

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

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THE APPLICATION OF EAST KENTUCKY POWER)
COOPERATIVE, INC. FOR A CERTIFICATE OF)
PUBLIC CONVENIENCE AND NECESSITY FOR THE)
CONSTRUCTION OF MODIFICATIONS TO THE)
WATER INTAKE SYSTEM AT COOPER POWER)
STATION IN PULASKI COUNTY, KENTUCKY)

PUBLIC SERVICE
COMMISSION
CASE NO. 2007-00168

ATTORNEY GENERAL'S COMMENTS

Comes now the intervenor, the Attorney General of the Commonwealth of Kentucky, by and through his Office of Rate Intervention, and tenders the following comments in the above-styled matter.

I. Introduction

This matter is before the Commission as a result of its September 14th, 2007 Order finding a significant deviation by East Kentucky Power Cooperative, Inc. (hereafter the "Company") from its May 11th, 2007 Order granting the Company's request for a Certificate of Public Convenience and Necessity concerning emergency modifications to the Cooper Power Station generating facility ("Cooper Station").

In its April 27th, 2007 application, the Company had requested permission to construct the modifications as proposed in the application to address cooling water issues related to the repairs currently underway at the Wolf Creek Dam by the U.S. Army Corps of Engineers ("Corps"). The Company stated that it was informed by the Corps on February 9th, 2007 that due to the seepage problems experienced at the dam, the Corps would lower the water pool immediately to approximately 680 feet but cautioned that further reductions may become necessary and that the Company should make the preparations necessary for continued operations at a lake level of 650 feet. The Corps stated that such preparations should be in place no later than December 31st, 2007.

In response, the Company enlisted Stanley Consultants, Inc. (“Stanley”), the original designer of Cooper Station, to investigate and recommend alternatives to address cooling water supply at the lower lake levels. The result of this investigation was a report issued by Stanley and dated March, 2007.

In its report, Stanley identified six options for ensuring an adequate supply of cooling water. Of these six options, the Company chose a hybrid option consisting of the installation of seven (7) 10,000 gpm barge mounted, vertical turbine pumps for Unit #1 and the installation of a recirculating water cooling tower system for Unit #2. The barge mounted pumps would connect to the existing water intakes through a common header and flexible piping arrangement and would supply cooling water to Unit #1 and make-up water to Unit #2. The Company proposed to install the barge mounted pumps during the summer of 2007 and to have the cooling tower system operational by December 31st, 2007. The Company stated that it estimated that the project would cost \$24,045,411.00, with \$7,821,000.00 for the barge mounted pumps, \$15,179,000.00 for the cooling tower system, and \$1,045,500.00 for engineering and field services costs.

The Company stated that these expenses were necessary for the continued operation of Cooper Station at the 650 foot water level and that should the proposed modifications not be accomplished that the Company may be forced to purchase electrical power to serve its members at a significantly higher cost.

Subsequent to the Commission’s approval, the Company began construction on the modifications such that the barge mounted pumps were in operation by the end of the summer of 2007. Additionally, the Company has constructed the sump/foundation concrete for the cooling tower. However, the Company has delayed erection of the cooling tower and proposes to extend this delay until after the December 31st, 2007 final completion date referenced in its application. Further, the Company has installed an additional 10,000 gpm vertical turbine pump bringing the total pumps associated with the project to eight (8). As the Commission’s Order specified that any deviation from the construction approved therein should only be undertaken with prior

approval of the Commission, the delay in the erection of the cooling tower and the addition of another pump have been found by the Commission to be significant deviations from its Order. As a result, the Commission re-opened the matter and issued requests for information from the Company in regard to the deviations. Data requests were also propounded by the Attorney General. A public hearing on the matter was held by the Commission on October 3rd, 2007.

At this hearing, the Company was extensively questioned concerning its rationale for the deviations from the Commission's Order and the effect of these deviations upon the generating capabilities of Cooper Station. The Company was also questioned concerning the status of the repairs at Wolf Creek Dam and the Corps' current and projected lake levels and the effects upon the generating capabilities of Cooper Station.

