COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF SHELBY ENERGY COOPERATIVE, INC. FOR AN ADJUSTMENT OF RATES	) CASE NO.) 2009-00410

ORDER

On December 30, 2009, Shelby Energy Cooperative, Inc. ("Shelby Energy") filed an application requesting approval to increase its electric rates and to make changes to certain nonrecurring charges. Shelby Energy proposes to adjust its electric rates to increase its operating revenues from $37,313,217 to $39,581,414, an increase of $2,268,197. Shelby Energy's application provided for the new rates to become effective for services rendered on or after February 1, 2010. A review of the application revealed that it did not meet the minimum filing requirements set forth in 807 KAR 5:001, Section 10, and a notice of filing deficiencies was issued. On January 25, 2010, Shelby Energy filed information to cure the last remaining deficiency and proposed a new effective date of February 28, 2010. The Commission found that an investigation would be necessary to determine the reasonableness of Shelby Energy's proposed rates and suspended them for five months, from February 28, 2010 up to and including July 27, 2010, pursuant to KRS 278.190(2). By this Order, the Commission approves the proposed nonrecurring charges and establishes electric rates that will produce annual revenues of $39,237,939, an increase of $1,925,347 over Shelby Energy's adjusted normalized revenues of $37,312,592.

Shelby Energy is a consumer-owned rural electric cooperative organized pursuant to KRS Chapter 279 and engaged in the sale of electric energy to approximately 15,300 customers in the Kentucky counties of Anderson, Carroll, Franklin, Henry, Jefferson, Oldham, Owen, Shelby, Spencer, and Trimble. It is one of 16 member distribution cooperatives that own and receive wholesale power from East Kentucky Power Cooperative, Inc. ("EKPC").

The Commission held a public hearing on the proposed rate adjustment on June 2, 2010.[1] The following persons testified at the hearing on behalf of Shelby Energy: Debbie Martin, President and Chief Executive Officer, and James R. Adkins, Consultant. There were no intervenors in this proceeding.

TEST PERIOD

Shelby Energy proposes to use the 12-month period ending July 31, 2009 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 gives full consideration to appropriate known and measurable changes.

VALUATION

Rate Base

Shelby Energy proposed a net investment rate base of $52,717,992[2] based on the test-year-end value of plant in service, the 13-month average balances for materials and supplies and prepayments, plus a cash working capital allowance, minus the

[1] There was also an informal conference in this matter on April 29, 2010, which was attended by representatives of Shelby Energy and Commission Staff.

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

adjusted accumulated depreciation balance and the test-year-end level of customer advances for construction.

The Commission concurs with Shelby Energy'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. Based on this adjustment, Shelby Energy's net investment rate base for rate-making purposes is as follows:

Utility Plant in Service	$	63,478,258
Construction In Progress		498,796
Total Utility Plant	$	63,977,054
ADD:		
Materials and Supplies	$	310,666
Prepayments		111,589
Working Capital		570,646
Subtotal	$	992,901
DEDUCT:		
Accumulated Depreciation	$	11,378,794
Customer Advances for Construction		897,015
Subtotal	$	12,275,809
NET INVESTMENT RATE BASE	$	52,694,146

Capitalization and Capital Structure

The Commission finds that Shelby Energy's capitalization at test-year-end for rate-making purposes was $54,039,352[3] and consisted of $19,532,384 in equity[4] and $34,506,968 in long-term debt. Using this capital structure, Shelby Energy's equity to total capitalization ratio is 36.15 percent.

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[3] Id. at page 1 of 7.

[4] The Commission normally excludes Generation and Transmission Capital Credits ("GTCCs") from equity and the capital structure. During the test year, Shelby Energy had $350,180 in GTCCs.

REVENUES AND EXPENSES

Shelby Energy proposed several adjustments to revenues and expenses to reflect current and expected operating conditions. The Commission finds that 14 of the adjustments proposed by Shelby Energy are reasonable and should be accepted. Those adjustments are contained in Table 1 below.

