

Goss ■ Samford PLLC



David S. Samford
david@gosssamfordlaw.com
(859) 368-7740

December 17, 2014

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PUBLIC SERVICE
COMMISSION

Via Hand-Delivery

Mr. Jeffrey Derouen
Executive Director
Kentucky Public Service Commission
P.O. Box 615
211 Sower Boulevard
Frankfort, KY 40602

Re: In the Matter of: An Examination of the Application of the Fuel
Adjustment Clause of East Kentucky Power Cooperative, Inc.
from November 1, 2013 through April 30, 2014
PSC Case No. 2014-00226

Dear Mr. Derouen:

Enclosed please find for filing with the Commission in the above-referenced case an original and ten (10) copies of East Kentucky Power Cooperative, Inc.'s Brief regarding the above-styled matter. Please return a file-stamped copy to me.

Do not hesitate to contact me if you have any questions.

Very truly yours,

David S. Samford

Enclosures

M:\Clients\4000 - East Kentucky Power\1700 - FAC Cases\
Correspondence\Ltr. to Jeff Derouen - 141217

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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PUBLIC SERVICE
COMMISSION

IN THE MATTER OF:

AN EXAMINATION OF THE APPLICATION)
OF THE FUEL ADJUSTMENT CLAUSE OF)
EAST KENTUCKY POWER COOPERATIVE,)
INC. FROM NOVEMBER 1, 2013 THROUGH)
APRIL 30, 2014)

CASE NO. 2014-00226

BRIEF OF
EAST KENTUCKY POWER COOPERATIVE, INC.

Comes now East Kentucky Power Cooperative, Inc. ("EKPC"), by counsel, pursuant to the direction of the Commission as given at the hearing held in this matter on November 12, 2014, as amended in an Order entered on December 1, 2014, and for its Brief in the above-captioned proceeding, respectfully states as follows:

I. Introduction

This case presents a question regarding the extent to which energy purchases made within the context of EKPC's participation in the Day-Ahead and Real-Time Energy Markets administered by PJM Interconnection, LLC ("PJM") are recoverable through the Company's Fuel Adjustment Clause ("FAC") tariff. In data requests posed by Commission Staff prior to the aforementioned hearing, and in the context of the hearing itself, an issue has arisen as to whether certain such energy purchases may be passed through the FAC in light of language set forth in an Order entered by the Commission on May 2, 2002, in Case No. 2000-00496-B, which limits the recovery of energy purchases to those that have a net energy cost below the highest variable cost

of the utility's available generating units.¹ Based upon the record of this proceeding and the ample legal and administrative precedent construing the Commission's general plenary ratemaking authority and the plain language of the FAC regulation in particular, EKPC respectfully submits that all energy purchases made through PJM's energy markets, exclusive of those made as a result of forced outages, are based upon economic dispatch and are, therefore, recoverable under 807 KAR 5:056, Section 1(3)(c), or, in the alternative, are otherwise recoverable as fuel expenses under 807 KAR 5:056, Section 1(3)(b).

II. Background

A. Procedural

EKPC is an electric generation and transmission cooperative that provides electricity to approximately 525,000 retail customers. EKPC is owned by sixteen Members, all of whom are distribution cooperatives. EKPC owns four primary electric generation stations: (1) the William C. Dale Generating Station ("Dale Station") in Ford, Kentucky; (2) the John Sherman Cooper Generating Station ("Cooper Station") near Burnside, Kentucky; (3) the H. L. Spurlock Generating Station near Maysville, Kentucky; and (4) the J. K. Smith Generating Station ("Smith Station") near Trapp, Kentucky. Altogether, EKPC currently has 2,929 megawatts (MWs) of wintertime net electric generating capacity in its fleet.

On August 13, 2014, the Commission established this proceeding to examine the application of EKPC's FAC from November 1, 2013 through April 30, 2014. The Commission propounded initial and supplemental data requests, which EKPC timely answered. In addition, the Commission granted a Motion for Leave to Intervene filed by Grayson Rural Electric Cooperative Corporation ("Grayson"). Grayson propounded one set of data requests, which

¹ See *In the Matter of An Examination of the Application of the Fuel Adjustment Clause of East Kentucky Power Cooperative, Inc. from May 1, 2001 to October 31, 2001*, Order, Case No. 2000-00496-B (Ky. P.S.C. May 2, 2002).

EKPC also timely answered. In the course of the hearing held on November 12, 2014, EKPC agreed to provide responses to five post-hearing data requests, the answers to which EKPC timely filed on November 25, 2014. With the filing of this brief, the record is complete and the case now stands ready for final adjudication.

B. Commission Jurisdiction

Kentucky's highest Court has recognized that the Commission is a creature of statute and, as such, its authority may not exceed the delegation of authority expressed in Kentucky law.² KRS 278.040(2) provides that the Commission's jurisdiction is limited to the "rates" and "services" of public utilities in Kentucky.³ However, the Kentucky Supreme Court has also found that the Commission's authority within the context of its consideration of rate and service issues is plenary in nature.⁴ Thus, many of the statutes in KRS Chapter 278 serve as legislative limitations upon the Commission's otherwise expansive and permissive delegated authority to assure that rates are "fair, just and reasonable" and that service is "adequate, efficient and reasonable."⁵ In this case, the Commission plainly has jurisdiction to determine whether the

² See *Boone Co. Water and Sewer Dist. v. Public Service Comm'n*, 949 S.W.2d 588, 591 (Ky. 1997); *Simpson Co. Water Dist. v. City of Franklin*, 872 S.W.2d 460, 462 (Ky. 1994); *Com., ex rel. Stumbo v. Kentucky Public Service Comm'n*, 243 S.W.3d 374, 378 (Ky. App. 2007); *Cincinnati Bell Tel. Co. v. Kentucky Public Service Comm'n*, 223 S.W.3d 829, 836 (Ky. App. 2007); *Public Service Comm'n v. Jackson Co. Rural Elec. Co-op., Inc.*, 50 S.W.3d 764, 767 (Ky. App. 2000).

³ The terms "rate" and "service" are defined in KRS 278.010(12) and (13) respectively.

⁴ See *Kentucky Public Service Comm'n v. Commonwealth of Kentucky, ex rel. Conway*, 324 S.W.3d 373, 383 (Ky. 2010) ("In sum, we agree with the view that the PSC had the plenary authority to regulate and investigate utilities and to ensure that rates charged are fair, just, and reasonable under KRS 278.030 and KRS 278.040.").

