COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF SOUTH KENTUCKY RURAL ELECTRIC COOPERATIVE CORPORATION FOR A GENERAL ADJUSTMENT OF RATES, APPROVAL OF DEPRECATION STUDY, AND OTHER GENERAL RELIEF	))))	Case No. 2021-00407

ATTORNEY GENERAL'S POST-HEARING BRIEF

The intervenor, the Attorney General of the Commonwealth of Kentucky, through his Office of Rate Intervention ("Attorney General"), submits the following Post-Hearing Brief to the Public Service Commission ("Commission") in the above-styled matter.

STATEMENT OF THE CASE

South Kentucky Rural Electric Cooperative Corporation ("South Kentucky RECC" or the "Company"), a not-for-profit, member-owned rural electric distribution cooperative organized under KRS 279, distributes retail electric power to approximately 68,000 member customers in the Kentucky counties of Adair, Casey, Clinton, Cumberland, Laurel, McCreary, Pulaski, Rockcastle, Russel, and Wayne.[1] The Company owns approximately 7,000 circuit miles of distribution line in its service territory, and purchases its power requirements from East Kentucky Power Cooperative, Inc. ("EKPC"), pursuant to an October 1, 1964 wholesale power contract, and subsequent amendments.[2] South Kentucky RECC is a utility subject to the rates and service jurisdiction of the Commission.

[1] Application at unnumbered page 1.
[2] *Id*.

South Kentucky RECC filed its notice of intent to file an application for an adjustment of rates on October 27, 2021. The Company subsequently filed its application on December 14, 2021, utilizing a historic test year ended March 31, 2020.[3] The Commission issued a deficiency letter to South Kentucky RECC on December 21, 2021, and the Company filed a response to the letter on the same day. The Commission issued an Order on January 10, 2022, requiring South Kentucky RECC to submit information to cure the deficiencies in the tariff and notice, but deemed the application filed as of December 14, 2021. The Attorney General was granted intervention by Commission Order on January 10, 2022.

In the application, South Kentucky RECC requests an increase in revenues totaling \$8,685,396 per year, or 7.71% over current revenues.[4] However, in response to the testimony of the Attorney General's expert witness, Mr. Lane Kollen, the Company revised its increase in revenues to \$8,669,257.[5] South Kentucky RECC is also requesting to increase the residential monthly customer charge from \$13.29 to \$24.00,[6] or an 80.59% increase. The Company proposes to phase in the total revenue increase in two steps by employing an initial revenue increase of \$4,336,975 (Phase 1), and then twelve months later, increase revenues by an additional \$4,348,421 (Phase 2).[7] Under the proposal, the residential monthly customer charge increase will become effective in Phase 1 and remain the same when Phase 2 is implemented.[8]

[3] *Id*. at unnumbered page 3.
[4] *Id*.
[5] Rebuttal Testimony of William Steven Seelye ("Seelye Rebuttal Testimony") at 27; Seelye Rebuttal Testimony, Rebuttal Exhibit WSS-3, Revised Revenue Increase Analysis.
[6] Application at unnumbered page 3.
[7] *Id*.
[8] *Id*.

South Kentucky RECC responded to multiple rounds of discovery propounded by the Attorney General and Commission Staff. The Attorney General filed Mr. Kollen's testimony on March 9, 2022, and responded to discovery propounded by the Commission Staff and the Company on April 1, 2022. On May 10, 2022, a formal hearing was conducted, and on May 18, 2022, the Company filed responses to post-hearing discovery.

ARGUMENT

Pursuant to KRS 278.190(3), South Kentucky RECC bears the burden of proof to demonstrate "that an increase of rate or charge is just and reasonable."[9] South Kentucky RECC has failed to meet its burden of proof to demonstrate that the requested revenue increase will result in fair, just, and reasonable rates.[10] The Attorney General recommends a downward adjustment to the requested $8,669,257 revised revenue increase because approving the Company's application as is will result in unjust, unfair, and unreasonable rates due to the following issues.

I. South Kentucky RECC's proposal to increase its residential monthly customer charge by 80.59% is unreasonable.

As previously discussed, with respect to the residential class, South Kentucky RECC proposes to increase its residential monthly customer charge from $13.29 to $24.00,[11] which equates to an 80.59% increase. An increase of this magnitude to the residential charge will hinder residential customers' ability to control their monthly electric bills, and pose a financial hardship on those customers struggling to make ends meet. If

[9] Kentucky-American Water Company v. Commonwealth ex rel. Cowan, 847 S.W.2d 737,741 (Ky. 1993).
[10] *See* KRS 278.190. "At any hearing involving the rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the utility…"; *See also* Energy Regulatory Commission v. Kentucky Power Co., 605 S.W.2d 46, 50 (Ky. App. 1980). (At such hearing and through the Commission proceeding, the municipal utility seeking the rate adjustment bears the burden of showing that the proposed adjustment is reasonable.)
[11] Application at unnumbered page 3.

the Commission grants South Kentucky RECC's proposed $24.00 residential monthly customer charge then the Company will have a higher customer charge than 19 other electric cooperatives in the Commonwealth, with only 3 electric cooperatives having a higher customer charge.[12]

The average poverty rate in South Kentucky RECC's service territory is 22.1%,[13] with the highest poverty rate of 36.2% in McCreary County[14] and the lowest of 17.9% in Laurel County.[15] The Company admits that the federal poverty rates for its service territory "are likely among the highest in the United States."[16] Due to the existing poverty and difficult economic conditions, the Attorney General appeals to the Commission to employ gradualism when awarding any increase in South Kentucky RECC's residential monthly customer charge. The Commission has relied upon the principle of gradualism in ratemaking, which mitigates the financial impact of rate increases on customers.[17] South Kentucky RECC's proposed 80.59% increase to the residential monthly customer charge violates this important ratemaking principle.

If the Commission were to grant South Kentucky RECC's requested $24.00

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[12] South Kentucky RECC's Response to the Attorney General's Second Request for Information ("Attorney General's Second Request"), Item 7.

[13] South Kentucky RECC's response to the Attorney General's First Request for Information ("Attorney General's First Request"), Item 1(a).

[14] https://www.census.gov/quickfacts/fact/table/mccrearycountykentucky,KY/POP060210; South Kentucky RECC's response to the Attorney General's First Request, Item 1(c).

