

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) CASE NO.
AUTHORITY TO IMPLEMENT AN) 2004-00321
ENVIRONMENTAL SURCHARGE)

AND

APPLICATION OF BIG SANDY RECC, BLUE)
GRASS ENERGY COOPERATIVE CORPORATION,)
CLARK ENERGY COOPERATIVE, CUMBERLAND)
VALLEY ELECTRIC, FARMERS RECC,)
FLEMING-MASON ENERGY, GRAYSON RECC,)
INTER-COUNTY ENERGY COOPERATIVE,)
JACKSON ENERGY COOPERATIVE, LICKING) CASE NO.
VALLEY RECC, NOLIN RECC, OWEN ELECTRIC) 2004-00372
COOPERATIVE, SALT RIVER ELECTRIC, SHELBY)
ENERGY COOPERATIVE, SOUTH KENTUCKY)
RECC AND TAYLOR COUNTY RECC FOR)
AUTHORITY TO PASS THROUGH THE)
ENVIRONMENTAL SURCHARGE OF EAST)
KENTUCKY POWER COOPERATIVE, INC.)

O R D E R

On September 17, 2004, East Kentucky Power Cooperative, Inc. ("East Kentucky") filed an application, pursuant to KRS 278.183, seeking Commission approval of an environmental compliance plan consisting of new and additional pollution control facilities and to establish its Environmental Surcharge tariff ("ES tariff"). East Kentucky maintains that it will need these facilities and will incur the related compliance costs in order to comply with the requirements of the Clean Air Act¹ at its coal and gas-

¹ As amended, 42 U.S.C.A. § 7401 *et seq.*

fired generating units and other federal, state, and local environmental requirements applicable to coal combustion wastes and by-products from its coal-fired generating units. East Kentucky proposes that its ES tariff become effective for service rendered beginning April 1, 2005.

Also on September 17, 2004, each of the 16 distribution cooperatives² of East Kentucky filed a joint application seeking Commission approval of a pass through mechanism that would allow each distribution cooperative to bill its respective retail customers for the portion of the environmental surcharge that East Kentucky bills each distribution cooperative. The distribution cooperatives also propose that their pass through mechanism tariffs become effective for service rendered beginning April 1, 2005, to coincide with East Kentucky's environmental surcharge tariff.

The following parties requested and were granted full intervention in both cases: the Attorney General of the Commonwealth of Kentucky, by and through his Office of Rate Intervention ("AG"), and Gallatin Steel Company ("Gallatin"). A consolidated hearing was held on February 2, 2005.

BACKGROUND

East Kentucky is a rural electric cooperative organized pursuant to KRS Chapter 279 and is a utility subject to Commission jurisdiction. East Kentucky owns and operates facilities used to generate and transmit electricity to its 16 member distribution

² The 16 East Kentucky distribution cooperatives are Big Sandy Rural Electric Cooperative Corporation ("RECC"), Blue Grass Energy Cooperative Corporation, Clark Energy Cooperative ("EC"), Cumberland Valley Electric, Farmers RECC, Fleming-Mason Energy, Grayson RECC, Inter-County EC, Jackson EC, Licking Valley RECC, Nolin RECC, Own Electric Cooperative, Salt River Electric, Shelby EC, South Kentucky RECC, and Taylor County RECC.

cooperatives for compensation for lights, heat, power, and other uses. Each of the 16 distribution cooperatives are also rural electric cooperatives organized pursuant to KRS Chapter 279, and each is a utility subject to Commission jurisdiction. The distribution cooperatives are engaged in the distribution of electricity to the public for compensation for lights, heat, power, and other uses. They collectively serve approximately 474,000 member-consumers in all or parts of 89 counties in Kentucky.

KRS 278.183 provides that a utility shall be entitled to the current recovery of its costs of complying with the Clean Air Act as amended and those federal, state, or local environmental requirements that apply to coal combustion wastes and by-products from facilities utilized for the production of energy from coal. Pursuant to KRS 278.183(2), a utility seeking to recover its environmental compliance costs through an environmental surcharge must first submit to the Commission a plan that addresses compliance with the applicable environmental requirements. The plan must also include the utility's testimony concerning a reasonable return on compliance-related capital expenditures and a tariff addition containing the terms and conditions of the proposed surcharge applied to individual rate classes. Within 6 months of submission, the Commission must conduct a hearing to:

- (a) Consider and approve the compliance plan and rate surcharge if the plan and rate surcharge are found reasonable and cost-effective for compliance with the applicable environmental requirements;
- (b) Establish a reasonable return on compliance-related capital expenditures; and
- (c) Approve the application of the surcharge.

COMPLIANCE PLAN

The compliance plan proposed by East Kentucky calls for nine capital projects that include the following facilities:

- (1) Installation of a specific type of boiler, Selective Non-Catalytic Reduction equipment, baghouse, and flash dry absorber to control fly ash and particulate, nitrogen oxide (“NOx”), and sulfur dioxide (“SO₂”) at the new Gilbert Unit. The Gilbert Unit utilizes a fluidized coal bed and is located at East Kentucky’s Spurlock Station.
- (2) Installation of a new electrostatic precipitator to control particulates at the coal-fired Spurlock Unit 1.
- (3) Installation of low NOx burners to control NOx emissions at the gas-fired J. K. Smith Combustion Turbines (“CTs”) Nos. 1 through 7.³
- (4) Installation of Selective Catalytic Reduction equipment (“SCR”) to control NOx emissions at the coal-fired Spurlock Unit 1.
- (5) Installation of a SCR to control NOx emissions at the coal-fired Spurlock Unit 2.

The proposed compliance plan has a total estimated capital cost of \$223.8 million.⁴

In support of the proposed compliance plant, East Kentucky presented testimony describing each project in detail.⁵ East Kentucky also noted that, except for the Spurlock Unit 1 precipitator replacement project, it had sought and been granted certificates of public convenience and necessity for the projects.⁶

³ These facilities reflected five of the nine capital projects proposed by East Kentucky.

⁴ Eames Direct Testimony, Eames Exhibit 1.

⁵ Johnson Direct Testimony at 3-19.

⁶ Hughes Direct Testimony at 3.

Gallatin was the only intervenor to file testimony, and it opposed the inclusion of the capital projects associated with the J. K. Smith CTs. Gallatin contends that KRS 278.183 authorizes only the recovery of environmental costs associated with the generation of electricity from coal, not gas. Gallatin recommends the removal of all gas-fired generation projects from East Kentucky's proposed compliance plan.⁷

SURCHARGE MECHANISM AND CALCULATION

East Kentucky proposes that its environmental surcharge mechanism use a "base/current" approach, although its proposal differs from what the Commission previously approved for Louisville Gas and Electric Company ("LG&E") and Kentucky Utilities Company ("KU"). The base/current approach calculates the revenue requirements for a current period, which reflects recoverable compliance costs for the current expense month, and for a base period, which reflects corresponding environmental costs already included in base rates. The calculation of the base period revenue requirement usually is where the impact of retirements and replacements resulting from the projects approved in the compliance plan are recognized. The current period and base period revenue requirements are each divided by the appropriate level of revenues to determine the current period and base period surcharge factors. The net difference between the two factors is the environmental surcharge factor billed to customers.

East Kentucky proposes that its base period be initially set at zero, even though it is able to calculate its compliance costs included in base rates. Subsequently, when its environmental surcharge is incorporated into base rates, its base period will reflect the

⁷ Kollen Direct Testimony at 9-11.

amount so incorporated. East Kentucky also proposes to recognize the effects of retirements and replacements resulting from the projects approved in the compliance plan by treating the plant balances, accumulated depreciation, and associated operation and maintenance (“O&M”) expenses as reductions or offsets to the current balances of the projects included in the approved compliance plan. This proposal for retirements and replacements follows an incremental approach, rather than the “base/current” approach as approved for LG&E and KU.

As proposed by East Kentucky, the current period revenue requirement is comprised of a return on the environmental compliance rate base, plus specified environmental compliance operating expenses, less proceeds from by-product and emission allowance sales, plus or minus 6-month surcharge over- or under-recovery adjustments.⁸ The environmental compliance rate base includes plant in service and construction work in progress associated with the approved compliance plan projects adjusted for accumulated depreciation, spare parts and limestone inventories, emission allowance inventory,⁹ and cash working capital allowance. The environmental compliance operating expenses include incremental O&M expenses, including air permit fees, that exceed the 1993 level of certain O&M expenses, depreciation expense, property taxes, insurance expense, emission allowance expense, and consulting fees. The incremental O&M expenses include expenses associated with

⁸ Bosta Direct Testimony, Bosta Exhibit 1.

