

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

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

REBUTTAL TESTIMONY OF WILLIAM STEVEN SEELYE

ON BEHALF OF

SOUTH KENTUCKY RURAL ELECTRIC COOPERATIVE CORPORATION

Filed: May 7, 2018

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

2 A. My name is William Steven Seelye. My business address is 6001 Claymont Village
3 Drive, Suite 8, Crestwood, Kentucky 40014.

4 **Q. BY WHOM AND IN WHAT CAPACITY ARE YOU EMPLOYED?**

5 A. I am the managing partner for The Prime Group, LLC, a firm located in Crestwood,
6 Kentucky, providing consulting and educational services in the areas of utility regulatory
7 support, revenue requirement analysis, cost of service studies, rate design and economic
8 analysis.

9 **Q. ON WHOSE BEHALF ARE YOU TESTIFYING IN THIS PROCEEDING?**

10 A. I am testifying on behalf of South Kentucky Rural Electric Cooperative Corporation
11 (“South Kentucky”).

12 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

13 A. The purpose of my testimony is provide rebuttal addressing the positions taken in the
14 direct testimony of the following intervenor witnesses in this proceeding: Anthony S.
15 Campbell on behalf of East Kentucky Power Cooperative, Inc. (“East Kentucky” or
16 “EKPC”); Michael McNalley on behalf of EKPC; Don Mosier on behalf of EKPC;
17 William T. Prather on behalf of Farmers Rural Electric Cooperative; Carol Ann Fraley on
18 behalf of Grayson Rural Electric Cooperative; and John Wolfram on behalf of EKPC’s
19 other Member Systems.

20 **Q. PLEASE SUMMARIZE YOUR TESTIMONY.**

21 A. South Kentucky is proposing to exercise its right to purchase power from an Alternate
22 Source pursuant to *Amendment No. 3 to Wholesale Power Contract Between East*
23 *Kentucky Power Cooperative, Inc. and South Kentucky Rural Electric Cooperative*

1 *Corporation* (“Amendment 3”), dated October 23, 2003, and the *Memorandum of*
2 *Understanding and Agreement Regarding Alternate Power Sources* (“MOU”), dated July
3 23, 2015. Under its proposed agreement to purchase power from an Alternate Source
4 (“Proposed Transaction”), South Kentucky will purchase 58 MW of firm energy for 20
5 years.

6 There is no aspect of the Proposed Transaction that conflicts with Amendment 3
7 and the MOU. EKPC and each of its Member Systems agreed to Amendment 3 and the
8 MOU, as executed. Amendment 3 and the MOU are a part of EKPC’s filed tariffs, with
9 the MOU affirmatively approved by the Kentucky Public Service Commission
10 (“Commission”) on December 18, 2015. As I discuss in my rebuttal testimony, the
11 Commission has a long history of strictly enforcing the Filed Rate Doctrine, a
12 fundamental principle of utility regulation that, in essence, requires a utility to adhere to
13 its filed rates and tariffs. The Commission has called the Filed Rate Doctrine the
14 “bedrock of utility rate regulation.” EKPC and the intervenors’ attempt to block South
15 Kentucky’s Proposed Transaction by encouraging the Commission to amend or cast aside
16 Amendment 3 and the MOU plainly violates the Filed Rate Doctrine.

17 I also address the argument made by the intervenor witnesses that the Proposed
18 Transaction should be refused because it could result in cost shifts to EKPC’s other
19 Member Systems. Cost shifts are a normal occurrence for all utilities. More importantly
20 though for this proceeding, cost shifts do not constitute a reason to disqualify South
21 Kentucky’s Alternate Source transaction under Amendment 3 or the MOU. The
22 intervenors argue that the transaction could create stranded costs that would have to be
23 recovered through EKPC’s rates. But such a possibility was fully recognized by the

1 parties when they negotiated the MOU and was specifically addressed in the agreement.
2 Consequently, the *possibility* that South Kentucky's Proposed Transaction *could* result in
3 the reallocation of stranded costs is irrelevant to the operation of Amendment 3 and the
4 MOU.

5 Notwithstanding this irrelevance, I demonstrate in my rebuttal that the analyses of
6 cost shifts performed by the intervenor witnesses are rudimentary and flawed.
7 Specifically, the intervenors offer no analysis of the marginal cost impacts of the
8 Proposed Transaction, instead relying on an overly-simplistic and flawed fixed cost
9 approach. Economic impacts can only be analyzed by examining the effect of changes in
10 demand on a utility's *marginal costs*. This is the approach that the Commission has
11 endorsed in both integrated resource planning and the economic evaluation of demand-
12 side management projects. Accordingly, the claims of cost shifts by intervenors are
13 speculative at best.

14 South Kentucky is filing its application for approval of the Proposed Transaction
15 pursuant to KRS 278.300(3), which requires the contract obligation to be for a lawful
16 objective within the corporate duties of the utility, to serve a need for the transaction, and
17 not to create wasteful duplication on South Kentucky's system. South Kentucky's
18 Proposed Transaction meets all these requirements. It is not incumbent on South
19 Kentucky to consider the impact of the Proposed Transaction on its wholesale supplier's
20 operations, or the downstream effects of the supplier's possible response to the Proposed
21 Transaction, if any.

22 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL AND PROFESSIONAL**
23 **BACKGROUND.**

1 A. I received a Bachelor of Science degree in Mathematics from the University of Louisville
2 in 1979. I have also completed 54 hours of graduate level course work in Industrial
3 Engineering and Physics. From May 1979 until July 1996, I was employed by LG&E.
4 From May 1979 until December 1990, I held various positions within the Rate
5 Department of LG&E. In December 1990, I became Manager of Rates and Regulatory
6 Analysis. In May 1994, I was given additional responsibilities in the marketing area and
7 was promoted to Manager of Market Management and Rates. I left LG&E in July 1996
8 to form The Prime Group, LLC, with two other former employees of LG&E. Since
9 leaving LG&E, I have performed or supervised the preparation of cost of service and rate
10 studies for over 150 investor-owned utilities, rural electric distribution cooperatives,
11 generation and transmission cooperatives, and municipal utilities. Therefore, including
12 my time at LG&E, I have almost 40 years of experience in the utility industry. In
13 addition. from 2012 through 2015, I was an instructor at Louisville's Walden School and
14 a private tutor and instructor in advanced placement calculus, linear algebra, pre-calculus,
15 college algebra and differential equations. A more detailed description of my
16 qualifications is included in Exhibit WSS-1.

17 **Q. HAVE YOU EVER TESTIFIED BEFORE ANY STATE OR FEDERAL**
18 **REGULATORY COMMISSIONS?**

19 A. Yes. I have testified in over 70 regulatory and court proceedings in 13 different
20 jurisdictions including the Kentucky Public Service Commission. I have testified on
21 behalf LG&E, Kentucky Utilities Company ("KU"), Columbia Gas Company of
22 Kentucky, Delta Natural Gas Company, and several other utilities in Kentucky. A listing
23 of my testimony in other proceedings is included in Exhibit WSS-1.

1 **Q. PLEASE DESCRIBE YOUR WORK AND TESTIMONY EXPERIENCE AS**
2 **THEY RELATE TO THE TOPICS ADDRESSED IN YOUR TESTIMONY?**

3 A. While working with tariffs and rates schedules for utilities in Kentucky and across the
4 United States, I have become intimately familiar with the Filed Rate Doctrine and with
5 the Commission's strict enforcement of the Filed Rate Doctrine in Kentucky. I have
6 written and supported the filing of rate schedules and special contracts for numerous
7 utilities in Kentucky and in other states. I also have in-depth personal experience with
8 the Commission's longstanding practice of strictly enforcing filed special contracts. I
9 have negotiated, drafted, and filed numerous purchased power agreements and ownership
10 participation agreements on behalf of electric utilities. I have supported several electric
11 cooperatives that have entered into agreements to purchase power from Alternate
12 Sources. I have also performed marginal cost studies that have investigated the impact of
13 changes in load on utility cost structures. In fact, the first several times I testified before
14 this Commission in the early 1980s, I testified on the analysis of marginal cost of service.

