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MAR 13 2018

PUBLIC SERVICE
COMMISSION

**COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION**

In the matter of:

: CASE NO: 2018-00050

THE APPLICATION OF SOUTH KENTUCKY
RURAL ELECTRIC COOPERATIVE CORPORATION
FOR APPROVAL OF MASTER POWER
PURCHASE AND SALE AGREEMENT
AND TRANSACTIONS THEREUNDER

**RESPONSE OF SOUTH KENTUCKY RURAL ELECTRIC COOPERATIVE
CORPORATION TO COMMISSION STAFF'S
FIRST REQUEST FOR INFORMATION**

Respectfully submitted,



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Counsel for the Petitioner,

**SOUTH KENTUCKY RURAL ELECTRIC
COOPERATIVE CORPORATION**

CERTIFICATE OF SERVICE

Pursuant to 807 KAR 5:001 Section 6, the undersigned certifies that consistent with 807 KAR 5:001 Section 4(8)(d)(3), a copy of this document has been electronically served upon the following:

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This 13th day of March, 2018.



ATTORNEY FOR SKRECC

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MAR 13 2018

PUBLIC SERVICE
COMMISSION

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the matter of: : CASE NO. 2018-00050

THE APPLICATION OF SOUTH KENTUCKY RURAL :
ELECTRIC COOPERATIVE CORPORATION FOR :
APPROVAL OF MASTER POWER PURCHASE AND :
SALE AGREEMENT AND TRANSACTIONS :
THEREUNDER :

VERIFICATION

STATE OF GEORGIA

COUNTY OF FULTON

Carter Babbit, being duly sworn, states that he has supervised the preparation of the Responses of South Kentucky RECC in the above-referenced case dated February 26, 2018, 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.



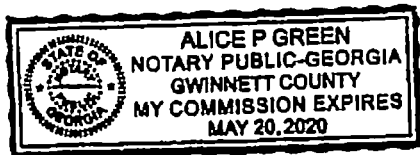
CARTER BABBIT

Subscribed and sworn before me on the 12th day of March, 2018



Notary Public

My commission expires May 20, 2020.



COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

IN THE MATTER OF:

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

VERIFICATION

STATE OF KENTUCKY
COUNTY OF PULASKI

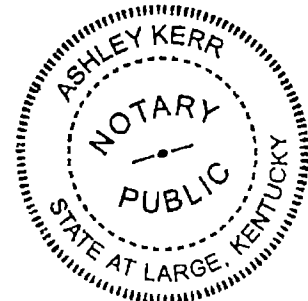
Michelle D. Herrman, being duly sworn, states that she has supervised the preparation of the Responses of South Kentucky RECC in the above-referenced case dated February 26, 2018, and that the matters and things set forth therein are true and accurate to the best of her knowledge, information and belief, formed after reasonable inquiry.

Michelle D. Herrman

Subscribed and sworn before me on the 8th day of March, 2018.

Ashley Kerr
Notary Public

My commission expires 8/31/19.



COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

IN THE MATTER OF:

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

VERIFICATION

STATE OF KENTUCKY
COUNTY OF PULASKI

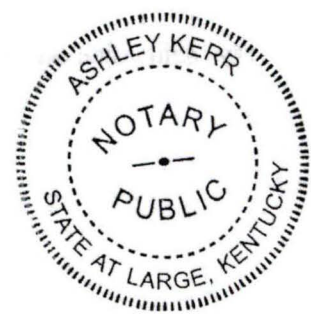
Dennis Holt, being duly sworn, states that he has supervised the preparation of the Responses of South Kentucky RECC in the above-referenced case dated February 26, 2018, and that the matters and things set forth therein are true and accurate to the best of his knowledge, information and belief, formed after reasonable inquiry.

Dennis Holt

Subscribed and sworn before me on the 8th day of March, 2018.

Ashley Kerr
Notary Public

My commission expires 8/31/19.



COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION


IN THE MATTER OF:

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

VERIFICATION

STATE OF FLORIDA
COUNTY OF ST. JOHNS COUNTY

William Steven Seelye, being duly sworn, states that he has supervised the preparation of the Responses of South Kentucky RECC in the above-referenced case dated February 26, 2018, 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.



Subscribed and sworn before me on the 5th day of March, 2018.



BRADLEY T. RING
MY COMMISSION # GG 025453
EXPIRES: September 29, 2020
Bonded Thru Budget Notary Services



Notary Public

My commission expires 9/29/2020.

**South Kentucky Rural Electric Cooperative Corporation
Case No. 2018-00050
Commission Staff's First Request for Information**

1. Provide South Kentucky's peak demand for 2016 and 2017.

Response:

South Kentucky's peak demand for 2016 and 2017 was 352.2 MW and 353.4 MW, respectively.

