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PUBLIC SERVICE COMMISSION

Via Overnight Mail

December 12, 2007

Beth A. O'Donnell, Executive Director
Kentucky Public Service Commission
211 Sower Boulevard
Frankfort, Kentucky 40602

Re: Case No. 2006-00472

Dear Ms. O'Donnell:

Please find enclosed the original and twelve (12) copies each of the PETITION FOR REHEARING OF KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC. in the above-referenced matter. By copy of this letter, all parties listed on the Certificate of Service have been served.

Please place this document of file.

Very Truly Yours,

Michael L. Kurtz, Esq.
BOEHM, KURTZ & LOWRY

MLKkew
Attachment
cc: Certificate of Service

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing was served by mailing a true and correct copy, by overnight mail to all parties on the December 12, 2007.

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RECEIVED

DEC 13 2007

PUBLIC SERVICE
COMMISSION

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In The Matter Of: General Adjustment of Electric Rates of East Kentucky Power Cooperative, Inc.	: : : :	**Case No. 2006-00472**

PETITION FOR REHEARING OF
KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC.

Pursuant to KRS 278.400, Kentucky Industrial Utility Customers, Inc. ("KIUC") petitions the Kentucky Public Service Commission ("Commission") for Rehearing of its December 5, 2007 Order in Case No. 2006-00472.

KIUC seeks rehearing on the limited issue of how the final rate increase of $19.0 million should be allocated among ratepayers. East Kentucky Power Cooperative ("EKPC") proposed a total base revenue (including fuel and purchased power) allocation of its April 1, 2008 interim increase. The Commission accepted this allocation method for the interim increase and carried over that methodology for the final base rate increase. For the reasons set forth herein, KIUC requests that the cost-of-service based allocation proposed by its witness Kevin C. Higgins and advocated in the Joint Brief of EKPC, the Attorney General and KIUC be adopted prospectively from the date of the Commission Order on Rehearing.

Procedural Background

On January 29, 2007, EKPC filed its application which sought an increase in wholesale electric rates of $43.4 million. EKPC requested that the proposed rate increase become effective on April 1, 2007. Testimony regarding EKPC's proposed allocation of the April 1, 2007 interim increase was provided by William A. Bosta. Mr. Bosta explained that given the nature of EKPC's extraordinary request to implement a base rate increase on an expedited basis:

1. the results of EKPC's cost-of-service study were not considered in his proposed allocation;
2. the equal percentage increase allocation (based on total base revenue including fuel and purchased power) was used for simplicity because *"In conjunction with the need for immediate rate relief, it was determined that it would not be prudent to embark on significant efforts to alter the existing rate design structure in this case;"* and
3. EKPC does not intend to ignore cost-of-service issues permanently and that such issues will be addressed in future cases. (Bosta Direct Testimony at p. 8-9).

On March 16, 2007, the Commission issued an Order setting the ground rules for the hearing on EKPC's interim rate increase request. The hearing was limited to evidence regarding the potential impairment of EKPC's credit and operations. No other issues, including revenue allocation, were permitted to be raised.

> *"We further place the parties on notice that the subject matter of the hearing of March 22, 2007 is limited to the potential impairment of EKPC's credit and operations that may result from a denial of EKPC's request for interim rate relief. No evidence or argument on other issues will be entertained."*

(March 16, 2007 Order at p. 2.)

At the Interim Hearing, the Chairman reiterated the Commission's ruling that the only issue to be addressed was material impairment of credit or operations.

> *"This case is before the Commission today on East Kentucky's Application for an increase in its wholesale revenues. This Application was deemed filed by this Commission on February 6, 2007. Specifically, today's hearing is limited to the issue regarding whether East Kentucky's request for immediate implementation of its proposed*

wholesale rate adjustment should be sustained to take effect for service on and after April 1, 2007 pursuant to KRS 278.190, which provides for such relief in the event that this Commission finds that the company's credit or operations will be materially impaired or damaged by the failure to permit the rates to go into effect."

March 22, 2007 TE at 5.

Following the March 22, 2007 hearing, the Commission found that EKPC would experience a material credit and operational impairment unless interim rate relief was granted. Accordingly, the Commission granted EKPC an interim increase in its base rates of $19.0 million on an annualized basis for service rendered on and after April 1, 2007. The interim increase was allocated as proposed by Mr. Bosta. At that stage of the case, Mr. Bosta's proposal was the only evidence of record on allocation. In fact, it was the only evidence permitted on the subject of revenue allocation.

