COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the matter of: : CASE NO: 2018-00050

THE APPLICATION OF SOUTH KENTUCKY
RURAL ELECTRIC COOPERATIVE CORPORATION
FOR APPROVAL OF MASTER POWER
PURCHASE AND SALE AGREEMENT
AND TRANSACTIONS THEREUNDER

RESPONSE OF SOUTH KENTUCKY RURAL ELECTRIC COOPERATIVE CORPORATION TO ATTORNEY GENERAL'S SUPPLEMENTAL DATA REQUESTS

Respectfully submitted,

/s/Matt Malone

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CERTIFICATE OF SERVICE

Pursuant to 807 KAR 5:001 Section 6, the undersigned certifies that consistent with 807 KAR 5:001 Section 4(8)(d)(3), a copy of this document has been electronically served upon the following:

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This 5th day of April, 2018.

/s/Matt Malone

ATTORNEY FOR SKRECC

South Kentucky Rural Electric Cooperative Corporation

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1. Reference the response to AG 1-5. Provide copies of any and all due diligence reviews SKRECC may have conducted pertaining to additional environmental risk and additional environmental costs.

Response:

South Kentucky has conducted no such due diligence reviews.

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2. Refer to SKRECC's responses to Staff 1-5 (a) wherein SKRECC answered that, "[t]he Alternate Source is not tied to a specific generating unit or units within PJM," and its response to AG 1-5, wherein SKRECC answered that, " South Kentucky recognized that it faces the same or essentially similar risk whether it purchases power from Morgan Stanley, EKPC or any other energy provider."

   a. Explain in complete detail how SKRECC has the information available to know that the environmental costs for the Alternate Source is the same or essentially similar risk as it would face if it purchased power from EKPC or any other energy provider.
   b. Confirm that differently fueled generators have different environmental concerns, and thus different "environmental costs" as defined in the confirmation letters cited.
   c. Confirm that SKRECC has no belief, understanding, or knowledge about the generation fuel or environmental compliance of the Alternate Source(s) in the Morgan Stanley transaction.
   d. Explain, in complete detail what SKRECC means when its states, " Changes in laws and regulations, for example, changes in environmental law, are applicable to PJM." Any response should provide a detailed explanation of how any and all environmental laws apply to PJM.

Response:

a. As noted in the response to Question AG 1-5, the definition of "Additional Environmental Costs" is the same in both the energy confirmation and the capacity confirmation. That definition covers costs imposed by a Governmental Authority, such as fees, licenses, charges, and the like. These costs do not include, however, capital investment or expenditures incurred by a utility to comply with the Clean Air Act or mandates affecting coal combustion wastes and by-products from coal-fired facilities. By comparison, the costs that EKPC is permitted to pass through to South Kentucky pursuant to EKPC's Environmental Surcharge include both categories of costs (*i.e.*, fee/license type costs and compliance-related investments and expenses).

With this in mind, and all else being equal, South Kentucky's view that the energy transaction with Morgan Stanley Capital Group ("MSCG") bears the same or essentially the same environmental cost risk as comparable supply from EKPC is a conservative one. As the additional questions in this request indicate, however, all else is not equal. Environmental cost risk will vary by generating unit, and thus the risk could be incrementally higher or lower depending on the resource portfolio of EKPC and the unit(s) supporting the energy transaction at the time of any applicable environmental cost. With respect to fees, licenses, charges and the like imposed by a Government Authority, South Kentucky believes the risk to be the same or essentially the same.

b. Confirmed.

c. Confirmed.

d. The point of this answer is that bidders into the PJM capacity market will be required to meet national, state and local environmental laws, and those laws can be expected to apply to all such bidders in a relatively comparable manner.

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3. Refer to SKRECC's response to AG 1-5 (c), particularly where SKRECC states that the incurrence of additional environmental costs "alone does not provide a basis to terminate the proposed transaction."

   a. Confirm that SKRECC is unable to reasonably anticipate "additional environmental costs" arising under the proposed transaction.
   b. Confirm that SKRECC is unable to determine any difference between the additional environmental costs if it continues to purchase energy from EKPC or through the proposed transaction.

Response:

a. Confirmed.
b. Confirmed. Note that this question and the confirmation herein are consistent with the responses to Question AG 2-2 a. and AG 2-2 d.

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4. Reference the response to AG 1-8. Does SKRECC believe RUS approval would be necessary as a pre-condition to obtaining any "additional line of credit"? If so, how long does SKRECC anticipate will be required to obtain such approval?

