

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

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

**DIRECT TESTIMONY OF MARK A. STALLONS
ON BEHALF OF INTERVENORS,
OWEN ELECTRIC COOPERATIVE, INC., AND
SHELBY ENERGY COOPERATIVE, INC.**

Filed: April 12, 2018

1 **Q. PLEASE STATE YOUR NAME, POSITION, AND BUSINESS ADDRESS.**

2 A. My name is Mark A. Stallons, and my business address is Owen Electric Cooperative, Inc.,
3 (“Owen Electric”), 8205 Highway 127 North, P.O. Box 400, Owenton, Kentucky 40359-
4 0400. I serve as President and Chief Executive Officer at Owen Electric.

5 **Q. HOW LONG HAVE YOU BEEN EMPLOYED AT OWEN ELECTRIC?**

6 A. I began work at Owen Electric in January of 2009.

7 **Q. PLEASE SUMMARIZE YOUR EDUCATION AND PROFESSIONAL EXPERIENCE.**

8 A. I graduated from Ohio Northern University in 1979 with a Bachelor of Science in electrical
9 engineering, and the University of Dayton in 1986 with a Masters in Business
10 Administration. I am a licensed Professional Engineer in the State of Ohio. I have spent the
11 last twenty-six (26) years of my career with electric cooperatives, and have worked in areas
12 of increasing managerial responsibility, including engineering, operations, marketing,
13 customer service, power supply and senior executive management positions in Michigan and
14 Illinois before coming to Kentucky for Owen Electric.

15 **Q. PLEASE PROVIDE A BRIEF DESCRIPTION OF YOUR DUTIES AT OWEN
16 ELECTRIC.**

17 A. As President and CEO, I am responsible for the management and oversight of all the
18 cooperative’s business operations, its employees, and public and community relations. I work
19 under the supervision, and at the pleasure of, a seven (7) member Board of Directors. My
20 duties also include assisting the Board of Directors in developing a strategic plan, creating
21 a mission and vision statement for the organization, and ensuring that the organization moves
22 forward as directed by the Board of Directors.

1 **Q. IN ADDITION TO OWEN ELECTRIC, WILL YOU BE TESTIFYING ON BEHALF**
2 **OF SHELBY ENERGY COOPERATIVE, INC.?**

3 A. Yes. I have been authorized to speak on behalf of Shelby Energy for this proceeding.

4 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?**

5 A. The purpose of my testimony is first to generally describe the business of Owen Electric and
6 Shelby Energy Cooperative, Inc. (“Shelby Energy”) to include the service they provide
7 within their respective retail electric service territories. I will then discuss Owen Electric and
8 Shelby Energy’s roles as Owners-Members of East Kentucky Power Cooperative, Inc.
9 (“EKPC”), their respective cooperatives’ past wholesale power procurement practices, and
10 the agreements that govern those practices. Finally, I will explain Owen Electric and Shelby
11 Energy’s opposition to South Kentucky’s Application requesting authorization to purchase
12 58 MWs of energy on a 7 x 24 x 365 basis (100% load factor) for 20 years beginning June
13 1, 2019, from Morgan Stanley Capital Group.

14 **Q. ARE YOU SPONSORING ANY EXHIBITS?**

15 A. No, I am not sponsoring any exhibits as part of my testimony.

16 **Q. PLEASE GENERALLY DESCRIBE THE BUSINESS OPERATIONS OF OWEN**
17 **ELECTRIC AND SHELBY ENERGY.**

18 A. Owen Electric is engaged in the sale of electric power at retail rates to approximately 49,600
19 members (equating to approximately 61,000 accounts) in Owen, Carroll, Gallatin, Boone,
20 Kenton, Campbell, Pendleton, Grant and Scott counties in Kentucky. Owen Electric utilizes
21 approximately 4,511 miles of distribution lines for the delivery of power to its members, and
22 has 125 employees at present.

1 Shelby Energy is engaged in the sale of electric power at retail rates to approximately 12,663
2 members (equating to approximately 16,207 accounts) in Anderson, Shelby, Trimble, Henry,
3 Carroll, Franklin, Jefferson, Oldham, Owen and Spencer counties in Kentucky. Shelby
4 Energy utilizes approximately 2,139 miles of distribution lines for the delivery of power to
5 its members and has 41 employees at present.

6 Owen Electric and Shelby Energy are each governed by a Board of Directors elected from
7 their respective memberships. Owen Electric's Board consists of seven (7) members, and
8 Shelby Energy's Board has six (6) members. The mission of both Owen Electric and Shelby
9 Energy is to safely and reliably provide electricity and related services to their members at
10 a nondiscriminatory competitive price, and to improve the quality of life in their members'
11 communities.

