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January 13, 2015

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PUBLIC SERVICE
COMMISSION

Via Hand Delivery

Mr. Jeffrey Derouen
Executive Director
Kentucky Public Service Commission
P.O. Box 615
211 Sower Boulevard
Frankfort, KY 40602

Re: In the Matter of: An Examination by the Public Service Commission of the Environmental Surcharge Mechanism of East Kentucky Power Cooperative, Inc. for the Six-Month Billing Period Ending December 31, 2013 and the Pass Through Mechanism for its Sixteen Member Distribution Cooperatives PSC Case No. 2014-00051

Dear Mr. Derouen:

Enclosed please find for filing with the Commission in the above-referenced case an original and ten (10) copies of the Brief of South Kentucky Rural Electric Cooperative Corporation. Please return a file-stamped copy to me.

Do not hesitate to contact me if you have any questions.

Sincerely,

David S. Samford

Enclosures

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JAN 13 2015

PUBLIC SERVICE
COMMISSION

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

IN THE MATTER OF:

AN EXAMINATION BY THE PUBLIC SERVICE)
COMMISSION OF THE ENVIRONMENTAL)
SURCHARGE MECHANISM OF EAST KENTUCKY)
POWER COOPERATIVE, INC. FOR THE SIX-MONTH)
BILLING PERIOD ENDING DECEMBER 31, 2013,)
AND THE PASS THROUGH MECHANISM FOR ITS)
SIXTEEN MEMBER DISTRIBUTION COOPERATIVES)

CASE NO.
2014-00051

BRIEF OF SOUTH KENTUCKY RURAL ELECTRIC COOPERATIVE CORPORATION

Comes now South Kentucky Rural Electric Cooperative Corporation ("South Kentucky") by counsel, and, pursuant to the Commission's direction at the conclusion of the hearing held in this matter on December 16, 2014, hereby tenders its Brief upon certain legal issues which have arisen in this proceeding, respectfully stating as follows:

I. BACKGROUND

South Kentucky is a rural electric cooperative corporation formed under Chapter 279 of the Kentucky Revised Statutes. It serves 66,211 Members in parts of eleven Kentucky counties, including: Pulaski, Russell, Wayne, Clinton, McCreary, Casey, Lincoln, Adair, Rockcastle, Cumberland and Laurel Counties. South Kentucky has 6,711 miles of distribution lines with an average customer density of 9.78 Members per mile. South Kentucky's headquarters is in Somerset and four service centers are located in Albany, Monticello, Russell Springs and Whitley City.

The Commission initiated this case as a six month review of the environmental surcharge mechanism of East Kentucky Power Cooperative, Inc. ("EKPC") on March 6, 2014. The period under review began on July 1, 2013 and concluded on December 31, 2013. As part of the proceeding, the Commission also reviewed the environmental surcharge pass-through mechanism employed by each of the sixteen Members of EKPC, including South Kentucky. In all, South Kentucky responded to six rounds of data requests and participated in three informal conferences. A hearing was held on December 16, 2014, in which South Kentucky's Vice President of Finance, Ms. Michelle Herrman, was subject to cross-examination from the Commission's Staff and the Commission. With the filing of this brief, the case stands submitted for final adjudication.

II ARGUMENT

South Kentucky supports the position of EKPC and the other fifteen Member distribution cooperatives who are asking the Commission to exclude the figure for prior amortized over- and under-recoveries when calculating the environmental surcharge on a prospective basis.¹ South Kentucky agrees that this change will help alleviate the significant swings between over- and under-recoveries that EKPC's Members have experienced and should result in greater rate stability and predictability for retail customers. However, due largely to timing issues beyond anyone's control, South Kentucky finds itself in a position where it would be inequitable and unjust to change this method for calculating the environmental surcharge without first taking into consideration the historic under-collection of prior environmental surcharge expenses that South Kentucky has incurred. In short, South Kentucky has paid substantially more to EKPC for environmental costs than it has recovered from its own retail customers. If the Commission fails

¹ See Hearing Video Record ("HVR"), 10:22:20 AM (Dec. 16, 2014) (explanation of the calculation changes explained by Mr. Isaac Scott); *Id.*, 11:00:42 (South Kentucky's support for the calculation change reiterated by Ms. Michelle Herrman).

to take this circumstance into account, South Kentucky will be severely prejudiced and its financial condition will materially deteriorate through no fault of its own. Such a result is plainly inconsistent with the spirit and letter of the environmental surcharge.

