COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF EAST KENTUCKY POWER COOPERATIVE, INC. FOR AN ADJUSTMENT OF RATES	)))	CASE NO. 94-336

O R D E R

IT IS ORDERED that the Attorney General ("AG") shall file the original and 10 copies of the following information with the Commission no later than March 21, 1995, with a copy to all parties of record. Each copy of the data requested should be placed in a bound volume with each item tabbed. When a number of sheets are required for an item, each sheet should be appropriately indexed, for example, Item 1(a), Sheet 2 of 6. Include with each response the name of the witness who will be responsible for responding to questions relating to the information provided. Careful attention should be given to copied material to ensure that it is legible.

Questions for Thomas C. DeWard

1. East Kentucky Power Cooperative, Inc. ("East Kentucky") filed its proposed rate reduction using a historic test year, the 12 months ending December 31, 1993. Both you and East Kentucky have proposed adjustments to the test year reflecting events occurring, or expected to occur, throughout 1994 and early 1995.

a. Explain the differences between a historic test period and a forecasted test period.

b. Theoretically, when a rate case is based on a historic test period, how are post-test-year adjustments supposed to be evaluated?

c. What impact does the concept of known and measurable have when evaluating post-test-year adjustments in the context of a historic test period?

2. Explain the rationale for the proposed adjustment to reduce the margins on off-system sales (Exhibit_TCD-1, Schedule 3). Are you recommending that 1993 amounts should be adjusted to 1994 levels simply because 1994 is more current or is there some other reason?

3. Explain the rationale for the proposal to remove East Kentucky's pro forma sales adjustments (Exhibit_TCD-1, Schedule 4). Are you contending that the adjustments are not known and measurable? Are you contending that these adjustments, to a 1993 test year, cannot be made unless sales to such customers produced smaller margins in 1994 than in 1993? Explain.

4. Provide the reason(s) supporting your acceptance of East Kentucky's proposed pro forma adjustment for the combustion turbines.

5. Provide the reason(s) supporting your determination that East Kentucky's proposed wheeling expense adjustment does not meet the known and measurable test.

6. Explain the rationale for proposing to remove East Kentucky's adjustment to increase wheeling expense by $1,664,212 (Exhibit_TCD-1, Schedule 7). Given that the adjustment is based on

a $2,651,496 net charge from KU ($4,146,782 charged to East Kentucky less $1,495,286 charged to KU), how do you conclude there will be increased wheeling revenues for East Kentucky under KU's proposal? If KU's FERC proposal is not decided by the conclusion of this case, do you recommend that East Kentucky be limited only to recovery of its 1993 test-year expense?

7. Refer to Exhibit_TCD-1, Schedule 10 of your direct testimony. You propose to decrease the medical trend rate by one percent. East Kentucky used a trend rate of 15 percent in the first year. Are you suggesting that a 14 percent medical trend rate in year 1 is reasonable?

8. Refer to page 15 of your direct testimony. Describe how you determined that 50 percent was the appropriate reduction to East Kentucky's proposed pension expense adjustment. Include any supporting analysis or documentation.

9. On page 16 of your direct testimony you state that it is not in accordance with generally accepted accounting principles ("GAAP") to treat the entire amount of other postretirement employee benefits ("OPEB") as an expense. East Kentucky stated in response to Item 12a of the AG's January 27, 1995 request for information that this treatment is in accordance with GAAP. Explain more fully your position.

10. Refer to page 16 of your direct testimony. Is it your opinion that since East Kentucky has neither initiated a funding policy nor targeted a date for doing so that it should be allowed to recover only the pay-as-you-go OPEB costs?

11. Refer to Exhibit_TCD-1, Schedule 15 and page 18 of your direct testimony.

a. How did you determine the 5 percent rate used to estimate 1994 principle payments?

b. Why did you have to estimate the principle payments?

c. Why were the debt balances as of December 31, 1994 not used?

