COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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PUBLIC SERVICE COMMISSION

In the Matter of

GENERAL ADJUSTMENT OF ELECTRIC)
RATES OF EAST KENTUCKY POWER) CASE NO. 2010-00167
COOPERATIVE, INC.)

GALLATIN STEEL, INC.'S RESPONSES TO
INFORMATION REQUESTS OF
EAST KENTUCKY POWER COOPERATIVE, INC.

Data request to Paul A. Coomes

1. Please refer to Dr. Coomes' exhibit, "The Estimated Economic and Fiscal Impacts of Gallatin Steel's Operations in Kentucky." In the second paragraph of the Executive Summary is the statement "Gallatin Steel is interested in learning about and documenting the regional economic importance of its operations, so they can better communicate the ramifications if the steel production operations were financially threatened." As Dr. Coomes' testimony has been filed along with Gallatin Steel's testimony in EKPC's rate case, is it the position of either Dr. Coomes or Gallatin Steel that the pending rate case "financially threatens" the steel production operations? If so, please provide the data which supports this position.

Response:

The phrase in quotation was composed to provide context for the rest of the study. I have no specific knowledge that the plant is, or is likely to be, financially threatened by energy costs or any other economic factor. I also have no specific knowledge about current energy rates paid by Gallatin Steel, nor even what is proposed in the rate case. However, given that steel mills are energy-intensive operations, it is certainly true that there is some price point for energy costs that would threaten the financial viability of the steel plant at this location. Steel prices are set in a competitive market, and some combination of low steel prices and/or high energy costs would cause the plant to close. But I have not studied this in enough detail to know what the threshold is for energy costs relative to current and projected steel prices.

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Data request to Lane Kollen

2. Please refer to Exhibit LK-1, pages 5 through 34 of 34.

a. Based upon a review of the testimony appearances listed for Mr. Kollen, it appears that Mr. Kollen has had very limited experience with proceedings utilizing the Kentucky forecasted test period filing option. Please detail the extent of Mr. Kollen's experience both with Kentucky's forecasted test period filing option and the utilization of forecasted test periods in other non-Kentucky cases.

Response:

Please refer to Mr. Kollen's Exhibit___(LK-1) for a listing of the testimony Mr. Kollen has filed since 1986. Mr. Kollen filed testimony in KPSC Case Nos. 2008-00472 and 2009-00040 in which the utility used a forecasted test year. Mr. Kollen also filed testimony in FPSC Docket Nos. 910890-EI, 001148-EI, 050045-EI, 080677-EI; CPUC Docket No. 09AL-299E; GPSC Docket Nos. 14000-U, 14311-U, 18638-U, 20298-U, 25060-U, 27163, 30442, 31647; PUCO Docket Nos. 04-169-EL-UNC; and WPSC Docket Nos. 05-UR-103, 6680-UR-116, 6690-UR-119, 6680-UR-117 in which utilities in other jurisdictions used a forecasted test year.

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3. Please refer to page 3 of Mr. Kollen's direct testimony, starting at line 15.

a. Would Mr. Kollen agree he was a witness for Kentucky Industrial Utility Customers ("KIUC"), representing Gallatin Steel and Air Liquide, in EKPC's last general rate case, Case No. 2008-00409?

b. Would Mr. Kollen agree that he made the following statement in his direct testimony filed in Case No. 2008-00409, page 19 beginning at line 23, "Fourth, for the first time in this proceeding, the Company's revenue requirement will be determined on the basis of a projected test year rather than a historic test year."?

c. Based on this statement from his direct testimony in EKPC's last general rate case, please explain Mr. Kollen's statements on page 3, starting at line 15, indicating that the current rate case application was the first time EKPC had submitted a rate application utilizing the projected test year approach.

Response:

a. Yes.

b. Yes.

c. In Mr. Kollen's review of the prior EKPC rate filings, he overlooked Case No. 2008-00409. The phrase "and for the first time," on page 3 lines 18-19 and the word "new" on page 4 line 15 should be stricken.

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4. Please refer to page 4 of Mr. Kollen's direct testimony, lines 10 through 18.

a. When developing this portion of his testimony, did Mr. Kollen review the testimony of Mr. Oliva and EKPC's response to the Commission Staff's First Data Request, Item 9?

b. If Mr. Kollen reviewed this testimony and data response, which addressed EKPC's budgeting processes, please explain why Mr. Kollen makes no reference to it in this section, or any section, of his testimony.

c. Given the information provided in Mr. Oliva's testimony and EKPC's response to the Commission Staff's First Data Request, Item 9, please explain how Mr. Kollen can conclude that the forecasted test year expenses in this rate application were not developed in the normal course of business for use by EKPC to manage its costs in the same manner that its operating budgets are developed and utilized.

d. Would Mr. Kollen agree that when a forecasted test period is utilized, the focus is on determining the reasonableness of the utility's budgeting and other processes used to arrive at the forecasted test period balances?

