COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

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

ORDER

On June 8, 2011, South Kentucky Rural Electric Cooperative Corporation ("South Kentucky") filed an application requesting approval to increase its rates for retail electric service by $8.9 million, a 6.97 percent increase over its normalized revenues.[1] A review of the application revealed that it did not meet the minimum filing requirements set forth in 807 KAR 5:001, Sections 6(2)(a) and 10(3)(b); therefore, a notice of filing deficiencies was issued. On July 6, 2011, South Kentucky filed information to cure the deficiencies; however, the information was insufficient and a second deficiency letter was issued July 13, 2011. On July 28, 2011, South Kentucky filed the information needed to cure the deficiencies and the application was accepted as filed on that date.

KRS 278.180(1) requires 30 days' notice of a change in rates. Accordingly, the Commission advised South Kentucky that, based on the July 28, 2011 filed date the earliest the proposed rates could become effective was August 27, 2011. Finding that an investigation would be necessary to determine the reasonableness of South Kentucky's proposed increase, the Commission suspended the rates for five months, up to and including January 26, 2012, pursuant to KRS 278.190(2). For various reasons,

[1] South Kentucky's most recent general rate case was Case No. 2005-00450, Application of South Kentucky Rural Electric Corporation for an Adjustment of Rates (Ky. PSC, Aug. 31, 2006).

including South Kentucky's requests to reschedule hearing dates, South Kentucky agreed to extend the rate suspension to April 1, 2012.

BACKGROUND

South Kentucky is a consumer-owned rural electric cooperative organized pursuant to KRS Chapter 279. It is engaged in the sale of electric energy to approximately 66,000 member customers in Adair, Casey, Clinton, Cumberland, Laurel, Lincoln, McCreary, Pulaski, Rockcastle, Russell and Wayne counties in Kentucky, and Pickett and Scott counties in Tennessee. It is one of 16 member distribution cooperatives that own and receive wholesale power from East Kentucky Power Cooperative, Inc.

On August 8, 2011, a procedural order was issued that provided for discovery, intervenor testimony, and rebuttal testimony. There were no intervenors in this matter. The Commission held a public hearing on the proposed rate adjustment on January 11, 2012. No members of the public attended the hearing and the Commission received no written comments on the proposed increase. On February 22, 2012, South Kentucky filed its Post-Hearing Brief. All information requested at the public hearing has been filed and the case now stands submitted for a decision.

TEST PERIOD

South Kentucky proposed the 12-month period ending September 30, 2010 as the test period to determine the reasonableness of its proposed rates. The Commission finds the use of this test period to be reasonable. In using a historic test period, the Commission has given full consideration to appropriate known and measurable changes.

VALUATION

Rate Base

South Kentucky proposed a net investment rate base of $165,274,919 based on test-year-end plant in service and construction work in progress, the 13-month average balances for materials and supplies and prepayments, plus a cash working capital allowance, minus the adjusted accumulated depreciation balance and the test-year-end level of customer advances for construction.[2]

The Commission concurs with South Kentucky's proposed rate base with the exception that working capital has been adjusted to reflect the pro forma adjustments to operation and maintenance expenses found reasonable herein. With this adjustment, South Kentucky's net investment rate base for ratemaking purposes is as follows:

Utility Plant in Service	$ 198,773,326
Construction In Progress	4,182,904
Total Utility Plant	$ 202,956,230
ADD:	
Materials and Supplies	$ 2,277,554
Prepayments	329,234
Working Capital	2,301,834
Subtotal	$ 4,908,622
DEDUCT:	
Accumulated Depreciation	$ 41,950,551
Customer Advances for Construction	735,793
Subtotal	$ 42,686,344
NET INVESTMENT RATE BASE	$ 165,178,508

[2] Application, Exhibit K, page 2 of 7.

Capitalization and Capital Structure

The Commission finds that South Kentucky's capitalization at test-year-end for ratemaking purposes was $182,070,277[3] and consisted of $38,232,573 in equity[4] and $143,837,704 in long-term debt. Using this capital structure, South Kentucky's year-end equity to total capitalization ratio was 21 percent.

REVENUES AND EXPENSES

South Kentucky proposed seventeen adjustments to revenues and expenses to reflect current and expected operating conditions. The Commission finds that 14 of the adjustments proposed by South Kentucky are reasonable and should be accepted. Those adjustments are shown in the following table:

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[3] Id., page 7 of 7.

[4] Generation & Transmission Capital Credits ("G&T Capital Credits") are typically excluded by the Commission in calculating a distribution cooperative's equity and capital structure. At test year-end, South Kentucky had a balance of $22,924,768 in G&T Capital Credits.

South Kentucky's Proposed Adjustments

Descriptions	Adjustments
Payroll – Salaries & Wages	$ (58,346)
Payroll Taxes	(824)
Normalize Property Taxes	49,040
Normalize Interest on Long Term Debt	207,638
Financial Accounting Standard 106 Costs	43,791
Retirement and Security Plan Costs	84,113
Health Insurance Costs	93,949
Professional Services	(22,763)
Donations	(60,790)
Miscellaneous Expenses	(74,295)
Directors Expenses	(415,695)
Generation and Transmission Credits	(4,918,417)
Normalize Purchased Power Costs	(3,714,620)
Normalize Base Rates	(3,547,653)

The Commission has modified the remaining proposed adjustments and made further adjustments to the test-year revenues and expenses as discussed herein.

Customer Growth Adjustment

The Commission finds that an adjustment of $50 should be made to decrease the proposed amount of the customer growth adjustment to reflect a revision filed in response to a Staff data request.[5]

Depreciation and Amortization

South Kentucky proposed to increase its test-year depreciation and amortization expense by $3,551,492, from $5,618,934 to $9,170,426. Its proposed adjustment is shown in Appendix A to this Order.

After considering the evidence, we find that the test-year expense should be

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[5] Response to Item 32 of Commission Staff's Third Information Request (Staff's Third Request"), October 24, 2011.

increased by $782,460. The adjustment is shown in Appendix B to this order with differences in South Kentucky's and the Commission's adjustments shown in bold text.

The three major components of the depreciation and amortization adjustments are: 1) Depreciable Basis; 2) Change in Composite Depreciation Rates for Distribution Assets; and 3) Amortization of the Loss on the Early Disposition of Mechanical Meters. Each component is discussed in detail in the subsequent sections of this Order.

Depreciable Basis. For all plant account groups except meters, South Kentucky normalized depreciation by multiplying a composite depreciation rate by the test year-end plant account balance. The Commission finds the use of test year-end balances for these plant account groups to be appropriate.

For the meter account, South Kentucky proposes to go beyond the test year to the estimated completion date of its Advanced Metering Infrastructure ("AMI") project,[6] September 30, 2012,[7] to include the project's full cost. Through this project, which we approved in Case No. 2009-00489,[8] South Kentucky will replace all mechanical meters at a total anticipated cost of $19,636,215.[9] The project will be funded by a Department of Energy ("DOE") grant of $9,538,234 and loan funds from the Rural Utility Service

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[6] Although the Depreciation Exhibit in South Kentucky's Application at Exhibit 3, page 2, shows a test-year ending balance for meters of $19,636,215, South Kentucky confirmed in response to Item 31 of Commission Staff's Second Information Request ("Staff's Second Request") that this amount is not the actual test year ending balance but is the anticipated final cost of the AMI project to be completed in September, 2012.

[7] Response to Staff's Second Request, Item 34.b.

[8] Case No. 2009-00489, In the Matter of the Application of South Kentucky Rural Electric Cooperative Corporation for a Certificate of Convenience and Necessity to Install an Advanced Metering Infrastructure System (Ky. PSC, January 19, 2010).

