



July 29, 2005

HAND DELIVERED

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

RECEIVED

JUL 29 2005

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 ten (10) copies of the Emissions Allowance Strategy Plan of East Kentucky Power Cooperative, Inc., which is submitted in compliance with Item 14 of the Settlement Agreement, which was approved by the Commission's order dated March 17, 2005.

Very truly yours,

A handwritten signature in cursive script, appearing to read 'Charles A. Lile'.

Charles A. Lile
Senior Corporate Counsel

Enclosures

Cc: Elizabeth E. Blackford, Esq.
Michael L. Kurtz, Esq.

Emissions Allowance Strategy Plan

Introduction

EKPC's goal in the operation of its power plants is to be in compliance with regulatory requirements while minimizing costs to its Member Systems. EKPC constantly reviews compliance options and their costs. EKPC's strategy is to develop a program that meets federal and state standards at the lowest cost while providing operational flexibility to meet all of its power production needs.

Clean Air Act Amendments of 1990 (CAAA)

The Clean Air Act of 1990 mandated that electric utilities reduce both sulfur dioxide and nitrogen dioxide emissions from utility sources. Reduction of these emissions was to be accomplished in two phases. The first phase reductions became effective in 1995 and the second phase reductions took effect at the beginning of 2000. EKPC was able to comply with the first phase SO₂ reductions by using coal with lower sulfur content at the power plants. This strategy proved economical and effective in reducing EKPC Phase I emissions below the legally allowed level.

The NO_x program was also implemented in two phases, beginning in 1996 and 2000. EKPC came under the NO_x regulations beginning in May, 2004. The NO_x program incorporates many of the same principles of the SO₂ trading program.

SO₂ and NO_x Emission Allowance Allocation

To achieve the emission reduction objective of the CAAA, emission allowances have been allocated by the Environmental Protection Agency to EKPC's affected generating units. Each allowance permits a generating unit to emit one ton of SO₂ or NO_x during or after a specified year. For each ton of SO₂ or NO_x emitted during a given year, one allowance is retired. Allowances may be purchased, sold, or banked. Regardless of the number of allowances a source possesses, it may not emit at levels that would violate federal or state limits set under Title IV of the CAA.

SO₂ Emissions Strategy for Phase II

To comply with Phase II sulfur dioxide requirements, EKPC's current compliance strategy includes a combination of buying low-sulfur fuel, purchasing SO₂ allowances, and upgrading the existing scrubber or building a new one at the Spurlock 2 generating station.

NO_x Emissions Strategy for Phase II

Starting May 31, 2004, EKPC was required by law to comply with limitations on its NO_x emissions. In 2002, EKPC installed Selective Catalytic Reduction ("SCR") equipment on its Spurlock 1 and Spurlock 2 units. These units were operated prior to May 31, 2004, resulting in EKPC accruing a total of 1,791 NO_x emission allowances, called Early Reduction Credits.

Strategy for Purchasing and Selling SO₂ and NO_x Allowances

For each year, EKPC projects the number of tons of SO₂ and NO_x to be emitted from its plants by utilizing a generation planning model. Emission levels are also considered in EKPC's least-cost planning methodology as a factor in evaluating new generation resources or environmental related capital projects. EKPC monitors the number of tons of SO₂ and NO_x emitted from its generating stations monthly. Based on these measured emissions and the projected generation and fuel consumption for the remainder of the year, EKPC estimates the number of SO₂ and NO_x allowances that will be needed to be held at the end of the year in order to comply with state and federal emissions limitations. In general, EKPC will endeavor to hold in inventory a sufficient number of allowances to cover the year-to-date utilization of SO₂ and NO_x allowances.

EKPC anticipates that it will need to purchase some SO₂ emission allowances above the EPA-allocated amount over the next five years. The number of allowances depends on various factors including load growth, coal quality, pollution control equipment installed, and generation availability.

If a determination is made that additional allowances need to be acquired, they can be purchased in the marketplace at the current market price.

EKPC utilizes Energy Venture Associates, a firm experienced in long-term emissions allowance forecasting, for the forecast of emission allowance prices for planning purposes.

EKPC currently plans to either rebuild or replace the scrubber at the Spurlock 2 generating station. The anticipated date of completion is mid-2008. Consequently, this scrubber will reduce EKPC's SO₂ emissions. In consideration of these reduced future requirements, EKPC is considering a swap of a quantity of future SO₂ emission allowances for a number of vintage spot SO₂ allowances having equivalent value.

Approximately 75% of EKPC's currently banked NO_x allowances have the potential to be reduced in value due to EPA imposed "flow control". Flow control provisions were designed by the EPA to discourage extensive use of banked allowances in a particular ozone season. Flow control is triggered if the total number of banked allowances from all sources exceeds 10% of the region-wide NO_x emissions budget. Therefore, EKPC anticipates the need to purchase a number of NO_x allowances in 2005 since it has been emitting more tons of NO_x than were allocated. This strategy would minimize the use of the "devalued" NO_x allowances.

The availability and economic value of emission allowances over the long run is uncertain. Should the market price for emission allowances or lower-sulfur coal increase substantially from current estimates, EKPC will consider capital-intensive options.

Tracking and Reporting

EKPC's Environmental Affairs Department regularly monitors and measures generating station SO₂ and NO_x emissions. The Finance, Planning and Risk Management Department is responsible for monitoring and evaluation of the emissions allowances market and for the execution of trades. The Accounting and Materials Management Department is responsible for the accounting of the emissions allowances. The Pricing Department is responsible for regulatory filings for the recovery of emission allowance costs.