

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF KENERGY)	CASE NO.
CORP. FOR A WAIVER PURSUANT TO KRS)	2020-00215
278.2219)	

ORDER

On July 17, 2020, Kenergy Corp. (Kenergy) filed an application, pursuant to KRS 278.2219, for a waiver, to the extent required, of KRS 278.2201,¹ which prohibits a regulated utility from subsidizing a nonregulated activity provided by an affiliate or by the utility itself, and a waiver, to the extent required, of KRS 278.2213(14),² which prohibits a utility from entering into any arrangement for financing nonregulated activities through an affiliate that would permit a creditor upon default to have recourse to the assets of the utility. Kenergy also purports to generally seek “to the extent necessary, a waiver of the affiliate transaction rules.”³ For the reasons discussed below, the Commission has only considered the waivers expressly requested by Kenergy, and declines to consider waivers of other statutes. Kenergy states in its application that because the letter of credit into which it may enter will be for a one-year term, Commission approval under KRS 278.300 is not required with regard to the letter of credit, and any renewals thereof

¹ Application at 6.

² *Id.*

³ *Id.*, Kenergy’s application correctly notes the affiliate transaction rules are found at KRS 278.2201 through KRS 278.2213.

up to an aggregate of six years.⁴ In the alternative Kenergy seeks Commission approval of its guarantee of Kenergy's letter of credit.⁵

Kenergy seeks these waivers in connection with its intention to provide broadband⁶ internet service in and adjacent to its certified territory⁷ through a for-profit, wholly owned affiliate, Kenect, Inc. (Kenect).⁸ This proceeding, as stated above, only addresses Kenergy's application for the waivers. The financing options for constructing the fiber infrastructure and any consideration of a Certificate of Public Convenience and Necessity (CPCN) to build the fiber infrastructure are outside the scope of this proceeding.

The Attorney General of the Commonwealth of Kentucky, by and through the Office of Rate Intervention (Attorney General) is the only intervenor in this case. By Order dated August 5, 2020, the Commission established a procedural schedule to provide for efficient and timely review of Kenergy's application. However, following the filing of its

⁴ Application at 8.

⁵ *Id.*

⁶ 7 CFR §1738.2 defines "Broadband service" as "any technology identified by the Administrator as having the capacity to provide transmission facilities that enable the subscriber to receive a minimum level of service equal to at least a downstream transmission capacity of 25 Mbps and an upstream transmission capacity of 3 Mbps. . ." KRS 278.5461(1) defines "Broadband" as "any service that is used to deliver video or to provide access to the Internet and that consists of the offering of the capability to transmit information at a rate that is generally not less than two hundred (200) kilobits per second in at least one direction; or any service that combines computer processing, information storage, and protocol conversion to enable users to access Internet content and services. Nothing in this definition shall be construed to include any intrastate service, other than digital subscriber line service, tariffed at the commission as of July 15, 2004." KRS 224A.011(9) defines "Broadband" as "any wireline or fixed terrestrial technology having a capacity to transmit data from or to the Internet with a minimum speed of twenty-five (25) megabits per second downstream and three (3) megabits per second upstream as defined by the Federal Communications Commission or the United States Department of Agriculture and any amendments to those definitions. If the agencies use different speed definitions, the faster speed definition shall apply to KRS 224A.110, 224A.112, and 224A.1121."

⁷ Application at 2.

⁸ *Id.* at 1–2. Kenergy serves Breckinridge, Caldwell, Crittenden, Daviess, Hancock, Henderson, Hopkins, Livingston, Lyon, McLean, Muhlenberg, Ohio, Union, and Webster counties, Kentucky. *Annual Report of Kenergy Corp. for the Year Ended December 31, 2019*, at 52.

Response to Staff's First Request for Information (Response to Staff's First Request), Kenergy requested an informal conference,⁹ which was held on September 11, 2020. Following the informal conference, Kenergy filed a motion for leave to file testimony, and by Order dated September 17, 2020, the Commission granted the motion and suspended the procedural schedule.

On September 18, 2020, Kenergy filed a motion to reinstate the procedural schedule and, for the first time in this proceeding, informed the Commission that Kenergy needed a final Order from the Commission in this matter on or before October 23, 2020, in order to proceed with its proposed project.¹⁰ Because all dates designated on the August 5, 2020 procedural schedule had passed, the Commission was unable to grant Kenergy's motion. Instead by Order dated September 28, 2020, the Commission denied the motion to reinstate, and established a procedural schedule for the remaining procedural events. Kenergy and the Attorney General filed briefs pursuant to that schedule and both waived an evidentiary hearing.¹¹ This matter now stands submitted for a decision on the case record.

