COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF EAST KENTUCKY POWER COOPERATIVE, INC. FOR APPROVAL OF AN ENVIRONMENTAL COMPLIANCE PLAN AND AUTHORITY TO IMPLEMENT AN ENVIRONMENTAL SURCHARGE	)))))	CASE NO. 2004-00321

COMMISSION STAFF'S SECOND DATA REQUEST
TO EAST KENTUCKY POWER COOPERATIVE, INC.

Pursuant to Administrative Regulation 807 KAR 5:001, Commission Staff requests that East Kentucky Power Cooperative, Inc. ("East Kentucky") file the original and 7 copies of the following information with the Commission with a copy to all parties of record. The information requested herein is due December 3, 2004. Each copy of the information 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 its legibility. When the requested information has been previously provided in this proceeding in the requested format, reference may be made to the specific location of that information in responding to this request.

1. Refer to the Commission Staff's First Data Request dated October 22, 2004 ("Staff's First Request"), Item 1. The first sentence in KRS 278.183(1) reads as follows:

> Notwithstanding any other provision of this chapter, effective January 1, 1993, a utility shall be entitled to the current recovery of its costs of complying with the Federal Clean Air Act as amended and those federal, state, or local environmental requirements which apply to coal combustion wastes and by-products from facilities utilized for production of energy from coal in accordance with the utility's compliance plan as designated in subsection (2) of this section.

On page 2 of 3 of the response, East Kentucky states, "The statute's scope was clearly made broader than the fairly narrow environmental compliance issue that was at the center of the legislative intent, and applicability of the environmental surcharge to compliance costs of gas-fired generating units is not inconsistent with such intent."

a. Does East Kentucky agree that the sentence structure of KRS 278.183(1) makes no separation between the Federal Clean Air Act and other federal, state, or local environmental requirements? Explain the response.

b. What is the basis of East Kentucky's response on page 2 of 3 concerning the statute's scope? Explain the response in detail.

c. Given that KRS 278.183(1) clearly references "facilities utilized for production of energy from coal," explain in detail how East Kentucky can conclude it was the legislature's intent that environmental costs associated with gas-fired generating units could be included in the environmental surcharge.

2. Refer to the Staff's First Request, Item 1, pages 2 and 3 of 3. East Kentucky contends that Kentucky Utilities Company ("KU") has been allowed to recover costs of emission allowances for non-coal generating units through the environmental surcharge.

a. Provide the basis for East Kentucky's understanding that this situation has in fact occurred with KU's environmental surcharge. Include all details of which East Kentucky is aware concerning this situation.

b. Based on East Kentucky's understanding of the approved environmental compliance plans for KU, would East Kentucky agree that the Commission's approval has been related only to projects associated with coal-fired generation? Explain the response.

c. Explain why KU's possible inclusion of emission allowances related to non-coal-fired generation justifies East Kentucky's proposal to include environmental projects related to gas-fired generation in its environmental compliance plan and surcharge.

3. Refer to the Staff's First Request, Item 7(b).

a. Describe East Kentucky's activities during the past 12 months concerning the marketing of combustion by-products.

b. Provide the level of income received from the marketing of combustion by-products for the past 12 months.

4. Refer to the Staff's First Request, Item 9.

a. Explain why East Kentucky has not previously sought the Commission's approval of the depreciation rates proposed in the environmental surcharge application.

b. Did the Rural Utilities Service ("RUS") approve the depreciation rates contained in the study submitted in response to Item 9?

(1) If yes, provide copies of the approval from RUS.

(2) If no, provide the depreciation rates actually in use by East Kentucky and explain why East Kentucky is proposing to use rates other than those approved by RUS.

c. The depreciation study submitted with the response to Item 9 encompasses only the Spurlock and Cooper generating stations.

(1) Why was this depreciation study limited to the Spurlock and Cooper generating stations instead of examining all of East Kentucky's assets?

(2) When did East Kentucky last prepare a depreciation study for all of its assets?

(3) Has East Kentucky been using the depreciation rates from that study? Explain the response.

(4) Have the depreciation rates in that depreciation study been approved in a previous Commission proceeding? If yes, identify the case number. If no, explain why the Commission's approval was not sought.

(5) Have the depreciation rates in that depreciation study been approved by the RUS? If yes, provide copies of the RUS approval.

d. The Management Applications Consulting, Inc. ("MAC") study submitted as part of the response to Item 9 only examined the Cooper and Spurlock generating stations. East Kentucky's proposed environmental compliance plan includes the new Gilbert generating unit and combustion turbines ("CTs") at the J. K. Smith site.

(1) Provide copies of the depreciation study that was the source of the depreciation rates used in East Kentucky's proposed environmental surcharge for the Gilbert unit and the Smith CTs.

