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VIA OVERNIGHT MAIL

October 1, 2010

RECEIVED
OCT 04 2010
PUBLIC SERVICE COMMISSION

Mr. Jeff Derouen, Executive Director
Kentucky Public Service Commission
211 Sower Boulevard
Frankfort, Kentucky 40602

Re: **Case No. 2010-00167**

Dear Mr. Derouen:

Please find enclosed the original and twelve (12) copies each of GALLATIN STEEL COMPANY'S' RESPONSES TO COMMISSION STAFF'S FIRST REQUEST FOR INFORMATION and its RESPONSES TO INFORMATION REQUESTS OF EAST KENTUCKY POWER COOPERATIVE, INC. filed in the above-referenced matter.

By copy of this letter, all parties listed on the attached Certificate of Service been served. Please place this document of file.

Very Truly Yours,

Michael L. Kurtz, Esq.
BOEHM, KURTZ & LOWRY

MLKkew
Attachment
cc: Certificate of Service
Richard G. Raff, Esq.
Quang D. Nguyen, Esq.

G:\WORK\MLK\GALLATIN\2010-00167 (Rate Case)\Derouen Ltr .doc

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing was served by mailing a true and correct copy, by first-class postage prepaid mail, to all parties on the 1st day of October, 2010.

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Michael L. Kurtz, Esq.

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

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PUBLIC SERVICE COMMISSION

In the Matter of:

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

GALLATIN STEEL COMPANY'S RESPONSES TO COMMISSION STAFF'S FIRST REQUEST FOR INFORMATION

1. Refer to the Direct Testimony of Lane Kollen ("Kollen Testimony") starting at page 3, line 22, and continuing to page 4, line 1. The referenced sentence states that "In this filing, and for the first time, the Company has used a fully projected test year to quantify its rate increase request." Mr. Kollen testified in the most recent base rate case filed by East Kentucky Power Cooperative, Inc. ("EKPC"), Case No. 2008-00409,' in which EKPC based its requested revenue increase on a fully forecasted test year. Confirm that the statement referenced in this request is in error.

Response:

Yes. 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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2. Refer to the Kollen Testimony, page 10, lines 6-11, and Exhibit___(LK-4). The testimony states that the exhibit reflects EKPC's updated response to Commission Staffs Request 1-43 which shows actual year-to-date expenses through July 2010. However, the exhibit contains a response with year-to-date expenses through April 2010. Provide the correct exhibit referenced in the testimony.

Response:

Please refer to the attached pdf file.

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3. Refer to pages 10-12 of the Kollen Testimony, which discusses payroll and payroll tax adjustments proposed by Mr. Kollen.

a. Mr. Kollen recommends that EKPC's payroll expense increase be limited to a 3.0 percent annual escalation factor, or 4.0 percent from the base year to the test year. Explain why a fixed percentage increase, which does not appear to have a connection to any of the specific wage and salary adjustments identified by EKPC in this proceeding, is a reasonable basis for establishing EKPC's payroll expense.

b. Explain how 3.0 percent was selected as the escalation factor.

Response:

a. There are several reasons. First, there are no major planned additions of generating capacity or scrubbers after the historic year until after the test year. The base year incorporates the increases in payroll expense resulting from the additions of generating capacity and scrubbers in the historic year. Consequently, the use of a fixed percentage increase for the test year applied to the base year should provide a reasonable amount of payroll expense for the test year under the assumption that there are no changes in staffing either up or down. Second, the 3.0% annual rate proposed by Mr. Kollen is more than twice the present rate of inflation. Third, the 3.0% is only slightly less than the 3.9% average annual increase in payroll costs since 2005, a period during which the Company added two new coal-fired generating units, multiple CTs and various emission control equipment. Fourth, the Company has not justified any increases in staffing other than additional construction employees at the Smith site. The payroll costs for additional construction employees would not be expensed, but would be capitalized.

b. Refer to the response to part (a) of this question. An increase of 0% from the base year to the test year would be reasonable based on the present rate of inflation less increases in the present rate of productivity based on statistics published by the U.S. Bureau of Labor Statistics, all else equal. However, Mr. Kollen selected a 3.0% annual escalation rate to allow for additional growth due to other factors that he was not able to precisely quantify, one of which was the annualization of payroll expenses associated with the Spurlock 1 and 2 scrubbers.

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4. Refer to page 16, lines 13-15, of the Kollen Testimony which indicates that EKPC's benefits expense should be reduced by $2.661 million. In the summary of the recommended adjustments on page 6 of the testimony, the adjustment to benefits expense is $2.961 million. Explain this discrepancy and provide the appropriate correct ions.

Response:

The correct amount is $2.961 million. This amount is consistent with the computations shown on Mr. Kollen's Exhibit___(LK-10). The $2.661 in the referenced testimony should be corrected to read $2.961 million.

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5. Refer to pages 24-26 of the Kollen Testimony.

a. Provide the calculation of the $18.129 million in interest expense incurred to finance cash and cash equivalents.

b. Provide the calculation of the average cash and cash equivalent balance of $101.881 million.

c. Provide the calculation of the $27.329 million reduction to EKPC's revenue requirement based on interest expense incurred to fund excess cash.

d. Explain why the amount on page 26 differs from the $28.093 million in the summary of recommended adjustments on page 6 of the testimony.

Response:

a. Please see the attached excel file entitled "Interest Expense Adjustment 1," which details each of the calculations sought in the subparts of this question. The amount listed on page 24, line 16 should read $18.728 million.

b. See attached file referred to in response to subpart a.

c. See attached file referred to in response to subpart a. The amount listed on page 26, line 20 should read $28.093 million.

d. See response to subpart c.

