

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

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

POST HEARING BRIEF OF JOINT INTERVENORS

July 2, 2018

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The Joint Intervenors,<sup>1</sup> by counsel, for their post-hearing brief state as follows:

## I. INTRODUCTION

The applicant, South Kentucky Rural Electric Cooperative Corporation (“South Kentucky”), conducted a flawed due diligence process and failed to properly analyze the risks and potential costs of its proposed Power Purchase Agreement (“PPA”) with Morgan Stanley Capital Group, Inc. (“Morgan Stanley”), including the cost-shift to South Kentucky’s fifteen sister distribution cooperatives, being the Joint Intervenors and six other distribution cooperatives<sup>2</sup> who, with South Kentucky own East Kentucky Power Cooperative, Inc. (“EKPC”). A proper analysis by South Kentucky would have confirmed that the PPA is not in the best interest of South Kentucky’s member-owners, its sister cooperatives, or their largest asset, EKPC. In addition, as explained below in more detail, the Commission should deny South Kentucky’s application and declare invalid both Section I of Amendment 3 (“Amendment 3”) to the Wholesale Power Contract (“WPC”) dated October 1, 1964 between and among EKPC and its sixteen member distribution cooperatives

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<sup>1</sup> The “Joint Intervenors” are nine of the fifteen EKPC sister distribution cooperatives of the applicant, being 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.

<sup>2</sup> Grayson Rural Electric Cooperative Corporation, Jackson Energy Cooperative Corporation, Owen Electric Cooperative, Inc., Shelby Energy Cooperative, Inc., Salt River Electric Cooperative Corporation, and Taylor County Rural Electric Cooperative Corporation.

(EKPC's "Owner-Members"), and the Memorandum of Understanding and Agreement regarding Alternate Power Sources dated July 24, 2015 (the "MOU").

## II. FACTUAL BACKGROUND

### A. Amendment 3 to the Wholesale Power Contract

In 2003, EKPC needed additional financing from the Rural Utilities Service ("RUS") to finance construction of new generation facilities.<sup>3</sup> As a condition to that financing, RUS required an extension of the WPC.<sup>4</sup> Amendment 3<sup>5</sup> to the WPC extended the term of the WPC to match the maturity date of EKPC's new financing with RUS.<sup>6</sup> Some of the Owner-Members refused to agree to the extension unless they were granted the right to purchase energy from a source other than EKPC (an "Alternate Source").<sup>7</sup> Commission Chair Michael J. Schmitt aptly described this negotiation ploy as "putting your gun at your own head."<sup>8</sup> This resulted in Section I to Amendment No. 3, which amended the "all-requirements" section of the WPC to add that right.<sup>9</sup>

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<sup>3</sup> EKPC's Responses to South Kentucky's First Request for Information, Attachment SK\_5, page 30; and Joint Intervenors' Response to Commission Staff's First Request for Information, Item 4, and DC Attachment PSC#4 (RUS required EKPC, as a condition to obtaining financing of the Gilbert Generating Unit at the Spurlock Power Station and related transmission facilities, to obtain an extension of the wholesale power contracts from January 1, 2025 to January 1, 2041).

<sup>4</sup> Direct Testimony of Mr. William T. Prather at page 6, 10-12.

<sup>5</sup> An example of Amendment No. 3 is attached as Exhibit 1 to the Application.

<sup>6</sup> *Id.*; and Hearing Testimony of Mrs. Carol Wright, May 16, 2018 at 4:00:30 p.m.

<sup>7</sup> Hearing Testimony of Mrs. Carol Wright, May 16, 2018 at 4:00:40 p.m.

<sup>8</sup> *Id.* at 4:01:18 p.m.

<sup>9</sup> Direct Testimony of Mr. William T. Prather at page 6, 12-15.

## B. The Memorandum of Understanding

As the Commission knows, since 2003, EKPC and its Owner-Members have experienced consternation over the interpretation and application of Amendment 3, including but not limited to its flawed allocation system for Alternate Source elections (the “Alternate Source Scheme”). The first issue arose in 2009 when Jackson Energy Cooperative Corporation (“Jackson”) gave notice to EKPC of Jackson’s intent to purchase 40 MW, Jackson’s full 15% Alternate Source election, at a 100% load factor from an Alternate Source under Amendment 3.<sup>10</sup> At that time, nobody appreciated the cost-shifting consequences of such an election.<sup>11</sup> However, in 2010, Jackson withdrew its notice after discussions with EKPC President and CEO Tony Campbell because “it was going to shift costs to the other cooperatives, and that’s not in our Cooperative Principles.”<sup>12</sup>

These flaws in Amendment 3 also spawned the 2012 case before the Commission filed by Grayson RECC, PSC Case No. 2012-00503 (the “Grayson Case”), which involved Grayson’s attempt to enter into a power purchase agreement for its full 15% allotment. To resolve the Grayson Case and “stop the bleeding” of extensive litigation costs resulting from it, EKPC and its Owner-Members executed the MOU.<sup>13</sup> The MOU purported to “interpret” Amendment 3 and was signed by the parties because three of EKPC’s Owner-Members refused to agree on provisions

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<sup>10</sup> Direct Testimony of Mr. Tony Campbell at page 6, 5-6; and EKPC’s Response to South Kentucky’s First Request for Information, Item 30.

<sup>11</sup> Hearing Testimony of Mrs. Carol Wright, May 16, 2018 at 3:56:51 p.m.

<sup>12</sup> *Id.* at 4:06:10 p.m.; see also Direct Testimony of Mr. Tony Campbell at page 6, 9-10, and page 18, 8-13.

<sup>13</sup> Direct Testimony of Mr. William T. Prather at page 8, 4-6; and the MOU is attached as Exhibit 2 to the Application.

that would have eliminated most or all of the flaws in the Alternate Source Scheme.<sup>14</sup>

South Kentucky claims on pages 2 and 3 of its Initial Post-Hearing Brief that the Commission “approved” the MOU. However, in the Grayson Case, the Commission only found that the MOU is “comprehensive in nature, does not violate any legal or regulatory principle, and results in a reasonable resolution of all issues to be investigated in this case.”<sup>15</sup> As noted by Commission staff during cross-examination of Mr. Dennis Holt, President and CEO of South Kentucky, the Commission conducted no hearing in the Grayson Case<sup>16</sup> and only investigated “whether Amendment 3 requires, or a need exists for a methodology for sharing among all Members the allocation of alternative sourced power authorized under Amendment 3.”<sup>17</sup> The cost shift dilemma caused by the Alternative Source Scheme was not investigated, considered or approved by the Commission. When asked whether the Commission can consider the cost shifting aspects of the PPA in this proceeding, Mr. Holt testified, “That is a Commission decision. We would stand by the Order of the Commission. But the cost shifting is a factor, a part of the MOU. They can take that into consideration most certainly as they can any other issue.”<sup>18</sup>

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<sup>14</sup> EKPC’s Responses to South Kentucky’s First Request for Information, Item 32 and Attachment SK\_5, page 33; *see also* Direct Testimony of Mr. Tony Campbell at page 5, line 18-page 6, line 2.

<sup>15</sup> December 10, 2015 Order in PSC Case No. 2012-00503 at page 5, introduced into evidence as P.S.C. Hearing Exhibit 1.

<sup>16</sup> Hearing Testimony of Mr. Dennis Holt, May 15, 2018 at 3:27:40 p.m.

<sup>17</sup> P.S.C. Hearing Exhibit 1 at page 2.

<sup>18</sup> Hearing Testimony of Mr. Dennis Holt, May 15, 2018 at 3:30:10 p.m.

### C. South Kentucky's PPA

It is now clear that the MOU did not resolve the problems with Amendment 3, including cost-shifting.<sup>19</sup> The chief executive officers of EKPC's sixteen distribution cooperatives who served in that capacity during negotiation and execution of the MOU understood and believed that no distribution cooperative would exercise rights under Amendment 3 that would cause a cost shift that harmed other distribution cooperatives in violation of the seven Cooperative Principles, including "Cooperation among Cooperatives," highlighted throughout this case.<sup>20</sup> However, Mr. Holt was not President and CEO of South Kentucky at the time the MOU was negotiated and executed. Allen Anderson was the President and CEO of South Kentucky when the Liberty Report and EKPC management audit occurred, during the Grayson Case, and during negotiation and execution of the MOU.<sup>21</sup> Mr. Holt failed to consult about the PPA with Mr. Anderson.<sup>22</sup> Instead, with no understanding of the history of these documents, Mr. Holt, without discussion with any other distribution cooperative and very little discussion with EKPC, covertly hired a consultant, initiated an RFP, and negotiated a deal with a third party to purchase from someone other than EKPC 40% of South Kentucky's

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<sup>19</sup> See, e.g., Hearing Testimony of Mrs. Carol Wright, May 16, 2018 at 3:58:45 p.m.

<sup>20</sup> See, e.g., Direct Testimony of Mr. William T. Prather at page 13, 1-10; Hearing Testimony of Mrs. Carol Wright, May 16, 2017 at 4:07:58 p.m.; and Hearing Testimony of Mr. Mark Stallons, May 17, 2018 at 4:22:30 p.m. ("My recollection tells me that all co-ops that were expected to possibly want to run a 15% member election...were asked that same question...and we were not the ones who have done it and we were surprised.")

<sup>21</sup> Hearing Testimony of Mr. Dennis Holt, May 15, 2018 at 2:31:35 – 2:33:10 p.m.

<sup>22</sup> *Id.* at 2:31:40 p.m.



energy requirements<sup>23</sup> over a twenty-year period. This resulted in South Kentucky executing the PPA with Morgan Stanley on December 19, 2017 for 58 MW of firm energy over a twenty-year term beginning June 1, 2019 at a fixed price of \$33.95/MWh with a 68 MW financial capacity hedge for eighteen years beginning June 1, 2021 at a price of \$125/MW-day.<sup>24</sup>

### III. STANDARD OF REVIEW

There are several requirements that South Kentucky must satisfy under the applicable standard of review, which are set forth below.

#### A. KRS 278.300 and KRS 278.020(1)

Long term power purchase agreements, including contracts with minimum payment or take/pay provisions like the PPA, constitute “evidences of indebtedness” that are subject to Commission review under KRS 278.300.<sup>25</sup> KRS 278.300(3) expressly requires the Commission to make three findings:

1. The PPA is for a lawful object within the corporate purposes of the utility.
2. The PPA is necessary or appropriate for or consistent with the proper performance by the utility of its service to the public and will not impair its ability to perform that service.
3. The PPA is reasonably necessary or appropriate for such purpose.

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<sup>23</sup> *Id.* at 1:13:40 p.m.

<sup>24</sup> Application, page 1. Before the hearing in this case, South Kentucky withdrew its request for confidential treatment of the price of the energy and capacity hedge.

<sup>25</sup> *See In the Matter of: Application of Louisville Gas and Electric Company and Kentucky Utilities Company for a Declaratory Order and Approval pursuant to KRS 278.300 for a Capacity Purchase and Tolling Agreement*, Order, P.S.C. Case No. 2014-00321 (Nov. 24, 2014).

Also, when the evidence of indebtedness is a power purchase agreement, a utility must establish a “need” for additional generation and the absence of “wasteful duplication,” factors considered when evaluating a certificate of public convenience and necessity under KRS 278.020(1).<sup>26</sup> The Commission cited these same standards in another case involving a power purchase agreement:<sup>27</sup>

...[Kentucky Power’s] proposal to enter into a long-term contract to purchase such generation will have the same operational and financial implications and impacts to the utility and its ratepayers as if new generation were being constructed. Consequently, in examining the statutory criteria for approving financing under KRS 278.300(3), the ‘purposes and uses of the proposed issue’ are for the acquisition of new generation; and for the debt to be for some lawful object within the corporate purposes of the utility, there must be a need for additional generation and the absence of wasteful duplication.

“Need” requires a showing of substantial inadequacy of existing service, involving a consumer market sufficiently large to make it economically feasible for the new system or facility to be constructed or operated.<sup>28</sup> The inadequacy must be due either to a substantial deficiency of services facilities, beyond what could be supplied by normal improvements in the ordinary course of business; or to indifference, poor management or disregard of the rights of consumers, persisting

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<sup>26</sup> *Id.*

<sup>27</sup> *In the Matter of: Application of Kentucky Power Company for Approval of Renewable Energy Purchase Agreement for Wind Energy Resources between Kentucky Power Company and FPL Illinois Wind, LLC*, Order, P.S.C. Case No. 2009-00545 (June 28, 2010), at 5-6.

