

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE ELECTRONIC APPLICATION OF EAST)
KENTUCKY POWER COOPERATIVE, INC.)
FOR A GENERAL ADJUSTMENT OF RATES,) Case No. 2021-00103
APPROVAL OF DEPRECIATION STUDY,)
AMORTIZATION OF CERTAIN REGULATORY)
ASSETS AND OTHER GENERAL RELIEF)

REBUTTAL TESTIMONY OF THOMAS J. STACHNIK

VICE PRESIDENT AND TREASURER

ON BEHALF OF EAST KENTUCKY POWER COOPERATIVE, INC.

Filed: July 27, 2021

1 **Q. PLEASE STATE YOUR NAME, TITLE, AND BUSINESS ADDRESS.**

2 A. My name is Thomas J. Stachnik and I am the Vice President and Treasurer for
3 East Kentucky Power Cooperative, Inc. (“EKPC”). My business address is 4775
4 Lexington Road, Winchester, Kentucky 40391.

5 **Q. DID YOU FILE DIRECT TESTIMONY AND DATA RESPONSES IN THIS**
6 **PROCEEDING?**

7 A. Yes, I filed direct testimony, Exhibit 17 of the Application, and provided
8 responses to data requests propounded by the Commission Staff, the Attorney
9 General (“AG”), and Nucor Steel Gallatin (“Nucor”).

10 **Q. PLEASE PROVIDE THE PURPOSES OF YOUR REBUTTAL**
11 **TESTIMONY.**

12 A. The purpose of my testimony is to respond to numerous issues raised in the direct
13 testimony filed on behalf of the AG and Nucor. I will address the short-term
14 investment portfolio and Times Interest Earned Ratio (“TIER”) issues raised by
15 Mr. Lane Kollen on behalf of the AG and Nucor.

16 **Q. WHAT WOULD BE THE EFFECT ON EKPC’S KEY FINANCIAL**
17 **MEASURES AND HOW WOULD THE RATING AGENCIES RESPOND**
18 **IF EKPC WERE ORDERED TO CUT RATES BY THE AMOUNT**
19 **SUGGESTED BY THE TABLE ON PAGE 4 OF THE LANE KOLLEN**
20 **TESTIMONY?**

21 A. If EKPC were to cut rates by this amount, there would be a high likelihood that it
22 would fail to meet the credit facility covenant. Furthermore, the rating agencies
23 would recalculate their expectations about the financial measures we would

1 achieve and would be likely to downgrade our ratings. The rating agencies
2 consider a cooperative's ability to adjust rates to be a key factor contributing to
3 credit strength.

4 **Q. IS EKPC ABLE TO REDEEM LONG-TERM DEBT IN THE SAME**
5 **MANNER THAT IT REDEEMED FFB DEBT UNDER THE FARM BILL**
6 **PROVISION?**

7 A. No. The Farm Bill prohibited new deposits into the cushion of credit as of the
8 effective date of the Farm Bill. EKPC was limited to using funds which were
9 already in the cushion of credit, plus interest for the purposes of repayment of
10 debt with no penalty. Any additional redemptions of long-term debt would
11 require payment of a make-whole penalty. This obviously negates the benefit of
12 any pre-payment.

13 **Q. HOW DID THESE REPAYMENTS UNDER THE FARM BILL**
14 **PROVISION BENEFIT OWNER-MEMBERS?**

15 Being able to prepay this debt with no prepayment penalty greatly reduced both
16 the interest and scheduled principal payments, which improved EKPC's DSC
17 ratio. While EKPC did lose a commensurate amount of interest income on the
18 phase-out of the cushion of credit, interest expense greatly declined. Since TIER
19 is calculated using only interest expense and not interest income, the reduction
20 leads to less required margin given a target TIER.

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1 **Q. IF EKPC SOLD ITS SHORT TERM INVESTMENTS AS MR. KOLLEN**
2 **SUGGESTS, WHAT WOULD BE THE EFFECT ON NET MARGIN?**

3 A. Though it would be unreasonable to do so, if EKPC sold all of these short-term
4 investments, it would be able to pay down the credit facility balance. The
5 earnings on these investments are about 1% per annum lower than the cost of
6 financing on the credit facility, so annual interest expense would be reduced by
7 about \$10,000 for each \$1 million in cash equivalents sold. This would have a
8 negligible effect on EKPC's Equity Ratio, TIER, and DSC, and a significant
9 negative effect on EKPC's liquidity profile.

10 **Q. WOULD IT BE ADVISABLE FOR EKPC TO SELL ALL OF THESE**
11 **SHORT-TERM INVESTMENTS?**

12 Fitch's methodology ("US Public Power Rating Criteria" dated April 3, 2019)
13 states that

14 "a liquidity cushion above 90 days is neutral to ratings, as long as
15 unrestricted cash is above 30 days. A liquidity cushion below 90
16 days or unrestricted cash below 30 days are considered 'weak' and
17 risk additive".

