COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION OF KENTUCKY

In the Matter of:

APPLICATION OF SOUTH KENTUCKY RURAL ELECTRIC COOPERATIVE CORPORATION FOR APPROVAL OF MASTER POWER PURCHASE AND SALE AGREEMENT AND TRANSACTIONS THEREUNDER	)))))	**Case No. 2018-00050**

DIRECT TESTIMONY

OF

WILLIAM T. PRATHER
PRESIDENT & CEO OF FARMERS RURAL ELECTRIC COOPERATIVE CORPORATION

ON BEHALF OF

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
NOLIN RURAL ELECTRIC COOPERATIVE CORPORATION

FILED: **April 12, 2018**

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OF
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I. INTRODUCTION

Q. Please state your name, business address, and position.

A. My name is William T. Prather. I am employed by Farmers Rural Electric Cooperative Corporation ("Farmers"), 504 South Broadway, Glasgow, Kentucky 42141 as its President and CEO. I have held this position since August 2007, a period of over ten years.

Q. Please provide a brief overview of Farmers' operations.

A. Farmers' is a "distribution cooperative" as defined in KRS 278.010(10) that provides retail electric service using 3,659 miles of distribution lines to approximately 25,300 members located in Adair, Barren, Edmonson, Grayson, Green, Hart, Larue and Metcalfe counties in Kentucky.

Q. What was your employment experience before working for Farmers?

A. I was employed at Owen Electric Cooperative, Inc., from February 1979 to October 2005, a period of almost twenty-seven years. I held various positions during my tenure with Owen Electric, including supervision of the corporate general accounting, customer accounting and billing, member and public relations, IT services, construction, engineering staking, and vehicle fleet services. In October 2005, I accepted a position with East Kentucky Power Cooperative, Inc. ("EKPC") in Economic Development and Industrial Recruitment. I later assumed responsibility for the Member Service Department and Envision Energy Services Subsidiary. I left EKPC in August of 2007 to accept the CEO position at Farmers.

Q. What is your educational background?

A. I have a Bachelor of Business Administration from Eastern Kentucky University and a Master of Business Administration from the University of Kentucky.

Q. Have you previously testified before the Kentucky Public Service Commission ("Commission")?

A. Yes. I have previously testified in two Farmers rate cases, P.S.C. Case Nos. 2008-00030 and 2016-00365.

II. PURPOSE OF TESTIMONY

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to show that the proposed power purchase agreement between South Kentucky Rural Electric Cooperative Corporation ("South Kentucky") and Morgan Stanley Capital Group and related documents, attached as exhibits 5 through 15 to the application (the "PPA") and the contractual arrangements authorizing South Kentucky to pursue purchase of a portion of its power requirements from an alternate source will create an unreasonably discriminatory shift in responsibility for the fixed and variable operating costs of EKPC among the sixteen distribution cooperatives that are members and owners of EKPC. My recommendation is that South Kentucky's request for approval of the PPA be denied, and that the Commission revisit the reasonableness of the contractual arrangements pursuant to which South Kentucky solicited and entered into the PPA.

Q. What are the contractual arrangements authorizing South Kentucky to pursue purchase of a portion of its power requirements from an alternate source to which you refer?

A. Those contractual arrangements are Amendment No. 3 dated November 13, 2003, to the Wholesale Power Contract dated October 1, 1964 between and among EKPC and its sixteen member cooperatives ("Amendment No. 3"), an example of which is attached as Exhibit 1 to the application herein, and the Memorandum of Understanding and Agreement Regarding Alternate Power Sources dated July 24, 2015, between and among EKPC and its sixteen member distribution cooperatives (the "MOU"), which is attached as Exhibit 2 to the application herein.

Q. Are you appearing on behalf of Farmers only, or are you also testifying on behalf of other distribution cooperatives?

A. I am primarily representing Farmers, but I have been authorized to say that my testimony also represents the positions and opinions of eight other distribution cooperatives who are parties in this case, namely Big Sandy Electric Cooperative Corporation, Blue Grass Energy Cooperative Corporation, Clark Energy Cooperative, Inc., Cumberland Valley Electric, Inc., Fleming-Mason Energy Cooperative, Inc., Inter-County Energy Cooperative Corporation, Licking Valley Rural Electric Cooperative Corporation, and Nolin Rural Electric Cooperative Corporation.

