

Goss ■ Samford PLLC



David S. Samford
(859) 368-7740
david@gosssamfordlaw.com

December 10, 2014

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PUBLIC SERVICE
COMMISSION

Via Hand-Delivery

Mr. Jeffrey Derouen
Executive Director
Kentucky Public Service Commission
P. O. Box 615
211 Sower Boulevard
Frankfort, KY 40602

RE: *In the Matter of: The Application of East Kentucky Power Cooperative, Inc. for an Order Approving the Establishment of Regulatory Assets for the Depreciation and Accretion Expenses Associated with Asset Retirement Obligations*
Case No. 2014-00 432

Dear Mr. Derouen:

Enclosed please find for filing with the Commission in the above-referenced case an original and ten (10) copies each of East Kentucky Power Cooperative, Inc.'s ("EKPC") Application regarding the above-styled matter. As noted in the Application, EKPC is requesting that the Commission approve this request no later than February 27, 2015. Please return the file-stamped copies to me.

Do not hesitate to contact me if you have any questions.

Very truly yours,

David S. Samford

Enclosures

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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DEC 10 2014

PUBLIC SERVICE
COMMISSION

IN THE MATTER OF:

THE APPLICATION OF EAST KENTUCKY POWER)
COOPERATIVE, INC. FOR AN ORDER APPROVING)
THE ESTABLISHMENT OF REGULATORY ASSETS)
FOR THE DEPRECIATION AND ACCRETION) CASE NO. 2014- 00432
EXPENSES ASSOCIATED WITH ASSET)
RETIREMENT OBLIGATIONS)

APPLICATION

Comes now East Kentucky Power Cooperative, Inc. ("EKPC"), by counsel, pursuant to KRS 278.030(1), KRS 278.040(2), KRS 278.220 and other applicable law, and does hereby request the Kentucky Public Service Commission ("Commission") to approve the establishment of regulatory assets for the depreciation and accretion expenses associated with EKPC's Asset Retirement Obligations ("ARO"), respectfully stating as follows:

I. Applicant Information and General Filing Requirements

1. EKPC is an electric generation and transmission cooperative that provides electricity to approximately 525,000 retail customers. EKPC is owned by sixteen Members, all of whom are distribution cooperatives. EKPC owns four primary electric generation stations, including: the William C. Dale Generating Station ("Dale Station") in Ford, Kentucky; the John Sherman Cooper Generating Station ("Cooper Station") near Burnside, Kentucky; the H. L. Spurlock Generating Station ("Spurlock Station") near Maysville, Kentucky and the J. K. Smith Generating Station ("Smith Station") near Trapp, Kentucky. Altogether, EKPC currently has 2,929 megawatts (MWs) of wintertime net electric generating capacity in its fleet.

2. Pursuant to 807 KAR 5:001, Section 14(1), EKPC's mailing address is P.O. Box 707, Winchester, Kentucky 40392-0707 and its email address is psc@ekpc.coop. The facts and law upon which this Application is based are stated in paragraphs 4-15 below.

3. Pursuant to 807 KAR 5:001, Section 14(2), EKPC is a Kentucky corporation that was incorporated on July 1, 1941. EKPC is in good standing to transact business within the Commonwealth of Kentucky.

II. Request to Establish Regulatory Assets

4. AROs are legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development and/or the normal operation of such assets. Financial Accounting Standards Board Accounting Standards Codification ("ASC") Topic 410-20, *Asset Retirement Obligations*, requires legal obligations associated with the retirement of long-lived assets to be recognized at fair value when incurred and capitalized as part of the related long-lived asset. ASC Topic 410-20 also clarifies the term "conditional asset retirement obligation" where an obligation exists even though the method or timing of settlement may be conditional. The liability is accreted to its present value each period and the capitalized cost is depreciated over the useful life of the related asset. When the asset is retired, the entity settles the obligation for its recorded amount or incurs a gain or loss.

