

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF)	
KENTUCKY POWER COMPANY FOR 1))	
AUTHORITY UNDER KRS 278.2207(2) AND)	CASE NO.
KRS 278.2219 TO THE EXTENT)	2018-00287
REQUIRED TO ENABLE THE COMPANY)	
TO PAY FEES AND COSTS IMPOSED BY)	
THE GRID ASSURANCE, LLC)	
SUBSCRIPTION AGREEMENT; 2) THE)	
GRANT OF ALL OTHER REQUIRED)	
APPROVALS AND RELIEF)	

ORDER

On September 10, 2018, Kentucky Power Company (Kentucky Power) filed a Verified Application pursuant to 807 KAR 5:001, Section 19, KRS 278.2207(2), and KRS 278.2219(2), for (1) an order declaring that Grid Assurance, LLC (Grid Assurance), is not an affiliate of Kentucky Power such that the affiliate transaction rules in KRS Chapter 278 do not apply to the proposed transactions with Grid Assurance, or, alternatively, (2) an order approving necessary deviations from the affiliate transaction rules to allow Kentucky Power to enter into the proposed transactions with Grid Assurance.¹

There are no intervenors in this matter. At the request of Kentucky Power, an informal conference was held on September 6, 2018, to discuss Kentucky Power's proposed subscription to Grid Assurance and the applicability of KRS 278.2201 *et seq.* to Kentucky Power's purchase of goods and services under that subscription. Kentucky

¹ Application at 1. Kentucky Power also generally seeks "all other required relief or approvals."

Power supplemented its application on October 1 and 5, 2018, and responded to Commission Staff's First Request for Information (Response to Staff's First Request) on October 17, 2018. Kentucky Power originally requested a decision by October 15, 2018, but revised this request to November 17, 2018.²

BACKGROUND

Grid Assurance Sparing Service

Grid Assurance is a Delaware limited liability company.³ Kentucky Power states Grid Assurance was created "to address an increasingly critical and foreseeable need for grid resilience facing transmission-owning electric utilities."⁴ Grid Assurance "provides services to subscribing utility members designed to assist subscribing members in promptly restoring the bulk electric system in the wake of catastrophic events such as a natural disaster or a physical or cyber-attack."⁵ These services generally fall into three categories:

1. Purchasing and maintaining critical transmission infrastructure equipment;
2. Securely storing this equipment in strategic locations; and
3. Selling the equipment during certain types of emergencies to entities that have entered into an agreement with Grid Assurance.⁶

² Response to Staff's First Request, Item 24.

³ Application at 3.

⁴ *Id.* at 4.

⁵ *Id.* at 3.

⁶ *Id.* at 4–5.

More specifically, Kentucky Power states Grid Assurance purchases and maintains an inventory of new spare transformers, circuit breakers, and other critical transmission equipment (Inventoried Spares).⁷ The type and quantity of Inventoried Spares Grid Assurance maintains are based on the needs of transmission owners contracting with Grid Assurance (Subscribers), as indicated in their individual contracts with Grid Assurance known as Subscription Agreements.⁸ Grid Assurance stores the Inventoried Spares in secured warehouses “in areas that meet criteria for long-haul transportation facilities, security topology, weather, and environment.”⁹ Grid Assurance will sell Inventoried Spares under certain conditions pursuant to its Subscription Agreements. Upon the sale of an Inventoried Spare, Grid Assurance also provides delivery logistics,¹⁰ which includes advance logistic plans for transport of equipment from a Grid Assurance Warehouse (GA Warehouse) to pre-determined destinations designated by Subscribers.¹¹ Kentucky Power states “these advance plans will allow efficient and expeditious delivery in times of emergency.”¹²

⁷ *Id.* at 5–6.

⁸ *Id.*

⁹ *Id.* at 6.

¹⁰ *Id.*

¹¹ Response to Staff’s First Request, Item 10.

