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	)

REBUTTAL TESTIMONY OF CARTER BABBIT

ON BEHALF OF

SOUTH KENTUCKY RURAL ELECTRIC COOPERATIVE CORPORATION

Filed: May 7, 2018

REBUTTAL TESTIMONY OF CARTER BABBIT ON BEHALF OF SOUTH KENTUCKY RURAL ELECTRIC COOPERATIVE CORPORATION

Q: PLEASE STATE YOUR NAME, POSITION AND BUSINESS ADDRESS.

A. My name is Carter Babbit. I am Vice President of Power Supply with EnerVision, Inc. ("EnerVision"). My office is located at 4170 Ashford Dunwoody Road, Suite 500, Atlanta, Georgia 30319.

Q. ARE YOU THE SAME CARTER BABBIT WHO OFFERED DIRECT TESTIMONY IN THIS PROCEEDING?

A. Yes.

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. The purpose of my rebuttal testimony is respond to certain claims of witnesses for East Kentucky Power Cooperative ("EKPC") and the coalition of Distribution Cooperatives,[1] through which these parties appear to be trying to cast aspersions on the value of the transaction that South Kentucky has entered into with Morgan Stanley Capital Group ("MSCG"), and for which South Kentucky currently seeks approval pursuant to KRS 278.300.

Q: ARE YOU RESPONDING TO EVERY ASSERTION BY EVERY INTERVENOR?

A: No. While the intervenors' testimony is certainty fraught with anxiety, there is nothing of substantive merit that might provide a basis for either South Kentucky or the Commission to question the upside potential of the MSCG transaction and how South Kentucky's

[1] The Distribution Cooperatives include 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., Grayson Rural Electric Cooperative Corporation, Inter-County Energy Cooperative Corporation, Jackson Energy Cooperative Corporation, Licking Valley Rural Electric Cooperative Corporation, Nolin Rural Electric Cooperative Corporation, Owen Electric Cooperative, Inc., Shelby Energy Cooperative, Inc., and Taylor County Rural Electric Cooperative Corporation.

members might benefits as a result. I do take an opportunity to address certain claims by intervenors, so that the record is clear for the Commission to make the correct decision. Thus, the absence of a response to a particular comment or statement by an intervenor should not be construed as an endorsement of that comment or statement by South Kentucky.

Q: HAVE YOU REVIEWED THE TESTIMONY OF MR. DON MOSIER?

A: I have.

Q: DO YOU BELIEVE HIS STATED CONCERNS REGARDING THE DESIGN OF THE MSCG TRANSACTION ARE REASONS FOR SOUTH KENTUCKY NOT TO PURSUE THE TRANSACTION OR FOR THE COMMISSION TO DENY APPROVAL.

A: I do not. Ultimately, EKPC through its witnesses and the Distribution Cooperatives through Mr. Wolfram appear to be advancing to the Commission everything they possibly can imagine that might negatively affect the long-term value of the MSCG transaction to South Kentucky and its members, and then assail South Kentucky for not having undertaken an analysis of those possibilities. As any analyst knows, a sensitivity can be designed that will render a potential transaction uneconomic. I believe and South Kentucky believes that the MSCG transaction represents a significant opportunity and that the material, knowable risks have been assessed and are reasonably assumed.

Q: MR. MOSIER CLAIMS THE LENGTH OF THE TERM IS ATYPICAL OF INDUSTRY NORMS, CONSIDERING THE COUNTERPARTIES AND STRUCTURE OF THE TRANSACTION (E.G., NOT FULL REQUIREMENTS

SERVICE AND WITHOUT A SPECIFIC GENERATING RESOURCE DESIGNATED TO THE TRANSACTION). DO YOU AGREE WITH THIS?

