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February 17, 2015

Via Hand-Delivery

Mr. Jeffrey Derouen
Executive Director
Kentucky Public Service Commission
P.O. Box 615
211 Sower Boulevard
Frankfort, KY 40602

Re: In the Matter of: An Application of East Kentucky Power Cooperative, Inc. for a Certificate of Public Convenience and Necessity for Construction of an Ash Landfill at J. K. Smith Station to Receive Impounded Ash from William C. Dale Station, and for Approval of a Compliance Plan Amendment for Environmental Surcharge Recovery
PSC Case No. 2014-00252

Dear Mr. Derouen:

Enclosed please find for filing with the Commission in the above-referenced case an original and ten (10) copies of the Brief of East Kentucky Power Cooperative, Inc., regarding the above-styled matter. Please return a file-stamped copy to me.

Do not hesitate to contact me if you have any questions.

Very truly yours,

Mark David Goss

Enclosures

M:\Clients\4000 - East Kentucky Power\1450 - Dale Ash Landfill CPCN\Correspondence\Ltr. to Jeff Derouen - 150217

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN APPLICATION OF EAST KENTUCKY POWER COOPERATIVE, INC. FOR A CERTIFICATE OF PUBLIC CONVENIENCE AND NECESSITY FOR CONSTRUCTION OF AN ASH LANDFILL AT J. K. SMITH STATION TO RECEIVE IMPOUNDED ASH FROM WILLIAM C. DALE STATION, AND FOR APPROVAL OF A COMPLIANCE PLAN AMENDMENT FOR ENVIRONMENTAL SURCHARGE RECOVERY	)	**CASE NO. 2014-00252**

BRIEF OF EAST KENTUCKY POWER COOPERATIVE, INC.

Comes now East Kentucky Power Cooperative, Inc. ("EKPC"), by and through counsel, pursuant to the directive of the Kentucky Public Service Commission ("Commission") at the conclusion of the public hearing held February 3, 2015, in the above-captioned proceeding, and for its post-hearing Brief concerning the proposed amendment of EKPC's Environmental Compliance Plan for the purpose of recovering the costs of the Project (as that term is defined herein) through EKPC's Environmental Surcharge, respectfully states as follows:

I. INTRODUCTION

EKPC requests that the Commission issue a Certificate of Public Convenience and Necessity ("CPCN") for the construction of a coal ash landfill at EKPC's J. K. Smith Station ("Smith" or "Smith Station") to receive coal ash removed and transported from its William C. Dale Station ("Dale" or "Dale Station") (collectively, the "Project"), and for approval of an Environmental Compliance Plan amendment for purposes of recovering the costs of the Project

through EKPC's Environmental Surcharge. The Project, which is necessitated by relevant state and federal environmental requirements relating to the permanent disposal of coal combustion residuals ("coal ash" or "CCR"), represents the safest, most reasonable, least cost option for addressing the approximately 560,000 cubic yards of coal ash[1] currently stored at the Dale Station property.

II. BACKGROUND

EKPC's Dale Station, located on the Kentucky River at Ford, Clark County, Kentucky, is comprised of four electric baseload generating units comprised of pulverized coal-fired boilers with steam turbine generators. Units 1 and 2, each rated at 25 Megawatts ("MW"), were commissioned in 1954. Units 3 and 4, each rated at 75 MW, were commissioned in 1957 and 1960, respectively. Dale was the first power plant facility constructed by EKPC and for many years served as the backbone for EKPC's power generating fleet.

During the first few decades of power generation at Dale Station, EKPC deposited the coal ash produced by Dale's generating units in on-site surface impoundments, or ash ponds. In the mid-1980's, it became necessary for EKPC to find an off-site location to deposit coal ash from Dale due to capacity constraints in the on-site impoundments and insufficient space available at Dale for the construction of a new impoundment. Accordingly, in 1985, EKPC obtained a permit from the Kentucky Division of Waste Management ("KDWM") to construct and operate an off-site landfill known as the Hancock Creek Inert Landfill ("Hancock Creek"). EKPC used Hancock Creek as well as beneficial reuse projects to permanently dispose of coal ash produced at Dale from roughly 1985 until Hancock Creek reached maximum capacity and was closed in 2010.

[1] *See* Application, ¶ 2, n. 1.

At the time of Hancock Creek's closing, EKPC began an evaluation to identify a new disposal site for coal ash produced at Dale. EKPC and outside consultants identified and examined a number of alternative proposals, including: (1) construct a new Special Waste Landfill at the Dale Station site ("Alternative 1");[2] (2) construct a new Special Waste Landfill in close proximity to Dale Station ("Alternative 2"); (3) truck Dale's coal ash to an existing Special Waste Landfill at EKPC's H. L. Spurlock ("Spurlock") Power Station in Mason County, Kentucky ("Alternative 3"); (4) rail Dale's coal ash to the same Special Waste Landfill at Spurlock ("Alternative 4"); (5) truck Dale's coal ash to an existing private solid waste landfill in Montgomery County, Kentucky, operated by Rumpke of Kentucky ("Alternative 5"); and (6) truck Dale's coal ash to a newly-constructed Special Waste Landfill at Smith Station in Clark County, Kentucky (*i.e.*, the Project). After extensive evaluation, each of the Alternatives 1-5 was rejected by EKPC.[3] The Smith Special Waste Landfill alternative was selected and EKPC obtained a Permit from KDWM to construct a Special Waste Landfill at Smith Station on July 29, 2013.[4]

In April of 2014, EKPC made the decision to close Dale Station Units 1 and 2 and begin exploring the marketing of the assets.[5] At the time this matter was commenced, and in light of the impending deadline for compliance with the federal Mercury and Air Toxics Standards ("MATS") rule, EKPC planned to condition Dale Station Units 3 and 4 for indefinite storage beginning in April of 2015. However, at the request of PJM Interconnection, LLC ("PJM"), EKPC sought and obtained from the Kentucky Department of Air Quality ("DAQ") a one-year

[2] "Special Waste Landfill" means a landfill designed in accordance with the technical requirements of 401 KAR 45:110.