¹² *Id.*

Grid Assurance collectively refers to these services as its “Sparing Service.”¹³ A Subscriber will have a contractual right to receive Sparing Service pursuant to the Subscription Agreement’s terms.¹⁴

Qualifying Event Purchases

A Subscriber has a contractual right to purchase an Inventoried Spare if there is a Qualifying Event, which is defined in the Subscription Agreement to include various types of emergencies:

Any damage, destruction or other material impairment of the safe operation of any equipment comprising the electric transmission system of a Transmission Group Member, which damage, destruction or impairment is caused by, or the result of: (a) an act of war, terrorism, rebellion, sabotage or a public enemy, or any other physical attack (whether or not such physical attack is conducted in connection with an act of war, terrorism or a public enemy); (b) a cyber-attack, whether or not in connection with an act of war, terrorism or a public enemy; (c) an electromagnetic pulse or intentional electromagnetic interference; or (d) an act of God, a catastrophic event (natural or otherwise) or a severe weather condition, including a solar storm, earthquake, volcanic eruption, hurricane, tornado, derecho, windstorm, wildfire or ice storm.¹⁵

In a Qualifying Event purchase, the Subscriber pays “Original Cost,” which is “the total cost incurred by Grid Assurance to purchase or acquire that Inventoried Spare and have it delivered to a GA Warehouse, including all transportation and delivery charges, taxes, duties (including custom duties), assessments, fees (including import and export

¹³ Application at 5.

¹⁴ *Id.* at 7.

¹⁵ *Id.* at Exhibit 2, pp. 4-10, 50. Capitalized terms are defined in the Subscription Agreement. Grid Assurance has developed “Deployment Protocols” to establish the priority of sales if there are insufficient inventoried Spares.

fees) and other charges.”¹⁶ Kentucky Power states the Original Cost to be paid upon a Qualifying Event may be greater or less than the market price at the time, but anticipates comparable spares will be more costly because the Qualifying Event will likely increase the price of comparable spares.¹⁷ Additionally, comparable spares will likely be subject to long lead times, whereas Grid Assurance intends for Inventoried Spares to be readily available.¹⁸

Grid Assurance’s Discretionary Sales

The Subscription Agreement does not require Grid Assurance to sell equipment other than upon a Qualifying Event, but grants Grid Assurance the power to make certain Discretionary Sales of Inventoried Spares, defined as:

Any sale of any Inventoried Spare(s) by Grid Assurance other than a sale that is: (a) made to a Transmission Group Member; (b) due to damage or destruction caused by a Qualifying Event affecting the electric transmission system of that Transmission Group Member; (c) from an Equipment Class in which such Transmission Group Member is participating; and (d) in a quantity, for each such Equipment Class, no greater than the Nominated Quantity of such Transmission Group Member in that Equipment Class.

Kentucky Power explains that allowing Grid Assurance to make such optional sales provides Grid Assurance with the ability to better manage its inventory by, for example, mitigating risk of maintaining technologically or physically obsolete Inventory Spares.¹⁹

¹⁶ *Id.* at Exhibit 2 at pp. 8 and 21. Kentucky Power further explains Original Cost at Response to Staff’s First Request, Item 25.

¹⁷ Application at 11.

¹⁸ Response to Staff’s First Request, Items 19 and 22.

¹⁹ Application at 11.

Under the Subscriber Agreement, if a Subscriber asks to receive a Discretionary Sale, and Grid Assurance agrees, the sale will be at the greater of Original Cost or Replacement Cost of the Inventoried Spare, in which Replacement Cost means:

With respect to an Inventoried Spare, the total costs and expenses that Grid Assurance incurs or would incur to purchase or acquire new equipment to replace such Inventoried Spare and have it delivered to a GA Warehouse in accordance with Grid Assurance's policies, procedures and procurement practices, including all transportation and delivery charges, taxes, duties (including custom duties), assessments, fees (including import and export fees) and other charges, as such costs and expense are determined by Grid Assurance in its reasonable judgment.²⁰