<sup>28</sup> *In the Matter of: Application of Kentucky Power Company for Approval of the Terms and Conditions of the Renewable Energy Purchase Agreement for Biomass Energy Resources between the Company and Ecopower Generation-Hazard LLC; Authorization to Enter into the Agreement; Grant of Certain Declaratory Relief; and Grant of All Other Required Approvals & Relief*, Order, P.S.C. Case No. 2013-00144 (Oct. 10, 2013), at 13, citing *Ky. Utilities v. Public Service Commission*, 252 S.W.2d 885, 890 (Ky. 1952).

over such a period of time as to establish an inability or unwillingness to render adequate service.<sup>29</sup>

“Wasteful duplication” is defined as “an excess of capacity over need,” “an excessive investment in relation to productivity or efficiency, and an unnecessary multiplicity of physical properties.”<sup>30</sup> For an applicant to demonstrate that a proposed facility does not result in wasteful duplication, the Commission has held that the applicant must demonstrate that a thorough review of all reasonable alternatives has been performed. Selection of a proposal that ultimately costs more than an alternative does not necessarily result in wasteful duplication. All relevant factors must be balanced.<sup>31</sup> In addition, when considering supply-side planning or acquisition, including power purchase agreements, the Commission has historically applied a least cost analysis in setting rates that are fair, just and reasonable.<sup>32</sup>

Contrary to the assertions of South Kentucky, it is not absolved of its burden of proving “need” and absence of “wasteful duplication” merely because it is a distribution cooperative and not a generation and transmission cooperative or because it is “supplementing” generation. The Commission cases cited above make no such distinction. South Kentucky, like Kentucky Power in the cited cases, is adding generating capacity. South Kentucky, with its fifteen sister cooperatives,

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<sup>29</sup> *Id.*

<sup>30</sup> *Id.*

<sup>31</sup> *Id.* at 13-14 (citation omitted).

<sup>32</sup> *Id.*; see also *In the Matter of: Application of Kentucky Power Company for Approval of Renewable Energy Purchase Agreement for Wind Energy Resources between Kentucky Power Company and FPL Illinois Wind, LLC*, Order, P.S.C. Case No. 2009-00545 (June 28, 2010) at 5, citing *Public Service Commission v. Continental Tel. Co.*, 692 S.W.2d 794, 799 (Ky. 1985).

owns EKPC and, until 2003, relied on EKPC for all of its energy requirements. South Kentucky was an Owner-Member of EKPC when all decisions were made to undertake “steel in the ground”<sup>33</sup> projects to adequately and reliably serve EKPC’s Owner-Members.<sup>34</sup> As noted by Nucor Steel Gallatin (“Nucor”) in its brief on pages 10-11, the Commission does not require South Kentucky to file an Integrated Resource Plan because its load is included in EKPC’s load. South Kentucky cannot require the Commission, when applying the standards of need and wasteful duplication, to view South Kentucky in a vacuum when South Kentucky is intimately interconnected with EKPC and its other Owner-Members through a well-established and Commission-regulated generation and transmission system.

**B. KRS 278.030(1)**

The Commission has previously held that, where the application involves a power purchase agreement, the Commission must also analyze the need for the power purchase agreement under the Commission’s existing statutory authority, which includes the provision in KRS 278.030(1) that every utility may demand, collect and receive fair, just and reasonable rates for the services rendered or to be rendered by it to any person.<sup>35</sup> Mr. Holt agrees that the Commission must consider

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<sup>33</sup> This term was originally used by Mr. Tony Campbell on page 10, line 15, of his Direct Testimony in reference to the Commission’s conclusion in a six-month review of EKPC’s FAC (PSC Case No. 2014-00226, Order, Jan. 30, 2015, page 8) that it was important to incentive utilities to keep outages at a minimum and have sufficient capacity to meet load.

<sup>34</sup> Hearing Testimony of Mr. Dennis Holt, May 15, 2018 at 10:57:08 a.m.

<sup>35</sup> *In the Matter of: Application of Kentucky Power Company for Approval of the Terms and Conditions of the Renewable Energy Purchase Agreement for Biomass Energy Resources between the Company and Ecopower Generation-Hazard LLC; Authorization to Enter into the Agreement; Grant of Certain Declaratory Relief; and Grant of All Other Required*

whether the effects of the PPA transaction are fair, just and reasonable.<sup>36</sup> In the Grayson Case, the Commission, based on its authority under KRS 278.030(1), held that Grayson's petition set forth sufficient allegations to support an investigation of whether Grayson's power purchase agreement with an alternate source was reasonable:

The Commission went on to encourage all electric utilities to file long-term purchase power contracts for prior approval even if the contracts do not constitute evidences of indebtedness because, absent prior approval, there is a significant risk that the contracts will be subject to subsequent review in rate cases and the contracts' costs could be subject to rate disallowances if the Commission finds the costs to be unreasonable or not prudent. The Commission has previously reviewed the reasonableness of a purchase power contract. Thus, based on our prior practice, the Commission finds that the reasonableness of the Magnum contract should be investigated in this case to determine whether or not it should be approved.<sup>37</sup>

Based on the Grayson Case, the Commission should also apply a reasonable and prudent standard to its review of the PPA.

### C. KRS 278.170(1)

On pages 46-56 of this brief, the Joint Intervenors establish how the flawed Alternative Source Scheme guarantees that the sixteen Owner-Members cannot share equally in the Alternate Source energy available under Amendment 3 and the MOU. For this reason, the Commission must also analyze the PPA under KRS 278.170(1), which provides:

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*Approvals & Relief*, Order, P.S.C. Case No. 2013-00144 (Oct. 10, 2013), at 12-13 (footnotes omitted).

<sup>36</sup> Hearing Testimony of Mr. Dennis Holt, May 15, 2018 at 1:27:05 p.m.

<sup>37</sup> Grayson Case, Order (July 17, 2013) at 21 (citations omitted) (emphasis added).

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.

This statute also applies to the Commission's review of South Kentucky's application.

Therefore, based on the foregoing authority, South Kentucky must satisfy the following requirements:

1. The PPA is for a lawful object within the corporate purposes of the utility (KRS 278.300(3)).
2. The PPA is necessary or appropriate for or consistent with the proper performance by the utility of its service to the public and will not impair its ability to perform that service (KRS 278.300(3)).
3. The PPA is reasonably necessary or appropriate for such purpose (KRS 278.300(3)).
4. There is a need for the PPA (KRS 278.020(1)).
5. The PPA does not cause wasteful duplication (KRS 278.020(1)).
6. The PPA is fair, just and reasonable (KRS 278.030(1)).
7. The PPA is reasonable and prudent (KRS 278.030(1)).
8. The PPA does not result in unreasonable preference or advantage to South Kentucky or unreasonable prejudice or disadvantage to South Kentucky's sister distribution cooperatives (KRS 278.170(1)).

South Kentucky claims that the intervening parties "argue for the addition of further elements to the [Commission's] analysis" than those required by KRS

278.300(3), including the “need” and “wasteful duplication” requirements.<sup>38</sup>

However, as noted above, the applicable statutes and previous Commission decisions require this detailed analysis.

Mr. Holt correctly notes that South Kentucky has the burden of proof in this matter.<sup>39</sup> Because South Kentucky cannot meet its burden to satisfy these requirements, the Commission must deny South Kentucky’s application. In addition, because the Alternative Source Scheme provides an unreasonable preference to some Owner-Members and unreasonably discriminates against other Owner-Members, the Commission should declare invalid Section I of Amendment 3 and the MOU.

**D. The Filed Rate Doctrine does not prohibit denial of South Kentucky’s Application**

The Joint Intervenors agree that the Commission’s statutory scheme encompasses the filed rate doctrine.<sup>40</sup> “That doctrine in essence stands for the proposition that when the legislature has established a comprehensive ratemaking scheme, the filed rate defines the legal relationship between the regulated utility and its customer with respect to the rate that the customer is obligated to pay and that the utility is authorized to collect.”<sup>41</sup> However, South Kentucky does not and

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<sup>38</sup> South Kentucky’s Initial Post-Hearing Brief at page 1, fn. 1.

<sup>39</sup> Hearing Testimony of Mr. Dennis Holt, May 15, 2018 at 11:08:32 a.m.

<sup>40</sup> See, e.g., *Cin. Bell Tel. Co. v. Ky. Public Service Comm’n*, 223 S.W.3d 829, 837-38 (Ky.App. 2007), citing KRS 278.160(2) (“No utility shall charge, demand, collect, or receive from any person a greater or less compensation for any service rendered or to be rendered than that prescribed in its filed schedules, and no person shall receive any service from any utility for a compensation greater or less than that prescribed in such schedules”).

<sup>41</sup> *Cin. Bell Tel. Co.* at 837, citing *Big Rivers Elec. Corp. v. Thorpe*, 921 F.Supp. 460 (W.D.Ky. 1996).

cannot claim that its proposed PPA with Morgan Stanley is a filed rate. Therefore, the PPA is subject to Commission review under the statutory standards applicable to it, and the Commission may deny South Kentucky's application for approval of the PPA if the PPA fails to satisfy any of those standards.

Moreover, the filed rate doctrine only prohibits retroactive changing of filed rates, and does not prohibit the Commission making a prospective change to filed rates.<sup>42</sup> The Commission may review Amendment 3 and the MOU and either revoke or modify those documents if they violate any statutory standards applicable to them. KRS 278.270 and KRS 278.280(1) authorize the Commission to modify utility rates or services and the related rules, regulations and practices if it determines that they are "unjust, unreasonable, or insufficient." In reviewing the Commission's authority over rates and services, the courts repeatedly have recognized that this authority is not limited by contract.<sup>43</sup> Thus, the normal standard to be used by the Commission in determining whether to exercise its authority to modify conditions of rates or service is the standard reflected in KRS 278.270 and KRS 278.280(1), which in practice is analogous to the "fair, just and

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<sup>42</sup> KRS 278.390 ("Every order entered by the commission shall continue in force...until revoked or modified by the commission..."), KRS 278.270 ("Whenever the commission...finds that any rate is unjust, unreasonable, insufficient, unjustly discriminatory or otherwise in violation of any of the provisions of this chapter, the commission shall by order prescribe a just and reasonable rate to be followed in the future"), and KRS 278.280(1) ("Whenever the commission...finds that the rules, regulations, practices...or service of any utility... are unjust, unreasonable...improper, inadequate or insufficient, the commission shall determine sufficient rules, regulations, practices...or methods to be observed...and shall fix the same by its order, rule or regulation").

<sup>43</sup> See, e.g., *Board of Education of Jefferson County v. William Dohrman, Inc.*, 620 S.W.2d 328, 329 (Ky. App. 1981), and *National-Southwire Aluminum Co. v. Big Rivers Electric Corp.*, 785 S.W.2d 503, 517 (Ky.App. 1990).



reasonable” standard for utility rates pursuant to KRS 278.030(1). The fact that the parties agreed to the possibility of cost shifts does not prohibit the Commission from declaring such an agreement invalid if it violates any applicable statutory principles. “The Commission ha[s] the right and duty to regulate rates and services, no matter what a contract provide[s].”<sup>44</sup> Prior approval of a contract and rate does not estop the Commission from subsequently changing the rate.<sup>45</sup>

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. Indeed, the PPA expressly requires approval of it by both the Commission and RUS.<sup>46</sup>

In addition, Kentucky courts have not explicitly adopted a standard for modifying contracts similar to the heightened “public interest” standard applicable under the Federal Power Act<sup>47</sup> pursuant to the *Mobile-Sierra* doctrine.<sup>48</sup> In *National-Southwire Aluminum Co. v. Big Rivers Electric Corp.*,<sup>49</sup> an aluminum smelter challenged the Commission’s decision to modify its power purchase contract

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<sup>44</sup> *Board of Education of Jefferson County v. William Dohrman, Inc.*, *supra* at 329 (Ky. App. 1981).

<sup>45</sup> *National Southwire Aluminum*, *supra*, at 517, citing *Fern Lake Co. v. Public Service Commission*, 357 S.W.2d 701 (Ky. 1962). *See also In the Matter of City of Jeffersonville v. Montgomery County Water District No. 1*, P.S.C. Case No. 97-377, Order (April 9, 1998)(“That the parties have contracted for a certain rate does not immunize the agreed rate from modification”).

<sup>46</sup> *See* Exhibit 7 to Application, Section 14, and Exhibit 8 to Application, Section 17.

<sup>47</sup> 16 U.S.C. § 792 *et seq.* (2000).

