EAST KENTUCKY POWER COOPERATIVE

December 3, 2004

HAND DELIVERED

Ms. Elizabeth O'Donnell
Executive Director
Public Service Commission
211 Sower Boulevard
Frankfort, KY 40602

RECEIVED

DEC 03 2004

PUBLIC SERVICE COMMISSION

Re: PSC Case No. 2004-00321
PSC Case No. 2004-00372

Dear Ms. O'Donnell:

Please find enclosed for filing with the Commission in the above-referenced cases an original and seven (7) copies of the Responses of East Kentucky Power Cooperative, Inc., and the Joint Applicants to the Supplemental Data Requests of the Commission Staff and Gallatin Steel Company dated November 19, 2004.

Very truly yours,

Charles A. Lile

Charles A. Lile
Senior Corporate Counsel

Enclosures

Cc: Elizabeth E. Blackford, Esq.- Office of the Attorney General
Michael L. Kurtz, Esq.- Gallatin Steel Co.

4775 Lexington Road 40391
P.O. Box 707, Winchester,
Kentucky 40392-0707

Tel. (859) 744-4812
Fax: (859) 744-6008
http://www.ekpc.coop

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

RECEIVED
DEC 03 2004
PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF EAST KENTUCKY POWER COOPERATIVE, INC. FOR APPROVAL OF AN ENVIRONMENTAL COMPLIANCE PLAN AND AUTHORITY TO IMPLEMENT AN ENVIRONMENTAL SURCHARGE	)))))	CASE NO. 2004-00321

RESPONSES TO COMMISSION STAFF'S SECOND DATA REQUEST TO EAST KENTUCKY POWER COOPERATIVE, INC. DATED NOVEMBER 19, 2004

EAST KENTUCKY POWER COOPERATIVE, INC.

PSC CASE NO. 2004-00321
ENVIRONMENTAL SURCHARGE
SECOND DATA REQUEST RESPONSE

COMMISSION STAFF'S SECOND DATA REQUEST DATED 11/19/04
REQUEST 1
RESPONSIBLE PARTY: David G. Eames/Counsel

REQUEST 1. Refer to the Commission Staff's First Data Request dated October 22, 2004 ("Staff's First Request"), Item 1. The first sentence in KRS 278.183(1) reads as follows:

> Notwithstanding any other provision of this chapter, effective January 1, 1993, a utility shall be entitled to the current recovery of its costs of complying with the Federal Clean Air Act as amended and those federal, state, or local environmental requirements which apply to coal combustion wastes and by-products from facilities utilized for production of energy from coal in accordance with the utility's compliance plan as designated in subsection (2) of this section.

On page 2 of 3 of the response, East Kentucky states, "The statute's scope was clearly made broader than the fairly narrow environmental compliance issue that was at the center of the legislative intent, and applicability of the environmental surcharge to compliance costs of gas-fired generating units is not inconsistent with such intent."

REQUEST 1a. Does East Kentucky agree that the sentence structure of KRS 278.183(1) makes no separation between the Federal Clean Air Act and other federal, state, or local environmental requirements? Explain the response.

RESPONSE 1a. EKPC believes that the statute can reasonably be interpreted to authorize the current recovery by a utility of two distinct classes of environmental compliance costs: 1) any costs of complying with "the Federal Clean Air Act requirements, as amended"; and 2) costs of complying with "those federal, state, or local environmental requirements which apply to coal combustion wastes and by-products from facilities utilized for production of energy from coal." EKPC contends the sentence structure indicates that the reference to "coal combustion wastes and by-products from facilities utilized for production of energy from coal" applies only to the second category of environmental requirements, and not the first.

REQUEST 1b. What is the basis of East Kentucky's response on page 2 of 3 concerning the statute's scope? Explain the response in detail.

RESPONSE 1b. The specific issue that led to the enactment of KRS §278.183 was a desire to promote the use of high sulfur Kentucky coal by allowing utilities to use the environmental surcharge to recover costs of flue gas scrubbers. The legislature could have limited the scope of KRS §278.183 to this specific concern, by restricting the applicability of the environmental surcharge to the recovery of scrubber costs, and could have attempted to further limit the surcharge to utilities using high sulfur Kentucky coal. Instead, the statute allows recovery of a utility's costs of compliance with the Federal Clean Air Act, which now covers nitrogen oxide and particulate emissions, and may soon cover mercury and other types of emissions from coal-fired and non-coal-fired power plants. EKPC believes that this clearly indicates the intent of the legislature that compliance costs beyond the original legislative concern with costs of flue gas scrubbers would be recoverable, and compliance with the Federal Clean Air Act, as amended, was the only express limitation.

The Commission has interpreted the statute broadly enough to allow utilities with a surcharge to recover costs of compliance with nitrogen oxide and particulate limitations of the Clean Air Act at coal-fired plants, even though such recovery does not serve to promote the use of high sulfur Kentucky coal. EKPC contends that the recovery of such nitrogen oxide compliance costs for its combustion turbines is consistent with the scope of KRS §278.183, absent a clear indication in the statute that recovery of Federal Clean Air Act compliance costs is, in fact, limited to coal-fired plants.

<u>REQUEST 1c.</u> Given that KRS 278.183(1) clearly references "facilities utilized for production of energy from coal," explain in detail how East Kentucky can conclude it was the legislature's intent that environmental costs associated with gas-fired generating units could be included in the environmental surcharge.

<u>RESPONSE 1c.</u> As explained above, EKPC believes that the reference in KRS § 278.183 to compliance costs relating to "coal combustion wastes and by-products from facilities utilized for production of energy from coal" can reasonably be interpreted to be completely separate from compliance costs relating to the Federal Clean Air Act. EKPC cannot point to any clear intent to include environmental costs relating to gas/oil-fired units in the surcharge, but contends that the language which provides that "a utility shall be entitled to the current recovery of its costs of complying with the Federal Clean Air Act as amended" is broad enough to include a range of environmental costs beyond the original motivation for the statute. EKPC believes that a reasonable interpretation of the statute allows broad recovery of Federal Clean Air Act compliance costs of any kind, and does not contain a clear exclusion of such costs which relate to non-coal-fired plants.