Table 1: Shelby Energy's Proposed Adjustments		
Descriptions		Adjustments
Payroll – Salaries	$	57,550
Payroll Taxes	$	5,082
Normalize Depreciation	$	38,849
Normalize Property Taxes	$	24,459
Normalize Interest Exp. Long-Term Debt	$	35,241
Normalize Interest Exp. Short-Term Debt	$	(32,654)
Financial Accounting Standards 106 Costs	$	7,647
Donations	$	(3,562)
Rate Case Amortization	$	24,000
Normalize Nonrecurring Revenues	$	17,698
G & T Capital Credits	$	(350,180)
Test-Year-End Customer Adjustment	$	(15,338)
Normalize Expenses	$	(738,226)
Normalize Revenues	$	(55,836)

The Commission makes the following modifications to the remaining proposed adjustments:

Maintenance of Overhead Lines

During the test year, Shelby Energy experienced an increase of $291,689 for maintenance of overhead lines compared to the 12 months immediately preceding the test period. Shelby Energy attributed $236,537 of this increase to expenses incurred as a result of the September 2008 windstorm and 2009 ice storm events. Shelby Energy stated that this amount represents expenses that were not reimbursed by the Federal Emergency Management Agency ("FEMA"), as only 87 percent of eligible expenses can be recovered and because it had requested to be reimbursed for expenses that FEMA determined did not meet its eligibility criteria for reimbursement.

The Commission recognizes that Shelby Energy experienced two extraordinary weather events in the test year, resulting in an increase in certain levels of expense that may not have occurred otherwise. Due to the extraordinary nature of the events giving rise to the additional maintenance expenses, the Commission finds that these expenses are nonrecurring and should be removed from the test-year expense. Accordingly, the Commission is reducing Shelby Energy's pro forma operating expenses by $236,537. In response to a Commission Staff information request, Shelby Energy agreed that this was the proper treatment for rate-making purposes.

Retirement and Security Expense

Using normalized wages of $1,548,498 and a contribution rate of 24.83 percent, Shelby Energy calculated a pro forma retirement and security expense of $455,356, which resulted in an increase of $211,554 above the test-period level of $243,802.[5] Of the $211,554, $92,688 was capitalized[6] and $118,866 was expensed. In reviewing Shelby Energy's proposed adjustment, Commission Staff calculated the pro forma retirement and security contribution as $384,492, resulting in an increase of only $140,690 above the test-period level. In response to an information request, Shelby Energy verified that the Commission Staff calculation was correct. This produces a

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[5] Application, Exhibit 7, Retirement and Security.

[6] The capitalized portion reflects actual capitalized costs and costs allocated to various clearing accounts. Unless otherwise noted, references in this Order to "capitalized" reflect this combination of actual capitalized costs and allocations to various clearing accounts.

revised retirement and security adjustment, of which $61,650 should be charged to capital and $79,040 charged to expense. This results in a reduction to Shelby Energy's pro forma operating expenses of $39,826. The Commission finds, therefore, that Shelby Energy's pro forma retirement and security expense adjustment of $118,865 should be reduced by $39,826, to $79,040.

Subsidiary Income

During the test year, Shelby Energy realized $50,722 of income from its investment in a propane subsidiary. Shelby Energy owns 75 percent of Shelby Energy Services Corporation and EKPC owns the remaining 25 percent. Shelby Energy's initial investment in the subsidiary was made in 1998. It has been the Commission's practice to eliminate any subsidiary activities from test-year operations in electric cooperative rate cases. Shelby Energy acknowledged this at the hearing and stated that it was an oversight not to have made the appropriate adjustment in its application. Therefore, in keeping with its practice of maintaining separation between regulated and non-regulated operations, the Commission has removed the subsidiary income of $50,722 from the test-year operating results.

