

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

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

RESPONSES TO ATTORNEY GENERAL'S INITIAL DATA REQUEST
TO EAST KENTUCKY POWER COOPERATIVE, INC.
DATED APRIL 20, 2018

EAST KENTUCKY POWER COOPERATIVE, INC.
PSC CASE NO. 2018-00050
RESPONSE TO INFORMATION REQUEST

ATTORNEY GENERAL'S INITIAL DATA REQUESTS DATED 04/20/18
REQUEST 1

RESPONSIBLE PARTY: Don Mosier

Request 1. Refer to the direct testimony of Mr. Don Mosier, pages 4-5.

Request 1a. What specific details, risks, benefits or assumptions does Mr. Mosier believe should have been included or considered in the contemplated empirical analyses?

Response 1a. Because of the significant and material changes that could occur over a vast period of 20 years, it is impossible to identify the specific risks and/or benefits. Suffice to say, however, SKRECC analyses should have included a broad range of reasonable outcomes and assessed whether those outcomes were within the risk tolerance of SKRECC. The Application materials do not reflect that such analyses were conducted.

See also EKPC Response to Commission Staff's First Request for Information, Request 2 and EKPC's Response to SKRECC's First Request for Information, Request 17a.

Request 1b. In referencing the likelihood that Morgan Stanley has conducted analyses ensuring “that it will benefit from the transaction,” is it Mr. Mosier’s opinion that a series of transactions such as the instant Application is a zero-sum game, in that either of the parties can receive benefits, but not both? Explain your response in complete detail.

Response 1b. Not necessarily. An “arm’s length” transaction implies both counterparties believe they will accrue benefits in the transaction. SKRECC has indicated it is receiving significant benefits. The intent of my testimony was to highlight the fact, informed by my own experience transacting with Morgan Stanley and other similarly sophisticated commodity traders, that Morgan Stanley has the analytical depth, market experience, deal management and internal risk management expertise to adequately stress test their risks. I did not see in the Application materials this same level of analysis by SKRECC. Also, as noted by Mr. McNalley in his testimony at page 12-13, a significant portion of the perceived benefit by SKRECC is the cost shifting to other owner-members as opposed to an inherent advantageous financial position *vis-à-vis* Morgan Stanley under the contract.

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REQUEST 2

RESPONSIBLE PARTY: Don Mosier

Request 2. Refer to the direct testimony of Mr. Don Mosier, pages 9-10.

Request 2a. Explain why the confusion and unanswered questions pertaining to the purchase of firm capacity “are concerning to me and should concern this Commission.”

Response 2a. First, SKRECC has not fulfilled its eventual PJM RPM capacity obligation. As stated in my testimony, EKPC first learned of this omission in SKRECC’s response to Commission inquiry. In the Capacity Confirm, it has transacted for a financial fixed-for-floating derivative transaction to lock in a specific, fixed capacity price exposure when it has yet to physically fulfill that obligation.

Further, it is concerning to me that this derivative hedge creates unnecessary and avoidable exposure to economic risk. Section 4 of the Capacity Confirm puzzlingly refers to the EEI Master Power Purchase and Sale Agreement instead of the International Swaps and Derivatives Association (“ISDA”) document that the parties signed, the latter being applicable to such forms of derivative transactions. EEI Master Agreements pertain to products with physical

attributes, not derivative products. For whatever reason, SKRECC desired to settle on a fixed price hedge to its as yet unpurchased capacity price exposure, which price point is jeopardized by the agreement's Change in Law provisions. When taken in conjunction with statements in the instant Application that are referenced in my testimony, (page 9, lines 16 – 19), regarding the capacity needs of the Alternate Resource, it causes concern regarding the general understanding of the transaction and its inherent risks. In other words, it does not satisfy the physical RPM capacity needs, curiously imbues physical attributes to a financial derivative, and appears to confuse the EEI Master Agreement's applicability to a derivative product. Were it simply a price hedge sought by SKRECC, the Capacity Confirm should have referenced the aforementioned ISDA agreement as the base document, and avoided the need for detailed Change in Law provisions.

Request 2b. If Mr. Mosier believes there are inherent risks of the portion of the agreement, explain those risk and describe the most likely consequences to EKPC, South Kentucky RECC ("SKRECC"), or SKRECC's customers.

Response 2b. Please refer to the response to Request 2a. above.

Request 2c. Explain why the Capacity Confirm is unnecessary.

Response 2c. It is unnecessary to achieve SKRECC's need for a physical RPM product. It is an optional hedge to future capacity pricing.