Kentucky Power's Sparing Service Fee

Kentucky Power proposes to enter into a Subscription Agreement with Grid Assurance along with other AEP transmission-owning affiliates for Grid Assurance's Sparing Service.²¹ In exchange, Kentucky Power will pay a portion of the Sparing Service Fee (Kentucky Power's Contract Allocated Share).²² Kentucky Power explains the Sparing Service Fee is "designed to reflect Grid Assurance's costs, including its cost to purchase, store, and maintain an inventory of spare parts; general and administrative expenses; and financing costs."²³ The fee will also support Grid Assurance's return on equity (ROE), which "will be equal to the simple average of the then-current ROE in the transmission formula rates on file at FERC for all affiliates of the then-current owners of

²⁰ *Id.* at Exhibit 2, p. 21.

²¹ Kentucky Power will participate through a Multi-Subscriber Addendum, executed by American Electric Power Service Corporation on behalf of Kentucky Power and other AEP affiliates. A copy of the contemplated Multi-Subscriber Addendum was filed as Exhibit 2 to the application.

²² *Id.* at 7-9.

²³ *Id.* at 7-8.

Grid Assurance that have transmission formula rates on file at FERC.”²⁴ Kentucky Power states its portion of the fee is based on the asset makeup of the AEP affiliates participating in Grid Assurance.²⁵ Current projections have Kentucky Power’s Contract Allocated Share for June 2019 through May 2020, as \$11,000.²⁶

Kentucky Power states that, by entering into the Subscriber Agreement, it “gains access to the multiple benefits available . . . through Grid Assurance, including an enhanced ability to avoid the potentially devastating impacts of prolonged transmission outages by . . . [having] ready access to a pre-positioned and optimized inventory of critical transmission grid equipment.”²⁷ Kentucky Power states it anticipates acquiring Inventoried Spares from Grid Assurance only upon a Qualifying Event, but will retain the ability to request a Discretionary Sale.²⁸

The Subscription Agreement does not require Kentucky Power to purchase equipment from Grid Assurance under any circumstances, including upon a Qualifying Event or through Discretionary Sale.²⁹

Grid Assurance’s Ownership Structure

AEP Transmission Holding Company, LLC (AEP Transmission Holding), is a Delaware limited liability company wholly owned by American Electric Power Company,

²⁴ *Id.* at 8.

²⁵ *Id.* at 9.

²⁶ *Id.* at Exhibit 3, p. 4.

²⁷ Application at 10.

²⁸ *Id.* at 12.

²⁹ See Response to Staff’s First Request, Item 15.

Inc. (AEP).³⁰ Kentucky Power is also a wholly-owned AEP subsidiary, and Kentucky Power does not dispute that it and AEP Transmission Holding are affiliates under KRS 278.010(18).³¹

AEP Transmission Holding is one of six initial equity investors in Grid Assurance and, at this time, holds 16.67 percent equity in that company.³² Kentucky Power states final equity interests in Grid Assurance will not be determined until the date on which the company issues general interests (Transition Date), which is anticipated to be in the fourth quarter of 2018.³³ AEP Transmission Holding may increase its equity investment in Grid Assurance to approximately 30-35%, which would make AEP Holding Transmission the largest equity holder in Grid Assurance.³⁴

Although Kentucky Power has not provided a copy of Grid Assurance's operating agreement,³⁵ it represents Grid Assurance is or will be governed by a board of managers comprised of six or seven individuals.³⁶ Grid Assurance's board currently consists of six members appointed by the six equity owners.³⁷ According to Kentucky Power, at some point after the Transition Date, all board members will be elected by owners.³⁸ Although,

³⁰ Application at 2.

³¹ *Id.*

³² *Id.* at 4.

³³ *Id.*

³⁴ *Id.* at 13.

³⁵ See Response to Staff's First Request, Item 1.

³⁶ Application at 12.

³⁷ Response to Staff's First Request, Item 2.

³⁸ *Id.*, see also Item 3.

