

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN ELECTRONIC EXAMINATION BY THE	)	
PUBLIC SERVICE COMMISSION OF THE	)	
ENVIROMENTAL SURCHARGE MECHANISM	)	CASE NO.
OF EAST KENTUCKY POWER COOPERATIVE,	)	2025-00266
INC. FOR THE TWO-YEAR EXPENSE PERIOD	)	
ENDING MAY 31, 2025, AND THE PASS-	)	
THROUGH MECHANISM OF ITS SIXTEEN	)	
MEMBER DISTRIBUTION COOPERATIVES	)	

DIRECT TESTIMONY OF JACOB R. WATSON
ON BEHALF OF EAST KENTUCKY POWER COOPERATIVE, INC.

Filed: October 15, 2025

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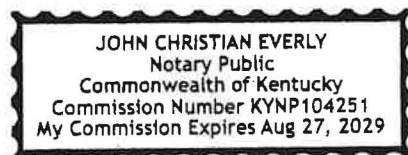
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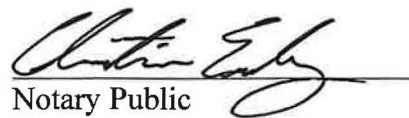
STATE OF KENTUCKY)
)
COUNTY OF CLARK)

Jacob R. Watson, being duly sworn, states that he has read the foregoing prepared testimony and that he would respond in the same manner to the questions if so asked upon taking the stand and that the matter and things set forth therein are true and correct, to the best of his knowledge, information and belief.


Jacob R. Watson

Subscribed and sworn before me on this 15th day of October, 2025.




Notary Public

1 **Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, AND OCCUPATION.**

2 A. My name is Jacob R. Watson, and I am the Manager of Rates and Regulatory for East
3 Kentucky Power Cooperative, Inc. ("EKPC"). My business address is 4775 Lexington
4 Road, Winchester, Kentucky 40391

5 **Q. PLEASE STATE YOUR EDUCATION AND PROFESSIONAL EXPERIENCE.**

6 A. I received a Bachelor of Science in Accounting, from the University of the Cumberland
7 in 2011, a Masters of Business Administration from the University of the Cumberland in
8 2014, and a Ph.D. in Business Administration with a concentration in Accounting from the
9 University of the Cumberland in 2021. I am also a Certified Fraud Examiner. My
10 professional experience includes working as a Financial Analyst for Pepsi MidAmerica
11 and Internal Auditor for Farmers Capital Bank Corporation. For the last ten years I have
12 been at East Kentucky Power Cooperative having worked as an Accountant, Sr. Load
13 Forecast Analyst, and I am currently the Manager of Rates and Regulatory.

14 **Q. PLEASE PROVIDE A BRIEF DESCRIPTION OF YOUR DUTIES AT EKPC.**

15 A. As Manager of Rates and Regulatory, I am responsible for compiling filings presented to
16 the Commission as well as rate-making activities which include designing and developing
17 wholesale and retail electric rates and developing pricing concepts and methodologies. I
18 report directly to the Director of Regulatory and Compliance Services, Mr. Gregory H.
19 Cecil.

20 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?**

21 A. The purpose of my testimony is to address the following topics:

- 22 • Describe how EKPC and its Owner-Members applied the environmental surcharge
23 mechanism and the pass-through mechanism in a reasonable manner during the period
24 under review;

- 1 • Propose updating the rate of return used in the environmental surcharge calculation;
- 2 and
- 3 • Discuss EKPC and its Owner-Members' position concerning a roll-in of the
- 4 environmental surcharge into EKPC's wholesale base rates.

5 **Q. IS EKPC PREPARING TESTIMONY AND RESPONDING TO DATA REQUESTS**
6 **ON BEHALF OF ITS OWNER-MEMBERS?**

7 A. Pursuant to the Commission's September 19, 2025 Order, EKPC is preparing testimony on
8 behalf of each Owner-Member. The Owner-Members are: Big Sandy Rural Electric
9 Cooperative Corporation ("RECC"), Blue Grass Energy Cooperative Corporation, Clark
10 Energy Cooperative, Inc., Cumberland Valley Electric, Inc. ("Cumberland Valley"),
11 Farmers RECC, Fleming-Mason Energy Cooperative ("Fleming-Mason"), Grayson
12 RECC, Inter-County Energy Cooperative Corporation ("Inter-County"), Jackson Energy
13 Cooperative, Licking Valley RECC, Nolin RECC ("Nolin"), Owen Electric Cooperative
14 ("Owen"), Salt River Electric Cooperative Corporation, Shelby Energy Cooperative, Inc.
15 ("Shelby"), South Kentucky RECC, and Taylor County RECC. EKPC is also providing
16 Response No. 2 to the Commission Staff's First Request for Information ("Staff's First
17 Request").

