

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF	)	
SOUTH KENTUCKY RURAL ELECTRIC	)	
COOPERATIVE CORPORATION FOR	)	CASE NO.
APPROVAL OF MASTER POWER	)	2018-00050
PURCHASE AND SALE AGREEMENT	)	
AND TRANSACTIONS THEREUNDER	)	

ORDER

On January 31, 2018, South Kentucky Rural Electric Cooperative Corporation (South Kentucky RECC) filed an application, pursuant to KRS 278.300, requesting approval of a power purchase and sale agreement (PPA) between South Kentucky RECC and Morgan Stanley Capital Group, Inc. (MSCG). Under the PPA, South Kentucky RECC would purchase 58 megawatts (MW) of firm energy for 20 years and a financial capacity hedge of 68 MW for 18 years from MSCG.

There are 11 Intervenors in this proceeding: the Attorney General of the Commonwealth of Kentucky, by and through the Office of Rate Intervention (Attorney General); Cumberland Valley Electric, Inc. (Cumberland Valley Electric); East Kentucky Power Cooperative, Inc. (EKPC); Grayson Rural Electric Cooperative Corporation (Grayson RECC); Jackson Energy Cooperative Corporation (Jackson Energy); Nucor Steel Gallatin (Nucor); Owen Electric Cooperative, Inc. (Owen Electric); Shelby Energy Cooperative, Inc. (Shelby Energy); Salt River Electric Cooperative Corporation (Salt River Electric); Taylor County Rural Electric Cooperative Corporation (Taylor County RECC); and, filing as joint intervenors, Big Sandy Rural Electric Cooperative Corporation, Blue

Grass Energy Cooperative Corporation, Clark Energy Cooperative, Inc., Farmers Rural Electric Cooperative Corporation, Fleming-Mason Energy Cooperative, Inc., Inter-County Energy Cooperative Corporation, Licking Valley Rural Electric, Cooperative Corporation, and Nolin Rural Electric Cooperative Corporation (Joint Intervenors).

Multiple rounds of discovery were conducted, the parties filed written testimony, a three-day formal evidentiary hearing was held May 15–17, 2018, and the parties filed post-hearing briefs and responses to post-hearing data requests. After Salt River Electric filed a motion to strike a portion of EKPC’s brief, the Commission entered an Order on July 23, 2018, granting the parties additional time to file responses to Salt River Electric’s motion. EKPC subsequently filed a motion to strike Salt River Electric’s brief. Pursuant to the July 23, 2018 Order, this matter stood submitted for a decision effective August 8, 2018.

### BACKGROUND

South Kentucky RECC is a not-for-profit, member-owned rural electric distribution cooperative engaged in the retail sale of electric power to approximately 50,000 members in Pulaski, Wayne, McCreary, Cumberland, Lincoln, Rockcastle, Casey, Russell, Laurel, Clinton, and Adair counties, Kentucky.<sup>1</sup> South Kentucky RECC is one of the 16 owner-members (Owner-Members) of EKPC, an electric generation and transmission cooperative that provides wholesale power to its Owner-Members under an all-requirements wholesale power contract (Wholesale Power Contract).<sup>2</sup>

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<sup>1</sup> Application at paragraph 3.

<sup>2</sup> *Id.* at paragraph 4.

This matter has its genesis in two modifications to the Wholesale Power Contract. Between 1946 and 2003, the Owner-Members were required to obtain all of their electric power from EKPC under the Wholesale Power Contract.<sup>3</sup> In a Wholesale Power Contract extension in 2003, EKPC and its Owner-Members agreed to a modification (Amendment 3) that permitted Owner-Members to purchase limited quantities of power from an alternate source.<sup>4</sup> The Wholesale Power Contract was modified again in 2015 in a Memorandum of Understanding (MOU) that, among other things, established a methodology for allocating the limited alternate source allotments in order to resolve the ambiguity in the allocation provision in Amendment 3.<sup>5</sup> The Owner-Members and EKPC entered into the MOU as a compromise to end multi-year litigation before the Commission and in state court regarding ambiguous allocation methodology provisions in Amendment 3.<sup>6</sup>

Under the MOU, the amount of available alternate source power is limited by an Owner-Member's and EKPC's peak demand. If the aggregate amount of all Owner-Members' loads being served with alternate source power is under 2.5 percent of EKPC's peak demand, an Owner-Member can obtain up to 15 percent of the Owner-Member's peak demand from an alternate source.<sup>7</sup> If the aggregate load of all alternate source power is between 2.5 percent and 5 percent, an Owner-Member can obtain up to 5

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<sup>3</sup> *Id.* at paragraph 5.

<sup>4</sup> *Id.*

<sup>5</sup> *Id.* at paragraph 6.

<sup>6</sup> See May 16, 2018 Hearing Video Transcript (HVT) at 3:56:00; May 17, 2018 HVT at 3:46:27 and 4:58:00.

<sup>7</sup> Application, Exhibit 2 at Section 3.

percent of the Owner-Member's peak demand.<sup>8</sup> The ability to purchase alternate source power is capped at 5 percent of EKPC's peak demand (5 Percent Cap).<sup>9</sup> Once the aggregate amount of all Owner-Members' loads being served with alternate source power reaches the threshold of 2.5 percent of EKPC's peak demand, only a portion of the Owner-Members could obtain 5 percent of their peak demand because the 5 Percent Cap would be exceeded before all Owner-Members exercised their option.<sup>10</sup>

### PROPOSED TRANSACTION

In August 2017, after being contacted by an entity selling wholesale power, South Kentucky RECC retained EnerVision, Inc. (EnerVision), an electric industry consultant, to investigate options for purchasing 58 MW of competitively priced wholesale power for a term of 5 to 20 years.<sup>11</sup> EnerVision identified seven entities that could meet the criteria in the proposal requests.<sup>12</sup> Six of the entities submitted bids; two bidders were shortlisted; MSCG was awarded the bid.<sup>13</sup>

Under the PPA, South Kentucky RECC would purchase 58 MW 7x24 firm energy at a fixed price of \$33.95 per MWh for 20 years, beginning June 1, 2019, and a financial capacity hedge of 68 MW at a price of \$125.00 per MW-day for 18 years.<sup>14</sup> South Kentucky RECC estimated a wholesale power cost savings of \$89.7 million to \$122.8

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<sup>8</sup> *Id.*

<sup>9</sup> *Id.*

<sup>10</sup> Direct Testimony of Anthony S. Campbell at 8–9.

<sup>11</sup> Application at paragraph 7; Direct Testimony of Dennis Holt (Holt Direct Testimony) at 10.

<sup>12</sup> Direct Testimony of Carter Babbit at 10.

<sup>13</sup> *Id.* at page 11; Holt Direct Testimony at 10–11.

<sup>14</sup> Application at paragraph 1.

million net present value (NPV) over 20 years.<sup>15</sup> South Kentucky RECC subsequently revised the estimated NPV cost savings to \$77.8 million to \$110.8 million over 20 years.<sup>16</sup>

MSCG would obtain power from the PJM Interconnection, LLC (PJM) market and deliver the power to the EKPC zone; EKPC would deliver the power to South Kentucky RECC through EKPC's transmission system.<sup>17</sup> South Kentucky RECC would pay EKPC for the transmission service at EKPC's Open Access Transmission Tariff (OATT) rate.<sup>18</sup> South Kentucky RECC would be required to join PJM and become a PJM Market Participant.<sup>19</sup> EKPC would serve as South Kentucky RECC's agent for PJM market participant activities under an agency agreement that has not been fully negotiated.<sup>20</sup>

On November 28, 2017, South Kentucky RECC provided EKPC and the other Owner-Members with written notice of its intent to exercise the option to purchase 58 MW of power from an alternate source.<sup>21</sup> With South Kentucky RECC's alternate source election, the aggregate load served by alternate sources is under 2.5 percent of EKPC's peak demand. The 58 MW of alternate source power represents 15 percent of South Kentucky RECC's highest peak demand and 40 percent of its load.<sup>22</sup>

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<sup>15</sup> *Id.*

<sup>16</sup> Rebuttal Testimony of Carter Babbit at 10 and 15; South Kentucky RECC Initial Post-Hearing Brief (filed June 15, 2018) at 22.

<sup>17</sup> Holt Direct Testimony at 12–13.

<sup>18</sup> *Id.* at 12.

<sup>19</sup> *Id.* at 13.

<sup>20</sup> *Id.*; South Kentucky RECC's Response to EKPC's Second Request for Information, Item 7.

