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	)

REPLY BRIEF OF

SOUTH KENTUCKY RURAL ELECTRIC COOPERATIVE CORPORATION

Filed: July 23, 2018

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South Kentucky Rural Electric Cooperative Corporation ("South Kentucky") hereby submits this reply brief in support of its application 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"). This brief responds to the post-hearing brief submitted by Nucor Steel Gallatin ("Nucor") on June 18, 2018, and the post-hearing briefs of the Attorney General; East Kentucky Power Cooperative ("EKPC"); the "Joint Intervenors";[1] Grayson Rural Electric Cooperative Corporation; and Jackson Energy Cooperative Corporation submitted on July 2, 2018.

I. Introduction

At a glance, more than 200 pages of opposition briefing have been filed. Fortunately for South Kentucky and future petitioners and applicants like it, the literal "weight" of the evidence and arguments does not decide cases. The Commission decides cases based on the merits. And once the Commission digests the merits before it, South Kentucky submits that the answer is apparent: the owner-members and EKPC should be treated like the business entities they are, and they should be held responsible for their decisions.

EKPC and its sixteen owner-member cooperatives twice committed to allow the owner-members the opportunity to designate an alternate source of supply other than EKPC. Over the course of more than a decade, the parties twice put pen to paper: once to lay out general terms, and a second time to define more specific parameters of the understanding. South Kentucky then acted

[1] As noted in their brief, Joint Intervenors comprise nine of the fifteen owner-member cooperatives of EKPC: Big Sandy Rural Electric Cooperative Corporation, Blue Grass Energy Cooperative Corporation, Clark Energy Cooperative, Inc., Cumberland Valley Electric, Inc., Farmers Rural Electric Cooperative Corporation, Fleming-Mason Energy Cooperative, Inc., Inter-County Energy Cooperative Corporation, Licking Valley Rural Electric Cooperative Corporation and Nolin Rural Electric Cooperative Corporation. In addition, on July 2 Owen Electric Cooperative, Inc. and Shelby Energy Cooperative, Inc. filed a brief reciting their support of Joint Intervenors' brief. Taylor County Rural Electric Cooperative Corporation filed a notice July 2 adopting the positions of Nucor and Joint Intervenors.

on those agreements, investing time and resources (with EKPC's assistance) to identify an alternate source of supply, only to meet claims from the owner-members, the system's largest customer (Nucor), EKPC, and the Attorney General[2] that the sky is falling.

Things are not so dire. Before assuming its litigation posture here, EKPC repeatedly and confidently professed the ability to avoid any consequential impact of an alternate source designation. Moreover, there are constructive rate-making tools at EKPC's disposal that it can use to give effect to South Kentucky's decision and avoid any immediate cost-shifting that might result. One approach noted at hearing would be the introduction of a regulatory asset to permit a measured amortization of any revenue shortfalls, giving EKPC and the system the time it needs (if any) to absorb the alternate source designation.

South Kentucky is not trying to skirt Commission oversight.[3] South Kentucky recognizes the Commission's authority and responsibilities under the law, including the fact that the Commission must approve this PPA; just as South Kentucky recognizes that in the future, it likely will need to come before the Commission for a rate adjustment, at which time it can expect (if this application is approved) a thorough examination of its wholesale power costs. No, South Kentucky respects the regulatory process—which is partly what compels South Kentucky to

[2] The Attorney General's hyperbole is particularly notable – as apparently the Commission put the entire Commonwealth at risk when it approved EKPC's and the owner-members' agreement to reaffirm Amendment 3 through the MOU and permit alternate source designations such as that being made by South Kentucky here. *See* Attorney General Brief, p. 12.

[3] Among the various zigzags in EKPC's brief is just this claim (*see*, *e.g.*, pp. 2-4, 6), followed by the acknowledgment that the PPA itself called for filing with the Commission (*see* pp. 15-16). South Kentucky has never shied from Commission review under KRS 278.300 and the corresponding regulations. What South Kentucky objects to is intervenors' distortion of these requirements, through the mischaracterizations and straw men and red herrings and business judgment substitution and any other number of irrelevant and immaterial arguments thrown against the proverbial wall in an effort to frustrate South Kentucky's legitimate goal of achieving savings for its members by lowering its wholesale power costs.

emphasize the Filed Rate Doctrine and other far-reaching implications of the opposing parties' myopic arguments.[4]

For all the briefing, perhaps most telling is what the intervenors ignored. With limited exception, the briefs ignored the fact that South Kentucky's application was presaged by the alternate source designation at issue in the Grayson litigation—a 100% load factor purchase power agreement.[5] The intervenors likewise ignored the fact that the prospect for cost shifts was on the forefront of the minds of EKPC and other owner-member cooperatives in the time leading up to the adoption of the MOU.[6] Intervenors also ignored the measures previously taken by the sixteen owner-member cooperatives and EKPC, as part of an amendment to the Wholesale Power Contract, to mitigate the potential for cost shifting when they deemed the circumstances to so warrant.[7]

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[4] *See, e.g.*, EKPC Brief, p. 44 ("… [EKPC] also recognizes that the Commission may very well conclude that there are very few, if any, Alternate Source elections under Amendment 3 and the MOU as written that will ever withstand Commission scrutiny on their individual merits – particularly to the extent they are similar to the exercise by South Kentucky in this Application."). *But see id.*, pp. 13-14 ("EKPC has not challenged South Kentucky's manner of election or notice under the MOU ….").

[5] The Attorney General notes a different 100% load factor example: the alternate source designation by Jackson in 2010. *See* Attorney General Brief, p. 2.

[6] *See* Deposition of Anthony Campbell, South Kentucky Exhibit 7, page 45, line 19 through page 46, line 7 (stating that "when you go over the 5 percent, then all of a sudden you get cost shifting."). *Compare* Attorney General Brief, p. 6 ("Contrary to SKRECC's statement in its initial post-hearing brief, the member-owners clearly did not understand the potential for cost-shifting and the ramifications thereof, it would simply have been illogical for the member-owners to have signed it had they understood those ramifications.") *with* Hearing Transcript (Carol Wright), May 16, 2018, 3:51:15 p.m. — 3:51:28 p.m. (noting that Jackson was aware at the signing of the MOU that cost shifting could occur). The Attorney General's citation to Ms. Wright's hearing testimony in support of the position that no owner-member understood the cost shift when the MOU was signed is unhelpful as Ms. Wright was describing that they were unaware of the potential for cost shift <u>at the time of</u> Jackson Energy's 100% load factor election and prior to Jackson's withdrawal of that election, <u>some five years prior to the signing of the MOU</u>. *See also* Hearing Transcript (Carol Wright), May 16, 2018, 3:59:32 p.m. — 3:59:47 p.m. ("In my opinion, I believe that the CEOs knew that there was cost shifting if there was a total 15% take by any one cooperative…. We all agreed that that was the best that we could do.").

[7] *See* Wholesale Power Contract, South Kentucky Exhibit 9, page 1089 (requiring an owner-member, with respect to owner-member reorganizations, dissolutions or consolidations/mergers, not only 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]").

The significance of this silence is made clear by EKPC's concluding account of the "behind-closed-doors" arrangement struck between it and the other fifteen owner-member cooperatives on June 8, 2018. Specifically, EKPC and fifteen of the distribution cooperatives unanimously passed a resolution to deny South Kentucky its contractual rights and the benefits of an executed agreement and filed rate. As EKPC's brief recites, South Kentucky was not allowed to participate in the discussions leading up to the vote and passage of the described resolution. It is quite rich then for EKPC to profess a "genuine desire that this ongoing fifteen-year controversy be resolved by <u>unanimous agreement</u> of the EKPC family of cooperatives"[8] when not only did EKPC support South Kentucky throughout its pursuit of the alternate source designation—only to do an about face after South Kentucky filed its application—EKPC also excluded South Kentucky from the resolution development process.[9]

These points, together and individually, betray the veracity of intervenors' arguments. This case is not a "shame on us," "save us from ourselves" watershed moment for the Commission. This is not a case where customers of the other owner-member cooperatives face the prospect of an unavoidable or immitigable cost increase. Fifteen years ago, EKPC <u>and all of the owner-members</u> decided that the potential benefits presented by an opportunity to designate a portion of their wholesale requirements service for alternative supply outweighed the potential risks that such alternate sourcing might present. Nearly three years ago, EKPC <u>and all of the owner-members</u> reaffirmed that agreement, and that reaffirmation was memorialized and filed with this

[8] EKPC Brief, p. 44.

[9] *See* Response of Salt River Electric Cooperative Corporation to East Kentucky's Brief and Motion to Strike Page 43, line 6 Through Page 44, For Its Actions In Obtaining the Document Recited Therein, p. 8 (July 20, 2018) ("[W]hat's wrong is how EKPC handled this issue with a Board Members only meeting. Without [other attorneys] present one of EKPC's attorneys apparently convinced these Board members that they had no choice but to adopt some type of resolution that EKPC wanted.").

Commission as a tariff of EKPC.[10] This case is an opportunity for the Commission to validate the sanctity of contract and the fact that an eyes-wide-open entry into such a contract carries obligations that cannot be avoided by sheer force of will or number or regret.

As South Kentucky stated at the outset of its initial brief, the single question for this Commission is whether South Kentucky's application satisfies the applicable requirements of KRS 278.300. South Kentucky submits that the evidence proves this so, and that its application should be approved.

II. South Kentucky's Application Satisfies the Requirements of KRS 278.300

As previously identified by South Kentucky,[11] KRS 278.300 requires South Kentucky to demonstrate that the Morgan Stanley agreement is for a lawful object within South Kentucky's corporate purpose, is necessary and appropriate for and consistent with South Kentucky's provision of electric service to its members, does not impair South Kentucky's ability to provide electric service to its members, and is necessary and appropriate for providing electric service to its members.[12] As discussed in its initial brief, and as reiterated below, South Kentucky satisfies these requirements.[13]

Intervenors offer little, if any, challenge to South Kentucky's satisfaction of these statutory requirements. Instead, and in various ways, intervenors attempt to micromanage South Kentucky's business judgment by attacking the sufficiency of South Kentucky's analysis of the long-term

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

[11] *See* South Kentucky Initial Brief, pp. 39-42; Joint Intervenors Brief, pp. 6-10, EKPC Brief, pp. 16-18; Attorney General Brief, pp. 13-15.

[12] *In re Application of Kentucky Power*, Case No. 2013-00144, 2013 WL 5615904, at *6 (Ky. P.S.C. 2013) (citing the Commission's Order in Case No. 2009-00545).

[13] Application, pages 7-8; Direct Testimony of Dennis Holt, page 15, line 13 through page 14, line 2; Rebuttal Testimony of Dennis Holt, page 22, lines 4-5; Rebuttal Testimony of William S. Seelye, page 3, lines 14-21; South Kentucky Initial Brief, Section IV.

value of the PPA. They also try and confuse matters with their misinterpretations of the PPA or other instruments. The thrust of intervenors' opposition, however, is a press on the Commission to include two additional requirements as part of its review of the KRS 278.300 standards: a demonstration by South Kentucky of both a need and the absence of wasteful duplication, as those standards have been applied to investor-owned utilities seeking approval of a PPA.[14] As explained in its initial brief and underscored here, those standards, as applied in those cases, should not apply to South Kentucky's application. Nevertheless, even if they do, South Kentucky's agreement with Morgan Stanley satisfies them.

A. The Need and Wasteful Duplication Standards Do Not Apply to South Kentucky's Application

The Commission previously has applied the need and wasteful duplication requirements the intervenors seek to impose here to investor-owned utilities seeking approval of PPAs under KRS 278.300.[15] The intervenors would have the Commission take their applicability to a cooperative making a designation under Amendment 3 and the MOU as a given. But this is not so. First, and most obviously, neither of those cases dealt with the unique situation of a cooperative designating an alternate resource under the governing agreements. Second, but perhaps more instructive, when the Commission has considered the need and wasteful duplication standards in connection with a cooperative seeking a certificate of public convenience and necessity ("CPCN") as part of an Amendment 3 designation, its review was far different than what intervenors demand now.