Q. Are you sponsoring any exhibits?

A. Yes. Two exhibits are attached to my testimony:

1. Exhibit WTP_1, which is the last, unnumbered page of the documents produced by South Kentucky in response to the Distribution Cooperatives First Request for Information, Item 4, filed as "DC Attachment 4 – Public."

2. Exhibit WTP_2, which is EKPC's December 29, 2017 email and December 27, 2017 memorandum attached to that email produced by South Kentucky in response to

Nucor Steel Gallatin's First Request for Information, Item 1, and elsewhere in its responses.

III. <u>DESCRIPTION OF ISSUES WITH AMENDMENT NO. 3 AND THE MOU</u>

Q. Please briefly describe the history behind Amendment No. 3 and the MOU.

A. In general, I agree with the summary of the history of Amendment No. 3 and the MOU set forth on pages 5-10 EKPC's PowerPoint presentation titled "Amendment No. 3 and MOU History and MOU Cost and Mitigation Plan" dated February 13, 2017, although the correct date is February 13, 2018, filed by South Kentucky as part of "DC Attachment 4," which is part of the information for which South Kentucky is seeking confidential treatment. Amendment No. 3 was required in connection with an EKPC financing transaction to extend the term of the wholesale power contracts between EKPC and each of its members to match the maturity date of EKPC's new debt. The additional terms in Amendment No. 3, allowing purchase by a distribution cooperative of alternately-sourced power, represent concessions EKPC had to make to induce all its members to agree to extension of the term of the wholesale power contracts.

Q. Were there problems with Amendment No. 3?

A. Yes. While the provision in Amendment No. 3 extending the term of the wholesale power contracts was appropriate, several of the provisions in Section 1 that allowed purchase by a distribution cooperative of alternately-sourced power were poorly drafted. The Commission identified one of the problems in its July 17, 2013 Order entered in P.S.C. Case No. 2012-00503 (the "<u>Grayson case</u>"). The Commission noted that while each member had the right to purchase 15% of its coincident peak[1]("<u>Alternate</u>

[1] As used throughout my testimony, the term "coincident peak" is intended to mean the rolling average of the referenced utility's coincident peak demand for the single calendar month with the highest peak

Source Allotment") from a supplier other than EKPC (an "Alternate Source"), the total of all member purchases from an Alternate Source could not exceed 5% of EKPC's coincident peak. That created the inconsistency whereby one or more members could purchase its or their full Alternate Source Allotment of 15%, resulting in other members not being able to purchase all or any energy from an Alternate Source. This issue has been called the "first hog to the trough" problem.

Another related issue with Amendment No. 3 is the "run on the bank" problem. When members see that the total Alternate Source Allotment available to all members, 5% of EKPC's coincident peak, is significantly diminishing, there is a strong incentive for many or all of them to exercise their right to purchase their entire, respective Alternate Source Allotments so they do not lose that right. A cooperative that does not do so may lose some or all of its Alternate Source Allotment.

On pages 16-17 of its July 17, 2013 Order, the Commission decided to conduct an investigation into Amendment No. 3 and whether it was ambiguous as to "how the allocation of alternative sourced power is to be shared by Members" and "whether if Amendment 3 is not ambiguous, the Commission should nonetheless impose an allocation sharing requirement." The Commission further noted, on page 20 of that Order, that the members had been debating this issue for some time and could not reach a consensus, and that the issue may arise again if not resolved.

Q. Did the MOU solve these problems?

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demand occurring during each of the three twelve-month periods immediately preceding the relevant election or act. In other words, "coincident peak" is calculated as described in Amendment No. 3 and the MOU.

A. No. As we now know, if anything the MOU made the problems worse. The MOU was ostensibly intended to memorialize the agreement of the parties to Amendment No. 3 about how the Alternate Source power arrangements would operate in practice. But the signatories to it were strongly motivated by a desire to settle the contentious and resource-intensive litigation regarding Alternate Source power that Grayson Rural Electric Cooperative Corporation was pursuing in the Grayson case, and other venues. Once again, the terms of the MOU reflect the concessions that were required to obtain the signatures of the seventeen parties to Amendment No. 3.

The first hog to the trough problem still exists, and is demonstrated by what has happened since South Kentucky gave its 58 MW Alternate Source election notice on November 28, 2017. Please turn to my Exhibit WTP_1.

