

**COMMONWEALTH OF KENTUCKY**  
**BEFORE THE PUBLIC SERVICE COMMISSION**

**In the Matter of:**

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

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**DIRECT TESTIMONY OF ANTHONY S. CAMPBELL**  
**ON BEHALF OF EAST KENTUCKY POWER COOPERATIVE, INC.**

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**Filed: April 12, 2018**

1 **Q. Please state your name, business address, and occupation.**

2 A. My name is Anthony S. Campbell and my business address is East Kentucky Power  
3 Cooperative, Inc. (“EKPC”), 4775 Lexington Road, Winchester, Kentucky 40391. I am  
4 President and Chief Executive Officer (“CEO”) of EKPC.

5 **Q. Please state your education and professional experience.**

6 A. I obtained a Bachelor of Science degree in electrical engineering from the University of  
7 Southern Illinois at Carbondale and a Masters of Business Administration from the  
8 University of Illinois at Champaign. I have been employed by EKPC since June 2009.  
9 Prior to joining EKPC, I served as CEO of Citizens Electric Corporation, an electric  
10 transmission and distribution cooperative located in southeast Missouri.

11 **Q. Please provide a brief description of your duties at EKPC.**

12 A. The EKPC Board of Directors has given me, as CEO, the responsibility for managing the  
13 Cooperative’s business on a day-to-day basis. I develop and recommend to the Board  
14 EKPC’s objectives and policies, short- and long-range plans, and annual budgets and work  
15 plans. I administer the Board’s approved wage and salary plan, authorize prudent  
16 investments, administer the budget, implement policies, plans and programs established by  
17 the Board, ensure an appropriate organizational structure, negotiate contracts, and submit  
18 periodic and special reports to the Board on operations, financial issues, budgets, power  
19 supply, rates, construction, and other areas. This is just a sampling of the responsibilities  
20 established for the president and CEO in EKPC Board policy.

21 **Q. What is the purpose of your testimony in this proceeding?**

22 A. The purpose of my testimony is to discuss the Wholesale Power Contract between EKPC  
23 and each of its 16 owner-members and more specifically Amendment No. 3 to the  
24 Wholesale Power Contract. I will also discuss the 2015 Memorandum of Understanding

1 and Agreement (“MOU”) that EKPC and the owner-members reached to attempt to resolve  
2 allocation issues in Amendment No. 3. Lastly, I will discuss EKPC’s concerns about how  
3 the power purchase agreement proposed by South Kentucky Rural Electric Cooperative  
4 Corporation (“South Kentucky”) affects the cooperative relationship between South  
5 Kentucky, EKPC, and the 15 remaining owner-members.

6 **Q. Please describe the Wholesale Power Contract.**

7 A. The Rural Utilities Service<sup>1</sup> (“RUS”) requires its borrowers to enter into contracts for the  
8 purchase and sale of power as a precondition to lending funds. Effective October 1, 1964,  
9 EKPC entered into separate Wholesale Power Contracts with each of its owner-members.  
10 These contracts replaced and superseded the 1951 Wholesale Power Contracts. Each of  
11 the 1964 Wholesale Power Contracts contained identical provisions and were subject to  
12 the approval of the RUS Administrator in accordance with various terms of the loan  
13 agreements in place among RUS, EKPC and the owner-members. The RUS Administrator  
14 approved the Wholesale Power Contracts entered into by EKPC and the owner-members.  
15 The 1964 Wholesale Power Contracts were to remain in effect until January 1, 2010.

16 **Q. Have the Wholesale Power Contracts between EKPC and the owner-members been**  
17 **amended since 1964?**

18 A. Yes, the 1964 Wholesale Power Contracts have been amended four times. Each of the  
19 amendments was required by RUS in conjunction with long-term loans EKPC was seeking  
20 for the construction of generating assets. Each of the amendments extended the term of  
21 the Wholesale Power Contracts. Amendment No. 1 was executed as of November 1, 1976  
22 and extended the term of the Wholesale Power Contracts to January 1, 2018. Amendment  
23 No. 2 was executed as of April 1, 1980 and extended the term to January 1, 2025.

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<sup>1</sup> Formerly the Rural Electrification Administration.

1 Amendment No. 3 was executed as of October 17, 2003 and extended the term to January  
2 1, 2041. Amendment No. 4 was executed as of May 12, 2009 and extended the term to  
3 January 1, 2051.

4 **Q. Did these amendments result in any other changes to the provisions of the Wholesale**  
5 **Power Contracts?**

6 A. Yes. In addition to extending the term of the Wholesale Power Contract, Amendment No.  
7 3 provides each owner-member certain limited rights to obtain a portion of its power  
8 requirements from a source or sources other than EKPC. Specifically, Amendment No. 3  
9 indicates that each owner-member is permitted to purchase power and energy from an  
10 entity other than EKPC in an amount up to 15 percent of the rolling average of the owner-  
11 member's highest coincident peak demand occurring during each of the three 12-month  
12 periods immediately preceding the election of this option by the owner-member  
13 ("Member's Peak Demand"). However, Amendment No. 3 explicitly limits the aggregate  
14 of the owner-members' non-EKPC purchases to no more than 5 percent of the rolling  
15 average of EKPC's highest coincident peak demand occurring during each of the three 12-  
16 month periods immediately preceding the election of this option by the owner-member  
17 ("EKPC's Peak Demand").

