

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

GENERAL ADJUSTMENT OF ELECTRIC )  
RATES OF EAST KENTUCKY POWER ) Case No. 2006-00472  
COOPERATIVE, INC. )

ATTORNEY GENERAL'S BRIEF

Comes now the Attorney General of the Commonwealth of Kentucky, by and through his Office of Rate Intervention, and states as follows for his brief in the above-styled matter.

Eastern Kentucky Power Cooperative ["EKPC"] has petitioned the Commission for an order establishing emergency rate relief pursuant to KRS 278.190 (2).<sup>1</sup> Upon completion of discovery,<sup>2</sup> a public hearing was held on March 22, 2007, in which EKPC and various other parties submitted evidence. At the conclusion of the hearing, the Commission requested that any post-hearing briefs address in particular the issue of what Constitutes "material impairment or damage," as that phrase is used in KRS 278.190 (2).

EKPC's request for emergency rate relief prior to the expiration of the suspension period is not only highly unusual and extraordinary, but indeed appears to be a case of first impression for this Commission. Oral testimony adduced at the hearing clearly

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<sup>1</sup> That statute provides, in pertinent part: ". . . Provided, however, if the commission, at any time, during the suspension period, finds that the company's credit or operations will be **materially impaired or damaged** by the failure to permit the rates to become effective during the period, the commission may, after any hearing or hearings, permit all or a portion of the rates to become effective under terms and conditions as the commission may, by order, prescribe. . . ." [emphasis added]

<sup>2</sup> Due to the emergency nature of the interim relief EKPC requested, only one round of discovery could be completed prior to the April 1, 2007 effective date of the utility's proposed revised tariffs.

indicates that EKPC finds itself enmeshed in a series of highly unusual, extraordinary and unforeseeable events that led to the filing of the instant rate case. Moreover, EKPC's overall condition has been the subject of justifiable concern and intense scrutiny from the Commission for at least the last calendar year.<sup>3</sup>

EKPC's testimony bases its needs for the extraordinary interim rate relief upon a series of unusual events that have led to a decline of its overall financial condition.<sup>4</sup> The factors contributing to the deterioration of EKPC's financial condition included: (a) a four-month forced outage at Spurlock in 2004 which was caused by events beyond the company's control;<sup>5</sup> (b) legal expenses associated with on-going unprecedented litigation with the EPA;<sup>6</sup> and (c) increased interest expense for construction funds to meet new generation and transmission needs.<sup>7</sup>

Testimony at the hearing also made it quite clear that EKPC's financial woes are not yet over. EKPC relies heavily upon the 100 Mw of peaking power produced by the Cooper Station hydro plant, located on Lake Cumberland. Due to circumstances beyond any party's control, the U.S. Army Corps of Engineers was recently forced to reduce significantly water levels in Lake Cumberland, which has reduced Cooper's current output to only 28 Mw. This will force EKPC to spend another \$25 million to build a

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<sup>3</sup> See, e.g., 2006-00455 (An Investigation of the Financial Condition of EKPC); 2006-00564 (An Investigation into the Need of EKPC for Certificated Power); and 2006-00471 (Integrated Resource Plan).

<sup>4</sup> See responses to AG DR Nos. 1 – 5, and see generally testimony of Mr. Marshall, Mr. Walker, and Mr. Eames.

<sup>5</sup> See response to AG DR No. 3.

<sup>6</sup> There are two EPA lawsuits, one regarding physical or operating changes to three coal-fired generators allegedly in violation of the Clean Air Act; the other regards a notice of alleged violations pertaining to the nameplate ratings on the Dale 1 and 2 generators. At the hearing, Mr. Eames testified that each year, the company spends several million dollars defending these lawsuits, and that if the company should lose either or both of these actions, the company would be forced to adopt measures that would have a severe impact on the company's financial condition.

<sup>7</sup> See response to AG DR No. 5, and specific references to EKPC's testimony in this regard.

cofferdam and pumps to remedy the situation.<sup>8</sup> Moreover, Mr. Eames testified that the company has already deferred all the maintenance it can, that these maintenance deferrals already greatly exceed industry standards, and that some generating units could go down at any time due to the elongated deferrals, to the detriment of the company's financial condition.<sup>9</sup>

Perhaps the most striking and telling testimony came from Mr. Jonathan Don, RUS Vice-President of Capital Markets. Mr. Don testified that EKPC's current credit rating would probably be the equivalent of below investment grade.<sup>10</sup> Mr. Don stated that a below investment grade rating sometimes precludes an entity from obtaining financing. Moreover, several banks participating in EKPC's existing credit facility have placed EKPC "on watch." Mr. Don concluded that if EKPC was to syndicate some new financing, these factors constitute a material impairment to the company's credit.<sup>11</sup> Mr. Eames previously testified that in fact, EKPC will be forced to seek financing for the \$25 million in costs to remedy the problems with Cooper Station. Moreover, it will need another \$200 million in new financing by the end of 2007, in addition to the remaining \$195 million left in its existing credit facility.<sup>12</sup>

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<sup>8</sup> Video Record ["V.R."] at 1:52:20. Additional future costs that apparently are not yet fixed include: (a) costs incurred due to the withdrawal of Warren RECC from the EKPC system, some of which it is attempting to recoup through negotiations (see 2006-00564); and (b) potential cancellation charges if EKPC decides to change the model of CTs it purchases from General Electric, which could range from between \$10 million to \$40 million (V.R. at 1:51:00).