⁵ See *id.*; KRS 278.030(1), (2).

energy purchases that EKPC makes in the PJM energy market are recoverable expenses under the Company's FAC tariff.⁶

III. Argument

In order for EKPC to prevail, it must show that the Company's FAC tariff is fair, just and reasonable and that the tariff has been correctly applied in the context of the subject energy purchases. The record of this case, as well as Kentucky law, support the Commission making affirmative findings on both of these questions.

A. EKPC's FAC Tariff is Fair, Just and Reasonable

The purpose for having a fuel adjustment rate mechanism in a utility's tariff is well-established in Commission precedent. An FAC tariff is:

... a means for [an electric] utility to recover from its customers its current fuel expense through an automatic rate adjustment without the necessity for a full regulatory rate proceeding. This rate may increase or decrease from one billing cycle to the next depending on whether the utility's cost of fuel increased or decreased in the same period. The rate provides for a straight pass-through of fuel costs, with no allowance for a profit to the utility.⁷

In Kentucky, each electric utility has an FAC tariff that conforms to certain regulatory prescriptions that have been set forth in regulations promulgated by the Commission. The current iteration of the Commission's FAC regulation, 807 KAR 5:056, became effective on April 7, 1982.⁸ The preamble to the regulation states that, "Fuel adjustment clauses which are

⁶ EKPC's FAC tariff substantially mirrors the language of the Commission's FAC regulation, 807 KAR 5:056. Unless otherwise noted herein, any reference to either EKPC's FAC tariff or the Commission's FAC regulation is intended to be interchangeable.

⁷ *In the Matter of East Kentucky Power Cooperative's Request for a Declaratory Ruling on the Application of Administrative Regulation 807 KAR 5:056 to its Proposed Treatment of Non-Economy Energy Purchases*, Order, Case No. 2004-00430 (Ky. P.S.C. Feb. 7, 2005) (quoting *In the Matter of Kentucky Power Company*, Order, Case No. 6877, p. 2 (Ky. P.S.C. Dec. 15, 1977)).

⁸ See 8 Ky.R. 822.

not in conformity with the principles set out below are not in the public interest and may result in suspension of those parts of such rate schedules.”⁹

In accordance with the filed rate doctrine (KRS 278.160) and the FAC regulation, EKPC prepared and tendered a proposed FAC tariff that the Commission accepted. Though EKPC’s FAC tariff has been revised from time to time over the intervening decades, its current tariff became effective on June 1, 2011, and, for purposes of this proceeding, substantially mirrors the definition of “Fuel Cost” set forth in 807 KAR 5:056, Section 1(3), stating in relevant part:

Fuel cost (F) shall be the most recent actual monthly cost of:

- (a) Fossil fuel consumed in the utility’s own plants, and the utility’s share of fossil fuel and nuclear fuel consumed in jointly owned or leased plants, plus the cost of fuel which would have been used in plants suffering forced generation and/or transmission outages, but less the costs of fuel related to substitute generation, plus
- (b) The actual identifiable fossil and nuclear fuel costs associated with energy purchased for reasons other than identified in paragraph (c) below, but excluding the cost of fuel related to purchases to substitute the forced outages, plus
- (c) The net energy cost of energy purchases, exclusive of capacity or demand charges (irrespective of the designation assigned to such transaction) when such energy is purchased on an economic dispatch basis. Included therein may be such costs as the charges for economy energy purchases and the charges as a result of scheduled outages, also such kinds of energy being purchased by the buy to substitute for its own higher cost energy; and less
- (d) The cost of fossil fuel recovered through inter-system sales including the fuel costs related to economy energy sales and other energy sold on an economic dispatch basis.
- (e) All fuel costs shall be based on weighted average inventory costing.¹⁰

⁹ 807 KAR 5:056, Section 1.

¹⁰ EKPC Tariff P.S.C. No. 34, First Revised Sheet No. 2 (June 1, 2011).

Any textual differences in the Commission's FAC regulation and EKPC's FAC tariff are immaterial for purposes of the questions posed in this proceeding. Thus, any analysis of EKPC's tariff and the FAC regulation should consistently lead to the same result. Because EKPC's FAC tariff substantially mirrors 807 KAR 5:056, the Commission should find that EKPC's tariff is fair, just and reasonable.

B. EKPC's FAC Tariff Requires Recovery of All Energy Purchases From PJM that are Used to Serve Native Load

The strict purpose of the FAC tariff is to require EKPC to recover on a current basis its fuel costs incurred in the service of native load. This is evidenced by the tariff's plain terms and is consistent with KRS 278.160. Indeed, the Commission has held:

The [FAC] regulation prescribes a strict procedure for accounting and reporting fuel costs and requires the reporting of all fuel costs. It does not allow any discretion to a utility to ignore or underreport such costs that are otherwise considered a "fuel cost" or to use other than actual costs. The regulation makes no exceptions and provides for no variations or deviations from the stated reporting methodology.¹¹

The application of the FAC tariff to energy purchases made in the PJM energy market confirms that such purchases are subject to the FAC and that the associated energy costs are recoverable thereunder. While EKPC believes that the cost of energy purchases used to serve native load are expressly allowed under Section 1(3)(c) of the regulation due to the fact that these purchases are made on an economic dispatch basis, the Company also believes that the purchases would otherwise be allowed under Section 1(3)(b) relating to other types of energy purchases as well.

¹¹ *In the Matter of East Kentucky Power Cooperative's Request for a Declaratory Ruling on the Application of Administrative Regulation 807 KAR 5:056 to its Proposed Treatment of Non-Economy Energy Purchases*, Order, Case No. 2004-00430, p. 5 (Ky. P.S.C. Feb. 7, 2005).

1. EKPC's FAC Tariff Requires Recovery of All Net Energy Costs of Power Purchased Based upon Economic Dispatch Principles

a. Overview of the PJM Markets

On December 20, 2012, the Commission authorized EKPC to transfer functional control of its electric transmission system to PJM and to become a full-participant in PJM's capacity and energy markets.¹² PJM currently serves more than 61 million electric consumers in the eastern United States by coordinating the operation of the high-voltage electric transmission grid in thirteen states and the District of Columbia.¹³ In addition to serving as a balancing authority and regional transmission operator ("RTO"), PJM facilitates several markets for the purchase and sale of electric generating capacity, electric energy and various ancillary services.