Response:

a. Yes.

b. There was no reason for Mr. Kollen to reference Mr. Oliva's testimony or the response to Staff 1-9 in his testimony. Mr. Kollen read Mr. Oliva's testimony and understood it to provide an "overview of EKPC's budgeting process" and "a detailed explanation of the methodology and assumptions used to forecast items other than projections of major construction projects and projections of capital and operations and maintenance expenses for the power production and power delivery functions." Mr. Oliva did not assert that the amounts projected for the test year were developed in the normal course of business.

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c. Please refer to Mr. Kollen's testimony at page 4 lines 6-14.

d. The focus is on the reasonableness of the assumptions and methodologies used to project the amounts in the forecasted test year.

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5. Please refer to pages 6 through 9 of Mr. Kollen's direct testimony. Mr. Kollen repeatedly makes comparisons between the 2011 forecasted test year and calendar year 2009. He rarely compares the 2011 forecasted test year with the base test year, the period September 1, 2009 through August 31, 2010. Please explain why Mr. Kollen has focused his comparisons on calendar year 2009 instead of the base test year.

Response:

Mr. Kollen does not believe that the partially projected base year amounts are as reliable for comparison purposes as the actual historic year amounts. This belief is borne out through a comparison of the actual and budget amounts for the 2010 calendar year to date as discussed on page 10 lines 4-17 of Mr. Kollen's testimony and his Exhibit___(LK-4), which is a copy of the Company's response to Staff 1-43 for the year to date through July 2010. The Company's actual expenses are less than its budget year to date through July 2010, except for the categories of fuel, other power supply (purchased power expense) and transmission.

The Company's actual production operation expense, excluding fuel, is $5.6 million below budget. The Company's actual distribution operation expense is $0.3 million below budget. The Company's actual customer service and information operation expense is $0.6 million below budget. The Company's actual A&G expense is $0.9 million below budget. The Company's actual maintenance expenses for production, transmission, distribution and general are $5.3 million below budget. The Company's actual depreciation expense is $2.3 million below budget. The Company's actual interest on long term debt is $4.0 million below budget. These actual expenses are $18.8 million below budget for the first seven months of 2010.

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6. Please refer to the table on page 8 of Mr. Kollen's direct testimony. Did Mr. Kollen remove the expenses associated with the environmental surcharge in either period presented? If not, please explain why these expenses were not removed.

Response:

No. The purpose of the table is to compare the Company's test year expenses to the historic year expenses.

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7. Please refer to Page 8 of Mr. Kollen's testimony, beginning at line 3. To what extent has Mr. Kollen considered the extremely mild weather/lower than normal generation in 2009 when making his comparison to 2011?

Response:

The purpose of the table is to compare the projected test year expenses to the historic test year expenses. Mr. Kollen did not make any adjustments to the expense amounts.

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8. Please refer to page 9, lines 4 through 8, of Mr. Kollen's direct testimony. Since EKPC added over $1 billion in production assets in 2009 and 2010 (Spurlock 4, two combustion turbines, and the Spurlock 1 and 2 scrubbers), would Mr. Kollen agree that O & M expenses would also increase due to these additions, considering maintenance items are generally covered under warranty for only the first year? Please explain your response.

Response:

Mr. Kollen agrees generally that there is incremental O&M expense when new generators or scrubbing equipment are added, all else equal.

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9. Please refer to pages 18 and 19 of Mr. Kollen's direct testimony. Concerning the unamortized costs of the 2004 Spurlock 1 outage,

a. Would Mr. Kollen agree that EKPC was permitted to begin the amortization of these costs in December 2007?

b. Would Mr. Kollen agree that the Commission originally authorized a 3-year amortization of these costs in Case No. 2006-00472?

c. Would Mr. Kollen agree that his proposal of an additional 3-year amortization period for the unamortized balance of these costs in effect results in a 6-year amortization period?

d. Please explain why Mr. Kollen believes it is reasonable to require a 6-year amortization of these costs.

e. On page 19 of his direct testimony, Mr. Kollen states that EKPC "is allowed to recover the interest expense plus a TIER margin on the debt incurred to finance this cost, so the longer amortization period does not harm the Company." Please explain why Mr. Kollen has assumed these outage costs have been financed with long-term debt.

Response:

a. Yes.

b. Yes.

c. Yes.

d. Mr. Kollen explained why he recommends a three year amortization period for the remaining unamortized deferred amounts on page 18 lines 1-15 of his testimony.

e. The Company uses debt on the margin to actually finance deferred expenses. The deferred expenses were not recovered from ratepayers prior to or when they were incurred; thus, none of the margins financed these costs on the margin.

