

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

RECEIVED

In the Matter of:

JAN 11 2013

PUBLIC SERVICE
COMMISSION

PETITION AND COMPLAINT OF GRAYSON)
RURAL ELECTRIC COOPERATIVE)
CORPORATION FOR AN ORDER)
AUTHORIZING PURCHASE OF ELECTRIC)
POWER AT THE RATE OF SIX CENTS PER)
KILOWATTS OF POWER VS. A RATE IN)
EXCESS OF SEVEN CENTS PER KILOWATT)
HOUR PURCHASED FROM EAST KENTUCKY)
POWER COOPERATIVE UNDER A)
WHOLESALE POWER CONTRACT AS)
AMENDED BETWEEN GRAYSON RURAL)
ELECTRIC COOPERATIVE CORPORATION)
AND EAST KENTUCKY POWER)
COOPERATIVE, INC.)

Case No.
2012-00503

RESPONDENT'S ANSWER
AND MOTION TO DISMISS

Comes now the Respondent, East Kentucky Power Cooperative, Inc. ("EKPC"), by counsel, in response to the Commission's Order dated December 19, 2012 directing EKPC to file a response to the Petition and Complaint filed by Grayson Rural Electric Cooperative Corporation ("Grayson") on November 19, 2012 (the "Petition"), respectfully stating as follows:

I. INTRODUCTION

Grayson asks the Commission to determine whether it may economically enter into a power supply contract with Magnum Drilling of Ohio, Inc. ("Magnum") to purchase up to 9.4 MW of electricity over a twenty year term (the "Magnum Contract"). The Commission clearly has authority to review the Magnum Contract and EKPC agrees with Grayson that, absent an

agreement between and amongst all sixteen distribution cooperatives that are Members of EKPC, it will be necessary for the Commission to construe Amendment 3 to the Wholesale Power Contract in place between EKPC and Grayson as part of that analysis. In fact, EKPC welcomes the Commission's review of Amendment 3 as it has been a source of conflict amongst EKPC's Members. By ascertaining the duties and obligations of EKPC and Grayson under Amendment 3, the Commission will establish a precedent that impacts all of EKPC's Members, who therefore should be afforded an opportunity to intervene in this proceeding.

However, most of the other issues raised in Grayson's Petition are clearly beyond the scope of the Commission's jurisdiction. The Petition fails to state a prima facie case for a violation of a statute in KRS Chapter 278, a regulation promulgated thereunder or a specific Commission Order. Therefore the Commission's authority has not been properly invoked under KRS 278.260 and no civil penalty may be imposed under KRS 278.990(1). Likewise, the Commission has no authority to resolve allegations that EKPC has in anyway engaged in a restraint of trade. Grayson's specific insistence that EKPC has failed to perform various contractual obligations is an unripe claim due to the fact that Grayson's application to purchase power from Magnum has not been denied and certain notice requirements have not been satisfied by Grayson. The Commission's jurisdiction in this proceeding is narrower than that conceived by Grayson and, as a result, EKPC respectfully requests the Commission to dismiss the superfluous elements of Grayson's Petition.

II. COUNTERSTATEMENT OF FACTS

The Rural Utilities Service (formerly the Rural Electrification Administration) ("RUS") requires its borrowers to enter into contracts for the purchase and sale of power as a precondition to lending funds. On or about October 1, 1964, EKPC entered into separate Wholesale Power

Contracts with each of its Members. Each of the Wholesale Power Contracts contained identical provisions and was subject to the approval of the RUS Administrator in accordance with various terms of the loan agreements in place between RUS and EKPC and RUS and the Member distribution cooperatives. The RUS Administrator approved the Wholesale Power Contract entered into by EKPC and Grayson on December 24, 1964. Between 1964 and 2003, there were two amendments to the Wholesale Power Contract, but neither of those amendments is important for purposes of the issues raised in Grayson's Petition.

The present controversy traces its roots to at least the Spring of 2003 when EKPC's Board discussed at its April meeting the advisability of establishing off-system power supply contracts for the distribution cooperative Members. At EKPC's May 2003 Board meeting, the need to extend the term of the Wholesale Power Contract was also discussed in the context of RUS's unwillingness to fund a long-term loan to finance the planned Gilbert Unit without such an amendment. EKPC's management agreed to facilitate a meeting whereby several representatives of the Member distribution cooperatives could meet with RUS officials to discuss these issues. In subsequent Board meetings in the summer of 2003, RUS refined its requirements for funding the Gilbert loan and settled upon four major points – each of which was discussed at length by EKPC's Board. One of these points is particularly relevant to Grayson's Petition and was characterized in the September 2003 EKPC Board meeting as follows: "If member systems want to get off-system supply power from a non-EKPC source, that is a combination of two factors – each members system cannot exceed 15% of its peak over a three-year period, nor can those 15%, collectively for all the members, exceed 5% of EKPC's peak during the same period."¹ The minutes to that meeting suggest that the purpose of including an

¹ Minutes of September 9, 2003 EKPC Board Meeting summarizing RUS requirements for amendment of the Wholesale Power Contract, attached as Exhibit 1 hereto.

off-system power supply option in the Wholesale Power Contract was to give each of EKPC's Members an opportunity to procure economic power for the purpose of attracting new load to their system and retaining existing load. In other words, the off-system power supply provision was originally intended to be an economic development tool in areas where EKPC's rates were higher than neighboring investor-owned utilities. In discussing RUS's position, Mr. Roy Palk (EKPC's President and Chief Executive Officer at the time), explained that a mechanism would need to be devised in order that all Members could participate in the off-system power supply option if they so chose without forcing other Members to pay for resulting stranded investment costs.