Disposition of Assets

In its application, Shelby Energy reflected a loss on the disposition of assets in the amount of $110,710 for the test year. This amount included a loss of $120,827 on the sale of vehicles. As a result of information presented at the informal conference and the hearing, it was determined that Shelby Energy incurred losses on the sale of vehicles in April, June and July of 2008, but did not recognize the losses until the 2008 year-end closing of its books. This resulted in inclusion of those losses in the test year even though the transactions resulting in the losses occurred prior to the test year. Since these transactions were outside the test year, the Commission has reduced test-year expenses to remove the loss of $120,827. Shelby Energy acknowledged that it was proper to remove these transactions from the test year but proposed an adjustment of $16,500 to recognize the average losses it incurred on asset dispositions for 2004 through 2009.

Although the results of Shelby Energy's disposition of assets vary from year to year, the magnitude of its gains or losses is not large enough to indicate that this is an item for which an average should be included for rate-making purposes. The Commission finds it more appropriate to reflect the actual test-year amount and, therefore, will not make the $16,500 adjustment Shelby Energy proposed.

Professional Services Expenses

Shelby Energy proposed to reduce professional services expenses by $60,989 for items not normally included for rate-making purposes and certain nonrecurring items. During the test year, Shelby Energy deferred costs of $107,695 incurred for a Commission-ordered management audit. Shelby Energy is proposing to amortize the cost over three years at $35,898 annually. In addition, Shelby Energy's outside employees formed a union for which Shelby Energy incurred legal fees totaling $121,745 during the test year. Shelby Energy is proposing to amortize these legal costs over three years, resulting in an annual expense of $40,582. In addition to these adjustments, Shelby Energy removed nonrecurring expenses in the amount of $15,724 from test-year operations.

The Commission agrees with the adjustments proposed by Shelby Energy and has identified three additional adjustments that should be made to professional services. Legal fees were incurred in the amount of $3,269 for a complaint case involving a former employee. Shelby Energy recognized this as a nonrecurring expense which the Commission will remove for rate-making purposes. Shelby Energy has included in professional services $11,866 for consultant fees related to various human resource issues. Shelby Energy expects the annual recurring costs to be $7,500 for this service and, accordingly, the Commission finds that $4,366 should be removed for rate-making purposes. Shelby Energy estimates that it will incur $8,500 in annual legal fees related to the administration of issues arising as a result of its new union contract. Therefore, the Commission will increase professional services expenses by $8,500. The net effect of these three adjustments is to increase professional services by $865. When combined with Shelby Energy's adjustment to reduce professional services by $60,989, the total net adjustment to professional services is a reduction of $60,124.

Directors' Fees and Expenses

During the test year, Shelby Energy paid its seven directors fees and expenses totaling $89,234. Shelby Energy proposed adjustments to reduce this expense by $44,202 to exclude certain expenses for rate-making purposes.[7] The Commission agrees with the exclusions identified by Shelby Energy. The Commission has also determined that the per diem adjustment was overstated by $600 and that this amount

[7] Application, Exhibit 10. The $44,202 adjustment was comprised of life insurance premiums, per diems, and annual meeting expenses for directors who were not delegates or alternate delegates to the Kentucky Association of Electric Cooperatives ("KAEC"), and EKPC annual meetings.

should be deducted from Shelby Energy's proposed adjustment to test-year directors' fees and expenses. This results in a net reduction of $43,602 to directors' fees and expenses.

Miscellaneous Expenses

Shelby Energy proposed to exclude $43,445 in miscellaneous expenses for items the Commission normally has not included for rate-making purposes.[8] The Commission agrees with the exclusions identified by Shelby Energy. The Commission has also calculated the total to be excluded from Account 909.00, Informational Expense, to be $4,810, rather than $3,910 as proposed by Shelby Energy. Accordingly, the Commission has reduced Shelby Energy's operating expenses by $900.

