

**COMMONWEALTH OF KENTUCKY**  
**BEFORE THE PUBLIC SERVICE COMMISSION**

**In the Matter of:**

<b>THE ELECTRONIC APPLICATION OF SOUTH</b>	)	
<b>KENTUCKY RURAL ELECTRIC COOPERATIVE</b>	)	
<b>CORPORATION FOR A GENERAL ADJUSTMENT</b>	)	<b>CASE NO.</b>
<b>OF RATES, APPROVAL OF A DEPRECIATION</b>	)	<b>2021-00407</b>
<b>STUDY, AND OTHER GENERAL RELIEF</b>	)	

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**SOUTH KENTUCKY RURAL ELECTRIC  
COOPERATIVE CORPORATION’S REPLY BRIEF**

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Comes now South Kentucky Rural Electric Cooperative Corporation (“South Kentucky” or “Cooperative”), by counsel, pursuant to the May 11, 2022 Order of the Kentucky Public Service Commission (“Commission”) setting forth a post-hearing procedural schedule in the above-styled docket, and does hereby tender its Reply Brief responding to the Attorney General’s (“AG”) Post-Hearing Brief filed May 25, 2022, respectfully stating as follows:

**I. INTRODUCTION**

The AG’s Brief addressed nine issues which South Kentucky discusses below in the same order.

**II. SOUTH KENTUCKY’S ARGUMENT IN REPLY**

**A. South Kentucky’s proposal to increase its residential consumer charge is reasonable**

Even though South Kentucky’s consumer charge is among the lowest in Kentucky and has not been raised in more than ten years, the AG claims it should not be raised by the amount

requested because of the negative effects it will have on low-income customers. South Kentucky disagrees with the AG's position for three reasons.

First, South Kentucky's request to increase the consumer charge from \$13.29 to \$24.00 was based on a comprehensive class cost of service study which showed that the charge should actually be \$26.41.<sup>1</sup> Even though it had the opportunity to do so, the AG offered no independent cost of service evidence of its own that South Kentucky's requested consumer charge is unreasonable. Moreover, the AG failed to provide a single calculation from South Kentucky's cost of service study demonstrating that the proposed \$24.00 consumer charge is not supported by cost of service. In fact, the AG's rate expert, Mr. Kollen, did not even address the consumer charge in any fashion, much less challenge its reasonableness.

Second, the AG's claim that recovering more costs through the consumer charge than the energy charge will harm low-income customers is without support in the case record. Even though it had the opportunity to do so, the AG failed to provide any evidence to support this claim. It is merely a refrain which the AG posits on this issue in every electric distribution cooperative rate case. The actual evidence adduced in the case shows that consumers receiving Low Income Home Energy Assistance ("LIHEAP") use 1,137 kWh of energy per month compared to the average consumer who uses 1,014 kWh of energy per month.<sup>2</sup> Therefore, recovering more customer-related costs through the consumer charge will benefit low-income consumers, just the opposite effect suggested by the AG. Customer charges that are below cost of service actually compound high bill issues by adding customer-related costs to every kWh purchased. This creates

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<sup>1</sup> See Direct Testimony of Steve Seelye, Exhibit WSS-8, p. 35.

<sup>2</sup> See South Kentucky's response to PSC-DR-02-29.

more bill variability for members and higher bills during extreme weather. It is inequitable and unsound economically to recover fixed customer costs through an energy charge.<sup>3</sup>

Third, South Kentucky's proposed consumer charge increase does not violate the principle of gradualism since gradualism should be considered in regard to the *totality* of all rate components, not just the consumer charge. For the vast majority of South Kentucky's residential consumers the impact of the proposed consumer charge increase will not have any greater impact on monthly bills than recovering more of the increase through the energy charge.

The AG recommends, for the first time in this case, that if the Commission grants South Kentucky's requested \$24.00 consumer charge it should follow the two-step phase-in and increase the charge to \$18.64 in the first year and \$24.00 in the second year. Assuming that South Kentucky is allowed to increase its revenues by an amount greater than \$6.000 million, the Cooperative agrees to the AG's recommendation on this point.