15 **Q. UNDER EKPC'S FILED TARIFF, IS SOUTH KENTUCKY PERMITTED TO**
16 **ENTER INTO ITS PROPOSED AGREEMENT TO PURCHASE POWER FROM**
17 **AN ALTERNATIVE SOURCE ("PROPOSED TRANSACTION").**

18 A. Yes. Amendment 3 and the MOU permit South Kentucky to enter into the Proposed
19 Transaction.

20 **Q. IN THEIR TESTIMONY, DO ANY OF THE INTERVENOR WITNESSES**
21 **ASSERT THAT SOUTH KENTUCKY'S PROPOSED TRANSACTION**
22 **VIOLATES AMENDMENT 3 OR THE MOU?**

23 A. No. Mr. Campbell, EKPC's President and Chief Executive Officer, states that "EKPC

1 does not dispute that under the literal terms of the Amendment 3 and the MOU, South
2 Kentucky is permitted to make this election subject, of course, to Commission approval.”
3 (*Direct Testimony of Anthony S. Campbell*, p. 24, lines 9-11.) Furthermore, nowhere in
4 the testimonies of the other parties in this proceeding do any of the witnesses claim that
5 South Kentucky’s proposed transaction is not permitted under Amendment 3 or the
6 MOU. For example, while Mr. Prather expresses regret that the Members should not
7 have signed Amendment 3 and the MOU, nowhere in his testimony does he claim that
8 South Kentucky’s Proposed Transaction violates Amendment 3 or the MOU. Mr.
9 Prather’s comments about Amendment 3 and the MOU simply underscore the fact that
10 South Kentucky’s Proposed Transaction is consistent with the agreements that the
11 EKPC’s Members signed. Specifically, on page 8 of his testimony, Mr. Prather states:

12 But the signatories to [the MOU] were strongly motivated by a desire to
13 settle the contentious and resource-intensive litigation regarding
14 Alternative Source power that Grayson Rural Electric Cooperative was
15 pursuing in the Grayson case, and other venues. (*Testimony of William T.*
16 *Prather*, at p. 8, lines 4-6.)

17 Mr. Prather goes on to state:

18 Shame on us for not doing a better job of analyzing and understanding
19 those agreements, and anticipating the consequences of a large cooperative
20 electing most or all of its entitlements to Alternative Source power at a
21 100% load factor. (*Id.*, at p. 13, lines 10-12.)

22 Implicit in Mr. Prather’s statements is the recognition that South Kentucky’s Proposed
23 Transaction is permitted under Amendment 3 and the MOU.

24 **Q. HOW DID AMENDMENT 3 COME ABOUT?**

25 A. Amendment 3 is an agreement that was put in place as part of an effort by EKPC to
26 extend the term of its Wholesale Power Contracts from January 1, 2025, to January 1,
27 2041. (*See, e.g., Testimony of Anthony S. Campbell*, pp 3-4, beginning on line 21 of p.

1 3.) In return for EKPC's Members agreeing to extend their Wholesale Power Contracts
2 for twenty years, EKPC agreed to provide each Member System certain rights to obtain a
3 portion of its power requirements from a source or sources other than EKPC. Mr. Prather
4 addresses the importance of this consideration in his testimony:

5 Amendment No. 3 was required in connection with an EKPC financing
6 transaction to extend the term of the wholesale power contracts between
7 EKPC and each of its members to match the maturity date of EKPC's new
8 debt. The additional terms in Amendment No.3, allowing purchase by a
9 distribution cooperative of alternately-sourced power, represent
10 concessions EKPC had to make to induce all its members to agree to
11 extension of the term of the wholesale power contracts. (*Id.*, at p.6, lines
12 10-15.)

13 Documents provided by EKPC in response to data requests in this proceeding support
14 Mr. Prather's statement. For example, EKPC's CEO during the time period when
15 Amendment 3 was negotiated stated in a letter to EKPC's Members that there were five
16 Members who had "requested consideration of an off-system purchase allowance and a
17 possible exit policy or clause." (*See, e.g.*, Exhibit WSS-2.) South Kentucky was one of
18 the five Members seeking the ability to acquire power from an Alternative Source. (*Id.* at
19 p. 358.) Therefore, allowing Member Systems to acquire power from an Alternate
20 Source under Amendment 3 was the consideration provided to at least five Members for
21 agreeing to extend their Wholesale Power Contracts. Amendment 3 was thus a product
22 of a *quid pro quo* type of exchange between EKPC (and RUS) and its Members. (In
23 Latin, *quid pro quo* means "something for something".) In return for rights of the
24 Members to install their own generation or purchase alternative sources of power from a
25 party other than EKPC (the *quid* for EKPC) EKPC would receive an extension of its
26 Wholesale Power Contracts (the *quo* for EKPC). Importantly, EKPC and all of EKPC's
27 Members agreed to Amendment 3.

1 **Q. HOW DID THE MOU COME TO EXIST?**

2 A. The MOU was the result of an agreement reached between EKPC and each of its
3 Members to resolve a petition and complaint filed against EKPC by Grayson Rural
4 Electric Cooperative in Case No. 2012-00503 about the interpretation of Amendment 3.
5 The MOU is a document that was developed to clarify Amendment 3. EKPC and each
6 EKPC member system agreed to the MOU.

7 **Q. IS THE MOU A PART OF EKPC'S FILED TARIFF?**

8 A. Yes. On September 30, 2015, EKPC filed with the Commission fully-executed copies of
9 the MOU, which EKPC entered into with its 16 Members. Consequently, the MOU is
10 part of EKPC's filed rates. In its filing of the MOU with the Commission, EKPC stated
11 as follows:

12 Attached hereto as Exhibit 1 is a complete, fully executed copy of the
13 Amendment 3 MOU, as signed by EKPC and each of its Members. As
14 reflected by the signature pages of each of EKPC and each of EKPC's
15 Owner-Members along with the accompanying Resolution of EKPC's
16 Board of Directors, the Amendment 3 MOU has been approved and now
17 governs the parties' relationship with respect to the acquisition and
18 allocation of alternatively sourced power under Amendment 3. (Case No.
19 2012-00503, EKPC's Notice of Filing, dated September 30, 2015, at p. 2.)
20

21 EKPC's filing made it clear that the MOU was an integrated contract that was to govern
22 fully the "parties' relationship with respect to the acquisition and allocation of
23 alternatively source power under Amendment 3." (*Id.*) As an integrated contract, the
24 MOU represents the full and final statement of EKPC and its Member Systems'
25 agreement regarding alternatively sourced power. Consistent with this fact, EKPC
26 subsequently rescinded its Board Policy 305 on April 12, 2016. (Exhibit WSS-3.)
27 Because the MOU embodied the full agreement among the parties, EKPC and the other

1 Member Systems' current dissatisfaction with the MOU should not be used to disturb
2 what the parties agreed to and the Commission approved.

