COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

IN THE MATTER OF: **THE APPLICATION OF KENTUCKY POWER COMPANY FOR: (1) THE APPROVAL OF THE TERMS AND CONDITIONS OF THE RENEWABLE ENERGY PURCHASE AGREEMENT FOR BIOMASS ENERGY RESOURCES BETWEEN THE COMPANY AND ECOPOWER GENERATION-HAZARD LLC; (2) AUTHORIZATION TO ENTER INTO THE AGREEMENT; (3) THE GRANT OF CERTAIN DECLARATORY RELIEF; AND (4) THE GRANT OF ALL OTHER REQUIRED APPROVALS AND RELIEF**	**CASE NO. 2013-00144**

POST-HEARING BRIEF OF KENTUCKY POWER COMPANY

I. INTRODUCTION

I'm sure the region would like to have those jobs.[1]
– Dr. Paul Coomes, University of Louisville Professor Emeritus

Through its Amended Application, Kentucky Power Company ("Kentucky Power" or the "Company") seeks approval under KRS 278.300 to enter into a renewable energy purchase agreement ("REPA") for biomass energy resources with ecoPower Generation Hazard LLC ("ecoPower"). Additionally, the Company seeks approval in accordance with KRS 278.271 for concurrent recovery of the full costs of the ecoPower REPA through its proposed biomass energy rider ("Tariff B.E.R.").

[1] Coomes Hearing Testimony at 272.

The ecoPower REPA presents a unique opportunity for Kentucky Power to invest in its service territory, to promote economic development, to provide for future load growth, and to diversify its generation portfolio with a home-grown renewable resource. During the 20 year term of the agreement, Kentucky Power will purchase the entire output of ecoPower's proposed 58.5 MW (net) biomass power generating facility to be constructed in its service territory in Perry County, Kentucky .[2] The ecoPower facility will use low grade wood, timber harvest residuals, and mill residuals primarily from eastern Kentucky as its renewable fuel source.[3] ecoPower estimates that the facility will create approximately 230 construction jobs, 30 full-time jobs at the facility, and 225 timber and trucking-related jobs.[4] [redacted]

Kentucky Power began negotiations with ecoPower concerning the REPA in 2011.[6] Kentucky Power made clear from the beginning that any agreement would require appropriate regulatory and contractual provisions to ensure timely cost recovery during the term of the ecoPower REPA.[7] These provisions were necessary to avoid potential negative credit impacts and, therefore, to protect the Company's customers from increased credit costs. In late 2011, Kentucky Power terminated contract negotiations when the parties could not agree on contractual safeguards for cost recovery.[8] Negotiations resumed in 2012 after ecoPower re-approached Kentucky Power with new cost recovery language.[9] After evaluating the proposed new

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[2] Pauley Direct Testimony at 5-6; Godfrey Direct Testimony at 5.

[3] Godfrey Direct Testimony at 8.

[4] Pauley Direct Testimony at 7.

[redacted]

[6] Kentucky Power's response to Commission Staff Data Request 1-7.

[7] *Id.*

[8] *Id.*

[9] *Id.*

language, ecoPower's pro forma financial projections, and the financial and accounting implications of the agreement, and following months of extensive negotiations, Kentucky Power and ecoPower executed the REPA on March 15, 2013.[10]

Under the ecoPower REPA, Kentucky Power will purchase all of the "Renewable Energy Products" from ecoPower's facility at an initial around-the-clock price with a fixed annual escalation.[11] Renewable Energy Products include capacity, energy, renewable energy certificates ("RECs"), and other ancillary services from the ecoPower facility.[12] Because of the capacity from the ecoPower facility, Kentucky Power anticipates being able to sell an additional 58.5 MW of capacity into the PJM capacity market, offsetting the cost of the Renewable Energy Products under the REPA.[13]

A REC represents one megawatt hour of energy produced from a qualified source and can be used by utilities subject to renewable portfolio standards to meet their renewable energy obligations.[14] Kentucky Power can either bank the RECs until such time as a federal or Kentucky renewable portfolio standard exists or sell them in the market.[15] Currently, the market price for RECs is approximately $14 to $15 per REC.[16] Revenues from the sale of RECs, if any, will further offset the cost of Renewable Energy Products under the REPA.

[redacted]

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[10] *Id.*

[11] Godfrey Direct Testimony at 11.

[12] *Id.*

[13] Wohnhas Hearing Testimony at 83-84.

[14] Godfrey Direct Testimony at 11.

[15] *Id.*

[16] Godfrey Hearing Testimony at 118.

[redacted]

[redacted]

Kentucky Power estimates that, based on 2012 revenues, the ecoPower REPA will increase the Company's 2017 revenue requirements by 7.02%.[21] The increased revenue requirement is offset by economic development benefits, additional capacity for future load growth, increased fuel diversity, and investment in renewable energy development. In that context, the ecoPower REPA presents a unique opportunity that will benefit Kentucky Power's customers and the region for years to come.

II. ARGUMENT

A. The ecoPower REPA Complies with the Requirements of KRS 278.300(3).

Kentucky Power seeks approval of the ecoPower REPA as an evidence of indebtedness under KRS 278.300. In order to approve a utility's issuance of an indebtedness, the Commission must find that the indebtedness (1) is for some lawful object within the corporate purposes of the utility; (2) is necessary or appropriate for or consistent with the proper performance by the utility of its service to the public; (3) will not impair its ability to perform that service; and (4) is reasonably necessary and appropriate for such purpose.[22] The ecoPower REPA meets each of these requirements.

[redacted]

[21] Exhibit RKW-1.

[22] KRS 278.300(3).

1. <u>The Financial Obligations To Be Assumed by Kentucky Power Under the ecoPower REPA are for a Lawful Object Within the Company's Corporate Purpose</u>.

Under the ecoPower REPA, Kentucky Power will add a capacity and energy resource that will support economic development and future load growth in the Company's service territory while diversifying the Company's generation fuel supply.[23] Each of these are lawful objects within the Company's corporate purpose. In addition, because the "indebtedness" to be assumed is a long-term purchase power agreement, the Company must further demonstrate there is a need for the additional generation and the absence of wasteful duplication.[24] The ecoPower REPA also meets this test.