The PJM capacity market is established in the Base Residual Auction ("BRA") and Incremental Auction ("IA") process. Load Serving Entities ("LSEs") such as EKPC participate in PJM's capacity market by bidding and purchasing capacity and reserves in the BRA and IA in order to satisfy historical load demands and reserve requirements.¹⁴ Due to the large capital investments and lead times associated with adding capacity to the PJM system, the annual BRA looks ahead to a delivery year three years in the future, thereby incentivizing the deployment of capital to construct new generation units necessary to assure continued reliability within the PJM territory. The long-term capacity price signals are further developed and refined in successive IAs. EKPC's participation in the capacity market does not guarantee that EKPC's electric generating units will, or will not, run on any given day, however. Rather, participation in the

¹² See *In the Matter of the Application of East Kentucky Power Cooperative, Inc. to transfer Function Control of Certain Transmission Facilities to PJM Interconnection, LLC*, Order, Case No. 2012-00169 (Ky. P.S.C. Dec. 20, 2012).

¹³ See <http://www.pjm.com/about-pjm/who-we-are.aspx> (last visited Dec. 8, 2014).

¹⁴ See EKPC Response to Staff's Initial Data Request 26b(1) (filed Aug. 27, 2014).

capacity market simply means that those electric generating units that have cleared in the course of either the BRA or an IA will be available to serve load by producing electric energy if called upon to do so by PJM. Thus, by participating in PJM's capacity market, each of EKPC's electric generating units becomes subject to the dispatch instructions given by PJM in the course of a delivery year for which the applicable unit has cleared the BRA or IAs.¹⁵ The payments made or received by EKPC by virtue of its participation in the capacity market are for the cost of purchasing or providing capacity.

Whether EKPC's electric generating units will actually operate on any given day is solely a function of the operation of PJM's energy market. The energy market consists of: (1) a Day-Ahead market that arranges for the service of loads forecasted to arise during each hour of the following day; or (2) a Real-Time market that reacts to the current load requirements of the PJM system by adjusting to variations between the prevailing load and the forecasted load from the prior day's Day-Ahead market.¹⁶ Unlike the capacity market that recovers the fixed costs of an electric generating unit, the energy market is intended to recover the cost of energy. The Day-Ahead and Real-Time energy markets both operate on a security constrained, economic dispatch basis. In other words, the purpose and goal of the energy markets is to reliably provide the least cost power to all consumers within the PJM territory.¹⁷ This is accomplished by determining the cost of reliably supplying power to all points on the grid, while taking into account any transmission constraints, generation outages or other reliability circumstances affecting the

¹⁵ See EKPC Response to Staff's Initial Data Request 26b(1) (filed Aug. 27, 2014).

¹⁶ See *id.*

¹⁷ See *id.*

electric transmission grid. The determination of this cost establishes what is known as the Locational Marginal Price (“LMP”) for energy.

EKPC’s participation in PJM has been very valuable for EKPC’s Members. For instance, over the course of the first ten months of its participation in PJM, EKPC has recognized over \$14 million in savings in the energy market.¹⁸ Likewise, in the six month period under review in this proceeding, EKPC’s ability to participate in PJM allowed it to acquire sufficient energy to serve native load during peak periods that exceeded EKPC’s prior winter peaks by over 250 MW, which allowed EKPC to avoid having to initiate load curtailments equal in magnitude to approximately 450 MW.¹⁹ Without having had access to PJM’s energy market in January and February of 2014, there is no guarantee that EKPC could have arranged enough energy purchases to meet its native load requirements.

b. By Operating in PJM, EKPC's Energy Purchases are Based upon Economic Dispatch Principles

The test is simple and straightforward for determining whether the cost of purchased energy qualifies for recovery under Section 1(3)(c) of the FAC regulation: (1) the net energy cost must not include any capacity or demand charges; and (2) the purchase must be made on an economic dispatch basis. EKPC’s energy purchases in PJM’s energy market satisfy both elements of the tariff.

As set forth above, the separation of the capacity and energy markets in PJM means that there are no capacity or demand charges incorporated in the costs incurred in making purchases in the energy market. Thus, the first criterion is satisfied. Likewise, the entire PJM system is

¹⁸ See EKPC’s Response to Staff’s Supplemental Data Request 3d (filed Oct. 10, 2014).

¹⁹ See *In the Matter of an Examination of the Application of the Fuel Adjustment Clause of East Kentucky Power Cooperative, Inc., from November 1, 2013 through April 30, 2014*, Order, Case No. 2014-00226, App. B, p. 1 (Ky. P.S.C. Aug. 13, 2014).

dispatched on an economic dispatch basis,²⁰ meaning that EKPC also satisfies the second criterion of the tariff. As set forth in EKPC's response to Staff's initial data request, EKPC is able to "serve [its] load with the market when the market is cheaper than [EKPC's] resources and service [its] load with [its] resources when [EKPC's] resources are cheaper than the market."²¹

As Ms. Tucker explained:

If EKPC has a generator that is available and not being dispatched, then PJM has determined that it is more economical to run a different combination of units to reliably meet load requirements than to run the EKPC generator. It could be due to start-up costs, locational transmission flow issues, minimum run times or other reasons that the generator was not dispatched to operate. However, the total costs should be less than they would have been if the EKPC generator had been started. Therefore, as long as EKPC is purchasing from PJM and PJM is dispatching all of its resources in an economic manner, then EKPC is making economy purchases at all times.²²

The energy that EKPC purchases in the PJM energy market will always be purchased on an economic dispatch basis, which is consistent with the plain language of EKPC's FAC tariff and 807 KAR 5:056, Section 1(3)(c).

The record of this case reflects that all of the energy purchases made by EKPC during the review period were made to serve native load.²³ Likewise, the record also confirms that EKPC applies its own netting and stacking methodology to assure that when its own generation

²⁰ See EKPC Response to Staff's Initial Data Request 26b(1) (filed Aug. 27, 2014); *In the Matter of the Application of East Kentucky Power Cooperative, Inc. to Transfer Function Control of Certain Transmission Facilities to PJM Interconnection, LLC*, Order, Case No. 2012-00169, p. 12 (Ky. P.S.C. Dec. 20, 2012) ("As described in the Supplemental Report, CRA estimated \$40 million in trade benefits over the study period. In general, this is the benefit of being able to sell excess generation into the PJM Market, taking into account the production costs associated with that generation as well as the benefit associated with being able to buy needed generation or generation that is less expensive than EKPC can generate at any given time.").

