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January 31, 2012

Edward T. Depp, Esquire  
Dinsmore & Shohl LLP  
101 South Fifth Street, Suite 2500  
Louisville, KY 40202

**PSC STAFF OPINION 2012-004**

Re: Kentucky Association of Electric Cooperatives Staff Opinion Request  
Electric Distribution Cooperative Work Plans

Dear Mr. Depp:

Commission Staff is in receipt of your letter sent on behalf of the Kentucky Association of Electric Cooperatives (KAEC) dated November 7, 2011. In that letter, you request "clarification" and "interpretation" of whether the electric distribution cooperatives' construction work plans require a certificate of public convenience and necessity ("CPCN") from the Commission prior to beginning work implementing their construction work plans ("CWP"). Commission Staff understands your request for "clarification" and "interpretation" is premised on the fact that "construction work plan" is not specifically stated in the applicable law, namely KRS 278.020 and 807 KAR 5:001 § 9, and the fact that "construction work plans" are considered by your client to be ordinary extensions of existing systems in the usual course of business, and therefore, exempt from prior Commission approval. Your letter presumes that application of the "10% rule" in implementing regulation, 807 KAR 5:001 § 9, supports your premise that CWPs are ordinary extensions of business.

Commission Staff understands that the guidance you request is not for a specific CWP but for electric distribution cooperatives' construction work plans in general. Historically, the Commission has treated CWPs as one construction project partly because the cooperatives have financed CWPs as one project.

The language in KRS 278.020 and 807 KAR 5:001 § 9 does not distinguish between construction projects which are part of a CWP and those that are not. Rather, prior approval from the Commission is required prior to beginning

. . . the construction of any plant, equipment, property, or facility for furnishing to the public any of the services enumerated in KRS 278.010. . .

The Commission has previously required prior approval through a CPCN for a construction project whether part of a CWP or not. The Commission has and continues to apply the CPCN requirement to construction projects on a project by project basis unless a particular project falls within two exemptions. KRS 278.020(1) exempts from prior approval through CPCN retail “electric suppliers from obtaining a CPCN for service connections to electric consuming facilities within its certified territory” and “ordinary extensions of existing systems in the usual course of business.” The Commission has defined “ordinary extensions of existing systems in the usual course of business” by regulation found in 507 KAR 5:001 § 9(3):

No certificate of public convenience or necessity will be required for extensions that ***do not create wasteful duplication of plant, equipment, property, or facilities***, or conflict with the existing certificates or service of other utilities operating in the same area and under the jurisdiction of the Commission that are in the general area in which the utility renders service or contiguous thereto, and that ***do not involve sufficient capital outlay to materially affect the existing financial condition of the utility involved, or will not result in increased charges to its customers.*** *(Emphasis added).*

The regulation provides for three areas of inquiry to determine whether a construction project is an “ordinary extension of existing systems in the usual course of business;” (1) whether there will be a wasteful duplication of plant, including interference with another utility’s certificates or service; (2) whether the capital investment is so minimal that it will not “materially” affect the financial condition of the regulated utility; and (3) whether the rates will increase as a result of construction. Importantly, the Kentucky Court of Appeals has held that the purpose of KRS 278.020 and 807 KAR 5:001 § 9(3) is to “protect the public against exorbitant utility rates emanating from unnecessary and duplicitous power facilities.” *Duerson v. East Kentucky Power Coop., Inc.*, Ky. App., 843 S.W.2d 340, 342 (1992) *superseded on other grounds by statute in Jent v. Kentucky Utilities Co.*, 332 S.W.3d 102 (Ky.App. 2010). Thus, 807 KAR 5:001 § 9(3) is the legal definition of “ordinary extension” in the “usual course of business.” The focus of the review is duplication and cost not whether a construction project is part of an electric cooperative’s CWP or that of an investor-owned utility’s project.

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<sup>1</sup> KRS 278.020(1).

In reviewing a CPCN application for a construction project, the Commission examines the project's capital investment in relation to the net plant investment of the regulated utility. Commission Staff respectfully disagrees with the position set forth in your letter that the "10%" rule is dispositive of whether a project requires a CPCN or not because it is an extension in the "ordinary course of business." This is no longer the criteria used by the Commission and has not been since the passage of KRS 13A in 1984. In response to KRS 13A, the Commission promulgated 807 KAR 5:001. Specifically, 807 KAR 001 § 9(3) directs the Commission to examine if the project will result in wasteful duplication; what the project's "material financial effect" on the financial condition of the utility; and whether the project will increase rates.

