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**FEB 4 2014**

**PUBLIC SERVICE  
COMMISSION**

**VIA OVERNIGHT MAIL**

February 3, 2014

Mr. Jeff Derouen, Executive Director  
Kentucky Public Service Commission  
211 Sower Boulevard  
Frankfort, Kentucky 40602

**Re: Case No. 2013-00259**

Dear Mr. Derouen:

Please find enclosed the original and ten (10) copies of the BRIEF OF GALLATIN STEEL COMPANY for filing in the above-referenced matter.

By copy of this letter, all parties listed on the attached Certificate of Service been served. Please place this document of file.

Very Truly Yours,



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

MI Klew  
Attachment

cc: Certificate of Service  
Quang Nyugen, Esq.

## 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 3<sup>rd</sup> day of February, 2014.



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COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

RECEIVED

FEB 4 2014

PUBLIC SERVICE  
COMMISSION

THE APPLICATION OF EAST KENTUCKY POWER :  
COOPERATIVE INC. FOR CERTIFICATE OF PUBLIC :  
CONVENIENCE AND NECESSITY FOR ALTERATION :  
OF CERTAIN EQUIPMENT AT THE COOPER STATION : Case No. 2013-00259  
AND APPROVAL OF A COMPLIANCE PLAN :  
AMENDMENT FOR ENVIRONMENTAL SURCHARGE :  
COST RECOVER :

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BRIEF OF  
GALLATIN STEEL COMPANY

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For the reasons stated below, Gallatin Steel Company (“Gallatin”) supports the Application of East Kentucky Power Cooperative, Inc. (EKPC).

1. **Granting The Application Will Provide Consumers With A Low-Cost Clean Coal Resource.**

By Order issued May 1, 2009 in Case No. 2008-00472, this Commission granted a CPCN for the construction of an Air Quality Control System (AQCS) on the 220 MW Cooper 2. The AQCS was the result of a 2007 Consent Decree with the United States EPA.<sup>1</sup> The AQCS on Cooper 2 includes a dry flue gas desulfurization system and pulse jet fabric filter.<sup>2</sup> The AQCS on Cooper 2 allowed it to comply with the Mercury and Air Toxics Standards (MATS) and the Regional Haze State Implementation Plan particulate emission limitation and Best Available Retrofit Technology (BART) requirement.<sup>3</sup> The actual installed cost of the 220 MW Cooper 2 AQCS was \$222 million, and it was completed in the

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<sup>1</sup> Application at p. 3.

<sup>2</sup> Exhibit BA-1, p. 7 of 43.

<sup>3</sup> *Id.*

summer of 2012.<sup>4</sup> The cost of turning Cooper 2 into a state-of-the-art clean coal facility was therefore \$1,000/kW.

Granting this Application will allow the 116 MW Cooper Unit 1 to tie into the existing AQCS through the re-routing of certain ductwork. The cost of the project is \$15 million.<sup>5</sup> This means that for \$129/kW, Cooper 1 can also be converted into a state-of-the-art clean coal facility. Stated another way, the Cooper 1 project will provide consumers with 52.7% of the clean coal capacity as the recently completed Cooper Unit 2 AQCS, at just 6.8% of the price. This project was described by Mr. Read of the Brattle Group as *"low hanging fruit."*

As described in the testimonies of Ms. Tucker and Mr. Read, EKPC conducted a thorough and unbiased request for proposals (RFP) and economic analysis to determine that the Cooper 1 project was the best and least cost means to meet part of EKPC's 300 MW capacity needs. This conclusion was challenged by Sierra Club witness Mr. Comings. A central element of Mr. Comings' analysis purporting to show that the Cooper 1 project was not least cost was his criticism of EKPC's long-term market energy price forecast.<sup>6</sup> Mr. Comings observed that there was a 42% increase in EKPC's forecasted market energy price from 2017-2020, which he found to be *"unreasonable and unlikely"*.<sup>7</sup> However, Mr. Comings did find that EKPC's long-term natural gas forecast was reasonable and he used it to extrapolate a new energy forecast. *"Therefore, I calculated an implied marginal heat rate from the Company's natural gas forecast compared to broker values for 2013 through 2017 and applied this heat rate to natural gas prices going forward. This methodology assumes that the energy prices in the future will continue to track with natural gas prices in a similar manner."*<sup>8</sup>

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<sup>4</sup> Exhibit ISS-1.

<sup>5</sup> Application at p. 2.

<sup>6</sup> Direct Testimony of Tyler Comings at pp. 11-25.

<sup>7</sup> *Id.* at p. 14.

