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**Via Hand Delivery**

March 2, 2007

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

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COMMISSION

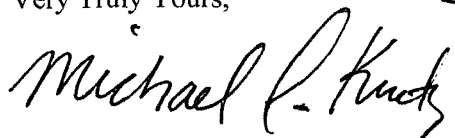
**Re: Case No. 2006-00472**

Dear Ms. O'Donnell:

Please find enclosed the original and twelve (12) copies of the Summary of Testimony of Lane Kollen filed on behalf of the Kentucky Industrial Utility Customers, Inc. to be filed 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

David S. Samford, Esq. (via electronic mail)  
Isaac S. Scott (via electronic mail)  
Dennis Howard (via electronic mail)

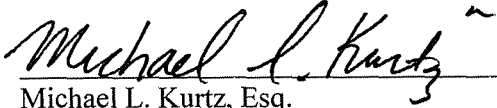
**CERTIFICATE OF SERVICE**

I hereby certify that a copy of the foregoing was served by mailing a true and correct copy, by electronic mail (when available) and by first-class postage prepaid mail, unless otherwise noted, to all parties on the 2<sup>nd</sup> day of March, 2007

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**SUMMARY OF TESTIMONY  
OF LANE KOLLEN**

**ON BEHALF OF KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC.**

**PSC CASE NO. 2006-00472**

**EAST KENTUCKY POWER COOPERATIVE, INC.**

**I. Summary.** The Commission should reject the Company's request to raise rates by \$43.4 million on April 1. The Company has failed to meet the difficult legal standard for the Commission to authorize a substantial rate increase before there is a hearing. It has failed to demonstrate that if the Commission does not increase rates on April 1 that its credit or operations will be materially impaired or damaged. It has failed to demonstrate that it is in default under any of its loan agreements or that it will be in default if normal ratemaking procedures are applied. It has failed to demonstrate that it will not be able to finance its construction program. EKPC continues to have access to its \$650 million Credit Facility and RUS financing. It has failed to demonstrate why its September 30, 2006 short term investments of \$94.7 million and RUS cushion of credit of \$25.8 million should not be utilized before an extraordinary rate increase. It has failed to demonstrate that its requested rate increase, including an unprecedented TIER of 1.35, is reasonable. It has failed to demonstrate that its conclusory representations regarding its 2007 budget can constitute a sufficient basis to prove material financial impairment. In addition, using 2006 actual results as the most recent financial information, the Company achieved a TIER of 1.13, which is in excess of the 1.05 required by the RUS and Credit Facility loan covenants. In the event the Commission believes some rate increase is necessary on April 1, then the increase should be no more than \$11.5 million. This amount accepts as true every fact, figure, and assumption in the utility's rate case filing, except that its proposed TIER of 1.35 is replaced with a TIER of 1.05.

**II. EKPC has failed to meet the difficult legal standard for changing the normal rate case rules by waiving the five month suspension period.**

A. The legal standard for waiving the 5 month suspension period for a rate case using an historic test year is as follows:

**“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.”**  
**KRS 278.190**

1. In accordance with this requirement, the Commission should not raise rates on consumers prior to the expiration of the suspension period unless the failure to do so will cause the Company's credit or operations to be materially impaired or damaged. This is a difficult and high hurdle. The extraordinary remedy of raising rates on consumers before a hearing should be applied only if the utility has met its burden of proof with clear and convincing evidence.