[3] *See* Application, pp. 7-11; Direct Testimony of Matt Clark, pp. 5-11 (filed Sept. 8, 2014).

[4] *See* Exhibit JBP-1 to the Direct Testimony of Jerry B. Purvis (filed Sept. 8, 2014).

[5] *See* Supplemental Direct Testimony of Don Mosier, p. 2 (tendered Dec. 18, 2014).

extension of the deadline for compliance with MATS with respect to Dale Station Units 3 and 4 and, as a result, those units will remain operational through April 2016.[6] Although the timeline with respect to the closure of Dale Station has been lengthened by one year to encourage reliability within PJM's regional electric grid, the impending cessation of generation operations at Dale Station requires substantial work to be undertaken with regard to Dale's ash ponds.

Pursuant to 401 KAR 45:060 Section 1(4), special waste surface impoundments in substantial compliance with a Kentucky Pollutant Discharge Elimination System permit are "deemed to have a permit without the owner or operator having made application or registration with the [C]abinet," or a permit by rule. However, when EKPC discontinues generation operations at Dale Station and the ash ponds at Dale are no longer used as impoundments, they will lose the permit by rule status provided by 401 KAR 45:060 Section 1(4).[7] Consequently, EKPC has only two feasible options for complying with state environmental requirements: either permit the former impoundments at Dale Station as a disposal facility in accordance with the special waste regulations; or remove the coal ash stored in the former impoundments and permanently dispose of it in the permitted off-site Special Waste Landfill at Smith Station.

EKPC engaged Burns & McDonnell Engineering Co., Inc. ("Burns & McDonnell") to provide assistance in assessing these alternatives. Burns & McDonnell's work culminated in its *Report on the Dale Station-Ash Impoundment Closure and Site Restoration Project, April 2014* ("Report") providing three options for EKPC's consideration.[8] The on-site alternatives

[6] *See* EKPC's Motion for Leave to file Supplemental Direct Testimony (filed Dec. 18, 2014) and accompanying Supplemental Direct Testimony of Don Mosier; *see also* EKPC's Response to Commission Staff's Third Request for Information, Request No. 1 (filed Jan. 23, 2015).

[7] *See* Direct Testimony of Jerry B. Purvis, pp. 7-9.

[8] A copy of the Burns & McDonnell Report is attached as Exhibit ET-1 to the Direct Testimony of Ed Tohill (filed Sept. 8, 2014).

examined by Burns & McDonnell (designated in EKPC's Application as Alternatives 6 and 7) were rejected by EKPC because: (1) both alternatives keep Dale's coal ash permanently located immediately adjacent to the Kentucky River; (2) it is highly improbable that either closure in place option could be successfully permitted as a Special Waste Landfill by KDWM because the location cannot reasonably meet the Special Waste Landfill siting requirements;[9] and (3) both alternatives are more costly than the Smith Special Waste Landfill alternative.[10] Thus the Project, at a total estimated cost of $26.962 million, was selected by EKPC as the most prudent, cost-effective course of action to ensure compliance with applicable state environmental law.

Notably, certain new federal environmental requirements are also relevant to this proceeding. On December 19, 2014, the U.S. Environmental Protection Agency ("EPA") issued the Disposal of Coal Combustion Residuals from Electric Utilities rule ("CCR Final Rule"),[11] which deals extensively with coal ash storage and disposal and is expected to become effective later this summer. While EKPC and Burns & McDonnell were first required to consider disposal alternatives that would comply with Kentucky environmental rules, they also designed the proposed Smith Special Waste Landfill to be compliant with the federal CCR Final Rule. Timely completion of the Project is imperative to ensure that EKPC complies with both the state and federal regulatory regimes.[12]

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[9] 401 KAR 45:130 establishes siting requirements for a Special Waste Landfill. Specifically, 401 KAR 45:130 Section 1(1) prohibits a Special Waste Landfill within 250 feet of a perennial stream unless the Cabinet issues a water quality certification, Section 1(4) prohibits a Special Waste Landfill within 100 feet of a property line, and 401 KAR 45:130 Section 2 effectively prohibits the siting of a Special Waste Landfill within the 100-year floodplain.

[10] *See* Direct Testimony of Matt Clark, p. 13.

[11] *Available at* http://www2.epa.gov/sites/production/files/2014-12/documents/ccr_finalrule_prepub.pdf (last accessed February 16, 2015). The CCR Final Rule was issued in a prepublication version, and has not yet been published in the Federal Register.

[12] *See, e.g.*, EKPC's Supplemental Response to Commission Staff's Initial Request for Information, Request No. 20(c) (filed Jan. 23, 2015).

EKPC tendered to the Commission its Notice of Intent to file its Application in this matter on July 11, 2014.[13] On August 27, 2014, EKPC provided notice of the proposed amendment of its Environmental Compliance Plan and Environmental Surcharge Mechanism to its sixteen Members.[14] EKPC filed its Application on September 8, 2014, and discussed the particulars of the proposed amendment to the Environmental Compliance Plan and the resulting impact to EKPC's Environmental Surcharge. EKPC proposed that the return authorized for the existing projects in its Environmental Compliance Plan should be applied to the Project as well.[15] Once the Project is completed, EKPC estimates that the annual revenue requirement will be $4.70 million, which translates into an increase of approximately 0.53% in the environmental surcharge for all customer classes at wholesale and would be passed through as an approximate 0.38% retail increase.[16] The estimated increase on an average residential customer's monthly bill would be approximately $0.34.[17] The inclusion of the Project in the approved Environmental Surcharge Compliance Plan would not require any revisions to the text of EKPC's Rate ES – Environmental Surcharge.[18]

The Attorney General of the Commonwealth of Kentucky, by and through his Office of Rate Intervention ("Attorney General"), moved to intervene in this proceeding on August 6,

[13] *See* Application, Exhibit 5.

[14] *See id.*, Exhibit 6.

