EAST KENTUCKY POWER COOPERATIVE

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DEC 12 2008

PUBLIC SERVICE COMMISSION

December 12, 2008

HAND DELIVERED

Ms. Stephanie L. Stumbo
Executive Director
Public Service Commission
211 Sower Boulevard
Frankfort, KY 40602

Re: PSC Case No. 2008-00409

Dear Ms. Stumbo:

Please find enclosed for filing with the Commission an original and nine copies of the responses of East Kentucky Power Cooperative, Inc. ("EKPC"), to the Commission Staff's First Data Request regarding East Kentucky's request to establish a regulatory asset in the above-referenced case, dated December 4, 2008.

Very truly yours,

David A. Smart
General Counsel

Enclosures

Cc: Parties of Record

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COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

IN THE MATTER OF:

GENERAL ADJUSTMENT OF ELECTRIC RATES	)	**CASE NO.**
OF EAST KENTUCKY POWER	)	**2008-00409**
COOPERATIVE, INC.	)	

CERTIFICATE

STATE OF KENTUCKY)
)
COUNTY OF CLARK)

Frank J. Oliva being duly sworn, states that he has supervised the preparation of the responses of East Kentucky Power Cooperative, Inc. to the Public Service Commission Staff First Data Request regarding East Kentucky's request to establish a regulatory asset in the above-referenced case dated December 4, 2008, and that the matters and things set forth therein are true and accurate to the best of his knowledge, information and belief, formed after reasonable inquiry.

Frank J. Oliva

Subscribed and sworn before me on this 10th day of December, 2008.

Peggy S. Duffin
Notary Public

My Commission expires: December 8, 2009

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

IN THE MATTER OF:

GENERAL ADJUSTMENT OF ELECTRIC RATES	)	**CASE NO.**
OF EAST KENTUCKY POWER	)	**2008-00409**
COOPERATIVE, INC.	)	

CERTIFICATE

STATE OF KENTUCKY)
)
COUNTY OF CLARK)

Ann F. Wood being duly sworn, states that she has supervised the preparation of the responses of East Kentucky Power Cooperative, Inc. to the Public Service Commission Staff First Data Request regarding East Kentucky's request to establish a regulatory asset in the above-referenced case dated December 4, 2008, and that the matters and things set forth therein are true and accurate to the best of her knowledge, information and belief, formed after reasonable inquiry.

Ann F. Wood

Subscribed and sworn before me on this 10th day of December, 2008.

Peggy S. Duffin
Notary Public

My Commission expires: December 8, 2009

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

GENERAL ADJUSTMENT OF ELECTRIC RATES	)	CASE NO.
OF EAST KENTUCKY POWER	)	2008-00409
COOPERATIVE, INC.	)	

RESPONSES TO COMMISSION STAFF'S FIRST DATA REQUEST
TO EAST KENTUCKY POWER COOPERATIVE, INC.
DATED DECEMBER 4, 2008

EAST KENTUCKY POWER COOPERATIVE, INC.
PSC CASE NO. 2008-00409
FIRST DATA REQUEST RESPONSE
REGULATORY ASSET

COMMISSION STAFF'S FIRST DATA REQUEST DATED 12/4/08
REQUEST 1
RESPONSIBLE PERSON: **Frank J. Oliva**
COMPANY: **East Kentucky Power Cooperative, Inc.**

Request 1. Refer to Paragraph No. 2 on page 2 of East Kentucky's Motion for the Creation of a Regulatory Asset Relating to Unrecovered Revenues ("Motion"), specifically, the last sentence of the paragraph which refers to East Kentucky's ability to meet its loan covenants being jeopardized if it is unable to recover the costs of Spurlock Unit 4 ("Spurlock 4") that it will begin to incur upon Spurlock 4's commercialization.

Request 1a. Page 2 of 2 in Item 2 of East Kentucky's responses to questions raised at the November 13, 2008 informal conference ("IC questions") shows that East Kentucky's projected Times Interest Earned Ratio ("TIER") and Debt Service Coverage Ratio for 2009 exceed its minimum mortgage requirements even if its requested rate increase is delayed until June 1, 2009. Identify and describe in detail the specific loan covenants under East Kentucky's financing through the Rural Utilities Service ("RUS"), the National Rural Utilities Cooperative Finance Corporation or its private Credit Facility that it believes would be jeopardized absent the relief sought in its Motion.