3 The MOU is also considered a "Rate" or a "Tariff" under Kentucky statutes and
4 Commission regulations. Under KRS 278.010, the term "rate" is defined broadly, as
5 follows:

6 "Rate" means any individual or joint fare, toll, charge, rental, or other
7 compensation for service rendered or to be rendered by any utility, and
8 any rule, regulation, practice, act, requirement, or privilege in any way
9 relating to such fare, toll, charge, rental, or other compensation, and any
10 schedule or tariff or part of a schedule or tariff thereof.
11

12 Therefore, a rate not only refers to a charge but also to "any rule, regulation, practice, act,
13 requirement, or privilege." The term "tariff" is defined in equally broad terms under the
14 KYPSC's regulations. 807 KAR 5:011 states that:

15 "Tariff" means the schedules of a utility's rates, charges, regulations,
16 rules, tolls, terms, and conditions of service over which the commission
17 has jurisdiction.
18

19 807 KAR 5:011 specifies that utilities are required to file their tariffs and any additions,
20 revisions or withdrawals of their tariffs or tariff sheets with the Commission.
21 Furthermore, 807 KAR 5:011 states that utilities must also file any special contracts that
22 establish "rates, charges, or conditions of service not contained in its tariff."

23 **Q. WAS THE MOU AFFIRMATIVELY APPROVED BY THE COMMISSION?**

24 A. Yes. The Commission approved the MOU in its Order in Case No. 2012-00503 dated
25 December 18, 2015. In approving the MOU, the Commission stated as follows:

26 Based on a review of the evidence of record and being otherwise
27 sufficiently advised, the Commission finds that the Amendment 3 MOU is
28 comprehensive in nature, does not violate any legal or regulatory
29 principle, and results in a reasonable resolution of all issues to be

1 investigated in this case. (Order in Case No. 2012-00503, dated December
2 18, 2015, at p. 5.)

3 The Commission also required “EKPC to file in the Commission’s Tariff Filing System
4 one copy of the Amendment 3 MOU with the signature pages of each of its 16
5 Members.” (*Id.*, at p. 6.)

6 **Q. BASED ON YOUR EXPERIENCE IN KENTUCKY, WHAT IS THE**
7 **COMMISSION’S POLICIES AND PRACTICES REGARDING FILED RATES**
8 **SUCH AS AMENDMENT 3 AND THE MOU?**

9 A. It has been my experience that the Commission closely adheres to and applies the Filed
10 Rate Doctrine. Stated simply, the *Filed Rate Doctrine* refers to the principle that any
11 “filed rate” – that is, any tariff, rate schedule, special contract, or set of terms and
12 conditions for service – must be strictly enforced. The Filed Rate Doctrine requires that,
13 in providing service to customers, regulated utilities must provide service in exactly the
14 manner described in their filed tariffs or filed service contracts. By requiring strict
15 adherence to filed tariffs, the Filed Rate Doctrine protects both customers and utility
16 service providers alike. Because of the Filed Rate Doctrine, utilities are forbidden from
17 charging rates different from those on file with the regulatory commission. Likewise,
18 utilities cannot deviate from the terms and conditions of service that are set forth in their
19 filed contracts or tariffs. The Filed Rate Doctrine thus ensures both enforceability and
20 predictability in the rates and terms and conditions of service offered by utilities.

21 In Kentucky, the Filed Rate Doctrine originates directly from the Commission’s
22 statutory authority. KRS 278.160 requires that “each utility shall file with the
23 commission, within such time and in such form as the commission designates, schedule
24 showing all rates and conditions for service established by it and collected and enforced.”

1 KRS 278.160 goes on to state:

2 No utility shall charge, demand, collect, or receive from any person a
3 greater or less compensation for any service rendered or to be rendered
4 than that prescribed in its filed schedules, and no person shall receive any
5 service from any utility for a compensation greater or less than that
6 prescribed in such schedules.

7 Furthermore, 807 KAR 5:011 of the Commission's regulations specifies that utilities are
8 required to file their tariff and any additions, revisions or withdrawals of their tariffs or
9 tariff sheets with the Commission. Additionally, 807 KAR 5:011 also states that utilities
10 must file any special contracts that establish "rates, charges, or conditions of service not
11 contained in its tariff." The Filed Rate Doctrine thus emerges directly from the statutes
12 under which utility rates, tariffs, terms and conditions, and special contracts must be filed
13 in accordance with the Kentucky Revised Statutes.

14 **Q. HAS THE FILED RATE DOCTRINE BEEN ADDRESSED IN ANY**
15 **COMMISSION ORDERS?**

16 A. The Filed Rate Doctrine has been addressed extensively by the Commission, including
17 many proceedings in which I was directly involved. My first direct encounter with the
18 Commission's strict adherence to the Filed Rate Doctrine was in Case No. 95-037. In
19 that proceeding, when I was the head of the rate department for LG&E, I had filed a
20 replacement rate schedule for firm gas transportation service (Rate FT). LG&E had
21 secured agreements from each of its large gas transportation customers for the customers
22 to pay for the cost of the telemetry equipment necessary to provide gas transportation
23 service, and had begun charging the customers in accordance with those agreements. The
24 company had not, however, filed the individual agreements with the Commission or
25 stated the requirement for the customers to pay for the telemetry equipment in its tariff.

1 In its Order in Case No. 95-037 the Commission determined that it was appropriate for
2 LG&E to require that transportation customers pay for the cost of the telemetry
3 equipment; however, the Commission ordered the company to refund the payments that
4 had already been collected from the customers because the provision requiring customers
5 to pay for the equipment was not set forth in LG&E's tariff and because the contracts
6 signed by the individual customers had not been filed with the Commission as special
7 contracts. This order drove home to me how strictly the Commission enforces the Filed
8 Rate Doctrine.

9 **Q. ARE THERE OTHER COMMISSION ORDERS ADDRESSING THE FILED**
10 **RATE DOCTRINE?**

11 A. Yes, there are many. In its Order in Case No. 95-107, the Commission grounded its
12 enforcement of KRS 278.160 explicitly in terms of the filed rate doctrine. In Case No.
13 95-107, the KYPSC addressed a situation where the utility had entered into a Settlement
14 Agreement that relieved the utility of collecting undercharges under its filed rates from
15 certain customers. The KYPSC found that the Settlement Agreement violated the Filed
16 Rate doctrine. In its Order, the KYPSC stated:

17 While the amount of undercharges is small, the principle at stake is not.
18 ***The filed rate doctrine is the bedrock of utility rate regulation.***
19 Acceptance of the Settlement Agreement [which had not been filed with
20 the Commission] would erode the basic bulwark against rate
21 discrimination and arbitrary utility action. Even the smallest erosion of
22 this rule must be avoided. (Order in Case No. 95-107, *In the Matter of*
23 *North Marshall Water District*, dated October 13, 1995, at p. 3. Emphasis
24 added.)

25 In an order in a subsequent case, Case No. 95-517, the Commission provided a detailed
26 discussion of the file rate doctrine. Case No. 95-517 concerned an investigation into
27 violations of KRS 278.160 by Leslie County Telephone Company. Specifically, the

1 utility was being investigated for charging rates that were not in its tariff. In its order in
2 Case No. 95-517, the Commission stated that “KRS 278.160 codifies the ‘filed rate
3 doctrine.’” The Commission ruled that a utility must bill charges in accordance with its
4 filed tariff. The order states that filed tariffs “have been reviewed and found reasonable
5 by the Commission. Prior to becoming effective, they are examined and questioned. The
6 scrutiny is the principal reason for the Commission’s existence.” (Order in Case No. 95-
7 517, *In the Matter of Leslie County Telephone Company, Inc.*, dated June 21, 1996, at p.3
8 and 5.)