(a). The REPA is for a Lawful Object.

(i). *The ecoPower REPA Provides Needed Investment in Kentucky Power's Service Territory.*

The ecoPower REPA provides a unique economic development opportunity for Kentucky Power's service territory. ecoPower anticipates that the Facility will result in approximately 230 construction jobs, 30 full time power plant jobs, and 225 timber and trucking-related jobs in Eastern Kentucky.[25] [redacted] These jobs will be located in an economically depressed area of the Commonwealth where, as KIUC Witness Coomes testified, "they would be a nice addition to the regional economy" and that "I'm sure the region would like to have those jobs."[27] The jobs created by Kentucky Power's investment in the ecoPower REPA

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[23] Pauley Hearing Testimony at 16-18, 64.

[24] *Application of Kentucky Power Company for Approval of Renewable Energy Purchase Agreement for Wind Energy Resources Between Kentucky Power Company and FPL Illinois Wind, LLC*, Case No. 2009-00545 (June 28, 2010).

[25] Pauley Direct Testimony at 7.

[redacted]

[27] Coomes Hearing Testimony at 272.

will serve as a catalyst for further economic development in the region. There is a crucial need for this type of investment in the Company's service territory.

(ii). *The ecoPower REPA is Needed to Support Fuel Diversity and Renewable Energy Development in Kentucky Power's Service Territory.*

In addition to providing new jobs in its service territory, the ecoPower REPA allows Kentucky Power to diversify its generation portfolio and develop renewable energy alternatives. Kentucky Power's current generation portfolio is currently 100% coal-fired. The Company hopes to submit an application later this year for the natural gas conversion of Big Sandy Unit 1,[28] adding approximately 20% gas to the mix of generation sources. The ecoPower REPA gives Kentucky Power the opportunity to add renewable energy and further diversify its portfolio.[29]

The ecoPower REPA also helps Kentucky Power meet the goals set forth in Governor Beshear's 2008 "Intelligent Choices for Kentucky's Future" Energy Plan. Strategy Two of the Governor's plan calls for increased renewable energy development, especially the development of woody biomass fueled energy.[30] Other renewable energy sources, such as wind or solar, are simply not viable resources in Kentucky Power's service territory.[31] The ecoPower REPA is necessary for Kentucky Power to diversify its generation portfolio and support renewable development in Kentucky.

[28] Pauley Hearing Testimony at 61.

[29] Pauley Direct Testimony at 7-8.

[30] *Id.*

[31] Taylor Hearing Testimony at 197-202; Kentucky Power Hearing Exhibits 1 and 2; Godfrey Hearing Testimony at 136-138.

(b). *There is Both Need For the ecoPower Generation and an Absence of Wasteful Duplication.*

(i). *The ecoPower REPA is Needed to Support Future Load Growth in Kentucky Power's Service Territory.*

The ecoPower facility is not scheduled to come on line until January 2017. Prior to then Kentucky Power will have undergone, due to emerging environmental regulations, a dramatic shift in its generation portfolio. The Company has proposed, in Case No. 2012-00578, retiring the 800 MW Big Sandy Unit 2 and replacing it with a 780 MW interest in the Mitchell Generating Station – a reduction of 20 MW.[32] Additionally, if, following approval of the Mitchell Stipulation and Settlement Agreement, the Company submitted an application for a certificate of public convenience and necessity to authorize the conversion of the 278 MW coal-fired Big Sandy Unit 1 into a 268 MW natural gas fired facility, and if the Commission were to approve the certificate, there would be a further reduction of 10 MW.[33] In the next two years, the Company will see a reduction of 20 MW, and perhaps as much as 30 MW, of capacity.[34] The 58.5 MW from the ecoPower REPA will help the Company mitigate the effects of this loss.

In 2017, under its current forecast and without the ecoPower generation, Kentucky Power will enjoy only a three percent cushion over its peak demand (plus the approximate 15% reserve margin required by PJM).[35] The addition of the ecoPower REPA increases that narrow cushion to approximately six percent.[36] The additional capacity that comes from the ecoPower REPA, and the added cushion above what is required by PJM, gives Kentucky Power the ability to

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[32] Pauley Hearing Testimony at 65-66.

[33] *Id.* at 66.

[34] *Id.* at 66.

[35] *Id.* at 64; Wohnhas Hearing Testimony at 83-84.

[36] Pauley Hearing Testimony at 64.

accommodate needed load growth in its service territory without going to the market or constructing new generation assets.[37]

(ii). *The ecoPower REPA is Needed as a Capacity Resource Following the Termination of the Pool Agreement.*

For over fifty years, Kentucky Power has enjoyed access to low cost capacity and energy through the AEP-East Interconnection Agreement ("Pool Agreement"). The Pool Agreement will terminate on January 1, 2014 and, as a result, Kentucky Power will no longer have ready access to the low cost capacity and energy previously available through the pool.[38] Following the termination of the Pool Agreement, Kentucky Power will be required to make up whatever capacity and energy shortfalls it experiences as a stand-alone company within PJM.[39] Unlike being a price-taker in the PJM market, the ecoPower REPA gives the Company price certainty going forward.[40] This fact alone distinguishes the REPA from the wind REPA rejected in Case No. 2009-00545 (when the pool was still in existence).[41]

(iii). *The ecoPower REPA will not Result in Wasteful Duplication.*

Wasteful duplication involves both "an excess of capacity over need" and "an excessive investment in relation to productivity or efficiency, and an unnecessary multiplicity of physical properties."[42] The Commission historically has required an applicant to demonstrate an absence of wasteful duplication through a review of all reasonable alternatives.[43] In addition, the

[37] *Id.* at 64.

[38] Pauley Direct Testimony at 7.

[39] Pauley Rebuttal Testimony at 2; Pauley Hearing Testimony at 16.

[40] Pauley Rebuttal Testimony at 2.

[41] *Id.* at 2.

[42] *Kentucky Utilities Co. v. Public Service Commission*, 252 S.W.2d 885, 890 (Ky. 1952).