At the October 2003 meeting, EKPC's Board adopted a resolution accepting the language of the proposed Amendment 3 to the Wholesale Power Contract. Amendment 3, in relevant part, replaced Section 1 of the Wholesale Power Contract with new language which reads:

1. General – The Seller shall sell and deliver to the Member and the Members shall purchase and receive from the Seller all electric power and energy which shall be required to serve the Member's load, including all electric power and energy required for the operation of the Member's system. Notwithstanding the foregoing, the Member shall have the option, from time to time, with notice to the Seller, to receive electric power and energy, from person other than the Seller, or from facilities owned or leased by the Member, provided that the aggregate amount of all members' elections (measured in megawatts in 15-minute intervals) so obtained under this paragraph shall not exceed five percent (5%) of the rolling average of Seller's coincident peak demand for the single calendar month with the highest peak demand occurring during each of the 3 twelve month periods immediately preceding any election by the Member from time to time, as provided herein and further provided that no Member shall receive more than fifteen percent (15%) of the rolling average of its coincident peak demand for the single calendar month with the highest average peak demand occurring during each of the 3 twelve month periods immediately preceding any election by the Member from time to time, as provided herein.

For any election made or cancelled under this Section, the following provisions shall apply:

a. During any calendar year, the Member may make or cancel any such election or elections by giving at least 90 days' notice to the Seller with respect to any load or loads with an average coincident peak demand (calculated in the same manner as provided in the preceding paragraph of 5.0 Megawatts or less, in the annual aggregate.

b. During any calendar year, the Member may make or cancel any such election or elections by giving at least 18 months or greater notice to the Seller with respect to any load or loads with an average coincident peak demand (calculated in the same manner as provided in the preceding paragraph) of 5.0 Megawatts or more, in the annual aggregate.

Upon the effective date of the Member's cancellation of any such election under this Agreement, the load or loads shall be governed by the all requirements obligations of the Seller and the Member in this Section, and notice of same shall be provided to the Rural Utilities Service ("RUS") by the member. Such loads which are transferred to Seller's all-requirements obligations shall not thereafter be switched by Member to a different power supplier.

c. Should any such election by Member involve the acquisition of new service territory currently served by another power supplier or municipal utility, Member shall provide evidence to Seller and RUS in the new Load Purchase Agreement that the acquired territory must be served by the current power supplier as a condition of the acquisition of the new load.

Seller will provide transmission, substation, and ancillary services without discrimination or adverse distinction with regard to rates, terms of service or availability of such service as between power supplies under paragraphs above and Member will pay charges therefore to Seller. Seller also agrees to allow, at Member's sole cost and expense, such additional interconnection as may be reasonably required to provide such capacity and energy as contemplated in the above paragraphs.

Member will be solely responsible for all additional cost associated with the exercise of elections under the above paragraphs including but not limited to administrative, scheduling, transmission tariff and any penalties, charges and costs, imposed by the Midwest Independent System Operator ("MISO") or other authorities.

While Amendment 3 does allow a Member to procure up to 15% of its coincident peak demand from an off-system resource, it does not expressly guarantee that a Member may do so in its sole discretion. The resulting ambiguity inherent in Amendment 3 is likely the product of

the fact that it was principally drafted by RUS for the primary purpose of extending the existing term of the Wholesale Power Contract. In fact, since the Wholesale Power Contract is one of the primary collateral assets relied upon by RUS to secure repayment of loans made to EKPC, the allowance of any portion of a distribution cooperative's power needs to be purchased off-system was a major concession by RUS. Perhaps for that reason, the language of Amendment 3 is quite silent with regard to the circumstances by which allocations of such off-system resources shall be apportioned. Moreover, the fact that Amendment 3 was aimed at economic development – and not a carte blanche grant of authority to purchase power from non-EKPC resources – is confirmed by the fact that any off-system power purchases are required to be load-following. Due to the long-term horizons associated with resource planning, Amendment 3 includes strict notice requirements that include eighteen months of advance notice for any load greater than 5 MW that intends to leave or return to the EKPC system. Thus, in exchange for having the option to purchase energy from a non-EKPC resource, electing distribution cooperatives expressly assumed the risk for meeting the energy needs of the designated load(s).

At the October¹ 2003 meeting of EKPC's Board, discussion was had regarding the fact that not all of the Member distribution cooperatives were willing to sign Amendment 3 and there was still no clear methodology for how each Member's share of the available off-system power supply option would be apportioned. Mr. Palk outlined a plan whereby each cooperative would have a prescribed period of time in which to submit a plan for use of its initially allocated 5% of the off-system power supply option. If a Member's plan was not presented or enacted upon as presented, then that Member's allocation would be returned to the pool. Any other Member desiring more than its initial allocation could then make a request for an additional allocation. Mr. Palk proposed that the pool would be managed by a Member group comprised of a mix of

Member system managers, EKPC Directors and EKPC staff, which would rotate. Mr. Palk opined that the advantages to having a trading mechanism like the one he proposed would be that: 1) everyone has an opportunity to participate; 2) such a pool is intended to be used the way RUS wanted it established; and 3) it prescribed an orderly system of administration. On November 21, 2003, EKPC and Grayson entered into and made Amendment 3 to the Wholesale Power Contract. Amendment 3 was approved by the RUS Administrator on May 6, 2004. EKPC's Board adopted Board Policy 305 – which essentially followed Mr. Palk's recommended allocation procedure – on March 9, 2004.

