

**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. :

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**BRIEF OF NUCOR STEEL GALLATIN**

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**TABLE OF CONTENTS**

SUMMARY OF ARGUMENT ..... 1

FACTUAL BACKGROUND..... 2

ARGUMENT ..... 3

    I.    South Kentucky’s November 28, 2017 Notice Fails To Comply With  
          Amendment 3 And The MOU And Its Application Should Be Rejected As A  
          Violation Of The Filed Rate Doctrine. .... 3

    II.   Approval Of The Application Would Violate The Non-Discrimination  
          Provisions Of KRS 278.170(1) and the Requirement of KRS 278.030(1) That  
          Rates Must Be Fair, Just, and Reasonable. .... 5

        A.   The Application Seeks to Give Unreasonable Preference and Advantage to  
              South Kentucky. .... 6

        B.   The Application Seeks To Subject The Other EKPC Owner-Members To  
              Unreasonable Prejudice Or Disadvantage Through Cost-Shifting, Resulting In  
              Rates That Are Not “*Fair, Just, and Reasonable.*” ..... 7

    III.  Approval Of The Application Would Violate The Prohibition Against Wasteful  
          Duplication Of KRS 278.020(1)..... 9

REQUESTED RELIEF ..... 11

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Nucor Steel Gallatin (“Nucor”) submits this Brief in support of its recommendations to the Kentucky Public Service Commission (“Commission”). Nucor is the largest end-use customer of Owen Electric Cooperative (“Owen”), which is provided generation and transmission service by East Kentucky Power Cooperative, Inc. (“EKPC”).

**SUMMARY OF ARGUMENT**

Amendment 3 and the July 23, 2015 Memorandum of Understanding (“MOU”) set forth specific requirements for selecting non-EKPC sources of power supply. Those requirements have not been met in this proceeding and South Kentucky Rural Electric Cooperative Corporation’s (“South Kentucky”) Application should be rejected for failure to comply with the filed rate doctrine. In addition, Commission approval of the Application as proposed would violate the non-discrimination provisions of KRS 278.170(1), the requirement of KRS 278.030(1) that rates must be fair, just, and reasonable, and the prohibition against wasteful duplication found in KRS 278.020(1).

Instead, the Commission should do two things. First, it should impose revised terms and conditions for obtaining energy and capacity from non-EKPC sources. EKPC’s CEO Mr. Campbell set forth three revised conditions for selecting non-EKPC sources and those conditions should be adopted. Second, the Commission should finish the process of designing energy rates that do not recover fixed costs. A cost-based rate design where fixed costs are recovered in demand rates would lessen the ability of an Owner-Member to improperly shift costs when building or purchasing non-EKPC generation.

## FACTUAL BACKGROUND

Amendment 3 to the 1964 all requirements Wholesale Power Contract between EKPC and its sixteen Owner-Members and the MOU authorize each distribution cooperative to purchase energy and capacity from a non-EKPC source in an amount up to 15% of the Owner-Members' coincident peak demand. Because the Owner-Members vary by size, the 15% non-EKPC purchase limitation ranges from a high of 64 MW for Owen and a low of 10.8 MW for Grayson.<sup>1</sup>

Amendment 3 and the MOU also limit the total amount of non-EKPC purchases among all of the distribution cooperatives to 5% of EKPC's coincident peak demand, or approximately 158.5 MW.<sup>2</sup> But if the total Owner-Member elections exceed 2.5% of EKPC's coincident peak demand (approximately 79.25 MW), then each Owner-Member's maximum election drops to 5% of its own individual peak demand. Again, this 5% limit varies from a high of 21.3 MW for Owen to a low of 3.6 MW for Grayson.<sup>3</sup> Consequently, once any Owner-Member elects to use its 15% individual maximum, three classes of Owner-Members are created: 1) those who can acquire 15% of their individual coincident peak demand from non-EKPC sources; 2) those who can acquire up to 5% of their individual coincident peak demand from non-EKPC sources; and 3) those at the end of the line with zero opportunity to acquire power from non-EKPC sources. Which of the three classes any Owner-Member falls into is purely a matter of timing.