Pole Attachment Rates

Shelby Energy proposed increases in its cable television ("CATV") attachment charges that resulted in additional revenues of $16,961. In response to data requests, Shelby Energy revised its CATV rates to reflect a revised rate of return. The Commission has reviewed the revised approach used by Shelby Energy to determine its CATV rates and finds it to be reasonable, as it is consistent with previous Commission decisions on CATV rates. The Commission believes that the CATV rate calculations should reflect the most current rate of return. Therefore, the Commission finds that Shelby Energy's CATV rates should be calculated based on the rate of return approved in this Order, resulting in an increase in revenues of $16,336. This results in CATV revenues being reduced by $625.

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[8] Application, Exhibit 11. These expenses include promotional advertising, sponsorships, employee picnic, and nominating committee expenses.

PSC Assessment

Shelby Energy did not propose an adjustment to its PSC Assessment to reflect the effects of its normalization of 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 in this Order is appropriate. Based on the 2009-2010 PSC Assessment rate, the calculation of such an adjustment results in a decrease in the PSC Assessment for the test year of $529. The Commission has also determined that an adjustment to the PSC Assessment based on the revenue increase being granted herein should be calculated using the 2009-2010 PSC Assessment rate. This calculation results in an increase in the PSC Assessment in the amount of $2,957. The result of these adjustments is a net increase of $2,428 in the PSC Assessment.

Pro Forma Adjustments Summary

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

	Actual Test Period	Pro Forma Adjustments	Adjusted Test Period
Operating Revenues	$37,238,060	$ 74,532	$37,312,592
Operating Expenses	35,391,323	589,775	35,981,098
Net Operating Income	1,846,737	(515,243)	1,331,494
Interest on Long-Term Debt	1,652,811	35,241	1,688,052
Interest Expense-Other	54,824	(32,654)	22,170
Other Income and (Deductions) – Net	420,904	(276,513)	144,391
NET INCOME	$ 560,006	$ (794,343)	$ (234,337)

REVENUE REQUIREMENTS

The rate of return earned on Shelby Energy's net investment rate base established for the test year was 4.86 percent.[9] Shelby Energy's requested rates would result in a Times Interest Earned Ratio ("TIER") of 2.00X, excluding GTCC, and a rate of return of 6.40 percent on its proposed rate base of $52,717,992.[10] Shelby Energy proposes an increase in revenues of $2,268,197 to achieve the 2.00X TIER excluding GTCCs.[11]

Shelby Energy's actual TIER excluding GTCCs for the test period was 1.13X.[12] For the calendar years 2007 and 2008, Shelby Energy's TIERs were 1.65X and 0.84X, respectively.[13] After taking into consideration the allowable pro forma adjustments without an increase in revenues, Shelby Energy would have an adjusted test-year TIER of 0.86X excluding GTCCs.

The Commission finds that the use of a 2.00X TIER is reasonable for Shelby Energy. In order to achieve the 2.00X TIER, Shelby Energy would need an increase in annual revenues of $1,925,347.

Based upon the pro forma adjustments found reasonable, the Commission has determined that an increase in Shelby Energy's revenues of $1,925,347 would result in a TIER of 2.00X. This additional revenue should produce net income of $1,688,052

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[9] Application, Exhibit K at 1.

[10] Id.

[11] Id. Exhibit S at 1.

[12] Application, Exhibit K at 6.

[13] Id.

and, based on the net investment rate base of $52,694,146 found reasonable herein, should result in a rate of return on rate base of 6.41 percent.[14]

PRICING AND TARIFF ISSUES

Cost of Service

Shelby Energy filed a fully allocated cost-of-service study ("COSS") for the purposes of determining the cost to serve each customer class and the amount of revenue to be allocated to each customer class. The COSS indicates that the General Service Rate 1, Off-Peak Marketing Rate, Optional Rate 10, and Outdoor and Street Lighting Service customer classes all produce revenues insufficient to meet the costs to serve their respective classes, while the large industrial rate classes, Schedules B1 and B2, produce revenues in excess of the costs Shelby Energy incurs to serve those classes.

Having reviewed Shelby Energy's COSS, the Commission finds it to be acceptable for use as a guide in allocating the revenue increase granted herein.