[15] https://www.census.gov/quickfacts/fact/table/laurelcountykentucky,KY/POP060210; South Kentucky RECC's response to the Attorney General's First Request, Item 1(c).

[16] South Kentucky RECC's Response to the Attorney General's First Request, Item 1(a).

[17] Case No. 2014-00396, In the Matter of Application of Kentucky Power Company for: (I) A General Adjustment of its Rates for Electric Service; (2) An Order Approving its 2014 Environmental Compliance Plan; (2) An Order Approving its Tariffs and Riders; and (4) An Order Granting All Other Required Approvals and Relief, Order (Ky. PSC June 22, 2014) ("the Commission has long employed the principle of gradualism"); *See also* Case No. 2000-00080, In the Matter of: The Application of Louisville Gas & Electric Company to Adjust its Gas Rates and to Increase its Charges for Disconnecting Service, Reconnecting Service and Returned Checks, Order (Ky. PSC Sept. 27, 2000) ("the Commission is adhering to the rate-making concepts of continuity and gradualism in order to lessen the impact of these increases on the customers that incur these charges.")

residential monthly customer charge, the Attorney General recommends that the increase be implemented in a two-phased approach. For example, during the first phase the residential monthly customer charge could increase to $18.64 in the first year, and then under the second phase increase to $24.00 in the second year. This provides an opportunity for South Kentucky RECC's customers to absorb the higher monthly customer charge over a longer period of time, rather than immediately force customers to pay an 80.59% increase.

II. South Kentucky RECC incorrectly uses Operating Times Interest Earned Ratio ("OTIER") in lieu of Times Interest Earned Ratio ("TIER").

As set forth in Mr. Kollen's testimony, South Kentucky RECC incorrectly uses OTIER instead of TIER when calculating the necessary margins needed in rates, which in turn improperly inflates the requested rate increase.[18] In other words, when South Kentucky RECC states that the proposed rates are based upon a 2.0 TIER, the Company's calculations are actually based on a 2.0 OTIER. The 2.0 OTIER actually translates into a much greater 2.33 TIER.[19]

Mr. Kollen further explains that the erroneous calculation of TIER began when South Kentucky RECC's expert witness Mr. Seelye started with per books *operating*

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[18] Direct Testimony of Lane Kollen ("Kollen Testimony") at 10.

[19]

Seelye Rebuttal Adjusted Net Operating Margin	$	5,780,462
Add Back Interest Income Adjustment Made to Net Operating Margin In Error		1,401,979
Adjusted Seelye Rebuttal Net Operating Margin		7,182,441
Add Non-Operating Margins - Interest (After Seelye Adjustment)		281,757
Add Non-Operating Margins Other		115,206
Add Other Capital Credits and Dividends		135,552
Adjusted Net Patronage Margins Excluding G&T Capital Credits	$	7,714,956
Seelye Rebuttal Adjusted Long Term Debt Interest Expense	$	5,780,462
TIER ($7,714,956+$5,780,462)/$5,780,462)		2.33

margins of $0.616 million and made all of his adjustments to this starting point, including the adjustment to reduce *nonoperating* interest income, instead of starting with *net* margins of $7.639 million and then making an adjustment to remove the EKPC capital credits.[20] Mr. Kollen states that Mr. Seelye incorrectly excluded all nonoperating income items from the calculation of the base revenue deficiency, and thus used the operating margin instead of the net margin.[21] These fundamental errors were made due to Mr. Seelye's incorrect use of OTIER instead of TIER.[22] The difference between the two is that TIER uses net margin in the numerator, while OTIER uses operating margin in the numerator.[23] The net margin used in TIER reflects the additional nonoperating income and expense line items that are not included in operating margin used in OTIER, excluding the EKPC capital credits.[24]

This is a critically important issue and one that directly affects South Kentucky RECC's rate increase. The TIER includes nonoperating income and expense in the revenue requirement despite erroneous testimony to the contrary.[25] Unlike investor-owned utilities, where operating income is used in the revenue requirement calculation, cooperatives start with net margins (operating margins plus or minus nonoperating income and expense items) and then subtract the Generation and Transmission ("G&T") capital credits to determine the revenue requirement.

By incorrectly using OTIER instead of TIER, South Kentucky RECC failed to include three substantial income items, which would otherwise reduce the Company's requested base rate increase.[26] Specifically, South Kentucky RECC's request ignores: (a)

[20] Kollen Testimony at 10.
[21] *Id*. at 10 – 11.
[22] *Id*. at 11.
[23] *Id*.
[24] *Id*.
[25] Video Transcript of Evidence ("VTE") at 11:42:30 – 11:43:48.
[26] Kollen Testimony at 11.

nonoperating margins – interest income; (b) nonoperating margins – other; and, (c) other capital credits income.[27] All three of these income items are included in the Rural Utilities Service ("RUS") definition of TIER and the Commission historically includes these items in the calculation of the revenue requirement.[28]

As Mr. Kollen illustrated, the first income item incorrectly excluded from the Company's requested revenue requirement is the $1.684 million in interest income for the test year, consisting primarily of the RUS Cushion of Credit interest income, included in the net margin, but not in the operating margin.[29] The Commission historically includes interest income in the calculation of the revenue requirement.[30] Even though South Kentucky RECC did not include the per books interest income in the calculation of the revenue requirement, the Company nevertheless subtracted $1.402 million for the reduction in the RUS Cushion of Credit interest income as a proforma adjustment in the calculation of the revenue requirement.[31] The Company's failure to include the per books interest income is therefore an obvious error that increases the revenue requirement. South Kentucky RECC would need to include the $1.684 million in per books interest income in the margin in the first place before the Company could subtract the proposed $1.402 million in per books interest income as an adjustment. In the Company's calculations, the interest income is negative $1.402 million.[32] Mr. Kollen recommends the Commission correct this error by including the per books interest income of $1.684 million in the net margin used to calculate the base revenue deficiency, because this interest income is included in the

[27] *Id*.
[28] *Id*. at 11 – 12; South Kentucky RECC's response to the Attorney General's Second Request, Item 28.
[29] Kollen Testimony at 12.
[30] South Kentucky RECC's response to the Attorney General's Second Request, Item 28.
[31] *Id*.; Seelye Rebuttal Testimony, Rebuttal Exhibit WSS-3, Revised Revenue Increase Analysis.
[32] Seelye Rebuttal Testimony, Rebuttal Exhibit WSS-3, Revised Revenue Increase Analysis.

actual definition of TIER.[33] Alternatively, the Commission should reject the Company's proposed adjustment to reduce the interest income. Either both the interest income and the adjustment are included in the calculation of the TIER used for the revenue requirement or they both need to be excluded.