<sup>21</sup> Holt Direct Testimony at 13; Application, Exhibit 4.

<sup>22</sup> May 16, 2018 HVT at 2:54:57.

## STANDARD OF REVIEW

It is well settled that the Commission reviews requests to approve a purchase power agreement as evidence of indebtedness under KRS 278.300.<sup>23</sup> Three elements must be met in order for the Commission to approve an evidence of indebtedness:

1. The purchase power agreement is for some lawful object within the corporate purposes of the utility;
2. The purchase power agreement is necessary or appropriate for or consistent with the proper performance by the utility of its service to the public and will not impair its ability to perform that service; and
3. The purchase power agreement is reasonably necessary and appropriate for such purpose.

When the purpose and use of a purchase power agreement is to acquire new generation, the Commission will review the agreement pursuant to the certificate of public convenience and necessity statute, KRS 278.020.<sup>24</sup> This is because entering into a long-term contract to purchase generation has the same operational and financial impact as if new generation were being constructed. Under KRS 278.020(1), a utility must establish a need for additional generation and the absence of wasteful duplication.<sup>25</sup> As a result,

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<sup>23</sup> Case No. 2009-00545, *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* (Ky. PSC June 28, 2010); Case No. 2013-00144, *Application of Kentucky Power Company for Approval of the Terms and Conditions of the Renewable Energy Purchase Agreement for Biomass Energy Resources Between the Company and ecoPower Generation-Hazard LLC; Authorization to Enter into the Agreement; Grant of Certain Declaratory Relief; and Grant of All Other Required Approvals and Relief* (Ky. PSC Oct. 10, 2013).

<sup>24</sup> *Id.*

<sup>25</sup> *Ky. Utilities Co. v. Public Service Comm'n*, 252 S.W.2d 885, 890 (Ky. 1952).

under KRS 278.300(3), the Commission views the purpose and use of the PPA as the acquisition of new generation, and for it to be a “lawful object within the corporate purposes of the utility,” there must be a need for additional generation and the absence of wasteful duplication.<sup>26</sup>

In addition to reviewing the PPA as an evidence of indebtedness, the parties have raised issues as to whether the PPA, Amendment 3, and the MOU should be reviewed separately under the filed rate doctrine; KRS 278.030(1); and KRS 278.170(1). The filed rate doctrine, which is codified in KRS 278.160, requires a utility to adhere strictly to its published rate schedules and terms of service. KRS 278.030(1) provides that utility rates should be fair, just, and reasonable. KRS 278.170(1) prohibits rates and services that result in an unreasonable preference or disadvantage for the same or like service provided under the same or substantially the same conditions.

### PARTIES' ARGUMENTS

#### Summary of South Kentucky RECC's Argument

South Kentucky RECC argued that the PPA should be approved because the elements of KRS 278.300 were satisfied, and, according to South Kentucky RECC, that was the only applicable standard of review. South Kentucky RECC further argued that denying the PPA would violate the filed rate doctrine because the PPA is permitted by and complied with provisions in the MOU, which is filed as part of EKPC's tariff.

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<sup>26</sup> Case No. 2009-00545, *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* (Ky. PSC June 28, 2010), Order at 6.

South Kentucky RECC contended that the PPA is within its corporate purpose, which is to deliver “safe, reliable, and cost-effective service.”<sup>27</sup> South Kentucky RECC argued that the PPA would result in cost-effective service because the PPA will produce cost savings between \$77.8 million and \$110.8 million, which would reduce wholesale power expenses and delay the need for a general rate adjustment until 2023.<sup>28</sup>

South Kentucky RECC contended that the PPA was necessary for providing service because of significant cost savings to its members and it would “mitigate the volatility inherent in being supplied solely from EKPC.”<sup>29</sup> South Kentucky RECC disputed that KRS 278.300 requires “literal” need.<sup>30</sup> South Kentucky RECC argued that, under these facts, need “is more properly viewed as the need for South Kentucky RECC to provide reliable, cost-effective service.”<sup>31</sup> Additionally, South Kentucky RECC insisted that it made a business judgment that the PPA would satisfy the need to provide reliable, cost-effective service, and the Commission “cannot and should not usurp” South Kentucky RECC’s business judgment.<sup>32</sup>

South Kentucky RECC contended that the PPA would not impair its physical or financial ability to provide electric service. South Kentucky RECC asserted that the

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<sup>27</sup> South Kentucky RECC Initial Post-Hearing Brief at 21–22.

<sup>28</sup> *Id.* at 23 (citing Direct Testimony of Michelle Herrman at 13).

<sup>29</sup> *Id.* at 25.

<sup>30</sup> *Id.* at 27.

<sup>31</sup> *Id.*

<sup>32</sup> *Id.* (citing Case No. 2008-00371, *Application of South Kentucky Rural Electric Cooperative Corporation for a Certificate of Public Convenience and Necessity to Construct a New Headquarters Facility in Somerset, Kentucky* (Ky. PSC May 11, 2010) at 5; Case No. 2008-00436, *Application of East Kentucky Power Cooperative, Inc. for an Order Approving Accounting Practices to Establish a Regulatory Asset Related to Certain Replacement Power Costs Resulting from Generation Forced Outages* (Ky. PSC Dec. 23, 2008) at 8).



physical delivery of energy to its system would not substantially change under the PPA, and that EKPC would serve as a backstop in case of service interruption, with MSCG responsible for paying the cost of replacement energy above the PPA contractual rate.

South Kentucky RECC rejected allegations that the PPA would financially impair its ability to provide service because of alleged failure to conduct appropriate due diligence or alleged errors in the NPV analysis. South Kentucky RECC countered that it performed considerable due diligence and a “measured review” of the PPA.<sup>33</sup> South Kentucky RECC maintained that other parties’ allegations regarding the NPV were misplaced, failed to consider equivalent costs whether energy was obtained from EKPC or under the PPA, and created “no-win scenarios” that produced dire results but did not rebut South Kentucky RECC’s evidence.<sup>34</sup> South Kentucky RECC stated that it corrected errors in the NPV, and that the \$10.4 million reduction in the projected savings does not have a material impact on the value of the PPA. Regarding the potential for changes to EKPC rate redesign, South Kentucky RECC declared that it could not have identified a rate structure that might be imposed in the future given that EKPC has not analyzed or considered such a rate design.<sup>35</sup>

South Kentucky RECC rejected concerns that the Environmental Change in Law (ECL) provision in the PPA, which requires South Kentucky RECC to pay additional costs related to future changes in federal or state environmental laws, could have a material impact. Disputing assertions about the type of costs included in the ECL provision, South

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<sup>33</sup> South Kentucky RECC Post-Hearing Reply Brief (filed July 23, 2018) at 12.

<sup>34</sup> *Id.* at 27.

<sup>35</sup> *Id.* at 31 (*citing* May 16, 2018 HVT at 7:58:10, 8:00:00).

Kentucky RECC argued that the ECL only limits its liability to costs associated with federal or state carbon tax or greenhouse gas tax.<sup>36</sup> South Kentucky RECC also argued that costs eligible for recovery under the ECL had to be imposed by governmental authorities and that “[c]ompliance decisions that translate into capital investment” are made by the facility operator and not imposed by governmental authorities.<sup>37</sup> South Kentucky RECC explained that it did not develop a “specific plan” to mitigate costs from the ECL because it faced the same cost risks whether it purchased power from EKPC or under the PPA.<sup>38</sup> Finally, South Kentucky RECC stated the ECL would not create financial risk because MSCG was required to take commercially reasonable efforts to avoid triggering the ECL and passing along additional costs.

South Kentucky RECC contended that the need and absence of a wasteful duplication standard in KRS 278.020(1) are inapplicable to the PPA. South Kentucky RECC maintained that this standard applies only when additional or supplemental generation is sought, but, here, the PPA replaces, rather than supplements, generation. South Kentucky RECC further argued that even if this standard were applicable, it is satisfied. As a threshold issue, South Kentucky RECC contended that the analysis should be from the perspective of providing lowest-cost power to its members, and not from EKPC’s system-wide perspective. First, South Kentucky RECC reasoned that the PPA is needed because, under the terms of the MOU, 58 MW of its load must be served by a source other than EKPC after June 1, 2019. Once it gave notice of its election, South

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<sup>36</sup> Rebuttal Testimony of Dennis Holt at 20.

<sup>37</sup> South Kentucky Initial Post-Hearing Brief at 36.