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[14] Joint Intervenors Brief, pp. 7-8 & 39-41; EKPC Brief, pp. 17-21; Jackson Energy Brief, pp. 9-11; Nucor Brief, pp. 9-11; Attorney General Brief, pp. 13-15.

[15] *See, e.g.*, Joint Intervenor Brief, pp. 7-8 (citing *In re Application of Kentucky Power*, Case No. 2009-00545, 2010 WL 2640998 (K.y. P.S.C. 2010); EKPC Brief, pp. 17-18 (citing *In re Application of Kentucky Power*, Case No. 2013-00144, 2013 WL 5615904 (Ky. P.S.C. 2013) (hereinafter referred to collectively as the "*Kentucky Power Orders*").

The circumstances and underlying facts of the *Kentucky Power Orders* are materially different than those present here. In the *Kentucky Power Orders*, the Commission recognized that when an investor-owned utility such as Kentucky Power seeks to secure generation supply through the entry into a PPA, such a request should be considered a request by the utility for authorization to supplement <u>its existing portfolio of generation assets</u>, as if it were building a new resource.[16] In this way, the Commission could fully assess whether the addition of the generation, through the PPA, was fair to the utility's customers from a least-cost perspective and otherwise consistent with the governing statutory requirements.[17]

South Kentucky, as a distribution cooperative, occupies a role distinct from utilities like Kentucky Power. Indeed, South Kentucky's only source of supply is not its own—rather, it is the long-term Wholesale Power Contract under which EKPC is obligated to meet all of South Kentucky's requirements, except for that portion designated by South Kentucky for alternate source supply. Thus, the Morgan Stanley PPA does not supplement any generating capacity owned by South Kentucky, as South Kentucky has no generation to supplement.[18] The intervenors would have the Commission disregard this fact.[19] Intervenors argue that because South Kentucky is an owner-member of EKPC, South Kentucky's actions should be imputed to EKPC, and the application should be viewed as if EKPC were adding supplemental generating capacity.[20]

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[16] *In re Application of Kentucky Power*, Case No. 2009-00545, 2010 WL 2640998, pp. 4-5 (Ky. P.S.C. 2010); *see also In re Application of Kentucky Power Company*, Case No. 2013-00144, 2013 WL 5615904, at *6 (emphasis added).

[17] *In re Application of Kentucky Power*, Case No. 2009-00545, 2010 WL 2640998, pp. 4-5 (Ky. P.S.C. 2010). As the Commission recognized, the cost of energy from the proposed wind-power deal was "substantially above Kentucky Power's cost of generation …." *See id.*, p. 6.

[18] South Kentucky Initial Brief, pp. 39-40.

[19] Joint Intervenors Brief, pp. 8-9 & 39; Nucor Brief, pp. 10-11; Attorney General Brief, pp. 14-15.

[20] Joint Intervenors Brief, pp. 8-9 & 40-41; EKPC Brief, pp. 20-21; Nucor Brief, pp. 10-11; Attorney General Brief, pp. 14-15. In connection with this argument, intervenors note that South Kentucky does not file an IRP with the Commission, as its load is included in the IRP filed by EKPC.[20] *See, e.g.*, Nucor Brief, pp. 10-11. This fact is then used in an attempt to support the argument that South Kentucky's alternate source designation

Intervenors also argue that South Kentucky has failed to show that EKPC's provision of service is inadequate or unreliable.[21]

For the reasons discussed, these arguments should likewise fail. They are deficient for another reason, however, as they would call for the Commission to treat South Kentucky's PPA-based alternate source designation differently than it treated another alternate source designation. Specifically, the Commission has considered a request by one of the EKPC owner-members for a certificate of public convenience and necessity ("CPCN") to construct a distributed generation facility under Amendment 3, and the analysis employed by the Commission was a far cry from what intervenors say the law requires.

In 2015 (while the Grayson litigation was pending no less), Owen Electric sought a CPCN to construct a 2 MW natural gas-fired distributed generation facility.[22] In support of its request, Owen cited its ability under Amendment 3 to the Wholesale Power Contract to designate a source of supply other than EKPC.[23] The Commission approved the request.[24] In so doing, the Commission did not impute the request as being one by EKPC. Rather, the Commission assessed

cannot be viewed in a vacuum when analyzing the wasteful duplication requirements. Joint Intervenors Brief p. 9. The intervenors neglect to observe, however, that EKPC has known for the last fifteen years that up to 5% of its load was subject to alternate source designations, and with that knowledge, has maintained (until this proceeding) that the full 5% could be absorbed, let alone South Kentucky's portion. *See* Deposition of Anthony Campbell, South Kentucky Exhibit 7, page 49, lines 12-24 ("I mean I'm really not worried about let's say the 150 megawatts, our 5 percent … I mean I can certainly mitigate that."). In fact, EKPC addressed just such a possibility in its 2015 IRP. *See* Case No. 2015-00134, Staff Report on the Integrated Resource Plan of East Kentucky Power Cooperative, Inc., April 2016, at p. 56 (noting that "EKPC's exposure from Amendment 3 resources is stated as a maximum of 5 percent of its rolling three year peak load").

[21] Joint Intervenors Brief, pp. 39-40; EKPC Brief, pp. 19-20.

[22] *See In re Application of Owen Elec. Coop.*, Case No. 2015-00213, 2015 WL 6758433, at *1 (Ky. P.S.C.) (Oct. 30, 2015).

[23] *See id.* at *5 ("Owen Electric states that it can produce power for its members utilizing the DG Facility for less than it can purchase power from EKPC. Amendment 3 of the Wholesale Power Contract allows a member system of EKPC to serve up to 15 percent of its load from a power supplier other than EKPC.").

[24] *See id.* at *6.

whether Owen had shown a need for the facility, if it amounted to wasteful duplication, and if it was reasonable in terms of its impact on Owen's rates.[25] The conclusion warrants repeating:

> Having reviewed the record and being otherwise sufficiently advised, the Commission finds that Owen Electric has established a need to provide the lowest-cost power to its ratepayers and that the proposed DG Facility is the lowest reasonable-cost alternative to satisfy that need. We note that the proposed DG Facility is optimally sized to meet Owen Electric's load at the Bromley substation and has the shortest payback period of all the alternatives considered by Owen Electric. The Commission takes administrative notice of Case No. 2015-00267, wherein EKPC indicated that upon the closure of the Dale Generating Station in April 2016, EKPC's winter capacity would be approximately 650 MW short of its highest winter peak demand. As a result of its capacity deficit position, EKPC is currently requesting to acquire the 594 MW Bluegrass Generating Station. Further, in Case No. 2015-00134, we take administrative notice that EKPC projects a need to add 150 MW and 250 MW of intermediate/peaking capacity assets in 2016 and 2017, respectively. We note that the proposed DG Facility would enable Owen Electric to be relatively less dependent on EKPC for its capacity and energy needs, which in turn could enable EKPC to mitigate its planned future capacity needs. We further note that the DG Facility will allow Owen Electric and EKPC to diversify their generating portfolio and serve as a hedge against future CO_2 compliance costs.[26]

Thus, while the need issue was reviewed in connection with Owen's request for a CPCN, it was done so from the perspective of Owen's objective to provide lowest-cost power to its customers. Similarly, the question of wasteful duplication was examined against the fact that the facility "would enable Owen Electric to be relatively less dependent on EKPC for its capacity and energy needs," "could enable EKPC to mitigate its planned future capacity needs," and would "allow Owen Electric and EKPC to diversify their generation portfolio and serve as a hedge against future [carbon dioxide] compliance costs."[27] In short, in determining whether Owen had demonstrated a need and the absence of wasteful duplication in connection with its proposed alternate source designation, the Commission did not consider whether EKPC needed the

[25] *See id.* at *5.

[26] *Id.* at *5.

[27] *Id.*

generation, nor did it assess the quality or reliability of EKPC's service. Rather, it considered the same types of objectives that underlie South Kentucky's application here: the procurement of lower cost wholesale power, savings to its members, and diversity of supply.[28]

For the reasons offered in its initial brief and above, even if the additional requirements of "need" and the "absence of wasteful duplication" do apply in the context of a cooperative's designation of a PPA as an alternate source, South Kentucky has proven that its alternate source designation meets those requirements.[29] Contrary to the arguments of intervenors, South Kentucky is not creating its own need or in EKPC's words, fulfilling a mere desire.[30] Rather, it is exercising a contractual right to pursue cost savings and supply diversity for its members, in furtherance of its fiduciary duty to them. And having now made the alternate source designation, South Kentucky is obligated under the MOU to fulfill that designation from a source other than EKPC by the end of 2019. While the other owner-members and EKPC have offered to waive the requirement,[31] South Kentucky has no reason to abandon its designation or rely on any such (non-binding) offer of waiver. Such would certainly not inure to the benefit of its members.

Moreover, while the intervenors may be willing to interpret the MOU to suit their ends, the fact remains that the governing terms in place when South Kentucky made its election will, in accordance with the Filed Rate Doctrine, govern that election going forward. Thus, were the Commission to reject this application (a result South Kentucky does not believe the evidence or law supports), South Kentucky must return to the market to identify a new alternate source that addresses any deficiencies the Commission were to find. Those efforts would continue to be

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[28] Application, page 7; Direct Testimony of Dennis Holt, page 15, line 13 through page 16, line 2; Rebuttal Testimony of Dennis Holt, page 3, lines 6-11; South Kentucky Initial Brief, Section IV.

[29] South Kentucky Initial Brief, pp. 40-42.

[30] Joint Intervenors Brief, p. 40; EKPC Brief, pp. 19-20.

[31] *See* Joint Intervenors Brief, p. 40.

governed by Amendment 3 and the MOU, as they existed in November 2017. Contrary to what the intervenors claim, preventing South Kentucky from pursuing these measures (now or later) would indeed constitute a retroactive violation of a filed rate. The MOU was in full force and effect when South Kentucky made its election under the MOU, and this election cannot be retroactively denied without violating the Filed Rate Doctrine.[32]

B. South Kentucky's Application Satisfies the Remaining KRS 278.300 Standards

As addressed extensively by South Kentucky in its initial brief, South Kentucky's application, as supported by the evidence developed in this proceeding throughout discovery and the hearing, meets the KRS 278.300 standards for assuming an obligation of indebtedness.[33] The intervenors seem to suggest that South Kentucky expects the Commission to rubber stamp its application[34] solely because South Kentucky complied with the MOU.[35] These allegations are obviously without merit, a fact most simply evidenced by South Kentucky's submission of its application to the Commission and inclusion of a requirement in the PPA to pursue such an approval.[36] South Kentucky has not represented at any time during this proceeding that its

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[32] *See* Joint Intervenors Brief, p. 13. The Joint Intervenors also claim that South Kentucky cannot rely on the Filed Rate Doctrine because South Kentucky's proposed PPA is not a filed rate. *Id.* This observation completely misses the point. South Kentucky is not claiming that the proposed PPA is a filed rate. South Kentucky is asserting that the MOU is filed rate and that South Kentucky's election of alternately-sourced power under the MOU cannot be retroactively denied because of perceived problems that the Joint Intervenors may have with Amendment 3 and the MOU without violating the Filed Rate Doctrine.

[33] South Kentucky Initial Brief, Section IV.

[34] EKPC Brief, p. 13 ("South Kentucky contends in this proceeding that it entered into the PPA…in compliance with all the MOU requirements and, therefore, the Commission is bound to approve this transaction notwithstanding any statutory or regulatory burdens to the contrary.").

[35] EKPC Brief, p. 6 ("According to South Kentucky, the evaluation occurred when the Commission ordered that the MOU be filed in its Order dismissing the Grayson case, and the Commission now has no authority to question the merits of the Application."); Joint Intervenors Brief, p. 14 ("South Kentucky's reliance on Amendment 3 and the MOU when making its Alternate Source election and pursuing the PPA has no relevance to the Commission's review of the PPA. Neither Amendment 3 nor the MOU guarantee Commission approval of the PPA.").