²¹ See EKPC Response to Staff's Initial Data Request 26b(1) (filed Aug. 27, 2014).

²² EKPC Response to Staff's Supplemental Data Request 2 (filed Oct. 10, 2014).

²³ See Hearing Video Record ("HVR"), 10:45:55 AM (Nov. 12, 2014).

dispatched by PJM exceeds that of its native load, EKPC's Members are allocated the least cost energy first.²⁴ Because the entire PJM system is dispatched on an economic dispatch basis, EKPC's Members will always receive the lowest cost available electric energy regardless of whether it comes from an electric generating unit that is owned by EKPC or by some other entity. The fact that EKPC determined that it was appropriate to discontinue using the highest variable cost of its own generating units in January 2014 was brought about by EKPC's ability to gain experience in the PJM markets and to better understand the nature of the costs incurred through the purchase of energy therein.²⁵ As stated at the hearing, not all of the potential categories of PJM costs are incurred each month, and it is only with the passage of time that EKPC was able to discern which costs would be applicable.²⁶ Nevertheless, it is always the case that EKPC's energy purchases in PJM have been based upon economic dispatch principles.²⁷ Therefore, EKPC's energy purchases within the PJM energy market comply with both the literal meaning and spirit of the FAC tariff.

c. Commission Precedent in Case No. 2000-00496-B is Distinguishable

The data requests propounded to EKPC and certain questions that were asked in the course of the hearing held November 12, 2014, have given rise to an issue as to whether certain language contained in an Order entered in Case No. 2000-00496-B might preclude EKPC from recovering under its FAC tariff certain energy costs for purchases made in PJM's energy market. However, a close reading of the Order in that case reveals that it is distinguishable in several

²⁴ See EKPC Response to Staff's Initial Data Request 26b(1) (filed Aug. 27, 2014).

²⁵ See HVR 11:04:00 AM (Nov. 12, 2014).

²⁶ See *id.*

²⁷ EKPC Response to Staff's Supplemental Data Request 2 (filed Oct. 10, 2014).

respects. Accordingly, it should not be regarded as controlling or persuasive authority in the circumstances now before the Commission.

i. The Interpretation of 807 KAR 5:056, Section 1(3)(c) set forth in the Case No. 2000-00496-B Order Elevates a Permissive “May” over a Mandatory “Shall”

Without question, the Order in Case No. 2000-00496-B primarily focuses upon the term “economy energy purchase” in the second sentence of 807 KAR 5:056, Section 1(3)(c).²⁸ However, focusing exclusively upon that term, or even that sentence, opens the door for misinterpreting the regulation by placing too much emphasis upon a permissive interpretation at the expense of the mandatory rule expressed in the first sentence of the same provision. A cursory review of the relevant portion of the FAC regulation which is identical in wording to EKPC’s FAC tariff reveals that the only mandatory aspect of the provision is that “Fuel costs (F) *shall be* the most recent actual monthly cost of: ... (c) [t]he net energy cost of energy purchases...when such energy is purchased on an economic dispatch basis.” (Emphasis added). The “shall” in the prefatory clause of 807 KAR 5:056, Section 1(3) plainly applies to the first clause of subparagraph (c), which ends with a period. This stands in stark contrast to the permissive second sentence of Section 1(3)(c), which begins, “[i]ncluded therein *may be such costs as...*” (Emphasis added). It is well-established in Kentucky law that an affirmative, mandatory obligation takes precedence over a permissive, illustrative example.²⁹

²⁸ The Commission’s Order states that the previously undefined phrase “economy energy purchases” in 807 KAR 5:056, Section 1(3)(c) would henceforth mean:

...purchases that an electric utility makes to serve native load, that displace its higher cost of generation, and that have an energy cost less than the avoided variable generation cost of the utility’s highest cost generating unit available to meet native load during the FAC expense month.

In the Matter of An Examination of the Application of the Fuel Adjustment Clause of East Kentucky Power Cooperative, Inc. from May 1, 2001 to October 31, 2001, Order, Case No. 2000-00496-B (Ky. P.S.C. May 2, 2002).

²⁹ See KRS 446.010(26), (39); *Kentucky Public Service Comm’n v. Shadoan*, 325 S.W.3d 360, 363-364 (Ky. 2010) (discussing and distinguishing between mandatory and permissive duties of local planning commissions); *Fox v.*

It is the permissive second sentence of the regulation that drew the Commission's attention in Case No. 2000-00496-B, as the Commission adopted an interpretation of the phrase "economy energy purchases."³⁰ The Commission's emphasis upon the phrase "economy energy purchases" is very logical when one considers the fact that the Order in Case No. 2000-00496-B was entered at a time when there was no regional market for wholesale electric energy available in Kentucky. The absence of such a market gave rise to the need for the Commission to specify what constitutes economic dispatch. The subsequent development and operation of PJM's security constrained, economic dispatch energy market now makes that specificity unnecessary for utilities participating in the PJM energy market.

Moreover, to the extent that this interpretive guidance would practically result in an amendment of the tariff, such a result runs afoul of KRS 278.160, which codifies what is commonly referred to as the filed rate doctrine. "[T]he filed rate defines the legal relationship between the regulated utility and its customer with respect to the rate that the customer is obligated to pay and that the utility is authorized to collect."³¹ A "rate," of course, is defined very broadly in KRS 278.010(12). While the Commission is certainly permitted to, and often must, interpret the various provisions of utilities' tariffs, it may not ignore the plain and ordinary meaning of the tariff or adopt an interpretation of the tariff that is at odds with the plain and

Grayson, 317 S.W.3d 1, 13 (Ky. 2010) ("Of course, as the Governor correctly points out, the word *may* generally signifies something as being permissive in nature in contrast to the word *shall*, which generally signifies something being mandatory.").

³⁰ Most of the question raised by Grayson at the hearing in this proceeding had to do with the definition of "economy energy purchases" set forth in the Order in Case No. 2000-00496-B. Since Grayson has not filed any testimony in this proceeding, it is difficult for EKPC to respond to any issues that Grayson might raise for the first time in its brief. Nevertheless, to the extent that Grayson's simultaneously-filed brief focuses upon the nuances of the definition of economy energy purchases in Case No. 2000-00496-B, the point which Grayson is likely to overlook is that the definition is a part of the permissive portion of the regulation and not the mandatory rule regarding recovery under the FAC.