18 **Q. HAVE OTHER EKPC REPRESENTATIVES PROVIDED RESPONSES TO**
19 **COMMISSION STAFF'S FIRST REQUEST FOR INFORMATION IN THIS**
20 **PROCEEDING?**

21 A. Yes. Mark Horn, Director of Fuel and Emissions, provided emission allowance
22 information in Response No. 3 to the Staff's First Request. Thomas Stachnik, Vice
23 President – Finance and Treasurer, provided the debt and average interest rate information
24 in Response No. 5 to the Staff's First Request.

1 **Q. WOULD YOU IDENTIFY THE TWO-YEAR REVIEW PERIOD INCLUDED IN**
2 **THIS PROCEEDING?**

3 A. The Commission's September 19, 2025 Order identified the two-year review period as the
4 expense month ending May 31, 2025.

5 **Q. PREVIOUS COMMISSION ORDERS REQUIRED EKPC TO INCORPORATE**
6 **CERTAIN PROVISIONS INTO THE CALCULATION OF THE MONTHLY**
7 **ENVIRONMENTAL SURCHARGE FACTORS. PLEASE COMMENT ON HOW**
8 **EKPC ADDRESSED THE MOST SIGNIFICANT ASPECTS OF THESE ORDERS**
9 **DURING THE PERIODS UNDER REVIEW.**

10 A. A brief description of each component of the environmental surcharge calculation, applied
11 consistently with Commission Orders, is discussed below.

12 **• Compliance Plan Projects**

13 As of the end of the 24-month review period, EKPC has 40 projects in its
14 Environmental Compliance Plan. These projects were approved by the Commission in
15 Case Nos. 2004-00321,¹ 2008-00115,² 2010-00083,³ 2013-00259,⁴ 2014-00252,⁵

¹ See *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*, Order, Case No. 2004-00321, (Ky. P.S.C., Mar. 17, 2005).

² See *In the Matter of the Application of East Kentucky Power Cooperative, Inc. for Approval of an Amendment to Its Environmental Compliance Plan and Environmental Surcharge*, Order, Case No. 2008-00115, (Ky. P.S.C., Sep. 29, 2008).

³ See *In the Matter of Application of East Kentucky Power Cooperative, Inc. for Approval of an Amendment to Its Environmental Compliance Plan and Environmental Surcharge*, Order, Case No. 2010-00083, (Ky. P.S.C., Sep. 24, 2010).

⁴ See *In the Matter of Application of East Kentucky Power Cooperative, Inc. for a Certificate of Public Convenience and Necessity for Alteration of Certain Equipment at the Cooper Station and Approval of a Compliance Plan Amendment for Environmental Surcharge Cost Recovery*, Order, Case No. 2013-00259, (Ky. P.S.C., Feb. 20, 2014).

⁵ See *In the Matter of Application of East Kentucky Power Cooperative, Inc. for a Certificate of Public Convenience and Necessity for construction of an Ash Landfill at J.K. Smith Station, the Removal of Impounded Ash from William C. Dale Station for Transport to J.K. Smith and Approval of a Compliance Plan Amendment for Environmental Surcharge Recovery*, Order, Case No. 2014-00252, (Ky. P.S.C., Mar. 6, 2015).

1 2017-00376,⁶ 2018-00270,⁷ 2023-00177,⁸ and 2024-00109⁹. EKPC is also proposing
2 to include 18 new projects in Case No. 2025-00053¹⁰. In conjunction with the
3 establishment of a regulatory asset for the undepreciated balance of the William C.
4 Dale Generating Station assets that were being retired early, EKPC was required in
5 Case No. 2015-00302¹¹ to remove Project 5, Dale Low Nitrogen Oxide Burners, and
6 Project 10, Dale Continuous Monitoring Equipment, from the environmental
7 surcharge. The monthly environmental surcharge reports, incorporated by reference in
8 this case, show the capital costs for the remaining projects.

9 • **Base/Current Method**

10 The surcharge mechanism, as shown in EKPC's Rate ES – Environmental Surcharge,
11 reflects the base/current method through the formula $MESF = CESF - BESF$.¹² As

⁶ See *In the Matter of Application of East Kentucky Power Cooperative, Inc. for Approval to Amend Its Environmental Compliance Plan and Recover Costs Pursuant to Its Environmental Surcharge, Settlement of Certain Asset Retirement Obligations and Issuance of a Certificate of Public Convenience and Necessity and Other Relief*, Order, Case No. 2017-00376, (Ky. P.S.C., May 18, 2018).

⁷ See *In the Matter of Application of East Kentucky Power Cooperative, Inc. for Approval to Amend Its Environmental Compliance Plan and Recover Costs Pursuant to Its Environmental Surcharge, and for the Issuance of a Certificate of Public Convenience and Necessity*, Order, Case No. 2018-00270, (Ky. P.S.C., Apr. 1, 2019).

⁸ See *In the Matter of Application of East Kentucky Power Cooperative, Inc. for Approval to Amend Its Environmental Compliance Plan and Recover Costs Pursuant to Its Environmental Surcharge, and for the Issuance of a Certificate of Public Convenience and Necessity*, Order, Case No. 2023-00177, (Ky. P.S.C., Jan. 11, 2024).