After the interim phase of the case was over and the procedure returned to normal, on July 6, 2007 KIUC submitted the testimony of Kevin C. Higgins on revenue allocation and cost-of-service (this Petition for Rehearing is limited to revenue allocation). Mr. Higgins recommended that any permanent rate increase be allocated on the basis of base demand revenue, not total base revenue. (Higgins Dir. Test. at p. 3). Mr. Higgins reached his recommendation because:

1. fifty percent of the base revenues EKPC used for allocating the interim increase is comprised of fuel and purchased power which are unrelated to the factors driving this rate increase;

2. demand revenues are a more appropriate allocator because this case is driven by EKPC's need to build equity which is a component of fixed cost recovery;

3. EKPC's approach overstates cost responsibility to those classes where energy related revenues compared to demand related revenues are above system average, and that such high load factor customers already pay for the full recovery of their fuel and purchased power costs in their energy charges and through the fuel adjustment clause; and

4. an allocation based on the demand related revenues of each class results in a better alignment of revenue recovery and cost causation. (Higgins Dir. Test. at 3-9).

As to the allocation within the group of special contract customers, Mr. Higgins recommended that Gallatin Steel be treated separately given its large size and unique interruptible load characteristics.

(*Id*. at 9). This refinement did not affect any customer on Rate E (residential) or Rates B/C (commercial and industrial).

In response to discovery, Mr. Bosta stated that he *"agrees that the overall rate increase is more oriented to demand-related cost and that an apportionment of the increase on the basis of demand-related revenue or non-fuel revenue would be another way to reasonably apportion the increase."* (EKPC Response to KIUC 1.1).

On August 31, 2007, EKPC, the Attorney General, and KIUC filed with the Commission a Joint Stipulation and Recommendation ("Joint Stipulation") that addressed revenue requirements and revenue allocation. The Joint Stipulation provided for an additional annual increase in revenues of $19.5 million. The Joint Stipulation also adopted the revenue allocation that had been fully supported by the testimony of Mr. Higgins. EKPC, the Attorney General and KIUC also filed a Joint Brief which again adopted the revenue allocation method proposed by Mr. Higgins.

The final order in this case was issued on December 5, 2007. Cost-of-service and revenue allocation was addressed on pages 36-38. The Commission concluded:

> *"The Commission finds that EKPC's cost-of-service study is reasonable and consistent with the methodology accepted in previous rate cases and should be used as a basis for determining the allocation of any increase in revenues."*
>
> * * *
>
> *"On April 1, 2007, the Commission granted EKPC's request for interim relief of $19.0 million and accepted EKPC's allocation of the increase to the rate classes as proposed in the application. KIUC did not voice any opposition to the allocation methodology used for the interim increase. Having reviewed EKPC's proposed allocation and KIUC's recommendation, we find that EKPC's allocation is reasonable and should be approved in this proceeding."*

(December 5, 2007 Order at 37-38).

Argument

While it may seem facially reasonable to maintain the allocation previously approved in the interim phase, there are compelling reasons to adopt the revenue allocation proposed by Mr. Higgins for the setting of final rates.

First, although the Commission ruled that EKPC's cost-of-service study is reasonable and should be used as the basis for determining the allocation of the final increase, Mr. Bosta did not rely on the cost-of-service study when he developed his allocation proposal. Mr. Bosta ignored the cost-of-service results because the need for expedited rate relief led him to conclude that *"it would not be prudent to embark on significant efforts to alter the existing rate design structure in this case."* (Bosta Dir. Test. at 7). Mr. Bosta did commit to address cost-of-service difference in a future case. (*Id*. at 8). Because the Commission merely carried over the interim allocation when setting permanent rates, the Commission also effectively ignored cost-of-service.

Second, when it maintained the interim allocation on a permanent basis the Commission seemed to place weight on the fact that *"KIUC did not voice any opposition to the allocation methodology used for the interim increase."* (Order at 38). But, the only issue permitted to be addressed in the interim case was material impairment to credit or operations. *"No evidence or argument on other issues will be entertained."* (March 16, 2007 Order at 2). The Chairman reiterated this limitation at the beginning of the interim hearing. (March 22, 2007, TE at p. 5). It was not possible for KIUC to address the allocation methodology in the interim phase of the case and our failure to voice any opposition was unavoidable. Therefore, this is an unfair criticism.

Third, the base demand allocation proposed by Mr. Higgins is the only proposal of record that has any cost-of-service basis. This case has nothing to do with energy or fuel costs. EKPC stated *"...[T]his case is geared to improving EKPC's equity and TIER level and the increase in cost is more oriented to demand-related costs."* (Bosta Dir. Test. at 9). As explained by Mr. Higgins there is no valid reason to allocate the demand related rate increase in this case on the basis of total revenue which is comprised by fifty percent of fuel and purchased power costs. (Higgins Dr. Test. at 3). Mr. Bosta agreed that the method of allocation proposed by KIUC is reasonable. (EKPC Response to KIUC 1.1). Setting final rates based on cost causation and therefore sending proper price signals is important to promote the efficient utilization of electric power. This is consistent with the policy goals being addressed in Administrative Case No. 2007-00477. When cost-of-service is ignored, any subsidy built into existing rates is maintained. Subsidized pricing leads to over consumption, which is contrary to the goal of energy efficiency.

