COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF SOUTH KENTUCKY RURAL	)	
ELECTRIC COOPERATIVE CORPORATION FOR	)	
APPROVAL OF MASTER POWER PURCHASE AND	)	Case No. 2018-0050
SALE AGREEMENT AND TRANSACTIONS THEREUNDER	)	

INITIAL POST-HEARING BRIEF OF JACKSON ENERGY COOPERATIVE CORPORATION

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INTRODUCTION

Jackson Energy Cooperative Corporation ("Jackson Energy") files this post-hearing brief in opposition to the application of South Kentucky Rural Electric Cooperative Corporation ("South Kentucky") for approval of the purchase of a block of power of approximately 58 megawatts at one hundred percent load factor from Morgan Stanley Capital Group, Inc. ("Morgan Stanley"). Jackson Energy and South Kentucky, along with fourteen other distribution cooperatives, are all owner members of East Kentucky Power Cooperative, Inc. ("EKPC"). All sixteen owner members are cooperatives and as such are owned by their consumer members rather than investors.

Jackson Energy, along with several other distribution cooperatives, serves members who reside in geographic areas that are regularly ranked among the most impoverished in the nation. Jackson Energy's members are highly sensitive to any increase in electricity rates, since it is quite difficult for many of its members to afford the initial capital outlay required to reduce their usage through HVAC system upgrades, added insulation and other upgrades.

Electric cooperatives in this country have long sought to further goals that are broader than providing their members safe and reliable electricity at reasonable rates. Electric cooperatives have adopted a noble mission to improve the lives of Americans living in rural areas. One of the primary ways of doing so is by engaging in collaborative efforts to foster and encourage economic development. To a significant degree, economic growth is encouraged by low utility rates. South Kentucky's application is detrimental to the remaining distribution cooperatives and their members because it will probably result in higher rates and slowed economic growth. While South Kentucky argues that it will enjoy a financial benefit from the proposed transaction, it will result in a direct impairment to its fellow EKPC members

and will impact consumers who are already struggling. Moreover, a portion of the alleged savings to be enjoyed by South Kentucky will completely leave the EKPC system and be devoured by the investment firm of Morgan Stanley.

For the reasons stated in more detail in this brief, Jackson Energy, on behalf of its members, respectfully asks that the Commission deny the application of South Kentucky.

FACTUAL SUMMARY

Having endured three lengthy days of testimony and having reviewed volumes of written material in this matter, the Commission and its staff are well aware of the facts and issues. As such, Jackson Energy will not unnecessarily belabor the facts of this case. Suffice it to say, EKPC, being involved in a capital intensive industry generating and transmitting electricity on a large scale, has found it necessary and advantageous to borrow money from various lenders, including the United States Department of Agriculture, Rural Utilities Service ("RUS"). To support the loans and mortgages between EKPC and RUS and in the furtherance of good business practices, in 1964, a wholesale power contract between EKPC and its distribution cooperative members was executed.[1] Thereafter, primarily for the purpose of extending the wholesale power contract, various amendments to it were executed by the cooperatives. Amendment 3 to that wholesale power contract likewise extended the length of the contract, but also included a provision which would allow the distribution cooperatives to purchase a small amount of electricity from a source or sources other than EKPC.[2] Specifically, the amendment allowed each owner member to purchase up to fifteen percent of its coincident peak demand from an alternative source, but the aggregate of all purchases could not exceed five percent of EKPC's coincident peak demand. Thought debatable, the reasons for this appear to have been the desire for flexibility on the part of some of the distribution cooperatives, and to allow South Kentucky to purchase the Monticello Plant Board, which had to complete its obligations with a pre-existing wholesale power supplier.

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[1] A copy of the 1964 Wholesale Power Contract between EKPC and its owner members is on file of record in this matter.
[2] A copy of Amendment 3 to the Wholesale Power Contract is filed in the record in this matter.

Thereafter, little of significance transpired between and among the cooperatives with respect to purchases of electricity from a source other than EKPC. Some of the distribution cooperatives entered into power purchase agreements with small suppliers for various distributed generation projects.[3] However, none of these projects arose to such a level as would cause consternation in the cooperative community.

