Rivers auditor, its tax counsel, and representatives of the Rural Utilities Service ( RUS ) have been consulted over the past 60 days regarding these issues, and discussions are ongoing.<sup>15</sup> Given the uniqueness of the arrangement concerning the Coleman scrubber, Big Rivers should provide the Commission with the results of these discussions before a final entry, if any, is made to its books and records. Therefore, within 10 days of finalizing its accounting for the Coleman scrubber, Big Rivers should provide the Commission with a written discussion

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<sup>14</sup> Application, paragraph 14 at 12.

<sup>15</sup> Response to the Commission Staff s First Data Request dated June 21, 2002, Item 1.

of the proposed accounting treatment. This discussion should include, but not be limited to, any proposed accounting entries, the evaluations and conclusions of its auditor, its tax counsel and the RUS, and the rationale supporting the accounting approach proposed.

The Commission is concerned that it is asked to approve amendments that have not yet received approval from the majority of the parties to the Nondisturbance Agreement. The Big Rivers lease transaction involves a number of highly complex and detailed documents, and changes to the proposed amendments required by any one party could significantly impact the operation of these amendments. The Commission's approval of the proposed amendments is based upon the documents as filed in the application on June 10, 2002. Any revisions to these documents should be promptly filed, clearly identified, and supported by a narrative explanation of each change so that the Commission can review the revisions expeditiously and, if necessary, modify this Order.

Big Rivers and the LG&E Parties have requested expedited consideration for these proposed amendments, seeking Commission approval by July 10, 2002. This date was selected because it gave the Commission 30 days from the filing of the application to issue a decision.<sup>16</sup> The requested approval dates from the Commission and the parties to the Nondisturbance Agreement Amendments have been coordinated with WKEC's timetable for the scrubber construction. However, the terms of these amendments were developed in sufficient detail to allow Big Rivers to begin discussions on accounting treatments with its auditor, tax counsel, and the RUS in late April 2002.

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<sup>16</sup> Id., Item 6(f).

In Case No. 1999-00450, the Commission admonished Big Rivers that time-sensitive applications must be filed as early as possible, not weeks after the major parameters of the transaction are known with reasonable certainty.<sup>17</sup> With the present filing, Big Rivers appears to have ignored that admonition. It was inappropriate for Big Rivers and the LG&E Parties to assume that an investigation of the lease transaction documents, which are quite complex and detailed, could be concluded in only 30 days. In an effort to accommodate this request for expedited consideration, the Commission has had to divert its limited resources from other pending cases. Since the transaction details were sufficiently developed to commence discussions on the accounting treatment in late April, Big Rivers and the LG&E Parties should have filed this application at that time, not 6 weeks later.

The Commission reiterates that Big Rivers should file any time-sensitive applications as early as possible, but no later than 60 days prior to the requested approval date, absent extraordinary circumstances. Future applications should be filed as soon as the major parameters of those transactions are known with reasonable certainty.

IT IS THEREFORE ORDERED that:

1. The amendments to the lease transaction between Big Rivers and the LG&E Parties, as described in the Fifth Amendment, the LEM Mortgage Amendment, and the Nondisturbance Agreement Amendment, are approved, and Big Rivers is authorized to execute those amendments, as described in the application.

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<sup>17</sup> Case No. 1999-00450, Big Rivers Electric Corporation's Application for Approval of a Leveraged Lease of Three Generating Units, final Order dated November 24, 1999, at 12.



2. The request of the LG&E Parties to deviate from any filing requirements associated with this application is granted.

3. Within 10 days of finalizing the accounting treatment for the Coleman scrubber, but prior to any accounting entry being made to its books, Big Rivers shall provide the Commission with a discussion of the proposed accounting treatment. This discussion shall include, but not be limited to, any proposed accounting entries, the evaluations and conclusions of its auditor, its tax counsel and the RUS, and the rationale supporting the accounting approach proposed.

4. In the event that any further revisions are made to the Fifth Amendment, the LEM Mortgage Amendment or the Nondisturbance Agreement Amendment, Big Rivers shall file the revised documents within 7 days of obtaining concurrence by all parties and shall reference each revision and include an explanation for each.

5. In any future proceeding involving time-sensitive applications, Big Rivers shall file said applications as soon as the major parameters of those transactions are known with reasonable certainty, but no later than 60 days prior to the requested approval date, absent extraordinary circumstances.

Done at Frankfort, Kentucky, this 12<sup>th</sup> day of July, 2002.

By the Commission

ATTEST:



Executive Director