[43] *Joint Application of Louisville Gas and Electric Company and Kentucky Utilities Company for a Certificate of Public Convenience and Necessity for the Construction of Transmission Facilities in Jefferson, Bullitt, Meade, and Hardin Counties*, Case No. 2005-00142 (September 8, 2005).

Commission traditionally has considered whether the proposal is the "least-cost" alternative.[44] However, cost is not the only factor to be considered, and a proposal that ultimately costs more than an alternative does not necessarily result in "wasteful duplication."[45] All relevant factors should be balanced.[46]

The Company acknowledges that the renewable energy product it will obtain under the ecoPower REPA is more expensive than other traditional fossil fuel options for capacity and energy needs.[47] However, renewable energy and, in particular renewable energy from biomass, is typically more expensive.[48] The ecoPower REPA provides other benefits that must be weighed in evaluating whether the capacity and energy to be added constitutes wasteful duplication. As Company Witness Godfrey stated in response to questioning from Commission Staff on the reasonableness of the agreement:

> Given the fact sets that were there, it seemed reasonable. In the context of everything else, it's more expensive, and so the question is, is do you want biomass? Do you want the investment? I mean, that's what it all comes down to. I mean, if you want the investment in that part of your state, you know, and if you want to add renewables for portfolio diversity, that's what it's going to cost. So that's - - you know, in that context, yes that's reasonable.[49]

Equally important, the only evidence in the record indicates that other renewable resources are not available. In March 2013, Kentucky Power issued a request for proposals ("RFP") for capacity and energy to replace the Big Sandy Unit 1 as a coal-fired generation unit.[50]

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[44] *Application of Kentucky Power Company for Approval of Renewable Energy Purchase Agreement for Wind Energy Resources Between Kentucky Power Company and FPL Illinois Wind, LLC*, Case No. 2009-00545 (June 28, 2010).

[45] *Kentucky Utilities Co. v. Public Service Commission*, 390 S.W.2d 168, 175 (Ky 1965).

[46] *Application of East Kentucky Power Cooperative, Inc. for a Certificate of Public Convenience and Necessity for the Construction of a 138 kV Electric Transmission Line in Rowan County, Kentucky*, Case No. 2005-00089 (August 19, 2005).

[47] Pauley Direct Testimony at 6.

[48] Godfrey Hearing Testimony at 135.

[49] Godfrey Hearing Testimony at 141.

[50] Pauley Hearing Testimony at 23; Kentucky Power Hearing Exhibit 3.

This RFP included clear language that Kentucky Power would accept bids from renewable energy providers:

> 4.1 Product - The Company is seeking a low-cost bundled product from PJM Generation Capacity Resources that include the following
>
> 4.1.1 Capacity (MW)
>
> 4.1.2 Energy (MWh)
>
> 4.1.3 Ancillary Services (if available)
>
> 4.1.4 Environmental Attributes[51]

The RFP defines "Environmental Attributes" as products that "include, but are not limited to any associated renewable energy credits (RECs) and any other current or future environmental attributes, including any greenhouse gas emission reductions with the quantity contracted from a facility."[52] [redacted] Despite the clear invitation to do so, no renewable resource submitted a proposal.[54] That no renewable resource submitted a proposal is telling, considering the testimony of KIUC Witness Taylor that renewable resources are available generally and are competitive with any other resource.[55] The lack of response to the Company's March 2013 RFP by any renewable energy suppliers is indicative that there are no other renewable resources available in Kentucky Power's service territory.

The ecoPower REPA allows Kentucky Power to make an important investment in the economic development of its service territory, provides an increased margin for future load

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[51] Kentucky Power Hearing Exhibit 3, Section 4.1; Taylor Hearing Testimony at 203-204.

[52] Kentucky Power Hearing Exhibit 3 at Section 4.1, fn. 2.

[redacted]

[54] Pauley Hearing Testimony at 23.

[55] Taylor Hearing Testimony at 204; Taylor Direct Testimony at 16.

growth, and diversifies its generation portfolio. The benefits from these factors outweigh the cost and make entering into the ecoPower REPA a lawful object within Kentucky Power's corporate purpose.

2. The Financial Obligations Assumed by Kentucky Power Under the ecoPower REPA are Necessary and Appropriate For, and Consistent with, the Provision of Electric Service in its Service Territory.

The ecoPower REPA presents Kentucky Power with a unique opportunity to invest in its service territory, promote economic development, and provide for future load growth. In addition, the ecoPower REPA gives Kentucky Power the opportunity to invest in a "home-grown" renewable energy development. Renewable energy is important for Kentucky's energy future, as demonstrated by Governor Beshear's 2008 comprehensive energy plan which called for an increase in renewable energy generation to 1000 MW by 2025.[56] In particular, Strategy 2 of the 2008 plan noted that Kentucky "has great potential for producing energy from woody biomass."[57]

Recent legislative efforts in the Kentucky General Assembly also demonstrate the importance of renewable energy, and in particular, the use of biomass as a renewable fuel source. Legislators, including Representative Rocky Adkins – the House Majority Leader, have introduced bills over the past few sessions seeking to create renewable or clean energy standards.[58] Those bills have not been enacted.[59]

The legislature did, however, unanimously pass Senate Bill 46 during the 2013 session. Senate Bill 46, signed into law by Governor Beshear and subsequently codified at KRS 278.271, makes the Commission's approval of a biomass power purchase agreement cost recovery

[56] Amended Application at ¶ 17.

[57] *Id.* at ¶ 17.

[58] *Id.* at ¶ 18.

[59] *Id.* at ¶ 18.

mechanism valid for the entire initial term of the agreement and demonstrates the legislature's commitment to and support of biomass energy development.[60] In light of its economic development, load growth, and portfolio diversity benefits and the emerging role of biomass in Kentucky's energy future, the ecoPower REPA is necessary, appropriate, and consistent with Kentucky Power's provision of electric service to its customers.

3. The Financial Obligations Assumed by Kentucky Power Under the ecoPower REPA Will Not Impair its Ability to Provide Adequate, Efficient and Reasonable Electric Service to its Customers.