<sup>48</sup> *See United Gas Pipeline Co. v. Mobile Gas Service Corp.*, 350 U.S. 332 (1956), and *Federal Power Comm’n v. Sierra Pacific Power Co.*, 350 U.S. 348 (1956).

<sup>49</sup> 785 S.W.2d 503 (Ky. App. 1990).

by imposing a variable rate methodology, and alleged that Kentucky law required specific findings to explain why the existing average cost provisions were against the public interest. The court disagreed that a “public interest” test had to be met before the Commission could change the contract rate.<sup>50</sup>

One of South Kentucky’s experts, Mr. Seelye, who is not an attorney, offered the legal opinion that the Commission has adopted the *Mobile-Sierra* doctrine, relying on *In the Matter of: Application of Kentucky Power to Withdraw its Tariff RTP Pending Submission by the Company and Approval by the Commission of a New Real-Time Pricing Tariff*, P.S.C. Case No. 2012-00226, Order (December 20, 2012). However, in that case, the Commission does not mention *Mobile-Sierra* except when it summarizes the arguments of the parties. When discussing the reasoning for its decision, the Commission did not comment on *Mobile-Sierra*, and the *Mobile-Sierra* standard, which applies to prospective changes to contracts and played no part in the Commission’s determination of issues of retroactive ratemaking in that case.

Moreover, it is questionable that the filed rate doctrine applies to Amendment 3 and the MOU. While those documents were filed with the Commission, the Commission conducted no hearing in regard to those documents and merely found that the MOU resulted in a “reasonable resolution of all issues to be investigated.” But the only issue investigated was the “methodology for sharing among all Members the allocation of alternative sourced power authorized under

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<sup>50</sup> *Id.* at 517 (“[W]e do not agree that a rate change in this case required a ‘public interest’ test”).

Amendment 3.” There was no finding by the Commission that Amendment 3 or the MOU was fair, just and reasonable.

#### IV. ARGUMENT<sup>51</sup>

##### A. South Kentucky did not perform adequate due diligence in regard to the PPA

South Kentucky failed to perform proper due diligence to confirm that entering into the PPA was in the best interests of South Kentucky and its member-owners. This failure justifies a finding by the Commission that the PPA is not necessary or appropriate for or consistent with the proper performance of South Kentucky’s service to the public, that it may impair South Kentucky’s ability to perform that service, that the PPA is not reasonably necessary or appropriate for that purpose, that the PPA is not fair, just and reasonable, and that South Kentucky entering into the PPA is not reasonable and prudent.

##### 1. South Kentucky’s proposed credit facilities to satisfy the requirements of the Collateral Annex of the PPA are not reasonable or prudent

South Kentucky has been unequivocal that it requires “either a master letter of credit or a line of credit from which a subordinate letter of credit may be drawn and presented to Morgan Stanley Capital Group” to support its collateral requirement obligations under the PPA.<sup>52</sup> The necessity for the credit facility was

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<sup>51</sup> The Joint Intervenors set forth in this brief numerous reasons why the Commission should grant the relief requested by the Joint Intervenors. Other parties assert additional grounds for denying South Kentucky’s application and declaring invalid Section I of Amendment 3 and the MOU. The fact that the Joint Intervenors did not address those grounds or did not address those grounds in detail should not be interpreted to mean that the Joint Intervenors disagree with the validity of those grounds.

<sup>52</sup> Direct Testimony of Mrs. Michelle Herrman, South Kentucky’s Vice President of Finance, Application Exhibit 17, page 11, lines 4-18.

described in more detail in the summary of the PPA that South Kentucky provided to the RUS as part of the process by which it sought RUS approval of the PPA.<sup>53</sup> But despite the importance of that credit facility, the record shows that South Kentucky was comfortable becoming irrevocably obligated to Morgan Stanley under the PPA without having a commitment on the credit facility, knowing what the terms of the credit facility may be, or understanding the interrelationship of that credit facility with its other credit agreements.

South Kentucky signed the PPA on December 19, 2017, the same evening on which its board of directors heard a presentation on the PPA and adopted a resolution approving it.<sup>54</sup> Mrs. Michelle Herrman, South Kentucky's Vice-President of Finance, informed the National Rural Utilities Cooperative Finance Corporation ("CFC") on January 10, 2018, that the PPA had been signed, and said she would "like to talk more fully about the letter of credit requirements."<sup>55</sup> There was no urgency in Mrs. Herrman's message about the time frame for the discussions, or learning the terms on which the credit facility might be available. She observed that "[o]ur contract does not go into effect until 2019, so we do have some time to work on this, but it would be helpful to know what CFC would require."<sup>56</sup> Mrs.

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<sup>53</sup> Response of South Kentucky to First Request for Information from Distribution Cooperatives, DC Attachment 3, pages 17 and 18 (pages 4 and 5 of the Summary of "Wholesale Power Contract with Morgan Stanley Capital Group under Amendment #3 of the All Requirements Wholesale Power Contract" attached to the January 25, 2018, e-mail message from Michelle Herrman to John Cheung, USDA, RUS).

<sup>54</sup> Hearing Testimony of Mr. Dennis Holt, May 15, 2018 at 11:33:33 a.m.

<sup>55</sup> Response of South Kentucky to First Request for Information from Distribution Cooperatives, DC Attachment 3, page 7, January 10, 2018, e-mail message from Michelle Herrman to Ashley Welsh, Associate Vice-President of CFC.

<sup>56</sup> *Id.*

Herrman testified at the hearing that she still did not know what the terms of the required credit facility would be,<sup>57</sup> and had only recently concluded that the amount of the credit available for use as collateral under the PPA should be \$35,000,000.<sup>58</sup>

Mrs. Herrman also did not know whether the term of the credit facility required for the 20-year PPA commitment would equal or exceed 24 months, which would require Commission review and approval of the credit facility.<sup>59</sup> While the CFC was willing to offer a credit facility for up to five years,<sup>60</sup> South Kentucky is obviously interested in avoiding Commission review of that credit facility, and has not even mentioned Commission review of that credit facility on its timeline for the transaction.<sup>61</sup> If South Kentucky manages to keep the term of its credit facility under 24 months, the Commission will not have an opportunity to review the credit facility to see if it makes sense and is fair, just and reasonable.

South Kentucky exposes itself to considerable risk by not knowing the availability or understanding the terms of the required credit facility before it became irrevocably bound by the PPA. For example, if South Kentucky successfully obtained the required credit facility from CFC, as it seems to believe it will,<sup>62</sup> it is reasonable to assume that the basic terms of the CFC credit facility would be similar to the terms of the “Revolving Line of Credit Agreement” that is currently in

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<sup>57</sup> Hearing Testimony of Mrs. Michelle Herrman, May 15, 2018 at 5:05:50 p.m.

<sup>58</sup> *Id.* at 4:53:05 p.m.

<sup>59</sup> Response of South Kentucky to First Request for Information from Distribution Cooperatives, DC Attachment 2 – Public, pp. 7-8, January 10, 2018 email correspondence between Mrs. Herrman and Ashley Webb.

<sup>60</sup> *Id.*

<sup>61</sup> South Kentucky Responses to Supplemental Data Requests of EKPC, Item 7, page 2.

<sup>62</sup> Hearing Testimony of Mrs. Michelle Herrman, May 15, 2018 at 4:50:40 p.m. and 5:05:40 p.m.

place between South Kentucky and CFC.<sup>63</sup> Section 4.02B of that revolving credit agreement provides that as a condition to the obligation of CFC to make each Advance under the revolving credit agreement, each of the representations and warranties contained in Article II of the revolving credit agreement must be true on the date of the making of each Advance. Section 2.01C of the revolving credit agreement provides, in the second paragraph, the following representation:

The Borrower is not in default in any material respect under any agreement or instrument to which it is a party or by which it is bound and no event or condition exists which constitutes a default or with the giving of notice or lapse of time, or both, would constitute a default under any such agreement or instrument.

A “Credit Event” occurs under the PPA if South Kentucky fails to maintain a high average TIER Ratio or DSC Ratio of 1.25 using two of the last three calendar years, or South Kentucky suffers a Regulatory event.<sup>64</sup> South Kentucky specifically worded the definition of “Credit Event” in the PPA to match exactly the Coverage Ratio covenant it undertakes in its November 1, 2016, RUS Loan Contract in Section 5.4(b).<sup>65</sup> If South Kentucky violates the Coverage Ratio covenant in the RUS Loan Contract and fails to correct that violation within 30 days after notice of

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<sup>63</sup> Revolving Line of Credit Agreement dated as of September 14, 2017, between South Kentucky and CFC, provided as “Attachment DISTCOOP#2” at page 26 of South Kentucky’s Supplemental Response to First Request for Information from Distribution Cooperatives.

<sup>64</sup> See definition of “Credit Event” in Application Exhibit 6, Paragraph 10 to Collateral Annex, page 2.

<sup>65</sup> Hearing Testimony of Mrs. Michelle Herrman, May 15, 2018 at 5:05:05 p.m. South Kentucky provided a copy of its November 1, 2016, “RUS Loan Contract” in response to the Distribution Cooperatives’ post-hearing information request. It is identified as “Kentucky\_0054.pdf, Exhibit DCPH-1.”

the violation is given to the RUS, which is an event of default under the RUS Loan Contract.<sup>66</sup>

So, if South Kentucky obtains the credit facility with CFC that it is counting on, and the terms of the loan agreement for that credit facility are the same as CFC's standard loan agreement terms, upon the occurrence of a Credit Event under the PPA, South Kentucky will not be in a position to issue a line of credit to satisfy its collateral requirements under the PPA because the circumstances that create a Credit Event under the PPA also constitute a Default under the RUS Loan Contract. CFC would have no obligation to allow issuance of a letter of credit because South Kentucky could not make the required representation that it was not in default under any other agreement to which it is a party. South Kentucky has apparently negotiated itself into a classic "Catch 22" that prevents the proposed CFC credit facility from being South Kentucky's solution to the collateral requirements to which it is bound by the terms of the PPA.

**2. South Kentucky's exposure to Additional Environmental Costs under the PPA is unreasonable**

Intervenors, the Commission staff, and even the Commissioners themselves, questioned South Kentucky about its potential exposure under the PPA to future environmental costs incurred by Morgan Stanley. Both the Firm Physical Energy Confirmation and the Financial Capacity Confirmation provide that in the event of a Change in Law with respect to any Environmental Law or Tax Law, South Kentucky is responsible for reimbursing Morgan Stanley for Additional

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<sup>66</sup> RUS Loan Contract, Section 7.1(d).

Environmental Costs, subject to Morgan Stanley's duty to use commercially reasonable efforts to minimize the Additional Environmental Costs.<sup>67</sup> South Kentucky describes numerous actions that it believes Morgan Stanley must take to comply with this provision.<sup>68</sup> However, the PPA does not list those actions as obligations that Morgan Stanley must satisfy, and there is certainly no guarantee or evidence in the record that Morgan Stanley agrees that it must perform those actions to comply with the "commercially reasonable efforts" standard.

Both documents define "Additional Environmental Costs" as:

(i) any and all fees, licenses, charges, green tags, certificates, expenses and products (including but not limited to any charges or products required on a per unit-of-energy-output, per-unit-of-energy-input, per-weight-of-pollutant, cap and-trade or other basis) and all losses, costs and liabilities with respect thereto, imposed or required by a Governmental Authority with respect to this Transaction or supplied hereunder; and

(ii) any and all Taxes and all costs and liabilities with respect thereto, imposed or required by a Governmental Authority with respect to this Transaction or supplied hereunder;

in each case, only to the extent such Additional Environmental Costs result from or are attributable to a Change in Law with respect to any Environmental Law or Tax Law and directly cause the price of Product paid by [South Kentucky] to be increased.

South Kentucky characterizes this language as "limited" and not exposing South Kentucky to fixed and capital costs,<sup>69</sup> but the relevant language in that provision states that Additional Environmental Costs include "any and all charges...[and] expenses, and all losses, costs and liabilities with respect thereto

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<sup>67</sup> Firm Physical Energy Confirmation (Exhibit 7 to the Application), Paragraph 17, and Financial Capacity Confirmation (Exhibit 8 to the Application), Paragraph 20.

<sup>68</sup> South Kentucky's Brief at page 36.

<sup>69</sup> South Kentucky's Brief at page 35.



