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	)

INITIAL POST-HEARING BRIEF OF

SOUTH KENTUCKY RURAL ELECTRIC COOPERATIVE CORPORATION

Filed: June 15, 2018

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Before the Kentucky Public Service Commission ("Commission") is an application by South Kentucky Rural Electric Cooperative Corporation ("South Kentucky") under KRS 278.300 and 807 KAR 5:001 §§ 14 and 18 for approval to assume an obligation of indebtedness in connection with a purchase power arrangement ("PPA") that South Kentucky has entered into with Morgan Stanley Capital Group, Inc. ("Morgan Stanley"). As demonstrated by the evidence in this proceeding, and the legal considerations underlying the application and described more fully in this brief, the application should be approved.

I. Introduction

The standard for approval of an application under KRS 278.300 is straightforward:

> The commission shall not approve any [] assumption unless, after investigation of the purposes and uses of the [] proposed assumption of obligation or liability, the commission finds that the [] assumption 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.[1]

The only pertinent question before the Commission then is not controversial: has South Kentucky's application satisfied these elements?

A number of intervenors[2] oppose South Kentucky's application, including East Kentucky Power Cooperative ("EKPC"); several owner-members comprising EKPC referred to here as "Opposing Cooperatives";[3] and Nucor Steel Gallatin ("Nucor"), a customer of Owen Electric and

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[1] KRS 278.300(3). As discussed below, intervenors also argue for the addition of further elements to the analysis that, heretofore, only have been applied to utilities seeking to supplement their existing generating capacity. *See, e.g., In re Application of Kentucky Power Co.*, Case No. 2013-00144, 2013 WL 5615904 at *6-*8 (Ky.P.S.C.) (Oct. 10, 2013). South Kentucky does not believe these considerations apply given the facts of this case. Nevertheless, South Kentucky includes an explanation as to why the application satisfies even the heightened "supplemental generation" standard.

[2] The Office of the Attorney General appeared at hearing to be joined with intervenors in opposition to the application.

[3] During this case, the term "Distribution Cooperatives" has been used to include the following coalition: Big Sandy Rural Electric Cooperative Corporation, Blue Grass Energy Cooperative Corporation, Clark Energy

subsidiary of Nucor Corporation.[4] For these intervenors, the relevant question before the Commission is too readily answered "yes." Accordingly, they have gone to extraordinary lengths to derail South Kentucky's application by complicating the record with virtually every argument imaginable. Each assertion bears no relevance to the real subject matter of the application. The most provocative claims, however, implicate the very foundation of public utility law, one with common roots both in Kentucky and across the country—*should intervenors really be allowed to invalidate a contract that seventeen (17) parties signed and that the public service commission approved and directed to be filed as a tariff?*

Surely the answer must be no. The nation's very system of commerce is predicated on the notion of enforceable contracts, an idea the Founders believed so important they included express protections in the Constitution to keep the fledgling state governments in check.[5] Amendment 3 and the MOU[6] are no cause for exception to this bedrock tenet. Intervenors can invoke no authority—including any of the seven cooperative principles—that might justify vitiation of these commercial agreements, and undo the predicate for South Kentucky's application. Except in the

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Cooperative, Inc., Cumberland Valley Electric, Inc., Farmers Rural Electric Cooperative Corporation, Fleming-Mason Energy Cooperative, Inc., Grayson Rural Electric Cooperative Corporation, Inter-County Energy Cooperative Corporation, Jackson Energy Cooperative Corporation, Licking Valley Rural Electric Cooperative Corporation, Nolin Rural Electric Cooperative Corporation, Owen Electric Cooperative, Inc., Shelby Energy Cooperative, Inc., and Taylor County Rural Electric Cooperative Corporation. As the case has progressed, it is clear that not all of the cooperatives bear the same level of animosity as cooperatives like Farmers, Owen and Shelby—including Grayson and Taylor County, and also Salt River Electric Cooperative Corporation (who never joined the Distribution Cooperatives coalition).

[4] *See* Exhibit 21 to Nucor Corporation 2017 Form 10-K, *available at* http://www.nucor.com/investor/sec/html/?id=12093735&sXbrl=1&compId=107115.

[5] U.S. Const., Art. I, Section 10 ("The Contracts Clause").

[6] Amendment 3 is the November 13, 2003 amendment to the Wholesale Power Contract dated October 1, 1964 between EKPC and the other owner-member cooperatives, including South Kentucky. A full copy of the Wholesale Power Contract is included with the Rebuttal Testimony of Dennis Holt at Exhibit DH-1, and also was introduced at hearing as South Kentucky Exhibit 9. The MOU is the Memorandum of Understanding and Agreement dated July 23, 2015 between EKPC and the other owner-member cooperatives, including South Kentucky. A copy of the MOU is on file with the Commission, and was included as Exhibit 2 to South Kentucky's application. Henceforth, this brief refers to those documents simply as Amendment 3 and MOU.

rarest of circumstances—neither found nor claimed to be presented here—a tariff may only be changed prospectively.[7]

Intervenors know this. Thus, their attempts to subvert Amendment 3 and the MOU also include efforts to inject ambiguity in the agreements—particularly the MOU—in an effort to argue that the PPA underlying South Kentucky's application is ineligible or that South Kentucky's notice under the MOU is technically deficient. Here too, intervenors are on the wrong side of the law. The energy South Kentucky will receive under the Morgan Stanley PPA qualifies as an alternate source under the MOU, and South Kentucky's notice, prepared with input from EKPC, provides more than enough information for EKPC to use in preparation for the commencement of alternate source supply to South Kentucky beginning in June 2019.

The potential for cost shifts to other owner-members does not change this result. Such a possibility was known to all signatories of the MOU when the document was executed and approved by this Commission.[8] Had that prospect truly been a concern at the time, the owner-members and EKPC could have taken steps to mitigate that possibility or required a system cost impact study prior to election. Or they could have declined execution altogether.[9] They did not. Instead, each of the owner-members authorized entry into the MOU, as did the board of EKPC (comprising a representative of each of the owner-members).[10] In so doing, all recognized the

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[7] *See Cincinnati Bell Tel. Co. v. KPSC*, 223 S.W.3d 829, 837-39 (Ky. Ct. App. 2007); *In re Kentucky Cable Telecomm. Ass'n*, Case No. 2014-00025, 2015 WL 1457019, at * (K.y.P.S.C. March 27, 2015) ("The right to challenge a rate that is in effect, however, is limited to prospective review of that rate only."). *See also* Rebuttal Testimony of William S. Seelye, page 10, line 6 through page 18, line 22.

[8] *See* Deposition of Anthony Campbell, South Kentucky Exhibit 7, Case No. 2012-00503, page 37, line 12 through page 49, line 24.

[9] *Cf.* Wholesale Power Contract, South Kentucky Exhibit 9, pages 1088-1089 (providing for compensation or other relief by an owner-member to EKPC or owner-members if a merger or other enumerated activity causes an adverse effect).

[10] *See* Hearing Transcript (Anthony Campbell), May 16, 2018, 11:12:30 p.m.—11:13:31 p.m.

inherent bargained-for-exchange being accomplished through Amendment 3 and the MOU—trade limited benefits from system growth in the absence of the alternate supply option in favor of the cost savings potentially realized through alternate supply (while simultaneously facilitating EKPC's access to additional financing). One opportunity knowingly and willingly exchanged for another, preferred course, which otherwise would have been unavailable given the full requirements obligations of the original Wholesale Power Contract.

To facilitate the Commission's decision here, South Kentucky has divided this initial brief into two principal sections. First, South Kentucky reviews Amendment 3 and the MOU in order to clarify the appropriateness of the PPA as an alternate source of supply. This section of the brief also demonstrates the underpinnings for the enforceability of the MOU, and confirms the technical correctness of South Kentucky's notice. Second, South Kentucky shows how the evidence in this case provides a sufficient basis for the Commission to conclude that the application satisfies the prerequisites of KRS 278.300.

In 2003, the owner-members of EKPC made a decision to allow for alternate sources of supply. In 2015, they re-confirmed their commitment to that decision. These owner-members, along with EKPC, are sophisticated corporate entities. They should not be allowed to commandeer these proceedings in order to avoid regrets they may have regarding a prior decision. Parties enter into contracts for many reasons, chief among them securing certainty in the face of an unknown future. South Kentucky reasonably relied on such certainty when it pursued and executed the PPA, and when it filed its application. Neither it nor its members deserve to have those expectations unilaterally modified midcourse. The application should be approved.

II. Amendment 3, the MOU, and South Kentucky's Notice of Election of an Alternate Source

A. A Brief History of Amendment 3 and the MOU

Amendment 3 is the third amendment to the Wholesale Power Contract between EKPC and its owner-members. Agreed to in November 2003 by EKPC and all of its owner-members, Amendment 3 extended the Wholesale Power Contract from January 2025 to January 2041 (i.e., the approximately 21 years remaining on the term lengthened to approximately 37 years).[11] With this extension, EKPC gained the benefit of additional financing from the Rural Utilities Service ("RUS"). As a condition, however, the parties agreed to allow each owner-member the option to receive supply from a party other than EKPC.[12]

> The Seller [EKPC] shall sell and deliver to the Member and the Member shall purchase and receive from the Seller all electric power and energy which shall be required to serve the Member's load, including all electric power and energy required for the operation of the Member's system. Notwithstanding the foregoing, the Member shall have the option, from time to time, with notice to Seller, to receive electric power and energy, from persons other than the Seller, or from facilities owned or leased by the Member, provided that the aggregate amount of all members' elections (measured in megawatts in 15-minute intervals) so obtained under this paragraph shall not exceed five percent (5%) of the rolling average of Seller's coincident peak demand for the single calendar month with the highest peak demand occurring during each of the 3 twelve month periods immediately preceding any election by the Member from time to time, as provided herein and further provided that no Member shall receive more than fifteen percent (15%) of the rolling average of its coincident peak demand for the single calendar month with the highest average peak demand occurring during each of the 3 twelve month periods immediately preceding any election by the Member from time to time, as provided herein.[13]

Thus, Amendment 3 allowed owner-members to designate alternate sources of supply, subject to two key conditions: the aggregate amount of all owner-members' elections could not exceed 5%

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[11] *See* Wholesale Power Contract, South Kentucky Exhibit 9, pages 1075, 1077 & 1096-97.

[12] *See* Rebuttal Testimony of William S. Seelye, page 7, lines 1-27 & Exhibit WSS-2.