The ecoPower REPA contains numerous provisions that protect Kentucky Power and its customers from risk over the term of the agreement. The price Kentucky Power pays for the Renewable Energy Products is fixed (with an established yearly escalator).[61] The price cannot increase. This coupled with other protections in the agreement means that the ecoPower REPA will not impair Kentucky Power's ability to serve its customers.

(a). *ecoPower, not Kentucky Power or its Customers, Bear the Risk of Increased Costs.*

First and foremost, Kentucky Power only pays for the Renewable Energy Products it actually receives from ecoPower.[62] Under the REPA negotiated by Kentucky Power, all risk of changed circumstances lies with ecoPower, not Kentucky Power or its customers. If the cost of diesel fuel increases leading to increased fuel supply trucking costs, or if fuel costs themselves increase, those increased costs are solely borne by ecoPower, not Kentucky Power or its customers.[63] If changes in environmental regulations require ecoPower to install additional pollution control equipment, the equipment installation and operation costs must be borne by

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[60] *Id.* ¶ 19.

[61] Godfrey Direct Testimony at 11.

[62] *Id.* at 12.

[63] Taylor Hearing Testimony at 207-208.

ecoPower, not Kentucky Power or its customers.[64] If PJM determines that ecoPower must make transmission system upgrades as part of the interconnection, ecoPower bears those costs, not Kentucky Power or its customers.[65]

Company Witness Godfrey described the Company's risk from cost overruns as follows:

[redacted]

All of the risk of future increased costs lies with ecoPower.[67] No changed circumstances in the future can make this agreement more expensive to Kentucky Power's customers or the Company. Increased costs to operate the ecoPower facility will have no impact on Kentucky Power's ability to serve its customers.

(b). *The Cost Recovery Provisions of the ecoPower REPA Protect Kentucky Power and its Customers.*

Because they commit a utility to a long-term financial obligation, long-term power purchase agreements, such as the ecoPower REPA, have the potential to negatively impact a utility's credit rating. If that were to occur, the utility's customers could be affected as higher borrowing costs flow through to rates.

Rating agencies such as Standard & Poor's treat power purchase agreements as fixed, debt-like, financial obligations in reviewing a utility's credit rating.[68] In order to determine what

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[64] *Id.* at 209-210; Pauley Hearing Testimony at 58-59; Godfrey Direct Testimony at 13.

[65] Godfrey Hearing Testimony at 157.

[redacted]

[67] *Id.* at 13-14.

[68] Exhibit RKW-2 at 2.

amount to treat as debt, Standard & Poor's multiplies the net present value of the capacity payments (or an inferred capacity charge if one is not specified in the agreement) by a risk factor.[69] Standard & Poor's describes the risk factors:

> These risk factors typically range between 0% to 50%, but can be as high as 100%. Risk factors are inversely related to the strength and availability of regulatory or legislative vehicles for the recovery of the capacity costs associated with the power supply agreements. The strongest recovery mechanisms translate into the smallest risk factors.[70]

In evaluating the strength of the recovery mechanism and, therefore, the associated risk factor, Standard & Poor's states a preference for legislative cost recovery mechanisms:

> Finally, we view legislatively created cost recovery mechanism as <u>longer lasting</u> and <u>more resilient to change</u> than regulatory cost recovery vehicles. Consequently, such mechanisms lead to risk factors between 0% and 15%, depending on the legislative provisions for cost recovery and the supply function borne by the utility. Legislative guarantees of complete and <u>timely</u> recovery of costs are particularly important to achieving the lowest risk factors.[71]

Accordingly, the potential for the ecoPower REPA to affect Kentucky Power's credit rating and, therefore, its borrowing costs is tied to the Company's ability to recover its costs through rates. Upon approval of cost recovery by the Company under the ecoPower REPA, the Company will enjoy both contractual and legislative guarantees of complete and timely cost recovery so that a 0% risk factor appropriate.[72]

Kentucky Power negotiated strong provisions in the ecoPower REPA that ensure concurrent (i.e. timely) recovery through rates of all of the REPA costs. First, under Section 6.1(A) of the ecoPower REPA, Kentucky Power has the right to terminate the agreement, without financial penalty, if the Commission fails to issue an order approving the contract and

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[69] *Id.* at 3.

[70] *Id.*

[71] *Id.* at 4 (emphasis added).

[72] Wohnhas Hearing Testimony at 85-88.

the full and concurrent recovery of costs.[73] Second, the cost recovery mechanism through which Kentucky Power will recover the costs related to the ecoPower REPA is a monthly rider.[74] As with the Company's Fuel Adjustment Clause, Kentucky Power will recover its costs concurrently without regulatory lag.[75] Finally, as KIUC Witness Kollen admits, should the Commission ever issue an order that disallows concurrent cost recovery, Sections 6.1 (C) and (D) of the ecoPower REPA give Kentucky Power the right to terminate the agreement, again without financial penalty.[76] These provisions eliminate the risk that Kentucky Power will not be able to timely recover its costs, a key point leading to low risk factors from rating agencies.

In addition to the contractual provisions in the ecoPower REPA, recent legislation passed unanimously by the Kentucky General Assembly adds to Kentucky Power's protection from imputed debt and increased borrowing costs. Senate Bill 46, codified at KRS 278.271, provides that upon a finding by the Commission that the full costs of the purchase power agreement are fair, just and reasonable, the approval of cost recovery under a biomass power purchase agreement shall be valid for the entire initial term of the agreement.[77] KIUC Witness Kollen acknowledged the certainty that Senate Bill 46 provides Kentucky Power for its recovery of costs incurred under the ecoPower REPA:

> Q. All right. But if - - just so we're clear, that if the Commission approves the cost recovery mechanism that the Company is seeking for this biomass resource, under Senate Bill 46, that cannot be changed for the full term of the REPA; is that correct?
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> A. Well, I'm not an attorney, but that's my understanding. In other words, once the Commission sets in motion its approval of this contract, that's it

[73] Godfrey Direct Testimony at 12; Exhibit JFG-1 at Section 6.1.

[74] Wohnhas Supplemental Testimony at 3.