9 **Q. ARE THERE MORE RECENT COMMISSION ORDERS ADDRESSING THE**
10 **FILED RATE DOCTRINE?**

11 A. Yes. The Filed Rate Doctrine was addressed in a recent complaint case filed against KU
12 in *David Shouse and Brian Shouse, D/B/A Shouse Farms, and Bryan Hendrickson, D/B/A*
13 *Hendrickson Grain and Livestock, LLP v. Kentucky Utilities Company* (Case No. 2015-
14 00417). This is another proceeding in which I was involved, this time as an outside
15 expert witness. In the complaint proceeding, two customers that operated grain drying
16 operations taking service under KU’s Power Service rate schedule (Rate PS) filed formal
17 complaints against KU concerning the determination of the customers’ billing demand
18 under Rate PS. The complainants argued that because their grain drying operations were
19 seasonal in nature, the determination of the billing demands under Rate PS caused KU to
20 collect revenues from the customers that exceeded the actual cost of power over the
21 course of the year.

22 Even though the customers did not dispute that KU followed its rules and
23 conditions in calculating the billing demands for the rate, the complainants argued that

1 the rates, specifically the terms for calculating the billing demands in the application of
2 the rates, were “unjust, unfair, unreasonable.” The complainants claimed that “unjust,
3 unfair, unreasonable and/or discriminatory rates are always subject to review [pursuant
4 to] KRS 278.260 and KRS 278.270.” (Complainants’ Response to KU’s Motion to
5 Dismiss in Case No. 2015-00417, paragraph 11.) The Commission disagreed.

6 In its Order in Case No. 2015-00417, the Commission once again emphasized the
7 importance of the Filed Rate Doctrine, stating:

8 In the present case, the Complaint does not allege that KU charged
9 Complainants a rate other than one in KU’s schedule of rates on file with
10 the Commission for the service Complainants received. Rather, the
11 Complaint simply reflects Complainants’ displeasure with KU’s rates, in
12 particular the demand-rate structure of Rate PS. Yet, a customer’s
13 dissatisfaction with a utility’s filed rate schedule does not provide grounds
14 for lawfully ordering, or allowing, a utility to collect from that customer a
15 rate different from that collected from other customers who are similarly
16 situated. (Order in Case No. 2015-00417, *In the Matter of David Shouse*
17 *and Brian Shouse, D/B/A Shouse Farms, and Bryan Hendrickson, D/B/A*
18 *Hendrickson Grain and Livestock, LLP v. Kentucky Utilities Company*,
19 dated June 29, 2016, at pp. 10-11.)
20

21 The Commission granted KU’s motion to dismiss the complaint with prejudice but
22 directed KU to “include in its next application for a general adjustment in rates testimony
23 in support of the monthly billing demand provisions of Rate PS.” (*Id.* at p. 13.) In KU’s
24 and LG&E’s next rate case application filed in Case No. 2016-00370 and 2016-00371,
25 respectively, I submitted direct testimony in support of the provisions in Rate PS for
26 determining customer billing demands. In its order in that proceeding, the billing
27 demand provisions for Rate PS were permitted by the Commission to remain unchanged.

28 Like the intervenors in the current South Kentucky proceeding, the complainants
29 in Case No. 2015-00417 did not dispute that the tariff was being misapplied. They
30 simply did not like the effect of applying the tariff. In other words, as with the

1 intervenors in the current South Kentucky proceeding, the complainants did not approve
2 of the outcome of applying the tariff. As the Commission found in Case No. 2015-
3 00417, a party's displeasure with the impact or application of a tariff is not a valid reason
4 for a utility to deviate from its filed tariff.

5 **Q. HAVE COURTS IN THE UNITED STATES AND KENTUCKY ALSO**
6 **ADDRESSED THE FILED RATE DOCTRINE?**

7 A. Yes. I won't go into detail describing the numerous U.S. and Kentucky court decisions
8 that have addressed the Filed Rate Doctrine, but I have included as Exhibit WSS-4 a draft
9 of a paper that I have been writing that identifies a number of court decisions that address
10 the doctrine.

11 **Q. WHAT IMPLICATIONS DOES THE COMMISSION'S STRICT**
12 **ENFORCEMENT OF THE FILED RATE DOCTRINE HAVE ON SOUTH**
13 **KENTUCKY'S APPLICATION?**

14 A. South Kentucky's proposed Alternative Source Transaction is fully authorized under
15 EKPC's Amendment 3 and MOU, which are filed rates of EKPC. The MOU was not
16 only filed by EKPC but also found reasonable by the Commission. The MOU must be
17 strictly enforced until it is no longer a part of EKPC's filed tariff.

18 **Q. ARE ANY OF THE PARTIES ASKING THAT AMENDMENT 3 AND THE MOU**
19 **TO BE AMENDED OR CANCELLED?**

20 A. Yes. Mr. Campbell, the CEO for EKPC, states as follows:

21 However, upon thorough review and consideration, EKPC believes that
22 this election has caused many, if not all, of its owner-member to realize
23 that, for the sake of all of our owner-members and their customers, the
24 MOU must be amended or done away with to avoid inequitable results
25 such as would occur here. It is my belief that first, power purchase
26 agreements should not be allowed. (Testimony of Anthony S. Campbell, at

1 p. 23. Emphasis supplied)

2 Thus, Mr. Campbell is asking the Commission to amend or cancel Amendment 3 and the
3 MOU. Mr. Prather, who filed testimony on behalf of nine EKPC Members, considers
4 Amendment 3 and the MOU to be “flawed agreements” and calls for the Commission to
5 revisit the agreements.

6 **Q. SHOULD EKPC AND THE OTHER MEMBER SYSTEMS BE PERMITTED TO**
7 **EXTRICATE THEMSELVES FROM THE AGEEMENTS?**

8 A. No. Allowing the Member Systems to purchase Alternative Power, as provided in
9 Amendment 3, was a major consideration for South Kentucky and several other Members
10 agreeing to extend the Wholesale Power Contracts for another 20 years. EKPC’s current
11 effort to prevent Members from purchasing Alternative Power is a bold attempt to
12 remove the concession that EKPC provided in 2003 when it agreed to allow Members to
13 purchase power from an Alternate Source in exchange for an extension of the Wholesale
14 Power Contracts. In what is essentially a *post hoc* collateral attack against Amendment 3
15 and the MOU, EKPC is now encouraging the Commission to abolish the rights that
16 Members currently have under Amendment 3 to purchase Alternative Power. (*Id.*)
17 With respect to the *quid pro quo* exchange that was an integral part of the Members
18 agreeing to extend the Wholesale Power Contracts, EKPC would retain the 20-year
19 extension of the Wholesale Power Contracts (the *quo* that EKPC received) that the
20 Member Systems agreed to, but EKPC is now pursuing an agenda with the Commission
21 to take back the concession EKPC made to allow its Members to purchase Alternative
22 Power (the *quid* that EKPC provided.) EKPC’s promise to allow its Member Systems the
23 ability to purchase power from an Alternative Source created a definite and foreseeable
24 reliance on the part of the Member Systems, inducing them to extend their Wholesale

1 Power Contracts for 20 years. EKPC should be held to the promise it made.

2 Furthermore, EKPC and each of its Members agreed to Amendment 3 and to the
3 MOU. EKPC and its Members therefore assented to Amendment 3 and the MOU as the
4 expression of their agreement regarding the “relationship with respect to the acquisition
5 and allocation of alternatively source power.” (Case No. 2012-00503, EKPC’s Notice of
6 Filing, dated September 30, 2015, at p. 2.) Mr. Prather saying, “Shame on us for not
7 doing a better job of analyzing and understanding those agreements” (*Testimony of*
8 *William T. Prather*, at p. 8, lines 4-6.), should not be a basis for abolishing Amendment 3
9 and the MOU. The MOU was executed after intensive scrutiny of Amendment 3 by
10 EKPC and its Member Systems and after extensive negotiations by the parties. The
11 MOU was then filed with and approved by the Commission. The MOU thus established
12 settled expectations with respect to purchasing power from an Alternate Source. Relying
13 on the agreement struck in the MOU, South Kentucky has incurred significant costs
14 preparing a request for proposal (RFP), evaluating proposals from bidders, negotiating
15 contract language, preparing a filing of the Proposed Transaction with the Commission,
16 and now defending the Proposed Transaction in this proceeding.