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10. Please refer to page 18, lines 7-8, of Mr. Kollen's testimony. Please explain why, when computing an arithmetic average of five years of actual forced outage costs incurred, it is appropriate to exclude the costs of outages incurred in 2008.

Response:

Please refer to page 16 lines 1-14 of Mr. Kollen's testimony.

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11. What would Mr. Kollen's recommended annual allowance for forced outage costs be if the 2008 outage costs are included in the calculation? Please provide the calculation.

<u>Response</u>:

Mr. Kollen has not made this calculation.

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12. Please refer to page 20 of Mr. Kollen's testimony, beginning at line 19. Mr. Kollen states that EKPC's total capitalization is projected to increase by $427.019 million between December 31, 2009 and December 31, 2011. He then states that EKPC's net investment rate base is projected to increase by $311.675 million between those two dates, resulting in Mr. Kollen's assertion that EKPC "will finance $115.334 million more than the increase in its net investment rate base (including environmental) during the two year period."

a) Would Mr. Kollen agree that the projected $427.019 million increase in capitalization is comprised of increased debt of $333.722 million and increased equity of $93.297 million? Please explain your response.

b) Would Mr. Kollen agree that the source of the increased equity is net margins generated internally by EKPC? Please explain your response.

c) Would Mr. Kollen, therefore, agree that the projected increase in long-term debt of $333.722 million during the two year period is only $22.047 million greater than the projected increase in EKPC's net investment rate base of $311.675? Please explain your response.

d) Further, would Mr. Kollen agree that EKPC's unsecured revolving and term credit facility is used both for certain capital expenditure needs and for general corporate purposes (Case No. 2010-00166, Revised Application Exhibit 2)? Please explain your response.

Response:

a. Yes. Please refer to Exhibit___(LK-12) attached to Mr. Kollen's testimony. The increased equity is an accrual amount that measures the cumulative margins over the two year period that are projected to be retained by the Company. The increase in equity is not a measure of cash flow provided by the ratepayers or cash financing provided by third parties, unlike the amount of debt that is issued and outstanding. The Company's cash requirements first are met by internal cash generation, which is not measured by its margins, but rather by cash receipts less cash disbursements. Any additional cash requirements are met by issuing debt, so debt is the financing on the margin.

b. Yes. In addition, please refer to the response to part (a) of this question.

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c. Yes. Mathematically, that is true. However, that is an irrelevant comparison because the Company's financing on the margin is through long-term debt, not through increases in members' equity.

d. Yes. The Company's financing on the margin is through the credit facility or other sources of long-term debt to the extent that internal cash generation is insufficient to meet its cash requirements.

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13. Page 21 of Mr. Kollen's testimony refers to his Exhibit _(LK-13) and his Exhibit ___(LK-14. Utilizing the data for December 2009 in Exhibit_(LK-13), the sum of Total Utility Plant in Service of $3,083.748 million and Total CWIP of $382.843 million is $3,466.591 million. Utilizing the data projected for December 2011 in Exhibit_(LK-14), the sum of Total Utility Plant in Service of $3,392.929 million and Total CWIP of $545.584 million is $3,938.513 million. Using this data, EKPC's total capital expenditures for the two year period are projected to be $471.922 million ($3,938.513 million less $3,466.591 million).

a. Since EKPC's capital expenditures from December 2009 to December 2011 are projected to be $471.922 million and EKPC's projected increase in long-term debt is projected to by $333.722 million, please explain Mr. Kollen's statement on page 22, lines 18 and 19, that EKPC is projecting "excessive financing."

Response:

Refer to page 21 line 5 through page 22 line 22 of Mr. Kollen's testimony. The table on page 21 compares the Company's projections of capitalization to net investment rate base at December 2009 and for each month during the test year based on the Company's responses to Staff 1-16 and Tab 47 from the Company's filing. The table demonstrates that the excessive financing from endpoint to endpoint (December 2009 to December 2011) is $166 million (the difference between net investment rate base and capitalization). However, the endpoint to endpoint comparison masks the extent of the excessive financing problem with the Company's test year projection. The excessive financing is much greater in the earlier months of the test year, starting at $279 million in January 2011 and increasing to $319 million in March 2011 before slowly declining throughout the remainder of the year to the $166 million. The interest expense and the related TIER are based on the Company's assumptions regarding the total amount of debt outstanding during each month of the test year, not the endpoint (December 2011).