[9] Response to Staff's Second Request, Item 31.

("RUS") of $10,097,981.[10] South Kentucky requests recovery of depreciation on the full cost of the AMI project including the portion funded by the DOE grant.[11]

We find that South Kentucky's request to extend the cut-off date beyond the test year-end for the meter account violates the "matching principle" long recognized by the Commission. For ratemaking purposes, the matching principle means that all revenues, expenses, rate base components, plant additions, and capital items are updated to the same period.

South Kentucky calculated each component of its revenue requirement based on the end of its test year except depreciation on the AMI project and the loss on the early retirement of mechanical meters. On these two items, it would reflect changes through September 30, 2012. By not updating all revenue requirement components to the same date, South Kentucky's proposal results in a mismatch of various components of its revenue requirement and is not consistent with South Kentucky's decision to file its rate case based on a historic test year. It is not appropriate to update just these selected accounts to reflect balances two years beyond the test year and, therefore, these adjustments are denied.

As shown in Table 2, the Commission determined the depreciable basis for the AMI project and mechanical meters based on investment in the project and the number of mechanical meters in service at test year-end. The test-year cut-off date also affects lost revenues and expense savings due to the AMI project and loss on the retirement of mechanical meters. In considering these components, we determined that holding the cut-off date to test year-end results in an $183,230 increase to South Kentucky's

[10] Response to Staff's Third Request, Item 24.b.(1).

[11] Response to Staff's Second Request, Item 26.c.

revenue requirement. Extending the cut-off to September 2012, as South Kentucky requests, results in an overall decrease to revenue requirements of $83,377. An overall decrease of $137,453 results when the date of the hearing, January 11, 2012, is used as the cut-off date. The calculation of these amounts is shown below in Table 1:

Table 1

	Cut-Off Date		
	September 30, 2010	January 11, 2012	September 30, 2012
Impact on Deprecation Expense	$ 293,799	$ 366,127	$ 537,101
Impact on Loss on Mechanical Meters	44,238	201,478	248,248
Impact on Changes to Revenues and O&M Expenses	(154,807)	(705,058)	(868,726)
Net Change to Revenue Requirement	$ 183,230	$ (137,453)	$ (83,377)

As previously stated, a DOE grant of $9,538,234 will be used to fund part of the AMI project. South Kentucky requested depreciation on the full cost of the AMI project, including the portion funded by the DOE grant.

The Commission has the authority under KRS 278.220 to establish a system of accounts for utilities under its jurisdiction, and the system established for electric utilities is to conform as nearly as practicable to the system adopted or approved by the Federal Energy Regulatory Commission ("FERC"). South Kentucky borrows funds from the RUS, and the RUS loan documents require South Kentucky to keep its books, records, and accounts in accordance with the methods and principles of accounting set forth in 7 CFR Part 1767,[12] which is known as the RUS Uniform System of Accounts ("USoA"). The RUS USoA, which is substantially similar to the FERC USoA, has been generally

[12] 7 CFR 1767.11(a).

accepted by the Commission for use by South Kentucky and all other electric cooperatives under its jurisdiction, although the Commission has the authority under KRS 278.220 to prescribe different accounting methods and principles.[13]

The RUS USoA contains instructions related to the accounting for electric plant in 7 CFR 1767.16(b)(4). The RUS USoA states, in pertinent part, that:

> "The electric plant accounts shall not include the cost or other value of electric plant contributed to the company. Contributions in the form of money or its equivalent toward the construction of electric plant shall be credited to accounts charged with the cost of such construction. Plant constructed from contributions of cash or its equivalent shall be shown as a reduction to gross plant constructed with assembling cost data in work orders for posting to plant ledgers of accounts. The accumulated gross costs of plant accumulated in the work order shall be recorded as a debit in the plant ledger of accounts along with the related amount of contributions concurrently be recorded as a credit."

As required by this instruction, the DOE grant must be credited to Account 370, Meters.

South Kentucky has decided to deviate from the USoA by crediting the DOE grant to Account 208, Donated Capital. This deviation would allow South Kentucky to establish the depreciable basis of the AMI project at its full cost, without reflecting the credit for the DOE grant. However, crediting the DOE grant to Account 208 is contrary to the RUS instructions for that account. 7 CFR 1767.19 of the RUS USoA states that Account 208, Donated Capital, "[s]hall include credits arising from forfeiture of membership fees and from donations of capital not otherwise provided for." Thus, the DOE grant is not properly recorded in Account 208 since it is a donation of capital that is

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[13] The RUS expressly recognizes the authority of a state regulatory commission to prescribe accounting methods and principles that differ from the RUS USoA. See 7 CFR 1767.13(c).

otherwise provided for, under the instructions in 7 CFR 1767.16(b)(4), to be recorded as a credit to Account 370, Meters. Therefore, Account 208, Donated Capital, should not be used for recording South Kentucky's DOE grant funds.

South Kentucky states that RUS representatives verbally indicated that the proper accounting of the DOE contribution was to credit Account 208, Donated Capital, but no written confirmation was presented.[14] South Kentucky provided no evidence that RUS representatives required the proposed accounting treatment. When asked for such evidence, South Kentucky only stated that its representatives "attended a seminar presented by RUS on July 13, 2010 that addressed grant proceeds from the Department of Energy. Part of the presentation dealt with how to account for grant proceeds."[15] However, even assuming that South Kentucky was given verbal direction by RUS representatives to record the DOE grant in Account 208, Donated Capital, such direction is in direct conflict with RUS's regulations, which expressly state that, "[n]o departures are to be made to the prescribed RUS USoA without the prior written approval of the RUS."[16]

South Kentucky also cites the case of *Public Service Com'n v. Dewitt Water Dist.*, 720 S.W.2d 725 (Ky. 1986), that water districts, being publicly-owned utilities, were entitled to the recovery of depreciation expense on all plant in service including that funded through contributions. South Kentucky argues that it is similar to a water district in that they are both publicly-owned, their rates are regulated by the

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[14] Response to Staff's Second Request, Item 33.i.

[15] Response to Staff's Third Request, Item 26.a.

[16] 7 CFR 1767.13(a).

Commission, and they are subject to the same regulation under KRS Chapter 278. Consequently, South Kentucky asserts that it is entitled the same rate relief afforded by the Court under its decision in *Dewitt*.[17]

South Kentucky's claims that it is similar to a water district, and that the *Dewitt* decision is controlling here, are misplaced. A water district is a political subdivision of a county, and is created by the fiscal court of a county pursuant to KRS 62.805 to 65.830 and KRS 74.010. South Kentucky, on the other hand, is a private corporation formed under KRS Chapter 279 and is owned by its member/customers, not by the public.

In the *Dewitt* case, the Court cited the USoA for Class C and D Sewer Utilities as establishing the proper method to account for depreciation on all classes of property. Noting that Account 403, Depreciation Expense, provides for depreciation expense on all classes of depreciable plant in service, the Court found no basis to distinguish between contributed and non-contributed property of a water district. The Court then cited KRS 74.480(2)(c) as a further basis for its decision that a water district is legally entitled to recover in rates depreciation expense on contributed property. That statute requires rates to be set, "[t]o provide an adequate fund for renewals, replacements, and reserves."[18] The Court read this replacement to mean that depreciation expense for a nonprofit water district was not limited to the recoupment of investment, but included funds for the renewal and replacement of assets.

For South Kentucky, the applicable provision of the RUS USoA, 7 CFR 1767.16(b)(4), requires contributed property to be recorded as a credit to the electric

[17] Response to Staff's Third Request, Item 26.c., and South Kentucky's Post-Hearing Brief at 7.