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REQUEST 3

RESPONSIBLE PARTY: Don Mosier

Request 3. Refer to the direct testimony of Mr. Don Mosier, pages 6-7.

a. Does Mr. Mosier believe that a potential change in law such as, for example, increased regulatory requirements under the federal government's Coal Combustion Residual Rule, or any provision in a state having jurisdiction over one or more of the generating sources producing power under the contemplated PPA, could, or likely may, cause SKRECC's costs to increase under the PPA? Provide a discussion.

Response 3. Yes. Refer to my testimony where I discuss potential for states to adopt Green House Gas mechanisms that impose unanticipated costs as a risk that cannot be discerned or assessed over a potentially multi-jurisdiction transaction. Also, see above responses.

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REQUEST 4**

RESPONSIBLE PARTY: Mike McNalley

Request 4. Refer to the direct testimony of Mr. Mike McNalley, pages 5 & 9-10.

a. Provide an estimated benefit to EKPC's 16 cooperatives, individually, from the "mitigation actions in the ordinary course of business" over the next few years if the contemplated transaction is not approved.

i. Is it Mr. McNalley's opinion that these benefits should be included in any "baseline" comparison SKRECC or the Commission conducts of the proposed transaction?

Response 4. It is not possible to estimate these benefits because they depend on opportunities arising and being seized by EKPC. For example, if an employee left EKPC and we could reallocate work such that a replacement was not hired, that would be an action in the ordinary course of business. When it would occur and how much might be saved is speculative. Or, if a new industrial customer were to locate in an owner-member's territory, the positive impact in offsetting system expense would benefit all owner-members. Over time, developments such as these can accumulate to significant mitigation benefits, helping EKPC offset inflationary pressures and defer potential rate increases. I do not believe these benefits should be included in any

“baseline” comparisons of the proposed transaction because these are independent of the transaction.

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REQUEST 5

RESPONSIBLE PARTY: Mike McNalley

Request 5. Refer to the direct testimony of Mr. Mike McNalley, page 9.

Request 5a. Explain the process involved should EKPC “undertake cost of service and rate design studies” as a result of the approval of the proposed transaction.

Response 5a. Such studies would be undertaken in the context of a base rate case and would be submitted in conjunction with a rate application. The process of conducting those studies would involve rate design and cost of service consultants and EKPC staff developing and analyzing options, then presentation to EKPC management and its Board for approval and authorization to submit the overall rate case to the Commission for consideration and approval.

Request 5b. Confirm that upon a change in rate design, the “savings” SKRECC contemplates under the proposed transaction that are actually shifts in fixed costs currently allocated to SKRECC, could diminish or disappear under a new allocation methodology.

i. Is it Mr. McNalley’s opinion that SKRECC has properly considered this possibility? Provide a discussion.

Response 5b. Some or all of the savings SKRECC contemplates could diminish or disappear under a new allocation methodology, if such a methodology is developed and approved. I do not see this possibility having been considered by SKRECC in the record of this case. I presume that in ignoring this possibility, SKRECC is relying on Memorandum of Understanding (“MOU”) language that prohibits assessments of stranded costs against an owner-member because said owner-member has elected an Alternate Source; however, EKPC’s intent in designing such a methodology would not be to single out SKRECC, but rather to achieve a legal, fair, just, and reasonable rate design for all EKPC owner-members.

Request 5c. Provide an estimate of the costs involved with preparing the cost of service and rate design studies discussed in subpart (a) of this question, together with costs to address such issues in EKPC’s next base rate case.

Response 5c. Based on EKPC’s most recent work in this area, the likely cost would be several hundred thousand dollars.

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REQUEST 6

RESPONSIBLE PARTY: Mike McNalley

Request 6. Refer to the direct testimony of Mr. Mike McNalley, page 14.

Request 6a. Explain how EKPC calculated the administration fee incorporated in its cogeneration tariffs.

Response 6a. The administration fee in the 2017 cogeneration tariff is based on EKPC's costs associated with the services it receives from Alliance for Cooperative Energy Services and the costs to operate EKPC's Market Operations Center. The sum of these costs was then divided by the real time generation for 2016 to arrive at a per kWh rate.

Request 6b. Explain if there are any inherent differences between QFs taking under the cogeneration tariffs and SKRECC that may cause the administration fee to be different between them.

Response 6b. The expense for the agency agreement will likely be different than the Cogeneration Tariff administration fee because there will be different services provided. As noted in EKPC's response to the Commission Staff's First Request for Information, Item 1, the methodology for determining the expenses for the agency agreement would be the same as the methodology used to develop the administration fee of the Cogeneration Tariff. What was not known until SKRECC responded to EKPC's Supplemental Data Request, Item 4, was the list of services SKRECC desires. Section 5.E.vii of the MOU calls for EKPC to act as agent for the Alternate Source and load in the PJM market. The list of services listed in SKRECC's response to EKPC's Supplemental Data Request, Item 4, and the list of services implied in the MOU Section 5.E.iv is beyond the scope of what is included in the Cogeneration Tariff administration fee calculation.