⁹ The emission allowance inventory weighted average cost would include the estimated cost of emission allowances East Kentucky anticipated purchasing within the year. After the actual purchase, the weighted average cost would be adjusted to reflect the actual cost. This approach would also impact the determination of the monthly emission allowance expense.

environmental compliance, but are not related to the projects included in the approved compliance plan. Any proceeds East Kentucky receives from the sale of by-products or emission allowances would be used as an offset in the determination of the current period revenue requirement. Finally, East Kentucky would accumulate all over- and under-recoveries of the environmental surcharge for a 6-month period and amortize the net cumulative amount over a subsequent 6-month period.

Gallatin challenged the inclusion of several items contained in East Kentucky's surcharge mechanism. Consistent with its objection to including environmental projects associated with gas-fired generation, Gallatin argued that no costs associated with the gas-fired generation should be included in the surcharge mechanism. Gallatin also opposed the inclusion of incremental O&M expenses for environmental compliance that was not related to projects in the approved compliance plan. Gallatin contended that East Kentucky had not removed all expenses associated with retired or replaced plant, and Gallatin disagreed with the depreciation practices followed by East Kentucky in the month new plant went into service. Finally, Gallatin stated that revenues associated with sales to certain industrial customers needed to be adjusted before being included in the determination of the monthly environmental surcharge factor.¹⁰

RATE OF RETURN

East Kentucky proposes 5.635 percent as its reasonable rate of return on its compliance-related capital expenditures. This return is determined by multiplying East Kentucky's average cost of debt at July 31, 2004 of 4.90 percent by the Times Interest Earned Ratio ("TIER") of 1.15X, which was approved in its 1993 general rate case.

¹⁰ Kollen Direct Testimony at 5-7.

East Kentucky believes this approach is consistent with the requirements of KRS 278.183 and will allow it to comply with the financial coverage requirements of its debt covenants. East Kentucky also proposes to update its average cost of debt at 6-month intervals.¹¹

Gallatin opposes East Kentucky's proposed rate of return because the TIER multiplier results in an imputed interest expense that East Kentucky does not actually incur. Gallatin argues that the use of a TIER adder is inconsistent with the concept of dollar-for-dollar recovery through the ES tariff, nothing more and nothing less.¹² Gallatin recommends the use of East Kentucky's overall cost of capital at October 31, 2004, with the cost of debt component based on East Kentucky's average cost of debt and the cost of members' equity at 0.0 percent.¹³

PASS THROUGH MECHANISM

The distribution cooperatives propose a pass through mechanism that uses the base/current approach. The current period revenue requirement in the pass through mechanism will be the amount of the environmental surcharge billed by East Kentucky to each distribution cooperative. The base period revenue requirement will be zero until a pass through has been incorporated into the distribution cooperatives' existing base rates. The current period revenue requirement will be divided by the corresponding level of distribution cooperative revenues, resulting in a pass through factor which will

¹¹ Oliva Direct Testimony at 4-5.

¹² Kollen Direct Testimony at 15-17.

¹³ Gallatin's Response to the Commission Staff's First Data Request dated January 6, 2005, Item 1.

be applied to the retail bills of the distribution cooperative. East Kentucky and its distribution cooperatives also propose that the environmental surcharge be passed through to retail customers in the same month that East Kentucky bills the environmental surcharge to the distribution cooperatives.

SETTLEMENT AGREEMENT

On January 20, 2005, an informal conference was held at the request of East Kentucky for the purpose of discussing all issues. As a result of those discussions, the parties reached a unanimous settlement in principle for both cases. A unanimous Settlement Agreement was filed at the public hearing on February 2, 2005, and East Kentucky testified in support of the Settlement Agreement. A copy of the Settlement Agreement is attached as Appendix A to this Order.

Provisions

Below is a summary of the major provisions of the Settlement Agreement.

- (1) East Kentucky's environmental compliance plan will only include projects associated with coal-fired generation. The J. K. Smith CTs will not be included. Only costs and expenses associated with coal-fired generation and the approved compliance plan will be included in the surcharge mechanism.
- (2) East Kentucky's surcharge mechanism will use the base/current approach consistent with the base/current approach used for LG&E and KU. The base period surcharge factor ("BESF") will be initially set at 0.51 percent.
- (3) The cost of emission allowances included in the surcharge mechanism will only reflect the actual cost of allowances, not estimated costs. Revenues from the annual Environmental Protection Agency's allowance auction will be reflected as a credit in the emission allowance inventory and reflected in the average inventory price used to determine the monthly surcharge factor. In addition, East Kentucky will prepare an Emissions Allowance Strategy Plan, which will be submitted to the Commission no later than July 31, 2005.

- (4) The reasonable rate of return on compliance-related capital expenditures will be determined by multiplying the weighted average debt cost for the debt issuances directly related to projects in the approved compliance plan times a TIER of 1.15. The initial rate of return shall be based on the weighted average cost of project debt as of December 31, 2004 of 4.918 percent and multiplied by a 1.15X TIER. This results in an initial rate of return of 5.66 percent. The rate of return on capital expenditures will be updated to reflect current average debt cost at the conclusion of the 6-month and 2-year surcharge reviews.
- (5) When the commercial operation date of a project is something other than the first of the month, East Kentucky will pro rate the depreciation expense included in the surcharge mechanism for the initial month. In addition, East Kentucky will perform a new depreciation study for all assets within 2 years of the date of the Commission's Order in this case. East Kentucky will file an application seeking Commission approval of the new depreciation rates for accounting and rate-making purposes. If the new depreciation study is completed in advance of the 2-year time period, the study will be filed within 60 days of its completion.
- (6) The monthly surcharge factor will:
 - a. Exclude any revenues associated with power purchased by East Kentucky to meet the requirements of Gallatin and Tennessee Gas Pipeline.
 - b. Include any revenues from steam sales to Inland Container and those sales will be subject to the environmental surcharge.
 - c. Exclude any revenues associated with sales under the "Green Power" tariffs and those sales will not be subject to the surcharge.
- (7) Proceeds from the sale of Gilbert unit by-products of fly ash, bed ash, and scrubber particles will be credited to the revenue requirement in the monthly surcharge calculation.
- (8) A 12-month rolling average of O&M expenses associated with the approved Compliance Plan and air permit fees will be used in the Surcharge Mechanism. For the Gilbert unit, until 12 months of operations have been achieved, the average will reflect the actual O&M expenses for the months of operation divided by the number of months of operation.

- (9) Over- and under-recoveries of the surcharge will be computed for each month of each 6-month surcharge review period and East Kentucky will seek approval to amortize the amount during a subsequent period. East Kentucky will be allowed to recommend a reasonable amortization period, depending on the size of the amount to be amortized.
- (10) The use of the “base/current” approach for the pass through mechanism is not being decided in this case and the issue may be raised at the first 2-year environmental surcharge review. Until that time, the distribution cooperatives will utilize their proposed tariffs which reflect the “base/current” approach, with the base factor set at 0.0 percent.
- (11) The pass through mechanism will be billed to the distribution cooperatives’ retail customers at approximately the same time as East Kentucky bills the Environmental Surcharge to the distribution cooperatives.

Evaluation

The unanimous Settlement Agreement appears to resolve all the issues raised in the environmental surcharge and pass through mechanism applications. The agreed to compliance plan for East Kentucky will contain only those environmental projects related to the generation of electricity by burning coal. This is consistent with the stated provisions of KRS 278.183, the Commission’s previous decisions in environmental surcharge applications, and the decision of the Kentucky Supreme Court in *Kentucky Industrial Utility Customers v. Kentucky Utilities Co.*, Ky., 983 S.W.2d 493 (1998). In upholding the constitutionality of the environmental surcharge statute, the Supreme Court cited the preamble to the act, which provides as follows:

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; and
WHEREAS, electric utilities should have incentive to use Kentucky coal in deciding how to best achieve and maintain compliance with the Federal Clean Air Act as amended and

those environmental requirements which apply to coal combustion wastes and by-products from facilities utilized for production of energy from coal.