BACKGROUND

Broadband in Rural Areas

Citing census data from 2017, Kenergy maintains that Kentucky is the ninth most underserved state when it comes to access to broadband.¹² Kenergy points to a

⁹ Kenergy's Motion for Informal Conference (filed Sept. 2, 2020).

¹⁰ Kenergy's Motion to Reinstate Procedural Schedule (filed Sept. 18, 2020), Item 3.

¹¹ Attorney General's Notice Regarding Hearing and Kenergy's Waiver of Formal Evidentiary Hearing, (filed Sept. 29, 2020).

¹² Application at 2.

“Broadband Progress Report” issued in 2015 by the Federal Communications Commission (FCC), which defines a geographical area as “underserved” in terms of access to broadband if an area has internet service, but lacks access to either download speeds of at least 25 Mbps (Megabits per second) or upload speeds of 3 Mbps.¹³ Kentucky law defines “Underserved area” as “any project area where fixed, terrestrial broadband service with a minimum twenty-five (25) megabits per second downstream and three (3) megabits per second upstream is not available.”¹⁴ Kentucky law also defines “Unserved area” as “any project area where fixed, terrestrial broadband service with a minimum ten megabits per second downstream and one megabit per second upstream is not available.”¹⁵

Kenergy maintains that the majority of Kentuckians within its service territory are underserved or unserved¹⁶ because broadband providers have neglected to serve rural areas.¹⁷ The Commission received numerous public comments in this proceeding from individuals and groups in Kenergy’s service territory who expressed their frustration at not being able to receive broadband services at their homes and businesses. In addition to assertions made by Kenergy and anecdotal evidence of the lack of broadband service contained in the public comments, the Commission takes administrative notice of the statistics appearing in Appendix 4 of the FCC’s 2020 Broadband Deployment Report. According to the FCC, as of December 31, 2018, Hancock County had the least access

¹³ *Id.* at 2–3.

¹⁴ KRS 224A.011(44).

¹⁵ KRS 224A.011(45).

¹⁶ Application at 3.

¹⁷ *Id.* at 4.

to fixed broadband of all of the counties within Kenergy's service territory with only 21.2 percent of the population having access.¹⁸ Lyon County ranked next lowest with only 28.9 percent of the population having access to fixed broadband.¹⁹ The counties in Kenergy's service territory with the greatest access to fixed broadband by population are Henderson County with 94.6 percent²⁰ and Daviess County with 93.3 percent.²¹ The statistics published by the FCC indicate that, with the exception of Henderson and Daviess counties, a significant percentage of the population in Kenergy's service territory lacks access to fixed broadband.²²

The FCC indicates that only 65.0 percent of rural Americans have access to high-speed fixed broadband.²³ [REDACTED]

[REDACTED]

¹⁸ FCC 20-50 *In the Matter of Inquiry Concerning Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable and Timely Fashion, 2020 Broadband Deployment Report*, (rel. Apr. 24, 2020) (Broadband Deployment Report) Appendix 4 at 38. <https://docs.fcc.gov/public/attachments/FCC-20-50A2.pdf> (Last accessed Oct. 12, 2020).

¹⁹ *Id.* at 39.

²⁰ *Id.* at 38.

²¹ *Id.* at 37.

²² *Id.* at 37–40.

²³ *Bridging the Digital Divide for All Americans*, <https://www.fcc.gov/about-fcc/fcc-initiatives/bridging-digital-divide-all-americans> (Last accessed Oct. 12, 2020).

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED] In order to

establish this financial capability, Kenect needs to be able to supply a letter of credit from an eligible bank.³¹

The Affiliate Transaction Rules, KRS 278.2201 through KRS 278.2219

As a nonprofit cooperative corporation having as its primary purpose the distribution of electric energy, Kenergy, if it desires, may engage in any other lawful business or activity, provided that any nonregulated business or activity is conducted through an affiliate³² and that such activities are secondary to its primary purpose of distributing electric energy.³³ Kenergy acknowledges it considers providing broadband as secondary to its primary purpose of supplying electrical service; however, Kenergy

[REDACTED]

27 [REDACTED]

28 [REDACTED]

[REDACTED]

[REDACTED]

³¹ *Id.* and Application at 5–9.

³² KRS 279.020.