17 **Q. IN ANY OTHER PROCEEDINGS, HAS THE COMMISSION ADDRESSED A**
18 **PROPOSAL TO MODIFY AN AGREEMENT WHEN A PARTY TO THE**
19 **AGREEMENT NO LONGER SUPPORTED WHAT THEY HAD AGREED TO?**

20 A. Yes. In Case No. 2012-00226, Kentucky Power Company (“Kentucky Power”) was
21 proposing to withdraw a real-time pricing tariff that had been implemented as part of a
22 settlement agreement in an earlier proceeding. Kentucky Industrial Utility Customer, Inc.
23 (“KIUC”) filed motions to dismiss Kentucky Power’s applications on the grounds that,

1 among other things, the *Mobile-Sierra Doctrine* limited Kentucky Power’s ability to
2 modify the settlement agreement that provided for the implementation of the real-time
3 pricing tariff. (The *Mobile-Sierra Doctrine* was established in two U.S. Supreme Court
4 decisions in the 1950s that placed a virtually insurmountable barrier to overturning
5 agreements between parties filed with the Federal Energy Regulatory Commission. The
6 doctrine has been upheld subsequently in numerous Supreme Court decisions.)
7 Specifically, KIUC argued that, in accordance with the *Mobile-Sierra doctrine*, the
8 Commission could modify an approved settlement agreement if the Commission found
9 “the settlement to seriously harm the public interest.” (See Case No. 2012-00226, *Reply*
10 *of Kentucky Industrial Utility Customers, Inc. to Response of Kentucky Power*, June 19,
11 2012, at p.2) In its Order in Case No. 2012-00226, using language essentially similar to
12 the U.S. Supreme Court decisions dealing with the *Mobile-Sierra Doctrine*, the
13 Commission denied Kentucky Power’s request to withdraw the real-time pricing tariff
14 that was approved in the settlement agreement, stating as follows:

15 Arguably, there could be situations in which the public interest could
16 require the Commission to exercise its jurisdiction under KRS Chapter
17 278 to allow withdrawal of a tariff prior to its expiration under the terms
18 of that particular tariff. The prevention of extreme financial difficulty or
19 bankruptcy of a utility might be a situation in which the public interest
20 could require the Commission to act pursuant to its authority under KRS
21 Chapter 278 to allow a tariff to be withdrawn prior to its expiration date.
22 (Order in Case No. 2012-00226, dated December 20, 2012, at p. 15.)
23

24 **Q. HAVE THE INTERVENORS IN THIS PROCEEDING DEMONSTRATED THAT**
25 **AMENDMENT 3 AND THE MOU WILL RESULT IN FINANCIAL HARM TO**
26 **EKPC AND ITS OTHER MEMBERS?**

27 **A.** No. As I will discuss in greater detail later in my testimony, EKPC has not performed a

1 system impact study demonstrating that South Kentucky’s exercising of its right to
2 purchase alternately-sourced power will result in financial harm to the EKPC, or that the
3 Proposed Transaction will precipitate the need for EKPC to file a base rate increase.
4 EKPC’s load growth appears robust enough to offset the impact of the transaction.
5 EKPC’s last long-range load forecast indicated that EKPC would have robust sales
6 growth, increasing its net energy requirements from 13.2 million MWh to 17.4 million
7 MWh over a twenty-year period. (See Volume 1 of the Technical Appendix filed by
8 EKPC in its last IRP filing in Case No. 2015-00134.) EKPC’s forecast indicated that its
9 peak demands would increase by similar percentages (*Id.*, at pp. 6-7.) Based on the
10 current strength of the economy there are indications that EKPC is experiencing stronger
11 growth than what was projected in its last IRP filing.

12 **Q. THE INTERVENORS MAINTAIN THAT SOUTH KENTUCKY’S PROPOSED**
13 **TRANSACTION SHOULD BE DISALLOWED BECAUSE IT COULD RESULT**
14 **IN “COST SHIFTS” TO OTHER MEMBERS. IS THIS A VALID**
15 **CONSIDERATION?**

16 A. No. Neither Amendment 3 nor the MOU prevent an Alternative Source transaction
17 because the transaction could shift costs to other Members. Certainly, the Members
18 would have realized that cost shifts were possible when they agreed to Amendment 3 and
19 the MOU. The point that the intervenors are trying to make is that South Kentucky’s
20 Proposed Transaction could create “stranded costs” that would have to be recovered
21 through future increases in EKPC’s rates. (The term “stranded costs” refers to a utility’s
22 existing infrastructure costs that are made redundant after significant reduction in the
23 utility’s sales.) It is always possible for a utility to realize stranded costs when there is a

1 significant reduction in load. But the MOU explicitly addresses this very possibility.
2 Specifically, Section 6(A) of the MOU states:

3 EKPC shall not be entitled to charge any Owner Member for so-called
4 “stranded costs” related to the Owner Member’s implementation of its
5 rights to use Alternate Sources. As a result, to the extent that an Owner
6 Member’s use of Alternate Sources reduces its billing demands under
7 EKPC’s rates under the Wholesale Power Contract as in effect from time to
8 time, EKPC shall not be entitled to charge any special rate or charge to the
9 Owner Member attributable to such billing demand reduction. EKPC will,
10 however, be entitled to continue to set its rates for all Owner Members
11 under the Wholesale Power Contracts to produce revenues that are
12 sufficient to cover all of its costs, in accordance with the Wholesale Power
13 Contracts. (MOU, Section 6(A), at p. 9).

14
15 By signing the MOU, EKPC and its Members fully recognized that it was possible
16 that a Member exercising its right to use an Alternative Source could create
17 stranded costs and thereby place upward pressure on EKPC’s rates. Therefore, any
18 possible “cost shift” that could be created by South Kentucky’s proposed
19 transaction is irrelevant to its right to acquire Alternate Source power under
20 Amendment 3 and the MOU.

21 **Q. HAVE ANY OF THE INTERVENOR WITNESSES DEMONSTRATED THAT**
22 **THERE WILL BE COST SHIFTS?**

23 A. No. While any consideration of “cost shifts” is irrelevant to South Kentucky’s right to
24 utilize Amendment 3 and the MOU, any possible cost shifts resulting from the Proposed
25 Transaction are speculative at best. Furthermore, the types of cost shifts that the
26 intervenors are concerned about take place all of the time in the ratemaking process. To
27 put a finer point to this, whenever a utility’s marginal cost differs from the embedded cost
28 of service reflected in rates, it is possible for changes in sales to result in cost shifts.

29 For example, if the annual marginal cost (incremental cost) of serving a new

1 residential electric customer is \$4,000, but if the utility only charges the new customer
2 \$3,000 per year based on rates reflecting embedded cost of service, then an additional
3 cost burden of \$1,000 per new customer is placed on the utility's overall costs and must
4 eventually be reflected in future rates. If the utility adds 21,000 residential customers
5 per year then an additional cost burden of \$21 million is placed on the utility. Similarly,
6 if a customer leaves the system and if the marginal cost (the decremental cost) of serving
7 the customer is once again \$4,000 per year but the lost revenue is only \$3,000, then a loss
8 of a customer will result in net reduction in the utility's cost of service. In this case, the
9 utility's remaining customers would be better off if there were a reduction in the number
10 of customers served by the utility.

11 Differences between marginal and embedded costs occur all of the time, as do
12 adding new customers and losing existing customers. Adding new customers often place
13 increased pressure on the rates of current customers but sometimes adding new customers
14 place downward pressure on a utility's rates. The impact of a utility's existing rates
15 depends on the difference between marginal and embedded costs.