⁹ See *In the Matter of Application of East Kentucky Power Cooperative, Inc. for Approval to Amend Its Environmental Compliance Plan and Recover Costs Pursuant to Its Environmental Surcharge, and for the Issuance of a Certificate of Public Convenience and Necessity*, Order, Case No. 2024-00109, (Ky. P.S.C., Nov. 22, 2024).

¹⁰ See *In the Matter of Application of East Kentucky Power Cooperative, Inc. for Approval to Amend Its Environmental Compliance Plan and Recover Costs Pursuant to Its Environmental Surcharge, and Other General Relief*, Case No. 2025-00053.

¹¹ See *In the Matter of Application of East Kentucky Power Cooperative, Inc. for an Order Approving the Establishment of a Regulatory Asset for the Undepreciated Balance of the William C. Dale Generating Station*, Order, Case No. 2015-00302, (Ky. P.S.C. Feb. 11, 2016). Projects 5 and 10 were originally approved as part of EKPC's environmental compliance plan and eligible for surcharge recovery in Case No. 2008-00115.

¹² MESF is the Monthly Environmental Surcharge Factor; CESF is the Current Environmental Surcharge Factor; and BESF is the Base Environmental Surcharge Factor.

described later in my testimony, EKPC is proposing no change to the BESF. EKPC has not identified any additional projects or expenses being recovered in both the Environmental Surcharge Compliance Plan and Base Rates.

- **Actual Emission Allowance Expense**

EKPC included only actual sulfur dioxide (“SO₂”) and nitrogen oxide (“NO_x”) emission allowance expense in the monthly filings.

- **Return on Emission Allowance Inventory and Limestone Inventory**

EKPC included a return on all environmental surcharge assets, including emission allowances. Any purchase of allowances during the review period is addressed in Response No. 3 to the Staff’s First Request. EKPC also included a return on its limestone inventory.

EKPC’s emission allowance inventories for SO₂ and NO_x reflect operations under the Cross-State Air Pollution Rules (“CSAPR”) along with a continuation of the Acid Rain program. Under CSAPR, SO₂ and NO_x allowances are awarded annually with carry-forward of unused balances from prior years. The allowances allocated to EKPC by the Environmental Protection Agency (“EPA”) under CSAPR have a dollar value of \$0, which is consistent with the valuation afforded EPA allocated allowances under prior programs. EKPC’s SO₂ inventory as of the end of the review period reflects the allowances remaining from the Acid Rain program. The NO_x inventory as of the end of the review period has a \$0 balance as all the allowances were issued under CSAPR.

- **Return on Construction Work in Progress (“CWIP”), Net of Allowance for Funds Used During Construction**

As approved in Case No. 2008-00115, EKPC included a return on CWIP during the period under review.

1 • **Rate of Return**

2 Three rates of return were in effect during the periods under review. For the expense
3 months of May 2023 through January 2024, the rate of return was 5.093%, which was
4 approved by the Commission in Case No. 2021-00103.¹³ For the expense months of
5 February 2024 through October 2024, the rate of return was 6.487%, which was
6 approved by the Commission in Case No. 2023-00177¹⁴. For the expense month of
7 November 2024 through May 2025, the rate of return was 6.484%, which was approved
8 by the Commission in Case No. 2024-00109¹⁵.

9 In Case No. 2022-00141,¹⁶ EKPC was allowed revised rate of returns; 4.894% for the
10 six-month period ending May 31, 2022, 4.918% for the six-month period ending
11 November 30, 2022, 6.146% for the six-month period ending May 31, 2023, 6.747%
12 for the six-month period ending November 30, 2023, and 6.481% for December 2023
13 and January 2024. The under-recovery stemming from this revision is being amortized
14 over 12 months beginning in August of 2024.

15 EKPC's rate of return on environmental compliance rate base is determined by
16 multiplying the weighted average debt cost for the debt issuances directly related to

¹³ See *In the Matter of Electronic Application of East Kentucky Power Cooperative, Inc. for a General Adjustment of Rates, Approval of Depreciation Study, Amortization of Certain Regulatory Assets, and Other General Relief*, Case No. 2021-00103, (Ky. P.S.C., Sep. 30, 2021).

¹⁴ See *In the Matter of Application of East Kentucky Power Cooperative, Inc. for Approval to Amend Its Environmental Compliance Plan and Recover Costs Pursuant to Its Environmental Surcharge, and for the Issuance of a Certificate of Public Convenience and Necessity*, Order, Case No. 2023-00177, (Ky. P.S.C., Jan. 11, 2024).

¹⁵ See *In the Matter of Application of East Kentucky Power Cooperative, Inc. for Approval to Amend Its Environmental Compliance Plan and Recover Costs Pursuant to Its Environmental Surcharge, and for the Issuance of a Certificate of Public Convenience and Necessity*, Order, Case No. 2024-00109, (Ky. P.S.C., Nov. 22, 2024).