Specifically, the error regarding the $1.402 million subtraction in interest income is illustrated using information from Mr. Seelye's Direct Testimony Exhibit WSS-2[34] and WSS-3.[35] Exhibit WSS-2 represents Mr. Seelye's calculation of the 2.0 TIER based on a starting point of per books net operating margins.[36] Exhibit WSS-3 reflects not only the net operating margins, but also reflects each of the other amounts appropriately used in the TIER calculation.[37] Thus, Exhibit WSS-3 should have been used as the source of the TIER calculation. Exhibit WSS-2 indicates on line 19 that total adjustments of ($3,559,066) were made to the level of per books net operating margins of $615,560 as reflected on line 1.[38] This resulted in a test year adjusted level of net operating margins on line 20 of ($2,943,507), before application of the additional PSC assessment fee found on line 22.[39] The $1.402 million subtraction in Cushion of Credit interest income was made on line 9 and erroneously included in the total adjustments to net operating margins found on line 19.[40] Exhibit WSS-3 reflects the same level of per books net operating margins on line 21

[33] Kollen Testimony at 13.
[34] Direct Testimony of William Steven Seelye ("Seelye Testimony"), Exhibit WSS-2, Pro-Forma Revenue Requirement Analysis.
[35] Seelye Testimony, Exhibit WSS-3, Test Year Operating Results.
[36] Seelye Testimony, Exhibit WSS-2, Pro-Forma Revenue Requirement Analysis.
[37] It should be noted that the adjustment to nonoperating interest income on Exhibit WSS-3 was made incorrectly to operating income on Exhibit WSS-2, which resulted in negative interest income of $1.402 million in Mr. Seelye's calculation of the Company's revenue deficiency on Exhibit WSS-2.
[38] Seelye Testimony, Exhibit WSS-2, Pro-Forma Revenue Requirement Analysis.
[39] *Id*.
[40] *Id*.

of $615,560, as the per books net operating margins found on Exhibit WSS-2.[41] However, the $1.402 million subtraction in interest income was appropriately reflected on line 22, the non-operating margins-interest.[42] The adjustment was not included in the net operating margins on line 21 on Exhibit WSS-3, but was included in error in adjusted net operating margins found on Exhibit WSS-2. This highlights the Company's use of the OTIER instead of the TIER, and its inaccuracies in the line items it included or excluded in the OTIER to determine the revenue requirement and deficiency.

The second income item incorrectly excluded from the requested revenue increase is the $0.115 million in nonoperating margins – other income in the test year.[43] This error incorrectly contributes another $0.115 million to the Company's claimed revenue deficiency.[44] Mr. Kollen recommends the Commission correct this error by including the per books nonoperating margins - other income of $0.115 million in the net margin that is used to calculate the base revenue deficiency. This other income is included in the actual definition of TIER and the Commission historically includes nonoperating margins – other income in the calculation of the revenue requirement.[45]

The third income item incorrectly excluded is $0.136 million in other capital credits and dividends income from South Kentucky RECC's investment in the Cooperative Finance Cooperation ("CFC").[46] Mr. Kollen recommends correcting this error by including the other income of $0.136 million in the net margin that is used to calculate the base revenue deficiency. This recommendation is because the other capital credits and dividends

[41] Seelye Testimony, Exhibit WSS-3, Test Year Operating Results.
[42] *Id*.
[43] Kollen Testimony at 13.
[44] *Id*.
[45] *Id*.; South Kentucky RECC's response to the Attorney General's Second Request, Item 28.
[46] Kollen Testimony at 13 – 14.

income from the Company's investment in CFC is included in the actual definition of TIER, and because the Commission historically includes other capital credits and dividends in the calculation of the revenue requirement.[47] Furthermore, the cash capital credits and dividends income is included in the definition of OTIER. The Company's failure to include both, even in the OTIER calculation, which it substituted for the TIER calculation is in error.

In rebuttal testimony, Mr. Seelye rejects Mr. Kollen's proposed TIER adjustments, but admits that the way he calculated TIER is not in line with the definition of TIER used by RUS in its debt covenants.[48] Further, Mr. Seelye conflates TIER and OTIER in discovery responses by asserting that while the Commission refers to TIER in prior cases, the rural electric cooperatives often refer to this formula as OTIER.[49] As previously discussed, TIER and OTIER are two completely different formulas. In numerous Orders, the Commission refers separately to the TIER and OTIER.[50] They are not interchangeable.

Mr. Seelye further cites to the streamlined ratemaking process for rural electric cooperatives stemming out of the Commission's Final Order in Case No. 2018-00407, and states that in those cases an OTIER is used instead of TIER.[51] Mr. Seelye fails to mention that in the streamlined ratemaking process rural electric cooperatives are limited to a maximum of a 1.85 OTIER, not a 2.0 OTIER.[52] Even though in a general base rate case the rural electric cooperatives practice is to almost always propose rates based upon a 2.0

[47] *Id*. at 14; South Kentucky RECC's response to the Attorney General's Second Request, Item 28.
[48] Seelye Rebuttal Testimony at 14; *See* Kollen Testimony at 12.
[49] South Kentucky RECC's response to the Attorney General's First Request, Item 30(b).
[50] South Kentucky RECC's response to the Attorney General's Second Request, Item 28.
[51] South Kentucky RECC's response to the Attorney General's First Request, Item 30(b).
[52] Case No. 2018-00407, A Review of the Rate Case Procedure for Electric Distribution Cooperatives (Ky. PSC Mar. 25, 2019), Order at Appendix A.

TIER,[53] if Mr. Seelye preferred to calculate South Kentucky RECC's proposed rates based upon OTIER then: (a) he should not have claimed that the proposed rates were based upon a 2.0 TIER; and, (b) his proposed rates should have been calculated with a maximum OTIER of a 1.85. Thus, the Attorney General requests that the Commission adopt Mr. Kollen's proposed modifications, which are necessary to properly calculate South Kentucky RECC's revenue requirement based upon TIER instead of OTIER.

III. South Kentucky RECC's proposed long-term debt interest expense greatly overstates the Company's actual long-term debt interest expense.

