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May 13, 2019

VIA HAND DELIVERY

Ms. Gwyn Pinson
Executive Director
Kentucky Public Service Commission
211 Sower Boulevard
Frankfort, KY 40601

RE: *In the Matter of the Application of East Kentucky Power Cooperative, Inc. for an Order Approving the Establishment of Regulatory Assets for Present and Future Maintenance Expenses*, Case No. 2019-00146

Dear Ms. Pinson:

Enclosed, please find an original and ten copies of an Application for an Order Approving the Establishment of Regulatory Assets for Present and Future Maintenance Expenses, filed on behalf of East Kentucky Power Cooperative, Inc. Please return a file-stamped copy of this filing to my office.

Please let me know if you have any questions.

Sincerely,

David S. Samford

Enc.

RECEIVED

MAY 13 2019

PUBLIC SERVICE
COMMISSION

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

IN THE MATTER OF:

THE APPLICATION OF EAST KENTUCKY POWER COOPERATIVE, INC. FOR AN ORDER APPROVING THE ESTABLISHMENT OF REGULATORY ASSETS FOR PRESENT AND FUTURE MAINTENANCE EXPENSES	)	CASE NO. 2019- 00146

VERIFIED APPLICATION

Comes now East Kentucky Power Cooperative, Inc. ("EKPC"), by counsel, pursuant to KRS 278.030(1), KRS 278.040(2), KRS 278.220, 807 KAR 5:001, Section 14, and other applicable law, and does hereby request the Kentucky Public Service Commission ("Commission") to approve the establishment of regulatory assets for present and future maintenance expenses, respectfully stating as follows:

I. Introduction

1. Regulatory assets, as defined in Accounting Standards Codification Topic 980, Regulated Operations ("ASC 980"), enable regulated utilities to capitalize incurred costs that would otherwise be charged to expense if it is probable that such costs will be considered allowable for rate-making purposes. Accordingly, regulatory assets enable utilities to match revenues and expenses, which offsets the impact of margin volatility associated with the regulatory lag that occurs between when allowable costs are incurred and when the next rate-making action takes place. While ASC 980 permits the establishment of a regulatory asset when the criteria within 980-340-25-1 is met for Generally Accepted Accounting Principles ("GAAP") reporting purposes,

utilities within Kentucky must first receive authorization from the Commission. Kentucky's process for establishing regulatory assets has worked, but it is sometimes time-consuming and costly to all parties. EKPC respectfully requests the Commission to authorize it to: (1) establish regulatory assets without the need to first obtain Commission approval, both now and in the future, for certain costs that would otherwise be accounted for as maintenance expenses; and (2) amortize those regulatory assets over a reasonable time period for which they will provide benefits. In lieu of the traditional application process, EKPC proposes to: (1) give the Commission notice of its intent to establish a regulatory asset under the provisions set forth in this case; and (2) make an annual filing providing updates as to the status of all regulatory assets established under the provisions of this case in order to provide an appropriate level of transparency. If approved, this proposal will allow EKPC to avoid spikes in operating expenses which might trigger base rate increases and the costs associated with those base rate cases, while also diminishing the administrative burden currently resting upon the Commission. EKPC's proposal only applies to the establishment and amortization of maintenance related regulatory assets, and does not in any way impact, limit or affect the existing policies and procedures for seeking approval to recover regulatory assets or the Commission's jurisdiction over such cost recovery.

II. Background

A. General Filing Requirements

2. Pursuant to 807 KAR 5:001 Section 14(1), EKPC's mailing address is P.O. Box 707, Winchester, Kentucky 40392-0707. EKPC's electronic mail address to receive service is psc@ekpc.coop. Applicant's counsel should be served at david@gosssamfordlaw.com and allyson@gosssamfordlaw.com.

3. Pursuant to 807 KAR 5:001, Section 14(1), the grounds for EKPC's request for the establishment of regulatory assets for present and future maintenance expense are set forth herein.

4. Pursuant to 807 KAR 5:001, Section 14(2), EKPC is a Kentucky corporation, in good standing, and was incorporated on July 9, 1941.