[36] *See* Application, page 1; Application, Exhibit 7, Section 16(c); Application, Exhibit 8, Section 19(c).

application is beyond the Commission's jurisdiction to review. Furthermore, as noted above, the Commission has oversight over any future rate adjustment proposed by South Kentucky.

Intervenors also take aim at the analyses, studies, and other due diligence performed by South Kentucky, claiming that the Morgan Stanley agreement was insufficiently sensitized, myriad additional analyses were not performed, qualitative risks were not reduced to quantifiable numbers, risks were not properly understood or considered, and that too many unknowable variables exist to allow a finding that South Kentucky's application meets the requirements of KRS 278.300. It is telling that intervenors' arguments largely rehash pre-filed testimony and choose to ignore the points made by South Kentucky in its initial brief as to the adequacy of its due diligence and measured review of the Morgan Stanley PPA. In any case, the fact remains that South Kentucky and its Board of Directors, in their business judgment, and as informed by extensive analysis and discussion, believe the Morgan Stanley PPA provides the best option to secure cost savings to South Kentucky's members through the diversity of supply through an alternate source.

i. <u>Joint Intervenors' Procedural Claims Regarding the PPA Are Unfounded</u>

At the outset, South Kentucky must respond to two procedural claims by Joint Intervenors regarding matters addressed in the PPA related to the application's timely submittal to the Commission and the time period for obtaining Commission approval. First, Joint Intervenors allege that South Kentucky has already defaulted on its obligations under the PPA due to the fact that a final application was not accepted by the Commission until February 19, 2018.[37] Joint Intervenors claim that because this acceptance date falls after the forty-five-day requirement for

[37] Joint Intervenors Brief, pp. 26-27.

filing the PPA with the Commission,[38] South Kentucky is in breach of its obligations and has defaulted under the agreement. Yet, as has been a theme in this proceeding, Joint Intervenors' argument is predicated on their failure to correctly read the Morgan Stanley PPA.

The Master Agreement to the Transaction,[39] which is referenced in each of the Confirmations, states that an event of default only occurs with respect to the failure of a party to perform a material obligation under the agreement after such failure is not cured within three business days of notice of such failure.[40] While South Kentucky does not view the short delay in its filing acceptance (to correct an apparent defect in the filing timely made on January 30, 2018) as a failure to perform a "material" obligation, Morgan Stanley never issued a notice to South Kentucky regarding the delay. What's more, this immaterial procedural issue has been cured, as the agreement has now been filed, subject to hearing and, with this brief, goes before the Commission for approval. Accordingly, under the plain terms of the Master Agreement and PPA, no default has occurred with regard to the timing of the filing of South Kentucky's Application.

Second, Joint Intervenors argue that South Kentucky's failure to properly consider the implications of an appeal obligation in the PPA, as it relates to a separate early termination option included in the PPA, amounts to a less than full appreciation of its obligations under the PPA.[41] Like the filing-deadline argument above, this dispute serves no other reason than to distract from the merits. In the event the Commission denied South Kentucky's application, South Kentucky would discuss with Morgan Stanley the procedural options available and what appropriately should be pursued. Should an appeal be warranted, South Kentucky would consider that option,

[38] Application, Exhibit 7, Section 16(c).

[39] Application, Exhibit 5.

[40] Application, Exhibit 5, Section 5.1(c).

[41] Joint Intervenors Brief, pp. 25-26.

and the implications of pursuing or not pursuing it insofar as the PPA is concerned. But informed by the notice and cure requirements discussed above, the PPA does not automatically obligate South Kentucky to rush off and take an appeal should such not be in its interest. In short, there is no failure of "understanding or appreciation" here on South Kentucky's part. To the contrary, it is Joint Intervenors who fail to understand or appreciate the nature of South Kentucky's business arrangement with Morgan Stanley and the obligations it places on the respective parties.

ii. Joint Intervenors Misinterpret the Credit Facility Requirements and Related Agreements

Joint Intervenors make several claims regarding South Kentucky's pursuit of credit facilities required by the PPA, one of which is a newly launched "Catch-22" theory. Like all the other arguments, this too springs from a host of assumptions and mischaracterizations of relevant agreements. The theory goes like this: if South Kentucky secures a new line of credit from National Rural Utilities Cooperative Finance Corporation ("CFC") for purposes of the PPA, and if the terms of that facility are exactly the same as South Kentucky's existing revolving facility with CFC, and if South Kentucky has a credit event that requires it under the Collateral Annex to draw on the aforementioned new line of credit, then CFC actually would not be obligated to extend support, because South Kentucky's credit event also would have placed it in default of its November 1, 2016 RUS Loan Contract, and under the new line of credit, with the assumed terms, South Kentucky cannot be in default of an agreement at the time of an advance under the line of credit.[42]

[42] *See* Joint Intervenors Brief, pp. 19-20.

In constructing this hypothetical conundrum, Joint Intervenors gloss over Section 5.4 of the RUS Loan Contract.[43] It is true that the credit event definition in the Collateral Annex tracks the Coverage Ratio requirements of Section 5.4(b) of the RUS Loan Contract; however, a failure to meet these metrics, on its own, does not automatically result in a default under the RUS Loan Contract.[44] Section 5.4(f) requires South Kentucky to provide a written plan setting forth actions to be taken to achieve the Coverage Ratios on a timely basis within thirty days of sending or receiving notice that South Kentucky is not meeting the Coverage Ratios.[45] Section 5.4(g) further provides that if such a plan is not developed and implemented by South Kentucky, a default occurs only if South Kentucky does not cure the breach (i.e., develop and implement the correctional plan) within thirty days of notice from RUS.[46] Thus, the occurrence of a credit event does not automatically lock South Kentucky out of its line of credit (assuming for discussion Joint Intervenors' assumptions are correct). Rather, South Kentucky would have to affirmatively disregard its obligations under Sections 5.4(f) and (g) of the RUS Loan Contract—for a period of months—before it found itself in Joint Intervenors' Catch-22.

Joint Intervenors also argue that South Kentucky's failure to execute an agreement regarding its credit facilities before executing the PPA with Morgan Stanley opens South Kentucky up to considerable risk, as it does not know the availability or terms of the credit facility.[47] These concerns are belied by the evidence. First, as indicated by Joint Intervenors, South Kentucky plans to meet its collateral requirements under the PPA through either a master letter of credit or a line

[43] Response of South Kentucky to Distribution Cooperatives Post-Hearing Information Request, Exhibit DCPH-1 ("RUS Loan Contract").

[44] RUS Loan Contract § 5.4.

[45] RUS Loan Contract § 5.4(f).

[46] RUS Loan Contract § 5.4(g).

[47] Joint Intervenors Brief, p. 18.

of credit. As reflected in communications between South Kentucky's CFO, Michelle Herrman, and CFC, South Kentucky would be able to obtain a $45 million master letter of credit without a formal review process.[48] In addition, in November of 2017, through discussions with CFC and CoBank prior to the execution of the PPA, South Kentucky became comfortable with the potential terms that the credit facilities could take.[49] Moreover, if Joint Intervenors' assumptions for its Catch-22 theory are believable,[50] then South Kentucky's expectations, predicated on both its historical experience with CFC as well as actual discussions in connection with the PPA, must be equally reasonable, if not more so.

Finally, Joint Intervenors accuse South Kentucky of attempting to skirt Commission review by ensuring that any credit facility that it executes is for a term of less than twenty-four months.[51] Joint Intervenors similarly disparage South Kentucky for "not even mention[ing] Commission review of that credit facility on its timeline for the transaction."[52] Rhetoric aside, Joint Intervenors opt not to mention South Kentucky's own data response to them, where it was noted that although a master letter of credit could have a term of up to five years,[53] the normal course of business among cooperatives is to utilize shorter-term borrowing facilities of less than twenty-four months.[54] More importantly though, South Kentucky has made clear from the beginning (and in

[48] *See* Response of South Kentucky to Distribution Cooperatives Supplemental Request for Information, Attachment DC#2-42 (Public), p. 22.

[49] *See id.*, pp. 17-20.

[50] Joint Intervenors Brief, pp. 18-19.

[51] *Id.*, p. 18.

[52] *Id.*

[53] Response of South Kentucky to Distribution Cooperatives First Request for Information, Attachment DC#1-3 (Public), p. 7. It is also worth noting that in this same communication between Ms. Herrman and CFC, CFC acknowledged that a term exceeding twenty-three months would require Commission review.

[54] Response of South Kentucky to Distribution Cooperatives Supplemental Request for Information, Item 31a.

data responses to the Joint Intervenors) that it would seek Commission approval for any credit facility having a term exceeding twenty-four months.[55] And as South Kentucky has observed throughout this proceeding, the actions it takes relative to the Morgan Stanley PPA are not insulated from future Commission review, in connection with any rate case that the cooperative brings forth to the Commission.

In sum, South Kentucky has been open and transparent regarding the requirements of the Collateral Annex and its intentions with regard to credit facilities it intends to utilize. Joint Intervenors' arguments in no way call into question the merits of the Morgan Stanley transaction or South Kentucky's compliance with the applicable KRS 278.300 standards.

iii. <u>The Environmental Change in Law Provisions Do Not Pose an Unreasonable Risk to South Kentucky</u>

The Environmental Change in Law ("ECL") provisions of the Morgan Stanley PPA afford Morgan Stanley a very limited opportunity to adjust the fixed energy cost (assuming Morgan Stanley demonstrates compliance with the ECL provisions). South Kentucky explained at length in its initial brief the manner by which these provisions operate and the actual risks they pose.[56] Intervenors, however, continue to frame the ECL provisions as limitless opportunities for Morgan Stanley to modify the price ("drive a truck through"), under the belief that the ECL provisions are the means by which Morgan Stanley has taken advantage of South Kentucky, which is "merely a distribution cooperative."[57]

South Kentucky showed in its initial brief why the ECL provisions appearing in the Capacity Hedge Confirmation cannot be used to modify the capacity hedge price. Nevertheless,

[55] Response of South Kentucky to Distribution Cooperatives First Request for Information, Item 10c.

[56] South Kentucky Initial Brief, pp. 35-37.

[57] Attorney General Brief, p. 17.

Joint Intervenors wholly avoid South Kentucky's explanation and instead continue to advance the same tired arguments. The fact remains, however, that 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 (i.e. Firm LD Energy from the PJM market and a financial capacity hedge) paid for by South Kentucky to be increased.[58] 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.[59] Those components do not include any reference to or incorporation of Additional Environmental Costs or a recalculation of the components in the event of such costs.[60] By comparison, South Kentucky and Morgan Stanley did include a provision expressly allowing for recalculation of the Floating Price 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.[61] Accordingly, South Kentucky maintains that a proper reading of the Capacity Hedge Confirmation requires the conclusion that the ECL provisions there constitute surplusage.[62]

Intervenors also continue their attack on the ECL provisions in the PPA, claiming that the risks of the cost increases allowed by these provisions have been underestimated and misunderstood by South Kentucky. These arguments fail for at least two reasons. First, the arguments neglect to give meaning to the PPA Confirmation in its entirety or the surrounding realities of the transaction. Joint Intervenors, for example, claim that Morgan Stanley's obligation

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[58] Application, Exhibit 8, Section 23.

[59] *Id.*, Section 8; *see also* Response of South Kentucky to EKPC's Supplemental Requests for information, Item 36c.

[60] Application, Exhibit 8, Section 8.

[61] *Id.*, Section 21.

[62] South Kentucky Initial Brief, p. 37.

to take commercially reasonable efforts to avoid any additional environmental costs does not include the requirement to explore the PJM market in order to avoid such costs.[63] Joint Intervenors argue that because the PPA does not "list those actions as obligations," Morgan Stanley has no such obligation.[64] This represents a fundamental misunderstanding of basic contract law. Parties to a contract do not have to list every single action that comprises "commercial reasonable efforts" to know what constitutes a commercially reasonable undertaking.[65] Because Morgan Stanley would be advocating a change to the PPA, it would have to show that it had undertaken commercially reasonable efforts to avoid the cost increase. And in providing energy from the PJM market, any efforts that did not consider the purchase of energy through the PJM market itself would be less than "unreasonable," they would be commercially illiterate.