The Company calculated $5.814 million in long-term debt interest expense, consisting of the $5.529 million in per books test year long-term debt interest expense plus a proforma adjustment for $0.285 million in annualized interest on two new debt issuances in February and March 2020.[54] Mr. Kollen identified four separate errors the Company made when calculating the proposed long-term debt interest included in the revenue requirement.[55] It is important to get the long-term debt interest correct not only because it directly affects the revenue requirement, but because it is multiplied by the TIER, in this case, the requested 2.0 TIER, so that every dollar of long-term debt interest equals to two dollars of revenue requirement. In rebuttal testimony, the Company's Vice President of Finance and Member Services Ms. Herrman, agreed to correct two of the four errors Mr. Kollen identified,[56] and provided a revised, slightly lower long-term debt interest amount of $5.78 million.[57] It is the Attorney General's position that the revised amount of $5.78 million still greatly overstates South Kentucky RECC's *actual* long-term debt interest, and

[53] South Kentucky RECC's response to the Attorney General's Second Request, Item 28.
[54] Kollen Testimony at 18 – 19.
[55] *Id*. at 18 – 21.
[56] Rebuttal Testimony of Michelle D. Herrman ("Herrman Rebuttal Testimony") at 7 – 8.
[57] Seelye Rebuttal Testimony, Rebuttal Exhibit WSS-3, Revised Revenue Increase Analysis.

moreover, the two additional errors Mr. Kollen identified must be corrected in order to accurately annualize interest expense on debt outstanding as of March 31, 2020.

However, the Company's interest expense has continued to decline since the end of the test year. South Kentucky RECC's long-term debt interest expense as of December 31, 2021, had declined to $5.24 million.[58] Then, on January 20, 2022, the Company drew down a $10 million note at an interest rate of 2.098%.[59] Yet, even with this additional $10 million loan, the most recent updated long-term debt interest expense in the record from April 2022 declined to $5.01 million.[60]

In the April 8, 2022 Final Order in Case No. 2021-00358, the Commission stated that 807 KAR 5:001, Section 16(1) does not specify a time limitation on a proposed adjustment to a historical test period, but rather that the adjustment must be based upon known and measurable changes.[61] Thus, the Company should be required to use this updated data that it is both known and measurable, and more reflective of the Company's *actual* long-term debt interest expense. This should result in a decrease to South Kentucky RECC's requested rate increase.

IV. RUS Cushion of Credit Program and CFC Commercial Paper Program Issues

Mr. Kollen describes how South Kentucky RECC proposes a reduction in interest income to reflect changes in the RUS Cushion of Credit Program that became effective with the enactment of the 2018 Farm Bill.[62] The RUS Cushion of Credit Program allowed

[58] South Kentucky RECC's response to the Attorney General's Second Request, Item 32.
[59] Herrman Rebuttal Testimony at 7 – 8.
[60] South Kentucky RECC's response to the Attorney General's First Request, Item 36 (Update filed on May 9, 2022.)
[61] Case No. 2021-00358, Electronic Application of Jackson Purchase Energy Corporation for a General Adjustment of Rates and Other General Relief, (Ky. PSC Apr. 8, 2022), Order at 8.
[62] Kollen Testimony at 22 – 23.

cooperative utilities to deposit cash with the RUS from funds available in excess of its debt service requirements and earn interest on those deposits at 5.0%.[63] Changes in 2018 to the RUS Cushion of Credit Program reduced the interest rate on those deposits from 5% to the 1-year variable treasury rate on October 1st of each year.[64] The 2018 Farm Bill also allowed for cooperatives to apply the Cushion of Credit funds to outstanding RUS/FFB loans by September 30, 2020, without prepayment penalties.[65]

Before the modifications to the Cushion of Credit Program, South Kentucky RECC along with many other cooperatives, maintained long-term debt far greater than required for their utility plant investments in order to take advantage of this opportunity to bolster their net margins at no risk.[66] At the end of the test year the Company had $179.452 million in outstanding long-term debt, and $29.164 million in funds on deposit with RUS.[67] In other words, absent the funds on deposit with RUS, the Company would have only had $150.288 million in long-term debt outstanding.[68] Therefore, if South Kentucky RECC would have used its Cushion of Credit funds to pay off the highest cost long-term debt then only the interest expense on the lesser outstanding debt would have been included in the revenue requirement and in the TIER,[69] which would in turn require a lower proposed rate increase.

Mr. Kollen discusses in his testimony how Jackson Purchase Energy Cooperative and EKPC used their cash that had been in the Cushion of Credit Program to prepay

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[63] *Id*. at 23.
[64] *Id*.
[65] *See* https://www.federalregister.gov/documents/2019/06/07/2019-11924/announcement-of-new-cushion-of-credit-program-provisions; https://www.usda.gov/farmbill; https://www.electric.coop/farm-bill-advances-electric-co-op-interests-in-rural-development-broadband.
[66] Kollen Testimony at 23 – 24.
[67] *Id*. at 24.
[68] *Id*.
[69] *Id*.

outstanding higher cost long-term debt used to finance their Cushion of Credit deposits, without prepayment penalty, in anticipation of significant reductions of the interest rates on their deposits and to reduce their revenue requirements.[70] These actions benefitted their customers in two ways. First, the future interest rates on the Cushion of Credit deposits were less than the cost of the debt used to finance those investments, so there no longer was an "arbitrage" benefit from interest income greater than interest expense. Second, the reduction in long-term debt interest had a double benefit because the reduction in interest expense resulted in the elimination of the TIER on that interest expense also included in the revenue requirement

The second benefit is critically important because there is *not* an equivalence between interest income and interest expense. Thus, the use of Cushion of Credit deposits to prepay debt is not solely a matter of arbitraging the interest rate earned on Cushion of Credit deposits against interest rate paid on the debt used to finance those deposits, To the contrary, each dollar of interest income reduces the revenue requirement by only one dollar; however, each dollar of interest expense increases the revenue requirement by two dollars, assuming a 2.0 TIER. In other words, there is almost no possibility, let alone a reasonable probability that interest income will ever be double that of the interest expense on the debt incurred to finance the cash deposits. This dichotomy between the interest income and interest expense is further magnified in this case where the Cushion of Credit interest income is ostensibly included at 0.09%,[71] with an equivalent revenue requirement effect, while the interest expense is included at 3.01%, with an equivalent revenue

[70] *Id*. at 23 – 27.