[13] Amendment 3, ¶ 1.

of EKPC's coincident peak (as defined), and the designating owner-member's election or elections could not exceed 15% of the designating owner-member's coincident peak (again as defined).[14]

As the record reflects, Amendment 3 as agreed to by EKPC and the owner-members did not provide for complete clarity, and ultimately litigation arose regarding its application. This in turn prompted this Commission to commence an investigation in its own right (collectively the "Grayson Litigation").[15] After extended proceedings, however, the primary litigants moved to dismiss the case, having reached a settlement. In connection therewith, the parties submitted the MOU, which was intended to "successfully resolve lingering uncertainties regarding operation of Amendment 3 to EKPC's Wholesale Power Agreement."[16] Finding the MOU "is comprehensive in nature, does not violate any legal or regulatory principle, and results in a reasonable resolution of all issues to be investigated in this case …," the Commission granted dismissal and directed EKPC to file the MOU in its Tariff Filing System (along with a signature page from each of the owner-members).[17]

The MOU alludes to this history and the signatories' past disagreements over interpretation.[18] The MOU also acknowledges both the owner-members' "keen interest in pursuing or investigating opportunities to develop or otherwise obtain and use sources of electric power and energy other than EKPC", as well as their "desire to avoid litigation over the provisions

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[14] Amendment 3 further provided for the notice required to make or cancel alternate supply elections, and in the event of one or more cancelations, the return of the corresponding supply load(s) to service by EKPC. *See* Amendment 3, ¶¶ 1a & 1b.

[15] *See, e.g.*, Direct Testimony of Dennis Holt, page 6, line 14 through page 7, line 18; Direct Testimony of Carol Ann Fraley, page 4, line 52 through page 6, line 96; Direct Testimony of Anthony Campbell, page 6, line 1 through page 7, line 11. *See also In re Petition and Complaint of Grayson Rural Elec. Coop. Corp.*, Case No. 2012-00503, 2013 WL 3777161, at *1 (Ky.P.S.C.) (July 17, 2013).

[16] *In re Petition and Complaint of Grayson Rural Elec. Coop. Corp.*, Case No. 2012-00503 (Dec. 18, 2015) (Introduced at hearing as PSC Exhibit 1).

[17] *Id*.

[18] *See* MOU ¶ 0.5.

of the Wholesale Power Contract that pertain to Alternate Sources, and thereby avoid the costs and uncertainty of such litigation."[19] With this context, the MOU laid out the provisions intended by all signatories at the time of its execution to resolve lingering uncertainties of Amendment 3. These are the provisions upon which South Kentucky relied when it pursued the alternate source election and ultimately gave notice of its election on November 28, 2017.[20]

B. The Relevant Provisions of the MOU

The purpose of the MOU was to "memorialize EKPC's and the Owner Members' mutually agreed interpretation of Amendment No. 3 with respect to Alternate Sources."[21] Nothing in the MOU was "intended to modify any of the express provisions of Amendment No. 3."[22] Instead, the MOU clarified aspects of Amendment No. 3 that previously were unclear. Foremost, the MOU set forth in detail the manner by which alternate source designations could be made. Specifically, the MOU maintained Amendment 3's allowance of a 15% alternate source election, but only when such election did not exceed, when aggregated with all existing elections, 2.5% of EKPC's coincident peak demand.[23] Any election that would exceed the 2.5% threshold, but not otherwise exceed 5% of EKPC's coincident peak demand, was capped at 5%.[24]

Although the terms of Amendment 3 implied the eligibility of PPAs as alternate sources,[25] the MOU made clear that such arrangements could be used. In the Scope section of the MOU, the

[19] *See id.* ¶¶ 0.6-0.7.

[20] *See* Application, Exhibit 4.

[21] MOU ¶ 2(A).

[22] *Id.* ¶ 2(C).

[23] *See id.* ¶ 3(A)(iii).

[24] *See id.* ¶ 3(A)(iv).

[25] *See* Amendment 3, ¶ 1 (affording owner-members the right to receive power and energy from facilities "owned or leased by the Member…."). Likewise, in the Grayson Litigation, the subject alternate source designation was a "purchase on a continuous basis, 24/7, for 5 MW in 2012, increasing by 4.4 MW in 2013 to a total of 9.4

parties agreed that alternate sources encompassed any generating resource (owned or controlled by the designating owner-member, in whole or part) as well as "any purchase power 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."[26] In limiting the term of any alternate source designation, the parties similarly provided that "whether the Alternate Source is a generating facility owned or controlled by the Owner Member or a contract with a third party, [the term] shall not exceed twenty (20) years."[27] Further, in the Alternate Source Notices section of the MOU, the parties included among the items to be enumerated in an alternate source notice a statement of the term, "which length may not exceed 20 years (including any renewal options for an Alternate Source that is a contract with a third party)."[28]

Regarding the components of an alternate source notice, the MOU directed electing parties to include (in addition to the term) "the maximum electrical capacity, in kW"; "a general description of the nature of the Alternate Source and the primary generating facilities from which the subject power and energy will be produced"; "the approximate, expected pattern of use or dispatching of the Alternate Source and the corresponding pattern of hourly reductions in energy to be purchased by the Owner Member from EKPC"; and details regarding how the alternate source would interconnect with the system (e.g., as a "Behind the Meter Source").[29] The MOU

MW.") *In re Petition and Complaint of Grayson Rural Elec. Coop. Corp.*, Case No. 2012-00503, 2013 WL 3777161, at *3 (Ky.P.S.C.) (July 17, 2013).

[26] MOU ¶ 2(A).

[27] *Id*. ¶ 2(A)(vi); *see also id*. ¶ 2(A)(vi)(a) (discussing additional considerations for any "Alternate Source that is a contract ….").

[28] *Id.* ¶ 4(A)(i).

[29] *See* MOU ¶¶ 4(A)(i)-(v).

also reiterated the timing requirements that Amendment 3 prescribed for alternate source elections—with at least 18 months' notice required for alternate source designations exceeding 5 MW—and also set forth timing considerations for modifications or cancelations to any designation.[30] In addition, in connection with the development of any alternate source, the MOU directed the owner-member "to use commercially reasonable efforts to develop or otherwise acquire the subject Alternate Source so that such source may be used to supply a portion of the Owner Member's requirements beginning on the noticed date", and it directed EKPC to "use commercially reasonable efforts to cooperate with and assist the Owner Member in its development of acquisition", provided that EKPC was not obligated to make out-of-pocket expenditures or provide or facilitate financing.[31]

The MOU also included a number of additional administrative details, including the obligation of the electing owner-member to pay an administrative fee to EKPC to cover increased operation and administrative costs and a fee for PJM market participant services.[32] The MOU made clear, however, that EKPC could not "charge any Owner Member for so-called 'stranded costs' related to the Owner Member's implementation of its rights to use Alternate Sources." The parties did agree though that EKPC could "continue to set its rates for all Owner Members under the Wholesale Power Contracts to produce revenues that are sufficient to cover all of its costs, in accordance with the Wholesale Power Contracts."[33]

C. Additional Considerations Influencing and Informing the MOU

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[30] *See id*. ¶¶ 4(B)-(E).

[31] *Id.* ¶ 5(A).

[32] *See, e.g.*, *id*. ¶¶ 5(E) (vi) & (vii).

[33] *Id.* ¶ 6(A).

As discussed, the MOU grew from, and resulted in a resolution of, the Grayson Litigation. During that litigation, participants recognized that alternate source elections would have potential impacts on the owner-members. EKPC Chief Executive Officer, Anthony Campbell, testified during a deposition in the case that an election of 15% could result in cost shifting.[34] Mr. Campbell expressed a lack of concern over EKPC being able to mitigate such an election—"I mean I'm really not worried about let's say the 150 megawatts, our 5 percent … I mean I can certainly mitigate that." His stated concern was "that if owners take over their 5 percent, that the other owners need to understand that … we are only going to give up to [EKPC's] 5 percent so somebody is going to be left out."[35] Mr. Campbell went on to acknowledge, however, that "if all of our owners construe that the MOU is fair, then we [EKPC] will be all right with it and we will say that it is fair and I think the same thing with the Commission."[36] Notwithstanding those reservations, the owner-members and EKPC ultimately agreed to the MOU as a reasonable solution to the issues surrounding Amendment 3 and the Grayson Litigation.[37]

The backdrop of the Grayson Litigation likewise informed the parties understanding of the types of alternate source deliveries authorized by Amendment 3 and thereafter the MOU. As the Commission's order establishing an investigation into Amendment 3 recites, the power purchase agreement entered into by Grayson provided for supply "on a continuous basis, 24/7 …."[38] In addition, at the time of the Grayson designation, EKPC was operating as a PJM market participant

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[34] *See* Deposition of Anthony Campbell, South Kentucky Exhibit 7, page 45, line 19 through page 46, line 7.

[35] *Id.*, page 49, lines 12-24.

[36] *Id.*, page 76, lines 9-12. *See also* MOU Discussion, South Kentucky Exhibit 8, page 2 (reflecting notes from meeting regarding MOU and recorded statements of Mr. Campbell).

[37] *See, e.g.*, PSC Exhibit 1, pages 1, 3-4.

[38] *See also In re Petition and Complaint of Grayson Rural Elec. Coop. Corp.*, Case No. 2012-00503, 2013 WL 3777161, at *3 (Ky.P.S.C.) (July 17, 2013).

and relying on PJM to make decisions regarding the dispatch of generating resources to serve load on an economic basis.[39] Consistent with this operating environment, the MOU directed EKPC to "pass through to the Owner Member all revenues, credits and charges from PJM associated with the Alternate Source, including without limitation PJM day-ahead and real-time energy market revenues, charges and credits …."[40]

D. South Kentucky's Notice of Election of An Alternate Source

South Kentucky gave notice of its election under Amendment 3 and the MOU on November 28, 2017.[41] Prepared with input from EKPC personnel,[42] the notice sets forth, item by item, the content required by Section 4(A) of the MOU: (1) the term of the alternate source (20 years); (2) the maximum capacity in kW and the corresponding reduction in demands (58,000 kW); (3) a general description of the nature of the alternate source (energy, capacity and transmission services from the PJM market, as required by PJM); (4) the approximate, expected pattern of use or dispatch and the corresponding pattern of hourly reductions (all hours of every year of the term—i.e., 24/7); and (5) a designation of the alternate source's interconnection (either EKPC or another entity's transmission system).[43] Respecting the 58,000 kW designation, the amount did not exceed 15% of South Kentucky's rolling average coincident peak demand for the single calendar month (considering the highest average peak demand occurring during each of the

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[39] *See* Deposition of Anthony Campbell, South Kentucky Exhibit 7, page 94, line 19 through page 97, line 10; *see also* Hearing Transcript (David Crews), May 17, 2018, at approximately 10:33 a.m. (to approximately 10:35 a.m.) & at approximately 10:44 a.m. (through approximately 10:48 a.m.).

[40] MOU ¶ 5(E)(iv).

[41] *See* Application, Exhibit 4.

[42] *See, e.g.*, Response of EKPC to South Kentucky's First Request for Information, Request 1, 3 & 5, Attachment SK 1, 3 & 5, pages 587-90 & 595-607.

[43] *See* Application, Exhibit 4.

three (3) twelve-month periods immediately preceding the election).[44] In addition, the designation, when aggregated with all prior alternate source elections by other owner-members, was less than 2.5% of EKPC's rolling average coincident peak demand for the single calendar month (considering the highest average peak demand occurring during each of the three (3) twelve-month periods immediately preceding the election).