A: No, and his characterization of matters in testimony seem at odds with his original reaction that "the agreements executed are typical of the type and kind expected when dealing with sophisticated counterparties like MS." (*See* Exhibit CB REB-1.) In any event, much has changed in the wholesale power market since Mr. Mosier left Ameren Energy Marketing and joined EKPC in 2010. The offering that South Kentucky was able to secure from MSCG in 2017 represents the type of cost-competitive deals that are being offered today and can benefit utilities like South Kentucky. Indeed, as I explained in my initial testimony, South Kentucky considered proposals of varying lengths, but the MSCG transaction with its 20-year term presented the greatest value to South Kentucky and its members. In addition, the notion of a 20-year agreement should not be, alone, inherently problematic. The term of the current Wholesale Power Contract between EKPC and the owner-members extends to 2051.

Q: IS MSCG ACTIVE IN THE WHOLESALE POWER MARKET?

A: Yes. They have a strong reputation and are very active in the wholesale power market.

Q: MR. MOSIER SEEMS TO BELIEVE THAT LACK OF AN ATTACHED GENERATING RESOURCE TO THE ENERGY COMPONENT OF THE MSCG TRANSACTION CREATES ADDITIONAL RISK. DO YOU AGREE WITH THAT?

A: I do not. In fact, I see this as a strength of the MSCG transaction. The energy component of the MSCG transaction is for a Firm LD product. Thus, MSCG is obligated to deliver, or pay South Kentucky the difference in cost for replacement power if it fails to deliver, unless of an event of Force Majeure. Because of this, the energy South Kentucky will receive under the transaction, and thus the benefit to members, is more assured than if tied to specific generation resources.

Q: IS A FORCE MAJEURE EVENT SOMETHING THAT CAN EASILY HAPPEN?

A: No. Under the contract, an event of Force Majeure is defined as

> [An] event or circumstance which prevents one Party from performing its obligations under one or more Transactions, which event or circumstance was not reasonably foreseeable as of the date the Transaction was agreed to, which is not within the reasonable control of, or the result of the negligence of, the Claiming Party, and which, by the exercise of due diligence, the Claiming Party is unable to overcome or avoid or cause to be avoided. Force Majeure shall not be based on (i) the loss of Buyer's markets; (ii) Buyer's inability economically to use or resell the Product purchased hereunder or Buyer's ability to obtain the Product at a more advantageous price or advantageous terms and conditions from a third party supplier; (iii) the loss or failure of Seller's supply; or (iv) Seller's ability to sell the Product at a price greater than the Contract Price or on more advantageous term and conditions to another purchaser. Neither Party may raise a claim of Force Majeure based in whole or in part on curtailment by a Transmission Provider unless (i) such Party has contracted for firm transmission with a Transmission Provider for the Product to be delivered to or received at the Delivery Point and (ii) such curtailment is due to "force majeure" or "uncontrollable force" or a similar term as defined under the Transmission Provider's tariff; provided, however, that existence of the two foregoing factors shall not be sufficient to conclusively or presumptively prove the existence of a Force Majeure absent a showing of other facts and circumstances which in the aggregate with such factors establish that a Force Majeure as defined in the first sentence hereof has occurred. The applicability of Force Majeure to the Transaction is governed by the terms of the Products and Related Definitions contained in Schedule P.

This is a very high standard, and as the definition provides, cannot be invoked in the mere event that MSCG suffers a "loss or failure of [its] supply." Given this restriction, it reasonable for MSCG to want to have the flexibility to use the various resources at its disposal to meet its obligations under the transaction, and the converse to this is that

South Kentucky gains strong assurance of delivery, or, in the event of failure, assurance that the price it agreed upon will be the price it ultimately pays for replacement energy.

Q: MR. MOSIER ALSO SEEMS TO THINK THAT THE CHANGE IN LAW PROVISIONS IN THE TRANSACTION PLACE SOUTH KENTUCKY AT RISK. DO YOU BELIEVE THIS IS A VALID CONCERN?

A: No. First, to be clear, the Change in Law provisions of the transaction as they might affect the fixed energy price only apply in the limited situations of a Change in Law in Environmental Law or Tax Law, as those terms are defined, that give rise to Additional Environmental Costs. While Mr. Mosier is correct that MSCG can advance a price change predicated on a "good faith market-based quotation", Mr. Mosier neglects to observe that MSCG carries the corresponding obligation to take "commercially reasonable efforts to minimize any Additional Environmental Costs." And because the transaction is not tied to a specific generating resource, the commercial reasonableness of this obligation will include assessing the market for replacement sources of supply that do not carry the Additional Environmental Costs. In short, I do not believe there is a risk here of a kind claimed by Mr. Mosier.

