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PUBLIC SERVICE
COMMISSION

Via Overnight Mail

July 23, 2008

Stephanie Stumbo, Executive Director
Kentucky Public Service Commission
211 Sower Boulevard
Frankfort, Kentucky 40602

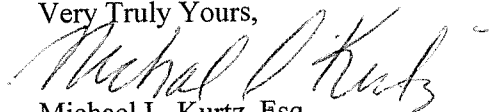
Re: Case No. 2008-00115

Dear Ms. Stumbo:

Please find enclosed the original and twelve (12) copies each of: RESPONSE OF KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC. TO FIRST SET OF DATA REQUESTS OF STAFF and FIRST SET OF DATA REQUESTS OF EAST KENTUCKY POWER COOPERATIVE 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.

Kurt J. Boehm, Esq.

BOEHM, KURTZ & LOWRY

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Attachment
cc:

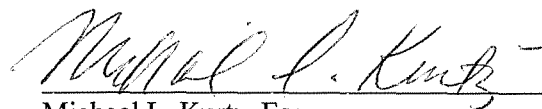
Certificate of Service

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing was served by mailing a true and correct copy, by first-class postage prepaid mail, to all parties on the 23rd day of July, 2008.

Honorable Charles A Lile
Senior Corporate Counsel
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Winchester, KY 40392-0707

Honorable David A Smart
Attorney at Law
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Michael L. Kurtz, Esq.

Kurt J. Boehm, Esq.

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In The Matter Of: Application Of East Kentucky Power : Case No. 2008-00115
Cooperative, Inc. For Approval Of An Amendment To Its :
Environmental Compliance Plan And Environmental :
Surcharge :

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COMMISSION

KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC.
RESPONSES TO FIRST SET
OF DATA REQUEST OF COMMISSION STAFF

1. Refer to the Direct Testimony of Lane Kollen (“Kollen Testimony”), pages 8 through 12. For East Kentucky Power Cooperative, Inc. (“East Kentucky”), the reasonable rate of return on compliance-related capital expenditures is determined by multiplying the weighted average debt cost for the debt issuances directly related to projects in the approved compliance plan times the authorized Times Interest Earned Ratio (“TIER”). For Louisville Gas and Electric Company, Kentucky Utilities Company, and Kentucky Power Company (“Kentucky Power”), the reasonable rate of return is the weighted average cost of capital, which includes a rate of return on common equity (“ROE”).
 - a. Would Mr. Kollen agree that, since the Commission began using the weighted average cost of capital as the environmental surcharge reasonable rate of return for the investor-owned utilities, the ROE component has generally been the same as the ROE authorized in the most recent general rate case for the investor-owned utility?
 - b. Would Mr. Kollen agree that calculating East Kentucky’s rate of return based on the 1.35 TIER authorized in its recent base rate case would be similar to the situation for the investor-owned utilities where the ROE utilized in the environmental surcharge is updated to match the ROE used in the most recent rate case? Explain the response.
 - c. Concerning the reasonable rate of return, explain why Mr. Kollen believes East Kentucky should be treated differently than the investor-owned utilities that have been authorized an environmental surcharge.
 - d. Other than noting the achieved TIER levels for various time periods since the test year in East Kentucky’s last general base rate case, has Mr. Kollen performed any in-depth analyses of the financial condition and revenue requirements for East Kentucky to support his proposal to utilize a 1.15 TIER for the environmental surcharge? Explain the response and include any analyses performed.

Response:

- a. Yes.
- b. No. The circumstances under which EKPC was granted the 1.35X TIER have no analog among the investor owned utilities. Unlike the situation with the investor owned utilities, EKPC requested and obtained an interim rate increase due to its then-desperate financial condition, which the Commission subsequently made permanent also based on the Company's distressed financial condition. The 1.35X TIER granted by the Commission in Case No. 2006-00472 was not and is not reasonable for the environmental surcharge for the reasons cited by Mr. Kollen in his Direct Testimony. The 1.35X TIER likely would not be reasonable for base ratemaking purposes if there was a base ratemaking proceeding pending today given the substantial improvement in the Company's financial condition.
- c. Mr. Kollen does not agree with the premise of the question that EKPC is being treated differently than the investor owned utilities. The statutory standard for recovery through the environmental surcharge specified in KRS 178.183 is that costs be "just and reasonable." The statute limits the return to a "reasonable return." This standard is applicable to all utilities, not only the investor owned utilities. Thus, the Commission must determine the "reasonable return" for each utility specifically for environmental surcharge purposes irrespective of the return authorized for base ratemaking purposes. The statutory standard does not refer to, require or suggest that the most recent return used for base ratemaking purposes must be or should be used as the reasonable return for environmental surcharge purposes. This distinction is particularly important in the case of EKPC due to the circumstances surrounding its interim and base rate increases last year. This distinction results in a different reasonable return for EKPC for environmental surcharge purposes.

