

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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In The Matter Of: Application Of East Kentucky Power : Case No. 2008-00115
Cooperative, Inc. For Approval Of An Amendment To Its :
Environmental Compliance Plan And Environmental :
Surcharge :

JUL 24 2008

PUBLIC SERVICE
COMMISSION

KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC.
RESPONSES TO FIRST SET
OF DATA REQUEST OF EAST KENTUCKY POWER COOPERATIVE, INC.

1. Regarding Mr. Kollen's recommendation, on pages 8-12 of his Direct Testimony, that the Commission reject EKPC's request for a 1.35 TIER for its environmental compliance plan:
 - a). Does Mr. Kollen acknowledge that the Commission granted EKPC a 1.35 TIER in PSC Case No. 2006-00472 based on two factors: its need to comply with RUS mortgage covenants and its financial condition?
 - b). Does Mr. Kollen contend that EKPC's financial condition has improved to the point that the rising interest expense, cash flow and long-term credit concerns discussed in PSC Case No. 2006-00472 have been fully resolved? If so, please explain.
 - c). By what standard does Mr. Kollen, on page 9 of his Direct Testimony, declare the requested 1.35 TIER in this case to be "extreme and unnecessary"?
 - d). Does Mr. Kollen contend that current EKPC equity and margins are sufficient to eliminate the risks of unexpected events, such as weather conditions or system forced outages? If so, please explain.
 - e). Please cite any orders of the Kentucky Public Service Commission wherein a TIER level or rate of return for any electric cooperative or investor-owned utility was determined through an analysis of the "risk associated with cost recovery".

RESPONSE:

- a. The Commission stated in its Order in Case No. 2006-00472 the following:

The Commission finds that the use of a 1.35X TIER is reasonable for EKPC, given the current financial condition of EKPC and its need to comply with the requirements of the RUS mortgage agreement and the unsecured credit facility.

- b. The Company no longer is under financial duress. It is financially healthy and overearning from a ratemaking perspective. Consequently, there is no reasonable justification to increase the TIER margin in the environmental surcharge from 1.15X, which already is a 0.10X premium over the 1.05X minimum required pursuant to the RUS loan covenants, to 1.35X, which is a 0.30X premium. The Company's request, if granted, unnecessarily and unjustifiably will triple the premium already recovered through the environmental surcharge.
- c. Please refer to the response to part (b) of this question. Also, please refer to the KIUC response to Staff 1-1(c).

In addition, the Commission is charged pursuant to KRS 278.183 to provide recovery of qualifying costs that are "just and reasonable," including a "reasonable return on construction and other capital expenditures." With respect to the statutory requirements, Mr. Kollen would note that the TIER of 1.15X previously has been deemed a qualifying cost. The addition of another 0.20X premium cannot be considered an additional qualifying cost because it is simply a gratuitous adder to the cost. In addition, Mr. Kollen would note that this gratuitous adder is not just and reasonable. It not only is unnecessary, but indeed is harmful to ratepayers.

Finally, Mr. Kollen would note that the Company has made no demonstration that its request provides a "reasonable return" on construction and other capital expenditures. If anything, and as noted in Mr. Kollen's testimony, the recovery of a return on these environmental surcharge is a near-certainty and argues for the minimum return, or a TIER of 1.05X, not an excessive return, or a TIER of 1.35X that is not justified by uncertainty or other qualitative or quantitative measure of risk.

- d. No margin can completely eliminate the risks of unexpected events. However, this question appears to confuse the relationship between the TIER that might be applicable for base ratemaking purposes and the TIER that is reasonable for environmental surcharge purposes. The environmental surcharge does not allow the Company dollar for dollar recovery of costs that it reasonably incurs on an almost real-time basis. Thus, the Company does not bear the same level of risk on costs recovered through the environmental surcharge that it does for base ratemaking purposes. The risk parameters, and thus, the reasonable rate of return, are significantly different between the costs recovered through base rates and those recovered through the environmental surcharge.
- e. Mr. Kollen has not performed a review of Commission Orders responsive to the question. Nevertheless, Mr. Kollen notes that “the risk associated with cost recovery” is a factor in the business and regulatory risk generally considered by Commissions in setting authorized returns. This risk is commonly referred to as “regulatory risk.”

2. Regarding Mr. Kollen's recommendation, on pages 17-19 of his Direct Testimony, that EKPC's calculated environmental surcharge revenue requirement of \$64 million be reduced to account for expected future reductions in emission allowance expenses:

a). What is the basis for Mr.Kollen's assumption that the EKPC environmental surcharge revenue requirements figure in this case includes emission allowance expenses?

b). Does Mr. Kollen dispute that the current EKPC environmental surcharge methodology will fully reflect any future reductions in emission allowance expense? If so, please explain.

RESPONSE:

- a. The Company's environmental surcharge filings presently include recovery of allowance expenses. To the extent that the new projects will reduce this expense, the savings will be captured in the revenue requirement and should be used as an offset in the quantification of the impact on ratepayers resulting from these projects.
- b. No. Please see page 6 lines 16-22 and page 17 line 1 through page 19 line 2 of Mr. Kollen's Direct Testimony wherein he explains that such reductions will be reflected in the environmental surcharge revenue requirement as it is presently approved.