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FAX TRANSMISSION SHEET

DATE: February 21, 2012

RE: South Kentucky Rural Electric Cooperative Corporation
Case No. 2011-00096

RECIPIENT: Jeff Derouen, Public Service Commission

FAX NUMBER: 502-564-3460

FROM: Darrell Saunders

TOTAL NUMBER OF PAGES (INCLUDING COVER): 10

MESSAGE:

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF SOUTH KENTUCKY RURAL ELECTRIC COOPERATIVE CORPORATION FOR AN ADJUSTMENT OF RATES	)))	CASE NO. 2011-00096

POST-HEARING BRIEF

Comes South Kentucky Rural Electric Cooperative Corporation ("South Kentucky"), by counsel, and files this post-hearing brief to highlight certain issues it believes are particularly relevant to the Commission's consideration of its application for a rate increase. This brief is not all-inclusive and merely highlights certain portions of South Kentucky's application. Due to the volume of documentation that has been submitted it would be impractical to touch upon all issues. All documentation included in the application and responses to the numerous data requests are relied upon and adopted herein by reference. The exclusion of any particular issue from this brief is not intended to mean that those issues are not important to South Kentucky but, rather, South Kentucky believes those issues have already adequately been stated without highlighting them in this brief.

I

REASONS FOR THE APPLICATION FOR RATE INCREASE

South Kentucky has not filed an application for rate adjustment since 2005. It seeks an $8.9 million increase in its retail electric rates for the following principal reasons:

A. South Kentucky needs to increase its equity capitalization ratio which, excluding capital credits from East Kentucky Power Corporation, was 21% as of the end of the test year. South Kentucky hopes to increase its equity capitalization ratio pursuant to the following projections:

ESTIMATED EQUITY CAPITALIZATION RATIOS
BASED ON A 15 YEAR – 35% RATIO PLAN

YEAR	EQUITY/CAPITAL RATIO
First	21.46%
Second	23.69%
Third	24.47%
Fourth	25.29%
Fifth	26.12%
Sixth	26.99%
Seventh	27.88%
Eighth	28.81%
Ninth	29.76%
Tenth	30.73%

B. South Kentucky needs to once again commence paying capital credits consistent with its Equity Management Policy as South Kentucky has not been able to pay any capital credits since 2005 and can do so with the rate increase requested.

KRS 272.010(1)(a) defines a cooperative corporation as a business concern that distributes the net profit of its business pro-rata as patronage refunds to its members as provided in the by-laws. Article VII of South Kentucky's By-Laws contemplates that members will provide capital through their patronage and in order to induce patronage and to assure that the cooperative will operate on a non-profit basis, the cooperative is obligated to account on a patronage basis to its members for all amounts received or receivable from the furnishing of electric energy in excess of operating costs and expenses properly chargeable against the furnishing of electric energy. In short, being a cooperative corporation which obtains patronage capital from its members, South Kentucky believes it is its duty to make capital contributions per the above statute and provisions of its by-laws.

No capital credits have been paid since 2005 and South Kentucky submits that payment of capital credits is fair, just and reasonable and that newer members, through their capital contributions, should assist in payment of capital credits to longer term members who have heretofore financed much of South Kentucky's operations. It would be inequitable for the newer members to not bear any responsibility for capital contributions and to exist upon the capital contributions that have been made by past members.

C. It is necessary that South Kentucky increase its margins pursuant to its loan agreement with its principal lender, Rural Utilities Service. If not, South Kentucky could be in default of debt covenants which could result in Rural Utilities Service calling its loans. That requirement is as follows:

> The average Coverage Ratios achieved by the Borrower in the two best years out of the three most recent calendar years must not be less than any of the following:
>
> | | |
> |---|---|
> | TIER: | 1.25 |
> | DSC: | 1.24 |
> | OTIER: | 1.1 |
> | ODSC: | 1.1 |

South Kentucky did receive notice of a covenant violation for the calendar year 2009 from Rural Utility Service. But, as yet, has not failed to meet any of the ratios for any two years out of a three year period.

D. South Kentucky maintains that the use of the Capital Growth Method as outlined in its application and responses to data requests allows for its ability to both increase equity and pay capital credits.

E. Since the latest rate increase applied for in 2005, there have been increases in operating expenses occasioned by (1) inflation; (2) increase in depreciation rates per South Kentucky's depreciation study; (3) the additional investment made by South Kentucky for its AMI system; and (4) the write-off of the cost of old meters replaced by the new meters in the AMI system. As to the latter, South Kentucky has gained the approval of its lender, Rural Utility Service, to amortize the expense of the old meters over a five year period.

II

SOUTH KENTUCKY'S RATE DESIGN

South Kentucky has used a Cost of Service Study as the basis for the requested increase for each rate class. A principal component of the Cost of Service Study is a necessary increase of its residential customer charge so that the customer charge adequately provides sufficient funds for purely customer related costs and not electric charges. It is South Kentucky's position that its Demand Side Management (DSM) programs should not be a deterrent to an increase to the residential customer charge. The Commission has recently so held in the Meade County Rural Electric Cooperative application for rate increase case and the same rationale applies.

III

DEPRECIATION STUDY

South Kentucky has filed a Depreciation Study with this rate application. This study indicates that South Kentucky needed to change its depreciation rates for its distribution plant investment. South Kentucky is moving from one standard depreciation rate for all of its distribution plant to one that varies by plant account and one that is much more reflective of South Kentucky's actual plant experience for each plant account. This results in depreciation rates that will increase South Kentucky's annual depreciation expense but ones that present a much truer picture of the actual depreciation that South Kentucky is experiencing.

