The Right Decision for Changing Times

How East Kentucky Power Cooperative Ratepayers Benefit from Canceling Plans for a New Coal Burning Power Plant In Clark County

A Report Prepared for:

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Executive Summary

Overview:

East Kentucky Power Cooperative (EKPC) is a non-profit electric generation and transmission cooperative that provides wholesale energy and services to 16 rural electric cooperatives serving 511,000 customers across 87 Kentucky counties.

EKPC is committed to providing least cost power to its member cooperatives, and by extension to their members, who are the ratepayers. For decades, that mandate has led the Cooperative to depend heavily on coal-fired power, a fuel which was locally abundant and comparatively inexpensive to mine, ship and burn. As a result, more than 97% of the Cooperative's energy is generated by burning coal, and EKPC is planning several additional coal plants. In April the Cooperative will bring on line a new 278 MW coal-fired power plant in Mason County (Spurlock #4). It also intends to construct a similar plant in Clark County (Smith #1) by 2013.

This report examines EKPC's financial and credit position and the financial impact that going forward with the Smith #1 plant will have on the Cooperative and its ratepayers. Much of the evidence used in this analysis comes directly from public documents filed by EKPC before the Kentucky Public Service Commission (KPSC). This analysis shows that EKPC, its member cooperatives, and their ratepayers would benefit from canceling Smith #1 and investing in energy efficiency, renewables, and natural gas capacity to meet energy demand.

Key Findings:

The Cooperative's priority to build new coal-fired power plants is misaligned with the direction of capital markets and national energy policy. Coal is no longer a low-risk or least-cost fuel source for utilities or their ratepayers. Nationwide, 95 proposed coal-fired power plants have been abandoned in the past two years due to skyrocketing construction costs, the anticipated costs of greenhouse gas emissions, rising fuel costs and reduced demand for electricity. In 2008 these factors led the Rural Utility Service (RUS), a federal agency that has historically provided low cost capital to rural electric cooperatives, to impose a moratorium on loans for coal plants. EKPC's own experience demonstrates the dramatic rise in construction costs for new coal plants. The proposed Smith #1 plant will cost approximately $766 million to build, a figure that is 78% more than EKPC spent on a similar plant in 2005.

EKPC's current financial position is weak, and its decision to build Smith #1 is one of the main impediments to improving its credit status. When EKPC is compared by standard financial measures to other rural electric cooperatives, its ratings are far below the norm. For example, the average equity rating among cooperatives in the nation is 18.38%. EKPC's equity rating is only 6.34%, and most of the remaining 93% of the Cooperatives capital value is borrowed. Testimony from EKPC's financial consultants emphasizes that the Cooperative cannot afford to continue to take on long-term debt to build additional coal plants (Smith #1) and improve its financial position, even with a recently approved rate increase. This is due to EKPC's dangerously low credit margins and the need to rebuild its financial position quickly if it is to be able to secure a badly needed loan in September 2010. Stopping development of Smith #1 will avoid approximately $500 million of new debt. Otherwise, it is likely the organization will have to borrow at historically high interest rates, if it can find backers at all given its credit position and the current economic climate.

EKPC's financial statements and accounting practices warrant review. EKPC's financial advisor has questioned the Cooperative's financial statements. One consultant said the Cooperative had overstated revenues by almost $30 million in its 2007 Annual Report. Other accounting practices also require review.

EKPC underestimates the cost of power from the Smith #1 plant. EKPC's 2007 estimate of the cost of electricity from Smith #1 is $.053 per kWh. However, this report concludes that a conservative estimate would be closer to $.074 per kWh, given higher interest rates and construction costs. In addition, the true cost of power from Smith #1 could range between $.09 and $.13 per kWh once costs of complying with greenhouse gas emissions limits are included. (In comparison, energy efficiency programs cost, on average, about $.03 cents per kilowatt-hour of electricity saved.)

The justification for the Smith Plant is weak, and EKPC has acknowledged a recent drop in demand for electricity. When the Smith Plant was approved by the KPSC in 2007, the Commission acknowledged it was not convinced by EKPC's estimate of electricity demand. Recent statements by EKPC suggest that the current recession will diminish demand for electricity.

Stopping the Smith #1 plant will avoid an additional price increase to ratepayers of at least 5% to recover the costs of building and operating the new plant. This would be welcome news for EKPC's members who experienced a 57% increase in the cost of electricity between 2002 and 2007. The KPSC approved an increase of an additional 7% on March 31, 2009. EKPC's representatives offer conflicting opinions whether this recent increase will be adequate. EKPC has expressed its intentions to file for a series of additional increases in the future.

The Cooperative has options to reduce losses and recover some of the money it has already spent on Smith #1. EKPC's public documents show that the utility has already identified opportunities to resell or reuse equipment that it has purchased for the Smith #1 plant. In addition, KPSC approved additional natural gas capacity that could serve as an alternative to the Smith coal plant.

Recommendations:

This report offers some practical suggestions to help pave the way for a new EKPC – a cooperative that spends within its means, successfully navigates the changing policy landscape, protects ratepayers' interests, and drives sustainable economic development in the region. Key recommendations include:

- **EKPC should abandon its plans to build the Smith #1 plant, cut its losses, and move forward with less risky and less capital intensive investments, including energy efficiency, renewable energy, and natural gas generation.**

- **EKPC should protect itself and consumers by requesting a rating from the nation's credit agencies.** Most other cooperatives of its size benefit from these ratings when communicating with members, regulators, and prospective lenders.

- **EKPC and the Kentucky Public Service Commission should broaden the scope of the management audit EKPC is currently undertaking.** A top to bottom review of the organization can identify what has gone wrong and offer important recommendations related to EKPC's board of directors, financing, new emissions regulations, and how to best provide energy services at a reasonable cost so Kentuckians can live healthy lives and grow their businesses.

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A copy of the full report may be found at www.kftc.org/rightdecision

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