Response 1a. Following are the TIER and DSC requirements contained in EKPC's financing agreements that could be jeopardized absent the relief sought in EKPC's Motion for the Creation of a Regulatory Asset in this case:

- **Restated and Consolidated Mortgage and Security Agreement ("Mortgage Agreement") with the Rural Utilities Service ("RUS") and National Rural Utilities Cooperative Finance Corporation ("CFC"):**

(a) Debt Service Coverage Ratio ("DSC"). EKPC will not permit, as of the last day of any calendar year, the average Debt Service Coverage Ratio during the two best years out of the three calendar years then ended to be less than 1.00 to 1. DSC is defined as the total of Net Margins, Interest on Long-Term Debt, and Depreciation and Amortization Expense divided by the amount equal to the sum of all payments of principal and interest on Long-Term Debt.

(b) Times Interest Earned Ratio ("TIER"). EKPC will not permit, as of the last day of any calendar year, the average Times Interest Earned Ratio during the two best years out of the three calendar years then ended to be less that 1.05 to 1. TIER is defined as the sum of Net Margins and Interest on Long-Term Debt divided by Interest on Long-Term Debt.

- **$650 Million Unsecured Credit Agreement with 16 Financial Institutions ("Credit Agreement"):**

(a) Debt Service Coverage Ratio ("DSC"). Same as Mortgage Agreement, except the definition of Net Margins has been modified (1) to add back the actual extraordinary non-cash charges recorded in calendar year 2005 associated with the alleged violations of the Clean Air Act with respect to the Dale Generating Station and (2) to deduct in 2007 any future payment obligations made in 2007 on account of such alleged violations in accordance with Generally Accepted Accounting Principles.

(b) Times Interest Earned Ratio ("TIER"). Same as Mortgage Agreement, except the definition of Net Margins has been modified (1) to add back the actual extraordinary non-cash charges recorded in calendar year 2005 associated with the alleged violations of the Clean Air Act with respect to the Dale Generating Station and (2) to deduct in 2007 any future payment obligations made in 2007 on account of such alleged violations in accordance with Generally Accepted Accounting Principles.

Item 2, page 2 of 2 of East Kentucky's responses to the IC questions shows a projected TIER of 1.30 and a projected DSC of 1.14 for the year 2009. This projection is based on the assumption that EKPC is granted 100% of the rate increase requested in its rate case. The net margin projection of $39 million is also contingent on EKPC's load (sales) being at least at the budgeted level for the year and all other budget assumptions holding up in this current tumultuous economic environment. EKPC's net margin for 2009 will be impacted negatively by the inability to sustain any of these assumptions.

As an example of the potential consequences that could occur due to the current economic downturn, please consider that EKPC's year-to-date energy load through November 2008 is 3% below budget. In fact for the period of April through November 2008, EKPC's energy load is 6% below budget. If this trend were to continue and EKPC's load for 2009 were to be 6% below budget, the effect could be a reduction in 2009 TIER and DSC to approximately 1.14 and 1.03, respectively. In addition, receipt of less than the full amount of the requested rate increase would further reduce the TIER and DSC , to perhaps levels below that necessary to maintain compliance with EKPC's debt covenants.

Request 1b. Page 1 of 2 in Item 2 of East Kentucky's responses to the IC questions references the "Testimony of William Steven Seelye in Support of EKPC Motion to Create a Regulatory Asset" ("Seelye Testimony") which refers to East Kentucky's projected mid-2009 equity percentage of 6.8 percent as dangerously low. The response concludes by stating that "the impact on EKPC equity of the failure to recover the Spurlock 4 costs for April and May 2009 is the most important concern behind EKPC's request for relief." Describe in detail the implications of East Kentucky's not maintaining or increasing its equity ratio.

Response 1b. Please refer to the Direct Testimony of Mr. Jonathan Andrew Don filed in this proceeding for an extensive discussion regarding the implications of EKPC not increasing its equity ratio. On page 5 of his testimony, in summation, Mr. Don recommends that EKPC be allowed to gradually increase its equity-to-asset ratio to a minimum of 10%.

On page 17 of his Direct Testimony in this proceeding, Mr. Daniel M. Walker also references the necessity for EKPC to increase its deficient equity ratio and compares EKPC's low equity level of 6.83% to the 14.35% average of his Reference Group.