[71] As noted previously, the Company failed to include the per books interest income, so the interest income included in the revenue requirement is negative $1.402 million, or a rate of negative 4.7%, not even 0.09%.

requirement effect of 6.02%, assuming a 2.0 TIER. It is not rational to retain debt that costs its customers 6.02% in exchange for interest income of 0.09%, or even 2.86%, assuming the Company correctly calculated a 30-year historical average of the 1-year treasury yield.[72]

Conversely, even though the 1-year treasury interest rate continued to plummet throughout 2019 and 2020, South Kentucky RECC elected to keep the funds on deposit with RUS instead of paying off higher cost long-term debt without a prepayment penalty. By the end of 2019, the 1-year treasury interest rate was 1.59%,[73] and continued to drop throughout 2020 to the point that on March 27, 2020 it was 0.11%.[74] The 1-year treasury interest rate hovered around that low point up until the September 30, 2020 deadline to use the Cushion of Credit funds to pay off outstanding RUS/FFB debt without penalty. To the detriment of its customers, South Kentucky RECC's Cushion of Credit account interest rate was set at a mere 0.09% on October 1, 2021.[75]

Significantly, the Company acknowledged in response to the Attorney General's discovery and at the formal hearing that it did not perform in-depth substantive analyses when making the decision to keep the Cushion of Credit funds in an account that would no longer earn anywhere close to the 5% interest that it previously earned, and that would most likely never earn more than twice the cost of the debt outstanding issued to finance

[72] South Kentucky RECC's response to Commission Staff's Fourth Request for Information ("Commission Staff's Fourth Request"), Items 1(e)(2) and (3).
[73] https://home.treasury.gov/resource-center/data-chart-center/interest-rates/TextView?type=daily_treasury_yield_curve&field_tdr_date_value=2019.
[74] https://home.treasury.gov/resource-center/data-chart-center/interest-rates/TextView?type=daily_treasury_yield_curve&field_tdr_date_value=2020.
[75] Testimony of Michelle D. Herrman ("Herrman Testimony") at 8; Kollen Testimony at 23; https://home.treasury.gov/resource-center/data-chart-center/interest-rates/TextView?type=daily_treasury_yield_curve&field_tdr_date_value=2021.

the Cushion of Credit deposits.[76] This decision results in an excessive interest expense, which is compounded by the requested TIER in the calculation of the claimed revenue requirement and deficiency. Further, as previously discussed, South Kentucky RECC made a proforma adjustment to the Cushion of Credit interest expense to reflect the 1-year treasury interest rate of 0.09% on October 1, 2021, which greatly reduces the amount of interest income the Company should reflect in the proposed revenue requirement.[77]

In his testimony, Mr. Kollen recommends the Commission to direct the Company to use the entirety of the Cushion of Credit funds to repay its highest cost long-term debt with a prepayment penalty.[78] This will benefit the customers by reducing the outstanding interest expense as well as removing that portion of the interest expense from the TIER calculation.[79] In Ms. Herrman's rebuttal testimony she attaches an email from RUS, and states that at this point the Company is not allowed to use the Cushion of Credit funds to prepay any of its long-term debt unless it pays off all of its RUS/FFB long-term debt, as well as exit the RUS Borrowers program.[80]

If the debt cannot be prepaid, even with a prepayment penalty, then South Kentucky RECC's decision to retain the funds on deposit and not prepay the debt when it could have without penalty has irreparably harmed its customers, not only in this proceeding, but for the next twenty or more years until the excessive outstanding debt is finally repaid. South Kentucky RECC's customers should not be burdened with paying higher electric rates because the Company made an unwise decision to leave funds in the Cushion of Credit

[76] South Kentucky RECC's response to the Attorney General's First Request, Item 28(b); VTE at 11:27:00 – 11:28:47.
[77] Herrman Testimony at 8.
[78] Kollen Testimony at 31.
[79] *Id*.
[80] Herrman Rebuttal Testimony at 11 – 12.

account after the 2018 Farm Bill modifications to the program. If South Kentucky RECC had paid off, or still could pay off its five highest interest rate loans then there would be an approximate reduction of $1.032 million in long-term interest expense, and a reduction of over $2.064 million in the revenue requirement, assuming a 2.0 TIER. This will harm the customers through an excessive revenue requirement year after year. Yet, the Company appears to be unaware of the negative consequences and impact that its decision has on its customers. The Attorney General recognizes that the Company is owned by its members and there are no shareholders to penalize for imprudent or unreasonable management actions. Thus, the Attorney General makes three additional recommendations for the Commission to consider in an attempt to mitigate the harm from this decision.

The first recommendation is for the Commission to direct the Company to expeditiously seek a waiver from the RUS/FFB allowing it to prepay the nearly $30 million in excessive debt used to finance the Cushion of Credit funds on deposit even with a prepayment penalty. The savings will be significant in the form of reduced interest expense and the related TIER of an equivalent amount, assuming a 2.0 TIER. The Company would be required to report back to the Commission within 90 days on its efforts, and if successful, reduce rates accordingly. Second, the Commission could set the TIER on this $30 million debt used to finance the Cushion of Credit deposits at something less than what it sets the TIER on the remainder of the debt that is used to finance plant in service. Third, as discussed more fully below, the Commission could set the Cushion of Credit interest income that should be included in the revenue requirement using an interest rate greater than 0.09%.

Ms. Herrman asserts that the extremely low 1-year treasury interest rate of 0.09%

for the Cushion of Credit is temporary and will change,[81] and points to the 1-year treasury interest rate as of April 1, 2022 at 1.72%.[82] In response to discovery, the Company conveys that the 1-year treasury rate as of April 14, 2022, was 1.84%, and could be 2.86% by June 29, 2022.[83] Ms. Herrman further stated at the May 10, 2022 formal hearing that the 1-year treasury interest rate as of May 6, 2022, was 2.08%,[84] and she projected that by June 29, 2022, it could be even higher than 2.86%.[85]

Pursuant to 807 KAR 5:001, Section 16(1), the Commission could deny South Kentucky RECC's proforma adjustment to set the interest rate of the Cushion of Credit funds at 0.09%, and instead use a more recent known and measurable 1-year treasury interest rate. The Company lends support to this proposed adjustment when speculating that the 1-year treasury interest rate will continue to rise above 2.86% by June 2022,[86] which is the same month that rates will likely go into effect.