18 **Q. Does Amendment No. 3 address how to allocate the right to purchase non-EKPC**  
19 **power among the owner-members when one owner-member seeks to purchase more**  
20 **than 5 percent of its coincident peak load?**

21 A. No, the methodology for allocation was not set forth in Amendment No. 3. The ambiguity  
22 inherent in Amendment No. 3 is likely the product of the fact that it was principally drafted  
23 by RUS for the primary purpose of extending the existing term of the Wholesale Power  
24 Contract. The language of Amendment No. 3 is silent with regard to the circumstances by

1 which allocations of such off-system resources shall be apportioned. The EKPC Board  
2 attempted to establish an allocation approach through the adoption of a board policy in  
3 2004.

4 In March 2004, EKPC's Board approved "Board Policy No. 305,"<sup>2</sup> which  
5 established allocation procedures for non-EKPC sourced power acquisitions under  
6 Amendment 3. Board Policy No. 305 established an "Allocation Pool" reflecting the  
7 combined total of the unused portions of each owner-member's load ratio share of the 5  
8 percent of EKPC's Peak Demand. It also created an "Allocation Committee"<sup>3</sup> to  
9 administer the assignment of the Allocation Pool to requesting eligible owner-members.  
10 Within 90 days of the adoption of Board Policy No. 305, each owner-member was required  
11 to submit a detailed written plan of its intended use of its load ratio share of the 5 percent  
12 of EKPC's Peak Demand. Unused portions of the load ratio share of the 5 percent of  
13 EKPC's Peak Demand or portions from plans that were not executed were placed in the  
14 Allocation Pool. At any time after the submission of the initial plan, an owner-member  
15 that desired its initial allocation or an allocation greater than its load ratio share of the 5  
16 percent of EKPC's Peak Demand had to submit a written request to the Allocation  
17 Committee. The Allocation Committee would then vote whether to grant the request. Any  
18 determination or decision of the Allocation Committee could be reviewed by the EKPC  
19 Board of Directors at the request and upon the motion of any Director and the EKPC Board  
20 could affirm, overturn, or modify such determination or decision at its discretion.

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<sup>2</sup> The objective of Board Policy No. 305 was to provide a reasonable mechanism to allocate the 5 percent of EKPC's Peak Demand among the owner-members so that those owner-members with specific identifiable projects wishing to utilize the 15 percent of the Member's Peak Demand could proceed in a timely manner.

<sup>3</sup> The Allocation Committee reported directly to the EKPC Board of Directors. The Allocation Committee had five members, three of whom were Managers or CEOs of the owner-members, one who was an owner-member representative on the EKPC Board, and one who was an employee or other representative of EKPC.

1 **Q. In the years after 2004, did this Board Policy adequately address the allocation issue?**

2 A. In some, but not all respects. The first formal election under Amendment No. 3 occurred  
3 in 2005, with a second election in 2010 and a third election in 2011. In two of the three  
4 elections, the electing owner-member did not request to go beyond the 5 percent threshold.  
5 The 2010 election, however, was for 15 percent of the Member's Peak Demand at a 100%  
6 load factor. I suggested to that owner-member and the Board that this wasn't fair and I felt  
7 that 5 percent across the board was the only option fair to all owner-members, plus I  
8 disagreed with the appropriateness of a 100% load factor. I suggested this needed to be  
9 fixed. The owner-member withdrew its request for the reason it was not in the cooperative  
10 spirit. During 2011 and 2012, the EKPC Board and the owner-members held numerous  
11 extensive discussions in an attempt to develop a fair and reasonable allocation procedure.  
12 While these discussions were occurring, another owner-member did submit a formal  
13 election under Amendment No. 3, which would have involved a purchase utilizing the  
14 owner-member's full 15 percent of its coincident peak demand. Again, EKPC stressed that  
15 this request was unfair and the Board rejected it. As a result, this owner-member filed a  
16 formal complaint case at the Commission in late 2012.<sup>4</sup>

17 **Q. How was this complaint case eventually resolved?**

18 A. EKPC proposed to modify the provisions of Amendment 3 to allow each owner-member  
19 to obtain 5 percent of its load from non-EKPC source(s) and further proposed that if an  
20 owner-member wanted more than that proposed allocation, the owner-member would need  
21 to negotiate with another owner-member to acquire a portion of that owner-member's

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<sup>4</sup> See *In the Matter of Petition and Complaint of Grayson Rural Electric Cooperative Corporation for an Order Authorizing Purchase of Electric Power at the Rate of Six Cents per Kilowatts of Power Vs a Rate in Excess of Seven Cents per Kilowatt Hour Purchased from East Kentucky Power Cooperative Under a Wholesale Power Contract as Amended Between Grayson Rural Electric Cooperative Corporation and East Kentucky Power Cooperative, Inc.*, Case No. 2012-00503.

1 allocated 5 percent. Three of EKPC's owner-members refused to support such a proposed  
2 resolution. Ultimately, our owner-members' CEO's and EKPC reached a resolution of the  
3 Amendment No. 3 allocation issues through the adoption of the MOU. The MOU  
4 expressly stated that it was not to be construed as a modification of any provisions of  
5 Amendment No. 3. In its December 18, 2015 Order, the Commission found that the MOU  
6 resulted in a reasonable resolution of the issues that had been under investigation in that  
7 case. The Commission acknowledged the MOU's statement that it was not intended to  
8 modify the terms of Amendment No. 3, and the Commission required EKPC to file a copy  
9 of the MOU with the signature pages of each owner-member using the Commission's  
10 Tariff Filing System. The Commission then closed the complaint case. After the adoption  
11 of the MOU, Board Policy No. 305, described above, was rescinded in April 2016.