<sup>38</sup> South Kentucky RECC Response to Attorney General's First Request for Information, Item 5.

Kentucky RECC had a six-month grace period to cancel its notice, which has passed. Under the MOU, it cannot obtain the 58 MW from EKPC until another 18-month notice window passes. South Kentucky RECC further reasoned that, because the MOU is a tariff, the filed rate doctrine precludes EKPC from waiving these provisions. Second, South Kentucky RECC explained that, because it does not own physical generation, it could not create wasteful duplication. Third, the PPA represents a least-cost option over a 20-year term because it provides cost savings to South Kentucky RECC's members.

South Kentucky RECC dismissed arguments that the PPA should be denied because Amendment 3 and the MOU violated KRS 278.030(1). First, South Kentucky RECC explained that Amendment 3 and the MOU are contracts voluntarily entered into by EKPC and Owner-Members, and that the enforceability of contracts is a “bedrock tenet” included in the U.S. Constitution “to keep fledgling state governments in check.”<sup>39</sup> Next, South Kentucky RECC acknowledged that the MOU is a tariff, and, as a tariff, is subject to the filed rate doctrine. South Kentucky RECC argued that, when the rates in a tariff have been found reasonable and the tariff has been strictly complied with, the Commission does not review whether those rates are fair, just, and reasonable.<sup>40</sup> South Kentucky RECC asserted that the MOU was found reasonable,<sup>41</sup> and that South Kentucky

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<sup>39</sup> South Kentucky RECC Initial Post-Hearing Brief at 2.

<sup>40</sup> Rebuttal Testimony of William Steven Seelye (Seelye Rebuttal Testimony) at 14 (*citing* Case No. 2015-00417, *David Shouse and Brian Shouse, D/B/A Shouse Farms, and Bryan Hendrickson, D/B/A Hendrickson Grain and Livestock, LLP v. Kentucky Utilities Company* (Ky. PSC June 29, 2016) at 10–11).

<sup>41</sup> Case No. 2012-00503, *Petition and Complaint of Grayson Rural Electric Cooperative Corporation for an Order Authorizing Purchase of Electric Power at the Rate of Six Cents per Killowatts of Power vs a Rate in Excess of Seven Cents per Killowatt 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.* (Ky. PSC Dec. 18, 2015) at 5.

RECC's election strictly complied with the terms of the MOU. Thus, South Kentucky RECC argued that there is no basis to review the MOU under KRS 278.030(1).

South Kentucky RECC rejected assertions that, due to cost shifting, Amendment 3 and the MOU were unreasonably discriminatory and thus violated KRS 278.170(1). South Kentucky RECC argued that EKPC and its Owner-Members were aware of the potential for cost shifting to occur when an Owner-Member elected to obtain power from an alternate source and included a provision in the MOU that prohibits EKPC from charging an Owner-Member for stranded costs arising from the alternate source election. South Kentucky RECC argued that the Commission should start with the assumption that the MOU is reasonable, based on its previous finding, and that the parties anticipated the potential for cost shifting and addressed it in the MOU. Under such an analysis, Amendment 3 and the MOU cannot provide South Kentucky RECC with an unreasonable preference because all Owner-Members had the opportunity to make alternative source elections. South Kentucky RECC disputed that EKPC could not mitigate the loss of load or that cost shifting would occur, but proposed that, if there is cost shifting, a regulatory asset be approved to amortize any shortfall.

In its Post-Hearing Reply Brief, South Kentucky RECC alleged that EKPC and 15 Owner-Members met on June 8, 2018, and struck a deal to deny South Kentucky RECC its contractual rights and benefits.<sup>42</sup>

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<sup>42</sup> Reply Brief of South Kentucky RECC (filed July 23, 2018) at 3.

## Summary of Attorney General's Argument

The Attorney General requested that the Commission deny South Kentucky RECC's request for approval of the PPA and rescind approval of Amendment 3 and the MOU.

The Attorney General claimed that South Kentucky RECC, as a "novice" in negotiating or analyzing transactions such as the PPA, failed to conduct appropriate due diligence and, as a result, the PPA poses an unreasonable risk that significantly outweighs any purported benefit to South Kentucky RECC or its members.<sup>43</sup> The Attorney General argued that the case record is devoid of any risk analysis regarding changing market conditions arising from the 20-year term of the PPA, which is significantly longer than typical for power purchase agreements, or regarding the potential for South Kentucky RECC to incur increased costs arising from the ECL provision in the PPA. This is especially so given that, unlike EKPC, MSCG is exposed to environmental law changes in all 13 states in the PJM footprint, which increases the risk that the ECL provision will be triggered.<sup>44</sup> The Attorney General further argued that South Kentucky RECC failed to consider all relevant costs, such as EKPC moving to a cost-based rate design to reduce or eliminate the impact of cost shifting, which, in turn, would eliminate the majority of the purported cost savings because they are based on avoided costs.

The Attorney General maintained that, under Commission precedent, South Kentucky RECC must demonstrate a need for the proposed PPA and an absence of wasteful duplication, as required by KRS 278.020(1). The Attorney General asserted that

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<sup>43</sup> Attorney General's Post-Hearing Brief (filed July 2, 2018) at 16–17.

<sup>44</sup> *Id.* at 15 (citing Direct Testimony of Don Mosier (Mosier Direct Testimony) at 2–3).

South Kentucky RECC failed to demonstrate a substantial inadequacy of the existing service received from EKPC, and thus failed to demonstrate the need for the PPA. The Attorney General further asserted that, because the EKPC system is planned and operated as a whole, South Kentucky RECC failed to demonstrate that the PPA would not result in a wasteful duplication of service given that EKPC has no plans to add generating capacity until 2026, and its summer reserve margin exceeds the level required for a member of PJM.

Finally, the Attorney General argued that the PPA would shift costs to other Owner-Members, resulting in discriminatory, unfair, unjust, and unreasonable rates in violation of KRS 278.170(1) and KRS 278.030(1). The Attorney General explained that, under the PPA, South Kentucky RECC would avoid a portion of the fixed and variable costs for the EKPC system that are allocated to South Kentucky RECC, which would require EKPC to re-allocate the fixed costs among the other Owner-Members. In support of this assertion, the Attorney General claimed that \$15.9 to \$18.3 million in costs that South Kentucky RECC committed to pay would be shifted to other Owner-Members in order for South Kentucky RECC members to obtain a \$5.9 million cost savings.<sup>45</sup> Further, allowing South Kentucky RECC to “abrogate [its] prior commitments to pay its full share of the EKPC systems costs” results in a rate reduction that makes South Kentucky RECC’s “retail rates appear more attractive” than the remaining Owner-Members’ rates, which must be increased to cover the cost shifting.<sup>46</sup>

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<sup>45</sup> *Id.* at 13 (*citing* Direct Testimony of John Wolfram (Wolfram Direct Testimony) at 21–23, and Exhibit JW-2).

<sup>46</sup> *Id.* at 10–11.

As noted above, South Kentucky RECC argued that the Owner-Members and EKPC were aware of the possibility of cost shifting when they signed Amendment 3 and the MOU. In rebuttal, the Attorney General reasoned that the Owner-Members “clearly did not understand the potential for cost-shifting and the ramifications” because it would have been “illogical” for the Owner-Members to agree to something that causes financial harm to themselves and their members.<sup>47</sup>

Also, as noted above, South Kentucky RECC asserted that EKPC said it could mitigate the loss of load from the PPA, which would mitigate cost shifting. In response, the Attorney General pointed to testimony that EKPC’s mitigation statements were based on an incorrect understanding that South Kentucky RECC would only obtain 19 MW, when South Kentucky RECC actually sought a significantly greater amount of alternate source power. The Attorney General also pointed to EKPC’s testimony that it could partially mitigate the impact of base rate increases given sufficient time, and that EKPC could not mitigate the permanent cost shifts that will force other Owner-Members to raise their rates.

In response to South Kentucky RECC’s argument that the filed rate doctrine precluded the Commission from retroactively altering the MOU to nullify South Kentucky RECC’s election, the Attorney General stated that the Commission has clear authority under statutory and case law to modify or vacate a previous order that is subsequently determined to have violated KRS Chapter 278.<sup>48</sup> The Attorney General declared that the

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<sup>47</sup> Attorney General’s Post-Hearing Brief at 6.

<sup>48</sup> *Id.* at 24–25 (citing KRS 278.390 and *Union Light, Heat & Power Co. v. Public Svc. Comm’n*, 271 S.W.2d 361, 365–366 (Ky. App. 1954)).