Kentucky Power states the founders “have expressed a desire” that each owner have no more than one representative on the board after the Transition Date equity owners will possess voting power with respect to the election of board members in proportion to their percentage ownership interest.³⁹ Board decisions will require different voting thresholds (e.g., majority) depending on the subject matter.⁴⁰

KENTUCKY POWER’S REQUEST AND ARGUMENTS

Kentucky Power seeks a declaration that Grid Assurance is not an affiliate under Kentucky’s affiliate transaction statutes and related regulations. Kentucky Power argues Grid Assurance is not an affiliate because it is an independent company managed by a board of managers, each with an equal vote, and AEP Transmission Holding will not have a controlling interest in the company.⁴¹

Alternatively, Kentucky Power requests deviation to the extent necessary from the affiliate transaction rules to: (1) pay all fees and costs required in connection with the Grid Assurance Subscription Agreement, including Kentucky Power’s Contract Allocated Share; (2) pay the purchase cost associated with purchases in connection with a Qualifying Event; and (3) pay the purchase cost associated with purchases in connection with a Discretionary Sale.⁴²

As for the Subscription Agreement fees and costs, Kentucky Power argues that, unlike inventory sharing arrangements, Grid Assurance’s purchase of inventory will

³⁹ *Id.*, Item 3.

⁴⁰ *Id.*, Item 5.

⁴¹ Application at 13 and 15

⁴² *Id.* at 21–22.

increase the supply of critical infrastructure equipment.⁴³ Thus, Kentucky Power argues, Grid Assurance provides a unique service for which there is no market comparison.⁴⁴ Kentucky Power argues the Contract Allocated Share is a cost-based fee and, thus, reasonable.⁴⁵

As for sales of equipment, Kentucky Power argues the Original Cost is fully distributed cost under KRS 278.2207(1)(b), and only in “limited circumstances” would the Original Cost be greater than the market price.⁴⁶ Kentucky Power argues that because Original Cost is cost-based, it is reasonable for both sales upon a Qualifying Event and Discretionary Sales.⁴⁷

As for Discretionary Sales to Kentucky Power, should Replacement Cost be greater than Original Cost?⁴⁸ Kentucky Power argues that Replacement Cost would be reasonable because “it approximates the market price Kentucky Power would otherwise pay for the Inventoried Spare in the absence of Kentucky Power being a Subscriber.”⁴⁹ Kentucky Power argues that Grid Assurance is likely to benefit from high volume sales not available to Kentucky Power as an individual customer, which will reduce Original and Replacement Cost.⁵⁰

⁴³ *Id.* at 17.

⁴⁴ *Id.*

⁴⁵ *Id.* at 16.

⁴⁶ *Id.* at 14.

⁴⁷ *Id.* at 16.

⁴⁸ *Id.*

⁴⁹ *Id.*

⁵⁰ *Id.*

Moreover, Kentucky Power argues typical sales of large equipment take up to two years, and, thus, purchases from Grid Assurance provide additional value in terms of short lead times and the ability to “rely upon a known dedicated inventory of new equipment for sparing purposes.”⁵¹

Kentucky Power further emphasizes the importance of grid resilience and argues that participation in Grid Assurance will support grid resilience.⁵² Kentucky Power argues that this contribution to grid resilience, combined with the program’s additional benefits described above, demonstrates the Subscription Agreement and related purchases are in the public interest.⁵³

FINDINGS AND CONCLUSIONS

Request for Declaration Grid Assurance is Not an Affiliate

KRS 278.2201 through 278.2219 contain specific provisions regarding a utility’s⁵⁴ interaction with affiliates. KRS 278.2207, in particular, imposes certain restrictions on “transactions between a utility and its affiliates.” “Affiliate” is defined at KRS 278.010(18) to mean “a person that controls or that is controlled by, or is under common control with, a utility.” “Control,” in this context, “means the power to direct the management or policies of a person through ownership, by contract, or otherwise.” Pursuant to KRS 278.040(3),

⁵¹ *Id.* at 16–17.

⁵² *Id.* at 18–20.