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6. Refer to page 28, at lines 17-21 of the Kollen Testimony. Provide a detailed explanation of how, based on his review of the confidential information related to EKPC's credit facility borrowings, Mr. Kollen determined that the assumed interest rate should be 4.0 percent or less, rather than 5.5 percent as proposed by EKPC.

Response:

The Company computed the annualized interest rate pursuant to the credit facility in the confidential response to Gallatin 2-7 (revised). Mr. Kollen relied on the Company's computation based on the June 2010 Indicative Pricing for a BB+ rating found on page 7 of 7 of this response.

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7. Refer to page 10 of the Direct Testimony of Stephen J. Baron ("Baron Testimony"). Starting at line 5, Mr. Baron states that, to the extent there were differences in methodology between the Dennis Eicher cost of service study ('COSS'') filed in the current case and the COSS used in EKPC's 2008 rate case, he applied the methodology used in the 2008 rate case. Explain why the 2008 methodology was used.

Response:

Mr. Baron relied on the EKPC 2008 methodology primarily because this 2008 functionalization was relied on by EKPC for a class cost of service analysis and ultimately rate design. In this case, while Mr. Eicher performed a functional cost analysis, it was not relied on for any class cost of service analysis or rate design. As such, Mr. Baron relied on the same functional cost methodology used by EKPC in its 2008 case in which the Company developed a class cost of service study using the results of the functional cost analysis. Mr. Baron disagreed with a number of Mr. Eicher's functional cost assignments. For example, Mr. Eicher assigned customer service and sales expense as 100% energy related, while in the 2008 study this expense was functionalized on the basis of Total Utility Plant, which Mr. Baron believes is more reasonable. Another example concerns Transmission O&M expenses. While we accepted Mr. Eicher's functionalized transmission plant, Mr. Eicher did not follow the transmission plan functionalization to functionalize Transmission O&M expenses, as was done in the 2008 EKPC study. Mr. Baron believes that it is reasonable to functionalize transmission O&M expense following the transmission plant functionalization.

Notwithstanding this, Mr. Baron has calculated the EKPC class cost of service for each rate schedule using Mr. Eicher's functionalization of costs. The impact on Gallatin of using Mr. Eicher's functionalization is an increase of $64,517, compared to Mr. Baron's analysis. The overall revenue increase to Gallatin using Mr. Eicher's functionalization is $2,205,877 vs. Mr. Baron's recommended increase of $2,141,359 (Note: neither of these increases include the effect of Mr. Baron's recommended increase in the Gallatin 10-minute interruptible credit). Other than the substitution of Mr. Eicher's functionlization of costs into the model, no other changes were made to the Gallatin class cost of service study. The results continue to show that Gallatin is paying current rates above cost of service. A summary of the cost of service analysis with Mr.

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Eicher's functionalization is attached, as well as the full study, in electronic form with all formulas.

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8. Refer to page 17 of the Baron Testimony which shows a $3.547 million calculated "fuel savings" associated with Gallatin's interruptible load using the maximum load interruptible and the maximum hours of annual interruption.

a. Explain why it is appropriate to use the maximum amount of load interruptible and hours of annual interruption when calculating the "fuel savings."

b. Provide the amount of "fuel savings'' that would be calculated if the load interrupted and hours of interruption equaled those that were used to calculate the load interrupted that is shown for Gallatin in EKPC's billing analysis at Volume 5, Tab 58, page 11 of 13, of the Application. Include in the response the effect this would have on the COSS filed by Mr. Baron.

Response:

a. Pursuant to the Gallatin contract, EKPC has the right to interrupt Gallatin for 360 hours per year for both reliability and economic reasons or event. An "economic reason" refers to a situation in which EKPC can force Gallatin to purchase market priced energy, resulting in fuel savings for its firm customers. Based on EKPC's test year purchased power costs, market prices are assumed to exceed average fuel rates substantially. Since there is no reason for EKPC not to interrupt Gallatin for economic reasons, and the projected market energy costs substantially exceed average fuel costs, it is reasonable to assume that EKPC will, in fact, interrupt Gallatin to the extent provided in the contract (360 hours).
b. Mr. Baron cannot perform the requested analysis. The billing analysis for Gallatin shown in 5, Tab 58, page 11 of 13, of the Application, which is a projected test year billing analysis, does not show the number of hours of interruption for Gallatin that EKPC expects in the test year. There is no need to include EKPC's assumptions on the number of hours of interruption in its proof of revenues since there are no revenue or expense impacts for the EKPC test year related to interruption and buy through. Gallatin interruption and the related buy through at market prices results in no net revenue to EKPC, since the revenues received from Gallatin for buy through kWh exactly equals the expenses incurred to provide buy through kWh.

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9. Refer to pages 30 and 31 of the Baron Testimony. Starting at line 7 on page 30, Mr. Baron recommends increasing the IO-minute interruptible credit to $6.22 but states that he does not recommend a change in the 90-minute interruptible credit. Explain why Mr. Baron recommends no change to the 90-minute interruptible credit.

Response:

While Mr. Baron believes that some increase to the 90-minute interruptible credit might be justified, it is not clear the extent to which the avoided cost associated with a 90-minute notice interruptible load should be adjusted to reflect the inclusion of a planning reserve margin. As a result, Mr. Baron elected not to make any adjustment to the 90-minute interruptible credit in this case. In the case of a 10-miniute interruptible load, Mr. Baron strongly believes that it is a reasonable proxy for a quick start combustion turbine and therefore should receive full avoided cost, which includes an adjustment for 12% planning reserves.

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10. Provide an electronic version of Baron Exhibit SJB-2 with the formulas intact and unprotected.

Response:

See response to EKPC First Request for Information, attachment to Question No. 16.