³³ KRS 279.020(1).

maintains that providing broadband through an affiliate actually supports Kenergy's primary purpose by enabling rural areas to grow and generate the need for electrical services.³⁴ The provision of broadband services is a nonregulated activity in Kentucky.³⁵ Therefore, if Kenergy desires to provide broadband service to the public, it must do so through an affiliate. "Affiliate" is defined in KRS 278.010(18).³⁶ Kenergy organized Kenect in Kentucky on July 6, 2020, as a for-profit corporation with the primary goal of providing broadband internet services in and adjacent to Kenergy's certified territory.³⁷ Kenect has the same board of directors as Kenergy.³⁸ Kenergy acknowledges Kenect is an affiliate,³⁹ and that it controls Kenect.⁴⁰ "Control" is defined in KRS 278.010(19) as meaning "the power to direct the management or policies of a person through ownership, by contract, or otherwise." KRS 278.2201 through 278.2219 contain specific provisions regarding a utility's interaction with affiliates including, among other things, the pricing of services and products provided to an affiliate by the utility, and vice versa.⁴¹ These statutes are commonly referred to as "the affiliate transaction rules."

³⁴ Application at 7.

³⁵ KRS 278.5462.

³⁶ KRS 278.010(18), "Affiliate" means a person that controls or that is controlled by, or is under common control with, a utility.

³⁷ Application at 2

³⁸ Response to Staff's First Request (filed Aug. 31, 2020), Item 10.

³⁹ Application at 1 and 4.

⁴⁰ *Id.* at 7.

⁴¹ KRS 278.2207.

As Kenergy is a utility,⁴² and Kenect, as Kenergy's affiliate, seeks to become engaged in the nonregulated activity of providing broadband service to the public, the affiliate transaction rules apply to Kenergy's interactions with Kenect, and present the first of several legal obstacles Kenergy must overcome in order to proceed with this project. Specifically, KRS 278.2201 prohibits a utility from subsidizing a nonregulated activity provided by an affiliate or by the utility itself. Additionally, KRS 278.2201 provides that "[t]he commission shall require all utilities providing nonregulated activities, either directly or through an affiliate, to keep separate accounts and allocate costs in accordance with procedures established by the commission." Kenergy expressly seeks a waiver, to the extent required, of KRS 278.2201.⁴³

Kenergy also expressly seeks a waiver, to the extent required, of KRS 278.2213(14).⁴⁴ As the Kentucky Broadband and Cable Association correctly pointed out in its public comment filed in this proceeding, KRS 278.2213 has 17 subparts and articulates requirements, such as prohibitions against sharing confidential customer information with the utility's affiliates and vice versa,⁴⁵ providing any type of undue preferential treatment to a nonregulated affiliate to the detriment of a competitor,⁴⁶ solicitation of business for the affiliate,⁴⁷ providing advertising space in the utility's billing

⁴² "Utility" is defined in KRS 278.010(3). Kenergy does not dispute it is a utility subject to the Commission's jurisdiction.

⁴³ Application at 6 and 9.

⁴⁴ *Id.*

⁴⁵ KRS 278.2213(5) and KRS 278.2213(10).

⁴⁶ KRS 278.2213(11).

⁴⁷ KRS 278.2213(8).

envelope to its affiliate unless it offers the same to competing service providers under the same terms,⁴⁸ and use of the utility's name, trademark, brand, or logo without a preapproved disclaimer.⁴⁹ KRS 278.2213 also imposes affirmative duties on utilities engaged in affiliate transactions such as the requirement that all dealings between a utility and a nonregulated affiliate be at arm's length,⁵⁰ and the requirement that if a utility responds to a request from a customer seeking a recommendation of a provider of a service offered by the utility or its affiliate by mentioning itself or its affiliate, the utility must also mention competing suppliers of that service.⁵¹ KRS 278.2213(1) requires that a utility and its affiliate maintain separate books and records and that the expenses of any officers, directors, or employees that the utility and the affiliate have in common be subject to the cost allocation requirements set forth in KRS 278.2203 and KRS 278.2207.

The only waiver Kenergy expressly seeks in relation to the numerous requirements and prohibitions contained in KRS 278.2213 is a waiver of KRS 278.2213(14), which provides that "[a] utility shall not enter into any arrangement for financing nonregulated activities through an affiliate that would permit a creditor upon default to have recourse to the assets of the utility." As stated above, Kenergy also purports to generally seek "to the extent necessary, a waiver of the affiliate transaction rules."⁵² However, neither Kenergy's application nor any of its subsequent filings in this proceeding expanded upon or clarified this vague and indefinite request. The Commission expects a utility petitioning

⁴⁸ KRS 278.2213(2).

⁴⁹ KRS 278.2213(13).

⁵⁰ KRS 278.2213(6).

⁵¹ KRS 278.2213(12).

⁵² Application at 6.

for a waiver of statutory or regulatory requirements to fully express its need for a waiver, and not make such indefinite requests that the Commission is unable to evaluate them. Therefore, the Commission will only consider the requests for waivers expressly articulated in the application.