The methodology utilized by South Kentucky is the same as utilized by other electric cooperatives in Kentucky to change their depreciation rates to reflect their actual experience. An alternative methodology was also presented in the process of adjudicating this case that showed some variation in suggested depreciation rates but also indicated that South Kentucky needs to change its depreciation rates. Also, the original methodology used in the depreciation study is one that is very similar to the one used by the Rural Utility Services ("RUS"). Finally, RUS has found the methodology used by South Kentucky to be an acceptable one as it has accepted this methodology for other electric cooperatives in Kentucky.

IV

AMI GRANT

There was not inconsiderable discussion at the hearing of South Kentucky's treatment of the grant funds from the United States Department of Energy for its AMI system. South Kentucky was previously granted a certificate of need and necessity by the Commission to install an AMI system for the proposed sum of $19,000,000.00 with $9,000,000.00 received in grant funds from the United States Department of Energy. South Kentucky has depreciated the total amount of the cost of the AMI system including the $9,000,000.00 in grant funds. South Kentucky relies upon the Kentucky Supreme Court case of Public Service Commission of Kentucky v. Dewitt Water District, 720 SW2d 725 (Ky. 1986) as authority for it to do so. That case involved depreciation of grant funds by three (3) water districts and Justice Wintersheimer succinctly identified the question presented as follows:

> The question is whether the Public Service Commission may disallow a depreciation expense on contributed property when determining the rates of publically-owned water districts.

Justice Wintersheimer equally succinctly states the holding of the case on page 728 of the opinion as follows:

> This Court affirms the decision of the Court of Appeals in the Dewitt Water Case and reverses the decision in the East Clark and Warren County cases. Depreciation expense on contributed plant property may be considered as an operating expense for rate-making purposes and matters involving publicly held water districts as distinguished from investor-owned companies.
>
> The Public Service Commission's disallowance of a rate of recovery for depreciation expenses on contributed property was arbitrary, capricious and confiscatory.

The court concludes with the following on page 732 of the opinion:

> The Commission's rate-making determinations in these cases constitute an unlawful and unreasonable exercise of its regulatory authority. It is the holding of this Court that depreciation expense on a publically-owned water district plant that has been purchased by federal grants and

> contributions and/or customer tap-on fees should be allowed in the revenue requirement because they have no private investor capital and their rates do not generate a return on rate base. Public water districts rely on internally generated cash flow.

Of course, the Public Service Commission, pursuant to KRS Chapter 278 regulates the rates of both water and electric utilities. It makes no difference that the holding in the decision in Public Service Commission of Kentucky v. Dewitt Water District, supra, involves water utilities and not electric utilities.

Water districts are subject to PSC regulation per KRS 278.012 and as recognized in City of Georgetown v. Public Service Commission, 516 SW2d 842 (Ky. 1974) which holds that a water district is a "utility" for purposes of KRS Chapter 278.

For electric utilities, KRS 279.110(10) grants a general power to a rural electric cooperative corporation to "fix and collect reasonable rates it charges for services, subject to the provisions of KRS Chapter 278". Thus, water utilities and electric utilities are subject to the same regulatory provisions of KRS Chapter 278 and what is held as to one, such as a water utility should be held for the other such as an electric utility. Therefore, there is not meaningful distinction between water utilities and electric utilities and Public Service Commission of Kentucky v. Dewitt Water, supra, should apply to South Kentucky with depreciation of the grant funds from the Department of Energy permitted.

V

DEMAND SIDE MANAGEMENT

South Kentucky is committed to demand side management (DSM). It has perhaps been the leader in implementing DSM programs among the regulated electric cooperatives in Kentucky, South Kentucky was the major influence in establishing the first DSM program among the Kentucky electric cooperatives which has the Electric Thermal Storage ("ETS") program in 1988 and has continued to be a leader in the implementation of DSM programs for electric cooperatives.

Energy savings programs in existence include:

Members Served or Units Distributed:

Tune UP Program Participants:	1,681
Button Up Participants:	2,530
All Seasons Comfort Home:	270
All Seasons Model Home:	13
Geothermal	190
Touchstone Energy Home Air	140
Touchstone Energy Home Geothermal:	30
Geothermal Energy Manufactured Home:	2
Compact Fluorescent Lighting	84,684

Utilization of Members Annually:

ETS Heating Members (3,241 units installed):	1,641
Energy Audits Annually:	950
Heating Air Calculations Annually:	250
Water Heater Promotions Annually:	180
School and Civic Organization Energy Efficiency Presentations Annually:	650-700

VI

SOUTH KENTUCKY HEADQUARTERS

South Kentucky has received approval for the construction of a new headquarters building. However, due to the slow economy and lack of new customers, that project has temporarily been put on hold. In any event, no part of any cost related to the headquarters facility is included in the test year or the financial records which have been submitted in support of the application for a rate adjustment.

CONCLUSION

South Kentucky last filed an application for a rate increase in 2005 and has withheld filing the within application as long as it deemed feasible. But, the financial information which has been submitted through the application and through responses to the numerous data requests establish the need for the rate adjustment and the Commission is requested to grant the $8.9 million rate increase as per the specific classifications set forth in the proposed tariffs.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the above and foregoing was this 21st day of February, 2012 deposited in the regular United States mail, all postage prepaid and addressed for delivery to Mr. Richard Raff, Public Service Commission, 211 Sower Blvd., P.O. Box 615, Frankfort, KY 40602-0615.

Ten (10) copies to: Mr. Jeff Derouen, Executive Director, Public Service Commission, 211 Sower Blvd., P.O. Box 615, Frankfort, KY 40602-0615.

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