³¹ *Cincinnati Bell Telephone Co. v. Kentucky Public Service Comm'n*, 223 S.W.3d 829, 837 (Ky. App. 2007) (citing *Big Rivers Elec. Corp. v. Thorpe*, 921 F.Supp. 460 (W.D. Ky.1996)).

ordinary meaning.³² Rather, in the event the Commission ever finds that a utility's tariff is not "fair, just and reasonable," it must make findings in accordance with KRS 278.270 and prescribe the appropriate terms on a prospective basis. While the difference between informally relying upon interpretive guidance to re-interpret an existing tariff and formally prescribing a particular change to a tariff may seem to be two equal avenues for arriving at the same legal destination, important principles of due process set forth in KRS 278.160, KRS 278.260, KRS 278.270 and other legal precedent mandate that the plain language of a tariff must be applied until such time as the Commission orders that it be formally changed. That never happened in Case No. 2000-00496-B or any subsequent FAC proceeding.

For these reasons, the Commission's Order in Case No. 2000-00496-B must be viewed for what it is – an interpretation of a phrase that appears in a permissive sentence that lists illustrative examples of what constitutes energy purchased on an economic dispatch basis. The Order does not in any way change, amend, delete or repeal the previously expressed, mandatory rule that energy purchases made on an economic dispatch basis "shall" constitute fuel costs for FAC purposes. Kentucky law requires the language of the tariff to be given its plain and ordinary meaning.

**ii. The Commission's Interpretive Definitions for "Economy Energy Purchases"
and "Non-Economy Energy Purchases" in Case No. 2000-00496-B
Were Not General Regulatory Changes**

The definitions which are at the heart of the Commission's Order in Case No. 2000-00496-B are further called into question in a trio of cases dating back to 1994, but not finally

³² As stated in *W.P. Brown & Sons Lumber Co. v. Louisville & N.R. Co.*, 7 F. Supp. 593, 594 (W.D. Ky. 1934) ("The quoted language seems to me clear and unambiguous, and, as a legally established rate tariff has the force and effect of a statute, it should be construed in the same manner as statutes are construed. Applying that rule of construction, there being no ambiguity in the wording of the tariff, it should be construed as written."); *see also State ex rel. Laclede Gas Co. v. Public Service Comm'n*, 156 S.W.3d 513, 521 (Mo. App., 2005) ("...our role in interpreting the PSP Tariff is to 'ascertain the intent of [Laclede and the Commission] from the language used, to give effect to that intent if possible, and to consider the words used in their plain and ordinary meaning.'").

resolved until 2002. In those cases, the Commission determined that Kentucky Utilities Company (“KU”) and Louisville Gas & Electric Company (“LG&E”) “had improperly calculated their FAC charges” relating to inter-system sales and system line loss.³³ After nearly eight years of litigation, the Commission accepted a Settlement Agreement that required KU and LG&E to collectively refund \$1.67 million to ratepayers.³⁴ In addition, the Commission, KU, LG&E, Kentucky Industrial Utility Customers, Inc. (“KIUC”), and the Office of the Attorney General (“AG”) stipulated that 807 KAR 5:056, Section 1(3) would be interpreted, on a prospective basis, by using substantially similar definitions for “economy energy purchases” and “non-economy power purchases” as those adopted a couple of weeks before in EKPC’s Case No. 2000-0496-B. In accepting the Settlement Agreement, however, the Commission noted that it “is not a perfect resolution of the contested issues in these [15 FAC] proceedings.”³⁵ Furthermore, Section 4.10 of the Settlement Agreement, which the Commission approved and adopted, expressly provided that, “Nothing in this Settlement Agreement is intended to be, nor shall it be construed as a general regulatory change.”³⁶ The fact that the Commission would accept a Settlement Agreement that expressly limits the definitions of two terms previously adopted in Case No. 2000-00496-B adds credence to the notion that the Order in Case No. 2000-00496-B should not be applied blindly.

³³ See Case No. 1994-00461-A; Case No. 1994-00461-B; Case No. 1994-00461-C.

³⁴ See *id.*, Order (Ky. P.S.C., May 17, 2002).

³⁵ See *id.*

³⁶ See *id.*, Appendix A.

iii. The Commission Deviated from Case No. 2000-00496-B by Granting Kentucky Power Company a Price Proxy for Highest Cost Generation in 2002

Shortly after approving the Stipulation in the KU and LG&E cases, the Commission also recognized that the newly-minted definitions of “economy energy purchases” and “non-economy energy purchases” in Case No. 2000-00496-B would be unfair, unjust and unreasonable as applied to Kentucky Power Company (“Kentucky Power”), due to the unique characteristics of that utility’s generation portfolio.³⁷ Rather than literally applying the definitions, the Commission instead authorized Kentucky Power to employ a “peaking unit equivalent cost” formula as a proxy for determining the avoided variable cost of its highest cost generating unit. This exception allowed Kentucky Power to use the market price of natural gas as the key variable in determining whether its energy purchases from third parties would be considered as either an economy energy purchase, a non-economy energy purchase or a non-FAC energy purchase. Moreover, the use of a market proxy allowed the Commission to account for the fact that Kentucky Power’s energy procurement practices, which were undertaken as part of a multi-state system, were very different from the traditional, vertically-integrated structure of other regulated electric utilities in Kentucky. The Kentucky Power case further undercuts the notion that the language of the Order in Case No. 2000-00496-B is binding in every factual circumstance.

³⁷ See *In the Matter of an Examination by the Public Service Commission of the Application of the Fuel Adjustments Clause of American Electric Power Company from May 1, 2001 to October 31, 2001*, Order, Case No. 2000-00495-B (Ky. P.S.C. Oct. 3, 2002).

iv. The Commission Overruled the Definition of "Non-Economy Energy Purchases" in Case No. 2004-00430

In addition, the Commission subsequently expressly overruled a significant portion of its Order in Case No. 2000-00496-B in Case No. 2004-00430.³⁸ In that case, the Commission considered the situation where EKPC was purchasing power to meet native load requirements that were in excess of the utility's available generation capacity. In an Order entered on March 21, 2005, the Commission stated:

The definition of "non-economy energy purchases" set forth in our Order in Case No. 2000-00496-B too narrowly construes 807 KAR 5:056 and conflicts with the regulation. A more accurate definition of non-economy energy purchases recognizes that the energy costs therefore may be greater or less than the variable cost of the highest cost generating unit available to serve native load. To the extent that the definition in our Order in Case No. 2000-00496-B conflicts with our Order of February 7, 2005, we find that it was incorrect and should be overruled.³⁹

The Order in Case No. 2004-00430 substantially altered the Commission's interpretation of 807 KAR 5:056, Section 1(3) as expressed in Case No. 2000-00496-B. In essence, the Commission's Order returned the FAC to its original purpose of requiring that all fuel expenses associated with the production or purchase of energy should be accounted for and recovered through the FAC. The Commission accomplished this by recognizing that the cost of non-economy energy purchases may be higher or lower than the variable cost of the highest cost generating unit available to serve native load.