Kentucky Utilities at 496. The Court then stated that, “The legislative intent of the statute was to promote the use of high sulfur Kentucky coal ...,” and that the surcharge statute “allows utilities to use Kentucky coal and collect the costs of cleaning high sulfur coal.” *Id.* at 496-497. Thus, both the legislative and judicial histories of KRS 278.183 clearly limit the surcharge cost recovery to coal-related costs.

The environmental surcharge mechanism will provide for the recovery of actual environmental expenses associated only with the projects contained within the approved compliance plan. The environmental surcharge mechanism will apply the base/current approach in a manner consistent with the surcharge mechanisms approved in other proceedings. The Settlement Agreement eliminates East Kentucky’s proposal to utilize an “incremental” approach in the determination of the current period revenue requirement. The adjustments to the revenues used to determine the environmental surcharge factor and the pass through mechanism factor are designed to remove the impact of sales by East Kentucky that do not result in East Kentucky incurring environmental compliance costs.

The Commission has reviewed the provisions of the Settlement Agreement and finds that they are reasonable and should be approved in total. The compliance plan and environmental surcharge mechanism established by the Settlement Agreement conform to the requirements of KRS 278.183. Given that it has had to purchase emission allowances during recent years, East Kentucky should benefit from the development of an emissions allowance strategy. East Kentucky should also benefit

from conducting a company-wide depreciation study. The monthly environmental surcharge report formats contained in the Settlement Agreement should provide sufficient information for the Commission to review the environmental surcharge factor each month prior to the implementation of the surcharge factor.

It was noted at the public hearing that no monthly reporting format had been proposed for the distribution cooperatives' pass through mechanism. East Kentucky agreed that such a reporting format should be developed and filed so the Commission can review the determination of the monthly pass through factors before they appear on retail bills.¹⁴ East Kentucky subsequently distributed to the parties and the Commission a draft reporting format. The Commission has reviewed that draft and finds it reasonable with minor revisions so that the same format can be used by each distribution cooperative. A copy of this reporting format is attached to this Order as Appendix B. The monthly pass through mechanism reporting format will be submitted to the Commission at the same time the monthly environmental surcharge reports are filed.

EFFECTIVE DATE

East Kentucky and its distribution cooperatives had originally proposed that the environmental surcharge and the pass through mechanism be effective for service rendered beginning April 1, 2005. On February 17, 2005, East Kentucky informed the parties and the Commission that some of its distribution cooperatives requested the implementation date be delayed "to moderate the effect of adding the new Surcharge to

¹⁴ Transcript of Evidence, February 2, 2005 at 15-16.

Spring 2005 retail bills which will include relatively high Fuel Adjustment Clause charges relating to fuel and power purchase costs for winter months.”¹⁵ Consequently, East Kentucky requests a 3-month delay so the surcharge and pass through mechanism will be effective for service rendered on or after July 1, 2005.

East Kentucky has determined that this 3-month delay would result in a one-time revenue reduction of \$7.0 to \$8.0 million and that this revenue reduction can be absorbed without severe disruptions to its cash flow. During 2004, East Kentucky experienced cash flow constraints due to construction expenditures for the Gilbert Unit and delays in obtaining advances on a then-pending Rural Utilities Service (“RUS”) loan. The result was East Kentucky having to delay its purchase of emission allowances for its 2004 compliance. East Kentucky states that the RUS loan has been approved and it has been securing advances on that loan, which in turn have been used to reimburse East Kentucky funds used for construction and to pay off short-term borrowings. Thus, East Kentucky contends that the 2004 cash flow problem has been resolved and is not anticipated to recur.

Based upon the representations offered by East Kentucky, the Commission believes that the 3-month delay should not adversely impact East Kentucky’s cash flow. Therefore, the Commission finds that the request to delay the effective date to July 1, 2005 is reasonable and should be approved.

¹⁵ February 17, 2005 letter at 1.

IT IS THEREFORE ORDERED that:

1. The Settlement Agreement dated February 2, 2005, and attached hereto as Appendix A, is hereby approved.

2. East Kentucky's proposed ES tariff is denied.

3. The ES tariff contained in the February 2, 2005 Settlement Agreement is approved for service rendered on and after July 1, 2005.

4. East Kentucky's rate of return shall be determined consistent with the provisions of the February 2, 2005 Settlement Agreement. The current rate of return is 5.66 percent.

5. East Kentucky's BESF initially shall be 0.51 percent.

6. The East Kentucky distribution cooperatives' proposed pass through mechanism tariff is denied.

7. The pass through mechanism tariff contained in the February 2, 2005 Settlement Agreement is approved for service rendered on and after July 1, 2005.

8. East Kentucky shall file monthly the environmental surcharge reporting formats included in the February 2, 2005 Settlement Agreement. Each of East Kentucky's distribution cooperatives shall file monthly the reporting format included in Appendix B for its monthly pass through mechanism.

9. Within 10 days of the date of this Order, East Kentucky and its distribution cooperatives shall file with the Commission revised tariff sheets setting out the ES tariff and pass through mechanism tariff as approved herein.

Done at Frankfort, Kentucky, this 17th day of March, 2005.

By the Commission

ATTEST:

A handwritten signature in black ink, consisting of several overlapping loops and flourishes, positioned above a horizontal line.

Executive Director

Case No. 2004-00321
Case No. 2004-00372

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NOS. 2004-00321 and 2004-00372 DATED March 17, 2005

FEBRUARY 2, 2005 SETTLEMENT AGREEMENT

SETTLEMENT AGREEMENT

This Settlement Agreement, is entered this 2nd day of February, 2005, by and among East Kentucky Power Cooperative, Inc., (hereinafter referred to as "EKPC"); Big Sandy RECC, Blue Grass Energy Cooperative Corporation, Clark Energy Cooperative, Cumberland Valley Electric, Farmers RECC, Fleming-Mason Energy, Grayson RECC, Inter-County Energy Cooperative, Jackson Energy Cooperative, Licking Valley RECC, Nolin RECC, Owen Electric Cooperative, Salt River Electric, Shelby Energy Cooperative, South Kentucky RECC and Taylor County RECC (hereinafter collectively referred to as the "EKPC Member Systems"); the Kentucky Office of the Attorney General (hereinafter referred to as the "Attorney General"); and Gallatin Steel Company (hereinafter referred to as "Gallatin Steel").

W I T N E S S E T H:

WHEREAS, EKPC filed an Application with the Kentucky Public Service Commission (the "Commission") on September 17, 2004 for approval of an Environmental Compliance Plan and authority to implement an Environmental Surcharge pursuant to KRS §278.183 in PSC Case No. 2004-00321; and the EKPC Member Systems filed an Application with the Commission on the same date in PSC Case No. 2004-00372, seeking authority to pass through to their retail electric rates any Environmental Surcharge granted to EKPC;

WHEREAS, The Attorney General was made a party to PSC Case No. 2004-00321 and 2004-00372 by orders of the Commission dated September 22, 2004 and

October 12, 2004, respectively, and Gallatin Steel was made a party to PSC Case No. 2004-00321 and 2004-00372 by orders of the Commission dated October 7, 2004;

WHEREAS, The Parties to the above-referenced cases participated in a settlement conference on January 20, 2005 at the offices of the Commission, with the assistance and participation of Commission staff, and discussed and resolved all contested issues in said cases; and

WHEREAS, The Parties desire to settle all issues in the above-referenced cases based on the terms contained in this Settlement Agreement.

NOW, THEREFORE, for and in consideration of the premises and conditions set forth herein, the Parties hereby agree, as follows:

Amendment of EKPC's Application in PSC Case No. 2004-00321

1. The Parties agree to use the Base-Current methodology for calculation of the monthly surcharge factor for EKPC. The Base (BESF) for EKPC will be 0.51%. The Parties agree that the issue of the distribution cooperative's use of the base/current approach is not being decided in these cases, and that issue may be raised in the first two-year environmental surcharge review. Until that time, the distribution cooperatives will utilize their proposed tariffs, which reflect the base/current approach, with the Base (BESF) set at 0%. The BESF for EKPC is based on the computation outlined in Attachment 1 herein. It reflects the recognition of the cost of those environmental-related assets already included in EKPC's base rates that are being replaced by new projects under EKPC's Environmental Compliance Plan.