¹⁶ See *In the Matter of An Electronic Examination by the Public Service Commission of the Environmental Surcharge Mechanism of East Kentucky Power Cooperative, Inc. for the Sixth-Month Expense Periods Ending November 30, 2019, May 31, 2020, November 30, 2020, and November 30, 2021, the Two-Year Expense Period Ending May 31, 2021 and the Pass-Through Mechanism of its Sixteen Member Distribution Cooperatives*, Order, Case No. 2022-00141, (Ky. P.S.C., Aug. 9, 2024).

1 projects in the approved compliance plan times a stated TIER.¹⁷ The rate of return on
2 the environmental compliance rate base is updated to reflect the current average debt
3 cost at the conclusion of the six-month and two-year surcharge reviews.¹⁸ The use of
4 debt costs is based on the fact that all of EKPC's environmental compliance
5 investments are financed with long-term debt.¹⁹ The use of a 1.50 TIER was first
6 authorized in Case No. 2011-00032²⁰. This rate-making methodology is different from
7 that employed by investor-owned utilities. The rate of return for the environmental
8 compliance rate base for investor-owned utilities reflects a weighted average cost of
9 capital approach. The weighted average cost of capital reflects the blended interest
10 rates for the investor-owned utilities' long-term and short-term debt and a return on the
11 common equity. The weighted average cost of capital is then "grossed up" for income
12 taxes. Consequently, the rate of return for the investor-owned utilities is higher than
13 the rate of return proposed by or authorized for EKPC.²¹

¹⁷ As a result of the settlement agreement in Case No. 2021-00103, EKPC's rate of return on environmental compliance rate base also includes a cost of debt component for construction work in progress included in the environmental compliance rate base. The interest rate of EKPC's credit facility is used to determine this portion of the cost of debt.

¹⁸ The determination of the rate of return was a provision in the settlement agreement filed in Case No. 2004-00321, which the Commission approved in ordering paragraph 4 of the March 17, 2005 Order authorizing an environmental surcharge for EKPC.

¹⁹ Many of EKPC's environmental compliance investments are initially funded through existing general funds or short-term debt; however, these forms of financing are later replaced by long-term debt.

²⁰ See *In the Matter of An Examination by the Public Service Commission of the Environmental Surcharge Mechanism of East Kentucky Power Cooperative, Inc. for the Six-Month Billing Period Ending December 31, 2010; and the Pass-Through Mechanism for Its Sixteen Member Distribution Cooperatives*, Order, Case No. 2011-00032, (Ky. P.S.C., Aug. 2, 2011). EKPC requested authority to use the 1.50 TIER as it was consistent with the TIER authorized by the Commission in EKPC's last base rate case, Case No. 2010-00167. The Commission found the request reasonable and approved the use of the 1.50 TIER.

²¹ See *In the Matter of Electronic Examination by the Public Service Commission of the Environmental Surcharge Mechanism of Kentucky Utilities Company for the Six-Month Billing Period Ending October 31, 2019*, Case No. 2020-00170 (Ky. P.S.C., May 20, 2021). Utilizing the weighted average cost of capital approach with a gross up for income taxes, the Commission authorized a rate of return for the Kentucky Utilities Company of 8.86% for its pre-2020 compliance plan projects and 8.48% for its 2020 compliance plan projects.

1 As discussed in the Direct Testimony of Thomas J. Stachnik in Case No. 2025-00208²²,
2 EKPC targets a TIER of 1.50 in order to achieve several financial objectives including
3 financial ratios that meet covenants in various EKPC debt agreements and maintaining
4 financial metrics that support strong credit ratings. For the environmental surcharge,
5 the Commission recently approved a TIER of 1.50 in Case No. 2025-00013²³.

6 EKPC's Indenture and current Credit Facility covenants target a 1.1 "Margins for
7 Interest" Ratio, which approximates TIER. In order to achieve this each year, a
8 somewhat higher TIER must be targeted to allow for fluctuations. The rating agencies
9 look more closely at Debt Service Coverage Ratio ("DSC"), which evaluates EKPC's
10 ability to service principal and interest payments and thus is more relevant to lenders
11 than TIER which only considers interest payments. EKPC's Board Policy 203 states
12 that, "The Debt Service Coverage Ratio (DSC) is a financial measurement of EKPC's
13 ability to repay its long-term debt and is computed as depreciation plus interest on long-
14 term debt plus net margins divided by interest on long-term debt plus scheduled
15 principal payments. EKPC shall strive to maintain a DSC of at least 1.25 for each
16 calendar year."

17 Fitch Ratings ("Fitch") and Standard & Poor's ("S&P"), both prefer high DSC ratios
18 to support EKPC's BBB+ Stable and A Stable credit ratings respectively, which in turn
19 result in lower cost of borrowings. In its October 2015 report on EKPC, Fitch set a
20 DSC of 1.25 as a threshold that would support EKPC's upgrade to A-, which occurred

²² See *Electronic Application of East Kentucky Power Cooperative, Inc. for a General Adjustment of Rates, Approval of Depreciation study, Amortization of Certain Regulatory Assets, and Other General Relief*, Case No. 2025-00208.