12 **Q. EXPLAIN OWEN ELECTRIC AND SHELBY ENERGY'S RELATIONSHIP TO**
13 **EKPC AND THE OTHER DISTRIBUTION COOPERATIVES THAT COMPRISE**
14 **THE EKPC SYSTEM.**

15 A. EKPC, like both Owen Electric and Shelby Energy, is a cooperative that is owned by the
16 members they serve. Owen Electric and Shelby Energy are two (2) of the sixteen (16)
17 Owner-Member distribution cooperatives in the EKPC system that serves approximately
18 537,000 electric consumers. Owen Electric is the system's largest Owner-Member in terms
19 of demand served. Owen Electric serves Nucor Steel Gallatin ("Nucor"), the first (1st) largest
20 retail ratepayer on the EKPC system, as well as Safran Landing Systems and Air Liquide,
21 representing the eighth (8th) and thirteenth (13th) largest ratepayers on the system,
22 respectively. Shelby Energy is the system's twelfth (12th) largest Owner-Member in terms

1 of demand served.

2 As of December 31, 2017, Owen Electric had total margins and equity of \$124,564,380 and
3 total assets of \$249,029,549 or an equity ratio of 50.02%. Owen Electric's Patronage Capital
4 or equity in EKPC totaled \$75,054,515. Owen Electric's equity ratio without its patronage
5 capital in EKPC was 28.46%.

6 As of December 31, 2017, Shelby Energy had total margins and equity of \$42,818,316 and
7 total assets of \$110,047,493 for an equity ratio of 38.91%. Shelby Energy's Patronage
8 Capital or equity in EKPC totaled \$23,108,706. Shelby Energy's equity ratio without its
9 patronage capital in EKPC was 22.67%.

10 Each of the remaining thirteen (13) Owner-Members also has patronage capital, or equity,
11 in EKPC. Consequently, each of the sixteen (16) Owner-Members has not only a direct
12 interest in the financial health of EKPC, but also in the financial health of the other fifteen
13 (15) Owner-Members.

14 **Q. DO OWEN ELECTRIC AND SHELBY ENERGY PURCHASE POWER AT**
15 **WHOLESALE FROM EKPC?**

16 A. Yes, Owen Electric, Shelby Energy and EKPC, as well as each other Owner-Member
17 distribution cooperative and EKPC, respectively, have entered into a Wholesale Power
18 Contract, dated October 1, 1964, and as approved by the Rural Electrification
19 Administration, as amended, which governs their commercial relationship with respect to the
20 sale and purchase of power.

21 **Q. IS THE WHOLESALE POWER CONTRACT AN ALL-REQUIREMENTS**
22 **ARRANGEMENT, SUCH THAT EKPC IS OWEN ELECTRIC AND SHELBY**

1 **ENERGY'S EXCLUSIVE WHOLESALE POWER SUPPLIER?**

2 A. Yes, from the time the Wholesale Power Contract became effective until 2003, Owen
3 Electric and Shelby Energy were required to satisfy all of their electric power and energy
4 requirements through purchases made from EKPC. However, in late 2003, EKPC's
5 Wholesale Power Contract with each of its Owner-Members was amended to grant the
6 distribution cooperatives the ability to obtain power and energy from non-EKPC sources,
7 subject to certain limitations and required procedures. This amendment was designated, and
8 is known as "Amendment No. 3". Thereafter, EKPC and its Owner-Members developed a
9 framework for utilizing Amendment No. 3 to purchase alternatively-sourced power in a
10 Memorandum of Understanding and Agreement regarding alternate power sources ("MOU").
11 The MOU was adopted by EKPC and the sixteen (16) Owner-Members, and executed in the
12 summer of 2015. Copies of Amendment No. 3, and the MOU, are attached to South
13 Kentucky's Application as Exhibits 1 and 2, respectively.

14 **Q. IN REGARD TO THE HISTORY OF AMENDMENT NO. 3, THE DEVELOPMENT**
15 **AND ADOPTION OF THE MOU, IS THE DOCUMENT TITLED "EAST**
16 **KENTUCKY POWER COOPERATIVE AMENDMENT NO. 3 AND MOU**
17 **HISTORY" COOPERATIVES' FIRST DC ATTACHMENT 4 (PDF PAGES 59**
18 **THROUGH 66) GENERALLY ACCURATE?**

19 A. Yes, the document attached is generally accurate, but I would note first that it should be
20 dated February 13, 2018, instead of February 13, 2017. In addition, from my viewpoint, all
21 sixteen (16) cooperatives and EKPC recognized in trying to negotiate and adopt the MOU
22 that Amendment No. 3 as drafted was not fair to EKPC and the sixteen (16) member