The affiliate transaction rules also subject the behavior of affiliates to the scrutiny of the Commission. The remedies for noncompliance of the affiliate transaction rules, or for not providing sufficient evidence of compliance, permit the Commission to access the books and records of a utility's nonregulated affiliate.⁵³ If, after examining the affiliate's books and records, the Commission finds that the utility has not complied with any provision of KRS 278.010 to 278.450, the Commission may perform a financial audit of the utility's affiliate to the extent necessary to ensure compliance.⁵⁴

THE PROJECT

The Fiber Network

Kenergy states that its electric system will provide the backbone of the fiber infrastructure and that it intends to utilize its poles to provide broadband service.⁵⁵ Kenergy also intends to utilize a portion of the fiber infrastructure to provide intra-system communications for its electric system.⁵⁶ Kenergy states that the fiber network could

⁵³ KRS 278.2211(1)(a).

⁵⁴ KRS 278.2211(2).

⁵⁵ Application at 4.

⁵⁶ *Id.* at 4 and Response to Staff's First Request (filed Aug. 31, 2020), Items 3(g) and 3(h).

support its electric systems' metering infrastructure and data transport and provide increased resiliency and security to its current systems.⁵⁷

Kenergy obtained a consultant, Conexon, to produce a feasibility study on the fiber network.⁵⁸ Kenergy assumes that the fiber network will consist of [REDACTED] miles, following Kenergy's electric distribution system, and be placed into service over six years.⁵⁹ Kenergy states that the fiber network is expected to have a useful life of 50 years.⁶⁰ Kenergy explains that the total project costs are expected to be approximately \$166 million, composed of [REDACTED] for the fiber infrastructure and [REDACTED] in related equipment.⁶¹ The annual maintenance costs are estimated to be \$50 per mile, totaling approximately \$0.3 million annually once the entire project is in service.⁶²

Kenergy explains that the board of directors and corporate officers of Kenergy and Kenect currently mirror each other and that Kenect will likely have its own officers as the project progresses.⁶³ Kenergy states that Kenect will require its own employees, but that any work performed by Kenergy will be allocated to Kenect.⁶⁴

⁵⁷ Response to Staff's First Request for Information, Item 3(h), and Response to Attorney General's Second Request (filed Aug. 31, 2020), Item 11.

⁵⁸ Application at 2 and Response to Staff's First Request, Item 3(b).

⁵⁹ Kenergy's Supplemental Response to the Attorney General's First Request for Information (filed Sept. 3, 2020), Item 3, and Response to Staff's First Request, Item 3(d).

⁶⁰ Response to Staff's First Request, Item 4.

⁶¹ Response to Attorney General's Second Request for Information, Item 8, and Response to Staff's First Request, Item 3(b).

⁶² Response to Staff's First Request, Item 3(d).

⁶³ Response to Staff's First Request, Item 10.

⁶⁴ Response to the Attorney General's Second Request, Item 3(b).

The Financing

In order to participate in the [REDACTED], Kenect must obtain a letter of credit, which will secure the subsidy proceeds [REDACTED].⁶⁵ Kenergy states that CoBank will supply the letter of credit under two scenarios: (1) Kenergy provides a parent-guarantee for the letter of credit; or (2) Kenergy invests \$3 million in Kenect.⁶⁶ Under the first scenario, while no specific assets are associated with the letter of credit, Kenergy would be responsible for satisfying the letter of credit should Kenect default.⁶⁷ Under the second scenario, in which Kenergy does not provide a parent guarantee, CoBank will require Kenergy to maintain at least a 50.0 percent equity position in Kenect.⁶⁸ Kenergy states that it will use funds that would otherwise be used to retire capital credits to make the \$3 million investment, such that there is no adverse impact on Kenergy's equity ratios, interest income, or margins.⁶⁹

Although the financing of a fiber network is beyond the scope of this proceeding, the Commission notes that Kenergy approached Rural Utility Service (RUS), CoBank, and Cooperative Finance Corporation (CFC) about financing the fiber network. Kenergy states that RUS and CFC have policies of only lending directly to the electric

⁶⁵ Response to Staff's First Request, Item 1 and Response to Attorney General's Second Request, Item 1.

⁶⁶ Application at 5; Jeffery Hohn Direct Testimony (filed July 17, 2020) (Hohn Direct Testimony) at 2; Response to Staff's First Request, Item 1; and Supplemental Testimony of Jeffery Hohn (filed Sept. 18, 2020) at 5.

⁶⁷ Response to Staff's First Request, Item 5.

⁶⁸ Response to Staff's First Request, Item 1 and Responses to Attorney General's First Request, Items 1(b), 5(b), 5(c), and 23.