²³ See *An Electronic Examination By the Public Service Commission of the Environmental Surcharge Mechanism of East Kentucky Power Cooperative, Inc. for the Sixth-Month Expense Periods Ending May 31, 2022, November 30, 2022, November 30, 2023, May 31, 2024, and November 30, 2024, the Two-Year Expense Period Ending May 31, 2023, and the Pass-Through Mechanism of its Sixteen Member Distribution Cooperatives*, Case No. 2025-00013.

1 in October 2016. In its reports, S&P repeatedly praised EKPC's DSC ratio being at or
2 above 1.25.

3 Based on the Board Policy and Rating Agency input, EKPC management targets a DSC
4 ratio of 1.35 each year. This target recognizes that the DSC will vary each year as its
5 components vary (for example, mild weather would result in lower margins and a lower
6 DSC) and thus allows for some decline without crossing the 1.25 threshold discussed
7 above. EKPC's current targeted TIER results in maintaining this strong DSC ratio.

8 EKPC's achieved DSC and TIER²⁴ were as follows for calendar years 2020 through
9 2024:

Calendar Year Ending	DSC	TIER
December 31, 2020	1.35	1.28
December 31, 2021	1.38	1.12
December 31, 2022	1.54	1.40
December 31, 2023	1.31	1.17
December 31, 2024	1.31	1.06
Five-Year Averages	1.38	1.21

10
11 Based upon the foregoing, EKPC proposes continuing the TIER component of the rate
12 of return to a 1.50 TIER. EKPC only achieved a 1.25 or higher TIER two of the last
13 five years. EKPC is proposing a rate of return of 6.488% in this proceeding, as shown
14 in Response No. 5 to the Staff's First Request. EKPC's proposed rate of return is
15 consistent with the Settlement Agreement approved in Case No. 2004-00321, which
16 provided that the rate of return on compliance-related capital expenditures would be
17 updated to reflect current average debt cost as of the end of each six-month review
18 period.

²⁴ DSC is calculated by dividing the sum of depreciation, interest expense, and net margins by the sum of interest expense and principal payments. TIER is calculated by dividing the sum of interest expense and net margins by interest expense.

1 • **Operation and Maintenance (“O&M”) Expenses**

2 EKPC continued to use a 12-month rolling average for O&M expenses associated with
3 the compliance plan projects. For those instances where the change in the level of
4 O&M expenses exceeded 10 percent, EKPC provided an explanation. These
5 explanations are provided in Response No. 4 to the Staff’s First Request.

6 **Q. WERE THE ENVIRONMENTAL-RELATED AMOUNTS INCLUDED IN THE**
7 **MONTHLY SURCHARGE CALCULATION BASED ON BOOKED COSTS?**

8 A. Yes. EKPC continues to use the amounts booked for the various cost categories included
9 in the surcharge calculation and these costs were actual costs and incurred in a prudent
10 manner.

11 **Q. DID EKPC INCUR ANY OVER- OR UNDER-RECOVERIES DURING THE**
12 **PERIOD UNDER REVIEW?**

13 A. Yes. However, as shown in Response No. 1 to the Staff’s First Request, EKPC applied its
14 May 2025 under-recovery to the June 2025 expense month, which was billed in July 2025.
15 Thus, from the normal operation of the surcharge mechanism, no adjustment is needed in
16 this proceeding to collect any under-recovery from the Owner-Members.

17 **Q. PREVIOUS COMMISSION ORDERS REQUIRED EKPC’S OWNER-MEMBERS**
18 **TO INCORPORATE CERTAIN PROVISIONS INTO THE CALCULATION OF**
19 **THE MONTHLY PASS-THROUGH FACTORS. PLEASE COMMENT ON HOW**
20 **THE OWNER-MEMBERS ADDRESSED THE MOST SIGNIFICANT ASPECTS**
21 **OF THESE ORDERS DURING THE PERIODS UNDER REVIEW.**

22 A. Under the pass-through mechanism, the environmental surcharge factors computed for
23 retail customers were billed by EKPC’s Owner-Members at approximately the same time
24 as EKPC billed the Owner-Members at wholesale. The calculation of the monthly factors

1 for each Owner-Member was provided in the monthly reports filed with the Commission.
2 EKPC and the Owner-Members adhered to these and all other requirements and provisions
3 of the Commission's Orders for the periods under review.

