COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

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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, 1980, TO OCTOBER 31, 1982	)	CASE NO. 8590

O R D E R

On January 24, 1983, the Commission held a public hearing, pursuant to 807 KAR 5:056(12), to review and evaluate operations of the fuel adjustment clause ("FAC") of Kentucky Utilities Company ("KU") from November 1, 1980, to October 31, 1982. As of December 1982 KU was paying $50.20 per ton FOB mine and $7.43 per ton for transportation, or $57.63 per ton total for coal delivered to its Ghent plant by River Processing, Inc., and Hub Coal Company ("River Processing") and $56.08 per ton FOB mine and $9.93 per ton for transportation, or $66.01 total per ton for coal delivered to its Ghent plant by South East Coal Company ("South East"). In the FAC hearing, Case No. 8588, for East Kentucky Power Cooperative, which requires similar coal delivered to a similar location, the price per ton of coal FOB mine and for transportation in December 1982 was found to be[1]:

[1] East Kentucky Power Cooperative's Analysis of Coal Purchases for the Month of December 1982.

Supplier	FOB Mine	Transportation	Total
Transcontinental Coal	$35.05	$8.68	$43.73
Bartrip, Inc.	$37.84	$3.61	$41.45
Armco Material Resources	$37.32	$3.61	$40.93

The Courier-Journal indicates that current contract and spot market prices for steam coal of similar quality produced in a similar area are $38 per ton FOB mine under a term contract and $29 per ton FOB mine on the spot market.[2]

KU's Contracts

KU has two long term contracts for the provision of low-sulfur compliance coal to its Ghent plants. On May 20, 1976, KU entered into a 15-year contract with River Processing for the purchase and delivery of 900,000 tons per contract year with deliveries to commence on September 1, 1976. The base price for coal delivered and accepted under this contract was $28 per ton, subject to adjustment based on increases or decreases in the cost to River Processing to produce, process and deliver the coal.

Section 13 of KU's contract with River Processing entitled "Force Majeure" defines this term as:

> . . .any and all unforeseeable causes beyond the control and without the fault or negligence of the party failing to perform. . .which wholly or partly prevent the mining, delivering and/or loading of the coal by Seller, or the receiving, accepting or utilizing of the coal by the Buyer.

[2]The Courier-Journal, April 30, 1983, "Current Contract and Spot Marker Steam Coal Prices," p. B12.

If because of force majeure, either KU or River Processing is unable to carry out its obligations under the contract, such obligations shall be suspended to the extent made necessary by such force majeure.

Section 15 of the contract entitled "Adjustments for Gross Inequities" provides in part:

> Any gross inequity that may result from unusual economic conditions not contemplated by the parties at the time of execution of the contract may be corrected by mutual agreement. In case of a claim of gross inequity, each party shall furnish the other with any pertinent information requested.

This Section does not absolve the parties from the obligation to deliver or take delivery of coal under the contract.

On June 30, 1978, KU entered into a contract for a term of 12 years and 6 months with South East for the provision of increasing amounts of coal, leveling off at 1 million tons per year for the period commencing January 1, 1982. The base price for coal under this contract was $43.76 per ton, composed of a coal component of $38 per ton and a transportation component of $5.76. The base price of coal under this contract is also subject to adjustment based on certain escalators and conditions.

Section 11.01 of KU's contract with South East has a force majeure clause similar to the one in the River Processing contract. Section 12.01 of this contract entitled "Reviews" has two pertinent subsections; the first relates to escalation, the second to the base price. Under these subsections, the parties are required to determine whether the base price and its components are required to be adjusted because of the occurrence of material unforeseen events or changed conditions. The subsections specify the events, conditions and items which the parties must take into account. This determination should have been made 1 year prior to the end of the third year of operation under the contract, i.e., July 1, 1980, and will be made 1 year prior to the end of each third year of operation thereafter. The next review is thus due before July 1, 1983.

The Commission is of the opinion that it is in the public interest for it to be kept informed of negotiations related to the ongoing reviews and adjustments of the contracts between KU and South East and River Processing. The Commission is aware that the information requested is sensitive and should be treated in a confidential manner. For this reason, the Commission on its own motion will order KU to file a single copy of its response to this information request, such response to be labeled "Confidential." Upon proper motion and the execution of an appropriate agreement to preserve the confidentiality of the information, the Attorney General will be allowed to review KU's response.

The Commission, having considered the matter and being advised, hereby ORDERS that KU shall file one copy (original) of the following information with the Commission by the close of business June 1, 1983. The data requested should 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. In the event of a further hearing, include with each response the name of the witness who would be responsible for responding to questions relating to the information provided. Careful attention should be given to copied material to insure that it is legible. If neither the requested information nor a motion for an extension of time is filed by the stated date, the Commission may take appropriate action to compel the submission of the information.

