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November 29, 2006

Honorable Charles A. Lile
Senior Corporate Counsel
East Kentucky Power Cooperative, Inc.
4775 Lexington Road
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CERTIFICATE OF SERVICE

RE: Case No. 2006-00236
East Kentucky Power Cooperative, Inc.

I, Beth O'Donnell, Executive Director of the Public Service Commission, hereby certify that the enclosed attested copy of the Commission's Order in the above case was served upon the addressee by U.S. Mail on November 29, 2006.

Executive Director

BOD/jc
Enclosure

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF EAST KENTUCKY POWER COOPERATIVE CORPORATION, INC. FOR APPROVAL TO ADOPT NEW DEPRECIATION RATES	))))	CASE NO. 2006-00236

ORDER

East Kentucky Power Cooperative, Inc. ("EKPC") filed its application on June 2, 2006 for approval of a new depreciation study relating to all of its regulated assets, and to change its depreciation rates to reflect an annual reduction of approximately $13.5 million. EKPC, as part of a settlement agreement reached in Case No. 2004-00321,[1] agreed to conduct a new depreciation study within two years and then file the study for approval by the Commission. In September 2005, EKPC selected Gannett Fleming, Inc. ("Gannett") to perform a depreciation study for its assets in service as of December 31, 2005.

Gannett calculated the depreciation accrual rates by the straight-line method, using the average service life procedure and remaining life basis. The depreciation rates for certain general plant accounts were determined using amortization accounting. Due to the lack of sufficient aged retirement data for most plant accounts, Gannett used the Simulated Plant Record ("SPR") Method of life analysis to indicate generalized survivor curves that best represent the life characteristics of a property group. The selection of curves is based on the closeness of the match between actual and

[1] 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.

simulated annual amounts. The SPR is a trial-and-error model used to estimate the average service life of a depreciable group. SPR simulates retirement and resultant plant balances, combining standardized survivor curves and average service lives and comparing the results to historical data until a good match is found, or successive trials are made until that type curve and average service life are found which produce the best agreement with the actual plant balances. EKPC's depreciation study shows that Gannett has considered the estimated future net salvage when formulating their expected depreciation rates. The future net salvage is expressed as percentages of the plant now in service, which includes all future retirements. Net salvage is an estimate of the gross salvage to be realized from resale, re-use, or scrap disposal of the retired units less their cost of removal. When removal costs are expected to exceed salvage receipts, a negative net salvage is estimated. The net salvage estimate was based on data from 1992 to 2004 and judgment of which accounts are expected to experience positive or negative net salvage. Overall, given the nature of EKPC's historic depreciation data, and based on the approaches followed in the depreciation study, the Commission finds that the proposed rates contained in EKPC's depreciation study are reasonable and should be approved.

On July 12, 2006, EKPC filed a request with the Rural Utilities Service ("RUS") for approval of the proposed depreciation rates. The RUS has not yet approved EKPC's request. EKPC proposed that upon Commission approval, the new depreciation rates would be applied retroactively to January 1, 2006 for both accounting and rate-making purposes. For its environmental surcharge, EKPC proposed to include a "catch up" adjustment for the depreciation expense included in its monthly environmental surcharge filings. This adjustment would reflect the depreciation expense based on the new depreciation rates, for the period of January 2006 through the current expense month.[2] EKPC indicated that if the new depreciation rates had been in effect for the September 30, 2006 expense month, its surcharge revenues would have been reduced by $216,283 for that expense month.

In support of its "catch up" adjustment, EKPC argued that the proposal was designed to simplify the administration of depreciation expenses and to share the resulting reduction in environmental surcharge expenses with its member systems at the earliest possible time.[3] EKPC stated that it had assumed such an adjustment for a reduction in expenses could be made to the environmental surcharge prior to final action by the Commission in a 2-year surcharge review.[4] However, after considering previous Commission decisions relating to the application of new depreciation rates as part of the environmental surcharge, EKPC modified its request and withdrew the proposal to retroactively apply the new depreciation rates in the environmental surcharge filings.[5]

In approving new depreciation rates, the Commission has previously authorized the new rates to be used for accounting purposes retroactively to the beginning of the

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[2] Wood Direct Testimony at 4.

[3] Assuming that the September 2006 expense month is representative, the "catch up" adjustment proposed by EKPC would result in a refund of approximately $2.6 million of surcharge revenues collected in 2006.

[4] Response to the Commission Staff's First Data Request dated July 27, 2006, Item 3(a).

[5] Response to the Commission Staff's Second Data Request dated September 26, 2006, Item 1(a).

calendar year of the approval. However, utilities have only been permitted to apply new depreciation rates prospectively for rate-making purposes, which includes the environmental surcharge calculations.[6] By limiting such retroactive approvals to accounting purposes, there are no impacts on the utilities' rates, which can be changed on a prospective basis only. Nothing has been provided in the record of this case to persuade the Commission to deviate from this approach.

Therefore, the Commission finds it is reasonable for EKPC's new depreciation rates to be implemented for accounting purposes as of January 1, 2006, and to be implemented for future rate purposes, including the environmental surcharge, after the date of this Order. For environmental surcharge calculations, the new depreciation rates are to be used beginning with the first monthly surcharge filing after the date of this Order. The Commission also finds that EKPC should file a copy of the RUS approval of the new depreciation rates within 10 days of its receipt.

IT IS THEREFORE ORDERED that:

1. The new depreciation rates proposed by EKPC are approved for accounting purposes as of January 1, 2006, and for environmental surcharge purposes, beginning with the first monthly surcharge filing after the date of this Order.

2. EKPC shall file with the Commission, within 10 days of receipt, a copy of the RUS approval of the new depreciation rates.

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[6] See Case Nos. 2001-00140, Application of Kentucky Utilities Company for an Order Approving Revised Depreciation Rates; and 2001-00141, Application of Louisville Gas and Electric Company for an Order Approving Revised Depreciation Rates, December 3, 2001 Order at 7-8.

Done at Frankfort, Kentucky, this 29th day of November, 2006.

By the Commission

ATTEST:

Executive Director