B. Overview of East Kentucky Power Cooperative, Inc.

5. EKPC is a not-for-profit, rural electric cooperative corporation established under KRS Chapter 279 with its headquarters in Winchester, Kentucky. Pursuant to various agreements, EKPC provides electric generation capacity and electric energy to its sixteen (16) Owner-Member Cooperatives ("owner-members"), which in turn serve approximately 535,000 Kentucky homes, farms and commercial and industrial establishments in eighty-seven (87) Kentucky counties. EKPC's Board has stated its strategic objective is to maintain a generation fleet that prudently diversifies its fuel sources while maximizing its capital investments and minimizing stranded assets.

6. EKPC is a "utility" as that term is defined in KRS 278.010(3)(a) and a "generation and transmission cooperative" as that term is defined in KRS 278.010(9). Each of EKPC's sixteen (16) owner-members is a "utility" under KRS 278.010(3)(a), as well as a "distribution cooperative" under KRS 278.010(10) and a "retail electric supplier" under KRS 278.010(4).

7. In total, EKPC owns and operates approximately 2,965 MW of net summer generating capability and 3,267 MW of net winter generating capability. EKPC owns and operates coal-fired generation at the John S. Cooper Station in Pulaski County, Kentucky (341 MW) ("Cooper Station") and the Spurlock Station (1,346 MW). EKPC also owns and operates natural gas-fired generation at the J. K. Smith Station in Clark County, Kentucky (753 MW (summer)/989 MW (winter)) ("Smith Station") and the Bluegrass Station in Oldham County, Kentucky (501 MW

(summer)/567 MW (winter)), landfill gas-to-energy facilities in Boone County, Laurel County, Greenup County, Hardin County, Pendleton County and Barren County (16 MW total), and a Community Solar facility (8 MW) in Winchester, Kentucky. Finally, EKPC purchases hydropower from the Southeastern Power Administration at Laurel Dam in Laurel County, Kentucky (70 MW), and the Cumberland River system of dams in Kentucky and Tennessee (100 MW). EKPC's record peak demand of 3,507 MW occurred on February 20, 2015.

8. EKPC owns 2,967 circuit miles of high voltage transmission lines in various voltages. EKPC also owns the substations necessary to support this transmission line infrastructure. Currently, EKPC has seventy-four (74) free-flowing interconnections with its neighboring utilities.

III. Request to Establish Regulatory Assets

9. Pursuant to KRS 278.220, the Commission has adopted the Uniform System of Accounts ("USoA"), as issued by the United States Department of Agriculture, Rural Utilities Service ("RUS"), for use by EKPC in maintaining its financial accounts.[1] Commission precedent requires that the utility obtain approval prior to establishing a regulatory asset.[2] This requirement is a unique feature of Kentucky Law and is not a provision of ASC 980.

10. The Commission has previously authorized EKPC and other jurisdictional utilities to establish regulatory assets where a utility has incurred: (a) an extraordinary, nonrecurring expense which could not have reasonably been anticipated or included in the utility's planning; (b)

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[1] Codified as 7 CFR Part 1767. The current version of the RUS system of accounts became effective May 27, 2008 and is also published and referenced as RUS Bulletin 1767B-1.

[2] *See In the Matter of the Application of East Kentucky Power Cooperative, Inc. for an Order Approving Accounting Practices to Establish a Regulatory Asset Related to Certain Replacement Power Costs Resulting from Generation Forced Outages*, Order, Case No. 2008-00436, p. 4 (Ky. P.S.C., Dec. 23, 2008);

an expense resulting from a statutory or administrative directive; (c) an expense in relation to an industry sponsored initiative; or (d) an extraordinary or nonrecurring expense that over time will result in a saving that fully offsets the cost.[3] The costs expected to be incurred that give rise to the request to establish the regulatory assets most closely resemble the criteria listed for (a) above, as they are non-routine costs that were not anticipated or included in EKPC's base rates. However, the above listed criteria should not be the only basis for establishing regulatory assets. ASC 980 clearly describes that utilities should capitalize incurred costs that would otherwise be charged to expense if it is probable that such costs will be considered allowable for rate-making purposes. Replacement of minor items of property and major maintenance are traditionally included in allowable costs for rate-making purposes.