Amendment 3 was first formally invoked by Jackson Energy Cooperative Corporation (“Jackson Energy”), when EKPC's Board approved a resolution on July 13, 2010 authorizing Jackson Energy to purchase 375 kW from Wellhead Energy. Two months later, Jackson Energy filed a second application to purchase 40 MW of capacity and energy from Owensboro Municipal Utilities (“OMU”) under Amendment 3.² In December 2011, EKPC's Board approved a resolution authorizing Owen Electric Cooperative, Inc. (“Owen Electric”) to purchase 1 MW of solar-powered electricity from NuFranc, Inc. These applications spurred considerable discussion about the purpose and impact of Amendment 3 on EKPC's Members. Throughout 2011, the topic was included as an agenda item in various meetings involving Board Committees and by EKPC's full Board. These discussions, which centered around the off-system power supply option in Amendment 3 and the need to firmly determine an allocation procedure, led to the preparation of a proposed Amendment 5, which took various forms, but as of yet has not been adopted. The minutes of meetings including discussions involving

² Jackson Energy's request equaled approximately 15% of its average coincidental peak demand for the previous 3 twelve month periods – making its application similar in scope to Grayson's request for 9.4 MW. Jackson Energy subsequently withdrew its application before any decision was reached as to whether it should be approved by EKPC's Board.

Amendment 3/Amendment 5 demonstrate a desire to maximize the economic development opportunities of EKPC's Members while avoiding the cost-shifting inequities occasioned by removing load from EKPC's system.

A scheduled vote on Amendment 5 in November 2011 was delayed at the request of three Members who desired to independently evaluate the advantages and disadvantages of procuring off-system power supplies. The independent analysis stretched into May of 2012 and was presented to EKPC's management in June 2012. In response to the efforts of the three Members, EKPC agreed to give its Members sixty days to develop a Memorandum of Understanding ("MOU") to govern the allocation of off-system power supply allocations as an alternative to Amendment 5. At the same time, EKPC's Board approved a resolution authorizing Jackson Energy to procure an additional 2.6 MW of energy from a distributed generation project and a landfill gas project. Owen's authority to purchase 1 MW of solar power was simultaneously rescinded when the developer was unable to proceed with the project.

On June 22, 2012, Grayson sent a notice to EKPC stating its intent to purchase 10.7 MW of electricity from Magnum. Grayson's notice stated that it expected to realize savings of \$800,000 per year by entering into the power supply agreement with Magnum, however, it did not provide a date upon which it proposed to actually begin taking such power or a description of the load that would be served by Magnum – as expressly required by Amendment 3. Grayson's request was substantially greater than any prior request received under Amendment 3 and, if granted, would have allowed it to take the full 15% of its coincident peak demand. At the EKPC Board's Strategic Issues Committee meeting held on July 16, 2012, EKPC President and Chief Executive Officer, Mr. Tony Campbell, summarized Grayson's request as well as EKPC's interpretation of Amendment 3. Mr. Campbell explained that: 1) Amendment #3 is intended to

allow every member to benefit from its 5% self-supply option; 2) electing Members taking greater than a 5% allocation should pay the stranded investment cost based on cost-shifting to remaining Members for that portion of its load(s) no longer served by EKPC; and 3) no Member should exceed 5% without the consent of another Member who agrees to forfeit a portion of its 5% allocation. Mr. Campbell provided two options for responding to Grayson's notice in a manner consistent with EKPC's interpretation of Amendment 3, including: 1) other Members may assist Grayson by voluntarily relinquishing a portion of their 5% allocation;³ and 2) EKPC would be willing to purchase the amount of electricity available to Grayson over and above its 5% if it was economical to do so and the Public Service Commission would approve it.

On August 9, 2012, Grayson sent an amended notice to EKPC informing that it now intended to only purchase 5 MW of electricity from Magnum in 2012. Again, however, no firm date for the purchases to commence was provided and no particular load to be served by Magnum was identified. On August 24, 2012, Grayson and Magnum entered into the power supply agreement that is attached as Exhibit 5 to Grayson's Petition (the "Magnum Contract"). Grayson did not file the Petition seeking approval of the Magnum Contract until November 19, 2012 – nearly three months later – which was the first time EKPC had an opportunity to review the agreement.

When the initial deadline for developing a MOU between EKPC's Members approached in August 2012, EKPC agreed to the Members' request to delay a vote on the proposed Amendment 5 for an additional sixty days to allow for more work on the contemplated MOU. That effort continued through mid-December when the draft of a tentative MOU was presented to EKPC and its Members for review, which is ongoing. While the Members were working on

³ On information and belief, two of EKPC's Members offered to share a portion of their 5% allocation with Grayson in order to help diffuse the controversy, but Grayson rejected the offers.

the MOU, the EKPC Board's Strategic Issues Committee also decided to take no action on Grayson's request for approval of the Magnum Contract. Grayson's President and Chief Executive Officer is a member of the EKPC Board's Strategic Issues Committee, was present at the August 13th meeting and agreed with the Committee's decision.

In the meantime, Grayson filed a notice of intent to file a base rate case with the Commission as well as a lawsuit against EKPC, Charleston Bottoms RECC ("Charleston Bottoms") and EKPC's other fifteen Members in the Mason Circuit Court on October 11, 2012.⁴ Grayson asserted that it had an ownership interest in Charleston Bottoms and that it had been denied its rightful share of the distributed assets of Charleston Bottoms. As a result, Grayson claimed that it was being forced to seek an increase in its base rates. Not one of the other fifteen Members of EKPC has joined Grayson in asserting an ownership interest. In a Counterclaim asserting that Grayson's Complaint was an abuse of process, EKPC alleged that Grayson filed the action in the Mason Circuit Court with the intent "to disrupt and interfere with EKPC's relationship with creditors, credit rating agencies, regulators and the other fifteen distribution cooperatives formed under KRS Chapter 279, which are members of EKPC" and "to give [Grayson] leverage in negotiations on other matters not related to the ownership of Charleston Bottoms in which it has not been able to gain a consensus among EKPC's Board of Directors." Grayson thereafter moved to dismiss EKPC's Counterclaim by incorrectly characterizing it as a claim for malicious prosecution. EKPC subsequently filed a response pointing out that abuse of process and malicious prosecution are completely separate and unique causes of action. The motion remains pending.

⁴ The Members were not named as defendants until the filing of an Amended Complaint on October 24, 2012.

