

Phyllis K. Fong
Inspector General
United States Department of Agriculture
Room 117-W Jamie Whitten Bldg
1400 Independence Avenue SW
Washington, DC 20250

February 23, 2010

Dear Ms. Fong,

As taxpayers and members of electric cooperatives served by the East Kentucky Power Cooperative (EKPC), an electricity generation and transmission cooperative supported by the U.S. Department of Agriculture's (USDA) Rural Utilities Service (RUS), we request that the Inspector General's office conduct an immediate review of a decision by the RUS to grant EKPC a lien accommodation on up to \$900 million in debt that it currently owes taxpayers.

Furthermore, we are requesting that the USDA undertake a broader formal review of its internal procedures regarding financial and environmental due diligence and decision-making regarding loans, loan guarantees, and lien accommodations for electric utilities developing coal-burning power plants such as EKPC's proposed Smith plant.

RUS actions such as its loan guarantee to EKPC have the potential to put billions of dollars in taxpayer money at risk and to enable individual cooperatives to create debt beyond their financial capacity, which would dramatically increase electricity rates for members. Thus, in order to protect American taxpayers and electric cooperative members from such detrimental consequences, we submit this formal petition with the aim of improving RUS procedures.

We applaud RUS for maintaining its March 2008 decision to halt its loan program for new coal-fired power plants because of the financial risks involved. However RUS's decision to grant loan guarantees and lien accommodations to electric cooperatives developing such facilities contradicts this decision, and should be reconsidered for the good of co-ops and their members like us.

We believe that RUS has unwisely provided financial support in the form of loans, loan guarantees, or lien accommodations to EKPC without proper fiscal and environmental due diligence. Specifically, RUS's financial support for EKPC's proposed J.K. Smith coal-burning Circulating Fluidized Bed Unit #1 has placed hundreds of millions of dollars in taxpayer resources at risk, and may result in unnecessary and expensive increases in our electric rates and more pollution of our air, water, and climate.

These unintended outcomes directly contradict the mission of the USDA, RUS, and federal policies to promote economic development in rural areas, to encourage reliable

electric service at reasonable rates, and to ensure transparency and public participation in efforts to protect the environment. Through conversations with many other electric cooperative members, we understand that these concerns are widely shared, although the EKPC action appears to be an egregious example of irresponsible financial support. In the spirit of RUS's mission and based on the following considerations, we urge you to take swift, decisive action to review RUS procedures to ensure that these problems are remedied and do not recur.

Our concerns about RUS's financial support of EKPC are based on several factors. First, EKPC is a cooperative in dire financial straits. It lacks a credit rating, and its TIER rating is far below most other cooperative utilities (see Attachment 1). EKPC is dependent on coal for more than 90 percent of its electricity and therefore vulnerable to changing federal regulations that protect public health and welfare. EKPC is poorly positioned for taking on such a large capital project.

Second, the cost of the Smith power plant has risen by 54 percent since it was first proposed, and EKPC projects that it will go even higher. At the same time, EKPC's electricity demand has not increased as much as it originally projected, which brings further questions about EKPC's justification for the new unit.

Another factor is that EKPC is undergoing a management audit, mandated by the Kentucky Public Service Commission (KPSC), to address the utility's decision-making processes. The timeline for completion of the audit has been postponed to April 2010, yet EKPC plans to move ahead with planning for the Smith plant in that timeframe.

Despite these troubling circumstances, on July 31, 2009, RUS Acting Administrator James R. Newby approved a lien accommodation of RUS's existing mortgage with EKPC for up to \$900 million "in order to permit EKPC to finance the construction of the new J.K. Smith Unit 1." The lien accommodation was approved despite the fact that EKPC does not have permission from the KPSC to issue the debt, and regardless of evidence that EKPC may not need electricity from the Smith plant in the first place due to lower-than-projected energy demand.

The decision to proceed with financing and building this unnecessary coal-burning plant will force EKPC to seek approval for electric rate increases at a time when many Kentucky families and businesses are already struggling to pay utility bills. This could eventually lead EKPC, which is already financially unstable, to default on its debt obligations. By subordinating its existing mortgage to other financial interests, RUS is placing in jeopardy the billions of taxpayer dollars it has loaned or provided loan guarantees to EKPC, and effectively guarantees that our electric rates will substantially increase.