**B. South Kentucky did not incorrectly use OTIER in lieu of TIER. In fact, South Kentucky's calculation of TIER for ratemaking purposes is consistent with longstanding Commission precedent**

The AG's Brief claims that South Kentucky incorrectly uses OTIER instead of TIER when calculating margins needed for rates which inflates the requested increase. The AG is wrong on this point and wants to ignore how the Commission has traditionally calculated TIER in general rate cases. For setting electric distribution cooperative rates the Commission has always modified the TIER calculation to eliminate non-operating items such as Generation & Transmission capital credits and other non-cash credits simply because there is no assurance that the cooperative will ever realize such credits as cash.<sup>4</sup> Like Generation & Transmission capital credits it is equally

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<sup>3</sup> See South Kentucky's response to AG-DR-02-05.

<sup>4</sup> See a long line of such cases where, in each instance, the Commission excluded G & T capital credits for purposes of calculating TIER for ratemaking purposes: South Kentucky's last rate case is a prime example, Case No. 2011-

appropriate to eliminate from the TIER calculation all interest which South Kentucky earned on the Cushion of Credit since there are significant restrictions on the uses of the earned interest which distinguishes it from other revenues and cash credits. Interest earned on Cushion of Credit funds do not get passed on to South Kentucky by RUS and may only be applied to RUS debt payments.

Mr. Kollen's unfamiliarity with how the Commission has historically calculated TIER for purposes of setting rates for electric distribution cooperatives is exemplified by the AG's argument on this point. South Kentucky's calculation of TIER for purposes of arriving at the necessary margins needed in rates is correct and should be approved by the Commission.

**C. South Kentucky's proposed long-term debt interest expense is accurate**

The AG claims South Kentucky overstated its long-term debt interest expense. This is incorrect and the AG's statement "that the revised amount of \$5.78 million still greatly overstates South Kentucky's *actual* long-term debt interest..." is an improper attempt by the AG to introduce sur-rebuttal testimony by including it in a Reply Brief; as such, it should be disregarded by the Commission, not to mention that the statement is not supported by any evidence in the record.

The AG's Brief points out that South Kentucky's interest expense has continued to decline since the end of the test year and points to a January 20, 2022 drawdown of \$10 million on its line of credit at an interest rate of 2.098%. South Kentucky currently maintains a work plan loan funding with \$33 million remaining available for drawdown. Once drawn these funds will incur interest set at the date of the drawdown. Over the last several years, South Kentucky has been able to replace higher interest rate debt with lower interest rate debt. However, this trend is changing.

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00096, *Application of South Kentucky Rural Electric Cooperative Corporation for an Adjustment of Rates*, Final Order, March 30, 2012; Other cases decided similarly are: Case No. 2017-00374, *Application of Big Sandy Rural Electric Cooperative Corporation for a General Adjustment of Existing Rates*, Final Order, April 26, 2018; Case No. 2018-00129, *Application of Inter-County Energy Cooperative Corporation for a General Adjustment of Existing Rates*, Final Order, January 25, 2019; Case No. 2018-00272, *Application of Grayson Rural Electric Cooperative Corporation for an Adjustment of Rates*, Final Order, March 28, 2019.

For example, if South Kentucky were to borrow the same \$10 million today as it did on January 20, 2022, those funds would be subject to an interest rate of 3.00%, an increase of 902 basis points in less than six months. Because the cost of everything has increased exponentially South Kentucky's capitalized costs have also increased substantially and will certainly accelerate its future borrowing over historical norms. As South Kentucky stated in its initial Brief<sup>5</sup> the AG's annualization of long-term debt expense based upon the March 31, 2020 end of test year principal balances negates the utilization of a test year as the basis for the determination of South Kentucky's revenue requirements.<sup>6</sup> The premise for the AG's adjustment on this issue remains flawed and should be rejected by the Commission.