First, I think it is notable that even though every distribution cooperative has an Alternate Source Allotment of up to 15% of its coincident peak, if each of them elected only 5% of its coincident peak the resulting aggregate amount of the elections would exceed the 158.5 MW cap on elections, which is 5% of EKPC's coincident peak. The circumstances that existed as of November 28, 2017, but without considering South Kentucky's noticed 58 MW purchase, were that the combination of existing and noticed Alternate Source acquisitions by the 16 EKPC member cooperatives was 11.2 MW, as noted by South Kentucky in its response to Item 14 of the Commission Staff's First Request for Information. Of that amount, I should note that Farmers recently withdrew its previous election to take Alternate Source power from 3.6 MW of Federal Mogul distributed generation. The existing and noticed Alternate Source acquisitions at that time consisted of relatively small acquisitions, many of which were "behind the meter," not market power purchase agreements. After South Kentucky made its 58 MW election, the aggregate existing and noticed Alternate Source acquisitions jumped to 69.2 MW.

When the implications of South Kentucky's actions became clear, five more distribution cooperatives gave Alternate Source election notices, raising the total amount of Alternate Source projects to 114.4 MW, well above 2.5% of EKPC's coincident peak. My Exhibit WTP_1 does not include Farmers in that group, but Farmers also gave notice of 1.9 MW in additional Alternate Source projects as a defensive move to protect its interests during the developing "run on the bank." That notification occurred on February 8, 2018, but was subsequently withdrawn on April 4, 2018, along with a request to withdraw 3.6 MW of Farmers' previous Amendment 3 allocation pertaining to its Federal Mogul generators.

Once the amount of Alternate Source projects reached 2.5% of EKPC's coincident peak, the Alternate Source Allotment of a distribution cooperative dropped from 15% to 5% for purposes of all future Alternate Source elections. This leaves the distribution cooperatives that still have any remaining Alternate Source allotment after the reduction with the difficult choice of giving notice to take that allotment and exacerbate the damage to the other distribution cooperatives, or take nothing, lose its remaining allotment and suffer the consequences if others do take their allotments.

Q. What are the consequences of Amendment No. 3 and the MOU?

A. Amendment No. 3 and the MOU create classes of winners and losers based on no rational classification other than who is first to give its Alternate Source notice. The losers get to share in the rate impacts caused by the winners reducing their participation in EKPC's fixed and variable costs. No cooperative has given Alternate Source notices to elect more than 5% of its coincident peak, except South Kentucky, which took 15% of its coincident peak, at least three times more than any other cooperative. Especially in regard to South Kentucky, its proposed transaction results in a shift of EKPC's costs to the other cooperatives, since South Kentucky will purchase significantly less power from EKPC, and a defensive "run on the bank" by other distribution cooperatives threatens to basically double the negative impact of South Kentucky's strategy.

Q. What is your understanding of the potential cost-shift to the other cooperatives that may result if the Commission approves South Kentucky's proposed transaction?

A. My understanding is based on the December 27, 2017 memorandum produced as part of South Kentucky's response to Nucor Steel Gallatin's First Request for Information, Item 1, a copy of which is attached to my testimony as Exhibit WTP_2. EKPC states therein that this loss of load will shift costs, consisting of fixed costs that EKPC can no longer recover from South Kentucky in base rates, and the environmental surcharge that will be reallocated to all members based on revenue. EKPC estimates that $4.1 million in annual environmental surcharge costs and $13 million in annual fixed costs will be allocated to the other fifteen cooperatives, for a total of $17.1 million. While EKPC mentioned potential mitigation efforts, any possible mitigation is speculative and cannot eliminate this cost shift. As John Wolfram has calculated in his testimony, the total annual cost shift could range between $15.9 million and $18.3 million.

Q. How will this cost shift impact Farmers and its member-owners?

A. In John Wolfram's testimony, Mr. Wolfram estimates that the cost shift caused by South Kentucky's election, alone, will cause an annual increase in Farmer's wholesale power costs of approximately $768,205 composed of an estimated $589,291 in base rate increases and $178,914 in reallocated environmental surcharge costs. Farmers cannot absorb the additional base rate fixed costs without an increase in its rates to its member-owners. The same is also probably true of the other cooperatives, with the possible exception of South Kentucky. Also, there will be a considerable shift in environmental surcharge costs to Farmers and the other cooperatives which will be added to our member-owners' monthly electric bills. These cost shifts will burden all of our member-owners with higher electric bills, and will be especially hard on those cooperatives in Eastern Kentucky that are already losing load and members due to the declining economy. So, approval of South Kentucky's PPA may result in sixteen new rates cases filed by EKPC and its members, with the possible exception of South Kentucky.