At the time of the notice, the PPA that would ultimately be the contractual basis for the designation itself had not yet been finalized or approved by the South Kentucky board of directors. Accordingly, firm details regarding the agreement itself were not yet available and not included. At no time, prior to or following issuance of the notice by South Kentucky, did EKPC state or otherwise indicate that the absence of this information, or for that matter, the general reference to the PJM market as the basis of supply for the alternate source, constituted any sort of deficiency—let alone one that might require South Kentucky to resubmit or supplement its notice with additional information.[45]

III. South Kentucky's Alternate Source Designation Is a Valid Exercise of the Rights Granted South Kentucky and all Other Owner-Members by Amendment 3 and the MOU

Based on the tenor of testimony and questions at the hearing, it seems clear that intervenors are challenging the very designation made by South Kentucky under the MOU. There can be no doubt, however, that the MOU affords South Kentucky the right to make the alternate source

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[44] *See, e.g.*, Response of South Kentucky to Attorney General's First Request for Information, Item 17; *see also* MOU ¶ 3(A)(iii).

[45] *See, e.g.*, Response of EKPC to South Kentucky's First Request for Information, Request 1, 3 & 5, Attachment SK 1, 3 & 5, page 595 ("My comments on the notice. Call me Monday to discuss. Without a firm contract at this point, I think the best option is to point to PJM as the Power Supply. PJM will be part of the power supply regardless of the supplier). Compare Deposition of Anthony Campbell, South Kentucky Exhibit 7, page 94, line 19 through page 97, line 10; *see also* Hearing Transcript (David Crews), May 17, 2018, at approximately 10:33 a.m. (to approximately 10:35 a.m.) & at approximately 10:44 a.m. (through approximately 10:48 a.m.).

designation that it did. PPAs are expressly permitted forms of alternate sources under the MOU. An election by South Kentucky of up to 15% of its demand, when such election does not with existing elections exceed 2.5% of EKPC's total demand, likewise is permissible under the MOU.

A. The Filed Rate Doctrine Secures South Kentucky's Right to Make the Alternate Source Election

The Filed Rate Doctrine is a cornerstone of public utility law. As the Kentucky Court of Appeals has explained, the "underlying principles [of the doctrine] are incorporated and recognized in both our statutory and our case law."[46] Specifically, the statutory provisions for setting rates call for utilities to file with the Commission all rates and conditions for service, and to collect charges and provide services only in accordance with those rates and conditions on file.[47] Changes to the rates likewise are prescribed by statute, with the consistent prerequisite that such changes shall become effective only upon action by the Commission or by law at a future point in time relative to the filing or action (e.g., a customer complaint) precipitating the change.[48] Existing rates, however, cannot be changed retroactively.[49]

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[46] *See Cincinnati Bell Tel. Co. v. Ky. Pub. Serv. Comm'n*, 223 S.W.3d 829, 837-39 (Ky. Ct. App. 2007); *see also In re North Marshall Water Dist.*, Case No. 95-107, page 3 (Oct. 13, 1995) ("While the amount of undercharges is small, the principle at stake is not. The filed rate doctrine is the bedrock of utility rate regulation. Acceptance of the Settlement Agreement would erode the basic bulwark against rate discrimination and arbitrary utility action. Even the smallest erosion of this rule must be avoided.").

[47] KRS 278.160. Lest intervenors endeavor to sow doubt here, the General Assembly has defined "rate" to include not only various forms of compensation for service, but also any rule, regulation, practice, or requirement, as well as any schedule or tariff. *See* KRS 278.010; *see also* 807 KAR 5:011 ("'Tariff' means the schedules of a utility's rates, charges, regulations, rules, tolls, terms, and conditions of service over which the commission has jurisdiction.").

[48] *See Cincinnati Bell Tel. Co. v. KPSC*, 223 S.W.3d 829, 837-39 (Ky. Ct. App. 2007) (citing *inter alia* KRS 278.180, 278.190, 278.270, and 278.390).

[49] *Id*. at 839 ("In light of the General Assembly's comprehensive rate-making scheme, including only a narrowly defined circumstance under which refunds can be ordered, the filed rate can only be lawfully altered prospectively."); *cf. Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 578-79 (1981) ("No matter how the ruling of the Louisiana Supreme Court may be characterized, they argue, it amounts to nothing less than the award of a retroactive rate increase based on speculation about what the Commission might have done had it been faced with the facts of this case. This, they contend, is precisely what the filed rate doctrine forbids. We agree.").

For this reason, the intervenors cannot be allowed to retroactively revoke the MOU in order to nullify South Kentucky's November 28, 2017 election, made under EKPC's filed rates, to receive alternatively-sourced supply. No action has been taken in accordance with applicable law—by the Commission or any other affected party—seeking a withdrawal of the MOU, which is part of EKPC's tariff. Therefore, at the time of South Kentucky's election and today, the MOU was and continues to be in full force and effect.

Intervenors likewise cannot be allowed to hold South Kentucky to the standards of a reimagined MOU that has never been proposed to, let alone accepted by, the Commission. Alternate source designations are made in terms of the demand associated with the owner-member's load that will be served by the alternate source—kW or kilowatts (demand/capacity), not in terms of the energy (kWh or kilowatt hours) that might be produced by the source. The calculations required by the MOU permitted South Kentucky to make a 58,000 kW election, without regard to the corresponding energy such demand could yield or South Kentucky might consume. Moreover, the MOU expressly permits the use of PPAs, restricted only by the same demand calculations that attend to designations associated with an actual generator. The MOU does not require such agreements to be tied to a specific resource, an unremarkable and indeed wholly logical component given the fact that EKPC (both at the time of the MOU's execution and to this day), meets its wholesale supply obligations to the owner-members through deliveries from the PJM market. Likewise, the MOU in no way restricts that designation to any particular load shape.[50] Furthermore, the MOU does not require electing owner-members to conduct any sort of

[50] *Cf.* MOU ¶ 4(A)(iv); *see also In re Petition and Complaint of Grayson Rural Elec. Coop. Corp.*, Case No. 2012-00503, 2013 WL 3777161, at *3 (Ky.P.S.C.) (July 17, 2013) ("The contract provides that the purchase is on a continuous basis, 24/7, for 5 MW in 2012, increasing by 4.4 MW in 2013 to a total of 9.4 MW."); Response of EKPC to South Kentucky's First Request for Information, Request 1, 3 & 5, Attachment SK 1, 3 & 5, page 580 (noting that South Kentucky was considering "PPAs where the provider will guarantee around the clock delivery

analysis to discern what potential cost shifting might occur as a result of the election. Instead, the MOU provides in no uncertain terms that EKPC cannot seek to ascribe stranded costs associated with the election directly to the owner-member making the election. In other words, the MOU clearly acknowledges and addresses the potential for cost shifts.

This last point is especially important, given intervenors' tack in this proceeding. As noted at hearing, the parties to the Wholesale Power Contract have, in connection with a prior amendment, provided for relief from potential cost shifts associated with an action by an owner-member to leave the system. Specifically, this provision concerned owner-member reorganizations, dissolutions or consolidations/mergers, and directed the owner-member not only to pay a portion of EKPC's outstanding indebtedness, but also take steps to "eliminate any adverse effect that such action seems likely to have on the rates of other members of [EKPC]."[51] Thus, when the owner-members and EKPC thought the rights bestowed owner-members under the contract had the potential to cause overly impactful or immitigable cost shifts, they knew how to craft language to address the issue. The parties to the MOU clearly did not find alternate source designations to rise to this level, however, <u>as they went the opposite direction</u> and expressly agreed to insulate electing members from any direct assignment of potential costs attributable to the alternate source designation.

The reasons for this could be several. The alternate source designations allowed under Amendment 3 and the MOU could be mitigated, a prospect confidently voiced by EKPC during the Grayson Litigation and in communications contemporaneous with South Kentucky's

…") & page 427 (describing South Kentucky's election as "a block purchase 58 MWs 100% load factor. This is one of the things the MOU did to accommodate A3s.").

[51] Wholesale Power Contract, South Kentucky Exhibit 9, page 1089.

election.[52] Alternatively, EKPC may seek to modify its existing rates to address any short-term concerns with an alternate source designation. In any case, the design of the MOU provides EKPC with a "long notice period" to address the situation—at least 18 months.[53] Not surprisingly then, the MOU does not place any onus on the electing owner-member to propose mitigation or calculate the amount of mitigation that might be necessary. Any such efforts, to the extent taken, are the prerogative of EKPC.

The MOU also contemplates the possibility that an owner-member might make an alternate source election for which the supplying resource or PPA is not yet known. As noted earlier, the MOU directs the owner-member to use "commercially reasonable efforts to develop or otherwise acquire the subject Alternate Source so that such source may be used to supply a portion of the Owner Member's requirements beginning on the noticed date"; with a reciprocal obligation placed on EKPC to similarly "cooperate and assist the Owner Member in its development or acquisition …."[54] Thus, by its plain terms, the MOU envisioned a situation where an owner-member made an alternate source designation before it had locked down (at the time of the notice) the actual supply source or power purchase agreement. This too should not be surprising, given the demand calculations set forth in the MOU and the fact that a later-in-time designation could be constrained by earlier-in-time designations by other owner-members (i.e., elections exceeding 2.5% of EKPC's demand would be limited to 5%, and those exceeding 5% forbidden).

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[52] *See* Deposition of Anthony Campbell, South Kentucky Exhibit 7, page 49, lines 12-17; Mitigation of Amendment 3 Load Loss, South Kentucky Exhibit 5; Response of EKPC to South Kentucky's First Request for Information, Request 1, 3 & 5, Attachment SK 1, 3 & 5, page 361. In addition, at hearing, EKPC witness Don Mosier provided examples of the options EKPC could pursue to mitigate the election. *See* Hearing Transcript (Don Mosier), May 16, 2018, at approximately 4:16 p.m. through 4:18 p.m. (adding at approximately 4:17:45 p.m. that EKPC did not have a "burning platform" to pursue measures "at this point in time").

[53] Mitigation of Amendment 3 Load Loss, South Kentucky Exhibit 5; *see also* MOU ¶ 4(B).

[54] MOU ¶ 5(A).

South Kentucky recognizes that the MOU, in the Alternate Source Notices section, calls for a "general description of the nature of the Alternate Source and the primary generating facilities from which the subject electric power and energy will be produced."[55] This provision cannot be reasonably construed, however, to constrain alternate source designations—and particularly those associated with power purchase agreements—to specific, named generating facilities.