5. Pursuant to KRS 278.220, the Commission has established a system of uniform accounts for EKPC which was issued by the United States Department of Agriculture, Rural Utilities Service ("RUS").¹ The RUS Uniform System of Accounts ("RUS USoA") states:

(1) An asset retirement obligation represents a liability for the legal obligation associated with the retirement of a tangible long-lived asset that a company is required to settle as a result of an existing or enacted law, statute, ordinance, or

¹ Codified as 7 CFR Part 1767. The current version of the RUS system of accounts became effective May 27, 2008 and is also published and referenced as RUS Bulletin 1767B-1.

written or oral contract or by legal construction of a contract under the doctrine of promissory estoppel. An asset retirement cost represents the amount capitalized when the liability is recognized for the long-lived asset that gives rise to the legal obligation. The amount recognized for the liability and an associated asset retirement cost shall be stated at the fair value of the asset retirement obligation in the period in which the obligation is incurred.²

6. The RUS USoA requires that a utility initially record a liability for an ARO in Account 230 – Asset Retirement Obligations, and charge the associated asset retirement costs to the electric utility plant that gave rise to the legal obligation. The asset retirement cost is to be depreciated over the useful life of the related asset that gives rise to the obligation. In periods subsequent to the initial recording of the ARO, the utility shall recognize the period-to-period changes of the ARO that result from the passage of time due to the accretion of the liability by recording a debit to Account 411.11 – Accretion Expense, and a credit to Account 230. For any subsequent measurement changes to the initial liability for the legal obligation recorded in Account 230 for each specific ARO, the utility shall recognize said changes as an adjustment to the liability in Account 230 with a corresponding adjustment to the appropriate electric utility plant account. The utility shall on a timely basis monitor measurement changes of the AROs.³

7. During 2011, information became available to reasonably quantify AROs for asbestos at certain generating plants, which is required by law to be removed or contained if the plants are renovated or demolished. In March 2011, EKPC recognized and established an ARO liability of \$1,905,278 relating to asbestos abatement at Dale Station Units 1 and 2. During 2012 EKPC was able to quantify an ARO for asbestos abatement for Dale Station Units 3 and 4 and the Cooper Station.⁴ As of December 31, 2012, the ARO liability was \$4,875,498. During 2013

² Section 1767.15, General Instructions, subpart (y), Accounting for asset retirement obligations.

³ EKPC generally evaluates changes in the AROs annually.

⁴ EKPC does not believe there is any asbestos abatement issues associated with the Spurlock Station.

EKPC increased its ARO liability for legal obligations associated with ash ponds and landfills that existed in prior periods but were not recorded until 2013. In December 2013, EKPC revised its ARO estimates for the reclamation and capping of ash disposal sites at its coal-fired facilities. The ARO reserve revisions were pursued in response to industry developments and a reassessment of environmental risks during 2013.⁵ As of December 31, 2013, the total ARO liability was \$32,238,032, composed of \$5,127,906 in AROs associated with asbestos abatement and \$27,110,126 in AROs associated with ash disposal sites.

8. Pursuant to the requirements of the RUS USoA, EKPC monthly records depreciation expense for the ARO-related assets and accretion expense for the ARO-related liabilities. As of September 30, 2014, the year-to-date ARO-related depreciation expense was \$4,003,577 and the accretion expense was \$807,949. Based on the monthly depreciation and accretion expense, at the end of 2014 the ARO-related depreciation expense will be \$5,275,341 and the accretion expense will be \$1,077,266.

9. While the specific AROs will be settled and resolved at a future date, under the RUS USoA EKPC is required to currently recognize depreciation and accretion expense. EKPC believes that the actual ARO settlement costs will be recoverable in rates or through the Environmental Surcharge mechanism when the projects are identified, costs are finalized, and the Commission has so authorized. However this deferred recovery creates a mis-match of revenues and expenses in the financial statements because expenses are recognized as the ARO balances are accreted and depreciated but the revenue will not be recognized until the actual projects are authorized for recovery. These ARO-related expenses therefore reduce EKPC margins and understate the actual financial performance for 2014. In later accounting periods