**South Kentucky Rural Electric Cooperative Corporation
Case No. 2018-00050
Commission Staff's First Request for Information**

2. Refer to the Application, paragraph 12, which states that South Kentucky believes that the expected financial benefits from the proposed transaction outweigh the risks. Also refer to the Application, Exhibit 3, which states that South Kentucky's board of directors were "fully briefed" on the possible risks of the proposed transaction.
 - a. Provide a copy of the briefing referenced in Exhibit 3 to the Application.
 - b. State with specificity the possible risks of the proposed transaction that were evaluated by South Kentucky's Board of Directors.
 - c. State with specificity the expected financial benefits of the proposed transaction that South Kentucky's Board of Directors evaluated.

Response:

- a. Please see Attachment STAFF#2. This Attachment, as well as the response to item b. below, includes confidential information that is subject to a motion for confidential treatment. A redacted Public version and an unredacted Confidential version are being filed with the Commission.
- b. As reflected in Attachment STAFF#2, South Kentucky identified the following possible risks of the proposed transaction:
 1. Market price decline on energy during the term of the proposed transaction and South Kentucky's inability to re-price the proposed transaction to reflect a lower market price.
 2. Changes within PJM in regard to new potential capacity and energy rules that could impact the overall value to be realized from the proposed transaction.
 3. Changes in laws or regulations; for example, changes in environmental laws applicable to PJM, as well as its participants that could impact the overall value to be realized from the proposed transaction.

4. Variability in capacity pricing associated with the capacity hedge risk, to the extent that the final zonal price in PJM settles at a value higher than the Floating Price (*i.e.*, the BRA Resource Clearing price).
 5. Failure of Morgan Stanley to perform under the proposed transaction and make good on its collateral obligations to make South Kentucky whole on the difference in price between the cost of energy under the agreement and the cost of replacement power.
 6. Cost risks associated with South Kentucky's Master Letter of Credit obligations under the proposed transaction.
 7. Lack of PSC approval.
- c. The economic evaluation of the proposed transaction indicated Net Present Value savings of between [REDACTED], depending on possible fluctuations in the PJM market. Additionally, the proposed transaction increases the diversity in South Kentucky's power supply, which aids in the overall financial stability of South Kentucky by enabling it to draw upon multiple sources for power should an unforeseen event occur with East Kentucky Power Cooperative ("EKPC").

Amendment 3 / MOU RFP Process Update

for



December 19, 2017

AGENDA

- ◆ Where We Left Off Last Meeting
- ◆ What has Changed
- ◆ Specifics of Morgan's Capacity Proposal
- ◆ New Estimated NPV Savings
- ◆ Benefits and Risks
- ◆ Conclusions
- ◆ Contract Negotiations
- ◆ What is Left to do

Where We Left Off Last Meeting

- Decision to move forward with Morgan Stanley to contract negotiations
- 20 year Morgan Stanley product
 - 20 year fixed energy to EKPC Zone at \$ [REDACTED] /MWh
 - 13 year RTO capacity at \$ [REDACTED] MW-day
 - First 2 years of capacity purchased from PJM at the Final Zonal Capacity Price
 - Will be finalized by PJM before start date of contract
 - Last 5 years at \$ [REDACTED] MW-day escalated at 2%
 - NPV savings estimated \$ [REDACTED]

What Has Changed

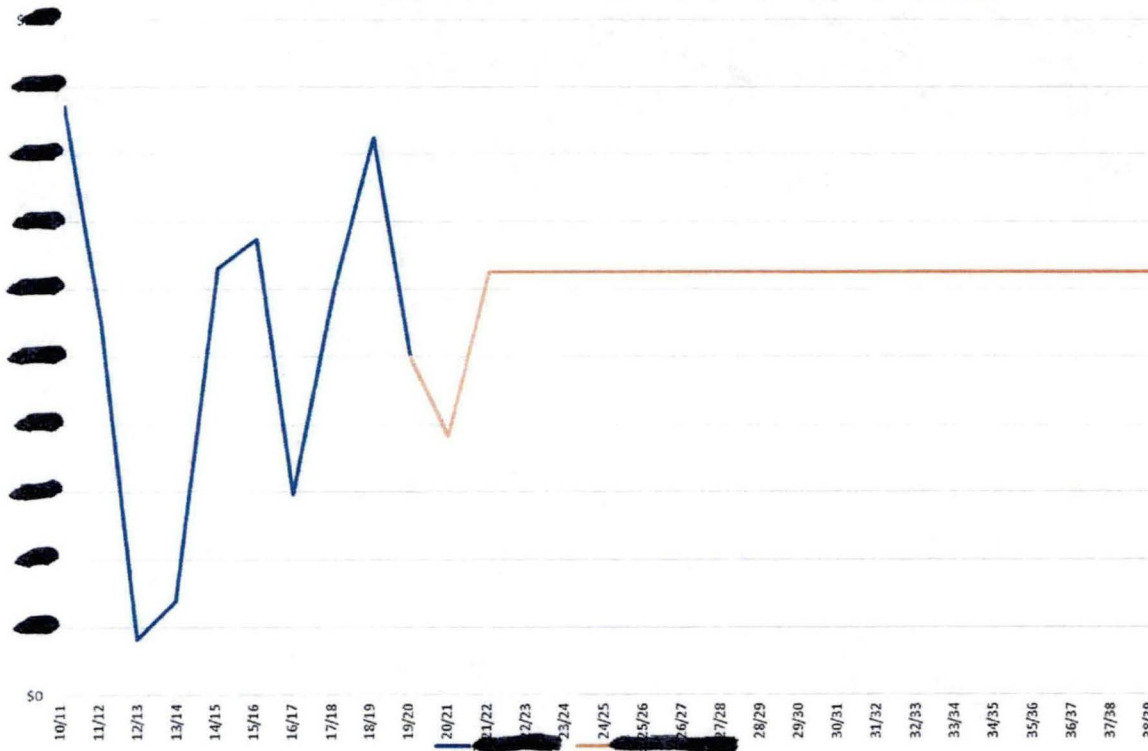
- Morgan offered a 18 year capacity deal for \$ [REDACTED] /MW-Day, 13 year deal was \$ [REDACTED] /MW-day
 - Benefit
 - Matched up terms of capacity and energy
 - More confidence in approvals of EKPC and PSC for full 20 year deals
 - Cost
 - Reduced estimated NPV savings to \$ [REDACTED] M (\$ [REDACTED] energy price, no admin fee)
 - Worth the cost for more confidence on approvals
- Energy Market has gone up, then come back down
 - 11/9/2017 = \$ [REDACTED] for 20 years
 - 11/29/2017 = \$ [REDACTED] for 20 years
 - 12/14/2017 = \$ [REDACTED] for 20 years