A. Overview of KRS 278.183, the Environmental Surcharge Statute

The environmental surcharge, codified in KRS 278.183, is intended to provide “a mechanism whereby electric utilities...are entitled to immediately recover environmental compliance costs through a special environmental surcharge rather than having to wait until a general rate case to seek recoupment.” *Com., ex rel. Stumbo v. Kentucky Public Service Comm’n*, 243 S.W.3d 374, 377 (Ky. App. 2007). The Commission must fulfill the legislature’s intent in enacting the statute by giving the words of the statute their plain and ordinary meaning. *See* KRS 446.080(4); *Samons v. Kentucky Farm Bureau Mut. Ins. Co.*, 399 S.W.3d 425 (Ky. 2013) (“When engaging in statutory interpretation, it is imperative that we give the words of the statute their literal meaning and effectuate the intent of the legislature.”); *Johnson v. Branch Banking and Trust Co.*, 313 S.W.3d 557, 559 (Ky. 2010).

The matters at issue in this case all arise from operation of KRS 278.183(3), which describes the monthly operation of the environmental surcharge mechanism and the Commission’s semi-annual review of same. In this regard, the statute states as follows:

At six (6) month intervals, the commission shall review past operations of the environmental surcharge of each utility, and after hearing, as ordered, shall, by temporary adjustment in the surcharge, disallow any surcharge amounts found not just and reasonable and reconcile past surcharges with actual costs recoverable pursuant to subsection (1) of this section.

Thus, the purpose of this six month review is twofold: (1) to determine whether any surcharge amounts may be found to be unjust or unreasonable, and therefore disallowed from the surcharge; and (2) to reconcile past surcharges with actual costs recoverable pursuant to

subsection (1) of the statute. The record of this case reflects that no question has been raised as to whether any particular charge that has been passed through South Kentucky's environmental surcharge during the review period is unjust or unreasonable. All such charges reflect the amounts billed to South Kentucky by EKPC. Thus, the sole question for the Commission is whether any adjustments are necessary to reconcile past surcharges with the actual costs recoverable under the statute.

B. Reconciling the Environmental Surcharge Requires Taking Historical Calculations Into Account

Ms. Herrman likened the six month review of the environmental surcharge mechanism as a process similar to reconciling a bank statement.² It is a good analogy. Accurately reconciling a bank account, or any account, requires that the right numbers be used as a starting point, however. While the purpose of excluding previously amortized over- and under-recoveries from the prospective calculation of the environmental surcharge will effectively reset the environmental surcharge so that South Kentucky and EKPC's other Members begin making future calculations with "zero" as the starting point, the fact remains that South Kentucky's historical under-recovery must also be taken into account at the outset of this reset. Otherwise, South Kentucky will permanently lose the ability to collect revenue to which it is lawfully entitled, resulting in a material financial detriment.³

² See HVR, 10:47:37.

³ See HVR, 11:09:08 and 11:10:20. Ms. Herrman explained that South Kentucky would be entitled to the full amount of under-recoveries at issue if there was no change to the existing environmental surcharge calculation, however, South Kentucky's retail customers would continue to be subjected to rate volatility.

**1. South Kentucky's Historical Under-Recovery Primarily Arises from the
Overlapping Amortization Periods of Case No. 2012-00486,
Case No. 2013-00140 and Case No. 2013-00324**

As the record of this case has developed and the issues have become more focused, the nature of the relief that South Kentucky is seeking has also become clearer. In early data request responses, South Kentucky and other distribution cooperatives requested that the Commission employ a "since inception" calculation to arrive at the net historical over- or under-recovery for distribution cooperatives since the environmental surcharge was implemented in 2005.⁴ However, as Ms. Herrman explained at the hearing, further analysis has demonstrated that the real source of the growth in over- and under-recoveries occurred when twenty-four months of environmental surcharge adjustments were set to be amortized over a seven month period due to the overlapping amortization periods established in Case No. 2012-00486 and Case No. 2013-00140.⁵ The simultaneous review of three separate six month billing periods resulted in the Commission finding that South Kentucky had over-collected \$1,730,504 during the eighteen month review period. This amount was refunded to South Kentucky's customers at the rate of \$288,417 per month for six months, beginning in September 2013.⁶ Six weeks later, the Commission found in Case No. 2013-00140 that South Kentucky had under-collected \$169,367

⁴ Ms. Herrman testified that South Kentucky has paid \$71,102,693 in environmental surcharges to EKPC since the surcharge's inception and has collected \$70,221,045 from its retail customers during that same time. *See* HVR 10:40:3; South Kentucky Response to Post-Hearing Data Request 11(c)-(d) (filed Jan. 7, 2015).