EAST KENTUCKY POWER COOPERATIVE, INC.

PSC CASE NO. 2004-00321
ENVIRONMENTAL SURCHARGE
SECOND DATA REQUEST RESPONSE

COMMISSION STAFF'S SECOND DATA REQUEST DATED 11/19/04
REQUEST 2
RESPONSIBLE PARTY: **William A. Bosta**

REQUEST 2. Refer to the Staff's First Request, Item 1, pages 2 and 3 of 3. East Kentucky contends that Kentucky Utilities Company ("KU") has been allowed to recover costs of emission allowances for non-coal generating units through the environmental surcharge.

REQUEST 2a. Provide the basis for East Kentucky's understanding that this situation has in fact occurred with KU's environmental surcharge. Include all details of which East Kentucky is aware concerning this situation.

RESPONSE 2a. The basis of EKPC's understanding is from a review of KU's monthly environmental surcharge filings and the orders from several environmental surcharge proceedings, as well as through discussion with the current KU regulatory staff.

REQUEST 2b. Based on East Kentucky's understanding of the approved environmental compliance plans for KU, would East Kentucky agree that the Commission's approval has been related only to projects associated with coal-fired generation? Explain the response.

RESPONSE 2b. In general, yes. However, the Commission has also recognized the cost of emission allowances for the KU Combustion Turbines. The turbines are not part of KU's compliance plan.

REQUEST 2c. Explain why KU's possible inclusion of emission allowances related to non-coal-fired generation justifies East Kentucky's proposal to include environmental projects related to gas-fired generation in its environmental compliance plan and surcharge.

RESPONSE 2c. As indicated in EKPC's response to Item 1, Staff First Data Request, it simply means that the Commission, at least in one instance, has recognized that the costs of meeting the Federal Clean Air Act requirements using non-coal projects is allowable for recovery under the surcharge. It lends credence to EKPC's interpretation of the broader scope of the language in the environmental surcharge statute, compared to the original legislative intent.

EAST KENTUCKY POWER COOPERATIVE, INC.

PSC CASE NO. 2004-00321
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COMMISSION STAFF'S SECOND DATA REQUEST DATED 11/19/04
REQUEST 3
RESPONSIBLE PARTY: Craig A. Johnson/Ann F. Wood

REQUEST 3. Refer to the Staff's First Request, Item 7(b).

REQUEST 3a. Describe East Kentucky's activities during the past 12 months concerning the marketing of combustion by-products.

RESPONSE 3a. East Kentucky has an agreement with Trans Ash to market our combustion by-products. Trans Ash did market 539 tons of combustion by-products to cement producers over the last 12 months.

REQUEST 3b. Provide the level of income received from the marketing of combustion by-products for the past 12 months.

RESPONSE 3b. The amount related to the marketing of combustion by-products for the past 12 months is $378.

EAST KENTUCKY POWER COOPERATIVE, INC.

PSC CASE NO. 2004-00321
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SECOND DATA REQUEST RESPONSE

COMMISSION STAFF'S SECOND DATA REQUEST DATED 11/19/04
REQUEST 4
RESPONSIBLE PARTY: Ann F. Wood

REQUEST 4. Refer to the Staff's First Request, Item 9.

REQUEST 4a. Explain why East Kentucky has not previously sought the Commission's approval of the depreciation rates proposed in the environmental surcharge application.

RESPONSE 4a. East Kentucky submitted a copy of the depreciation study to Commission Staff in December 2002. The cover letter to this depreciation study stated that East Kentucky planned to implement the changes proposed in the depreciation study effective January 1, 2003. East Kentucky did not receive comments from Commission Staff. A copy of this letter is attached.

REQUEST 4b. Did the Rural Utilities Service ("RUS") approve the depreciation rates contained in the study submitted in response to Item 9?

REQUEST 4b(1). If yes, provide copies of the approval from RUS.

RESPONSE 4b(1). East Kentucky received approval from RUS to implement the changes proposed by the useful life study. A copy of a letter sent to RUS regarding the depreciation study is attached. East Kentucky did not receive a response from RUS. Typically, if RUS has questions or concerns, they contact us.

REQUEST 4b(2). If no, provide the depreciation rates actually in use by East Kentucky and explain why East Kentucky is proposing to use rates other than those approved by RUS.

RESPONSE 4b(2). Not Applicable.

REQUEST 4c. The depreciation study submitted with the response to Item 9 encompasses only the Spurlock and Cooper generating stations.

REQUEST 4c(1). Why was this depreciation study limited to the Spurlock and Cooper generating stations instead of examining all of East Kentucky's assets?

RESPONSE 4c(1). East Kentucky limited the depreciation study to the Spurlock and Cooper generating stations because RUS required that a useful life study be performed in order to finance proposed pollution control additions (selective catalytic reduction and upgrading precipitators) at these generating stations. These pollution control additions had a significant financial impact on East Kentucky.

REQUEST 4c(2). When did East Kentucky last prepare a depreciation study for all of its assets?

RESPONSE 4c(2). East Kentucky's last depreciation study was performed by Edwards and Associates in 1998.

REQUEST 4c(3). Has East Kentucky been using the depreciation rates from that study? Explain the response.

RESPONSE 4c(3). East Kentucky has been using the depreciation rates promulgated by RUS and subject to annual audit procedures by an independent accounting firm.

REQUEST 4c(4). Have the depreciation rates in that depreciation study been approved in a previous Commission proceeding? If yes, identify the case number. If no, explain why the Commission's approval was not sought.

RESPONSE 4c(4). The Commission requested a depreciation study as part of Case No. 94-336, which was submitted to the Commission in 1998.

REQUEST 4c(5). Have the depreciation rates in that depreciation study been approved by the RUS? If yes, provide copies of the RUS approval.