What Has Changed

- More details about the Capacity product Morgan/Calpine has offered
 - Financial hedge rather than physical capacity
 - Hedge at \$■■■■/MW-day not a perfect hedge, but tool used to keep from large swings
 - Some variable in price paid for capacity
- Estimate of EKPC fee to be our Agent in PJM
 - Estimate to be \$400k/yr
 - Still in negotiations to reduce this cost
- **New NPV \$■■■■ M (\$■■■■ energy price, with admin fee)**

The Capacity Hedge Decision

Historical Capacity Market Prices versus Capacity Proposals (\$/MW-Day)



- ◆ Compares historical market prices for capacity to Morgan’s capacity offer for future periods (x-axis represents PJM’s planning years).
- ◆ Capacity sellers are weighing their expectations of future market prices versus the security of an assured future revenue stream. SKRECC’s decision represents the flip side of this equation.



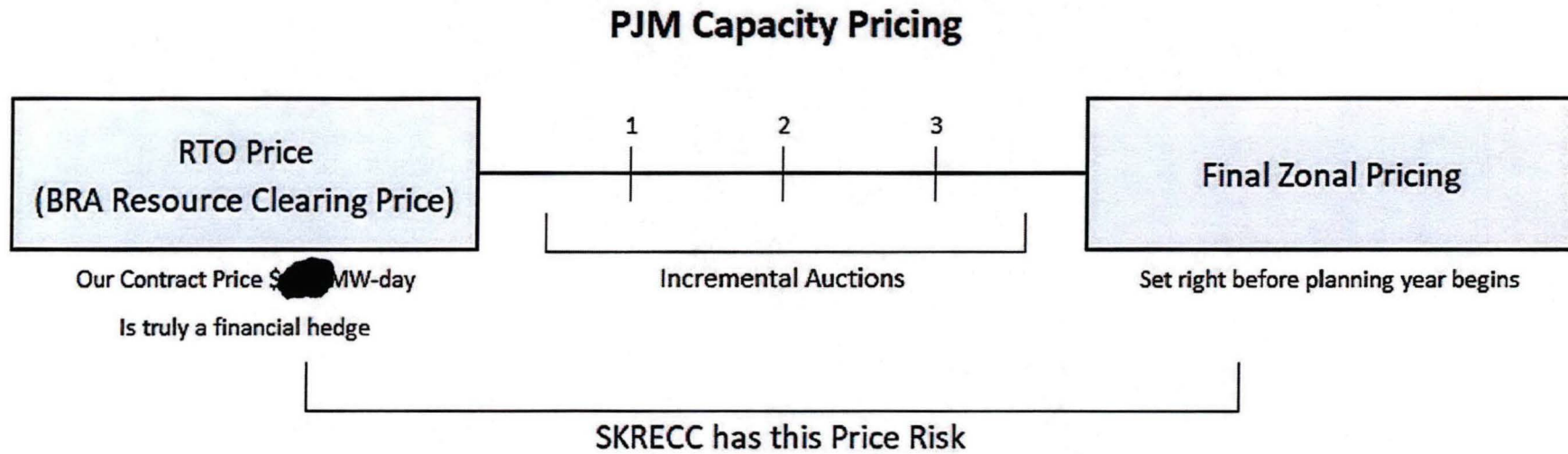
Contract Capacity Price is really a Financial Hedge

Example of How the Hedge Works

Planning Year	Our Contract Price	RTO Price (BRA Resource Clearing Price)	Settlement
2019/2020	\$█/MW-day	\$█	Morgan Pays SKRECC difference (\$15*68*31)
2020/2021	\$█/MW-day	\$█	SKRECC Pays Morgan difference (\$65*68*31)

- Not a perfect hedge because RTO Price is not the final price
- Not a perfect hedge because volume could be plus or minus 68 MW

Why the Hedge is not Perfect



- How large is the risk?