Commission has both the authority and the responsibility to rescind its prior approval of the MOU and Amendment 3 because they—and the PPA—result in discriminatory preferences and unjust, unfair, and unreasonable rates in violation of provisions in KRS Chapter 278. Additionally, the Attorney General contended that the Commission should rescind Amendment 3 and the MOU because the unequal opportunities under those agreements resulted in “palpable conflict” among the Owner-Members and EKPC that is contrary to cooperative principles and impedes the governance of EKPC.<sup>49</sup>

#### Summary of Cumberland Valley Electric’s Argument

Cumberland Valley Electric intervened as a party to this proceeding, but filed testimony and briefs as one of the Joint Intervenors.

#### Summary of EKPC’s Argument

EKPC asserted that the PPA should be denied because South Kentucky RECC failed to satisfy standards to approve a PPA as an evidence of indebtedness under KRS 278.300 or satisfy KRS 278.020(1) requirements regarding need and absence of wasteful duplication standards, and because the transaction results in rates that are not fair, just, and reasonable, as required by KRS 278.030(1).

EKPC rejected South Kentucky RECC’s assertions that the filed rate doctrine limited the Commission’s review of the PPA. First, EKPC argued that the Commission’s statutory authority over utility rates and service could not be contractually modified. Second, EKPC questioned whether the Commission had found the MOU reasonable, arguing that the Commission has never held that the MOU “was *ipso facto* fair, just and

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<sup>49</sup> *Id.* at 22.



reasonable, necessary and not duplicative.”<sup>50</sup> Last, EKPC asserted that the contractual ability to enter into an alternate source election under the MOU does not prevent the Commission from reviewing whether the transaction is fair, just, and reasonable.

EKPC argued that South Kentucky RECC failed to satisfy the standard of review set forth in KRS 278.300 because it failed to demonstrate that the PPA was financially prudent and would not impair South Kentucky RECC’s ability to provide service to its members. EKPC alleged that in South Kentucky RECC’s “rush to maneuver to the perceived ‘front of the line,’” it failed to conduct reasonable due diligence given the nature, length, and magnitude of the transaction.<sup>51</sup> In support of its argument that the PPA is not financially prudent, EKPC asserted that South Kentucky RECC failed to analyze the possibility that EKPC’s rate structure could change to eliminate an Owner-Member’s ability to avoid fixed costs. Given that the purported cost savings arise from avoided costs, any change to EKPC’s rate structure that eliminates an Owner-Member’s ability to avoid fixed costs eliminates the primary foundation for cost savings to South Kentucky RECC’s members.

EKPC argued that South Kentucky RECC and its members face financial liability associated with the ECL provision. South Kentucky RECC acknowledged that it had not conducted due diligence regarding the risk of additional environmental costs, explaining that it believed any changes in environmental laws would apply equally to EKPC and to MSCG. South Kentucky RECC also believed the ECL provision applied to carbon or greenhouse gas fees and taxes, but not to capital investment or O&M costs. EKPC stated

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<sup>50</sup> EKPC Post-Hearing Brief (filed July 2, 2018) at 15.

<sup>51</sup> *Id.* at 23.

that South Kentucky RECC could not point to any provision in any of the PPA documents to support its interpretation of the ECL provision and that South Kentucky RECC's interpretation was contrary to express language in the PPA documents.<sup>52</sup>

EKPC further argued that the NPV analysis, which provided the financial underpinning to the projected costs savings, contained significant errors in assumptions and projections. These errors included applying incorrect rate schedules; calculating the NPV based on lower, incorrect rates; and substantial underestimates of costs that, with minimal effort, could have been correctly determined. EKPC provided a schedule with its adjustments to the NPV, including transmission escalation factors based on historical information, that reduced the NPV valuation between 83 percent and 108 percent.<sup>53</sup>

EKPC contended that South Kentucky RECC failed to demonstrate a need for the PPA or that the PPA will not result in wasteful duplication, and therefore had not satisfied KRS 278.020(1). EKPC refuted South Kentucky RECC's argument that "need" can be satisfied by cost savings, explaining that the Commission's standard of review clearly defines indices of need as inadequate or unreliable service. EKPC argued that South Kentucky RECC never claimed or documented that EKPC's service has been inadequate or unreliable, and therefore never demonstrated a need for the PPA.

EKPC disputed South Kentucky RECC's assertion that the wasteful duplication standard is inapplicable to the PPA. EKPC argued that, despite South Kentucky RECC's attempt to characterize the transaction as replacement rather than supplemental

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<sup>52</sup> *Id.* at 26 (*citing* May 15, 2018 HVT at 11:50:40, 3:47:50; May 16, 2018 HVT at 10:41:35, 11:28:22, and 11:55).

<sup>53</sup> Direct Testimony of Mike McNalley (McNalley Direct Testimony) at 16–17; Mosier Direct Testimony at 11–12 (reflecting average escalation of EKPC's transmission rates between 2012 and 2017 of 8.068 percent and average change in PJM's transmission service charges of 13.08 percent).

generation, the PPA duplicates the service currently provided by EKPC, and therefore creates an excess of capacity over need. EKPC pointed out that its generation assets were constructed and financed with the authority of its Owner-Member Board for the benefit of the Owner-Members. Because of that, EKPC argued that securing another power supply for over 40 percent of South Kentucky RECC's energy when there is no demonstrated need constitutes a wasteful duplication of EKPC's generation assets.

Finally, EKPC argued that when balancing the interests of all the parties, the PPA does not result in rates that are fair, just, and reasonable, and therefore should be denied. EKPC cited case law to support its position that, in considering whether the PPA is fair, just, and reasonable, the Commission must consider the "full costs" over the "full term" of the PPA and must balance the interests of all parties impacted by the PPA.<sup>54</sup> EKPC estimated a \$17.1 million annual cost shift to other Owner-Members, based on actual 2017 billing records, which compares to testimony from Joint Intervenors estimating annual cost shifts between \$15.9 million and \$18.3 million.<sup>55</sup> Based on cost shifting to other Owner-Members, EKPC argued that the PPA does not result in fair, just, and reasonable rates.

EKPC disputed South Kentucky RECC's argument that EKPC can mitigate the load loss and thus avoid cost shifts. EKPC argued that South Kentucky RECC based its assumption on informal discussions held with EKPC executives several months before South Kentucky RECC issued its initial request for proposals for the alternate source.

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<sup>54</sup> *Id.* at 37–38 (citing *Ky. Indus. Utility Customers, Inc. v. Public Svc. Comm'n*, 504 S.W.3d 695, 705 (Ky. App. 2016)).

<sup>55</sup> *Id.* at 39 (citing Wolfram Direct Testimony at 18).

EKPC further argued that the discussions were in general terms and that South Kentucky RECC failed to indicate it was seeking 24/7/365 power or a 100 percent load factor. Thus, any discussion of mitigation was preliminary and based on much lower amounts of alternate source power than the PPA.

In its post-hearing brief, EKPC stated that, after the formal hearing, its board passed a resolution with recommendations for modifying Amendment 3 and the MOU. Because EKPC's board action is outside this proceeding, the Commission will not consider the recommendations as evidence in the case record.

#### Summary of Grayson RECC's Argument

In filed testimony, Grayson RECC stated that it did not object to South Kentucky RECC's request to enter into the PPA so long as the transaction did not result in "inequitable and detrimental cost shifting" to the other Owner-Members.<sup>56</sup> However, Grayson RECC recommended that, if the Commission determined that the cost shifting estimates were credible, the PPA be denied because the other Owner-Members would pay substantially more in power costs than the proposed savings to South Kentucky RECC.<sup>57</sup>

Grayson RECC declared that the filed rate doctrine is not relevant to this matter because the primary dispute is whether the PPA results in fair, just, and reasonable rates and the filed rate doctrine is not applicable to an evaluation whether rates are fair, just, and reasonable.

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<sup>56</sup> Direct Testimony of Carol Ann Fraley at 6.

<sup>57</sup> *Id.*; Grayson RECC Post-Hearing Brief (filed July 2, 2018) at 8.