⁶⁹ Hohn Direct Testimony at 2 and Response to Staff's First Request, Item 5.

cooperative.⁷⁰ Kenergy explains that CoBank, while it prefers lending directly to Kenergy, did offer a proposal to lend directly to Kenect, such that Kenect constructs and owns the fiber infrastructure.⁷¹ Kenergy would be required to make an initial equity investment in Kenect of \$3 million and then increase that equity investment as needed in order to maintain a 50.0 percent equity position.⁷² Kenergy explains that the required equity investments would be infeasible and will likely require outside investors.⁷³ Kenergy also explains that alternatively, if Kenergy borrows the funds required to build the fiber infrastructure from RUS and leases the fiber to Kenect, then the required equity investment in Kenect would be insubstantial.⁷⁴

Kenergy, until it filed its brief, consistently described the requested \$3 million capital transfer as a one-time cash infusion⁷⁵ and future equity investments as inconsequential.⁷⁶ Kenergy initially stated that its preferred course of action was to provide Kenect \$3 million in start-up capital.⁷⁷ However, Kenergy now states its preference is the letter of credit with the parent-guarantee because the requirement to

⁷⁰ Response to Staff's First Request, Item 1.

⁷¹ *Id.*

⁷² *Id.* and Response to Attorney General's First Request, Item 5(c). These are the same terms as the letter of credit without a parent guarantee.

⁷³ Response to Attorney General's Second Request, Item 4.

⁷⁴ Response to Staff's First Request, Items 1 and 4(b). See also Response to Attorney General's First Request, Items 5(b) and 5(c) and Response to Attorney General's Second Request, Item 4.

⁷⁵ See Application at 8, Hohn Direct Testimony at 2, and Response to Staff's First Request, Item 7.

⁷⁶ See Response to Staff's First Request, Items 1 and 4(b) and Response to Attorney General's First Request, Item 5(b).

⁷⁷ Hohn Direct Testimony at 3.

maintain a 50.0 percent equity position would necessitate future capital investment.⁷⁸ Kenergy appears to conflate the equity investments necessary for CoBank to lend directly to Kenect to build the fiber infrastructure and those necessary to receive a letter of credit without a parent-guarantee. While both require an initial investment of \$3 million and a 50.0 percent equity position, the financing arrangements for the fiber infrastructure are not at issue in this proceeding. Whether Kenergy can receive approval, pursuant to KRS 278.300, to finance the fiber infrastructure will be decided when, or if, Kenergy files such an application.

Kenergy's request in this proceeding is a waiver, to the extent required, of KRS 278.2201 for the purposes of participating in the [REDACTED].⁷⁹ Additionally, in the event that Kenergy is unable to receive approval to own and finance the fiber infrastructure, the parent-guarantee would essentially circumvent the Commission's authority to deny the fiber network and associated financing. It is a distinction without a difference for Kenergy to guarantee a debt for which it would otherwise had to receive approval pursuant to KRS 278.300.

The Attorney General also appears to combine the CoBank proposals, by definitively stating that if the project progresses Kenergy would be required to make larger equity investments in subsequent years.⁸⁰ However, the Attorney General recommends that the Commission conditionally approve the application with certain customer

⁷⁸ Kenergy's Brief (filed Oct. 8, 2020) at 4–5.

⁷⁹ Response to Staff's First Request, Item 7.

⁸⁰ Attorney General's Brief (filed Oct. 8, 2020) at 5–6. See Response to Attorney General's Second Request, Item 4. The additional equity investments discussed in this response are conditional on CoBank lending directly to Kenect, not an inherent requirement of the letter of credit without a parent guarantee.

protections, including liability limits for the letter of credit with parent guarantee or limiting the transfer of capital to Kenect.⁸¹

Concerning the requirement in KRS 278.300 that a utility obtain Commission approval to issue any evidence of indebtedness for a period of more than two years, or renewals of such notes exceeding in the aggregate six years, Kenergy argues that because the letter of credit will be for a one-year term, Commission approval under KRS 278.300 is not required with regard to the letter of credit, and any renewals thereof up to an aggregate of six years.⁸² Kenergy anticipates that within that six-year limit, Kenect will have established its own creditworthiness and will no longer require Kenergy's guarantee for further extensions of the letter of credit.⁸³ In the alternative Kenergy seeks Commission approval of Kenergy's guarantee of Kenergy's letter of credit.⁸⁴

ANALYSIS

As discussed above, Kenergy is permitted by Kentucky law to engage in nonregulated activities if it does so through an affiliate.⁸⁵ Since the General Assembly, by amending KRS 279.020,⁸⁶ permitted electrical cooperative corporations, such as Kenergy, to establish an affiliate and to engage in nonregulated activities through that affiliate, it is only logical to conclude that the waiver provisions of KRS 278.2219 may operate to permit electrical cooperative corporations to provide start-up capital to

⁸¹ Attorney General's Brief at 8.