12 **Q. Please describe how the MOU attempted to resolve the Amendment No. 3 allocation**  
13 **issue.**

14 A. The MOU establishes certain thresholds that in turn determine whether the owner-member  
15 making an election for an "alternate source" of power<sup>5</sup> is limited to 5 or 15 percent of the  
16 rolling average of the Member's Peak Demand. The thresholds are based on the  
17 relationship of the aggregate amount of all owner-member loads being served with  
18 alternate sources, including the load included in the owner-member election notice, and the  
19 rolling average of EKPC's Peak Demand. If the aggregate amount reflects less than 2.5  
20 percent of the EKPC rolling average, then the owner-member's election cannot be more  
21 than 15 percent of the Member's Peak Demand. If the aggregate amount reflects 2.5

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<sup>5</sup> As defined in the MOU in Section 2(A), an alternate source is any generating resource that is owned (directly or indirectly, in whole or in part) or controlled (directly or indirectly, in whole or in part) by an owner-member, regardless of whether the resource is connected to the owner-member's distribution system, or any power purchase arrangement under which an owner-member purchases capacity or energy (or both), if such generating resource or power purchase arrangement is used to serve any portion of the owner-member's load.

1 percent or more of the EKPC Peak Demand, then the owner-member's election cannot be  
2 more than 5 percent of the Member's Peak Demand. If the aggregate amount reflects more  
3 than 5 percent of the EKPC Peak Demand, the owner-member's election is not permitted  
4 unless the load to be served is reduced so that the 5 percent threshold is not exceeded.

5 **Q. South Kentucky filed its notice of election on November 28, 2017. At that time, what**  
6 **was the aggregate amount of all owner-members' loads being served by alternate**  
7 **sources, including the South Kentucky election?**

8 A. The total aggregate amount of all owner-members' loads being served by alternate sources,  
9 including the 58 MW election by South Kentucky, was 69.2 MW. The other 11.2 MW that  
10 had been elected by owner-members were utilized for "back of the meter" initiatives such  
11 as three landfill gas projects totaling 4 MW, two diesel units totaling 3.6 MW, and an  
12 owner-member's utilization of a 2 MW gas unit for its office complex. Based on the  
13 applicable coincident peak data, this 69.2 MW represents 2.32 percent of the rolling  
14 average of EKPC's Peak Demand.

15 **Q. Given these calculations, how much more load could be served by alternate sources**  
16 **before the 2.5 percent threshold would be reached?**

17 A. Based on the date South Kentucky provided in its election notice and the applicable  
18 coincident peak load data, at this point an additional election of load to be served by  
19 alternate sources of 5.3 MW would reach the 2.5 percent threshold.

20 **Q. Based on these results, what is the effect on the 15 remaining owner-members**  
21 **concerning their ability to seek an alternate source up to their respective 15 percent**  
22 **limit?**

23 A. No other owner-member would be able to elect the full 15 percent from alternate sources.  
24 (Nor is there even sufficient remaining availability for all of the other owner-members to



1 elect to take their 5 percent, as discussed below.) Any additional election of load to be  
2 served by alternate sources of 5.3 MW or more would result in the 2.5 percent threshold  
3 being exceeded. If the 2.5 percent threshold is met or exceeded, then under the terms of  
4 the MOU, an owner-member's aggregate demand reduction from alternate sources may not  
5 exceed 5 percent of the Member's Peak Demand.

6 **Q. Would there be any impact on the ability of the 15 remaining owner-members to each**  
7 **secure 5 percent of their respective load from alternate sources?**

8 A. If South Kentucky does acquire the 58 MW from alternate sources, only a portion of the  
9 remaining 15 owner-members could secure 5 percent of their load from alternate sources.  
10 While several owner-members could seek their respective 5 percent from alternate sources,  
11 the 5 percent threshold established in the MOU would be exceeded before all 15 owner-  
12 members could exercise that option.

13 **Q. The impacts on the remaining 15 owner-members you have discussed are based on**  
14 **the coincident peak data as of South Kentucky's notice of election date. Would these**  
15 **calculations still apply in the future if an owner-member submits its own election to**  
16 **be served from an alternate source?**

17 A. The methodology would be the same, but the coincident peak data and the aggregate  
18 amount of all owner-members' loads being served by alternate sources would be updated.  
19 However, without significant increases in the experienced coincident peaks, EKPC  
20 believes the resulting impacts on the remaining owner-members would be very similar to  
21 what I have outlined here.

22 **Q. You previously indicated that EKPC has concerns about how the proposed power**  
23 **purchase by South Kentucky could affect the cooperative relationship between South**  
24 **Kentucky and the other 15 owner-members. Are EKPC's concerns related to how**

1           **the proposed South Kentucky power purchase affects the other owner-members’**  
2           **ability to exercise options under the MOU?**

3    A.     That is one of the concerns. EKPC is concerned about how the proposed power purchase  
4           limits or forecloses the ability of any other owner-member to exercise its options under the  
5           MOU. EKPC is also concerned about how this transaction could negatively affect the  
6           working relationship among all of our owner-members. For this very reason, the EKPC  
7           Board of Directors tabled any vote regarding approval of this transaction pending this  
8           proceeding.

9    **Q.     Could you provide an example of the fixed costs that South Kentucky’s actions will**  
10           **shift to other owner-members?**

11   A.     In a previous EKPC fuel adjustment clause (“FAC”) six-month review case, the  
12           Commission concluded that it was important to maintain the limitation for recovery  
13           through the FAC of “non-economy energy purchases” in order to incentivize utilities to  
14           keep outages to a minimum and to have sufficient capacity to meet load.<sup>6</sup> I often refer to  
15           having sufficient capacity to meet load as having “steel on the ground.” With significant  
16           encouragement from the Commission, EKPC has made these “steel on the ground”  
17           investments to provide reliable and affordable power to EKPC owner-members and their  
18           customers, which form part of the fixed legacy costs that must be recovered from the  
19           owner-members. South Kentucky’s proposed alternate source transaction shifts the  
20           recovery of non-mitigated fixed costs like these to other owner-members.