Grayson RECC recommended that the Commission modify the MOU to provide Owner-Members with equitable access to alternate power. Grayson RECC maintained the Commission has the authority under KRS 278.030(1), KRS 278.170, and KRS 278.260 to investigate whether the MOU results in fair, just, and reasonable rates that are not unreasonably discriminatory, and, if it is not, to prescribe a fair, just, and reasonable rate to be followed in the future. Grayson RECC also cited to case law to support its position that the Commission can review contracts, such as the MOU, to ensure the rates are fair, just, and reasonable, and that prior approval of a contract does not prevent the Commission from prospectively changing the rate.<sup>58</sup>

#### Summary of Jackson Energy's Argument

Jackson Energy opposed South Kentucky RECC's request for approval of the PPA, arguing that any financial benefit obtained by South Kentucky RECC resulted from cost shifting, and thus came at the expense of the remaining Owner-Members and their members.<sup>59</sup> Jackson Energy acknowledged that if there were no cost shifting, it would not be opposed to the PPA.<sup>60</sup>

Jackson Energy argued that the PPA should not be approved as evidence of indebtedness under KRS 278.300 because it subjects South Kentucky RECC and its members to unreasonable risks that have not been adequately investigated or mitigated. Those risks include cost impacts from changes in environmental law, changes in network

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<sup>58</sup> Grayson RECC Post-Hearing Brief at 13–16 (*citing Nat'l-Southwire Aluminum Co. v. Big Rivers Elec. Corp.*, 785 S.W.2d 503 (Ky. App. 1990); *Bd. of Ed. of Jefferson Co. v. William Dohrman, Inc.* 620 S.W.2d 328 (Ky. App. 1981); *Fern Lake Co. v. Public Svc. Comm'n*, 357 S.W.2d 701 (Ky. 1962)).

<sup>59</sup> Jackson Energy's Post-Hearing Brief (filed July 2, 2018) at 3–4.

<sup>60</sup> May 16, 2018 HVT at 3:52:14.

integrated transmission service (NITS) and PJM charges, and lower capacity price than the fixed hedge price. Jackson Energy further argued that South Kentucky RECC failed to satisfy the elements of KRS 278.020(1) because South Kentucky RECC failed to demonstrate that the PPA is needed to serve its power supply and because the PPA duplicates the resources already developed by EKPC to serve South Kentucky RECC and the other Owner-Members, and therefore results in a wasteful duplication of services.

Jackson Energy argued that the PPA violates KRS 278.170(1) because it would result in an unreasonable preferential treatment to South Kentucky RECC. Jackson Energy maintains that because the EKPC system was constructed to serve its Owner-Members, approving the PPA “undermines the financial foundation of EKPC and the equity all owner-members have in that system” by allowing South Kentucky RECC to avoid a portion of the fixed costs of the EKPC system.<sup>61</sup> Jackson Energy argued that other Owner-Members’ members would have to pay higher rates in order to mitigate the significant financial impact from cost shifting, which would result in preferential treatment to South Kentucky RECC at the expense of the other Owner-Members.

Jackson Energy disputed that the MOU is a filed rate, and therefore concluded that the filed rate doctrine does not apply to the PPA. Jackson Energy asserted that if the MOU were a filed rate, the Commission “always maintains the right and authority” to review the MOU and PPA.<sup>62</sup>

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<sup>61</sup> Jackson Energy Post-Hearing Brief at 8–9.

<sup>62</sup> *Id.*

### Summary of Joint Intervenors' Argument

Joint Intervenors' requested that the Commission deny the PPA and declare Amendment 3 and the MOU invalid.

Concerning South Kentucky RECC's assertion regarding the filed rate doctrine, Joint Intervenors argued that the Commission could prospectively modify Amendment 3 and the MOU because KRS 278.270 and KRS 278.280(1) authorize the Commission to modify utility rates or service found to be unjust, unreasonable, or insufficient.

Joint Intervenors argued that the PPA should not be approved as evidence of indebtedness under KRS 278.300 because South Kentucky RECC failed to perform proper due diligence and, as a result, the PPA would impair South Kentucky RECC's ability to provide service and would expose members to substantial financial risk. Joint Intervenors accused South Kentucky RECC of "grossly underestimating" potential costs, which results in "little to no savings" under the PPA.<sup>63</sup> As an example, Joint Intervenors asserted that South Kentucky RECC utilized a lower escalation factor in NITS costs than EKPC's historical NITS escalation factor of 10 to 13 percent.<sup>64</sup> Joint Intervenors explained that using a 10 percent escalation factor for NITS costs produces an 83 percent reduction in the NPV or potential savings under the PPA of only \$20 million.<sup>65</sup> Using a 13 percent escalation factor produces a 108 percent reduction in the NPV, with a loss under the PPA of \$9.2 million.<sup>66</sup> Joint Intervenors delineated other errors or underestimated costs, including South Kentucky RECC's failure to evaluate the

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<sup>63</sup> Joint Intervenors' Post-Hearing Brief (filed July 2, 2018) at 32, 34.

<sup>64</sup> *Id.* at 36 (*citing* Mosier Direct Testimony at 12, 18–19).

<sup>65</sup> *Id.* at 37 (*citing* McNalley Direct Testimony at 16, 22–23).

<sup>66</sup> *Id.* (*citing* McNalley Direct Testimony at 17 and Exhibit MM-3, sheet 1).

consequences of a change in EKPC's rate design to reduce or eliminate cost shifting, which would further reduce the projected cost savings from the PPA. Joint Intervenors stressed that South Kentucky RECC's failure to conduct any analysis of its exposure to additional costs from the ECL provision is especially concerning, given that South Kentucky RECC interprets the ECL provision in a manner different from the actual language of the ECL. Joint Intervenors claimed that South Kentucky RECC "oversimplifies" the financial risk from the PPA.<sup>67</sup> South Kentucky RECC said it faces equivalent financial risk from additional financial costs whether it purchases energy from EKPC or under the PPA. Joint Intervenors noted that the PPA is not tied to a specific generation unit, thus it is unreasonable to conclude changes in environmental law will have an equivalent impact. Based upon evidence filed by Joint Intervenors, South Kentucky RECC conceded certain errors in the NPV analysis and decreased the NPV by \$10.4 million.

Next, Joint Intervenors argued that South Kentucky RECC failed to satisfy the need for additional generation and the absence of wasteful duplication under KRS 278.020(1). South Kentucky RECC asserted that it satisfied the need requirement because, under the terms of Amendment 3 and the MOU, it cannot obtain energy from EKPC in an equivalent amount to the alternate source election beginning 18 months after giving notice of its election to purchase alternate source power. Joint Intervenors asserted that this argument is illogical because South Kentucky RECC "cannot create a need in order to satisfy the need requirement" when it did not have a need before signing the PPA.<sup>68</sup> Joint

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<sup>67</sup> Wolfram Direct Testimony at 12.

<sup>68</sup> Joint Intervenors' Post-Hearing Brief at 40.



Intervenors noted that EKPC and other Owner-Members said they would waive the contractual 18-month waiting period, which removed the alleged “need” to obtain energy from a source other than EKPC.

Finally, Joint Intervenors argued that the PPA should be denied because it will cause an unfair, unjust, and unreasonable shift of costs from South Kentucky RECC to the other Owner-Members. Joint Intervenors presented expert testimony that the annual cost shift for the environmental surcharge would be \$4.3 million and the annual cost shift for fixed costs would be between \$15.9 million and \$18.3 million but could increase to \$33.0 million to \$36.0 million per year.<sup>69</sup> The Joint Intervenors discussed testimony that EKPC could not immediately mitigate the entire 58 MW load loss and is unlikely to mitigate this loss in the foreseeable future.<sup>70</sup> Joint Intervenors argued that, based on the cost shifting, South Kentucky RECC cannot meet its burden to establish that the PPA is fair, just, and reasonable, and therefore should be denied.

Joint Intervenors argued that Amendment 3 and the MOU should be declared invalid, on a prospective basis, because the purported benefits of the alternate source provision are allocated on an unreasonably discriminatory basis and the effects of Amendment 3 and the MOU—such as cost shifting—are unfair, unjust, and unreasonable. Joint Intervenors declared that Amendment 3 and the MOU promote conflict among the Owner-Members and is antithetical to cooperative principles.

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<sup>69</sup> *Id.* at 44–45.

<sup>70</sup> *Id.* at 43 (*citing* McNalley Direct Testimony at 5, 7, 10–12).

## Summary of Nucor's Argument

Nucor recommended that South Kentucky RECC's request for approval of a PPA be rejected for failing to comply with the filed rate doctrine, for violating the non-discrimination provisions of KRS 278.170(1), for violating the requirement of KRS 278.030(1) that rates must be fair, just, and reasonable, and for violating the prohibition against wasteful duplication in KS 278.020(1). Nucor proposed that the Commission modify Amendment 3 and the MOU. Nucor also proposed that the Commission approve cost-based rate design with fixed costs recovered in demand rates, rather than in energy rates, to lessen the type of cost shifting at issue in this proceeding.

