COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE ELECTRONIC APPLICATION OF SHELBY ENERGY COOPERATIVE, INC. FOR A GENERAL ADJUSTMENT OF RATES PURSUANT TO STREAMLINED PROCEDURE PILOT PROGRAM ESTABLISHED IN CASE NO. 2018-00407	))))))	Case No. 2023-00213

SHELBY ENERGY COOPERATIVE, INC.'S
COMMENTS IN SUPPORT OF APPLICATION

Comes now Shelby Energy Cooperative, Inc. ("Shelby Energy"), by counsel, pursuant to the Commission's August 17, 2023 Procedural Order, and in further support of its Application requesting a general adjustment of its existing rates, respectfully offers the following comments:

Shelby Energy is a not-for-profit, member-owned, rural electric distribution cooperative organized under KRS Chapter 279 that provides retail electric service to approximately 13,960 members in ten counties.[1] Approximately fifty-two (52%) percent of Shelby Energy's total energy usage is consumed by residential customers.[2] Using a historical, twelve-month test period ending on December 31, 2022, Shelby Energy seeks approval to increase its annual revenues by $2,179,595, or 4.00%, to achieve a Times Interest Earned Ratio ("TIER") of 2.11, which equates to an Operating Times Interest Earned Ratio ("OTIER") of 1.75.[3] This revenue requirement is

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[1] *See* Application, p. 1.

[2] *See* Jack Bragg, Jr. Testimony ("Bragg Testimony"), p. 6 (August 4, 2023).

[3] *See* Application, p. 3 and John Wolfram Direct Testimony ("Wolfram Testimony") Exhibit JW-2, p. 1 (August 4, 2023). Using its pro forma test year, Shelby Energy could justify a higher rate increase of up to $2,442,669 using a 1.85 Operating Tier ("OTIER"). *See* Wolfram Testimony Exhibit JW-2, p. 1. Should the Commission choose to

proposed to be allocated by increasing the Rate 12 monthly Facility Charge from \$15.48 per month to \$19.75 per month and increasing the Energy Charge per kWh from \$0.08960 to \$0.09509. For those customers on Rate 15, Shelby Energy proposes increasing the daily Facility Charge from \$0.52 per day to \$0.65 per day and increasing the Energy Charge the same amount as Rate 12. For those customers on Rate 11, Shelby Energy proposes increasing the monthly Facility Charge from \$18.57 per month to \$22.84 per month for single-phase service, and from \$41.27 per month to \$45.54 per month for three-phase service. For all B Rate and C Rate customers, Shelby Energy proposes increasing the Contract Demand Charge from \$7.40 per kW to \$7.49 per kW and decreasing the Excess Demand Charge from \$10.30 per kW to \$9.98 per kW.[4] The increase would result in a 6.78% increase for Rate 12 (Residential) customers, a 6.30% increase for Rate 15 (Prepay) customers, a 3.59% increase for Rate 11 (General Service) customers, a 0.13% increase for Rate B1 customers, and a 0.18% increase for Rate B2 customers.[5] Using an average number of kWh a month per applicable rate class, a Rate 12 (Residential) customer would see their bill increase by \$11.87 per month, a Rate 15 (Prepay) customer would see their bill increase by \$0.41 per day, a Rate 11 (General Service) customer would see their bill increase by \$4.57 per month, a Rate B1 customer would see their bill increase \$78.85 per month, and a Rate B2 customer would see their bill increase by \$419.71 per month.[6] Each of these rate design proposals is consistent with the Cost of Service Study ("COSS") prepared by Mr. John Wolfram.[7]

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disallow costs cumulatively totaling less than \$263,075 included within Shelby Energy's test year, Shelby Energy respectfully requests the option to still award a 1.75 OTIER to arrive at the overall 4.0% rate increase.

[4] *See* Wolfram Testimony Exhibit JW-9, pp. 2 – 3.

[5] *See* Wolfram Testimony p. 23.

[6] *See* Wolfram Testimony p. 26.