21                   I would like to point out that EKPC is not suggesting that South Kentucky should  
22           be assessed a fee or charge for “stranded costs.” EKPC is aware that the MOU in paragraph

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<sup>6</sup> 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, p. 8 (Ky. P.S.C., Jan 30, 2015).

1 6 prohibits EKPC from charging any owner-member those avoided stranded costs related  
2 to the owner-member implementing its rights to use alternate sources. The shifting of these  
3 fixed costs is, nevertheless, a reality. Moreover, Paragraph 6 of the MOU also provides  
4 that EKPC is entitled to continue to set its rates for all owner-members to produce revenues  
5 that are sufficient to cover all of its costs. To the extent that EKPC cannot mitigate all the  
6 costs associated with the South Kentucky transaction (and others like it), it will have to  
7 seek adjustments in its rates for *all* owner-members to recover those costs.

8 **Q. Do you know if South Kentucky considered or reviewed how these cost shifts would**  
9 **affect the other owner-members?**

10 A. The Attorney General and Nucor Steel Gallatin asked South Kentucky to provide all  
11 studies, estimates, and projections of the effect on the base rates and environmental  
12 surcharges of the 15 other owner-members if South Kentucky's Application was approved  
13 as filed.<sup>7</sup> The owner-members asked South Kentucky if its management and board of  
14 directors considered the potential impact of a transaction on EKPC's wholesale rates  
15 (including but not limited to EKPC's environmental surcharge) and the extent to which  
16 such a transaction would shift EKPC's costs to the other owner-members.<sup>8</sup> EKPC asked if  
17 South Kentucky or EnerVision, Inc. incorporated into its analyses the impacts the proposed  
18 Morgan Stanley transaction would have on the allocation of EKPC annual margins to all  
19 owner-members.<sup>9</sup> In its responses to these questions, South Kentucky stated that it had not  
20 conducted any studies or estimated the potential impacts of the proposed transaction on the  
21 base rates and environmental surcharges of the other owner-members. Instead, South

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<sup>7</sup> See South Kentucky's responses to the Attorney General's First Request for Information, Item 12 and Nucor Steel Gallatin's First Request for Information, Item 1.

<sup>8</sup> See South Kentucky's response to the Distribution Cooperatives' First Request for Information, Item 6.

<sup>9</sup> See South Kentucky's response to EKPC's First Request for Information, Item 29.

1 Kentucky asserted that it had received assurances from EKPC that the loss of 58 MW could  
2 be “mitigated” without an increase in wholesale rates, apparently suggesting that this  
3 eliminated any need for South Kentucky to analyze or evaluate the potential effect of the  
4 transaction on other owner-members. South Kentucky cited two informal discussions in  
5 August 2017 and a December 29, 2017 e-mail to support this assertion.

6 **Q. Would you comment on South Kentucky’s claim that it had informal discussions with**  
7 **EKPC in August 2017 concerning mitigating an alternate source designation?**

8 A. On August 7, 2017, South Kentucky’s Director on the EKPC Board approached me after a  
9 Board Risk Oversight Committee meeting with a question. We then went into a room off  
10 to ourselves. The Director told me that South Kentucky was thinking about exercising the  
11 MOU with a purchase power agreement. Nothing was shared with me about the size of  
12 the load or the load factor. The Director asked if this would hurt EKPC. I assumed at the  
13 time that South Kentucky would be taking some of its load off the EKPC system, but not  
14 at a 100 percent load factor. Believing South Kentucky would not exceed its 5 percent and  
15 it would be taking load off the EKPC system at a normal load factor, I told the South  
16 Kentucky Director that EKPC could mitigate the 150 MWs of load exposure under the  
17 MOU, not anticipating that South Kentucky was contemplating 58MW at 100 percent load  
18 factor.

19 On August 21, 2017, South Kentucky’s CEO asked to talk with me after a quarterly  
20 owner-members CEO meeting. We sat together at a table in the lunch room. Several other  
21 CEO’s were also in the room but I do not recall who specifically was sitting nearby. South  
22 Kentucky’s CEO stated South Kentucky was considering a transaction under the MOU.  
23 South Kentucky’s CEO did not mention the size of the load, the percentage of the load  
24 leaving, or the load factor. Again, thinking that South Kentucky was likely considering a

1 purchase at approximately 5 percent of its coincident peak load, I told the South Kentucky  
2 CEO the same thing I had told the South Kentucky Director on EKPC's Board that EKPC  
3 could mitigate the 150 MWs of load exposure EKPC had from the MOU. Again, I was  
4 certainly not contemplating a 100% load factor, and assumed that any election would be  
5 load following, i.e., more in the range of 50% load factor.

6 In responding to these two brief and informal inquiries from South Kentucky, I  
7 knew that if all 16 owner-members exercised a 5 percent reduction this would equal  
8 approximately 150 MWs of load. Based on the load growth we had been experiencing, if  
9 each of our owner-members took its respective 5 percent share, at EKPC's average load  
10 factor, EKPC would grow past that cost in about two years. The key here is if all the  
11 owner-members exercised the same 5 percent reduction, any cost shifts caused by one  
12 owner-member would be countered by the cost shifts from the other owner-members, and  
13 by the same token, EKPC mitigation efforts would benefit all owner-members on a relative  
14 basis.