2. The Parties agree that EKPC's Environmental Compliance Plan shall consist of the following projects:

Project 1: Gilbert 1 Boiler (pollution-control related only), SNCR, Baghouse and Flash Drier Absorber

Project 2: Spurlock 1 Precipitator

Project 3: Spurlock 1 SCR

Project 4: Spurlock 2 SCR

3. The Parties agree that only the environmental activities and costs directly related to these four projects are eligible for cost recovery.
4. The Parties agree that the reasonable return on construction expenditures shall be based on a weighted average debt cost of those debt issuances directly related to the four projects in EKPC's compliance plan, multiplied by a 1.15 TIER factor. Further, the initial rate of return shall be based on the weighted average cost of such debt as of December 31, 2004 of 4.918%, multiplied by a 1.15 TIER factor, or 5.66%. Attachment 2 provides the basis of this rate of return. The Parties agree that the 5.66% return will remain in use until altered by Commission Order. EKPC will update the return as of the end of each six-month review period and request Commission approval of the updated average cost of debt. The 1.15 TIER factor will be applied to the updated average cost of debt. Upon Commission approval, the updated rate of return will be applied prospectively until altered by the Commission.
5. The Parties agree that EKPC will use only actual property tax expense and actual insurance expense in the monthly surcharge calculation.
6. The Parties agree that EKPC will only include a pro-rated share of depreciation expense for eligible projects in the initial month of service when the commercial operation date of the project is something other than the first day of the month.
7. The Parties agree that the revenues from steam sales to Fleming-Mason/Inland Container will be included in the revenues, R (m), of the monthly surcharge calculation and that such sales will be subject to the environmental surcharge.
8. The Parties agree that the portion of the sales to Owen Electric/Gallatin Steel which are sourced from Louisville Gas & Electric pursuant to a Letter Agreement between EKPC and LG&E dated October 27, 1994, will be excluded from the revenues, R(m), and that the surcharge will not be charged to Owen/Gallatin on that portion of their revenues. This provision shall remain effective until the current Agreement between EKPC and LG&E is terminated.
9. The Parties agree that the on-peak portion of revenues from sales to Taylor County RECC for Tennessee Gas Pipeline (TGP) and to Fleming-Mason EC for TGP shall be excluded from the revenues, R(m), and that the surcharge will not be charged to Taylor County/TGP and Fleming-Mason EC/TGP on that portion of their revenues. All other sales to Taylor County RECC and Fleming Mason EC for service to TGP will be subject to the surcharge. This provision shall remain effective until the current Agreements are terminated.
10. The Parties agree that the sale of by-products from the Gilbert Unit, such as fly ash, bed ash and scrubber particles, will be credited to the revenue requirement in the monthly surcharge calculation.

11. EKPC agrees to perform, or have performed, a depreciation study on all of its assets within the two-year period commencing from the date of the Commission's Order in this proceeding. EKPC agrees to file an Application seeking approval of the Commission for the rates contained in the depreciation study for accounting and ratemaking purposes. EKPC will also seek the approval of RUS. Should the study be completed in advance of the two-year time period, EKPC agrees to file the study with the Commission within 60 days of completion.
12. The Parties agree to use a 12-month rolling average of O&M expenses for the surcharge calculation. The accounts subject to this provision are Accts. 50144, 50621, 50631, 50641, 50642, 50644 50645, 51241, 51242, and 51244. The Parties agree that the environmentally-related O&M expenses for the Gilbert generating unit (Accts. 50144, 50644, 51244) shall be recovered by using the actual cost in month one of operation; for month two, use the average of expenses incurred in months one and two, for month three, use the average of expenses incurred in months one, two and three. This process will continue until the end of the first twelve months of operation at which time the Gilbert O&M costs will be treated like all other eligible O&M costs.
13. The Parties agree that EKPC and the distribution cooperatives will compute over/under recoveries for each month of each six-month review period and will seek approval to amortize the amount during a subsequent six-month review period. EKPC and the distribution cooperatives will be allowed to recommend an appropriate period of amortization, depending upon the size of the amortization amount.
14. EKPC will prepare an Emissions Allowance Strategy Plan for submittal to the Commission by no later than July 31, 2005. The study will focus on EKPC's strategy for purchasing SO₂ and NO_x allowances, as required, including the timing of such purchases.
15. EKPC agrees to include, for inventory balance and emission allowance expense purposes, the actual emission allowances purchased. Use of estimated emission allowance purchases shall not be permitted for surcharge recovery purposes. EKPC will only include emission allowances associated with coal-fired generating units in the surcharge calculation.
16. The Parties agree that the benefit from the sale of any allowances at the annual EPA auction shall be reflected as a credit in the emission allowance inventory and reflected in the average inventory price used in the computation of the monthly surcharge factor.
17. The Parties agree that the revenues associated with sales under the Green Power tariffs for EKPC and the Member Systems, as applicable, shall not be included in the denominator of the surcharge calculation nor subject to the environmental surcharge.

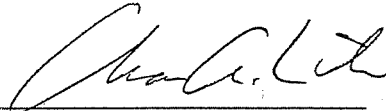
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18. The Parties agree that the methodology for billing the distribution cooperatives outlined in EKPC's testimony and exhibits will be utilized. The methodology allows the distribution cooperatives to bill their customers the environmental surcharge at approximately the same time as EKPC bills the environmental surcharge to the distribution cooperatives, thus avoiding a billing lag for the distribution cooperatives.
 19. EKPC has estimated the impact of the approval of the environmental surcharge on the distribution cooperatives and on their retail customers. EKPC has estimated that the surcharge factor will be 7.08% in the first full month, resulting in an estimated \$33.5 million in revenue annually. This is depicted in Attachment 3. The surcharge at the retail level is estimated to be 4.96% for the first month. For a residential customer using 1,000 kWh per month at an average rate of 6.5c/kWh, the increase is estimated to be about \$3.20 per month. The effect of the surcharge on each distribution cooperative and on their retail customers will vary depending upon the relationship of the level of purchased power to the total revenues of each distribution cooperative.
 20. Attachment 4 to this document provides the revised Environmental Surcharge Monthly Filing forms and tariff sheets in conformance with the provisions of this settlement. The attachment includes a redlined version compared to the original filing as well as a new version.

Other Provisions

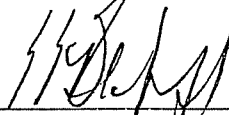
21. The Parties will jointly move the Commission to amend EKPC's Application in PSC Case No. 2004-00321, as provided hereinabove, to approve EKPC's Environmental Compliance Plan on such amended terms, and to authorize EKPC to implement its Environmental Surcharge on such amended Compliance Plan effective for service rendered beginning April 1, 2005.
22. This Settlement Agreement is subject to the approval of the Commission and shall not be deemed to affect the jurisdiction of the Commission or to in any way supercede Chapter 278 of the Kentucky Revised Statutes. Nothing in this settlement shall be considered as precedent in future cases before the Commission.
23. Upon formal adoption and acceptance by the Commission of this Settlement Agreement as a full resolution of all issues arising from the proceedings in the subject cases, all Parties agree that no petition for rehearing, pursuant to KRS §278.400, nor any appeal, pursuant to KRS §278.410, will be filed by any Party.

IN WITNESS WHEREOF, the duly authorized counsel for the Parties have affixed
their signatures to this Settlement Agreement on the date first above written.

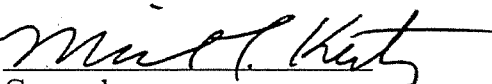
EAST KENTUCKY POWER
COOPERATIVE, INC. and
EKPC MEMBER SYSTEMS