⁵ *See* HVR 10:39:47; *In the Matter of an Examination by the Public Service Commission of the Environmental Surcharge Mechanism of East Kentucky Power Cooperative, Inc. for the Two-Year Billing Period Ending June 30, 2011, for the Six-Month Billing Periods Ending December 31, 2011 and June 30, 2012, and the Pass-Through Mechanism for its Sixteen Member Distribution Cooperatives*, Case No. 2012-00486 (Ky. P.S.C. Aug. 2, 2013); *In the Matter of an Examination by the Public Service Commission of the Environmental Surcharge Mechanism of East Kentucky Power Cooperative, Inc. for the Six-Month Billing Period Ending December 31, 2012 and the Pass Through Mechanism for its Sixteen Member Distribution Cooperatives*, Case No. 2013-00140 (Ky. P.S.C. Sept. 17, 2013). Case No. 2012-00486 covered one three six-month review periods beginning on January 1, 2011 and ending on June 30, 2012. Case No. 2013-0140 covered six months, beginning on July 1, 2012 and ending on December 31, 2012. Mr. Scott provided an explanation of the effect of these overlapping cases. *See* HVR 10:19:00; 10:29:15 AM.

⁶ *See* Order, Case No. 2012-00486, Appendix A (Ky. P.S.C. Aug. 2, 2013).

over the course of the next six month review period and ordered South Kentucky to collect an additional \$28,228 per month from customers for six months, beginning in October 2013.⁷ The overlapping collection and refund of the sums from Case No. 2012-00486 and Case No. 2013-00140 began during the six month period that is currently under review in this proceeding, but extended into March of 2014, which is half-way through the review period that will be the subject of the Commission's next six month review proceeding.

In addition, on March 21, 2013, the Commission entered an Order in Case No. 2013-00324 that found South Kentucky to have over-collected an additional \$360,764 through the review period ending on June 30, 2013.⁸ Thus, on top of the net refunds established in Case No. 2012-00486 and Case No. 2013-00140, South Kentucky was required to refund an additional \$60,127 to its retail customers during the billing months of May 2014 through October 2014.⁹

Ironically, because four of the months of the amortized refunds associated with Case No. 2012-00486 and three months of the amortized charges associated with Case No. 2013-00140 were recognized within the six month period that is the subject of this review period, South Kentucky ended the subject review period, which ended on December 31, 2013, with a net cumulative under-recovery of \$881,647.¹⁰ Following the close of the subject review period on December 31, 2013, South Kentucky continued to apply the refunds and charges mandated by Case No. 2012-00486 (January and February 2014) and 2013-00140 (January – March 2014) and

⁷ See Order, Case No. 2013-00140, Appendix A (Ky. P.S.C. Sept. 17, 2013).

⁸ See *In the Matter of an Examination by the Public Service Commission of the Environmental Surcharge Mechanism of East Kentucky Power Cooperative, Inc. for the Two-Year Billing Period Ending June 30, 2013 and the Pass Through Mechanism for its Sixteen Member Distribution Cooperatives*, Order, Case No. 2013-00324 (Ky. P.S.C. Mar. 21, 2013).

⁹ See *id.*, *Nunc Pro Tunc Order*, Appendix A (Ky. P.S.C. Apr. 2, 2014).