At the November meeting of the EKPC Board's Strategic Issues Committee, it was pointed out that sixty days had elapsed since Grayson's application was first tabled. Grayson's President and Chief Executive Officer then requested that the application be tabled once again, until the Committee's next meeting in December. A motion adopting this request was passed by the Committee.

Approximately two weeks later, Grayson filed the Petition against EKPC which alleges that EKPC has "failed to act in accordance with its obligations" under the Wholesale Power Contract and Amendment 3.⁵ In light of the nature of the allegations in EKPC's Counterclaim in the Mason Circuit Court, Grayson's participation in the MOU process, Grayson's repeated requests to delay final consideration of its Amendment 3 application and the lack of substance relating to the merits of the Magnum Contract in the Petition itself, the Petition would appear to be for the primary purpose of attempting to establish a defense to EKPC's abuse of process Counterclaim.

IV. ANSWER

Grayson's Petition is filed pursuant to authority granted by KRS 278.060. While that statute refers to the requisite qualifications of Commissioners and grants no authority to the Commission to hear this case, EKPC assumes that Grayson intended to cite KRS 278.260, which does in fact give the Commission jurisdiction over complaints as to rates and services that are filed against jurisdictional utilities. It is well-established that the Petitioner has the burden of proof with regard to each of its claims when filing a Petition pursuant to KRS 278.260.⁶ For its

⁵ See Petition, ¶ 14.

⁶ See *In the Matter of Atmos Energy Corporation*, Order, Case No. 2005-00057 (Ky. P.S.C. Feb. 9, 2007) ("The Court of Appeals of Kentucky clearly stated...that '[a]pplicants before an administrative agency have the burden of proof.' While the term 'applicant' is not defined in KRS Chapter 278, it is generally held to mean '[o]ne who requests something; a petitioner....'" The Commission finds that the AG is the applicant in this proceeding and that,

Answer, EKPC states that Grayson's Petition fails to state a prima facie case and likewise is substantively deficient.

A. GRAYSON'S COMPLAINT FAILS TO ESTABLISH A PRIMA FACIE CASE

Under KRS 278.260, the Commission has jurisdiction over a complaint only so long as the complainant alleges at least one of four specified claims that: 1) the utility's rates are "unreasonable or unjustly discriminatory;" 2) "any regulation, measurement, practice or act affecting or relating to the services of the utility or any service connection therewith is unreasonable, unsafe, insufficient or unjustly discriminatory;" 3) "any service is inadequate;" or 4) "any service cannot be obtained." Grayson's Complaint contains many allegations, but none of them include the requisite statutory elements of a well-pled complaint. Grayson does not allege that EKPC's rates are unreasonable or unjustly discriminatory. Likewise, Grayson does not allege that the service provided by EKPC is unreasonable, unsafe, insufficient, unjustly discriminatory, inadequate or unavailable. In short, Grayson's Complaint utterly fails to allege any particular violation of EKPC's tariff, a PSC regulation, a statute in KRS Chapter 278 or a Commission Order. In the absence of such an allegation, there can be no showing of a prima facie case and dismissal is required.

B. SUBSTANTIVE ANSWER

1. With regard to the allegations in paragraph 1 of Grayson's Petition, EKPC admits that the Commission has jurisdiction over the "rates" and "services" of jurisdictional electric utilities in Kentucky. EKPC denies that the Commission has authority to hear the Petition under KRS 278.060.

contrary to his arguments, nothing in the language of KRS 278.260 relieves him from his burden of proof.") *citing Energy Regulatory Comm. v. Kentucky Power Company*, 605 S.W.2d 46, 50 (Ky. App. 1980).

2. EKPC admits the allegations contained in paragraphs 2, 3, 4, 5 and 6 of the Petition.

3. With regard to the allegations contained in paragraph 7 of Grayson's Petition, EKPC denies that Grayson accurately states the rate at which it pays for energy and services provided by EKPC. According to EKPC's analysis, Grayson has two customers on EKPC's rate B while the remaining customers are on EKPC's rate E2. The rate E2 has on- and off-peak energy. Because of the mix of rate B and rate E2 customers, the actual base rate charged to Grayson will vary slightly over time, however, it would be closer to the rate E2, which has a demand rate of \$6.02 per kW; an on-peak energy rate of \$0.053279 per kWh; and an off-peak energy rate of \$0.044554 per kWh. Moreover, this bundled rate includes all costs for capacity, energy, transmission, ancillary services, and any other costs associated with the provision of electric service. The environmental surcharge assessed to Grayson currently averages 0.9 cents per kilowatt hour and is designed to recover the costs of EKPC's compliance with federal, state and local environmental mandates and regulations. For the 12 month period ending November 2012, the average of the demand and energy charges to Grayson is 6.25 cents per kWh. The average of the demand charge, energy charge, metering point charge, and substation charge is 6.44 cents per kWh. The average of all charges, including the FAC and environmental surcharge, is 7.24 cents per kWh. All of the rates charged by EKPC to Grayson have been specifically authorized by the Commission and are deemed to be fair, just and reasonable. Grayson will continue to pay some of these charges even if it is authorized to purchase power from Magnum. EKPC disputes the pejorative notion that these rates are "extracted" from Grayson.

4. The allegations set forth in paragraphs 8, 10 and 11 of the Petition all contain characterizations of the terms of various documents. The terms of these documents speak for themselves and no affirmative response is required.

5. With regard to the allegations in paragraph 9 of Grayson's Petition, EKPC admits that Grayson tendered a document purporting to be a notice of its intent to purchase power from Magnum, but denies that the so-called notice was sufficient. The notice does not include a date upon which Grayson will purchase power from Magnum, does not indicate the load to be served and fails to give the requisite advance notice. EKPC disputes that Grayson will forever pay only six cents per kilowatt hour for power purchased from Magnum based upon the plain language of the Magnum Contract.

6. EKPC is without knowledge sufficient to allow it to form an opinion as to the truth of the allegations in paragraphs 11, 12, 13 and 16 of the Petition and therefore denies same at this time.