Counsel

OFFICE OF THE ATTORNEY
GENERAL


Counsel

GALLATIN STEEL COMPANY


Counsel

Support for BESF Per Settlement Agreement

	<u>\$ Amount</u>	<u>Total \$</u>	<u>Source</u>
1.	Depreciation Expense	501,570	Staff 8, p. 3 of 3, 1st Request
		70,778	Staff 8, p. 3 of 3, 1st Request
		<u>30,960</u>	Staff 8, p. 3 of 3, 1st Request
	Total	603,308	
2.	Oper & Mtce*	39,462	Page 2 of 2
	Air Permit Fees	<u>188,636</u>	Wood Exhibit 2, p. 1 of 1
	Total O & M	228,098	
3.	Property Tax	12,217	Staff 8, p. 3 of 3, 1st Request
		1,974	Staff 8, p. 3 of 3, 1st Request
		<u>861</u>	Staff 8, p. 3 of 3, 1st Request
		15,052	
4.	Insurance	<u>11,203</u>	Gallatin 10, 1st Request
		11,203	
 <u>Return on Rate Base</u>			
5.	Rate Base		
	Precip	8,144,692	Wood Exhibit 1, p. 1 of 11
	Preheater	1,315,867	Wood Exhibit 1, p. 9 of 11
	Fans	<u>573,729</u>	Wood Exhibit 1, p. 10 of 11
		10,034,288	
6.	Cash Working Capital (1/8 of O&M)	<u>28,512</u>	Line 5* 1/8
	Total Rate Base	10,062,800	
	Apply Rate of Return	7.58%	
7.	Total Return on Rate Base	<u>762,760</u>	Gallatin 3 1st Request, P. 2 of 4
8.	Total Costs	1,620,421	Line 1+2+3+4+7
9.	Calculation of % of Member System Revenues to total revenues including off-system sales.		
	Member Sys Rev	240,629,490	76.29%
	Off System Sales Revenue	<u>74,774,167</u>	<u>23.71%</u>
		315,403,657	100.00%
	Total Costs Incl Rate of Return	1,620,421	
	Exclusion of Off-System Sales	<u>76.29%</u>	
	Revenue Requirement	<u>1,236,219</u>	
	Member Sys Revenue	240,629,490	
	Rev Req / Mbr Sys Revenues	0.51%	

Oper & Mtce Expense Reconciliation--BESF	1993 Costs	SOURCE
1. Operation & Maintenance Costs	\$213,791	Gallatin Request 3, Attachment, Page 1 of 4.
Elimination of O&M costs for Projects Not Tied to a Compliance Project		
2. Routine Ash System Maintenance	(\$86,526)	PSC First Data Request 13, Attachment, Page 1 of 1
3. Spurlock 2 Precipitator Maintenance	(\$68,787)	PSC First Data Request 13, Attachment, Page 1 of 1
4. Spurlock 2 Scrubber Maintenance	(\$19,016)	PSC First Data Request 13, Attachment, Page 1 of 1
O&M Cost for Settlement - BESF	\$39,462	Line 1 - Line 2 - Line 3 - Line 4

Weighted Average Cost of Debt

Compliance Project	Loan Source (1)	NBV as of 3/31/05 (2)	Cost (3)	Weights (4)=(2)*(3)
1. Gilbert	Z-8	\$69,612,000	4.84%	1.696%
2. Spurlock 1 - Precipitator	Y-8	\$22,480,163	4.96%	0.561%
3. Spurlock 1 - SCR	Y-8	\$69,937,007	4.96%	1.746%
4. Spurlock 2 - SCR	Y-8	\$36,670,706	4.96%	0.915%
		<u>\$198,699,876</u>		<u>4.918%</u>

Y-8 30 year

Note Number (1)	Current Liability 12/31/04 (2)	Interest Rate (3)	Yearly Interest (4)	Composite Rate Total (4)/ Total (2) (5)
F0720	\$25,000,000	4.460%	\$1,115,000	
F0725	\$25,000,000	4.819%	\$1,204,750	
F0730	\$24,800,000	4.950%	\$1,227,600	
F0750	\$25,000,000	5.091%	\$1,272,750	
F0755	\$25,000,000	5.149%	\$1,287,250	
F0760	\$25,000,000	5.065%	\$1,266,250	
F0765	\$25,000,000	5.011%	\$1,252,750	
F0770	\$27,000,000	5.149%	\$1,390,230	
	\$201,800,000		\$10,016,580	4.96%

Z8 34 Year

Note Number (1)	Current Liability 12/31/04 (2)	Interest Rate (3)	Yearly Interest (4)	Composite Rate Total (4)/ Total (2) (5)
F0810	\$50,000,000	4.744%	\$2,372,000	
F0815	\$50,000,000	4.825%	\$2,412,500	
F0820	\$50,000,000	4.946%	\$2,473,000	
	\$150,000,000		\$7,257,500	4.84%

ATTACHMENT 3

Environmental Surcharge: Recoverable Dollars

Based on Weighted Average Cost of Debt of: 4.918% @ 12/31/04 with TIER of 1.15 = 5.66%

Line No.	Description (1)	Estimated Value 3/31/2005 (2)	RORB: Col. (2) x 5.66% (3)	Annual Depreciation Expense (4)	Annual O&M Expense (5)	Taxes and insurance (6)	Environmental Surcharge Recoverable \$ (3)+(4)+(5)+(6)= (7)
	I. Return on Rate Base, Depreciation, Taxes and Insurance						
1	Gilbert	\$69,612,000	\$3,940,039	\$0			\$3,940,039
2	Spurlock 1- Precipitator	\$22,480,163	\$1,272,377	\$988,139		\$68,822	\$2,329,338
3	Spurlock 1 - SCR	\$69,937,007	\$3,958,435	\$3,702,644		\$214,110	\$7,875,189
4	Spurlock 2 - SCR	\$36,670,706	\$2,075,562	\$2,575,036		\$112,266	\$4,762,864
5	SO2 Allowance Inventory	\$14,166,551	\$801,827				\$801,827
6	NOx Emission Allowance Inventory	\$0	\$0				\$0
7	Cash Working Capital	\$178,605	\$10,109				\$10,109
8	Spare Parts & Limestone Inventory	\$0	\$0				\$0
	II. Other Expenses						
9	O&M Expense (including Air Permit Fees)				\$1,428,839		\$1,428,839
10	O&M Expense - Gilbert				\$0		\$0
11	SO2 Emission Allowance Expenses				\$14,816,460		\$14,816,460
12	NOx Emission Allowance Expenses				\$0		\$0
	Totals	\$213,045,032	\$12,058,349	\$7,265,819	\$16,245,299	\$395,198	\$35,964,665
13	Monthly Surcharge Allocation Factor	99.79%					
14	Recoverable Dollars = Monthly Surcharge Allocation Factor x Total ES Recoverable \$	\$35,889,139					
15	Projected Electric Energy Revenues from Member Systems in year ending March 31, 2005	\$472,783,000					
16	CESF: Recoverable \$ / Revenues	7.59%					
17	BESF	0.51%					
18	MESF (Line 16 - Line 17)	7.08%					
19	Recoverable Dollars (Line 15* 7.08%)	\$ 33,473,036					

EAST KENTUCKY POWER COOPERATIVE, INC

RATE ES – ENVIRONMENTAL SURCHARGE

APPLICABILITY

Applicable to all sections of this rate schedule and this rate schedule shall apply to each Member System.

AVAILABILITY

This rate schedule shall apply to EKPC rate sections A, B, C, E, and G and all special contracts with rates subject to adjustment upon the approval of the Commission.

RATE

The Environmental Surcharge shall provide for monthly adjustments based on a percent of revenues equal to the difference between the environmental compliance costs in the base period and in the current period based on the following formula:

$$\text{CESF} = \text{E(m)} / \text{R(m)}$$

$$\text{MESF} = \text{CESF} - \text{BESF}$$

MESF = Monthly Environmental Surcharge Factor

CESF = Current Environmental Surcharge Factor

BESF = Base Environmental Surcharge Factor of 0.51%

where E(m) is the total of each approved environmental compliance plan revenue requirement of environmental costs for the current expense month and R(m) is the revenue for the current expense month as expressed below.

Definitions

$$(1) \text{E(m)} = [(\text{RB}/12)(\text{RORB}) + \text{OE} - \text{BAS} + (\text{Over})\text{Under Recovery}]$$

where:

(a) RB is the Environmental Compliance Rate Base, defined as electric plant in service and CWIP for applicable environmental projects adjusted for accumulated depreciation, cash working capital, spare parts and limestone inventory, emission allowance inventory;

(b) RORB is the Rate of Return on the Environmental Compliance Rate Base, designated as the average cost of debt for environmental compliance plan projects approved by the Commission plus application of a times-interest-earned ratio of 1.15;

DATE OF ISSUE September 17, 2004 DATE EFFECTIVE Service rendered beginning April 1, 2005

ISSUED BY _____ TITLE _____ PRESIDENT/CEO _____

Issued by authority of an Order of the Public Service Commission of Kentucky in

CASE NO. _____ DATED _____

EAST KENTUCKY POWER COOPERATIVE, INC

-
- (c) OE is the Monthly Pollution Control Operating Expenses, defined as the average of the twelve month operating and maintenance expense; depreciation expense, property taxes, insurance expense, emission allowance expense, and consulting fees. O&M expense for the pollution-control related equipment at the Gilbert generating unit will be recovered by including an average of the monthly expense as the Unit begins operation;
 - (d) BAS is the net proceeds from By-Products and Emission Allowance Sales, and;
 - (e) (Over) or Under recovery amount as amortized from prior six-month period.