Request 6c. Provide and explain what a reasonable escalation assumption for the administration fee may be for 20 years.

Response 6c. SKRECC first provided its initial listing of four minimum items to be included in the agency agreement in its response to the Commission Staff's First Request for Information, Item 16. It later expanded this list to 14 items in its response to EKPC's Supplemental Data Request, Item 4. Consequently, determining the "appropriate" escalation factor cannot be performed at this time. However, it clearly is unreasonable to assume the agency fee would not

change during the 20-year period. A fixed agency fee for the period would likely result in cost-subsidization of SKRECC's agency agreement by the other owner-members.

Request 6d. Explain, and quantify if possible, the risk to SKRECC and its customers if the proposed transaction is approved but EKPC and SKRECC are unable to agree to an agency agreement and fee.

Response 6d. EKPC will, in good faith, attempt to consummate an agency agreement with SKRECC at a negotiated fee. EKPC's interest will be to: (a) conform to the requirements of sections E of the MOU and (b) to ensure that all costs are borne by SKRECC and there is no subsidy to or from other EKPC owner-members. The MOU also provides for a dispute resolution by the Commission.

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REQUEST 7

RESPONSIBLE PARTY: **Don Mosier and Mike McNalley**

Request 7. Reference the direct testimony of Messrs. Don Mosier and Mike McNalley generally

Request 7a. Provide an approximate amount of “Environmental Costs” EKPC has expended over the time horizons of: the past 20 years, the past 10 years and the past 5 years. Any response should attempt to categorize the spending generally (i.e. ELG/CCR compliance, scrubbers, etc.).

Response 7a. Over the past twenty years, EKPC has expended over \$1 billion on environmental related projects, which were comprised of plant environmental capital projects of \$947 million, landfill capital projects of \$32 million, and \$25 million for settlement of ash asset retirement obligations. Plant environmental capital projects include CFB projects of \$166 million, SCR/Scrubber projects of \$761 million, and monitoring/drainage and other projects of \$20 million. Ongoing operation and maintenance (O&M) expenses associated with environmental assets for the same twenty years were approximately \$310 million.

Looking at these same costs over the past 10 year horizon, approximately \$782 million was expended on projects while O&M was approximately \$282 million.

Looking at these same costs over the past 5 year horizon, EKPC expended approximately \$95 million on capital projects while O&M was approximately \$168 million.

Request 7b. Provide a brief explanation of how EKPC currently allocates environmental costs.

Response 7b. EKPC's environmental surcharge is allocated to its owner-members under the percentage of revenue approach. One monthly surcharge factor is calculated and this surcharge factor is applied to the monthly billings. The surcharge factor is applied to the sum of the demand charge, energy charge, FAC, metering point charge, and substation charge. Green power revenues are excluded from the calculations. In addition, a credit is applied to those owner-members participating in the direct load control program.

Request 7c. Provide a brief explanation of any contemplated methodologies that EKPC could use to allocate environmental costs if the proposed transaction is approved. Any response may consider whether other cooperatives have made amendment 3 elections or not.

Response 7c. We would not anticipate any change in the allocation methodology for environmental costs under the Environmental Surcharge Mechanism. This mechanism will

“automatically” reallocate environmental costs based on the revenues of the owner-member systems, and thereby shift a portion of these costs immediately from SKRECC to the other 15 owner-members.

Request 7d. State whether EKPC’s estimates of cost impacts should the contemplated transaction be approved include the estimated \$262 million in new environmental costs as set forth in Case No. 2017-00376. If not, discuss how those new costs would be reallocated in the event the Commission should approve the contemplated transaction in the instant case.

Response 7d. The costs referenced in the question have not been included because (a) the analysis of potential cost shifting was done based on actual Environmental Surcharge costs and allocations to show how those actual amounts would have been different under the proposed transaction, and (b) the cited case has not been decided.

The costs referenced in the question will be included over time as the project is completed and funds are expended and eligible for recovery. If the SKRECC 58MW and 508,080 MWh leaves EKPC’s system, the revenue associated with them will leave and the Environment Surcharge allocation calculation will reflect that change, effectively shifting costs to the remaining systems. This will persist throughout the duration of the SKRECC contract, and thus will impact recovery of the costs referenced in this question in a similar manner.