Mr. Kollen believes that simply using the TIER established in Case No. 2006-00472 fails to comply with the statutory requirements. Mr. Kollen also believes that such an approach represents an overly simplistic and flawed approach to ratemaking given the unique circumstances of financial duress the Commission was compelled to address in that base ratemaking proceeding. These circumstances no longer exist and it would be punitive to impute circumstances that no longer exist into the environmental cost recovery.

- d. No. The earned TIER is sufficient to demonstrate that the Company is no longer in a distressed financial condition. Thus, it is unnecessary and inappropriate to provide the Company a premium TIER that is more than three times the premium already authorized over the minimum TIER requirements pursuant to the RUS loan covenants. In addition, it should be noted that the Company has offered no demonstration that it requires a 1.35X TIER for any reason or that a 1.15X is inadequate or unreasonable. The Company simply asked for a 1.35X. Mr. Kollen believes that the Company should bear the burden to demonstrate that the status quo is not reasonable. It has not done so in any manner.

2. Refer to the Kollen Testimony, pages 14 through 16.

- a. Was East Kentucky requested to provide the costs for engineering, design work, permitting, and construction costs incurred for the pollution control equipment in conjunction with the Spurlock 4 project as of September 30, 2006? Explain the response.**
- b. Based on Mr. Kollen's experience, would engineering, design work, and permitting for a generating unit be approximately 15 percent of the total cost of the project? Explain the response.**
- c. Explain why Mr. Kollen believes using the total completed construction percentage of 15 percent is reasonable to apply the Construction Work in Progress ("CWIP") balance as of September 30, 2006.**

Response:

- a. Yes. The Staff requested the amount of Spurlock 4 CWIP related to pollution control at September 30, 2006 in Staff 2-1. The Staff did not limit its request to "equipment" that "had been erected." The Company stated "East Kentucky started construction on Spurlock 4 in June 2006. As of September 30, 2006, no pollution control equipment had been erected. Therefore, the pollution control portion of CWIP at September 30, 2006 is \$0." Unfortunately, the Company's response did not answer the Staff's question. Instead, the Company answered the question as to whether any pollution control equipment had been "erected."
- b. The premise of the question is incorrect. The Company computed the 15% as the percentage of the total cost of the Spurlock 4 unit for pollution control equipment, which includes, necessarily the design work and permitting. The Company did not compute, nor did Mr. Kollen assert that the design and permitting work was 15% of the total cost of the unit.
- c. Mr. Kollen's rationale is described on page 15 line 20 through page 16 line 22 of his Direct Testimony. In summary, Mr. Kollen believes that it is unreasonable to assume that \$0 of the CWIP at September 30, 2006 was related to pollution control equipment, particularly given that the CFB boiler is nearly half of the cost of the pollution control equipment at the plant and that this equipment was integral to the design and permitting of the plant. In the absence of any credible evidence to the contrary, and notwithstanding the Company's response to Staff 2-1, the only reasonable assumption is that the CWIP at September 30, 2006 had the same proportion of environmental costs as the Company's projection for the completed plant, no more and no less.

3. Refer to the Kollen Testimony, pages 17 through 19, concerning the effects of the new projects on the emission allowance expenses.
- a. Is Mr. Kollen proposing that an adjustment to the environmental surcharge mechanism is necessary to recognize the estimated potential savings in emission allowance expenses? Explain the response.
 - b. Would Mr. Kollen agree that only actual expenses are recovered through East Kentucky's environmental surcharge and that any future savings in emission allowance expenses will be reflected in the surcharge calculations as those savings are actually achieved?

Response:

- a. No. The Company overstated the impact of its proposed projects because it failed to reduce the quantification for the reduction in the emission allowance expenses. The Commission previously authorized recovery of emission allowance expenses through the surcharge. Thus, any reductions will be captured in the surcharge.
- b. Yes. Mr. Kollen made that point in his Direct Testimony.

4. Refer to the Kollen Testimony, pages 20 through 25.

- a. What is the basis for Mr. Kollen's statement on page 22 that Kentucky Power does not compute Allowance for Funds Used During Construction ("AFUDC")?
- b. Would Mr. Kollen agree that if East Kentucky recovers interest expense on CWIP through the environmental surcharge, the accounting treatment for this item should be as an expense instead of being deferred using AFUDC?
- c. Would Mr. Kollen agree that previous decisions by the Commission to exclude environmental surcharge-related investments, revenues, and expenses from the determination of general base rates would also minimize the risk of double recovery of environmental costs? Explain the response.

Response:

- a. Mr. Kollen has determined that Kentucky Power Company does compute AFUDC on a portion of its CWIP based on his review of the filing in Case No. 2005-00341. Consequently, Mr. Kollen's testimony on page 22 lines 13-17 should be revised to read as follows:

Only one of the other jurisdictional electric utilities with ECRs, Kentucky Power Company, computes AFUDC on any of its Kentucky jurisdictional CWIP, regardless of whether it is environmental or non-environmental. The other two companies, Louisville Gas and Electric Company and Kentucky Utilities Company, do not compute AFUDC on any of their jurisdictional CWIP.

- b. Yes.
- c. Yes. The Company should be allowed recovery of its environmental costs through the environmental surcharge only to the extent not already recovered through existing rates in accordance with KRS 278.183.