Prior to filing this Application, on November 28, 2017, South Kentucky gave the required 18-month Notice of its intent to exercise its rights under Amendment 3 and the MOU. The Notice stated that beginning on June 1, 2019, South Kentucky would purchase "*58,000 KW of energy all hours of each year for the 20 year term, by purchasing same from the PJM wholesale market.*" This 24 x 7 x 365 (100% load factor) purchase from the PJM market amounts to 508,080 MWh annually.<sup>4</sup> The 58 MW that is requested to leave the EKPC system is just below the 15% of coincident peak demand maximum available to South Kentucky. This November 2017 Notice

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<sup>1</sup> Nucor Ex. 3.

<sup>2</sup> Id.

<sup>3</sup> Id.

<sup>4</sup> 58 MW x 8,760 hours per year = 508,080 MWh.

was given before the South Kentucky Board of Directors formally authorized the transaction with Morgan Stanley Capital Group (“Morgan Stanley”) on December 19, 2017.<sup>5</sup>

South Kentucky’s Application seeks approval pursuant to KRS 278.300 of a twenty-year energy purchase from Morgan Stanley for 508,080 MWh at a fixed price of \$33.95/MWh (subject to environmental change in law escalation), the purchase of 58 MW of capacity from the PJM market, and the purchase of a 68 MW capacity hedge (58 MW plus a reserve margin) for \$125/MW-day from Morgan Stanley (subject to environmental change in law escalation).

### ARGUMENT

**I. South Kentucky’s November 28, 2017 Notice Fails To Comply With Amendment 3 And The MOU And Its Application Should Be Rejected As A Violation Of The Filed Rate Doctrine.**

Amendment 3, and the MOU that interprets it, are rates on file with and subject to the jurisdiction of this Commission. By Order entered December 18, 2015 in Case No. 2012-00503, the Commission approved the MOU, determined that it was a written agreement relating to utility rates subject to the Commission’s jurisdiction and required EKPC to file the MOU in the Commission’s Tariff Filing System. South Kentucky witness Mr. Seelye repeatedly testified that Amendment 3 and the MOU are filed rates that must be strictly enforced.<sup>6</sup> Nucor agrees, and for that reason the Application should be rejected.

By its express terms, in any conflict between the MOU and Amendment 3, Amendment 3 controls.<sup>7</sup> In at least three places Amendment 3 allows an Owner-Member to buy from a non-EKPC source only for its “load or loads.” This “load or loads” language indicates that any alternative supply will displace a proportional share of the load or loads previously supplied by EKPC. This interpretation of Amendment 3 was advanced by EKPC CEO Mr. Campbell at the hearing.<sup>8</sup>

The “load or loads” provision of Amendment 3 is explained further in the MOU. At Section 4(iv), the MOU provides that any Owner-Member seeking to buy from an Alternative Source “shall” set forth “the

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<sup>5</sup> December 19, 2017 Board presentation by EnerVision.

<sup>6</sup> Seelye Rebuttal Testimony at 2, 5, 10, and 15.

<sup>7</sup> MOU Section 2(C)(“Nothing in this MOU&A is intended to modify any of the express provisions of Amendment 3. In the event of an actual conflict between the Wholesale Power Contract, as amended, including by Amendment 3, and this MOU&A, the Wholesale Power Contract, as amended, including by Amendment 3, shall control.”).

<sup>8</sup> Tr. (May 16, 2018) at 10:50:32 p.m.

*approximate, expected pattern of use or dispatching of the Alternative Source and the corresponding pattern of hourly reductions in energy to be purchased by the Owner Member from EKPC.*” This language also indicates that the Alternative Source will displace a proportional share of Owner-Member load or loads by substituting a load-following resource for EKPC’s load-following service.