Q: DOES EKPC UNDERSTAND HOW THE TRANSACTION IS INTENDED TO OPERATE RELATIVE TO ADDITIONAL ENVIRONMENTAL COSTS, OR WHAT EKPC FREQUENTLY DESCRIBES AS THE "CHANGE IN LAW"?

A: I do not believe so. For example, in response to Request 3 from the Attorney General, EKPC (with Mr. Mosier designated as the responsible witness) states that the Coal Combustion Residuals Rule could cause South Kentucky's costs under the transaction to increase. That is not correct. Capital investments and associated O&M expenses are not a basis for Additional Environmental Costs. Rather, the Additional Environmental Costs provision covers situations like Mr. Holt discusses in his rebuttal testimony, a federal or state carbon or greenhouse gas fee or tax. This is very important, and is why South Kentucky stated in discovery that it does not perceive the risk of Additional Environmental Costs to be any greater than what it is exposed to today through single-source supply arrangement with EKPC. As EKPC noted in its response to Request 7 from the Attorney General, over the past 20 years, it has spent more than $1 billion on environmental projects, $947 million of which was capital. Thus, at least 94 percent of EKPC spending in this time was of a type not passable to South Kentucky under the MSCG Additional Environmental Costs definition (and more likely, it is 100 percent, although I have not undertaken to determine what items comprised the non-capital component). Mr. Mosier might claim that such cost avoidance is not properly viewed as cost savings, but from South Kentucky's point of view, avoiding the costs associated with environmental capital expenditures by reducing its exposure to costs associated with EKPC's generation portfolio certainly feels like cost savings.

Q: DOES EKPC FACE THE RISK OF FUTURE ENVIRONMENTAL EXPENSE OF A TYPE THAT WOULD NOT BE PASSABLE TO SOUTH KENTUCKY THROUGH THE MSCG TRANSACTION?

A: Yes. As reflected in EKPC's financial statements for years ended 2017 and 2016, there is the prospect for significant environmental expense associated with the Environmental Protection Agency's Effluent Limitations Guidelines rule and the NAAQS for ozone, not to mention potential revisions to or replacement of the Clean Power Plan. (*See* Exhibit CB REB-2.) EKPC acknowledges that the cost impacts associated with these matters cannot be determined at this time, although it does indicate its current effort to obtain authorization from the Commission to undertake a new project estimated at more than $260 million.

Q: IN SUPPORT OF HIS CLAIM THAT SOUTH KENTUCKY HAS NOT "VETTED" THE "VERY SERIOUS CONSIDERATIONS" ASSOCIATED WITH CHANGES IN ENVIRONMENTAL LAWS AND THE COST IMPLICATIONS OF SUCH CHANGES, MR. MOSIER SEEMS TO INDICATE THAT THE ABSENCE OF DIRECT COMMISSION OVERSIGHT OVER MSCG EXPOSES SOUTH KENTUCKY TO ADDITIONAL RISK. DO YOU AGREE WITH THIS?

A: I do not, either the points in his testimony or the discussion to South Kentucky's Request 17. The energy to be supplied by MSCG will come from a generating resource, and that resource will be subject to the applicable environmental laws enforced by federal and state agencies. While I readily agree that the pass-through of Additional Environmental Costs is not subject to Commission review, it remains subject to the parties' agreed-upon requirement that MSCG take commercially reasonable efforts to minimize any Additional Environmental Costs (efforts that, from South Kentucky's point of view, will be informed by its historical experience as a regulated entity and what typically is deemed prudent or imprudent). Furthermore, and to reiterate the point above, the principal Additional Environmental Costs being contemplated are things like a carbon or greenhouse gas tax that would have national applicability and affect EKPC and MSCG alike.