Scenario Analysis on Final Zone Price Risk

- NPV assuming a perfect hedge = \$ [REDACTED] M
- Scenarios considered for increase between RTO Price and Final Zonal Pricing
 - 10% = \$ [REDACTED] / MW-day in every year - NPV = \$ [REDACTED] M
 - 25% = \$ [REDACTED] / MW-day in every year - NPV = \$ [REDACTED] M
 - 50% = \$ [REDACTED] / MW-day in every year - NPV = [REDACTED] M
 - 75% = \$ [REDACTED] / MW-day in every year - NPV = \$ [REDACTED] M
 - \$ [REDACTED] / MW-day in every year - NPV = \$ [REDACTED] M
 - Morgan's offer to fully fix price through the Final Zonal Pricing
 - 100% = \$ [REDACTED] / MW-day in every year - NPV = \$ [REDACTED] M

* Now includes estimate for EKPC PJM Agent fee of \$400k/yr

Benefits and Risks of Executing this Contract

Benefits

- Estimated Savings – NPV
 - Between \$ [REDACTED] M and \$ [REDACTED] M (with a conservative Base Case)
- Diversity in Power Supplier
 - 15% of load served by someone other than EKPC
- Fuel Diversity
 - EKPC coal driven
 - This is fixed market energy

Risks

- PJM is constantly changing
 - New capacity and energy rules
 - Subsidized coal and nuclear
- Change in Law/Environmental
- Capacity Hedge Risk
- Future Market Energy Price below \$ [REDACTED]
- PSC approval and scrutiny

Conclusions

- This should be pretty easy
 - Yes, there is some variability in capacity pricing and other miscellaneous costs in PJM
 - These variables make up a small portion of the overall deal
 - 11% - 13% = Capacity costs
 - 10% - 13% = PJM costs and NITS
- We are still looking at probable savings well in excess of \$■■■ M
- Chance we pay more for this 58 MW than we would have paid if EKPC kept serving it – close to zero
- Yes, there are some risks of changes in PJM policy and Changes in Law
 - EKPC and the rest of PJM face same/similar risks
- Prepare internal strategy for PSC review

Contract Negotiations

- 99% done
- EEI Master Agreement
 - √ Coversheet
 - Collateral Annex (1 issue outstanding)
 - √ Capacity Confirmation
 - √ Energy Confirmation

What is left to do?

- Finalize and Execute Contracts
- PSC Approval
- RUS Approval
- Implementation
 - Start PJM Membership process
 - Facilitate Morgan Stanley/EKPC discussions on day to day policies and procedures
 - Formalize responsibilities of EKPC as SKRECC Agent in PJM

Q&A

**South Kentucky Rural Electric Cooperative Corporation
Case No. 2018-00050
Commission Staff's First Request for Information**

3. Refer to the Application, Exhibit 3, which states that South Kentucky's Board of Directors were briefed on "issues pertaining to membership in [PJM Interconnection LLC ("PJM")]" that were expected to result from the proposed transaction. State with specificity the possible issues pertaining to South Kentucky's participation in PJM as a market participant that South Kentucky's Board of Directors evaluated.

Response:

South Kentucky's Board has been informed that as a condition of exercising Amendment 3 and Memorandum of Understanding ("MOU") rights, EKPC is requiring South Kentucky to become a member of PJM, which does present the prospect for additional costs to be incurred by South Kentucky (South Kentucky also will incur costs in connection with its compensation to EKPC under the anticipated agency agreement, by which EKPC will serve as South Kentucky's agent in PJM.) South Kentucky's Board has also been informed that PJM now controls and dispatches EKPC generation. From a reliability standpoint, the actual energy utilized by South Kentucky could originate from EKPC or from any other generating asset sold into the PJM market.

**South Kentucky Rural Electric Cooperative Corporation
Case No. 2018-00050
Commission Staff's First Request for Information**

4. Refer to the Application, Exhibit 2, Memorandum of Understanding and Agreement Regarding Alternate Power Sources ("MOU"), paragraph 3(A)(iii), (iv), and (v).
 - a. State whether the alternate source will cause the aggregate amount of all Owner Members' loads being served with Alternate Sources (including the load proposed to be served by the South Kentucky's new Alternate Source to exceed 2.5% of the rolling average of EKPC'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 date the Owner Member delivers the election notice to be served by an Alternate Source.
 - b. State whether the alternate source will cause the aggregate amount of all Owner Members' loads being served with Alternate Sources (including the load proposed to be served by the South Kentucky's new Alternate Source) to exceed 5.0% of the rolling average of EKPC'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 date the Owner Member delivers the election notice to be served by an Alternate Source.

Response:

- a. No. The Alternate Source will not cause the aggregate amount of all Members' loads to exceed 2.5% of EKPC's rolling 3 year average.
- b. No. The Alternate Source will not cause the aggregate amount of all Members' loads to exceed 5.0% of EKPC's rolling 3 year average.