However, contrary to both Amendment 3 and the MOU, South Kentucky seeks permission to purchase 58 MW on an around-the-clock 100% load factor basis. No “*load or loads*” on the South Kentucky system operates at a 100% load factor.<sup>9</sup> In 2017, South Kentucky’s system load factor was only 41.17%.<sup>10</sup>

By requesting permission to purchase a 100% load factor product, South Kentucky sought to game the system in two ways. First, it maximized the amount of energy that would leave the EKPC system. Using the 100% load factor ruse would allow South Kentucky to purchase 40% of its energy from Morgan Stanley, not the 15% maximum envisioned by Amendment 3 and the MOU.<sup>11</sup> Because a substantial portion of EKPC’s Schedule E energy rate recovers fixed costs,<sup>12</sup> the 100% load factor nomination improperly exacerbates the cost shift to the remaining fifteen Owner-Members. EKPC and South Kentucky’s witness Mr. Seelye both recognize that energy rates should not recover fixed costs.<sup>13</sup> Correcting this rate design error would lessen the ability of an Owner-Member to shift fixed costs to its brethren through a gamed 100% load factor purchase. Second, the 100% load factor ruse maximized the amount of off-peak energy to be purchased from Morgan Stanley. Because off-peak energy is less expensive than on-peak, this allowed Morgan Stanley to quote a cheaper price.

South Kentucky’s Notice was deficient in two additional ways. First, the Notice states that energy is being purchased from the PJM wholesale market. It is not. Energy is being purchased from Morgan Stanley. Morgan Stanley is not even mentioned in the Notice. Second, Section 4(iii) of the MOU provides that the Owner-Member “*shall*” set forth “*a general description of the nature of the Alternative Source and the primary*

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<sup>9</sup> Tr. (May 16, 2018) at 10:51:02 p.m.

<sup>10</sup> Nucor Ex. 1, South Kentucky Response to Staff First Set, Item 23.

<sup>11</sup> Nucor Ex. 1 shows South Kentucky’s 2017 energy usage as 1,274,648 MW. The 508,080 MWh sought to be purchased from Morgan Stanley is 40% of this amount.

<sup>12</sup> Tr. (May 16, 2018) at 7:17:31.

<sup>13</sup> Nucor Ex. 7.

*generating facilities from which the subject electric power and energy will be produced.”* But South Kentucky concedes that the “*Alternative Source is not tied to a specific generating unit or units within PJM.*”<sup>14</sup>

The MOU’s requirement that the primary generating facilities be identified demonstrates an intent that non-EKPC power supply should come from behind-the-meter generation owned, purchased, or leased by the Owner-Member. Before this Application, all six Amendment 3 projects were of that type.<sup>15</sup> This Application is an aberration. Market-based energy and capacity purchases that are not tied to specific generation were not contemplated in Amendment 3.<sup>16</sup>

EKPC can and routinely does make market-based energy and capacity purchases from PJM on behalf of all sixteen Owner-Members, and it does so at a much lower transaction cost than sixteen separate transactions with sixteen separate sets of lawyers and consultants. The same economic efficiencies that originally caused the Owner-Members to band together in 1964 to form EKPC to build generation to serve all of their combined needs also applies to market purchases.

Because the Application fails to comply with both the letter and spirit of Amendment 3 and the MOU, it should be rejected.

## **II. Approval Of The Application Would Violate The Non-Discrimination Provisions Of KRS 278.170(1) and the Requirement of KRS 278.030(1) That Rates Must Be Fair, Just, and Reasonable.**

KRS 278.170(1) prohibits utilities (including EKPC) from giving any unreasonable preference or advantage to any person (including South Kentucky) or subjecting any person (including the remaining 15 Owner-Members) to any unreasonable prejudice or disadvantage for doing a like and contemporaneous service under the same or substantially the same conditions. KRS 278.170 (1) provides:

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<sup>14</sup> Nucor Ex. 1, South Kentucky Response to Staff First Set, Item 5.

<sup>15</sup> Nucor Ex. 3. 1) 1.6 MW landfill gas project with Jackson; 2) 1.0 MW small generator with Jackson; 3) 3.6 MW distributed generation project with Farmers; 4) 1.0 MW landfill gas project with Farmers; 5) 2.0 MW hydroelectric project with Salt River; and 6) 2.0 MW generator with Owen.