RESPONSE 4c(5). A letter similar to the one referred to in response 4b(1) was sent to RUS. Please see attached letter.

REQUEST 4d. The Management Applications Consulting, Inc. ("MAC") study submitted as part of the response to Item 9 only examined the Cooper and Spurlock generating stations. East Kentucky's proposed environmental compliance plan includes the new Gilbert generating unit and combustion turbines ("CTs") at the J. K. Smith site.

REQUEST 4d(1). Provide copies of the depreciation study that was the source of the depreciation rates used in East Kentucky's proposed environmental surcharge for the Gilbert unit and the Smith CTs.

RESPONSE 4d(1). The depreciation rate for the Gilbert Unit is based on a 32-year life, as promulgated by RUS. Please see the letter attached to Gallatin Response 17. The latest RUS bulletin on depreciation, dated 1977, does not specifically cover combustion turbines. Gas turbines are given a 33-year life in this bulletin; however, this was determined to be a longer life than was justifiable. Based on a discussion with a representative from Kentucky Utilities and research of Internal Revenue Service guidelines, East Kentucky estimated the useful life of the combustion turbines to be 25 years.

REQUEST 4d(2). Indicate when the Commission approved the depreciation rates used for the Gilbert unit and the Smith CTs. Include the case number for the approval proceeding. If East Kentucky did not seek the Commission's approval of these depreciation rates, explain in detail why approval was not sought.

RESPONSE 4d(2). The depreciation rates used for the Gilbert Unit and CT's have not been approved by the Commission. East Kentucky has always used RUS depreciation rates for its base load units. To the best of our knowledge, these rates have been accepted by the Commission.

REQUEST 4e. Refer to the Attachment to the Item 9 response, page 6 of 41. MAC expressed some concerns about East Kentucky's expensing practices and the associated impact on its depreciation rates. Describe East Kentucky's expensing versus capitalizing practices. Include in this description an explanation of how East Kentucky arrived at its practices. If available, include copies of any written policies or guidelines relating to expensing versus capitalizing.

RESPONSE 4e. East Kentucky follows generally accepted accounting principles in determining capitalizing versus expensing. East Kentucky is subject to an annual audit by an independent accounting firm. East Kentucky is also subject to field audits by RUS. These field audits are an examination of the proper capitalization of assets for financing purposes. RUS has not questioned East Kentucky's practices.

REQUEST 4f. On page 40 of 41 of the Attachment to the Item 9 response, MAC recommends East Kentucky perform depreciation studies every 3 to 5 years. The MAC study was dated June 2002. What are East Kentucky's current plans concerning another depreciation study?

RESPONSE 4f. East Kentucky anticipates the need for major modifications to its Cooper Power Station. East Kentucky plans to have a useful life study done on Cooper within the next 2 to 3 years.

REQUEST 4g. Concerning the depreciation expense proposed in its environmental surcharge, is East Kentucky seeking the Commission's approval of the depreciation rates used to determine the depreciation expense in this proceeding? Explain the response.

RESPONSE 4g. Yes. East Kentucky is seeking Commission approval of its environmental compliance plan and the environmental surcharge tariff utilizing these depreciation rates. The actual depreciation expense incurred will be subject to Commission review and approval in the six-month proceeding.

EAST KENTUCKY POWER COOPERATIVE

December 6, 2002

file depreciation study

Mr. Aaron Greenwell
Director, Division of Financial Analysis
Commonwealth of Kentucky
Public Service Commission
211 Sower Boulevard
Post Office Box 615
Frankfort, Kentucky 40602-0615

Dear Mr. Greenwell:

In order to comply with regulations enacted by the Environmental Protection Agency regarding emissions of nitrogen oxide, East Kentucky Power Cooperative, Inc. ("EKPC") is installing selective catalytic reduction ("SCR") technology and upgrading the precipitators on its Spurlock 1 and 2 generating units, and, possibly, on its Cooper 2 unit. In order to finance these units, RUS required EKPC to perform a useful life study. See the enclosed letter. EKPC selected Management Applications Consulting, Inc. ("MAC") to perform the useful life study on each of the Cooper and Spurlock Station units. MAC's final report is enclosed.

In accordance with RUS's letter and based upon the results of MAC's report, EKPC will depreciate future Cooper Station assets for 20 years beginning January 1, 2003, and existing and future Spurlock Station assets for 25 years beginning January 1, 2003. EKPC will implement this change in accounting estimate effective January 1, 2003.

If you have any questions or require additional information, please contact us.

Very truly yours,

David G. Eames

David G. Eames
Vice President, Finance and Planning

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Enclosures (2)

EAST KENTUCKY POWER COOPERATIVE

June 21, 2002

Mr. Kenneth Ackerman
Assistant Administrator
Rural Utilities Service
U.S. Department of Agriculture
Room 4063 South
1400 Independence Avenue, SW
Washington, DC 20250-1530

Dear Mr. Ackerman:

On July 12, 2001, East Kentucky Power Cooperative, Inc. ("EKPC") sent a letter to the attention of Blaine Stockton requesting an extension of the depreciable lives of our Cooper and Spurlock Stations. A copy of this letter is enclosed for your reference. On September 14, 2001, Alfred Rodgers sent EKPC a letter, enclosed for your reference, stating that the Rural Utilities Service ("RUS") would require a remaining useful life study on each unit before reviewing depreciation rates.

EKPC selected Management Applications Consulting, Inc. ("MAC") to perform a useful life study on each of the Cooper and Spurlock Station units. MAC's final report is enclosed.

Based upon the results of MAC's report, EKPC requests RUS approval to depreciate future Cooper Station assets for 20 years beginning January 1, 2003, and existing and future Spurlock Station assets for 25 years beginning January 1, 2003. Unless we hear from you otherwise, EKPC will implement this change in accounting estimate effective January 1, 2003.

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P.O. Box 707, Winchester,
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Tel. (859) 744-4812
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Mr. Kenneth Ackerman
Page 2
June 21, 2002

Thank you for your attention to this request. If you have comments or require additional information, please contact us.