¹⁰ See South Kentucky RECC Hearing Exhibit 1; HVR 11:06:09. A rounding error indicates that this amount may be incorrect by \$1.00, resulting in a net cumulative under-recovery of \$881,648. See South Kentucky Post-Hearing Data Request Response 11(e) (filed Jan. 7, 2015).

then began applying the additional \$60,127 monthly refund arising from Case No. 2013-00324 during the months of May – October 2014.¹¹ The additional refunds that have been applied to South Kentucky’s environmental surcharge mechanism through October 2014 have resulted in South Kentucky adding an additional \$852,912 in amortized over-recovery refunds to its retail customers’ bills through the first ten months of 2014.¹² The end result is that the amount required to be refunded in case 2012-00486, the \$1,730,504 over-collection, has now completely reversed itself into a net, cumulative under-recovery of \$1,734,559, which is the sum of: (1) the \$881,647 under-recovery that accumulated up through December 31, 2013, the last day of the subject six month review period; and (2) the \$852,912 in additional under-recoveries that accumulated between January 1, 2014 and October 31, 2014.¹³

Thus, while South Kentucky agrees with the proposal to exclude past amortizations from the present calculation of the environmental surcharge on a going-forward basis, the Commission should not penalize South Kentucky by failing to take into account either the \$881,647 under-recovery that had accrued through the end of the current review period or the additional \$852,912 under-recovery that has accrued in the following ten months. To correctly reset the statutory reconciliation to “zero” as part of the change of methodology going forward, the Commission should allow South Kentucky to recover the entirety of this net cumulative under-recovery.

While South Kentucky believes the Commission has discretion to allow recovery of the entire \$1,734,559 net cumulative under-recovery in this proceeding, and that there is precedent to

¹¹ See South Kentucky Post-Hearing Data Request Response 10 (filed Jan. 7, 2015).

¹² See *id.*

¹³ See *id.*

support such a post-review period adjustment,¹⁴ South Kentucky also recognizes that the Commission may prefer to only allow the \$881,647 in accumulated under-recoveries through December 31, 2013 in this proceeding and to defer consideration of the \$852,912 in post-review period under-recoveries until the next review proceedings. South Kentucky believes the facts, law and administrative economy support approving the recovery of the entire net cumulative under-recovery in this case, but is agreeable to also defer a decision on the amount related to the post-review periods to the next review proceedings. In practical term, the delay would mean that South Kentucky would be unable to switch to the new methodology for two review periods longer than the other Members of EKPC.

2. The Charge from June 2009 was Properly Recovered

As disclosed in South Kentucky's pre-filed testimony, the June 2009 environmental expense of \$535,927 that was paid by South Kentucky to EKPC was inadvertently excluded from the calculation of any past recovery amount of an environmental surcharge review proceeding.¹⁵ In subsequent data requests and at the hearing, South Kentucky was questioned as to whether this amount remains subject to recovery under the environmental surcharge in light of the two year limitation period for billing for utility service that is set forth in KRS 278.225. South Kentucky respectfully submits that KRS 278.255 does not apply to this case in light of: (1)

¹⁴ See *In the Matter of an Examination by the Public Service Commission of the Environmental Surcharge Mechanism of Kentucky Power Company for the Six-Month Billing Periods Ending June 30, 2006 and December 31, 2006, and for the Two-Year Billing Period Ending June 30, 2007*, Order, Case No. 2007-00381 (Ky. P.S.C. Aug. 19, 2008) (allowing post-review period adjustment for overpayment of AEP Power Pool payments); *In the Matter of an Examination by the Public Service Commission of the Environmental Surcharge Mechanism of Kentucky Power Company for the Six-Month Billing Periods Ending December 31, 2002, December 31, 2003, June 30, 2004, December 31, 2004 and December 31, 2005 and for the Two-year Billing Periods Ending June 30, 2003 and June 30, 2005*, Order, Case No. 2006-00128 (Ky. P.S.C. Jan. 31, 2007) (authorizing collection of \$347,425 in under-recoveries erroneously uncollected during the post-review period).

¹⁵ See Testimony of Michelle Herrman, pp. 6-8 (filed Sept. 30, 2014).

the plain and ordinary language of KRS 278.183; and (2) the facts and circumstances surrounding the actual billing of the \$535,927 amount.

a. KRS 278.183 Controls “Notwithstanding” KRS 278.225

KRS 278.183(1) includes the following phrase at the beginning of the statute, “Notwithstanding any other provisions of this chapter...” Thus, by its express terms, the provisions of the environmental surcharge statute shall take precedence over the terms of another statute in KRS Chapter 278 in the event of a conflict between them. Moreover, the purpose of the six month review process set forth in KRS 278.183(3) is to “reconcile past surcharges with actual costs recoverable...” If KRS 278.225 was applied in a manner that prevented the correct reconciliation of the past surcharge collections with the actual costs recoverable, it would result in a violation of KRS 278.183(3). Statutes are to be construed in a manner that effectuates the legislative intent. Accordingly, in the event of a conflict between the two statutes, KRS 278.225 cannot be used to prevent recovery of amounts that are owed by South Kentucky’s retail customers without expressly violating KRS 278.183.