Q: IN ITS RESPONSE TO SOUTH KENTUCKY'S REQUEST 8, EKPC (WITH MR. MOSIER THE DESIGNATED WITNESS) INCLUDED A REPORT FROM THE CREDIT RATINGS AGENCY STANDARD AND POOR'S ("S&P") DISCUSSING

THE MARKET RISKS AFFECTING MERCHANT GENERATORS AND SURPLUS GENERATION OWNERS, RELATIVE TO NOT-FOR-PROFIT COOPERATIVES. DO YOU HAVE A REACTION TO THIS REPORT?

A: I do. What this report tells me is that, at least from S&P's perspective, cooperatives like EKPC are perceived at being better able to recover their fixed investments (including environmental capital expenditures) than independent wholesale participants—even when the operation of the cooperative generation is uneconomic. As a result, independent producers are being forced to design more competitive offerings to compete in the market, offerings such as the MSCG transaction. In this respect, South Kentucky is not relying on MSCG as a merchant generator but as an entity with vast experience transacting with cooperative and investor-owned utility generation owners, merchant generation owners, and others to provide reliable and economic transactions for its customers.

Q: MR. MOSIER EXPRESSES CONFUSION OVER THE CAPACITY HEDGE AND ITS ROLE RELATIVE TO THE ENERGY COMPONENT OF THE MSCG TRANSACTION AND ANY FUTURE CAPACITY PURCHASE OBLIGATIONS OF SOUTH KENTUCKY IN THE PJM MARKET. CAN YOU PROVIDE CLARIFICATION HERE?

A: South Kentucky needs both capacity and energy to meet its members' needs. In no way does the capacity hedge impact the energy price agreed to in the transaction. South Kentucky will be purchasing capacity in the PJM market. The hedge locks in the capacity price at the RTO level, thus shifting to MSCG the risk associated with increases to the PJM RTO capacity price over the term. In other words, if the PJM RTO capacity auction produces prices in excess of capacity hedge price in the contract, Morgan Stanley will be responsible for the costs over the hedge price. In our original analysis we performed a scenario analysis to address the risk of the incremental auctions (Exhibit CB-8), the Board of South Kentucky decided to move forward with the transaction knowing the risk associated with prices above the capacity hedge. If prices were below the capacity hedge, the Board understood they would still pay the hedge price and decided to move forward with the transaction knowing the expected benefits at the hedge price.

Q: DOES THE CAPACITY HEDGE CREATE UNWARRANTED RISK IN YOUR VIEW?

A: No. To the contrary, the capacity hedge reduces the risk to South Kentucky and its members by shifting the risk of PJM RTO capacity price changes over time to MSCG. As stated above, to facilitate South Kentucky's review of the of the MSCG transaction, EnerVision analyzed the potential value of the hedge, a fact discussed in my initial testimony on pages 17 and 18, and in my initial Exhibit CB-8. The hedge component of the MSCG transaction does not constitute a significant portion of the overall deal, such that even if final incremental auctions capacity prices prove ***double*** the hedge price, the NPV savings of the transaction would remain in excess of $77.7 million over the term, based on my updated calculations.

Q: DID ENERVISION UNDERSTAND THE IMPORTANCE OF ASSESSING THE POTENTIAL RISKS ASSOCIATED WITH THE CAPACITY HEDGE, FOR PURPOSES OF SOUTH KENTUCKY'S ANALYSIS AND ULTIMATE DECISION TO PURSUE OR NOT PURSUE THE MSCG TRANSACTION?

A: Yes. South Kentucky stressed to us on numerous occasions that PJM-related costs and activities needed to be identified and understood. South Kentucky's representative during the process indicated as much to EKPC during communications over the development of South Kentucky's eventual notice to designate an alternate source. (*See* Exhibit CB REB-3.)

Q: LET'S TURN TO YOUR CALCULATIONS. MR. MOSIER, MR. MCNALLEY AND THE DISTRIBUTION COOPERATIVES' WITNESS MR. WOLFRAM ALL OFFER VARYING FORMS OF CRITICISM OF THE CALCULATED VALUE OF THE MSCG TRANSACTION TO SOUTH KENTUCKY.