[75] *Id.* at 3.

[76] Kollen Hearing Testimony at 282.

[77] KRS 278.271.

> unless the Company were to come in and seek a reopener for whatever reason.[78]

This statutory protection, along with the contract provisions, protect the Company and its customers from any negative balance sheet impacts. The ecoPower REPA will not affect Kentucky Power's ability to serve its customers.

4. <u>The Financial Obligations Assumed by Kentucky Power Under the ecoPower REPA are Reasonably Necessary and Appropriate for the Provision of Electric Service by the Company</u>.

The ecoPower REPA represents an important investment by Kentucky Power in the economic development of its service territory. It will allow the Company to support future load growth and will mitigate the impacts of the termination of the Pool Agreement. Through the ecoPower REPA, the Company will further diversify its generation portfolio and will support the Governor's and Legislature's goals of promoting biomass renewable energy in the Commonwealth. Importantly, the protections found in the agreement mean that the ecoPower REPA will not impair the Company's ability to provide service to its customers. The ecoPower REPA is reasonably necessary and appropriate for Kentucky Power to fulfill its obligations to its customers.

B. Both The REPA And Kentucky Power's Proposed Biomass Energy Rider Comply with the Requirements of KRS 278.271.

In addition to seeking approval of the ecoPower REPA, Kentucky Power also seeks approval of a new Biomass Energy Tariff ("Tariff B.E.R.") pursuant to KRS 278.271 to recover its costs, not otherwise recovered in rates, for the purchase of renewable energy under the ecoPower REPA. KRS 278.271 allows a utility to recover costs for the purchase of electric power from a biomass energy facility that has received a certificate from the Kentucky State Board on Electric Generation and Transmission Siting if the Commission determines that the full

[78] Kollen Hearing Testimony at 285-286.

costs of the purchase power agreement over the full term of the agreement are fair, just, and reasonable.[79] In determining whether the costs are fair, just, and reasonable, the Commission may consider the policy set forth by the General Assembly in KRS 154.27-020(2).[80] The ecoPower facility, which the REPA embodies and supports, is just the innovative energy-related business creating new jobs, new investment, and new sources of tax revenues envisioned by KRS 154.27-020(2):

> The General Assembly hereby finds and declares it is in the best interest of the Commonwealth to induce the location of innovative energy-related businesses in the Commonwealth in order to advance the public purposes of achieving energy independence, creating new jobs and new investment, and creating new sources of tax revenues that but for the inducements to be offered by the authority to approved companies would not exist.

It likewise will "assist the Commonwealth in moving to the forefront of national efforts to achieve energy independence by reducing the Commonwealth's reliance on imported energy resources."[81] The biomass that will fuel the ecoPower facility will be produced in southeastern Kentucky and not imported from overseas.[82]

In light of the new jobs, investment, and tax revenues to be produced by the ecoPower facility, the full recovery of its costs through the REPA over the full term of the agreement is fair, just, and reasonable, and the ecoPower REPA meets the requirements of KRS 278.271. The Commission should approve the recovery of its costs through Kentucky Power's proposed Tariff B.E.R.

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[79] KRS 278.271.

[80] *Id.*

[81] KRS 154.27-020(3).

[82] Godfrey Direct Testimony at 7-8.

(1). The ecoPower REPA Meets the Prerequisites of KRS 278.271.

The ecoPower facility received a certificate from the Kentucky State Board on Electric Generation and Transmission Siting in Case No. 2009-00530.[83] In addition, the ecoPower REPA is consistent with the policies outlined in KRS 154.27-020(2) because it promotes the development of an innovative energy-related business that advances the public purposes of creating new jobs and new investments, achieving energy independence, and creating new sources of tax revenues.[84] The ecoPower REPA meets the threshold requirements for approval under KRS 278.271.

(2). The Full Costs of the ecoPower REPA are Fair, Just, and Reasonable.

Kentucky Power has provided the full costs of the ecoPower REPA as part of its application in this case.[85] Kentucky Power estimates that, based on 2012 revenue numbers, the net first year revenue requirement increase under the ecoPower REPA would be approximately seven percent.[86] If, however, the revenue requirement impact of the ecoPower REPA is considered in the context of the comprehensive generation portfolio changes that Kentucky Power will undergo between now and 2017, the revenue requirement impact decreases to slightly less than six percent.[87]

The Company is proposing to recover the full costs of the ecoPower REPA through Tariff B.E.R. Under Tariff B.E.R., Kentucky Power will compute a monthly biomass adjustment factor (in $/kWh) based on the ratio of the price paid for renewable energy under the ecoPower

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[83] Godfrey Direct Testimony at 7.

[84] Amended Application at ¶ 51.

[85] Amended Application at ¶ 53.

[86] Wohnhas Hearing Testimony at 78-79; Exhibit RKW-1.

[87] *See* Kentucky Power's Response to Commission Staff Post-Hearing Data Request PH-3.

REPA to the Company's total energy sales during the month, excluding intersystem sales.[88] This biomass adjustment factor is applied to a customer's bill.[89] Tariff B.E.R. would not become effective until the first month it purchases energy under the ecoPower REPA.[90] Tariff B.E.R. charges would appear on customer bills approximately two months later.[91] As described above, this mechanism is similar to the Company's existing fuel adjustment clause.[92] Additionally, the recovery of costs under Tariff B.E.R. will include a "true-up" mechanism that allows the Company to avoid over or under recovery of costs.[93] The cost recovery mechanism contained in Tariff B.E.R. is consistent with other similar surcharge mechanisms and ensures that the Company recovers the ecoPower REPA costs in a timely and accurate manner.

Considering the benefits described above in the form of economic development, increased capacity for growth, fuel diversity, and investment in renewable energy technologies, the costs of the ecoPower REPA, over its full term, are fair, just and reasonable. The Commission should find the ecoPower REPA as consistent with the requirements of KRS 278.271 and approve Tariff B.E.R. as the cost-recovery mechanism.

C. Intervenors' Arguments in this Case are Without Merit.

1. <u>A Request for Proposal was Unnecessary</u>.