⁸² Application at 8.

⁸³ *Id.*

⁸⁴ *Id.*

⁸⁵ KRS 279.020(2).

⁸⁶ 2006 Ky. Acts ch. 114, sec. 1, effective July 1, 2006.

affiliates. Any business endeavor expressly permitted by KRS 279.020 would require initial capitalization and electrical cooperative corporations have no ability to provide such capitalization other than by initially subsidizing the affiliate. The relevant language of KRS 279.020 provides:

Any three (3) or more individuals, partnerships, associations, or private corporations, a majority of whom are citizens of Kentucky, may by executing, filing, and recording articles of incorporation as provided in KRS 279.030 and 279.040 organize to conduct a nonprofit cooperative corporation for the:

- (1) Primary purpose of generating, purchasing, selling, transmitting, or distributing electric energy to any individual or entity, and providing any good or service related to generating, purchasing, selling, transmitting, or distributing electric energy to any individual or entity; and
- (2) If the cooperative desires, for the secondary purpose of engaging in any other lawful business or activity, provided that any nonregulated business or activity is conducted through an affiliate. . .

KRS 278.2219 provides:

- (1) Notwithstanding any provisions in KRS 278.2201 to the contrary, a utility may apply to the commission for a waiver or deviation from any or all provisions of KRS 278.2201 to 278.2213.
- (2) The utility's application to the commission shall:
 - (a) Demonstrate the basis of the utility's need to be granted a waiver or deviation; and
 - (b) Contain, if appropriate, documentation regarding the costs and benefits of compliance with the provisions of KRS 278.2201 to 278.2213.
- (3) The commission shall grant a waiver or deviation if the commission finds that compliance with the provisions of KRS 278.2201 to 278.2213 is impracticable or

unreasonable. The findings of the commission shall be a final appealable order.

The Commission has discretion to grant a waiver of, or a deviation from, any of the affiliated transaction rules, if the Commission finds compliance with the rules is impracticable or unreasonable.⁸⁷ The Commission agrees with the Attorney General that had the General Assembly intended that a utility could never subsidize a nonregulated activity or secure the activities of an affiliate, those provisions would have been excluded from the scope of KRS 278.2219.⁸⁸

Any application for a waiver or deviation should demonstrate the utility's need to be granted a waiver or deviation and contain, if appropriate, documentation regarding the costs and benefits of compliance.⁸⁹ In this instance the need that Kenergy expresses is a need to exercise its statutory right to engage in nonregulated activities through an affiliate. To that end, Kenergy has appropriately applied to the Commission for a waiver, to the extent required, of the prohibition against subsidizing a nonregulated activity provided through an affiliate found in KRS 278.2201. Here the issue under consideration is the cost and benefit of compliance with KRS 278.2201 in these circumstances.

Kenergy states "there is no practical or reasonable way for Kenect to develop a broadband project without Kenergy's initial assistance."⁹⁰ Kenergy also maintains that the cost of strict compliance with KRS 278.2201 would mean the loss of an opportunity to obtain significant subsidies for supplying broadband service.⁹¹ The public comments

⁸⁷ KRS 278.2219(3).

⁸⁸ Attorney General's Brief at 4.

⁸⁹ KRS 278.2219(2).

⁹⁰ Supplemental Response to Staff's First Request, Item 5.

filed in this proceeding, and publicly available statistics from the FCC are evidence that a need exists for the service Kenergy seeks to provide through Kenect. Given that a potential exists for Kenergy to receive substantial subsidies to accomplish the goal of providing this needed service through Kenect, if Kenect can show [REDACTED],⁹² and strict compliance with KRS 278.2201 would require Kenergy to forgo that opportunity, the cost of strict compliance with KRS 278.2201 appears to potentially be great.

The benefit of strict compliance with KRS 278.2201 in this instance is that Kenergy's member-owners are spared any increased potential liability and risk associated with capitalizing Kenect. Although the amount of potential risk is further reduced by Kenergy's plan to have Kenect return the \$3 million capital investment if Kenect does not pursue the fiber network project,⁹³ and Kenergy has planned the capital investment in Kenect such that there is no adverse impact on Kenergy's equity ratios, interest income, or margins.⁹⁴ Strict compliance in this instance means Kenergy member-owners will receive a \$3 million capital credit retirement⁹⁵ instead of having their equity in Kenergy transferred to Kenect, and thereby receiving derivative equity in Kenect. Given that Kenergy controls Kenect by virtue of currently being its sole shareholder, Kenergy is in a position to ensure that its member-owners are not exposed to undue risk.

⁹¹ *Id.*

⁹² Supplemental Response to Staff's First Request, Item 5.

⁹³ Application at 5.