A: They do. Mr. Mosier believes the rate for network integrated transmission service ("NITS") has been understated. In addition to echoing Mr. Mosier's statements on our NITS assumptions, Mr. McNalley faults EnerVision's analysis for not assuming growth in energy sales, not escalating the agency fee, use of the Rate E1 option rather than Rate E2, omission of a fuel adjustment clause ("FAC") costs. Mr. McNalley then offers his own analyses at Exhibits MM-2 and MM-3.

Q: WHAT ARE YOUR REACTIONS TO MM-2 AND MM-3?

A: True to his word, Mr. McNalley has come up with analyses that "kill" the transaction. (*See* Exhibit CB REB-4.)

Q: Do you agree with his analyses?

A: No. I believe that some of Mr. McNalley's assumptions are grossly one-sided and fundamentally flawed. This conclusion is illustrated through Mr. McNalley's Exhibit MM-3. Specifically, if one makes what I think are four reasonable changes to his assumptions, the NPV savings for the transaction are restored to over $100 million, a number that is still very conservative in my view.

Q: CAN YOU EXPLAIN?

A: Yes. First, Mr. McNalley added the fuel adjustment charge ("FAC") as a reduction to the base energy rates. Because the energy rates were escalated as part of the total EKPC costs, the FAC rates were escalated annually by 2 percent. I removed the escalation and kept the FAC the same for every year. This is a very conservative estimate given the 2015 LRFF has the FAC changing from a credit to an expense in 2019 and escalating at an average rate of 6.61 percent annually.

Q: MR. MCNALLEY STATES IN DISCOVERY RESPONSES THAT THE 2015 LONG RANGE FINANCIAL FORECAST ("LRFF") PROJECTIONS SHOULD NOT BE RELIED UPON? DO YOU THINK THIS IS REASONABLE?

A: No. According to Mr. McNalley, the last LRFF approved by EKPC's Board of Directors is the 2015 Twenty-Year Financial Forecast, 2015-2034. As EKPC confirmed in its response to South Kentucky Request 21, this forecast is the latest official information available to the owner-members regarding long range projections of future power costs under the EKPC wholesale power contact. In the absence of an alternative source of board-approved information, it seems wholly reasonable to use this LRFF. Indeed, had South Kentucky ignored the forecast altogether, I fully expect that intervenors would have criticized us for doing so. While Mr. McNalley may be able to justify in his mind why the LRFF should be ignored, it seems self-serving, given that his claims of value erosion depend on a disregard of the LRFF. That being said, we did not rely solely on the 2015 LRFF for our updated estimates.

Q: WHAT OTHER CHANGES DO YOU THINK ARE REASONABLY MADE?

A: A second modified assumption would be to add the net savings to South Kentucky from avoiding the Environmental Surcharge ("ES") calculated in Mr. McNalley's Exhibit MM-1 to the analysis. The value was de-escalated by -2.33% as calculated from the ES in the 2015 LRFF. I did include the additional expense of the ES to the remaining South Kentucky load continuing to be served by EKPC. This increased cost was also de-escalated by -2.33% as calculated from the ES in the 2015 LRFF.

Q: WHAT IS YOUR THIRD MODIFICATION?

A: My third change was to adjust the escalation on the NITS costs back to the original 3%, rather than Mr. McNalley's escalation rate of 13%. Criticism of our NITS assumptions is misplaced for two reasons. First, because our analysis is intended to show the savings from the EKPC baseline cost South Kentucky would realize from the transaction, the NITS assumptions should be viewed relative to what is reflected in EKPC's rate projections. While Mr. McNalley indicated in response to South Kentucky Data Request 25 that "EKPC cannot speculate as to whether it could or could not absorb annual increases in Network Integration Transmission Service ("NITS") charges …." that has to be viewed in light of his response to Request 42a, where he states "it is likely EKPC would need a base rate increase very close to June 1, 2019" to replace the revenue lost from South Kentucky as a result of this transaction. With that statement in mind, I would not foresee EKPC absorbing the sort of transmission cost increases they suggest without multiple rate increases over the next 20 years.