**South Kentucky Rural Electric Cooperative Corporation
Case No. 2018-00050
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5. Refer to the MOU, paragraph 4(A)(iii), regarding a general description of the nature of the alternate source of electric power. Also, refer to the Application, Exhibit 4, Written Notice to EKPC ("Notice to EKPC"), page 2, section (iii).
- a. State whether the Alternate Source is one specific generating unit, or whether the Alternate Source could be any unit in the PJM market.
 - b. If the Alternate Source is one specific generating unit, provide the following:
 - i. Name and location of the unit;
 - ii. Owner of the unit;
 - iii. Nameplate capacity of the unit;
 - iv. Primary fuel source used for generation at the unit;
 - v. Commission date of the unit; and
 - vi. Forced outage rate of the unit, if operational.
 - c. If the Alternate Source could be from any unit in the PJM market, state whether South Kentucky will be required, as part of joining PJM, to choose between becoming a FAR entity or a RPM entity.

Response:

- a. The Alternate Source is not tied to a specific generating unit or units within PJM.
- b. Not Applicable.
- c. South Kentucky is not purchasing capacity as part of the Alternate Source designation. South Kentucky will be an RPM entity, paying PJM for capacity it procures for the system through the capacity auctions (with price uncertainty for that capacity mitigated through the capacity hedge).

**South Kentucky Rural Electric Cooperative Corporation
Case No. 2018-00050
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6. State whether South Kentucky is obligated to take all 58 MWs of energy in every hour, or if it can choose to take delivery of a lesser amount as needed.

Response:

Please refer to Exhibit 7, page 3, Section 10 of the application, in which South Kentucky will take 58 MW in each hour of the delivery period.

South Kentucky Rural Electric Cooperative Corporation
Case No. 2018-00050
Commission Staff's First Request for Information

7. Refer to the Notice to EKPC, page 2, which states, “[t]he 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.”
- a. State which PJM membership sector (i.e., transmission owner, generation owners, other supplier, electric distributor, or end-use customer) applies to South Kentucky’s membership, should South Kentucky join PJM.
 - b. State with specificity what obligations South Kentucky would have to PJM should South Kentucky join PJM as a member.
 - c. State whether South Kentucky is requesting Commission approval to become a PJM member.
 - i. If yes, explain why South Kentucky did not expressly request in its Application Commission approval to become a PJM member.
 - ii. If no, explain why South Kentucky did not request in its Application Commission approval to become a PJM member.

Response:

- a. South Kentucky anticipates joining the electric distributor sector of PJM.
- b. EKPC, through the anticipated agency agreement, would be meeting South Kentucky’s obligations as a member of PJM.
- c. No, not at this time. The MOU requires an eighteen (18) month notice. Joining PJM prematurely would require the payment of the annual membership cost of \$5,000 during a time in which South Kentucky would not be receiving the corresponding benefit. In addition, South Kentucky wishes to obtain approval of the proposed transaction with Morgan Stanley before pursuing such membership.

South Kentucky Rural Electric Cooperative Corporation
Case No. 2018-00050
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8. Refer to the Notice to EKPC. State whether South Kentucky consulted or informed EKPC's other Owner-Members that South Kentucky was exercising its contractual right to reduce purchases of electric power from EKPC.

Response:

Yes, EKPC was informed via hand delivered letter on November 28, 2017. The other fifteen (15) Owner-Member distribution cooperatives were all notified by e-mail on November 28, 2017.

South Kentucky Rural Electric Cooperative Corporation
Case No. 2018-00050
Commission Staff's First Request for Information

9. Refer to the Application, Exhibit 7, Firm Physical Energy Confirmation ("Firm Energy Confirmation"), paragraph 12(b), which states that South Kentucky "covenants to promptly apply for and diligently pursue membership in PJM as a Market Participant." Explain what steps South Kentucky already has undertaken to apply for PJM membership as a market participant.

Response:

No steps have been taken. As stated in the response to question 7 c., given the notice period associated with the designation of an Alternate Source, South Kentucky wishes to avoid incurring unnecessary membership costs. Also, South Kentucky wishes to obtain prior approval of the proposed transaction from the Commission before submitting its application to join PJM.

**South Kentucky Rural Electric Cooperative Corporation
Case No. 2018-00050
Commission Staff's First Request for Information**

10. Refer to Application, Exhibit 7, Firm Energy Confirmation, paragraph 14, which contains conditions subsequent to the Confirmation, one of which is the issuance of a final, non-appealable Commission order on or before May 31, 2018, approving the proposed Agreement.
 - a. Explain the consequences to South Kentucky if the Commission fails to issue an Order in this proceeding on or before May 31, 2018.
 - b. State whether South Kentucky will continue with its application to join PJM if the Commission fails to issue an Order in this proceeding on or before May 31, 2018.

Response:

- a. If the Commission fails to issue an Order in this proceeding on or before May 31, 2018, either Morgan Stanley or South Kentucky may terminate the proposed transaction. Per Exhibit 7, page 3, Section 14, both Commission approval and Rural Utilities Service approval are conditions subsequent to this transaction. South Kentucky obtained the approval from the Rural Utilities Service on January 30, 2018.