These billions of taxpayer dollars include the nearly \$500 million loan it approved for EKPC's Spurlock Unit 4 coal plant in March 2006, and more than \$200 million approved in September 2002 to keep some of EKPC's old and inefficient coal plants in operation. Given that EKPC's energy needs and future forecasts have declined considerably in the

last 18 months, and that the price of electricity from coal-fired power plants is likely to increase as new standards for pollution from coal mining and power plant are implemented, enabling EKPC's over-dependence on coal makes little sense. Any effective financial and environmental diligence on the part of RUS should have uncovered these glaring problems, but there is little evidence suggesting that RUS completed a substantial review as part of its "Lien Machine" process.

In facilitating loans for EKPC, RUS is not providing a safety net, but rather cutting new holes in an already thin net through which co-op members will fall. Had RUS exercised due financial and environmental diligence in EKPC's request for the Smith lien accommodation, it may instead have helped steer the co-op toward more financially secure investments to meet members' needs.

Unfortunately, there is no publicly available evidence that RUS conducted a critical review process. Therefore, we reiterate our request for an immediate review by the USDA Inspector General's office of RUS procedures regarding loans, loan guarantees, and lien accommodations for new and existing coal plants like the proposed Smith plant, before the financial future of any other co-ops and their members is jeopardized.

We eagerly await your actions in response to this request. The KPSC is presently considering EKPC's request to issue the \$921 million in debt to build Smith Unit #1, and RUS approval of the lien accommodation request was a prominent piece of evidence entered by EKPC in that proceeding. Federal taxpayer resources, our electric rates and our environment hang in the balance.

Sincerely,

Judy Yunker, *Big Sandy RECC member*

Ricky Handshoe, *Big Sandy RECC member*

Steve Wilkins, *Blue Grass Energy member*

Carissa Lenfert, *Blue Grass Energy member*

Teri Blanton, *Blue Grass Energy member*

Amy Hogg, *Blue Grass Energy member*

Mike Hannon, *Blue Grass Energy member*

Peter Hille, *Blue Grass Energy member*

Tim Hensley, *Blue Grass Energy member*

John Capillo, *Blue Grass Energy member*

Dick and Janet Futrell, *Blue Grass Energy member*

Beth Curlin Weber, *Blue Grass Energy member*

Billy Edwards, *Clark Energy member*

Matt Poole, *Clark Energy member*

Tom Rector, *Clark Energy Member*

Linda Edwards, *Clark Energy Member*

Brandon Stamper, *Clark Energy Member*

John Patterson, *Clark Energy member*

John Rausch, *Clark Energy member*

Erik L. Lewis, *Fleming-Mason Energy member*

Doug Doerrfeld, *Grayson RECC member*

Ted Withrow, *Grayson RECC member*

Preston Miles, *Inter-County Energy member*

Anne Lubbers, *Inter-County Energy member*

Barbara Warner, *Inter-County Energy member*

Hunter Hensley, *Inter-County Energy member*

Janice Hensley, *Inter-County Energy member*

James R Porter, *Inter-County Energy member*

Linda Porter, *Inter-County Energy member*

Mary Hunter Purdy, *Inter-County Energy member*

Robin Daugherty, *Jackson Energy member*

Phillip Gilbert, *Jackson Energy member*

Robin Reed, *Jackson Energy member*

Lois Kleffman, *Jackson Energy member*

Donna Morgan, *Jackson Energy member*

Gerald A. Walker, *Jackson Energy member*

Jan Pearce, *Jackson Energy member*

James Witt, *Jackson Energy member*

Hugh Bland, *Nolin RECC member*

Betty Heck, *Nolin RECC member*

Joan Noel, *Nolin RECC member*

Jeff Krahn, *Nolin RECC member*

Joseph Netherland, *Salt River Electric member*

Ed & Carin Zuger, *South Kentucky Rural Electric member*

Philip Hays, *Taylor County RECC member*