³⁸ In Case No. 2000-00496-B, the Commission defined a new phrase that is not used in the FAC regulation, "non-economy energy purchases," as "...purchases made to serve native load that have an energy cost greater than the avoided variable cost of the utility's highest cost generating unit available to serve native load during the FAC expense month." See *In the Matter of An Examination of the Application of the Fuel Adjustment Clause of East Kentucky Power Cooperative, Inc. from May 1, 2001 to October 31, 2001*, Order, Case No. 2000-00496-B (Ky. P.S.C., May 2, 2002).

³⁹ See *In the Matter of East Kentucky Power Cooperative's Request for a Declaratory Ruling on the Application of Administrative Regulation 807 KAR 5:056 to its Proposed Treatment of Non-Economy Energy Purchases*, Rehearing Order, Case No. 2004-00430, p. 6 (Ky. P.S.C., Mar. 21, 2005).

v. The Order in Case No. 2000-00496-B is Premised Upon a Market Structure that No Longer Applies to EKPC

The commercial realities and structures of the wholesale electric market have changed in several very fundamental ways since the Commission's Order was entered in Case No. 2000-0496-B. Over the intervening twelve years, the Federal Energy Regulatory Commission ("FERC") has encouraged and fostered the development of wholesale energy and capacity markets by RTOs such as PJM. Some of these changes effectively eliminated the concerns expressed by the Commission in Case No. 2000-00496-B. For instance, the development of separate markets for capacity and energy has virtually assured that capacity and demand charges may not be passed through the FAC tariff. Likewise, the implementation of reliability constrained, economic dispatch models make certain that utilities participating in PJM are using their generation assets in the most economically efficient manner possible, thereby lowering energy rates for all customers. The dispatch of generation and the purchase of energy are also conducted under procedures for the Day-Ahead and Real-Time markets, both of which have been deemed acceptable and in the public interest to FERC.

All of these more recent developments must be taken into account when determining whether the Commission's twelve year old Order in Case No. 2000-00496-B should take precedence over the plain language of the regulation itself in light of the realities of today's energy markets. Clearly, it should not. Indeed, Ms. Tucker's testimony pointed out how the historical context of the Order in 2000-00496-B has changed substantially over the intervening twelve years:

... the Order in Case No. 2000-00496-B is premised upon the underlying factual situation where EKPC is its own balancing authority, is forced to purchase energy for reliability purposes under exigent circumstances, has little or no involvement with regional

energy markets on a routine basis and has ultimate responsibility to assure that its load is served.⁴⁰

These same factors are no longer present in the context of participation in PJM's energy market. As such, the significance of the Order in Case No. 2000-00496-B is greatly diminished as it arose from an entirely different wholesale electric market structure and its continued effectiveness must be measured against the plain language of the FAC regulation and the market realities that apply to EKPC today. While it had usefulness for determining whether energy purchases were made prudently at a time when there was no regionally-organized wholesale electric market available to Kentucky's jurisdictional utilities, the subsequent development and maturation of the PJM energy market has eliminated the need for extensive interpretive rules to determine whether economic dispatch principles are being applied to particular energy purchases. While such interpretive guidance may continue to be helpful in the context of utilities that only make supplemental energy purchases through an RTO or from third parties on a bilateral basis, the Order no longer has significant relevance to EKPC's situation.

d. Summary

The plain language of EKPC's FAC tariff, as well as the plain language of the Commission's FAC regulation, require only that the net cost of energy purchases exclude capacity and demand charges and be incurred on an economic dispatch basis in order to be recoverable. Energy purchases made within PJM's energy markets satisfy both of these criteria. Moreover, the Commission's Order in Case No. 2000-00496-B is distinguishable for several reasons: (1) the Order cannot be interpreted so as to elevate the permissive and illustrative second sentence of the tariff over the mandatory obligation of the first sentence; (2) the Commission has expressly stated that it is not to be considered a general regulatory change; (3)

⁴⁰ EKPC Response to Staff's Initial Data Request 26b(2) (filed Aug. 27, 2014).

the Commission has disregarded the literal application of the Order in the context of Kentucky Power Company, in light of the unique profile of its generation fleet; (4) the Order has itself been repealed in part in a subsequent Commission Order; and (5) the market structure of the wholesale electric market, which served as the premise for the Order in the first place, no longer applies to EKPC. For all of these reasons, EKPC contends that all of its energy purchases in PJM are economy energy purchases and recoverable under 807 KAR 5:056, Section 1(3)(c) and the Company's corresponding FAC tariff provision.

2. Even if the Commission Found that EKPC's Energy Purchases in PJM are Not Economic Energy Purchases, They are Still Recoverable under 807 KAR 5:056, Section 1(3)(b)

In the event that the Commission determines that the variable cost of EKPC's most expensive available generating unit and not whether the energy is purchased on an economic dispatch basis sets the ceiling for what constitutes a fuel expense recoverable under 807 KAR 5:056, Section 1(3)(c), then EKPC has conceded that \$8,538,787 in energy purchases incurred during the review period would exceed the threshold.⁴¹ Nevertheless, EKPC believes this expense should be recoverable under the portion of EKPC's tariff that corresponds to Section 1(3)(b) of the FAC regulation. As the Commission plainly stated in Case No. 2004-00430, "[a] more accurate definition of non-economy energy purchases recognizes that the energy costs therefore may be greater or less than the variable cost of the highest cost generating unit available to serve native load."⁴² The record of this proceeding plainly reflects that the costs of energy acquired by EKPC through the PJM energy market were used to serve native load.⁴³

⁴¹ See EKPC Response to Staff's Supplemental Data Request 5 (filed Oct. 10, 2014).