In 2009 and 2010, Jackson Energy began to explore the possibility of purchasing a block of power from an alternative source at a one hundred percent load factor.[4] Jackson Energy's goal was to realize significant savings in power costs which could be passed along to its members. Various representatives of EKPC met with Jackson Energy in 2010 and discouraged Jackson Energy from pursuing its proposed transaction because, among other reasons, doing so would result in stranded costs which would then have to be spread among and shifted to the other owner members of EKPC.[5] Jackson Energy then ceased its efforts to proceed with this off system purchase, though it never actually withdrew its notice to EKPC.[6]

Thereafter, a few years later, Grayson Rural Electric Cooperative ("Grayson") likewise gave notice to EKPC of its intention to purchase a block of power at a one hundred percent load factor. This notice, along with a number of other issues which are irrelevant to this proceeding, resulted in protracted civil litigation in the Mason Circuit Court and in this Commission. Those proceedings were eventually settled and a memorandum of understanding ("MOU") between and among the distribution cooperatives and EKPC, which had been in the development stages for quite some time, was eventually executed.[7] The MOU did not cure the

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[3] Hearing testimony of Carol Wright, May 16, 2018, 4:02:30 – 4:03:25.
[4] Id. at 4:05:50.
[5] Id. At 4:06:08 – 4:06:40.
[6] Id.
[7] The MOU is filed of record with the Commission in this proceeding.

inherent defects within amendment 3, but rather sought to provide a framework as to how off system purchases would be noticed and effectuated. Importantly, the MOU would effectively throttle back any off system purchases once the aggregate of all such purchases exceeded two and a half percent of EKPC's coincident peak demand. South Kentucky's notice alone resulted in this threshold being crossed which has throttled back all other elections. Jackson Energy, along with a group of other distribution cooperatives, purely as a defensive mechanism to mitigate the effects of any cost shifting, gave notice of its intent to purchase a block of power from an alternative source. These elections have completely exhausted the allotment under Amendment 3 and the MOU and will not allow for any more distributed generation projects.

ARGUMENT

A. South Kentucky's Application is in Violation of KRS 278.170(1)

Kentucky law forbids a utility from giving any unreasonable preference or advantage to any person. Specifically, KRS 278.170(1) states as follows:

> No utility shall, as to rates or service, give any unreasonable preference or advantage to any person or subject any person to any unreasonable prejudice or disadvantage, or establish or maintain any unreasonable difference between localities or between classes of service for doing a like and contemporaneous service under the same or substantially the same conditions.

KRS 278.030(1) requires that rates charged by utilities be fair, just and reasonable, specifically stating as follows:

> Every utility may demand, collect and receive fair, just and reasonable rates for services to be rendered by it to any person.

These statutory rules apply to all utilities in the Commonwealth of Kentucky, including wholesale power suppliers such as EKPC. Under the law, South Kentucky may not receive an unreasonable preference or advantage, particularly when such an advantage is to the detriment of its fellow distribution cooperatives.

John Wolfram has provided expert testimony in this matter indicating that the loss of 58MW from the EKPC system could result in a shifting of EKPC's fixed costs to its remaining member owners unless such fixed costs could be mitigated in other ways.[8] Even if the loss of load could be mitigated by EKPC, it will result in a significant loss of economic opportunity to EKPC and its remaining members which will have a number of undesirable results – e.g. a rate case may be needed sooner than expected or capital credit retirements to member systems

[8] Pre-filed testimony of John Wolfram page 5, 15 – 18..

will be delayed. If South Kentucky is correct in its assertion that its members will see an economic benefit due to its off system purchase of power, that benefit is solely due to South Kentucky's avoidance of a portion of EKPC's fixed costs. This avoidance results in a negative economic impact to EKPC and, as a natural extension, to the remainder of its member owners.

Approval of South Kentucky's application would result in preferential treatment to South Kentucky at the expense of the other distribution cooperatives and their members. This is solely a result of South Kentucky's avoidance of a significant portion of the fixed costs of EKPC. Such an off system purchase undermines the financial foundation of EKPC and the equity all owner-members have in that system. To add insult to injury, not only would allowing such an off system purchase undermine the financial stability of EKPC, but it passes a portion of the alleged savings to Morgan Stanley as a profit for that investment company. Certainly, this is a boon to Wall Street, but it comes at the expense of Jackson Energy's members and those of all other distribution cooperatives that are part of the EKPC system.