East Kentucky believes it is entitled to recover the Spurlock 4 costs for April and May 2009. Absent a settlement allowing rates to be effective April 1, 2009 or earlier, the establishment of a regulatory asset appears to be the only other way to recover these costs.

EAST KENTUCKY POWER COOPERATIVE, INC.

PSC CASE NO. 2008-00409

FIRST DATA REQUEST RESPONSE

REGULATORY ASSET

COMMISSION STAFF'S FIRST DATA REQUEST DATED 12/4/08

REQUEST 2

RESPONSIBLE PERSON: **Gary T. Crawford/Ann F. Wood**

COMPANY: **East Kentucky Power Cooperative, Inc.**

Request 2. Refer to Item 3 of East Kentucky's responses to the IC questions which discusses deferring the operation date of Spurlock 4 from April 1, 2009 to June 1, 2009.

Request 2a. East Kentucky states that, "not only under generally accepted accounting principles, but also under guidelines established by the Internal Revenue Service, property is placed in service when it is ready and available for its intended use."

Request 2a(1) Provide the specific generally accepted accounting principles referred to in the response.

Response 2a(1) Accounting Research Bulletin (ARB) 43 provides accounting guidance on placing an asset into service and depreciating that asset. ARB 43, Chapter 9 ("Depreciation"), Section C, a portion of paragraph 5 reads as follows:

5. The cost of a productive facility is one of the costs of the services it renders during its useful economic life. Generally accepted accounting principles require

> that this cost be spread over the expected useful life of the facility in such a way as to allocate it as equitably as possible to the periods during which services are obtained from the use of the facility. This procedure is known as depreciation accounting, a system of accounting which aims to distribute the cost or other basic value of tangible capital assets, less salvage (if any), over the estimated useful life of the unit (which may be a group of assets) in a systematic and rational manner. It is a process of allocation, not of valuation....

Request 2a(2) Given that East Kentucky's accounting and financial reporting and, therefore, its TIER calculation, is based upon recording transactions in accordance with the Rural Utilities Service Uniform System of Accounts ("USoA"), explain why Internal Revenue Service requirements regarding the placement of property into service are relevant to this issue.

Response 2a(2) Even though East Kentucky is a tax-exempt cooperative, it does file Internal Revenue Service (IRS) Form 990 annually. Additionally, if East Kentucky were to fail the IRS "85/15 test," it would have to file a Form 1120 with depreciation calculated appropriately.

East Kentucky chose to use the IRS requirements in response 3 to the IC questions because said requirement concisely described the timing of depreciation when placing an asset into service.

Request 2a(3) Explain in detail whether East Kentucky considered recording the costs of Spurlock 4 in Account 105, Electric Plant Held for Future Use, from its estimated completion date of April 1, 2009 to June 1, 2009 as an alternative to its request to record a regulatory asset.

Response 2a(3) No, East Kentucky did not consider recording the costs of Spurlock 4 for April 2009 and May 2009 in Account 105, Electric Plant Held for Future Use. A two-month delay in commercial operation of Spurlock 4 does not meet the "held for future use" definition. Sections A and B of the Account 105 description (from the RUS USoA) are shown below.

105 Electric Plant Held for Future Use

A. This account shall include the original cost of electric plant (except land and land rights) owned and held for future use in electric service under a definite plan for such use, to include: (1) Property acquired (except land and land rights) but never used by the utility in electric service, but held for such service in the future under a definite plan, and (2) property (except land and land rights) previously used by the utility in service but retired from such service and held pending its reuse in the future, under a definite plan, in electric service.

B. This account shall also include the original cost of land and land rights owned and held for future use in electric service under a plan for such use, to include land and land rights: (1) Acquired but never used by the utility in electric service, but held for such service in the future under a plan, and (2) previously held by the utility in service, but retired from such service and held pending its reuse in the future under a plan, in electric service. (See §1767.16 (g).)

Request 2b. The response also states that East Kentucky would incur almost $900,000 per month in contractor delay costs if commercial operation was delayed. Clarify whether these costs would only be incurred if construction of Spurlock 4 was delayed or if these costs would also be incurred if Spurlock 4 was completed by April 1, 2009 but not placed into service until June 1, 2009.

Response 2b. The basis for the estimate was a delay in the completion of construction to June 1, 2009.