[15] *See* Application, ¶ 40. The return is composed of a Times Interest Earned Ratio ("TIER") component and an average cost of debt component. EKPC proposed that the TIER component be based on a 1.50 TIER, which the Commission approved in Case No. 2011-00032. EKPC also proposed that the average cost of debt component be 4.042%, which reflects the average cost of debt as of November 30, 2013, and is consistent with the average cost of debt proposed in EKPC's most current six-month environmental surcharge review case, Case No. 2014-00051. Using a TIER of 1.50 and an average cost of debt of 4.042% would result in a rate of return of 6.063%. *See* Direct Testimony of Isaac S. Scott, p. 8 (filed Sept. 8, 2014).

[16] *See* Application, ¶ 41; *see also* Direct Testimony of Isaac S. Scott, p. 14, and Exhibit ISS-4.

[17] *Id.*

[18] *See* Application, ¶ 42; *see also* Direct Testimony of Isaac S. Scott, p. 12.

2014, and was granted intervention by Order entered September 10, 2014. Grayson Rural Electric Cooperative Corporation ("Grayson") moved to intervene in this proceeding on October 3, 2014, and was granted intervention by Order entered November 21, 2014. During the course of the proceeding, Commission Staff and the Attorney General each propounded three sets of data requests upon EKPC, to which EKPC provided timely responses. Grayson did not propound any data requests. In filing its Application, testimony and responses to various data requests, EKPC also filed three motions for confidential treatment of various information,[19] which remain pending. The Commission held a public hearing in this matter on February 3, 2015, following the publication of notice of such hearing by EKPC in accordance with law.[20] No comments from the public were offered at the hearing,[21] and this matter now stands ripe for adjudication by the Commission.

III. ARGUMENT

A. Summary of Applicable Kentucky Law

It is well-established that the Commission only possesses such powers as are granted by the General Assembly.[22] However, the scope of the powers expressly granted by the General Assembly to the Commission to regulate the "rates" and "service" of utilities is plenary in nature,

[19] *See* EKPC's Motions for Confidential Treatment (filed Sept. 8, 2014, Oct. 24, 2014, and Jan. 23, 2015).

[20] *See* Proof of Publication of Notice (filed Jan. 30, 2015); Hearing Video Record ("HVR") at 10:08:02 (Feb. 3, 2015).

[21] HVR at 10:09:04.

[22] *See Boone Co. Water and Sewer Dist. v. Public Service Comm'n,* 949 S.W.2d 588, 591 (Ky. 1997); *Simpson Co. Water Dist. v. City of Franklin*, 872 S.W.2d 460, 462 (Ky. 1994); *Com., ex rel. Stumbo v. Kentucky Public Service Comm'n*, 243 S.W.3d 374, 378 (Ky. App. 2007); *Cincinnati Bell Tel. Co. v. Kentucky Public Service Comm'n,* 223 S.W.3d 829, 836 (Ky. App. 2007); *Public Service Comm'n v. Jackson Co. Rural Elec. Co-op., Inc.*, 50 S.W.3d 764, 767 (Ky. App. 2000).

unless otherwise expressly limited by statute.[23] In the context of a request for the issuance of a CPCN, the Commission's authority under KRS 278.020(1) remains very broad. The General Assembly has, however, chosen to limit the Commission's authority to prohibit or delay recovery of certain costs arising from compliance with environmental laws and regulations by enacting KRS 278.183, the environmental surcharge statute.

1. CPCN – KRS 278.020(1)

Before undertaking any construction that is not in the ordinary course of business, a utility must be granted a CPCN from the Commission under the authority of KRS 278.020(1). The statute is silent, however, with regard to the criteria which the Commission should apply to any such request from a utility. Accordingly, case law construing KRS 278.020(1) provides the appropriate standard for evaluating EKPC's request for a CPCN for the Project. The leading authority on CPCNs is *Kentucky Utilities Co. v. Public Service Comm'n*, 252 S.W.2d 885 (Ky. 1952), which articulates a two-part test for demonstrating entitlement to a CPCN: (1) need; and (2) absence of wasteful duplication. *Kentucky Utilities Co.* provides significant guidance as to what further considerations should be taken into account when evaluating a request for a CPCN under these two criteria.

As to "need", Kentucky's highest Court wrote:

> We think it is obvious that the establishment of convenience and necessity for a new service system or a new service facility requires first a showing of a substantial inadequacy of existing service, involving a consumer market sufficiently large to make it economically feasible for the new system or facility to be constructed and operated. Second, the inadequacy must be due either to a substantial deficiency of service facilities, beyond what could be supplied by normal improvements in the ordinary course of business; or to indifference, poor management or disregard of

[23] *See* KRS 278.040(2); *Kentucky Public Service Comm'n v. Commonwealth of Kentucky, ex rel. Conway*, 324 S.W.3d 373, 383 (Ky. 2010); *Southern Bell Tel. & Tel. Co. v. City of Louisville*, 96 S.W.2d 695, 697 (Ky. 1936).

> the rights of consumers, persisting over such a period of time as to establish an inability or unwillingness to render adequate service.[24]

With regard to what constitutes "wasteful duplication", the Court opined:

> [W]e think that 'duplication' also embraces the meaning of an excessive investment in relation to productivity or efficiency, and an unnecessary multiplicity of physical properties, such as right of ways, poles and wires. An inadequacy of service might be such as to require construction of an additional service facility to supplement an inadequate existing facility, yet the public interest would be better served by substituting one large facility, adequate to serve all the consumers, in place of the inadequate existing facility, rather than constructing a new small facility to supplement the existing small facility. A supplementary small facility might be constructed that would not create duplication from the standpoint of an excess of capacity, but would result in duplication from the standpoint of an excessive investment in relation to efficiency and a multiplicity of physical properties.[25]

In evaluating the "wasteful duplication" element of the CPCN analysis, the Court further instructed, "[w]e are of the opinion that the Public Service Commission should have considered the question of duplication from the standpoints of excessive investment in relation to efficiency, and an unnecessary multiplicity of physical properties."[26] While the avoidance of "wasteful duplication" is a primary consideration for evaluating a request for a CPCN, *Kentucky Utilities Co.* makes clear that the Commission must not focus exclusively upon the cost of a proposal alone. The Commission must also look at an application for a CPCN in relation to the service to be provided by the utility:

> [W]e do not mean to say that *cost* (as embraced in the question of duplication) is to be given more consideration than the need for *service*. If, from the past record of an existing utility, it should appear that the utility cannot or will not provide adequate service, we think it might be proper to permit some duplication to take

[24] *Kentucky Utilities Co.*, at 890.