(2) Total $E(m)$ is multiplied by the Member System Allocation Ratio to arrive at Net $E(m)$. The Member System Allocation Ratio is based on the ratio of the 12-month total revenue from sales to Member Systems to which the Surcharge will be applied, ending with the current expense month, divided by the 12-month total revenue from sales to Member Systems and off-system sales.

(3) The revenue $R(m)$ is the average monthly revenue, including base revenues and automatic adjustment clause revenues less Environmental Cost Recovery Surcharge revenues, for EKPC for the twelve months ending with the current expense month.

(4) The current expense month (m) shall be the second month preceding the month in which the Environmental Surcharge is billed.

DATE OF ISSUE September 17, 2004 DATE EFFECTIVE Service rendered beginning April 1, 2005

ISSUED BY _____ TITLE PRESIDENT/CEO

Issued by authority of an Order of the Public Service Commission of Kentucky in

CASE NO. _____ DATED _____

FOR ENTIRE TERRITORY SERVED
Community, Town or City

P.S.C. KY. NO. _____

Original SHEET NO. _____

Member System
(Name of Utility)

CLASSIFICATION OF SERVICE

RATES SCHEDULE ES – ENVIRONMENTAL SURCHARGE

AVAILABILITY

In all of the Company's service territory.

APPLICABILITY

This rate schedule shall apply to all electric rate schedules and special contracts.

RATE

$$CES(m) = ES(m) - BESF$$

where CES(m) = Current Month Environmental Surcharge Factor
ES(m) = Current Month Environmental Surcharge Calculation
BESF = Base Environmental Surcharge Factor of 0%

$$ES(m) = \frac{[(WESF) \times (\text{Average of 12-months ended revenues from sales to Member System for current expense month, excluding environmental surcharge}) + (\text{Over/Under Recovery})]}{[\text{Average of 12-months ending Retail Revenue (excluding environmental surcharge)}]} \text{ divided by } \underline{\hspace{2cm}} \% =$$

where WESF = Wholesale Environmental Surcharge Factor for Current Expense Month

DATE OF ISSUE September 17, 2004
Month / Date / Year

DATE EFFECTIVE April 1, 2005
Month / Date / Year

ISSUED BY _____
(Signature of Officer)

TITLE PRESIDENT/CEO

BY AUTHORITY OF ORDER OF THE PUBLIC SERVICE COMMISSION
IN CASE NO. _____ DATED _____

FOR ENTIRE TERRITORY SERVED
Community, Town or City

P.S.C. KY. NO. _____

Original SHEET NO. _____

Member System
(Name of Utility)

CLASSIFICATION OF SERVICE

(Over)/Under Recovery =

6-months cumulative (over)/under recovery as defined by amount billed by EKPC to Member System minus the amount billed by Member System to retail customer. Over or under recoveries shall be amortized over a six-month period.

BESF = zero

BILLING

The current expense month (m) shall be the second month preceding the month in which the Environmental Surcharge is billed.

DATE OF ISSUE September 17, 2004
Month / Date / Year

DATE EFFECTIVE April 1, 2005
Month / Date / Year

ISSUED BY _____
(Signature of Officer)

TITLE PRESIDENT/CEO

BY AUTHORITY OF ORDER OF THE PUBLIC SERVICE COMMISSION
IN CASE NO. _____ DATED _____

EAST KENTUCKY POWER COOPERATIVE, INC

DATE OF ISSUE September 17, 2004
Month / Date / Year

DATE EFFECTIVE April 1, 2005
Month / Date / Year

ISSUED BY _____
(Signature of Officer)

TITLE PRESIDENT/CEO

BY AUTHORITY OF ORDER OF THE PUBLIC SERVICE COMMISSION
IN CASE NO. _____ DATED _____

EAST KENTUCKY POWER COOPERATIVE, INC

RATE ES – ENVIRONMENTAL SURCHARGE

APPLICABILITY

Applicable to all sections of this rate schedule and this rate schedule shall apply to each Member System.

AVAILABILITY

This rate schedule shall apply to EKPC rate sections A, B, C, E, and G and all special contracts with rates subject to adjustment upon the approval of the Commission.

RATE

The Environmental Surcharge shall provide for monthly adjustments based on a percent of revenues equal to the difference between the environmental compliance costs in the base period and in the current period based on the following formula:

$$\text{CESF} = \text{E(m)} / \text{R(m)}$$

$$\text{MESF} = \text{CESF} - \text{BESF}$$

MESF = Monthly Environmental Surcharge Factor

CESF = Current Environmental Surcharge Factor

BESF = Base Environmental Surcharge Factor ~~of 0.51%~~

where E(m) is the total of each approved environmental compliance plan revenue requirement of environmental costs for the current expense month and R(m) is the revenue for the current expense month as expressed below.

Definitions

$$(1) \text{E(m)} = [(\text{RB}/12)(\text{RORB}) + \text{OE} - \text{BAS} + (\text{Over})\text{Under Recovery}]$$

where:

(a) RB is the Environmental Compliance Rate Base, defined as electric plant in service and CWIP for applicable environmental projects adjusted for accumulated depreciation, cash working capital, spare parts and limestone inventory, emission allowance inventory;

(b) RORB is the Rate of Return on the Environmental Compliance Rate Base, designated as the ~~average overall~~ cost of debt ~~for environmental compliance plan projects approved by the Commission updated every six months~~ plus application of a times-interest-earned ratio of 1.15;

DATE OF ISSUE September 17, 2004 DATE EFFECTIVE Service rendered beginning April 1, 2005

ISSUED BY _____ TITLE _____ PRESIDENT/CEO _____

Issued by authority of an Order of the Public Service Commission of Kentucky in

CASE NO. _____ DATED _____

EAST KENTUCKY POWER COOPERATIVE, INC

(c) OE is the Monthly Pollution Control Operating Expenses, defined as the average of the twelve month incremental operating and maintenance expense, () depreciation expense property taxes, insurance expense, emission allowance expense, and consulting fees, adjusted for average monthly expense included in base rates. O&M expense for the pollution control related equipment at the Gilbert generating unit will be recovered by including an average of the monthly expense as the Unit begins operation.

(d) BAS is the net proceeds from By-Products and Emission Allowance Sales, and;
(e) (Over) or Under recovery amount as amortized from prior six-month period.

(2) Total E(m) is multiplied by the Member System Allocation Ratio to arrive at Net E(m). The Member System Allocation Ratio is based on the ratio of the 12-month total revenue from sales to Member Systems to which the Surcharge will be applied, ending with the current expense month, divided by the 12-month total revenue from sales to Member Systems and off-system sales.

(3) The revenue R(m) is the average monthly revenue, including base revenues and automatic adjustment clause revenues less Environmental Cost Recovery Surcharge revenues, for EKPC for the twelve months ending with the current expense month.

(4) The current expense month (m) shall be the second month preceding the month in which the Environmental Surcharge is billed.

DATE OF ISSUE September 17, 2004 DATE EFFECTIVE Service rendered beginning April 1, 2005

ISSUED BY _____ TITLE _____ PRESIDENT/CEO

Issued by authority of an Order of the Public Service Commission of Kentucky in

CASE NO. _____ DATED _____

FOR ENTIRE TERRITORY SERVED
Community, Town or City

P.S.C. KY. NO. _____

Original SHEET NO. _____

Member System
(Name of Utility)

CLASSIFICATION OF SERVICE

(Over)/Under Recovery =

6-months cumulative (over)/under recovery as defined by amount billed by EKPC to Member System minus the amount billed by Member System to retail customer. Over or under recoveries shall be amortized over a six-month period.

BESF = zero

BILLING

The current expense month (m) shall be the second month preceding the month in which the Environmental Surcharge is billed.