With this background, the comparison in the question is based on an incorrect assumption, i.e., that financing is tied only to an increase in plant in service and CWIP. The correct assumption is that financing is generally tied to an increase in net investment rate base. More specifically, it is necessary to issue incremental financing to the extent that there is growth in the net investment that is financed. The net investment that is financed includes not only the additional investments in the plant in service and CWIP components of net investment rate base, but also the reductions in existing investment that is reflected in accumulated depreciation and other changes in the components of net investment rate base. The increase in accumulated depreciation is a significant offset to the increase in plant in service and CWIP that must be financed because the Company recovers cash revenues for depreciation expense, but has no related cash disbursement. With reference to Mr. Kollen's Exhibit___(LK-13) and Exhibit___(LK-14), the increase in accumulated depreciation from December 2009 to December 2011 is $152.443 million. This increase was financed through internal cash generation and reduced the amount that otherwise would have been financed through incremental long term debt, all else equal.

The excessive financing also is demonstrated through a review of the Company's response to Staff 1-15, which provides a reconciliation of the 13 month average rate base and capitalization for the base year. In the base year, $124 million of the excess of capitalization over net investment rate base is due to "cash and investments" that are not included in net investment rate base, but nevertheless are assumed to be financed by the Company. Thus, the excessive financing problem is evident even in the base year, but then is ratcheted up significantly for the test year.

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14. Please refer to page 24, lines 18-23, of Mr. Kollen's testimony. Mr. Kollen states that the debt pursuant to the planned $175 million private placement issuance "is not necessary." Please explain the rationale for this conclusion and why Mr. Kollen believes that EKPC either should not, or is not entitled to, finance properly incurred capital expenditures.

Response:

The Company's test year includes excessive debt financing. The $175 million private placement debt is not necessary within this context. To the extent that it is necessary to issue debt to meet the Company's cash requirements, then this issue is more expensive than other options. The Company assumed that it would issue $175 million in private placement debt in lieu of other long term debt financing available at a lower interest rate. That is not a reasonable assumption.

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15. Please refer to page 25, lines 14-15, of Mr. Kollen's testimony. Mr. Kollen refers to EKPC's response to Staff 2-32: "EKPC generally funds its capital expenditures in arrears". Please explain Mr. Kollen's understanding of this statement and, in this light, why he believes that new long-term debt should match up with projected capital expenditures.

Response:

Mr. Kollen's understanding is reflected in the entirety of the Company's response to Staff 2-32 cited by Mr. Kollen in his testimony, not just the portion cited in the question. Mr. Kollen does not believe that new long-term debt should match up with projected capital expenditures. Mr. Kollen believes that incremental financing should match up with increases in net investment rate base.

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Data request to Stephen J. Baron

16. Please provide all workpapers, in electronic format with formulae intact that were used in the preparation of Mr. Baron's testimony. In addition, please provide Baron Exhibit SJB-2 in electronic format with all formulae intact.

Response:

See attached.

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17. Please refer to page 4 of Mr. Baron's direct testimony, lines 13 through 20, and page 7, lines 7 through 11.

a. Please explain the basis for Mr. Baron's statement that EKPC did not file a cost of service analysis in this rate application.

b. Was Mr. Baron aware that one of the filing requirements for a forecasted test year is the submission of a cost of service study and that the Commission did not find EKPC's application deficient for this requirement?

c. Please explain why Mr. Baron has not acknowledged that Mr. Eicher filed a cost of service analysis in this case on behalf of EKPC.

d. Please confirm that Mr. Baron is aware that Mr. Seelye has not sponsored any exhibits or testimony on EKPC's behalf in the current rate case.

e. In preparing his testimony, did Mr. Baron review Mr. Scott's testimony, specifically page 7?

f. Does Mr. Baron agree the following statement appears on page 7 of Mr. Scott's testimony, "Yes, EKPC could have utilized the cost-of-service study prepared for this application to propose a rate design that more closely matched the cost-of-service study results."?

g. Please explain how Mr. Baron can claim that EKPC did not file a cost of service study in this rate case, considering the testimony of Mr. Eicher and Mr. Scott.

<u>**Response**</u>:

a. Mr. Baron's testimony on page 4 and on page 7 clearly referred to the fact that EKPC elected not to file a "class" cost of service study in this case. As is clear from the testimony and exhibits of EKPC witnesses Eicher and Scott, EKPC did not file a class cost of service study in this case.

b. Yes.

c. Mr. Baron did acknowledge this on page 8 at line 19 of his testimony.

d. Mr. Baron acknowledges that Mr. Seelye did not file testimony in this case.

e. Yes.

f. Yes.

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g. Mr. Baron's testimony clearly refers to the fact that EKPC did not file a class cost of service study in this case, which neither Mr. Eicher, Mr. Scott or any other EKPC witness presented in this case.

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18. Concerning EKPC's cost of service study filed in Case No. 2008-00409,

a. Would Mr. Baron agree that the Commission did not make a determination of the appropriateness or reasonableness of the cost of service study filed by EKPC in that case?

b. Would Mr. Baron agree that the increase in revenues authorized in Case No. 2008-00409 was allocated to the various rate schedules using a pro-rata allocation method?