[25] *Id.* at 891.

[26] *Id.*

> place, and some economic loss to be suffered so long as the duplication and resulting loss be not greatly out of proportion to the need for service.[27]

In other words, the complete absence of "wasteful duplication" need not be shown to an absolute certainty, "it is sufficient that there is a reasonable basis of anticipation" that the "consumer market in the immediately foreseeable future will be sufficiently large to make it economically feasible for a proposed system or facility to be constructed...."[28] As recently as 2012, the Commission has affirmed this point:

> To demonstrate that a proposed facility does not result in wasteful duplication, we have held that the applicant must demonstrate that a thorough review of all alternatives has been performed. Selection of a proposal that ultimately costs more than an alternative does not necessarily result in wasteful duplication. All relevant factors must be balanced.[29]

2. Environmental Surcharge – KRS 278.183

When a CPCN is issued for a facility that is necessary to comply with a federal, state or local environmental requirement, then the environmental surcharge statute, KRS 278.183, is also implicated. Section 1 of the statute contains a guarantee of current recovery for certain environmental compliance costs and states as follows:

> Notwithstanding any other provision of this chapter, effective January 1, 1993, a utility shall be entitled to the current recovery of its costs of complying with the Federal Clean Air Act as amended and those federal, state, or local environmental requirements which apply to coal combustion wastes and by-products from facilities utilized for production of energy from coal in accordance with the utility's compliance plan as designated in subsection (2) of this section. These costs shall include a reasonable return on construction and other capital expenditures and reasonable

[27] *Id.* at 892 (emphasis in original).

[28] *Kentucky Utilities Co. v. Public Service Commission*, 390 S.W.2d 168, 172 (Ky. 1965).

[29] *In re the Application of Big Rivers Electric Corporation for Approval of its 2012 Environmental Compliance Plan*, Case No. 2012-00063, Final Order, pp. 14-15 (Ky. P.S.C. Oct. 1, 2012) (citations omitted).

> operating expenses for any plant, equipment, property, facility, or other action to be used to comply with applicable environmental requirements set forth in this section. Operating expenses include all costs of operating and maintaining environmental facilities, income taxes, property taxes, other applicable taxes, and depreciation expenses as these expenses relate to compliance with the environmental requirements set forth in this section.[30]

In order to obtain rate relief under the environmental surcharge statute, a utility must "submit to the commission a plan, including any application required by KRS 278.020(1), for complying with the applicable environmental requirements set forth in [KRS 278.183(1)]." Following that action:

> ...[T]he commission shall conduct a hearing to: (a) Consider and approve the plan and rate surcharge if the commission finds the plan and rate surcharge reasonable and cost-effective for compliance with the applicable environmental requirements set forth in subsection (1) of this section; (b) Establish a reasonable return on compliance-related capital expenditures; and (c) Approve the application of the surcharge.[31]

The Kentucky Supreme Court characterized KRS 278.183 as "a new right" that "did not exist before the enactment of the surcharge."[32] Thus, the Kentucky General Assembly enacted a surcharge mechanism that guarantees a utility the ability to recover costs associated with compliance with environmental mandates applicable to coal-fired generation. The Commission has commented upon the prescriptive nature of the KRS 278.183 by observing that it "must consider the plan and the proposed rate surcharge, and approve them if [the Commission] finds

[30] KRS 278.183(1).

[31] KRS 278.183(2).

[32] *Kentucky Indus. Utility Customers, Inc. v. Kentucky Utilities Co.*, 983 S.W.2d 493, 500 (Ky. 1998).

the plan and rate surcharge to be reasonable and cost effective."[33] As the applicant in this proceeding, EKPC bears the burden to prove the foregoing statutory and common law criteria.[34]

B. The Commission Should Issue a CPCN, Approve the Amendment to EKPC's Environmental Compliance Plan and Authorize Associated Cost Recovery through the Environmental Surcharge

The Project satisfies the criteria for issuing a CPCN under KRS 278.020(1) because the Smith Special Waste Landfill is: (1) needed to allow EKPC to comply with existing state environmental regulations and newly issued federal regulations concerning coal ash; and (2) will not result in wasteful duplication. The Project also qualifies for inclusion in EKPC's Environmental Compliance Plan because: (1) the costs associated with the project will be incurred so that EKPC may comply with state and federal environmental requirements that apply to: (a) coal combustion wastes; and (b) by-products from facilities used for production of energy from coal; (2) these costs are not already included in EKPC's existing rates; (3) EKPC is proposing a return on compliance related capital expenditures that has already been adjudged by the Commission to be reasonable; and (4) EKPC is not proposing any changes to the text of its existing environmental surcharge tariff. For these reasons, which are further detailed below, the Application should be approved.

1. The Project Qualifies for a CPCN Under KRS 278.020(1)

The need for the Project is demonstrated by the fact that the Dale Station will cease generating electricity in April 2016, at the latest.[35] The existing coal ash impoundments will lose their permit by rule status at that point and must either be converted to Special Waste Landfills

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[33] *In re the Application of Big Rivers Electric Corporation for Approval of its 2012 Environmental Compliance Plan*, Case No. 2012-00063, Final Order, p. 16 (Ky. P.S.C. Oct. 1, 2012).

[34] *See Energy Regulatory Commission v. Kentucky Power Co.*, 605 S.W.2d 46, 50 (Ky. App. 1980) (*citing Lee v. International Harvester Co.*, 373 S.W.2d 418 (Ky. 1963)).