⁵ The study that evaluated options for dealing with the coal ash at the Dale Station was part of this reassessment of environmental risks. That study has been filed as part of EKPC's application in Case No. 2014-00252.

when the actual costs are being recovered, revenues and expenses will be inflated and thus overstate financial performance. Therefore, EKPC is requesting authorization from the Commission to reclassify the 2014 ARO-related depreciation and accretion expenses as regulatory assets with a total balance of \$6,352,607.⁶ EKPC is also requesting that all subsequent ARO-related depreciation and accretion expenses associated with the ARO balances at December 31, 2013 be recorded as regulatory assets. This treatment will defer recognition of these ARO expenses until recovery of the actual project costs is authorized, resulting in an appropriate matching of revenues and expenses in each accounting period.

10. EKPC has not established the requested regulatory assets on its books. EKPC acknowledges that prior Commission approval is required to establish the requested regulatory assets. At this time EKPC is requesting the regulatory asset treatment for accounting purposes only.

11. The Commission has previously authorized EKPC and other jurisdictional utilities to establish regulatory assets. The Commission has exercised its discretion to approve regulatory assets where a utility has incurred: (a) an extraordinary, nonrecurring expense which could not have reasonably been anticipated or included in the utility's planning; (b) an expense resulting from a statutory or administrative directive; (c) an expense in relation to an industry sponsored initiative; or (d) an extraordinary or nonrecurring expense that over time will result in a saving that fully offsets the cost.⁷ EKPC believes its request to establish regulatory assets for the ARO-

⁶ The ARO-related depreciation expense of \$5,275,341 plus the accretion expense of \$1,077,266.

⁷ See *In the Matter of the Application of East Kentucky Power Cooperative, Inc. for an Order Approving Accounting Practices to Establish a Regulatory Asset Related to Certain Replacement Power Costs Resulting from Generation Forced Outages*, Order, Case No. 2008-00436, p. 4 (Ky. P.S.C., Dec.23, 2008). Also See *In the Matter of Application of East Kentucky Power Cooperative, Inc. for an Order Approving the Establishment of a Regulatory Asset for the Amount Expended on Its Smith 1 Generating Unit*, Order, Case No. 2010-00449, p. 7 (Ky. P.S.C., Feb. 28, 2011).

related depreciation and accretion expenses is consistent with the second listed example, as the ARO-related depreciation and accretion expenses result from the accounting requirements of the RUS USoA and ASC Topic 410-20 concerning ARO accounting.

12. The Commission has previously approved the establishment of regulatory assets for ARO-related depreciation and accretion expenses. The Commission approved the establishment of regulatory assets for ARO-related depreciation and accretion expenses for Louisville Gas and Electric Company⁸ and Kentucky Utilities Company⁹ when those utilities adopted Statement of Financial Accounting Standards No. 143, *Accounting for Asset Retirement Obligations*.¹⁰

13. EKPC's Board of Directors has reviewed the proposal to seek the establishment of regulatory assets for the ARO-related depreciation and accretion expenses and authorized management to file this application. Exhibit 1 of this application is a copy of the June 2, 2014 Board Resolution authorizing this request.

14. EKPC is requesting that the Commission authorize EKPC to establish regulatory assets for ARO-related depreciation and accretion expenses resulting from ARO balances at December 31, 2013 beginning in January 2014 and for all years subsequent to 2014. Consequently, EKPC requests that the Commission approve this request no later than February 27, 2015. Authorization by this date will enable EKPC to establish the regulatory assets for 2014 before the closing of its books. The accounting entries reflecting the establishment of the

⁸ See *In the Matter of Application of Louisville Gas and Electric Company for an Order Approving an Accounting Adjustment to be Included in Earnings Sharing Mechanism Calculations for 2003*, Order, Case No. 2003-00426, p.6 (Ky. P.S.C., Dec. 23, 2003).

⁹ See *In the Matter of Application of Kentucky Utilities Company for an Order Approving an Accounting Adjustment to be Included in Earnings Sharing Mechanism Calculations for 2003*, Order, Case No. 2003-00427, p.6 (Ky. P.S.C., Dec. 23, 2003).