⁹⁴ Hohn Direct Testimony at 2 and Response to Staff's First Request, Item 5.

⁹⁵ Application at 8.

Given that, in this instance, the benefit of strict compliance is slight and the cost of strict compliance is potentially quite great, strict compliance with the prohibition on subsidizing the nonregulated activity of an affiliate found in KRS 278.2201 is impracticable and unreasonable in these circumstances.

FINDINGS AND CONCLUSIONS

Request for Waivers

For the reasons stated above, the Commission finds the prohibition of subsidizing the nonregulated activity of an affiliate to be impracticable and unreasonable as it pertains to Kenergy making a \$3 million one-time capital investment in Kenect for the purpose of assisting Kenect in obtaining a letter of credit in Kenect's name and thereby facilitating Kenect's participation in [REDACTED]. The Commission also finds a waiver of KRS 278.2201, only to the extent required to effectuate Kenergy's one-time \$3 million capital investment in Kenect, is appropriate. Any future investments will need separate Commission approval. Further, the Commission finds that if Kenect ultimately does not pursue the fiber network project, Kenergy should effectuate Kenect's return of the \$3 million capital investment.

Kenergy can accomplish its stated goal of participating in [REDACTED] without supplying a parent-guarantee for a letter of credit for Kenect. The Commission finds there is no need for a waiver of KRS 278.2213(14) and declines to approve Kenergy's request for such a waiver. The Commission finds that permitting a creditor of an affiliate to have a right of recourse to Kenergy's assets is not in the best interest of Kenergy's member-owners under these circumstances. As Kenergy articulated the

options in its application and subsequent filings, it is also unnecessary for Kenergy's immediate goal of [REDACTED].

Kenergy's application did not expressly request a waiver of any other provision of the affiliate transaction rules,⁹⁶ and the Commission declines to consider any additional waivers in connection with this application. The Commission reminds and cautions Kenergy that all provisions of the affiliate transaction rules apply to Kenergy's relationship with and behavior toward Kenect, with the exception of a waiver of KRS 278.2201 to the extent required for Kenergy to make a one-time \$3 million capital investment in Kenect. The Commission urges Kenergy to become familiar with the requirements of the affiliate transaction rules and to ensure it and Kenect govern themselves accordingly.

Because the Commission is approving a one-time \$3 million cash infusion of Kenect by Kenergy and declining to permit Kenergy to supply a parent-guarantee for a letter of credit for Kenect, further analysis of the applicability of KRS 278.300 to these circumstances is not relevant at this time. However, should Kenergy raise this issue in a future filing, the Commission cautions Kenergy that, for the reasons stated below, it is not persuaded by Kenergy's argument as Kenergy presented it here.

Legal Obstacles and Future Filings

As stated previously, the financing options for the construction of the fiber infrastructure and the consideration of a CPCN are outside the scope of this proceeding. However, in order for Kenergy to fulfill its goal of constructing, owning, and utilizing a fiber network for its intra-system communication, as well as leasing the fiber network to Kenect

⁹⁶ KRS 278.2201 through KRS 278.2213.

to provide broadband service to the public, the Commission must issue a CPCN⁹⁷ and approve any financing plan proposed by Kenergy.⁹⁸ To that end, the Commission implores Kenergy to carefully consider the requirements for obtaining a CPCN found in KRS 278.020 and existing case law, as well as the filing requirements for a CPCN found in 807 KAR 5:001, Section 15(2). To be granted a CPCN for a fiber network Kenergy must show a need for the fiber network, from the standpoint of its service requirements, and show that the proposed construction will not result in the wasteful duplication of facilities.⁹⁹

"Need" requires:

[A] showing of a substantial inadequacy of existing service, involving a consumer market sufficiently large to make it economically feasible for the new system or facility to be constructed or operated.

[T]he inadequacy must be due either to a substantial deficiency of service facilities, beyond what could be supplied by normal improvements in the ordinary course of business; or to indifference, poor management or disregard of the rights of consumers, persisting over such a period of time as to establish an inability or unwillingness to render adequate service.¹⁰⁰

In a petition for a CPCN, the need that Kenergy must show is not a need for broadband services in its service territory, but Kenergy's need for a fiber network to carry out its regulated activity of distributing electric service. Because Kenergy's service requirements relate to the distribution of electric service, not the distribution of broadband

⁹⁷ KRS 278.020.

⁹⁸ KRS 278.300.

⁹⁹ *Kentucky Utilities Company v. Public Service Commission*, 252 S.W.2d 885 (Ky. 1952).

¹⁰⁰ *Id.* at 890.

service, and because Kenergy will be utilizing the fiber network in its performance of regulated activity, Kenergy must successfully show a need for a fiber network to serve its intra-system communication needs.