[35] *See* Supplemental Direct Testimony of Don Mosier.

or eliminated.[36] Converting the existing ash impoundments to Special Waste Landfills is not a realistic option in light of the stringent permitting requirements for such facilities.[37] Thus, the only viable option is to eliminate the Dale Station impoundments by removing the ash and placing it in a fully engineered and permitted Special Waste Landfill that will comply with the Kentucky special waste regulations and the CCR Final Rule.[38] Because the existing facilities are becoming substantially inadequate to fulfill their necessary function in light of existing state and new federal environmental regulations, and because there is no ability to improve such facilities to bring them into compliance with said regulations, there is a need for the Project.

The Project will not result in wasteful duplication because it is the reasonable, least-cost option for removing the ash from the Dale Station. EKPC and Burns & McDonnell evaluated eight different options for complying with state and federal environmental regulations and ultimately settled upon the option that was least expensive and most environmentally responsible.[39] Moreover, although a larger footprint has been permitted by the KDWM, EKPC is only seeking a CPCN for the portion of the Special Waste Landfill that is necessary to accommodate the ash from the Dale Station while providing a modest emergency resource in the event of ash disposal problems at either the Spurlock Station or the Cooper Station.[40] Accordingly, the Project does not result in an excessive investment in relation to productivity or efficiency, or an unnecessary multiplicity of physical properties. The requirements of KRS 278.020(1) are satisfied and a CPCN should be issued for the Smith special waste landfill.

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[36] *See* Direct Testimony of Jerry B. Purvis, pp. 7-9.

[37] *See* 401 KAR 45:110; 401 KAR 45:130.

[38] Beneficial use ash which is used to support the coal pile, the adjacent state highway and the switchyard may remain at Dale Station under the applicable Kentucky and federal environmental regulations. *See* HVR at 11:50:54, 12:48:46.

[39] *See* Application, pp. 11-14.

[40] *See* Direct Testimony of Matt Clark, pp. 16-18.

2. The Project Satisfies the Requirements for Being Included in EKPC's Environmental Compliance Plan Under KRS 278.183

The environmental surcharge statute guarantees a utility the right to recover costs associated with complying with state and federal environmental requirements that apply to coal combustion wastes and by-products from facilities used for production of energy from coal. Clearly, the bottom ash and fly ash that are stored in the existing Dale Station ash impoundments are coal combustion wastes.[41] Moreover, the ash would also qualify as a by-product of a facility used for the production of energy from coal because it was produced in the course of the Dale Station's production of electricity by burning coal for over fifty years.[42] Under the existing state and newly issued federal rules regarding the permanent storage of such coal combustion wastes and by-products, removal of the ash from the Dale Station is necessary.

In data requests and at the hearing, Commission Staff cited the uncodified preamble to the bill enacting KRS 278.183 and asked whether there was any requirement that the Dale Station be operational in order for the environmental compliance costs to be recovered pursuant to KRS 278.183.[43] While "continued use of Kentucky coal" is a phrase used in the uncodified preamble to the statute, there is no requirement in KRS 278.183 itself that the facility that produced the coal combustion waste or by-product must be operational during the period when environmental cost recovery occurs.[44] The absence of such an express limitation indicates that

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[41] *See* Application, ¶ 2, n. 2; Direct Testimony of Don Mosier, p. 5 (filed Sept. 8, 2014); *see also In re the Application of Kentucky Utilities Company for Certificates of Public Convenience and Necessity and Approval of its 2011 Compliance Plan for Recovery by Environmental Surcharge*, Case No. 2011-00161, Final Order, p. 7 (Ky. P.S.C. Dec. 15, 2011) (describing bottom ash and fly ash as coal combustion residuals).

[42] *See* Application, ¶ 2, n. 2; Direct Testimony of Don Mosier, p. 5.

[43] *See, e.g.*, Commission Staff's Second Request for Information, Request No. 7 (propounded November 7, 2014).

[44] The Commission must be guided by the plain and ordinary meaning of KRS 278.183(1) unless the statue is found to be vague or ambiguous and, only then, may the Commission look to extrinsic sources to ascertain the legislative intent. *See* KRS 446.080(4); *Coffey v. Wethington*, 421 S.W.3d 394, 398 (Ky. 2014) ("Thus, we first look at the language employed by the legislature itself, relying generally on the common meaning of the particular words

legacy environmental obligations that must be dealt with following the closure of a coal-fired unit are also within the scope of the statutory prescription. There is no textual basis to limit recovery for environmental compliance activities to operational coal-fired generating units.

Moreover, the Project's costs are not already included in EKPC's existing rates. The Project was conceived only after EKPC closed Hancock Creek in 2010.[45] All of the costs of constructing the Smith Station Special Waste Landfill, removing the ash from the Dale Station impoundments, relocating the transmission lines and restoring the Dale Station facility to its natural state are costs that are solely attributable to this Project. None of these costs were included in the last base rate case when EKPC's existing rates were established.[46] Likewise, the TIER component that EKPC is proposing for the return on capital expenditures associated with the Project has already previously been determined by the Commission to be reasonable.[47] Finally, EKPC is not proposing any changes to the text of its existing environmental surcharge tariff.

The Project is a reasonable and cost-effective means to achieve compliance with existing state regulations pertaining to coal ash impoundments while also complying with the federal

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chosen.") (*quoting Jefferson Cnty. Bd. of Educ. v. Fell*, 391 S.W.3d 713, 718 (Ky. 2012)). The Commission may not add to the statute or supply language to cure any perceived omission of the General Assembly, whether real or perceived. *See Com. v. Harrelson*, 14 S.W.3d 541, 546 (Ky. 2000) ("Where a statute is intelligible on its face, the courts are not at liberty to supply words or insert something or make additions which amount to providing, as sometimes stated, for a *casus omissus*, or cure an omission.").

[45] *See* Application, p. 5.