¹⁰ Statement of Financial Accounting Standards No. 143 is now codified as ASC Topic 410.

regulatory assets in 2014 and entries for years subsequent to 2014 are shown in Exhibit 2 of this application.

15. Currently none of the assets associated with the AROs are included in EKPC's environmental surcharge. EKPC has pending before the Commission Case No. 2014-00252¹¹ wherein EKPC is seeking a Certificate of Public Convenience and Necessity for the Smith Special Waste Landfill and inclusion of the project in its environmental compliance plan and recovery through the environmental surcharge. This project includes the actual costs to relocate the ash pond contents from the Dale Station location to a special waste landfill at the Smith Station. The completion of that project will eventually settle the ARO liability associated with the Dale Station ash ponds with any gain or loss transferred to the ARO regulatory asset at the time of settlement. If the Commission grants EKPC's request to establish a regulatory asset for the ARO-related depreciation and accretion expenses, the portion of the regulatory asset associated with the Dale Station ash pond project included in Case No. 2014-00252 will be amortized as actual costs are recovered through the environmental surcharge. EKPC will request amortization and recovery mechanisms for the remaining ARO-related assets in future cases as actual projects are identified.

WHEREFORE, EKPC respectfully requests the Commission to authorize the establishment of a regulatory asset for the ARO-related depreciation and accretion expenses incurred during 2014 and subsequent years.

Done this 10th day of December, 2014.

¹¹ See *In the Matter of an Application of East Kentucky Power Cooperative, Inc. for a Certificate of Public Convenience and Necessity for Construction of an Ash Landfill at J. K. Smith Station to Receive Impounded Ash from William C. Dale Station, and for Approval of a Compliance Plan Amendment for Environmental Surcharge Recovery*, Application, Case No. 2014-00252, (filed Sept. 8, 2014).

VERIFICATION

This will certify that I, Mike McNalley, the Chief Financial Officer of East Kentucky Power Cooperative, Inc., on behalf of said corporation, after having first been duly sworn, did examine the contents of this Application and that, to the best of my knowledge and belief as formed after reasonable diligence and inquiry, said statements are true and correct as of this 10th day of December, 2014.

EAST KENTUCKY POWER COOPERATIVE, INC.

BY: *Mike McNalley*

ITS: *EVP & CFO*

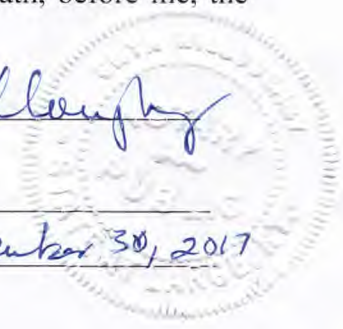
Commonwealth of Kentucky)
County of Clark)

This will certify that the foregoing Verification was signed, under oath, before me, the NOTARY PUBLIC, on this 10th day of December, 2014.

Greg M. Wilber
NOTARY PUBLIC

Commission #: *500144*

My Commission Expires: *November 30, 2017*



Respectfully submitted,

Mark David Goss

Mark David Goss
David S. Samford
GOSS SAMFORD, PLLC
2365 Harrodsburg Road, Suite B-325
Lexington, KY 40504
(859) 368-7740
mdgoss@gosssamfordlaw.com
david@gosssamfordlaw.com

*Counsel for East Kentucky Power
Cooperative, Inc.*

Exhibit 1

EKPC Board of Directors

Resolution dated June 2, 2014

**FROM THE MINUTE BOOK OF PROCEEDINGS
OF THE BOARD OF DIRECTORS OF
EAST KENTUCKY POWER COOPERATIVE, INC.**

At a regular meeting of the Board of Directors of East Kentucky Power Cooperative, Inc. held at the Headquarters Building, 4775 Lexington Road, located in Winchester, Kentucky, on Monday, June 2, 2014, at 10:30 a.m., EDT, the following business was transacted:

Approval of Regulatory Asset Treatment of Accretion and Depreciation Associated with Asset Retirement Obligations, and to File an Application with the Kentucky Public Service Commission for Accounting Authorization

After review of the applicable information, a motion to approve the Regulatory Asset Treatment of Accretion and Depreciation Associated with Asset Retirement Obligations, and to File an Application with the Kentucky Public Service Commission for Accounting Authorization was made by Strategic Issues Committee Chairman Lonnie Vice, and passed by the full Board to approve the following:

Whereas, East Kentucky Power Cooperative, Inc., (“EKPC”) currently has asset retirement obligations (ARO), which are legal obligations resulting from existing or enacted law, related to asbestos abatement and ash remediation at its coal-fired plant locations totaling approximately \$32 million;

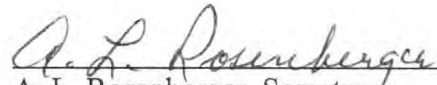
Whereas, EKPC has no current established recovery method for ARO accretion and depreciation and thus, these annual expenses will have a direct negative impact to margin and equity and could impact EKPC’s strategic initiative to meet and maintain an equity-to-assets ratio of 15 percent by 2015;

Whereas, establishment of a regulatory asset for accretion and depreciation associated with asset retirement obligations will provide EKPC the opportunity to recover such expenses through future rates or through future environmental surcharge projects and assist EKPC in meeting its equity goals; **now, therefore be it**

Resolved, that management is authorized to record a regulatory asset or assets for accretion and depreciation expenses associated with AROs and to initiate the regulatory filings necessary to obtain regulatory asset treatment of such expenses for all AROs (asbestos and ash) recorded at December 31, 2013 and that such treatment be granted retroactive to January 1, 2014..

The foregoing is a true and exact copy of a resolution passed at a meeting called pursuant to proper notice at which a quorum was present and which now appears in the Minute Book of Proceedings of the Board of Directors of the Cooperative, and said resolution has not been rescinded or modified.

Witness my hand and seal this 2nd day of June 2014.


A. L. Rosenberger, Secretary

Corporate Seal

Exhibit 2

Sample Accounting Entries

Entries to Establish Regulatory Assets at Year-End in 2014

Account 1823xx – Other Regulatory Assets	\$5,275,341	
Account 4074xx – Regulatory Credits		\$5,275,341

To reverse the depreciation expense recorded during 2014 to the regulatory asset. The entry to Account 4074xx offsets the ARO-related depreciation expense recorded in Account 403800, Depreciation Expense – Asset Retirement Costs, and neutralizes the effect on EKPC’s income statement.

Account 1823xx – Other Regulatory Assets	\$1,077,266	
Account 4074xx – Regulatory Credits		\$1,077,266

To reverse the accretion expense recorded during 2014 to the regulatory asset. The entry to Account 4074xx offsets the accretion expense recorded in Account 411100, Accretion Expense, and neutralizes the effect on EKPC’s income statement.

Monthly Entries in Subsequent Years for Regulatory Assets

(Depreciation and Accretion Expense amounts from 2014 used for illustrative purposes only)

Account 403800 – Depreciation Exp., Asset Retirement Costs	\$444,769	
Account 108902 – Accumulated Depreciation, ARO		\$444,769

To record the monthly ARO-related depreciation expense.

Account 1823xx – Other Regulatory Assets	\$444,769	
Account 4074xx – Regulatory Credits		\$444,769

To reverse the monthly ARO-related depreciation expense to the regulatory asset. This entry neutralizes the effect of the ARO-related depreciation expense on EKPC’s income statement.

Account 411100 – Accretion Expense	\$89,772	
Account 230002 – ARO, Steam		\$ 8,356
Account 230003 – ARO, Ash Ponds		\$81,416

To record the monthly accretion expense.

Account 1823xx – Other Regulatory Assets	\$89,772	
Account 4074xx – Regulatory Credits		\$89,772

To reverse the monthly accretion expense to the regulatory asset. This entry neutralizes the effect of the accretion expense on EKPC’s income statement.