<sup>16</sup> Section 2 (A) of the MOU does define an Alternative Source as including “*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.*” However, this description can best be harmonized with the controlling Amendment 3 by interpreting a power purchase arrangement to be a financing or lease arrangement for a physical generation asset such as landfill gas, hydroelectric or distributed generation that would otherwise be directly owned by the Owner-Member.

*No utility shall, as to rates or service, give any unreasonable preference or advantage to any person or subject any person to any unreasonable prejudice or disadvantage, or establish or maintain any unreasonable difference between localities or between classes of service for doing a like and contemporaneous service under the same or substantially the same conditions.*

Additionally, KRS 278.030(1) provides that utilities may only collect and receive “*fair, just and reasonable rates*” for the services rendered.

**A. The Application Seeks to Give Unreasonable Preference and Advantage to South Kentucky.**

Amendment 3 limits the amount of purchases from Alternative Sources to 5% of EKPC’s coincident peak demand, or approximately 158.5 MW. EKPC’s coincident peak demand is the sum of the demands of all sixteen of its Owner-Members. Yet Amendment 3 also allows an individual Owner-Member to purchase up to 15% of its capacity and related energy needs from Alternative Sources. Consequently, once any Owner-Member elects to use its 15% individual maximum, three classes of Owner-Members are created: 1) those who can acquire 15% of their individual coincident peak demand from non-EKPC sources; 2) those who can acquire up to 5% of their individual coincident peak demand from non-EKPC sources; and 3) those at the end of the line with zero opportunity to acquire power from non-EKPC sources. Which of the three classes any Owner-Member falls into is purely a matter of timing.

This disparity is shown on page 3 of Nucor Ex. 3. Only 0.67% of Salt River’s peak demand is from a non-EKPC source compared to 14.05% for South Kentucky. As of February 2018, the following nine Owner-Members had zero percent: Big Sandy, Blue Grass, Clark, Cumberland Valley, Grayson, Inter-County, Nolin, Shelby and Taylor.<sup>17</sup> Whether this disparity is due to a run on the bank or a race to the courthouse, the result is unduly discriminatory considering that all sixteen Owner-Members are otherwise similarly situated. This disparity is inherent in the structure of Amendment 3 and the MOU which allow some, but not all, Owner-Members to purchase up to 15% from a non-EKPC source. The fix to this inherent disparity is to limit each Owner-Member’s non-EKPC sources to 5% of their respective peak demands, as recommended by Mr. Campbell (discussed *infra*).

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<sup>17</sup> Nucor Ex. 3.



At the time of South Kentucky's Application, there were six existing Amendment 3 projects totaling 11.2 MW. A 1.6 MW landfill gas project with Jackson, a 1.0 MW small generator with Jackson, a 3.6 MW distributed generation project with Farmers, a 1.0 MW landfill gas project with Farmers, a 2.0 MW hydroelectric project with Salt River and a 2.0 MW generator with Owen.<sup>18</sup> Since the South Kentucky Application, seven new Amendment 3 projects have been noticed as a defensive "*if you can't beat them, join them*" strategy.<sup>19</sup> These seven projects total 45.1 MW, and include three PJM market purchases similar to South Kentucky's Morgan Stanley proposal. Presumably, the three PJM market purchases would require the same Commission process as here, with the same inefficient use of the Commission's resources. As of February 2018, 44.1 MW of Amendment 3 capacity was still available.<sup>20</sup> So even more PJM market purchase applications at the Commission are possible, depending upon the outcome of this case.

Because of the unequal distribution of non-EKPC supply opportunities created by South Kentucky's 15% election, approval of this Application would lead to an unreasonable preference or advantage for South Kentucky, and an unreasonable prejudice or disadvantage to the remaining Owner-Members.

**B. The Application Seeks To Subject The Other EKPC Owner-Members To Unreasonable Prejudice Or Disadvantage Through Cost-Shifting, Resulting In Rates That Are Not "Fair, Just, and Reasonable."**

Approval of South Kentucky's request would also result in unreasonable financial prejudice to those left behind. Those left behind may receive no low-cost market purchases,<sup>21</sup> and to add insult to injury, will be forced to pick up the tab for EKPC's lost margins through higher base rates as well as higher environmental surcharge costs.<sup>22</sup> Mr. Campbell described such a worst-case scenario at the hearing:

*Q: If cost-shifting occurs, do you believe that it will start immediately effective in the first month following approval?*

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<sup>18</sup> Nucor Ex. 3.