The lack of obtaining a final, non-appealable order approving the proposed transaction on or before May 31, 2018 would jeopardize the fulfillment of the transaction. If Morgan Stanley determines to terminate the proposed transaction, it will result in South Kentucky being required to seek an Alternate Source option to provide the subject energy and capacity contemplated by the proposed transaction on and after June 1, 2019.

The MOU, Exhibit 2, paragraph 4(B) of South Kentucky's application, required written notice to EKPC of South Kentucky's election to obtain power from an Alternate Source at least eighteen (18) months prior to the date on which the use of the subject Alternate Source is to begin. This notice was provided to and accepted by EKPC (See Exhibit 4 to South Kentucky's application) on November 28, 2017, with a cited start date for Alternate Source power of June 1, 2019.

Paragraph 4(D) of the MOU, allows an owner member to “change or cancel an Alternate Source Notice only by providing to EKPC prior written notice of such change or cancellation, as follows:...Otherwise, eighteen (18) months’ prior written notice to EKPC of a change or cancellation shall be required.” Thus, any notice of a change or cancellation will require South Kentucky to provide an eighteen (18) month notice. If the Commission fails to provide a final, non-appealable order and if Morgan Stanley terminates the agreement, per the terms of the MOU, South Kentucky will be required to purchase power from an Alternate Source outside of its wholesale power contract with EKPC for the time period corresponding to South Kentucky’s Amendment 3 notice date to EKPC (November 28, 2017) until 18 months from the date of any notice by South Kentucky to cancel the Alternate Source.

- b. As stated in 10 a. above, under the terms of the MOU, South Kentucky will need to purchase power from an Alternate Source outside of its wholesale power contract with EKPC for the time period corresponding to South Kentucky’s Amendment 3 notice date to EKPC (November 28, 2017) until 18 months from the date of South Kentucky’s notice to cancel the Alternate Source. This will require an alternate arrangement, which could include becoming a member of PJM. At this time, however, South Kentucky has not fully considered the potential different courses that might be available, as it believes the agreement with Morgan Stanley to be the optimal course for it and its members.

South Kentucky Rural Electric Cooperative Corporation
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11. Refer to Application, Exhibit 7, Firm Energy Confirmation, paragraph 16(d), which states that South Kentucky agrees to establish and maintain rates at least sufficient to meet its obligations to Morgan Stanley Capital Group. Explain whether South Kentucky will file a rate case to comply with this Confirmation provision.

Response:

South Kentucky does not anticipate that the requirements of the Firm Physical Energy Confirmation will require South Kentucky to file a rate case to comply with this Confirmation provision. South Kentucky presently is obliged to pay timely and properly all expenses associated with providing power to its members, which includes the cost of purchased power. Similarly, since the cost of purchased power is anticipated to be less under a blended cost utilizing power sourced both from Morgan Stanley and EKPC, rates currently in effect are estimated to be sufficient for a longer period of time than would be expected under South Kentucky's current sole-source purchased power contract with EKPC.

South Kentucky Rural Electric Cooperative Corporation
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12. Refer to Application, Exhibit 8, Financial Capacity Confirmation, paragraph 8, which states that Morgan Stanley Capital Group does not warrant that the "Financially-settled PJM Unforced Capacity ("UCAP") Annual Capacity Performance" product will satisfy any of South Kentucky's "RPM-imposed performance obligations to PJM."
 - a. Describe South Kentucky's RPM-imposed performance obligations to PJM under this provision and explain the basis for said obligations to PJM.
 - b. Explain under what authority South Kentucky will assume RPM-imposed performance obligations to PJM

Response:

- a. South Kentucky does not have RPM-imposed performance obligations to PJM. South Kentucky will purchase capacity from PJM rather than sell it. Only sales of capacity (not purchases) result in RPM-imposed performance obligations.
- b. South Kentucky is not providing capacity to PJM, and thus is not assuming any RPM-imposed performance obligations to PJM.

South Kentucky Rural Electric Cooperative Corporation
Case No. 2018-00050
Commission Staff's First Request for Information

13. Explain in detail all liabilities South Kentucky could incur and all benefits that accrue to South Kentucky as a result of becoming a PJM member.

Response:

The liabilities South Kentucky could incur as a result of becoming a PJM member are those items it will incur over and above the costs of purchasing energy and capacity as a load serving entity and are limited to the fees and costs associated with being a PJM member, which are currently an initial \$1,500 membership fee plus \$5,000 annually. The benefit of becoming a PJM member is the satisfaction of a requirement imposed on South Kentucky by EKPC in order to obtain the Alternate Source. An additional benefit of becoming a PJM member is the ability to purchase power from a source other than EKPC if an unforeseen event were to occur with EKPC or Morgan Stanley.

South Kentucky Rural Electric Cooperative Corporation
Case No. 2018-00050
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14. Refer to the Direct Testimony of Dennis Holt ("Holt Testimony"), page 6, lines 8-13. Identify the four EKPC Owner-Members who have pursued alternative-sourced power and the type of alternatively-source power.