In its opening statement, the Company characterized the deviation in the construction schedule of the cooling tower as merely a change in sequence¹ and not a material change in the project.² In support of this, Mr. John Twitchell, the Senior Vice-President for Generation and Transmission Operations, stated in his testimony that the intent of the Company was to build the cooling tower,³ however it was decided to delay further construction on the cooling tower until January 2, 2008 to clarify the position of the U.S. Army Corps of Engineers regarding further lake level reductions.⁴ Mr. Twitchell testified that additional investigation by the Company had indicated that the cooling tower would not be necessary to operate Cooper Station during the winter as water temperatures would be low enough to provide sufficient cooling water to the plant from the operation of the pumps alone.⁵ He further testified that it would take approximately four (4) months to erect the cooling tower.⁶ Mr. Twitchell testified that the additional pump was to provide the facility with a "back-up" pump in case of a failure of one of

¹ See 2007-00168, October 3rd, 2007, Video Transcript at 1:15 PM.

² See 2007-00168, October 3rd, 2007, Video Transcript at 1:16 PM.

³ See 2007-00168, October 3rd, 2007, Video Transcript at 1:37 PM.

⁴ See 2007-00168, October 3rd, 2007, Video Transcript at 1:48 PM.

⁵ See 2007-00168, October 3rd, 2007, Video Transcript at 1:51 PM.

⁶ See 2007-00168, October 3rd, 2007, Video Transcript at 2:22 PM.

the seven (7) pumps originally proposed in the application.⁷ Mr. Twitchell testified that the Corps was expected to revisit the issue of the lake water level in October 2007 in light of the repair work completed on the dam⁸ and that a final decision on whether to proceed with the erection of the cooling tower would be made if the Corps modified its previous directives.⁹

Mr. Robert Marshall, the President and CEO of the Company testified that a decision would be forthcoming regarding erection of the cooling tower by November 1st, 2007¹⁰ and that the Company would inform the Commission and the parties by the filing of a brief on November 8, 2007 as to the Company's decision.¹¹ The Company filed the aforementioned brief on November 6th, 2007 informing the Commission and the parties that there has been no change in the recommendations from the Corps of Engineers and therefore, the Company should be prepared for lower lake levels at some point in the future. As a result, the Company indicates in its brief that it will begin the erection of the cooling tower on or around December 1st, 2007.

II. Attorney General's Comments

The Attorney General believes the delay of the erection of the cooling tower to be reasonable in light of the Corps re-evaluation of the repair process at the dam. However, the Attorney General believes that the cooling tower should be constructed to reduce the Company's dependence upon lake water for cooling. Although the costs to operate and maintain the cooling tower will be on-going, these costs are negligible when compared to the risk associated with lower lake levels and the possible loss of generating capacity due to further lake level reductions. While the Company states that erection of the tower is expected to be completed within four (4) months, which should be well before the tower is needed for the summer season, the Attorney General recommends that construction be monitored by the Commission through monthly status

⁷ See 2007-00168, October 3rd, 2007, Video Transcript, at 2:45 PM.

⁸ See 2007-00168, October 3rd, 2007, Video Transcript at 2:38 PM.

⁹ See 2007-00168, October 3rd, 2007, Video Transcript at 2:40 PM.

¹⁰ See 2007-00168, October 3rd, 2007, Video Transcript at 3:51 PM.

¹¹ See 2007-00168, October 3rd, 2007, Video Transcript at 4:13 PM.

reports submitted and filed as part of the record in the matter. These reports need not be lengthy or burdensome, but should clearly indicate the current status of the project. At a minimum, each report should contain a description of the work completed, the completion level of the project expressed as a percentage, an estimate of the number of work days required for completion, a description of any significant delays or problems associated with the construction. As these reports are currently being generated by the Company, the requirement to submit same to the Commission should not represent an undue burden to the Company.

Additionally, the Attorney General agrees that the installation of another vertical turbine pump for use as a back-up is a prudent decision by the Company and again notes that the costs associated with the pump are more than offset by the reduction in the risk associated with a loss of generation capacity or plant de-rate by the failure of one of the existing pumps.

While the Attorney General supports the Company's decisions in regard to the delay of construction and the purchase of a back-up pump, the Attorney General is concerned that the Company does not have adequate programs and processes in place to identify, evaluate and address risks that could affect the Company's generation and transmission operations. The need for a formal process can be highlighted by what would otherwise appear to be a harmless example by the Company when it initiated the proposed work on Cooper Station without obtaining the necessary environmental approvals or exemptions. In particular, the United States Department of Agriculture advised the Company that failure to receive environmental approval prior to initiation of construction could result in loss of RUS loan funds.¹² In its testimony, the Company's management personnel agreed with the Attorney General that risk assessment in these areas was important,¹³ however they could identify no formal process used by the Company to evaluate these types of risks.¹⁴ While the Company does have audit and risk

¹² See Company Response to OAG Initial Request for Information 7 at page 139. See also 2007-00168, October 3rd, 2007, Video Transcript at 3:57 PM.