B. South Kentucky's Application Would Result in Wasteful Duplication of Resources

In KRS 278.020, Kentucky has adopted a legal framework for ensuring that the expenditure of resources by a utility is truly needed and in the best interest of the public, rather than being a wasteful duplication of resources. Common examples of this are the requirement for an application for a certificate of public convenience and necessity, and encouraging multiple utilities to utilize the same poles via pole attachment agreements.

Ironically, one of the most important cases to define wasteful duplication of services stemmed from the first application of EKPC to construct generating plants. Those plants were opposed by various investor owned utilities in Kentucky, who argued that the construction of

new generation would be a wasteful duplication of resources. While EKPC ultimately prevailed in that litigation, Kentucky's High Court set forth the legal rules and reasoning in this area as follows:

> We think it is obvious that the establishment of convenience and necessity for a new service system or a new service facility requires first a showing of a 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 and operated.
>
> Second, the inadequacy must be due either to a substantial deficiency of service 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 over such a period of time as to establish an inability or unwillingness to render adequate service.
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> . . . .
>
> Therefore, a determination of public convenience and necessity requires both a finding of the need for a new service system or facility from the standpoint of service requirements, and an absence of wasteful duplication resulting from the construction of the new system or facility. *Kentucky Utilities Co., et al. v. Public Service Commission, et al.*, 252 S.W.2d 885 (Ky. 1952).

South Kentucky was a part of the EKPC system when the above-cited case was filed and decided. Now, South Kentucky wishes to withdraw a portion of its load from a system that was built and designed, at least in part, to serve to serve its members, so that it may purchase part of its requirements from the wholesale market to avoid its share of the fixed costs of the system built to serve it. Not only is that position unfair and unjust, but it is a clear duplication of services.

EKPC has developed, built and obtained the capacity necessary to serve South Kentucky and its members. Allowing South Kentucky to now purchase a portion of its needs

from elsewhere simply duplicates the resources already developed by EKPC to serve South Kentucky. South Kentucky has not met its burden under the law to prove that (1) the additional power supplied by Morgan Stanley is needed; and (2) that such purchase would not be a wasteful duplication of services. In fact, South Kentucky has presented no evidence in this regard other than to argue that the off system purchase is not a duplication of South Kentucky's resources. This argument completely overlooks the fact that South Kentucky has a significant ownership interest in a generation and transmission cooperative such that duplication should be viewed from the perspective of EKPC, rather than South Kentucky's perspective.

In sum, EKPC has taken the necessary steps to ensure that its owners will have adequate power to serve the needs of their members. Allowing South Kentucky to partially escape the system and buy a significant percentage of its needs from a third party is obviously a duplication of East Kentucky's efforts, which is in violation of Kentucky law.

C. The Denial of South Kentucky's Application Would Not be in Contradiction to the Filed Rate Doctrine

South Kentucky argues that the MOU between and among the parties, being accepted by the Commission, is a filed rate. South Kentucky further argues that the filed rate doctrine prohibits a challenge to any distribution cooperative's election to exercise its "rights" under the MOU. However, South Kentucky's reliance on this doctrine is misplaced.

Generally speaking, Kentucky law has defined the filed rate doctrine to mean that when the legislature has established a rate making process, the filed rate adopted as a result of that process defines the parameters of the relationship between the utility and the customer with respect to the rate the customer must pay and that the utility must collect. *See Cincinnati Bell*

Telephone Company v. Kentucky Public Service Commission, 223 S.W.3d 829 (Ky. App. 2007). However, the filed rate doctrine implicitly assumes that the Commission has closely reviewed the particular rate that was filed by the utility and that notice of the proposed rate was given and that a hearing was conducted as to its reasonableness as provided by KRS 278.190. *See Cincinnati Bell Telephone* at 838.

With respect to the adoption of the MOU, while it was accepted by the Commission, there was no hearing on the issues contained therein. This is likely due to the fact that the MOU was not necessarily considered a “rate” that would be charged by a utility to its customers, but rather an agreement between and among utilities concerning the use of off system resources. The effect that off system purchases had on a utility’s finances and therefore on rates could be addressed in any individual utility’s rate case. Put simply, the MOU is not a filed rate and therefore the doctrine does not prohibit the denial of the exercise of South Kentucky’s alleged “rights” under the MOU.