<sup>19</sup> McNalley Testimony at 10.

<sup>20</sup> Nucor Ex. 3.

<sup>21</sup> It should be noted that market purchases based upon the marginal energy and capacity costs across all of PJM will not always be lower than EKPC's average embedded costs (e.g. cost-of-service). But right now that is the case due to low natural gas prices, renewable energy mandates and subsidies, excess generating capacity that had been built by utilities under a fully regulated paradigm before deregulation, and other reasons.

<sup>22</sup> McNalley Testimony at 6 and 12.

A: ...I think the environmental surcharge will be spread immediately...and then a lot of the rest, hypothetically, if we can't get it mitigated...probably wait until we do a base rate increase, but remember this is not just South Kentucky that you got to think about. We've got South Kentucky here, this deal. I've got three or four or five other big guys waiting and they are going to try and get their 5% and they're going to eat up that MOU. There will not be enough. And then I'm going to have a whole host of my Owners out here that are really at the bottom of the chain. They're going to get hurt the worst....Even Grayson...they're not in line. So in trying to protect their members, I'm going to really have to go out and get another 5% for them or they're not even going to be able to get anything. Those end consumers are going to be hurt the worst. And that's really the smaller co-ops. They serve the poorest people. So it starts to compound itself. And we'll be in here at the Commission as this moves forward.<sup>23</sup>

This worst-case scenario has already begun to develop. Indeed, as discussed above, if South Kentucky's request is approved, then the Commission can expect at least three additional cases addressing similar market purchase requests from other Owner-Members.<sup>24</sup> And Mr. Campbell testified that "*there will be more than that, until it's all evened up.*"<sup>25</sup> He predicted that approval of South Kentucky's request would mean that "*there's going to be a hardship*" for some Owner-Members.<sup>26</sup>

Mr. Wolfram also addressed the "*unreasonable preference or advantage*" that South Kentucky would experience through its gamed 100% load factor purchase, in contrast to the "*unreasonable prejudice or disadvantage*" that would be suffered by the remaining fifteen Owner-Members. He noted that South Kentucky's analysis determined that in 2020 it would achieve savings of \$5.9 million compared to the \$15.9 million to \$18.3 million annual cost increase to the remaining Owner-Members.<sup>27</sup> The cost shift to Nucor alone would be \$1.0 million per year, with an immediate rate increase of \$250,000 per year through the environmental surcharge.<sup>28</sup> This cost shift caused by contractual gaming would result in unjust and unreasonable rates to the remaining Owner-Members in violation of KRS 278.030(1).

In addition to an unreasonably prejudicial cost-shift, Mr. Wolfram's analysis demonstrates at least one additional important point. Because South Kentucky is saving much less (\$5.9 million) than the increased costs to the other Owner-Members (\$15.9 million to \$18.3 million), from a system-wide perspective, the Morgan Stanley transaction results in net system losses of between \$10.0 million and \$12.4 million in the first full year of the

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<sup>23</sup> Tr. (May 16, 2018) at 10:18:45 p.m. (emphasis added).

<sup>24</sup> Tr. (May 16, 2018) at 10:25:20 p.m.

<sup>25</sup> Tr. (May 16, 2018) at 10:25:27 p.m.

<sup>26</sup> Tr. (May 16, 2018) at 10:25:50 p.m.

<sup>27</sup> Wolfram Testimony at 21-23; Exhibit JW-2.

<sup>28</sup> Id. at 23

transaction. Part of this net system loss undoubtedly comes from Morgan Stanley's profit. The profit that Morgan Stanley takes out of this deal is a pure loss to the Kentucky economy which only adds to the "unreasonable prejudice or disadvantage" suffered by the fifteen remaining Owner-Members.

