

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN EXAMINATION BY THE PUBLIC SERVICE	)	
COMMISSION OF THE ENVIRONMENTAL	)	
SURCHARGE MECHANISM OF EAST KENTUCKY	)	
POWER COOPERATIVE, INC. FOR THE	)	CASE NO.
SIX-MONTH BILLING PERIOD ENDING	)	2006-00131
DECEMBER 31, 2005 AND THE PASS THROUGH	)	
MECHANISM FOR ITS SIXTEEN MEMBER	)	
DISTRIBUTION COOPERATIVES	)	

O R D E R

On April 25, 2006, the Commission initiated the first 6-month review of East Kentucky Power Cooperative, Inc.'s ("East Kentucky") environmental surcharge<sup>1</sup> as billed to the member distribution cooperatives for the 6-month period July 1, 2005 to December 31, 2005. Pursuant to KRS 278.183(3), the Commission must review, at 6-month intervals, the past operations of the environmental surcharge; disallow any surcharge amounts that are not just and reasonable; and reconcile past surcharge collections with actual costs recoverable. The April 25, 2006 Order also initiated a 6-month review of the 16 East Kentucky member distribution cooperatives' ("Member

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<sup>1</sup> Case No. 2004-00321, Application of East Kentucky Power Cooperative, Inc. for Approval of an Environmental Compliance Plan and Authority to Implement an Environmental Surcharge, final Order dated March 17, 2005.

Cooperatives”) pass through mechanism<sup>2</sup> as billed to retail member customers for the 6-month period August 1, 2005 to January 31, 2006.<sup>3</sup>

The Attorney General, by and through his Office of Rate Intervention (“AG”), and the Gallatin Steel Company (“Gallatin”) sought and were granted intervention in this proceeding. The Commission issued a procedural schedule on April 25, 2006 that provided for discovery, the filing of prepared testimony, and an informal conference.<sup>4</sup> East Kentucky filed prepared direct testimony and responded to requests for information. Neither intervenor filed requests for information or testimony. On July 27, 2006, Gallatin filed a response to the Commission’s July 24, 2006 Order stating that it had no material issues of fact that warranted a hearing in this proceeding. On August 2, 2006, East Kentucky and the Member Cooperatives filed a response to the Commission’s July 24, 2006 Order stating they were unaware of any material issues which warranted a hearing on the case and requested that the case be submitted for

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<sup>2</sup> Case No. 2004-00372, Application of Big Sandy RECC, Blue Grass Energy Cooperative Corporation, Clark Energy Cooperative, Cumberland Valley Electric, Farmers RECC, Fleming-Mason Energy, Grayson RECC, Inter-County Energy Cooperative, Jackson Energy Cooperative, Licking Valley RECC, Nolin RECC, Owen Electric Cooperative, Salt River Electric, Shelby Energy Cooperative, South Kentucky RECC and Taylor County RECC for Authority to Pass Through the Environmental Surcharge of East Kentucky Power Cooperative, Inc., final Order dated March 17, 2005.

<sup>3</sup> The Settlement Agreement approved in Case Nos. 2004-00321 and 2004-00372 allows the Member Cooperatives to pass through the environmental surcharge to their customers at approximately the same time as East Kentucky bills the environmental surcharge to the Member Cooperatives, thus avoiding a billing lag for the Member Cooperatives. Therefore, the costs incurred from June 2005 through November 2005 are billed to the Member Cooperatives in the months of July 2005 through December 2005. These same costs are passed through to the member customers on the bills for August 2005 through January 2006.

<sup>4</sup> The April 25, 2006 procedural schedule anticipated, but did not schedule, a public hearing and the filing of briefs.

adjudication based on the existing record. The AG filed no response to the July 24, 2006 Order.

### SURCHARGE ADJUSTMENT

East Kentucky determined that it had an over-recovery of its environmental costs of \$2,629,288.<sup>5</sup> East Kentucky proposed that the over-recovery be returned to its Member Cooperatives by decreasing the total jurisdictional environmental surcharge revenue requirement by \$438,215 a month for the 6-month period following the Commission's decision in this proceeding.<sup>6</sup>

The Commission has reviewed and finds reasonable East Kentucky's calculation of an over-recovery of \$2,629,288 for the review periods covered in this proceeding. The Commission also finds reasonable East Kentucky's proposal to decrease by \$438,215 the total jurisdictional environmental surcharge revenue requirement in each of the first 6 billing months following the date of this Order.

### PASS THROUGH ADJUSTMENT

Each of the Member Cooperatives determined an over- or under-recovery for its surcharge pass through mechanism, resulting in a total net under-recovery of \$1,644,187. Like East Kentucky, the Member Cooperatives proposed that the over-recovery be returned or under-recovery be collected from its ratepayers as an adjustment to the pass through factor for each month in the 6-month period following

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<sup>5</sup> Response to the Commission Staff's First Data Request dated April 25, 2006 Order, Item 1, Attachment 1, "Dec-05" column.