Response:

No. There is no requirement for RUS approval, except if the Limitation on Additional Indebtedness conditions are met per Article VI, Section 6.13 (e) of the Kentucky 0054-BD8-Wayne RUS Loan Contract dated November 1, 2016. This potential limitation was addressed in the letter to RUS dated January 5, 2018, as provided in the attachments to the response to Question DC 1-3, wherein South Kentucky requested a deviation from this contract requirement. As reflected in the response to Question DC 1-3, RUS granted its approval on January 30, 2018.

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5. Refer to SKRECC's response to AG 1-9 (d). Is it SKRECC's position that there is no risk in the long-term viability of the capacity transaction wherein Morgan Stanley defaults? Explain any answer in complete detail.

Response:

No. There is always a risk of default from any supplier, including suppliers such as EKPC and MSCG. Besides submitting a cost-effective proposal, MSCG was selected because of its market reputation and creditworthiness (including with the backing of its parent Morgan Stanley). Thus, the capacity transaction carries with it an inherent confidence that it is supported by a market participant capable of making South Kentucky whole in the unlikely event of a default. In addition, and as noted in the response to Question AG 1-9 d., even in the unlikely event of a default on the capacity transaction, South Kentucky would only be without the financial hedge provided by it.

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6. Refer to SKRECC's response to AG 1-10. The response provided did not detail an answer to the second part of the request. What does SKRECC believe the most likely causes of default or early termination are for Morgan Stanley Capital Group?

   a. Any cause of default should also indicate whether SKRECC has taken steps to mitigate the impact of such an occurrence, with details how SKRECC has planned or gone about doing so.
   b. A response that "South Kentucky does not anticipate a default or early termination by Morgan Stanley" is not an adequate response, as most entities do not enter into 20-year transactions with an expectation that the other parties will default.

Response:

South Kentucky does not anticipate a default or early termination by MSCG, and hence cannot identify "likely causes" of such events. However, an unlikely, but theoretical, cause would be market disruption akin to events in the latter half of 2008, which brought down Lehman Brothers. Similarly, a reversal in the trend of natural gas prices to levels such as those prevailing in the summer of 2008 could also theoretically precipitate a default by MSCG. The agreement includes defined protections for South Kentucky to mitigate such risk, in the General Terms of the Master Purchase and Power Agreement, Article Four and Article Five, as well as in the Collateral Annex. In addition, South Kentucky's membership in PJM will allow for the opportunity to purchase energy directly from PJM, without the assistance of MSCG, in the event of a default. Finally, Amendment 3 and the MOU afford South Kentucky a measure of relief in the event of an unmitigated default by MSCG.

South Kentucky also would note that the energy and capacity transactions do include an option for both parties to terminate in the event a final, non-appealable order is not obtained by May 31, 2018. While South Kentucky has no reason to think that MSCG will exercise that option if proceedings are not final by May 31, such is a potential early termination event as well.

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7. If SKRECC's Application is approved as filed, provide all studies, estimates or projection of the effect on the financial credit metric and borrowing costs of SKRECC.

Response:

Please see Attachment AG#2-7, which illustrates the financial credit metrics and borrowing costs for South Kentucky assuming the blended purchase of power from both Morgan Stanley, as described in the transaction, and EKPC. The financial effect of the agreement positively affects South Kentucky's financial outcomes. The effect of the blended cost of purchase power extends out the projected need for increased revenues by four (4) years, from 2019 to 2023. It also reduces the projected amount of needed increased revenues over the forecasted ten (10) year period.

This Attachment contains confidential information and is subject to a motion for confidential treatment. As confidential information pervades the Attachment, it is being filed with the Commission under seal.

Witness: Dennis Holt

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8. Refer to SKRECC's response to Staff 1-6. In the event of a default wherein SKRECC must purchase energy from a different alternate source or the market, state whether SKRECC will be obligated to take all 58 MWs of energy in every hour, or if it can choose to take delivery of a lesser amount as needed. Any response should assume the Commission approved this Application as filed.

Response:

Based on its Alternate Source designation and the provisions of the MOU, South Kentucky would be obligated to replace the Alternate Source with an equivalent product or products.

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9. State whether SKRECC has any special contract with customers. If so, provide the names of such special contract customers.

    a. Has SKRECC conducted any study on the effect, either with rates or services, of those special contract customers should the Commission approve this Application as filed? If so, provide all such studies or analysis. If no studies have been conducted, why not?
    b. Do any special contract customers identified above have contracts dealing with DSM or Energy Efficiency? If so, identify said customers.

Response:

Yes. Armstrong Wood Industries, Walmart Stores East, Eagle Hardwood, Superior Battery, Somerset Food Service, Kroger Limited Partnership, American Woodmark, Toyotetsu, USP McCreary and Equity Group KY.

a. South Kentucky has conducted no such study, as it does not expect the rates to change for any of our customers.
b. No