16 **Q. IS IT POSSIBLE TO ESTIMATE THE IMPACT OF SOUTH KENTUCKY'S**
17 **PROPOSED TRANSACTION WITHOUT ANALYZING THE DIFFERENCE**
18 **BETWEEN MARGINAL AND EMBEDDED COSTS?**

19 A. No.

20 **Q. BUT EVEN IF A CHANGE IN SALES PLACES ADDITIONAL NET MARGINAL**
21 **COSTS ON A UTILITY, DOES THAT NECESSARILY MEAN THAT THE**
22 **IMPACT WILL BE EXPERIENCED BY CUSTOMERS?**

23 A. No. The marginal cost impact of changes in sales may not be large enough to result in a

1 change in a utility's rates. For example, the utility's sales growth may be large enough
2 to fully offset the loss of sales from a particular customer or set of customers. In the case
3 of EKPC, its sales projections indicate that it will likely be able to offset the impact of
4 South Kentucky Proposed Transaction in a few short years. It is possible that increased
5 sales to a new or existing large industrial customer could more than offset the Proposed
6 Transaction. The marginal cost impact of South Kentucky's Proposed Transaction
7 cannot be estimated without analyzing the impact of sales growth on EKPC's system.
8 Thus, a marginal cost impact ultimately may not be large enough to cause EKPC to adjust
9 its rates.

10 **Q. IN ASSESSING THE IMPACT OF SOUTH KENTUCKY'S PROPOSED**
11 **TRANSACTION ON EKPC'S RATES, DID THE INTERVENOR WITNESS**
12 **EXAMINE THE DIFFERENCE BETWEEN EKPC'S MARGINAL AND**
13 **EMBEDDED COSTS.**

14 A. No. Intervenor witnesses McNalley and Wolfram did not consider the impact of South
15 Kentucky's proposed transaction on EKPC's marginal costs. They both assumed that the
16 reductions in revenues from South Kentucky's Proposed Transaction would be
17 automatically recovered through rates. This is a grossly over-simplistic assumption. Mr.
18 McNalley and Mr. Wolfram incorrectly assumed that the loss of revenues due to South
19 Kentucky's Proposed Transaction would immediately result in increased rates to other
20 Members. This is obviously incorrect. For example, for EKPC's base rates to be
21 affected by the Proposed Transaction in the manner claimed by Mr. McNalley and Mr.
22 Wolfram, EKPC would need to file a base rate increase. They have not demonstrated
23 that the Proposed Transaction will cause EKPC to file a base rate increase. As of

1 December 31, 2017, EKPC had \$133.9 million in cash and cash investments. (Exhibit
2 WSS-5.) With interest rates on the rise, the increased interest earnings realized from this
3 large cash reserve should help offset the impact of the transaction and thereby delay any
4 need EKPC could otherwise have to file a general rate increase. Interest earned on this
5 large cash reserve could perhaps offset the loss of revenue from the Proposed Transaction
6 until such time as on-system or off-system sales growth further mitigates the loss of
7 revenue. As EKPC stated in a response to a data request, “The timing and amount [of a
8 base rate increase will] depend on [EKPC’s] entire financial outlook, rather than any
9 single issue.” (EKPC’s Response to SK Request 42a.)

10 Indeed, the impact of South Kentucky’s Proposed Transaction on EKPC’s cost of
11 service cannot be identified without analyzing EKPC’s future resource options and
12 marginal costs. For example, fuel costs and variable operation and maintenance expenses
13 are short-run marginal costs and are therefore immediately avoidable. Because EKPC
14 will generate less power to serve South Kentucky as a result of the transaction, EKPC
15 will simply not incur the cost of fuel to generate the power. Fuel and variable operation
16 maintenance expenses are considered short-run marginal costs, or *short-run avoided*
17 *costs*, because they are fully avoided if it is no longer necessary to generate the electric
18 energy to serve the load. Mr. Wolfram assumed that the fuel costs not passed on to
19 South Kentucky as a result of the transaction would be automatically passed on to other
20 customers. This is incorrect. Fuel expenses are fully avoidable. If EKPC doesn’t
21 generate the power that would have otherwise been produced to serve the lost South
22 Kentucky load, then EKPC will simply incur proportionately less fuel expenses as a
23 result of not generating the power. Therefore, there should be little or no effect on the

1 fuel expenses paid by the other Members though EKPC’s Fuel Adjustment Clause
2 (FAC). Mr. McNalley acknowledged this when he stated that “[s]ome variable costs will
3 be avoided by no longer needing to supply the load.” (Direct Testimony of Michael
4 McNalley, at p. 5.) In contrast, Mr. Wolfram assumes that “all of the FAC costs avoided
5 by South Kentucky will have to be recovered from the other Owner Members.” (Direct
6 Testimony of John Wolfram, beginning on line 21 of p. 19.) Clearly, this is an incorrect
7 assumption, because, as Mr. McNalley correctly states, the reduction in sales to South
8 Kentucky as a result of the Proposed Transaction translate directly into a reduction in the
9 fuel expenses. There is no reallocation of fuel expenses due to the Proposed Transaction,
10 as claimed by Mr. Wolfram, because the fuel expenses will be fully avoided.

11 **Q. FUEL AND VARIABLE OPERATION AND MAINTENANCE EXPENSES ARE**
12 **OBVIOUSLY AVOIDABLE, BUT WHAT ABOUT EKPC’S OTHER COSTS?**

13 A. The impact on EKPC’s other costs resulting from South Kentucky’s proposed transaction
14 cannot be determined without performing a marginal cost analysis. As I discussed
15 earlier, adding new load can be beneficial or detrimental to the rates of current customers,
16 depending on the relationship between the utility’s marginal and embedded costs.
17 Likewise, load decreases can also place upward or downward pressure on existing rates,
18 depending on the marginal versus embedded cost relationship. But there is no way to
19 determine the impact on EKPC without performing a marginal cost analysis.

20 **Q. DID THE INTERVENOR WITNESSES CONSIDER THE IMPACT ON EKPC’S**
21 **MARGINAL COSTS RELATED TO THE SOUTH KENTUCKY CONTRACT?**

22 A. No.

23 **Q. WHAT WOULD A MARGINAL COST ANALYSIS CONSIDER?**

1 A. It would consider the change in the cost of EKPC’s generation resources, transmission
2 resources, demand-side management resources, and off-system sales opportunities due to
3 a change in EKPC’s load resulting from South Kentucky’s Proposed Transaction. This
4 type of analysis is often called a “system impact study”. For example, a system impact
5 study would determine whether South Kentucky’s Proposed Transaction would allow
6 EKPC to avoid or delay planned expenditures for demand-side management programs or
7 whether the transaction would cause EKPC to pursue a different environmental
8 compliance plan than what it recently proposed in Case No. 2017-00376. A system
9 impact study would analyze the impact on all resource spending. A system impact study
10 would also consider changes in EKPC’s sales. For example, on-system and off-system
11 sales growth on EKPC’s system could fully offset the impact of the Proposed
12 Transaction, thus negating the impact on EKPC’s generation, transmission, and demand-
13 side management resources of the proposed transaction. Furthermore, South Kentucky’s
14 Proposed Transaction could free up capacity that could be sold into the PJM capacity
15 market.

