

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN EXAMINATION BY THE PUBLIC SERVICE)
COMMISSION OF THE ENVIRONMENTAL)
SURCHARGE MECHANISM OF EAST KENTUCKY)
POWER COOPERATIVE, INC. FOR THE)
SIX-MONTH BILLING PERIODS ENDING) CASE NO.
JUNE 30, 2006 AND DECEMBER 31, 2006, FOR) 2007-00378
THE TWO-YEAR BILLING PERIOD ENDING)
JUNE 30, 2007, AND THE PASS THROUGH)
MECHANISM FOR ITS SIXTEEN MEMBER)
DISTRIBUTION COOPERATIVES)

O R D E R

On March 17, 2005, the Commission approved East Kentucky Power Cooperative, Inc.'s ("EKPC") environmental surcharge application and established a surcharge mechanism.¹ The Commission also approved a mechanism to pass through the environmental surcharge to EKPC's 16 member distribution cooperatives.² Pursuant to KRS 278.183(3), at 6-month intervals, the Commission must review the past operations of the environmental surcharge. After hearing, the Commission may, by temporary adjustment in the surcharge, disallow any surcharge amounts found not to be

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.

² Case No. 2004-00372, Application of Big Sandy RECC, Blue Grass Energy Cooperative Corporation, Clark Energy Cooperative, Cumberland Valley Electric, Farmers RECC, Fleming-Mason Energy, Grayson RECC, Inter-County Energy Cooperative, Jackson Energy Cooperative, Licking Valley RECC, Nolin RECC, Owen Electric Cooperative, Salt River Electric, Shelby Energy Cooperative, South Kentucky RECC and Taylor County RECC for Authority to Pass Through the Environmental Surcharge of East Kentucky Power Cooperative, Inc., final Order dated March 17, 2005.

just and reasonable and reconcile past surcharges with actual costs recoverable pursuant to KRS 278.183(1). At 2-year intervals, the Commission must review and evaluate the past operations of the environmental surcharge. After hearing, the Commission must disallow improper expenses and, to the extent appropriate, incorporate surcharge amounts found just and reasonable into the existing base rates of the utility.

The Commission has determined that it will be administratively efficient and reasonable to review the pending 6-month periods and the 2-year period in the same case. Therefore, the Commission hereby initiates the 6-month review of the surcharge as billed from January 1, 2006 to June 30, 2006 and July 1, 2006 to December 31, 2006, and the 2-year review of the surcharge as billed from July 1, 2005 to June 30, 2007 to the member distribution cooperatives. The Commission also initiates the corresponding reviews of the pass through mechanism as billed from February 1, 2006 to July 31, 2006; August 1, 2006 to January 31, 2007; and August 1, 2005 to July 31, 2007 to retail member customers.³

³ The Settlement Agreement approved in Case Nos. 2004-00321 and 2004-00372 allows the member distribution cooperatives to pass through the environmental surcharge to their customers at approximately the same time as EKPC bills the environmental surcharge to the member distribution cooperatives, thus avoiding a billing lag for the member distribution cooperatives. Therefore, the costs incurred from December 2005 through May 2006 are billed to the member distribution cooperatives in the months of January 2006 through June 2006, with these same costs passed through to the member customers on the bills for February 2006 through July 2006. The costs incurred from June 2006 through November 2006 are billed to the member distribution cooperatives in the months of July 2006 through December 2006, with these same costs passed through to the member customers on the bills for August 2006 through January 2007. The costs incurred in the months of June 2005 through May 2007 are billed to the member distribution cooperatives in the months of July 2005 through June 2007, with these same costs passed through to the member customers on the bills for August 2005 through July 2007.

To facilitate this review, a procedural schedule is set forth in Appendix A, attached hereto and incorporated herein. In accordance with that schedule, EKPC is to file prepared direct testimony: (a) in support of the reasonableness of the application of its environmental surcharge mechanism during the time periods under review; (b) on a proposal to roll-in its environmental surcharge into existing base rates; and (c) in support of the reasonableness of the application of the pass through mechanism during the time periods under review.⁴ In addition, EKPC is to file its response to the information requested in Appendix B, attached hereto and incorporated herein. Since each of the periods under review in this proceeding may have resulted in over- or under-recoveries, the Commission will entertain proposals to adopt one adjustment factor to net all over- or under-recoveries.

IT IS THEREFORE ORDERED that:

1. The procedural schedule set forth in Appendix A, attached hereto and incorporated herein, shall be followed in this proceeding.

