



EAST KENTUCKY POWER COOPERATIVE

September 28, 2007

HAND DELIVERED

Ms. Elizabeth O'Donnell
Executive Director
Public Service Commission
211 Sower Boulevard
Frankfort, KY 40602

RECEIVED

SEP 28 2007

PUBLIC SERVICE
COMMISSION

Re: PSC Administrative Case No. 2007-00300

Dear Ms. O'Donnell:

Please find enclosed for filing with the Commission in the above-referenced case an original and ten copies of the Comments of East Kentucky Power Cooperative, Inc., regarding the consideration of the Federal Energy Policy Act of 2005 standards for Fuel Sources and Fossil Fuel Generation Efficiency.

Very truly yours,

A handwritten signature in cursive script that reads "Charles A. Lile".

Charles A. Lile
Senior Corporate Counsel

Enclosures

Cc: Parties of Record

RECEIVED

SEP 28 2007

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

PUBLIC SERVICE COMMISSION

In the Matter of:

CONSIDERATION OF THE)
REQUIREMENTS OF THE FEDERAL) ADMINISTRATIVE
ENERGY POLICY ACT OF 2005) CASE NO. 2007-00300
REGARDING FUEL SOURCES AND FOSSIL)
FUEL GENERATION EFFICIENCY)

COMMENTS OF EAST KENTUCKY POWER COOPERATIVE, INC.

East Kentucky Power Cooperative, Inc. ("EKPC"), hereby submits these comments for consideration in response to topics discussed at the Informal Conference conducted by the Commission in Administrative Case No. 2007-00300.

Introduction

EKPC welcomes the opportunity to offer comments concerning the Commission's consideration of the requirements of the Federal Energy Policy Act of 2005 ("EPAAct of 2005") regarding fuel sources and fossil fuel generation efficiency. It is EKPC's understanding that state regulatory commissions are obligated to consider adoption of these federal standards but are in no way obligated to adopt them. For the specific reasons set forth below, EKPC believes that the existing regulatory process in Kentucky adequately addresses the issues identified in these two EPAAct standards and that the Commission should not adopt them.

I. Federal Standard Regarding Fuel Sources

The 2005 EPAAct requires state regulatory Commissions to consider adoption of the following standard:

Fuel Source: Each electric utility shall develop a plan to minimize dependence on one fuel source and to ensure that the electric

energy it sells to consumers is generated using a diverse range of fuels and technologies including renewable technologies.¹

EKPC asserts that this standard should not be adopted for three main reasons:

A. The existing regulatory process ensures that fuel diversity issues are addressed.

B. The utilities of this state operate under guidance from the General Assembly to utilize Kentucky coal as a preferred fuel source.

C. Mandating a percentage mix of alternative fuel sources will inevitably lead to higher costs to EKPC's members, imposing higher electric bills on consumers in our state who can least afford it.²

These three reasons are addressed in detail below:

1. The Existing Regulatory Process.

Fuel diversity issues are handled in three different ways in Kentucky:

First, the Certificate of Public Convenience and Necessity (CCN) process outlined in KRS 278.020 is comprehensive in nature, and offers the Commission a process to evaluate fuel diversity issues. EKPC has been heavily involved in this process in the last three years, having received a CCN for two different baseload power plants and two new peaking units. The review process is extensive, and EKPC has continually used a Request for Proposal (RFP) approach that enables our Company to consider the most cost-effective alternatives for meeting new load requirements. EKPC, through its RFP process, and the Commission, through the CCN process, considers all types of alternatives, including fuel source and Demand Side Management (DSM) alternatives. Fuel diversity issues are, thus, handled explicitly through this regulatory process.

Second, the Commission's Fuel Adjustment Clause (FAC) regulations, under 807 KAR 5:056, provide for a continued review of each utility's fuel costs and the prudence of its fuel procurement practices. The Commission, as well as intervenors, has the opportunity in these cases to question EKPC's on-going approach to the use of its resources to meet its load.

¹ 16 U.S.C. 2621 (d) (12).

² EKPC serves a number of counties in central and eastern Kentucky that have the lowest income levels in the state.

Third, the Commission's Integrated Resource Plan (IRP) regulations, pursuant to 807 KAR 5:058, require that each utility address a number of power supply issues every three years. The IRP requires EKPC to identify the resource mix necessary to meet anticipated load. The Commission and intervenors have an opportunity in these proceedings to probe and evaluate EKPC's proposed resource mix to meet load, including fuel diversity. The IRP simply provides a flexible forum to evaluate fuel diversity issues, as opposed to a strict mandate of fuel diversity percentages.

For these three reasons, EKPC believes that the basic regulatory infrastructure is already in place to handle the proposed standard.

2. The Kentucky General Assembly has established a public policy encouraging the use of Kentucky coal.

The Kentucky General Assembly has expressed its established public policy encouraging the use of Kentucky coal through the creation of the Environmental Surcharge,³ and through the establishment of tax credits for the use of Kentucky coal.⁴ Any action by the Commission, in establishing new fuel diversity requirements, must recognize this existing state policy.