KIUC argues that Kentucky Power should have conducted an RFP for a renewable resource instead of pursuing the unique opportunity that the ecoPower REPA presents to the Company and its customers.[94] The argument ignores the circumstances surrounding the

[88] Wohnhas Supplemental Testimony at 3; Exhibit RKW-1S.

[89] Wohnhas Supplemental Testimony at 3.

[90] *Id.* at 4.

[91] *Id.*

[92] *Id.* at 3.

[93] Wohnhas Hearing Testimony at 89-90.

[94] Taylor Direct Testimony at 8.

ecoPower REPA and the reality of the Eastern Kentucky renewables market. Company Witness Pauley explained both at the hearing and in his rebuttal testimony that given the unique circumstances presented by the REPA, an RFP was unnecessary.[95] ecoPower approached Kentucky Power with a unique opportunity to make an investment in its service territory and diversify its generation portfolio with homegrown renewable resources.[96] Kentucky Power then intermittently negotiated the terms and conditions of the ecoPower REPA over the course of two years, including a period where negotiations were suspended because ecoPower was unwilling to include cost recovery provisions that protected the Company and its ratepayers.[97] This approach is consistent with the cost-effective approach used in connection with other REPAs in the AEP system, where, as Company witness Godfrey testified, the last five agreements were not the result of RFPs.[98] In the end, the ecoPower REPA represents a reasonable agreement for Kentucky Power to add renewables to its portfolio and invest in its service territory.[99] An RFP was not necessary.

Further, where there is no established market for renewable energy resources and the available renewable technologies are limited, as is the case in Kentucky Power's service territory,[100] an RFP would be of no practical use. Conducting an RFP would be futile to identify local renewable resources in Eastern Kentucky that would be comparable to, or hypothetically more favorable than, the ecoPower option. In the real world, and in the absence of a mature market for local renewable generation, such resources will be developed through direct

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[95] Pauley Hearing Testimony at 20-21; Pauley Rebuttal Testimony at 3; Kentucky Power's response to Commission Staff Data Request 1-7.

[96] Pauley Hearing Testimony at 19-21; Pauley Rebuttal Testimony at 3.

[97] Pauley Rebuttal Testimony at 3; Kentucky Power's response to Commission Staff Data Request 1-7.

[98] Godfrey Hearing Testimony at 143-144.

[99] Pauley Rebuttal Testimony at 3.

[100] *See* Kentucky Power Hearing Exhibits 1 and 2.

negotiations and contact with interested developers like ecoPower. The lack of a renewable energy resources located in eastern Kentucky is evident from the response to Kentucky Power's March 2103 RFP. As discussed above, despite clear language in the RFP that allowed renewable energy developers to participate, Kentucky Power received no renewable bids.[101]

2. Because Wind and Solar Resources are not Viable, Renewables in Kentucky are More Expensive than Elsewhere.

KIUC argues better, less expensive renewable resources exist for Kentucky Power to meet its goal of investing in renewable energy in its service territory. KIUC Witness Alan Taylor testified that he had "seen 20-year REPA proposals offered at less than a third of the ecoPower REPA's price."[102] Mr. Taylor further testified that he has "seen many proposed renewable projects in recent years that could generate renewable energy and RECs at prices that are less than the forecasted prices for "brown" power."[103] Mr. Taylor's testimony is irrelevant to the issue before the Commission and Company's goal of investing in a renewable resource in its service territory.

When questioned further about the projects referred to in his testimony, KIUC Witness Taylor admitted that:

- he had never reviewed a biomass REPA;
- he had never reviewed a renewable energy project located in PJM;
- he had never reviewed a renewable energy project located in the Commonwealth of Kentucky; and
- he had never reviewed a renewable project in Kentucky Power's service territory.[104]

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[101] Pauley Hearing Testimony at 23; Kentucky Power Hearing Exhibit 3 at Section 4.1.

[102] Taylor Direct Testimony at 6.

[103] *Id.* at 16 (emphasis in original).

[104] Taylor Hearing Testimony at 194 – 197.

In fact, KIUC Witness Taylor even admitted a lack of familiarity with where Kentucky Power's service territory is located.[105] Importantly, Mr. Taylor confirmed that his testimony about low cost renewable projects did not apply to biomass:

> Q. Just - - again, just to clarify, you've reviewed - - you've never reviewed a biomass renewable project that produced a negative REC value; is that correct?
>
> A. I don't believe so.
>
> Q. And you've never reviewed a biomass REPA at prices that were one-third less than the ecoPower REPA; is that correct?
>
> A. I don't believe so.[106]

The reality is that the only renewable energy technology available in Kentucky Power's service territory is biomass. Data prepared by the National Renewable Energy Laboratory demonstrates that neither wind nor solar is a viable renewable alternative in Kentucky Power's service territory.