Additionally, the run on the bank by several of the other cooperatives that has occurred to date, and may continue in the future, will result in additional shifting of costs and likely cause the filing of a second series of rate cases by EKPC and all sixteen of its members, including South Kentucky.

Q. Do you believe the provisions of Amendment No. 3 and the MOU that allow South Kentucky to shift these costs to others and reduce the ability of EKPC and the other distribution cooperatives to mitigate those costs are reasonable?

A. No, I do not. The sole reason that South Kentucky can avoid these costs and shift them to the other cooperatives is because of when it submitted its notice of this transaction to EKPC. South Kentucky, along with the other cooperatives, who are members of EKPC, voted to invest millions of dollars in infrastructure so that EKPC could adequately provide power to its member cooperatives, resulting in significant additional fixed costs for EKPC. I do not believe that any cooperative should have the ability to avoid responsibility for such a significant portion of its share of those costs that it agreed to incur and force the fifteen other cooperatives and their retail members to pay more for their power. So, there will be winners, being South Kentucky and its members (if the proposed transaction truly reduces South Kentucky's costs), and there will be losers, being all of the other cooperatives and their members saddled with a disproportionate share of EKPC's costs. While South Kentucky's actions may be permitted under Amendment No. 3 and the MOU, for the reasons that I have previously stated in my testimony, those agreements permit an unreasonable and unreasonably discriminatory shift in the responsibility for fixed and variable operating costs of EKPC among South Kentucky and South Kentucky's sister cooperatives.

Q. Did Farmers sign Amendment No. 3 and the MOU?

A. Yes, Farmers signed both documents.

Q. Did Farmers and the other distribution cooperatives that are signatories to Amendment No. 3 and the MOU realize the implications of the Alternate Source terms in those agreements at the time they were signed?

A. As I mention above, the impetus for Amendment No. 3 was to extend the terms of the EKPC wholesale power contracts with its members to enable EKPC to obtain financing for construction of new plants to meet its demand. And for the MOU, the primary reason it was created was to settle litigation. Farmers did not like the terms of either document pertaining to the Alternate Source energy scheme, but signed each of them to accomplish the primary goal in each instance.

Speaking principally for myself, although I think my opinion is shared by many others, I did not expect that any distribution cooperative would take 15% of its load from an Alternate Source, and thought all Alternate Source projects would be relatively small and most likely behind-the-meter projects, like Farmer's landfill gas generation project. But to your question, we did not appreciate the potential for the dramatically negative impacts that have been exposed by the proposed South Kentucky PPA. In fact, I am not sure any of the distribution cooperatives realized the significance of South Kentucky's Alternate Source plans until EKPC provided the initial analysis contained in the December 27, 2017 memorandum from EKPC attached to my testimony as Exhibit WTP_2. Shame on us for not doing a better job of analyzing and understanding those agreements, and anticipating the consequences of a large cooperative electing most or all of its entitlement to Alternative Source power at a 100% load factor. But we are where we are now, trying to prevent the damage that those flawed agreements permit to be imposed upon the other parties to them.

IV. <u>CONCLUSION</u>

Q. What are your conclusions and recommendations to the Commission in this proceeding?

A. The Alternative Source power terms of Amendment No. 3 and the MOU operate in a manner that creates classes of winners and losers that are not based upon any legitimate rate-making principle, and unreasonably discriminate against the distribution cooperatives that are denied access to a proportionate amount of the available allotment of Alternate Source power. The PPA, a product of those flawed agreements, exposes the unreasonableness of the Alternate Source scheme, and should not be approved. In fact, the Commission should revisit the reasonableness of the entire Alternate Source scheme contained in Amendment No. 3 and the MOU.

Q. Does this conclude your testimony?

A. Yes.

Verification

I, William T. Prather, President and CEO of Farmers' Rural Electric Cooperative Corporation, hereby state and affirm that the foregoing testimony and attached exhibits were prepared by me or under my supervision, and all statements contained therein are true and correct to the best of my knowledge and belief, on this the 11th day of April, 2018.

William T. Prather

William T. Prather

COMMONWEALTH OF KENTUCKY)

COUNTY OF BARRON)

The foregoing verification statement was SUBSCRIBED AND SWORN to before me by William T. Prather, President and CEO of Farmers' Rural Electric Cooperative Corporation, on this the 11th day of April, 2018.

Linda Sue Jolene
ID# 44566

Notary Public, Ky., State at Large

My commission expires: 07-30-2019