In addition to need, Kenergy must show that the construction of such a fiber network will not result in wasteful duplication. “Wasteful duplication” is defined as “an excess of capacity over need” and “an excessive investment in relation to productivity or efficiency, and unnecessary multiplicity of physical properties.”¹⁰¹ To demonstrate that a proposed facility does not result in wasteful duplication, the Commission has held that the applicant must demonstrate that a thorough review of all reasonable alternatives has been performed.¹⁰² Again, Kenergy must show the proposed fiber network would not result in wasteful duplication of the network required for Kenergy’s intra-system communication needs. Whether the proposed fiber network results in wasteful duplication of a network for providing broadband services is not relevant to the analysis required for finding that public convenience and necessity require the construction of the fiber network.

As stated above, Kenergy has indicated a preference for borrowing the funds necessary to build the fiber network, owning the network, and leasing the network to Kenergy. The Commission reminds Kenergy that any financing plan for construction of a fiber network will require Commission approval. The Commission is required to evaluate any evidence of indebtedness issued by a regulated utility to ensure that it is

¹⁰¹ *Id.*

¹⁰² See Case No. 2005-00142, *Joint Application of Louisville Gas and Electric Company and Kentucky Utilities Company for a Certificate of Public Convenience and Necessity for the Construction of Transmission Facilities in Jefferson, Bullitt, Meade, and Hardin Counties, Kentucky* (Ky. PSC Sept. 8, 2005).

[F]or some lawful object within the corporate purpose of the utility, is necessary or appropriate for or consistent with the proper performance by the utility of its service to the public and will not impair its ability to perform that service and is reasonably necessary and appropriate for such purpose.¹⁰³

While it is true that notes issued for proper purposes that are payable in two years or less, or renewals of such notes not exceeding the aggregate of six years, do not require Commission approval,¹⁰⁴ the Commission urges Kenergy to be mindful of the “proper purpose” requirement and not simply assume Commission approval for an evidence of indebtedness payable in two years or less, or renewals of such notes not exceeding the aggregate of six years, is not required. Kenergy notes the issue of an electric cooperative corporation building a fiber network is an issue of first impression in Kentucky.¹⁰⁵ Kenergy should not assume, without seeking a determination, that the Commission would find the building of a fiber network a proper purpose under current law.

The lease payments Kenergy anticipates receiving from Kenect could necessitate a change in Kenergy’s tax filing status. In order to maintain its tax-exempt status, 85.0 percent or more of a cooperative’s income must consist of amounts collected from members for the sole purpose of meeting losses and expenses.¹⁰⁶ Payments from Kenect to Kenergy will constitute nonmember income, unless it is from qualified pole rentals.¹⁰⁷ Kenergy did not address this in any meaningful way in its description of the

¹⁰³ KRS 278.300(3).

¹⁰⁴ KRS 278.300(8).

¹⁰⁵ Kenergy’s Motion for Informal Conference and Supplemental Response to Staff’s First Request, Item 5.

¹⁰⁶ 26 U.S.C. § 501(c)(12)(a).

¹⁰⁷ 26 U.S.C. § 501(c)(12)(c)(i) and 26 U.S.C. § 501(c)(12)(d).

project included in this application. In future filings regarding the planned fiber infrastructure, Kenergy should fully describe the potential implications for its tax status, and the resulting effect on its members, of its relationship with Kenect and financing alternatives.

Finally, given the challenges Kenergy and Kenect face in pursuit of this project under current law, the Commission joins the Attorney General in acknowledging it would be appropriate for the General Assembly to review the statutes at issue in this Order to provide guidance regarding the Commonwealth's policy with respect to a cooperative corporation's involvement in broadband expansion.

IT IS THEREFORE ORDERED that:

1. Kenergy's July 17, 2020 application is granted in part and denied in part.
2. Kenergy's request for a waiver of KRS 278.2201, only to the extent required to make a one-time \$3 million capital investment in Kenect, is granted.
3. In the event Kenect decides not to pursue the fiber network project, Kenergy shall effectuate a return of the \$3 million capital investment from Kenect.
4. Kenergy's request for a waiver of KRS 278.2213(14) is denied.
5. This Order does not provide any additional waiver or deviation from the requirements of any statute or Commission regulation to Kenergy except those expressly stated herein.
6. This Order in no way affects the authority of the Commission over rates, services, or any matters whatsoever subject to the Commission's jurisdiction that may come before it, nor shall anything herein be construed as acquiescence in any matter

claimed or asserted. The Commission retains jurisdiction over this subject matter and Kenergy to effectuate the provisions of this Order.

7. This case is closed and removed from the Commission's docket.

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By the Commission



ATTEST:



Deputy Executive Director

Case No. 2020-00215

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