(2) Indicate when the Commission approved the depreciation rates used for the Gilbert unit and the Smith CTs. Include the case number for the approval proceeding. If East Kentucky did not seek the Commission's approval of these depreciation rates, explain in detail why approval was not sought.

e. Refer to the Attachment to the Item 9 response, page 6 of 41. MAC expressed some concerns about East Kentucky's expensing practices and the associated impact on its depreciation rates. Describe East Kentucky's expensing versus capitalizing practices. Include in this description an explanation of how East Kentucky arrived at its practices. If available, include copies of any written policies or guidelines relating to expensing versus capitalizing.

f. On page 40 of 41 of the Attachment to the Item 9 response, MAC recommends East Kentucky perform depreciation studies every 3 to 5 years. The MAC study was dated June 2002. What are East Kentucky's current plans concerning another depreciation study?

g. Concerning the depreciation expense proposed in its environmental surcharge, is East Kentucky seeking the Commission's approval of the depreciation rates used to determine the depreciation expense in this proceeding? Explain the response.

5. Refer to the Staff's First Request, Item 12(a), Attachment 1. Concerning East Kentucky's purchase of SO_2 emission allowances, provide the following information for each of the three purchases:

a. Was this a single purchase or the total of several purchases in the year? If several purchases, list the quantity, purchase price, and total cost for each purchase.

b. In what month did the purchase occur?

c. Was the purchase made directly from another utility, from a trading market, or some other venue? If a trading market or other venue, identify the source of the purchase.

6. Refer to the Staff's First Request, Item 12(a), Attachment 1. In 2004, East Kentucky has purchased 22,000 SO_2 emission allowances at a price of $500 per allowance.

a. Explain why the purchase price for this transaction was so significantly higher than the prices of previous purchases.

b. Did East Kentucky attempt to purchase these additional SO_2 emission allowances through the Environmental Protection Agency's ("EPA") annual auction?

(1) If yes, was East Kentucky successful in securing allowances through the EPA annual auction? Explain the response and state the number of allowances, if any, purchased and the price per allowance.

(2) If no, explain why East Kentucky did not attempt to purchase SO_2 emission allowances through the EPA annual auction.

c. At the time East Kentucky purchased the 22,000 SO_2 emission allowances, what was the average price for such allowances offered in the market?

d. If the average price for SO_2 emission allowances offered in the market was lower than the $500 purchase price East Kentucky paid, explain why East Kentucky paid more for these allowances than the average market price.

7. Provide a schedule showing the proceeds East Kentucky received from the EPA annual auction of SO_2 emission allowances from 1995 to 2004. The schedule should show for each year the number of allowances withheld by EPA, the proceeds from the EPA auction, and the date East Kentucky received the proceeds.

8. Refer to the Staff's First Request, Item 12(c). Concerning East Kentucky's management strategy for SO_2 and NOx emission allowances,

a. Based on East Kentucky's response, is it correct that East Kentucky has not developed a formal, written management strategy? Explain the response.

b. East Kentucky has utilized a significantly higher number of SO_2 emission allowances than it was allocated by the EPA every year since 2000. To make up its shortfall, East Kentucky has purchased 84,500 SO_2 emission allowances at a cost of $21,653,750.

(1) Over the next 5 years, does East Kentucky anticipate annually purchasing similar quantities of SO_2 emission allowances?

(2) Has East Kentucky considered and evaluated other emissions compliance options other than the purchase of SO_2 emission allowances? Explain the response.

9. Refer to the Staff's First Request, Item 13.

a. Concerning the response to Item 13(a),

(1) Does East Kentucky anticipate large fluctuations in the monthly operation and maintenance expenses and its air permit fee?

(2) Explain why East Kentucky appears to believe it is necessary to mitigate fluctuations in the calculation of the environmental surcharge factor.

b. Refer to the response to Items 13(b) and 13(c). KRS 278.183(1) clearly states that the utility is entitled to the current recovery of its costs of environmental compliance in accordance with its approved compliance plan. Explain in detail how East Kentucky reached the conclusion that it could recover through the environmental surcharge the costs of projects not specifically included in its proposed compliance plan.

10. Refer to the Staff's First Request, Item 15, the analysis of expenses. For each of the accounts listed below, provide a description of the nature of the expense East Kentucky proposes to recover in its environmental surcharge and why that expense is appropriate for surcharge recovery.

a. Account No. 50144 – Fuel Coal Gilbert.

b. Account No. 50644 – Miscellaneous Steam Power Expense Gilbert.

c. Account No. 51243 – Maintenance of Boiler Plant Scrubber.

11. Refer to the Staff's First Request, Item 15. Concerning the air permit fees,

a. Do the amounts shown as of December 31, 1993 for the air permit fees reflect the actual amounts on East Kentucky's books as of that date, or an estimated amount? Explain the response.

b. Explain why there were no air permit fees associated with the Cooper generating station in 1993.

