

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF SOUTH KENTUCKY RURAL)	
ELECTRIC COOPERATIVE CORPORATION)	CASE NO.
FOR A CERTIFICATE OF PUBLIC)	2008-00371
CONVENIENCE AND NECESSITY TO)	
CONSTRUCT A NEW HEADQUARTERS)	
FACILITY IN SOMERSET, KENTUCKY)	

O R D E R

On October 15, 2009, the Commission issued an Order denying, without prejudice, South Kentucky Rural Electric Cooperative Corporation's ("South Kentucky") application requesting a Certificate of Public Convenience and Necessity ("CPCN") to construct a new headquarters complex in Somerset, Kentucky. Although finding that a new headquarters facility was needed, the Commission ruled that the proposed facility would result in wasteful duplication of facilities. The October 15, 2009 Order permitted South Kentucky to elect to revise its application to address the Commission's concerns regarding the size and scope of the proposed headquarters facility. On November 4, 2009, South Kentucky filed notice of its intent to revise its application. An informal conference was conducted on December 8, 2009 to discuss the issues South Kentucky needed to address as part of its revised application. South Kentucky ultimately filed its revised application on January 22, 2010.

Commission Staff issued, and South Kentucky responded to, four data requests. The matter now stands submitted to the Commission for a decision on the evidentiary record.

DISCUSSION

As originally proposed, the size of South Kentucky's new headquarters facility would total 134,112 square feet. The headquarters would be comprised of an office building (46,060 square feet), a warehouse (62,662 square feet), and a covered fleet parking facility (25,390 square feet). The cost of the proposed headquarters was estimated to be \$18.1 million.

According to the revised application, South Kentucky reduced the total size of the headquarters facility to 122,312 square feet, which represented an 11,800-square-foot reduction from the size of the facility as originally proposed. Specifically, South Kentucky reduced the size of the warehouse to 60,862 square feet and the parking facility to 15,390 square feet. South Kentucky also made adjustments in site improvements to reduce the overall cost of the project to \$15.3 million, which is a 15.5 percent reduction from the originally projected cost.

South Kentucky stated that it analyzed each area of the proposed design and arrived at a revised proposal that satisfies the objective of reducing size and cost in a reasonable and economically feasible manner. According to South Kentucky, the areas selected to be reduced met the criteria of meeting near-term needs with the ability to expand in an economically feasible manner. South Kentucky maintained that cost reduction items that resulted in a "dollar for dollar" savings were selected in preference over items that would have a higher cost if needed in the future.

Based upon these parameters, South Kentucky elected not to revise the office building, stating that the cost savings to reduce square footage in the office building would be much less than the additional cost to expand these areas at a later date.

More specifically, South Kentucky asserted that reducing the size of the office building would not result in cost savings because the cost per square foot would increase as the total square footage of a project decreases. Thus, any reduction in the size of the office building would not result in a “dollar for dollar” savings and any subsequent expansion would be significantly more costly because the size of the expansion project would be smaller in comparison to the current project due to economies of scale. Lastly, South Kentucky pointed out that reductions in the office building would incur additional redesign fees which would further negate any cost savings associated with reducing the size of the office building.

South Kentucky did elect to change certain site improvements as these items could be defined as stand-alone improvements that are not typically impacted by the overall size of the project.

Although revising the pre-engineered cold storage parking structure did not result in a “dollar for dollar” savings, South Kentucky elected to redesign this area because it was considerably more cost-effective than reducing the size of the office building. Reducing the size of the fleet storage did not impact the overall personally occupied space at the garage or the office building. Future expansion of this area could be accomplished without making changes to the existing construction, which makes this expansion cost-effective.

Regarding the headquarters construction project’s impact on rates, South Kentucky forecasts that it would seek a base rate increase in 2012 in the amount of \$8,514,484 if the new headquarters is constructed. In comparison, South Kentucky advised that, if the new headquarters is not constructed, it would still need to seek a

base rate increase in 2012, but the amount would be \$7,228,554, or 18 percent less than projected if the headquarters is built. As a result of building the new headquarters, residential customers would see their average monthly bill increase approximately \$1.19, or by 1.1 percent.

ANALYSIS

Because we have previously determined that South Kentucky has established a need for a new headquarters complex, our focus in this Order is whether South Kentucky's revised proposal will result in wasteful duplication of facilities. "Wasteful duplication" is defined as "an excess of capacity over need" and "excessive investment in relation to productivity or efficiency, and an unnecessary multiplicity of physical properties."¹

Having reviewed the record and being otherwise sufficiently advised, the Commission finds that South Kentucky's revised proposal would not result in wasteful duplication of facilities. As revised, the proposed headquarters complex would reasonably satisfy South Kentucky's near-term needs for office and warehouse space without jeopardizing its ability to expand in the future. The Commission will note, however, that South Kentucky's revised headquarters is on the high end of what could be considered reasonable given the size and scope of the project compared to South Kentucky's net plant investment.² South Kentucky's board of directors owes a fiduciary

¹ *Kentucky Utilities Co. v. Pub. Serv. Comm'n.*, 252 S.W.2d 885, 890 (Ky. 1952).

² South Kentucky's net plant investment for 2009 was projected to be \$152,519,075. See South Kentucky's Responses to Commission Staff's Supplemental Data Request filed February 22, 2010. The total cost of the headquarters project, \$15.3 million, would account for 10 percent of South Kentucky's net plant investment.

duty to its customers to safeguard the financial and operational viability of the cooperative. This fiduciary duty is heightened given the fact that South Kentucky's customers are also the owners of the cooperative.

Although the Commission cannot and should not usurp South Kentucky's board of directors' duty to make business judgments, the Commission will closely scrutinize South Kentucky's expenditures relating to this proposed headquarters project in the company's upcoming rate case proceedings to ensure that only reasonable costs are placed into the utility's rate base, and we will look with disfavor on any rate impact beyond the \$15.3 million total cost for the headquarters project.

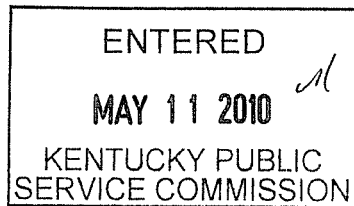
IT IS THEREFORE ORDERED that:

1. South Kentucky is granted a CPCN to construct the proposed facilities set forth in its revised application.
2. South Kentucky shall obtain the approval of the Commission prior to performing any additional construction not expressly authorized by this Order.
3. Any material deviation from the construction approved shall be undertaken only with the prior approval of the Commission.
4. South Kentucky shall furnish documentation of the total costs of this project, including the cost of construction and all other capitalized costs and including, but not limited to, engineering, legal, and administrative expenses, within 60 days of the date construction is substantially completed. Construction costs shall be classified into appropriate plant accounts in accordance with the Uniform System of Accounts for electric utilities as prescribed by the Commission.

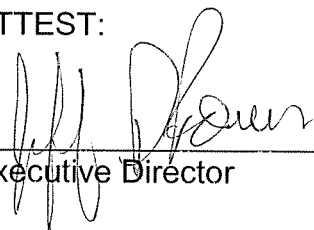
5. South Kentucky shall file with the Commission a copy of the "as-built" drawings and a certified statement that the construction has been satisfactorily completed in accordance with the contract plans and specifications within 60 days of the substantial completion of the construction certificated herein.

6. Any documents filed in the future pursuant to ordering paragraphs 2, 3, 4, and 5 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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