Very truly yours,

David G. Eames

David G. Eames
Vice President, Finance and Planning

aw/dd
Enclosures (3)
By Federal Express

cc/enc: Mr. Steve Jennings
Crowe, Chizek and Company LLP
144 North Broadway, Suite 300
Lexington, Kentucky 40507
By Regular Mail

Mr. Wei Moi
Rural Utilities Service
Room No. 0270
1400 Independence Avenue, SW
Washington, DC 20250-1568
By Federal Express

cc: Mr. Alfred Rodgers
Deputy Assistant-Administrator
Rural Utilities Service – Electric Program
United States Department of Agriculture
Stop 1560
1400 Independence Avenue, SW
Washington, DC 20250-1560
By Regular Mail

bc: Thea Kamber
Jim McCarty
Frank Oliva
Ann Wood

EAST KENTUCKY POWER COOPERATIVE, Inc.
4775 Lexington Road 40391
P.O. Box 707
Winchester, Kentucky 40392-0707
Tel (606) 744-4812
Fax: (606) 744-6008

April 1, 1998

Ms. Helen Helton - Hand Delivered
Executive Director
Kentucky Public Service Commission
P. O. Box 615
Frankfort, Kentucky 40602

and

Ms. Roberta D. Purcell
Program Accounting Services Division
RUS, USDA
Stop 1523
1400 Independence Avenue, S.W.
Washington, D.C. 20250

Dear Mss. Helton and Purcell:

Enclosed find copies of the depreciation study ordered in East Kentucky Power Cooperative's ("EKPC") rate decrease case No. 94-336—six copies for the PSC and three copies for RUS. EKPC intends to implement the recommendations as to service lives and depreciation rates effective January 1, 1999, subject to your organizations' approvals.

As to the recommendation regarding upgrading our plant accounting system, we are currently installing a new financial, human resources, and material management software system. We will evaluate this system when installed to see if it can accommodate the recommendations made in the study. It is our intention to either use this system or install a new system in year 2000 following completion of our Year 2000 compliance work.

If you have any questions, please call Don Miller or me.

Very truly yours,

David G. Eames

David G. Eames
Vice President,
Finance and Corporate Services

DGE:dd
Enclosures
(WORD\FINDIV\FINANCE\GENERAL\DEPRECIA)

bc: Don Miller
Charles Lile
Vault w/Enclosures (Depreciation Study and Exec Summary)

EAST KENTUCKY POWER COOPERATIVE, INC.

PSC CASE NO. 2004-00321
ENVIRONMENTAL SURCHARGE
SECOND DATA REQUEST RESPONSE

COMMISSION STAFF'S SECOND DATA REQUEST DATED 11/19/04
REQUEST 5
RESPONSIBLE PARTY: Frank J. Oliva

REQUEST 5. Refer to the Staff's First Request, Item 12(a), Attachment 1. Concerning East Kentucky's purchase of SO_2 emission allowances, provide the following information for each of the three purchases:

REQUEST 5a. Was this a single purchase or the total of several purchases in the year? If several purchases, list the quantity, purchase price, and total cost for each purchase.

RESPONSE 5a. The allowances acquired in 2001 and 2002 were from multiple purchases. Please see the response to 5c.

The 22,000 allowances listed for 2004 were estimated in advance of purchase in accordance with the RUS Uniform System of Accounts – Electric. The instructions for accounting for allowances in 7 CFR 1767.15 state . . . "In any period in which actual emissions exceed the amount allowable based on eligible allowances owned, the utility shall estimate the cost to acquire the additional allowances needed and charge Account 158.1 with the estimated cost."

REQUEST 5b. In what month did the purchase occur?

RESPONSE 5b. Please see the response to 5c.

REQUEST 5c. Was the purchase made directly from another utility, from a trading market, or some other venue? If a trading market or other venue, identify the source of the purchase.

RESPONSE 5c. Please see the schedule below.

SO_2 Purchases

Year	Purchase or Sale	Price per Ton	Quantity (Tons)	Total Cost	Counterparty	Date EA's Received
	Purch	$ 183.00	2,500	$ 458,000	Constellation Power Source	10/31/2001
	Purch	$ 183.00	2,500	$ 458,000	Exelon Generation Co., LLC	10/31/2001
	Purch	$ 183.00	2,500	$ 458,125	Exelon Generation Co., LLC	10/31/2001
	Purch	$ 188.50	5,000	$ 943,500	Enron North America	11/02/2001
	Purch	$ 183.00	2,500	$ 458,000	Aquila Energy Marketing	11/08/2001
	Purch	$ 186.00	2,500	$ 465,500	Dynegy Marketing and Trade	12/03/2001
	Purch	$ 178.50	2,500	$ 446,750	Aquila Energy Marketing	12/04/2001
	Purch	$ 178.50	2,000	$ 357,400	Dynegy Marketing and Trade	12/20/2001
	Purch	$ 173.25	2,500	$ 433,625	Dynegy Marketing and Trade	12/31/2001
	Purch	$ 173.00	2,500	$ 432,750	Dynegy Marketing and Trade	12/31/2001
	Purch	$ 163.00	2,500	$ 408,000	Dynegy Marketing and Trade	12/31/2001
2001		$ 180.33	29,500	$5,319,650		
	Purch	$ 178.50	500	$ 89,350	Dynegy Marketing and Trade	01/07/2002
	Purch	$ 162.00	2,500	$ 405,500	Dynegy Marketing and Trade	02/22/2002
	Purch	$ 162.00	2,500	$ 405,250	Dynegy Marketing and Trade	02/22/2002
	Purch	$ 157.00	2,500	$ 393,000	Dynegy Marketing and Trade	02/22/2002
	Purch	$ 157.50	2,500	$ 394,000	Dynegy Marketing and Trade	02/22/2002
	Purch	$ 165.00	2,500	$ 412,750	Aquila Merchant Services, Inc.	06/25/2002
	Purch	$ 164.50	2,500	$ 411,500	Constellation Power Source, Inc.	07/09/2002
	Purch	$ 162.50	2,500	$ 406,500	Reliant Energy Services	07/09/2002
	Purch	$ 157.00	2,500	$ 392,750	Reliant Energy Services	07/09/2002
	Purch	$ 155.50	2,500	$ 389,250	Constellation Power Source, Inc.	07/09/2002
	Purch	$ 162.00	2,500	$ 405,500	TXU Energy Trading Company LP	07/15/2002
	Purch	$ 164.00	2,500	$ 410,500	PPL Generation, LLC	07/18/2002
	Purch	$ 166.00	2,500	$ 415,250	NRG Power Marketing, Inc.	08/07/2002
	Purch	$ 161.00	2,500	$ 403,000	American Electric Power Co. Inc.	08/07/2002
2002		$ 161.64	33,000	$5,334,100		