[18] KRS 74.480(2).

plant account charged with the cost of the construction. Consequently, all funds received by South Kentucky under the DOE grant must be recorded as a reduction to Account 370, Meters. Recording the contributed DOE grant funds as a credit to Account 370, Meters, results in the value of the depreciable plant in service being reduced by an equal amount. Depreciation expense is still calculated on the basis of South Kentucky's depreciable plant in service, but that depreciable plant has a lower value due to the credit for the contributed property. In addition, neither KRS 74.480(2)(c), nor any other provision of KRS Chapter 74, is applicable to an electric cooperative such as South Kentucky.

The *Dewitt* Court also found that a significant percentage of a water district's plant is contributed property. The Court noted that for the water districts in that case one had 64 percent of its property contributed, while the other had 50 percent contributed. For this reason, the Court stated that the failure to allow depreciation on the contributed portion will result in increased short-term financing charges which will lead to increases in the overall cost of service. Accordingly, the Court found that recovery of depreciation expense should be allowed on all water district property, including that which was funded by contributions, to reduce the overall cost of service.

Unlike a water district, South Kentucky has a very small percentage of contributed property. Once South Kentucky has received the entire DOE grant and its AMI project is complete, the DOE funds will represent 4.9 percent of the total plant in service at the end of the test year.[19] Thus, the DOE grant represents a relatively small percentage of plant when compared to the water districts in *Dewitt.* The Commission

[19] ($9,538,234/$195,827,709).

further finds that, in this instance, disallowance of depreciation on contributed property should not result in higher short-term financing charges. While not allowing depreciation on the DOE-funded property to be included in rates, the Commission has approved depreciation rates that will allow for the annual accumulation of deprecation in the amount of $6,401,464. These funds must first be used to retire debt principal. South Kentucky's projected average annual principal retirements from 2012 until 2020 on all debts outstanding as of the end of the test year are $4,467,948[20] leaving $1,933,446 ($6,401,464-$4,467,948) available for funding plant improvements. This amount is well in excess of $435,224,[21] which is South Kentucky's average annual cost of internally-funded improvement projects constructed during the previous 10 years. Therefore, disallowance of depreciation of contribution property should not result in higher short-term financing charges.

Finally, South Kentucky's stated purpose for depreciation is contrary to that of the *Dewitt* Order. South Kentucky's depreciation study uses the depreciation definition that is contained in the USoA which is:

> "[t]he loss in service value, not restored by current maintenance, incurred in connection with the consumption or prospective retirement of electric plant in the course of service from causes which are known to be in current operation and against which the utility is not protected by insurance. Among the causes to be given consideration are wear and tear, decay, action of the elements, inadequacy, obsolescence, changes in art, changes in demand and requirements of public authorities."[22]

[20] Response to Staff's Third Request, Item 21.

[21] Response to Staff's Third Request, Item 22.

[22] Application, Exhibit 20, Page 4.

Clearly, South Kentucky's stated purpose for deprecation is the recoupment of investment due to loss of service value and not to provide funds for renewals and replacement of assets, which is the foundation for the Supreme Court decision in the *Dewitt* case.

Based on the evidence relating to the depreciation expense on contributed property, the Commission finds that South Kentucky's proposed accounting treatment for the DOE grant should be denied. South Kentucky should follow the requirements set out in Section 1767.16(b)(4) of the RUS USoA when recording the grant.

We have determined South Kentucky's depreciable basis in mechanical meters and the AMI project at test year-end to be $3,737,389 and $4,615,202, respectively. The calculations of these amounts are shown in Table 2. The basis in mechanical meters was determined by multiplying the original cost of mechanical meters by the percentage of meters remaining in service as of the end of the test year, 82.18 percent [1 - (11,837 meters replaced at test year end[23] / 66,436 customers at test year end[24])]. The basis for the AMI project was set at $4,615,202, or half of the $9,230,403[25] expended on the project as of the test year-end, since the DOE grant represents matching funds.

[23] Response to Item 3 of the Data Request Resulting from the Hearing on January 11, 2012 ("Hearing Data Request").

[24] Response to Item 32 of Staff's Third Request, Revised Exhibit 16, Year-end Customer Adjustment.

[25] Response to Item 4 of the Hearing Data Request.

Table 2		
Depreciable Basis in Mechanical Meters at September 30, 2010		
Total Original Cost of all Mechanical Meters	$	4,547,809
Percent remaining in service at September 30, 2010		82.18%
Original Cost Allocated to those Remaining In Service at September 30, 2010	$	3,737,389
Depreciable Basis in AMI Project at September 30, 2010		
Total Invested as of September 30, 2010	$	9,230,403
Subtract Matching Grant Proceeds up to $9,538,234		(4,615,202)
Depreciable Basis at September 30, 2010	$	4,615,201

Composite Depreciation Rates – Distribution Plant. South Kentucky depreciates all plant, except the AMI project, using a three percent composite rate. The AMI project, which is being charged to the meter account, is depreciated at a 6.67 percent annual rate. South Kentucky has not received Commission approval of this rate.

South Kentucky requests approval of the 6.67 percent rate for its AMI project and authorization to increase the composite depreciation rate assigned to other distribution plant accounts based upon a depreciation study submitted as a part of its application.[26] South Kentucky supports the need for increasing depreciation rates by applying procedures established by the RUS Bulletin 183-1.

South Kentucky's depreciation practices are governed by Bulletin 183-1, which prescribes a range of whole life depreciation rates for distribution assets.[27] REA recommends that borrowers whose systems are operated under "normal" conditions choose rates near the middle of the ranges while only borrowers operating under

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[26] Application, Exhibit 20.

[27] RUS Bulletin 183-1, page 1, I.

"extreme" conditions select rates toward the outer limits of the ranges.[28] Rates outside these ranges must be approved by RUS except when they are required by a regulator. RUS must be informed when a regulator requires alternative rates.[29]

RUS Bulletin 183-1 provides a method using guideline curves to determine if an adjustment to deprecation rates may be warranted. The guideline curves are used as a tool to determine whether a depreciation reserve is consistent with normal experience.[30]

The guideline curves, charted on a graph where the X-axis is the "Ratio of Current Distribution Plant in Service to Distribution Plant in Service 10 Years Ago" and the Y-axis is the "Reserve Ratio – Percent" consist of three curves representing three different useful lives. The maximum curve was determined using a 25 R3 curve. The minimum curve is based on a 35 R1 curve. The optimum curve, between the minimum and maximum curves, represents a 30 R1 curve, and indicates the optimum level of reserve ratios that may be expected of a typical RUS borrower.[31] All three curves reflect a net salvage value[32] of 10 percent of the total distribution plant's original cost.

The reserve ratio should fall between the maximum and minimum curves. When it falls outside these curves, additional study is needed to determine whether a change in accounting procedures or depreciation rates is warranted.[33] When an adjustment to

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[28] RUS Bulletin 183-1, page 9, 3.

[29] RUS Bulletin 183-1, page 1, I.

[30] RUS Bulletin 183-1, page 3, V.

[31] RUS Bulletin 183-1, page 5, C. 1.

[32] Net Salvage Value = Salvage – Cost of Removal.

[33] RUS Bulletin 183-1, page 4, B. 2.

rates is warranted, the bulletin states that rates should be adjusted so that the reserve ratio is gradually moved within the guideline curves over a number of years.[34]

South Kentucky presented the reserve ratio analysis shown in Table 3.[35] Based on that analysis, it posits that an adjustment to its depreciation rates is warranted.