15 I must stress that at no time during either of these discussions did I know that South  
16 Kentucky was considering an election of more than 5 percent of its coincident load. In  
17 fact, South Kentucky's data responses are not consistent on this point. In the responses to  
18 the Attorney General and Nucor Steel Gallatin, no reference is made to the August 2017  
19 discussions. In the response to the other owner-members, South Kentucky notes the  
20 August 2017 discussions but does not state that a 58 MW transaction was being considered.  
21 Only in the response to EKPC does South Kentucky state that the August 2017 discussions  
22 mentioned the 58 MW. This is not consistent with my recollection. I would also note that  
23 in none of these responses does South Kentucky claim to have told me it was considering  
24 the alternate source at a 100 percent load factor. In South Kentucky's supplemental data

1 responses South Kentucky indicates that it specifically and repeatedly described the  
2 anticipated size and load factor for its intended election. This is not consistent with its  
3 prior responses or with my recollection of the brief, very informal conversations that took  
4 place.

5 As I noted previously, I anticipated that South Kentucky was considering a  
6 purchase that would approximate 5 percent of its coincident peak load and that if all 16  
7 owner-members exercised a 5 percent reduction this would equal approximately 150 MW  
8 of load. It should be noted that 5 percent of South Kentucky's coincident peak load at this  
9 time was approximately 19 MW, not 58 MW. I also was not assuming that all 150 MW of  
10 load would be leaving EKPC's system at the same time. These factors would influence  
11 any comments I made at the time about mitigation. In addition, I had discussed South  
12 Kentucky's proposal with two other owner-members that had been considering  
13 Amendment 3 elections but I had no idea that South Kentucky was considering a 15 percent  
14 purchase power agreement at 100 percent load factor. When I later learned that they  
15 intended to take 15 percent at 100 percent load factor, I informed Mr. Holt that he was  
16 going to stir up the other owner-members. Mr. Holt stated he understood and he asked that  
17 I "keep it confidential."

18 **Q. Describe what was conveyed in your December 29, 2017 e-mail concerning the**  
19 **mitigation of the alternate source designation?**

20 A. On December 29, 2017, an e-mail with a two-page attachment was sent to the owner-  
21 member representatives on the EKPC Board and the owner-member CEOs describing  
22 possible actions EKPC could take to mitigate the effects of South Kentucky's decision to  
23 remove 58 MWs of load. In the e-mail I stated, "In addition, please note that we will do  
24 everything possible to totally mitigate this loss of load, and will protect our Owner

1 Members should it return at an inopportune time.” Doing everything possible to mitigate  
2 is an obligation that EKPC has, but it is certainly not the same as guaranteeing there will  
3 be no cost shifts, nor is it a suggestion that inequitable cost shifting is not a concern.

4 The two-page attachment to the e-mail is a memorandum that was drafted by Mike  
5 McNalley, CFO of EKPC, and it described and discussed the possible cost shifts and what  
6 mitigation options might be available. While the narrative expresses hopes that full  
7 mitigation may be possible, achieving full mitigation is dependent on certain events  
8 happening, such as a “bounce back to weather-normal” conditions. The narrative does not  
9 guarantee that full mitigation will actually happen. Mr. McNalley’s testimony discusses  
10 the mitigation issue in more detail.

11 It should be remembered that if the proposed transaction does take place, the loss  
12 of 58 MW of load and approximately 508,000 MWh of energy sales following the 18-  
13 month waiting period would be immediate. The FAC and the environmental surcharge  
14 would be affected in the first month after the transaction becomes effective. Mitigation  
15 efforts will take time and even if EKPC were able to fully mitigate this loss of load, it will  
16 take time to get back to where we were before the loss. Moreover, the mitigation efforts  
17 would be devoted to offsetting the load loss from the South Kentucky election, rather than  
18 benefiting all of the owner-members on a relative basis.

19 It should also be noted that this e-mail and attachment were sent out on December  
20 29, 2017, a full month after South Kentucky’s Board gave its notice to EKPC that it was  
21 exercising an alternate source designation under the MOU of approximately 15 percent of  
22 its coincident peak load. The e-mail and attachment were prepared and distributed *in*  
23 *response to* South Kentucky’s election, not *prior to the election*, and thus could not have  
24 been relied upon in South Kentucky’s determination to make its election on November 28,

1 2017. While the MOU that all owner-members signed gave me no choice but to exercise  
2 best efforts to manage the cost shift, my e-mail was an attempt to calm our owners down  
3 to avoid further cost shifts with additional purchase power agreements, which would have  
4 compounded the problem. I actually knew at the time that three other owner-members had  
5 informed me that they were preparing to sign purchase power agreements, thus foretelling  
6 a potential “run on the MOU bank.”

7 **Q. What conclusions do you reach concerning South Kentucky’s decision not to consider**  
8 **the effects of its proposed transaction on the other owner-members?**

9 A. Given the history with Amendment 3 and the MOU, South Kentucky should have  
10 realized that its alternate source notice requesting nearly all of its 15 percent election would  
11 raise serious concerns among the other owner-members. I raised this concern to South  
12 Kentucky. Likewise, as South Kentucky was evaluating making an election (initially for a  
13 different alternative source) and its formal notice of election, South Kentucky’s  
14 representatives met with David Crews, EKPC’s Senior Vice President, Power Supply, who  
15 explained the mechanical manner in which elections under Amendment 3 and the MOU  
16 are made. Mr. Crews likewise advised Mr. Holt that an election of more than 5 percent of  
17 a Member’s Peak Load would have a negative impact on other owner-members. This  
18 negative impact was recognized by South Kentucky because Mr. Holt informed me that he  
19 knew that taking more than 5 percent would create distress to the other owner-members,  
20 however, he underestimated the magnitude and speed of discontent that would result from  
21 such action.