At the risk of redundancy, South Kentucky would emphasize that the PPA is not tied to any single generating facility, but instead is an agreement with Morgan Stanley that it will provide 58 MW of Firm LD Energy to South Kentucky from the PJM market. Unlike "unit sales" agreements, the Morgan Stanley PPA does not designate a specific generating resource that it would later point to in seeking to recover capital costs. Morgan Stanley always has the option of purchasing PJM market energy for resale to South Kentucky under the PPA.

A similar criticism from intervenors is their insistence that the overly broad language in the PPA Confirmation will allow Morgan Stanley to recover capital investments through the ECL provisions.[66] But contrary to the arguments of intervenors, the operative provisions are relatively inflexible in terms of what costs can be passed through to South Kentucky. Specifically, the

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[63] Joint Intervenors Brief, p. 21.

[64] *Id.*

[65] *See e.g.*, Application, Exhibit 5, Section 5.2 (stating that in establishing a termination price for default purposes, the parties do not have to actually go out and enter into a transaction).

[66] EKPC Brief, pp. 25-26; Joint Intervenors Brief, pp. 21-22.

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 affected unit and avoid the cost. Moreover, because the PPA does not require or permit Morgan Stanley to point to any generator as the "source" for its required deliveries—which at 58 MW on a 24/7/365 basis, could not be borne by a single generator—the notion that Morgan Stanley could successfully pass the costs of capital improvement made on a single generating facility through this clause is a stretch the language will not bear.

South Kentucky readily admits that capital investments often translate into price risk. In South Kentucky's view, the PPA adequately insulates it from this risk, as detailed throughout South Kentucky's pleadings. If, despite these protections, the Commission remains concerned, there are reasonable, constructive courses available that can further mitigate this issue. First, the Commission can, as part of an order on this application, affirm South Kentucky's view of the document. While such a finding would not be binding on a future adjudicator as part of a future dispute, it certainly would be instructive, given the evidence in this proceeding and the robust opportunity afforded the Commission to consider the issue. Second, the Commission can condition its approval on Morgan Stanley and South Kentucky acknowledging in a mutual writing that the ECL provisions do not encompass capital expenditures.[67]

The arguments of intervenors characterizing the ECL provisions as overly risky to South Kentucky and detrimental to the value of the transaction likewise fail to properly consider the

[67] KRS 278.300(4) ("The commission may grant or deny the application in whole or in part, or may grant it with such modifications and upon such terms and conditions as the commission deems necessary or appropriate.").

corresponding impact new environmental laws will have on the costs of energy under the Wholesale Power Contract. Joint Intervenors claim that there is no evidence that Morgan Stanley will undertake the same due diligence and forecasting EKPC plans to take in preparing for potential new environmental laws, and, therefore, the risks to South Kentucky under the PPA are greater than those under the Wholesale Power Contract.[68] Joint Intervenors further state that because EKPC does not pass through new charges until it undergoes a rate case, South Kentucky is "buffered" from such exposure under the status quo. In like vein, the Attorney General argues that equating the risk to South Kentucky under the Wholesale Power Contract and the Morgan Stanley PPA "*strikingly* illustrates that SKRECC simply does not comprehend the risk its members face under the PPA."[69]

The only striking component of these arguments is intervenors' refusal to accept the realities of the comparative potential for environmental cost increases under the Wholesale Power Contract. The EKPC system is overwhelmingly reliant on coal-fired generation. Greenhouse gas-emitting generators are indisputably the target of the bulk any foreseeable environmental laws or regulations. Any additional environmental costs incurred by EKPC to comply with new environmental requirements will be passed through to the owner-members.[70] In contrast, as discussed above, Morgan Stanley is unable to pass along additional costs related to capital investments. Moreover, Morgan Stanley's delivery obligation is not tied to any single generation source but, rather, a range of resources, including renewable energy sources and market energy. To the extent Morgan Stanley faces such costs, it must try and avoid them. Only when Morgan

[68] Joint Intervenors Brief, p. 23.

[69] Attorney General Brief, p. 17 (emphasis in original).

[70] Hearing Transcript (Don Mosier), May 16, 2018, 5:41:45 p.m. — 5:41:57 p.m. (noting that cost increases experienced by EKPC are reflected in base rates during any rate increase).

Stanley actually incurs such costs and cannot, using commercially reasonable efforts, minimize the passage of them to South Kentucky may the fixed energy price change. In such a situation, however, EKPC, the PJM market, and likely the entire nation can be expected to be facing similar cost pressures (e.g., the passage of a national or regional carbon or greenhouse gas tax). Thus, the likelihood that an event affects Morgan Stanley alone, or generation in the PJM market <u>but not EKPC</u>, is remote.

Furthermore, the fact that EKPC will not pass any costs along to the owner-members "unless and until EKPC files for and is rewarded a rate increase"[71] does not diminish the reality, agreed to by Mr. Mosier, that EKPC will be made whole for the costs that it incurs.[72] To the extent that EKPC incurs additional costs related to an ECL, those costs will eventually be recovered by EKPC. While there may be a timing difference in the cost pass-through,[73] South Kentucky cannot reasonably be asked to assume that EKPC will not seek to recover its costs.

South Kentucky and its Board of Directors considered the possibility of the ECL provisions resulting in adjustments to the fixed energy price in the PPA.[74] South Kentucky has properly evaluated this risk, recognizing that its costs under the Wholesale Power Contract will likely be increased at least at the same rate as any increases to the firm energy price in the PPA. Intervenors' ECL arguments do not change this fact, nor do they refute South Kentucky's deliberate and

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[71] Joint Intervenors Brief, p. 23.

[72] Hearing Transcript (Don Mosier), May 16, 2018, 5:41:45 p.m. — 5:41:57 p.m. (noting that cost increases experienced by EKPC are reflected in base rates during any rate increase); *see also* Hearing Transcript (Mike McNalley), May 16, 2018, 6:58:55 p.m. — 6:59:21 p.m. (noting that rate increases would be utilized to keep EKPC whole and so long as the increased costs could be supported, such rate increases would likely maintain EKPC's credit ratings).

[73] Hearing Transcript (Carter Babbit), May 16, 2018, at approximately 9:49:10 a.m.

[74] Response of South Kentucky to Distribution Cooperatives First Request for Information, Item 4 and Attachment DC#1-4 (Public), pp. 38-39; Response of South Kentucky to Commission Staff's First Post-hearing Request for Information, Item 3, Exhibit PHPSC-1.

reasonable conclusion that the alternate source designation is the best option for fulfilling its corporate purpose to provide efficient, reliable, and safe electric service to its members.

iv. South Kentucky's Analyses Adequately Consider Risk and Support Approval of the Application

Intervenors raise a myriad of issues related to the analyses upon which South Kentucky and its Board of Directors relied to make the alternate source designation and enter into the Morgan Stanley transaction. These arguments are incorrect, incomplete, or both. Before turning to these points, however, South Kentucky would (for completeness) note that intervenors also raise a number of non-issues, ostensibly to obfuscate the Commission's consideration of the salient facts. For example, Joint Intervenors claim that South Kentucky's failure to execute the agency agreement prior to submitting its application constitutes error detrimental to South Kentucky's application.[75] As reflected in South Kentucky's initial brief (of which Joint Intervenors make no mention),[76] South Kentucky's decision to wait to execute the agency agreement reflects South Kentucky's desire to proceed with its members' interests in mind.[77] Additionally, as it is EKPC's (or its agent's) duty under the MOU to provide such services,[78] South Kentucky does not foresee this to present any risk to the alternate source designation.[79] The Attorney General also seems to indicate that South Kentucky failed to include capacity costs in its analysis of the proposed transaction, supporting the Attorney General's position that all the costs associated with the

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[75] Joint Intervenors Brief, pp. 29-30.

[76] South Kentucky Initial Brief, pp. 37-38.

[77] *Id.*

[78] 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.").

[79] *See infra* p. 24, n.79. Additionally, the cogeneration tariff upon which the agency fee is based has recently been reduced by EKPC, which will likely result in lower costs to South Kentucky under the agency agreement. *See* Hearing Transcript (Dennis Holt), May 15, 2018, 11:29:50 a.m. — 11:30:30 a.m.

transaction were not considered.[80] This claim is baseless. The net present value ("NPV") analyses provided by EnerVision explicitly include the capacity costs associated with the transaction for every year of the transaction.[81]

Intervenors frequently target the NPV analyses. The general thrust of the direct attacks is that South Kentucky failed to account for certain factors, used erroneous information, or neglected to sensitize for all possible scenarios. On this last point, South Kentucky <u>also</u> receives criticism for the fact that the sensitivities it did run produced differing results.[82] Thus, South Kentucky is faulted for both running sensitivities and not running sensitivities. This reproach is indicative of intervenors' view of the case. There can be no path to 'yes,' even if closing off those paths requires the adoption of wholly contradictory,[83] or self-defeating positions.[84]

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[80] Attorney General Brief, pp. 17-18. To the extent the Attorney General was referring to the inclusion of agency costs associated with the purchase of the capacity necessary for the transaction were not included, that claim is wrong as well. South Kentucky has included the costs of the agency agreement throughout the proceeding. *See* Rebuttal Testimony of Carter Babbit, page 16, line 12 through page 17, line 2.

[81] Response of South Kentucky to EKPC's First Request for Information, Item 26 & Attachment EKPC#26. A final example is Joint Intervenors' observation that Mr. Holt did not use the term "risk" in his rebuttal testimony and associated claim that South Kentucky has brought a "naïve and uninformed approach to the $400 million, 20-year transaction presented to the Commission for approval." Joint Intervenors Brief, p. 31. Such a statement (predicated on word selection in rebuttal testimony no less) <u>completely ignores</u> the fact that South Kentucky analyzed the value of the Morgan Stanley arrangement against the expected costs it would pay, over the same period, as part of its remaining <u>thirty-three-year commitment</u> to receive supply exclusively from EKPC, absent the alternate source designation. *See* Wholesale Power Contract, Amendment 4; *see also* Response of South Kentucky to EKPC's First Request for Information, Item 26 & Attachment EKPC#26; Response of South Kentucky to Distribution Cooperatives First Request for Information, Item 4 and Attachment DC#1-4 (Public), pp. 1-42; Response of South Kentucky to Commission Staff's First Post-hearing Request for Information, Item 3, Exhibit PHPSC-1.

[82] EKPC Brief, p. 5.

[83] Take for example, the need and wasteful duplication arguments, which as cast by intervenors, render Amendment 3 and the MOU a nullity. *See* South Kentucky Initial Brief, pp. 39-41; EKPC Brief, p. 44 ("[EKPC] recognizes that the Commission may very well conclude that there are very few, if any, Alternate Source elections under Amendment 3 and the MOU as written that will ever withstand Commission scrutiny on their individual merits."). In any event, those arguments, even if applicable, fail in light of the Commission's precedent respecting Owen Electric's alternate source designation. *See In re Application of Owen Elec. Coop.*, Case No. 2015-00213, 2015 WL 6758433, at *5 (Ky. P.S.C.) (Oct. 30, 2015); *see also supra* pp. 9-11.

[84] *See infra* Section III.

EKPC points to errors in the original NPV analysis performed by EnerVision, suggesting that the mere presence of these errors amounts to some fundamental misunderstanding of the transaction.[85] Yet South Kentucky corrected for these errors, and as demonstrated by the updates, they did not have a material impact on the inherent value of the transaction.[86] Rather, South Kentucky reasonably expects to save its members between $77 million and $110 million, over the course of the twenty-year term of the PPA, as compared to continuing to receive all of its wholesale supply from EKPC.[87] Not surprisingly, South Kentucky's Board of Directors found the changes to not affect their decision to proceed with the agreement.[88]

For their part, intervenors attempt to impugn the likelihood of South Kentucky realizing these savings. The primary claim (in terms of its alleged impact of savings) is that South Kentucky did not factor an assumption that it would be paying higher transmission costs as a result of the arrangement. Although South Kentucky and the intervenors have engaged in a robust examination as to whose escalation assumptions are more indicative of actual future increases, an important predicate fact must be remembered. Whatever the annual percentage escalation, <u>the transmission costs borne by EKPC and passed on to owner-members now are the same transmission costs that South Kentucky faces for its portion of transmission service under the PPA</u>.[89] The only cost

[85] EKPC Brief, pp. 29-33.