Response:

a. Since the case was settled, the Commission did not make such a determination.

b. Yes.

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19. Please refer to page 10 of Mr. Baron's direct testimony, starting at line 17 and continuing to page 12, line 3. Concerning the allocation of purchased power and fuel expense,

a. Please explain why Mr. Baron believes allocating these costs using a detailed monthly energy allocation is more appropriate than using an annual energy allocation.

b. Please explain why only these costs should be allocated on a monthly allocation basis and not all costs.

c. Please provide citations to the applicable sections of cost allocation and/or cost of service study manuals published by the National Association of Regulatory Utility Commissioners or the Federal Energy Regulatory Commission that support the use of a monthly energy allocation approach. Also, please include copies of the applicable text from these manuals.

d. Please refer to Exhibit SJB-2, page 16 of 24. Would Mr. Baron agree that if his proposed adjustments to operating expenses related to the reallocation of purchased power and fuel expense were removed from the cost of service study, the resulting return on rate base for the Large Special Contract class would be approximately 4.20% and the dollar subsidy would be approximately $476,000?

__Response__:

a. As explained in Mr. Baron's testimony, to the extent that purchased power expenses vary by on-peak and off-peak periods and fuel expenses vary by month on a per kWh basis (which they do), it is more accurate to assign cost responsibility on monthly kWh usage by each rate class than on annual kWh usage. It should be noted that the use of a monthly allocation of fuel expense resulted in an assignment of an additional $82,967 of costs to Gallatin, which is a detriment. It further resulted in a reduction of $224,669 in fuel expenses to Rate E, which is a benefit to Rate E.

b. Fixed production and transmission costs generally do not vary by month, but are calculated on an annual revenue requirement basis and are not influenced by monthly kWh usage. More significantly, fixed production and transmission costs are incurred on the basis on 6 CP demands for production and 12 CP demands for transmission, as modeled in Mr. Baron's class cost of service study. Other costs (besides fixed production and transmission costs and fuel and purchased power expense) are generally not sensitive to seasonal or monthly variations in kWh usage and thus have not been allocated on this basis in Mr. Baron's cost of service study.

c. While the NARUC manual does not specifically discuss monthly or seasonal energy allocation, it does state that "It is allocated using appropriate time-differentiated allocators; e.g., on-peak KWH and off-peak KWH…" The monthly allocation approach used by Mr. Baron has a similar foundation – that is, matching cost responsibility to cost causation. Page 64 of the NARUC manual is attached. In fact, Mr. Baron's class cost of service study relies on an on/off peak allocation method for purchased power costs.

d. If the referenced adjustments were removed from the class cost of service study, the resulting return on rate base for the Large Special Contract class would be 4.20% and the dollar subsidy would be approximately $478,000.

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20. Please refer to page 12 of Mr. Baron's direct testimony, lines 8 through 13.

a. Please provide all workpapers, calculations, and assumptions utilized to determine the 24.84% and 29.4% on-peak usage values.

b. Please provide Gallatin Steel's projected on-peak usage for calendar year 2011. Include all workpapers, calculations, and assumptions utilized to determine the usage value. If this information is not available, please so state.

c. Would Mr. Baron agree that since his cost of service study is for a forecasted test period, it would be more reasonable to reflect Gallatin Steel's projected on-peak usage percentage rather than a current historical usage percentage?

Response:

a. See Mr. Baron's workpapers provided in response to question 16.

b. No such analysis has been provided to or developed by Mr. Baron.

c. While such a projection could be useful, Mr. Baron believes that the most recent on/off peak usage percentages for Gallatin based on the 12 months ending June 2010 is a reasonable assumption to use in a projected test year analysis. There is no basis to assume that EKPC's assumed on/off peak percentages are reasonable, given the recent usage characteristics of Gallatin for the 12 months ending June 2010.

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21. Please refer to page 13 of Mr. Baron's direct testimony, starting at line 4 and continuing through page 18, line 2. Concerning the "fuel savings" resulting from interruptions,

a. Please refer to the discussion on page 15 concerning the fuel savings resulting from interruptions and the resulting average fuel rate paid by EKPC firm customers. Would Mr. Baron agree that this average fuel rate paid by EKPC firm customers would be included as part of the fuel adjustment clause mechanism? If not, please explain why not.

b. Would Mr. Baron agree that the same monthly fuel adjustment clause rate is paid by all customers of EKPC, including the customer being interrupted? If not, please explain why not.

c. Would Mr. Baron agree that if fuel savings resulting from the interruption of an interruptible load are reflected in the fuel adjustment clause mechanism and all customers pay the same fuel adjustment clause rate, all customers including the interruptible customer share in those fuel savings? If not, please explain why not.

d. Mr. Baron proposes an adjustment in his cost of service study for this fuel savings from interruption. Please explain why this adjustment doesn't result in a double counting of the benefit from these fuel savings, as the fuel savings would already be reflected in the fuel adjustment clause.

e. Please refer to Exhibit SJB-2, page 16 of 24. Would Mr. Baron agree that if his proposed adjustment to operating expenses related to the avoided fuel costs of interruption were removed from the cost of service study, the resulting return on rate base would be approximately 2.47% and the dollar subsidy would be approximately a negative $2,543,000?