[resulting from or attributable to “a Change in Law with respect to any Environmental Law”] imposed or required by a Governmental Authority with respect to this Transaction.” This provision is clearly broad enough to include fixed and capital costs incurred by a generating plant to comply with a change in environmental laws. During the hearing, Mr. Holt tried to allay concerns about South Kentucky’s exposure to Additional Environmental Costs by repeatedly assuring questioners that Additional Environmental Costs do not include fixed or capital costs.<sup>70</sup> When asked where he found that exception in the definition of Additional Environmental Costs, he could not find it and instead relied on discussions with Morgan Stanley that those costs are not included.<sup>71</sup>

The most generous critique of Mr. Holt’s assurances is that the words “expenses,” “losses,” and “costs and liabilities” found in the definition of Additional Environmental Expenses are extremely broad and could be read to include fixed or capital costs. Realistically, if fixed and capital costs are supposed to be excluded from that definition, South Kentucky should have done so with explicit language that does not leave a hole in the PPA “big enough to drive a truck through,” as opined by Mr. Don Mosier, EKPC’s Executive Vice-President and Chief Operating Officer.<sup>72</sup> South Kentucky’s interpretation and analysis of the Additional Environmental Costs provision, which assumes no risk of an increase in the price of energy under the PPA,<sup>73</sup> is unreasonable and exposes South Kentucky and its

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<sup>70</sup> See, e.g., Hearing Testimony of Mr. Dennis Holt, May 15, 2018 at 10:29:50 a.m.

<sup>71</sup> *Id.* at 11:52:00-11:54:24 a.m.

<sup>72</sup> Hearing Testimony of Mr. Don Mosier, May 16, 2018 at 4:26:14 p.m.

<sup>73</sup> *Id.* at 11:36:10 a.m.

members to unquantifiable risks for future costs that have not been properly evaluated by South Kentucky.

South Kentucky's claim that it faces the same environmental cost increases if it only buys power from EKPC lacks merit. Mr. Mosier has described in detail the extensive analysis, assessment, forecasting and risk balancing that EKPC performs to assess environmental issues,<sup>74</sup> and there is no evidence that Morgan Stanley does or will adhere to those same standards in regard to its environmental liabilities.<sup>75</sup> And, as noted regarding PJM transmission costs,<sup>76</sup> any increase in environmental costs under the PPA will be passed directly to South Kentucky via an increase in the price, and this will not occur with EKPC, which has a bundled rate that serves as a buffer to such cost impacts and cannot be increased unless and until EKPC files for and is awarded a rate increase. Moreover, since South Kentucky has no knowledge of the unit(s) that will source the PPA,<sup>77</sup> it is unreasonable to assert that any change in environmental laws or regulations will equivalently impact the PPA and EKPC.<sup>78</sup> Thus, South Kentucky has not proven it will face the same environmental risks and costs under the PPA as it will under the status quo.

South Kentucky also failed to adequately assess the risks associated with the application of this provision to the capacity hedge, since this same provision is set

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<sup>74</sup> EKPC Responses to South Kentucky's First Request for Information, Item 17.

<sup>75</sup> Direct Testimony of Mr. Don Mosier, page 7, line 10-page 9, line 3.

<sup>76</sup> Distribution Cooperatives' Response to Request for Information of South Kentucky, Item 10.

<sup>77</sup> Hearing Testimony of Mr. Don Mosier, May 16, 2017 at 4:31:10 p.m., and Hearing Testimony of Mr. David Crews, May 17, 2018 at 9:59:48 a.m.

<sup>78</sup> Distribution Cooperatives' Response to Attorney General's Initial Data Requests, Item 3.

forth in the Financial Capacity Confirmation.<sup>79</sup> Mr. Carter Babbit with Enervision, South Kentucky's consultant, claims these provisions were "left in" the Financial Capacity Confirmation but "won't come into play."<sup>80</sup> First, there is no evidence that Morgan Stanley considers these provisions as surplus. Mr. Mosier, who has experience dealing with Morgan Stanley, does not believe that Morgan Stanley left these provisions in the Financial Capacity Confirmation as surplus.<sup>81</sup> It is certainly imprudent for South Kentucky to fail to remove language from a draft contract that both South Kentucky and Morgan Stanley believe is unneeded, but which could expose South Kentucky to significant liability.

Second, this language could "come into play" if, for example, a carbon tax results in retirement of coal generators and an increase in capacity prices.<sup>82</sup> Morgan Stanley may claim that this event entitles it to relief from its obligation to pay South Kentucky if the capacity price increases above \$125 per MW-day.<sup>83</sup> Yet, Mr. Babbit's NPV analysis does not account for or assess the risk of an increase in the price of capacity under the PPA due to a Change in Environmental Law.<sup>84</sup> This is yet another risk that South Kentucky did not properly recognize or analyze.

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<sup>79</sup> See Paragraphs 20 and 23 of the Financial Capacity Confirmation attached as Exhibit 8 to the Application.

<sup>80</sup> Hearing Testimony of Mr. Carter Babbit, May 16, 2018 at 10:42:35 a.m.

<sup>81</sup> Hearing Testimony of Mr. Don Mosier, May 16, 2018 at 4:40:40 p.m.

<sup>82</sup> *Id.* at 11:28:45 a.m.

<sup>83</sup> *Id.*

<sup>84</sup> *Id.* at 11:36:10 a.m.

3. South Kentucky failed to properly consider the timing of obtaining a final non-appealable order from the Commission

Mr. Holt testified at the hearing that if the Commission fails to approve the PPA by May 31, 2018, either party to the PPA may terminate the PPA with no further obligation.<sup>85</sup> His testimony confirmed a prior response to an information request.<sup>86</sup>

Mr. Holt's statements are based upon his understanding of the "Conditions Subsequent" sections of the Firm Physical Energy Confirmation and the Financial Capacity Confirmation.<sup>87</sup> The relevant condition subsequent provides that if the Commission has not issued a final, non-appealable order approving the PPA, including the confirmations, on or before May 31, 2018, either Party may, by delivering written notice to the other party, terminate the PPA, "which shall thereupon become void with no further obligations" thereunder.

But Mr. Holt and South Kentucky fail to appreciate the potential application of another paragraph found in each of those conditions subsequent, which is an exception to that release, and states in pertinent part:

Notwithstanding the foregoing, [South Kentucky] shall be bound by, and liable to [Morgan Stanley] for any losses, costs and expenses (including those associated with hedging this Transaction) occasioned by any breach of, . . . Section 16 (Buyer Additional Covenants) notwithstanding the failure of [South Kentucky] to procure . . . [Commission] approval.

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<sup>85</sup> Hearing Testimony of Mr. Dennis Holt, May 15, 2018 at 11:48:55 a.m.

<sup>86</sup> Response of South Kentucky to Supplemental Request for Information from Distribution Cooperatives, Item 13.

<sup>87</sup> Firm Physical Energy Confirmation, Application Exhibit 7, Paragraph 14, pages 3-4; Financial Capacity Confirmation, Application Exhibit 8, Paragraph 17, pages 3-4.

South Kentucky has not obtained a written waiver of this condition subsequent from Morgan Stanley,<sup>88</sup> which means South Kentucky remains liable to Morgan Stanley for any breach of Section 16 in the confirmations.

One of the Buyer Additional Covenants (subparagraph (c)) is that “[i]n the event that the [Commission] denies the petition, or approves the petition with material conditions, [South Kentucky] shall promptly and diligently appeal such decision.” This language certainly suggests that South Kentucky has an obligation to pursue appeal of an adverse order by the Commission, even though the order will come after May 31, 2018. South Kentucky has stated that this provision does not prohibit South Kentucky from terminating the PPA if no final order is issued by May 31, 2018.<sup>89</sup> Mr. Holt and South Kentucky have failed to fully understand or appreciate that their failure to diligently pursue appeal following an unfavorable decision by the Commission could expose South Kentucky to liability to Morgan Stanley for breach of this warranty.

4. South Kentucky has already defaulted under the PPA because of its late filing of the PPA with the Commission

Another of the Buyer Additional Covenants in both the Firm Physical Energy Confirmation and the Financial Capacity Confirmation is that South Kentucky “shall promptly file a petition for approval of the Agreement and this Confirmation with the PSC as soon as reasonably practicable after the Trade Date, but in no

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<sup>88</sup> Hearing Testimony of Mr. Dennis Holt, May 15, 2018 at 1:33:40 p.m.

<sup>89</sup> Response of South Kentucky to Supplemental Request for Information from Distribution Cooperatives, Item 14.

event later than forty-five (45) days after the Trade Date . . . .”<sup>90</sup> South Kentucky “filed” its application in this matter on January 31, 2018, which was within 45 days after the Trade Date of December 19, 2017.<sup>91</sup> But the Commission refused to accept the application because it was incomplete,<sup>92</sup> and did not declare the application “filed” until February 19, 2018,<sup>93</sup> which is more than 45 days from the Trade Date.

The Commission’s regulations expressly state that a paper is not “deemed filed with the commission” until the paper meets all applicable requirements of KRS Chapter 278 and KAR Title 807.<sup>94</sup> The endorsement of the executive director of the date of its filing constitutes the date of the filing.<sup>95</sup>

Mr. Holt was unaware at the hearing that South Kentucky’s application had not been filed with the Commission within the time required by the PPA.<sup>96</sup> He also had not informed Morgan Stanley of that issue, and did not know whether Morgan Stanley considered the late filing to be a default under the PPA.<sup>97</sup> South Kentucky has not obtained from Morgan Stanley a waiver of this requirement. This is another significant issue South Kentucky has overlooked in its quest to escape its responsibility for its share of the fixed costs of EKPC. If Morgan Stanley considers this error on the part of South Kentucky to be a default, as pointed out above

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<sup>90</sup> Firm Physical Energy Confirmation, Paragraph 16(c), and Financial Capacity Confirmation, Paragraph 19(c).

<sup>91</sup> The “Trade Date” is defined in Paragraph 1 of each of the Firm Physical Energy Confirmation and the Financial Capacity Confirmation as December 19, 2017.

<sup>92</sup> Order dated February 19, 2018.

<sup>93</sup> *Id.* at page 3.

<sup>94</sup> 807 KAR 5:001, Section 4(9)(a)(2).

<sup>95</sup> 807 KAR 5:001, Section 4(9)(b)

<sup>96</sup> Hearing Testimony of Mr. Dennis Holt, May 15, 2018 at 1:34:40 p.m.

<sup>97</sup> *Id.* at 1:34:55 p.m.

Morgan Stanley has a right to recover certain of its losses from South Kentucky even though Commission approval of the PPA was not received by May 31, 2018.

5. South Kentucky failed to comply with the notice requirements of the MOU

In South Kentucky's rush to the trough to claim its 15% Alternate Source election at a 100% load factor before any of its sister cooperatives learned about it, South Kentucky failed to comply with the notice requirements of the MOU. Section 4(A) requires South Kentucky to provide "prior written notice [an "Alternate Source Notice"]...in accordance with the procedures and requirements set forth herein."<sup>98</sup> Section 4(A)(iii) of the MOU requires the Alternate Source Notice to include "a general description of the nature of the Alternate Source and the primary generating facilities from which the subject electric power and energy will be produced."<sup>99</sup> In response to this requirement, South Kentucky's November 28, 2017 Alternate Source Notice stated, "The Alternate Source shall be in the form of South Kentucky RECC becoming a PJM member and purchasing energy, capacity, transmission and services required by PJM policies from the PJM market." Because South Kentucky's notice fails to comply with the requirements of the MOU, and the MOU must be strictly enforced as a filed rate, the Commission should deny South Kentucky's application.<sup>100</sup>

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<sup>98</sup> MOU, attached as Exhibit 2 to the Application, page 6.

<sup>99</sup> *Id.* at page 6, Section 4(A)(iii).

<sup>100</sup> While Mr. David Crews, EKPC's Senior Vice-President of Power Supply, assisted South Kentucky in preparing its notice, Mr. Crews testified that did not mean that the notice conformed to the requirements of the MOU, and other parties to the MOU could challenge the sufficiency of the notice (*see* Hearing Testimony of Mr. Crews, May 17, 2018 at 10:02:10 a.m. and 10:04:30 a.m.). Mr. Crews also testified that if South Kentucky's notice is not

First, Mr. Holt admits that the MOU requires the notice to describe the primary generating facilities that are the source of the power, and that South Kentucky's notice did not satisfy this requirement.<sup>101</sup> Second, Mr. Holt also admits that the notice states South Kentucky is purchasing energy from the PJM Market, but South Kentucky is actually purchasing power from Morgan Stanley via the PPA.<sup>102</sup> Because, as South Kentucky admits, it must strictly comply with the filed rate that is the MOU,<sup>103</sup> South Kentucky's failure to comply with the notice requirements in Section 4(A)(iii) requires the Commission to deny the application.