22 As part of its decision-making process, South Kentucky should have at least  
23 considered the potential impacts of any cost shift of taking more than 5% to the other  
24 owner-members. Ideally, South Kentucky should have attempted to estimate the impacts



1 on the other owner-members in the areas of base rates, the FAC, and the environmental  
2 surcharge and evaluated these impacts in determining whether the election was an  
3 appropriate one. Likewise, the December 29, 2017 e-mail and attachment are certainly not  
4 evidence that there would be no cost shifts to the other owner-members. While South  
5 Kentucky had the right to exercise an alternate source notice requesting nearly all of its 15  
6 percent limitation, it also has the burden of proof to support its decision, foreseeing the  
7 potential negative financial impact to the other owner-members.

8 **Q. Given the responses it has provided to data requests, South Kentucky appears to**  
9 **believe that the messages EKPC distributed regarding the mitigation of load loss and**  
10 **cost shifting somehow justify its decision to proceed with the proposed transaction.**  
11 **Is this an accurate reflection of what EKPC conveyed concerning mitigation?**

12 A. No. The messages relating to mitigation have to be considered in the appropriate evolving  
13 context. Once South Kentucky gave its notice that it would be seeking an alternate source  
14 at approximately 15 percent of its Member Peak Demand, it was EKPC's responsibility to  
15 encourage the other owner-members to remain calm and not panic. EKPC felt it had the  
16 responsibility to provide assurance that it would manage, as best as it could, the effects of  
17 this MOU election. While EKPC understood why other owner-members felt the need to  
18 swiftly evaluate this action, EKPC also needed to encourage the other owner-members to  
19 think carefully before rushing into their own alternate source elections under the MOU, for  
20 multiple additional elections would only worsen financial matters, result in more cost  
21 shifting among the owner-members, and possibly increase the timing and magnitude of a  
22 base rate case by EKPC. EKPC needed to manage this issue and demonstrate it would do  
23 everything possible to manage the cost shift. This has been an evolving process, beginning  
24 in the summer of 2017 when South Kentucky initially proposed a general, hypothetical

1 transaction. As a result of South Kentucky's election, everyone now understands that the  
2 MOU did not adequately address the allocation concerns that have always existed  
3 regarding Amendment No. 3, and that the MOU can be utilized in a fashion that is punitive  
4 to EKPC's end consumers. In no way should EKPC's messages on mitigation be viewed  
5 as an endorsement of South Kentucky's proposed transaction. For South Kentucky to  
6 imply that these mitigation messages somehow provide justification for its actions  
7 disregards the function of the Generation and Transmission Cooperative within the  
8 cooperative corporate model, as well as the resulting cost shifts. The election in this  
9 fashion disregards the interests of each of the remaining 15 owner-members that are  
10 operating within that cooperative corporate model and is inconsistent with Cooperative  
11 Principle Number 6: "Cooperation Among Cooperatives. Cooperatives serve their  
12 members most effectively and strengthen the cooperative movement by working together  
13 through local, national, regional and international structures."

14 **Q. Have EKPC and the owner-members had to address a similar situation previously?**

15 A. In 2009, the Commission ordered that EKPC undergo a focused management and  
16 operations audit. In its final report, The Liberty Consulting Group concluded:

17 Liberty has concluded that a de facto conflict does indeed exist and it is real,  
18 continuing and dangerous. The conflict forces a philosophy of low rates at  
19 the expense of all else and hence influences all of the board's actions in key  
20 areas, including financial health, rate strategies, and strategic planning. It  
21 manifests itself most directly in the balancing of financial health, as  
22 expressed in targets for TIER and equity, against the goal of lower rates.

23 Since this recommendation calls for a change in underlying philosophy,  
24 there is a tendency to see the required fixes as intangible, but that is not true.  
25 A fundamental change in thinking is necessary, but that must be  
26 accomplished along with numerous tangible actions.

27 The board must articulate a new, EKPC-centric way of thinking and  
28 acknowledge that, while the consumer's voice must be heard, a role of  
29 consumer advocate is not acceptable for directors. Further the board needs  
30 to commit to enforcing this notion on a continuing basis, with specific

1 measures for the removal of directors who sacrifice EKPC's interests for  
2 others, including the interests of the distribution cooperatives.<sup>10</sup>  
3

4 In its response to this section of the Liberty report, EKPC stated:

5 The EKPC Board acknowledges the conflict of interest concerns expressed  
6 by Liberty Group. The nature of the federated system of cooperatives  
7 creates a situation where the distribution cooperative will be conducting  
8 business with the G&T. This business relationship creates a perceived  
9 inherent conflict of interest that is unavoidable; however, this does not  
10 preclude directors from fulfilling their fiduciary responsibility to EKPC.  
11 This Board structure is in place at financially stable, well governed G&T's  
12 throughout the country. ...