11. EKPC has requested and been granted approval to establish several regulatory assets over the past decade, including for: (1) power purchase expenses resulting from forced outages;[4] (2) stranded costs associated with the cancellation of the Smith Station coal-fired Unit #1;[5] (3) accretion and depreciation associated with asbestos and ash asset retirement obligations

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[3] *See id.*; *In the Matter of Application of East Kentucky Power Cooperative, Inc. for an Order Approving the Establishment of a Regulatory Asset for the Amount Expended on Its Smith 1 Generating Unit*, Order, Case No. 2010-00449, p. 7 (Ky. P.S.C., Feb. 28, 2011).

[4] *See In the Matter of the Application of East Kentucky Power Cooperative, Inc. for an Order Approving the Accounting Practices to Establish a Regulatory Asset Related to Certain Replacement Power Costs Resulting from Generation Forced Outages*, Order, Case No. 2008-00436 (Ky. P.S.C. Dec. 23, 2008).

[5] *See In the Matter of the Application of East Kentucky Power, Cooperative, Inc. for an Order Approving the Establishment of a Regulatory Asset for the Amount Expended on its Smith 1 Generating Unit*, Order, Case No. 2010-00449 (Ky. P.S.C. Feb. 28, 2011).

("ARO") in existence at December 31, 2013;[6] (4) the early retirement of the Dale Station;[7] and (5) Smith Station landfill ARO accretion and depreciation expenses.[8]

12. These regulatory assets enabled EKPC to properly match expenses with future revenue and prevented dramatic and unnecessary swings in its annual expenses and margins. In fact, the use of regulatory assets allows EKPC to defer base rate increases, better match expense with cost recovery, maintain its accounting records in a manner consistent with the RUS USoA and ASC 980, and provide for a more gradual rate impact of significant expenses to customers.

13. Given the accounting deadlines attendant to closing out a utility's financial records and preparing financial statements, the window for seeking Commission approval to establish a regulatory asset is typically very short and often falls at a time of the year when the Commission and EKPC have multiple other year-end obligations. The lag in timing between when the costs are incurred and the subsequent issuance of an Order approving the establishment of a regulatory asset may result in financial statement volatility between reporting periods. Both margin and equity are initially understated due to the costs being recognized as expense and then, large entries are subsequently made to reverse the original expense impact when the Order is granted. Therefore, EKPC requests authorization to record certain maintenance costs as regulatory assets

[6] *See In the Matter of the Application of East Kentucky Power Cooperative, Inc. for an Order Approving the Establishment of Regulatory Assets for the Deprecation and Accretion Expenses Associated with Asset Retirement Obligations*, Order, Case No. 2014-00432 (Ky. P.S.C., Mar. 6, 2015); *see also See In the Matter of Application of Louisville Gas and Electric Company for an Order Approving an Accounting Adjustment to be Included in Earnings Sharing Mechanism Calculations for 2003,* Order, Case No. 2003-00426, p. 6 (Ky. P.S.C., Dec. 23, 2003); *In the Matter of Application of Kentucky Utilities Company for an Order Approving an Accounting Adjustment to be Included in Earnings Sharing Mechanism Calculations for 2003,* Order, Case No. 2003-00427, p.6 (Ky. P.S.C., Dec. 23, 2003).

[7] *See In the Matter of the Application of East Kentucky power Cooperative, Inc. for an Order Approving the Establishment of a Regulatory Asset for the Undepreciated Balance of the William C. Dale Generating Station*, Order, Case No. 2015-00302 (Ky. P.S.C. Feb. 11, 2016).