Your letter states that the Commission does not require investor-owned utilities to seek CPCNs for construction projects and requests that the Commission afford the electric distribution coops the "operational discretions enjoyed by the investor-owned utilities." While different standards appear to apply, it must be acknowledged that cooperative utilities and investor-owned utilities are fundamentally different. If the Commission finds that an investor-owned utility has built unnecessarily, the shareholders of that utility will bear the burden. A cooperative utility, in contrast, has no shareholders and only its customers will bear the burden. According to the Kentucky Court of Appeals in *Duerson*, this is exactly the situation 807 KAR5:001 § 9 is designed to prevent.<sup>2</sup> Furthermore, if an investor-owned utility does not secure a CPCN it assumes the risk of not recovering the construction project's costs in a subsequent rate case if the Commission finds that it resulted in wasteful duplication, or materially affected the utility's financial condition, or resulted in an increase of customer rates. Prior approval through a CPCN removes such a risk to the utility. Simply stated all construction projects are reviewable by the Commission.

The Commission's policy is to apply the law to all construction projects and it will continue to require CPCNs prior to construction of all projects not exempt by law. Commission Staff has reviewed the past 20 years of CPCN orders and advisory opinions and have attached examples. These orders demonstrate that the Commission reviews both investor owned utility projects as well as cooperative utility projects; these examples also demonstrate the Commission's policy of applying the statutory criteria to each project regardless of ownership. As you can see, of 11 cases in which the Commission determined a CPCN was not required due to low capital investment, five of those exemptions belong to East Kentucky Power Cooperative. Of the nine advisory opinions issued with regard to construction projects, seven projects belonging to electric cooperatives, the Commission deemed those projects to be an extension in the ordinary course of business and, thus, a CPCN was not required. Finally attached is a show cause order in which an investor owned utility was fined for failing to secure a CPCN.

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<sup>2</sup> 843 S.W.2d at 342.

#### Commission Orders

1. 1991-00115 KU Brown Combustion Turbines
2. 2004-00507 LG&E/KU Trimble County 2
3. 2011-00161 KU Environmental Compliance Plan
4. 2011-00162 LG&E Environmental Compliance Plan
5. 2002-00352 EKPC Landfill Gas to Energy
6. 2002-00474 EKPC Landfill Gas to Energy
7. 2005-00164 EKPC Landfill Gas to Energy
8. 2006-00033 EKPC Landfill Gas to Energy
9. 2007-00509 EKPC Landfill Gas to Energy
10. 1994-00182 Columbia Gas Show Cause Order

#### Advisory Opinions

1. PSC Staff Opinion 2011-010 Kenergy replacement of certain cutouts
2. PSC Staff Opinion 2011-009 Owen Electric first phase of VVO project
3. PSC Staff Opinion 2011-002 EKPC office space expansion
4. PSC Staff Opinion 2010-0010 Cumberland Electric regarding jurisdiction
5. PSC Staff Opinion 2010-009 Big Rivers construction of improvements on substation
6. PSC Staff Opinion 2009-001 Salt River Electric warehouse and storage
7. PSC Staff Opinion dated 2-21-2008 Clark Energy warehouse
8. PSC Staff Opinion dated 1-26-2006 Cincinnati Gas and Electric replacement and upgrade of electric facilities
9. PSC Staff Opinion dated 10-26-2005 KPC replacement and upgrade of transmission line

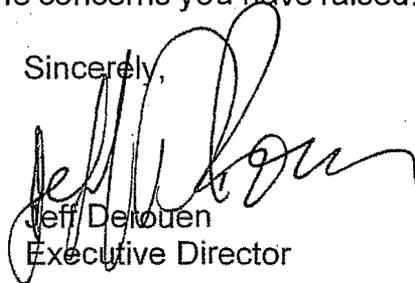
This letter represents Commission Staff's interpretation of the law as applied to the request presented. This opinion is advisory in nature and not binding on the Commission should the issues herein be formally presented for Commission resolution. Questions concerning this opinion should be directed to Helen C. Helton, General Counsel, at 502-546-3940, Ext. 244.

However, the Commission Staff plans to establish a work group to examine the current application of the law to CPCNs and invite you and Bill Corum to participate. We would like to form this group as soon as possible. Please expect the Commission

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Staff to contact you to begin the process. We are looking forward to working with the group to explore possible solutions to the concerns you have raised.

Sincerely,



Jeff Derouen  
Executive Director

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Enclosures

## COMMISSION ORDERS

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## **ADVISORY OPINIONS**

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