The interpretation of a tariff like the MOU is subject to the "same rules [of] interpretation of other contracts or instruments, that is, treat and consider all their provisions and conditions together in an effort to ascertain their meaning …."[56]

> Any contract or agreement must be construed as a whole, giving effect to all parts and every word in it if possible. Where a contract is ambiguous or silent on a vital matter, a court may consider parol and extrinsic evidence involving the circumstances surrounding execution of the contract, the subject matter of the contract, the objects to be accomplished, and the conduct of the parties. Absent an ambiguity in the contract, the parties' intentions must be discerned from the four corners of the instrument without resort to extrinsic evidence. A contract is ambiguous if a reasonable person would find it susceptible to different or inconsistent interpretations. The fact that one party may have intended different results, however, is insufficient to construe a contract at variance with its plain and unambiguous terms.[57]

Furthermore, the "course of dealing between parties and any usage of trade may be competent to explain any ambiguities in a contract."[58]

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[55] MOU ¶ 4(A)(iii).

[56] *Louisville Water Co. v. Louisville H. & St. L. Ry. Co.*, 110 S.W.2d 668, 670 (Ky. Ct. App. 1937); *see also In re: American Comms. Servs. of Louisville, Inc.*, Case No. 98-212, 2000 WL 35951273, at *1 (K.y. P.S.C.) (May 16, 2000) ("Each provision of the contract has been construed in light of the other provisions, giving meaning to each in light of the whole."); *In re: Application of Big Rivers Elec. Corp.*, Case No. 2016-00278, 2018 WL 348073, at *7 (Ky. P.S.C.) (Jan. 5, 2018) ("… [I] in the absence of ambiguity, the terms of a contract should be interpreted by assigning language its ordinary meaning and without resort to extrinsic evidence.").

[57] *Cantrell Supply, Inc. v. Liberty Mut. Ins. Co.*, 94 S.W.3d 381, 384-85 (Ky. Ct. App. 2002) (internal citations and quotations omitted).

[58] *Brooks v. Lexington-Fayette Urban Cty. Housing Auth.*, 132 S.W.3d 790, (Ky. 2004) (quoting *Martin v. Ben P. Eubank Lumber Co.,* 395 S.W.2d 385, 386 (1965)).

The MOU is unambiguous here. In the Scope section of the MOU, alternate sources are defined to include both generating resources and PPAs.[59] Neither the Scope section nor any other section of the MOU expressly limits PPAs to only those associated with a specific generating resource.[60] Furthermore, the MOU makes clear that alternate sources can be used to supply capacity, or energy, or both.[61] If the MOU permitted only capacity-oriented alternate source designations, and if the MOU limited capacity purchases to non-RTO markets, then perhaps one might make a case for the proposal of an amendment to the MOU to add a generating resource requirement. But given the flexibility afforded owner-members under the MOU, as well as the expectation that alternate source power and energy would be coming from PJM,[62] it does not follow that the parties to the MOU intended, by a lone reference in the Alternate Source Notices section calling for a description of "facilities", to limit power purchase-based alternate sources to only agreements purchasing power from dedicated facilities.[63] The more logical read, giving

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[59] MOU ¶ 2(A).

[60] *See also* MOU ¶¶ 3(A)(vi)(a) & (b) (addressing the situation when the 2.5% threshold is reached during the term of an alternate source designation, with provisions for when the alternate source is a contract ((vi)(a)) and when the alternate source is a generating facility ((vi)(b)).

[61] *See* MOU ¶ 2(A).

[62] *See* MOU ¶ 5(E)(iv) & (vii); *see also* Response of EKPC to South Kentucky's First Request for Information, Request 1, 3 & 5, Attachment SK 1, 3 & 5, page 595 ("My comments on the notice. Call me Monday to discuss. Without a firm contract at this point, I think the best option is to point to PJM as the Power Supply. PJM will be part of the power supply regardless of the supplier); Deposition of Anthony Campbell, South Kentucky Exhibit 7, page 94, line 19 through page 97, line 10; Hearing Transcript (David Crews), May 17, 2018, at approximately 10:33 a.m. (to approximately 10:35 a.m.) & at approximately 10:44 a.m. (through approximately 10:48 a.m.).

[63] Intervenors and the Attorney General also implied at the hearing that South Kentucky's notice was defective because in generally describing the alternate source, it referred to purchases of energy and capacity from the PJM market. These arguments are baseless. As discussed, that notice was developed with assistance from EKPC. *See, e.g.*, Response of EKPC to South Kentucky's First Request for Information, Request 1, 3 & 5, Attachment SK 1, 3 & 5, pages 587-90 & 595-607. At no time following its submission did EKPC indicate that the notice was deficient. Furthermore, since the time of South Kentucky's notice, additional notices of alternate source designations have been submitted to EKPC by other owner-members. These notices also did not designate a specific resource or include a facility description. *See, e.g.*, Response of Jackson Energy Cooperative Corp. to South Kentucky's Request for Information to Distribution Cooperatives, Item 4, pages 30-33 (of the response as filed) (reflecting the notice of an alternate source election by Owen Electric Cooperative, Inc.).

meaning to the entire document, is that electing owner-members were asked to identify the generating facility when the election involved one.

For similar reasons, South Kentucky's agreement to take an alternate source of supply on a continuous basis (i.e., 24/7/365) does not contravene the MOU. As with the "facility" requirement that intervenors seek to add to the MOU, the supply limitation simply finds no basis in the plain words used in the MOU. Insofar as intervenors want to transform the requirement in the Alternate Source Notices section regarding "the approximate, expected pattern of use or dispatching of the Alternate Source", this language in no way constrains the pattern or manner of dispatch. South Kentucky's alternate source will be dispatched like a base load unit—it will operate continuously and the energy pattern will be constant.

If intervenors were being reasonable, they would acknowledge that this form of operation is the more easily managed paradigm. There will be no complicated and varying schedules that EKPC will have to plan for, nor any variations in load (relative to the schedules) that EKPC will have to manage on a real-time basis.[64] Indeed, had the PPA been for some type of load-following product, South Kentucky fully expects that the intervenors would be arguing that the agreement is unmanageable and inefficient because actual load levels rarely, if ever, match day-ahead projections.

In sum, all of intervenors' arguments regarding the suitability of South Kentucky's agreement as an alternate source under the MOU, or the potential for cost-shifting, must fail. These arguments are akin to the facts of the United States Supreme Court's decision in *Arkansas*

More importantly, and consistent with the purpose of the notice, South Kentucky did inform EKPC of the term of the alternate source, the amount of the alternate source, and the manner of delivery. Thus, since the day of the notice (and even before then, given South Kentucky's and EKPC's collaboration on that document), EKPC has known South Kentucky's material intentions, for purposes of adapting to the election. *See* Mitigation of Amendment 3 Load Loss, South Kentucky Exhibit 5.

[64] *Cf.* MOU ¶¶ 6(E)(ii) & (iii).

Louisiana Gas Co. v. Hall, 453 U.S. 571, 578-79 (1981), where the Court reversed a decision of the Louisiana Supreme Court awarding damages on the theory that had certain information been available, a different rate would have been in effect.[65] As the Court found, the action of the Louisiana Supreme Court "amounts to nothing less than the award of a retroactive rate increase based on speculation about what the Commission might have done had it been faced with the facts of this case. This, they contend, is precisely what the filed rate doctrine forbids. We agree."[66] Intervenors' arguments regarding the MOU and the appropriateness of South Kentucky's alternate source election essentially boil down to the claim that had intervenors' known (when they signed the MOU) that an election of the kind by South Kentucky could occur, they would not have signed the MOU.[67] This position runs afoul of the Filed Rate Doctrine and cannot be sustained.

IV. South Kentucky's Application Satisfies KRS 278.300

Pursuant to KRS 278.300(3) and Commission precedent,[68] a utility requesting approval of a PPA as evidence of indebtedness 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

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[65] *See Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 575 (1981) ("While Arkla's petition for certiorari was pending the Supreme Court of Louisiana granted respondents' petition for review and reversed the intermediate court on the measure of damages. The court held that respondents were entitled to damages for the period between 1961 and 1972 notwithstanding the filed rate doctrine. The court reasoned that Arkla's failure to inform respondents of the lease payments to the United States had prevented respondents from filing rate increases with the Commission, and that had respondents filed rate increases with the Commission, the rate increases would have been approved. (internal citation omitted)).

[66] *Id.* at 578-79.

[67] *See* Testimony of William Prather, page 13, lines 1-14.

[68] *In re Application of Kentucky Power*, Case No. 2013-00144, 2013 WL 5615904, at *6 (K.y.P.S.C. 2013) (citing the Commission's Order in Case No. 2009-00545); ("*Case No. 2013-00144*"); *see also In re Application of Kentucky Power*, Case No. 2009-00545, 2010 WL 2640998, at *4 (K.y.P.S.C. 2010) ("*Case No. 2009-00545*"); Administrative Case No. 350, In the Matter of the Consideration and Determination of the Appropriateness of Implementing a Rate Making Standard Pertaining to the Purchase of Long-Term Wholesale Power by Electric Utilities as Required in Section 712 of the Energy Policy Act of 1992 (Ky.P.S.C. Oct. 25, 1993).

and will not impair its ability to perform that service, and is reasonably necessary and appropriate for such purpose.[69] South Kentucky has met this standard. Moreover, intervenors cannot derail South Kentucky's PPA by insisting that South Kentucky also must satisfy the additional requirements applicable to utilities seeking to supplement their current generation capacity.[70] First, the application of these requirements to South Kentucky's application is not supported by Commission precedent, the MOU, or the Commission's approval of the MOU. Second, even if applicable, those additional requirements are satisfied here.

A. *The Morgan Stanley PPA Is for a Lawful Object within the Corporate Purpose of South Kentucky*

South Kentucky is a not-for-profit, member-owned, rural electric distribution cooperative organized under KRS Chapter 279 and is engaged in the business of distributing retail electric power to approximately 50,000 members in the Kentucky counties of Pulaski, Wayne, McCreary, Cumberland, Lincoln, Rockcastle, Casey, Russell, Laurel, Clinton, and Adair, as well as members in the Tennessee counties of Pickett and Scott.[71] Pursuant to KRS 279.020, members may incorporate for the "[p]rimary purpose of generating, purchasing, selling, transmitting, or distributing electric energy."[72] Furthermore, KRS 279.095 requires that cooperatives operate on a nonprofit basis "for the mutual benefits of its members and patrons."[73] In short, South Kentucky

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[69] *Case No. 2013-00144*, at *6 (K.y.P.S.C. 2013) (citing *Case No. 2009-00545*).

[70] *Id.* at *6-*7 ("[W]here, as here, the purchase power agreement is intended to add supplemental generating capacity to the utility … [a] utility must also establish a need for additional generation and the absence of wasteful duplication ….").

[71] Application, page 2.

[72] KRS 279.020(1).

