

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

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

ATTORNEY GENERAL’S POST-HEARING RESPONSE BRIEF

The intervenor, the Attorney General of the Commonwealth of Kentucky, through his Office of Rate Intervention (“Attorney General”), submits the following Post-Hearing Response Brief pursuant to the Commission’s May 11, 2022 Order, and in response to South Kentucky Rural Electric Cooperative Corporation’s (“South Kentucky RECC” or the “Company”) Post-Hearing Brief filed on May 25, 2022.

ARGUMENT

I. Since the end of the test year South Kentucky RECC’s actual and projected residential kilowatt hour (“kWh”) sales and its number of customers have increased.

In its Post-Hearing Brief, South Kentucky RECC contends that the decline in residential kWh sales is a contributing factor to the necessity for the requested rate increase.¹ South Kentucky RECC asserts that in 2011 the Company’s residential kWh sales were 825,681,500, while at the end of the test year the residential kWh sales were only 776,790.917, or a 5.8% reduction.² The Company argues that because residential customer usage accounts for 67.5% of South Kentucky RECC’s total electric revenue on a

¹ South Kentucky RECC’s Post-Hearing Brief (“Brief”) at 5.

² *Id.*

yearly basis any negative or flat load growth can significantly impact net margins.³

However, South Kentucky RECC fails to mention that since the end of its test year, which was March 30, 2020,⁴ electric sales have rebounded. South Kentucky RECC's actual residential kWh sales in 2021 were 819,860,471,⁵ and the projected residential kWh sales for 2022 are 808,771,000.⁶ Moreover, the number of customers that the Company provides electric service to also increased since the end of the test year.⁷ As of December 2021, South Kentucky RECC had 70,123 customers.⁸

Thus, the Company's lower kWh sales in the test year, should not be viewed as a valid factor for a rate increase due to the actual and projected kWh sales in 2021 and 2022, respectively, being close to the high kWh sales that South Kentucky RECC cites to from 2011. Additionally, the Company has more customers now than in the test year, or even in the past decade, so the kWh sales should at least remain stable, if not rise.

II. South Kentucky RECC's flawed Net Present Value ("NPV") analysis conducted during the pendency of this case does not justify the Company's prior decision to keep the Cushion of Credit funds on deposit with the Rural Utilities Service ("RUS").

South Kentucky RECC asserts that it made the correct decision to keep the Cushion of Credit funds on deposit with RUS, and alleges that its NPV analysis corroborates this decision.⁹ The Company asserts that "[f]or all the darts which the AG has thrown attempting to discredit South Kentucky's NPV analysis it is notable that he chose not to

³ *Id.*

⁴ Application at unnumbered page 3.

⁵ South Kentucky RECC's response to the Attorney General's First Request for Information ("Attorney General's First Request"), Item 21.

⁶ *Id.*

⁷ *Id.*, Item 3(b).

⁸ *Id.*

⁹ South Kentucky RECC's Brief at 13.

provide a separate and independent NPV analysis for the Commission’s consideration.”¹⁰ South Kentucky RECC further contends that the NPV analysis was filed into the record “several days” before Mr. Kollen’s testimony was due for filing so the “Commission should wonder why Mr. Kollen failed to support his claims with a competing NPV analysis...”¹¹

First and foremost, the Attorney General does not bear the burden of proof in this case,¹² or the burden to correct South Kentucky RECC’s flawed NPV analysis. Instead, it is the Company that bears the burden to prove it acted prudently and that the proposed revenue requirement will lead to fair, just, and reasonable rates.¹³ By stating that the Attorney General should have filed an independent NPV analysis the Company is attempting to shift the burden of proof from the utility to the Attorney General, which violates both statutory law as well as Commission precedent.¹⁴

Second, it is undisputed that the Company’s NPV analysis was not a contemporaneous analysis performed at the time when it needed to make the decision on whether to use the Cushion of Credit funds on deposit to prepay some of its outstanding debt without prepayment penalty.¹⁵ South Kentucky RECC failed to properly conduct in-depth substantive analyses in 2018 when the Farm Bill modifications to the Cushion of

¹⁰ *Id.* at 14.

¹¹ *Id.*

¹² KRS 278.190(3), “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* Kentucky-American Water Company v. Commonwealth ex rel. Cowan, 847 S.W.2d 737,741 (Ky. 1993); *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.)

¹³ *Id.*

¹⁴ *Id.*

¹⁵ South Kentucky RECC’s response to the Attorney General’s First Request, Item 28(b); Video Transcript of Evidence (“VTE”) at 11:27:00 – 11:28:47.

Credit Program were initially made, or in 2019, or in 2020 up until the deadline¹⁶ that South Kentucky RECC had to prepay outstanding RUS/FFB debt without prepayment penalty.¹⁷ The Company only attempted to perform the after the fact analysis in the pending case at the behest of the Commission Staff's discovery questions.¹⁸ Other Kentucky rural electric cooperatives independently performed such studies and concluded that it was economically beneficial to use their Cushion of Credit funds on deposit to prepay outstanding debt used to finance the deposits.¹⁹

South Kentucky RECC conducting the NPV analysis over a year and a half after the aforementioned deadline,²⁰ represents a time lapse that is a fundamental flaw, and cannot be corrected. Furthermore, it is disingenuous for the Company to criticize Mr. Kollen for not conducting an independent NPV analysis in the "several days" he was allegedly provided, when the Company failed to perform substantive analyses on its Cushion of Credit funds for years, and only did so when required by the Commission.