<sup>9</sup> See V.R. at approximately 2:07:40. Mr. Eames stated that the industry standard for generator overhauls is every 6 years; EKPC is on a schedule of every 10-11 years.

<sup>10</sup> V.R. at approximately 2:54:00. Mr. Don noted that credit rating agencies do not issue ratings for non-publicly traded entities such as EKPC. However, this is the CFC projection for the company. He noted that the last projected credit rating (conducted 1 ½ years ago) was bbb to -bbb, but that EKPC's credit has since then further deteriorated.

<sup>11</sup> V.R. at 2:56:50.

<sup>12</sup> V.R. at 2:12:35.

The Attorney General believes that the “materially impaired or damaged” standard of KRS 278.190 (2) should be set exceptionally high. Such a finding should be made only if the harm posed is so substantial as to approach being irreversible. The threshold should be set high, because a utility with a guaranteed service territory, provides an essential service for our public safety and welfare. The potential financial or operational “collapse” of a utility would consequently result in substantial hardship for its ratepayers. However, a utility must not conduct itself in such a way as to *create* an emergency because of malfeasance, misfeasance, or otherwise disregard due diligence. Thus, while a utility must not allowed to be impaired, the regulator must nonetheless ensure that a potential implosion would not otherwise be preventable by proper, diligent conduct by a utility under *foreseeable* events.

At the hearing EKPC was subjected to some questioning wherein the company initially responded that its current financial credit and operations will not be immediately materially impaired or damaged. However, some understanding of “immediacy” is necessary in order to demonstrate that the term can easily be misconstrued. For example, the company stated it still has access to its credit facility. However, the remaining \$195 million in the facility will likely be exhausted by the end of 2007. If EKPC at that time fails to meet its RUS required threshold, its financial stability as determined by RUS will be severely compromised and downgraded to the magnitude that the RUS will be contractually entitled to essentially “foreclose” on EKPC and the credit facility will halt all future loans – either of which would potentially (if not imminently), financially and operationally impair the company. Thus, the company, while not today as presumably argued by some, is in fact materially impaired.

Without such a high standard, any regulated company could use such a finding as precedent for requesting relief prior to the suspension period's termination. Furthermore, such a result would work a substantial injustice, as it would preclude the Commission and interested parties from conducting and evaluating the meaningful, detailed discovery made necessary in a utility rate case. The standard should, therefore, be applied only on a case-by-case basis.

In the case at bar, EKPC has demonstrated a series of unforeseeable contingencies which acting in synchrony have indeed imposed a material impairment to its credit or operations. It is the confluence of the factors EKPC cites which necessitates the interim relief. Any one factor alone would not be enough to meet the standard.

The case at bar is easily distinguished from the Commission's prior ruling in Case No. 2001-211.<sup>13</sup> In that case, the Commission refused to grant interim relief prior to the expiration of the suspension period because it specifically found that its ruling in the overall rate case would be issued two weeks prior to an anticipated event of default, thus obviating the need for any interim relief. In the case at bar, the Commission was forced to narrow the scope of discovery in order to accommodate EKPC's request to approve tariffs with an effective date of April 1, 2007. Much more work remains to be done in the underlying rate case.

Moreover, the petitioner in 2001-211 failed to demonstrate evidence sufficient for a finding that the company's operations would be materially impaired but for an award of interim relief. In EKPC's case, the evidence indicated that because the company has

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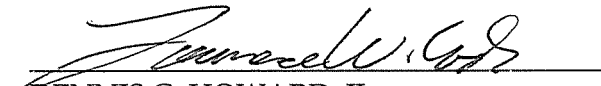
<sup>13</sup> 2002 WL 1575062, "The Application Of Hardin County Water District For: (1) Issuance Of A Certificate Of Public Convenience And Necessity; (2) Authorization To Borrow Funds And To Issue Its Evidence Of Indebtedness Therefor; (3) Authority To Adjust Rates; and (4) Approval To Revise And Adjust Tariff."

been forced to defer maintenance of its essential generating units far beyond industry standards, its generation capabilities are at risk, thus making reliability a major issue for all ratepayers. Any significant failure in this regard could also have significant ripple effects for the Commonwealth's other electric utilities, as they would be forced to shoulder at least a portion of the burden of supplying EKPC's customers.

WHEREFORE, the Attorney General maintains that while the standard for issuing a finding of material impairment or damage to a utility's credit or operations should be made quite high, it nonetheless appears that EKPC has met that extraordinary, and virtually insurmountable burden in the instant case, and the partial settlement should be approved.

Respectfully submitted,

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Counsel certifies that an original and ten photocopies of the foregoing were served and filed by hand delivery to Beth O'Donnell, Executive Director, Public Service Commission, 211 Sower Boulevard, Frankfort, Kentucky 40601; counsel further states that true and accurate copies of the foregoing were mailed via First Class U.S. Mail, postage pre-paid, to:

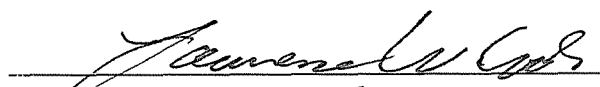
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this 27<sup>th</sup> day of March, 2007.

  
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