Table 3

Year Ended	Distribution Plant in Service	Distribution Plant Accumulate Depreciation	Reserve Ratio	Ratio of Current Distribution Plant to Distribituion Plant 10 Years Prior
2009	$ 82,006,321	$ 20,716,588	25.26%	1.85
2008	79,412,895	19,148,191	24.11%	1.94
2007	76,020,263	17,461,623	22.97%	2.03
2006	71,399,630	16,181,781	22.66%	2.04
2005	66,374,927	14,810,722	22.31%	2.08
1999	44,363,056	9,937,785	22.40%	
1998	40,845,433	9,289,706	22.74%	
1997	37,522,573	8,632,283	23.01%	
1996	34,972,409	8,178,601	23.39%	
1995	31,958,257	7,742,742	24.23%	

When plotting the information shown in Table 3 on the graph in RUS Bulletin 183-1, it appears that South Kentucky's current percent depreciation rate has resulted in ratios near the optimum curve, which indicates no adjustment is warranted. However, as noted previously, the guideline curves were designed using a net salvage value equal to 10 percent of the distribution plant's total gross book cost. When the net salvage value is decreased, the curves must move up the y-axis accordingly to account for the resulting increase to accumulated depreciation. Conversely, when this value is increased, the curves must move down the y-axis.

[34] RUS Bulletin 183-1, page 10, 4. Review Prior Practices.

[35] South Kentucky's Application, Exhibit 3, page 4.

South Kentucky determined its annual net salvage to be $1,093,501[36] using the average cost approach. To determine how this compares to the 10 percent value used in RUS's guideline curves, it must be restated as a percentage of total distribution plant. Using the 30-year life assigned to the optimum curve, this percentage is (19.67).[37] This represents nearly a 30 percent decrease compared to the net salvage value used in RUS Bulletin 183-1. This decrease requires a significant move of the curves up the y-axis. After moving the curves, South Kentucky's ratios fall outside the guideline curves indicating an adjustment to depreciable lives may be warranted, absent accounting errors. The Commission, being unaware of any errors in South Kentucky's accounting procedures that would have a material effect on the reserve ratio analysis,[38] finds that South Kentucky's current 3 percent composite depreciation rate should be increased.

With regard to the depreciation rate for the AMI project, South Kentucky assigned no salvage to this asset. Having no salvage, the 6.67 percent rate represents a 15-year

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[36] Application, Exhibit 20, Section 7.

[37]

Average Annual Salvage Costs	$(1,093,501)
Times: 30 years as used for optimum curve	30
Total anticipated salvage over 30 years	(32,805,030)
Divide by: Distribution plant in service as of December 31, 2009, the test-year ended used in South Kentucky's Depreciation Study	166,785,438
Salvage Stated as a Percentage of Original Cost	(19.67)%

[38] While other sections of this Order discuss the potential overstatement of the cost of retired units due to the average cost approach, it is the Commission's opinion that the average cost approach does not materially impact the analysis of the reserve ratio for two reasons. First, any misstatement resulting from the average cost approach is reflected in both the plant in service balances and the reserve balances. Second, the effects of the average cost approach are included in the calculation of the reserve ratio for each year shown in the comparison. These facts minimize any adverse effects the average cost approach may have on the comparative analyses of the reserve ratios.

service life.[39] While South Kentucky agrees that the physical attributes of the AMI project will likely exceed 15 years, it argues that the threat of obsolescence within 15 years makes the proposed rate appropriate.[40] In further support of the proposed rate, South Kentucky notes that 12 other rural electric cooperatives have assigned a 15-year life to AMI systems.[41]

Recognizing the changes in technology by which electric power is distributed, we agree that the service life of the AMI system will not likely exceed 15 years. The Commission, therefore, finds that a 6.67 percent depreciation rate is appropriate. This is consistent with the AMI depreciation rate approved most recently for another electric cooperative.[42]

South Kentucky prepared a depreciation study to calculate deprecation rates for all assets other than the AMI system. It used survivor curves to determine the average service lives, average age, and remaining service lives of each plant account group.[43] It then developed depreciation rates using the whole-life and remaining-life methods.[44] The depreciation rates that were requested by South Kentucky were based on the whole-life method.

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[39] Application, Exhibit 20, Scope, page 3.

[40] Response to Staff's Second Request, Item 49.a.

[41] Response to Staff's Second Request, Item 49.c.

[42] Case No. 2008-00154, In the Matter of the Application of Owen Electric Cooperative, Inc. for Adjustment of Rates (Ky. PSC, June 25, 2009).

[43] Application, Exhibit 20, Sections 4, 5, and 6.

[44] The rates calculated using the remaining-life method is shown in the Application, Exhibit 20, Section 3, page 1. The whole-life rates are shown in the Application, Exhibit 20, Section 10.

The survivor curves were assigned to each distribution plant account group using a computer program designed to select the curve that best fits the plant retirement dispersion of each plant account group. Without vintage accounting information for mass property units, the Simulated Plant Record ("SPR") method was used to develop plant retirement dispersions. Simulated balances were compared to actual balances.

The depreciation study also includes an analysis of net salvage values. South Kentucky requested annual recovery of net salvage in the amount of ($1,093,501), which was calculated using the average net salvage allowance method. This method was first allowed by the Commission in Case No. 2000-00373.[45] The amount requested in this case is equal to the historic five-year average of actual net salvage costs incurred during the years 2005 - 2009.[46] To incorporate this salvage value into its composite depreciation rates, South Kentucky allocated the amounts to various plant account groups and then restated the allocated amount as a percentage of each group's original each plant account group that was based on the group's average service lives only.[47]

The Commission has concerns with the accounting data used by South Kentucky to develop its depreciation study. In the absence of vintage accounting data, South Kentucky uses the "average cost approach" to determine the cost of retirement units.[48] South Kentucky's witness stated that this results in an overstatement of the cost of retirement units which, in turn, results in an understatement of the cost of surviving

[45] Case No. 2000-00373, In the Matter of an Application for an Adjustment to Base Rates of Jackson Energy Cooperative (Ky. PSC, May 21, 2001).

[46] Application, Exhibit 20, Section 7.

[47] Application, Exhibit 20, Sections 9 and 10.

[48] January 11, 2012, Hearing, Video Transcript ("Video Transcript") at 16:19:25.

units. The witness also stated that these misstatements result in steeper survivor curves than would be assigned to plant accounts had vintage accounting data been used.[49] Based on this testimony, we find that the survivor curves assigned in South Kentucky's depreciation study do not reflect actual plant mortality. Therefore, the Commission denies South Kentucky's requested depreciation rates for distribution assets except for the rate assigned to the AMI project.

Recognizing that South Kentucky's reserve ratio analysis indicates an increase to the current deprecation rates is warranted, the Commission has developed new rates using the ranges prescribed by RUS Bulletin 183-1. To determine where within the RUS ranges South Kentucky's depreciation rates should be set, the Commission compared the depreciation expense, for all plant accounts except for meters, resulting from the use of South Kentucky's current depreciation rate, the mid-point of the RUS ranges, the high end of the RUS ranges, and the average of the mid-point and high end. This comparison is shown on page 21 in Table 4.

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[49] Video Transcript beginning at 16:21.

Table 4

	Current	RUS Bulletin 183-1 Midpoint	RUS Bulletin 183-1 Average of Midpoint and High	RUS Bulletin 183-1 High
Distribution Plant (No AMI or mechanical meters)				
Land				
Station Equipment	3.00%	2.95%	3.075%	3.20%
Poles, Towers, and Fixtures	3.00%	3.50%	3.750%	4.00%
Overhead Conductors and Devices	3.00%	2.55%	2.675%	2.80%
Underground Conduit	3.00%	2.05%	2.175%	2.30%
Underground Conductors and Devices	3.00%	2.65%	2.775%	2.90%
Line Transformers	3.00%	2.85%	2.975%	3.10%
Services	3.00%	3.35%	3.475%	3.60%
Security Lights	3.00%	4.05%	4.175%	4.30%
Street Lights	3.00%	4.05%	4.175%	4.30%
Resulting Depreciation Expense	$ 5,022,917	$ 5,105,564	$ 5,376,413	$ 5,647,262
Increase Over Expense at Current Rate		82,647	353,496	624,345
Percent of Increase		1.65%	7.04%	12.43%

As shown above, the current rate results in an expense level slightly less than the level resulting from the RUS midpoint rates. When using the RUS high rate, a significant increase to the expense occurs, greater than 12 percent. The average of the mid-point and high rates results in a less significant increase to the expense, 7 percent, and a gradual move of the reserve ratio as recommended by RUS Bulletin 183-1. The Commission finds that these average rates are reasonable and should be approved.