DATE OF ISSUE September 17, 2004
Month / Date / Year

DATE EFFECTIVE April 1, 2005
Month / Date / Year

ISSUED BY _____
(Signature of Officer)

TITLE PRESIDENT/CEO

BY AUTHORITY OF ORDER OF THE PUBLIC SERVICE COMMISSION
IN CASE NO. _____ DATED _____

EAST KENTUCKY POWER COOPERATIVE, INC

DATE OF ISSUE September 17, 2004
Month / Date / Year

DATE EFFECTIVE April 1, 2005
Month / Date / Year

ISSUED BY _____
(Signature of Officer)

TITLE PRESIDENT/CEO

BY AUTHORITY OF ORDER OF THE PUBLIC SERVICE COMMISSION
IN CASE NO. _____ DATED _____

East Kentucky Power Cooperative, Inc.
Environmental Surcharge Report

Form 1.0

Calculation of Monthly Billed Environmental Surcharge Factor - MESF

For the Expense Month Ending March 31, 2005

$$\text{MESF} = \text{CESF} - \text{BESF}$$

Where:

CESF = Current Period Environmental Surcharge Factor

BESF = Base Period Environmental Surcharge Factor

Calculation of MESF:

CESF, from ES Form 1.1 = _____
BESF, from Case No. 2004-00321 = 0.51%

MESF = _____

Effective Date for Billing: _____

Submitted by:

Date Submitted:

East Kentucky Power Cooperative, Inc.
Environmental Surcharge Report

Form 1.1

Calculation of Current Month Environmental Surcharge Factor (CESF)

For the Expense Month Ending March 31, 2005

1 $E(m) = RORB + OE - BAS$

2 Rate Base

3 Rate Base / 12

4 Rate of Return =

5 Return on Rate Base (RORB) +

6 Operating Expenses (OE) +

7 By-Product and Emission Allowance Sales (BAS) - _____

8 Sub-Total E(m)

9 Member System Allocation Ratio for the Month
(Form 3.0)

10 Subtotal E(m) = Subtotal E(m) x Member System
Allocation Ratio

11 Adjustment for (Over)/Under Recovery,
as applicable

12 E(m) = Subtotal E(m) plus (Over)/Under Recovery

13 R(m) = Average Monthly Member System
Revenue for the 12 Months Ending with the
Current Expense Month (Form 3.0)

14 CESF:
E(m) / R(m); as a % of Revenue

**East Kentucky Power Cooperative, Inc.
Environmental Surcharge Report**

Form 2.0

Revenue Requirements of Environmental Compliance Costs
For the Expense Month of Ending March 31, 2005

Determination of Environmental Compliance Rate Base

Eligible Pollution Control Plant (Gross Plant)	
Eligible Pollution CWIP	
Subtotal	_____
<i>Additions:</i>	
Inventory - Spare Parts	
Inventory - Limestone	
Inventory - Emission Allowances	
Cash Working Capital Allowance	
Subtotal	_____
<i>Deductions</i>	
Accumulated Depreciation on Eligible Pollution Control Plant	
Subtotal	_____
Environmental Compliance Rate Base	_____

Determination of Pollution Control Operating Expenses

Monthly O&M Expense	
Monthly Depreciation and Amortization Expense	
Monthly Taxes Other Than Income Taxes	
Monthly Insurance Expense	
Monthly Emission Allowance Expense	
Monthly Surcharge Consultant Fee	
Total Pollution Control Operating Expense	_____

Gross Proceeds from By-Product and Emission Allowance Sales

Total Proceeds from By-Product and Allowance Sales	_____
--	-------

**(Over)/Under Recovery of Monthly
Surcharge Due to Timing Differences**

1	E(m) Revenue Requirement for Six Month Period Ending _____	\$
2	Revenue Collected for Six-Month Period Ending _____	\$
3	Net (Over)/Under Recovery (Row 1 - Row 2)	\$
4	Amortization of Net (Over)/Under Recovery Line (3) / 6	\$

Form 2.1

East Kentucky Power Cooperative, Inc.
Environmental Surcharge Report
Plant, CWIP, Depreciation, & Taxes and Insurance Expenses
For the Month Ending March 31, 2005

	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Project No.	Description	Eligible Gross Plant in Service	Eligible Accumulated Depreciation	CWIP Amount	Eligible Net Plant in Service $(2)-(3)-(4)+(5)$	Monthly Depreciation Expense	Monthly Taxes and Insurance Expense
1	Gilbert						
2	Spurlock 1 Precipitator						
3	Spurlock 1 SCR						
4	Spurlock 2 SCR						
	Total						

East Kentucky Power Cooperative, Inc.
Environmental Surcharge Report

Form 2.2

Inventories of Spare Parts and Limestone

For the Month Ending March 31, 2005

(1)	(2)	(3)	(4)	(5)	(6)	(7)
	Beginning Inventory	Purchases	Other Adjustments	Utilized	Ending Inventory	Reason(s) for Adjustment
					(2)+(3)+(4)-(5)	
Spare Parts						
Limestone						
Total						

East Kentucky Power Cooperative, Inc.
Environmental Surcharge Report

Inventory and Expense of Emission Allowances

For the Month ending March 31, 2005

SO2 Allowances

<i>Month Ending March 31, 2005</i>					
	Beginning Inventory	Allocations/ Purchases	Utilized	Sold	Ending Inventory
Total SO2 Emission Allowances in Inventory*					
Quantity					
Dollars					
\$/Allowance					

NOx Allowances

<i>Month Ending March 31, 2005</i>					
	Beginning Inventory	Allocations/ Purchases	Utilized	Sold	Ending Inventory
Total NOx Emission Allowances in Inventory*					
Quantity					
Dollars					
\$/Allowance					

*Includes coal-fired allowances only.

East Kentucky Power Cooperative, Inc. Form 2.4
Environmental Surcharge Report
O&M Expenses and Determination of Cash Working Capital Allowance

For the Expense Month Ending March 31, 2005

Eligible O&M Expenses	Non-Gilbert	Gilbert	Total
11th previous month			
10th previous month			
9th previous month			
8th previous month			
7th previous month			
6th previous month			
5th previous month			
4th previous month			
3rd previous month			
2nd previous month			
Previous month			
Current month			
Total 12 Month O&M			
Average Monthly O&M			

Determination of Working Capital Allowance			
12 Months O&M Expense			
One-Eighth (1/8) of 12 Month O&M Expenses			

East Kentucky Power Cooperative, Inc.
Environmental Surcharge
Operating and Maintenance Expenses
For the Expense Month Ending March 31, 2005

Form 2.5

Expense Type	Account Description	Amount
I Maintenance		
50144	Fuel Coal Gilbert	
51241	Maintenance of Boiler Plant Spurlock 1	
51242	Maintenance of Boiler Plant Spurlock 2	
51244	Maintenance of Boiler Plant Gilbert	
		=====
II Air Permit Fees		
50621	Misc Steam Power Environmental Dale	
50631	Misc Steam Power Environmental Cooper	
50645	Misc Steam Power Environmental Spurlock	
		=====
III Operating Expense - Ammonia and Limestone		
50641	Misc Steam Power Expense - Spurlock 1	
50642	Misc Steam Power Expense - Spurlock 2	
50644	Misc Steam Power Expense - Gilbert	
		=====

Form 3.0

East Kentucky Power Cooperative, Inc.
Environmental Surcharge Report
Monthly Average Revenue Computation of R(m)

For the Month Ended March 31, 2005

		Revenues from Member Systems					Total Company Revenues		
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	
Month	Base Rate Revenues	Fuel Clause Revenues	Environmental Surcharge Revenues	Total (2)+(3)+(4)	Total Excluding Environmental Surcharge (5)-(4)	Off-System Sales	Total (5)+(7)	Total Excluding Environmental Surcharge (8)-(4)	
Apr-04									
May-04									
Jun-04									
Jul-04									
Aug-04									
Sep-04									
Oct-04									
Nov-04									
Dec-04									
Jan-05									
Feb-05									
Mar-05									
Totals									
Average Monthly Member System Revenues, Excluding Environmental Surcharge, for 12 Months Ending Current Expense Month.									
		Member System Allocation Percentage for Current Month							
		(Environmental Surcharge excluded from Calculations): Column (6) / Column (9) =							

East Kentucky Power Cooperative, Inc.
Environmental Surcharge Report

Form 1.0

Calculation of Monthly Billed Environmental Surcharge Factor - MESF

For the Expense Month Ending March 31, 2005

$$\text{MESF} = \text{CESF} - \text{BESF}$$

Where:

CESF = Current Period Environmental Surcharge Factor
BESF = Base Period Environmental Surcharge Factor

0

Calculation of MESF:

CESF, from ES Form 1.1 =
BESF, from Case No. 2004-00321 = 0.5195
MESF = _____

Effective Date for Billing: _____

Submitted by:

Date Submitted:

East Kentucky Power Cooperative, Inc.
Environmental Surcharge Report

Form 1.1

Calculation of Current Month Environmental Surcharge Factor (CESF)

For the Expense Month Ending March 31, 2005

1 $E(m) = RORB + OE - BAS$

2 Rate Base

3 Rate Base / 12

4 Rate of Return =

5 Return on Rate Base (RORB) +

6 Operating Expenses (OE) +

7 By-Product and Emission Allowance Sales (BAS) - _____

8 Sub-Total E(m)

9 Member System Allocation Ratio for the Month
(Form 3.0)

10 Subtotal E(m) = Subtotal E(m) x Member System
Allocation Ratio

11 Adjustment for (Over)/Under Recovery,
as applicable

12 E(m) = Subtotal E(m) plus (Over)/Under Recovery

13 R(m) = Average Monthly Member System
Revenue for the 12 Months Ending with the
Current Expense Month (Form 3.0)

14 CESF:
E(m) / R(m); as a % of Revenue

**East Kentucky Power Cooperative, Inc.
Environmental Surcharge Report**

Form 2.0

Revenue Requirements of Environmental Compliance Costs
For the Expense Month of Ending March 31, 2005

Determination of Environmental Compliance Rate Base

Eligible Pollution Control Plant (Gross Plant)	
Eligible Pollution CWIP	
Subtotal	_____
<i>Additions:</i>	
Inventory - Spare Parts	
Inventory - Limestone	
Inventory - Emission Allowances	
Cash Working Capital Allowance	
Subtotal	_____
<i>Deductions</i>	
Accumulated Depreciation on Eligible Pollution Control Plant	
Subtotal	_____
Environmental Compliance Rate Base	_____

Determination of Pollution Control Operating Expenses

Monthly O&M Expense	
Monthly Depreciation and Amortization Expense	
Monthly Taxes Other Than Income Taxes	
Monthly Insurance Expense	
Monthly Emission Allowance Expense	
Monthly Surcharge Consultant Fee	
Total Pollution Control Operating Expense	_____

Gross Proceeds from By-Product and Emission Allowance Sales

Total Proceeds from By-Product and Allowance Sales	_____
--	-------

**(Over)/Under Recovery of Monthly
Surcharge Due to Timing Differences**

1	E(m) Revenue Requirement for Six Month Period Ending _____	\$
2	Revenue Collected for Six-Month Period Ending _____	\$
3	Net (Over)/Under Recovery (Row 1 - Row 2)	\$
4	Amortization of Net (Over)/Under Recovery Line (3) / 6	\$

East Kentucky Power Cooperative, Inc.
Environmental Surcharge Report

Form 2.2

Inventories of Spare Parts and Limestone

For the Month Ending March 31, 2005

(1)	(2)	(3)	(4)	(5)	(6)	(7)
	Beginning Inventory	Purchases	Other Adjustments	Utilized	Ending Inventory	Reason(s) for Adjustment
					(2)+(3)+(4)-(5)	
Spare Parts						
Limestone						
Total						

East Kentucky Power Cooperative, Inc.
Environmental Surcharge Report

Inventory and Expense of Emission Allowances

For the Month ending March 31, 2005

SO2 Allowances

<i>Month Ending March 31, 2005</i>					
	Beginning Inventory	Allocations/ Purchases	Utilized	Sold	Ending Inventory
Total SO2 Emission Allowances in Inventory					
Quantity					
Dollars					
\$/Allowance					

NOx Allowances

<i>Month Ending March 31, 2005</i>					
	Beginning Inventory	Allocations/ Purchases	Utilized	Sold	Ending Inventory
Total NOx Emission Allowances in Inventory					
Quantity					
Dollars					
\$/Allowance					

***Includes coal-fired allowances only.**

East Kentucky Power Cooperative, Inc. Form 2.4
Environmental Surcharge Report
O&M Expenses and Determination of Cash Working Capital Allowance

For the Expense Month Ending March 31, 2005

Eligible O&M Expenses	Non-Gilbert	Gilbert	Total
11th previous month			
10th previous month			
9th previous month			
8th previous month			
7th previous month			
6th previous month			
5th previous month			
4th previous month			
3rd previous month			
2nd previous month			
Previous month			
Current month			
Total 12 Month O&M			
Less: Baseline			
Average Monthly O&M			
12 months Incremental O&M			
Monthly Incremental O&M			

Determination of Working Capital Allowance			
12 Months Incremental O&M Expense			
One-Eighth (1/8) of 12 Month Incremental O&M Expenses			

East Kentucky Power Cooperative, Inc.
Environmental Surcharge
Operating and Maintenance Expenses
For the Expense Month Ending March 31, 2005

Form 2.5

Expense Type	Account Description	Amount	Amt. for 12 months ended 12/31/1993	Eligible Recovery
I	Maintenance			
	50144 Fuel Coal Gilbert			
	51240 Maintenance of Boiler Plant Spurlock			
	51241 Maintenance of Boiler Plant Spurlock 1			
	51242 Maintenance of Boiler Plant Spurlock 2			
	51243 Maintenance of Boiler Plant Scrubbers			
	51244 Maintenance of Boiler Plant Gilbert			
	55354 Maintenance of Generating Equipment CT			
II	Air Permit Fees			
	50621 Misc Steam Power Environmental Dale			
	50631 Misc Steam Power Environmental Cooper			
	50645 Misc Steam Power Environmental Spurlock			
	51964 Environmental Expense CT			
III	Operating Expense - Ammonia and Limestone			
	50641 Misc Steam Power Expense - Spurlock 1			
	50642 Misc Steam Power Expense - Spurlock 2			
	50644 Misc Steam Power Expense - Gilbert			

Form 3.0

East Kentucky Power Cooperative, Inc.
Environmental Surcharge Report
Monthly Average Revenue Computation of R(m)

For the Month Ended March 31, 2005

(1) Month	Revenues from Member Systems						Total Company Revenues	
	(2) Base Rate Revenues	(3) Fuel Clause Revenues	(4) Environmental Surcharge Revenues	(5) Total (2)+(3)+(4)	(6) Total Excluding Environmental Surcharge (5)-(4)	(7) Off-System Sales	(8) Total (5)+(7)	(9) Total Excluding Environmental Surcharge (8)-(4)
Apr-04								
May-04								
Jun-04								
Jul-04								
Aug-04								
Sep-04								
Oct-04								
Nov-04								
Dec-04								
Jan-05								
Feb-05								
Mar-05								
Totals								
Average Monthly Member System Revenues, Excluding Environmental Surcharge, for 12 Months Ending Current Expense Month.								
Member System Allocation Percentage for Current Month (Environmental Surcharge excluded from Calculations): Column (6) / Column (9) =								

APPENDIX B

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NOS. 2004-00321 and 2004-00372 DATED March 17, 2005

Monthly Reporting Format for Pass Through Mechanism

The attached reporting format should be submitted by the Distribution Cooperatives along with East Kentucky's monthly environmental surcharge report.

**East Kentucky Power Cooperative, Inc. – Distribution Cooperatives
Pass Through Mechanism Report for _____ (Cooperative)**

For the Month Ending _____

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)
Surcharge Factor Expense Month	EKPC CESF %	EKPC BESF %	EKPC MESF %	EKPC Monthly Rev. from Sales to Coop.	On Peak Rev. Adjust.	EKPC Net Monthly Sales to Coop.	EKPC 12-mon. Ended Aver. Monthly Rev. from Sales to Coop., Net	Coop. Rev. Require	Amort. Of (Over)/ Under Recover.	Coop. Net Rev. Require	Coop. Total Monthly Retail Rev.	On Peak Retail Rev. Adjust.	Coop. Net Monthly Retail Rev.	12-mon. Ended Aver. Retail Rev., Net	Coop. Pass Through Mechanism Factor
			(1) – (2)			(4) – (5)		(3) x (7)		(8) + (9)			(11) – (12)		(10) / (14)

Notes:

List monthly revenues for Columns (4), (5), (6), (11), (12), and (13) used to determine the average revenues shown in Columns (7) and (14).

Coop. Total Monthly Retail Revenues in Column (11) includes demand and energy revenues, customer charges, and FAC revenues.

Amounts should be shown in Columns (5), (9), and (12) as applicable.

If Cooperative has a Green Power Tariff, include the following statement below the column headings:

“Revenues reported in Columns (11), (13), and (14) are net of Green Power Revenues.”