I also have reason to doubt the accuracy of the projected NITS increases, based on information from PJM. PJM's Transmission Cost Information Center ("TCIC") was established to help stakeholders better understand and anticipate changes in future transmission costs. The TCIC model provided by PJM estimates the impact of planned transmission upgrades in the revenue requirements of transmission owners, including EKPC. This information is available at http://www.pjm.com/planning/rtep-upgrades-status/cost-allocation-view.aspx (from the link "Full Version"). From April 2018 through April 2028 (ten years is the maximum period in the model), the EKPC Total Transmission Revenue Requirement is shown to be increasing 5.1%, or one half percent each year. With load growth, the NITS rate would likely be lower than the current level based on this model. I realize it does not reflect the full NITS cost picture, but clearly this is more supportive of our escalation assumption than the over 1,000% escalation over the term proposed by EKPC.

Q: WHAT IS THE FOURTH MODIFICATION?

A: In Mr. McNalley's direct testimony (pg 15 , lines 21-23, pg 16, line 1-2), he claims that "Transmission Enhancement Cost Recovery" should be escalated by 14 percent. My basis for stating Mr. McNalley's assertion of an escalator of this magnitude is incorrect is mathematical in nature and reflects the difference in load factor between the overall PJM system and South Kentucky's purchase from MSCG. His testimony fails to recognize that the Transmission Enhancement Cost Recovery prices in the PJM State of the Market reports reflect a conversion to dollars per MWh ($/MWh) of costs that are assessed to transmission customers on a peak demand basis and are thus another way in which the benefit calculation for the South Kentucky transaction is conservative in nature, rather than understated as Mr. McNalley claims. For example, using data from EKPC's Form 1 equivalent for 2016, I calculated a load factor for EKPC of 53 percent, compared to the

100% load factor of the South Kentucky purchase from MSCG. Under this example, each dollar of cost associated with peak demand would be spread over 88 percent more MWh of energy, almost twice as many, for the South Kentucky purchase from MSCG than for the EKPC system. While I do not have the load factor used to calculate the $0.64/MWh in the PJM State of the Market report for 2017 and used in the PJM Summary worksheet of Mr. McNalley's Exhibit MM2 and MM3, if that were calculated using the 53 percent EKPC load factor from my example, the equivalent cost for the South Kentucky purchase from MSCG would be $0.34/MWh. As such, using the cost factor in the PJM State of the Market report results in under-estimating the savings associated with the MSCG purchase.

Q: WHAT ARE THE RESULTS OF THESE MODIFICATIONS?

A: With these four changes in assumptions, the NPV on the transaction with MSCG provides savings estimated to be $110.8 million over the 20-year term. In addition, I would note that we ran a separate scenario in which the FAC and ES were used from the 2015 LRFF, Schedule IV. The only other change was to the escalation of the NITS, which was set at the original 3 percent. The NPV under this scenario is $235.9 million over the 20-year term.

Q: MR. MCNALLEY ALSO ATTACKS SOUTH KENTUCKY'S PROJECTIONS FOR NOT INCORPORATING POSSIBLE CHANGES TO EKPC'S RATE DESIGN IN RESPONSE TO THE MSCG TRANSACTION, CORRECT?

A: Yes. In EKPC's response to Request 5 from the Attorney General, EKPC (with Mr. McNalley as the sponsoring witness) says that some or all of the projected savings "could diminish or disappear under a new allocation methodology, if such a methodology is developed and approved", and then says that South Kentucky ignored this possibility.

Q: DO YOU THINK THIS IS A DEFICIENCY IN THE ANALYSIS?

A: No. First, while EKPC attempts to distinguish such an allocation methodology from the prohibition against assigned stranded costs to alternate source designees under the MOU, the fact remains that the MOU prohibits such action. Regardless, as EKPC explains later in its response to PSC Request 3, these rate design efforts are "in preliminary internal discussion stages" and will be preceded by "[s]ignificant research and analysis … Board authorization" and Commission approval. Thus, given that EKPC itself does not know what form, if any, such an allocation methodology would take, I find it hard to see how South Kentucky can be criticized for running an analysis on the unknown.

Q: MR. MCNALLEY ALSO CLAIMS IN RESPONSE TO SOUTH KENTUCKY'S REQUEST 48 THAT IT "CLEARLY IS UNREASONABLE" FOR THE AGENCY FEE TO REMAIN FIXED FOR THE 20-YEAR PERIOD. DO YOU AGREE?