¹³ See 2007-00168, October 3rd, 2007, Video Transcript at 3:27 PM.

¹⁴ See 2007-00168, October 3rd, 2007, Video Transcript at 2:56 PM.

management committees as part of its board structure,¹⁵ these committees primarily evaluate risk for insurance coverage purposes.¹⁶ Given the various risks inherent with the operations of the Company, it conceded that there should be a committee in place to address all risks.¹⁷ Currently, risk assessment responsibilities are handled only by the audit committee. This is insufficient. In fact, to highlight the lack of the Company's understanding of the importance associated with risk assessment, it was only in June of 2007 that the Company *formalized* a risk management policy as offered by the audit committee.¹⁸

The Cooper Station issue and the evidence regarding the lack of risk assessment, and management thereof, currently before the Commission clearly illustrate the need for the Company to establish a formal program or process to identify and evaluate the risks associated with the Company's generation and transmission operations as well as risk management in general. The program should be designed to address the reliability related issues to identify and strengthen key components and systems associated with the Company's generation and transmission facilities as well as risk management in general. While no criticism of Company personnel is intended, the Company appears to have made the decision to delay erection of the cooling tower based on an informal discussion between Mr. Twitchell, Mr. Purvis and Cooper Station management. Although the decision to delay construction appears to have been prudent at this point, the significant risk associated with the loss of generation at Cooper Station requires that such important decisions which affect the operation of the plant and the ratepayers be made as part of a more formal program or process and not as the result of ad hoc discussions.

Therefore, the Commission should require the Company to establish a formal program or process to identify, evaluate and address any and all foreseeable risks.¹⁹ The program or process

¹⁵ See 2007-00168, October 3rd, 2007, Video Transcript at 3:26 PM.

¹⁶ See 2007-00168, October 3rd, 2007, Video Transcript at 3:26 PM.

¹⁷ See 2007-00168, October 3rd, 2007, Video Transcript at 3:32 PM.

¹⁸ See 2007-00168, October 3rd, 2007, Video Transcript at 3:39 PM.

¹⁹ During the Company's recent rate case, Case No. 2006 -00472, the Attorney General agreed to an unprecedented, extraordinary intermediate rate increase as a consequence of the Company experiencing significant financial hardship stemming from a series of unforeseeable, cascading events. The Attorney General puts the Company on notice that he now is concerned that effective risk management, had it been in place, might have foreseen some if not all of the previously labeled "unforeseen" events.

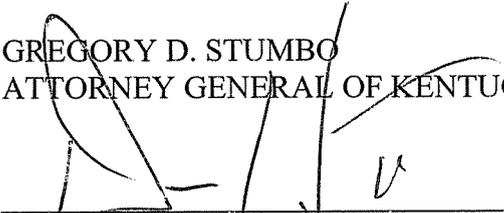
should be made up of personnel from the engineering and operations personnel along with representatives from the Company's legal and financial departments and supervised by a member of the Company's board of directors who is qualified in risk assessment.

III. Conclusion

Subject to the above comments, the Attorney General would recommend the Commission approve the Company's decision to delay the erection of the cooling tower and the purchase of an additional vertical turbine pump. Moreover, he urges the Commission to require the Company to demonstrate that it has a formal program or process to identify, evaluate and address any and all foreseeable risks.

Respectfully submitted,

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ATTORNEY GENERAL OF KENTUCKY


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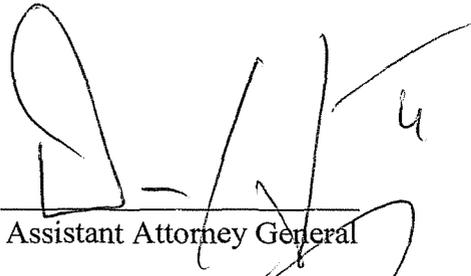
CERTIFICATE OF SERVICE AND NOTICE OF FILING

I hereby give notice that this the 15th day of November, 2007, I have filed the original and ten copies of the foregoing Attorney General's Comments with the Kentucky Public Service Commission at 211 Sower Boulevard, Frankfort, Kentucky, 40601 and certify that this same day I have served the parties by mailing a true copy of same, postage prepaid, to those listed below.

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