16 **Q. DID EKPC PERFORM A SYSTEM IMPACT STUDY TO ESTIMATE THE**
17 **IMPACT OF SOUTH KENTUCKY’S PROPOSED TRANSACTION?**

18 A. No. The intervenor witnesses did not analyze the impact on EKPC’s generation,
19 transmission and demand-side management resources or changes in off-system sales
20 opportunities of the Proposed Transaction. In response to data requests, EKPC
21 acknowledged that it has not analyzed the Proposed Transaction utilizing production cost
22 modeling or resource optimization modeling showing the impact on EKPC’s capacity and
23 DSM resources. (See EKPC’s Responses to SK Request 38 and 39(a).) Furthermore,

1 EKPC admitted that it has not prepared any present value revenue requirement (PVRR)
2 analyses showing the impact of the Proposed Transaction on EKPC's revenue
3 requirements nor did it attempt to measure the effect of the Proposed Transaction on its
4 future capacity resource and demand-side management expenditures. (See EKPC's
5 Responses to SK Request 39(b) and 40.) Likewise, the EKPC and the other intervenors
6 did not consider whether revenue growth on EKPC's system, or growth in revenues from
7 off-system sales could offset the impact of the Transaction.

8 **Q. EXPLAIN HOW SOUTH KENTUCKY'S PROPOSED TRANSACTION COULD**
9 **CREATE OFF-SYSTEM SALES OPPORTUNITIES FOR EKPC.**

10 A. During 2017, EKPC's off-system sales into the PJM market were substantial.
11 Specifically, during the 12 months ended December 31, 2017, EKPC collected \$40.3
12 million in revenue by selling capacity and energy into the PJM market. (Exhibit WSS-6.)
13 As Mr. Mosier acknowledged in the testimony and data responses he submitted in
14 EKPC'S application to amend its environmental compliance plan filed in Case No. 2017-
15 00376, EKPC is currently "reaping the benefits from its ability to bid capacity and energy
16 into the PJM wholesale markets." (Direct Testimony of Don Mosier in Case No. 2017-
17 00376, at pp. 15-16. Also see Mr. Mosier's response to Request 3 to the Commission
18 Staff's first data request in Case No. 2017-00376.) As Mr. Mosier explains, because
19 EKPC is a winter peaking utility, it reaps significant benefits from selling capacity into
20 the PJM market. South Kentucky's proposed transaction will free up an additional 58
21 MW of summer and winter capacity that EKPC can sell into the PJM capacity market.
22 The 58 MW capacity made available by the South Kentucky transaction will allow EKPC
23 to significantly increase its off-system sales until the 58 MW are needed to serve native

1 load on EKPC's system. A marginal cost analysis would need to take into consideration
2 the additional benefits that EKPC could realize from making additional capacity sales
3 into the PJM. Mr. McNalley and Mr. Wolfram's analysis failed to place a value on the
4 increased capacity sales that EKPC could realize from the capacity made available from
5 South Kentucky's Proposed Transaction. Although EKPC cited capacity sales into the
6 PJM as a justification for pursuing its recommended environmental compliance plan in
7 Case No. 2017-00376, these same benefits were waved away when EKPC's witnesses
8 were discussing South Kentucky's Proposed Transaction.

9 **Q. DOES AMENDMENT 3 OR THE MOU REQUIRE THAT A SYSTEM IMPACT**
10 **STUDY BE PERFORMED TO PERMIT A MEMBER TO EXERCISE ITS RIGHT**
11 **TO PURCHASE ALTERNATIVE POWER?**

12 A. No.

13 **Q. HAS THE COMMISSION STATED WHAT THE STANDARD OF REVIEW IS**
14 **FOR CASES INVOLVING THE APPROVAL OF A PURCHASED POWER**
15 **AGREEMENT?**

16 A. Yes. The Commission described its standard of review for the approval of a purchased
17 power agreement in Case No. 2009-00545, where it stated:

18 The fundamental principle of least cost is also embedded in KRS
19 278.020(1) which prohibits a utility from constructing a new facility to
20 provide service to the public until it has demonstrated both a need for the
21 new facility and that its construction will not result in wasteful duplication.
22 Even though Kentucky Power is not now proposing to construct new
23 generating facilities, its proposal to enter into a long-term contract to
24 purchase such generation will have the same operational and financial
25 implications and impacts to the utility and its ratepayers as if new
26 generation were being constructed. Consequently, in examining the
27 statutory criteria for approving financing under KRS 278.300(3), the
28 "purpose and uses of the proposed issue" are for the acquisition of new
29 generation; and for the debt to be "for some lawful objective within the

1 corporate purposes of the utility,” there must be a need for additional
2 generation and the absence of wasteful duplication. (Order in Case No.
3 2009-00545, dated June 28, 2010, at pp. 5-6.)
4

5 **Q. HAS SOUTH KENTUCKY SATISFIED THE STANDARDS FOR REVIEW**
6 **ARTICULATED BY THE COMMISSION?**

7 A. Yes. South Kentucky’s Proposed Transaction is for a *lawful purpose* within the corporate
8 purposes of the utility. As has been demonstrated in the Application and in the testimony
9 filed by South Kentucky in this proceeding, the *need* served by the Proposed Transaction
10 is the reduction of cost and cost uncertainty associated with the provision of service to
11 South Kentucky’s members/customers, relative to the current supply arrangement by
12 which all of South Kentucky’s needs are the responsibility of a single entity, EKPC. The
13 Proposed Transaction does not result in any wasteful duplication on South Kentucky’s
14 system. As I discussed earlier, the Proposed Transaction represents an exercise by South
15 Kentucky of a bargained-for right obtained as part of the overall agreement by EKPC and
16 the Member Systems to Amendment 3. As for the transaction itself, it affords South
17 Kentucky price certainty over an extended period, with the opportunity to realize
18 significant cost savings over its current arrangement with EKPC. The possibility of
19 creating “stranded investments” on EKPC’s system was addressed in the MOU and is
20 irrelevant to South Kentucky’s application for approval of the Proposed Transaction in
21 this proceeding. KRS 278.020(1) does not require South Kentucky to analyze the impact
22 of a purchase power transaction on its supplier, but only on its own operations. It is not
23 reasonable, nor required by KRS 278.020(1), for a purchaser to be forced to analyze the
24 impact of a purchase transaction on the cost structure of its power supplier, as suggested
25 by Mr. Campbell. (See *Direct Testimony of Anthony S. Campbell*, p. 23, lines 1-4.)

1 Specifically, Mr. Campbell states that “South Kentucky should have addressed the issues
2 of need and wasteful duplication in its application as well as the financial reasonableness
3 of the transaction.” While South Kentucky has fully addressed the financial
4 reasonableness of the transaction *on its own operations*, there is no requirement in
5 Amendment 3, the MOU, KRS 278.020(1), or otherwise that requires South Kentucky to
6 address “need and wasteful duplication” *on its wholesale power supplier’s operations*.
7 To require a purchaser of electric energy to perform an evaluation of the impact on its
8 wholesale suppliers costs would be the same as requiring the local gas distributors in
9 Kentucky, such as Columbia Gas of Kentucky, Delta Natural Gas Company, Atmos,
10 Duke Energy, or LG&E to perform an analysis of their interstate pipeline suppliers’ costs
11 and system impacts whenever a local distribution company exercise its rights under its
12 pipeline tariffs to purchase gas transportation from another interstate pipeline. It is the
13 responsibility of the suppliers to assess the impacts of purchasers exercising their rights
14 under the suppliers’ tariffs, not the purchasing parties. EKPC has known since 2003,
15 when it agreed to and executed Amendment 3, that its Members could take, in aggregate,
16 up to 5 percent of EKPC’s peak demand from alternately-sourced suppliers. Surely
17 EKPC took this into consideration in its financial and strategic planning.