A: No. When South Kentucky approached EKPC regarding the agency responsibility, EKPC quoted the administrative fee from its new cogeneration tariff as the charge it would assess South Kentucky to manage the alternate source contract. (*See* Exhibit CB REB-5). The rate at the time would have put the cost just over $400 thousand annually. Given that the Alternate Source is a 58 MW Block of power in every hour and the capacity will be purchased from the PJM market, this seemed like a high cost for preforming these functions. I realize there are other functions that are associated with the Agency responsibility, but I have seen these service performed for much lower costs in

PJM. For these reasons we felt it was reasonable for the fee to remain fixed over the term.

Q: CAN YOU SUMMARIZE MR. WOLFRAM'S CRITICISM OF YOUR ANALYSIS.

A: Except for certain items that I address below, Mr. Wolfram's challenges to the supporting analysis is little more than a collection of what ifs. For example, Mr. Wolfram appears to share Mr. Mosier's view that the absence of a designated resource is a problem. As indicated above, the flexibility inherent in this arrangement is one aspect of it that makes it attractive to the parties and helps ensure the fixed price of energy that South Kentucky has secured for the next 20 years.

Q: MR. WOLFRAM CLAIMS THAT THE RISKS OF THE TRANSACTION WERE NOT QUALIFIED FOR THE SOUTH KENTUCKY BOARD OF DIRECTORS. DO YOU AGREE WITH THIS?

A: No. As Mr. Holt reiterates in his rebuttal testimony, the South Kentucky Board of Directors were presented with the potential risks of the MSCG transaction so that an informed decision could be made whether or not to proceed forward. As I noted above, the need for this information was repeatedly communicated to EnerVision by South Kentucky. And where reasonably feasible, such as with capacity hedge risk, we provided scenarios to illustrate the potential change in the overall expected value of the transaction, depending on fluctuations in assumptions. Not all risks lend themselves to quantitative analysis. In this respect, I agree with Mr. McNalley, who recognized in communications with certain representatives of the Distribution Cooperatives that quantification of the

PJM-related variables was guess-work and would tend to inject error into the analysis. (*See* Exhibit CB REB-6.)

Q: IS SOUTH KENTUCKY WITHOUT PROTECTION FROM THESE RISKS?

A: No. PJM comprises 1,037 members, with many of these members possessing a vested interest in seeing associated costs remaining manageable over time. PJM also is subject to FERC oversight. These and other factors, including the evolution of the RTO and other changes over time, all contribute to the qualitative consideration of whether the MSCG transaction is of value to South Kentucky and its members.

Q: IN RESPONSE TO STAFF REQUEST 2, MR. WOLFRAM SPECULATES ON WHAT HE PERCEIVES AS RISKS TO SOUTH KENTUCKY ASSOCIATED WITH THE ABSENCE OF A DESIGNATED RESOURCE, NAMELY POWER SCARCITY AND COST. DO YOU CONCUR WITH HIS VIEW?

A: No. As I discussed earlier, the flexibility that MSCG has under the transaction is of value both to MSCG and to South Kentucky. Among other things, it establishes the baseline expectation that MSCG will find ways to deliver, because there is not a specific generation resource associated with the deal that the parties would know to be subject to unforced outages or fuel curtailment at some point over a 20-year span. The lack of a designated resource also helps to ensure that South Kentucky is protected against Additional Environmental Costs, as it will be inherent on MSCG to look to the market for supply before seeking to pass along such costs to South Kentucky. And in the event MSCG failed to deliver, South Kentucky would be made whole for the replacement power procured.

Q: WHAT ABOUT THE LONGER-TERM RISKS MR. WOLFRAM IDENTIFIES IN HIS RESPONSE TO THE PSC STAFF?