[86] *See* Rebuttal Testimony of Carter Babbit, page 15, lines 12-13; Response of South Kentucky to Commission Staff's First Post-hearing Request for Information, Item 3, Exhibit PHPSC-1.

[87] *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 Post-hearing Request for Information, Item 3, Exhibit PHPSC-1; Hearing Transcript (Dennis Holt), May 15, 2018, at approximately 10:14 a.m.

[88] Hearing Transcript (Carter Babbit), May 16, 2018, 12:04:55 p.m. — 12:06:00 p.m.

[89] Hearing Transcript (Don Mosier), May 16, 2018, 5:40:58 p.m. — 5:41:56 p.m.; Joint Intervenors Brief, p. 38 ("EKPC, on the other hand, also incurs these costs, but those costs do not carry over into rates unless and until EKPC files for and is awarded a base rate increase.").

difference results from regulatory lag—the time between PJM increases and EKPC rate increases.[90]

Thus, whether transmission costs increase at a 3% or 8% or 13% level, the impacts to South Kentucky manifest (for purpose of savings under the Morgan Stanley agreement) only when EKPC neglects to recover its costs. Intervenors seemingly would have the Commission think there will be infrequent recovery.[91] Yet in the spirit of continuing contradiction, EKPC admits that it will recover its costs and will do so with a rate case,[92] as soon as June 1, 2019.[93] Thus, South Kentucky's exposure here is not what the intervenors would have the Commission believe[94]—an important context for the future transmission cost debate that has raged throughout this proceeding.

In this regard, the proposed 13% escalation factor for network integrated transmission service ("NITS"), as used by EKPC's Mr. McNalley,[95] is wholly unreasonable.[96] As Mr. Babbit explained, data from PJM's Transmission Cost Information Center ("TCIC") actually supports an annual escalation in NITS charges lower than the 3% used by EnerVision.[97] Intervenors claim that reliance on the TCIC is an "apples-to-oranges" comparison because it only projects out ten years and does not include, as noted by Mr. Babbit,[98] the full NITS cost picture.[99] The length of the

[90] Hearing Transcript (Carter Babbit), May 16, 2018, at approximately 9:49:10 a.m.

[91] Joint Intervenors Brief, pp. 38-39.

[92] Hearing Transcript (Don Mosier), May 16, 2018, 5:40:58 p.m. — 5:41:56 p.m.

[93] EKPC Response to South Kentucky's Requests for Information, Item 42a.

[94] Joint Intervenors Brief, pp. 36-39; EKPC Brief, p. 35; Jackson Brief, p. 13.

[95] EKPC Brief, p. 32; Joint Intervenors Brief, p. 37.

[96] Rebuttal Testimony of Carter Babbit, page 13, line 9 through page 14, line 11. Note also that while Mr. McNalley's analysis uses a 10% NITS escalation factor for the Morgan Stanley PPA, the corresponding EKPC rate (which includes the same NITS charges) escalates at only 2% in his analysis. *See* Direct Testimony of Mike McNalley, Exhibits MM-2 & MM-3.

[97] *Id.*

[98] Rebuttal Testimony of Carter Babbit, page 14, lines 9-11.

[99] Joint Intervenors Brief, p. 37.

projection of course has no bearing whatsoever on its appropriateness for use. If the information were unreliable, PJM would not be publishing it for market members and participants to incorporate into their operations and projections. As to the apples-and-oranges claim, that too is misplaced. As noted by Mr. Babbit,[100] despite not being a comprehensive list of all NITS costs, the NITS information included in the TCIC reflects the current costs and major transmission projects that represent the main drivers of costs increases related to transmission in PJM. The TCIC is also intended by PJM to be used as a tool for PJM stakeholders to better understand and estimate their future transmission costs. Therefore, while Mr. Babbit's candid acknowledgment that the information did not contain "the full NITS cost picture" is correct, the delta is far less dire than intervenors would have the Commission believe and certainly does not present incomparable data. In any case, the data offers a valid set of future data upon which to rely.[101]

Finally, EKPC challenges South Kentucky's NPV sensitivities for their use of EKPC's Long Range Financial Forecast ("LRFF"), a constant fuel adjustment charge ("FAC") rate, and the inclusion of environmental surcharge savings. EKPC claims these analyses are unreasonable and have been offered purely to "restore the value of the original claimed savings."[102] These arguments, however, are nothing more than another series of intervenors' no-win scenarios that provide no real rebuttal to South Kentucky's evidence. As for the LRFF, South Kentucky struggles

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[100] Rebuttal Testimony of Carter Babbit, page 13, line 9 through page 14, line 11.

[101] Intervenors also criticize the NPV's escalation for Transmission Enhancement Cost Recovery ("TECR"), substituting a 14% escalation factor instead of the 2% escalation used in EnerVision's analysis. *See* EKPC Brief, pp. 31 & 36. Mr. Babbit explained that a 14% escalation factor fails to recognize the conversion to dollars per MWh used in the TECR prices in the PJM State of the Market reports. *See* Rebuttal Testimony of Carter Babbit, page 14, line 13 through page 15, line 10. Instead of even attempting to refute this explanation, EKPC resorts to disparaging South Kentucky for waiting to include this explanation in its rebuttal testimony. *See* EKPC Brief, p. 36. Yet, South Kentucky had no need to provide this elaboration until EKPC chose to pursue an attack based on an incorrect calculation and a misunderstanding of the data.

[102] EKPC Brief, pp. 33-36 & 37. As noted above, apparently the only sensitivities South Kentucky is allowed to run are sensitivities that sink the Morgan Stanley agreement.

to see the fault in using EKPC's most recent, Board-approved financial forecast.[103] Indeed, had South Kentucky or EnverVision crafted its own, EKPC most surely would be claiming that South Kentucky had disregarded EKPC's issued forecast for one that suited its own needs. Use of a constant value for the FAC likewise is reasonable, as it conservatively reflects the expected fuel-related impacts of the alternate source designation (given that the LRFF projects the FAC moving from a credit to an expense in 2019).[104]

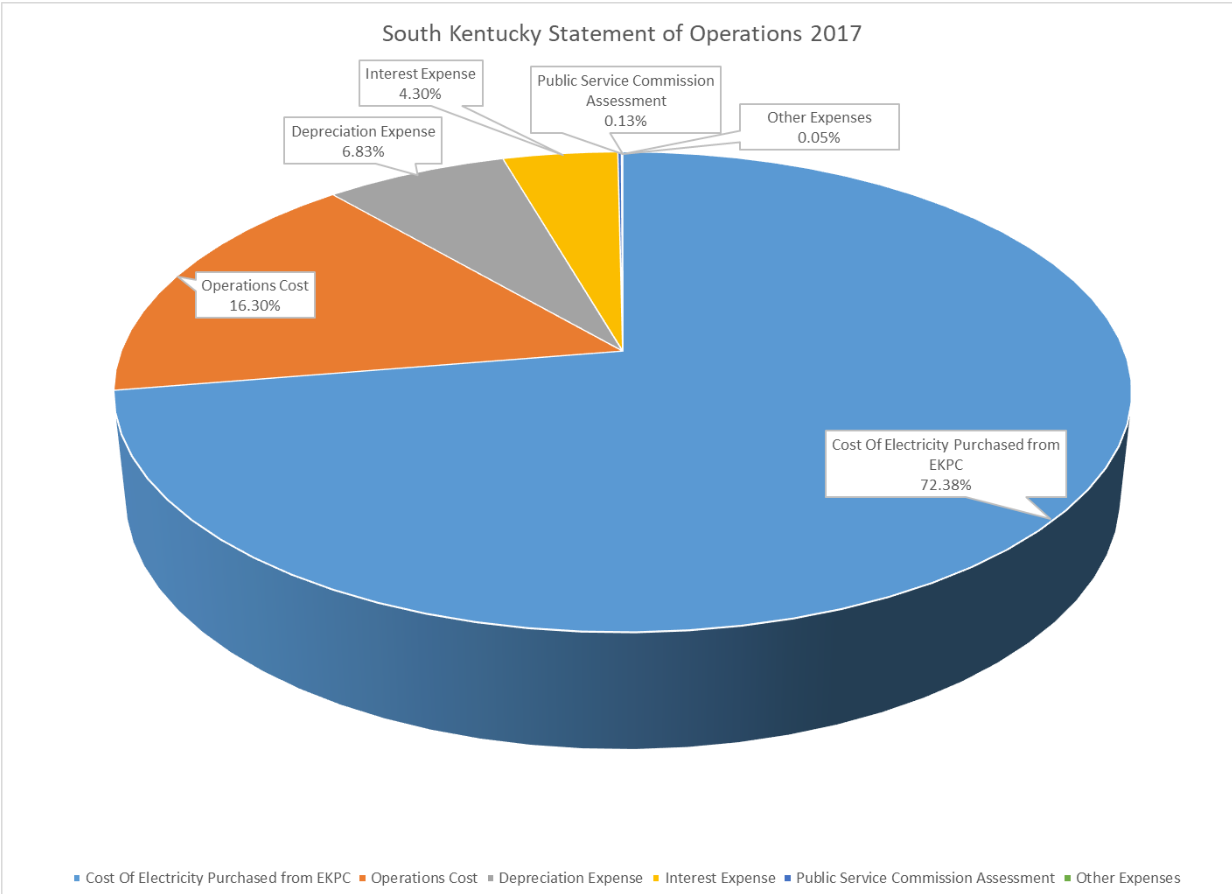
Lastly, EKPC's objection to South Kentucky's modeling of environmental surcharge savings again strays into double-speak, given that EKPC's brief opens with a recitation of the cost-shifting that may occur under that rate mechanism as a result of South Kentucky's alternate source designation. Numerous pages of intervenors' briefs stress the fact that much of the savings to be realized—and it is a significant amount of savings—stems from the environmental-related costs that South Kentucky will avoid through its alternate source designation. Yet, when South Kentucky attempts to reflect those dollars in a sensitivity, it is accused of wrongdoing. In short, and leaving aside the Filed Rate Doctrine implications of the cost-shifting issue (as discussed below), it is difficult to understand how EKPC can credibly attempt to challenge South Kentucky's correction to Mr. McNalley's flawed analysis. There is nothing wrong with Mr. Babbit's inclusion of those savings in his sensitivity, as it enables the Commission to evaluate the value of the Morgan Stanley PPA while at the same time providing the proper context for Mr. McNalley's calculations.

Intervenors can mount all the unfounded criticisms they wish, but the fact remains that South Kentucky reasonably expects to save its members between $77 million and $110 million

[103] Rebuttal Testimony of Carter Babbit, page 12, lines 13-23.

[104] *Id.* at page 12, lines 4-9.

over the term of the Morgan Stanley agreement. These savings are significant, particularly given the portion of South Kentucky's overall operating expense occupied by purchase power costs.[105]



As noted in South Kentucky's initial brief, analyses can be constructed to eliminate the value of the transaction. The prospect of those scenarios arising are unlikely, however, and do not provide a sufficient reason for South Kentucky to abandon the transaction. Similarly, the quality of a decision always will be dependent on the quality of the information available. Yet over the course of this proceeding, South Kentucky and its Board of Directors actually have had the luxury of having the information underlying the Morgan Stanley transaction vetted and tested on an order of magnitude rarely experienced.

[105] *See* South Kentucky 2017 Annual Report, *available at* http://skrecc.com/annualreport.pdf.