7. EKPC denies the allegations contained in paragraphs 14, 15 and 17 of the Petition in their entirety. EKPC also points out that Grayson itself specifically requested that EKPC defer any action on its application in August, November and December of 2012.

8. All allegations in Grayson's Petition which are not expressly admitted above are hereby expressly denied.

IV. MOTION TO DISMISS

Certain portions of Grayson's Petition should be dismissed because they allege claims that are simply beyond the scope of the Commission's jurisdiction. When these claims are stripped away, the remaining allegations against EKPC are unripe and otherwise fail to

adequately take into account the genuine and important interests of the other Members of EKPC. For these reasons, much of the Petition should be dismissed.

A. GRAYSON’S PETITION ALLEGES CLAIMS BEYOND THE SCOPE OF THE PUBLIC SERVICE COMMISSION’S JURISDICTION

1. The Commission Lacks Authority to Impose the Civil Penalty Requested by Grayson

In paragraphs 14 through 17 of its Petition, Grayson alleges that EKPC “will not comply” with and is “failing to take appropriate action...to honor its obligations” under Amendment 3. As a remedy, Grayson requests that EKPC be “penalized civilly” under KRS 278.990(1). There is clearly no nexus between performance under Amendment 3 thereto (or alleged lack of performance) and the Commission’s civil penalty authority under the statute. In clear, simple and unambiguous language, KRS 278.990(1) grants the Commission authority to impose a civil penalty upon a utility for a “willful violation of the provisions of this chapter or any regulation promulgated pursuant to this chapter, or...any order of the commission from which all rights of appeal have been exhausted.” Neither the Wholesale Power Contract nor Amendment 3 is a provision of KRS Chapter 278, a regulation promulgated pursuant to KRS Chapter 278, or an Order of the Commission. Thus, even if EKPC failed to perform its obligations under the Wholesale Power Contract and Amendment 3 as Grayson alleges, as a matter of law it could not be subject to a civil penalty under KRS 278.990(1) for failing to do so. The Commission is without statutory authority to grant Grayson’s request to impose a civil penalty and this element of the Petition should be dismissed.

2. The Commission Lacks Jurisdiction to Hear Claims Alleging a Restraint of Trade

Paragraph 17 of the Petition alleges that EKPC has engaged in conduct equating to “an unfair and illegal restraint of trade.” Clearly, allegations relating to restraints of trade arise in

other areas of law separate and apart from KRS Chapter 278 and do not relate to the “rates” and “services” of a utility. *See e.g.* 15 U.S.C. § 1; KRS 367.175(1). Ironically, Grayson itself has previously pointed out that claims alleging a restraint of trade are beyond the scope of the Commission’s authority and jurisdiction. In *Walter and Goldie Callihan v. Grayson Rural Elec. Coop. Corp.*, Case No. 2005-00280 (Ky. P.S.C. Aug. 1, 2005), the Commission refused to hear certain aspects of a complaint filed against Grayson pursuant to KRS 278.260 on the basis that it lacked authority to hear a restraint of trade claim. *See id.*, Order, pp. 2-3. The Commission clearly lacks jurisdiction to adjudicate claims for an alleged restraint of trade and this portion of Grayson’s Petition should also be dismissed.

B. GRAYSON’S PETITION IS UNRIPE

Grayson’s request to purchase power pursuant to Amendment 3 has not been denied in whole or in part by EKPC. It is still pending and EKPC will implement any decision reached by its Board. The issues raised by Grayson’s request are questions of first impression for EKPC and, apart from Board Policy 305 (which EKPC’s Members point out is not binding upon them), there is no expressly prescribed method for responding to requests such as Grayson’s. As the facts set forth above demonstrate, Amendment 3 has been a source of controversy since its inception and it has been the subject of much discussion, evaluation and interpretation. EKPC has consistently approached Grayson’s request from the standpoint of seeking to accommodate its request to the extent reasonably possible, but in a manner that is not prejudicial to the rights of EKPC’s other Members or inconsistent with the original intent of Amendment 3 to promote economic development in the Members’ service territories.

It is true that four months have elapsed since Grayson tendered its Amended Notice to EKPC, however, the Amended Notice was itself deficient and a significant portion of the delay

was occasioned by Grayson's own requests to defer consideration of its request and the Members' efforts to achieve a consensus on Amendment 3 through the MOU process. Grayson has not just given its consent to the deferral of a decision on its request – it has repeatedly and expressly requested that no decision be made. Moreover, since Grayson intends to purchase in excess of 5 MW from Magnum, it is required to give EKPC at least eighteen months' advance notice. Thus, Grayson would itself be unable to purchase power from Magnum as contemplated in the Magnum Contract before January 2014 in any event. For this reason alone, those portions of Grayson's Petition alleging failure to perform should be dismissed as unripe.

C. GRAYSON'S PETITION FAILS TO NAME ALL INDISPENSIBLE PARTIES

While Grayson named EKPC as the Respondent in the Petition, in truth its dispute is really with the other fifteen Members of EKPC. Under Amendment 3, the maximum aggregate amount of power which may be purchased from sources other than EKPC is 5% of the rolling average of EKPC's coincident peak demand for the single calendar month with the highest peak demand occurring during each of the 3 twelve months periods immediately preceding any Member's election to purchase power from a non-EKPC source. The dispute over how this percentage should be allocated amongst EKPC's Members is as old as Amendment 3 itself. As alluded to previously, some have advocated that each Member should share equally in the allocation. Others have advocated that the initial allocation should be equal, but subject to a voluntary reallocation of unused allocations. Grayson argues that the allocation should be made on a first-come, first-serve basis. None of these allocation choices is expressly set forth in the Wholesale Power Contract or Amendment 3. While EKPC's Board did adopt an allocation methodology in the form of Board Policy 305, EKPC acknowledges that the Policy is only binding upon EKPC's Board and management.