4 **Q. DID THE OWNER-MEMBERS INCUR ANY OVER- OR UNDER-RECOVERIES**
5 **DURING THE REVIEW PERIOD?**

6 A. Yes. The over- or under-recovery amounts for each Owner-Member are shown in
7 Response No. 2 to the Staff's First Request. The determination of the over- or under-
8 recovery amounts has been prepared utilizing the revised methodology approved by the
9 Commission in Case No. 2015-00281.²⁵

10 This two-year review proceeding includes the fifth two-year surcharge review since the
11 adoption of the revised methodology approved in Case No. 2015-00281. Request No. 2
12 directs EKPC and the Owner-Members to prepare a summary schedule showing the
13 Owner-Member's pass-through revenue requirement for the months corresponding with
14 the six-month and two-year reviews. In the previous two-year reviews, Case No. 2017-
15 00326,²⁶ and 2019-00380, EKPC provided Excel spreadsheets for each Owner-Member
16 that included four "tabs." The most recent two-year reviews, Case No. 2022-00141 and
17 2025-00013, covered more than 24-months and were presented similarly. EKPC believes
18 this approach accomplished the desired review of each Owner-Member's revenue
19 requirement during the previous review periods. EKPC is following this same approach

²⁵ See *In the Matter of an Examination by the Public Service Commission of the Environmental Surcharge Mechanism of East Kentucky Power Cooperative, Inc. for the Six-Month Billing Periods Ending June 30, 2014 and December 31, 2014, Two-Year Billing Period Ending June 30, 2015, and the Pass Through Mechanism for Its Sixteen Member Distribution Cooperatives*, Order, Case No. 2015-00281, (Ky. P.S.C., Apr. 8, 2016).

²⁶ See *In the Matter of an Examination by the Public Service Commission of the Environmental Surcharge Mechanism of East Kentucky Power Cooperative, Inc. for the Two-Year Billing Period Ending June 30, 2017 and the Pass Through Mechanism for Its Sixteen Member Distribution Cooperatives*, Order, Case No. 2017-00326, (Ky. P.S.C., Jan. 5, 2018).

1 when preparing the response to Request No. 2 in this review proceeding, with each Excel
2 spreadsheet tab reflecting a six-month review period. EKPC is also providing a summary
3 tab for the prior review, Case No. 2025-00013, to document the previous over- or under-
4 recovery presented in the review period as well as tabs supporting that summary.

5 **Q. HOW WILL THE OWNER-MEMBERS REFLECT RECOVERY OF THESE**
6 **OVER- OR UNDER-RECOVERY AMOUNTS?**

7 A. As approved in the Commission's November 5, 2010 Order in Case No. 2010-00021,²⁷
8 fifteen of the Owner-Members propose that the over- or under-recovery amounts be
9 amortized over a period of six months beginning in the first month after the Commission's
10 Order in this proceeding. Taylor County RECC requested a one-month amortization
11 beginning in the first month after the Commission's Order in this proceeding.

12 **Q. HAS EKPC UPDATED THE RATE OF RETURN TO BE USED**
13 **PROSPECTIVELY?**

14 A. Yes. As previously discussed, EKPC proposes an updated rate of return of 6.488%. This
15 updated rate of return reflects an average debt cost as of May 31, 2025, of 4.325% and a
16 TIER of 1.50. The determination of the average debt cost as of May 31, 2025, is shown in
17 Response No. 5 to the Staff's First Request.

18 **Q. WHEN DOES EKPC PROPOSE TO APPLY THE UPDATED RATE OF RETURN**
19 **IN ITS SURCHARGE CALCULATIONS?**

20 A. EKPC proposes to use the updated rate of return in the surcharge calculations in the first
21 month following the Commission's final Order in this proceeding.

²⁷ See *In the Matter of an Examination by the Public Service Commission of the Environmental Surcharge Mechanism of East Kentucky Power Cooperative, Inc. for the Six-Month Billing Period Ending December 31, 2009 and the Pass-Through Mechanism for Its Sixteen Member Distribution Cooperatives*, Order, Case No. 2010-00021, (Ky. P.S.C., Nov. 5, 2010).

1 **Q. DOES EKPC BELIEVE THAT ITS ENVIRONMENTAL SURCHARGE SHOULD**
2 **BE ROLLED INTO ITS WHOLESALE BASE RATES?**

3 A. No. While EKPC is providing the information related to a potential roll-in of the
4 environmental surcharge into the wholesale base rates in Response No. 6 to the Staff's First
5 Request, EKPC does not believe it is appropriate at this time to roll its environmental
6 surcharge into its wholesale base rates.

7 **Q. WOULD YOU EXPLAIN THE REASONS IN SUPPORT OF EKPC'S POSITION?**

8 A. Yes. EKPC would initially note that whether or not there are amounts of environmental
9 costs incorporated into wholesale base rates, the effect on EKPC, the Owner-Members, and
10 the retail ratepayer is that the total environmental revenue requirement should remain the
11 same. In addition, EKPC believes there are several reasons why a roll-in of the
12 environmental surcharge is not appropriate at this time.