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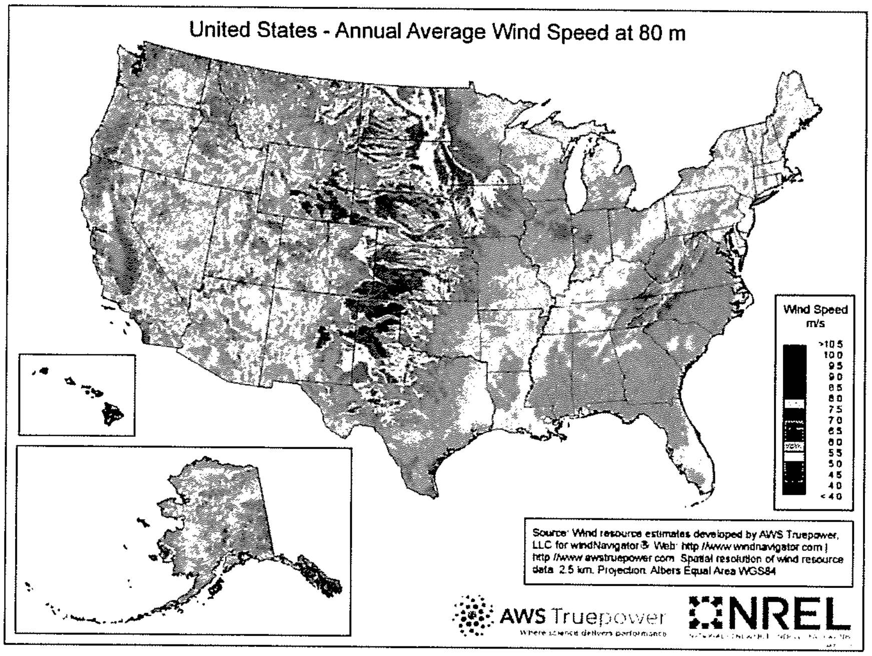
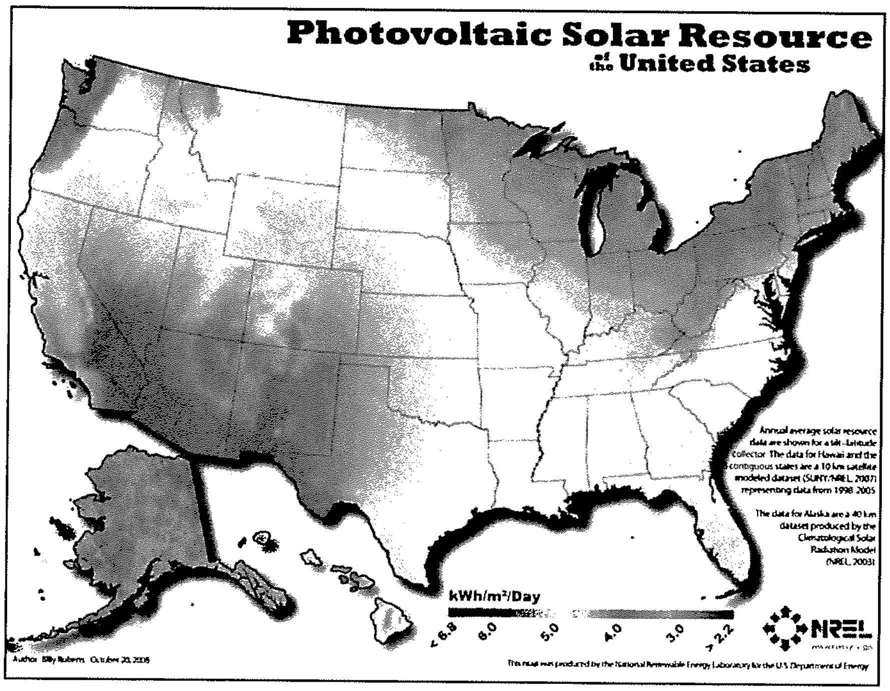
[105] *Id.* at 201.

[106] *Id.* at 206.

Eastern Kentucky ranks as among the worst areas in the country for wind resources:[107]



Similarly, solar resources in Eastern Kentucky are poor and on par with those found in Upstate New York and the Upper Peninsula of Michigan:[108]



[107] Kentucky Power Hearing Exhibit 1; Taylor Hearing Testimony at 199-200.

[108] Kentucky Power Hearing Exhibit 2; Taylor Hearing Testimony at 200-201.

Company Witness Godfrey explained that biomass, the renewable resource available for Kentucky Power, is more expensive than wind because of the higher per kilowatt-hour cost driven in large part by the favorable production tax credits available to wind project developers and the higher capital expense for biomass facilities.[109] In response to a question about solar costs, Company Witness Godfrey explained how regional differences affect available renewable options:

> Q. Okay. So I guess the price differential for a biomass facility versus wind, solar, or - - well, versus wind and solar would be associated with capital expenditures?
>
> A. Yeah. Now, solar is different. I didn't say that biomass was more expensive than solar, so - -
>
> Q. It is not?
>
> A. - - they're - - no, they're more - - you know, they're more of an even playing field or it could be one - - you know, one could be more or less. But solar is more expensive than wind in most areas. Not Arizona. You know, in Kentucky you've got trees, so the renewable that you can - - you know, the resource that you can take advantage of is trees. In Arizona they have sunshine, golf courses, so you can put solar up. In the Pacific northwest and further south in the TVA area you've got the hydro. But, you know, you to - - you have to go with what - - with what's available, you know too. You can't wish for something that's in Minn - - for what - - you can't buy wind in Minnesota and bring it to - - and bring it to Kentucky as well.
>
> So you if you want investment in Kentucky, you know, you have trees and, you know, that's a renewable that you can have, and so we're - - what we were looking at is also, I think, is you're referring to Greg Pauley's testimony, he brought up the Governor's, you know, energy plan, and so renewables were a part of it, and this is a renewable that indigenous to the state, and that's - - you know, that's why we're presenting it to you-all today.[110]

If Kentucky Power is going to invest in renewable energy development – as envisioned by Governor Beshear in his 2008 "Intelligent Choices for Kentucky's Future" Energy Plan, and

[109] Godfrey Hearing Testimony at 135-137.

[110] *Id.* at 137-138.

by the General Assembly in enacting subchapter 27 of Chapter 154 of the Kentucky Revised Statutes – in its service territory to promote economic development and fuel diversity, it must invest in biomass. Simply put, to meet these goals of the Executive and Legislative Branches, the Company must invest in the ecoPower REPA.

3. There will be No "Common Equity Penalty."

KIUC also argues that Kentucky Power has understated the increase in revenue that the Company will recover under the ecoPower REPA.[111] KIUC asserts that the ecoPower REPA will be treated by credit rating agencies as imputed debt and that the Company will be required to increase its actual common equity at the expense of less expensive long-term debt.[112] According to KIUC, the additional common equity required to maintain the Company's credit rating as a result of the ecoPower REPA would necessitate a 7.84% increase in revenue requirement, as opposed to the 7.02% increase identified by the Company.[113] KIUC's arguments, however, ignore the method by which rating agencies determine if debt should be imputed, the terms of the ecoPower REPA, and the impact of the newly adopted KRS 278.271.

