

adjustment is driven exclusively by purchased power costs. Purchased power costs are among the factors causing this rate adjustment.

5. Some comments requested Southeastern implement a pass-through charge for purchases of replacement energy. These comments included the following:

- The SeFPC would encourage Southeastern to implement a rate recovery mechanism that would allow immediate pass through of purchased power costs for the Cumberland System of Projects. (SeFPC, SMEPA)
- When the Southeastern anticipates making expenditures for purchased power, the Customers would ask Southeastern to work with Team Cumberland Group to minimize high costs. In the event Southeastern expects to make extended replacement power purchases, the Customers would ask Southeastern to implement a consultation process that involves more frequent coordination with the Customers so that replacement power purchases are the lowest possible consistent with sound business principles. (SeFPC)
- Because of the need to raise rates in light of previous purchases of replacement energy, the SeFPC submits that Southeastern needs to revise the rate proposal to account for the purchased power costs in a more transparent manner so that the Customers can accurately measure the costs in the Customers' individual resource portfolios. In this regard, the SeFPC recommends changing the rate schedule to provide for the immediate pass through of purchased power cost and coordination with the Team Cumberland Group to ensure that such costs are incurred in a manner consistent with sound business principles. (SeFPC)

Response: Southeastern implemented a pass-through mechanism to recover purchases of replacement energy in Southeastern's Georgia-Alabama-South Carolina System starting in fiscal year 2003. However, marketing arrangements and rate design issues make implementation of a replacement energy pass-through rate on the Cumberland System complex. As the rates are proposed, most of the customers outside the TVA system have no energy charge. Most of Southeastern's Cumberland customers outside the TVA system receive a firm energy allocation of 1500 kilowatt-hours of energy for each kilowatt of capacity. TVA and the 160 preference entities on the TVA system receive the residual output of the Cumberland Projects.

Southeastern believes it is inappropriate to propose a pass-through to attempt to implement a replacement energy pass-through without soliciting comments from all interested parties. Southeastern will consider developing a proposed pass-through mechanism for comment from all interested parties. As such, Southeastern will give consideration to the comment and may propose a pass-through of replacement energy costs with the next proposed rate adjustment for the Cumberland Projects.

C. Comments Regarding Sales of Water Storage

6. The proposed rate does not accurately capture the revenues that the Corps should be receiving from sale of water storage at Corps projects. The Southeastern should verify whether the Corps has executed all necessary contracts for water storage at facilities in the Cumberland River Basin system. To remain consistent with the Flood Control Act, Southeastern must factor into rates the recovery of the revenues to be provided in Water Storage contracts. In the event that Southeastern is aware of non-authorized use of water storage at the projects for which the Corps has not executed a water storage contract, the members of the SeFPC believe that Southeastern has an obligation to disclose such use in the rate schedules. (SeFPC, SMEPA)

Response: The Corps expects to execute and collect new water storage agreements for projects in the Cumberland System in the near future. When the Corps has executed these agreements and collects funds for the sale of water storage, Southeastern will include these revenues as part of the cost recovery for the Cumberland System projects.

D. Comments Regarding TVA Transmission

7. The proposed rate includes Tennessee Valley Authority ("TVA") transmission charges that have not been deemed to be just and reasonable. As the Customers have held longstanding concerns regarding the appropriateness of the TVA transmission rate, the detailed concerns of the SeFPC on this specific topic, which were not addressed in Southeastern's prior rate proposal, are incorporated herein by reference. (SeFPC, SMEPA)

Response: The review of public comments in Southeastern's prior rate proposal states "Section 9.1 of the TVA-Southeastern Contract, executed October 1, 1997, allows TVA to adjust rates for delivering power to the points of delivery to the "Other Customers" defined as customers outside the TVA

area. Section 9.1 does not provide any means for Southeastern to determine an appropriate transmission rate. TVA and "Other Customers" are disagreeing over the appropriateness of the rate increase." The comments further state "Southeastern will support discussions between TVA and the customers outside the TVA system in an effort to reach a negotiated settlement on an appropriate amount for the TVA transmission charge."

As such, Southeastern's role in this issue is as a facilitator. Southeastern remains willing to support discussions between TVA and the customers outside the TVA system in an effort to reach a negotiated settlement on an appropriate amount for the TVA transmission charge.

E. Comments Regarding Marketing

8. In Southeastern's forum exhibit 6 the base energy shown for East Kentucky Power Cooperative (EKPC) is 251,618 MWh. Based on EKPC's entitlement to 1500 kWh/kW capacity (170 MW), this should be 255,000 MWh. (East Kentucky)

Response: Southeastern's marketing arrangements with East Kentucky provide that East Kentucky receive the entire output of the Laurel Project (70 megawatt), plus 100 megawatt from the other projects in the Cumberland System. East Kentucky receives 36,900 megawatt-hours of additional energy from the other Cumberland projects to supplement the generation available at the Laurel Project. With the additional energy from the other Cumberland projects, the Laurel Project was expected to provide an average of 1500 megawatt-hours of energy per megawatt of capacity per contract year. In actual operation during the past few years, the Laurel Project has produced less energy, on average, than was forecast. The average energy available to East Kentucky has been 251,618 megawatt-hours per year. Southeastern has revised the repayment study to show that East Kentucky is expected to receive an estimated average of 255,000 megawatt-hours of energy per contract year.

9. Since 70 MW of EKPC's total Southeastern allocation of 170 MW and related energy is to be produced by the Laurel Project, EKPC is at the mercy of the actual annual rainfall in the Laurel Lake watershed and resulting power production. EKPC asks that provisions be made to guarantee that EKPC receive its entitlement of a minimum of 255,000 MWh each and every year. (East Kentucky)

Response: The comment relates to Southeastern's marketing arrangements with East Kentucky, and is not pertinent