EAST KENTUCKY POWER COOPERATIVE, INC.

PSC CASE NO. 2004-00321
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SECOND DATA REQUEST RESPONSE

COMMISSION STAFF'S SECOND DATA REQUEST DATED 11/19/04
REQUEST 6
RESPONSIBLE PARTY: **Frank J. Oliva**

REQUEST 6. Refer to the Staff's First Request, Item 12(a), Attachment 1. In 2004, East Kentucky has purchased 22,000 SO_2 emission allowances at a price of $500 per allowance.

REQUEST 6a. Explain why the purchase price for this transaction was so significantly higher than the prices of previous purchases.

RESPONSE 6a. The market price of SO_2 allowances has increased significantly since 2003. In December 2003, the spot price for SO_2 allowances was about $215. Currently, the spot price is over $700 per allowance.

REQUEST 6b. Did East Kentucky attempt to purchase these additional SO_2 emission allowances through the Environmental Protection Agency's ("EPA") annual auction?

(1) If yes, was East Kentucky successful in securing allowances through the EPA annual auction? Explain the response and state the number of allowances, if any, purchased and the price per allowance.

(2) If no, explain why East Kentucky did not attempt to purchase SO_2 emission allowances through the EPA annual auction.

RESPONSE 6b. No, EKPC did not attempt to purchase SO_2 allowances through the EPA annual auction. There is usually no special advantage to purchasing allowances through the EPA auction, because prices tend to settle around the current market value, as happened in 2004.

REQUEST 6c. At the time East Kentucky purchased the 22,000 SO_2 emission allowances, what was the average price for such allowances offered in the market?

RESPONSE 6c. $500 per allowance was the estimated price in early July 2004.

REQUEST 6d. If the average price for SO_2 emission allowances offered in the market was lower than the $500 purchase price East Kentucky paid, explain why East Kentucky paid more for these allowances than the average market price.

RESPONSE 6d. As stated above, $500 per allowance was an estimated price. EKPC will purchase these allowances at the market price.

EAST KENTUCKY POWER COOPERATIVE, INC.

PSC CASE NO. 2004-00321
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COMMISSION STAFF'S SECOND DATA REQUEST DATED 11/19/04
REQUEST 7
RESPONSIBLE PARTY: Frank J. Oliva

REQUEST 7. Provide a schedule showing the proceeds East Kentucky received from the EPA annual auction of SO_2 emission allowances from 1995 to 2004. The schedule should show for each year the number of allowances withheld by EPA, the proceeds from the EPA auction, and the date East Kentucky received the proceeds.

RESPONSE 7. See schedule below.

Year	Date Received	No. of Allowances	Proceeds
1995	May 1995	2,608	$ 124,764.30
1996	Jun 1996	2,604	$ 117,787.89
1997	Jul 1997	2,547	$ 202,477.66
1998	May 1998	2,320	$ 202,416.73
1999	Jun 1999	3,176	$ 350,887.80
2000	Jul 2000	1,127	$ 112,677.67
2001	May 2001	1,127	$ 161,090.95
2002	May 2002	1,127	$ 140,901.70
2003	Jun 2003	1,125	$ 145,342.22
2004	May 2004	1,125	$ 225,629.20

EAST KENTUCKY POWER COOPERATIVE, INC.

PSC CASE NO. 2004-00321
ENVIRONMENTAL SURCHARGE
SECOND DATA REQUEST RESPONSE

COMMISSION STAFF'S SECOND DATA REQUEST DATED 11/19/04
REQUEST 8
RESPONSIBLE PARTY: **Frank J. Oliva**

REQUEST 8. Refer to the Staff's First Request, Item 12(c). Concerning East Kentucky's management strategy for SO_2 and NOx emission allowances,

REQUEST 8a. Based on East Kentucky's response, is it correct that East Kentucky has not developed a formal, written management strategy? Explain the response.

RESPONSE 8a. East Kentucky's base strategy is outlined on pages 59-60 and page 160 of its Integrated Resource Plan (IRP) filed April 2003. Allowances are managed in conjunction with EKPC's overall power supply strategy.

REQUEST 8b. East Kentucky has utilized a significantly higher number of SO_2 emission allowances than it was allocated by the EPA every year since 2000. To make up its shortfall, East Kentucky has purchased 84,500 SO_2 emission allowances at a cost of $21,653,750.

REQUEST 8b(1). Over the next 5 years, does East Kentucky anticipate annually purchasing similar quantities of SO_2 emission allowances?

RESPONSE 8b(1). EKPC anticipates that it will need to purchase some SO_2 emission allowances above the EPA-allocated amount over the next five years. The quantity required will depend on various factors including coal quality, pollution control equipment installed, and generation levels.

REQUEST 8b(2). Has East Kentucky considered and evaluated other emissions compliance options other than the purchase of SO_2 emission allowances? Explain the response.

RESPONSE 8b(2). Yes. EKPC routinely evaluates strategies that could mitigate the amount of allowances needed to be purchased. Options being considered include the use of SO_2 scrubbers on at least one of its units, in order to reduce the amount of SO_2 emissions.