[73] KRS 279.075.

is tasked with delivering to its members safe, reliable, and cost-effective service, and South Kentucky owes its members a fiduciary obligation in the performance of these tasks.[74]

South Kentucky's agreement with Morgan Stanley provides for significant wholesale power cost savings over a fixed, 20-year period. First, South Kentucky has locked in an energy price of $33.95 per megawatt ("MW") hour for 20 years. Second, South Kentucky has hedged fluctuations in the cost of capacity required to be purchased from the PJM market, with Morgan Stanley paying South Kentucky the difference if capacity prices exceed $125/MW-day. Already this hedge looks to yield benefits, as the 2021/2022 Reliability Pricing Model (RPM) Base Residual Auction ("BRA") cleared at $140/MW-day for the zone comprising EKPC.[75] In any case, projections by South Kentucky's analyst show the savings to range from $77.8 million to $110.8 million.[76]

While these numbers could track lower or higher based on future market conditions, the benefits of the agreement are evident. South Kentucky and its Board of Directors have taken measures to fix a portion of South Kentucky's future wholesale power purchase costs and reduce the uncertainty surrounding those costs, with the understanding that this action will result in significant cost savings to South Kentucky.[77] In this respect, the cost savings realized from the

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[74] *In re Application of South Kentucky*, Case No. 2008-00371, 2010 WL 1938172, *2 (K.y. P.S.C. 2010) ("South Kentucky's board of directors owes a fiduciary duty to its customers to safeguard the financial and operational viability of the cooperative. This fiduciary duty is heightened given the fact that South Kentucky's customers are also the owners of the cooperative.").

[75] Response of South Kentucky to Commission Staff's First Posthearing Request for Information, Item 2. This result is also contrary to the expectations of Mr. Mosier that the BRA would clear at significantly lower prices. Hearing Transcript (Don Mosier), May 16, 2018, beginning at approximately 4:19:32 p.m. (stating that the results of the BRA are "expected to be in the $80 to $90 range. I wouldn't be surprised if it was less than $80 range.").

[76] *See* Rebuttal Testimony of Carter Babbit, page 10, line 17 & page 15, line 13; Rebuttal Testimony of Dennis Holt, page 14, lines 21-22; Response of South Kentucky to Commission Staff's First Posthearing Request for Information, Request 3, Exhibit PHPSC-1; Hearing Transcript (Dennis Holt), May 15, 2018, at approximately 10:14 a.m.

[77] *Cf.* Direct Testimony of Michelle Herrman, page 6, line 20 through page 7, line 3 (discussing fluctuations South Kentucky's wholesale power costs).

agreement will support South Kentucky's key financial metrics, and place downward pressure on rates by enabling the cooperative to avoid the need for a rate case for several years.[78] As South Kentucky's Vice President of Finance Michelle Herrman explained, "South Kentucky estimates that the effect of the reduction in wholesale power expenses will delay a possible general rate adjustment until at least 2023."[79]

Intervenors seemingly would have the Commission believe that South Kentucky's decision to make the alternate source designation and enter into the Morgan Stanley PPA should be reduced to a PowerPoint.[80] To the contrary, the decision-making timeline stretches for more than a year. It began in the spring of 2017, when South Kentucky was approached by an independent power producer.[81] It then proceeded across the summer months, as South Kentucky investigated its options and ultimately issued an RFP (participation in which was extended to EKPC). Over the fall months, South Kentucky reviewed the offerings, challenging the proposals, until it finally landed on two principal players. From this, the agreement with Morgan Stanley emerged. Throughout this time, the South Kentucky Board of Directors was kept apprised of matters.[82] Yet the Board of Directors' attention did not stop there. As Mr. Babbit testified at hearing, the Board of Directors again revisited the decision prior to the hearing and reaffirmed their commitment despite all of the arguments and accusations that had been introduced through discovery and the

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[78] Direct Testimony of Michelle Herrman, page 13, lines 11-12; *see also* Hearing Transcript (Michelle Herrman), May 15, 2018, at approximately 5:51 p.m.

[79] *See* Direct Testimony of Michelle Herrman, page 13, lines 8-12.

[80] Hearing Transcript (Carter Babbit), May 16, 2018, at approximately 12:09:40 p.m.—12:10:40 p.m. (recalling that board meetings involved considerable discussion of the transaction and were not limited to reciting the bullet points in the presentations).

[81] Direct Testimony of Dennis Holt, page 8, line 19 through page 9, line 4.

[82] *See* Direct Testimony of Dennis Holt, page 15, lines 4-8; Application, Exhibit 3, "Resolution of the Board of Directors of South Kentucky, dated December 19, 2017"; Response of South Kentucky to Distribution Cooperatives First Set of Data Requests, Item 4 & Attachment DC#1-4, at pages 1-42 (providing materials reviewed by the South Kentucky Board of Directors).

intervenors' testimony.[83] In short, the decision to designate an alternate source and enter into the long-term PPA with Morgan Stanley was an action taken by the Board of Directors of South Kentucky in a thoughtful and deliberate manner.

Finally, it is worth observing that—by virtue of the MOU itself—the entry by South Kentucky into the Morgan Stanley agreement represents a lawful objective within the corporate purpose. As discussed earlier in this brief, the parties to the MOU expressly recognized that the owner-members "each have a keen interest in pursuing or investigating opportunities to develop or otherwise obtain and use sources of electric power and energy other than EKPC."[84] And the owner-member signatories (and EKPC) agreed that PPAs were acceptable forms by which an owner-member could obtain a source of power and/or energy other than EKPC.[85] Thus, in exercising an express right under the MOU, it seems difficult, if not impossible, to characterize the pursuit of an alternative source of supply to EKPC (and the vehicle chosen by South Kentucky's Board of Directors to accomplish that) as beyond the corporate purpose or unlawful, when the governing tariff permits that very act.

For all the various arguments and allegations, to date no intervenor has claimed that the alternate source designation was made for some unlawful purpose or that the decision exceeds South Kentucky's corporate purpose. Although this may well be explained by the points made above, intervenors likely also recognize that the Commission "cannot and should not usurp South Kentucky's board of directors' duty to make business judgments …"[86] in a situation such as this,

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[83] Hearing Transcript (Carter Babbit), May 16, 2018, at approximately 12:05 p.m.; Response of South Kentucky to Commission Staff's First Posthearing Request for Information, Request 3, Exhibit PHPSC-1.

[84] MOU ¶ 0.6; *see also* Direct Testimony of Michelle Herrman, page 15, lines 4-12.

[85] MOU ¶ 2(A).

[86] *In re Application of South Kentucky*, Case No. 2008-00371, 2010 WL 1938172, *2 (K.y. P.S.C. 2010); *but see In re East Kentucky Power Coop.*, Case No. 2008-00436, 2008 WL 6691449, * (K.y. P.S.C. 2008) ("Ultimately, the responsibility for East Kentucky's viability lies firmly within the province of its board of directors,

where the lone relevant question before the Commission should be whether the decision of South Kentucky satisfies the requirements of KRS 278.300. Hence the efforts of intervenors to transform this case into a referendum on the MOU. As explained earlier, however, those efforts are misplaced and must fail. Just as the Morgan Stanley agreement is a lawful object, so too is the MOU.

B. The Morgan Stanley PPA Is Necessary or Appropriate for or Consistent with South Kentucky's Provision of Electric Service to Its Members

The PPA likewise satisfies the requirement of KRS 278.300 that it be necessary or appropriate for, or consistent with, South Kentucky's provision of electric service to its members. As the evidence in the record reflects, the agreement stands to bring South Kentucky significant savings over its 20-year term—with an expected range of savings exceeding $100 million. Absent the alternate source designation, South Kentucky is slated to receive all of its capacity and energy from EKPC for the next 33 years. The costs for that supply have fluctuated in recent years, with a trending increase.[87] The agreement with Morgan Stanley adds a measure of price certainty to these wholesale power costs, while at the same time injecting supplier diversity into its wholesale power portfolio. In short, while the agreement is projected to bring significant savings to South Kentucky and its members, the agreement also will mitigate the volatility inherent in being supplied solely from EKPC.

As the Commission knows, the agreement with Morgan Stanley includes a hedge component to protect against fluctuations in the PJM capacity markets. Already, this arrangement stands to bring benefits to South Kentucky, with the PJM capacity market recently having cleared

who have a fiduciary duty to safeguard the financial and operational viability of the cooperative. The Commission cannot and should not usurp the directors' duty to make business judgments, but as the statutorily created regulatory authority, it also cannot and should not turn a blind eye to a situation which does not appear to be getting better.").

[87] Direct Testimony of Michelle Herrman, page 6, line 20 through page 7, line 3.

$15 above the target hedge price—when no one, including EKPC, expected such an outcome.[88] Utilization of such tools is common in the energy markets. In fact, the energy supply component of the PPA also is a form of hedge, with South Kentucky and its Board of Directors determining that the value of fixing a portion of the cooperative's energy supply for a future period outweighing any risk that energy prices might somehow prove to be lower than the fixed price.

This hedge-type architecture may seem familiar, because it is actually the same construct at play in the MOU. Much was made at hearing over the idea of lost opportunity, and how South Kentucky's alternate source designation constitutes a lost opportunity for intervenors that could never be mitigated.[89] Intervenors' arguments, however, strain to avoid the very simple fact that when the owner-members all agreed to Amendment 3 and the MOU, they decided that the right to designate an alternate source carried an intrinsic value greater than committing to 100 percent supply from EKPC for the remaining term of the Wholesale Power Contract.[90] Rather than be exposed perpetually to EKPC costs, the owner-members secured a hedge on the assumption that an option for owner-members to pursue supplier diversity could be an effective way for an electing owner-member to lower or stabilize future wholesale power costs.

The discussion in the following section reiterates why the Morgan Stanley arrangement is appropriate and will not impair South Kentucky's service to its members. These facts are as informative to the question of whether the agreement is necessary, appropriate, and consistent with South Kentucky's duties as a cooperative as anything else. Regarding the necessity of the PPA,

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[88] *See* Response of South Kentucky to Commission Staff's First Posthearing Request for Information, Item 2; *see also* Hearing Transcript (Don Mosier), May 16, 2018, beginning at approximately 4:19:32 p.m.; Green Tech Media, "Prices Spike in PJM Capacity Auction" (May 23, 2018), *available at* https://www.greentechmedia.com/articles/read/prices-spike-in-pjm-capacity-auction?utm_source=google&utm_medium=organic&utm_campaign=google_news#gs.eHJ993k).

[89] *See, e.g.*, Hearing Transcript (Mike McNalley), May 16, 2018, at approximately 8:56 p.m.

[90] *See* MOU ¶ 0.6.

however, South Kentucky submits that the standard of KRS 278.300 does not require proof of "necessity" or "need" here in the literal sense. South Kentucky is and continues to be a full requirements customer of EKPC. At the same time, however, Amendment 3 and the MOU have a field of operation. They provide for South Kentucky to make an alternate source designation and receive supply from someone other than EKPC. Thus, for these rights to be meaningful, the "need" standard in KRS 278.300 cannot be viewed in a constrained fashion. Rather, the "need" is more properly viewed as the need for South Kentucky to provide reliable, cost-effective service to its members. And as to that, in the business judgment of South Kentucky and its Board of Directors, the Morgan Stanley agreement will serve that need well.