Amortization of Loss on Disposal of Mechanical Meters. As a result of its AMI project, South Kentucky will realize a loss on the early disposition of its existing mechanical meters in the amount of $3,723,715.[50] It asks to recognize this loss in Account 186, Miscellaneous Deferred Debits, and amortize the loss over a five-year

[50] Application, Exhibit 3, page 7.

period recognizing annual amortization expense of $744,743.[51] In support of its request, South Kentucky states that amortization over a period of three years is too short and a period longer that five years "would have the effect of recognizing an expense for periods much after the retired meters were removed from service."[52] The Commission finds that South Kentucky's request to recognize the loss in Account 186 is reasonable, but the loss should be amortized over a 15-year period for the reasons discussed below. This will result in an annual recovery of $248,248.

South Kentucky's requested accounting treatment represents a departure from regulatory accounting requirements. Section 1767.16(j)(2)(ii) of the RUS USoA governs the accounting for the retirement of depreciable assets. It states, in part, that "[i]f the retirement unit is of a depreciable class, the book cost of the unit retired and credited to electric plant shall be charged [debited] to the accumulated provision for depreciation applicable to such property. The cost of removal and the salvage shall be charged or credited, as appropriate, to such depreciation account."

Under the accounting treatment prescribed by the RUS USoA, gains and losses on the disposition of a depreciable asset are embedded in the accumulated depreciation account. Their effects are recognized in the determination of depreciation rates when the remaining life method is used. Gains have the effect of decreasing the composite rate while losses increase the rate. However, gains and losses have no impact in the determination of depreciation rates when the whole life method is used to calculate

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[51] Application, Exhibit 3, page 7.

[52] Response to Staff's Second Request, Item 33.h.

depreciation rates.[53] When using the whole life method, gains and losses remain embedded in the accumulated depreciation account with no impact on depreciation rates absent an accounting treatment alternative to that required by the RUS USoA.

In this case, South Kentucky requested, and the Commission accepted, the use of whole life deprecation rates. With the use of whole life depreciation, the loss on the disposition of meters will be carried forward in South Kentucky's property records indefinitely absent an alternative accounting treatment. Recognizing that the amount of the loss is material when compared to the meter account group's gross book balance both before and after the AMI project,[54] the Commission finds that alternative accounting is warranted so that the loss may be charged to income. The Commission therefore finds that South Kentucky's request to record the loss in account 186 is appropriate.

However, we are not persuaded by South Kentucky's proposal to use a five-year amortization period. The loss requires special accounting treatment due to the use of

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[53] When using the remaining-life method, depreciation rates are determined using net book value. The sum of an account group's net book value and net salvage value is divided by the group's average remaining life to calculate the annual accrual. The annual accrual is divided by the account group's gross book value to determine the group's composite depreciation rate. Since gains and losses are reflected in the accumulated depreciation account, they are a component of the depreciation accrued over the average remaining life of the asset group. However, the accumulated depreciation account is not considered in the determination of whole life depreciation rates. Whole life depreciation rates are based on the plant group's average service life and gross book value, not its remaining life and net book value. Therefore, with this method, gains and losses remain embedded in the accumulated depreciation account and have no impact on depreciation rates. Unless an accounting treatment alternative to that required by the USoA is allowed, gains and losses are not recognized in income.

[54] The loss of $3,723,716 represents 82 percent of $4,547,809, the gross book value of the old mechanical meters, and 19 percent of $19,636,215, the gross book value of the AMI replacement project.

the whole-life depreciation method. Had South Kentucky elected to use the remaining-life method for depreciation, there would be no need to now request special accounting treatment because the loss would have been accounted for in accordance with the RUS USoA using the accumulated depreciation account. Under remaining life depreciation, the loss would have been recognized over the 15 years average remaining life of the AMI project as a component of South Kentucky's depreciation expense.

The Commission finds that the utility's choice of a depreciation method should have no effect on the period of time over which the loss is recognized and paid for by ratepayers. If the meters had been depreciated under the remaining life method, the loss on the old meters would have been recovered over the life of the new meters, which is 15 years. Therefore, the appropriate amortization period for the loss is 15 years. The Commission's use of the 15-year amortization period will ensure that the entire cost of the AMI project, which includes the loss on mechanical meters, will be recognized over the AMI project's estimated useful life of 15 years.

Following the test year cut-off requirement as previously discussed, the amount of the annual amortization included in pro forma operations was limited to $44,238, 17.82 percent (11,837 meters replaced at test year-end / 66,436 customers at test year-end) of the $248,248 total annual amortization expense based on the number of mechanical meters removed from service as of the end of the test year.

Rate Case Expense

South Kentucky proposed estimated rate case expenses of $75,000 based on the level of costs it had incurred in previous rate cases before the Commission. South Kentucky proposed that its estimated rate-case expense be amortized over a three-year period, consistent with Commission treatment in previous rate cases.[55] This resulted in an expense adjustment of $25,000 for rate-making purposes.

The Commission's longstanding practice is to allow recovery of rate case expenses based on the utility's most recent actual costs, typically through the date of the hearing. South Kentucky's most recent actual expense, through January 27, 2012, as reported in its response to the post hearing data request, was $144,660.[56] This actual expense is significantly greater that the proposed estimated expense of $75,000 due to additional consulting services provided to South Kentucky for assistance in responding to Staff's five data requests and responding to post hearing data requests. The Commission finds that South Kentucky's rate case expense should be increased by $69,660, from $75,000 to $144,660. Amortizing this amount over three years will result in an annual expense of $48,220, which is $23,220 more than the amount proposed.

Miscellaneous Revenues and Electrical Inspection Expenses

The Commission finds that South Kentucky's miscellaneous revenues from electrical inspections and electrical inspection expenses should be decreased by $244,219 and $161,668, respectively, to reflect the discontinuation of this program.[57] The total test year electrical inspection expense was $238,855, but this amount was reduced by $77,187 to reflect the wages and benefits of an employee who worked in this program but who was transferred to another area. The salary and benefits related to this employee are an allowable expense for rate-making purposes and, therefore, are not being eliminated as part of this adjustment.

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[55] Application, Exhibit 12, Rate Case Expenses.

[56] Response to Hearing Data Request, Item 23.

[57] Id., Item 16.

PSC Assessment

South Kentucky did not propose an adjustment to its PSC Assessment to reflect the effects of normalizing revenues and purchased power expense or the impact of its proposed revenue increase. The Commission has determined that an adjustment to the PSC Assessment to reflect the normalization of revenue and purchased power expense found reasonable herein is appropriate. Based on the 2010–2011 assessment rate, the adjustment results in a $7,046 increase in the PSC Assessment for the test year. The Commission has determined that an adjustment to the PSC Assessment based on the revenue increase being granted herein should also be calculated. This calculation results in an increase in the PSC Assessment Fee of $5,672. The total result of these adjustments is an increase of $12,718 in the PSC Assessment Fee.

