

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF SHELBY ENERGY COOPERATIVE,)	
INC. FOR A CERTIFICATE OF PUBLIC CONVENIENCE)	Case No.
AND NECESSITY FOR ITS 2010-2014)	2010-00244
CONSTRUCTION WORK PLAN)	

ORDER

Shelby Energy Cooperative, Inc. ("Shelby") filed its application on July 23, 2010 for a Certificate of Public Convenience and Necessity ("CPCN") to construct certain improvements and additions to its existing plant at an estimated cost of \$19,645,739. In support of its application, Shelby filed its 2010-2014 Construction Work Plan ("CWP"), which describes in detail the improvements and additions to its plant that are required over the next four years to serve its load.

Shelby seeks authorization to construct extensions and additions to its plant as follows:

New Distribution Line	\$2,864,078
Line Conversion & Improvement	6,244,027
Miscellaneous Equipment & Poles	7,261,154
Security Lights	316,480
AMI – Meters and Substations	<u>2,960,000</u>
TOTAL	\$19,645,739 ¹

The CWP covers a four-year period and is designed to serve an expected load of 125 MW for the 2014 winter peak.

¹ Shelby's application requests approval of a Construction Work Plan totaling \$16,685,739; however, the application also included an amendment for an additional \$2,960,000 for AMI equipment.

Shelby stated that it is currently in the process of replacing all of its old electric meters, and is installing an advanced metering infrastructure ("AMI") system. Shelby stated that it evaluated bids from vendors of Cannon, Hunt, Landis & Gyr, and TWACS. It chose to purchase the TWACS meters because they have certain advantages over the other meter brands, including the speed at which the meters can be read. The TWACS was less expensive than the Cannon system, but more expensive than the Hunt system. TWACS allows for more Smart Grid functions, such as an in-home display. The TWACS system also does not need the repeaters that the Cannon and Hunt systems needed.

Shelby stated that the TWACS system has been employed by a number of other cooperatives that expressed satisfaction with it. Shelby's Board of Directors has been considering an AMI system for a number of years, but it did not want Shelby to be the first adopter. The Board wanted to learn from other utilities' experiences before making a decision about which system to use.

On March 22, 2010, Shelby submitted its proposal to the Kentucky Department for Energy Development and Independence ("DEDI") regarding a request for proposals for Utility Smart Grid Initiative ("USGI"). Shelby's proposal consisted of a number of components, most of which were enhancements to the AMI system that it was already planning to install. The components included distribution automated equipment consisting of conservation voltage reduction to lower energy losses and peak demand by reducing voltages during critical times, and automated reclosers on substations feeders to improve reliability to customers. Shelby estimated the cost of the components in the DEDI proposal to be \$528,000, and it was successful in receiving a

\$264,000 grant from DEDI. According to Shelby, the components of its proposal would provide:

- End-user energy savings of 1.5 percent;
- Approximately 6,000 kWh of green-energy produced via PV demo installation;
- Peak load reduction of two percent;
- System losses improvement of one percent; and
- Reliability indices (CAIDI, SAIDI and SAIFI) improvement of 35 percent (excluding major storms).

On August 3, 2010, Shelby notified DEDI that it was withdrawing its participation in the USGI project. Shelby states the implementation of the USGI project was totally dependent on having the AMI system installed and operational. The AMI meters were not delivered to Shelby until September 2010 and installation did not begin until October 2010, which is six months after the start date anticipated in the original proposal. Shelby decided that it would be unable to finish all phases of the USGI project unless the time for each phase was accelerated substantially. Shelby states that this would result in considerably more cost through overtime for its employees and substantial use of contracted and consulting personnel. Shelby estimated the additional cost to meet the deadline for the USGI project to be \$265,628. However, Shelby stated in response to a data request that it, "continues to believe in the viability of the described projects and foresees completion of such in the future; a timeline has not been established but expectations would be in the 12-18 month horizon."²

² Response to Item 2.c.(1) of Commission Staff's Fourth Information Request.

Shelby states that no construction on any portion of the 2010-2014 CWP started prior to filing this application on July 23, 2010; however, some work was done after filing this case. As of May 4, 2011, Shelby had begun work on a project identified as the Batt's Lane project at a cost of approximately \$78,000. In addition, the AMI project, as identified in the amendment to the CWP, is substantially complete.

On May 12, 2011, Shelby filed a Memorandum of Law in response to the May 5, 2011 Informal Conference. Therein, Shelby states that it did not need a CPCN for the AMI project of \$2.96 million because the project falls within one of the two exemptions set forth in the CPCN statute, KRS 278.020(1). The first exemption is for "retail electric suppliers for service connections to electric-consuming facilities located within its certified territory." Shelby argues that, as a retail electric supplier, its installation of AMI is an integral part of the service connections to its member/customers and, consequently, the AMI project falls within the "service connection" exemption from the requirement to obtain a CPCN.

The second statutory exemption is for "ordinary extensions of existing systems in the usual course of business." This exemption is further defined by Commission regulation 807 KAR 5:001, Section 9(3), which states that no CPCN is needed if the extension does not create wasteful duplication of facilities, does not conflict with existing certificates or service of other jurisdictional utilities in the same area, does not involve sufficient capital to materially affect the existing financial condition of the utility, and does not result in increased charges to its customers. Shelby argues that the "ordinary extension" exemption applies because: 1) existing meters are being replaced, so there is no wasteful duplication; 2) the AMI program does not conflict with existing certificates

or service of other utilities in the area; 3) the AMI program is funded with internally generated funds, so it does not involve sufficient capital to materially affect Shelby's existing financial condition; and 4) the AMI project will not result in increased charges to Shelby's customers.