12. Refer to pages 20 and 21 of your direct testimony.

a. What studies or analyses have you performed which support your recommendation of a 1.10 Times Interest Earned Ratio ("TIER")? Include copies of the studies or analyses.

b. East Kentucky's equity level (equity to asset ratio) for the test year was 5.34 percent.[1] If the Rural Utilities Service[2] is requiring generating and transmission cooperatives to work towards an equity level goal of 20 percent, why would this requirement not be a factor in determining the appropriate TIER for East Kentucky?

13. Refer to pages 22 and 23 of your direct testimony.

a. Why is your proposed adjustment to interest income on short-term investments not based on the short-term investment balances as of December 31, 1994?

b. Would the facts that East Kentucky canceled its Deferred Power Bill Plan in 1994 and that all outstanding balances

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1 Response to Item 2 of the October 26, 1994 Order, page 58 of 77.

2 Formerly the Rural Electrification Administration.

are to be paid by April 1, 1995, impact your proposed adjustment? If yes, explain.

14. Refer to Exhibit_TCD-1, Schedule 21. In calculating this adjustment, explain why you did not work through the entire 1995 member payment formula, as shown in the response to Item 66b of the AG's January 27, 1995 request for information, page 4 of 4, steps 1 and 2.

15. Refer to page 24 of your direct testimony. How did you determine that expense reductions of 50 and 75 percent were reasonable for these expenses? Include copies of any studies or analyses which support these percentages.

Questions for David H. Brown Kinloch

16. In Exhibit DHBK-1, you calculate economic development rate credits for Inland Container for the year 1995. This calculation is made by applying discounted demand charges in 1995 to Inland Container's monthly KW billing demand in 1993. Why is it appropriate to calculate a revenue adjustment for 1995 using 1993 billing demand?

17. On page 7 of your testimony, you propose to accept East Kentucky's 50 percent reduction to advertising expense and then reduce the acceptable level by the amount of unacceptable advertising included therein. Using this approach, you have proposed an additional reduction of $102,563 in advertising expenses. Given the methodology used by East Kentucky, explain how you have determined that none of the $102,563 was already included in East Kentucky's proposed adjustment. Include any study or

analysis which supports your assumption that East Kentucky has included the $102,563 for rate-making purposes.

18. How did you arrive at your conclusion, as expressed on page 8 of your testimony, that "[t]he primary goal of the ETS program is to increase sales of electricity?"

19. On page 16 of your testimony you recommend that the Commission allocate the rate reduction to all classes on the basis of total revenue, with the exception of Inland Steam. Demonstrate how such an allocation would be made.

20. You are recommending a rate design for East Kentucky's Rate Schedule E that is essentially unchanged from the existing rate design. Explain how maintaining the status quo for rate design will send a strong pricing signal to customers.

21. You contend that marginal cost pricing "... is fine as long as it only sends a price signal and it doesn't force some customers to pay more than they would under embedded costs."

a. Explain how marginal cost pricing can send a price signal if some customers are not forced to pay more than they would under embedded cost pricing.

b. Explain what you mean when you refer to the "unacceptable, adverse effects" of marginal cost pricing.

22. You contend that power costs (rates) should be "based on embedded costs" and state "there is already a tremendous pricing signal that can be sent using embedded prices."

a. Setting rates based on marginal cost principals is frequently espoused as a means of sending pricing signals that influence customers' behavior so that they, their power supplier, and society as a whole can make better and more efficient use of resources. If these are the goals of marginal cost pricing, explain why you appear to be diametrically opposed to the use of marginal costs in setting utility rates.

b. Describe, in detail, the pricing signal that can be sent by East Kentucky using its embedded costs.

Done at Frankfort, Kentucky, this 14th day of March, 1995.

PUBLIC SERVICE COMMISSION

Robert M. Davis

For the Commission

ATTEST:

Don Mills

Executive Director