Additionally, the Commission should consider another adjustment to include additional interest income to reduce the revenue requirement. South Kentucky RECC asserts in response to recent discovery that as of December 2021 the Company began using Cushion of Credit funds to pay debt service payments when due, and the funds that would normally be used to make the debt service payments are currently being invested with the CFC in their Commercial Paper Program.[87] Nevertheless, at the May 10, 2022 formal hearing, Ms. Herrman admitted that none of the interest from the CFC Commercial Paper Program was included in the proposed revenue requirement, which would have reduced

[81] Herrman Rebuttal Testimony at 10.
[82] *Id*.
[83] South Kentucky RECC's response to Commission Staff's Fourth Request, Item 1(e)(3).
[84] VTE at 11:33:37 - 11:33:53.
[85] VTE at 11:34:14 – 11:37:50.
[86] VTE at 11:34:14 – 11:37:50.
[87] South Kentucky RECC's response to Commission Staff's Fourth Request, Item 1(b).

the rate increase.[88] Pursuant to 807 KAR 5:001, Section 16(1) the Commission could also require South Kentucky RECC to include the CFC Commercial Paper Program investment funds in the proposed revenue requirement, which should lower the Company's proposed rate increase.

V. The Commission should evaluate South Kentucky RECC's compensation and benefit plan and only allow what is reasonable.

South Kentucky RECC made proforma changes to increase the salary and wage expense for employees, and the Attorney General is concerned about the magnitude of the Company's proposed compensation plan expense. South Kentucky RECC's President and Chief Executive Officer ("CEO") Mr. Simmons admits that even though South Kentucky RECC has reduced its employee headcount, the cost per employee has increased, with the total payroll from 2012 – 2021 increasing by 41%.[89] However, after reviewing the wage, salary, and benefits that the Company provides to its employees, it is not surprising that there has been a tremendous increase in total payroll expense. South Kentucky RECC provides vacation, holiday, sick leave, employee assistance programs, educational reimbursement,[90] annual raises, bonuses, awards, vehicle allowances,[91] and dental and vision insurance.[92] The Company also pays for 100% of the cost for the following benefits to employees: employee health insurance, life and accidental death benefits, long-term disability benefits, short-term disability benefits, business travel insurance, and 24-hour accident insurance.[93] Additionally, the Company contributes 100% for employee

[88] VTE at 11:42:30 – 11:43:21.
[89] South Kentucky RECC's response to the Attorney General's First Request, Item 3(c)(1); VTE at 09:19:00 – 09:23:30.
[90] Herrman Testimony at 12.
[91] South Kentucky RECC's response to the Attorney General's First Request, Item 15; South Kentucky RECC's response to the Attorney General's Second Request, Item 10.
[92] South Kentucky RECC's response to the Attorney General's First Request, Item 15(p).
[93] South Kentucky RECC's response to the Attorney General's Second Request, Item 15.

retirement through the National Rural Electric Cooperative Association ("NRECA") Retirement and Security plan, while also providing matching contributions up to 2% base salary for employees' 401(k) plans.[94] Mr. Simmons admitted at the hearing that South Kentucky RECC provides a "rich benefit plan."[95]

Moreover, South Kentucky RECC's CEO annual salary has increased in the past decade. In 2012 the base salary for South Kentucky RECC's CEO was $190,340.80, but the new CEO's base salary is $250,016.00.[96] South Kentucky RECC also provided six-figure severance packages to the last two CEOs,[97] and even awarded a prior CEO with a Company owned vehicle.[98]

South Kentucky RECC contends that it bases its wage and salary increases, at least in part, upon a compensation study.[99] The Company asserts that it worked with an outside consultant to perform a comparative wage and salary analysis utilizing the NRECA and Economic Research Institutes' Salary Assessor Database.[100] In general, the first issue with utility compensation studies is that they normally only compare compensation plans to other utilities, instead of conducting comparisons to state and local non-utility industry as well. The second issue is that most compensation studies compare a Kentucky utility's compensation plan to utility compensation on a national level, even though the cost of living is vastly different from state to state, and can even differ greatly amongst regions within a state. Third, the use of benchmarks in compensation studies drastically increase

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[94] Herrman Testimony at 12.
[95] VTE at 09:22:44 – 09:22:52.
[96] South Kentucky RECC's response to the Attorney General's First Request, Item 25(c).
[97] South Kentucky RECC's response to the Commission Staff's Post-Hearing Request for Information ("Commission Staff's Post-Hearing Request"), Item 11.
[98] South Kentucky RECC's response to the Attorney General's Second Request, Items 12(d) and (e).
[99] Seelye Testimony at 12; Seelye Rebuttal Testimony at Exhibit WSS-3.
[100] South Kentucky RECC's response to Commission Staff's First Request for Information ("Commission Staff's First Request"), Item 19(a).

compensation costs because utilities are always trying to reach the median benchmark for their employees, which continuously pushes the benchmark median higher. For these reasons, the Attorney General believes it would be more reasonable to compare the Company's compensation plan against state and local wage, salary, and benefit data, including information from utilities as well as non-utilities.

Based upon the foregoing, the Attorney General respectfully requests that the Commission review South Kentucky RECC's salary, wage, and benefit expenses and only allow what is reasonable to be included in the rates.

VI. A 2.0 TIER is not necessary for South Kentucky RECC to provide safe and reliable electric service.

South Kentucky RECC has failed to meet its burden of proof to establish that a 2.0 TIER will lead to fair, just, and reasonable rates. The Company includes $5.725 million over and above its $5.814 million proforma interest expense to achieve the proposed 2.0 TIER requirement.[101]

First, South Kentucky RECC provides no analytical support for its proposed 2.0 TIER.[102] Second, a 2.0 TIER is excessive when compared to the financial and credit metrics required by its lenders. South Kentucky RECC's loan covenants for RUS loans require it to meet a 1.25 TIER, 1.25 Debt Service Coverage Ratio ("DSCR"), and a 1.10 OTIER, and a 1.25 DSCR for its CoBank loans.[103]

Third, a 2.0 TIER is not necessary to increase members' equity from present levels.[104] South Kentucky RECC's members' equity to total capitalization ratio was 50.6%

[101] Kollen Testimony at 33 – 34.
[102] *Id*. at 34.
[103] *Id*. at 35.
[104] *Id*.