Nucor claimed that the PPA violated the terms of Amendment 3 and the MOU, and therefore violated the filed rate doctrine because (1) Amendment 3 and MOU require the Owner-Member to "displace a proportional share of Owner-Member load"<sup>71</sup> with alternate source power, but South Kentucky RECC seeks to purchase a 100 percent load factor, which is higher than its actual load factor of 41.17 percent;<sup>72</sup> (2) South Kentucky RECC is effectively purchasing 40 percent of its energy from an alternate source, and not the 15 percent maximum as set forth in Amendment 3 and the MOU; (3) the intent of Amendment 3 was for alternate power to come from behind-the-meter generation facilities owned, purchased, or leased by the Owner-Member, and that purchases not tied to specific generation, such as the PPA, were not contemplated, and (4) South Kentucky RECC's notice to EKPC was deficient because it did not identify that the power would be

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<sup>71</sup> *Id.* at 3.

<sup>72</sup> *Id.* at 4 (*citing* Nucor's Hearing Exhibit 1).

purchased from MSCG and because it did not identify a specific generating unit, as required by the MOU.

Nucor argued that the PPA violates the non-discrimination provisions of KRS 278.170(1) because South Kentucky RECC will receive an unreasonable preference over similarly situated Owner-Members. Nucor explained that the MOU alternate source allocation methodology creates three classes of Owner-Members regarding the election to purchase power from an alternate source: those that can acquire 15 percent of their peak demand; those that can acquire 5 percent of their peak demand; and those that cannot obtain any power from an alternate source because the 5 Percent Cap has been reached. Nucor asserted that the MOU allocation methodology results in unequal distribution of the opportunity to purchase power from an alternate source based upon nothing more than timing. Nucor proposed that the Commission amend the MOU to limit each Owner-Member to alternate source power equal to 5 percent of the Owner-Members respective peak demands.

Nucor claimed that the PPA would result in an unreasonably prejudicial cost shift to the other Owner-Members in violation of the KRS 278.030(1) requirement that rates be fair, just, and reasonable. In support of its assertion, Nucor argued that other Owner-Members “will be forced to pick up the tab for EKPC’s lost margins.”<sup>73</sup> Nucor pointed to testimony that South Kentucky RECC would receive an annual cost savings of \$5.9 million, while the other Owner-Members would bear a \$15.9 million to \$18.3 million annual

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<sup>73</sup> Nucor’s Post-hearing Brief at 7–8.

cost increase if the PPA is approved.<sup>74</sup> Nucor asserted that it would pay \$1.0 million more per year due to cost shifting if the PPA is approved.

Nucor contended that South Kentucky RECC's argument that it was "supplementing" generation and not "replacing" generation was disingenuous and that South Kentucky RECC was required to demonstrate a need for the PPA and an absence of wasteful duplication, per KRS 278.020(1). Nucor asserted that need and absence of wasteful duplication should be analyzed from the perspective of the EKPC system because the EKPC system is planned and operated as a whole. For example, electric generating utilities are required to file their respective integrated resource plan (IRP) with the Commission to ensure that they meet future demand with an adequate and reliable supply of electricity.<sup>75</sup> Because the EKPC system is owned by the Owner-Members, the Owner-Members' respective loads are included in EKPC's IRP rather than requiring Owner-Members to file their own IRP. As a member of PJM, EKPC's capacity obligation is based on its summer load. Since EKPC's summer load is significantly less than its summer capacity, EKPC has surplus capacity, which, according to Nucor, negates the need for the PPA and supports a conclusion that the PPA results in wasteful duplication of facilities.

Nucor suggested modifications to Amendment 3 and the MOU.

#### Summary of Owen Electric's and Shelby Energy's Argument

Owen Electric and Shelby Energy jointly requested that the Commission deny South Kentucky RECC's request for approval of the PPA. Owen Electric and Shelby

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<sup>74</sup> *Id.* at 8 (citing Wolfram Direct Testimony at 21–23 and Exhibit JW-2).

<sup>75</sup> 807 KAR 5:058.

Energy adopted the arguments in Nucor's and the Joint Intervenors' respective post-hearing briefs. In joint written testimony, Owen Electric and Shelby Energy are concerned about cost shifting to other Owner-Members from South Kentucky RECC's avoided costs and the economic impact on residential and industrial consumers if the PPA is approved.<sup>76</sup>

#### Summary of Salt River Electric's Argument

Salt River Electric did not file testimony or a post-hearing brief but did file a response to EKPC's post-hearing brief. Salt River Electric argued that EKPC and the Owner-Members signed Amendment 3 and the MOU, therefore, they should honor the terms. Salt River Electric contended that cost shifting would be avoided if all Owner-Members exercised their right to buy from an alternate source.<sup>77</sup>

#### Summary of Taylor County RECC's Argument

Taylor County RECC did not file witness testimony or file a post-hearing brief. Taylor County RECC filed notice that it adopted the positions of the Joint Intervenors and Nucor, as set forth in their respective post-hearing briefs.

### DISCUSSION AND FINDINGS

#### KRS 278.300 Evidence of Indebtedness

Having reviewed the case record and being otherwise sufficiently advised, the Commission finds that South Kentucky RECC failed to present sufficient evidence to

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<sup>76</sup> Direct Testimony of Mark Stallons at 9.

<sup>77</sup> Salt River Electric did not address that the 5 Percent Cap would be exceeded before all Owner-Members exercised their option, and therefore not all Owner-Members could elect to obtain power from an alternate source.

satisfy its burden of proof regarding KRS 278.300, and its application for approval of the PPA should be denied.

South Kentucky RECC failed to demonstrate that the PPA is for a lawful object. South Kentucky RECC's claim that the PPA is for a lawful object because South Kentucky RECC's corporate purpose is to provide safe, reliable, cost-effective service does not withstand scrutiny. Under Commission precedent, we evaluate the purpose and use of the PPA as the acquisition of new generation. This is especially so in this proceeding given that the contract would provide 40 percent of South Kentucky RECC's energy over two decades. Thus, the lawful object we evaluate under KRS 278.300 is not cost savings for South Kentucky RECC but EKPC's need for additional generation and the absence of wasteful duplication. South Kentucky RECC never discussed, much less established, that EKPC is not providing reliable, adequate energy under the Wholesale Power Contract or that the PPA is necessary to have sufficient energy to serve its members. South Kentucky RECC's argument that there cannot be wasteful duplication because South Kentucky RECC does not own generation assets is without merit. As one of EKPC's owners, South Kentucky RECC shares ownership of EKPC's generation assets, which have a generating capacity that exceeds the Owner-Members' summer loads. The evidentiary record supports the conclusion that the PPA duplicates existing resources, and results in wasteful duplication.

South Kentucky RECC failed to provide substantial evidence that demonstrated that the PPA would not impair its ability to provide service and is necessary to provide service. The case record is replete with evidence that South Kentucky RECC underestimated significant costs, such as transmission cost escalation, which creates

questions about the actuality of the projected cost savings. The case record is also replete with evidence that South Kentucky RECC failed to adequately consider or mitigate the financial impact of identified risks, including the ECL and the potential for change in EKPC rate design to capture a greater amount of fixed costs in a demand charge. South Kentucky RECC's interpretation of the ECL is of particular concern because it does not align with the express language of the ECL provisions. The underestimated costs and failure to consider identified risks creates questions about the financial viability of the PPA. Further, the case record supports a finding that South Kentucky RECC has not demonstrated that it has technical or managerial experience or knowledge to operate in the PJM marketplace, which presents a risk to South Kentucky RECC's ability to provide service to its members. Last, for the same reasons discussed above, South Kentucky RECC failed to establish that the PPA was necessary to provide service to its members.

KRS 278.020(1)

For the reasons discussed in the previous section, the Commission finds that South Kentucky RECC has not satisfied KRS 278.020(1) because it has not sufficiently established that there is a need for the PPA and that the PPA will not result in wasteful duplication.