Even assuming for the sake of argument that the MOU could be construed as a filed rate, the denial of South Kentucky’s application in this matter would not violate the doctrine. The Commission always maintains the right and authority to examine any potential transaction of this significance. Taken to the extreme, South Kentucky’s argument stands for the proposition that the Commission has no authority to examine this matter, and none of South Kentucky’s members could question South Kentucky’s application. By that logic, South Kentucky could enter into any contractual agreement with a third party seller with no regard to whether the transaction was a sound decision for its members. This is certainly not the intent of the filed rate doctrine. On the contrary, the filed rate doctrine was intended to provide

notice of proposed rate changes to customers and protect customers from unforeseen rate changes without the Commission's examination of them.

D. The Proposed PPA Unduly Subjects South Kentucky's Members to Unreasonable Risk

The agreement between South Kentucky and Morgan Stanley is, to put it mildly, complicated. The agreement contemplates numerous facets of the electric business that are out of the ordinary for a distribution cooperative, including transmission expenses, participation in the wholesale energy market, environmental costs and the use of a financial hedge. South Kentucky admittedly has little if any experience in these matters.

John Wolfram specifically testified at the hearing of this matter that the contract proposed by South Kentucky would generally not be in the best interests of a distribution cooperative.[9] Mr. Wolfram further opined that the contract poses significant risks to South Kentucky and its members that have not been adequately investigated or mitigated by South Kentucky.[10] Mr. Wolfram outlined those risks as follows: (a) the capacity price could be much lower than the fixed hedge price; (b) the PJM costs that South Kentucky must pay could escalate more than anticipated; and (c) unforeseen changes in environmental law and how such changes could affect the contract price.[11] In fact, the hearing testimony was replete with other references to risks facing South Kentucky which are too numerous to mention, but which include: (a) the length of the contract; (b) changes in EKPC's rate design; and (c) changes in NITS charges, just to name a few.

[9] Hearing testimony of John Wolfram, May 12, 2018 at 12:01:30.
[10] Id. at 12:03:00.
[11] Id. at 12:04:10.

These risks to South Kentucky's members are not only substantial in nature, but they are wholly unnecessary. Not only does South Kentucky's proposed transaction shift the fixed costs of EKPC to the other owner members, it exposes South Kentucky to the very risks that it now mostly avoids by being a member of a generation and transmission cooperative whose fixed costs exist to ameliorate such risks. It is clear from the testimony in this matter that South Kentucky did not properly vet this proposed transaction and the risks its poses are unreasonable, particularly in light of the fact that the anticipated "reward" only exists as a result of "punishing" fellow cooperatives.

E. Proposed Solutions

Throughout the hearing of this matter, the Commission noted its exasperation at the time and expense involved in this litigation. The Commission further expressed its view that a solution to the inherent problems created by Amendment 3 and the MOU should be adopted. Jackson Energy, along with many other cooperatives, shares the Commission's disappointment that the cooperatives have been unable heretofore to arrive at a sensible compromise among themselves that would obviate the need for further administrative or judicial proceedings.

As a preliminary matter, it should be noted that Mr. Holt was incorrect in his testimony that his fiduciary duty to South Kentucky required him to purchase power from a third party at a reduced price. Such an assertion overlooks the fact that one of the largest assets of South Kentucky is its ownership stake in EKPC. In fact, in many cases the share of equity in EKPC constitutes a significant portion of a distribution cooperative's equity. Surely the fiduciary duty of a distribution cooperative CEO does not require him or her to take measures to undermine one of the cooperative's largest assets. If South Kentucky was not a member of

EKPC, certainly it would have a duty to its members to seek the best deal it could find for purchased power, considering such factors as price and reliability. However, when one is a member of a generation and transmission cooperative, the calculus is quite different and must take into account how such actions affect the assets of the G & T, since those assets are owned, in part, by South Kentucky.

Based on the hearing testimony, there are certain particular aspects of South Kentucky's proposed purchase of power that are troubling. Those issues are that the purchase is for a block of power at one hundred percent load factor, and that the purchase is not behind the meter – i.e. the production facility is not within South Kentucky's territory. Furthermore, the size of the purchase is quite large.