[46] *In the Matter of the Application of Kentucky Utilities Company to Assess a Surcharge Under KRS 278.183 to Recover Costs of Compliance with Environmental Requirements for Coal Combustion Wastes and By-Products*, Case 1993-00465, pp. 9-10 (Ky. P.S.C. July 19, 1994) ("[A utility] need only show that the costs to be recovered by the surcharge are not included in existing rates.... KU has demonstrated that the current compliance costs it seeks to recover through the surcharge were not included in its last rate case when its existing rates were established and there is no persuasive evidence to the contrary.").

[47] *See 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 Period Ending December 31, 2010; and the Pass-Through Mechanism for its Sixteen Member Distribution Cooperatives*, Order, Case No. 2011-00032 (Ky. P.S.C. Aug. 2, 2011).

CCR Final Rule. Because the Project satisfies all of the elements of an environmental compliance plan that are set forth in KRS 278.183(1)-(2), the Application should be approved.

C. EKPC's Response to Other Issues Raised by Commission Staff and Intervenors

1. The Capitalization of Handling and Hauling Costs Associated with the Project is Reasonable

Commission Staff raised an issue at the hearing concerning whether the estimated $9,857,000 ash removal and hauling cost associated with the Project should be expensed as incurred or capitalized and amortized over a ten year period as requested by EKPC in the Application.[48] If the cost was capitalized, then the unamortized balance of said cost would earn a return under KRS 278.183(1).[49] On the other hand, if the cost is incurred through the surcharge as an expense, then the impact to ratepayers is significantly greater during the three year period when the Project is being implemented.[50] EKPC respects the Commission's desire to balance the interest of avoiding a return against the greater short-term impact to EKPC's Owner-Members resulting from expensing the handling and hauling costs.

The capitalization treatment proposed by EKPC is different from the manner in which removal and hauling expenses were accounted for in the context of Hancock Creek, however, the circumstances of the two situations are also different. First, the transfer of coal ash from Dale to Hancock Creek was from an operating generating plant and so the appropriate accounting treatment for those ash transfer costs was to expense the costs as incurred over a twenty-five year period. This time, however, there is no significant ongoing operational expense for the operation of the Dale Station to which the removal and hauling cost could be ascribed. The Project is a one-time effort. Second, the use of Hancock Creek was to essentially equalize the amount of ash

[48] *See* HVR at 14:22:36, *et seq.*

[49] *See* EKPC's Post-Hearing Data Request Response (filed Feb. 10, 2015).

[50] *See id.*

contained in the Dale ash impoundments. As Dale Station produced new ash, a corresponding amount of existing ash would be relocated to Hancock Creek. For the Project, however, the elimination of all non-beneficial reuse ash is the objective, making the scope of the removal and hauling task very different. Third, Hancock Creek predated the enactment of KRS 278.183 by many years and, when the statute was enacted, the accounting of the removal and hauling expenses was already established and there was no immediate need to alter the existing practice. Had EKPC sought to include Hancock Creek in its environmental compliance plan, it would have likely proposed that these ash transfer costs be deferred and amortized, as was done in the case of Louisville Gas & Electric Company's Mill Creek station.[51]

Regardless, the approach proposed by EKPC in this case is also consistent with the accounting requirements of the Rural Utilities Service Uniform System of Accounts ("RUS USoA"), wherein the costs associated with a retired generating plant are to be documented on retirement work orders and recorded in separate subaccounts of Account No. 108.8 – Retirement Work in Progress. The costs associated with retirement projects are to be kept separate from other work order costs and these costs are not expensed as incurred, but are accumulated in the applicable subaccounts of Account No. 108.8 until the retirement work is completed.[52] While the accounting treatment does not dictate the corresponding rate-making treatment, the

[51] *See In the Matter of the Application of Louisville Gas and Electric Company for Approval of Its 2004 Compliance Plan for Recovery by Environmental Surcharge*, Order, Case No. 2004-00421 (Ky. P.S.C. June 20, 2005). LG&E proposed to expense a one-time charge of approximately $6,000,000 for the transfer of ash from the ash pond to the landfill at Mill Creek station. The Kentucky Industrial Utility Customers, Inc. ("KIUC") opposed LG&E's proposal and contended that since the charge would restore and maintain the current useful life of the ash pond, the charge should be deferred and amortized over four years. KIUC also suggested that unamortized balance of the deferred asset should be included in the environmental compliance rate base. LG&E acknowledged it had agreed to this approach in a previous environmental surcharge case. The Commission agreed with KIUC's proposal to defer and amortize the charge and allow the unamortized balance of the deferred asset to be included in the environmental compliance rate base.

[52] *See* the RUS USoA, 7 CFR Part 1767, specifically Section 1767.16 – Electric Plant Instructions, subpart (k) – Work Order and Property Record System Required, and Section 1767.18 – Assets and Other Debits, Account 108 – Accumulated Provision for Depreciation of Electric Utility Plant, subsections B and C.

Commission generally has not required a rate-making treatment that is inconsistent with the appropriate accounting treatment.

Finally, as pointed out in EKPC's post-hearing data request response, the economic benefit to EKPC's Owner-Members in expensing these costs will not be seen for nine years and four months.[53] Accordingly, EKPC respectfully requests that the Commission approve the capitalization and ten year amortization of the removal and hauling expenses as requested.

2. The Accounting for the ARO in this Case and in Case No. 2014-00432 is Complimentary, not Duplicative

As discussed in the Application, during 2013 EKPC recorded an Asset Retirement Obligation ("ARO") on its books for the Dale Station ash pond retirement, which was in addition to the ARO previously recorded for asbestos remediation. On December 10, 2014, EKPC filed a separate application requesting the Commission to authorize EKPC to establish regulatory assets for ARO-related depreciation and accretion expenses resulting from ARO balances as of December 31, 2013.[54] Those ARO balances reflected obligations for asbestos abatement and remediation of ash disposal sites. The requested deferral of depreciation and accretion expenses would begin as of January 2014 and continue for all years subsequent to 2014, so long as the ARO existed. The ARO recorded for the Dale Station ash pond retirement is included in the ARO balances existing on December 31, 2013, but there are other ash disposal sites and asbestos remediation included in the year end ARO balance as well.