Third, even though Mr. Kollen was allotted only a few days to review the Company's NPV analysis, in his testimony he provides a thorough critique of the alleged analysis.²¹ Mr. Kollen explains in detail how South Kentucky RECC's NPV analysis is fundamentally flawed in every respect, from the structure of the analysis to the assumptions

¹⁶ South Kentucky RECC had until September 30, 2020, to utilize its Cushion of Credit funds to pay outstanding RUS/FFB debt without prepayment penalty. 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>.

¹⁷ South Kentucky RECC's response to the Attorney General's First Request, Item 28(b); VTE at 11:27:00 – 11:28:47.

¹⁸ South Kentucky RECC's response to the Commission Staff's Third Request for Information ("Commission Staff's Third Request"), Item 8.

¹⁹ Direct Testimony of Lane Kollen ("Kollen Testimony") at 23 – 27; Attorney General's Post-Hearing Brief ("Brief") at 13 – 14.

²⁰ South Kentucky RECC's response to the Commission Staff's Third Request, Item 8.

²¹ Kollen Testimony at 31 – 33.

that were used, and therefore could not be corrected.²² Mr. Kollen also independently illustrates in his testimony that the Company made the wrong decision by keeping the Cushion of Credit funds on deposit with RUS instead of paying off its highest cost long-term outstanding debt without prepayment penalty, and that this will continue to harm its customers for decades.²³ Thus, the fatally flawed NPV analysis provided by the Company does not, and more importantly cannot, support its decision to keep its Cushion of Credit funds on deposit with RUS.

III. Times Interest Earned Ratio (“TIER”) Issues

South Kentucky RECC states that “for decades virtually every electric distribution cooperative appearing before the Commission seeking rate relief has based its underlying request on the ability to earn revenues sufficient to achieve a 2.00 TIER.”²⁴ During the pendency of this case, the Attorney General thoroughly explained and laid out five specific reasons as to why South Kentucky RECC’s requested 2.0 TIER will result in unjust, unfair, and unreasonable rates.²⁵ One of the reasons is that the Company provided no analytical support for a 2.0 TIER.²⁶ Merely making a statement that rural electric cooperatives normally request and/or receive a 2.00 TIER is not evidentiary proof that a 2.00 TIER leads to fair, just, and reasonable rates. South Kentucky RECC did not provide any substantive analysis supporting a 2.0 TIER as necessary for its operations, and thus failed to meet the burden of proof on this issue. Moreover, the Company does not acknowledge that there is at least one rural electric cooperative that recently requested less than a 2.0 TIER in a

²² *Id.*

²³ *Id.* at 22 – 33.

²⁴ South Kentucky RECC’s Brief at 16.

²⁵ Attorney General’s Brief at 21 – 24; Kollen Testimony 33 – 38.

²⁶ Attorney General’s Brief at 21; Kollen Testimony at 34.

streamlined case,²⁷ and is still providing safe and reliable electric service to its customers.

South Kentucky RECC further asserts that because Mr. Kollen recommends a 1.5 TIER it appears he “does not understand the inner workings of an electric distribution cooperative and how it functions.”²⁸ In order to refute this baseless attempt to denigrate Mr. Kollen’s credibility one only needs to look at Mr. Kollen’s distinguished resume demonstrating that he is a certified public accountant, certified management accountant, and chartered global management accountant, with a multitude of professional affiliations.²⁹ Mr. Kollen’s esteemed career serving clients such as utilities, commissions, government agencies, and industrial groups spans over four decades.³⁰ Hence, not only is Mr. Kollen highly qualified to make his recommendations, but he is also unbiased and principled in his approach. Further, Mr. Kollen has been working on rural electric cooperative cases since 1986, and specifically has extensive experience assisting the Louisiana Public Service Commission in several management audits of distribution cooperatives.³¹ Based upon his experience with regulated electric cooperatives in Louisiana, Mr. Kollen advises that the Louisiana Public Service Commission normally authorizes TIERs ranging from 1.50 to 1.75.³²

Additionally, the Company contends that Mr. Kollen is improperly focusing on the minimum financial metrics that South Kentucky RECC must satisfy, not what a reasonable TIER is for the Company to continue providing safe and reliable service for the

²⁷ See Case No. 2020-00338, Electronic Application of Licking Valley Rural Electric Cooperative Corporation for a General Adjustment of Rates pursuant to Streamlined Procedure Pilot Program Established in Case No. 2018-00407.

²⁸ South Kentucky RECC’s Brief at 17.

²⁹ Kollen Testimony at Exhibit ___ (LK-1).