[7] *See* Application, Exhibit JW-3 through JW-8.

Shelby Energy filed its last general rate case in 2017.[8] With an average annual growth rate in membership of 1.6% percent[9], and reduced large commercial load since the last rate increase[10], inflationary pressures have continued to erode the cooperative's margins. Inflation has driven labor expenses and material costs significantly higher over the past several years. Interest rates have also increased sharply since March 2022, significantly increasing Shelby Energy's cost of borrowing. These are market-driven factors which Shelby Energy cannot control.

To provide safer and more reliable service, Shelby Energy has included approximately $100,000 for a pole inspection program in the test-year which was not included in the previous rate case. Additionally, COVID-19 resulted in higher-than-normal write-offs of accounts receivable due to non-payment. [11]

In response to the increased costs mentioned above, Shelby Energy has implemented the below list of cost-saving initiatives since its last rate increase:

- Shelby Energy has reduced its workforce by 1.9 full-time equivalent employees since the last rate increase;[12]
- Shelby Energy began outsourcing underground locates rather than performing those duties with Shelby Energy employees and equipment resulting in annualized savings in the test year of approx. $231,000;[13]

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[8] *See In the Matter of Adjustment of Rates of Shelby Energy Cooperative, Inc.*, Case No. 2016-00434 (Ky. P.S.C. Feb 1, 2017).

[9] *See* Bragg Testimony, p. 6.

[10] *See* excel attachment to Request 10 of OAG First Request for Information (Sep 12, 2023).

[11] *See* response to OAG First Request for Information pp. 5 – 6.

[12] *See* Bragg Testimony, p. 7.

[13] *See* Michael Moriarty Testimony ("Moriarty Testimony"), p. 7 (Aug 4, 2023).

- Shelby Energy has changed the format of the Annual Meeting to a virtual business meeting and scaled down member appreciation costs that resulted in savings of approx. $15,000;[14]
- Shelby Energy utilized funds from the Paycheck Protection Program to upgrade technology to minimize headcount and improve reliability for members; [15]
- As part of Shelby Energy's response to supply-chain constraints experienced due to COVID-19, Shelby Energy has expanded the number of vendors used to source material. Through this process Shelby Energy has identified lower-cost alternatives for specific material items; [16]
- Shelby Energy put out to bid its banking services in 2022 and transitioned to a new primary financial institution that pays higher interest rates on deposits and reduced banking fees;

Despite these cost-saving initiatives, Shelby Energy's financial metrics have generally deteriorated. Based on year-to-date results and budgeted amounts for the remainder of the year, Shelby Energy anticipates that its 2023 TIER, OTIER, and DSC ratios will fall below the required minimum thresholds of its loan covenants. The requested OTIER in this rate application will allow Shelby Energy to operate in a healthy manner and meet financial covenants in future years. The financial stability will also allow Shelby Energy to maintain consistent retirement of its capital credits that are due to members.

A significant factor in Shelby Energy's poor financial performance in 2023 has been moderate temperatures that have yielded lower-than-expected residential demand. The year-to-

[14] *See* Bragg Testimony, p. 8.

[15] *See* Bragg Testimony, p. 7.

[16] *See* response to OAG First Request for Information, p. 10.

date average monthly residential kWh usage in 2023 is lower than any year provided in the excel attachment in response to request 10a of the OAG First Request for Information. This can be calculated by dividing the Residential kWh sales from Residential customers by the number of Residential customers, and further dividing by the number of months included in the year presented (7 months for the 2023 YTD figures). The volatility of temperatures can be mitigated by allocating more of the rate increase to Facility Charge rather than the kWh energy charge.

The Summary of Cost-Based Rates included in the COSS shows that the full Facility Charge for Residential Services should be $28.34 per month.[17] The requested Facility Charge of $19.75 per month reflects a gradual increase in the Facility Charge. The requested increase of $4.27 per month represents only 33% of the total difference between the full Facility Charge in the COSS ($28.34) and the current Facility Charge ($15.48). The reason for allocating the majority of the rate increase to the Residential class is due to the negative rate of return on rate base as shown in the COSS. All other rate classes had a higher rate of return on rate base in the test year, indicating that those rate classes are currently subsidizing Residential customers.