Regardless of how the allocation of EKPC's rolling average coincident peak demand is determined, EKPC's exposure is capped and no allocation methodology will cause it to lose more than 5% of its peak load. Thus, the real issue underlying Grayson's Petition – but assiduously glossed over – is whether any of the other Members of EKPC must surrender their future ability to procure economic sources of energy so that Grayson may enter into a wholesale power supply agreement with Magnum. In light of the economic development purpose inherent in Amendment 3, it should be self-evident why most Members have been unwilling to surrender their future ability to attract new large load centers. Grayson's dispute is really with the other fifteen Members of EKPC – not with EKPC. Although EKPC believes its interpretation of Amendment 3 is correct and consistent with the circumstances and intent surrounding the adoption of Amendment 3 and Board Policy 305, it will of course implement any allocation mechanism which its Board adopts.⁷

Because Grayson requests the Commission to issue an Order that declares its rights with regard to the procurement of a disproportionate amount of power from a non-EKPC source, the substantive rights of the other fifteen Members of EKPC will be affected by this proceeding and – as a result – they are most certainly necessary and indispensable parties. It is unclear why Grayson did not join the other distribution cooperatives as Respondents to its Petition. In the Mason Circuit Court action, Grayson sued each of the fifteen distribution cooperatives and alleged that they must come forward or forever relinquish any claim to an ownership interest in Charleston Bottoms. Here, the same type of claim is asserted as Grayson is in essence asking the Commission to force EKPC's other Members to forfeit a portion of their access to economic

⁷ Work on the MOU by EKPC's Members is continuing. On January 7, 2012 Grayson's application was indefinitely tabled by EKPC's Strategic Issues Committee so that the remaining issues relating to the MOU could be resolved – hopefully within the next sixty days. Members of the Committee were advised that Grayson's President and Chief Executive Officer – who was unable to participate in the meeting due to an illness – consented to this approach.

power resources. Yet Grayson focuses its Petition exclusively against EKPC. EKPC acknowledges that it is easier for Grayson to vilify EKPC than to directly challenge the substantive rights of its fifteen co-owners, but that narrative does not readily apply to the facts of the underlying dispute. To the extent that the Commission seeks to determine any single distribution cooperative's rights under the Wholesale Power Contract and Amendment 3, the due process rights of all interested parties must be respected and they should be afforded an opportunity to assert their rights. In the absence of joinder of all necessary and indispensable parties by Grayson, its Petition should be dismissed.

V. OTHER ISSUES

Due to the unique nature of this matter, EKPC is compelled to also comment upon two issues implicit throughout the Petition, but which are not specifically raised by Grayson. First, Grayson ignores the obvious connection between the action it has filed in the Mason Circuit Court and this administrative proceeding. Second, Grayson spends more time criticizing EKPC than it does supporting the lawfulness of, and providing the factual support for, entering into the Magnum Contract. Both issues must be briefly addressed by EKPC.

A. GRAYSON'S PETITION IS AN IMPROPER ATTEMPT TO ESTABLISH AN AFFIRMATIVE DEFENSE TO AN ABUSE OF PROCESS CLAIM FILED BY EKPC IN THE MASON CIRCUIT COURT

As set forth above, EKPC has asserted a Counterclaim in the Mason Circuit Court that states the Complaint filed by Grayson with regard to a purported ownership interest in Charleston Bottoms lacked merit and was for an improper purpose. EKPC's Counterclaim alleges that Grayson filed the Mason Circuit Court action with the intent "to disrupt and interfere with EKPC's relationship with creditors, credit rating agencies, regulators and the other fifteen distribution cooperatives formed under KRS Chapter 279, which are members of EKPC" and "to

give [Grayson] leverage in negotiations on other matters not related to the ownership of Charleston Bottoms in which it has not been able to gain a consensus among EKPC's Board of Directors." Significantly, not one of the other fifteen Members of EKPC has joined Grayson in asserting an ownership interest in Charleston Bottoms.

The timing of the filing of the Petition is curious in so far as the Magnum Contract was executed in August, but no regulatory approval was sought until after EKPC's Counterclaim was filed in November. So far, EKPC has produced over 1,800 pages of documentation responding to Grayson's discovery requests and providing documentation of EKPC's sole ownership and control of Charleston Bottoms prior to that corporation's dissolution on October 10, 2012. EKPC propounded discovery requests to Grayson that sought the documentary basis upon which Grayson relied in filing its Complaint and asserting a membership interest in Charleston Bottoms. Grayson failed to timely respond to the discovery requests and then produced less than two hundred pages of documents – none of which evidenced that Grayson was a member of Charleston Bottoms and some of which that squarely contradicted its own position. When questioned about these documents in recent depositions, Grayson indicated that it had additional documents that still needed to be produced.

While EKPC certainly does not object to the Commission proceeding with its consideration of whether the Magnum Contract should be approved under KRS 278.300, the Commission should be appropriately cautious in allowing Grayson to use this proceeding to assist it in the prosecution/defense of the Mason Circuit Court action.