12. Refer to the Staff's First Request, Item 16. The attachment to the response shows how a 5.635 percent rate of return on rate base will result in a 1.15X Times Interest Earned Ratio ("TIER").

a. The calculations shown on the attachment include as an environmental surcharge expense an interest expense of $10,276,848. Is it correct that East Kentucky's application did not include interest expense as a component of the environmental surcharge expenses that it proposes to recover through the surcharge?

b. If yes to part (a) above, explain why interest expense was included as an environmental surcharge expense on the attachment in the response to Item 16.

13. Refer to the Staff's First Request, Item 17. East Kentucky has proposed that its rate of return on rate base should be 5.635 percent, the result of multiplying East Kentucky's weighted average cost of debt of 4.90 percent by a TIER of 1.15X. In its response to Item 17, East Kentucky calculated that its current rate of return on its total rate base as of July 31, 2004 is 4.13 percent, while its rate of return on its total rate base as of July 31, 2004 reflecting a 1.15X TIER is 3.30 percent. Explain why either of the rates of return on rate base calculated in the response to Item 17 would not be more reasonable to use as the rate of return on East Kentucky's environmental rate base instead of East Kentucky's proposed rate of return.

14. Refer to the Staff's First Request, Item 18.

a. Was East Kentucky aware that the environmental surcharge approved for the Kentucky Power Company ("Kentucky Power") was based on the base-current approach from its inception, and did not go through a period where it utilized the incremental approach?

b. Would East Kentucky agree that all three environmental surcharge mechanisms currently authorized by the Commission reflect a base-current approach?

c. Explain why East Kentucky believes it is necessary and reasonable to start with the incremental approach and then convert to the base-current approach at the time of the first environmental surcharge roll-in.

15. The base-current approach used in the environmental surcharge mechanism authorized for Louisville Gas and Electric Company ("LG&E") and KU is slightly different from the base-current approach used in Kentucky Power's environmental surcharge mechanism. In the LG&E and KU surcharges, a base period surcharge factor and a current period surcharge factor are calculated. The base period factor is subtracted from the current period factor in order to determine the surcharge factor applied to current bills. In the Kentucky Power surcharge, a base period revenue requirement and current period revenue requirement are calculated. The base period revenue requirement is subtracted from the current period revenue requirement. The difference is then used to calculate the surcharge factor applied to current bills. Assume for purposes of this question that the Commission authorizes an environmental surcharge mechanism for East Kentucky using the base-current approach. Would East Kentucky favor using the LG&E and KU version or the Kentucky Power version of the base-current approach? Explain the response.

16. Refer to the Staff's First Request, Item 20.

a. Explain why the desire to "smooth out the monthly surcharge factors over time" should be a consideration in whether to deal with over- and under-recoveries of the surcharge using a 2-month true-up adjustment.

b. Concerning over- and under-recoveries of the surcharge:

(1) Would East Kentucky agree that, if the average monthly member system revenues for the most recent 12 months is greater than the billing month member system revenues, there will probably be an under-recovery of the surcharge?

(2) Would East Kentucky agree that, if the average monthly member system revenues for the most recent 12 months is lower than the billing month member system revenues, there will probably be an over-recovery of the surcharge?

(3) Would East Kentucky agree that this difference between the average monthly member system revenues and the billing month revenues is essentially a timing difference that is normally part of the environmental surcharge mechanism?

c. Based upon its understanding of the three authorized environmental surcharges currently in effect, would East Kentucky agree that the 2-month true-up adjustment primarily addresses this timing difference? Explain the response.

d. Would East Kentucky agree that, if the 2-month true-up adjustment addresses the revenue timing differences that result in over- or under-recoveries of the surcharge, it would be reasonable to resolve these over- and under-recoveries sooner, within 2 months, rather than later, at the 6-month surcharge reviews? Explain the response.

17. Refer to the Staff's First Request, Item 21(c). Using the example set forth in Item 21(c):

a. Explain in detail how a retail customer could see the environmental surcharge for the expense month of July 2005 on his bill before the applicable member system would see the environmental surcharge for the expense month of July 2005 on its bill.

b. Under the regular billing cycles of East Kentucky and its member systems, would it be correct that while the environmental surcharge for the expense month of July 2005 would appear on the member system's bill in early September 2005, the pass through of the surcharge would not appear on the retail customer's bill until the appropriate billing cycle in October 2005? Explain the response.

c. Provide charts or diagrams showing how and when base rate and fuel adjustment charges progress from East Kentucky to its member systems to the retail customer progresses and which also show that same progression as proposed for the environmental surcharge. The charts or diagrams should mark the passage of time involved with the billing processes.

18. Refer to the Staff's First Request, Item 22(a).

a. Explain in detail why East Kentucky is proposing to file its member systems' monthly environmental surcharge factors rather than the individual member systems filing their respective monthly surcharge factors.

b. Explain in detail why it is necessary to "enable the Member Systems to bill their customers at about the same time as they are being billed by EKPC."

19. Refer to the Staff's First Request, Item 23. In order to better understand the response, provide all supporting workpapers, calculations, and assumptions used to develop the percentages provided in the attachment to the Item 23 response.

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DATED November 19, 2004

cc: All Parties