[8] *See In the Matter of the Application of East Kentucky Power Cooperative, Inc. for an Order Approving the Establishment of a Regulatory Asset for the Depreciation and Accretion Expenses Associated with the Smith Station Landfill Asset Retirement Obligations*, Order, Case No. 2018-00027 (Ky. P.S.C. Mar. 8, 2018).

without prior authorization, similar to the provisions granted in Case No. 2014-00432. In that case, the Commission granted EKPC permission to record additional AROs and use regulatory asset treatment for the associated accretion and depreciation without further Commission approval if AROs by type and location were previously approved by the Commission. In lieu of obtaining prior authorization, EKPC agreed to file an annual report of the changes in the ARO calculations with the Commission. Here, EKPC is also similarly proposing to file a report annually of all regulatory assets established under the criteria set forth in this application. Finally, EKPC anticipates the need for regulatory asset treatment of maintenance related expenses to be more frequent than previously experienced, resulting in an increased case load for EKPC and the Commission which also supports a streamlined process for establishing regulatory assets.

14. The USoA establishes that all utility property consists of retirement units and minor items of property. Retirement units are considered major components that are separately identified on EKPC's books. Minor items of property are the associated parts or items of which the retirement units are composed (the term "minor" does not refer to the size or scope of an item, only that it is a part of a retirement unit). When minor items of depreciable property are replaced independently of the retirement unit of which it is a part, the cost of replacement must be charged to the maintenance expense account appropriate for the item unless it constitutes a betterment.

15. EKPC anticipates the need to replace high-cost, non-routine minor items of property that will be required to be expensed under the USoA and GAAP. EKPC also periodically incurs major maintenance expenses associated with the inspection and repair or replacement of minor components of the combustion turbines, steam turbines, and their associated generators. These inspections are performed as specified by original equipment manufacturers or as required based upon observed equipment condition. These projects, which are costly in nature, must be

expensed when incurred. As EKPC's power plants age, the costs to keep them operational are becoming higher and occurring more frequently than in the past. Therefore, EKPC anticipates these types of projects could result in regular requests for regulatory asset treatment in the future.

16. The project types noted above are not currently included in base rates. Including these maintenance costs in rates could result in significant rate swings (up and down), depending on the timing of when these costs are incurred in correlation to a rate case. If these costs were not incurred in a historic test year, EKPC would lose the opportunity for recovery. However if the costs had been incurred and included in the historic test year, base rates could be set too high for future years when such maintenance costs are not incurred. Similar results would follow if a forecasted test year had been utilized. However, a regulatory asset may be recognized if such costs may be recoverable in a future base rate case, when authorized. Therefore, establishment of regulatory assets for these specific types of maintenance projects will enable EKPC to defer these expenses and match them with future related revenues, thus eliminating unnecessary adverse margin and rate impacts.

17. ASC 980 specifies that a regulatory asset should be recognized for current expenses when it is probable that the collection of such amounts through rates or other regulatory mechanisms will occur at a later date. Accordingly, to ensure that EKPC preserves the opportunity for future recovery of expenses through rates, it is advisable to establish regulatory assets for these types of maintenance projects on a regular basis.

18. In light of the foregoing, EKPC requests permission to establish regulatory assets for the replacement of high-cost, non-routine minor items of property and major maintenance costs that would otherwise be accounted for as maintenance expenses. EKPC proposes that this treatment be applicable to: (1) the replacement of minor items of property in the amount of

$500,000 or greater due to unanticipated equipment failures or obsolescence; and (2) major maintenance costs of at least $1,500,000, which are not expected to recur for at least five years. See Exhibit 1 for a listing of projects that are expected to meet the above-listed criteria in 2019. Such projects will begin amortizing immediately upon completion based on a reasonable time period not to exceed the number of years the expenditure is expected to provide benefit to EKPC. EKPC requests that any unamortized balances be considered for recovery in its next base rate case proceeding. Projects that qualify for recovery as maintenance expense under the Environmental Surcharge would be excluded from the above-listed criteria. EKPC proposes this treatment solely to minimize rate and margin impacts. And although Commission precedent supports authorizing a carrying charge for regulatory assets to compensate for the time-value of money, EKPC is not seeking any carrying charges for the proposed regulatory assets described herein. Accordingly, EKPC respectfully requests the Commission to allow it to establish regulatory assets, without seeking prior authorization, for high-cost, non-routine minor items of property and major maintenance as outlined in this application. EKPC would propose to give the Commission written notice when it establishes a regulatory asset, which would include:

a) A unique identifier for the regulatory asset;
b) The date the regulatory asset is established;
c) A description of the project and costs to be included in the regulatory asset;
d) The known or anticipated amount of the regulatory asset;
e) The amortization period expected to be used;
f) A description of the rationale for the amortization period pertaining to the regulatory asset; and

g) A copy of the general ledger entries that would be used to establish and amortize the regulatory asset.[9]

19. EKPC would also propose to file an annual written report with the Commission listing all existing regulatory assets established under the provisions of this case, and which would include the accrued balances and the amortization to date.