Fourth, the regulatory goal of promoting stakeholder consensus is advanced by adopting Mr. Higgin's proposed allocation. Even though the Joint Stipulation was not considered, EKPC, the Attorney General and KIUC did file a Joint Brief. On the issue of revenue allocation here is what we said:

> *"EKPC and representatives of its Member Systems evaluated Mr. Higgins's recommended rate design with KIUC during settlement discussions in this case, and agreed that it was a reasonable alternative to its proposed rate design. This approach was accepted by EKPC and its Member System representatives, and the AG has reviewed and approved the allocation, which became a part of the Joint Stipulation. (Footnote omitted). While the Sierra Club did not enter into the Joint Stipulation, Geoffrey Young, testifying on behalf of the Sierra Club at the September 5, 2007 hearing in this case, stated that he has no concerns about this recommended rate design. (Footnote omitted). EKPC, the AG, and KIUC believe that this is a just and reasonable allocation of revenue requirements to the EKPC customer classes."*

(Joint Brief at p. 11).

The major parties to this case tried to work together to responsibly address the financial concerns of an important public utility. While the Commission reached a different conclusion on revenue requirements given the statutory framework under which it is required to operate, there is no such constraint on the issue of revenue allocation. On this issue the consensus reached by the major parties should be given effect.

Table KCH-2 at page 11-12 of Mr. Higgins' testimony shows the results of allocating $19.0 million on the basis of base demand revenue. This is detailed on Exhibit KCH-2 which is attached.

Exhibit KCH-2 shows that under this method each customer class will get the same 14.37% increase to its demand charge. This is the allocation method which should be used for final rates.

This issue of cost allocation is important. KIUC proposed a reasonable cost-of-service based methodology which was adopted by EKPC, its Members and the Attorney General. The Commission is no longer constrained by the limits of the interim proceeding. This is precisely the case where revenue allocation is supposed to be addressed. The method set forth in the Joint Brief is superior to the simple but flawed method that had to be used in the interim phase.

WHEREFORE, KIUC respectfully requests that the revenue allocation set forth on Exhibit KCH-2 be adopted prospectively from the date of the Commission's Order on Rehearing.

Respectfully submitted,

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COUNSEL FOR KENTUCKY INDUSTRIAL UTILITY CUSTOMERS INC.

KIUC Revenue Allocation to Major Classes & Rate Design
Using Current Demand Revenue at KIUC's Recommended $19.0 Million Increase

Line No.	(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)
1	**I. Test Year Base Rate Revenue**									
		Energy	Demand	Total						
2	Total Test Yr. Existing Revenue Including Buy-Through	$ 368,343,135	$ 143,682,168	$ 512,025,304						
3	Less Buy Through Revenue	$ (1,356,273)	$ -	$ (1,356,273)						
4	Total Test Yr. Existing Revenue Excluding Buy-Through	$ 366,986,862	$ 143,682,168	$ 510,669,031						
5	Load Center Rev. - Substation Charges	$ -	$ (10,219,764)	$ (10,219,764)						
6	Metering Point Charges	$ -	$ (433,500)	$ (433,500)	Rate categories for which no increase being sought					
7	TGP Contract	$ (8,857,116)	$ (806,531)	$ (9,663,647)						
8	Net Revenue	$ 358,129,747	$ 132,222,373	$ 490,352,120						
9	**II. Base Revenue**				% of Base Demand Revenue Total	Allocate to Class	% Change from Current Demand Revenue	% Change from Current Total Revenue	Billing kW	$/kW
10	Proposed Revenue Increase					$ 19,000,000	14.37%	3.87%		
		Energy	Demand	Total						
11	Rate B	$ 19,944,370	$ 6,676,264	$ 26,620,634						
12	Rate B - Inter	$ 2,874,370	$ 546,551	$ 3,420,921						
13	Rate C	$ 11,768,844	$ 4,218,721	$ 15,987,564						
		$ 34,587,585	$ 11,441,535	$ 46,029,120	8.65%	$ 1,643,500	14.36%	3.57%	2,138,666	$ 0.77
14	Bundled Contracts (Inland Electric, AGC & Inland Steam)	$ 16,166,156	$ 4,739,161	$ 20,905,316	3.58%	$ 680,200	14.35%	3.25%	1,060,389	$ 0.64
15	Gallatin	$ 26,455,869	$ 4,414,903	$ 30,870,772	3.34%	$ 634,600	14.37%	2.06%	1,942,343	$ 0.33
16	Special Contract Total	$ 42,622,025	$ 9,154,063	$ 51,776,088	6.92%	$ 1,314,800	14.36%	2.54%	3,002,732	$ 0.44
17	**III. Energy Adder to "E" Rate**								"E" Billing kWh	$/kWh
18	Total Revenue Increase					$ 19,000,000				
19	B & C					$ (1,643,500)				
20	Special Contract					$ (1,314,800)				
21	Amount Remaining to "E"					$ 16,041,700	14.37%	4.09%	9,181,636,048	$ 0.00175