

Strategy Alternatives for Frankfort Plant Board's Participation in KyMEA

01 September 2017



Energy+Environmental Economics

1. Background

In April 2017, Energy + Environmental Economics (E3) was engaged by FPB to (a) analyze the economic and contractual risks and benefits of the Interlocal Agreement, the AR Contract, and other contracts such as the power purchase agreements that KyMEA has executed, and (b) provide recommendations for any clarifications and/or changes that should be made to the contracts. E3 issued a final report on 15 June 2017 containing its findings. On 20 June, the FPB Board of Directors adopted these findings and requested that KyMEA respond to these and several additional issues (together “FPB Requests”).

In August 2017, KyMEA issued a 49-page response (“KyMEA Response”). This document provided KyMEA’s rationale for continuing the status quo and none of the FPB Requests were accommodated. This is an extremely troubling outcome for two reasons.

- 1) **KyMEA does not bear the risk of its actions.** The risk and the consequences of KyMEA decision-making pass directly through to Members and their customers. Many of FPB’s Requests are changes to Agency voting procedures and Agency processes. FPB’s Requests intend to provide controls and other processes to minimize Agency risk.
- 2) **KyMEA signals it will not change the way it engages with Members.** FPB Requests included measures to ensure that Members are able to freely carry out supply procurement that best meets the needs of their customers. If FPB remains in KyMEA under these circumstances, its customers will not obtain the benefits that the establishment of KyMEA was intended to deliver.

In light of the KyMEA Response, E3 is pleased to submit the following strategy alternatives to the Frankfort Plant Board of Directors. FPB now has three paths it can pursue:

- (1) FPB can remain in KyMEA and pursue changes to the Interlocal Agreement, the AR Contract, and can work with KyMEA to attempt to generally improve Agency conduct and its interactions with Members;
- (2) FPB can withdraw from KyMEA and pursue its own power procurement program; or
- (3) FPB can remain in KyMEA and not pursue changes (status quo option).

This document describes potential strategies under options (1) and (2). Pursuing option (3) is not recommended because of the level of risk that FPB customers will bear under this scenario.

2. Discussion of Alternatives

A. Option 1: Remain in KyMEA and Pursue Changes

If FPB remains in KyMEA, it is critical that KyMEA implement the FPB Requests described below. As noted earlier, KyMEA does not bear any risk. The consequences of poor KyMEA decision-making are passed directly through to Members. Additionally, Members are directly impacted by the commercial and organizational structure established in KyMEA's suite of contracts. Because of this situation, if the changes described below are not implemented, Members' customers will pay the price. These costs are real. For example, the additional costs related to KyMEA's over-procurement of capacity are estimated to be at least \$12 million in the 2019-2022 period. FPB customers' share of these costs is approximately \$6 million.

In a scenario where FPB remains in KyMEA and pursues changes to the contracts, at a minimum the following should be accomplished:

a) Least Cost Procurement

- **With appropriate confidentiality provisions in place, release historical actual bid responses to Members (not KyMEA summaries).**

FPB has for months been seeking to obtain from KyMEA the actual bids it received in response to its September 2015 solicitation. KyMEA has to-date only released summary information. There is no reason why Members should be denied access to this information - these resources have been procured to serve Members. This situation is troubling because in KyMEA's summary information the resource shown as the lowest cost resource is not the resource with the lowest cost contract.

- **With appropriate confidentiality provisions in place, release actual bid responses to current procurement.**

For reasons described above, FPB requests actual bid responses received for all current and historical procurement efforts.

- **Modify the Interlocal Agreement to require unanimous approval of KyMEA entering into or financing any contracts or projects serving all Members.**

The Interlocal Agreement currently provides that contracts are approved by a majority vote. Absent modifying the contract to require unanimous voting to approve resources intended to serve all Members, there is no way enable a Member to elect to not receive an allocation of power from a particular resource. Unanimous approval will be critical if KyMEA is in the future able to issue bonds to

construct generation projects that may serve all Members as the cost of such bonds will be borne by Member customers.

b) Rate Design

- **Modify the AR Contract to include an appendix describing the methodology for how Member power rates will be calculated.**

Members are unable to evaluate the economics of participation in KyMEA without this information. Key issues include the treatment of costs for partial requirements Members, allocation of costs to future Members, design of TOU rates, and treatment of formation costs.

c) Agency cost reduction

Because Agency costs are directly passed through to each Member's customers, FPB Requests contained the following cost reduction strategies. KyMEA did not respond to any of these requests.