⁵³ *Id.*

⁵⁴ “Utility” is defined at KRS 278.010(3). Kentucky Power does not dispute it is a utility subject to the Commission’s jurisdiction.

the Commission has adopted regulations to further explain that an “affiliate” of a utility is an entity:

- (a) That is wholly owned by a utility;
- (b) In which a utility has a controlling interest;
- (c) That wholly owns a utility;
- (d) That has a controlling interest in a utility; or
- (e) That is under common control with the utility.⁵⁵

“Controlling interest in’ and ‘under common control with’ mean a utility or other entity if the utility or entity”:

- (a) Directly or indirectly has the power to direct, or to cause the direction of, the management or policies of another entity; and
- (b) Exercises that power:
 - 1. Alone or through one (1) or more intermediary companies;
 - 2. In conjunction with, or pursuant to an agreement;
 - 3. Through ownership of ten (10) percent or more of the voting securities;
 - 4. Through common directors, officers, stockholders, voting or holding trusts, or associated companies;
 - 5. By contract; or
 - 6. Through direct or indirect means.⁵⁶

⁵⁵ 807 KAR 5:001, Section 1(1).

⁵⁶ *Id.* at (4).

Thus, “control” in the context of the affiliate transaction statutes and regulations has been defined to include through direct or indirect means and specifically through ownership of ten (10) percent or more of voting security. Because AEP wholly owns both Kentucky Power and AEP Transmission Holding, and because AEP Transmission Holding owns more than ten percent of the voting membership of Grid Assurance, the Commission finds that Grid Assurance is an affiliate of Kentucky Power under these statutes and regulations. Therefore, transactions between Kentucky Power and Grid Assurance are subject to KRS 278.2207.

Request for Deviation under KRS 278.2207(2)

Because we find Grid Assurance is an affiliate of Kentucky Power, transactions between them must comply with KRS 278.2207 unless we grant a deviation. When not subject to a tariff, services, and products provided to a utility from its affiliate must be priced “at the affiliate’s fully distributed cost but in no event greater than market or in compliance with the utility’s existing USDA, SEC, or FERC approved cost allocation methodology.”⁵⁷ A utility may request a deviation “for a particular transaction or class of transactions” and, in doing so, “[t]he utility shall have the burden of demonstrating that the requested pricing is reasonable.”⁵⁸ “The [C]ommission may grant the deviation if it determines the deviation is in the public interest.”⁵⁹ Kentucky Power has requested such deviation in its application to: (1) pay all fees and costs required in connection with the Grid Assurance Subscription Agreement, including Kentucky Power’s Contract Allocated

⁵⁷ KRS 278.2207(1)(b).

⁵⁸ KRS 278.2207(2).

⁵⁹ *Id.*

Share; (2) pay the purchase cost associated with purchases in connection with a Qualifying Event; and (3) pay the purchase cost associated with purchases in connection with a Discretionary Sale.⁶⁰

Grid Assurance Subscription Agreement Cost

The Commission finds that the Contract Allocated Share to be paid by Kentucky Power under the Grid Assurance Agreement, as presented in the application and discovery responses, is reasonable and in the public interest. According to its application, Kentucky Power's Contract Allocated Share of the Sparing Service Fee is currently \$11,000 per year. Whether this fee is reasonable depends on the nature of the services provided in exchange for payment. By paying this amount, Kentucky Power will be entitled to Grid Assurance's Sparing Service. The Commission agrees this service will increase Kentucky Power's ability to restore electricity to customers during catastrophic events. In light of the service provided, the amount of the fee is reasonable, and it is in the public interest for Kentucky Power to enter into the Subscription Agreement.

However, the Commission recognizes that both the fee and services provided are subject to potential change, which could alter the Commission's determination. The Commission's approval for Kentucky Power to enter into the Subscription Agreement and pay the Contract Allocated Share of the Sparing Service Fee is, therefore, subject to the limitations in the Appendix.