2. EKPC shall appear at the Commission's offices on the date set forth in Appendix A, to submit itself to examination on the application of its environmental surcharge as billed to its member distribution cooperatives from (a) January 1, 2006 through June 30, 2006; (b) July 1, 2006 through December 31, 2006; and, (c) July 1, 2005 through June 30, 2007. EKPC shall also submit itself to examination on the

⁴ The lawfulness of the retail pass through methodology of EKPC's environmental surcharge appears to be called into question by the Opinion and Order entered by the Franklin Circuit Court on August 1, 2007 in the case of Commonwealth of Kentucky, ex rel., Gregory D. Stumbo, Attorney General v. Kentucky Public Service Commission and The Union Light, Heat and Power Company, Civil Action 06-CI-269. The impact of the Opinion and Order upon the pass through methodology will be an issue in this proceeding.

application of the pass through mechanism as billed to the distribution cooperatives' member customers from (d) February 1, 2006 through July 31, 2006; (e) August 1, 2006 through January 31, 2007; and, (f) August 1, 2005 through July 31, 2007. At the public hearing there shall be no opening statements or summaries of testimony.

3. East Kentucky shall, by the date set forth in Appendix A, file its prepared direct testimony in support of the reasonableness of the application of its environmental surcharge mechanism and the application of the pass through mechanism during the periods under review.

4. Any party filing testimony shall file an original and 10 copies.

5. a. The information requested herein is due on or before October 24, 2007. Responses to requests for information shall be appropriately bound, tabbed and indexed and shall include the name of the witness responsible for responding to the questions related to the information provided, with copies to all parties of record and 7 copies to the Commission.

b. Each response shall be answered under oath or, for representatives of a public or private corporation or a partnership or association or a governmental agency, be accompanied by a signed certification of the preparer or person supervising the preparation of the response on behalf of the entity that the response is true and accurate to the best of that person's knowledge, information, and belief formed after a reasonable inquiry.

c. Any party shall make timely amendment to any prior responses if it obtains information which indicates that the response was incorrect when made or, though correct when made, is now incorrect in any material respect.

d. For any requests to which a party fails or refuses to furnish all or part of the requested information, that party shall provide a written explanation of the specific grounds for its failure to completely and precisely respond.

6. Within 7 days of the Commission granting intervention to a party, EKPC shall provide the party with a copy of its monthly environmental surcharge reports as filed with the Commission for the review period.

7. EKPC's monthly environmental surcharge reports and supporting data for the review period shall be incorporated by reference into the record of this case.

8. The case records of Case Nos. 2004-00321 and 2004-00372 shall be incorporated by reference into the record of this case.

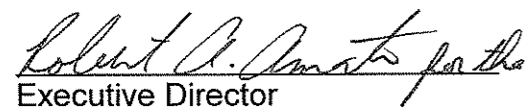
9. The Commission does not look favorably upon motions for continuance. Accordingly, motions for extensions of time with respect to the schedule herein shall be made in writing and will be granted only upon a showing of good cause.

10. Nothing contained herein shall prevent the Commission from entering further Orders in this matter.

Done at Frankfort, Kentucky, this 19th day of September, 2007.

By the Commission

ATTEST:


Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2007-00378 DATED September 19, 2007

EKPC shall file its prepared direct testimony and responses to the information requested in Appendix B no later than..... 10/24/07

An informal technical conference is to begin at 1:30 p.m., Eastern Daylight Time, in Conference Room No. 1 of the Commission's offices at 211 Sower Boulevard, Frankfort, Kentucky for the discussion of issues..... 10/31/07

All additional requests for information to EKPC shall be filed no later than 11/07/07

EKPC shall file responses to additional requests for information no later than 11/21/07

Intervenor testimony, if any, in verified prepared form shall be filed no later than..... 12/07/07

All requests for information to Intervenors shall be filed no later than 12/21/07

Intervenors shall file responses to requests for information no later than 01/08/08

Public Hearing is to begin at 9:00 a.m., Eastern Standard Time, in Hearing Room 1 of the Commission's offices at 211 Sower Boulevard, Frankfort, Kentucky, for the purpose of cross-examination of witnesses of EKPC and Intervenors..... To be scheduled

Briefs, if any, shall be filed by To be scheduled

APPENDIX B

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2007-00378 DATED September 19, 2007

DATA REQUEST TO
EAST KENTUCKY POWER COOPERATIVE, INC.

For Each of the Three Billing Periods Under Review

1. Prepare a summary schedule showing the calculation of E(m) and the surcharge factor for the expense months covered by the applicable billing period. Form 1.1 can be used as a model for this summary. Include the expense months for the two expense months subsequent to the billing period in order to show the over- and under-recovery adjustments for the months included for the billing period. Include a calculation of any additional over- or under-recovery amount EKPC believes needs to be recognized for each 6-month and the 2-year review. Include all supporting calculations and documentation for the additional over- or under-recovery.