- **Direct KyMEA to take free Member office space.**

FPB and other Members have offered the use of free office space to KyMEA.

- **Direct KyMEA to carry out competitive procurement for all Agency professional services above a certain dollar threshold.**

Current Agency consulting services have not been competitively procured. KyMEA formation costs are expected to reach nearly \$7 million before service commences in 2019. FPB's share of these costs will be approximately \$3.5 million.

- **Direct KyMEA to appoint a Member staff person to lead rate design activities.**

Rate design is a knowledge area in which all Members have expertise. This recommendation could increase Agency interaction with Members and may expedite this important scope of work.

- **[Direct KyMEA to not include employees in CERS.]¹**

Any CERS pension obligations would be passed through to Member customers.

¹ FPB Board of Directors request.

d) Incorporation of Member Needs

- **Modify the Interlocal Agreement to state that Members have the right to not be served by a resource or a PPA.**

Without such a change, there is no contractual mechanism to prevent a Member from being served by a resource it does not desire. This could also be accomplished via a requirement for unanimous voting to approve resources that serve all Members as described above.

- **Modify the Interlocal Agreement to prevent a Member that does not receive an allocation of power from a proposed PPA or Project from voting for or against KyMEA's executing the PPA or carrying out the Project on behalf of a Member or subset of Members. Modify the Interlocal Agreement Project definition to include PPAs.**

Without these changes, a Member can be blocked from pursuing a resource it desires.

- **Modify the AR Contract to ensure that Members can fully utilize or retire any Member renewable energy credit (REC) Attribute allocations.**

Without such a modification, a Member may not be able to freely utilize (i.e., retire, bank or sell) any allocation of REC Attributes it receives.

- **Direct KyMEA to hire a third-party consultant to carry out an IRP with a term of at least 10 years and preferably 20 years, from 2019. The IRP should be performed per industry best practices. Members should be consulted extensively to incorporate the procurement desires of all Members, any future renewable energy projects and Member load characteristics including the impacts of any future distributed resource programs. IRP results should inform future Agency procurement activities.**

An IRP will determine the least-cost set of resources required to serve loads. It is difficult for the Agency to demonstrate that least-cost procurement has been conducted, and to incorporate Member desires, in absence of such a study.

- **Modify the AR Contract to clearly state that NEM and DR program coordination with the Agency shall not be unreasonably constrained, that all Members are not required to implement identical programs, that an individual Member's program implementation will not be impeded by other Members.**

Without these modifications, a Member may be constrained in its ability to implement programs for its customers.

e) Other

- **[Direct Auditor of Public Accounts to perform a financial compliance audit]¹**
- **[Direct KyMEA to create a consumer advisory committee or have consumers sit on its board]¹**
- **Ensure adequate professional liability insurance is in place for any consultants engaged by KyMEA**

Because Agency risks pass through to Members and their customers, adequate professional liability insurance for Agency consultants is an important form of recourse in circumstances of consultant misconduct or negligence.

B. Option 2: Withdraw from KyMEA

A withdrawal from KyMEA should be seriously considered if KyMEA continues to be unresponsive to FPB Requests. Withdrawal from KyMEA and termination of the AR Contract could be accomplished in several ways. For example:

- Under the Interlocal Agreement, FPB may withdraw from KyMEA with one year's notice. In this scenario, FPB would no longer be a Member and would no longer be eligible receive power under the AR Contract.
- KyMEA willful misconduct or gross negligence constitutes an Event of Default under the AR Contract Section 24 (b). Under such an Event of Default the AR Contract can be terminated. It is not clear who would be liable for any outstanding cost obligations in this scenario. Per AR Contract Section 12 (d), in a termination scenario KyMEA is obligated to sell or utilize the Member's allocated share of the Attributes and credit the Member accordingly.

If FPB were to depart, FPB would need to procure power to serve its customers commencing from KU service expiry in May 2019. FPB could receive power from American Municipal Power (AMP) or other load serving entities, or FPB could develop its own power portfolio and procurement strategy.

C. Option 3: Continue Status Quo Arrangements

Because Members bear all risks of KyMEA arrangements including the costs of Agency procurement, and because Members will be continually reliant upon the Agency to interpret contracts and manage day-to-day interactions, continuing under the status quo is not recommended.