Revenue Allocation and Rate Design

Currently, two of Shelby Energy's rate classes, General Service Rate 1 ("Rate 1") and Optional Rate 10 ("Rate 10"), contain both residential and non-residential customers. Shelby Energy is proposing to eliminate both of those rate classes and replace them with two new rate classes: Residential Rate 12 for residential customers only, and General Service Rate 11 for non-residential customers. Shelby Energy's proposal to eliminate these two rates and establish two new rate classes would result in

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[14] The revised CATV rates provided in response to item 4, Third Data Request of Commission Staff to Shelby Energy, were based on a rate of return of 6.4 percent. The increase in the rate of return to 6.41 percent has no effect on the revised rates provided in that response.

an increase of 4.8 percent for current Rate 1 and 14 percent for current Rate 10 customers. Shelby Energy is also proposing a 22.7 percent increase to the Off-Peak Marketing class and an 18.5 percent increase to the Outdoor and Street Lighting class. No increase in revenues is proposed for the Large Power Service class, but Shelby Energy is proposing to change the rate structure by instituting a consumer facility charge of $50.15 while consolidating the multi-step energy charges per kWh into one energy charge. In addition, Shelby Energy is proposing to increase its CATV rates and nonrecurring charge rates.

Based on the results of its COSS, Shelby Energy is proposing an increase in the consumer facility charge from $7.92 to $9.75 for residential customers currently served under Rate 1. Because Shelby Energy is proposing to include all residential customers in the same rate class, residential customers currently served under Rate 10 would see a decrease in their consumer facility charge from $12.52 to $9.75.

The difference between the revenue increase of $2,268,197 proposed by Shelby Energy and the increase of $1,925,347 approved in this Order is $342,850. During the hearing in this matter, Shelby Energy recommended that, if the Commission approved a revenue increase less than had been proposed, the decrease in its proposed revenues should be reflected as a reduction in the residential energy charge. The reasons given by Shelby Energy for this recommendation are that the residential class is receiving the largest amount of the increase and therefore should benefit from any reduction in the requested increase, and the desire to maintain the proposed residential consumer facility charge at $9.75 given that the COSS justified a much larger charge.

The Commission finds that Shelby Energy's proposal to allocate the reduction in proposed revenues to the residential energy charge is reasonable and should be adopted. Based on Shelby Energy's average residential usage of 1,522 kWhs, the average bill for Rate 1 residential customers would increase from $146.02 to $149.09, or 2.08 percent; and the average bill for Rate 10 residential customers would increase from $133.28 to $149.09, or 11.87 percent.[15] All other rates and charges proposed by Shelby Energy are accepted as proposed, with the exception of the CATV attachment rates which were updated by Shelby Energy in response to a Commission Staff information request.[16]

OTHER ISSUES

Energy Efficiency and Demand-Side Management ("DSM")

The Commission believes that conservation, energy efficiency and DSM will become more important and cost-effective in the future, as more constraints are likely to be placed upon utilities whose main source of supply is coal-based generation. The Governor's proposed energy plan, *Intelligent Energy Choices for Kentucky's Future, November 2008,* calls for an increase in DSM by 2025. In addition, the Commission stated its support for cost-effective demand-side programs in response to several recommendations included in *Electric Utility Regulation and Energy Policy in Kentucky,*

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[15] The percentage increase for Rate 10 residential customers will be mitigated by the automatic inclusion of these customers on Shelby Energy's Direct Load Control Program, Tariff Section DSM.

[16] Response to item 4, Third Data Request of Commission Staff to Shelby Energy Cooperative, Inc., filed April 5, 2010.

the report the Commission submitted in July 2008 to the Kentucky General Assembly pursuant to Section 50 of the 2007 Energy Act.

According to the tariffs in its application, Shelby Energy offers its customers the Touchstone Energy Home Program and the residential and commercial direct load control programs available to the member cooperatives served by EKPC. In addition, Shelby Energy currently offers nine non-tariffed DSM programs to its residential and commercial members.[17] Although Shelby Energy has a number of energy efficiency programs in place, the Commission believes that it is appropriate to encourage Shelby Energy, and all other electric energy providers, to make a greater effort to offer cost-effective DSM and other energy efficiency programs.