**6. South Kentucky has yet to finalize the agency agreement with EKPC**

Paragraph 12(c) of the Firm Physical Energy Confirmation requires that South Kentucky "promptly enter into and file with PJM (or arrange to have filed by EKPC) a Declaration of Authority specifying SKRECC as principal and EKPC as its designated agent for purposes of EKPC acting as SKRECC's billing and scheduling agent for all purposes under this Transaction."<sup>104</sup> Yet, like the required credit facility, South Kentucky has not finalized such an agreement with EKPC. According to Mr. Holt, South Kentucky has not yet sent a draft of an agency

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valid, then South Kentucky has no MOU notice to withdraw and its 58 MW could immediately return to the EKPC system under the Wholesale Power Contract with no waiting period (*Id.* at 11:21:00 a.m.).

<sup>101</sup> Hearing Testimony of Mr. Dennis Holt, May 15, 2018 at 1:48:30 p.m.

<sup>102</sup> *Id.* at 1:40:45 p.m. and 1:50:07 p.m.

<sup>103</sup> *Id.* at 1:40:00 p.m.

<sup>104</sup> Firm Physical Energy Confirmation attached as Exhibit 7 to the Application, page 3; 1:10:37.



agreement to EKPC.<sup>105</sup> It is premature for the Commission to approve the PPA before South Kentucky has satisfied this condition.

**7. The PPA exposes South Kentucky's member-owners to unreasonable risk**

Mr. Holt admitted that before the PPA in question, nobody at South Kentucky had ever been involved with or participated in a PPA, participated in PJM or any other RTO, calculated transmission expenses such as NITS and RTEP, entered into energy market transactions, or negotiated the terms of a PPA with a party like Morgan Stanley.<sup>106</sup> Mr. Holt could not remember the total financial commitment of South Kentucky under the twenty-year PPA with Morgan Stanley.<sup>107</sup> Mr. Holt also did not know the correct price South Kentucky must pay if Morgan Stanley<sup>108</sup> does not deliver power to South Kentucky. Mr. Holt believed that EKPC was the “backstop” and must provide that power at the “EKPC rate” under the Wholesale Power Contract.<sup>109</sup> However, Mr. David Crews, EKPC's Senior Vice-President of Power Supply, confirmed that EKPC has no such obligation under the MOU and South Kentucky must obtain the energy from the PJM market, not

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<sup>105</sup> Hearing Testimony of Mr. Dennis Holt, May 15, 2018 at 1:12:00 p.m.; and *see* South Kentucky's Responses to EKPC's Supplemental Requests for Information, Item 7, which includes a “Morgan Stanley PPA Task List” noting South Kentucky did not schedule the completion of the agency agreement, collateral agreements, or becoming a member of PJM until well after it obtains approval of the PPA by the Commission.

<sup>106</sup> Hearing Testimony of Mr. Dennis Holt, May 15, 2018 at 10:40:50 a.m.

<sup>107</sup> *Id.* at 10:52:30 a.m.

<sup>108</sup> In an attempt to bolster its position on the unlikelihood of Morgan Stanley defaulting, South Kentucky goes outside the record on page 32 of its brief to cite the recent financial performance of Morgan Stanley's parent corporation, which guarantees Morgan Stanley's performance under the PPA.

<sup>109</sup> Hearing Testimony of Mr. Dennis Holt, May 15, 2017 at 10:33:30 a.m.

EKPC under its Wholesale Power Contract.<sup>110</sup> South Kentucky's response to Item 20 of EKPC's Supplemental Information Request, prepared by Mr. Babbit, agrees with Mr. Crews that South Kentucky will pay the real time cost of energy from PJM.

Mr. Holt never mentioned the word "risk" in his Rebuttal Testimony, which is striking given the amount of risk in the proposed transaction. Consistent with his refusal to realistically assess the risks inherent with a transaction like the PPA, Mr. Holt testified that there was "no way possible" that the PPA will cost South Kentucky more than the status quo.<sup>111</sup> This attitude of Mr. Holt evidences a naïve and unformed approach to the \$400 million, 20-year transaction presented to the Commission for approval.

Mr. John Wolfram, Principal at Catalyst Consulting LLC,<sup>112</sup> testified at the hearing that he would not recommend that a distribution cooperative enter into this type of PPA because South Kentucky has not produced sufficient evidence to establish whether or not the proposed transaction is in the best interest of South Kentucky.<sup>113</sup> Mr. Wolfram believes, and the evidence establishes, that there was an inadequate consideration of the risks of the transaction, and there certainly is a chance that South Kentucky customers will pay more under the PPA than the

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<sup>110</sup> Hearing Testimony of Mr. David Crews, May 17, 2018 at 10:11:20 a.m., 10:15:50 a.m., and 11:28:40 a.m.

<sup>111</sup> Hearing Testimony of Mr. Dennis Holt, May 15, 2018 at 10:35:27 a.m.

<sup>112</sup> Mr. Wolfram has offered testimony on behalf of the Joint Intervenors and the other six distribution cooperatives identified in footnote 2, *supra*.

<sup>113</sup> Hearing Testimony of Mr. John Wolfram, May 17, 2018 at 12:01:30.

status quo.<sup>114</sup> Mr. Wolfram notes the risks include the capacity price coming in much lower than the fixed hedge price, the potential increase in the price of energy over the lengthy twenty-year period of the PPA, and the PJM costs that South Kentucky must pay directly to PJM escalating well beyond the amounts assumed in the NPV analysis.<sup>115</sup>

Regarding the twenty-year term, Mr. Mosier testified that twenty years is an “unusual” term for this type of power purchase agreement, and the industry norm is “for very short periods, which would be a fraction of the term of the subject agreement.”<sup>116</sup> Based on the “contractual pricing mechanisms” such as the “Change in Law” provisions, Mr. Mosier believes Morgan Stanley will have the ability to pass along price increases, and the “fixed” energy and capacity hedge prices are not truly fixed.<sup>117</sup> Mr. Mosier also testified that the PPA does not identify the resource that Morgan Stanley will use, that it is likely located outside the Commission’s jurisdiction, and that this “creates a high degree of regulatory, market and economic risk for South Kentucky that has not been accounted for in its due diligence.”<sup>118</sup>

Regarding the PJM costs, the Joint Intervenors explain below in Section B that South Kentucky grossly underestimates the potential PJM charges that it must pay directly to PJM as part of the proposed transaction. Indeed, as noted

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<sup>114</sup> *Id.* at 12:03:00–12:03:50; and *see* EKPC’s Responses to Attorney General’s Initial Data Requests, Item 1 (South Kentucky’s analysis should have included a broad range of reasonable outcomes and assessed whether those outcomes were within the risk tolerance of South Kentucky, and “[t]he Application materials do not reflect that such analyses were conducted”).

<sup>115</sup> *Id.* at 12:04:10.

<sup>116</sup> Direct Testimony of Don Mosier at page 4, 1-7.

<sup>117</sup> *Id.* at page 4, 11-19.

<sup>118</sup> *Id.* at page 4, 7-11.

below, increased PJM costs may likely absorb the entire estimated savings that South Kentucky believes it will enjoy.

Additionally, South Kentucky failed to conduct any sensitivity analysis to evaluate the consequences for South Kentucky of a change in EKPC's rate design.<sup>119</sup> Mr. Wolfram reviewed Attorney General's Hearing Exhibit 2, being the Direct Testimony of South Kentucky's expert William Steven Seelye in the case styled *In Re: The Matter of: Application of Kentucky Utilities Company for an Adjustment of its Rates for Certificates of Public Convenience and Necessity*, Case No. 2016-00370. On page 14, Mr. Seelye testified that KU had installed generation, transmission and distribution infrastructure to serve customers, which were fixed costs that "typically will not change if a customer uses more energy or . . . less energy and [o]nce the facilities are installed they are invariant to customer usage and are therefore fixed." Mr. Seelye further testified that if a customer reduces energy consumption because the customer obtains generation through another source, the customer will reduce the utility's recovery of fixed costs collected through an energy charge, but will not have caused the utility to reduce its fixed costs.<sup>120</sup> This results in the shifting of fixed costs to customers who are not obtaining generation elsewhere.<sup>121</sup> Mr. Wolfram noted Mr. Seelye's opinion on page 3 that, "[I]t is important that the utility ensure that the rate design is structured in a way that recovers the actual cost of serving customers"<sup>122</sup> and Mr. Seelye's

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<sup>119</sup> *Id.* at 12:05:30.

<sup>120</sup> Attorney General Hearing Exhibit 2, at page 15.

<sup>121</sup> *Id.*

<sup>122</sup> Hearing Testimony of Mr. John Wolfram, May 17, 2018 at 12:21:20 p.m.

testimony on page 3 at line 10, “Therefore, it is important for the utility to design its rates so that the actual cost of providing service is recovered through rates even when customers reduce their energy consumption but still require the same utility infrastructure to serve them.”<sup>123</sup>

Mr. Wolfram testifies that nothing will prohibit EKPC from proposing, and the Commission approving, cost-based rates consistent with what Mr. Seelye proposed in this KU case, and that South Kentucky still needs EKPC’s infrastructure, being EKPC’s generation and transmission assets.<sup>124</sup> Mr. Seelye agrees that this type of cost-based rate design does not violate the stranded costs provision of the MOU.<sup>125</sup> Of course, such a rate restructuring could impact the savings projected by South Kentucky.<sup>126</sup> Indeed, EKPC believes that some or all of the savings contemplated by South Kentucky “could diminish or disappear under a new allocation methodology.”<sup>127</sup> But South Kentucky failed to consider the possibility of this type of rate restructuring by EKPC when evaluating the PPA.<sup>128</sup> For the foregoing reasons, the Commission should deny the application because South Kentucky fails to properly analyze the risks and costs of the PPA.

**B. The Commission should deny the application because the PPA exposes South Kentucky member-owners to the same or higher costs than the status quo**

Once the errors in South Kentucky’s Net Present Value analysis (“NPV”) calculation are corrected, it is clear that the PPA will result in little to no savings to

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<sup>123</sup> *Id.* at 12:21:45 p.m.

<sup>124</sup> *Id.* at 12:24:08 p.m. and 12:25:05 p.m.

<sup>125</sup> Hearing Testimony of Mr. William Steven Seelye, May 16, 2018 at 2:49:23 p.m.

<sup>126</sup> Direct Testimony of Mr. John Wolfram at page 13, 9-15.

<sup>127</sup> EKPC’s Responses to Attorney General’s Initial Data Request, Item 5b.

<sup>128</sup> *Id.*

South Kentucky and its member-owners. For this reason, the Commission should find:

- The PPA is not necessary or appropriate for or consistent with the proper performance by the utility of its service to the public and will not impair its ability to perform that service.
- The PPA is not reasonably necessary or appropriate for such purpose.
- The PPA is not fair, just and reasonable.
- The PPA is not reasonable and prudent.

In his Direct Testimony, Mr. John Wolfram found that the actual NITS rate for 2017 is 14% higher than the value used by South Kentucky in the NPV, and that South Kentucky applied this rate to the kWh instead of the kW.<sup>129</sup> Correcting these errors reduces the NPV by approximately \$9 million.<sup>130</sup> Mr. Wolfram also found that South Kentucky miscalculated the PJM OATT Schedule 1-A for Transmission Owner Scheduling, System Control and Dispatch Service, reducing the NPV by approximately \$1.4 million.<sup>131</sup> Mr. Babbit confirms the accuracy of Mr. Wolfram's corrections.<sup>132</sup>

South Kentucky's NPV also failed to adequately consider the long-term costs of membership in PJM, including the PJM Regional Transmission Expansion Plan ("RTEP") charges.<sup>133</sup> For example, the 2016 – 2017 increase in RTEP charges is ten times higher than those projected by South Kentucky in its NPV.<sup>134</sup> And, PJM transmission upgrade charges increased by over 400% from 2010 to 2013 and 24%

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<sup>129</sup> Direct Testimony of Mr. John Wolfram at page 6, 7-12.

<sup>130</sup> *Id.*

<sup>131</sup> *Id.* at page 7, 3-11.

<sup>132</sup> Rebuttal Testimony of Mr. Carter Babbit at page 19, 12-18.

<sup>133</sup> Direct Testimony of Mr. John Wolfram, page 8, line 8 - page 9, line 16.

