



Case No. 2010-00266

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Hand Delivery

August 17, 2010

Jeff DeRouen
Executive Director
Kentucky Public Service Commission
211 Sower Boulevard
Frankfort, KY 40601

RECEIVED

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PUBLIC SERVICE
COMMISSION

Allyson K. Sturgeon
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RE: Kentucky Utilities Company's Transfer of Obsolete Rail Cars

Dear Mr. DeRouen:

I am writing to you to inform the Commission that Kentucky Utilities Company ("KU") plans to transfer 149 obsolete, nineteen-year-old steel rail cars to Trinity Industries Leasing Company.¹ The planned transfer is part of a lease transaction under which KU will lease 150 new aluminum railcars from Trinity to transport coal from CSXT origins in Eastern Kentucky to KU's E.W. Brown Station, and to the CSX terminal in Maysville, Kentucky, for transfer into barges for final delivery to KU's Ghent Station. Pursuant to the Commission's Final Order in Case No. 92-493, KU will ultimately recover the full original purchase price of the cars through its Fuel Adjustment Clause ("FAC"), but the trade-in value of the cars will be used to reduce the lease payments that will be recovered through KU's fuel adjustment clause ("FAC").² KU does not believe Commission approval is necessary for the transfer under KRS 278.218 because the cars are obsolete.³

¹ KU originally purchased 150 steel cars, but one was lost and removed from KU's books. KU received the net book value of the car as compensation from CSX, so there is neither a gain nor a loss associated with the car. The car was later found and has been used and maintained by KU, but will not be transferred to Trinity because KU does not own it.

² *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, 1990 to October 31, 1992*, Case No. 92-493, Order (Jan. 2, 1997).

³ KRS 278.218 states: "No person shall acquire or transfer ownership of or control, or the right to control, any assets that are owned by a utility as defined under KRS 278.010(3)(a) without prior approval of the commission, if the assets have an original book value of one million



Under any reasonable definition of the term, KU's nineteen-year-old steel rail cars are obsolete. For example, Black's Law Dictionary defines "obsolescence" and "obsolete" as:

obsolescence ... 1. The process or state of falling into disuse or of becoming obsolete. 2. A diminution in the value or usefulness of property, esp. as a result of technological advances.

...

obsolete ... No longer in general use; out-of-date.⁴

As I describe further below, it is clear that the technology of carrying coal in rail cars has advanced substantially and that the value of KU's current steel cars has significantly diminished, making the cars obsolete.

With regard to advances in technology, each of the new aluminum cars will be able to carry approximately 19 more tons of coal than each of the steel cars KU plans to transfer. The new cars will use pneumatic technology to power rapid-discharge doors, rather than the manual doors on KU's existing railcars; this should allow for labor savings in the coal yard. Also, the cars KU plans to transfer require a significant amount of maintenance and repair; the new cars should require about 70% less maintenance expense over a five-year term than the steel cars would require. In short, the technology for rail cars transporting coal has advanced substantially since 1991, and KU plans to realize the potential savings associated with those advances through the planned lease and trade-in transaction.

Moreover, the trade-in value of cars is roughly one tenth of original purchase price of the cars; the original purchase price of 149 of the steel cars was \$7,596,250 (\$50,982 per car), and the trade-in value Trinity has offered is \$774,800 (\$5,200 per car, though the book value of the cars in October 2010, the time of the physical transfer of the cars is anticipated to occur, will be approximately \$1.26 million). Indeed, the trade-in value of the cars is approximately the value of an equivalent amount of scrap steel due to the cars'

dollars (\$1,000,000) or more and: (a) The assets are to be transferred by the utility for reasons other than obsolescence; ..." (emphasis added).

⁴ BLACK'S LAW DICTIONARY 908-909 (abridged 8th ed. 2005).



limited carrying capacity. A nearly 90% decrease in the nominal value of the cars over nineteen years is a strong indication that the cars are obsolete.

KU will recover the full amount of its investment in the 149 steel rail cars through its FAC. The trade-in value of the cars will be used to reduce the lease payments, thereby passing on to KU's customers the full trade-in value of the current steel railcars through its FAC over the full term of the lease. Upon the close of the trade-in and lease transaction and FERC approval, KU will recover its loss on the rail cars (approximately \$480,000) through its FAC in a single month. Over the life of the 5-year lease, KU will recover the trade-in value of the rail cars (\$774,800) in equal monthly amounts. This approach comports with the Commission's January 2, 1997 Order in Case No. 92-493, which required that gain on the sale of railcars depreciated through KU's FAC should be passed to customers through KU's FAC.⁵

KU presently anticipates executing the Trinity lease by August 31, 2010, and having physical possession of the 150 aluminum cars and completing the trade-in transaction in October 2010.

If you have any questions or concerns, please contact me at your first convenience.

Regards,

A handwritten signature in black ink that reads "Allyson K. Sturgeon". The signature is written in a cursive, flowing style.

Allyson K. Sturgeon

cc: Dennis Howard
Office of the Attorney General, Office of Rate Intervention

⁵ *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, 1990 to October 31, 1992, Case No. 92-493, Order (Jan. 2, 1997).*