at the end of the test year, which is significantly greater than necessary.[105] Thus, the Company does not need to increase its members' equity ratios beyond present levels because to do so would impose unnecessary costs on its customers.[106] If authorized, this will increase its members' equity by 3.9% annually, all else equal.[107] Mr. Kollen also notes that the members' equity already increases from the CFC capital credits and the EKPC capital credits, which together significantly exceed the margins from sales to its customers.[108]

Fourth, in theory, if the Commission authorizes an excessive TIER that provides excessive margins, it can be returned to ratepayers through future capital credits.[109] However, this is problematic because there is no tracking and no functional equivalence between excessive margins and future capital credits.[110] Furthermore, any return of excess margins is likely to be diluted and delayed because the member customers stand at the end of the line for any residual revenues that make it to the Company's net margins that are potentially available for any future capital credits.[111] In fact, any capital credit distributions to customers normally do not occur for decades.[112] Moreover, the collection of excessive revenues through a 2.0 TIER actually costs more than could ever be returned to the customers largely because the Company is required to add and collect sales tax of 6% on their non-residential sales and school tax (usually 3%).[113] These tax monies are not returned

[105] *Id*. at 36.
[106] *Id*. at 36 – 37.
[107] *Id*. at 37.
[108] *Id*.
[109] *Id*.
[110] *Id*.
[111] *Id*. at 38.
[112] *Id*.
[113] *Id*.

through capital credits.[114]

Fifth, the authorization of an excessive TIER is a disincentive to control discretionary expenses[115] such as employees' excess wages, salaries, raises, benefits, and the like. For example, even if the Commission disallows South Kentucky RECC's 100% funding of employee health insurance or the Company contributions to both a pension and 401(k) to be included in the rates, the Company can continue these practices because of the excess monies awarded to it through a 2.0 TIER.

Based upon the foregoing, the Attorney General asserts that a maximum 1.50 TIER is reasonable for South Kentucky RECC.[116] This will provide a margin of 50% in excess of the Company's proposed interest on long-term debt.[117] A 1.50 TIER is well in excess of the required TIER pursuant to its loan agreements, and will allow growth in members' equity of 1.95% annually, all else equal.[118] The effect of this recommendation is a reduction of approximately $2.258 million in the base revenue requirement.[119]

In the rebuttal testimony, Mr. Seelye argues that Mr. Kollen's 1.50 TIER recommendation is arbitrary and punitive.[120] Mr. Seelye further argues that because South Kentucky RECC has not filed a rate case in over ten years it demonstrates excellent stewardship of members' funds, and indicates that the Company is not inflating TIER in order to have more cash to engage in discretionary spending.[121] On the other hand, it can also indicate that South Kentucky RECC's rates were merely set too high a decade ago

[114] *Id*.
[115] *Id*. at 35.
[116] *Id*. at 39.
[117] *Id*.
[118] *Id*.
[119] *Id*.
[120] Seelye Rebuttal Testimony at 16.
[121] *Id*. at 22.

because of the additional funds provided through the 2.0 TIER.

Mr. Seelye cites to the recent Jackson Purchase Energy general rate case in which the Commission found that a lower TIER than 2.00 would reduce its cash flow and operating margin to an unreasonable level.[122] However, Mr. Seelye failed to include that the Commission further found that "the authorized TIER for an electric distribution cooperative will be addressed on a case by case basis, and the current interest rates for the cooperative and market conditions must be part of the consideration."[123]

As previously discussed, a 2.0 TIER does not result in fair, just, and reasonable rates. Therefore, the Attorney General respectfully requests the Commission adopt Mr. Kollen's recommendation and limit South Kentucky RECC's approved TIER to 1.5, or less.

VII. All expenses associated with unfilled positions should be disallowed from South Kentucky RECC's rates.

Mr. Simmons touts that the Company saved approximately $180,000 by eliminating most of its temporary office staff.[124] Yet, the Attorney General's expert witness Mr. Kollen pointed out that the Company did not propose a proforma adjustment to the requested revenue requirement to reflect these savings.[125] In Ms. Herrman's rebuttal testimony, she asserts that South Kentucky RECC only ended its use of temporary staffing assistance due to government mandated closures and safety measures associated with Covid-19.[126] Ms. Herrman further stated that South Kentucky RECC planned to resume

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[122] Case No. 2021-00358, Electronic Application of Jackson Purchase Energy Corporation for a General Adjustment of Rates and Other General Relief, (Ky. PSC Apr. 8, 2022), Order at 16 – 18.
[123] *Id*.
[124] Direct Testimony of Kenneth E. Simmons ("Simmons Testimony") at 8.
[125] Kollen Testimony at 8 - 9.
[126] Herrman Rebuttal Testimony at 3 - 4.

the use of temporary staffing at its district office locations based upon members' needs and the financial health of the Company.[127] However, at the May 10, 2022 formal hearing Ms. Herrman admitted that only one temporary staffing position had been filled.[128]

Further, Ms. Herrman states in her testimony that South Kentucky RECC has five vacant positions due to retirement and resignations.[129] Contrary to this assertion, Ms. Herrman states in discovery responses that there are only four vacant positions that were already existing positions and included in the proposed revenue requirement, with the fifth position being a newly created position called the Credit and Collections Representative that the Company would like to incorporate into staffing.[130] Even though these positions are not filled, South Kentucky RECC admits that it is requesting to include $514,754 in the proposed revenue requirement for the four vacant positions.[131] As of the May 10, 2022 formal hearing, Ms. Herrman testified that of the four vacant positions only one offer had been made for the Director of Corporate Services position.[132]

As previously discussed, the Company filed the pending rate case utilizing a historic test year ended March 31, 2020, and pursuant to 807 KAR 5:001, Section 16(1) a proposed adjustment to a historical test period must be based upon known and measurable changes. After reviewing South Kentucky RECC's unfilled positions, the only known and measurable adjustments are for the one temporary staffing hire and possibly the Director of Corporate Services position depending on if it is actually filled. It would be unfair to require South Kentucky RECC's customers to pay an electric rate that includes multiple

[127] *Id*. at 4.
[128] VTE at 11:45:50 - 11:47:15.
[129] Herrman Testimony at 10 – 11.
[130] South Kentucky RECC's Response to the Attorney General's Second Request, Item 21(a).
[131] South Kentucky RECC's Response to the Attorney General's Second Request, Item 21(b).
[132] VTE at 11:47:39 - 11:49:00.

vacant positions that provide no benefit to the customers or to the provision of safe and reliable electric service. At this time, the other temporary staffing positions and three vacant positions do not appear to meet the ratemaking criteria of being known and measurable, but are instead merely speculative.[133]

The Attorney General requests the removal of costs associated with these vacant positions from the requested rate increase because there is no guarantee that the positions will be filled. The Attorney General recommends only including costs for the one temporary position and the Director of Corporate Services position, if the Commission finds these positions are actually filled, necessary, the costs are reasonable, and the positions directly benefit the Company's customers.