<sup>134</sup> *Id.*

from 2014 to 2016, which is significantly higher than the escalation factor used by South Kentucky in its NPV.<sup>135</sup> Importantly, Mr. Wolfram notes that South Kentucky cannot terminate the PPA because of increased PJM costs.<sup>136</sup>

Mr. Mosier echoes and supplements Mr. Wolfram's concerns over the NPV analysis of transmission charges. EKPC experienced average annual increases of 8.068% in its NITS rates from 2013 – 2014 through 2017 – 2018.<sup>137</sup> Mr. Mosier found that the average annual increase in transmission service charges based on PJM data is 13.08%.<sup>138</sup> Based on EKPC's historical NITS rates and this information published by PJM, Mr. Mosier believes that a reasonable range of the escalation factor for transmission charges should be between 10% and 13%.<sup>139</sup> Both EKPC Executive Vice-President and Chief Financial Officer Mike McNalley and EKPC Senior Vice-President of Power Supply David Crews agree with Mr. Mosier.<sup>140</sup>

At the hearing, Mr. Mosier described in detail the extensive work that EKPC must perform on its transmission system, which will cause this escalation in NITS charges.<sup>141</sup> In addition, Mr. Mosier noted EKPC's "first-hand" involvement in the transmission side of the PJM market.<sup>142</sup> Mr. Mosier also cited the average

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<sup>135</sup> *Id.*

<sup>136</sup> *Id.* at page 9, 17-21.

<sup>137</sup> Direct Testimony of Mr. Don Mosier at page 11, 12-24.

<sup>138</sup> *Id.* at page 11, line 28 - page 12, line 13.

<sup>139</sup> *Id.* at page 12, 18-19.

<sup>140</sup> Direct Testimony of Mr. Mike McNalley at page 15, 12-16, and Hearing Testimony of Mr. David Crews, May 17, 2018 at 10:09:05 a.m.

<sup>141</sup> Hearing Testimony of Mr. Don Mosier, May 16, 2018 at 4:31:40 p.m.

<sup>142</sup> *Id.* at 4:35:20 p.m.

escalation of NITS charges over the past five years of other utilities, such as LG&E (9.2%), ATSI (10%), and AEP East (15.2%).<sup>143</sup>

Mr. McNalley modified South Kentucky's NPV analysis to include a 10% escalation factor to NITS transmission costs in one scenario and a 13% escalation factor in another scenario.<sup>144</sup> Using the 10% escalation factor produces an 83% reduction in the NPV, which results in potential savings to South Kentucky via the PPA of only \$20 million.<sup>145</sup> Using the 13% escalation factor produces a 108% reduction in the NPV and a loss to South Kentucky under the PPA of \$9.2 million.<sup>146</sup> Mr. Babbit tries to rebut these escalation factors by citing data from PJM's Transmission Costs Information Center ("TCIC") projecting certain transmission costs over the ten-year period of 2018 – 2028.<sup>147</sup> However, Mr. Babbit admits that this data "does not reflect a full NITS cost picture."<sup>148</sup>

Mr. Babbit's attempt to rebut the testimony of Mr. Mosier and Mr. McNalley regarding the escalation factor for the NITS rate is characterized by Mr. Wolfram as an "apples to oranges" comparison because the TCIC projection only goes out ten years (2018-2028), one-half of the PPA's duration, and because it fails to include costs associated with all transmission projects.<sup>149</sup> NITS costs include both (1) "top-down" region-wide transmission projects directed by PJM and found by PJM to be

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<sup>143</sup> *Id.* at 4:34:10 p.m.

<sup>144</sup> Direct Testimony of Mr. Mike McNalley at page 16, 16-19.

<sup>145</sup> *Id.* at page 16, 22-23, and Exhibit MM-2, sheet 1. Since South Kentucky determined that its NPV estimated savings need not be afforded confidential treatment, Mr. McNalley's modifications to the estimated savings need not be treated as confidential.

<sup>146</sup> *Id.* at page 17, 1-2, and at Exhibit MM-3, sheet 1.

<sup>147</sup> Rebuttal Testimony of Mr. Carter Babbit at page 13, line 22 - page 14, line 11.

<sup>148</sup> *Id.* at page 14, 9.

<sup>149</sup> Hearing Testimony of Mr. John Wolfram, May 17, 2018 at 1:07:05.



economically advantageous and needed for reliability of its system, which are spread across the entire PJM footprint; and (2) “bottom-up” projects identified by EKPC for local needs, which Mr. Mosier discussed at the hearing when he described in detail the many transmission updates that EKPC must perform over the next many years.<sup>150</sup> These “bottom-up” projects are not included in the TCIC projection, and Mr. Wolfram was not persuaded by Mr. Babbit’s Rebuttal Testimony on this subject.<sup>151</sup> The Commission also should not be persuaded because Mr. Babbit’s response to this issue is not accurate, adequate, or reliable.

South Kentucky argues that EKPC’s rates will be impacted to the same or a similar degree as what South Kentucky must pay via the PPA. This is not accurate. EKPC will likely be subject to these same transmission costs, but those costs will not have an equivalent impact on EKPC’s rates, and the difference is the extent to which EKPC’s bundled wholesale rates serve as a buffer with respect to these PJM cost impacts.<sup>152</sup> Under the PPA, PJM will directly bill South Kentucky each month for these costs.<sup>153</sup> 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, which has historically proven to be a relatively infrequent event.<sup>154</sup> Evidence suggests this is already the case, as EKPC joined

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<sup>150</sup> *Id.*; see also Hearing Testimony of Mr. David Crews, May 17, 2018 at 11:26:00 a.m. (RTEP transmission charges are “socialized” costs of transmission spread by PJM across its entire footprint, while NITS charges are a bigger piece of the transmission costs pie and are related to charges assessed by the balancing authority in its footprint).

<sup>151</sup> *Id.* at 1:08:30 p.m.

<sup>152</sup> Joint Intervenors’ Response to Request for Information of South Kentucky, Item 10.

<sup>153</sup> *Id.*

<sup>154</sup> *Id.*

PJM five years ago in June 2013, but has not filed a rate case since 2010.<sup>155</sup> Thus, the risk of an adverse impact to South Kentucky from these increases in transmission costs is much greater if South Kentucky enters into the PPA with Morgan Stanley.<sup>156</sup>

Based on the corrected NPV analysis and considering the other risks of the PPA previously discussed in this brief, the Commission should deny South Kentucky's application because the PPA is not necessary or appropriate for or consistent with the proper performance by the utility of its service to the public and will not impair its ability to perform that service, the PPA is not reasonably necessary or appropriate for such purpose, the PPA is not fair, just and reasonable, and the PPA is not reasonable and prudent.

**C. The Commission should deny the application because there is no need for the additional 58 MW of energy, it is wasteful duplication, and it is not the least cost alternative**

As noted on pages 7-9 of this brief, when a utility seeks Commission approval of a PPA, the utility must establish need, an absence of wasteful duplication, and that the PPA is the least cost alternative. There is no dispute that, when viewing the EKPC system as a whole, there is no need for an additional 58 MW of generation since EKPC adequately serves South Kentucky's load. South Kentucky has not proven a "substantial inadequacy of service."<sup>157</sup>

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<sup>155</sup> *Id.*, and EKPC's Responses to South Kentucky's First Request for Information, Item 25.

<sup>156</sup> Joint Intervenors' Response to Request for Information of South Kentucky, Item 10.

<sup>157</sup> *In the Matter of: Application of Kentucky Power Company for Approval of the Terms and Conditions of the Renewable Energy Purchase Agreement for Biomass Energy Resources between the Company and Ecopower Generation-Hazard LLC; Authorization to Enter into the Agreement; Grant of Certain Declaratory Relief; and Grant of All Other Required*

South Kentucky argues that it can establish need because it has exercised its rights under Amendment 3 and the MOU, and someone other than EKPC must service the 58 MW of its load starting June 1, 2019.<sup>158</sup> South Kentucky is claiming that it has a need for the 58 MW from Morgan Stanley because it has contracted to buy the 58 MW from Morgan Stanley, which makes no sense. It cannot create a need in order to satisfy the need requirement, and it did not have this need before signing the PPA. Moreover, Mr. Campbell and the other distribution cooperatives have stated on the record that they would waive the 18-month waiting period.<sup>159</sup>

In addition, the PPA constitutes wasteful duplication because it results in excess capacity over need. Moreover, when viewed in this context, adding the PPA to the EKPC system is not the least cost alternative. As noted by Mr. Wolfram, under the set of fundamental assumptions considered by the Joint Intervenors, the PPA could result in a cost shift to the remaining EKPC Owner-Members of between \$15.9 million and \$18.3 million per year.<sup>160</sup> This compares unfavorably to the estimated annual savings to be achieved by South Kentucky of \$5.9 million (in year 2020, and escalating slightly in the years that follow).<sup>161</sup> This means that on a net basis overall, Kentucky retail customers in the EKPC system could experience costs increases in the range of \$10 million to \$13 million per year if the PPA is approved.

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*Approvals & Relief* Order, P.S.C. Case No. 2013-00144 (Oct. 10, 2013), at 13, citing *Ky. Utilities v. Public Service Commission*, 252 S.W.2d 885, 890 (Ky. 1952).

<sup>158</sup> South Kentucky's Brief at page 41. South Kentucky notes that EKPC has an obligation to serve that load for a grace period of six months.

<sup>159</sup> See, e.g., Direct Testimony of Mark Stallons at page 10, line 17 – page 11, line 4, and Hearing Testimony of Mr. Tony Campbell, May 16, 2018 at 10:33:00 a.m..

<sup>160</sup> Direct Testimony of Mr. John Wolfram at page 5, 15-18.

<sup>161</sup> *Id.* at page 23, 20-21.

Therefore, since the PPA will cost the EKPC system \$10-\$13 million more per year than the status quo, it is not the least cost alternative.

**D. The Commission should deny the application because the PPA will cause an unfair, unjust and unreasonable shift of fixed costs from South Kentucky to its sister distribution cooperatives**

The Commission should not approve the PPA because it is likely to result in cost shifts among EKPC's Owner-Members that are unfair, unjust, unreasonable, and unreasonably discriminatory. Because of this cost-shift, the Commission should find:

- The PPA is not necessary or appropriate for or consistent with the proper performance by the utility of its service to the public and will not impair its ability to perform that service.
- The PPA is not reasonably necessary or appropriate for such purpose.
- The PPA is not fair, just and reasonable.
- The PPA is not reasonable and prudent.
- The PPA violates KRS 278.170(1) because it is unreasonably discriminatory.

If the PPA is approved, South Kentucky's share of EKPC's fixed costs will decrease considerably, and the share of EKPC's fixed costs to be borne by the remaining Owner-Members will correspondingly increase. The fixed cost savings achieved by South Kentucky come at the expense of other EKPC members. EKPC has stated that if the Commission approves the PPA, EKPC will likely need a base rate increase very close to June 1, 2019.<sup>162</sup> As noted above, the PPA will result in a net cost increase across the EKPC system in the range of \$10 million to \$13 million per year. Mr. McNalley notes this when he testifies that "the Morgan Stanley transaction is likely fundamentally uneconomic across EKPC's system and only

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<sup>162</sup> EKPC's Responses to South Kentucky's First Request for Information, Item 42.

appears to be attractive to South Kentucky because of its presumed ability to avoid and shift EKPC's fixed costs to EKPC's other fifteen owner-members."<sup>163</sup> While Mr. Holt believes he has a fiduciary duty only to the members of South Kentucky,<sup>164</sup> the Commission is not so limited and should be mindful of the adverse impacts of this transaction on all of the Kentuckians subject to their jurisdiction. For this reason the Commission should find the PPA to be unfair, unjust, and unreasonable.

South Kentucky argues that cost shifts are a normal occurrence for all utilities.<sup>165</sup> However, the cost shift that would result from the PPA is not a "normal occurrence" because it is not related to the electric consumption patterns of any end-users or to any similarly-situated customers, but instead is related simply to which Owner-Member(s) file their Notice pursuant to Amendment No.3 and the MOU first.<sup>166</sup> For this reason, the cost shift resulting from the PPA is unreasonable.

South Kentucky also argues that there will likely be no cost shift, because EKPC's load growth will mitigate the loss of South Kentucky's 58 MW.<sup>167</sup> This is simply not correct. Load growth in the normal course does not constitute mitigation.

Mr. Wolfram succinctly summarized the problem with South Kentucky's attempt to include EKPC's natural load growth as mitigation of the loss of the 58 MW covered by the PPA.<sup>168</sup> Any sales (i.e., load growth) that take place in both the

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<sup>163</sup> Direct Testimony of Mr. Mike McNalley at page 12, line 22-page 13, line 2.