2. For each of the 16 member distribution cooperatives, prepare a summary schedule showing the distribution cooperative's pass through revenue requirement for the months corresponding with each 6-month and the 2-year review. Include the two months subsequent to the billing period included in the applicable review period. Include a calculation of any additional over- or under-recovery amount the distribution cooperative believes needs to be recognized for each 6-month and the 2-year review. Include all supporting calculations and documentation for the additional over- or under-recovery.

3. Refer to Form 2.3, Inventory and Expense of Emission Allowances, for each of the expense months covered by the applicable billing period.

a. For the sulfur dioxide ("SO₂") emission allowance inventory, explain the reason(s) for all purchases of allowances reported during these expense months.

b. For the nitrogen oxide ("NOx") emission allowance inventory, explain the reason(s) for all purchases of allowances reported during these expense months.

c. Explain how the purchases of allowances in the expense months covered by the applicable billing periods comply with EKPC's emissions allowance strategy plan.

4. Refer to Form 2.5, Operating and Maintenance Expenses, for each of the expense months covered by the applicable billing period. For each of the 10 expense account numbers listed on this schedule, explain the reason(s) for any change in the expense levels from month to month if that change is greater than plus or minus 10 percent.

Billing Period from July 1, 2006 through December 31, 2006

5. Refer to Form 2.3, Inventory and Expense of Emission Allowances, for the July 2006 expense month. Explain in detail why the form was revised.

Billing Period from July 1, 2005 through June 30, 2007

6. Refer to Form 2.3, Inventory and Expense of Emission Allowances, for the January 2007 expense month. Explain the negative purchases reported for future vintage years for both SO₂ and NOx allowances.

7. The Settlement Agreement approved in Case No. 2004-00321 provides that East Kentucky's rate of return on compliance-related capital expenditures will be

updated to reflect current average debt cost at the conclusion of the 6-month surcharge review. Provide the following information as of May 31, 2007:

a. The debt issuances directly related to projects in the approved compliance plan and corresponding outstanding balances of each debt issuance.

b. The debt cost for each debt issuance directly related to the projects in the approved compliance plan.

c. East Kentucky's calculation of the weighted average debt cost and the rate of return resulting from multiplying the weighted average debt cost by a 1.15 Times Interest Earned Ratio ("TIER"). Include all supporting calculations showing how the weighted average debt cost was determined.

8. Provide the percentage of East Kentucky's debt issuances directly related to projects in the approved compliance plan that has a variable interest rate as of the May 2007 expense month.

9. The Settlement Agreement in Case No. 2004-00321 provides that the reasonable rate of return on compliance-related capital expenditures will be determined by multiplying the weighted average debt cost of the debt issuances directly related to projects in the approved compliance plan times a TIER of 1.15. Does EKPC believe that a TIER of 1.15 is still reasonable? Explain the response.

10. KRS 278.183(3) provides that during the 2-year review, the Commission shall, to the extent appropriate, incorporate surcharge amounts found just and reasonable into the existing base rates of the utility.

a. Provide the surcharge amount that EKPC believes should be incorporated into its existing base rates. Include all supporting calculations, workpapers, and assumptions.

b. The surcharge factor reflects a percentage of revenue approach, rather than a per kWh approach. Taking this into consideration, explain how the surcharge amount should be incorporated into EKPC's base rates. Include any analysis that EKPC believes supports its position.

c. Provide the Base Period Jurisdictional Environmental Surcharge Factor ("BESF") that reflects all environmental surcharge amounts previously incorporated into existing base rates and the amount determined in part (a). Include all supporting calculations, workpapers, and assumptions.

d. Does EKPC believe that there will need to be modifications to either the surcharge mechanism or the monthly surcharge reports, other than a revision to BESF, as a result of incorporating additional environmental surcharge amounts into EKPC's existing base rates? If yes, provide a detailed explanation of the modifications and provide updated monthly surcharge reports.

11. The Settlement Agreement approved in Case No. 2004-00321 provides that the use of the "base/current" approach for the pass through mechanism was not being decided in that case and the issue could be raised at the first 2-year environmental surcharge review. Provide EKPC's position concerning the use of the "base/current" approach for the pass through mechanism.

12. The environmental surcharge mechanisms approved for Kentucky Utilities Company, Kentucky Power Company, and Louisville Gas and Electric Company include

a 2-month true-up adjustment, which addresses the timing differences inherent in surcharge mechanisms. EKPC's surcharge mechanism does not include a 2-month true-up adjustment.

a. Would EKPC agree that a similar 2-month true-up adjustment to address inherent timing differences should be incorporated into its surcharge mechanism? Explain the response.

b. In light of EKPC's financial condition, would EKPC agree that such a 2-month true-up adjustment should favorably affect the over- or under-recovery of the surcharge determined during the 6-month and 2-year reviews? Explain the response.

c. Provide an example of a 2-month true-up adjustment that EKPC believes would address the timing differences inherent in its surcharge mechanism. Include all assumptions and supporting calculations.