Jackson Energy has been involved in off system purchases for a number of years which have included purchasing power generated by privately owned gas generators and hydroelectric facilities. These projects were all the result of third parties approaching Jackson Energy with an interest in developing the generating assets. Jackson Energy expects it will receive further interest in such projects in the future both from its members and from third parties. The testimony throughout the hearing in this matter was that these projects are not detrimental to the financial position of EKPC because the power being produced is not at a one hundred percent load factor, the projects are very modest in their generating capacity, all the projects are behind the meter and the projects have been developed incrementally over a long period of time. These behind the meter projects could be likened to demand side management programs which have been treated favorably by the Commission. These projects delay the need for additional generation and infrastructure investment while having no negative effect on EKPC's financial stability. The sum of the testimony at the hearing in this

matter is that not only is there no opposition with the cooperative family to such projects, but that both EKPC and the distribution cooperatives would like to continue the growth of such projects. These projects are good for local communities and for economic development in the region.

This poses the obvious question of how the Commission can legally deny the application of South Kentucky, yet leave the door open for the types of projects that the cooperative community supports. Jackson Energy would propose two alternative solutions.

First, the Commission could simply rule, as argued above, that South Kentucky's application does not comport with the law because it is unfair, unjust and unreasonable, or that it is a needless duplication of services. This is particularly true given that the proposed purchase of power is not behind the meter and duplicates the capacity of EKPC which is already in place. Any ruling by the Commission, specifically including the reasons stated in support of its ruling, will become legal precedent, and thereby, be added to the common law of the Commonwealth of Kentucky. If the Commission denies South Kentucky's application based on any of the above reasoning, that opinion, along with the enormous resources expended in this action, will serve as substantial notice to any cooperative in the future that the Commission will examine such an application closely and reject it if the application is for approval of a large block of market power as opposed to a small purchase from a behind the meter resource.

Not only would this solution be appealingly simple, it would also avoid the sticky legal wicket of a state utility commission seeking to partially or wholly invalidate a contract between legal entities which was drafted and approved by a federal regulatory body. While Jackson Energy believes that other cooperatives, perhaps even a majority of them, may take the position

that Amendment 3 and/or the MOU should be struck down in part by the Commission, such a ruling would inevitably set a course down a road fraught with legal potholes that could easily by avoided while still providing substantial guidance for decision making in the future by the cooperatives.

Second, if the Commission should attempt to undertake to partially invalidate Amendment 3 and/or the MOU and substitute a different framework for the allocation of capacity for off system purchases, Jackson Energy would submit that since Amendment 3 allows for a total of five percent of EKPC's coincident peak demand to be purchased off system, the fairest solution would be to limit each distribution cooperative to off system purchases of no more than five percent of its coincident peak demand and to further limit such purchases to behind the meter generation projects. This would ensure that the total aggregate of all off system purchases will never exceed five percent of EKPC's peak demand (and will in fact likely be so minor as to be insignificant), and there will be no block purchases from the market at a one hundred percent load factor. This solution is simple and fair and will not lead to further disputes among the cooperatives.

Jackson Energy believes other cooperatives may propose that those portions of amendment 3 that allow off system purchases should simply be stricken and all off system purchases, including behind the meter purchases, would have to be approved by the EKPC Board of Directors. While Jackson Energy respects the opinions of its fellow cooperatives, such a framework has the potential to cause more strife among the cooperatives. This idea would require the Board to weight the pros and cons of individual projects and their merits. This could lead to lobbying and even arguing between and among the cooperatives. All of this could be avoided by simply denying South Kentucky's application or adopting a five percent

across the board cap. Sometimes the simplest solution really is the best. Particularly when the interests of seventeen different cooperatives have the potential to collide.

CONCLUSION

The Board of Directors, management and the employees of Jackson Energy have worked tirelessly to control the rates it must charge to its members to remain economically viable. Jackson Energy has also long been on the forefront of economic development efforts in its region. All these pain staking efforts could be thwarted by allowing a fellow cooperative to undermine EKPC and then move part of its "savings" to a Wall Street investment firm.

For the reasons stated in this brief, Jackson Energy respectfully requests that the Commission deny South Kentucky's application and grant the relief requested herein.

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