COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

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	)	CASE NO. 2004-00276

O R D E R

On October 1, 2004, East Kentucky Utilities, Inc. ("East Kentucky") filed its application for approval of long-term financing in the amount of $245,891 from the Gas System Restoration Board ("GSRB") loan program administered by the Kentucky Infrastructure Authority ("KIA"). At the time of the application, funds were available from the GSRB for a term of 30 years at an annual interest rate of 4 percent.[1] A loan commitment letter from KIA setting out terms and conditions was included as Exhibit D of the application.

East Kentucky seeks approval of long-term financing as a means of financial rehabilitation of its system. East Kentucky has obligations to numerous creditors, including its wholesale natural gas supplier, Equitable Energy Company ("Equitable"), which must be met to maintain its financial viability and enable it to continue as a going concern. A summary schedule of these obligations, which was included as Exhibit B of the application, is appended hereto.

[1] These terms can be subject to change.

It appears, based on the application, that East Kentucky finds itself in a financial quandary that is due in part to the timing and magnitude of an under-billing correction by Equitable and to East Kentucky's failure to address the impact of increases in several operating expenses in a timely manner.

Having noted the situation facing East Kentucky, we must now determine how it can be remedied. Under ordinary circumstances, East Kentucky's request would be denied on the grounds that long-term financing should not be approved for the purpose of paying prior period operating expenses. It is a long-held regulatory axiom that ratepayers should not be required to pay, on a long-term basis, for short-term operating expenses. However, rejecting the full amount of the proposed financing would potentially inure to the long-term detriment of East Kentucky and its ratepayers by compromising its financial viability and its ability to provide continued service to its customers.

Given East Kentucky's current situation with its creditors, we are persuaded that approving a portion of the proposed financing will be in the best long-term interests of both East Kentucky and its ratepayers. We will approve financing in the amount of $189,255, which is the amount needed to allow East Kentucky to pay Equitable, refinance its existing automobile loans, and meet its loan obligation to Floyd County Fiscal Court. The remainder of the request, $56,626, which was for past due fuel cost payments and compensation that East Kentucky's president had foregone over the past two years, constitutes the type of short-term expenses that utilities are not permitted to include in long-term financing. Approving this portion of the financing request will enable East Kentucky to continue as a going concern and assure that its ratepayers will continue to receive gas service. In summary, this decision is based on the unusual circumstances present in this particular proceeding.

COMMISSION CONCERNS AND PRIORITY PAYMENT OF EXPENSES

The Commission is granting a portion of the proposed financing to help East Kentucky achieve financial stability. However, the approval of financing alone will not alleviate the financial problems of East Kentucky. It is incumbent upon East Kentucky to address its failure to pay current obligations to vendors.

Of paramount concern to the Commission is East Kentucky's failure to pay its natural gas supplier. East Kentucky has now been given notice by its gas supplier that it is in violation of several terms in its gas supply contract and that its supply will be terminated on October 31, 2004. The Commission does not find any compelling reason for the payment for purchased gas costs to have been deferred. East Kentucky has a Gas Cost Adjustment Clause that provides for the timely pass through of the cost of gas, as well as increases and decreases in gas costs to the customers. Consequently, funds to pay for wholesale gas costs are recovered directly from the customers. These costs should not be recovered a second time through rate increases or long-term financing. It is incumbent upon East Kentucky to remain current in the payment of its gas costs to ensure a continued gas supply for its customers. East Kentucky must implement procedures whereby payments can be made on a timely basis to all vendors and creditors.

Because of our concern in this area, the Commission believes it is essential for East Kentucky to establish and follow a payment priority for certain expenses in lieu of their deferral. The first priority of payments shall be East Kentucky's current gas supplier. As discussed above, East Kentucky is currently in arrears in its payments to its natural gas supplier. Debt service payments shall be the second priority. The third priority for payment shall be vendors that have liens against the assets of the company. Companies charging late payment penalties shall be the fourth item paid from the monthly operating revenues. The current GSRB loan and proposed financing may require escrow or other payments into an operating fund for contingencies. East Kentucky should use all proceeds from revenues after payment of current operating expenses to fund any escrow or reserve account as required.

This approval, moreover, is conditioned upon East Kentucky's use of the proceeds of the financing approved herein only for the purposes set forth in this Order. East Kentucky should file monthly reports with the Commission that detail the receipt and disbursement of funds from the financing for which it has sought approval.

In its October 1, 2004 application, East Kentucky requested that the Commission grant it a deviation from 807 KAR 5:001, Section 11(2)(a), and permit it to use its 2003 annual report on file with the Commission as its financial exhibit. East Kentucky cited its size, the fact that it prepares financial statements only once a year, and the cost of preparing additional financial statements in support of the requested deviation. The Commission finds that East Kentucky's request is reasonable and that the deviation should be granted.

FINDINGS AND ORDERS

The Commission, having considered the evidence of record and being otherwise sufficiently advised, finds as follows:

1. East Kentucky's proposed financing from KIA to effect its financial rehabilitation, in the amount of $189,255 as modified herein, is for lawful purposes within the corporate purposes of East Kentucky, is necessary and 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 reasonable, necessary and appropriate for such purposes.

2. The Commission has generally held that it is not appropriate to issue long-term financing to fund operating expenses; however, given the existing circumstances, in this instance, the Commission is permitting such financing based on our conclusion that the utility cannot survive as a going concern without this capital funding and that such approval is in the best long-term interests of both the utility and its ratepayers.

3. As a condition to our approval of the proposed loan, East Kentucky must establish a payment priority list of ongoing operating expenses from the proceeds of its operating revenues, in consideration of the priorities established in the section above entitled "Commission Concerns and Priority Payment of Expenses" and shall follow said priorities until further Order of the Commission.

4. The proceeds of the financing approved herein should be used only for the purposes stated in East Kentucky's application, which have been approved herein. Misuse of the proceeds could result in penalties being imposed on East Kentucky and its owners.

5. East Kentucky's request for a deviation from the requirements of 807 KAR 5:001, Section 11(2)(a), should be granted and East Kentucky should be permitted to submit its 2003 annual report as its financial exhibit.

IT IS THEREFORE ORDERED that:

1. East Kentucky is authorized to borrow $189,255 from KIA subject to the provisions and terms contained within its application.

2. East Kentucky shall establish a payment priority list of ongoing operating expenses from the proceeds of its operating revenues, in consideration of the priorities established in the section above entitled, “Commission Concerns and Priority Payment of Expenses,” and shall follow said priorities until further Order of the Commission.

3. The proceeds from the transaction authorized herein shall be used only for the lawful purposes set out in the application as modified herein.

4. East Kentucky shall file monthly reports, within 15 days after the end of the reporting month, with the Commission, which detail the receipt and disbursement of funds from the financing for which it has sought approval.

5. East Kentucky’s request to deviation from the requirements of 807 KAR 5:001, Section 11(2)(a), is granted.

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 12th day of October, 2004.

ATTEST:

Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2004-00276 DATED OCTOBER 12, 2004

Schedule of Amounts Owed by East Kentucky Utilities, Inc.

Equitable Energy LLC	$148,323
Bank One (Fuel for Vehicles)	2,636
Toyota Financial Services	20,932
Tax Consulting, Inc.	54,000
Floyd County Fiscal Court	20,000
Total	$245,891