Request 7e. Provide an exhibit identical to MM-2 and MM-3, but using EKPC's 5-year average escalation for the NITS transmission rates.

Response 7e. Please see Attachment AG 7e. The escalation rate for the NITS transmission was the only difference between Exhibits MM-2 and MM-3. Consequently, using the same escalation rate results in both exhibits producing identical results. The attached exhibits are being treated confidentially, pending SKRECC's request for confidential treatment.

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REQUEST 8

RESPONSIBLE PARTY: Don Mosier

Request 8. Reference the direct testimony of Messrs. Don Mosier, Mike McNalley, and Anthony Campbell generally.

Request 8a. Is EKPC aware of any agreements similar to the proposed transaction for a time period exceeding 15 years? i. If so, provide citation to same.

Response 8a. EKPC is not aware of any similar fixed-price energy transactions exceeding 15 years, that do not have specific assets identified and with some form of energy price indexing, variable cost pass through, and/or other mechanisms to routinely adjust energy pricing during the term. EKPC is not aware of any fixed-for-floating capacity price hedges.

Request 8b. If EKPC is aware of any examples of long-term agreements such as the one proposed, is it aware of whether they were intended to be cost-effective and whether or not the transactions were actually cost-effective. Conversely, is EKPC aware of any examples where similar long-term agreements were not cost-effective over the entire term, If so, please identify and discuss.

Response 8b. No.

Request 8c. Does EKPC believe that the fact that Morgan Stanley does not disclose the location of the generation source(s) increases the risk of changes in environmental law? Provide a discussion.

Response 8c. Yes. Since the Confirms are not specific regarding the types and locations of its generation sources, SKRECC is taking on unidentifiable risks. If the generation source location is in a state or region that intends to restrict emissions or output, then that risk is greater. Because the states have some latitude in implementation of federal rules, the state's "attitude" also might result in higher risk related to the same federal rules EKPC would be exposed to. Finally, the plant type and modifications installed (unit type, age, fuel source, emissions equipment already operational, etc.) might make it more or less susceptible to changes in environmental law – without knowing the source or its location it is not possible to make a valid comparison of the risks relative to EKPC's risk.

Request 8d. Is it EKPC's understanding that it and its 16 owner-members are generally concerned about customers not paying their reasonable allocation of "fixed" costs, including generation, transmission and distribution "fixed" costs, such as in instances that may arise as a result of KRS 278.466?

Response 8d. To the extent a customer or group of customers can benefit from shifting legitimate cost responsibilities to other customers, then, yes, this is a concern of EKPC.

Request 8d.i. Has EKPC or its personnel had any discussion with SKRECC personnel regarding KRS 278.466 or any revisions thereto within the last twelve (12) months?

Response 8d.i. Not to EKPC's knowledge.

Request 8d.ii. Is EKPC aware of any formal or informal position SKRECC has, or has taken, regarding any revision to KRS 278.466?

Response 8d.ii. Not to EKPC's knowledge.

Request 8d.iii. Does EKPC believe Kentucky's current net metering law should be changed? If so, is the allocation of fixed costs one of its concerns?

Response 8d.iii. The fundamental issue in the net metering law is similar to a fundamental issue in this case, namely that the system can be utilized in a manner that benefits a few at the cost of the many. By way of illustration, in the case of net metering for rooftop solar, the benefits accrue to homeowners who have the wealth and interest in installing solar panels on their homes, and the fixed or unavoidable costs of the electric system are thereby shifted to other rate payers, likely of lesser economic means. In this case, the fixed costs of the EKPC system are being

bypassed to some degree by SKRECC and therefore shifted to the remaining owner-members and their end-use retail members, who receive no benefit that corresponds to those additional costs.

Request 8e. Does EKPC believe the proposed transaction will more likely than not be cost-beneficial to SKRECC's customers? If not, why not?

Response 8e. The proposed transaction will allow SKRECC to avoid EKPC fixed costs at the time SKRECC begins to take energy and capacity pursuant to the agreement with Morgan Stanley. However, those cost avoidances, which are really shifts to the other owner-members of EKPC, may come back to SKRECC in whole or in part in future EKPC base rate cases. The costs that SKRECC estimated in its analyses of the proposed transaction understated some items as demonstrated in Mr. McNalley's testimony and Mr. Wolfram's testimony. Additionally, the SKRECC analyses are "point" estimates which do not include a range of possible outcomes and costs associated with the many risks inherent in the transactions. Taken together, these suggest that there is a significant possibility that the proposed transaction may not prove to be cost-beneficial to SKRECC's members, or as cost beneficial as SKRECC believes.