Prior Rate Case Expense

The Commission finds that an adjustment of $7,797 should be made to eliminate the rate case expense included in the test year that was related to South Kentucky's prior (2005) rate case. The amortization of this expense was completed during the first two months of the test year. As such, it will not be a recurring expense and it has been eliminated for rate-making purposes.

Economic Development Expense

The Commission finds that the expense of $200,214 related to South Kentucky's economic development contract should be eliminated for rate-making purposes. South Kentucky stated that this contract was cancelled after the test year and that it will not be renewed. Thus, this is a nonrecurring expense which should be removed for rate-making purposes.

Meter Related Cost Savings Due to AMI Deployment

The Commission finds that an adjustment should be made to decrease test year meter related expenses by $155,502 due to South Kentucky's deployment of AMI. With the AMI deployment, costs such as meter expense and meter reading expense will be reduced, requiring an adjustment to these expenses for rate making purposes. The adjustment is based on the AMI deployment of 17.82 percent as of the end of the test year, consistent with the depreciation adjustment discussed earlier in this Order, and the net cost savings projected by South Kentucky.[58]

Pro Forma Adjustments Summary

The effect of the pro forma adjustments on South Kentucky's net income is as follows:

	Actual Test Period	Pro Forma Adjustments	Adjusted Test Period
Operating Revenues	$122,728,201	$(771,118)	$121,957,083
Operating Expenses	114,089,960	(1,250,450)	112,839,510
Net Operating Income	8,638,241	(479,332)	9,117,573
Interest on Long-Term Debt	6,087,075	207,638	6,294,713
Interest Expense-Other	59,074		59,074
Other Deductions	65,474	(60,790)	4,684
NET INCOME	$ 2,426,618	$ (332,484)	$ 2,759,102

REVENUE REQUIREMENTS

South Kentucky's adjusted test year rate of return on net investment rate base was 5.23 percent.[59] Its test year Time Interest Earned Ratio ("TIER"), excluding G&T Capital Credits, was 1.44[60] and its equity ratio was 21 percent.

[58] Response to Item 12 of Staff's Third Request.

[59] Net Operating Inc. of $8,638,241 / Net Investment Rate Base of $165,178,508.

[60] Response to Item 14 of Staff's Third Request, page 1.

South Kentucky based its requested increase on an "equity growth and capital credit rotation" model.[61] Using that model, South Kentucky set a goal to increase its equity ratio to 35 percent over a period of 15 years while restarting its past practice of making general rotations of capital credits. This approach produced a revenue increase resulting in a TIER of 2.43 and a return on net investment rate base of 9.03 percent.

South Kentucky's current policy is to not make general rotations of capital credits. This current policy took effect in January 2007 shortly after its previous general rate case, Case No. 2005-00450, in which the Commission's acceptance of a settlement between the utility and the Attorney General's Office relieved South Kentucky of the requirement that it make general rotations of capital credits for amounts earned above a 2.00 TIER.[62] Although it has made no general rotations of capital credits since that last rate case, South Kentucky's equity ratio has declined, from 23 percent in 2005, ranging between 18 and 21 percent from 2006 through the end of the test period.

South Kentucky's policy reflects a goal of maintaining an equity ratio between 30 and 40 percent, with the midpoint of that range, 35 percent, being the target used in this rate application. For distribution cooperatives, which can rely largely on RUS for financing and which are not required to seek capital from private markets, the Commission believes this to be a reasonable equity range. Of the 19 distribution cooperatives under Commission jurisdiction, 8 had equity ratios between 30 and 40 percent at the end of 2010, the latest year for which such data is available. Eight

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[61] This model has been the basis for the rate increase requests of other electric distributive cooperatives, the most recent being the request of Meade County Rural Electric Cooperative Corporation in Case No. 2010-00222.

[62] That requirement was implemented in a settlement reached between South Kentucky and the Commission Staff in South Kentucky's 1989 rate case.

cooperatives had equity ratios below 30 percent at that time and three had equity ratios above 40 percent. South Kentucky and one other cooperative had equity ratios below 25 percent at the end of 2010.

Given how far South Kentucky is below the 35 percent equity ratio set as its goal, the Commission finds that it is reasonable to authorize a TIER greater than the 2.0 TIER typically granted in recent rate cases. However, under current economic conditions, we believe strongly that consumers are better served with a lesser increase in rates, without an explicit effort to rotate capital credits, than that which would result under South Kentucky's approach, which explicitly provides for the general rotation of capital credits.

The higher TIER awarded herein is intended for South Kentucky to increase its equity level until such time as it can pay capital credits without diminution of its cash flow or equity level. In this instance, the need for a stronger equity position is a major factor in the Commission's determination of South Kentucky's revenue requirement. However, other factors are of like importance in determining South Kentucky's revenue requirement, and ultimately, the amount of increase awarded. Those other factors are (1) the rate impacts on customers and (2) maintaining consistency in Commission rate decisions for electric distribution cooperatives.

The Commission finds, in this instance, that a 2.10 TIER is reasonable. Based on the pro forma adjustments found reasonable herein, the Commission has determined that, in order to produce a TIER of 2.10, South Kentucky will require an increase in revenues of $3,715,879. This should produce net operating income of $6,929,856, resulting in a 8.01 percent return on South Kentucky's net investment rate base found reasonable herein.

PRICING AND TARIFF ISSUES

Cost of Service

South Kentucky filed a fully allocated cost-of-service study ("COSS") for the purpose of determining the cost to serve each customer class and the amount of revenue to be allocated to each customer class. The Commission has reviewed South Kentucky's COSS and finds it to be acceptable for use as a guide in allocating the revenue increase granted herein.

South Kentucky proposed that four customer classes, Residential, Small Commercial, All Electric School, and Large Power 3, each receive the full increase indicated by the COSS. South Kentucky proposed a 4.5 percent increase for the Large Power class.[63] Although the COSS supported significant increases for the Street Lighting and Optional Power classes, South Kentucky proposed to temper the increases by holding them to approximately 15 percent. And finally, South Kentucky proposed to move its Residential ETS and Small Commercial ETS marketing rates closer to the rates indicated by the COSS.[64] The COSS indicated that the remaining classes were providing revenues in excess of the costs to serve them; accordingly, no increases were proposed for those classes. In addition, no changes are being proposed to South Kentucky's non-recurring charges or cable television attachment rates.

Revenue Allocation

The increase of $3,715,879 approved in this Order equates to an increase in

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[63] The COSS supported an increase of approximately 1 percent for this class.

[64] For Residential ETS customers under contract, South Kentucky proposed that the ETS remain at 60 percent of the regular Residential energy rate. For those not under contract, the rate would increase in three equal steps closer to the COSS rate. For Commercial ETS customers, the rate would move closer to the COSS rate in one step.

base rate revenue of 3.12 percent. This is roughly 40 percent of the increase South Kentucky requested. As discussed above, South Kentucky's proposed increases to the various rate classes were based largely on its COSS results. The Commission has reviewed South Kentucky's allocation proposal and finds it to be reasonable. Therefore, the $3,715,879 increase granted herein will be allocated to the customer classes using the same proportions between rate classes as proposed by South Kentucky. However, two exceptions will be made to this methodology as follows:

1. Outdoor Lighting class. During discovery, it was determined that an error had been made in South Kentucky's COSS.[65] Correcting for that error results in the COSS supporting an increase of 9.5 percent for the Outdoor Lighting class, a class for which South Kentucky proposed no increase. This class will receive the increase justified by the corrected COSS with it then being reduced using the proportional method described above, which results in an increase for the class of 3.84 percent.