2. If the Commission finds that not raising rates during the suspension period will cause the Company's credit or operations to be materially impaired, then it may permit all or a portion of the rates to become effective under terms and conditions that the Commission may prescribe. The Commission has the discretion to raise rates by some amount less than the full amount requested. Also, this issue may be revisited at any time during the five month suspension period.
- B. The Company failed to address this legal standard in its Application or the testimony filed in support of its request to implement the full amount of the increase requested on April 1.
  - C. The Company made no attempt to quantify the minimum amount of rate increase necessary on April 1 to meet the TIER of 1.05 and DSC of 1.0 in the event the Commission waives the normal five month suspension period. Its request for the increase on April 1 was for the entire amount requested, which the Commission normally would have five months to review and consider based on the merits of the Company's filing.
  - D. The Company's only support for a claim that its **credit** will be materially impaired or damaged is found in its response to Staff discovery (Staff 2nd Set, Request 6).
    1. The Company's support for this claim is limited to a series of conclusory statements based on its 2007 budget, which is tied neither to its actual historic results nor its rate filing. In other words, the Company now seeks to justify the April 1 increase on something other than its rate case filing. This substitute for its rate case filing in the form of the referenced 2007 budget has not been provided to the Commission in this proceeding. As such, the Commission cannot review the Company's budget to ascertain the validity of the budget or the underlying assumptions as the basis for judging whether to increase rates on April rather than on September 1.
    2. The Company's conclusory statements regarding the DSC and TIER based on the 2007 budget if the Company is granted no increase on April 1 compared to being granted its full request on Sept 1 in accordance with the normal 5 month suspension period have no evidentiary support. The validity of these conclusory statements is dependent not on the Company's actual financial results or its rate case filing in this proceeding, but rather on the assumptions included in its 2007 budget. It would be unreasonable for this Commission to start setting rates based upon the budgets unilaterally prepared by the utilities that are by law subject to state oversight and regulation.
    3. The Company's support that its credit will materially impaired includes a conclusory statement that AFUDC will comprise a larger share of margins in 2007 and that these are lower quality than cash earnings. Regardless of the claims regarding the quality of AFUDC earnings, AFUDC is included in the margin used to compute TIER and DSC. Also, the same cash flow argument could be made of the 2005 balance sheet write down to reflect the potential impact of the EPA violation as this will not impact cash flow until the issue is resolved sometime in the future.

4. The Company also references a federal budget proposal to eliminate all RUS loans for generation projects and an S&P news release describing the implications of such an occurrence. Such a federal budget proposal has never been enacted and there is no evidence that such a proposal will be enacted simply because it was proposed in the President's budget. Speculation regarding an unlikely event should not guide the Commission on whether to raise rates on April 1.
- E. The Company's only support for a claim that its **operations** will be materially impaired or damaged is based on its response to Staff discovery (Staff 2nd Set, Request 6).
1. The Company makes two conclusory statements. First, that it will be "forced" to defer or cancel generation and transmission maintenance projects. The Company was asked by Staff to provide specific examples, and it did not. Therefore, the Commission is left to guess about what maintenance projects (a major generator overhaul or changing the light bulbs in the lunch room) may be impacted and how long (one week deferral or one year). This assertion is undermined by the fact that EKPC retains full access to its \$650 million Credit Facility as well as its short term cash investments and RUS cushion of credit. Second, the Company argues that if the RUS declares EKPC in default on its loans, the RUS could freeze further loan advances. The odds of this occurring are remote. According to the Company, as of November 2006, "EKPC remains in good standing with all its lenders." Despite bad earnings in 2004 and 2005 due to unusual, non-recurring events, in 2006 EKPC's private financial institution lenders reaffirmed their commitment to EKPC's \$650 million revolving Credit Facility. RUS has expressed little concern with EKPC's financial situation. EKPC's plan submitted to RUS on how the utility proposes to meet its loan covenants consisted of a simple one-page letter submitted more than a year after the TIER and DSC loan covenants were not met. As of November 2006, EKPC anticipated new RUS loans totaling more than \$500 million.

**III. EKPC has not claimed that it is in "default" under its RUS loan covenants.**

- A. EKPC is not in default under its Credit Agreement or under its RUS loan agreements. The failure to meet the best two out of three year TIER and DSC requirements does not constitute a default on the RUS Mortgage.
- B. EKPC is in compliance with the RUS requirements to notify the RUS in writing and to provide a written plan to improve its financial situation. In its January 2007 one-page letter to the RUS constituting its written plan, EKPC stated that it would continue to take steps to reduce costs and to seek a rate increase before the Commission.