13 First, like the environmental surcharge mechanisms approved for Kentucky Utilities
14 Company, Louisville Gas and Electric Company, Kentucky Power Company, Duke Energy
15 Kentucky, and Big Rivers Electric Corporation, the environmental costs included in
16 EKPC's revenue requirement represent both investment costs and energy costs. As a
17 general matter, investment costs are usually reflected in demand charges while energy costs
18 are reflected in the energy charge. Because both investment costs and energy costs make
19 up the environmental costs, a roll-in of the surcharge into base rates is more complicated
20 than the roll-in performed in a two-year fuel adjustment clause proceeding. In the two-
21 year fuel adjustment clause proceeding, only energy costs are rolled into the energy charge
22 of base rates. If EKPC is required to roll-in its environmental surcharge into its wholesale
23 base rates, it believes the roll-in will have to be allocated to both the demand and energy
24 charges. Included in Response No. 6 is a rough allocation of the calculated roll-in amount

1 between demand and energy components. Please note that this rough allocation assumes
2 that the entire return on environmental compliance rate base would be assigned to demand.
3 A cost-of-service study would likely assign the components of the environmental
4 compliance rate base to both demand and energy.
5 Ideally, such an allocation should be performed utilizing a cost-of-service study. However,
6 there has not been any time in this review proceeding for EKPC to undertake a cost-of-
7 service study that would provide a reasonable allocation of an environmental surcharge
8 roll-in into demand and energy related components. The belief that a cost-of-service study
9 should be the basis for allocating a surcharge roll-in between demand and energy rate
10 components is the primary reason why EKPC believes a roll-in of environmental costs
11 should occur at the time of a wholesale base rate case proceeding. Including a roll-in as
12 part of a wholesale base rate case would allow for the allocation of environmental costs in
13 a manner consistent with other costs through the utilization of a cost-of-service study.
14 EKPC notes that the Commission agrees that a surcharge roll-in should be undertaken as
15 part of a base rate case in previous environmental surcharge reviews.²⁸
16 The second reason concerns how the change in the wholesale base rates would be reflected
17 in the Owner-Members' retail base rates. When the Commission approved the

²⁸ See *In the Matter of an Examination by the Public Service Commission of the Environmental Surcharge Mechanism of Kentucky Power Company for the Six-Month Billing Periods Ending June 30, 2006 and December 31, 2006, and for the Two-Year Billing Period Ending June 30, 2007*, Order, Case No. 2007-00381, p. 6 (Ky. P.S.C., Aug. 19, 2008); See *In the Matter of an Examination by the Public Service Commission of the Environmental Surcharge Mechanism of East Kentucky Power Cooperative, Inc. for the Two-Year Billing Period Ending June 30, 2009 and the Pass-Through Mechanism for Its Sixteen Member Distribution Cooperatives*, Order, Case No. 2009-00317, p. 5 (Ky. P.S.C., Jan. 28, 2010); See *In the Matter of an Examination by the Public Service Commission of the Environmental Surcharge Mechanism of East Kentucky Power Cooperative, Inc. for the Two-Year Billing Period Ending June 30, 2011, for the Six-Month Billing Periods Ending December 31, 2011 and June 30, 2012, and the Pass-Through Mechanism for Its Sixteen Member Distribution Cooperatives*, Order, Case No. 2012-00486, p. 5-6 (Ky. P.S.C., Aug. 2, 2013); See *In the Matter of an Examination by the Public Service Commission of the Environmental Surcharge Mechanism of East Kentucky Power Cooperative, Inc. for the Two-Year Billing Period Ending June 30, 2013 and the Pass Through Mechanism for Its Sixteen Member Distribution Cooperatives*, Order, Case No. 2013-00324, p. 6 (Ky. P.S.C., Mar. 21, 2014); also see the April 8, 2016 Order in Case No. 2015-00281, page 9 and the May 6, 2020 Order in Case No. 2019-00380, page 5.

1 environmental surcharge mechanism for EKPC and the corresponding pass-through
2 mechanism for the Owner-Members, there was no discussion of how or when retail base
3 rates would be adjusted to reflect the change in the wholesale base rates resulting from the
4 surcharge roll-in. Clearly, any adjustment to the retail base rates should be accomplished
5 in the same proceeding as the roll-in to wholesale base rates and both changes in the base
6 rates become effective at the same time. If a surcharge roll-in was required as part of the
7 two-year review case, EKPC believes the necessary adjustments to the retail base rates
8 need to correspond as closely as possible to the change in the wholesale base rates. The
9 change in the wholesale demand-related base rates should be reflected in the corresponding
10 retail customer charges and demand base rates. The change in the wholesale energy-related
11 base rates should be reflected in the corresponding retail energy base rates. However, as a
12 surcharge roll-in during the two-year review to the wholesale base rates would not be cost-
13 of-service based, neither would the corresponding adjustment to the retail base rates be
14 cost-of-service based.

15 As with a roll-in to its wholesale base rates, EKPC believes that the corresponding
16 adjustment to retail base rates should be performed in conjunction with a base rate
17 proceeding and not as part of a two-year surcharge review. The amount of the roll-in each
18 Owner-Member receives as a result of the change in wholesale base rates would be cost-
19 of-service based. The Owner-Members indicated a general agreement with this concept
20 during a rate design project EKPC undertook approximately 13 years ago.