2. Street Lighting class. South Kentucky's Street Lighting class has two different rates and eight lights that are charged one of the two rates based on the number of lumens applicable to each light. One rate applies to lights within a range of 7,000-10,000 lumens and the second (higher rate) applies to lights within a range of 15,000-28,000 lumens. However, there are lights in this class with lumens that fall either between these two ranges or above the upper end of the higher range. At the hearing, South Kentucky was asked to provide ranges that would capture all lights given the lumens listed for each light. It provided ranges of 7,000-13,000 lumens and 15,000-

[65] Response to Items 10.a. and 10.e. of Staff's Third Request.

50,000 lumens.[66] South Kentucky has been charging two street lights at the lower rate when those lights have lumens that would place them in range for the higher rate. These two street lights are the 400 watt 19,100 lumen mercury vapor light and the 160 watt 15,000 lumen sodium light. If the Commission accepts South Kentucky's proposed ranges, these two street lights would receive 76 percent increases at approved rates. The Commission has long employed the principal of gradualism and will do so in this case by setting the lumen ranges at "0-20,000 Lumens" for the lower rate and "Over 20,000 Lumens" for the higher rate. The resetting of the lumen ranges will result in a 34 percent rate reduction for one light in this class[67] and a 7.7 percent increase for the remaining lights using the proportional method described above.

Rate Design

South Kentucky argues that it should be allowed to increase its customer charges because of its comprehensive collection of demand-side management ("DSM") programs. South Kentucky states it "is a leader in the promotion of DSM and has been involved in DSM since the 1980s."[68] South Kentucky asserts that increasing the customer charges for the Residential and Small Commercial classes will increase its opportunity to continue and expand its DSM offerings.[69] The Commission agrees and commends South Kentucky for its commitment to DSM and energy efficiency programs. South Kentucky is strongly encouraged to continue its efforts and to pursue additional

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[66] Response to Item 15 of the Hearing Data Request.

[67] This light is the 250 watt Flood 12,100 lumen mercury vapor light which falls between South Kentucky's lumen ranges, but was being charged at the rate for the higher lumen range.

[68] Exhibit H-3 of the application, Prepared Testimony of James R. Adkins at 14.

[69] Id. at 15.

DSM and energy efficiency programs in the future. The Commission notes that the increases to the customer charges are also supported by South Kentucky's COSS. Therefore, the Commission finds that the increases to the Residential and Small Commercial classes should be allocated entirely to the customer charges. For all other classes receiving an increase (excluding the lighting classes), the customer charge and demand charge increases will be accepted as proposed by South Kentucky with the energy charges adjusted as necessary to achieve the class's revenue increase.

Customer charges as approved are shown in the following table:

Rate Class	Current	Utility Proposed	Approved
A - Residential	$ 9.14	$ 15.00	$ 12.82
B - Small Commercial	$ 17.14	$ 25.00	$ 23.79
LP - Large Power Rate	$ 34.28	$ 50.00	$ 50.00
OPS - Optional Power Service	$ 34.28	$ 50.00	$ 50.00
LP3 - Large Power	$ 142.85	$145.86	$ 145.86
AES - All Electric Schools	$ 79.28	$ 83.02	$ 83.02

Finally, the Commission will approve South Kentucky's proposed Residential ETS three-step rates for customers without contracts and its proposed Small Commercial ETS rate. The Residential ETS rate for customers with contracts, which is calculated as 60 percent of the Residential energy rate, will not change as no change is being made to the Residential energy rate.[70]

With the increase approved in this Order, the average Residential customer using 1,150 kWh will see a monthly increase of $3.68, or 3.43 percent.

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[70] South Kentucky's billing analysis provided total kWh usage for the Residential ETS class as a whole. When calculating revenues to be provided by the Residential ETS class using the rates approved in this Order, the kWh usage was allocated between contract and non-contract customers using the number of contract versus non-customers provided by South Kentucky in response to Item 13 of the Hearing Data Request.

OTHER ISSUES

Maintenance of Overhead Lines Right-of-Way ("ROW") - Account 593.50

During the test year, South Kentucky incurred $3.448 million in expense for maintenance of overhead lines ROW. In the 12 months immediately preceding the test year, it incurred $2.5 million for this expense. South Kentucky stated that this expense increased during the test year due to the concerns of a recent ice storm that hit the surrounding utilities and the Commission's subsequent inquiries into service restoration practices.[71] In light of these events, South Kentucky decided to take a more aggressive approach to its maintenance of overhead lines ROW. The Commission commends South Kentucky for taking a more aggressive approach in this area and encourages it to continue this effort.

Directors Expenses - Account 930.21

South Kentucky recorded expenses of $565,435 in this account in the test year compared to $233,491 in the 12 months immediately preceding the test year. $415,694 of the test year amount was for health insurance premiums and deferred compensation paid to or on behalf of the board of directors. The Commission has historically disallowed health insurance premiums and deferred compensation paid to or on behalf of the board of directors for rate-making purposes and disallows this expense in this case as proposed by South Kentucky. $333,876 was for deferred compensation to board members authorized under South Kentucky's Policy "H" and reflects the cumulative impact of amounts that should have been booked as a liability over several years, so it was the correct action from an accounting perspective. However, the Commission believes South Kentucky should be reminded to consider its financial

[71] Response to Item 21.e. of Staff's Second Request.

position as well as its equity management policy when making such decisions in order to minimize negative financial impacts.

Proposed New Headquarters Building

Almost two years ago, the Commission granted South Kentucky a Certificate of Public Convenience and Necessity ("CPCN") under KRS 278.020(1) to construct a new headquarters and related operation facility.[72] In response to inquiries in this case South Kentucky stated that it had not started construction of that facility and that its rate request in this proceeding contained no impacts related to the construction.[73] South Kentucky further indicated that rather than building a new headquarters facility, it was considering the possibility of purchasing an existing facility and rebuilding to meet its needs. The CPCN statute expressly provides that:

> "Unless exercised within one (1) year from the grant thereof, exclusive of any delay due to the order of any court or failure to obtain any necessary grant or consent, the authority conferred by the issuance of the certificate of convenience and necessity shall be void, but the beginning of any new construction or facility in good faith within the time prescribed by the. commission and the prosecution thereof with reasonable diligence shall constitute an exercise of authority under the certificate."[74]

South Kentucky did not start construction of its new headquarters facility within one year of the issuance of the CPCN, and the delay was not due to any court order or

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[72] Case No. 2008-00371, Application of South Kentucky Rural Electric Cooperative Corporation for a Certificate of Public Convenience and Necessity to Construct a New Headquarters Facility in Somerset, Kentucky (Ky. PSC May 11, 2010).

[73] See the Response to Item 35.b.(4) of Staff's Second Request and the Video Transcript at 10:27:19.

[74] KRS 278.020(1).

failure to obtain a necessary grant or permit. Consequently, the CPCN issued in Case No. 2008-00371 has lapsed and is void. In the event South Kentucky decides to pursue a new headquarters facility, either through a new construction or reconstruction of another building, it must file a new application for a new CPCN under the provisions of KRS 278.020(1).

SUMMARY

The Commission, after consideration of the evidence of record and being otherwise sufficiently advised, finds that:

1. The rates set forth in Appendix C to this Order are the fair, just, and reasonable rates for South Kentucky to charge for service rendered on and after the date of this Order.

2. The rate of return and TIER granted herein are fair, just, and reasonable and will provide for South Kentucky's financial obligations.

3. The rates proposed by South Kentucky would produce revenue in excess of that found reasonable herein and should be denied.

IT IS THEREFORE ORDERED that:

1. The rates and charges proposed by South Kentucky are denied.

2. The rates in Appendix C to this Order are approved for service rendered by South Kentucky on and after the date of this Order.

3. Within 20 days of the date of this Order, South Kentucky shall file new tariff sheets setting forth the rates and charges approved herein and reflecting their effective date and that they were authorized by this Order.