³⁰ *Id.*

³¹ *Id.*

³² Attorney General’s response to South Kentucky RECC’s First Request for Information (“South Kentucky RECC’s First Request”), Item 10.

customers.³³ South Kentucky RECC further asserts that “[f]ocusing on the minimum financial metrics will leave no cushion” for the Company in case any unknown expense arises.³⁴ The Company’s assertions are incorrect. Mr. Kollen fully explains why a maximum of a 1.5 TIER is reasonable for South Kentucky RECC’s operations,³⁵ and also provides five specific reasons as to why the Company’s proposed 2.0 TIER is unreasonable.³⁶ Mr. Kollen did not use the Company’s minimum 1.25 TIER as the recommended TIER level, but instead recommended a maximum of a 1.50 TIER, which provides a margin of 50% in excess of the Company’s interest on long-term debt.³⁷ A 1.50 TIER is well in excess of the Company’s loan requirements, and will allow growth to members’ equity of 1.95% annually.³⁸ It is important to note that the Company already has members’ equity of 50.6%, which is significantly greater than necessary.³⁹

The Company further asserts that Mr. Seelye’s removal of non-operating income, interest income, and Generation and Transmission (“G&T”) capital credits from the TIER calculation and from the proposed revenue requirement is based on Commission precedent,⁴⁰ but fails to cite to cases that allegedly support this accounting treatment. Contrary to this assertion, South Kentucky RECC provides discovery responses admitting that during the last decade the Commission’s Orders only excluded G&T capital credits from the 2.0 TIER calculation and revenue requirement.⁴¹ It is important to point out that

³³ South Kentucky RECC’s Brief at 20.

³⁴ *Id.*

³⁵ Kollen Testimony at 39.

³⁶ *Id.* at 34 - 39.

³⁷ *Id.* at 39.

³⁸ *Id.*

³⁹ *Id.* at 36.

⁴⁰ South Kentucky RECC’s Brief at 21 – 22.

⁴¹ South Kentucky RECC’s response to the Attorney General’s Second Request for Information (“Attorney General’s Second Request”), Item 28.

Mr. Kollen's proposed revenue requirement, as well as his TIER calculation, removes the G&T capital credits due to Commission precedent.⁴² However, Mr. Kollen does not remove other non-operating income or interest income from the calculation of TIER and the revenue requirement, because it is improper to do so and not based on Commission precedent.⁴³

In addition to the aforementioned, the Attorney General continues to rely upon his Initial Brief in which all TIER issues were thoroughly discussed and explained.

IV. A reasonable amount of the capitalized portion of the Company's annual salaries and wages should be excluded.

The Attorney General recommends that the Commission reduce South Kentucky RECC's proforma adjustment to annualize wages and salaries by \$0.094 million in order to remove the capitalized portion that will be recorded to construction work in progress and then closed to plant in service after construction is complete.⁴⁴ South Kentucky RECC disagrees with this proposed adjustment, arguing that it is based on an overall annual capitalization percentage for regular labor and does not include overtime labor.⁴⁵ The Company contends that the addition of overtime labor would reduce the capitalized labor percentage since overtime labor is primarily expensed because of its direct relationship with power restoration caused by weather and accident outages, or reconnection requests that occur afterhours.⁴⁶ The Company further asserts that each expensed/capitalized portion of labor varies by job position, and it would therefore be inappropriate to use a generalized

⁴² Kollen Testimony at 14 – 15.

⁴³ *Id.*

⁴⁴ *Id.* at 10.

⁴⁵ South Kentucky RECC's Brief at 22.

⁴⁶ *Id.* at 22 – 23.

capitalization percentage.⁴⁷ In response to discovery, South Kentucky RECC acknowledged that the capitalized percentage rates for labor and benefits were 37.17% in 2018, 38.23% in 2019, 40.59% in 2020, and 40.77% in 2021.⁴⁸ If South Kentucky RECC were simply arguing over the specific percentage amount to be capitalized for the labor it would be more understandable. Instead, South Kentucky RECC is refusing to exclude any of the capitalized portions of annual salaries and wages, even though the Company admits to over 40% capitalized labor and benefits in both 2020 and 2021.⁴⁹ The Company's stance on this issue is perplexing. Thus, the Attorney General requests the Commission exclude what it determines to be a reasonable amount of the capitalized portion of South Kentucky RECC's annual salaries and wages.

CONCLUSION

Based upon the foregoing arguments as well as those previously articulated in his Initial Post-Hearing Brief, 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, it should be limited to what the Company has proven with known and measurable evidence that will result in fair, just, and reasonable rates for the Company's ratepayers.

⁴⁷ *Id.*

⁴⁸ South Kentucky RECC's response to the Attorney General's Second Request, Item 35.

⁴⁹ South Kentucky RECC's Brief at 22 – 23; Rebuttal Testimony of Michelle D. Herrman (“Herrman Rebuttal Testimony”) at 4 – 6.

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 31, 2022, and there are currently no parties that the Commission has excused from participation by electronic means in this proceeding.

This 31st day of May, 2022.

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