EAST KENTUCKY POWER COOPERATIVE, INC.

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COMMISSION STAFF'S SECOND DATA REQUEST DATED 11/19/04
REQUEST 9
RESPONSIBLE PARTY: Ann F. Wood

REQUEST 9. Refer to the Staff's First Request, Item 13.

REQUEST 9a. Concerning the response to Item 13(a),

REQUEST 9a(1). Does East Kentucky anticipate large fluctuations in the monthly operation and maintenance expenses and its air permit fee?

RESPONSE 9a(1). Although East Kentucky does not anticipate large fluctuations in the monthly operation and maintenance expenses and air permit fees, use of the 12-month average serves to mitigate the effect if it does occur.

REQUEST 9a(2). Explain why East Kentucky appears to believe it is necessary to mitigate fluctuations in the calculation of the environmental surcharge factor.

RESPONSE 9a(2). East Kentucky believes it is necessary to mitigate fluctuations in the calculation of the environmental surcharge factor for the benefit of our member systems and their retail consumers. Also, please see the response to Item 16, Staff Second Data Request.

REQUEST 9b. Refer to the response to Items 13(b) and 13(c). KRS 278.183(1) clearly states that the utility is entitled to the current recovery of its costs of environmental compliance in accordance with its approved compliance plan. Explain in detail how East Kentucky reached the conclusion that it could recover through the environmental surcharge the costs of projects not specifically included in its proposed compliance plan.

RESPONSE 9b. East Kentucky seeks to recover only incremental O&M expenses on projects not specifically included in the proposed compliance plan. East Kentucky is not seeking recovery on capital costs. Such incremental O&M costs qualify as a recoverable item pursuant to the Federal Clean Air Act, as amended. While not directly tied to one of the nine projects outlined in Eames Exhibit 1, those incremental O&M costs are considered part of EKPC's Compliance Plan.

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REQUEST 10
RESPONSIBLE PARTY: **Ann F. Wood**

<u>REQUEST 10.</u> Refer to the Staff's First Request, Item 15, the analysis of expenses. For each of the accounts listed below, provide a description of the nature of the expense East Kentucky proposes to recover in its environmental surcharge and why that expense is appropriate for surcharge recovery.

a. Account No. 50144 – Fuel Coal Gilbert.

a. Account No. 50644 – Miscellaneous Steam Power Expense Gilbert.

b. Account No. 51243 – Maintenance of Boiler Plant Scrubber.

<u>RESPONSE 10.</u> The nature of the expense, by account, is as follows:

a. Account 50144—Expenses included are fly ash and bed ash removal system ($300,000) and ash disposal ($810,000).

b. Account 50644—Expense consists solely of limestone.

c. Account 51243—Expense represents maintenance expense on the Spurlock Unit 2 scrubber.

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REQUEST 11
RESPONSIBLE PARTY: Ann F. Wood/Robert E. Hughes

REQUEST 11. Refer to the Staff's First Request, Item 15. Concerning the air permit fees,

REQUEST 11a. Do the amounts shown as of December 31, 1993 for the air permit fees reflect the actual amounts on East Kentucky's books as of that date, or an estimated amount? Explain the response.

RESPONSE 11a. The air permit fees shown as of December 31, 1993, reflect the actual amounts on East Kentucky's books.

REQUEST 11b. Explain why there were no air permit fees associated with the Cooper generating station in 1993.

RESPONSE 11b. Cooper was a Phase 1 unit under the Clean Air Act. Air permit fees were not imposed on such units until a later date.

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REQUEST 12
RESPONSIBLE PARTY: William A. Bosta

REQUEST 12. Refer to the Staff's First Request, Item 16. The attachment to the response shows how a 5.635 percent rate of return on rate base will result in a 1.15X Times Interest Earned Ratio ("TIER").

REQUEST 12a. The calculations shown on the attachment include as an environmental surcharge expense an interest expense of $10,276,848. Is it correct that East Kentucky's application did not include interest expense as a component of the environmental surcharge expenses that it proposes to recover through the surcharge?

RESPONSE 12a. No. East Kentucky used a rate of return component comprised of interest expense and a 1.15 TIER requirement.

REQUEST 12b. If yes to part (a) above, explain why interest expense was included as an environmental surcharge expense on the attachment in the response to Item 16.

RESPONSE 12b. Not Applicable.

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REQUEST 13
RESPONSIBLE PARTY: William A. Bosta

REQUEST 13. Refer to the Staff's First Request, Item 17. East Kentucky has proposed that its rate of return on rate base should be 5.635 percent, the result of multiplying East Kentucky's weighted average cost of debt of 4.90 percent by a TIER of 1.15X. In its response to Item 17, East Kentucky calculated that its current rate of return on its total rate base as of July 31, 2004 is 4.13 percent, while its rate of return on its total rate base as of July 31, 2004 reflecting a 1.15X TIER is 3.30 percent. Explain why either of the rates of return on rate base calculated in the response to Item 17 would not be more reasonable to use as the rate of return on East Kentucky's environmental rate base instead of East Kentucky's proposed rate of return.

RESPONSE 13. EKPC is not aware of any utility that has had its "reasonable" rate of return for the environmental surcharge to be based on the actual rate of return earned in a particular period. For the investor owned utilities, the cost of debt and preferred stock was determined as of a particular period and was coupled with a determination of an appropriate return on equity percentage. In those cases, the overall cost of capital was used as the "reasonable" rate of return. EKPC is asking for similar treatment in this proceeding. Based on these prior rulings, EKPC is requesting that its average debt cost be used as the basis of the rate of return, coupled with an appropriate TIER. To the extent that the Commission has used an investor-owned utility's financial condition as a factor in determining the appropriate return on equity, EKPC requests that the same weight be given to its financial condition in the Commission's determination of an appropriate TIER level for EKPC.

In addition, the rate of return calculation for the 12 months ended July 2004 is quite different than the rate of return for 2002 and 2003. In those years the return was 7.54% (2002) and 5.30% (2003). This also illustrates that it is not appropriate to use the earned rate of return as the basis of the recoverable rate of return in the surcharge.