1 cooperatives, or their consumers, and had several major problems. Everyone realized that
2 the provision that allows a member to elect to use an alternate power source for up to 15%
3 of its load is not fair, particularly when the available alternate source power is limited to 5%
4 of EKPC's load. As written, this provision is skewed to benefit the largest cooperatives that
5 take the first initiative ("early movers"). In addition, the cooperatives recognized the
6 unfairness to consumers on the EKPC system caused by a 100% load factor and cost-shifting.
7 The cooperatives also recognized that Amendment No. 3 as written created the so-called
8 problem of a "run on the bank" whereby the largest cooperatives could completely use all of
9 the available alternate source power (5% of EKPC's load) to the exclusion of other
10 cooperatives. However, the cooperatives and EKPC were unable in the MOU to resolve their
11 differences in regard to the various problems created by Amendment No. 3. Consequently,
12 the MOU as drafted was the best the cooperatives and EKPC could do at the time given the
13 various problems created by Amendment No. 3.

14 **Q. PRIOR TO SOUTH KENTUCKY'S APPLICATION, DID OWEN ELECTRIC OR**
15 **ANY OTHER COOPERATIVE ELECT TO OBTAIN POWER FROM A NON-EKPC**
16 **SOURCE UNDER AMENDMENT 3?**

17 A. Yes. In 2016, Owen Electric installed a 2 MW Distributed Generation Unit at its main office
18 at 8205 Highway 127 North, Owenton, Kentucky, that feeds into the Bromley Substation.
19 In addition, three (3) other cooperatives, namely Jackson, Farmers and Salt River, also
20 installed small projects totaling 11.2 MW's of alternatively-sourced power. However,
21 unlike South Kentucky's Application, each of these projects are small local physical
22 resources that serve native load. As such, these alternate source projects are clearly within

1 the spirit of Amendment No. 3 and the MOU.

2 **Q. WHEN DID OWEN ELECTRIC AND THE OTHER FOURTEEN (14)**
3 **COOPERATIVES FIRST BECOME AWARE OF SOUTH KENTUCKY'S NOTICE**
4 **TO PURCHASE 58 MWs OF ENERGY FROM A NON-EKPC SOURCE?**

5 A. I first learned of South Kentucky's alternate-source notice shortly after it was received by
6 EKPC on or about November 28, 2017. It is my understanding that is also when Shelby
7 Energy, and the other thirteen (13) cooperatives, first learned of South Kentucky's alternate
8 source notice.

9 **Q. WHAT WAS OWEN ELECTRIC'S RESPONSE?**

10 A. The Owen Electric monthly board meeting was held on November 30, 2017, and I informed
11 the Board of the South Kentucky alternate-source notice. The Owen Electric Board directed
12 me to prepare options for its consideration at the next scheduled board meeting on December
13 14, 2017. In early December, I and three (3) other cooperative managers met with Tony
14 Campbell, President and CEO of EKPC, to, among other things, try to clarify the impact
15 South Kentucky's alternate-source notice would have on Owen Electric and the other Owner-
16 Members. I left that meeting feeling there was probably no chance South Kentucky would
17 cancel its notice, and that the impact of 58 MWs at 100% load factor would be significant
18 on Owen Electric and its consumers. So at the Owen Electric regular monthly board
19 meeting held on December 14, 2017, I informed the Board of the situation. The Board
20 authorized me, at my discretion, as a defensive move in response to South Kentucky's
21 alternate source notice, to give EKPC notice of Owen Electric's intent under Amendment
22 No. 3 and the MOU to reduce its purchases of electric power from EKPC, and replace same

1 with electric power furnished from an alternate source, to be calculated at the level equal to
2 five percent (5%) of Owen Electric's coincident peak demand for the single calendar month
3 during each of the three (3) twelve-month (12-month) periods immediately proceeding the
4 notice less the previously noticed 2 MW Bromley Substation Distributed Generation Unit.
5 In addition, the Board authorized me to enter into a professional services agreement with a
6 consultant to provide consulting support related to economic and operational viability
7 regarding the purchase of energy from a non-EKPC source. All of this was done in an effort
8 to try to avoid some of the cost shifting to Owen Electric consumers that South Kentucky's
9 plan to purchase 58 MWs of energy on a 7 x 24 x 365 basis (100% load factor) for 20 years
10 beginning June 1, 2019, from Morgan Stanley Capital Group will cause if approved.