C. South Kentucky's Alternate Source Designation Will Not Impair Its Ability to Provide Electric Service to Its Members

Under the Morgan Stanley agreement, South Kentucky will receive 58 MW of energy on a continuous basis (*i.e.*, 24x7x365) in lieu of the same amounts of energy that South Kentucky would otherwise have obtained from EKPC in accordance with the Wholesale Power Contract. This supply arrangement will not impair South Kentucky's ability to provide electric service to its members. Rather, service should occur much in the same way as it does today, with the actual electrons meeting the needs of South Kentucky's members coming from PJM pursuant to its dispatch instructions. Furthermore, and contrary to the doubt intervenors have endeavored to sow in the minds of the Commission, the PPA provides ample protection for South Kentucky in the event there is a failure of delivery on the part of Morgan Stanley.

i. <u>The Physical Delivery of Energy to South Kentucky's System Will Not Substantially Change under the PPA</u>

As the record reflects, the Morgan Stanley agreement does not associate the supply of energy to South Kentucky from a specific generating resource. Instead, the source of the energy

is the PJM market, with the underlying arrangements to secure rights to use that energy in service of South Kentucky incumbent on Morgan Stanley. While intervenors have made repeated efforts to portray the provision of market energy under the agreement as a risk to South Kentucky,[91] the supply of energy in this way is very much consistent with the manner of supply prevailing on the EKPC system today. As Mr. Crews explained during the hearing, the use of a market or pool to supply energy and meet and the electricity needs of consumers is commonplace, and EKPC, in practice, obtains the energy it provides to all sixteen owner-members from the PJM market.[92] To be sure, some energy comes from EKPC-owned generators, but the market does not try and match the electrons used to the generators that produced them.[93] The principal concern rather is that supply meets demand and that the system is being dispatched economically, and with an account for operating limitations and other reliability considerations.[94]

Thus, deliveries for South Kentucky under the Morgan Stanley agreement will continue to occur as they do today, only now there will be fixed-price energy deliveries corresponding to the agreement. And as noted earlier, those deliveries will not be complicated. Rather, the energy pattern for those deliveries will be continuous—thus, the same set of daily schedules is all that EKPC and PJM will need tendered in connection with the arrangement. Furthermore, the MOU provides for protection of South Kentucky in the event that there is a disruption or failure of

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[91] *See e.g.*, Direct Testimony of John Wolfram, page 14, line 24 through page 15, line 5.

[92] *See* Hearing Transcript (David Crews), May 17, 2018, at approximately 10:47:30 a.m.— 10:48:53 a.m.; Deposition of Anthony Campbell, South Kentucky Exhibit 7, page 94 line 19 through page 98, line 19 (discussing EKPC's operation in the PJM market).

[93] Hearing Transcript (David Crews), May 17, 2018, at approximately 10:43 a.m. (through approximately 10:46 a.m.).

[94] *Id.*, at approximately 10:43 a.m. (through approximately 10:44 a.m.).

delivery.[95] Intervenors can quibble over what the price of that replacement power will be,[96] but for South Kentucky (and the other owner-members who signed the MOU), the key point of the provision is that EKPC has agreed to serve as, and should be counted on as, a backstop in the event of a problem with the alternate source.

Finally, the power delivery risk shifting components of the PPA should be emphasized. With Morgan Stanley's energy delivery obligation not tied to a specific generating resource, the PPA greatly mitigates the prospect of a delivery failure—as compared to an agreement tied to a dedicated resource and thus exposed to unexpected (i.e., unforced) outages or extended maintenance outages.[97] In addition, the agreement calls for Morgan Stanley to provide Firm LD energy to the EKPC delivery node. Thus, the agreement also shifts any transmission congestion risk associated with getting power through PJM to the node—and importantly the costs of that congestion—to Morgan Stanley.[98]

ii. The PPA Provides a Number of Additional Protections for South Kentucky

The Morgan Stanley agreement affords South Kentucky multi-layered protections. Taking a step back, however, the identity of the counterparty itself warrants mention. Despite the occasional efforts of intervenors to demonize South Kentucky's counterparty (e.g., "New York bank"), Morgan Stanley and its subsidiary Morgan Stanley Capital Group are experienced, reputable participants in the wholesale power market. EKPC itself has familiarity with Morgan

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[95] MOU ¶ 5(E)(i).

[96] For South Kentucky, any debate over the price of the replacement power supplied by EKPC is among the school of red herring intervenors have invited to this case, as Morgan Stanley is obligated to make South Kentucky whole regardless. *See* Application, Exhibit 5, Section 4.1.

[97] Rebuttal Testimony of Carter Babbit, page 18, lines 13-17. In addition, as Mr. Babbit explained in his testimony, the force majeure provision of the agreement is very confined—consistent with the nature of the product purchased, Firm LD energy—further limiting South Kentucky's exposure to any non-delivery.

[98] Application, Exhibit 7, Section 8 (identifying the "Product" as Firm LD energy); *see also* Hearing Transcript (Don Mosier), May 16, 2018, at approximately 5:25 p.m. (through approximately 5:26 p.m.).

Stanley and does not question its commitment to the agreement.[99] To that end, and in the unlikely event of some willful breach by Morgan Stanley, South Kentucky will be able to avail itself of all protections available to it both in the contract and at law.[100] It is not reasonable, however, to presume that Morgan Stanley will default if the economics of the agreement prove contrary to its expectations. Perhaps it is an outgrowth of intervenors' persistent efforts to abandon the commitments agreed to by them as part of the MOU, but the notion that Morgan Stanley will intentionally default on the agreement if future circumstances prove contrary to assumptions is a proposition South Kentucky simply does not accept.[101]

In any event, under the agreement, in the event that Morgan Stanley fails to deliver energy, Morgan Stanley will be responsible for paying to South Kentucky the cost of replacement energy incurred by South Kentucky over and above what South Kentucky would have paid. Specifically, Morgan Stanley must pay a "Replacement Price", which includes not only the price for the replacement energy, but also "costs reasonably incurred by [South Kentucky] in purchasing such [replacement energy] …."[102] In other words, if Morgan Stanley fails to provide the energy, South

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[99] Direct Testimony of Carter Babbit, page 16, line 5 through page 6, line 8; Rebuttal Testimony of Carter Babbit, page 4, line 16; Response of South Kentucky to Attorney General's Supplemental Data Requests, Items 5 & 6; Hearing Transcript (John Wolfram), May 17, 2018, at approximately 12:57 p.m.; Hearing Transcript (Carter Babbit), May 16, 2018, at approximately 12:13 p.m.; Hearing Transcript (Don Mosier), May 16, 2018, at 4:25:42 p.m.—4:25:51 p.m. (noting that Morgan Stanley is an honorable counterparty).

[100] *See* Application, Exhibit 5, Section 5.1.

[101] The more reasonable expectation is akin to the situation recounted by Opposing Intervenors' witness John Wolfram. Hearing Transcript (John Wolfram), May 17, 2018, at approximately 12:52 p.m. Likewise, and as noted in Mr. Mosier's direct testimony, Morgan Stanley has the ability to hedge any losses it may experience as a result of the agreement with its many other dealings in the wholesale electric markets. Direct Testimony of Don Mosier, page 5, lines 5-6.

[102] *See* Application, Exhibit 5, Section 1.51 ("'Replacement Price' means the price at which Buyer , acting in a commercially reasonable manner, purchases for delivery at the Delivery Point a replacement for any Product specified in a Transaction but not delivered by Seller, plus (i) costs reasonably incurred by Buyer in purchasing such substitute Product and (ii) additional transmission charges, if any , reasonably incurred by Buyer to the Delivery Point, or absent a purchase, the market price at the Delivery Point for such Product not delivered as determined by Buyer in a commercially reasonable manner."). Note that this provision was slightly amended by the cover sheet included with the EEI Master Agreement in Exhibit 5 to the Application. The above quoted provision incorporates those revisions for convenience.

Kentucky will be reimbursed for any costs of obtaining replacement energy greater than what South Kentucky would have paid if Morgan Stanley had delivered the energy. Therefore, South Kentucky (and by extension, its members) will be made whole for any such delivery failure. This design eliminates any economic incentives Morgan Stanley would have to intentionally default, which is the entire purpose of the Firm LD product South Kentucky is purchasing.[103]

In addition, in the event that Morgan Stanley fails to deliver energy for ten consecutive days, or for a total of thirty days in any one-year period, such failure will be considered an event of default. In such a scenario, South Kentucky has the option to terminate the agreement and subsequently determine the appropriate termination payment that would be owed between the parties. To be clear, however, during the default period and until the termination payment is finalized, South Kentucky would continue to be entitled to receive the replacement costs described above, which would be factored into the termination payment.[104]

Finally, in the unlikely event that Morgan Stanley Capital Group (as the named counterparty to the PPA) is unable to make good on its obligations under the agreement as a result of a failure to perform or some other form of default, South Kentucky has secured a guarantee from Morgan Stanley, as parent for Morgan Stanley Capital Group, which recorded a net revenue

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[103] As FERC has noted, the "EEI Firm LD [energy] does not permit power to be interrupted for economic reasons." *Preventing Undue Discrimination and Preference in Transmission Service*, Order No. 890, FERC Stats. & Regs. ¶ 31,241 at P 1452 (2007). FERC goes on to state that the "EEI contract clearly obligates the supplier to provide power, except in the case of force majeure." *Id. See also Preventing Undue Discrimination and Preference in Transmission Service*, Order No. 890-A, FERC Stats. & Regs. ¶ 31,261, at P 835 (2007) ("The EEI firm LD product…make[s] the buyer adequately whole…").

[104] Application, Exhibit 5, Section 5.2. Because the termination price is structured to be the Replacement Price for the remainder of the term of the contract, Morgan Stanley has no economic incentive to default, in contrast to intervenor's allegations. *Id.* Additionally, in such a hypothetical scenario, South Kentucky has the right to formulate the termination price, which does not require South Kentucky to enter into another long term deal as "neither Party shall be required to enter into a replacement transaction in order to determine a market price." *Id.*

of over $11 billion in the first quarter of 2018,[105] to cover any such costs or monies owed to South Kentucky.[106] These protections, taken together, provide robust protection to South Kentucky to ensure that South Kentucky will be able to continue to provide reliable and cost-effective service to its members. Meanwhile, South Kentucky, through its agent in the PJM market, will continue to be able to obtain replacement power in the same manner in which EKPC already serves South Kentucky under the Wholesale Power Contract. As the record reflects, EKPC has ample expertise transacting in PJM, and there is no indication that the need for additional purchases from PJM (particularly given the simplicity of the schedule) will be overly burdensome for EKPC or its agent ACES.[107] Indeed, the MOU contemplated just this type of representation and service, with provisions to ensure both that South Kentucky would not be left on its own to navigate the PJM market in order to obtain replacement power if the alternate source failed to produce, as well as that EKPC would be compensated for any needed efforts.[108]

D. South Kentucky's Alternate Source Designation Is Necessary and Appropriate for Providing Electric Service to Its Members

The foregoing discussion covers broadly in South Kentucky's view the requirements of KRS 278.300. To this end, the need and appropriateness of the Morgan Stanley agreement are inherent in the decision by South Kentucky to pursue an alternate source of supply. This action is allowed under Amendment 3 and the MOU, and it will be in furtherance of South Kentucky's fiduciary duty to provide its members with reliable and cost-effective electric service. Moreover,

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[105] Morgan Stanley 2018 First Quarter Earnings Press Release, *available at* https://www.morganstanley.com/about-us-ir/shareholder/1q2018.pdf.