13 As part of Recommendation G3, policies addressing Director Roles &  
14 Responsibilities, Fiduciary Duty, Conflict of Interest, Confidentiality of  
15 Cooperative Information and Ethics will be developed or revised. Special  
16 attention will be given to clarify and emphasize the directors' obligation to  
17 EKPC and any duty or obligation to the member cooperative is fulfilled by  
18 actions taken in the best interest of EKPC that in turn inure to the benefit of  
19 all member cooperatives.<sup>11</sup>  
20

21 **Q. How is this previous situation applicable to the current circumstances?**

22 A. While the decision to pursue the proposed power purchase was an action taken by the South  
23 Kentucky Board as opposed to an action by South Kentucky's Director on the EKPC  
24 Board, similar conflict of interest issues as those addressed by the Liberty Consulting  
25 Group in 2009 are also implicated here. South Kentucky's decision to pursue the proposed  
26 power purchase reflects a focus on only what is perceived to be good for South Kentucky  
27 and shows limited, if any, evaluation or analysis of how this transaction will affect the  
28 remaining owner-members and EKPC. The proposed transaction involves the same  
29 conflict of interest concerns described in the Liberty report, expressed in a different  
30 manner. By opting to secure the maximum amount of power it could from alternate sources

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<sup>10</sup> Focused Management and Operations Audit of East Kentucky Power Cooperative, Inc., Final Report, The Liberty Consulting Group, dated April 20, 2010, p. 63.

<sup>11</sup> EKPC Responses and Implementation Plans to Management Audit Recommendations, filed with the Commission May 26, 2010, p. 46.

1 under the MOU, South Kentucky's action will shift a material portion of the recovery of  
2 EKPC's un-mitigated fixed costs to the other owner-members. This is inherently unfair  
3 and is certainly inconsistent with cooperative principles.

4 Following South Kentucky's notice of the proposed power purchase and because  
5 of my concern regarding its inequitable impact on the other fifteen owner-members,  
6 sometime around December 19 or 20, 2017, I asked South Kentucky's counsel if South  
7 Kentucky would back off their request from 15 percent to 5 percent. He suggested that I  
8 contact South Kentucky's CEO, Mr. Dennis Holt, directly. I called Mr. Holt the next day  
9 to communicate the concern that many owner-member CEOs had expressed to me about  
10 South Kentucky taking 15 percent and I asked him if South Kentucky could back down to  
11 5 percent. Mr. Holt stated he had not heard from the other owner-members regarding this  
12 issue. He also stated South Kentucky had just signed the Morgan Stanley agreement two  
13 days earlier. Mr. Holt told me to have any concerned CEOs of the other owner-members  
14 contact him personally.

15 **Q. Do you have any comments about potential fairness issues that are implicated by**  
16 **Amendment 3 and the MOU, and their utilization in this manner?**

17 A. While Amendment 3 and the MOU permit an owner-member to provide an alternate source  
18 notice requesting the 15 percent election, prior to the MOU, EKPC had adamantly  
19 advocated that any owner-member think very carefully about exercising a 15 percent  
20 election when that action could limit the ability of other owner-members to exercise the  
21 same election. The 2012 complaint case before the Commission, when an owner-member  
22 sought a full 15 percent election, reflected nearly three years of litigation between that  
23 particular owner-member and EKPC and the other owner-members. While the resolution  
24 of that complaint case included the establishment of the 2015 MOU, I have been a vocal

1 advocate for our owner-members proceeding with great caution in making MOU elections  
2 for the very reasons I have described today. I have been very consistent in this position  
3 even as the MOU was being developed.

4 **Q. Would you describe how EKPC has secured the resources it utilizes to provide**  
5 **capacity and energy to its owner-members?**

6 A. EKPC has provided wholesale power supply services to its 16 owner-members for many  
7 years. As a normal course of business to supply these services, EKPC has always sought  
8 and received Commission approval of long-term firm capacity and energy resources. In  
9 the process of these approvals, EKPC has had to prove need and absence of wasteful  
10 duplication, as required by KRS 278.020(1). In numerous decisions over the years, the  
11 Commission has articulated how it evaluates the proof of need and absence of wasteful  
12 duplication.<sup>12</sup>

13 **Q. Did South Kentucky file its application for the approval of the proposed Morgan**  
14 **Stanley transaction pursuant to KRS 278.020(1)?**

15 A. South Kentucky's application seeks approval of a purchase power agreement pursuant to  
16 the requirements of KRS 278.300, not KRS 278.020(1). Consequently, it has not addressed  
17 proof of need or absence of wasteful duplication.

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<sup>12</sup> See *In the Matter of Electronic Application of Louisville Gas and Electric Company for a Certificate of Public Convenience and Necessity for the Construction of an Electric Transmission Line*, Order, Case No. 2017-00195 (Ky. P.S.C., Aug. 31, 2017); *In the Matter of Electronic Application of Duke Energy Kentucky, Inc. for a Certificate of Public Convenience and Necessity for Construction of a Number 2 Distillate Fuel Oil System at the Company's Woodsdale Natural Gas-Fired Generating Station*, Order, Case No. 2017-00186 (Ky. P.S.C., Dec 21, 2017); and *In the Matter of Application of East Kentucky Power Cooperative, Inc. for Issuance of a Certificate of Public Convenience and Necessity, Approval of Certain Assumption of Evidences of Indebtedness and Establishment of a Community Solar Tariff*, Order, Case No. 2016-00269 (Ky. P.S.C., Nov. 22, 2016).