Is the arrangement risk free? No, but nothing is. Has the arrangement already defied the expectations of the naysayers? Yes, as PJM's base residual auction cleared at $140/MW-day, nearly double what EKPC told the Commission to expect.[106] In the business judgment of South Kentucky and its Board of Directors,[107] and based on all the information before both, does the Morgan Stanley PPA continue to represent the optimal solution for providing South Kentucky a means to reduce its wholesale power costs, as compared to what it pays today? Yes, it does.

v. An EKPC Rate Re-Design Analysis Is Not Required

A final tack of intervenors' warranting attention[108] is the constant criticism of South Kentucky's due diligence, insofar as it failed to include sensitivities reflecting a hypothetical move by EKPC, at some unknown point in the future, from undergoing a rate redesign to create purely cost-based rates for the owner-members.[109] The problems with these claims are several.

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[106] South Kentucky Initial Brief, p. 22 & p.22 n.75 (noting that the PJM 2021/2022 Reliability Pricing Model Base Residual Auction ("BRA") cleared at $140/MW-day for the zone comprising EKPC, which is $15/MW-day above South Kentucky's capacity hedge price and well above Mr. Mosier's expected outcome.). *See also* 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.").

[107] *In re Application of South Kentucky*, Case No. 2008-00371, 2010 WL 1938172, at *2 (Ky. P.S.C. 2010); *but see In re East Kentucky Power Coop.*, Case No. 2008-00436, 2008 WL 6691449, at *3 (Ky. P.S.C. 2008) ("Ultimately, the responsibility for East Kentucky's viability lies firmly within the province of its board of directors, 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.").

[108] Given the breadth of the record in the proceeding, while South Kentucky has endeavored to reply to all colorable arguments levied by intervenors, the absence of a specific response to each argument included in the briefs should by no means be viewed as a concession by South Kentucky. To the contrary, South Kentucky believes that all arguments offered in opposition to its satisfaction of the Commission's standards are meritless or beside the point. To that end, South Kentucky maintains that its application meets all Commission requirements and should be approved.

[109] Joint Intervenors Brief, p. 34; NUCOR Brief, pp. 1 & 12; Attorney General Brief, pp. 18-20; EKPC Brief, p. 41.

Most notably, such an exercise would constitute an undertaking beyond South Kentucky's capabilities, including a system-wide evaluation[110] of specific, individual member system data.[111] Mr. McNalley testified that to gather the appropriate data for such an effort, EKPC itself would have face-to-face meetings with owner-members to discuss the details inherent in such a rate redesign.[112] Despite taking South Kentucky to task for not endeavoring to pursue such a course, Mr. McNalley testified that EKPC has neither analyzed nor even considered what such a rate redesign might look like.[113] Thus, assuming for the sake of argument that EKPC would have made some of this data available to South Kentucky had it asked,[114] it is clear that South Kentucky could not have properly identified some yet-to-be-determined rate structure that EKPC might impose in the future (and certainly not one that intervenors would not have immediately pounced on as flawed, incomplete or self-serving).

The Attorney General observes that South Kentucky's witness Mr. Seelye recognizes that the economics of the Morgan Stanley transaction may change as a result of a cost-based rate redesign.[115] The Attorney General then points to the cost-based rate structure used by Kentucky Power to argue that South Kentucky should expect an erosion of its savings in the event EKPC adopts the same rate structure.[116] While the mathematics of the Attorney General's argument may be correct, the argument hardly gives South Kentucky or, more importantly, this Commission a clear picture of what is actually to come (and by extension, how the Morgan Stanley transaction

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[110] Hearing Transcript (Mike McNalley), May 16, 2018, 7:58:10 p.m. — 7:58:25 p.m.; 8:00:00 p.m. — 8:00:16 p.m.

[111] *Id.*.7:58:49 p.m. — 7:59:30 p.m.

[112] *Id.*, 8:01:00 p.m. — 8:02:25 p.m.

[113] *Id.*, 7:57:30 p.m. — 7:58:10 p.m.

[114] *Id.* at approximately 8:00:45 p.m.

[115] Attorney General Brief, p. 19.

[116] *Id.*, at pp. 19-20.

would fare in such a new world). As with their "fairness" arguments that are discussed later in this brief, intervenors' rate redesign efforts seem very short-sighted, and presume that a number of customers and owner-members benefitting from the current system will sit idly by and allow EKPC to transition to a fully cost-based structure.

Intervenors would have the Commission believe that to meet the KRS 278.300 standard requires South Kentucky to "guarantee that [South Kentucky's members] would see savings under the proposed transaction."[117] Thankfully, such a prediction is not a precondition to the approval of South Kentucky's application. Rather, that standard is that the assumption of the PPA as an obligation of indebtedness is for a lawful object within its corporate purpose, is necessary and appropriate for and consistent with South Kentucky's provision of electric service to its members, does not impair South Kentucky's ability to provide electric service to its members, and is necessary and appropriate for providing electric service to its members.[118] All reasonable indicators support the position that the Morgan Stanley PPA meets this standard.

III. South Kentucky's Alternate Source Election Does Not Create an Unfair Potential for Immitigable Cost Shifts

A common theory advanced by intervenors is that the PPA is inherently unreasonable because such an alternate source designation creates a risk of increased costs to the other distribution cooperatives, and by extension their members.[119] The intervenors claim that the

[117] *Id.*, at p. 20.

[118] KRS § 278.300; *In re Application of Kentucky Power*, Case No. 2013-00144, 2013 WL 5615904, at *6 (Ky. P.S.C. 2013) (citing the Commission's Order in Case No. 2009-00545); *see also In re Application of Kentucky Power*, Case No. 2009-00545, 2010 WL 2640998, at *4 (Ky .P.S.C. 2010); Administrative Case No. 350, *In re 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. 1993).

[119] Joint Intervenors Brief, pp. 41& 47-56 (citing KRS 278.170(1) and KRS 278.030(1)) & p. 45 (requesting that the Commission modify Amendment 3 and the MOU under KRS 278.270 and KRS 278.280(1) as they result in unreasonable rates); *see also* EKPC Brief, pp. 37-42; Nucor Brief, pp. 7-9 (stating that the Morgan Stanley PPA will result in unjust and unreasonable rates in violation of KRS 278.030(1)); Attorney General Brief,

Commission is free to judge and reject South Kentucky's application on this basis alone, as doing so does not implicate the Filed Rate Doctrine. These claims are wrong. First, they do offend the Filed Rate Doctrine. Second, the risk of cost-shift remains merely a potential risk, and one capable of mitigation.

South Kentucky fully accepts that the Commission must find the Morgan Stanley arrangement reasonable.[120] South Kentucky cannot accept, however, the proposition that the potential for cost shifts renders the PPA—indeed any such agreement, as EKPC implies—[121] per se unreasonable. Such a conclusion simply does not square with the agreement reached by the distribution cooperatives and EKPC in 2003, and reaffirmed in a 2015 agreement that was filed with and approved by this Commission and made a part of EKPC's tariff. As South Kentucky discussed in its opening brief—a discussion all intervenors avoided in their responses—the parties to the Wholesale Power Contract knew how to address the potential for cost shifting if such rose to a level truly detrimental to other owner-members. The words are there in the Wholesale Power Contract,[122] and could have easily been adopted as part of Amendment 3 or the MOU. Instead,

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pp. 9-12 (same) & pp. 12-13 (stating the PPA does not result in rates that are fair, just, and reasonable under KRS 278.030(1)); Grayson Brief, pp. 11-15; Jackson Brief, pp. 8-9.

[120] *Cf.* Joint Intervenors Brief, pp. 9-10. The measure of reasonableness, however, should be limited to South Kentucky's members. It is an entirely different question, and one with an order of significance none of the intervenors appear willing to acknowledge in their briefs, whether that measure of reasonableness should extend to the other distribution cooperatives, the largest electric customer on the system (who pays one of the lowest environmental surcharges on the system) and EKPC. If the answer to this question is 'yes,' any future rate action by a distribution cooperative or EKPC that has the potential to cause indirect, yet measurable cost impacts to another cooperative or cooperative customer, would be a basis for rejection by the Commission.

[121] EKPC Brief, p. 44 ("… [EKPC] also recognizes that the Commission may very well conclude that there are very few, if any, Alternate Source elections under Amendment 3 and the MOU as written that will ever withstand Commission scrutiny on their individual merits – particularly to the extent they are similar to the exercise by South Kentucky in this Application.").

[122] *See* Wholesale Power Contract, South Kentucky Exhibit 9, page 1089 (requiring an owner-member, with respect to owner-member reorganizations, dissolutions, or consolidations/mergers, not only pay a portion of EKPC's outstanding indebtedness, but also takes steps to "eliminate any adverse effect that such action seems likely to have on the rates of other members of [EKPC].").

the parties took an entirely different course, choosing not to include such provisions in Amendment 3, and expressly providing in the MOU that stranded costs could not be passed on to the owner-member making an alternate source designation.[123]

Thus, in assessing the reasonableness of South Kentucky's application, the Commission properly should account for how the parties to Amendment 3 and the MOU decided to deal with cost shifts when those parties chose to authorize alternate source designations. And in making such an account, the Commission properly gives effect to this decision by factoring it into the analysis in a manner consistent with the Filed Rate Doctrine. Rather than validating claims of regret or lack of foresight, the Commission should start with the assumption that the MOU is reasonable and the potential for cost shifts arising from alternate source designations under it were considered or, at a minimum, should have been considered by the parties, when they decided that the value of the alternate source designation option was worth including in the Wholesale Power Contract and reaffirming through the MOU.[124] Contrary to the claims of intervenors, the Commission does not shirk its statutory responsibilities by doing so. It honors them.[125]

[123] MOU ¶ 6(A) ("EKPC shall not be entitled to charge any Owner Member for so-called "stranded costs" related to the Owner Member's implementation of its rights to use an Alternate Source."). In a footnote, the Attorney General resists this conclusion, arguing that because "stranded costs" are not defined, and the word "shift" is not used, the parties to the MOU did not really mean to accept this potential risk. *See* Attorney General Brief, p. 11, n. 38. The Attorney General goes on to argue that "clearly, the 100% load factor [designation] was never contemplated by any owner-member at the time Amendment Three and the MOU were executed." *Id.* (emphasis added). The evidence conclusively proves otherwise. Indeed, earlier in the Attorney General's brief, it is recited that Jackson Energy's eventually withdrawn alternate source designation was a 100% load factor designation at 15% of Jackson Energy's peak demand. *See id.*, p.2 n.7 (citing Direct Testimony of Anthony S. Campbell, page 6). And as South Kentucky discussed in its initial brief, the alternate source designation at issue in the Grayson litigation, which gave rise to the MOU, was for a 100% load factor PPA at 15% of Grayson's peak demand. *See* South Kentucky Initial Brief, pp. 7-8, p.8 n.25. In short, such a reading of the MOU does not pass even the slightest scrutiny.

[124] As South Kentucky's initial brief and this brief should make clear, these "shame on us" claims are simply not credible, given the facts of the Grayson litigation and Mr. Campbell's testimony during that litigation. A case of true surprise might call for a different outcome, although even then, the Filed Rate Doctrine sets the bar high for revisiting history. *Cf. Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 578-79 (1981).

[125] *See Cincinnati Bell Tel. Co. v. Ky. Pub. Serv. Comm'n*, 223 S.W.3d 829, 837-39 (Ky. Ct. App. 2007) ("underlying principles [of the doctrine] are incorporated and recognized in both our statutory and our case law."); *Id.* at 839 ("In light of the General Assembly's comprehensive rate-making scheme, including only a narrowly

Many accusations (e.g., "astonishingly tone-deaf") have been hurled South Kentucky's way on the issue of potential cost shifts. Contrary to what intervenors would have the Commission believe, South Kentucky appreciates its role as an owner-member of EKPC, existing alongside the fifteen other owner-members. At the same time, South Kentucky also appreciates the fiduciary duty it owes to its members, and the benefits that can be visited upon them through a reduction in its wholesale power costs. These concepts are not mutually exclusive—a fact demonstrated, if by nothing else, Amendment 3 and the MOU, by which the group allowed an individual distribution cooperative to strike out, in part, on its own.