Response:

Farmers Rural Electric receives 3.6 MW of distributed generation and 1 MW from gas turbines, as approved by PSC Case #2014-00292.

Jackson Energy receives 2.6 MW from gas turbines.

Owen Electric receives 2 MW from gas turbines, as approved by PSC Case #2015-00213.

Salt River Electric receives 2 MW from hydro generation at lock #7.

**South Kentucky Rural Electric Cooperative Corporation
Case No. 2018-00050
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15. Refer to the Holt Testimony, page 13, which states that South Kentucky is required to become a member of PJM under the proposed transaction. Also refer to the Direct Testimony of Carter Babbit ("Babbit Testimony"), page 18, which states that South Kentucky will become a PJM market participant in order to best effectuate the proposed transaction.
 - a. Describe the steps necessary to become a member of PJM.
 - b. Describe what steps South Kentucky already has undertaken to become a PJM Market Participant and what steps remain.
 - c. Provide the underlying basis for this contract provision and explain why South Kentucky is required to join PJM under the proposed transaction.
 - d. Explain why South Kentucky joining PJM as a market participant will "best effectuate" the proposed transaction.
 - e. Describe all options South Kentucky considered other than becoming a PJM member in order to effectuate the proposed transaction.

Response:

- a. It requires completing the membership form and submitting the necessary documents, application and membership fees.
- b. No steps have been taken at the present time.
- c. It is the understanding of South Kentucky that PJM does not require membership in order to implement transactions such as for the Alternate Source. EKPC directed South Kentucky to join PJM in order to participate in the Alternate Source.

- d. South Kentucky joining PJM will “best effectuate” the proposed transaction because it would meet the obligation placed on South Kentucky by EKPC. South Kentucky believes the transaction could be implemented without PJM membership, with EKPC or its agent managing PJM market participant activities, as the MOU provides.
- e. South Kentucky considered the option of not becoming a PJM member and having EKPC or its agent manage PJM market participant activities, as provided for in the MOU. However, South Kentucky was directed by EKPC to become a member of PJM.

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16. Refer to the Holt Testimony, page 13, which states that the details of the agency arrangement between South Kentucky and East Kentucky Power Cooperative ("EKPC") regarding South Kentucky's PJM Market Participant activities are being "refined."
- a. State the expected date for the agency arrangement to be finalized and the expected date for the agency arrangement to be executed.
 - b. Provide a copy of the agency agreement between South Kentucky and EKPC. If a written agency agreement has not been finalized by the February 28, 2018 due date of the response to these requests, describe in detail what provisions South Kentucky reasonably expects will be included in the agency agreement.

Response:

- a. South Kentucky expects the agency arrangement to be finalized prior to the end of 2018.
- b. South Kentucky expects the agency agreement to include the management of the recurring activities required to manage the PJM load. It is anticipated that this would include the following minimum items:
 1. Communication with both South Kentucky and PJM and the scheduling of South Kentucky's 58 MW load on a 7x24x365 basis in the PJM market;
 2. Receiving, reviewing, and verifying the accuracy of South Kentucky's monthly energy and capacity settlement with PJM;
 3. Assistance in obtaining Network Integration Transmission Service from PJM and others, and the management of the same; and
 4. Assistance with the monthly settlement items with Morgan Stanley.

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17. Refer to the Holt Testimony, page 14. Explain whether South Kentucky will be the responsible party for any PJM capacity performance penalties due to unit nonperformance during a capacity performance event.

Response:

South Kentucky will not be providing capacity to PJM. Thus, South Kentucky is not responsible for any capacity performance penalties.

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18. Refer to the Holt Testimony, page 14, regarding potential risks arising from the proposed transaction. Also, refer to the Direct Testimony of Michelle Herrman, page 15. Describe all risks South Kentucky has identified related to the transactions, and how South Kentucky plans to mitigate each of those risks.

Response:

South Kentucky identified the following possible risks of the proposed transaction:

- a. Risk: Market price decline on energy during the term of the proposed transaction and South Kentucky's inability to re-price the proposed transaction to reflect a lower market price.

Mitigation plans: The resulting blending of the contract price and EKPC's current and forecasted prices are believed to result in a lower price than would be recognized if South Kentucky's energy was sourced solely from EKPC. EKPC's prices are not expected to fall to a level below its current contract price for energy under this contract agreement. Thus, the transaction itself is intended to mitigate risk.

- b. Risk: Changes within PJM in regard to new potential capacity and energy rules that could impact the overall value to be realized from the proposed transaction.

Mitigation plans: South Kentucky recognizes that it is currently facing the same risks whether it is a direct participant in PJM or a participant in PJM as a member owner of EKPC. In any event, South Kentucky expects to participate in PJM through its agent EKPC to mitigate potential impacts resulting from changes in rules.

- c. Risk: Changes in laws or regulations; for example, changes in environmental law applicable to PJM, as well as all its participants that could impact the overall value to be realized from the proposed transaction.