VIII. South Kentucky RECC's proposed inclusion of $514,429.25 in payment processing fees should be removed from the revenue requirement.

South Kentucky RECC asserts in its application that members using credit cards and other automated means to pay their electric bills has increased processing fees by 201.7% since 2012.[134] The Company includes $514,429.25 in payment processing fees in the proposed revenue requirement with the following breakdown: $477,656.94 in Credit Card Fees, $30,044.30 in E-Check Fees, $3,286.50 for Member Initiated Auto-Pay, and $3,441.51 in Kiosk Fees for check and credit cards.[135] Currently, the Company does not require any of the assessed fees to be passed through and paid by the customer except for the CheckOut (Retailer Fee) of $1.50.[136] South Kentucky RECC confirmed in discovery responses that its Board of Directors "is aware of this concern and has charged staff with

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[133] *See* Case No. 2018-00208, Electronic Application of Water Service Corporation of Kentucky for a General Adjustment in Existing Rates (Ky. PSC Feb. 11, 2019), Order at 4.
[134] South Kentucky RECC's response to the Attorney General's First Request, Item 3(c)(4).
[135] South Kentucky RECC's response to the Attorney General's Second Request, Item 2(b)(iv).
[136] *Id*.

addressing this issue."[137]

South Kentucky RECC provides the payment option associated fees in discovery, and indicates there is no fee to the Company when a customer pays with cash, paper check, bank draft, bank electronic funds transfer, or kiosk cash.[138] Thus, by including the processing fees of $514,429.25 in the revenue requirement the customers who are utilizing a payment option that does not assess a corresponding fee to the Company are subsidizing the customers who use a payment option that does require the Company to pay a fee. By not requiring the customer to pay the associated processing fees for using credit cards, it is possible the Company is enticing customers to use credit cards in order to increase points and rewards associated with various credit card loyalty programs. Due to low-income customers having more difficulty obtaining credit cards and bank accounts,[139] the Attorney General is concerned that the inclusion of over a half a million dollars in payment processing fees in the electric rates are being subsidized and borne by those customers who can least afford it.

The Attorney General requests that the Commission remove the processing fees of $514,429.25 from the revenue requirement. Even if the processing fees are removed, South Kentucky RECC can follow the example of other utilities by still allowing utility bills to be paid with credit cards, etc. as long as the customer pays 100% of the corresponding fee that is assessed to the Company.[140]

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[137] South Kentucky RECC's response to the Attorney General's Second Request, Item 2(b)(i).
[138] South Kentucky RECC's response to the Attorney General's Second Request, Item 2(b)(iv).
[139] https://www.federalreserve.gov/publications/2021-economic-well-being-of-us-households-in-2020-banking-and-credit.htm (The publication states that almost all people with income over $100,000 had a credit card, and most people with income over $50,000 had a credit card, but at lower income levels, having a credit card was less common. The publication further states that unbanked and underbanked rates were higher among adults with lower income.)
[140] *See* https://www.duke-energy.com/home/billing/billing-payment-options (Duke Energy Kentucky assesses a "small fee" to a residential customer paying a utility bill with a credit card, debit card, or electronic

IX. South Kentucky RECC should only receive rate case expense that leads to fair, just, and reasonable rates.

South Kentucky RECC filed updated rate case expense into the record on May 9, 2022. The Company is requesting total rate case expense of over $300,000;[141] however, the Company has included approximately $67,000 of expenses for South Kentucky RECC's employees to work on the rate case.[142] There is only a fraction of the $67,000 expense designated as employee overtime.[143] The Company's customers are already paying for the employees' salaries and wages through the electric rates. Therefore, it does not seem reasonable to require customers to pay additional amounts for South Kentucky RECC's employees to work on the rate case during business hours. The Attorney General respectfully requests the Commission to only award South Kentucky RECC rate case expense that will lead to fair, just, and reasonable rates for the customers.

CONCLUSION

WHEREFORE, the Attorney General requests that the Commission set fair, just, and reasonable rates for the customers of South Kentucky RECC. If the Commission is inclined to grant a rate increase, then it should be limited to what the Company has proven

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check.); https://www.amwater.com/kyaw/customer-service-billing/billing-payment-info/ (Kentucky-American Water assesses a $1.95 fee to a customer using a credit card to pay the utility bill); https://www.kentuckypower.com/account/bills/pay/compare (Kentucky Power Company assesses a $1.85 fee for a residential customer to pay a utility bill with a credit card, debit card, or ATM card.); https://lge-ku.com/residential/payment (Louisville Gas and Electric and Kentucky Utilities charge an additional fee to a residential customer paying a utility bill with a credit card, PayPal, Amazon Pay, or Venmo.); https://www.columbiagasky.com/bills-and-payments/pay-my-bill (Columbia Gas of Kentucky assesses a $1.75 fee to a residential customer paying a utility bill with a credit card, debit card, PayPal, Venmo, or Amazon Pay; https://mountainwaterdistrictky.com/Default.aspx (Mountain Water District assesses a $2.00 fee to a residential customer paying a utility bill with a credit card, and a $1.50 fee to use an e-check.)

[141] South Kentucky RECC's response to the Attorney General's First Request, Item 12(b) (Update filed May 9, 2022).

[142] *Id.*

[143] *Id.*

with known and measurable evidence that will result in fair, just, and reasonable rates for the Company's ratepayers.

Respectfully submitted,

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Certificate of Service and Filing

Pursuant to the Commission's Orders and in accord with all other applicable law, Counsel certifies that the foregoing electronic filing was transmitted to the Commission on May 25, 2022, and there are currently no parties that the Commission has excused from participation by electronic means in this proceeding.

This 25th day of May, 2022.

Angela M. Awad

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Assistant Attorney General