Aside from those instruments, however, none of the distribution cooperatives can say it uncompromisingly subscribes to an "All for one, one for all" business philosophy and is willing to forego perceived benefits for its members when such benefits may come at the expense of other cooperatives. Were such the case, the cooperatives would not be competing for new industrial and commercial load, or other economic expansion opportunities. The actual environmental surcharge paid by the distribution cooperatives would be equal, not skewed.[126] All of the various "solutions" proposed by intervenors would not call for the rejection of South Kentucky's application, but the continued preservation, or grandfathering, of the existing alternate source designations.[127]

Also not lost on South Kentucky is the fact that the potential cost shifts can be mitigated. During the Grayson litigation and in the months prior to the commencement of this proceeding,

defined circumstance under which refunds can be ordered, the filed rate can only be lawfully altered prospectively."); *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."); KRS 278.160 (requiring utilities to file with the Commission all rates and conditions for service, and collect charges and provide services only in accordance with those rates and conditions on file).

[126] Rebuttal Testimony of Dennis Holt, page 12, line 10 through page 13, line 9. (noting that while Nucor represents 7.8% of the total EKPC sales, it only incurs 5.3% of the total EKPC environmental surcharge).

[127] EKPC Brief, p. 44.

EKPC was confident that mitigation could be accomplished.[128] This is not surprising, given EKPC's history of generating revenues from sales into the PJM market.[129] Indeed, in 2017, EKPC sold 548,528 MWh into the PJM demand and energy markets at an average price of $75.20 per MWh.[130] Assuming the same average price (a conservative assumption, in light of the recent price at which the PJM base residual auction for capacity cleared),[131] EKPC would collect over $38.2 million from the capacity and energy made available from South Kentucky's alternate source designation.[132] Given these estimates, EKPC's refusal to perform analyses to assess the various ways by which mitigation may happen appears to be further evidence of its knowledge that mitigation can and will offset any impact of South Kentucky's alternate source designation.[133]

In addition, off-system sales are allocated a pro rata portion of environmental costs under EKPC's Rate ES (Environmental Surcharge). Specifically, in calculating the environmental surcharge factor, a portion of EKPC's environmental costs must be allocated to all off-system sales

[128] *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, Item 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 also* Hearing Transcript (Anthony Campbell), May 16, 2018, at approximately 10:17:45 p.m. (noting that he still thinks mitigation is a possibility).

[129] Direct Testimony of Don Mosier, PSC Case No. 2017-00376, South Kentucky Exhibit 3, page 15, lines 14-16 (noting that EKPC will be well-positioned to continue reaping the benefits from its ability to bid capacity and energy into the PJM wholesale markets).

[130] *See* Rebuttal Testimony of William S. Seelye, Exhibit 6 (noting that EKPC collected demand and energy revenues from Non Requirements Service of $40,284,036 from sales of 535,690 MWh, which equates to an average price of $75.20 per MWh ($40,284,036 ÷ 535,690 MWh = $75.20/MWh).

[131] *See* Response of South Kentucky to Commission Staff's First Post-hearing Request for Information, Item 2. As South Kentucky noted in its initial brief, this result is 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.").

[132] This amount reflects 58 MW x 8,760 hours x $75.20/MWh, or $38,207,616.

[133] *See* Response of EKPC to South Kentucky's Post-Hearing Data Request, Items 1 and 2; *see also* South Kentucky Initial Brief, p. 16 n.52 (noting multiple occasions on which EKPC acknowledged the ability to mitigate South Kentucky's designation).

based on the percentage of off-system revenues to total revenues.[134] Therefore, as EKPC sells the capacity and energy made available from South Kentucky's alternative source designation, a portion of EKPC's environmental costs would be allocated to those off-system sales. To the extent that the impact of South Kentucky's alternate source designation cannot be mitigated through off-system sales or the replacement of load on EKPC's system, other paths for mitigating the effect of South Kentucky's transaction could be pursued.

At hearing, EKPC offered several avenues for mitigation, and again expressed confidence that mitigation could be achieved, including through outside-the-box approaches.[135] The availability of all of these options, as well as demonstrated past performance, is why all the intervenors qualify any reference to cost shifts and any corresponding upward price pressure on rates as potential or speculative. EKPC's actual costs may, if not will, be addressed through load growth or otherwise offset by new revenues.[136] As a result, the need for the other distribution cooperatives to manage higher prices is far from certain. Here too, mitigation may readily address

[134] EKPC's Rate RS – Environmental Surcharge requires that EKPC's environmental costs to be allocated to EKPC's total off-system sales, as set forth in paragraph 2 of the rate schedule, as follows:

> Total E(m) is multiplied by the "Member System Allocation Ratio" to arrive at Net E(m). The "Member System Allocation Ratio" is based on the ratio of the twelve (12) total revenue from sales to owner-members to which the Surcharge will be applied, ending with the current expense month, divided by the twelve (12)-month total revenue from sales to owner-members ***and off-system sales***. (Emphasis added.)

[135] *See* Hearing Transcript (Don Mosier), May 16, 2018, at approximately 4:17:45 p.m. (noting that EKPC did not have a "burning platform" to pursue measures "at this point in time"); Hearing Transcript (Anthony Campbell), May 16, 2018, at approximately 10:17:45 p.m. (noting that he still thinks mitigation is a possibility); Hearing Transcript (Anthony Campbell), May 16, 2018, at approximately 11:11:22 p.m.

[136] As discussed in the rebuttal testimony of Mr. Holt, increases in system already may be signaling the ability of EKPC to mitigate any impact of South Kentucky's alternate source designation. *See* Rebuttal Testimony of Dennis Holt, page 12, lines 1-7. EKPC attempted to distract the Commission from this fact at hearing by wrongly implying that South Kentucky had misrepresented the data. South Kentucky did no such thing. Rather, it used EKPC's own data response in support of the year-over-year increase in system sales (a response that noted EKPC's own decision not to weather-normalize the data when providing it to South Kentucky). In addition, Mr. Holt was clear in his testimony that the increase was not proof positive of mitigation, but simply an indication of positive trends. *Id.*, lines 1-2 ("It is difficult to predict, but if current sales growth is any indication, it [the point at which any cost shift will be mitigated] could be very soon, if not immediate.").

any such development. To ensure the avoidance of impacts to other distribution cooperatives, however, and allow the system time to absorb the alternate source designation, EKPC has other, constructive means available to it.

Specifically, EKPC could seek authorization from the Commission to establish a regulatory asset to record and defer Environmental Surcharge cost-recovery deficiencies, if any, associated with South Kentucky's alternate source designation.[137] EKPC could then amortize that balance over time and in a measured fashion consistent with load growth on the system, to mitigate any impact to the other distribution cooperatives. South Kentucky recognizes the need for full Commission review regarding a proposal of this kind. Nevertheless, the uniqueness of the circumstances,[138] coupled with the scope of existing precedent,[139] support at least further consideration of the course if EKPC's ability to mitigate proves less effective than previously represented.

The likelihood that any cost shifts will not manifest into actual, sustained cost increases is why intervenors advance their "lost opportunity" theory.[140] Under the lost opportunity theory, the alternate source designation cannot be mitigated, save for the arrival of commensurate substitution for the South Kentucky load previously served by EKPC that would not have presented itself but for the designation. As intervenors tell it, for every load increase, and apparently for every revenue

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[137] Hearing Transcript (William S. Seelye), May 16, 2018, 3:42:00 p.m. — 3:43:43 p.m.

[138] Specifically, the situation represents the intersection of South Kentucky's alternate source designation, the first 15% election by an owner-member under the agreed-upon MOU reaffirming Amendment 3, and EKPC's Environmental Surcharge, a formulary rate that automatically adjusts to provide for full cost recovery without the requirement for an intervening rate filing submitted to, and approved by, the Commission.

[139] *See, e.g.*, *In re Application of EKPC*, Case No. 2010-00449, 2011 WL 756773 (Ky, P.S.C.) (Feb. 28, 2011) (noting situations for use of a regulatory asset as including "(1) an extraordinary nonrecurring expense which could not have reasonably been anticipated or included in the utility's planning … or (4) an extraordinary nonrecurring expense that over time will result in a saving that fully offsets the cost"); *see also In re Application of Louisville Gas & Elec. Co.*, Case No. 2011-00380, 2011 WL 6923149 (Ky. P.S.C.) (Dec. 27, 2011).

[140] Joint Intervenors Brief, pp. 42-44; Attorney General Brief, pp. 8-9; Hearing Transcript (Mike McNalley), May 16, 2018, 8:21:00 p.m. — 8:21:25 p.m.

offset as well, the distribution cooperatives lose out on benefits. Thus, while these developments may compensate for the alternate source designation, the system is at best net neutral, where in the absence of the designation, it would have been net positive.

There are at least two problems with this theory—both of which directly relate to Amendment 3 and the MOU. First, the theory proves too much. As EKPC's CFO Mr. McNalley testified at hearing, every alternate source designation fails the lost opportunity theory.[141] Regardless of whether the alternate source is a dedicated, behind-the-meter resource such as the distributed generation facility of Owen Electric discussed above, or whether it is South Kentucky's PPA, the "lost margins" associated with any new growth or revenues are put to the designation first, rather to the owner-members. Thus, with every alternate source designation there is a lost opportunity.

At hearing, EKPC attempted to correct for this flaw by claiming there would be no "winners or losers" if every member was allotted a uniform 5% election.[142] This presumes, however, that every cooperative somehow is able to find a right-sized generator corresponding to its 5% allocation, and that the annual output from every one of those generators is constant relative to the 5% among every distribution cooperative and does not vary (due to intermittency or outage or other reason). The "lost opportunity exception" also presumes that every cooperative manages to overcome the insurmountable "need" and "wasteful duplication" standards that intervenors would overlay on the process—standards that were not applied to the existing designations operating on the system today. Such is the problem with post hoc rationalizations—the

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[141] *See* Hearing Transcript (Mike McNalley), May 16, 2018, 8:55:55 p.m. — 8:56:25 p.m.

[142] *Id.*, 8:56:35 p.m. — 8:57:53 p.m.

manufacture of additional, after-the-fact evolution becomes even more obvious and even less credible.

Second, intervenors' lost opportunity theory forgets that the cooperatives pocketed an opportunity when they secured the right to designate alternate resources. South Kentucky discussed this in its initial brief (and the discussion is yet another item on the list of inconvenient matters avoided by intervenors). When the owner-members cooperatives all agreed to Amendment 3 and the MOU, they decided that the right to designate an alternate source and diversify suppliers carried with it an intrinsic value greater than renewing the existing commitment to receive supply exclusively from EKPC for the remaining term of the Wholesale Power Contract.[143] The decision was not arbitrary.[144] EKPC and the distribution cooperatives are sophisticated corporate entities, represented by executive management, boards of directors, and outside legal counsel, who freely entered into Amendment 3 and the MOU.

At least some of the cooperatives, if not all of them, knew there was the potential for benefit in having this right. And in reaching that conclusion, these cooperatives presumably considered the pros and the cons of incremental margins obtained through load growth and other means being applied to the cooperative loads directed to an alternate supplier. For these cooperatives, the answer may well have been as easy as turning over the "lost opportunity" coin and seeing the situation as a best of both worlds—securing the right to designate alternate sources, while leaving intact the ability of the system to mitigate any short-term impacts, and avoid long-term impacts altogether. Viewed clearly, neither EKPC nor the other owner-members "lose" an opportunity as a result of South Kentucky's alternate source designation; EKPC obtained the desired extension to

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[143] *See* MOU ¶ 0.6.

[144] *See* Rebuttal Testimony of William S. Seelye, page 6, line 25 through page 7, line 27; Exhibit WSS-2.

the Wholesale Power Contract and the cooperatives received the ability to seek alternate source power as intended under Amendment 3 and the MOU. Rather, intervenors seek to foreclose upon South Kentucky's ability to exercise its contractually granted opportunity to obtain alternate source power.