**IV. EKPC is not in financial distress and its financial condition does not require the Commission to authorize a rate increase on April 1 prior to the expiration of the normal suspension period.**

- A. The failure to meet the RUS TIER and DSC requirements in the best two out of three years is due to the extended forced outage of Spurlock 1 in 2004 and to the write-off due to the USEPA litigation in 2005. Absent those two specific and nonrecurring events, the

Company would have met its RUS TIER and DSC requirements in all three of the most recent three years. It should be noted that the write-off in 2005 not only was nonrecurring, but also that it was a non-cash write-off.

- B. The Company is NOT in default under its RUS loan covenants
- C. The Company's actual TIER for 2006 was 1.13.
- D. The Company continues to have unimpaired access to the \$650 million Credit Facility.
- E. The Company has large amounts of short term investments and RUS cushion of credit (discretionary amounts set aside to make future debt repayments). On Sept 30, 2006, the Company had temporary short term investments in general funds of \$94.7 million and other investments in RUS cushion of credit of \$25.8 million.
- F. The Company has imposed a certain amount of financial distress on itself by borrowing more debt than it needs for its construction program and investing it in short term investments and the RUS cushion of credit.
- G. The Company has not exhausted self-help measures to improve its financial performance.
- H. Since July 2005, the Company has raised rates by more than 10% by implementing an environmental surcharge. This provides monthly rate increases, timely recovery of all environmental costs, and a 1.15 TIER on the interest on environmental surcharge rate base investment.
- I. The Company itself voluntarily delayed filing the rate increase in this proceeding.

V. **EKPC's requested rate increase of \$43.4 million is excessive and should not be implemented on April 1.** The Commission should not attempt to conduct a "mini" rate case prior to the rate case itself, but the Company's filing is extremely aggressive and the increase requested is excessive. Prior to the filing I was advised by counsel that the general perception was that EKPC may truly have a significant revenue deficiency. My review of the filing does not bear this out. Simply reducing the Company's requested TIER to 1.05 and removing overly aggressive adjustments and correcting an error in the filing almost eliminates the Company's requested increase. Other smaller and less obvious adjustments do eliminate the Company's requested increase. The following issues demonstrate that the Company's request is excessive.

- A. **Excessive TIER of 1.35. Excess revenue requirement at least \$21.3 using 1.15 TIER and \$31.9 million using 1.05 TIER.** The Company requests a TIER of 1.35, well in excess of the 1.05 necessary for RUS loan covenants and the 1.15 presently authorized for the environmental surcharge. In addition, the interest and TIER requirements include excessive amounts of debt issued to hold short term investments and RUS cushion of credit.
- B. **Excessive payroll, benefits, payroll taxes expense associated with 36 positions that are unfilled, including 30 new positions. \$2.4 million.**
- C. **Excessive revenue requirement due to error in matching environmental surcharge revenues and costs. \$3.3 million.**

- E. **Forced Outage Expense. \$4.6 Million.** The Company included an adjustment to increase the forced outage expense incurred in the test year to reflect the costs of forced outages in prior years, including the Spurlock 1 extended forced outage in 2004
- F. **Interest Income. \$3.3 Million.** The Company included an adjustment to reduce the interest income incurred in the test year to reflect a five year average. There is no basis for this adjustment given the excessive amount of interest and TIER on the debt issued to invest in short term investments and the RUS cushion of credit.

**VI. In summary, the Commission should reject the Company's request to raise rates by \$43.4 million on April 1.** The Company has failed to meet the difficult legal standard for the Commission to authorize a substantial rate increase before there is a hearing or to demonstrate that it is in a financial crisis which requires a rate increase on April 1.

**VII. In the alternative, the Commission has the discretion to increase rates anytime during the suspension period by something less than the full rate increase request. If the Commission simply reduces the Company's TIER to 1.05 and accepts all facts, figures and assumptions the Company's rate case filing with no other adjustments, the maximum increase on April 1 is \$11.5 million. If any increase is granted, the Commission should ensure that it is subject to refund, with interest at the utility's overall cost of capital, based on the decision on the merits in the case in chief.**