The Commission Staff appears to link the request to recover the Dale Station ash transfer costs described in this case with the request in Case No. 2014-00432 to establish regulatory

[53] *See* EKPC's Post-Hearing Data Request Response.

[54] *See In the Matter of An Application of East Kentucky Power Cooperative, Inc. for an Order Approving the Establishment of Regulatory Assets for the Depreciation and Accretion Expenses Associated with Asset Retirement Obligations,* Application, Case No. 2014-00432 (filed Dec. 10, 2014).

assets reflecting the ARO-related depreciation and accretion expense. EKPC believes that any linkage of the two cases must be carefully approached, however, because the two cases address totally different accounting and rate-making situations.

As described in the RUS USoA, an ARO represents a liability for the legal obligation associated with the retirement of a tangible long-lived asset that a utility is required to settle as a result of an existing or enacted law, statute, ordinance, or written or oral contract or by legal construction of a contract under the doctrine of promissory estoppel.[55] An asset retirement cost represents the amount capitalized when the liability is recognized for the long-lived asset that gives rise to the legal obligation. The amount recognized for the liability and an associated asset retirement cost must be stated at the fair value of the ARO in the period in which the obligation is incurred. The RUS USoA further requires that EKPC must initially record a liability for an ARO in Account No. 230, Asset Retirement Obligations, and charge the associated asset retirement costs to electric utility plant as appropriate. The asset retirement cost shall then be depreciated over the useful life of the related asset that gives rise to the obligation. For periods subsequent to the initial recording of the ARO, the utility shall recognize the period to period changes of the ARO that result from the passage of time due to the accretion of the liability and any subsequent measurement changes to the initial liability for the legal obligation recorded in Account No. 230. The utility shall recognize any subsequent measurement changes of the liability for each specific ARO as an adjustment of that liability in Account No. 230 with the corresponding adjustment to electric utility plant.

At the time the utility settles the obligation, gains or losses resulting from the difference between the amount of the liability for the ARO included in Account No. 230 and the actual

[55] *See* the RUS USoA, 7 CFR Part 1767, specifically Section 1767.15 – General Instructions, subpart (y) – Accounting for Asset Retirement Obligations.

amount paid to settle the obligation will occur. The gains or losses in effect reconcile the estimated amounts reflected for the ARO recorded in Account No. 230 and the corresponding electric utility plant accounts with the actual costs to settle the legal obligation.

In summary, if there is a legal obligation associated with the retirement of an electric utility plant, the utility is required to record the original cost of the plant in the appropriate asset accounts and recognize depreciation expense as applicable. It also must establish an ARO liability account with corresponding electric utility plant accounts, which reflect the asset retirement cost, to recognize the estimated cost to settle the legal obligation. ARO-related depreciation and accretion expenses are booked and recognized in the determination of current net margins until the ARO is settled.

The ARO recorded for future Dale ash removal on EKPC's books in December 2013 was based on the preliminary estimated cost of $24,000,000. As required by the RUS USoA, that preliminary estimate was increased for inflation corresponding with the remaining depreciable life of the Dale Station. This amount was then discounted based upon the remaining depreciable life and an interest rate based upon risk-free rates of interest or lending rates as of December 2013, adjusted for EKPC's credit rating.[56] The preliminary estimated cost for the Dale ash removal did not include costs associated with the construction of the proposed Smith landfill cell. That methodology provided the basis for setting forth the numbers used in the application in the ARO case.

In this case, the total cost of the Project is $26,962,000, which is the sum of the estimated cost to construct the Smith landfill cell, $4,000,000, and the estimated cost to transfer the Dale ash to the Smith landfill cell, $22,962,000. These estimates are based on the Burns &

[56] *See* EKPC's Response to Commission Staff's Second Request for Information, Request 4 (filed Nov. 21, 2014).

McDonnell Report.[57] While these estimated costs reflect the best available information, EKPC will only earn a return on, and include for recovery through the environmental surcharge, the actual costs incurred with the proposed project.

Utilizing retirement work orders and retirement work in progress accounting, EKPC will accumulate the actual costs associated with the Dale ash pond retirement through the end of 2017. Once all the actual costs are incurred, EKPC will settle that portion of the ARO balance that is associated with the Dale ash pond retirement. The actual costs to settle the obligation will be reconciled with the estimated ARO balance and corresponding estimated asset retirement costs recorded in the utility plant accounts. If the Commission approves EKPC's request to establish regulatory assets for the ARO-related depreciation and accretion expenses, EKPC believes the gains or losses resulting from the difference between the accounting estimates and the actual costs to settle the obligations should be used to offset the regulatory assets associated with the Dale ash pond retirement. In this way, all accounts associated with the ARO accounting will have been reconciled and adjusted to reflect the actual costs to settle the obligation. EKPC would then recover the actual costs to settle the obligation through the amortization of the retirement work in progress balance it has proposed to include in the environmental surcharge. This methodology ensures that no estimated costs are recovered through the environmental surcharge, only actual, incurred costs.

During the processing of this case and Case No. 2014-00432, Commission Staff has implied that there may be a desire at this time to reconcile the establishment of regulatory assets for the ARO-related depreciation and accretion expenses with the retirement work in progress accounting proposed for the environmental surcharge. Such a reconciliation at this time is premature. Until the ARO is settled, the amounts recorded for the ARO, the corresponding asset

[57] *See supra*, n. 8.

retirement costs, and the ARO-related depreciation and accretion expenses reflect discounted, estimated costs only. The final actual costs to settle the Dale ash pond retirement obligation will not be known until late 2017. However, the estimates that determine the amount of the ARO are reviewed annually, and updated as appropriate. Such an update could follow any material actual costs being incurred and compared to the estimates. In this way, the ARO balance should reflect the ultimate actual project cost.

If the Commission were to exclude the depreciation and accretion expenses associated with the Dale ash pond retirement ARO from the proposed ARO-related regulatory assets, it would create a mismatch in cost recovery. EKPC would still be required by the RUS USoA to record the depreciation and accretion expense related to the Dale ash pond retirement and, absent regulatory asset treatment, that depreciation and accretion expense would adversely and unnecessarily impact margins in 2015, 2016, and 2017. The actual costs associated with the Dale ash pond retirement would not begin to be recovered through the environmental surcharge until late 2017.

