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NEWS RELEASE

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PSC Orders Management Audit of East Kentucky Power *Order also helps utility avoid credit default*

FRANKFORT, Ky. (Dec. 23, 2008) – The Kentucky Public Service Commission (PSC) today directed East Kentucky Power Cooperative, Inc., (EKPC) to submit to a comprehensive management audit, saying that the utility's worsening financial problems raise questions about its continued viability.

In an order issued today, the PSC also allowed EKPC to create a separate account to track the costs of purchasing replacement power to compensate for unscheduled shutdowns at its generating facilities. EKPC said it needed the accounting adjustment to avoid defaulting on its credit agreements.

EKPC's "precarious financial condition constitutes an extraordinary circumstance that warrants" granting permission to set up the \$12.3 million account, known as a regulatory asset, the PSC said in today's order.

Chairman David Armstrong and Vice Chairman Jim Gardner voted to grant the regulatory asset. Commissioner John Clay dissented, saying the decision will keep EKPC's "creditors at bay for at least one more year, but will not resolve the underlying financial problems" and could "create a disincentive for needed reform."

"Regulatory assets should not be established to allow a utility to adjust its year-end numbers to reflect a certain financial outcome," Clay said.

All three PSC members voted to initiate the comprehensive management audit.

EKPC is owned by the 16 distribution cooperatives to which it provides electricity. Those distribution cooperatives serve about 500,000 retail customers in 89 Kentucky counties.

Each of the 16 cooperatives has a seat on the utility's board of directors. The management audit will focus on the role of those directors in the utility's strategic planning, decision-making and management.

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The PSC has noted in the past that there is an inherent conflict in the role of EKPC's directors. They must balance the need to provide EKPC with sufficient revenue to maintain its financial well-being with the desire to maintain low rates for customers of the distribution cooperatives which they represent, the PSC said.

"Ultimately, the responsibility for (EKPC's) viability lies firmly within the province of its board of directors, who have a fiduciary duty to safeguard the financial and operational viability of the cooperative," the PSC said in today's order.

The PSC cannot make management decisions for EKPC, but it also should not shirk its regulatory responsibilities and "turn a blind eye to a situation which does not appear to be getting better," the commission said.

The management audit will be conducted by an independent consultant selected by the PSC. EKPC will pay for the audit.

Findings of management audits can serve as the basis for PSC recommendations or requirements. A utility may be asked to develop a plan to address issues raised by the audit.

In asking for creation of the regulatory asset, EKPC said that neither the rate of generation outages nor the cost of buying replacement power from other utilities was unusually high in 2008. However, the \$12.3 million spent on replacement power could have impacted the utility's bottom line enough to trigger default provisions that could lead to higher interest rates or even a credit cutoff.

In either case, the financial consequences would be borne by the distribution cooperatives and their customers, the PSC noted in approving the regulatory asset.

Regulatory assets are a tool that allows costs to be deferred for a period of time for possible future recovery through rates.

While the establishment of regulatory assets is done in expectation of future cost recovery through rates, it is not a guarantee of recovery. That determination will be made in a rate case based upon the evidence presented in that proceeding.

EKPC has a request for a rate increase pending before the PSC. The PSC expects to hold hearings in the case in the spring.

Today's order and related documents are available on the PSC Web site, psc.ky.gov. The case number is 2008-00436. The case number for EKPC's rate adjustment request is 2008-00409.

The PSC is an independent agency attached for administrative purposes to the Energy and Environment Cabinet. It regulates more than 1,500 gas, water, sewer, electric and telecommunication utilities operating in Kentucky and has approximately 100 employees.