As discussed above, ratings agencies evaluate the risk of cost recovery from a power purchase agreement in evaluating whether to impute debt to a company's balance sheet. Two aspects of the ecoPower REPA mitigate the risk of recovery. First, Kentucky Power included provisions in the ecoPower REPA guaranteeing concurrent cost recovery. Sections 6.1 (A), (C) and (D) of the ecoPower REPA give the Company the right to terminate the agreement, without financial penalty, if it ever fails to obtain the right to concurrent recovery of the Company's costs

[111] Kollen Direct Testimony at 12.
[112] *Id.* at 12.
[113] *Id.* at 15-16; Exhibit RKW-1.

under the ecoPower REPA.[114] Thus, timely recovery of costs is required by the REPA. Additionally, the Kentucky General Assembly recently passed Senate Bill 46, now codified at KRS 278.271, without a dissenting vote. KRS 278.271 provides that, once the Commission approves a biomass power purchase agreement, that approval remains valid for the entire initial term of the agreement.[115] KIUC Witness Kollen confirmed that Senate Bill 46 provides extraordinary certainty, going so far as to testify that the Commission should apply a heightened "strict scrutiny" test in reviewing the ecoPower REPA because "once a biomass power plant is approved for recovery from rate payers, the Commission can never revisit that decision."[116]

Through the protections included in Section 6.1 of the agreement and the strength of Senate Bill 46, the ecoPower REPA exceeds the requirements for a low risk factor from Standard & Poor's.[117] Kentucky Power has the right to terminate the agreement, without financial penalty, if it is ever denied concurrent or, as Standard and Poor's describes it "timely", cost recovery. Beyond that, with the enactment of KRS 278.271, the Company is entitled by law to recover its costs for the 20-year initial term of the ecoPower REPA upon issuance of the Commission's Order approving cost recovery. The combination of the two create a recovery mechanism that is long-lasting and resilient to change. Kentucky Power properly used a 0% risk factor in evaluating the potential treatment of the ecoPower REPA by ratings agencies. Kentucky Power's estimate of the revenue requirement impacts of the agreement were not understated.

Finally, without regard to the legislative and contractual cost-recovery certainty attendant to the REPA, it is important to recognize that the review of the REPA by credit agencies is not

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[114] Kollen Hearing Testimony at 282; Wohnhas Hearing Testimony at 87; Exhibit JFG-1 at Section 6.1.

[115] Wohnhas Hearing Testimony at 87.

[116] Kollen Direct Testimony at 16. Mr. Kollen confirmed that there is, in fact, no strict scrutiny test that would apply. Kollen Hearing Testimony at 284.

[117] Wohnhas Hearing Testimony at 87.

unique to REPAs. It is applicable to all long-term power purchase agreements. Moreover, no debt is ever added to the Company's balance sheet. Instead, where, ***unlike here***, the appropriate contractual and legislative cost-recovery protections do not exist, Standard & Poor's will *impute* some level of additional debt to the Company when reviewing the Company's credit rating. As a result, even if debt were to be imputed in connection with the ecoPower REPA, and it seems unlikely it would, the Company would need to add equity only if the imputed debt threatened a downgrade of the Company's credit rating.[118]

4. <u>KIUC's Economic Impact Analysis is Based on a Flawed Premise</u>.

The record clearly shows that the EcoPower project will bring jobs to the region and have a positive impact on tax revenues supporting local government.[119] KIUC seeks to counter these benefits by advancing the criticism that the net economic effect of the project would actually be detrimental, even though it offers no credible evidence to support its position. In fact, even after KIUC's Witness Coomes raised criticism about the expected economic effects of the project, he readily admitted that the project would result in an estimated $6.4 million per year in total earnings for permanent jobs with associated tax revenue benefits for the county.[120]

In advancing his theory, Dr. Coomes was unable to provide any real-world basis for his theory that the ecoPower facility would displace jobs that would have provided alternative economic benefits.[121] In fact, Dr. Coomes ignored the reality facing the coal industry by comparing the jobs created by the ecoPower facility with jobs at the soon to be retired Big Sandy Plant.[122] Dr. Coomes conceded his estimate about negative impact resulting from diminished

[118] *See* Kentucky Power's response to KIUC's Data Request 2-15.

[119] Pauley Direct Testimony at 7; Pauley Hearing Testimony at 29-30; [redacted]

[120] Coomes Direct Testimony at 3; Coomes Hearing Testimony at 243-244.

[121] Coomes Hearing Testimony at 243-245.

[122] Pauley Rebuttal Testimony at 4-5; Coomes Hearing Testimony at 265-266.

spending associated with rate increases was overstated.[123] Significantly, Dr. Coomes disclaimed knowledge about whether coal-fired generation could be economically built today to provide the alternative jobs that underlie his criticism.[124] Similarly, Dr. Coomes, on the stand and without the benefit of conducting any in-depth analysis, simply assumed that money paid in rates in Eastern Kentucky in connection with the EcoPower project would leave the area – a remarkable assumption given that much of that amount is directly connected with local wages, local construction, and local investment.[125] In the end, Dr. Coomes' criticism, based on unlikely assumptions and overstated estimates, simply does not disprove the only solid evidence in the case regarding the expected economic impact of the EcoPower project, namely new jobs for the region, increased earnings for a significant number of households that badly need it, and an increase in tax revenues for the local governments. In fact, the most relevant portion of Dr. Coomes' testimony was his candid response during examination by the bench when he readily admitted he is "sure somebody that gets a job is very happy to have it," and "sure the region would like to have those jobs."[126]

III. CONCLUSION

The ecoPower REPA provides Kentucky Power with a unique opportunity to make an investment in its service territory, provide for future load growth, and diversify its generation portfolio with a home-grown renewable resource. Kentucky Power respectfully requests that the Commission support this investment in eastern Kentucky, find that the standards of KRS 278.300 and KRS 278.271 have been satisfied, and approve the ecoPower REPA and Kentucky Power's full cost recovery under KRS 278.271 and Tariff B.E.R.

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[123] Coomes Hearing Testimony at 248-249.

[124] *Id.* at 246.

[125] *Id.* at 252-254.

[126] *Id.* at 272.

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CERTIFICATE OF SERVICE

I hereby certify that a true and accurate copy of the foregoing was served as indicated below upon:

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Kenneth J. Gish, Jr.