Shelby Energy stated at the hearing that it was in the process of purchasing and installing Advance Metering Infrastructure ("AMI") equipment. Shelby Energy indicated it had filed with the Commission an amendment to its current construction plan to include this investment. Shelby Energy also stated that it had recently filed a new construction work plan requesting approval to incur additional costs for the AMI meters. Subsequent to the hearing, a review of the Commission's records indicated that Shelby Energy had not filed an amendment to its current construction work plan, which covered years 2005 through 2009, and had not filed a new work plan. On June 18, 2010, Shelby Energy filed a notice of intent to file a new construction work plan, covering 2010 through 2014, and filed that plan on July 23, 2010. The Commission reminds Shelby Energy 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

[17] Response to Item 14, Third Data Request of Commission Staff to Shelby Energy Cooperative, Inc., filed April 5, 2010.

approved by our issuance of a Certificate of Public Convenience and Necessity prior to proceeding with any project activities.

Depreciation Study

Shelby Energy stated that it has not conducted a depreciation study since its inception. While it generally follows the Rural Utilities Service guidelines for depreciation rates, the Commission finds that Shelby Energy should perform a depreciation study by the earlier of five years from the date of this Order or the filing of its next rate case.

SUMMARY

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

1. The rates set forth in the Appendix to this Order are the fair, just, and reasonable rates for Shelby Energy 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 Shelby Energy's financial obligations.

3. The rates proposed by Shelby Energy 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 Shelby Energy are denied.

2. The rates in the Appendix attached to this Order and incorporated herein are approved for service rendered by Shelby Energy on and after the date of this Order.

3. Within 20 days of the date of this Order, Shelby Energy 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.

4. Shelby Energy shall perform a depreciation study within five years from the date of this Order, or with the filing of its next rate case, whichever is earlier.

By the Commission

ENTERED
JUL 27 2010
KENTUCKY PUBLIC
SERVICE COMMISSION

ATTEST:

Executive Director

APPENDIX

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2009-00410 DATED JUL 27 2010

The following rates and charges are prescribed for the customers in the area served by Shelby Energy Cooperative, Inc. 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.

RATE 12
RESIDENTIAL SERVICE

Consumer Facility Charge per Month	$	9.75
Energy Charge per kWh	$	.09155

RATE ETS
OFF-PEAK RETAIL MARKETING SERVICE

Energy Charge per kWh	$	.06519

RATE 11
GENERAL SERVICE

Consumer Facility Charge per Month		
Single Phase	$	12.52
Three Phase	$	32.56
Energy Charge per kWh	$	.09308

RATE 2
LARGE POWER SERVICE

Consumer Facility Charge per Month	$	50.15
Demand Charge per kW	$	4.97
Energy Charge per kWh	$	.06823

RATE 3
OUTDOOR AND STREET LIGHTING SERVICE

Monthly Rates:
High Pressure Sodium

100 Watt Security Light	$ 9.31
100 Watt Decorative Colonial Light	$ 12.44
400 Watt Directional Flood Light	$ 19.46
250 Watt Directional Flood Light	$ 13.90
150 Watt Decorative Acorn Light	$ 14.94

RATE 5
CABLE TELEVISION ATTACHMENTS

Annual charge as follows:

Two-party Pole Attachment	$ 5.30
Two-party Anchor Attachment	$ 6.86
Two-party Grounding Attachment	$ .24
Three-party Pole Attachment	$ 4.50
Three-party Anchor Attachment	$ 4.52
Three-party Grounding Attachment	$ .15

NONRECURRING CHARGES

Returned Check	$ 25.00
Collection	$ 30.00
Reconnect or Disconnect	$ 35.00
Meter Test	$ 32.50
Overtime	$ 75.00

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