21 While EKPC and its Owner-Members consistently argue that the appropriate proceeding
22 to roll-in the surcharge into base rates is during a base rate case, EKPC did not propose a
23 surcharge roll-in during its current base rate case, Case No. 2025-00208. EKPC had a cost-
24 of-service study available to allocate its environmental costs, but the Owner-Members were

1 utilizing the “flow-through” process available under KRS 278.455. That statute requires
2 the increase in wholesale rates and tariffs must be allocated to each class and within each
3 tariff on a proportional basis that will result in no change in the rate design currently in
4 effect for the Owner-Member. Thus, EKPC’s allocation of its environmental costs would
5 have been based on a cost-of-service study while the Owner-Members’ share of the EKPC
6 increase in revenues would have been allocated in total on a proportional basis. The
7 Owner-Members cannot make corresponding changes in their retail rates reflecting
8 EKPC’s allocation of its environmental costs to demand and energy.²⁹

9 A final reason is related to the disclosure of the cost of environmental compliance to retail
10 customers. EKPC’s currently approved environmental compliance plan contains 40
11 projects and the monthly surcharge filings reflect the investment costs and operating
12 expenses associated with those projects. The monthly cost of environmental compliance
13 will be known to EKPC even if there is a roll-in of the surcharge revenue requirement into
14 wholesale base rates. As there is no roll-in of the environmental surcharge into base rates,
15 the Owner-Members’ monthly surcharge pass-through factors serve as a means to disclose
16 to the retail customer the cost of environmental compliance for the approved projects.
17 However, if there were a roll-in, a significant portion of the EKPC monthly surcharge
18 factor would be collected through wholesale base rates and the corresponding Owner-
19 Members’ monthly surcharge pass-through factors would be reduced. The monthly
20 surcharge pass-through factors would no longer easily disclose to retail customers the full
21 cost of environmental compliance for the approved projects. Many of the Owner-Members
22 believe it is important that retail customers be aware of the full cost of environmental

²⁹ See Case No. 2021-00103, Application Exhibit 13, Direct Testimony of Isaac S. Scott, at 11, and EKPC’s Response to the Commission Staff’s Second Request for Information, Request Nos. 13a and 13b.

1 compliance for the approved projects and the impact this compliance cost has on the
2 monthly retail bill. Consequently, until an acceptable method can be developed to facilitate
3 transparency with regard to full cost of environmental compliance, EKPC and the Owner-
4 Members believe roll-in should not be undertaken as part of the two-year review
5 proceeding.

6 **Q. IS EKPC AWARE OF ANY PROBLEMS OR CONCERNS THE OWNER-**
7 **MEMBERS MAY HAVE WITH THE SURCHARGE PASS-THROUGH**
8 **MECHANISM?**

9 A. No.

10 **Q. YOU PREVIOUSLY STATED THAT EKPC'S SURCHARGE MECHANISM**
11 **REFLECTS THE BASE/CURRENT METHOD. THE RATE ES TARIFF**
12 **CURRENTLY REFLECTS A BESF OF 0.34%. WOULD YOU EXPLAIN WHY**
13 **EKPC IS NOT PROPOSING A NEW BESF VALUE?**

14 A. Under the base/current method, the BESF reflects the investment in utility plant and
15 associated operating costs for environmental compliance assets being recovered through
16 base rates that were replaced or retired early due to the deployment of new environmental
17 compliance assets whose costs are recovered through the environmental surcharge. A
18 BESF of zero indicates there are no investments in utility plant or associated operating
19 costs for environmental compliance assets being recovered through base rates. Primarily
20 due to the environmental compliance plan amendment approved in Case No. 2017-00376,
21 Project 16 – CCR/ELG Rule, EKPC added new investments in utility plant which retired
22 or replaced utility plant already being recovered in base rates. As those new investments
23 in utility plant have gone into service, it was necessary to recognize the base rate
24 component in the BESF. In addition, as a result of these new investments, EKPC

1 reclassified a dozen employees to be identified specifically with the CCR/ELG work
2 previously the expensed portion of those employees' salaries, payroll taxes, and benefits
3 were recovered through base rates. These items were addressed in the BESF of 0.34%.
4 EKPC is not aware of any other items that warrant an update to the BESF.

5 **Q. DOES EKPC HAVE A REQUEST CONCERNING THE TIMING OF THE**
6 **ISSUANCE OF THE FINAL ORDER IN THIS SURCHARGE REVIEW**
7 **PROCEEDING?**

8 A. Yes. EKPC is requesting that the Commission issue its final Order in this case either within
9 the first 10 days of the month or after the 21st day of the month. This is due to the
10 processing procedure for the monthly surcharge factor filing and the critical processing
11 period between the 11th and 20th of the month.

12 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

13 A. Yes.