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COMMISSION STAFF'S SECOND DATA REQUEST DATED 11/19/04
REQUEST 14
RESPONSIBLE PARTY: William A. Bosta

REQUEST 14. Refer to the Staff's First Request, Item 18.

REQUEST 14a. Was East Kentucky aware that the environmental surcharge approved for the Kentucky Power Company ("Kentucky Power") was based on the base-current approach from its inception, and did not go through a period where it utilized the incremental approach?

RESPONSE 14a. It is EKPC's understanding that the AEP-Kentucky environmental surcharge at inception reflected a reduction in the revenue requirement for certain costs associated with their Rockport generating unit. This net revenue requirement was then divided by Kentucky retail revenues to derive a percentage surcharge factor. A separate per unit "base" period rate was not developed and then subtracted from the total surcharge factor to derive the environmental surcharge factor for billing. EKPC interpreted the base-current method as relating to the establishment of a per unit base factor and that is why EKPC responded to Staff's First request, Item 18 by stating that the AEP-Kentucky Power, LG&E and KU had the same methods at the time of the inception of the respective surcharges for those utilities.

REQUEST 14b. Would East Kentucky agree that all three environmental surcharge mechanisms currently authorized by the Commission reflect a base-current approach?

RESPONSE 14b. Yes.

REQUEST 14c. Explain why East Kentucky believes it is necessary and reasonable to start with the incremental approach and then convert to the base-current approach at the time of the first environmental surcharge roll-in.

RESPONSE 14c. As indicated in the response to Item 18, First Staff Data Request, EKPC is not opposed to using the base-current methodology and it could be used at inception. EKPC continues to prefer using it at the first roll-in because the incremental approach was used at inception for LG&E and KU, and, as mentioned in response to Item 14a, the AEP-Kentucky Power base-current method used at inception did not utilize a base factor.

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REQUEST 15
RESPONSIBLE PARTY: William A. Bosta

REQUEST 15. The base-current approach used in the environmental surcharge mechanism authorized for Louisville Gas and Electric Company ("LG&E") and KU is slightly different from the base-current approach used in Kentucky Power's environmental surcharge mechanism. In the LG&E and KU surcharges, a base period surcharge factor and a current period surcharge factor are calculated. The base period factor is subtracted from the current period factor in order to determine the surcharge factor applied to current bills. In the Kentucky Power surcharge, a base period revenue requirement and current period revenue requirement are calculated. The base period revenue requirement is subtracted from the current period revenue requirement. The difference is then used to calculate the surcharge factor applied to current bills. Assume for purposes of this question that the Commission authorizes an environmental surcharge mechanism for East Kentucky using the base-current approach. Would East Kentucky favor using the LG&E and KU version or the Kentucky Power version of the base-current approach? Explain the response.

RESPONSE 15. EKPC continues to advocate subtracting the costs included in base rates, as it has proposed in this case. Of the two choices posed in the question, EKPC would prefer the use of the AEP-Kentucky Power method at inception because it is more akin to EKPC's proposal.

The use of a base factor, as is used in the LG&E and KU surcharges, would be more appropriate at the time of a base rate roll-in.

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REQUEST 16
RESPONSIBLE PARTY: William A. Bosta

REQUEST 16. Refer to the Staff's First Request, Item 20.

REQUEST 16a. Explain why the desire to "smooth out the monthly surcharge factors over time" should be a consideration in whether to deal with over- and under-recoveries of the surcharge using a 2-month true-up adjustment.

RESPONSE 16a. EKPC and the Member Systems believe it is extremely important to minimize the monthly fluctuations in the Environmental Surcharge factors in order to allow billing stability and bill predictability for our customers. Retail customers, particularly large commercial and industrial customers, have expressed concern about fluctuations in the FAC factor. That is a primary reason why EKPC proposed a cap on the monthly FAC factor as proposed in Case 2004-401. EKPC's response to Item 20 of the Staff's First Data Request illustrates the fluctuation in the environmental surcharge under a two-month lag compared to EKPC's proposal. As shown in the attachment to Item 20, Staff First Data Request, use of EKPC's proposal will serve to minimize monthly fluctuations in the environmental surcharge factor.

REQUEST 16b. Concerning over- and under-recoveries of the surcharge:

REQUEST 16b1. Would East Kentucky agree that, if the average monthly member system revenues for the most recent 12 months is greater than the billing month member system revenues, there will probably be an under-recovery of the surcharge?

RESPONSE 16b1. Yes.

REQUEST 16b2. Would East Kentucky agree that, if the average monthly member system revenues for the most recent 12 months is lower than the billing month member system revenues, there will probably be an over-recovery of the surcharge?

RESPONSE 16b2. Yes.

REQUEST 16b3. Would East Kentucky agree that this difference between the average monthly member system revenues and the billing month revenues is essentially a timing difference that is normally part of the environmental surcharge mechanism?

RESPONSE 16b3. EKPC agrees it is a timing difference. It is also influenced by use of an average of 12 months revenues compared to a monthly amount.

REQUEST 16bc. Based upon its understanding of the three authorized environmental surcharges currently in effect, would East Kentucky agree that the 2-month true-up adjustment primarily addresses this timing difference? Explain the response.

RESPONSE 16bc. While EKPC agrees that it addresses the timing difference, use of a two-month true-up typically results in monthly fluctuations that may adversely affect our customers. EKPC's proposal accomplishes the true-up, recovers actual cost, and most importantly serves to mitigate the monthly fluctuation in the environmental surcharge factor. This comparison is shown in the attachment to Item 20, Staff's First Data Request. See also the response to 16a, above.

REQUEST 16d. Would East Kentucky agree that, if the 2-month true-up adjustment addresses the revenue timing differences that result in over- or under-recoveries of the surcharge, it would be reasonable to resolve these over- and under-recoveries sooner, within 2 months, rather than later, at the 6-month surcharge reviews? Explain the response.