<sup>164</sup> Rebuttal Testimony of Mr. Dennis Holt at page 5, 5-10.

<sup>165</sup> Rebuttal Testimony of Mr. William Steven Seelye at page 2, 19.

<sup>166</sup> Direct Testimony of Mr. John Wolfram at page 24, 4-7

<sup>167</sup> Rebuttal Testimony of Mr. Dennis Holt at page 11, 20-21.

<sup>168</sup> Hearing Testimony of John Wolfram at 12:28:53.

status quo and if the PPA is approved do not count as mitigation because they do not occur as a result of the 58 MW in new capacity available for sale by EKPC due to the PPA. Load growth is not mitigation if it occurs regardless of the “freeing up” of the 58 MW.<sup>169</sup> EKPC agrees with Mr. Wolfram, stating that load growth or a decrease in expenses, both of which “offset inflationary pressures and defer potential rate increases,” should not be included in any “baseline” comparisons of the PPA and the status quo because these are independent of the proposed transaction.<sup>170</sup> Mitigation would occur if EKPC found a transaction that resulted in the sale of this 58 MW over twenty-years at a similar price, but Mr. Wolfram, citing the testimony of EKPC witnesses Mr. Mosier and Mr. McNalley, noted that this is not likely.<sup>171</sup>

Mr. Mosier testified that due to the length of the term (twenty years) and size of the load (58 MW), EKPC cannot and should not attempt to immediately mitigate the entire loss.<sup>172</sup> Based on Mr. Mosier’s testimony at the hearing, it is highly unlikely that EKPC can significantly mitigate this load loss in the foreseeable future.<sup>173</sup> Mr. McNalley also testified at length about EKPC’s mitigation options and concluded that full mitigation is unlikely.<sup>174</sup> Therefore, it is likely that a cost shift will occur if the PPA is approved.

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<sup>169</sup> *Id.* at 12:31:47 p.m...

<sup>170</sup> EKPC’s Responses to Attorney General’s Initial Data Requests, Item 4.

<sup>171</sup> *Id.* at 12:36:00.

<sup>172</sup> Direct Testimony of Mr. Don Mosier at page 5, 10-12.

<sup>173</sup> Hearing Testimony of Mr. Don Mosier, May 16, 2018 at 4:18:10: p.m., at 4:38:10 p.m. (in first year, EKPC likely can only mitigate approximately \$2 million of the estimated \$16 million cost shift for the first year); and at 5:30:25 p.m.

<sup>174</sup> Direct Testimony of Mr. Mike McNalley at page 7, line 21 to page 9, line 4.

Mr. Wolfram noted how this PPA will also affect the financial health of EKPC, which is striving to obtain a 20% equity level per requirements of RUS in order to pay patronage capital to its Owner-Members.<sup>175</sup> Due to the lost economic opportunities resulting from this PPA, EKPC's margins will decrease and this adversely affects EKPC's ability to obtain the 20% equity target.<sup>176</sup>

Finally, a cost shift within the Environmental Surcharge ("ES") will take place immediately, i.e. two months after the PPA becomes effective.<sup>177</sup> This is because the ES is determined each month as a percentage of total revenue. If the PPA is approved, base revenue will decline, which would cause the ES factor to increase,<sup>178</sup> and this is reflected automatically on member bills within two months. Thus the cost shift within the ES will be immediate and is estimated to be \$4.3 million annually.<sup>179</sup> For these reasons, South Kentucky's argument that there likely will be no cost shift is flawed and should be rejected.

The Commission must also consider the ultimate damage that will result when all 158.5 MW of the Alternate Source allotment is elected by some of the distribution cooperatives. As noted by Mr. Prather, "a defensive 'run on the bank' by other distribution cooperatives threatens to basically double the negative impact of South Kentucky's strategy."<sup>180</sup> If the Commission does not stop this unreasonably discriminatory Alternate Source Scheme, the cost shift Mr. Wolfram

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<sup>175</sup> Hearing Testimony of Mr. John Wolfram, May 17, 2018 at 12:34:00 p.m.

<sup>176</sup> *Id.* at 12:35:00.

<sup>177</sup> Hearing Testimony of Mr. Tony Campbell, May 16, 2018 at 10:18:45 p.m.

<sup>178</sup> Direct Testimony of Mr. John Wolfram at page 20, 5-6.

<sup>179</sup> *Id.*, Exhibit JW-2.

<sup>180</sup> Direct Testimony of Mr. William T. Prather at page 10, 5-6.

estimated at \$15.9 million and \$18.3 million per year could increase to almost \$33-\$36 million per year among the distribution cooperatives.

South Kentucky replies that the Commission should not listen to these arguments about cost shifting because the distribution cooperatives were aware of the potential for cost shifting when they signed the MOU. However, as previously noted, the distribution cooperatives understood when signing the MOU that none of them would take any action that would cause a cost shift to the other cooperatives.<sup>181</sup> Moreover, even if the cooperatives should have appreciated this risk, the Commission may still deny the application and declare invalid Section I of Amendment 3 of the MOU. The courts repeatedly have recognized that the Commission's authority is not limited by contract.<sup>182</sup> The Commission may review Amendment 3 and the MOU and either revoke or modify those documents if they violate any statutory standards applicable to them. KRS 278.270 and KRS 278.280(1) authorize the Commission to modify utility rates or services and the related rules, regulations and practices if it determines that they are "unjust, unreasonable, or insufficient . . . ."

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<sup>181</sup> See, e.g., Direct Testimony of Mr. William T. Prather at page 13, 1-10; Hearing Testimony of Mrs. Carol Wright, May 16, 2017 at 4:07:58 p.m.; and Hearing Testimony of Mr. Mark Stallons, May 17, 2018 at 4:22:30 p.m. ("My recollection tells me that all co-ops that were expected to possibly want to run a 15% member election...were asked that same question...and we were not the ones who have done it and we were surprised."); see also Hearing Testimony of Mr. David Crews, May 17, 2018 at 11:30:30 a.m. and 11:31:27 a.m. (no distribution cooperative expected any other distribution cooperative to make a 15% Alternate Source election at a 100% load factor because they did not want to harm each other).

<sup>182</sup> See, e.g., *Board of Education of Jefferson County v. William Dohrman, Inc.*, 620 S.W.2d 328, 329 (Ky. App. 1981), and *National-Southwire Aluminum Co. v. Big Rivers Electric Corp.*, 785 S.W.2d 503, 517 (Ky.App. 1990).



The filed rate doctrine does not prohibit the Commission from considering this cost shift. While Section 6(A) of the MOU provides that “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 Alternate Sources,”<sup>183</sup> that does not exempt the PPA from evaluation by the Commission under its applicable standards, including whether the PPA is fair, just and reasonable. South Kentucky does not and cannot claim that its proposed PPA with Morgan Stanley is a filed rate. This cost shift of between \$15.9 million and \$18.3 million per year results in rates to the other distribution cooperatives that are unfair, unjust and unreasonable, and justifies the Commission’s denial of South Kentucky’s application.

**E. The Commission should declare invalid Section I of Amendment 3 and the MOU**

The Amendment 3<sup>184</sup> Alternative Source Scheme for allowing EKPC’s member cooperatives to access Alternate Source power without violating their all-requirements contracts was fatally and legally flawed from its inception.<sup>185</sup> The structure of the Alternate Source Scheme assures conflict among the member distribution cooperatives, allocates the purported benefits of the Alternate Source Scheme among the member distribution cooperatives on an unreasonably discriminatory basis, and unlawfully forces parties to Amendment 3 to choose

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<sup>183</sup> MOU, Section 6(A) on page 9.

<sup>184</sup> Unless otherwise indicated, references to “Amendment 3” include the MOU, which purports to interpret Amendment 3.

<sup>185</sup> The portion of Amendment 3 referred to as the “Alternate Source Scheme” is the portion of Section I of Amendment 3 that follows and does not include the first sentence.

between breach of contract and breach of fiduciary duties. For the reasons stated below, the Commission should declare invalid the Alternate Source Scheme because it is unjust, unreasonable, and unlawfully discriminatory in violation of KRS 278.030(1) and KRS 278.170(1), and because it violates public policy.

1. The Alternate Source Scheme violates KRS 278.030(1) and KRS 278.170(1)

The Alternate Source Scheme is flawed because it assures conflict among the EKPC member distribution cooperatives. The very nature of the Alternate Source Scheme strongly encourages conflict among the EKPC member distribution cooperatives. That should come as no surprise considering the conditions that spawned the Alternate Source Scheme. As William Prather testified, the Alternate Source Scheme was forced upon the parties to the EKPC Wholesale Power Contract by a few distribution cooperatives as the price for extension of the term of the Wholesale Power Contract that was required for financing of construction of new EKPC generating facilities.<sup>186</sup> He further explained that adoption of the MOU was likewise driven by concessions required to resolve costly litigation rather than unanimous agreement about the wisdom of the MOU interpretation of Amendment 3.<sup>187</sup> Mr. Prather's explanations were echoed by other witnesses during the hearing.<sup>188</sup>

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<sup>186</sup> Testimony of Mr. William T. Prather, President and CEO of Farmers RECC, dated April 12, 2018, page 6:10-15, and page 12:17-22.

<sup>187</sup> *Id.*, page 8:1-8,

<sup>188</sup> *See, e.g.*, Hearing Testimony of Mr. Kerry Howard, General Manager and CEO of Licking Valley RECC, May 16, 2018 at 9:27:11 p.m.; Hearing Testimony of Mrs. Carol Wright, President and CEO of Jackson Energy Cooperative Corporation, May 16, 2018 at

There is no material disagreement among the parties in this case about the basic way the Alternate Source Scheme functions. A Member may elect, by giving written notice to EKPC, to take up to 15% of its Peak Demand<sup>189</sup> from an Alternate Source unless doing so would cause the aggregate amount of all Members' elections to exceed 2.5% of EKPC's Peak Demand. If the Member's election would cause the aggregate amount of all Members' elections to exceed 2.5% of EKPC's Peak Demand, then the Member's election is limited to 5% of its Peak Demand, unless that election would cause the aggregate amount of all Members' elections to exceed 5% of EKPC's Peak Demand. If the Member's election would cause the aggregate amount of all Members' elections to exceed 5% of EKPC's Peak Demand, then the Member's election is limited to an amount that would not cause the aggregate amount of all Members' elections to exceed 5% of EKPC's Peak Demand. If the aggregate amount of all Members' elections is already equal to 5% of EKPC's Peak Demand at the time the Member wants to make an Alternate Source election, the Member is prohibited from making an Alternate Source election.

The immediate problems caused by the Alternate Source Scheme are described by Mr. Prather in his filed testimony<sup>190</sup>:

The Commission identified one of the problems in its July 17, 2013 Order entered in P.S.C. Case No. 2012-00503 (the "Grayson case"). The Commission noted that while each member had the right to purchase 15% of

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4:07:00 p.m.; and Hearing Testimony of Mr. Mark Stallons, President and CEO of Owen Electric Cooperative, Inc., May 17, 2018 at 4:58:09 p.m.

<sup>189</sup> "Peak Demand" means the rolling average of the referenced utility's coincident peak demand for the single calendar month with the highest peak demand occurring during each of the 3 twelve month periods immediately preceding the relevant date. *See* Amendment 3, Application Exhibit 1, pages 1-2, and the MOU, Application Exhibit 2, pages 3-4.

<sup>190</sup> Testimony of Mr. William T. Prather, page 6:20-22, and page 7:1-12.

its coincident peak<sup>191</sup>(“Alternate 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.

He further testified that adoption of the MOU by the parties to Amendment 3 did nothing to help the problems created by Amendment 3, and even made them worse<sup>192</sup>:

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.<sup>193</sup>

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 . . . . After South Kentucky

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<sup>191</sup> “As used throughout [Mr. Prather’s] 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 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.”

<sup>192</sup> Testimony of Mr. William T. Prather, page 8:9-23, and page 9:1-18.

<sup>193</sup> A copy of Mr. Prather’s Exhibit WTP\_1 is attached to this brief as Appendix 1.

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.

Most of the distribution cooperatives did not favor the 15% option in Amendment 3. They operated on the assumption that, based upon adherence to the "Cooperative Principles," no distribution cooperative would exercise rights under Amendment 3 in a way that would damage the other distribution cooperatives.<sup>194</sup> But that has not worked. Mr. Holt believes that he has a "fiduciary obligation" to purchase 15% of his Peak Demand in order to shift South Kentucky's exposure to EKPC fixed costs and environmental surcharges away from his customers.<sup>195</sup> And consistent with the "run on the bank" theory, once South Kentucky elected to purchase 15% of its Peak Demand from the market, several other distribution

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<sup>194</sup> Hearing Testimony of Mrs. Carol Wright, May 16, 2018 at 4:07:58 p.m.; and Hearing Testimony of Mr. Mark Stallons, May 17, 2018 at 4:22:30 p.m.