**b. The Error Occurred in the Reporting of the Environmental Expense,
Not the Billing of the Environmental Expense**

South Kentucky also asserts that, even if the Commission adopted a different interpretation of the statutes, the facts and circumstances of the calculation and billing of the June 2009 environmental surcharge expense paid to EKPC was appropriate and consistent with South Kentucky’s tariff. As Ms. Herrman testified, the June 2009 expense paid to EKPC was appropriately and timely billed to South Kentucky’s customers. The error relating to this amount arises from the fact that the expense was unexplainably omitted from consideration in the corresponding review proceeding calculation of the over/under recovery amount.¹⁶ The

¹⁶ See HVR 10:35:32.

challenge in tracking the flow of revenues and payments through the environmental surcharge is that timing issues prevent there from being a direct monthly correlation between payments received by South Kentucky and payments made to EKPC.¹⁷ Nevertheless, Ms. Herrman explained that the June 2009 expense of \$535,927 that was omitted from subsequent surcharge calculation reviews was in fact collected through monthly surcharge filings.¹⁸ In other words, while the expenses paid to EKPC were correctly passed onto South Kentucky's customers, an error in the preparation of the materials associated with the corresponding six month review case caused the expense to be omitted from the calculation of the over/under recovery amount from the case record.

D. The Amount in Question is Material to South Kentucky's Financial Condition

If South Kentucky is not permitted to recover the accumulated under-recovery that resulted from the overlapping amortizations occurring in Case No. 2012-00486 and Case No. 2013-00140, serious financial consequences would follow. As Ms. Herrman testified at the hearing, the loss of \$1,694,324 (\$1,734,559 - \$40,240) in revenue to which South Kentucky is currently entitled would erase the entire budgeted margin of the cooperative for 2015.¹⁹ This would also have the adverse impact of causing South Kentucky to fail to satisfy its debt covenants with the Rural Utilities Service and the Cooperative Finance Corporation as a result of failing to achieve a prescribed Times Interest Earned Ratio ("TIER") and Debt Service Coverage

¹⁷ See HVR 10:37:56.

¹⁸ See HVR 10:42:00.

¹⁹ See HVR 10:50:15. As set forth above, the \$1,734,559 figure is the sum of the \$881,647 of under-recoveries that have occurred through the end of the current review period and the \$852,912 in additional under-recoveries that have occurred between January 1, 2014 and October 31, 2014. The \$40,240 is the amount that results when using the amortization exclusion model for the current review period months of July 2013- December 2013.

Ratio (“DSC”).²⁰ South Kentucky would have to reduce spending in operational areas such as maintenance and vegetation management to offset the loss.²¹ Ultimately, South Kentucky would likely have to pre-maturely seek an increase in its base rates to offset the loss of revenue.

III. CONCLUSION

The purpose of the environmental surcharge pass-through mechanism is to allow South Kentucky to recover from its retail customers exactly what it has paid to EKPC under the environmental surcharge mechanism. South Kentucky seeks not one dollar more or one dollar less than that to which it is lawfully entitled. While it is supportive of the plan to exclude past amortization amounts from future calculations of the environmental surcharge mechanism, doing so without taking into account the effect the past overlapping amortization periods have had on South Kentucky would be unfair, unjust and unreasonable, violate the spirit and letter of KRS 278.183 and materially and adversely impact South Kentucky’s financial condition.

WHEREFORE, on the basis of the foregoing, South Kentucky respectfully requests the Commission to take the historical under-recovery of environmental surcharge revenues into account prior to adopting the requested exclusion of previously amortized amounts from future environmental surcharge calculations.

This 13th day of January, 2015.

²⁰ See *id.*, 10:54:51.

²¹ See *id.*, 10:56:17.

Respectfully submitted,



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CERTIFICATE OF SERVICE

This is to certify that a true and correct copy of the foregoing was served by depositing same in the custody and care of the U.S. Mails, postage pre-paid, on this 13th day of January, 2015, addressed to the following:

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