**B. IT IS UNCLEAR WHETHER THE MAGNUM CONTRACT
IS IN FACT ECONOMIC**

The Commission has made it very clear that take-or-pay obligations such as those in the Magnum Contract are considered evidences of indebtedness under Kentucky law and, therefore,

the Commission's pre-approval is required under KRS 278.300.⁸ Grayson's Petition does not include a statement that it is filed pursuant to the requirements of KRS 278.300, but does include a statement in the prayer for relief that it be granted "the authority to purchase power from Magnum...." Moreover, certain portions of the Magnum Contract imply that Grayson will seek regulatory approval for the agreement. EKPC was not requested to provide any review of the Magnum Contract prior to Grayson executing it and was not a party to the negotiations.⁹ Having now had the opportunity to review the Magnum Contract, EKPC respectfully requests that consideration be given to several particular aspects of the agreement, which are as follows:

- 1) The Magnum Contract calls for Grayson to take 9.4 MW of power from Magnum on a continuous basis, twenty-four hours a day, seven days a week for twenty years. This amount of power exceeds the amount to which Grayson would be entitled if all of EKPC's Members received a proportional allocation of non-EKPC power resources and, in essence, would require other Members of EKPC to surrender their future right to seek a non-EKPC power supply resource. Grayson also fails to designate the load(s) to be served under the Magnum Contract, which undercuts the primary purpose for which Amendment 3 was originally adopted. Thus, there are long-term economic development considerations which should be taken into account.
- 2) Grayson claims that the cost of the power to be purchased from Magnum is less than the cost of power purchased from EKPC. However, Grayson's Petition does

⁸ See *In the Matter of: The Consideration and Determination of the Appropriateness of Implementing a Ratemaking Standard Pertaining to The Purchase of Long-Term Wholesale Power by Electric Utilities as Required in Section 712 of the Energy Policy Act of 1992*, Admin. Case 350 (Ky. P.S.C., Oct. 25, 1993).

⁹ EKPC has, upon request, previously provided significant assistance to its Members in the consideration and negotiation of other power purchase agreements that they might be contemplating.

not take into account the fact that the EKPC rate is a bundled rate that includes transmission, substation, metering and ancillary service costs while the Magnum Contract is for energy only. The recitals to the Magnum Contract include a statement that EKPC's transmissions system will be used to deliver power to Grayson, which will involve a charge that does not appear to be captured in the Magnum Contract. Thus, the Petition does not appear to offer a true "apples-to-apples" comparison of the economic benefit of the Magnum Contract. The Magnum Contract may not be economic.

- 3) The Magnum Contract includes an obligation for Magnum to avoid scheduling outages that would occur during EKPC's coincident system peak. This provision will allow Grayson to limit its apportionment of EKPC's costs relative to the other 15 distribution cooperatives within the EKPC system and, presumably, to shift risk to those distribution cooperatives and their members.
- 4) Grayson's application does not include any information describing how it intends to hold the other Members of EKPC harmless for the portion of long-term investment costs incurred by EKPC and charged to its Members which Grayson will no longer be paying. The purpose of Amendment 3 is not to force some Members of EKPC to, in effect, subsidize the rates of other Members, but this is the result that Grayson seeks.
- 5) The cost of power supplied under the Magnum Contract in each of the five three-year extensions is tied to EKPC's average energy charge and demand charge and not the costs incurred by the supplier. Grayson's Petition includes no information as to why this is a fair, just and reasonable rate mechanism, particularly in light of

the fact that the minutes to Grayson's Board meetings indicate Magnum appears to be relying upon wellhead gas supplied by some of Grayson's own members as its primary fuel source.

- 6) There are no credit terms or other provisions giving Grayson's ratepayers any adequate assurance of performance or security in the event that Magnum is unable to deliver power as obligated during the twenty years of the agreement. This would appear to be a material aspect of any agreement to purchase power from a non-EKPC resource since Amendment 3 requires a distribution cooperative to give EKPC eighteen months advance notice prior to returning any load served by a non-EKPC resource to the EKPC system. Thus, Grayson would appear to be assuming a material risk that should Magnum ever be unable to deliver power as contractually obligated, Grayson may be forced to purchase power at market rates for up to eighteen months.

These are substantive considerations which EKPC would itself take into account in evaluating the relative costs and benefits of a power purchase agreement it might choose to enter into with a third-party.

VI. SUMMARY


The Commission should evaluate Grayson's proposed contract with Magnum in accordance with KRS 278.300 and construing the right and obligations of EKPC and Grayson under Amendment 3 will be a necessary part of that analysis. Every Member of EKPC who has an interest in these issues should be afforded an opportunity to participate. Grayson's Petition is otherwise deficient in several respects and those portions should be dismissed for failing to state a prima facie case, alleging claims beyond the scope of the Commission's jurisdiction and being

generally unripe. Moreover, the Commission should be hesitant to allow its time and resources to be used as a bully-pulpit by Grayson to advance claims and defenses in other forums.

WHEREFORE, on the basis of the foregoing, EKPC respectfully requests the Commission to:

- 1) Examine Grayson's proposed power supply contract with Magnum in accordance with KRS 278.300 and construe Amendment 3 as part of that analysis;
- 2) Dismiss the Petition to the extent that it fails to state a prima facie case under KRS 278.260 or alleges matters which are plainly outside of the Commission's jurisdiction;
- 3) Afford all other Members of EKPC with an opportunity to assert any substantive rights that are implicated by Grayson's Petition which the Commission may choose to consider;
- 4) Enter a procedural order establishing a schedule that requires Grayson to file sworn testimony to substantiate its allegations and that affords EKPC adequate opportunity to test such testimony through data requests and rebuttal testimony; and
- 5) Grant any and all other relief to which EKPC may be entitled.

Respectfully submitted,



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*Counsel for East Kentucky Power
Cooperative, Inc.*

CERTIFICATE OF SERVICE

This is to certify that a true and correct copy of the foregoing was served via email and by depositing same into the custody and care of the U.S. Mail, postage prepaid on this 11th day of January, 2012, addressed to the following:

W. Jeffrey Scott
W. Jeffrey Scott, PSC
P. O. Box 608
Grayson, KY 41143



*Counsel for East Kentucky Power
Cooperative, Inc.*

- Allen Anderson reported that following surgery. is home from the hospital

REPORT OF THE OFFICERS

Report of the President and Chief Executive Officer

PartnersPlus Marketing Program Update – Gary Crawford introduced his staff, and he and Jeff Hohman, Manager of Marketing and Natural Resources, distributed and reviewed material regarding the PartnersPlus program. The goal is to develop marketing programs with the end-user in mind.