**III. Approval Of The Application Would Violate The Prohibition Against Wasteful Duplication Of KRS 278.020(1).**

The Commission has a long history of requiring utilities to prove need and the absence of wasteful duplication when ruling on generation resource additions or long-term energy and capacity purchases, as required by KRS 278.020(1).

In ruling on Kentucky Power's Application to enter into a twenty-year biomass power contract, the Commission stated:

*In Case No. 2009-00545, we articulated the standard of review for cases involving approval of a purchase power agreement as evidence of indebtedness under KRS 278.300. Pursuant to KRS 278.300, a utility must establish that the proposed assumption of obligation or liability is for some lawful object within the corporate purposes of the utility, is necessary or appropriate for or consistent with the proper performance by the utility of its service to the public and will not impair its ability to perform that service and is reasonably necessary and appropriate for such purpose. In addition to the standards set forth in KRS 278.300, the Commission must also analyze the need for the purchase power agreement under the Commission's existing statutory authority where, as here, the purchase power agreement is intended to add supplemental generating capacity to the utility. In examining the statutory criteria for approving financing under KRS 278.300(3), the 'purposes and uses of the proposed issue' are for the acquisition of new generation; and for the debt to be 'for some lawful object within the corporate purposes of the utility.' A utility must also establish a need for additional generation and the absence of wasteful duplication, both as required under KRS 278.020(1). (Order, Case No. 2013-00144 (October 10, 2013) at 12-13).*

When Kentucky Power sought approval to enter into a long-term purchase power agreement for wind generation located in Indiana, the Commission described its standard of review as follows:

*The fundamental principle of least cost is also embedded in KRS 278.020(1) which prohibits a utility from constructing a new facility to provide service to the public until it has demonstrated both a need for the new facility and that its construction will not result in wasteful duplication. Even though Kentucky Power is not now proposing to construct new generating facilities, its proposal to enter into a long-term contract to purchase such generation will have the same operational and financial implications and impacts to the utility and its ratepayers as if new generation were being constructed. Consequently, in examining the statutory criteria for approving financing under KRS 278.300(3), the 'purpose and uses of the proposed issue' are for the acquisition of new generation; and for the debt to be 'for some lawful objective within the corporate purposes of the utility,' there must be a need for additional generation and the absence of wasteful duplication. (Order, Case No. 2009-00545 (June 28, 2010) at 5-6).*

In approving EKPC's acquisition of the 594 MW Bluegrass generating station in December 2015, the Commission again articulated the prohibition against wasteful duplication. *"No utility may construct or acquire any facility to be used in providing utility service to the public until it has obtained a CPCN from this Commission. [Footnote omitted]. To obtain a CPCN, the utility must demonstrate a need for such facilities and an absence of wasteful duplication."* [Footnote omitted].

*'Need' requires:*

*[A] showing of a substantial inadequacy of existing service, involving a consumer market sufficiently large to make it economically feasible for the new system or facility to be constructed or operated.*

*[T]he inadequacy must be due either to a substantial deficiency of service facilities, beyond what could be supplied by normal improvements in the ordinary course of business; or to indifference, poor management or disregard of the rights of consumers, persisting over such a period of time as to establish an inability or unwillingness to render adequate service. [Footnote omitted].*

*'Wasteful duplication' is defined as 'an excess of capacity over need' and 'an excessive investment in relation to productivity or efficiency, and an unnecessary multiplicity of physical properties.'*<sup>29</sup>

Mr. Holt uses word games to claim that the 58 MW capacity purchase from PJM does not constitute wasteful duplication because it *"isn't supplementing generation; rather, it is replacing a portion of it with a more cost-effective source."*<sup>30</sup> Mr. Seelye claims that wasteful duplication is purely a matter of perspective. He argues that there is no legal requirement to address need from the perspective of the entire EKPC system, but only from the perspective of South Kentucky. *"KRS 278.020(1) does not require South Kentucky to analyze the impact of a purchase power transaction on its supplier, but only on its own operations."*<sup>31</sup> These arguments lack merit.