RESPONSE 16d. No. As mentioned above, minimizing the fluctuation of the monthly environmental surcharge on our customers is more significant than the timing of the cost recovery.

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REQUEST 17
RESPONSIBLE PARTY: William A. Bosta/Ann F. Wood

REQUEST 17. Refer to the Staff's First Request, Item 21(c). Using the example set forth in Item 21(c):

REQUEST 17a. Explain in detail how a retail customer could see the environmental surcharge for the expense month of July 2005 on his bill before the applicable member system would see the environmental surcharge for the expense month of July 2005 on its bill.

RESPONSE 17a. Under EKPC's proposal, the environmental surcharge factor for EKPC and the Member System for the expense month of July would be filed with the Commission on August 20th. Assuming the Commission accepts the factors for billing, the Member System will receive their bill, including the environmental surcharge, on or about September 5th. If a Member System's first billing cycle in September is prior to September 5th, that bill would include the retail environmental surcharge factor.

REQUEST 17b. Under the regular billing cycles of East Kentucky and its member systems, would it be correct that while the environmental surcharge for the expense month of July 2005 would appear on the member system's bill in early September 2005, the pass through of the surcharge would not appear on the retail customer's bill until the appropriate billing cycle in October 2005? Explain the response.

RESPONSE 17b. No. See the response to 17a above.

REQUEST 17c. Provide charts or diagrams showing how and when base rate and fuel adjustment charges progress from East Kentucky to its member systems to the retail customer progresses and which also show that same progression as proposed for the environmental surcharge. The charts or diagrams should mark the passage of time involved with the billing processes.

RESPONSE 17c. Please see the attached information.

Fuel Adjustment Clause Filing Schedule (Same Timeframe Applies to Basing Point Changes)

August 17	August 20	Early September	September 20	Beginning October 1
EKPC calculates the fuel adjustment factor based on the July expense month	EKPC files the fuel adjustment factor with the PSC	EKPC bills the fuel adjustment factor to the member system	The member system files the fuel adjustment factor with the PSC	The member system bills the fuel adjustment factor at the first billing cycle

Proposed Environmental Surcharge Filing Schedule

August 17	August 20	Early September
EKPC calculates its environmental surcharge factor based on the July expense month; EKPC also calculates the member systems' surcharge factor	EKPC files both its wholesale and the member systems' retail environmental surcharge factor with the PSC	EKPC bills the environmental surcharge factor to the member systems; the member systems also begin billing the environmental surcharge factor to the retail consumers

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REQUEST 18
RESPONSIBLE PARTY: William A. Bosta

REQUEST 18. Refer to the Staff's First Request, Item 22(a).

REQUEST 18a. Explain in detail why East Kentucky is proposing to file its member systems' monthly environmental surcharge factors rather than the individual member systems filing their respective monthly surcharge factors.

RESPONSE 18a. EKPC and its Member Systems believe that using one source for filing will be more efficient and easier to administer. Each individual Member System will approve the proposed factor prior to the actual filing.

REQUEST 18b. Explain in detail why it is necessary to "enable the Member Systems to bill their customers at about the same time as they are being billed by EKPC."

RESPONSE 18b. The environmental surcharge will result in a significant increase in the purchased power costs absorbed by the Member Systems. EKPC estimates that the increase will be in the 7-8% range at inception. Unless the Member Systems are able to bill their customers at about the same time as they are billed by EKPC, the Member System will absorb the carrying costs on the environmental surcharge. EKPC's proposal will help mitigate this cash flow lag and assist Member Systems from a financial standpoint.

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REQUEST 19
RESPONSIBLE PARTY: William A. Bosta

REQUEST 19. Refer to the Staff's First Request, Item 23. In order to better understand the response, provide all supporting workpapers, calculations, and assumptions used to develop the percentages provided in the attachment to the Item 23 response.

RESPONSE 19. Please see the attached information.

Percentage of EKPC's Total Sales Made to Entities other than its Member Systems

	MWh Sales				Revenues			
	Sales to Members	Off-System	Total	Off-System/ Total	Members	Off-System	Total	Off-System/ Total
Month-Year	(1)	(2)	(3)=(1)+(2)	(4)=(2)/(3)	(5)	(6)	(7)=(5)+(6)	(8)=(6)/(7)
August-03	997,643	6,819	1,004,462	0.68%	$ 39,048,890	$ 324,884	$ 39,373,774	0.83%
September-03	814,604	2,476	817,080	0.30%	$ 33,387,133	$ 88,146	$ 33,475,279	0.26%
October-03	825,726	2,147	827,873	0.26%	$ 30,834,460	$ 57,522	$ 30,891,982	0.19%
November-03	900,851	748	901,599	0.08%	$ 34,704,688	$ 21,520	$ 34,726,208	0.06%
December-03	1,177,500	1,394	1,178,894	0.12%	$ 46,131,438	$ 34,064	$ 46,165,502	0.07%
January-04	1,272,236	3,011	1,275,247	0.24%	$ 51,489,482	$ 98,761	$ 51,588,243	0.19%
February-04	1,107,168	5,636	1,112,804	0.51%	$ 47,586,880	$ 199,717	$ 47,786,597	0.42%
March-04	974,249	5,670	979,919	0.58%	$ 40,035,136	$ 179,966	$ 40,215,102	0.45%
April-04	844,747	554	845,301	0.07%	$ 35,793,161	$ 20,770	$ 35,813,931	0.06%
May-04	908,908	5,325	914,233	0.58%	$ 37,787,078	$ 233,064	$ 38,020,142	0.61%
June-04	934,199	2,248	936,447	0.24%	$ 38,182,351	$ 85,456	$ 38,267,807	0.22%
July-04	1,007,109	8,353	1,015,462	0.82%	$ 43,704,954	$ 205,170	$ 43,910,124	0.47%
Totals	11,764,940	44,381	11,809,321	0.38%	$ 478,685,651	$ 1,549,040	$ 480,234,691	0.32%