⁴² See *In the Matter of East Kentucky Power Cooperative's Request for a Declaratory Ruling on the Application of Administrative Regulation 807 KAR 5:056 to its Proposed Treatment of Non-Economy Energy Purchases*, Rehearing Order, Case No. 2004-00430, p. 6 (Ky. P.S.C. Mar. 21, 2005).

⁴³ See HVR 10:45:55 (Nov. 12, 2014).

Thus, for purposes of 807 KAR 5:056, Section 1(3)(b), it does not matter whether they exceeded or were below the variable costs of EKPC's own electric generating units. As set forth at the hearing, all of the costs for which EKPC is currently seeking recovery through the FAC have been determined to be fuel costs and the same types of fuel costs recovered by EKPC through the FAC prior to joining PJM.⁴⁴ Moreover the record demonstrates that EKPC has continued to review the invoices received from PJM and used the services of ACES to perform independent, shadow settlement of each PJM invoice to validate the accuracy of the amounts billed to EKPC.⁴⁵

Likewise, the record confirms that the costs incurred under PJM Account 1375 and 2375 are fuel costs. First, the memorandum tendered by EKPC in February 2014, which was attached as an exhibit to the Commission's Order establishing this case, plainly sets forth an explanation of the nature of these costs:

As defined by PJM, the costs included in Code 1375 are the total daily costs of operating reserve in the balancing market related to resources identified as Credits for Deviations and is allocated based on regional shares of real time locational deviations from the day-ahead scheduled quantities of (1) cleared generation offers (only for generating units not following PJM dispatch instructions and not assessed deviations based on their real time desired MWh); (2) cleared incremental offers and purchase transactions; and (3) cleared demand bids, decrement bids, and sale transactions.

PJM defines the costs included in Code 2375 as the daily credits for specified operating period segments provided to eligible pool-scheduled generators, demand response, and import transactions in real time for any portion of their offer amount in excess of (1) scheduled MWh times day-ahead bus LMP; (2) MWh deviation from day-ahead schedule times real time bus LMP; (3) any day-ahead operating reserve credits; (4) any day-ahead scheduling reserve market revenues in excess of offer plus opportunity cost; (5) any synchronized reserve market revenues in excess of offer

⁴⁴ See HVR 10:20:50 AM (Nov. 12, 2014).

⁴⁵ See EKPC Response to Intervenor's Initial Data Request 7 (filed Aug. 27, 2014).

plus opportunity, energy use, and startup costs; (6) any non-synchronized reserve market revenues in excess of opportunity costs and (7) any applicable reactive services credits. Cancellation credits are based on actual costs submitted to PJM Market Settlements. Credits for lost opportunity costs are also provided to generators reduced or suspended by PJM for reliability purposes.⁴⁶

Likewise, in response to Staff's Initial Data Request 26(c)(2), Ms. Tucker explained how EKPC came to understand that the expenses associated with these codes were fuel costs:

Prior to EKPC's financial settlement for January operations with PJM, EKPC believed that the charges in Account 1375 and 2375 did not include any fuel charges. The January 2014 settlement amount caused EKPC to question if that was a correct interpretation of the charge code. EKPC's Senior Vice President of Power Supply, David Crews, spoke with Frederick S. Bresler at PJM, Vice President of Market Operations and asked for clarification of the costs included in the codes. Mr. Bresler explained that the uplift and deviation charges included in the Operating Reserve charge code 1375 were primarily fuel costs. Some examples of the costs captured in the Operating Reserve account are:

1. Operating expenses from generation that are held on during periods when it is uneconomic to ensure that generation is available to serve during ramp and peak periods.
2. Operating expenses from generation that is operated at less than optimum levels to make room for generation that is held on line for reliability.
3. Operating expenses for generation that balances the deviations between Day Ahead load commitments and Real Time load.

All of these examples were situations that EKPC experienced as a Balancing Authority prior to June 1, 2013, and the fuel costs associated with these operations have historically been recovered through the FAC.⁴⁷

⁴⁶ See *In the Matter of an Examination of the Application of the Fuel Adjustment Clause of East Kentucky Power Cooperative, Inc., from November 1, 2013 through April 30, 2014*, Order, Case No. 2014-00226, App. B, p. 1 (Ky. P.S.C. Aug. 13, 2014).

⁴⁷ See EKPC Response to Staff's Initial Data Request 26c(2) (filed Aug. 27, 2014).

Plainly, the expenses incurred in Accounts 1375 and 2375 are fuel costs.⁴⁸ There is no evidence in the record to the contrary. While EKPC believes that these costs are recoverable under 807 KAR 5:056, Section 1(3)(c) because they were incurred in an energy market operating on an economic dispatch basis and do not include any capacity or demand charges, even if the Commission disagrees, these costs should nonetheless be recoverable under Section 1(3)(b) of the regulation.

C. Recovery of Costs for Energy Purchased Through PJM is Consistent with Commission Policy and the Purpose of the FAC

As a matter of public policy, the FAC regulation fulfills several important purposes. From the utility's perspective, it reduces regulatory risk and regulatory lag by assuring that the utility is able to recover the most substantial portion of its variable expenses in a timely manner. From the Member's perspective, the regulation: (1) reduces the volatility of incremental changes in monthly bills caused by a utility's fuel price fluctuations;⁴⁹ (2) avoids the need to pay for the expense of sequential base rate cases;⁵⁰ and (3) provides a general benefit of lowering utility borrowing costs as a result of reduced regulatory risk and regulatory lag. In administering FAC tariffs, the Commission has expressed a preference that fuel costs should be the subject of "uniform treatment" such that "the potential for recovery of non-fuel related costs through FACs" is reduced.⁵¹ However, as demonstrated above, the application of the FAC regulation has

⁴⁸ See HVR 11:14:40 AM (Nov. 12, 2014). EKPC noted that had these cost codes been charged as fuel costs since the first date of EKPC's entry into PJM, then EKPC's Members would have been entitled to a credit of \$522,754 for the months of June 2013 to December 2013. EKPC agrees that this amount should be credited to EKPC's Members as part of an Order authorizing the recovery of these categories of expenses as fuel costs. See EKPC Response to Staff's Initial Data Request 26c(3) (filed Aug. 27, 2014); EKPC's Response to Staff's Supplemental Data Request 7b (filed Oct. 10, 2014).