The EKPC system is planned and operated as a whole. The Commission's Integrated Resource Plan ("IRP") regulation exempts distribution cooperatives from complying with the regulation precisely because their load is included in their G&T's IRP.<sup>32</sup> The Staff Report from EKPC's most recent IRP states that *"[w]ith the acquisition of Bluegrass, EKPC does not plan on adding any additional resources to serve projected load until 2026."*<sup>33</sup> The Staff Report further shows that EKPC is required by PJM to carry only a 3% summer reserve

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<sup>29</sup> Order, Case No. 2015-00267 (December 1, 2015) at 24-25.

<sup>30</sup> Holt Rebuttal Testimony at 15.

<sup>31</sup> Seelye Rebuttal Testimony at 28.

<sup>32</sup> Nucor Ex. 2.

<sup>33</sup> Nucor Ex. 2.

margin of 72 MW, but that in 2019, its summer reserve margin will be 28% or 672 MW.<sup>34</sup> The addition of 58 MW of additional capacity would only exacerbate EKPC's surplus capacity situation.

Amendment 3 and the MOU are rates. And the enforcement of rates must comply with the law. Even though up to 158.5 MW of non-EKPC capacity may be acquired by the Owner-Members under Amendment 3, that acquisition cannot occur if it would violate KRS 278.020(1).

The Morgan Stanley proposal is particularly ill-advised from a statewide perspective given the significant surplus capacity situation of Big Rivers (loss of smelter load), Kentucky Power (depressed economic conditions), and Kentucky Utilities Company (loss of municipal load). If this Application is approved, then the only winners will be Morgan Stanley and possibly South Kentucky (depending on the enforcement of its environmental change in law clauses). Everyone else in the Commonwealth would lose.

### **REQUESTED RELIEF**

After denying this Application, the Commission should do two things:

First, the Commission should impose revised terms and conditions for obtaining energy and capacity from non-EKPC sources and require that EKPC seek approval of such revisions from the Rural Utilities Service ("RUS"). This would be in the form of a new Amendment to the 1964 Wholesale Power Contract. EKPC CEO Mr. Campbell set forth three revised conditions for selecting non-EKPC sources at page 23 of his Testimony, and those conditions should be adopted. They are: 1) purchase power agreements should not be allowed;<sup>35</sup> 2) each Owner-Member should only be entitled to 5% of its peak demand; and 3) alternative sources should be limited to behind-the-meter generation resources of approximately 3 MW or less.<sup>36</sup>

Second, the Commission should finish the process of designing energy rates that do not recover fixed costs. In 2008 rate case testimony on behalf of EKPC, Mr. Seelye stated: *"The unit charge components of EKPC's current rates do not accurately reflect the cost of providing service. From a cost of service perspective, too large of a portion of EKPC's fixed costs are recovered through the energy component of its rates. This is*

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<sup>34</sup> Nucor Ex. 2.

<sup>35</sup> At the hearing, it was clarified that purchase power agreements that are for financing or leasing of generation that would otherwise be directly owned by the Owner-Member should be allowed.

<sup>36</sup> Tr. (May 16, 2018) at 10:22:25.

particularly true of EKPC's Rate E."<sup>37</sup> EKPC's current Rate E Option 2 energy charge ranges from \$42.174/MWh off-peak to \$50.899/MWh on-peak.<sup>38</sup> At the hearing, Mr. McNalley testified that EKPC's current energy charge should probably be in the range of \$30/MWh.<sup>39</sup> Of course, any reduction in the energy charge would be accompanied by a revenue-neutral increase in the demand charge.<sup>40</sup> A cost-based rate design where fixed costs are recovered in demand rates would lessen the ability of an Owner-Member to improperly shift costs when building or purchasing non-EKPC generation.

Respectfully submitted,



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<sup>37</sup> Nucor Ex. 7.

<sup>38</sup> Nucor Ex. 4.

<sup>39</sup> Tr. (May 16, 2018) at 7:17:31.

<sup>40</sup> Tr. (May 16, 2018) at 7:18:08 ("Q: Now to make East Kentucky whole, if you lower the energy rate, you would have to increase your demand charges and your customer charges? A: Yes, or some other charge would have to increase to achieve our total revenue requirement.").