River Processing Contract

(1)(a) With reference to Section 13 Force Majeure, would an Order of this Commission disallowing as an above the line expense (for rate-making and FAC purposes) the cost of coal above the current market price operate as a force majeure under the terms of this contract?

(b) Why?

(c) Would KU have a remedy under the terms of the contract? If yes, state the remedy. If no, what terms of the contract apply?

(d) Identify the authorities relied on in reaching the above response.

(2)(a) With reference to Section 15 Gross Inequities, have there been unusual economic conditions not contemplated by the parties? Please be specific.

(b) If yes, have gross inequities resulted from these conditions?

(c) Has KU made a claim of gross inequity? If yes, please provide details.

(d) Is KU preparing to make a claim of gross inequity? Please explain.

South East Contract

(1)(a) With reference to Section 11.01 Force Majeure, would an Order of this Commission disallowing as an above the line expense (for rate-making and FAC purposes) the cost of coal above the current market price operate as a force majeure under the terms of this contract?

(b) Why?

(c) Would KU have a remedy under the terms of the contract? If yes, state the remedy. If no, what terms of the contract apply?

(d) Identify the authorities relied on in reaching the above response.

(2) Is there a price differential between current market price and Base Price which is so great that the Base Price can be deemed inequitable?

(3) If yes, what is that price under current conditions?

(4) What factors and information were considered in determining the price differential in (2) above?

(5) If the Commission were to allow, as an above the line expense, only 50 percent of fuel cost in a FAC proceeding, does the contract prevent or allow an adjustment of Base Price? Please explain, listing the Sections which apply.

(6) With reference to the first sentence of Section 12.01 Reviews, (1) Escalation:

(a) Are specified components in the Base Price Adjustment provisions required to be adjusted at this time because of material unforeseen events or changed conditions? Why?

(7) With reference to the second sentence of Section 12.01(1):

(a) Do the existing component provisions accurately reflect the decrease or increase in costs? Please explain.

(b) Do the existing component provisions accurately reflect the effects of deflation or inflation in the economy? Please explain.

(c) Please identify and provide copies of the information on which responses 7(a) - 7(b) are based; include in-house evaluations and analyses as well as information obtained from outside sources.

(8) With reference to the third sentence of Section 12.01(1):

(a) Are revisions to the contract appropriate because of:

(i) The costs of producing coal?

(ii) Replacement cost of plant, machinery and equipment (which is anticipated to require replacement during the term of the contract)?

(iii) The current levels of coal royalties paid by the Seller?

(iv) The current market price of like quality coal produced in the general area of the Seller's properties?

(v) Other items? Please be specific.

(b) Please identify and provide copies of the information on which responses (a)(i) - (v) are based; include in-house evaluations and analyses as well as information obtained from outside sources.

(c) What is the current market price of like quality coal produced in the general area of Seller's properties? Please specify price, producer, general location, etc. If information was provided by a person not an employee of KU, provide name and address.

(d) Has KU purchased like quality coal since July 1980?

(e) If yes, please indicate price, producer, quantity, terms and date of purchase.

(9) Has KU proposed or will KU propose revisions to the contract under Section 12.01(1)? If yes, please list proposed revisions. If no, why not?

(10) Has South East proposed revisions to the contract under Section 12.01(1)? Please explain.

(11) Have the parties submitted the question of revisions to arbitration under the provision of Section 13.04?

(12) With reference to the first two sentences of Section 12.01 Reviews, (2) Base Price:

(a) Is the Base Price Adjustment provision required to be adjusted at this time because of material unforeseen events or changed conditions?

(b) Why?

(c) Because of such events or conditions, is the existing Base Price inequitable to one of the parties?

(d) If yes, to which party?

(13) In determining whether an inequity exists, what consideration has been given to:

(a) A drastic increase or decrease in the cost of mining equipment (which is expected to require replacement during the term of the contract) which substantially is not accounted for by the price adjustment provisions in the contract?

(b) The effect upon Seller of any change in the existing federal tax laws and regulations related to depletion allowance?

(c) The current market price of coal of like quality produced in the same general area of Seller's properties?

(d) The general and prolonged recession and related effects on electric demand?

(e) Please identify and provide copies of the information on which responses (a) - (d) are based; include in-house evaluations and analyses as well as information obtained form outside sources.

(14) Has KU proposed or will KU propose revisions to the contract under Section 12.01(2)? If yes, please list proposed revisions. If no, why not?

(15) Has South East proposed revisions to the contract under Section 12.01(2)? Please explain.

(16) Have the parties submitted the question of revisions to arbitration under the provisions of Section 13.04?

Both Contracts

Please update responses herein as circumstances change.

Done at Frankfort, Kentucky, this 19th day of May, 1983.

PUBLIC SERVICE COMMISSION

Chairman

Vice Chairman

Commissioner

ATTEST:

Secretary