If the unit was completed by April 1, 2009 but not placed into service until June 1, 2009, East Kentucky would likely incur costs associated with demobilizing certain key contractors for the boiler, turbine generator, and engineering support and then re-mobilizing them to complete plant performance testing at a later point in time once the units became fully operational. The costs of the re-mobilization cannot be accurately determined at this time. In addition, East Kentucky would incur added risk in that the protection provided by equipment warranties would expire sooner since the contracted warranty periods cannot be extended without significant expense, if at all, due to a decision to defer the commercial operation date of the unit.

Please refer to response 2a for the accounting implications of deferring the commercial operation date of Spurlock 4.

EAST KENTUCKY POWER COOPERATIVE, INC.
PSC CASE NO. 2008-00409
FIRST DATA REQUEST RESPONSE
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COMMISSION STAFF'S FIRST DATA REQUEST DATED 12/4/08
REQUEST 3
RESPONSIBLE PERSON: Frank J. Oliva/Ann F. Wood
COMPANY: East Kentucky Power Cooperative, Inc.

Request 3. Refer to page 2 of 2 in Item 4 of East Kentucky's responses to the IC questions which contains a schedule of projected costs East Kentucky will incur in April and May of 2009 based on Spurlock 4 going into commercial operation April 1, 2009.

Request 3a. Provide clarification that the top part of the schedule reflects the total projected costs, including TIER, related to Spurlock 4's commercialization, while the middle part and bottom part reflect the projected Spurlock 4 costs, including TIER that would be recoverable through East Kentucky's environmental surcharge and its base rates, respectively.

Response 3a. The top part of the schedule of Item 4, page 2 of 2 of East Kentucky's responses to the IC questions reflects the total projected costs, including TIER, related to Spurlock 4's commercial operation. The middle part of the schedule reflects the projected Spurlock 4 costs, including TIER, which are recoverable through the environmental surcharge mechanism. The bottom part of the schedule is the net Spurlock 4 costs, including TIER, which are recoverable through base rates.

Request 3b. The total projected costs, including TIER, are $10.15 million. Given that the pollution control facilities at Spurlock 4 are included in the amended compliance plan approved for East Kentucky in Case No. 2008-00115,[1] if the middle part of the schedule reflects the costs that East Kentucky can include for recovery through its environmental surcharge, explain whether the amount of nearly $7.8 million identified as NET Total Expenses at the bottom of the schedule is a subset of the $10.5 million mentioned at line 5 on page 3 of the Seelye Testimony or if the $10.15 million at the top of the schedule is comparable to the $10.5 million.

Response 3b. The $10.5 million mentioned on Page 3, Line 5 of the Seelye testimony represents a "lost revenue" calculation. The $10.5 million was derived by applying the difference between East Kentucky's current rates and the proposed Phase I rates to the estimated test-year end billing determinants.

The $10.15 million shown on Item 4, Page 2 of 2 of East Kentucky's responses to the IC questions reflects estimated expenses associated with the commercial operation of Spurlock 4 for the months of April and May 2009. The $7.8 million is a subset of the $10.15 million as discussed in the response to 3a.

Please also see the response to request 4, which describes the differences in the journal entries.

[1]Case No. 2008-00115, *The Application of East Kentucky Power Cooperative, Inc. for Approval of an Amendment to its Environmental Compliance Plan and Environmental Surcharge*, Order dated September 29, 2008.

Request 3c. Provide clarification that Column 5 of the schedule. identified as NET TIER, equals the projected NET Interest Expense plus the margin resulting from a TIER calculated at 1.45 multiplied times the NET Interest Expense.

Response 3c. Column 5 of the schedule represents Interest Expense (Column 4) multiplied by a TIER of 1.45.

EAST KENTUCKY POWER COOPERATIVE, INC.
PSC CASE NO. 2008-00409
FIRST DATA REQUEST RESPONSE
REGULATORY ASSET

COMMISSION STAFF'S FIRST DATA REQUEST DATED 12/4/08
REQUEST 4
RESPONSIBLE PERSON: **William Steven Seelye/Ann F. Wood**
COMPANY: **East Kentucky Power Cooperative, Inc.**

Request 4. Refer to Item 5 of East Kentucky's response to the IC questions which reflects the accounting entries that could be made to reflect how it would record the proposed regulatory asset on its books. Clarify whether it is East Kentucky's position that the entries identified as "for the deferral of revenue" and "for the deferral of expenses" can be substituted one for the other, or is it East Kentucky's position that the former entries are appropriate if a regulatory asset is based on a revenue amount being recognized and deferred and that the latter entries are appropriate if the regulatory asset is based on an expense amount being recognized and deferred.