**D. South Kentucky acted prudently on the Cushion of Credit issue**

The AG proposes to penalize South Kentucky for its good stewardship of Cooperative funds related to the decision to remain in RUS's Cushion of Credit program. South Kentucky spent between pages 9 and 15 of the initial Brief justifying its decision on the Cushion of Credit issue and will not repeat the same arguments here except to remind the Commission that the Net Present Value analysis it performed, which was not challenged by a competing NPV analysis from the AG, clearly showed an approximate \$3.205 million dollar advantage to South Kentucky and its owners of keeping its Cushion of Credits deposits intact and not prepaying long-term RUS/FFB debt.<sup>7</sup>

Besides the NPV calculation which should be completely dispositive of this whole issue there were other substantial benefits to the decision which included the generation of interest

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<sup>5</sup> See South Kentucky's initial Brief filed May 25, 2022, p. 14.

<sup>6</sup> See more detail on this issue in the Rebuttal Testimony of Michelle Herrman, pp. 7-8 (April 13, 2022).

<sup>7</sup> See South Kentucky's response to PSC-DR-03-08.

income earnings that directly improved the Cooperative's equity position benefitting South Kentucky's consumer members by allowing for the retirement of capital credits and postponing by several years the need for the type of rate increase seen in the current case. The interest income generated by the Cushion of Credit is a key component of calculating a Modified Debt Service Coverage ("MDSC") ratio for the Cooperative Finance Corporation debt, an Operating Debt Service Coverage ratio ("ODSC") for RUS and a Debt Service Coverage ratio ("DSC") for CoBank. Contrary to the AG's implied argument that the sole focus of this issue should be on the relationship between interest income and interest expense, an equally important issue which should not get lost in the shuffle is the very positive impact the Cushion of Credit interest has historically and continues to play in the calculation of the above debt service coverage ratios with all of South Kentucky's lenders.

Finally, the AG's brand new recommendation that the Commission should "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"<sup>8</sup> is nonsense. First, the AG should know that unless expressly permitted, a federal agency cannot unilaterally waive a Congressional enactment (2018 Farm Bill). Second, the AG would apparently blindly have the Commission to direct this action without any foreknowledge of how much the cumulative prepayment penalty would even be.

**E. South Kentucky's salary, wage and benefit expenses are reasonable**

The AG's Brief "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."<sup>9</sup> The

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<sup>8</sup> See AG's initial Brief, p. 17.

<sup>9</sup> See AG's Brief, p. 21.

AG's Brief spends almost three pages discussing employee compensation and benefit issues. However, at best, the AG's recommendation for the Commission to "only allow what is reasonable" is typically what the Commission does anyway. The AG's request is vague and implies that South Kentucky's wage and benefit structure is somehow unreasonable. However, the AG has not offered any evidence nor did he offer any specific adjustments to establish unreasonableness.

**F. The AG's recommended TIER of 1.50 is unreasonable and could be harmful to South Kentucky's continued financial health**

The AG's Brief maintains insistence that a TIER of 1.50 is more than adequate for several reasons but principally because it provides a margin of 50% in excess of South Kentucky's proposed interest on long-term debt.<sup>10</sup> South Kentucky's rate expert, Mr. Seelye spends ten pages of his rebuttal testimony successfully deconstructing and illuminating fatal flaws in the AG's argument.<sup>11</sup> The AG's attempt to directly tie South Kentucky's revenue allowance from the Commission in this case to the TIER, MDSC, ODSC and DSC benchmarks contained in its loan covenants implies a false equivalence. If the Commission accepted the AG's recommendations on this issue there would be virtually no financial cushion for South Kentucky in the event of an unexpected decline in revenues or an unexpected increase in expenses. This could place South Kentucky in a precarious, if not dangerous, financial situation and is likely the reason the Commission has correctly and consistently approved rates based on an authorized TIER of 2.00 in many prior distribution cooperative traditional rate cases.

With the current uncertainty around inflation levels and rising interest rates, now is not the time to cut TIER to 1.50, or to any other value below 2.00, thereby compressing the important

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<sup>10</sup> See AG's Brief, p. 23.