<sup>8</sup> *Id.*

## 2. The Criticisms Of The Sierra Club Are Unwarranted.

There are at least three flaws in Mr. Comings' effort to convert EKPC's natural gas forecast into an electric energy forecast. First, there is no reason to believe that EKPC is very good at forecasting long-term natural gas prices, but very bad at forecasting long-term electric energy prices. It may be that EKPC's gas forecast – which served as the foundation for Mr. Comings' extrapolated energy forecast—is inaccurate. If so, then Mr. Comings' extrapolated forecast is equally inaccurate. Second, the EKPC natural gas forecast relied on by Mr. Comings is clearly outdated. The hearing in this case occurred on January 14-15, 2014. Yet the "*forecast*" used by Mr. Comings starts on 1/1/2013, or well over a year ago.<sup>9</sup> Finally, it is not reasonable to assume that "*energy prices in the future will continue to track natural gas prices in a similar manner.*" Over time, the generation portfolio mix in PJM is expected to shift away from coal and toward gas, nuclear and renewable resources. As this occurs, gas units may no longer be on the margin setting LMP energy prices. In sum, there are too many problems with Mr. Comings' extrapolated energy forecast to use it for resource addition and reliability decisions.

Sierra Club witness Mr. Loiter submitted testimony which purports to demonstrate that ratepayer money would be better spent on \$15 million worth of additional DSM projects, rather than on Cooper I. Mr. Loiter's analysis is based on a faulty assumption: that the Cooper I project and additional DSM spending are mutually exclusive. They are not. Cooper I can be approved and EKPC will continue to do all cost effective DSM projects which fit the needs of its members.

We do not wish to understate the important role that the Sierra Club has recently played in Commission proceedings. They bring talented lawyers and high quality witnesses who provide the Commission with added perspective and an alternative point of view. But in this case we respectfully submit that their quest for decommissioning coal plants has clouded their economic analysis.

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<sup>9</sup> *Id.* Figure 4, p. 16.

**3. PJM RPM Capacity Revenue From Cooper 1 Will Likely Exceed The Project's Fixed Costs, Thus Resulting In A Negative Cost To Consumers.**

If Cooper 1 is approved, the estimated increase in the environmental surcharge will be \$4.64 million.<sup>10</sup> And the estimated increase on the average residential customer's monthly bill will be approximately \$0.35.<sup>11</sup> Even though the environmental surcharge may go up as identified above, that is not the net rate impact on consumers. The \$4.64 million environmental surcharge increase includes \$2.6 million of Cooper 1 variable costs under the assumption that the unit will run at a 58% capacity factor.<sup>12</sup> But any increase in variable cost at Cooper 1 (whether it is fuel, variable O&M, or emission allowances) means that there will be reductions in variable cost elsewhere on the system. If energy is produced at Cooper 1 (even with the \$4.5/MWh increase in its operating costs due to the scrubber and bag house), it means that Cooper 1 energy is least cost on the PJM system. If the energy were not produced at Cooper 1, it would be produced or purchased from somewhere else at a higher price.

The projected operating cost of Cooper 1 is important in evaluating it in the RFP and choosing the least cost option. But once the choice is made to keep Cooper 1 in operation, it is only the fixed costs that have an effect on rates. EKPC no longer operates as an island. As a member of PJM, the lowest cost energy, whether generated at EKPC's plants or purchased on the market, will serve EKPC's native load. While it is still important to have low operating cost generation since native load consumers have first call on the this resource, the PJM energy market serves as a cap, since self-generation will not dispatch if PJM purchases are less expensive.

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<sup>10</sup> Revised Exhibit ISS-4.

<sup>11</sup> PSC Post-Hearing Data Response 2, p. 1 of 5.

<sup>12</sup> Application at p. 8; Exhibit BA-1, p. 40 of 43; Revised Exhibit ISS-4.

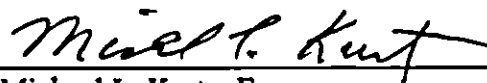
The only real rate increase from Cooper 1 comes from its fixed costs of about \$2.0 million per year.<sup>13</sup> A \$2.0 million increase in the environmental surcharge translates into an average monthly residential increase of only \$0.15, or about \$1.80 per year.

And these fixed costs will likely be more than offset by the PJM RPM capacity revenue from the added 116 MW. The project will likely have a negative cost to consumers as the RPM capacity value of the 116 MW will probably exceed the annual \$2.0 million fixed cost from Cooper 1. For example, using the actual PJM RPM capacity value of \$126/MW-day for the 2014/2015 PJM planning year and a capacity credit of 90%, Cooper 1 would generate approximately \$4.8 million in capacity revenue (116 MW x 90% x \$126/MW-day x 365). So even if Cooper 1 never produces a single kWh of energy it is still a good deal since the RPM capacity revenue will likely exceed the annual fixed cost.

The above analysis does not consider potential additional capital costs at the Cooper Station. But, based upon what is now known, the Cooper 1 project is as advertised – “*low hanging fruit*”.

The Cooper 1 project is reasonable and cost effective. The \$15 million investment will result in a low cost clean coal resource that will continue to use Eastern Kentucky coal, provide good paying jobs and provide property tax revenue to the local schools. Gallatin Steel supports EKPC.

Respectfully submitted,



Michael L. Kurtz, Esq.

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**COUNSEL FOR GALLATIN STEEL COMPANY**

February 3, 2014

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<sup>13</sup> Revised Exhibit ISS-4, p. 2 of 5. (13.508% x \$14,954,840 = \$2,020,099. This represents a return of and return on the Cooper 1 investment, plus property taxes and insurance).