A: Similarly, the transaction protects South Kentucky. In essence, Mr. Wolfram is saying that MSCG may economically default if circumstances require it. There is no "renegotiation" reopener in the MSCG transaction, however, and contrary to suggestions by Mr. Mosier, the Additional Environmental Costs provision does not serve as some backdoor price modifier. Moreover, the transaction is backed by MSCG's parent, Morgan Stanley. Thus, the transaction affords South Kentucky more than adequate protection in the unlikely event such a circumstance materialized.

Q: WHAT IS YOUR CONCLUSION OF MR. WOLFRAM'S CRITIQUE OF YOUR ANALYSIS OF POTENTIAL TRANSACTION VALUE?

A: Mr. Wolfram appears to a have calculated three sets of additional costs that he says should be included with the any savings assessment. (See PSC Response 3, Files 1, 2 and 3.) As South Kentucky indicated in discovery responses, there should be an increase in the costs of the NITS due to issues with the rate and the way it was applied. Mr. Wolfram quantifies this increase as $9 million, which is accurate. The second cost item relates to the PJM Schedule 1-A rate. Mr. Wolfram has calculated this as an approximate $1.4 million decrease to the value of the transaction, which likewise is accurate.

The third group of costs concern additional Transmission Enhancement Cost, which he claims when factored into the analysis would reduce savings by $65 thousand annually Mr. Wolfram's conclusions regarding this group of costs are incorrect and should be ignored by the Commission for three reasons. First, consistent with my discussion of EKPC's assertions regarding transmission, South Kentucky would expect to pay the same

Transmission Enhancement Cost whether buying power from EKPC or MSCG, so those charges are not relevant to South Kentucky's evaluation of savings under the MSCG transaction. Second, Mr. Wolfram's $65 thousand calculation is premised on an "if" of Transmission Enhancement Cost increasing by 20% every year. His premise of future cost escalations is not supported by PJM's own data. As I discussed above, the PJM TCIC reflects almost no escalation in the EKPC Total Transmission Revenue Requirement. My third basis for stating Mr. Wolfram's claim of reduced savings in this area is incorrect is the same argument regarding load factor that I mentioned above regarding Mr. McNalley's escalation of these costs.

Q: MR. WOLFRAM ALSO CLAIMS THE LENGTH OF THE MSCG TRANSACTION CREATES RISK SOUTH KENTUCKY COULD BE SUBJECT TO INCREASES IN PJM COSTS WITH NO WAY TO EXIT THE DEAL. DO YOU AGREE?

A: No. This is an example of Mr. Wolfram ignoring facts that don't support his desired conclusion. South Kentucky's contract with EKPC could also subject it to significant increases in PJM costs and South Kentucky has no way to exit that contract, either. As such, I don't see the risk associated with the MSCG transaction that Mr. Wolfram claims South Kentucky failed to consider.

Q: MR. WOLFRAM INDICATES IN RESPONSE TO SOUTH KENTUCKY'S REQUEST 10 THAT SOUTH KENTUCKY IS PARTICULARLY EXPOSED TO CHANGES IN PJM COSTS, NOTING THAT COST IMPACTS TO EKPC CAN BE SPREAD ACROSS ALL OWNER-MEMBERS, BUT SOUTH KENTUCKY IS FORCED TO BEAR THESE ON ITS OWN. WHAT ABOUT THESE COSTS?

A: Since most PJM costs are load-based, it seems like there would be little to no relative difference between EKPC and South Kentucky, save delays in cost recovery by East Kentucky due to rate case filing timing.

Q: MR. WOLFRAM ALSO CLAIMS THAT INSUFFICIENT SENSITIVITIES WERE PERFORMED. DO YOU AGREE WITH THAT?

A: No, as stated previously, scenarios were developed for changes in the capacity price versus the hedge. The fact that the MSCG transaction has a fixed energy price for a 58MW, 7x24, block, scenarios on energy costs are not necessary. As previously discussed, laws that added increased costs to the energy under the MSCG transaction, would most likely have a similar impact on EKPC costs. So, that leaves transmission and PJM charges. Mr. Wolfram tried to show that the variables in transmission and PJM charges decrease the value of the transaction. If Mr. Wolfram's assumptions are correct, South Kentucky would still see over $100 million in savings. This level of savings would fall into the range of expected benefit the Board of Directors was presented.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.