Witness: Dennis Holt & Michelle Herrman

Mitigation plans: South Kentucky recognizes that it faces the same or essentially similar risks whether it purchases power from Morgan Stanley, EKPC or any other energy provider, and no specific risk mitigation avenues are available here outside of activities before lawmakers and agencies as pursued in the normal course.

- d. Risk: Variability in capacity pricing associated with the capacity hedge risk, to the extent that the final zonal price in PJM settles at a value higher than the Floating Price (*i.e.*, the BRA Resource Clearing price).

Mitigation plans: There is variability in capacity pricing under the current structure of supplemental auctions. However, the capacity cost accounts for only a small portion of cost under this contract, 11-13 percent. The variability in capacity costs would likely impact EKPC's costs as well.

- e. Risk: Lack of PSC approval.

Mitigation Plans: South Kentucky intends to demonstrate through this proceeding that its decision to execute the proposed transaction with Morgan Stanley is in the best interest of its members, as it will provide for a lower-cost and more diversified supply than currently in place. As noted in the response to question 8, South Kentucky already has given notice consistent with Amendment 3 and the MOU; accordingly, denial of this petition would require further actions by South Kentucky to ensure that it has an Alternate Source in place during the period it is obligated to have such supply in place.

- f. Risk: Failure of Morgan Stanley to perform under the proposed transaction and make good on its collateral obligations to make South Kentucky whole on the difference in price between the cost of energy under the proposed transaction and the cost of replacement power.

Mitigation Plans: The proposed transaction provides for collateral to be provided as part of South Kentucky's agreement with Morgan Stanley. See Exhibit 6 of South Kentucky's Application in this proceeding. The collateral requirement protects South Kentucky's interests if Morgan Stanley were not to perform. Additionally, this risk is mitigated by South Kentucky's participation in PJM. Since the energy and capacity are not being provided from specific generating units, but rather by the PJM market resources, South Kentucky would have the ability to purchase from the PJM market with relative ease in the event that Morgan Stanley does not perform. South Kentucky has no such protections from EKPC if they were to fail to perform.

Witness: Dennis Holt & Michelle Herrman

- g. Risk: Cost risks associated with South Kentucky's collateral obligations under the proposed transaction.

Mitigation Plans: South Kentucky's collateral requirements are impacted by the threshold amount utilized in the collateral calculation. (See Paragraph 10. I. A. to the Collateral Annex.) Correspondingly, the threshold amount is impacted by its ability to maintain a TIER Ratio above a high average TIER Ratio of 1.25 using two of the last three calendar years; and its ability to maintain a DSC Ratio above a high average DSC Ratio of 1.25 using two of the last three calendar years. This requirement, however, is no more stringent than what is currently in place with current lenders. In situations where we maintain the ratios above the requirement described above, the threshold amounts reduce South Kentucky's collateral needs and the costs associated with its collateral obligations are expected to be immaterial. In the event that there is pressure on the ratio outcomes, South Kentucky recognizes that it will need to improve these ratio outcomes.

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19. Refer to the Babbit Testimony, page 15. Explain in detail the benefits and risks of the financial capacity hedge to South Kentucky and its Members.

Response:

The benefit of the financial capacity hedge to South Kentucky and its members is the fixing of the vast majority of costs associated with purchasing capacity from PJM over the Alternate Source term.

The risk associated with the financial capacity hedge is the potential for the price of capacity in the PJM market to fall below the hedged price. South Kentucky determined the price assurance the hedge provides supported an assumption of this risk.

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20. Refer to the Babbit Testimony, page 18, which states that it is not “particularly burdensome nor expensive” for South Kentucky to become a PJM member.
- a. Provide the expected cost to South Kentucky to become a PJM member.
 - b. Explain whether South Kentucky or Morgan Stanley Capital Group will bear this expense.

Response:

- a. The cost to become a PJM member is \$1,500, plus a \$5,000 annual membership fee.
- b. South Kentucky will bear this expense.

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21. Provide a copy of EKPC's Open Access Transmission Tariff sheets.

Response:

As of June 1, 2013, EKPC utilizes PJM's Open Access Transmission Tariff (OATT). PJM's OATT and EKPC's 2017-2018 Formula Rate (Attachment H-24A) are available on PJM Website at the following links:

PJM OATT:

<http://pjm.com/directory/merged-tariffs/oatt.pdf>

EKPC 2017-2018 Formula Rate:

<http://www.pjm.com/-/media/markets-ops/trans-service/2017/ekpc-2017-2018-formula-rate.ashx?la=en>

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22. Explain how South Kentucky would allocate the cost of PJM participation between retail sales and off-system sales.

Response:

South Kentucky does not make off-system sales, nor does it expect to make off-system sales in the future. All sales are made to retail native load customers.

Thus, all purchased power from the proposed transaction with Morgan Stanley would be used solely to serve South Kentucky's regular native load customers, excluding industrial and commercial load served by EKPC under individually metered tri-party arrangements pursuant to EKPC's Rate Schedules B and C.

Consequently, all costs of PJM participation would be assigned to South Kentucky's retail customers not being served under EKPC's Rate Schedules B and C.