Walker/Member Satisfaction Survey – Jim Lamb, Market Research Manager, distributed and reviewed the 2003 Member Customer Satisfaction Survey Report. Eighty-five persons, consisting of member system managers, directors, and key staff, were surveyed. As shown in the report, a comparative survey was also taken.

RUS Response to Amendment for Wholesale Power Contract ("WPC") – Roy Palk reviewed RUS' four responses regarding negotiations for extension of the WPC to make its term the same as the loan on Gilbert Unit No. 3 of Spurlock Station. The Gilbert Unit is approximately 60% complete. The Gilbert loan is going to the RUS loan committee tomorrow—September 10, but is subject to the four RUS conditions that were faxed and/or mailed to each Board member on September 4. The four RUS conditions are: 1. If member systems want to obtain service territory outside of their regular service territory and that serviced area is provided by another supplier, that supply contract needs to be honored. 2. If member systems want to get off-system supply power from a non-EKPC source, that is a combination of two factors—each member system cannot exceed 15% of its peak over a three-year period, nor can those 15%, collectively for all the members, exceed 5% of EKPC's peak during the same period. 3. If loads obtained off of EKPC's system are brought to EKPC's system, there is a differentiation between 5 MW and under and 5 MW and over, in terms of a notice provision to EKPC. If it is 5 MW and under, it is a 90-day notice period so EKPC can arrange power supply. If it is 5 MW and over, it is not to exceed 18 months notice period so EKPC can prepare to serve that load. 4. Once that load comes onto the EKPC system, that election is irrevocable—it stays on EKPC's system. Mr. Palk said he believes there is no disagreement with the first point—to honor a contract if it is another service provider; nor the third point—the 90 days vs. 18 months; nor the fourth point—the irrevocable election provision. The point of contention with RUS is point No. 2. as stated above.

EXHIBIT

1

Regarding point No. 2, Mr. Palk presented and discussed five points, as follows.

1. RUS final position – 4 points – Hilda Legg:

Mr. Palk said, upon verification this morning with RUS Administrator, Hilda Legg, the four above conditions are RUS' final position. He noted that as a result of negotiations among RUS, South Kentucky, Fleming-Mason, and EKPC, RUS did move the limit for member systems from 10% to 15%. RUS said it would go no higher than 15% stating they believe a default could occur at the member system level and put the G&T at risk. EKPC/member systems responded that the opportunities for additional territory for member systems would come with revenue and would be on-going business transactions of non-speculative risks. RUS said they understood that in EKPC's case, but that RUS would not want to set a precedence whereby they bind themselves to other transactions that may not be as strong as the EKPC system; that if they do this in a broader sense they want to make it a general policy of RUS rather than make individual exceptions.

2. Impact of 5% and 15%:

Mr. Palk distributed and reviewed a handout relative to EKPC peak loads from December 2000 through January 2003, and the 15% and 5% impact for that time period. The member system 15% allowance ranged from 9 MW to 47 MW, with the EKPC 5% average being 119 MW. He said a mechanism would need to be devised in order that all member systems could participate if they choose.

3. Cost of alternate financing:

Mr. Palk invited David Eames to discuss this point. Mr. Eames said there were two ways to look at the financing—if we have to find alternate financing for the Gilbert loan (\$400+ million), landfill gas loan (\$25 million), CFC \$50 million short-term financing loan for CT 6 and 7, and about \$30 million for transmission facilities. EKPC would probably work with CFC to syndicate a loan, with about a \$7.5 million increase in interest expense the first year, which would require a lien accommodation from RUS with possibly the same restrictions. The next alternative would be to refinance all RUS and FFB debt, which would mean a prepayment penalty (buy-out premium) of approximately \$63 million and increased interest expense of about \$11 million incurred on existing debt. Also, the annual interest expense would increase (interest rate differential) approximately \$18 million—based on non-RUS borrowings. Mr. Eames distributed this information.

4. Distribution Mortgage Allowance – i.e. Non-RUS \$, Lien Accommodation, Subsidiary of Distribution Coop.:

Mr. Palk continued with, if flexibility is not achievable to the degree that is sought at the G&T level, what are the options at the distribution level. He asked Sherman Goodpaster discuss alternatives he had researched regarding options which allow member distribution systems to acquire non-G&T power supply and keep their current power supply. According to Mr. Goodpaster, the most popular option was creation of a subsidiary—a separate entity created under the member cooperative. This allows the subsidiary to acquire a potential system and get the power supply out from under the wholesale power supply. The new load does not become a part of the cooperative system so it's not under the WPC. At that point the member system could acquire other power supply sources or honor existing power supply contracts. Another option for the distribution system is to acquire the new load and have the G&T (EKPC) become the purchaser under that existing power supply and then resell the power back to the member. This could be done either as a pass-through at the existing contract rate, which would probably entail a tariff change, or as actual assignment of the power supply contract to EKPC and allow EKPC to incorporate that contract into its own portfolio and pass that on to the members under its existing tariff. These are possible options that RUS may consider. Mr. Goodpaster will e-mail this information to the member systems.

5. How to handle if all 16 do not accept -

Finally, Mr. Palk, stated that he talked with Victor Vu at RUS this morning, and was told all sixteen members must accept.

He recapped all points noting the costs of alternate financing, the member system options presented by Mr. Goodpaster, and that all members must be on board. He also added that in RUS's letter of the four points, they did say that if there are transactions that you contemplate that would be beyond the 5% and 15% criteria, they would entertain an analysis of those on a case-by-case basis.

Following discussion, Allen Anderson and Tony Overbey said they would like to discuss this material with their boards. Mr. Palk said he will contact RUS today and report that two cooperatives will inform their boards of information discussed today. South Kentucky requested that EKPC work up several real scenarios for review. Mr. Palk stated that anyone needing any assistance regarding this matter to please contact him. It is anticipated this item will come before the Board in October.