Shelby's Memorandum of Law also cites a statement by Commission Staff at a water district commissioner training program that if a new project does not exceed five percent of a utility's plant, no CPCN is needed. Shelby states that, as of the end of 2009, its total plant value was \$71 million and its distribution plant value was \$64.6 million, so the AMI project at approximately \$3 million is less than five percent of Shelby's plant. Finally, Shelby argues that no approval was needed for financing the cost of the AMI project because all costs were paid for by internally-generated funds and no debt was incurred.

Based on the evidence of record, including Shelby's Memorandum of Law, the Commission finds that Shelby's AMI program does not qualify for either of the exemptions for obtaining a CPCN. As to the "service connection" exemption, Shelby already has a service connection with each of its customers. The purpose of installing AMI is not to make a service connection, but rather to replace and enhance the existing service connection with each customer. As to the "ordinary extension" exemption, the premature replacement of existing meters clearly constitutes a duplication of facilities, and this can only be determined to be a non-wasteful duplication after a full investigation of all of the facts by the Commission. As to the capital outlay for this project, the almost \$3 million cost would materially affect the utility's financial condition if the cost was not recoverable from ratepayers due to a Commission finding that the

project was either not needed or created wasteful duplication. In addition, although, over a 15-year analysis, the AMI program is less costly than continuing to use the existing mechanical meters, the AMI is more costly over the first five years. Thus, it is likely to result in increased charges to ratepayers.

As to the use of a five-percent rule for determining when a CPCN is required, the Commission speaks through its orders, not through its staff. Although a five-percent rule of thumb is easy to apply, it is not in our regulations and KRS 13A.130(1) prohibits an agency from having an internal policy that modifies, expands, or limits a statute or regulation. In addition, a five-percent rule may exempt review of projects that the Commission has repeatedly determined need to be reviewed, such as the construction of new service or headquarters buildings. In any event, if a five-percent rule were applied here, Shelby would not pass. The value it cites for its plant is its undepreciated original cost, not its net cost. As of the end of 2009, Shelby's net book value of plant in service was \$53.2 million. Five percent of that value results in a \$2.66 million threshold, whereas the AMI project will cost almost \$3 million.³

In addition, Shelby was formally notified by the Commission of the need to seek a CPCN for its AMI program. In the July 27, 2010 Order in Shelby's last rate case, the Commission stated that, "any projects involving significant capital investment by the cooperative, such as AMI, must be included in a work plan that is filed with the Commission and approved by our issuance of a CPCN prior to proceeding with any

³ Up until 1981, the Commission utilized a 10-percent rule of thumb to determine when a CPCN was required. "The Commission presumes that a new construction project of less than 10 percent of the net investment of the utility would not 'materially alter the existing financial condition of the utility' or 'result in increased charges.'" ADT v Utility Regulatory Comm'n, 619 S.W.2d 504, 506 (Ky. Ct. App, 1981).

project activities.”⁴

Shelby finances its construction projects with loans from the Rural Utilities Service (“RUS”), an agency of the federal government. As such, any RUS loan is exempt from Commission approval of financing under KRS 278.300(10). However, an exemption from approval of financing under KRS 278.300 does not create an exemption for approval of construction under KRS 278.020.

For these reasons, the Commission finds that Shelby should have received Commission approval under KRS 278.020(1) prior to beginning construction of the AMI. The Commission will, by separate Order, initiate another proceeding to investigate whether Shelby should be assessed a penalty under KRS 278.990 for beginning construction of the AMI prior to receiving a CPCN.

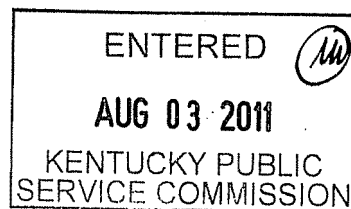
The Commission further finds that the proposed projects and additions to be constructed by Shelby are necessary to provide adequate, reliable electric service to existing customers and anticipated new customers. In addition, the proposed construction will not result in wasteful duplication of facilities. The Commission also finds that, within 30 days, Shelby should file a timeline for installing the components that were included in its DEDI project since Shelby has stated that it will proceed with those components. Shelby should include in this filing a list of the components that it does not plan to install and the reasons for not going forward with those items. Shelby should also be required to file annually, for three years, a report of its progress on installing the components and a quantification of the benefits.

⁴ Case No. 2009-00410, Application of Shelby Energy Cooperative, Inc. for an Adjustment of Rates (Ky. PSC Jul. 27, 2010).

IT IS HEREBY ORDERED that:

1. Shelby is granted a CPCN to construct the facilities described in its 2010-2014 CWP.
2. Within 30 days from the date of this Order, Shelby shall file a timeline for installing the components that were included in its DEDI project. Shelby should include in this filing a list of the components that it does not plan to install and the reasons for not going forward with those items. Shelby shall also file annually for three years a report of its progress on installing the components and a quantification of the benefits.
3. By separate order, the Commission will establish a proceeding to investigate Shelby's commencement of construction on its 2010-2014 CWP prior to obtaining a CPCN.
4. Any documents filed in the future pursuant to ordering paragraph 2 herein shall reference this case number and shall be retained in the utility's general correspondence file.

By the Commission



ATTEST:

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