The proposed increase to residential rates amounts to a gradual change that eliminates approximately 14 percent of the subsidization of residential by the other rate classes.[18] This is not only gradual but it is also fair, just, and reasonable. Because the proposed reduction is relatively small, and since doing so would not align with the COSS results, revising the proposed rate to reduce subsidization by any smaller amount is not needed. In fact, doing so, would unfairly require members who are already paying more than their fair share to carry an even greater rate burden and it would send a price signal to residential members that is well below cost.

[17] *See* Wolfram Testimony, Exhibit JW-3 p. 2 – 3.

[18] *See* response to Staff First Request for Information, Item 8.

As previously mentioned, increasing labor costs are a significant contributor to the need for a rate adjustment. Shelby Energy operates in a competitive labor market, and it is increasingly difficult being located near a large metropolitan area where competition for employees is strong. This is especially true in the area of linemen and technically trained employees such as engineers and GIS specialists. This creates an upward pressure on wages and benefits to be able to attract and retain quality employees to serve our members.

Related to labor costs, the OAG First Request for Information asked a number of questions related to executive compensation and benefits. The CEO is evaluated by the board annually and the process is managed by the Director of Human Resources of East Kentucky Power Cooperative in conjunction with the Shelby Energy board. The board determines and approves the appropriate increase for the CEO based on several criteria that have been rated by each member in an online survey. The Director of Human Resources at East Kentucky Power Cooperatives provides a compensation/market salary review to guide the board in setting proper compensation. One of the sources is Mercer's Compensation Planning Survey targeted for firms of similar size with approx. $50 million in revenue. In 2022, this review indicated the CEO's base salary was 42% below the 25th percentile, 53% below the 50th percentile, and 68% below the 75th percentile. Additionally, the base salary is compared to the average of all distribution cooperatives in the East Kentucky Power Cooperative system, and the current salary is 14% below the average.

Shelby Energy pays membership dues for inclusion in various associated organizations such as NRECA, Kentucky Electric Cooperatives, TVPPA, and KRUS. These peer groups provide many best practice opportunities, safety guidance, continuing education, and advocacy, as well as access to group benefit opportunities that allow Shelby Energy to offer a competitive benefit package. Shelby Energy's participation in the Shelby County Chamber of Commerce provides interaction with the business community which Shelby Energy serves or has the chance to serve in the future. One of the seven principles of electric cooperatives is Commitment to Community and these affiliations help Shelby Energy to follow and achieve the purposes of this principle. While there are a number of benefits to Shelby Energy for participating in these organizations, it should be noted that these membership dues are excluded from the revenue requirement in this case.

In addition to excluding the membership dues noted above, Shelby Energy also excluded income from its Shelby Propane subsidiary in the revenue requirement. The reason for excluding the subsidiary income is because the net income does not reflect an opportunity to offset Shelby Energy operating expenses on a dollar-for-dollar basis. First, the net income from the propane subsidiary is subject to a 21% Unrelated Business Income Tax (UBIT) by the federal government. Second, the net income of the subsidiary is used to fund capital expenditures of Shelby Propane so as to not require additional funding from Shelby Energy or the need to borrow long-term debt. Lastly, since the revenue requirement in this rate application is based on Shelby Energy's OTIER, the subsidiary net income was excluded as it is not part of Shelby Energy's OTIER.

Unlike the previous rate case, Shelby Energy is including credit card processing fees in the revenue requirement for the current rate application. The inclusion of these fees reflects a changing demographic trend that cash and checks continue to be utilized less and less, and newer generations will utilize credit cards and other electronic forms of payment. Shelby Energy has seen growth in the use of credit cards as a method of payment, and removing the convenience fee has made it more attractive to use this method for payment with potential to lower costs with reduction in bad debt and eliminate the cost of chasing "not sufficient funds" checks.