This presents two possible ways to match revenue and expense: (a) as EKPC has proposed, which is to defer the expense in a regulatory asset until such time as actual projects are authorized and recovery in rates or the environmental surcharge is approved; or (b) to include in base rates now an amount to recover the estimated costs which are associated with the ARO. EKPC favors and has proposed method (a) because it relies only on actual costs for recovery from Members, while method (b) recovers estimated costs and would necessitate true-ups, potential rate adjustments to ensure that Members pay only an appropriate amount for each ARO. EKPC's preferred approach has the added benefit to Members of deferring recovery along with expense.

EKPC acknowledges that this case is complicated by virtue of the requirements of ARO accounting and retirement work in progress accounting both being in operation essentially at the same time. EKPC must stress, however, that it is proposing to recover the actual costs associated with the Dale ash pond retirement only once and the best rate mechanism for doing so is the environmental surcharge. EKPC respectfully requests the Commission to allow the ARO accounting, the regulatory asset accounting, and the retirement work in progress accounting to operate in their normal and ordinary course. This will allow the reconciliation of the estimated costs to settle the Dale ash retirement obligations to occur as the Project develops and the actual costs are discerned.

3. Grayson's Apparent Belief that EKPC Should Pay for the Project Directly from Margins is Unreasonable and Inconsistent with Law

During its cross-examination of EKPC's witnesses, Grayson suggested that EKPC should simply "absorb" the costs of the Project instead of seeking cost recovery through the environmental surcharge.[58] Grayson apparently claims that this will provide a benefit to EKPC's Members and, ultimately, the retail members in the EKPC system. Grayson's position is contrary to the language of KRS 278.183, inconsistent with EKPC's strategic direction resulting from the 2009 management audit, and contradicted by the actions taken by its own Director on EKPC's Board, who voted to approve the Project, the expenditures associated with the Project and recovery of those expenditures through the environmental surcharge.

First, a utility's margin is not a proper element for consideration under KRS 278.183. No evaluation of whether the utility can "absorb" those costs is required or contemplated under the plain terms of the statute. In fact, the Commission addressed this subject extensively in the first environmental surcharge that was authorized for Kentucky Utilities Company, where it held:

[58] *See* HVR at 14:14:07, *et seq.*

> The traditional analyses of determining whether rates are fair, just, and reasonable simply have no place here. While this procedure may, at first blush, appear to leave ratepayers without recourse in a situation where the utility is already earning a fair return on its investment (or capital), other provisions of KRS Chapter 278 remain available to remedy that situation. Should the commission or an intervenor believe that KU's earnings from its existing rates are excessive, a proceeding to review those rates can be initiated pursuant to KRS 278.260. Thus, the General Assembly perceived a need to require ratepayers to be charged for all compliance costs not included in existing rates irrespective of the utility's current level of earnings, while leaving available a complete but separate remedy in the event that existing rates produce excessive earnings.[59]

The Kentucky Supreme Court agreed, affirming the Commission's decision four years later:

> ...[T]o add the requirement that the Utility demonstrate that it is not earning in excess of a previously approved rate base would mandate a full review of the Utility's earnings, or a general rate case pursuant to KRS 278.190. The judicial imposition of such a requirement would frustrate the legislative action in authorizing a surcharge provision.[60]

Second, the idea that EKPC should voluntarily absorb environmental compliance costs (or any other reasonably incurred costs) is the same line of thinking that directly led to the management audit. EKPC's Board and management have worked diligently to address the issues pointed out in the management audit and have been rewarded with better governance, stronger financial metrics and higher credit ratings – all of which benefit EKPC's Members. EKPC is on track to achieve the equity level set by its Board of Directors, but even then, its equity ratio would still be too low for RUS to sanction the return of any capital credits to Grayson or other Members. Grayson's request imprudently asks the Commission to grant temporary, short-term

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[59] *In the Matter of the Application of Kentucky Utilities Company to Assess a Surcharge Under KRS 278.183 to Recover Costs of Compliance with Environmental Requirements for Coal Combustion Wastes and By-Products,* Case 1993-00465, pp. 11-12 (Ky. P.S.C. July 19, 1994).

[60] *Kentucky Industrial Utility Customers, Inc. v. Kentucky Utilities Company,* 983 S.W.2d 493, 498 (Ky. 1998).

rate relief at the expense of long-term financial stability. It is necessary for EKPC to seek appropriate recovery of its environmental compliance costs through the environmental surcharge mechanism to continue making progress towards achieving the Board's strategic financial goals that were adopted in direct response to the management audit.

Finally, as pointed out at the hearing, Grayson's own representative on the EKPC Board approved of the plan to pursue the Project and seek cost recovery through the environmental surcharge. [61] His assent to the Project and its cost recovery aspects give an indication that Grayson's current objections are more perfunctory than considered, more imagined than real.

IV. CONCLUSION

The Project is necessary to comply with existing state and forthcoming federal environmental rules. The Project has been thoroughly vetted and is the least-cost solution for achieving compliance.

WHEREFORE, on the basis of the foregoing, EKPC respectfully requests that the Commission:

(1) Issue a Certificate of Public Convenience and Necessity, pursuant to KRS 278.020(1), for the Project;

(2) Authorize EKPC to amend its Environmental Compliance Plan, pursuant to KRS 278.183;

(3) Authorize EKPC to recover the costs associated with the amended Environmental Compliance Plan through its existing environmental surcharge mechanism; and

(4) Grant to EKPC all other necessary and appropriate relief.

[61] *See* Application, Exhibit 2; HVR at 10:55:00, *et seq.*

This 17th day of February, 2015.

Respectfully submitted,

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CERTIFICATE OF SERVICE

This is to certify that a true and correct copy of the foregoing was deposited in the custody and care of the U.S. Mail, postage prepaid, on this the 17th day of February, 2015, addressed to the following:

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