South Kentucky RECC's argument that KRS 278.020(1) is inapplicable because the PPA replaces, but does not supplement, generation is not persuasive. The Commission notes that, as a co-owner of EKPC generating assets, South Kentucky RECC seeks to obtain 40 percent of its energy from a source other than EKPC for 20 years. Given the facts of the case, South Kentucky RECC's argument is without merit and fails to provide a basis for the Commission to set aside its precedential findings that

entering into a long-term contract to purchase generation has the same operational and financial impact as if new generation were being constructed, and it should be evaluated under KRS 278.020(1).

#### Applicability of the Filed Rate Doctrine to the PPA

South Kentucky RECC asserted that, under the filed rate doctrine, the Commission is precluded from evaluating whether the PPA results in fair, just, and reasonable rates because the PPA is authorized by and strictly complied with a filed tariff, the MOU.

As a threshold issue, South Kentucky RECC misrepresented a previous Commission proceeding and incorrectly asserted that the Commission will not review a filed rate under the fair, just, and reasonable standard when the rates in a tariff have been found reasonable and the tariff has been strictly complied.<sup>78</sup> The Commission dismissed that matter under the filed rate doctrine because the complainants did not allege tariff violations, and under the *res judicata* doctrine, because the same parties sought to relitigate the same issues that were previously decided on the merits under the same facts and circumstances regarding the impact of the tariff, which had not changed over time.<sup>79</sup> Nowhere in the Order cited by South Kentucky RECC did the Commission decline to review a filed tariff under the fair, just, and reasonable standard.

The Commission has express statutory authority to investigate whether rates are fair, just, reasonable, and not unjustly discriminatory. KRS 278.270 states:

Whenever the [C]ommission . . . after a hearing had upon reasonable notice, finds that any rate is unjust, unreasonable, insufficient, unjustly discriminatory, or otherwise in violation of any of the provisions of this chapter, the [C]ommission shall

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<sup>78</sup> Seelye Rebuttal Testimony at 14 (*citing* Case No. 2015-00417, June 29, 2016 Order at 10–11).

<sup>79</sup> Case No. 2015-00417, (Ky. PSC June 29, 2016).



by order prescribed a just and reasonable rate to be followed in the future.

KRS 278.280 similarly states that whenever the Commission finds that any practice or service employed by a utility is not fair, just, or reasonable, or unjustly discriminates, the Commission can establish a just and reasonable practice to be followed in the future. Thus, the Commission has the statutory authority to modify utility rates, service, or practices once the Commission determines that the rates, service, or practices are not fair, just, and reasonable. However, the changes to rates and service apply on a prospective basis.

Here, the substantial evidence in the record regarding the resulting significant cost shifting under the PPA supports a finding that the PPA is not fair, just, and reasonable, and is unjustly discriminatory. The PPA is fundamentally different from existing alternate source facilities, which are typically small, community-driven projects that generate between 1.0 and 3.6 MW of alternate source power.<sup>80</sup> The Commission has not previously addressed the issue of cost shifting due to alternate source elections, and it appears that any cost shifting due to existing alternate source power facilities is *de minimus*. Here, based on the substantial evidence in the record, the Commission finds that implementing the PPA results in annual costs shifts to other Owner-Members between \$15.9 million and \$18.3 million. The Commission further finds that the cost shifts derive from South Kentucky RECC avoiding costs that were incurred on its behalf as a co-owner of EKPC, to the detriment of other Owner-Members that also co-own EKPC.

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<sup>80</sup> Application at 4, FN 58; South Kentucky RECC Response to Commission Staff's First Request for Information, Item 14.

Therefore, the PPA results in unfair, unjust, and unreasonable rates, and is unjustly discriminatory.

In regard to the filed rate doctrine, we are persuaded that, at a minimum, South Kentucky RECC failed to adhere to the notice requirements for alternate source elections in the MOU, and thus did not strictly comply with the MOU. However, we decline to address this issue because it is now moot, based on our finding that South Kentucky RECC failed to satisfy KRS 278.300 and KRS 278.020(1), and because the PPA is not fair, just, and reasonable.

#### Commission's Authority to Modify or Revoke Amendment 3 and the MOU

South Kentucky RECC argued that, under the filed rate doctrine and contract principles, the Commission does not have authority to modify or revoke Amendment 3 or the MOU.

As discussed in the above section, the Commission has the statutory authority, pursuant to KRS 278.270 and KRS 278.280, to review whether the MOU, as a filed rate, is fair, just, and reasonable. If the Commission finds that the MOU does not result in a fair, just, and reasonable rate or service, we can establish a just and reasonable rate or practice to be followed in the future.

The Commission has similar authority to modify or revoke contracts, including Amendment 3 and the MOU. Under well-settled case law, the Commission's exclusive jurisdiction to regulate a utility's rates and services under KRS 278.040(2) cannot be limited by a contract. The Commission has authority to change rates "upon a proper showing and . . . its power may not be limited by contract."<sup>81</sup> Moreover, prior approval of

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<sup>81</sup> *Fern Lake Co. v. Pub. Serv. Comm'n*, 357 S.W.2d 701, 704 (Ky. 1962).

a contract does not prevent the Commission from prospectively changing the rate.<sup>82</sup> The Commission also has “the right and duty to regulate rates and services, no matter what a contract provide[s].”<sup>83</sup>

Relevant to this proceeding, the MOU was filed as a special contract and part of EKPC’s tariff pursuant to our Order in Case No. 2012-00503; the same case where the Commission found that Amendment 3 relates to utility rates and service.<sup>84</sup> In that case, the Commission explained that because the Wholesale Power Contract contains provisions relating to utility rates and service as defined in KRS 278.010(12) and (13), it is within the Commission’s jurisdiction. Both Amendment 3 and the MOU modify the Wholesale Power Contract by creating a right for Owner-Members to purchase a limited quantity of power from alternative sources, and therefore are special contracts between EKPC and the Owner-Members that govern utility rates and service. As special contracts that govern utility rates and service, any issue that arises under Amendment 3 and the MOU that pertains to rates or service is subject to the Commission’s jurisdiction.

Having established our authority, we now review whether Amendment 3 and the MOU satisfies the requirements in KRS 278.030(1) and KRS 278.170(1) that rates be fair, just, and reasonable, and not unduly discriminatory.

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<sup>82</sup> *Id.*

<sup>83</sup> *Bd. of Ed. of Jefferson County v. William Dohrman, Inc.*, 620 S.W.2d 328, 329 (Ky. App. 1981); see also *National-Southwire Aluminum Co. v. Big Rivers Elec. Corp.*, 785 S.W.2d 503, 517 (Ky. App. 1990) (“Kentucky law generally holds utility contracts are subject to rate changes ordered by the PSC, no matter what the contracts provide.”) (citing *William Dohrman, Inc.*, 620 S.W.2d at 329 (Ky. App. 1981)).

<sup>84</sup> Case No. 2012-00503, *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.* (Ky. PSC July 17, 2013) at 15.

Based upon the evidence in the case record, the Commission finds that Amendment 3 and the MOU violate KRS 278.030(1) because they result in rates and service that are not fair, just, and reasonable, and violate KRS 278.170(1) because they result in rates and service that are unjustly discriminatory.

Despite South Kentucky RECC's argument, the Commission did not find that Amendment 3 and the MOU resulted in reasonable rates or service when we approved the settlement in Case No. 2012-00503, which was contained in the MOU.<sup>85</sup> As discussed above, the alternate source election provisions in Amendment 3 and the MOU could result in significant cost shifting and stranded costs. Given that the Owner-Members approved the construction and financing of EKPC's generating assets and given that much of the cost shifting arises from fixed costs related to those generating assets, permitting an Owner-Member to avoid costs it previously agreed to incur by shifting those costs to other Owner-Members is not fair, just, or reasonable.

The case record includes substantial evidence that the allocation methodology provision in Amendment 3 and the MOU creates three classes: those that can obtain up to 15 percent of their peak demand from an alternate source; those that can obtain up to 5 percent; and those that are prevented from obtaining any alternate source power. As the facts of this case show, Owner-Members are deprived of the opportunity to elect an alternate source of energy that should be equally available to all Owner-Members based on nothing more than timing. The existing allocation methodology rewards early actors, which can take a larger share of the opportunity, and penalizes the remaining Owner-Members, without a rational basis to justify the unequal distribution of opportunity.

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<sup>85</sup> See *Id.* at 5.