Response 4. In East Kentucky's response to Item 5 of the IC questions regarding the proposed accounting entries, the entries identified "for the deferral of revenue" and "for the deferral of expenses" cannot be substituted one for the other. Entries for the deferral of revenue are based on the application of the proposed Phase I rates to the actual billing determinants for the months of April and May 2009. Entries for the deferral of expense are based on actual expenses recorded for the operation and maintenance of Spurlock Unit 4, excluding expenses recoverable through the environmental surcharge mechanism.

EAST KENTUCKY POWER COOPERATIVE, INC.
PSC CASE NO. 2008-00409
FIRST DATA REQUEST RESPONSE
REGULATORY ASSET

COMMISSION STAFF'S FIRST DATA REQUEST DATED 12/4/08
REQUEST 5
RESPONSIBLE PERSON: **Frank J. Oliva**
COMPANY: **East Kentucky Power Cooperative, Inc.**

Request 5. Refer to Item 7 of East Kentucky's response to the IC questions which reflects the estimated fuel cost benefits (savings) associated with the commercialization of Spurlock 4 and indicates that, based on certain assumptions, the annual expected savings would be $43 million. Provide the estimated fuel cost savings East Kentucky expects to realize, by month, for the period April 1, 2009 through December 31, 2009, due to the commercialization of Spurlock 4.

Response 5. For the period April 1, 2009 through December 31, 2009, the EKPC budget projects that Spurlock Unit 4 will generate 1,257,211 MWh. This estimate includes some allowance for downtime and scheduled outages, which are typical of a new unit. Based on the assumption that this generation will displace purchased power during on-peak hours, the cost savings are estimated to be $32,316,000 for 2009. Monthly savings are shown on page 2 of this response.

Projection of Estimated Fuel Cost Savings due to Commercialization of Spurlock Unit #4

	Apr-09	May-09	Jun-09	Jul-09	Aug-09	Sep-09	Oct-09	Nov-09	Dec-09	Total
Monthly Purchased Power Cost	66.5137	66.0672	83.9671	101.5092	92.4778	74.3377	65.7328	55.5614	73.0574	
Monthly Spurlock #4 Fuel Cost	25.8220	25.8220	25.8220	25.8220	25.8220	25.8220	25.8220	25.8220	25.8220	
Monthly Fuel Cost Savings per MWh	40.6917	40.2452	58.1451	75.6872	66.6558	48.5157	39.9108	29.7394	47.2354	
Spurlock #4 - Net Generation (MWh)	153,269	162,988	158,312	154,287	159,362	148,780	53,810	104,011	162,392	1,257,211
On-Peak MWh @ 50%	76,635	81,494	79,156	77,144	79,681	74,390	26,905	52,006	81,196	
Fuel Cost Savings per MWh	$3,118,408	$3,279,742	$4,602,534	$5,838,813	$5,311,201	$3,609,083	$1,073,800	$1,546,627	$3,835,326	$32,215,534

EAST KENTUCKY POWER COOPERATIVE, INC.
PSC CASE NO. 2008-00409
FIRST DATA REQUEST RESPONSE
REGULATORY ASSET

COMMISSION STAFF'S FIRST DATA REQUEST DATED 12/4/08
REQUEST 6
RESPONSIBLE PERSON: **Ann F. Wood**
COMPANY: **East Kentucky Power Cooperative, Inc.**

Request 6. Section 1767.13 of the USoA states that RUS borrowers will not implement the provisions of Statement of Financial Accounting Standards ("SFAS") No. 71, SFAS 90 and SFAS 92 without RUS approval, except as provided in Paragraph (d), Subsections (1) through (5), of this section. Explain whether East Kentucky is required by the USoA to obtain prior RUS approval to establish the proposed regulatory asset.

Response 6. Based on 1767.13, Paragraph (d), Subsection (2) of the USoA, East Kentucky is not required to obtain prior RUS approval to establish the proposed regulatory asset. Under this Subsection, if an RUS borrower would have met each of its financial tests or coverage ratios that it has covenanted with RUS for that fiscal year had the deferral not been made, then no RUS approval is needed. Unless an unforeseen event occurs, such as circumstances described in the response to PSC Request 1a, East Kentucky will meet its financial ratios under the RUS mortgage agreements for 2009, even if the deferral is not made.