1 **Q. Has the Commission previously stated what its standard of review would be for cases**  
2 **involving approval of a purchase power agreement as an evidence of indebtedness**  
3 **under KRS 278.300?**

4 A. In Case No. 2013-00144 the Commission stated:

5 In Case No. 2009-00545, we articulated the standard of review for cases  
6 involving approval of a purchase power agreement as evidence of  
7 indebtedness under KRS 278.300. Pursuant to KRS 278.300, a utility must  
8 establish that the proposed assumption of obligation or liability is for some  
9 lawful object within the corporate purposes of the utility, is necessary or  
10 appropriate for or consistent with the proper performance by the utility of  
11 its service to the public and will not impair its ability to perform that service  
12 and is reasonably necessary and appropriate for such purpose. In addition  
13 to the standards set forth in KRS 278.300, the Commission must also  
14 analyze the need for the purchase power agreement under the Commission’s  
15 existing statutory authority where, as here, the purchase power agreement  
16 is intended to add supplemental generating capacity to the utility. In  
17 examining the statutory criteria for approving financing under KRS  
18 278.300(3), the “purposes and uses of the proposed issue” are for the  
19 acquisition of new generation; and for the debt to be “for some lawful object  
20 within the corporate purposes of the utility.” A utility must also establish a  
21 need for additional generation and the absence of wasteful duplication, both  
22 as required under KRS 278.020(1).<sup>13</sup>

23  
24 **Q. If EKPC was seeking approval from the Commission for a purchase power agreement**  
25 **similar to what South Kentucky has proposed, would you expect EKPC to be held to**  
26 **the requirements articulated in this Kentucky Power Company decision?**

27 A. Yes, I would expect EKPC would have to demonstrate that there was a need for the  
28 purchase, it did not constitute wasteful duplication, and the overall financial transaction  
29 was reasonable and least cost.

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<sup>13</sup> See *In the Matter of Application of Kentucky Power Company for Approval of the Terms and Conditions of the Renewable Energy Purchase Agreement for Biomass Energy Resources Between the Company and ecoPower Generation-Hazard LLC; Authorization to Enter into the Agreement; Grant of Certain Declaratory Relief; and Grant of All Other Required Approvals and Relief*, Order, Case No. 2013-00144, p. 12-13 (Ky. P.S.C., Oct. 10, 2013). Also See *In the Matter of Application of Kentucky Power Company for Approval of Renewable Energy Purchase Agreement for Wind Energy Resources Between Kentucky Power Company and FPL Illinois Wind, LLC*, Order, Case No. 2009-00545, p. 4-6 (Ky. P.S.C., Jun. 28, 2010).

1 **Q. Does EKPC believe South Kentucky’s proposed Morgan Stanley transaction should**  
2 **be held to the same standard that the Commission has previously outlined?**

3 A. Yes. South Kentucky should have addressed the issues of need and wasteful duplication  
4 in its application as well as the financial reasonableness of the transaction.

5 **Q. Do you believe there is a solution to the issues you have just discussed?**

6 A. At one point in the process, EKPC offered to buy two-thirds of the Morgan Stanley contract  
7 from South Kentucky to attempt to reallocate that resource to the other owner-members.  
8 However, upon thorough review and consideration, EKPC believes that this election has  
9 caused many, if not all, of its owner-members to realize that, for the sake of all of our  
10 owner-members and their customers, the MOU must be amended or done away with to  
11 avoid inequitable results such as would occur here. It is my belief that first, power purchase  
12 agreements should not be allowed. With substantial encouragement by the Commission,  
13 EKPC has expended hundreds of millions of dollars on developing generating assets, or  
14 “steel on the ground,” to serve its owner-members and their customers and protect them  
15 from high prices and poor reliability. If one or more owner-members can simply opt out  
16 of the cooperative ownership of portions of these assets to obtain temporary “better  
17 pricing” in the market, these investments are for naught, and result in unnecessary and  
18 duplicative resources. Second, each owner-member should be entitled to 5 percent of its  
19 Member Peak Demand. If an owner-member wishes to secure a larger alternate source  
20 within the limits of Amendment 3, then the owner-member will need to purchase or effect  
21 a trade arrangement with another owner-member(s). This ensures that there is no unilateral  
22 cost-shifting among the owner-members of the Cooperative based on a “first hog to the  
23 trough” concept. Lastly, alternate sources should be limited to behind-the-meter and a  
24 maximum of approximately 3 MW generation sources. This allows owner-members to

1 continue to pursue relatively small behind-the-meter alternate source initiatives, such as  
2 landfill gas electrification and the others described above, which promote Cooperative  
3 Principle No. 7 (focusing on member needs, while working for the sustainable development  
4 of their communities) without compromising the overriding cooperative principles and the  
5 obligation of EKPC to invest in hard assets to reliably serve its members and their  
6 customers.

7 **Q. Would you summarize your observations and concerns about South Kentucky's**  
8 **alternate source notice requesting nearly all of its 15 percent election?**

9 A. EKPC does not dispute that under the literal terms of the Amendment 3 and the MOU,  
10 South Kentucky is permitted to make this election subject, of course, to Commission  
11 approval. However, South Kentucky's request of nearly all of its 15 percent election at a  
12 100% load factor, while at the same time essentially blocking any other owner-member  
13 from making a similar request, is an example of the conflict of interest concerns raised in  
14 the Liberty Management Audit. This impression is reinforced by the fact that South  
15 Kentucky did not attempt to evaluate or analyze what cost shifts to the other owner-  
16 members might result from this transaction. In addition, South Kentucky did not analyze  
17 the compounding financial effects resulting from other owner-members taking  
18 Amendment 3 energy and power from alternate sources. Relying on comments I made  
19 during informal discussions or the mitigation discussion in the December 29, 2017 e-mail  
20 cannot substitute for evaluations or analyses South Kentucky should have undertaken.  
21 Regardless of how South Kentucky wants to characterize the cost mitigation issue, it should  
22 have realized that mitigating costs associated with a 58 MW load at a 100 percent load  
23 factor, approximately 508,000 MWh, could be difficult for EKPC to achieve, could cause  
24 a run on the MOU capacity bank, thus shifting more costs, would deprive other owner-



1 members of the opportunity to purchase alternate source energy and power, and would  
2 divert potential benefits to all owner-members to instead mitigating the loss created by  
3 South Kentucky's election .

4 **Q. Does this conclude your testimony?**

5 A. Yes.