20. EKPC understands and acknowledges that the cost recovery of any regulatory assets established under the provisions of this case would still require Commission approval through a separately docketed case, most likely brought as a base rate case pursuant to KRS 278.180, *et seq*. EKPC also acknowledges and agrees that should the Commission ever find that EKPC's establishment of regulatory assets has been undertaken in bad faith or without reasonable justification, the Commission could revoke the authority sought to be granted herein so as to once again require EKPC to seek prior authorization before establishing any additional future regulatory assets. EKPC further acknowledges that as part of its annual filing, the Commission could alter EKPC's amortization period for any regulatory assets established hereunder.

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

1) Authorize the establishment of regulatory assets on the terms and conditions set forth herein;
2) Adopt the annual regulatory asset reporting plan proposed herein; and
3) Grant all other relief to which EKPC might be entitled.

Done this 10th day of May, 2019.

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[9] A sample journal entry for a major maintenance expense is attached hereto and incorporated herein as Exhibit 2.

VERIFICATION

This will certify that I, Mike McNalley, the Executive Vice President and Chief Financial Officer of East Kentucky Power Cooperative, Inc., on behalf of said corporation, after having first been duly sworn, did examine the contents of this Verified Application and that, to the best of my knowledge and belief as formed after reasonable diligence and inquiry, said statements are true and correct as of this 13th day of May 2019.

EAST KENTUCKY POWER COOPERATIVE, INC.

BY: ______________________

ITS: Exec. V.P. + CFO

Commonwealth of Kentucky)
County of Clark)

This will certify that the foregoing Verification was signed, under oath, before me, the NOTARY PUBLIC, on this 13th day of May 2019.

Gwyn McWilloughby
NOTARY PUBLIC

Commission #: 590567

My Commission Expires: 11/30/2021

GWYN M. WILLOUGHBY
Notary Public
Kentucky – State at Large
My Commission Expires Nov 30, 2021

Respectfully submitted,

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L. Allyson Honaker
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Counsel for East Kentucky Power Cooperative, Inc.

Exhibit 1

Sample Data Sheet

EXHIBIT 1

Summary of Maintenance Projects Qualifying for Regulatory Asset Treatment in 2019

	Estimated Project Amount	**Plant Location**
Minor Items of Property		
Unit 3 Cooling Tower Motor Control	$ 602,000.00	Spurlock
Unit 4 Air Heater Module	2,700,000.00	Spurlock
Unit 2 Control Upgrade	650,000.00	Spurlock
Unit 4 Vortex Finders	747,000.00	Spurlock
Major Maintenance		
Unit 4 Major	5,000,000.00	Spurlock
	$9,699,000.00	

Exhibit 2

Sample Journal Entries

EXHIBIT 2

East Kentucky Power Cooperative, Inc.
Sample Journal Entries to Record and Amortize a Major Maintenance Regulatory Asset

To record a regulatory asset for Spurlock Unit 4 major maintenance as costs are incurred

Account Number	Account Description	Debit	Credit
182XXX	Other Regulatory Asset-SP04 2019 Maintenance	5,000,000.00	
232100	Accounts Payable		5,000,000.00
		5,000,000.00	5,000,000.00

To record monthly amortization of Spurlock unit 4 major maintenance regulatory asset over ten years

Account Number	Account Description	Debit	Credit
513000	Maintenance of Electric Plan	41,667.00	
182XXX	Other Regulatory Asset-SP04 2019 Maintenance		41,667.00
		41,667.00	41,667.00

Each non-routine minor item of property replacement and major maintenance project will be assigned a separately identifiable project number for tracking purposes. All costs charged to the project will be coded directly to the Regulatory Asset and Accounts Payable.