Qualifying Event Purchases

The Commission finds that, upon a Qualifying Event, it is unlikely the market price would be less than the Original Cost available from Grid Assurance. The Commission

⁶⁰ Application at 21-22.

further agrees that, to the extent the market price is lower, it would likely include significant lead time, perhaps a year or more, resulting in a delay in restoring the affected equipment.⁶¹ The Commission finds a Qualifying Event purchase from Grid Assurance at Original Cost is reasonable and in the public interest when compared to a market transaction that includes significant lead time. The Commission, therefore, will approve these purchases, subject to the limitations in the Appendix. To the extent Kentucky Power is able to purchase equipment at a lower market price, without lead time so significant as to negatively affect Kentucky consumers, Kentucky Power is to purchase equipment at market price.

Purchases through Discretionary Sales

The Commission finds that Kentucky Power has failed to demonstrate purchases through Grid Assurance's Discretionary Sales present the type of emergency found in Qualifying Event purchases that justifies categorical deviation from affiliate transaction rules. Although the Commission agrees with Kentucky Power that a purchase through a Discretionary Sale at a price greater than market price is "highly unlikely,"⁶² the Commission finds this fact undermines, rather than supports, a request for deviation. Moreover, the Commission can quickly and efficiently grant deviation to any purchases through Discretionary Sales that do not otherwise meet the affiliate transaction requirements should the need arise and the evidence support the deviation. Kentucky Power's application for deviation for purchases through Discretionary Sales is therefore denied and Kentucky Power is instructed to comply with the affiliate transaction

⁶¹ See Response to Staff's First Request, Items 19 and 22.

⁶² *Id.*, Item 20.

requirements for these transactions unless and until it receives a separate Order from the Commission.

IT IS THEREFORE ORDERED that:

1. Kentucky Power's September 10, 2018 application is granted in part and denied in part.

2. Kentucky Power's request for a declaration that Grid Assurance is not a Kentucky Power affiliate is denied.

3. Kentucky Power's request for deviation from KRS 278.2207 to enter into the Grid Assurance Subscription Agreement and pay its Contract Allocated Share is granted in part, subject to the limitations in the Appendix.

4. Kentucky Power's request for deviation from KRS 278.2207 to purchase equipment from Grid Assurance upon Qualifying Events at Original Cost, when comparable equipment is subject to lead times that would result in a delay in restoring the affected equipment that would negatively affect consumers, is granted.

5. Kentucky Power's request for deviation from KRS 278.2207 to purchase equipment from Grid Assurance through a Discretionary Sale is denied without prejudice to Kentucky Power's ability to request deviation for specific purchases.

6. Kentucky Power shall provide final transfer, or if applicable, acquisition details, within 30 days of any Qualifying Event transaction occurring under the terms of the Grid Assurance agreement and shall supplement such initial reporting with subsequent final documents.

7. Any documents filed pursuant to ordering paragraph 6 of this Order shall reference the number of this case and shall be retained in Kentucky Power's post-case correspondence files.

8. This Order in no way affects the authority of the Commission over rates, services, or any matters whatsoever subject to the Commission's jurisdiction that may come before it, nor shall anything herein be construed as acquiescence in any estimate of costs or any valuation of property claimed or asserted. The Commission retains jurisdiction over this subject matter and Kentucky Power to effectuate the provisions of this Order.

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

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By the Commission

ENTERED
NOV 15 2018
KENTUCKY PUBLIC
SERVICE COMMISSION

ATTEST:


Executive Director

APPENDIX

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2018-00287 DATED **NOV 15 2018**

1. The Commission's approval for Kentucky Power to enter into the Subscription Agreement is limited to five years. Should Kentucky Power wish to continue as a party to the Subscription Agreement beyond that period, separate approval shall be required.
2. Kentucky Power shall notify the Commission should there be any change in the Sparing Service to be provided by Grid Assurance or in the fee to be paid by Kentucky Power for that service. A copy of the correspondence regarding those changes shall reference the number of this case and will be kept in the utility's general correspondence file and subject to Commission review.
3. Kentucky Power shall notify the Commission of the terms of any purchase from Grid Assurance within 30 days of purchase. A copy of the correspondence regarding those purchases shall reference the number of this case and will be kept in the utility's general correspondence file and subject to Commission review.
4. This Order shall have no accounting or ratemaking implications.

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