We are not persuaded by South Kentucky RECC's argument that the parties are sophisticated corporate entities that knowingly agreed to the allocation methodology provisions in the MOU. As is clear from the case record,<sup>86</sup> the parties entered into the MOU for the sole purpose of ending multi-year litigation in state court and at the Commission that had become too expensive to continue. According to at least one Owner-Member, the MOU only addressed alternate source election notice provisions and did not address the inequities in the allocation methodology because the parties could not agree.<sup>87</sup> South Kentucky RECC's argument that the parties knowingly agreed to retain the inequities is refuted by the case record, which instead reflects that ongoing bickering prevented the parties from resolving the allocation inequities.

The Commission's finding in Case No. 2012-00503 that the MOU "results in a reasonable resolution" of issues, including allocation methodology, does not equal a finding that the MOU methodology is fair, just, and reasonable, or that it avoids unjust preference. When the parties unanimously moved to dismiss that proceeding because they had agreed to the MOU to settle the matter, the case had been pending before the Commission for three years. The Commission granted the motions to dismiss without a formal hearing or taking additional evidence. Notably, when the Order was entered in Case No. 2012-00503, there were no expectations that Owner-Members would pursue anything other than relatively small sources of alternate power, which was consistent with actions taken up through that point in time. However, it is now apparent that the

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<sup>86</sup> May 16, 2018 HVT at 3:56:27; May 17, 2018 HVT at 2:46:40, 2:56:45, and 3:47:04; Joint Intervenor Post-Hearing Brief, pages 3–4; and EKPC Post-Hearing Brief at 7–8.

<sup>87</sup> May 16, 2018 HVT at 3:58:52.

methodology results in an arbitrary distribution of the opportunity to purchase alternate source of power, which is not fair, just, or reasonable, and results in unjust preferences.

Because of the cost shifting and the allocation methodology, Amendment 3 and the MOU permit one Owner-Member to receive a benefit that is subsidized by other Owner-Members, which may be unable to exercise a similar option for alternate source power.

Pursuant to KRS 278.270 and KRS 278.280, the Commission's finding that Amendment 3 and the MOU are not fair, just, and reasonable and result in unjust preference, applies prospectively. Thus, from the date of the entry of this Order, the alternate source power provisions in Amendment 3 and the MOU are stricken from EKPC's tariff and no further alternate source power elections are permissible.

Because it applies prospectively, the existing alternate source facilities are not impacted by this finding. The PPA is not an existing alternate source because it was conditioned upon a final, non-appealable order from the Commission and the Commission had not approved the PPA prior to finding that Amendment 3 and the MOU are not fair, just, and reasonable, and that no further alternate source power elections are permissible. Further, the Commission's finding that the PPA should be denied because it violates KRS Chapter 278 stands separate and apart from the Commission finding that the alternate source provisions in Amendment 3 and the MOU should be stricken from EKPC's because they violate KRS Chapter 278.

#### Cooperative Principles

Much was made in this proceeding regarding the seven cooperative principles, in particular, the principle of cooperation among cooperatives. The parties' inability to

engage each other on a cooperative basis was on clear display in this proceeding. For examples of this, one need only read through the various motions and responses filed in this proceeding that contain harsh invective and accusations of improper motives tossed about like business cards at a networking event. The Commission notes that this proceeding is the second time EKPC and the Owner-Members have requested Commission intervention to resolve issues arising from Amendment 3 and the MOU because the parties could not agree on their own initiative. As some parties testified, EKPC's corporate governance requirement for unanimous consent is one of the major impediments to cooperation among the Owner-Members and EKPC. The Commission strongly encourages the parties to reconsider the unanimous consent requirement.

#### OTHER LEGAL ISSUES

Salt River Electric filed a response and motion to strike portions of EKPC's brief that reference an EKPC board meeting at which a proposed resolution was discussed and voted on. Other parties filed responses to Salt River Electric's motion to strike in compliance with a Commission Order. EKPC subsequently moved to strike Salt River Electric's brief as untimely. The Commission denies both motions.

IT IS THEREFORE ORDERED that:

1. South Kentucky RECC's application requesting approval of the PPA is denied.
2. The alternate source election provisions of Amendment 3 violate KRS Chapter 278 and the alternate source election provisions are terminated and stricken from EKPC's tariff effective as of the date of the entry of this Order. The remaining provisions

of Amendment 3 not in conflict with this Order continue in effect pursuant to the terms of Amendment 3.

3. The MOU violates KRS Chapter 278 and is terminated and stricken from EKPC's tariff effective as of the date of the entry of this Order.

4. Salt River Electric's motion to strike is denied.

5. EKPC's motion to strike is denied.

6. This case is closed and removed from the Commission's docket.

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By the Commission

Commissioner Talina R. Mathews  
dissenting in part

ENTERED  
SEP 27 2018  
KENTUCKY PUBLIC  
SERVICE COMMISSION

ATTEST:

  
Executive Director

Case No. 2018-00050

Partial Dissenting Opinion of Commissioner Talina R. Mathews  
in Case No. 2018-00050

I agree that South Kentucky's request for approval of the PPA should not be granted for the reasons stated in the Order. I am also in agreement that the Commission has the authority to modify or revoke Amendment 3 and the MOU for reasons expressed in this Order. The provisions in Amendment 3 and the MOU do result in rates and service that are not fair, just and reasonable.

However, I take issue with the decision to strike all of Amendment 3 and the MOU as I believe they should be modified instead. It is the allocation methodology referring to the 15 percent of each Owner-Member's load that results in the arbitrary distribution of the opportunity to purchase alternate sources of power, resulting in cost shifting to those remaining Owner-Members. It is arithmetically impossible to allow up to 15 percent of each Owner-Member's load without eventually hitting the 2.5 percent and 5 percent limits in the Amendment, which then leaves some Owner-Members unable to take advantage of the same opportunity.

When the Commission issued the Order in case 2012-00503, the expectations were that Owner-Members would pursue relatively small sources of alternate power, which was consistent with actions taken through that point in time. The record shows that these projects have had a *de minimus* impact on costs of other Owner-Members.

Instead of striking all of Amendment 3 and the MOU in full, thus creating disparity between the Owner-Members that have already elected to secure small sources of power and those that have not elected to do so, the Amendment and MOU should be amended by reducing the limit of 15 percent of each Owner-Member's load to a limit of 5 percent of each Owner-Member's load. This would allow all Owner-Members to take advantage of

the opportunity to develop local economic development projects and distributed generation projects to assist in solving problems on the distribution grid. Such a modification also would be consistent with the RUS approval of Amendment 3, allowing Owner-Members to purchase up to 5 percent of EKPC's load.

Instead of striking the provisions allowing alternate source power elections in their entirety, modifying Amendment 3 and the MOU would keep the Owner-Members on a level playing field with other retail electric suppliers in the Commonwealth who are able to provide small amounts of renewable energy to satisfy demands of current and future customers for renewable energy to meet their sustainability goals. Because such projects are becoming more and more prevalent, and blocking any further development, places the Owner-Members at a competitive disadvantage to other retail electric providers. Given that some of the service territories of the Member-Owners are among the most economically stressed communities in the country, this would seem to be counterintuitive.

To further protect the Owner-Members from cost shifting, I also would highlight the notice provision in the MOU, Section 4 part A, subpart iii and iv. The notice provision requires a general description of the nature of the alternative source and the primary generation facilities from which the subject electric power and energy will be produced, the approximate expected pattern of use or dispatch of the alternate source, and the corresponding pattern of hourly reductions in energy to be purchased by the Owner-Member from EKPC. The inclusion of such information in the notice provision would allow EKPC to model the impact of the location of such an alternate source and the expected pattern of use or dispatch on the other Owner-Members. As the entity responsible for the reliability of the generation and transmission system, EKPC has the tools and capabilities

of determining the impact of the integration of the alternate source and, therefore, should have the opportunity to determine whether there are significant cost shifts. Removing the corporate governance requirement of unanimous consent and allowing the Owner-Members to vote on such projects after being apprised of the results of the EKPC analysis of cost shifts would allow for a fair outcome. I agree with the majority in that this requirement for unanimous consent needs to be reconsidered. This proceeding and other related proceedings have highlighted the need for reconsideration of this rule of corporate governance.

Finally, I would clarify that I interpret Amendment 3 and the MOU to refer to small sources of alternate power consistent with those projects that have been developed by Owner-Members to date. Power purchases from the wholesale bulk power market are not consistent with the concerns expressed herein regarding small economic development or local reliability projects being blocked going forward if Amendment 3 and the MOU are stricken in their entirety.

Commissioner Talina R. Mathews  
dissenting in part

ENTERED  
SEP 27 2018  
KENTUCKY PUBLIC  
SERVICE COMMISSION

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