By the Commission

ENTERED
MAR 30 2012
KENTUCKY PUBLIC SERVICE COMMISSION

ATTEST:

Executive Director

APPENDIX A
South Kentucky's Request Depreciation and Amortization Adjustment

	Depreciable Basis	Requested Rate	Pro forma Depreciation
Distribution Plant			
Land	$ 52,264		
Station Equipment	864,832	6.67%	$ 57,684
Poles, Towers, and Fixtures	49,248,403	4.17%	2,053,658
Overhead Conductors and Devices	51,967,266	4.30%	2,234,592
Underground Conduit	425,821	2.69%	11,455
Underground Conductors and Devices	5,746,724	4.82%	276,992
Line Transformers	31,935,654	2.22%	708,972
Services	20,469,544	4.23%	865,862
Meters, AMI Project	19,636,215	6.67%	1,309,736
Security Lights	6,122,251	5.02%	307,337
Street Lights	650,070	7.52%	48,885
Total Distrbution Plant	187,119,044		7,875,173
		Current/Requested Rate	
General Plant			
Land	2,945,856		
Structures and Improvements	9,146,231	2.00%	182,925
Office Furniture and Equipment	204,136	6.00%	12,248
Computer Equipment	1,055,176	15.00%	158,276
Transportation Equipment	3,382,912	15.00%	507,437
Stores	163,507	6.00%	9,810
Tools, Shop and Garage	129,755	6.00%	7,785
Laboratory	195,823	6.00%	11,749
Power Operated Equipment	47,967	12.00%	5,756
Communication Equipment	2,415,458	6.00%	144,927
Miscellaneous	305,468	6.00%	18,328
Total General Plant	19,992,289		1,059,243
Grand Total	$ 207,111,333		8,934,416
Less: Charged to Non-Regulated Operations			(1,296)
Charged to Clearing Accounts			(507,437)
Pro forma Depreciation Expense			8,425,683
Plus: Five-Year Amortization of $3,723,716 Loss on Disposal of Meters			744,743
Requested Pro forma Depreciation and Amortization			9,170,426
Less: Test year			(5,618,934)
Increase			$ 3,551,492

APPENDIX B

Commission's Approved Depreciation and Amortization Adjustment

	Depreciable Basis	Rate	Pro forma Depreciation
Distribution Plant			
Land	$ 52,264		
Station Equipment	864,832	**3.075%**	**$ 26,594**
Poles, Towers, and Fixtures	49,248,403	**3.750%**	**1,846,815**
Overhead Conductors and Devices	51,967,266	**2.675%**	**1,390,124**
Underground Conduit	425,821	**2.175%**	**9,262**
Underground Conductors and Devices	5,746,724	**2.775%**	**159,472**
Line Transformers	31,935,654	**2.975%**	**950,086**
Services	20,469,544	**3.475%**	**711,317**
Meters, Existing Mechanical Meters	**3,737,389**	**3.275%**	**122,400**
Meters, AMI Project	**4,615,202**	6.670%	**307,834**
Security Lights	6,122,251	**4.175%**	**255,604**
Street Lights	650,070	**4.175%**	**27,140**
Total Distrbution Plant	**175,835,420**		**5,806,646**
General Plant			
Land	2,945,856		
Structures and Improvements	9,146,231	2.00%	182,925
Office Furniture and Equipment	204,136	6.00%	12,248
Computer Equipment	1,055,176	15.00%	158,276
Transportation Equipment	3,382,912	15.00%	507,437
Stores	163,507	6.00%	9,810
Tools, Shop and Garage	129,755	6.00%	7,785
Laboratory	195,823	6.00%	11,749
Power Operated Equipment	47,967	12.00%	5,756
Communication Equipment	2,415,458	6.00%	144,927
Miscellaneous	305,468	6.00%	18,328
Total General Plant	19,992,289		1,059,243
Grand Total	**$ 195,827,709**		**6,865,889**
Less: Charged to Non-Regulated Operations			(1,296)
Charged to Clearing Accounts			(507,437)
Pro forma Depreciation Expense			**6,357,156**
Plus: Amortization of Loss on Early Disposal of Mechanical Meters			**44,238**
Pro forma Depreciation and Amortization			**6,401,394**
Less: Test year			(5,618,934)
Increase			**$ 782,460**

APPENDIX C

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2011-00096 DATED MAR 3 0 2012

The following rates and charges are prescribed for the customers in the area served by South Kentucky Rural Electric Cooperative Corporation. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of the Commission prior to the effective date of this Order.

SCHEDULE A
RESIDENTIAL, FARM AND NON-FARM SERVICE

Customer Charge per Month	$ 12.82
Energy Charge per kWh	$ .08543

SCHEDULE A (ETS)
RESIDENTIAL, FARM AND NON-FARM SERVICE
MARKETING RATE

Customers with Contracts:	
Energy Charge per kWh	$ .05126
Customers without Contracts:	
Energy Charge per kWh:	
Year 1	$ .05519
Year 2	$ .05911
Year 3	$ .06304

SCHEDULE B
SMALL COMMERCIAL RATE

Customer Charge per Month	$ 23.79
Energy Charge per kWh	$ .09718

SCHEDULE B (ETS)
SMALL COMMERCIAL
MARKETING RATE

Energy Charge per kWh	$ .07004

SCHEDULE LP
LARGE POWER RATE

Customer Charge per Month	$ 50.00
Demand Charge per kW	$ 7.00
Energy Charge per kWh	$ .06007

SCHEDULE LP-3
LARGE POWER RATE 3 (500 kW TO 2,999 kW)

Metering Charge	$ 145.86
Substation Charge – 500-999 kW	$ 367.59
Substation Charge – 1,000-2,999 kW	$1,101.60
Contract Demand Charge per kW	$ 6.29
Excess Demand Charge per kW	$ 9.13
Energy Charge per kWh	$ .05153

SCHEDULE AES
ALL ELECTRIC SCHOOL SCHEDULE

Customer Charge per Month	$ 83.02
Energy Charge per kWh	$ .07962

SCHEDULE OPS
OPTIONAL POWER SERVICE

Customer Charge per Month	$ 50.00
Energy Charge per kWh	$ .10430

SCHEDULE STL
STREET LIGHTING SERVICE

Rate per Light per Month as Follows:

Mercury Vapor or Sodium	0-20,000 Lumens	$ 8.64
Mercury Vapor or Sodium	Over 20,000 Lumens	$ 14.13

SCHEDULE OL
OUTDOOR LIGHTING SERVICE-SECURITY LIGHTS

Rate per Light per Month as Follows:

Mercury Vapor or Sodium 7,000-10,000 Lumens (Unmetered)	$ 10.56
Mercury Vapor or Sodium 7,000-10,000 Lumens (Metered)	$ 7.51

Directional Flood Light:

250 Watt	Sodium (Unmetered)	$ 16.91
250 Watt	Sodium (Metered)	$ 9.53
250 Watt	Metal Halide (Unmetered)	$ 18.31
250 Watt	Metal Halide (Metered)	$ 10.61
400 Watt	Metal Halide (Unmetered)	$ 22.87
400 Watt	Metal Halide (Metered)	$ 10.61
1,000 Watt	Metal Halide (Unmetered)	$ 40.56
1,000 Watt	Metal Halide (Metered)	$ 11.85

Allen Anderson
Manager
South Kentucky R.E.C.C.
925-929 N. Main Street
P. O. Box 910
Somerset, KY 42502-0910

Stephen Johnson
Vice President of Finance
South Kentucky R.E.C.C.
925-929 N. Main Street
P. O. Box 910
Somerset, KY 42502-0910

Honorable Darrell L Saunders, P.S.C.
Attorney at Law
700 Master Street
P.O. Box 1324
Corbin, KENTUCKY 40702