18
19 Fitch also publishes an annual peer study that shows that the median BBB-rated
20 G&T cooperative holds 111 days cash and the median A/A- G&T cooperative
21 holds 99 days cash.

G&T Cooperative Systems

Obligor	Rating	Outlook/ Watch	Region	Total Operating Revenue (\$'000)	Coverage of Full Obligations (x)	Debt Service Coverage (x)	Net Adjusted Debt/ Adjusted FADS (x)	Equity/ Capitalization (%)	Days Cash on Hand	Liquidity Cushion (Days)	Capex/D&A (%)
AA-/A+ Rated Credits											
Arkansas Electric Cooperative Corporation, AR	AA-	Stable	SERC	739,632	1.48	1.91	7.44	39	60	217	191
Associated Electric Cooperative Inc., MO	AA-	Stable	SERC	1,135,982	1.60	1.83	5.52	31	155	386	153
Golden Spread Electric Cooperative, TX	AA-	Stable	SPP	413,615	1.83	2.30	4.01	45	232	462	58
South Texas Electric Cooperative Inc., TX	A+	Negative	ERCOT	503,935	1.19	1.42	8.18	29	42	271	141
Old Dominion Electric Cooperative, VA	A+	Stable	RFC	807,704	1.35	1.62	7.29	29	5	281	113
AA-/A+ Rated Median				739,632	1.48	1.83	7.29	31	60	281	141
A/A- Rated Credits											
Basin Electric Power Cooperative, ND	A	Stable	MRO	2,071,107	1.55	1.76	8.04	23	108	303	57
Central Iowa Power Cooperative, IA	A	Stable	MRO	179,019	1.69	2.08	5.85	35	287	464	302
Buckeye Power Inc., OH	A	Positive	RFC	670,065	1.38	1.43	6.26	32	35	222	38
Cooperative Energy, MS	A	Stable	SERC	738,836	1.48	2.03	6.60	27	133	417	237
North Carolina Electric Membership Corporation, NC	A	Positive	SERC	1,092,169	1.16	1.41	6.65	19	99	283	108
Arizona Electric Power Cooperative, Inc., AZ	A	Stable	WECC	178,421	1.41	1.59	6.32	48	54	265	70
Great River Energy, MN	A-	Stable	MRO	1,215,153	1.19	1.23	6.89	22	93	255	42
Western Farmers Electric Cooperative, OK	A-	Positive	SPP	665,048	1.18	1.43	7.57	29	108	285	101
Tri-State Generation & Transmission Association Inc., CO	A-	Stable	WECC	1,352,295	1.30	1.43	9.10	25	46	281	77
A/A- Rated Median				738,836	1.38	1.43	6.65	27	99	283	77
BBB Category Credits											
East Kentucky Power Cooperative, KY	BBB+	Stable	SERC	787,672	1.27	1.32	9.14	23	111	349	192
Oglethorpe Power Corporation, GA	BBB+	Negative	SERC	1,377,618	1.65	1.69	14.39	9	203	799	310
PowerSouth Energy Cooperative and Subsidiaries, AL	BBB+	Negative	SERC	547,219	1.76	2.09	7.23	22	136	404	244
Southern Illinois Power Cooperative, IL	BBB	Stable	MRO	164,455	1.06	1.06	8.48	19	43	268	46
Big Rivers Electric Corp., KY	BBB-	Positive	MRO	328,708	2.12	2.35	5.44	43	49	315	69
BBB Category Median				547,219	1.65	1.69	8.48	22	111	349	192

FADS - Funds available for debt service, D&A - Depreciation and amortization, SERC - Southeastern Electric Reliability Corporation, SPP - Southwest Power Pool, ERCOT - Electric Reliability Council of Texas, RFC - Reliability First Corporation, MRO - Midwest Reliability Organization, WECC - Western Electricity Coordinating Council.
Source: Fitch Ratings.

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As previously mentioned, during times of concerning market liquidity, the benefits of EKPC’s conservative approach of maintaining strong cash balances become clear. For example, at the beginning of the coronavirus pandemic, there were concerns about banks’ ability to fund credit commitments. However, with its strong cash position, EKPC was confident in its ability to fund operating requirements and support owner-members as needed. Other events that have caused corporations to draw down credit lines and strained banks liquidity have been the 2008 Credit Crisis culminating in the Lehman Brothers’ bankruptcy and the September 11, 2001 terrorist attacks.

EKPC currently targets 80 – 100 days of operating expenses in cash, cash equivalents, and available-for-sale securities. The available-for-sale securities (Treasuries held for compliance requirements) account for approximately 25 days; thus, the target implies 55-75 days (approximately \$90 – 120 million) in cash and

1 cash equivalents. Considering Fitch’s absolute minimum of 30 days, the fact that
2 the upper end of EKPC’s target range is consistent with the median of its G&T
3 peers, and the benefits of a conservative approach to liquidity, this target is
4 reasonable.