3. Mandating a percentage mix of alternative fuel sources ignores the regulatory tools already in place and will lead to higher costs to our members.

The aforementioned CCN, IRP and FAC regulatory processes already provide for a sound and prudent review of the fuel diversity issue. While a mandated percentage of renewable resources could serve to further certain environmental quality goals, it would be inconsistent with the goal of resource optimization. It is also highly likely to fail to meet the goal of maintaining equitable rates to consumers, in that electricity generated from renewable resources such as wind, solar or biomass is generally more costly than electricity generated from conventional sources.

The Commission should allow utilities the freedom to develop their own approach to fuel diversity, subject to Commission review and approval. The current regulatory process provides a more flexible and comprehensive approach to resource optimization,

³ See, preamble to SB 341, which was codified as KRS §278.183 in 1992, stating: "Whereas, it is hereby declared the policy of the General Assembly to foster and encourage the continued use of Kentucky coal by electric utilities serving the Commonwealth;"

⁴ KRS §141.0405.

and the regulatory review conducted by the Commission and intervenors ensures a prudent outcome. Mandating fuel diversity percentages is not a necessary or beneficial course of action in Kentucky.

II. Federal Standard Regarding Fossil Fuel Generation Efficiency

The 2005 EPAct requires state regulatory Commissions to consider adoption of the following standard:

“Each Utility shall develop and implement a 10-year plan to increase the efficiency of its fossil fuel generation.”⁵

As in the case of the Fuel Source Standard, EKPC does not believe that the Fossil Fuel Generation Efficiency Standard should be adopted. EKPC makes this recommendation for four main reasons:

- A. EKPC’s existing business model creates strong demands on EKPC to be as efficient as possible.
- B. Competition for new loads dictates improved efficiency.
- C. The Commission’s oversight of base rates, the CCN process and the forced outage provision of the FAC regulation all encourage generation efficiency.
- D. A singular standard for generation efficiency improvement would not be prudent.

These reasons are discussed in detail below:

1. EKPC’s existing business model offers a strong incentive for operating efficiently.

Unlike investor-owned utilities, EKPC has no stockholders. Its owners are its sixteen Member Systems. Any cost increases incurred by EKPC ultimately flows to our members via rates, or are reflected through reduced margins for EKPC. Our purpose and goal is to minimize cost, rather than maximize profits. As a result, EKPC operates from a “bottom-up” viewpoint, whereby each and every expenditure is examined from the perspective of the ultimate impact on each member-owner. With regard to the costs overtly passed through to its members via wholesale base rates, EKPC has been vigilant

⁵ 16 U.S.C. 1621 (d) (13).

in its efforts to minimize base rate increases. Until its filing in Case 2006-00472, EKPC had not applied for a base rate increase since 1983. As further evidence of its commitment to improving generation efficiency, EKPC is proceeding to construct two General Electric LMS 100 combustion turbine units, which have much lower heat rates than the traditional combustion turbines.

Today, EKPC is involved in a serious cost containment effort, and is looking closely at all aspects of operating efficiently, including the hour-to-hour operation of its generating units. The business model under which EKPC operates is a strong incentive to improve fossil fuel generation efficiency.

2. Competition for new loads.

EKPC and its Member Systems are continually in competition with neighboring utilities for new loads. In particular, EKPC and Kentucky Utilities Company (KU) are highly intertwined, and potential new commercial and industrial customers are frequently faced with a choice of location within an industrial park that includes both KU and an EKPC Member System's service territories.

Consequently, there is a strong incentive for EKPC to generate electricity at the most efficient level and lowest cost possible, to keep its Member Systems' retail rates competitive. As EKPC's FAC costs are directly affected by heat rate and generation efficiency, it is imperative that EKPC operate as efficiently as possible. Improving heat rates, and thus lowering per unit fuel costs, which are passed through directly to customers, allows EKPC's Member Systems to have a better opportunity to secure new, high load factor industrial customers, leading to an improvement in margins. The competition for such loads is a strong incentive to minimize cost and maximize efficiency.

3. Commission regulatory oversight.

The Commission's oversight of base rates, the CCN process, and the FAC regulation, as discussed above in regard to the fuel diversity standard, serve as an adequate regulatory process to ensure that utilities in Kentucky operate electric generating units efficiently.

4. A singular standard for Generation Efficiency Improvement is not appropriate.

Each utility in Kentucky has a different mix of generating units and operating conditions. To establish a uniform standard generating unit efficiency improvement plan throughout the state would ignore these differences. EKPC currently monitors the heat rate performance of its generating units on a continual basis and reports the results in year-end regulatory reports. Electric generating units in Kentucky have strong incentives to operate plants as effectively as possible, and are in the best position to evaluate and pursue the most effective measures to optimize the efficiency of their generating units.

SUMMARY

WHEREFORE, EKPC respectfully requests:

- (1) Issue an Order indicating that the existing regulatory process in this state adequately addresses the issues raised in this proceeding; and
- (2) That the Commission determine that adoption of these two Standards is not in the best interest of the Commonwealth.