Whatever the calculus, the decision to allow alternate source designations was made, the decision was later reaffirmed, and that decision was memorialized by the MOU that was filed as a tariff by EKPC and approved by the Commission. For the reasons discussed herein, the decision deserves to be respected as an intentional decision of the parties that, at the very least, they considered reasonable at the time they made it and, in the absence of any evidence to the contrary, considered reasonable up to and through the time South Kentucky predicated its actions in reliance upon it. South Kentucky is not "tone deaf." South Kentucky simply refuses to accede to the proposition inherent in intervenors' cost-shifting arguments that Amendment 3 and the MOU should be singled out as some aberrant action requiring unprecedented intervention by the Commission.

IV. Amendment 3, the MOU, and South Kentucky's Alternate Source Designation Do Not Afford it an Unlawful Unreasonable Preference

Several intervenors, including parties to the Wholesale Power Contract and the Attorney General, argue that South Kentucky's alternate source designation and the Morgan Stanley PPA provide it with an unlawful "unreasonable preference." These arguments have the issue exactly backwards. South Kentucky designated its alternate source in a manner prescribed by the MOU and equally available to all of the distribution cooperatives. Thus, denying South Kentucky the lawful exercise of its contractual right for the post hoc protection of the counterparties to the MOU and Amendment 3 would itself create the unreasonable preference the law prohibits.

Despite the occasional "shame on us" pleas, no one can dispute the contractual validity of Amendment 3 and the MOU. Sophisticated corporate parties, acting through their boards of directors and with the advice of legal counsel, signed these documents. The MOU was filed with and approved by the Commission, and then placed on file as a tariff of EKPC. Since 2003, the right to designate an alternate source has been available to all the distribution cooperatives. With varying degrees of form and success,[145] distribution cooperatives have made designations. Throughout that time, however, the parameters have remained the same for all: an electing cooperative could designate an alternate source up to 15% of its coincident peak load until 5% of EKPC's total coincident peak was covered, at which point elections were no longer allowed.[146]

Amendment 3 and the MOU cannot therefore reasonably be said to provide South Kentucky with any unreasonable preference. The provisions of these agreements have been, and continue to be, equally available to all owner-members.[147] All the cooperatives are bound to these agreements on the same terms and can avail themselves to alternate source elections, subject to the ratcheting down mechanism (i.e., the 5% EKPC system cap) that prevents any unmanageable load departures.[148] Following South Kentucky's election then, the additional designations that Owen

[145] *See In re Application of Owen Elec. Coop.*, Case No. 2015-00213, 2015 WL 6758433, at *6 (Ky. P.S.C.) (Oct. 30, 2015) (approving Owen's application). Jackson Energy also made an election for its full 15% at 100% load factor in 2010, which was later withdrawn. *See* Direct Testimony of Anthony Campbell, page 6, lines 5-6. Finally, the Grayson alternate source election for the full 15% at 100% load factor through a PPA was withdrawn at the signing of the MOU. *See* South Kentucky Initial Brief, pp. 7-8, p. 8 n.25.

[146] Like the cost shifting issue, this ratcheting down concept was plain on the face of the MOU when it was approved by the Commission as not violating any legal or regulatory principle. *In re Petition and Complaint of Grayson Rural Elec. Coop. Corp.*, Case No. 2012-00503 (Ky, P.S.C.) (Dec. 18, 2015) (introduced at hearing as PSC Exhibit 1).

[147] *See* 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 identifying the market as a source); Response of Salt River Electric Cooperative to South Kentucky's Request for Information to Distribution Cooperatives, Item 4, page 22 (reflecting notice of an alternate source election by Salt River identifying the market as a source); Direct Testimony of Mike McNalley, page 10, lines 7-8; Nucor Brief, p. 7.

[148] While the "run on the bank" argument has a catchy ring, it is obvious the parties to the Wholesale Power Contract anticipated and mitigated this outcome on the face of the agreements, first by including the 5% aggregate

and Jackson have made (and any future ones) will present the same potential for impact to South Kentucky as the other, non-electing members (although with these too, as the foregoing discussion illustrates, any such impact likely would be transitory, if there is an impact at all).

Faced with this clear bar to objections for past action taken entirely in accordance with the rate on file, intervenors engage in a shell game to try to portray the cost shift not as an essential and addressed element of the Wholesale Power Contract and the MOU (i.e., an element that was known by all parties and the subject of the very dispute that lead to the unanimous agreement memorialized in the MOU), but as somehow an element of the PPA for which South Kentucky here seeks approval. This conflates two completely separate issues: (1) whether the cost shifts that may result from a party's alternate source election pursuant to Amendment 3 and the MOU are fair and reasonable; and (2) whether the Morgan Stanley PPA is a lawful obligation of indebtedness under KRS 278.300. Lest there be any misunderstanding, South Kentucky's position is, with respect to the first issue, that an election pursuant to Amendment 3 and the MOU is inherently fair and reasonable and, as demonstrated in this case, proven to be so. With respect to the second issue, the Morgan Stanley PPA is a lawful obligation of indebtedness that should be approved by this Commission.

The "first-come-first-serve" nature of the ratcheting provision, or intervenors' far more colorful "first hog to the trough,"[149] does not call for a different conclusion. As explored with EKPC's Mr. Crews at hearing, the queuing feature on display here is a regular feature of regulated

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cap in Amendment 3, and then by further refining the mechanism with ratcheting down provisions when 2.5% of EKPC's peak load has elected an alternate source in the MOU. Arguments that the parties and Commission failed to perceive the resolution of the primary issue in the Grayson litigation when they agreed to the MOU and found it to be reasonable, respectively, give neither the owner-members nor the Commission their due regard.

[149] Joint Intervenors Brief, pp. 48-49; EKPC Brief, pp. 3-4; Nucor Brief, pp. 6-9; Grayson Brief, p. 17.

electric utility practice.[150] Specifically, transmission service and interconnection requests, and the cost responsibility for upgrades, are done through an analogous queue process: available capacity is given to those who secure first spots in the queue and those later in the queue take the risk that available capacity will be exhausted and they will bear the costs of required upgrades.[151]

The ratcheting provision of Amendment 3 and the MOU, which reduce the availability of alternate supply elections following earlier-in-time elections, employs this very same and widely respected convention. Indeed, its most common utilization is in the area of transmission and interconnection costs, the operations and cost assignments of which intervenors accept without question (so as to pursue their claims of unappreciated cost risks by South Kentucky). Thus, there really is no reasonable basis for intervenors to assail this rate design, particularly since the Commission (as well FERC, and countless other public service commissions across the country) has found it reasonable and not in violation of any legal or regulatory principle.[152]

There is, however, evidence of unreasonable discrimination and unreasonable prejudice in this case that the Commission should not ratify. Specifically, as dutifully recounted by EKPC in the closing pages of its brief, EKPC and fifteen of the distribution cooperatives unanimously

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[150] Hearing Transcript (David Crews), May 17, 2018, at 10:51:44 a.m. — 10:54:50 a.m.

[151] *Id.* Section 13.2 of the pro forma OATT adopted by FERC provides that "Long-Term Firm Point-To-Point Transmission Service shall be on a first-come, first-served basis, i.e., in the chronological sequence in which each Transmission Customer has requested service," and Article 15 notes that transmission service requests will be granted if the transmission owner facilities can accommodate the service and, if not, service is only granted if the customer agrees to pay for the cost of the upgrades. *See Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, Order No. 888, 61 FR 21540 (May 10, 1996), FERC Stats. & Regs. ¶ 31,036 (1996), *order on reh'g*, Order No. 888-A, 62 FR 12274 (Mar. 14, 1997), FERC Stats. & Regs. ¶ 31,048 (1997), *order on reh'g*, Order No. 888-B, 81 FERC ¶ 61,248 (1997), *order on reh'g*, Order No. 888-C, 82 FERC ¶ 61,046 (1998), *aff'd in relevant part sub nom. Transmission Access Policy Study Group v. FERC*, 225 F.3d 667 (D.C. Cir. 2000), *aff'd sub nom. New York v. FERC*, 535 U.S. 1 (2002).

[152] *See supra* at pp. 3-4, (citing the Grayson proceeding and discussing how cost shifting mechanisms were the basis of the dispute in the Grayson litigation and were apparent on the face of the MOU when approved by this Commission); *see also In re Petition and Complaint of Grayson Rural Elec. Coop. Corp.*, Case No. 2012-00503 (Ky. P.S.C.) (Dec. 18, 2015) (introduced at hearing as PSC Exhibit 1).

passed a resolution to deny a single sister cooperative its contractual rights and the benefit of a bargain twice struck—after excluding that same sister cooperative from participating in the deliberation and vote leading to the resolution. This sixteen-against-one power play epitomizes the antithesis of "Cooperation between Cooperatives" and showcases the very type of unreasonable discrimination, prejudice, and preference that Kentucky law prohibits. The fact that EKPC facilitated this action as part of its "service" to its Wholesale Power Contract customers is extremely troubling, and South Kentucky urges the Commission to discourage future such actions.[153]

V. Conclusion

One way for the Commission to discourage future such actions is to reaffirm the MOU and approve South Kentucky's application.[154] South Kentucky appreciates the situation in which the Commission finds itself. But in all fairness, South Kentucky brought this application having just completed what it thought was a well-executed effort to save its members money. An independent power producer offers it a deal, and after months of research, investigation, an RFP, and negotiations, South Kentucky secures a long-term deal that stands to bring savings approaching or exceeding $100 million. All the while, South Kentucky is in frequent communication with its supplying cooperative, EKPC, who is supportive and helpful and who, <u>at no time during that process</u>, signals the level of opposition that eventually would surface.

Should South Kentucky have anticipated this proceeding? The level of opposition would seem to support a "yes" answer—or a claim by someone that, "South Kentucky, the shame is on

[153] "**No utility shall, as to rates or service**, give any unreasonable preference or advantage to any person **or subject any person to any unreasonable prejudice or disadvantage**, or establish or maintain any **unreasonable difference between localities** or between classes of service for doing a like and contemporaneous service under the same or substantially the same conditions." KRS 278.170(1) (emphasis added).

[154] Hearing Transcript (Anthony Campbell), May 16, 2018, at 11:13:32 p.m. — 11:14:02 p.m.

you." But the facts are these. In 2017, South Kentucky made a decision to invest time and resources to exercise a right that it understood to be secured not only by the Wholesale Power Contract, but also by a reaffirming agreement that was part of EKPC's tariff. And in exercising that right, South Kentucky stood to achieve significant savings for its members. Thus, it seems hard to fault South Kentucky for this case.

South Kentucky submits that there is one solution, under the law and facts converging here. The Commission should validate its 2015 decision and find the terms of the MOU, as agreed upon by all the distribution cooperative and the MOU, to be just and reasonable from the date of the order forward. After all, it is a rare day when seventeen sophisticated parties can be said to have gotten together and made the wrong decision twice. What's more, a "second reaffirmation" of the MOU should put an end to the in-fighting once and for all, and likely will provide a basis for accord and development in the years to come.

The Commission also should find that South Kentucky's application is due to be approved. As demonstrated, the application satisfies KRS 278.300. To the extent that the Commission concludes that KRS 278.300 requires a showing of "need" and lack of "wasteful duplication" when an alternate source designation by an EKPC owner-member involves a PPA, South Kentucky submits that the evidence is wholly consistent with the standards laid out for the Commission's approval of Owen's alternate source designation. Moreover, the evidence fully shows that approval is both fair and reasonable, and most importantly, consistent with Filed Rate Doctrine principles applicable to this case.[155]

[155] In contrast, outcomes that call for retroactive revisions to the MOU or Amendment 3—including the proposal by Salt River that South Kentucky be assigned any stranded costs associated with the alternate source designation—cannot be reconciled with the Filed Rate Doctrine. Such a result would be akin to the Commission deciding that South Kentucky should be entitled to socialize the entirety of its expenses in this case across all other distribution cooperatives.

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 23rd day of July, 2018.

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