[106] Application, Exhibit 9 – Morgan Stanley Guarantee.

[107] Hearing Transcript (Don Mosier), May 16, 2018, at approximately 5:19 p.m.; Rebuttal Testimony of Carter Babbit, page 16, line 15 through page 17, line 2.

[108] MOU ¶ 5(E)(i) & (vii).

South Kentucky and its Board of Directors took this action after thorough and reasonable due diligence. South Kentucky's investigation into obtaining energy through an alternate source presented South Kentucky and its Board of Directors with an opportunity to realize substantial savings over the next twenty years as compared to the status quo (i.e., continued reliance on the Wholesale Power Contract and EKPC as South Kentucky's full-requirements provider). Based on the reasoned judgment of South Kentucky's management and that of its Board of Directors, which transpired across a period of many months, the Morgan Stanley agreement presented the best way to obtain cost savings to its members while mitigating as much risk as reasonably practicable. South Kentucky's analyses show that the transaction can be reasonably expected to produce over $100 million in savings to South Kentucky and its members.

Intervenors' ability to design a hypothetical scenario that erodes the projected savings of the agreement is a truism.[109] South Kentucky equally can envision scenarios that cause the savings to double.[110] The reality of the situation, however, is that a cooperative entity such as South Kentucky, with a fiduciary duty to its members and a corresponding obligation to serve those members reliably and cost effectively, must take the best information available to it and make a decision that it believes, in its business judgment, is in the best interests of its members. This means obtaining certainty where available, mitigating potential risks, and accepting that not every contingency can be sensitized or risk avoided.

South Kentucky did not enter into the agreement with Morgan Stanley in a vacuum. Well before South Kentucky entered into negotiations with Morgan Stanley and eventually reached

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[109] *See e.g.*, Direct Testimony of Mike McNalley, page 16, lines 17-19 & Exhibit MM-3 (utilizing a 13% annual NITS escalation factor to show erosion of savings); Hearing Transcript (Michelle Herrman), May 15, 2018, at approximately 5:07 p.m. (through approximately 5:10 p.m.) (where questions were posed noting that potential savings could be reduced if EKPC rates decreased in price).

[110] *See* Rebuttal Testimony of Carter Babbit, page 15, lines 12-17.

terms on the agreement, South Kentucky considered the proposal from the independent power producer and then took the step to issue an RFP to wholesale power market participants best qualified to provide competitive offerings. The RFP provided key information to South Kentucky and allowed it to negotiate a favorable deal for its members that offered cost savings greater than those that might have been realized from the independent power producer. Among other things, the RFP provided South Kentucky with a picture of the potential offerings for long-term supply arrangements—including arrangements with varying terms—that could be extracted from the wholesale power market at the time. The competitive process utilized in the RFP, which allowed for finalists in the RFP to resubmit bids, also helped South Kentucky further drive down prices and increased South Kentucky's leverage in obtaining favorable terms.

This information, including the various risks associated with entry into the agreement, were communicated to South Kentucky and its Board of Directors. These include the potential for a lag in transmission cost recovery by EKPC from its owner-members, which would translate (in terms of the value analysis) into the appearance of higher costs as part of the alternate source election.[111] Also contemplated were the prospect for other changes in the PJM market,[112] variability in capacity

[111] *See* Response of South Kentucky to Distribution Cooperatives First Set of Data Requests, Item 4 and Attachment DC#1-4, pages 1-42; Response of South Kentucky to Commission Staff's First Posthearing Request for Information , Request 3, Exhibit PHPSC-1; *see also* Hearing Transcript (Don Mosier), May 16, 2018, at 5:41:45 p.m.—5:41:56 p.m. (noting that increases in EKPC's NITS costs would be reflected in EKPC's base rates).

[112] Response of South Kentucky to Distribution Cooperatives First Set of Data Requests, Item 4 and Attachment DC#1-4, pages 1-42; Response of South Kentucky to Commission Staff's First Posthearing Request for Information, Request 3, Exhibit PHPSC-1; *see also* Rebuttal Testimony of Carter Babbit, Exhibit CB REB-3 (indicating in an email from Mark David Goss to David Crews that PJM costs have been a consideration throughout South Kentucky's review).

prices,[113] consequences associated with the agreement's collateral requirements,[114] and other factors affecting the price of energy.[115] In addition, South Kentucky considered the potential risks associated with changes in environmental law.

To this point, much was made at hearing regarding the Environmental Change in Law ("ECL") provisions included in the agreement—at one point, it was claimed that a truck could be driven through the provision.[116] For all the uncertainty intervenors seek to create here, it cannot be forgotten that none of the intervenors is a party to the agreement or negotiated its terms. The fact remains—and it is a fact intervenors have to accept—that the ECL provisions do not allow Morgan Stanley to recover costs related to capital expenditures associated with environmental laws for regulations. Rather, those costs are limited to the following:

> any and all fees, licenses, charges, green tags, certificates, expenses and products (including both not limited to any charges or products required on a per unit-of-energy-output, per-unit-of-energy input, per-weight-of-pollutant, cap and-trade or other basis) and all losses, costs and liability with respect thereto, imposed or required by a Governmental Authority with respect to this Transaction or supplied hereunder; and [] any and all Taxes and all costs and liabilities with respect thereto, imposed or required by a Governmental Authority with respect to this Transaction or supplied hereunder; in each case, only to the extent such Additional Environmental Costs result from or are attributable to a Change in Law with respect

[113] *See* Response of South Kentucky to Distribution Cooperatives First Set of Data Requests, Item 4 and Attachment DC#1-4, pages 33-37; Response of South Kentucky to Commission Staff's First Posthearing Request for Information , Request 3, Exhibit PHPSC-1, page 4; Rebuttal Testimony of Carter Babbit, page 9, line 19 through page 10, line 18. *See also* Response of South Kentucky to Commission Staff's First Posthearing Request for Information, Item 2 (regarding the results of the most recent BRA); Green Tech Media, "Prices Spike in PJM Capacity Auction" (May 23, 2018), *available at* https://www.greentechmedia.com/articles/read/prices-spike-in-pjm-capacity-auction?utm_source=google&utm_medium=organic&utm_campaign=google_news#gs.eHJ993k).

[114] *See* Direct Testimony of Michelle Herrman, page 9, line 7 through page 11, line 21; Response of South Kentucky to EKPC's Supplemental Data Requests, Request 22; Response of South Kentucky to Distribution Cooperatives Second Request for Information, Request 10, Attachment DC#2-10.

[115] *See* Response of South Kentucky to Distribution Cooperatives First Set of Data Requests, Item 4 and Attachment DC#1-4, pages 1-42; Response of South Kentucky to Commission Staff's First Posthearing Request for Information, Request 3, Exhibit PHPSC-1.

[116] Hearing Transcript (Don Mosier), May 16, 2018, at 4:23:35 p.m.—4:23:54 p.m.; *see also id.* at 5:08:05 p.m.—5:08:24 p.m. (where Mr. Mosier agrees that the ECL provisions are not intended to be some sort of "Trojan Horse" price reopener).

> to any Environmental Law or Tax Law and directly cause the price of the Product paid by SKRECC to be increased.[117]

As Mr. Holt testified, this provision "essentially comprises items like a federal or state carbon tax or greenhouse tax."[118]

South Kentucky does not dispute that environmental laws have changed and can be expected to do so in the future. But contrary to the arguments of intervenors, this provision is relatively inflexible in terms of what costs can be passed through. Specifically, the eligible costs must be "imposed or required by a Governmental Authority" respecting the transaction or the product supplied under it. Compliance decisions that translate into capital investment are not imposed or required by governmental authorities, as a plant operator typically has compliance options, including the option to retire an effected unit and avoid the cost.

Complementing the foregoing are the corresponding provisions of the ECL that require Morgan Stanley to "take commercially reasonable efforts to minimize any Additional Environmental Costs" and to seek to pass along to South Kentucky only those costs "suffered or incurred by [Morgan Stanley] …."[119] These provisions cannot be underemphasized. Because the agreement is not tied to a specific generating unit, but rather is an agreement for the provision of market energy, Morgan Stanley must take commercially reasonable efforts to avoid actions that might trigger the ECL. This means that Morgan Stanley first will be required to explore the market for available energy to procure and resell to South Kentucky to satisfy its obligations under the agreement <u>before</u> Morgan Stanley seeks to pass along Additional Environmental Costs to South Kentucky under the ECL. In addition, this will be an ongoing obligation. Thus, even if a situation

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[117] Application, Exhibit 7, Section 18; Application, Exhibit 8, Section 23.

[118] Rebuttal Testimony of Dennis Holt, page 20, lines 13-14.

[119] Application, Exhibit 7, Section 17; Application, Exhibit 8, Section 20.

arises where an Additional Environmental Cost might justifiably be passed along to South Kentucky and market supply is constrained such that Morgan Stanley must rely on the affected generating unit, Morgan Stanley would nonetheless be required to revisit that decision once the constraint resolved. In any case, the obligations inherent in Morgan Stanley's performance obligation provide comprehensive protection to South Kentucky against the imposition of Additional Environmental Costs, as Morgan Stanley effectively will be required to canvass the PJM market before attempting to pass along such costs.

These are the reasons South Kentucky sees little to no increased exposure to the imposition of Additional Environmental Costs as compared to its current supply arrangement with EKPC.[120] To the extent circumstances develop such that Morgan Stanley actually incurs such costs and cannot minimize the passage of them to South Kentucky through commercially reasonable efforts, the PJM market, if not the entire nation, can be expected to be undergoing a similar event (e.g., the passage of a national or regional carbon or greenhouse gas tax). The likelihood that an event affects Morgan Stanley alone, or generation in the PJM market but not EKPC, is remote.

Even more remote is the triggering of the ELC in the capacity hedge. Although South Kentucky recognizes that the provisions are in both confirmations, the definition of "Additional Environmental Cost" explicitly states that the applicable events—as imposed by Governmental Authorities—must actually cause the price of the Product paid for by South Kentucky to be increased.[121] As the record reflects, the Product for the hedge is not capacity—it is a financially settled transaction, the components of which are defined in the confirmation.[122] Those components

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[120] Rebuttal Testimony of Carter Babbit, page 6, line 20 through page7, line 15; Response of South Kentucky to Commission Staff's First Request for Information, Request 18.

[121] Application, Exhibit 8, Section 23.