11 On February 2, 2018, I gave EKPC notice of Owen Electric's election to reduce its
12 purchases of electric power from EKPC and replace same with electric power furnished from
13 an alternate source pursuant to Amendment No. 3 and the MOU beginning September 1,
14 2019. Since the MOU requires eighteen (18) months' prior written notice to EKPC of a
15 change or cancellation of an alternate source notice, Owen's notice was subsequently
16 amended to reflect a beginning or delivery date for the electric power of March 1, 2020. By
17 delaying the delivery date of the electric power to March 1, 2020, the Owen Electric Board
18 has sufficient time to fully risk access and consider whether it actually wants to proceed with
19 the purchase of power from a non-EKPC source, or cancel its alternate source notice and
20 continue to purchase the power at wholesale from EKPC.

21 **Q. WHY ARE OWEN ELECTRIC AND SHELBY ENERGY OPPOSED TO SOUTH**
22 **KENTUCKY'S APPLICATION REQUESTING AUTHORIZATION TO PURCHASE**

1 **58 MWs OF ENERGY ON 7 X 24 X 365 BASIS (100% LOAD FACTOR) FOR 20**
2 **YEARS BEGINNING JUNE 1, 2019, FROM MORGAN STANLEY CAPITAL**
3 **GROUP?**

4 A. Our biggest concern is the financial cost shifting that will result to Owen Electric, Shelby
5 Energy and the other thirteen (13) cooperatives, and their residential, commercial, and
6 industrial consumers caused by South Kentucky's purchase of 58 MWs of energy on 7 x 24
7 x 365 basis (100% load factor) for twenty (20) years from Morgan Stanley Capital Group.
8 Although, EKPC says it will attempt to mitigate the cost shifting to some degree, even if it
9 is able to do so, it will still likely be a substantial financial burden to the fifteen (15)
10 cooperatives and their consumers. Owen Electric and Shelby Energy will not likely be able
11 to absorb the additional base rate fixed costs without an increase in the rates to their
12 respective members-owners. In my view, the same is also likely true for the other thirteen
13 (13) cooperatives. I'm particularly concerned about the environmental surcharge cost shift
14 which EKPC is not likely to be able to fully mitigate which all cooperatives would then incur
15 and have to pass on to their consumers. Residential consumers are very sensitive to any
16 increase in their monthly electric bills. Industrial consumers such as Nucor, that's in the
17 process of constructing a new galvanizing line to its existing operations, are very sensitive
18 to the cost of electricity, and that expense is a major consideration when adding new
19 investments or expansions to their Kentucky operations.

20 In addition, if South Kentucky's application is approved, then other cooperatives such as
21 Owen Electric will be compelled to seriously consider proceeding under Amendment No. 3
22 with the purchase of energy from a non-EKPC source. This will likely lead to the so-called

1 problem of a “run on the bank” whereby the largest cooperatives use all of the available
2 alternate source power under Amendment No. 3 (5% of EKPC’s load) to the exclusion of
3 other cooperatives. If this occurs, the amount of cost shifting will increase dramatically and
4 be much larger than EKPC can mitigate.

5 Also, the cost shifting to the cooperatives and their consumers will be disproportionate and
6 unfairly distributed between those that are able to avail themselves of alternate source power
7 under Amendment No. 3, and those that could not do so. Thus, this additional expense to
8 consumers will not be because of their own electric consumption patterns or to any similarly
9 situated consumers, but instead is the result of which Cooperative has first given Notice to
10 avail itself under Amendment No. 3 and the MOU.

11 **Q. FOR THE ABOVE-STATED REASONS, DOES OWEN ELECTRIC AND SHELBY**
12 **ENERGY BELIEVE THE COMMISSION SHOULD DENY SOUTH KENTUCKY’S**
13 **APPLICATION REQUESTING AUTHORIZATION TO PURCHASE 58 MWs OF**
14 **ENERGY ON 7 X 24 X 365 BASIS (100% LOAD FACTOR) FOR 20 YEARS**
15 **BEGINNING JUNE 1, 2019, FROM MORGAN STANLEY CAPITAL GROUP?**

16 A. Yes.

17 **Q. IF THE COMMISSION DENIES SOUTH KENTUCKY’S APPLICATION AND**
18 **THE AGREEMENT WITH MORGAN STANLEY IS TERMINATED, WILL OWEN**
19 **ELECTRIC, SHELBY ENERGY, AND THE OTHER THIRTEEN (13)**
20 **COOPERATIVES WAIVE THE EIGHTEEN (18) MONTH PRIOR WRITTEN**
21 **NOTICE PROVISION TO EKPC OF CANCELLATION OF AN ALTERNATE**
22 **SOURCE NOTICE REFERENCED EARLIER IN YOUR TESTIMONY?**

1 A. Yes, to the extent that the notice requirement under the MOU is applicable, both Owen
2 Electric and Shelby Energy have taken board action to waive same. It is my understanding
3 from speaking to each of the other thirteen (13) cooperatives managers, that they have also
4 waived same to the extent it is applicable.

5 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

6 A. Yes.

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