Response:

a. Yes. While Mr. Baron would agree that the fuel adjustment clause average fuel rate is paid by all firm customers, to the extent that Gallatin buys through an interruption, Gallatin pays incremental cost for each buy through kWh.

b. Interruptible kWh that is interrupted does not share in the fuel savings. The fuel savings are provided to firm customer kWh. To the extent that Gallatin purchases some firm kWh during hours when Gallatin interruptible load is interrupted, these firm kWh would receive the benefit of the fuel savings. However, this does not change the fact that the value of Gallatin interruptible load includes the fuel savings benefit calculated by Mr. Baron and reflected in the Gallatin class cost of service study.

c. There is no double counting in Mr. Baron's analysis. In fact, the purpose of Mr. Baron's analysis is to reflect in the class cost of service study the fact that the fuel savings made possible by Gallatin interruptions is already reflected and passed-through to EKPC firm customers in the fuel adjustment clause, yet these fuel savings are not reflected in the interruptible credit paid to Gallatin. As a result, it is necessary to reflect these fuel savings in the class cost of service study in order to properly match cost of service with cost causation.

d. If the referenced adjustments were removed from the class cost of service study, the resulting return on rate base for the Large Special Contract class would be approximately 2.47% and the dollar subsidy would be approximately a negative $2,542,000.

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22. Please refer to page 21 of Mr. Baron's direct testimony. EKPC has proposed the following demand and energy charges for Gallatin Steel:

- Firm Demand Charge - $7.00 per kW per month.
- 10-Minute Interruptible Demand Credit - $5.60 per kW per month, or a net demand charge of $1.40 per kW per month.
- 90-Minute Interruptible Demand Credit - $4.20 per kW per month, or a net demand charge of $2.80 per kW per month.
- On-Peak Energy Charge - $0.049754 per kWh.
- Off-Peak Energy Charge - $0.046287 per kWh.

Using Mr. Baron's proposed rate increases as shown on Table 4 and his proposed 10-minute interruptible demand credit, please provide his proposed demand and energy charges for Gallatin Steel. Please include all workpapers, calculations, and assumptions.

Response:

Please see attached for a proposed Gallatin Steel rate, assuming that EKPC received its entire rate request in this case. Mr. Baron's rate design is based on a uniform increase to the Gallatin demand and energy charges, coupled with Mr. Baron's proposed 10-minute interruptible credit.

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23. Mr. Kollen has recommended a revenue increase for EKPC of $3.03 million. Utilizing Mr. Baron's cost of service study and including his proposed 10-minute interruptible credit, please provide the resulting demand and energy charges for Gallatin Steel. Please include all workpapers, calculations, and assumptions.

Response:

Please see attached.

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24. Please refer to page 22 of Mr. Baron's direct testimony. Please provide a description of the characteristics of a "standalone" customer.

Response:

Mr. Baron has fully discussed the reasons why he believes that Gallatin is a standalone customer for purposes of cost of service and rate design in his Direct Testimony at pages 22 to 23. This testimony provides Mr. Baron's description of a standalone customer, as applicable to Gallatin in this case.

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25. Please refer to pages 23 and 24 of Mr. Baron's direct testimony. Concerning the apportionment of the EKPC overall revenue increase to rate classes,

a. Please confirm that Mr. Baron is referring to KRS 278.455(3) concerning the treatment of special contracts.

b. Would Mr. Baron agree that Paragraph 15 of the current Gallatin Steel contract states "The rates, terms and conditions of this Agreement for electric service shall be subject to modification or change by order of the KPSC during the initial five year term and thereafter."

c. Please provide Gallatin Steel's legal argument supporting its position concerning the applicability of KRS 278.455(3) to the cost allocation issue as reference on page 24, lines 3 through 9.

Response:

a. As discussed in Mr. Baron's testimony, the principal reason for Mr. Baron's conclusion that Gallatin is a standalone customer of EKPC is the special rate treatment of Gallatin pursuant to its contract with EKPC. However, Mr. Baron agrees that Gallatin is a special contract customer of EKPC consistent with the provisions of KRS 278.455(3), and this is a factor that should be considered as well.

b. While the reference statement does appear in the contract, the contract also contains provisions that permit EKPC to charge Gallatin for load following and regulation service, the cost of which is determined by EKPC and not specifically approved by the Commission. In addition, pursuant to the contract, Gallatin must provide a schedule of usage to EKPC in advance. To the extent that Gallatin deviates from this schedule by stated parameters, EKPC can impose additional penalties on Gallatin. These penalties are not reflected in the Large Special Contract rates approved by the Commission.

c. Mr. Baron is not a lawyer and cannot offer a legal opinion on behalf of Gallatin.