<sup>6</sup> Bosta Testimony at 5.

the Commission's Order in this proceeding.<sup>7</sup> However, Inter-County Energy Cooperative Corporation ("Inter-County"), one of the Member Cooperatives, requested that the collection of its under-recovery be deferred until the conclusion of the next 6-month period due to an accounting method change that took place in January 2006.<sup>8</sup>

The Commission has reviewed and finds reasonable the Member Cooperatives' calculation of a total net under-recovery of \$1,644,187 for the review period covered in this proceeding. In addition, the Commission finds reasonable the Member Cooperatives' proposal to adjust the applicable pass through factor in each of the first 6 billing months following the date of this Order. Concerning the proposal by Inter-County to defer the collection of its pass through under-recovery, the Commission finds the approach to be reasonable given the accounting change and that the request should be approved. A schedule of the over- or under-recovery for each Member Cooperative and the monthly adjustment are shown in Appendix A to this Order.

#### RATE OF RETURN

The Settlement Agreement approved in Case No. 2004-00321 provided that the reasonable rate of return would be based on a weighted average debt cost of the debt issuances directly related to the four projects in East Kentucky's compliance plan, multiplied by a 1.15 Times Interest Earned Ratio ("TIER") factor. The Settlement

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<sup>7</sup> Id.

<sup>8</sup> Response to the Commission Staff's First Data Request dated April 25, 2006, Item 2 and Response to the Commission Staff's Second Data Request dated June 7, 2006, Item 1. Inter-County changed its accounting methodology for the environmental surcharge to better match the timing of the wholesale environmental surcharge billing to the retail pass through. Inter-County stated it was willing to absorb the carrying cost on the under-recovery it experienced during the first 6 months of the pass through mechanism operation.

Agreement further provided that East Kentucky would update the return as of the end of each 6-month review period and request Commission approval of the updated average cost of debt, with the 1.15 TIER factor applied to the updated average cost of debt.<sup>9</sup> East Kentucky updated the weighted average cost of debt as of November 30, 2005 and determined that the rate of return should be 5.59 percent.<sup>10</sup>

The Commission has reviewed and finds reasonable East Kentucky's determination of the updated rate of return. East Kentucky should use a rate of return of 5.59 percent for all environmental surcharge monthly filings submitted after the date of this Order.

IT IS THEREFORE ORDERED that:

1. East Kentucky shall include a \$438,215 monthly reduction in its jurisdictional environmental revenue requirement determined in each of the first 6 billing months following the date of this Order, as discussed herein.

2. The Member Cooperatives shall include the applicable monthly pass through adjustments, shown in Appendix A, in the determination of each Member Cooperatives' pass through mechanism, as discussed herein. Inter-County shall be permitted to defer the collection of its under-recovery until the conclusion of its next 6-month pass through review, and shall absorb the carrying costs on the under-recovery.

3. East Kentucky shall use a rate of return of 5.59 percent in all monthly environmental surcharge filings subsequent to the date of this Order.

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<sup>9</sup> Case No. 2004-00321, March 17, 2005 Order, Appendix A at 3.

<sup>10</sup> Bosta Testimony at 6.

Done at Frankfort, Kentucky, this 31<sup>st</sup> day of January, 2007.

By the Commission

ATTEST:

A handwritten signature in black ink, consisting of several overlapping loops and a horizontal line at the bottom.

Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE  
COMMISSION IN CASE NO. 2006-00131 DATED January 31, 2007

Member Cooperatives' Adjustment to  
Monthly Pass Through Mechanism

The East Kentucky Member Cooperatives shall include the following monthly adjustments in the determination of the applicable pass through factors for 6 months after the date of this Order.

	<u>Total Amount of Over-Recovery</u>	<u>Monthly Amount Returned</u>
Clark Energy Cooperative	\$ 2,870	\$ 478
Farmers RECC	\$ 11,074	\$ 1,846
Jackson Energy Cooperative	\$ 6,510	\$ 1,085
Owen Electric Cooperative	\$ 381,294	\$ 63,549
Salt River Energy Cooperative Corp.	\$ 42,633	\$ 7,106
South Kentucky RECC	\$ 23,652	\$ 3,942
Taylor County RECC	\$ 11,412	\$ 1,902
 Total All Over-Recovery	 \$ 479,445	
	<u>Total Amount of Under-Recovery</u>	<u>Monthly Amount Collected</u>
Big Sandy RECC	\$ 20,496	\$ 3,416
Blue Grass Energy Cooperative Corp.	\$ 684,258	\$ 114,043
Cumberland Valley Electric	\$ 253,176	\$ 42,196
Fleming-Mason Energy Cooperative	\$ 316,088	\$ 52,681
Grayson RECC	\$ 12,095	\$ 2,016
Inter-County Energy Cooperative Corp.	\$ 250,992	\$ 0
Licking Valley RECC	\$ 44,526	\$ 7,421
Nolin RECC	\$ 407,835	\$ 67,973
Shelby Energy Cooperative, Inc.	\$ 134,166	\$ 22,361
 Total All Under-Recovery	 \$2,123,632	
 Net Under-Recovery, All Member Cooperatives	 \$1,644,187	