<sup>11</sup> See Rebuttal Testimony of Steve Seelye, pp. 16-26 (April 13, 2022).

financial cushion just discussed. Moreover, the 1.50 TIER level espoused by Mr. Kollen is not supported by any Commission precedent nor is it consistent with TIER levels of electric distribution cooperatives throughout the United States as shown in the *2020 Key Ratio Trend Analysis* prepared by the National Rural Electric Cooperative Finance Corporation.<sup>12</sup> The AG's recommendation of a 1.50 TIER should be soundly rejected by the Commission.

**G. Expenses associated with unfilled positions should be allowed**

The AG requests removal of costs associated with unfilled positions at the Cooperative. This issue was discussed at length beginning on page 23 of South Kentucky's initial Brief. To reiterate, the positions in question were paused during the COVID-19 pandemic as a measure to reduce expenses but the pause was never intended to be permanent. In fact, as stated in Ms. Herrman's rebuttal testimony South Kentucky intends to resume the use of temporary staffing at its district office locations based upon members' needs when financially able to do so, to-wit, once this case is concluded.<sup>13</sup>

**H. The inclusion of payment processing fees is appropriate and should remain in the revenue requirement**

The AG's Brief requests that the Commission remove payment processing fees totaling \$0.514 million from the revenue requirement. By implication the AG's position is that South Kentucky should impose a processing fee to those consumers who pay by credit card. The very real problem associated with this recommendation is that South Kentucky does not want to erect any significant barriers that may serve to inhibit a consumer's ability or willingness to pay their electric bill. Imposition of a fee in the current economic climate would certainly erect such a barrier. For example, consumers who receive assistance payments from government agencies

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<sup>12</sup> See *Id.*, Exhibit WSS-1.

<sup>13</sup> See Rebuttal Testimony of Michelle Herrman, p. 4 (April 13, 2022).



often receive their benefits on debit cards and the imposition of a processing fee would most certainly apply to these debit card transactions creating an additional hardship on low income consumers.

South Kentucky also rejects the AG's assumption that many consumers use a credit card to pay their power bill to obtain bonus or membership points which can be redeemed for other perks. Many of South Kentucky's consumers use credit cards as their sole available financial resource to make their monthly power bill payment.

Finally, if South Kentucky requires consumers who use automated means to pay an associated third-party automation fee, shouldn't it also charge consumers who received mailed statements a fee for the third-party printing and mailing costs? South Kentucky does not at this time want to do anything that could create a disincentive for its credit card customers to pay their monthly power bills timely and in full. South Kentucky is currently studying this issue and would like an opportunity to develop a strategy that can be implemented fairly and with adequate notice to those utilizing the option to pay their bill using a credit card or employing other automation. This is not an easy issue to resolve for the reasons stated and the Commission should allow South Kentucky additional time to fashion a workable and fair resolution for its consumer owners.

**I. South Kentucky agrees that it should not recover internal labor expenses as part of rate case expense**

South Kentucky agrees with the AG that it is not proper to recover \$67,000 of expense associated with its employees working on the rate case. Exclusion of internal expense was how the original rate case expense adjustment was calculated.<sup>14</sup> However, through inadvertence the monthly rate case statements provided to the Commission included internal expense with the belief

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<sup>14</sup> See Direct Testimony of Steve Seelye, Exhibit WSS-4, Schedule 2.09.

that it should be included for tracking purposes. The AG is correct that this should not be a recoverable item in the case.

### CONCLUSION

As stated in its original Brief, South Kentucky's proposal in this case is both measured and necessary for its continued financial health. It is based on a comprehensive and reliable class cost of service study employing known and measurable changes to test year expense. It is fair, just and reasonable both in terms of the revenue request and the rate design chosen to implement it. For these reasons South Kentucky respectfully requests that the Commission enter a Final Order adopting its request in full.

This 31<sup>st</sup> day of May, 2022.

Respectfully Submitted,

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**CERTIFICATE OF SERVICE**

The undersigned certifies that the foregoing is a true and accurate copy of the same document filed electronically with the Commission on May 31, 2022; that there are currently no parties that the Commission has excused from participation by electronic means in this proceeding; and by virtue of the Commission's July 22, 2021 Order in Case No. 2020-00085, a copy of the filing in paper medium shall not be required.

*Mark David Goss*  
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