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26. Please refer to pages 26 through 31 of Mr. Baron's direct testimony.

a. Pursuant to the contract, Gallatin Steel can be interrupted for a total of 360 hours annually. The total operating hours in a year are 8,760. Would Mr. Baron agree that Gallatin Steel's potential total interruptions reflect approximately 4.1% of the total hours in a year?

b. Of the total demand of 160,000 kW, the combined 10-minute and 90-minute interruptible demand is 145,000 kW. Would Mr. Baron agree that the interruptible demand reflects approximately 90.6% of the total demand?

c. Would Mr. Baron agree that while Gallatin Steel can be interrupted for no more than 4.1% of the total hours in a year, 90.6% of its total demand is priced at a rate significantly lower than the firm demand charge for all of the hours in a year?

d. On page 27 of Mr. Baron's direct testimony, he states that if the Gallatin Steel load was firm instead of interruptible, EKPC would require an additional 162,400 kW of peaking capacity, the cost of which would be borne by all of EKPC's customers. Given the size of the required peaking capacity, and Mr. Baron's contention that Gallatin Steel is essentially a "standalone" customer, please explain why Mr. Baron assumes that all of EKPC's customers would bear the costs of this additional peaking capacity.

e. On pages 27 and 28 of Mr. Baron's direct testimony is a discussion of EKPC's peak load growth as reported in the 2009 Integrated Resource Plan. In preparing his testimony, did Mr. Baron review EKPC's response to the Commission Staff's Second Data Request, Item 11?

f. On page 29 of Mr. Baron's direct testimony is a discussion of his proposal to reflect the "value" of the avoided cost of peaking capacity, which Mr. Baron bases on the 12% reserve margin EKPC uses for generating capacity planning purposes. Please explain why it is

reasonable to incorporate the entire 12% reserve margin in the 10-minute interruptible credit calculations when Gallatin Steel can be interrupted no more than 4.1% of the hours in a year.

g. Mr. Baron recommends that the 10-minute interruptible credit should be raised to \$6.22 per kW. EKPC has proposed that the firm demand charge be \$7.00 per kW. The net demand charge for the 10-minute interruptible demand would be \$0.78 per kW. This \$0.78 per kW demand charge would be applied to 120,000 kW of demand per month for the entire year. Please explain how a demand charge of \$0.78 per kW can be considered reasonable for 75% of Gallatin Steel's total demand (120,000 kW of 160,000 kW total).

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Response:

a. Yes.

b. Yes.

c. While Mr. Baron agrees that EKPC's arithmetic is correct, the calculation is irrelevant because the basis Gallatin pays the full firm demand charge for each kW of interruptible load, less an interruptible credit based on avoided capacity cost. This methodology, which Mr. Baron agrees with, has been approved by the Commission for EKPC and other Kentucky utilities, such as LGE and KU.

d. If EKPC were to build or purchase an additional 162,000 kW of peaking capacity, Mr. Baron assumes that the cost of this capacity would be allocated in a fully allocated class cost of service study to all rate classes, including the Large Special Contract class.

e. Mr. Baron does not believe that he reviewed this response.

f. As Mr. Baron explained in response to part c. of this question, the 4.1% value, while arithmetically correct, is irrelevant for any rate design or cost of service purposes. The relevant basis, as discussed by EKPC witness Scott on page 3 of his testimony, is avoided cost. As explained by Mr. Baron in his testimony, avoided capacity cost, if properly calculated, would include a provision to reflect avoided reserves associated with interruptible load.

g. The proposal made by Mr. Baron is reasonable and is consistent with EKPC's own calculation of the appropriate rates for Gallatin. Gallatin pays the full firm demand charge for each kW of interruptible load, less an interruptible credit based on avoided capacity cost. This methodology, which Mr. Baron agrees with, has been approved by the Commission for EKPC and other Kentucky utilities, such as LGE and KU. The calculations made by EKPC in this question (26g) do not reflect the underlying foundation supporting an interruptible credit based on avoided cost. If, for the sake of argument, a $7/kW firm demand rate is appropriate, for Gallatin and EKPC's avoided capacity cost applicable to interruptible load is $6.22/kW, then the net of these two numbers is $0.78. [As discussed below, the $7/kW firm demand charge does not reflect the full firm demand charge paid by Gallatin, which also includes $4.52/kW of demand cost being recovered in the Large Special Contract rate energy charges.]