Shelby Energy's revenue requirement in the current rate application includes an upward pro-forma adjustment for right-of-way expense. Shelby Energy is committed to providing reliable electric service to members which requires an investment in right-of-way. While financially treated as an expense, right-of-way management is an investment in the future of the system. Right-of-way that is adequately maintained will result in decreased outages, less labor costs due to decreased over-time labor, and reduced loss of revenue. In addition to the financial benefits, member aggravation due to outages is also alleviated. Shelby Energy would like to note that the right-of-way expense included in the revenue requirement is not exorbitantly higher than actual right-of-way expenses incurred in previous years, and is actually less than or close to the amounts spent on right-of-way in the years 2016 – 2018.[19]

In filing a streamlined rate proceeding, Shelby Energy followed the requirements set forth in the streamlined rate case order dated December 20, 2019, Appendix A, pages 5 and 6, under "E. Items Excluded for Ratemaking Purposes", Item 2, which states, "If employee health care insurance premium contribution is zero, for ratemaking purposes the pro forma income statement should reflect healthcare insurance premiums adjusted for employee contributions based on the national average for coverage type." Since Shelby does not meet the stated criteria, no adjustment is required.[20]

Shelby Energy is aware of the current economic challenges members face and that no increase is ever welcomed by customers. However, as the Commission has opined regularly, a cooperative has a duty to safeguard its financial integrity for the benefits of its members who are

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[19] *See* response to OAG First Request for Information, excel Exhibit 24 I-J.

[20] *See* response to Staff's First Request for Information, Item 9.

also its customers.[21] In Shelby Energy's case, based on the adjusted test year under the OTIER cap, the revenue deficiency is $2,442,669. However, pursuant to the total revenue increase cap of 4.00%, Shelby Energy is limited to an overall increase of $2,181,638. Shelby Energy opted to use the streamlined case in order to limit the total impact on members and to keep rate case expenses to a minimum.

In summary, Shelby Energy's proposed rate application is fair, just, and reasonable both in regard to the amount of revenue requested and the rate design. Shelby Energy is grateful to the Commission for allowing this case to proceed under the streamlined rate case procedures and appreciates the Office of the Attorney General's constructive participation in the case. For the reasons set forth above, Shelby Energy respectfully requests the Commission to approve its Application and authorize the new rates.

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[21] *See*, *e.g.*, *In the Matter of the Application of South Kentucky Rural Elec. Coop. Corp. for A Certificate of Pub. Convenience & Necessity to Construct A New Headquarters Facility in Somerset, Kentucky*, Order, Case No. 2008-00371 (Ky. P.S.C. May 11, 2010) ("South Kentucky's board of directors owes a fiduciary duty to its customers to safeguard the financial and operational viability of the cooperative. This fiduciary duty is heightened given the fact that South Kentucky's customers are also the owners of the cooperative."); *In the Matter of the General Adjustment of Electric Rates of East Kentucky Power Cooperative, Inc.*, Order, Case No. 2006-00472, pp. 26-27 (Ky. P.S.C. Dec. 5, 2007):

> Unlike an investor-owned utility where the equity owners of the utility may or may not also be customers of the utility, an RECC is governed and owned by its members, who are also its customers. While members of the 16-member systems have an interest in keeping their distribution cooperative's rates as low as possible, they also have an interest in keeping their distribution cooperative's equity position in EKPC viable. The directors of EKPC — who generally are also officers and directors of the 16-member systems — have an obligation to either seek an increase or decrease in EKPC's base rates when the balance between low rates for end users and sufficiently high rates to keep EKPC viable falls out of equilibrium. Though there is a constant friction between these interests, it is one EKPC's board members voluntarily undertake.

This 19th day of September 2023.

Respectfully submitted,

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CERTIFICATE OF SERVICE

This is to certify that a true and accurate copy of the foregoing electronic filing was transmitted to the Commission on September 19, 2023 and that there are currently no parties that the Commission has excused from participation by electronic means in this proceeding.

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Counsel for Shelby Energy Cooperative, Inc.