⁴⁹ See EKPC Response to Staff Supplemental Data Request 3(a)-(b) (filed, Oct. 10, 2014).

⁵⁰ See *id.*

⁵¹ See *In the Matter of An Examination of the Application of the Fuel Adjustment Clause of East Kentucky Power Cooperative, Inc. from May 1, 2001 to October 31, 2001*, Order, Case No. 2000-00496-B (Ky. P.S.C., May 2, 2002).

never been so rigid that the Commission has lost sight of the over-riding legislative mandate to assure that EKPC's rates are "fair, just and reasonable," as required by KRS 278.030(1). The *Hope Doctrine* is alive and well in Kentucky law in determining rates charged by utilities, it is the outcome that matters most.⁵² In this case, EKPC believes that the FAC tariff may be applied as written without prejudicing either EKPC or its Members. EKPC is not asking the Commission to amend the FAC regulation or change the methodology for applying the FAC. Rather, EKPC simply asks the Commission to recognize that its energy costs incurred through the PJM energy market are, by virtue of that market's rules and parameters, made on an economic dispatch basis. Doing so requires the Commission to do nothing more than apply the FAC regulation in accordance with its plain terms. The FAC regulation may continue to be applied uniformly to all utilities without negating the value some utilities have achieved by operating within an RTO.⁵³

Applying the FAC tariff in accordance with its plain and ordinary meaning also satisfies the underlying concern that precipitated the Order in Case No. 2000-00496-B. For instance, in that Order, the Commission noted its concern that deregulation of the electric power wholesale market and "the increasing use of purchased power to meet native load requirements, would lead to disparate treatment of purchased energy costs."⁵⁴ The intervening twelve years have witnessed the PJM energy market develop and mature as a highly-structured wholesale market

⁵² See *National Southwire Aluminum Co. v. Big Rivers Electric Corp.*, 785 S.W.2d 503, 513 (Ky. App. 1990) ("[The Commission] has many appropriate rate-making methodologies available to it, and it must have some discretion in choosing the best one for each situation. Again, we must look more to whether the result is fair, just and reasonable rather than at the particular methodology used to reach the result.") (citation omitted); see also *Kentucky Indus. Utility Customers, Inc. v. Kentucky Utilities Company*, 983 S.W.2d 494, 498 ("[T]he Commission has discretion in working out the balance of interest necessarily involved and that it is not the method, but the result, which must be reasonable.") (citing *Federal Power Comm'n v. Hope Natural Gas*, 320 U.S. 591, 64 (1944)).

⁵³ See EKPC Response to Staff's Supplemental Data Request 3d (filed Oct. 10, 2014).

⁵⁴ See *In the Matter of An Examination of the Application of the Fuel Adjustment Clause of East Kentucky Power Cooperative, Inc. from May 1, 2001 to October 31, 2001*, Order, Case No. 2000-00496-B (Ky. P.S.C. May 2, 2002).

that operates on an economic dispatch basis, thereby tailoring the market to the express requirement of the FAC regulation and standardizing market terminology, commercial terms and billing codes to eliminate the Commission's original concern as to the potential for disparate treatment.

Finally, it must be remembered that while energy purchase expenses are being recovered through the FAC, this is just a part of the overall picture of EKPC's participation in PJM. As EKPC reported earlier this year, its participation in the PJM energy market had realized over \$14 million in trade benefits during the first ten months of full membership in PJM.⁵⁵ Those benefits would not have been realized if EKPC had continued to serve as its own balancing authority and had to serve native load with its own generating fleet. In fact, the extreme weather of January-February 2014 demonstrated that EKPC would not have been capable of doing this without significantly curtailing load.⁵⁶ The Commission previously recognized that the trade benefits associated with participation in the PJM energy market would "flow back to its 16 member cooperatives and their retail customers through the Fuel Adjustment Clause."⁵⁷ It would be inequitable for the Commission to commend EKPC for achieving meaningful trade benefits in the energy market and then punish EKPC by disallowing recovery of fuel costs which made those trade benefits possible. The FAC tariff – as it is currently written – provides an appropriate mechanism for recognizing both the cost and credits of participating in PJM's energy market.

⁵⁵ See EKPC's Response to Staff's Supplemental Data Request 3d (filed Oct. 10, 2014).

⁵⁶ See Note 19 *supra.*, and accompanying text.

⁵⁷ See EKPC Response to Staff's Initial Data Request 26b(1) (filed Aug. 27, 2014); *In the Matter of the Application of East Kentucky Power Cooperative, Inc. to Transfer Function Control of Certain Transmission Facilities to PJM Interconnection, LLC*, Order, Case No. 2012-00169, p. 20 (Ky. P.S.C., Dec., 20 2012).

IV. Conclusion

EKPC joined PJM in order to reduce costs for its Members through participation in PJM's energy market. Through the use of PJM's economic dispatched Day-Ahead and Real Time energy markets, EKPC has saved its Members over \$14 million in less than one year. The plain and ordinary understanding of EKPC's FAC tariff which is identical to 807 KAR 5:056, Section 1(3) allows for recovery of the net cost of all energy purchased on an economic dispatch basis. Purchases in PJM's energy market qualify as recoverable energy purchases made on an economic dispatch basis. But even if they did not, the record still demonstrates that the costs at issue in this proceeding are all fuel costs and, as such, are otherwise recoverable under 807 KAR 5:056, Section 1(3)(b) and the Company's corresponding tariff provision. The strict application of certain language set forth in an Order entered twelve years ago in Case No. 2000-00496-B is unnecessary and inappropriate for the many reasons set forth herein. Accordingly, EKPC respectfully requests the Commission to find that the costs incurred and passed through its FAC during the period under review were reasonably incurred and are recoverable.

This 17th day of December 2014.

Respectfully submitted,



Mark David Goss
David S. Samford
GOSS SAMFORD, PLLC
2365 Harrodsburg Road, Suite B325
Lexington, KY 40504
(859) 368-7740
mdgoss@gosssamfordlaw.com
david@gosssamfordlaw.com

Counsel for East Kentucky Power Cooperative, Inc.

CERTIFICATE OF SERVICE

This is to certify that a true and correct copy of the foregoing was served by depositing same into the custody and care of the U.S. Postal Service, postage pre-paid, on this the 17th day of December, 2014, addressed to the following:

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



Counsel for East Kentucky Power Cooperative, Inc.