<sup>195</sup> Hearing Testimony of Mr. Dennis Holt, May 15, 2018 at 10:45:49 a.m.

cooperatives felt compelled to give notice of Alternate Source elections, even though they did not want to do so, and would otherwise not have done so.<sup>196</sup>

But as Mr. Prather described, the Alternate Source Scheme punishes the distribution cooperative that hesitates to purchase as much of its load as possible from an Alternate Source, even if that distribution cooperative believes that the best interests of its members, and EKPC, would be served by it not doing so. The distribution cooperative that does not purchase the maximum available amount of its load from an Alternate Source is forced to pay the EKPC fixed costs that are shifted to it from the other distribution cooperatives that do elect to purchase power from an Alternate Source. The unfairness of this cost-shifting is exacerbated by the fact that even if a distribution cooperative wants to purchase from an Alternate Source solely as a defensive measure to mitigate the negative impact of the cost shift on its members, the limitations imposed by the Alternate Source Scheme's "first hog to the trough" allocation mechanism are likely to prevent it from taking a full 15% share of its load from an Alternate Source, and could prevent it from accessing any Alternate Source power.

Amendment 3's Alternate Source Scheme is responsible for two major conflicts among the distribution cooperatives that exploded into major, resource-consuming proceedings before the Commission and the courts, being this case and the Grayson case.<sup>197</sup> EKPC avoided a third such conflict when Mr. Campbell

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<sup>196</sup> Hearing Testimony of Mrs. Carol Wright, May 16, 2018 at 4:03:20 p.m.; and Hearing Testimony of Mr. Mark Stallons, May 17, 2018 at 4:26:30 p.m.

<sup>197</sup> Direct Testimony of Mr. William T. Prather at page 8, 4-6

convinced reasonable minds at Jackson to withdraw its 2009 Amendment 3 notice for its full 15% Alternate Source allotment at 100% load.<sup>198</sup>

The Alternate Source Scheme illegally forces parties to Amendment 3 to choose between committing a breach of contract and breaching other fiduciary duties. For example, as previously mentioned, Mr. Holt believes that he owed his members a fiduciary duty to purchase as much of their power requirements as possible from the market in order to shift EKPC fixed and environmental costs away from them.<sup>199</sup> That includes his conclusion that he had to keep South Kentucky's Alternate Source plans confidential<sup>200</sup> to avoid triggering Alternate Source notices by other distribution cooperatives that, as a result of the "first hog to the trough" mechanism, could prevent South Kentucky from achieving the maximum Alternate Source purchase.<sup>201</sup> But Mr. Holt was required by the Alternate Source Scheme to give EKPC notice of South Kentucky's Alternate Source election,<sup>202</sup> and to cooperate and work with EKPC in a number of respects regarding execution of its Alternate Source election.<sup>203</sup>

So Mr. Holt disclosed South Kentucky's plans to Mr. Campbell, EKPC's president and CEO, and swore him to secrecy for the reasons mentioned. Mr.

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<sup>198</sup> Hearing Testimony of Carol Wright, May 16, 2018 at 3:56:51 p.m. and 4:06:10 p.m.; and Direct Testimony of Tony Campbell at page 6, 5-6.

<sup>199</sup> Hearing Testimony of Mr. Dennis Holt, May 15, 2018 at 10:45:49 a.m.

<sup>200</sup> *See, e.g.*, Response of South Kentucky' to EKPC's Supplemental Information Request, Item 5 (South Kentucky did not inform the other cooperatives until its Nov. 28, 2017 Alternate Source Notice to EKPC).

<sup>201</sup> *Id.* at 3:55:00 p.m. and 4:00:25 p.m.

<sup>202</sup> Amendment 1, Application Exhibit 1, page 1, Section 1; MOU, Application Exhibit 2, page 5, Section 4.

<sup>203</sup> MOU, Application Exhibit 2, Section 5, pages 7-9.

Campbell knew that EKPC had a number of duties to South Kentucky under the MOU, including the obligation to perform the PJM market participant activities for South Kentucky for its Alternate Source activities in accordance with “good utility practice.”<sup>204</sup> But EKPC also owed fiduciary duties to its members, who would be adversely impacted by South Kentucky’s election, and a statutory duty under KRS 279.095 to operate for the mutual benefit of all of its member distribution cooperatives.<sup>205</sup> The Alternate Source Scheme put Mr. Campbell in the untenable situation of having to choose between violating his contractual duties to South Kentucky by disclosing South Kentucky’s plans to EKPC’s board and other members, and violating his fiduciary, statutory and other duties to EKPC’s board of directors and other members by keeping from them information that would definitely have the negative impact of shifting costs to the other members and reducing or eliminating the other members’ access to mitigating Alternate Source transactions.

South Kentucky argues on page 44 of its Initial Post-Hearing Brief that the officers and directors of all fifteen of its sister distribution cooperatives have breached their fiduciary duties to their respective corporations by failing to do what

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<sup>204</sup> MOU, Application Exhibit 2, Section 5(E)(vii), page 9.

<sup>205</sup> This conflict is evidenced by Mr. Don Mosier’s testimony that Mr. Boris Haynes, South Kentucky’s representative on the EKPC Board of Directors, at the February 2018 annual NRECA convention, apologized to him for what is going on, regretted it, underestimated the uproar, and told Mr. Mosier that he would like to see Amendment 3/MOU go away if this does not work out at the P.S.C. (Hearing Testimony of Mr. Don Mosier, May 16, 2018 at 5:51:30 p.m.).



South Kentucky has done.<sup>206</sup> What South Kentucky fails to acknowledge is that due to the “first hog to the trough” and “run on the bank” mechanisms in the Alternate Source Scheme, it is impossible for all fifteen distribution cooperatives to make an Alternative Source election of 15%. So, from South Kentucky’s perspective, the Alternative Source Scheme assures that officers and directors of some of the distribution cooperatives will breach their fiduciary duties. For these reasons, the Alternative Source Scheme is unfair, unjust, and unreasonable, and unreasonably discriminatory, and the Commission should declare invalid both Section I of Amendment 3 and the MOU.<sup>207</sup>

The invalidity of Section I of Amendment 3 does not affect the validity of the WPC or any other amendments to it. Where part of a contract is void, the whole contract will not be set aside unless the good and bad parts cannot be separated without altering its purpose.<sup>208</sup> Courts focus on the “main purpose” of the agreement and whether the objectionable provision could be stricken while still fulfilling this purpose.<sup>209</sup> Equitable considerations will prevail against a

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<sup>206</sup> The Joint Intervenors do not agree that choosing a course different from South Kentucky’s violates their fiduciary duties because many factors must be considered when making such a decision, including but not limited to pursuing opportunities beneficial to both the distribution cooperative and EKPC, which is owned by all of the distribution cooperatives. History has shown that when all distribution cooperatives work together, they have obtained competitively priced power for all of their members.

<sup>207</sup> The MOU expressly provides in Section 2 that its purpose is to interpret the Alternate Source provisions in Section I of Amendment 3 and that it does not modify any provision of Amendment 3. So, it follows from declaring invalid Section I of Amendment 3 that the MOU is also invalid and of no force or effect.

<sup>208</sup> *Cox v. Wagner*, 907 S.W.2d 770, 771 (Ky. 1995); see also *Farmers’ Bank of White Plains v. Bass*, 292 S.W. 489, 490 (Ky. 1927)(the illegal part of an agreement should not prevent the enforcement of the legal parts.)

<sup>209</sup> *Farmers’ Bank*, *supra*, at 490; see also *Hodges v. Todd*, 698 S.W.2d 317, 319-20 (Ky. App. 1985) (“With respect to partial illegality, the real issue is whether partial enforcement is

mechanistic approach as to whether the contract is divisible or indivisible and thus enforceable.<sup>210</sup> Factored into the analysis also are the “intention of the parties, the objects to be obtained and the common sense of the situation.”<sup>211</sup>

Amendment 3 was executed in 2003. It contains three modifications to the WPC. Section I permits members to buy a percentage of power from Alternate Sources (the present issue). Section II contains the other two modifications, being a provision prohibiting EKPC from competing at the retail level with the Owner-Members and an extension of the term from January 1, 2025 to January 1, 2041. Even assuming that the consideration for the extension of the term included Section I, the addition of a bar on retail competition by EKPC provides sufficient consideration to render the extended term enforceable. Additional consideration includes the approval of a loan package from RUS conditioned on the extension of the WPC’s term to 2041.

Section I can be deleted without altering the primary purpose of Amendment 3. The overarching purpose of the WPC is for EKPC to provide power to its Owner-Members. To do so, EKPC had to build generating stations and borrow millions of dollars from RUS to do so. RUS required extension of the term of the WPC as a condition to making the loans. Accordingly, Section I of Amendment 3 is tangential to the central purpose of the WPC, and striking it should not result in also striking

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quite possible without injury to the parties themselves. It is believed that such enforcement is quite possible in the great majority of cases.”); *Ceresia v. Mitchell*, 242 S.W.2d 359, 361 (Ky. 1951) (same).

<sup>210</sup> *Hodges, supra*, at 320.

<sup>211</sup> *Knight v. Hamilton*, 233 S.W.2 969, 971 (Ky. 1950).

the other provisions. Stated differently, the good (Amendment 3, Section II) and bad (Amendment 3, Section I) are not so interwoven that they cannot be separated without altering or destroying the general meaning and purpose of Amendment 3. Additionally, the “common sense” of the situation, and the equitable considerations (namely that RUS has relied upon these term extensions in loaning hundreds of millions of dollars) weigh in favor of keeping the terms as-is, even if Section I of Amendment 3 is stricken.

## 2. The Alternate Source Scheme violates public policy

Not only do Section I of Amendment 3 and the MOU violate KRS 278.030(1) and KRS 278.170(1), they also violate public policy. As noted above, the Alternate Source Scheme requires persons to breach their fiduciary duties. Contract provisions like Section I of Amendment 3 and the MOU that require a person to breach his or her fiduciary duties are void in violation of public policy.<sup>212</sup> Therefore, the Commission should declare invalid Section I of Amendment 3 and the MOU for this additional reason.

## F. Relief Sought by the Joint Intervenors

The Commission has asked the parties what they want the Commission to do, and the Joint Intervenors believe that the Commission should declare invalid

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<sup>212</sup> See *In re Big Rivers Elec. Corp.*, 233 B.R. 739,753 (W.D. Ky. 1998), and *In re Big Rivers*, 233 B.R. 726, 729 (Bankr. W.D. Ky. 1998), citing *Kessler v. Jefferson Storage Corp.*, 125 F.2d 108 (6<sup>th</sup> Cir. 1941); See also *Cadle v. Jefferson*, Case No. 3:07-CV-00070-CRS, 2017 WL 3013385, at \*17 (W.D. Ky. July 14, 2017), appeal dismissed (Oct. 26, 2017) (“In Kentucky, where the object or tendency of a contract is to constitute a breach of fiduciary duty, the contract is illegal and void.”); *Bassett v. Nat’l Collegiate Athletic Ass’n*, 428 F. Supp. 2d 675, 687 (E.D. Ky. 2006), *aff’d sub nom. Bassett v. Nat’l Collegiate Athletic Ass’n*, 528 F.3d 426 (6<sup>th</sup> Cir. 2008) (“Contracts that require an employee to breach his fiduciary duty to his employer are illegal and void under Kentucky law.”)

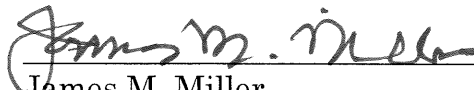
Section I of Amendment 3 and the MOU. This should not impact Amendment 3 projects that are already online – being the “behind the meter” projects previously identified. If the Commission takes this action, any future Alternate Source projects may be submitted to the EKPC Board of Directors for consideration according to policies adopted by the EKPC Board. This process will exemplify cooperation among cooperatives and eliminate the recurring problem of a few distribution cooperatives refusing to cooperate and creating the types of problems made evident in this case.

#### V. CONCLUSION

Based on the foregoing, the Commission should deny South Kentucky’s application and declare invalid both Section I of Amendment 3 and the MOU.

On this the 2<sup>nd</sup> day of July, 2018.

Respectfully submitted,



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