18 **Q. WHAT METHODOLOGY IS SPECIFIED IN AMENDMENT 3 AND THE MOU**
19 **FOR ALLOCATING THE AMOUNT OF ALTERNATELY-SOURCED POWER**
20 **TO THE MEMBER SYSTEMS?**

21 A. The MOU established thresholds that determine whether a Member is limited to 5 or 15
22 percent of the Member’s average peak demand. If the aggregate amount of alternately-
23 sourced power is less than 2.5 percent of EKPC’s rolling average peak demand, then a

1 Member cannot elect more than 15 percent of its peak demand. If the aggregate amount
2 represents 2.5 percent or more of EKPC’s rolling average peak demand, then a Member
3 cannot elect more than 5 percent of the Member’s peak demand. If the aggregate amount
4 exceeds 5 percent of EKPC’s rolling average peak demand, then no other elections of
5 alternatively-sourced power is allowed. Therefore, the method for allocating alternately-
6 sourced power can be characterized as a first-come-first-served methodology.

7 **Q. IS THE FIRST-COME-FIRST-SERVED METHODOLOGY A COMMON**
8 **APPROACH FOR ALLOCATING FINITE RESOURCES?**

9 A. Yes. With the first-come-first-served methodology, the first person or party in line is
10 served first. The methodology is also called “*Queuing Allocation*”. Queuing Allocation
11 is probably the most common methodology used in our society for allocating finite
12 resources. We often encounter the methodology when there is a potentially sold-out
13 movie, sporting event, music concert, or popular toy at department stores. Versions of
14 Queuing Allocation are even employed in resources as important as transplanted organs.
15 (For example, see Michael J. Trebilcock, *The Limits of Freedom of Contract* (1997).)
16 While the intervenor witnesses have referred to Queuing Allocation derisively as the “run
17 on the bank” approach (Direct Testimony of Carol Ann Fraley, at p. 7) and the “first hog
18 to the trough” problem (Direct Testimony of William T. Prather, at p. 7), Queuing
19 Allocation is one of the most common methodologies for allocating finite resources.

20 **Q. DID THE PARTIES TO AMENDMENT 3 AND THE MOU AGREE TO A**
21 **QUEUING ALLOCATION APPROACH?**

22 A. Yes. Queuing Allocation was specified in the Amendment 3 and the MOU.

23 **Q. WERE OTHER ALLOCATION METHODOLOGIES CONSIDERED?**

1 A. Yes. After EKPC had agreed to allow members to take 5% of its peak demand as
2 alternately-sourced power, the question arose regarding what to do with capacity from
3 Members that were not interested in taking alternatively sourced power. EKPC and its
4 Members considered four allocation methodologies: Method 1 – each Member is
5 allocated 5% and allowed to give, trade or sell it if they do not want to use it themselves;
6 Method 2 – each Member is asked if they want it and it is then allocated only to those
7 Members that express a desire to use their allocation, in which case, they could then use,
8 sell, trade or give away their allocation; Method 3 – EKPC auctions off its allocation in 5
9 MW (or any other size) bundles to the highest bidder; Method 4 – first-come-first-served
10 (Queuing Allocation). (Exhibit WSS-7.) The agreements that were ultimately signed by
11 the Members provided for Queuing Allocation.

12 **Q. HAVE FIRST-COME-FIRST-SERVED METHODOLOGIES BEEN USED IN**
13 **OTHER RATE SCHEDULES APPROVED BY THE COMMISSION?**

14 A. Yes. Over the years, I have seen numerous utility rate schedules utilize a first-come-first-
15 served approach for allocating finite resources. Three KU and LG&E rate schedules
16 currently have first-come-first served provisions. Additions in load that can be served
17 under Curtailable Service Rider 1 (CSR1) and Curtailable Service Rider 2 (CSR2) were
18 limited to the first 100 MVA of load for customers giving notice to be served under the
19 rate schedules. Customer could sign up under CSR1 and CSR2 on first-come-first-served
20 basis. Outdoor Sports Lighting Service (OSL) is limited to a maximum of 20 customers
21 on a “first-come-first-served” basis. All three of these rate schedules were approved by
22 the Commission and all three are fully enforced by the utilities.

23 **Q. DO YOU HAVE ANY OTHER CONCERNS ABOUT POSITIONS TAKEN BY**

1 **EKPC IN THIS PROCEEDING?**

2 A. Yes. EKPC seems to be contemplating measures by which Section 6(A) of the MOU
3 might be circumvented. Recall that Section 6(A) of the MOU states that “EKPC shall
4 not be entitled to charge any Owner Member for so-called “stranded costs” related to the
5 Owner Member’s implementation of its rights to use Alternative Sources.” (*Supra*, at p.
6 19.) Thus Section 6(A) of the MOU prohibits EKPC from recovering stranded costs
7 directly from the bypassing Member. But there are several instances in EKPC’s direct
8 testimony and responses to data requests suggesting that EKPC intends to pursue ways to
9 mitigate or circumvent altogether this section of the MOU. The first intimation of this
10 can found in Mr. McNalley’s direct testimony where he stated that “[i]f the proposed
11 transactions are approved, EKPC will need to undertake cost of service and rate design
12 studies to better understand these issues and may propose new rate design and rate
13 structures to ensure fair, ***non-bypassable rates***.” (*Direct Testimony of Michael McNalley*,
14 p. 9, lines 9-12. Emphasis supplied.) Then, in a response to a data request, EKPC
15 stated that it may “evaluate new rate designs with the intent of preventing future cost
16 shifting as a result of Amendment 3 notices or similar actions.” (Response to SK
17 Request 43.) The response goes on to state, “Thus, any proposed change to our rate
18 design would apply to all owner-members.” (*Id.*) In an email to David Crews dated
19 November 28, 2017, Mr. McNalley also wrote, “I would bet Cicero applauds them for
20 finding cheaper power but they and the other 15 will pay higher rates after our next rate
21 case to compensate for the fixed charges that they bypass (if any) with this.” (Exhibit
22 WSS-8.) The “if any” remark about South Kentucky not avoiding fixed charges by
23 bypassing EKPC with lower-cost alternately-sourced power again suggests an intention

1 on EKPC's part to circumvent Section 6(A) of the MOU by implementing a "non-
2 bypassable rate", thereby removing the consideration given by EKPC to its Members
3 when they agreed to extend their Power Supply Contracts for 20 years.

4 **Q. DO YOU HAVE ANY FINAL COMMENTS CONCERNING THE POSITIONS**
5 **TAKEN BY THE INTERVENORS IN THIS PROCEEDING?**

6 A. Yes. After reviewing the testimony and response to data requests in this proceeding, I
7 have concluded that EKPC and the other Member Systems' objective is to block South
8 Kentucky's Proposed Transaction by throwing any argument they can come up with at
9 the proposal. This objective was articulated quite bluntly in an email that Mr. Prather
10 sent to Mr. McNalley on February 22, 2018, wherein Mr. Prather wrote, "I got one
11 response.....'kill it at the Commission.'" And this email followed an email by Mr.
12 McNalley to Mr. Prather on February 20, 2018, in which Mr. McNalley voiced what
13 seems to be a similar goal: "I'm with you. Kill it. Don't negotiate." (Exhibit WSS-9.)
14 In point of fact, EKPC and the other Member Systems have no legitimate interest in
15 whether or not the Proposed Transaction results in savings to South Kentucky's
16 customers. EKPC and the other Member Systems are not customers of South Kentucky
17 and will not be affected by the rates charged by South Kentucky. Accordingly, their
18 claims that the Proposed Transaction will not result in long-term cost savings to South
19 Kentucky's customers should be viewed skeptically. South Kentucky has met the
20 requirements of KRS 278.020(1) by demonstrating that the Proposed Transaction is "for
21 some lawful objective within the corporate purposes of the utility," is based on a
22 legitimate "need" to reduce costs for South Kentucky's customers, and does not result in
23 "wasteful duplication" on South Kentucky's system. South Kentucky's Proposed

1 Transaction is also authorized under the MOU, which was approved by the Commission.

2 South Kentucky's Proposed Transaction should be approved.

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

4 **A. Yes.**