In addition, the EKPC arithmetic calculation fails to reflect the underlying basis for the rates. This "underlying basis" assumes that Gallatin is buying firm demand from EKPC and is providing, in a separate transaction, interruptible load that is "paid" avoided cost. It is improper to characterize these two transactions as a single purchase by Gallatin at $0.78/kW.

More significantly, EKPC's Large Special Contract rate includes a substantial portion of fixed demand related costs in the on-peak and off-peak energy charges of the rate. Based on the class cost of service study developed by Mr. Baron in this case, the actual demand cost for Gallatin (comprised of production and transmission demand) is $11.52/kW month, far in excess of the rate schedule demand charge. This $11.52/kW is the amount of fixed demand related cost per kW assigned to Gallatin in the test year. The amount in excess of the proposed demand rate of $7.00/kW (as proposed by EKPC) is $4.52/kW. This additional $4.52/kW of demand cost is recovered in the Gallatin on-peak and off-peak energy charges. As a result, EKPC's premise in this question that interruptible load is only being charge $0.78/kW is incorrect. The unit cost analysis is included in Mr. Baron's workpapers provided in response to Question No. 16.

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27. Please refer to pages 31 and 32 of Mr. Baron's direct testimony concerning the 20 MW limit in Section D – Interruptible Service in EKPC's tariff. Mr. Baron recommends the removal of the 20 MW limit.

a. In preparing his testimony, please indicate whether Mr. Baron performed any studies or analyses of the contract demand loads of the Rate B, Rate C, and Rate G retail customers served by EKPC's member cooperatives. If such a study or analysis was not performed, please explain why not.

b. Please indicate if Mr. Baron was aware that there are no Rate B, Rate C, or Rate G retail customers served by EKPC member cooperatives that have a contract demand in excess of 20 MW.

c. Given EKPC's response to the Commission Staff's Second Data Request, Item 11 and the fact that there are no Rate B, Rate C, or Rate G retail customers served by EKPC member cooperatives that have a contract demand in excess of 20 MW, please explain why Mr. Baron believes the 20 MW interruptible limit should be removed from the tariff.

Response:

a. Mr. Baron did not perform such an analysis and does not believe that such an analysis is necessary to support his recommendation.

b. Mr. Baron has not performed a review of the maximum kW demand of any Rate B, Rate C or Rate G customer. Notwithstanding this, Mr. Baron's recommendation would be applicable to any EKPC customer that may take service whose demand is in excess of 20 mW.

c. Mr. Baron's recommendation is a general recommendation that would permit customers whose demands exceed 20 mW to take interruptible service. To the extent, in the future, that such customers may take service on the EKPC system, there is no basis, in Mr. Baron's opinion to limit the size of such customer's interruptible load to 20 mW.

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28. Please refer to Exhibit SJB-2.

a. Please indicate the source of the $52,075,727 shown for Labor Expense – Total System on page 5 of 24.

b. Please explain why Interest on Long-Term Debt and Other Interest Expense was combined to arrive at the $112,379,925 shown for Interest Expense – Total System on page 9 of 24.

c. Please indicate the source of the following amounts shown under Total System on page 11 of 24:

i. Sales to Members of $937,679,954.
ii. Off System Sales Revenue of $4,077,873.
iii. Other Non-Operating Income of a negative $67,400.
iv. Other Credits of $161,756.

d. Please identify what entries shown just below Total Operating Revenues – Total System of $8,823,835 and $12,278,338 represent and the source of these amounts.

e. Please indicate the source of the $102,349,021 shown for Pro-Forma Adjustments, Remove Environmental Surcharge Revenue – Total System.

<u>Response:</u>

a. The $52,075,727 Labor Expense – Total System is the sum of the labor expense amounts by account, which are from workpaper WP-1 Labor Expense.xls provided by EKPC in response to Gallatin – Request 1.

b. The amounts were added in order to produce a revenue requirement analysis consistent with EKPC's presentation as shown on Oliva Exhibit 1 and Wood Exhibit 1.

c. i. Oliva Exhibit 1, lines 1 through 4 plus the adjustment to Gallatin revenues for the percentage of on-peak kWh (see workpapers provided in response to question 16.)

ii. Oliva Exhibit 1 line 5.

iii. Oliva Exhibit 1 line 35 and Workpaper DRE-3 Page 10 of 10, line 199, Column (t).

iv. Wood Exhibit 1 lines 44 and 45.

d. Those entries were temporary calculations used in attempting to verify consistency with EKPC's presentation of revenue requirements, and do not affect the class cost of service study. The actual calculations are shown in the live spreadsheet provided in response to question 16.

e. Wood Exhibit 1 line 6 plus the adjustment to Gallatin Environmental Surcharge revenues for the percentage of on-peak kWh (see workpapers provided in response to question 16.)