5 **Q. CAN EKPC COUNT ON BEING ABLE TO DRAW ON ITS SYNDICATED**
6 **CREDIT FACILITY WITH 100% CERTAINTY DURING TIMES OF**
7 **ECONOMIC TURMOIL?**

8 A. In ordinary circumstances, EKPC can count on next-day liquidity from the credit
9 facility. However, during times of economic turmoil, there is a possibility that
10 banks would not be able to meet their obligations to advance funds. Furthermore,
11 if EKPC failed to meet its financial covenants or any other covenant under the
12 credit agreement, banks could refuse to advance funds.

13 **Q. IS THE AMOUNT OF CASH AND SHORT-TERM INVESTMENTS HELD**
14 **AT A SUBSIDIARY OF A LARGE CORPORATION THAT HOLDS**
15 **LARGE CASH BALANCES AND HAS ACCESS TO A LARGE**
16 **COMMERCIAL PAPER PROGRAM A RELEVANT COMPARISON TO**
17 **THE CASH HELD BY A G&T COOPERATIVE?**

18 A. Subsidiaries of a large corporation can be funded as necessary by cash at the
19 parent company level. Mr. Kollen’s testimony discusses cash at the subsidiary
20 (e.g. Kentucky Power Company, Kentucky Utilities) level, but neglects to
21 mention that their parent companies hold large amounts of cash and short-term
22 investments. Furthermore, their parent company commercial paper programs and
23 credit facilities provide same-day liquidity. EKPC’s credit facility only provides

1 next-day liquidity (at a higher rate based on Prime and not LIBOR, with LIBOR
2 borrowings requiring three business days' notice).

3 **Q. ON PAGE 52 OF MR. KOLLEN'S TESTIMONY, HE NOTES THAT**
4 **EKPC EARNED AN AVERAGE TIER OR 1.34X FOR 2016-2020 WHILE**
5 **TARGETING 1.5X. IF A 1.3X TIER WERE TARGETED. WHAT DO YOU**
6 **BELIEVE THE AVERAGE EARNED TIER WOULD BE, AND WHAT**
7 **WOULD BE THE LIKELIHOOD OF MISSING THE 1.1X COVENANT IN**
8 **A GIVEN YEAR? WOULD EKPC BE ABLE TO MANAGE WITH A 1.3**
9 **TIER?**

10 A. EKPC rates have targeted a 1.5x TIER since 2010, but as Mr. Kollen notes,
11 achieved TIERS have been lower. With a 1.3x TIER target, it would be highly
12 likely that we would not exceed our 1.1x covenant requirement.

13 **Q. HOW DO A COOPERATIVE'S OWNER MEMBERS RECEIVE A**
14 **RETURN ON THEIR EQUITY INVESTMENT?**

15 A. The equity holders of a cooperative are the owner-members as well as the
16 customers. Owner-members can benefit by virtue of the fact that their equity
17 investment increases as the cooperative earns margin, as well as by lower rates.

18 The calculations of return on equity given in my direct testimony were not meant
19 to imply that a cooperative should seek the same level of returns as an investor-
20 owned utility, but to illustrate that the cooperative model affords the ability to
21 seek relatively lower returns, and thus lower rates. EKPC endeavors to keep rates
22 as low as possible, while maintaining the strength and flexibility to continue to
23 provide reliable energy to consumers. The fact that a cooperative's realized

1 returns on equity (Margin / Equity) are lower than those of an IOU are a direct
2 result of the fact that some of the benefit to the owner-member has already been
3 passed on as lower rates rather than a return on their investment.

4 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

5 A. Yes.

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VERIFICATION OF THOMAS J. STACHNIK

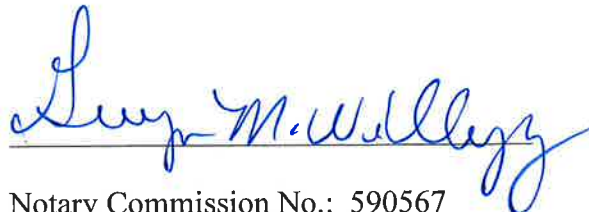
COMMONWEALTH OF KENTUCKY)
)
COUNTY OF CLARK)

Thomas J. Stachnik, being duly sworn, states that he has supervised the preparation of his Rebuttal Testimony in the above-referenced case and that the matters and things set forth therein are true and accurate to the best of his knowledge, information and belief, formed after reasonable inquiry.



Thomas J. Stachnik

The foregoing Verification was signed, acknowledged and sworn to before me this 27th day of July 2021, by Thomas J. Stachnik.



Notary Commission No.: 590567
Commission expiration: 11/30/2021