[122] *Id.*, Section 8; *see also* Response of South Kentucky to EKPC's Supplemental Data Requests, Request 36, Part c.

do not include any reference to or incorporation of Additional Environmental Costs or a recalculation of the components in the event of such costs.[123] By comparison, the parties to the agreement did include a provision expressly allowing for recalculation in the limited case of action by FERC or PJM in response to a recent decision from the United States Court of Appeals for the District of Columbia Circuit affecting the Floating Price or any component used in its calculation.[124] Accordingly, South Kentucky continues to view this provision as being what intervenors' counsel called it at one point: surplusage.

Finally, intervenors have argued about some of the action items that South Kentucky reasonably reserved for after the Commission's review of the application. These include finalization and execution of the agency agreement and membership in PJM. It is not at all clear to South Kentucky how these bear on the elements of the application under KRS 278.300. If anything, South Kentucky's measured progress here, particularly with regard to PJM membership, reflects its desire to proceed with its members' interests in mind and avoid unnecessary cost incurrence until such is necessary.[125] As to the agency agreement, unless EKPC intends to breach its obligations under the MOU, South Kentucky does not see the development of that document as an impediment or anything that should be controversial. South Kentucky understands that EKPC can and should be afforded cost recovery for any services provided, and South Kentucky will agree to that as part of any arrangement.[126]

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[123] Application, Exhibit 8, Section 8.

[124] Application, Exhibit 8, Section 21.

[125] Response of South Kentucky to Commission Staff's First Request for Information, Request 7.

[126] MOU ¶ 5(E)(vii) ("PJM market participant activities for the Alternate Source and related load will be managed by EKPC or EKPC's agent. The Owner Member shall pay EKPC a non-discriminatory, cost-based fee for such PJM market participant services, which shall be performed in accordance with good utility practices.").

In summary, and despite the myriad of claims to the contrary, South Kentucky undertook comprehensive and reasonable due diligence with regard to the transaction reflected in the Morgan Stanley agreement. Not every risk was reduced to a number, nor was every potential negative variable analyzed. (The remote positive ones were not either, at least until prompted by intervenors.[127]) Remote and qualitative considerations were understood by the Board of Directors, but ultimately the prospect for them did not outweigh the relative merits of the deal in the business judgment of South Kentucky and its board.[128] Quantitative analysis was undertaken of the different proposals against the relevant benchmark: the cost of wholesale power supply by EKPC across a 20-year horizon. And together, these considerations supported the decision of the Board of Directors to proceed with the Morgan Stanley agreement, as an agreement necessary and appropriate for its corporate purpose of serving its members.

E. The KRS 278.300 Requirements for Supplemental Generation Do Not Apply to South Kentucky's Decision and the Commission's Review of This Application

This Commission has required utilities seeking approval under KRS 278.300 to meet additional criteria where the utility is seeking to add supplemental generation. In those instances, the Commission noted that in determining whether KRS 278.300 is met, "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,' there must be a need for additional generation and the absence of wasteful duplication."[129] South Kentucky is not seeking to add supplemental generation. South Kentucky is exercising its contractual right—as agreed to by it,

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[127] Rebuttal Testimony of Carter Babbit, page 15, lines 13-17.

[128] *See* Response of South Kentucky to Distribution Cooperatives First Set of Data Requests, Request 4 and Attachment DC#1-4, pages 1-42; Response of South Kentucky to Commission Staff's First Posthearing Request for Information, Request 3, Exhibit PHPSC-1; Hearing Transcript (Carter Babbit), May 16, 2018, at approximately 12:05 p.m.; Direct Testimony of Michelle Herrman, page 15, lines 4-12.

[129] *See Case No. 2009-0054*, at 5-6.

EKPC, and all other owner-members under Amendment 3 and the MOU—to replace supply from EKPC with supply from an alternate source.[130] Accordingly, South Kentucky does not believe the additional considerations that the Commission has included with KRS 278.300 applications for supplemental generation to be appropriately included here. However, even if these requirements were applicable, South Kentucky believes them to be satisfied.

In the principal cases where the Commission has imposed additional considerations to its standard analysis under KRS 278.300, the applicant in question (Kentucky Power) was seeking to purchase power in addition to its current generation portfolio.[131] The Commission reasoned that, given the existing generation portfolio, it was appropriate to determine why the additional generation was needed and why it would not result in wasteful duplication.[132] While South Kentucky's application does seek approval of the Commission to enter into a PPA, the similarities between the Kentucky Power cases and South Kentucky's current application end there.

As the Commission is aware, all of South Kentucky's load currently is served by EKPC pursuant to the long-term Wholesale Power Contract, with its term extending to 2051.[133] An express component of this contract is the right to designate an alternate source of supply, limited only by the existing provisions of Amendment 3 and the MOU. There is no requirement to establish need stated or implied in these documents, as such would effectively correlate to a failure by EKPC to discharge the fiduciary duty it owes the owner-members to own or procure sufficient

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[130] Amendment 3, ¶ 1; MOU ¶ 0.4; *see also* Rebuttal Testimony of Dennis Holt page 15, line 15 through page 16, line 5.

[131] *See e.g., Case No. 2013-00144* (wherein Kentucky Power sought approval of a PPA to obtain the entire output of a 58.5 MW biomass facility in addition to its generation portfolio); *Case No. 2009-00545* (wherein Kentucky Power sought approval of a PPA to obtain 100 MW of output and environmental attributes from a wind facility).

[132] *Case No. 2013-00144*, at *6; *Case No. 2009-00545*, at 4-5.

[133] Wholesale Power Contract, South Kentucky Exhibit 9, Amendment 4 (extending the term until January 1, 2051).

generation to serve its needs. Thus, through its decision to enter into the Morgan Stanley agreement, South Kentucky is not bringing in any "supplemental" generation. Indeed, South Kentucky has no generation to supplement. Rather, South Kentucky has the contractually allotted portion of its EKPC-sourced supply to replace, if it chooses, and it has done so through the Morgan Stanley agreement.

Assuming, for the sake of argument, that South Kentucky's application for approval of the alternate source designation were subject to the additional requirements of the supplemental generation cases, South Kentucky believes the alternate source designation meets those requirements because the energy supply covered under the Morgan Stanley agreement is needed to serve South Kentucky's members and does not result in wasteful duplication.

The generation is needed because South Kentucky has now exercised its rights under Amendment 3 and the MOU and has given notice of its election of an alternate source. Under the applicable language, the proverbial clock is ticking, and 58 MW of South Kentucky's load will need to be served by someone other than EKPC as of June 1, 2019. South Kentucky does have a grace period, but only six months.[134] Under the MOU, however, South Kentucky cannot return to the fold, so to speak, until another 18-month notice window has passed (given the size of its election).[135] Thus, absent some form of beneficent relief from the applicable provisions of the MOU—which as a filed rate is a dubious proposition—South Kentucky is apparently out on its own for the 58 MW, until it gives a notice that it wishes to cancel the alternate source election.[136]

[134] MOU ¶ 4(E).

[135] MOU ¶ 4(D).

[136] *Id.* South Kentucky does not construe the MOU this way and believes this is yet another misconstruction/misunderstanding of the terms, intentional or otherwise. If the application fails, however, South Kentucky fully understands that it will have until at least December 1, 2019 to find a replacement for the Morgan Stanley agreement, and it expects that EKPC will honor its commitments in the MOU to assist it in that endeavor. MOU ¶¶ 5(A) & (C).

Thus, while the Commission's traditional consideration of what constitutes a "need" may not conform with these novel circumstances, the Morgan Stanley agreement would seem by most accounts to warrant the classification of needed generation.

Intervenors' attempts to characterize the alternate source designation as wasteful duplication under KRS 278.020(1) likewise falls short of the Commission's standard. Wasteful duplication is characterized by both "an excess of capacity over need" and "an excessive investment in relation to productivity or efficiency, and an unnecessary multiplicity of physical properties."[137] As stated above, South Kentucky does not own physical generation of its own, and thus South Kentucky cannot create wasteful duplication on its own. Indeed, to imply that the alternate source designation is "wasteful" necessarily impugns the Commission's decision to validate the alternate source designation rights in Amendment 3 by approving the MOU. The alternate source designation is thus better viewed as a replacement of a 58MW block of power from one provider with the same amount of energy from a separate provider.

South Kentucky recognizes that the Commission has traditionally considered (including in the context of the supplemental generation cases under KRS 278.300) whether a proposed PPA is the "least-cost" alternative in this analysis.[138] South Kentucky's alternate source designation was not the least-cost option in terms of short-term costs per MWh; however, over a 20-year term, South Kentucky's analyses show that the Morgan Stanley agreement represents the optimal choice, in terms of delivering savings to its members. Perhaps more importantly, the analyses show that South Kentucky's members will pay less for electricity than they would have under the Wholesale Power Contract for the same time period. Can South Kentucky guarantee savings? No. But all

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[137] *Kentucky Utilities Co. v. Public Service Commission*, 252 S.W. 2d 885, 890 (Ky. 1952).

[138] *Case No. 2009-00545*, at 5.

reasonable indicators support that outcome. In any event, the only certain thing about future costs is that they will be uncertain. Thus, certainty cannot be the benchmark for alternate source elections under the Amendment 3 and the MOU.

V. Conclusion

During the hearing, Mr. Holt was challenged on a portion of his rebuttal testimony in which he stated that, given the projected savings under the Morgan Stanley agreement, South Kentucky's fiduciary obligation to its members effectively made the decision evident.[139] Although Mr. Holt had not said as much, later in the hearing, intervenors' counsel wondered if the statement by Mr. Holt was intended to be an indictment of the other owner-members, to which Mr. Seelye explained that it was not, as each owner-member had its own circumstances to consider.[140]

The questions to Mr. Holt and Mr. Seelye betray the merits of intervenors' arguments—particularly Opposing Cooperatives. South Kentucky stands to realize significant value for its members—members to whom it owes a fiduciary duty—through the Morgan Stanley agreement. South Kentucky realized this opportunity by exercising a contractual right that had, relatively speaking, only been recently reaffirmed on a unanimous basis by all the principal participants in this case. South Kentucky invested the time, money and resources to search out a deal that it thought was the best it could obtain, under the circumstances, so that it actually could secure the benefits that all signatories to the MOU agreed were legitimate and worth protecting, in order to bring those benefits home to its members.

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[139] Hearing Transcript (Dennis Holt), May 15, 2018, at approximately 10:45 a.m. – 10:47 a.m.

[140] Hearing Transcript (William S. Seelye), May 16, 2018, at 2:23:21 p.m.—2:27:44 p.m. (specifically at 2:27:35 p.m.—2:27:44 p.m.).

How can the intervenors adopt any position other than what they have adopted in this case? To do otherwise would be tantamount to an acknowledgment of a failure and, as counsel wondered, potential exposure for breach of a fiduciary duty.

South Kentucky respectfully requests that its application be approved.

Respectfully submitted,

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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 15th day of June, 2018.

/s/Matt Malone
ATTORNEY FOR SKRECC