

**Non-Regulated Activities of RECCs
House Bill 568 – What's New – Reporting
Requirements, Other Mandates**

**Presentation to the
Kentucky Association of Energy Cooperatives**

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Before HB 568

- Organized for:
 - Generating electricity
 - Purchasing electricity
 - Selling electricity
 - Transmitting electricity
 - Distribution of electricity

 - Other services to operate utility

Authorized by HB 568

- Secondary purpose
 - Any other lawful business or activity
- Conducted through an affiliate
- Not exempt from KRS 278.2213-Code of Conduct Statute
- Subject to regulation 807 KAR 5:080

Requirements of Kentucky Revised Statute 278.2213

“Separate recordkeeping for utility and affiliate - Prohibited business practices – Confidentiality of information - Notice of service available from competitor.”

- Do's and Don'ts

- Do - Maintain separate books and records. (Section 1)

- Don't - Provide advertising space. (Section 2)

- Don't - Offer rebates or discounts. (Section 3)

Requirements of Kentucky Revised Statute 278.2213 (cont.)

- Do's and Don'ts (cont.)
 - Do - Abide by all FERC standards, orders and regulations. (Section 4)
 - Don't - Share confidential customer information. (Section 5)
 - Do - Insure arm's length transactions. (Section 6)
 - Don't - Let employees that transfer disclose confidential information. (Section 7)

Requirements of Kentucky Revised Statute 278.2213 (cont.)

- Do's and Don'ts (cont.)
 - Don't - Solicit business for non-regulated affiliate. (Section 8)
 - Do - Follow cost allocation requirements of KRS 278.2203. (Section 9)
 - Don't - Allow access to customer information. (Section 10)
 - Don't - Provide preferential treatment. (Section 11)

Requirements of Kentucky Revised Statute 278.2213 (cont.)

- Do's and Don'ts (cont.)
 - Do - Notify customer of competing suppliers. (Section 12)
 - Don't – Allow use of the utility's name, trademark, brand, or logo in any visual or audio media without a disclaimer. (Section 13)
 - Don't - Enter into any financing arrangements. (Section 14)

Requirements of Kentucky Revised Statute 278.2213 (cont.)

- Do's and Don'ts (cont.)
 - Do - Inform the Commission of all new non-regulated activities. (Section 15)
 - Don't - Include start-up costs in utility rate base. (Section 16)
 - Do - Remember the Commission may require annual reports relating to affiliate transactions. (Section 17)

Requirements of 807 KAR 5:080. Procedural and filing requirements and safeguards concerning nonregulated activities of utilities or utility affiliates.

- **Cost allocation manuals**
 - Before HB 568
 - “incidental nonregulated activity”
 - After HB 568
 - “incidental activity” provision no longer applies
 - Required to develop and file a cost allocation a manual
 - KRS 278.2203 and KRS 278.2205

Requirements of 807 KAR 5:080. Procedural and filing requirements and safeguards concerning nonregulated activities of utilities or utility affiliates. (cont.)

- 807 KAR 5:080.
 - “affected utility”
 - Requirements of regulation
 - Section 2 - Annual reporting requirements - March 31, each year
 - » Description of each change in the cost allocation manual
 - » List of nonregulated affiliates
 - » Brief description of activities
 - » New or amended service agreements

Requirements of 807 KAR 5:080. Procedural and filing requirements and safeguards concerning nonregulated activities of utilities or utility affiliates. (cont.)

- **807 KAR 5:080. (cont.)**
 - **Section 3 - Cost allocation manuals**
 - File new cost allocation manual or new amendment
 - » 60 days of any material change
 - » 90 days of engaging in a new nonregulated activity
 - **Section 4 - New nonregulated activity**
 - Notify the Commission in writing
 - Describe the new nonregulated activity
 - » 10 days of establishing
 - **Section 5 - Deviations**

Requirements of 807 KAR 5:080. Procedural and filing requirements and safeguards concerning nonregulated activities of utilities or utility affiliates. (cont.)

- 807 KAR 5:080. (cont.)
 - Section 6 – Disclaimer
 - Required Format
 - » “(affiliate’s name) is not the same company as (utility’s name). (Affiliate’s name) is not regulated by the Kentucky Public Service Commission. You do not have to buy (the affiliate’s) (products or services, as applicable) in order to receive quality regulated services from the utility”
 - Print
 - Television
 - Audio

Reporting Requirements After Forming an Affiliate

- Annual Report to member-owners
 - Describe the nature of the business or activity
 - Provide the financial status
 - Include future expectations
 - Include any other information the Board deems appropriate

Reporting Requirements After Forming an Affiliate (cont.)

- Annual Reports to Commission
 - Filed simultaneously with Annual Report to Commission
 - Separate affiliates
 - Balance sheet
 - Income statement
 - Business conducted within cooperative
 - Balance sheet
 - Statement of revenues and expenses
 - Confidentiality

Information Required to be filed with Commission – Format

- Example 1 - for an RECC with two affiliate entities
 - Based on a cooperatives that has a Service affiliate and a Propane affiliate

Example 1

Kentucky Energy Cooperative and Subsidiaries
 Consolidating Statement of Revenue and Patronage Capital for the year ended December 31, 2006

	Energy	Services	Propane
Operating Revenues	31,700,000		1,820,000
Operating Expenses:			
Cost of purchases	22,800,000		1,160,000
Distribution - operations	1,200,000		270,000
Distribution - maintenance	1,300,000		
Consumer accounts	800,000		46,000
Customer service and information	170,000		
Sales	20,000		
Administrative and general	650,000	10,000	60,000
Depreciation, excluding \$100,000 charged to clearing accounts	1,500,000		91,000
Taxes	30,000	1,000	13,000
Other	1,000		
	<u>28,471,000</u>	<u>11,000</u>	<u>1,640,000</u>
Operating Margins before Interest Charges	<u>3,229,000</u>	<u>(11,000)</u>	<u>180,000</u>
Interest Charges:			
Interest on long term debt	1,000,000	1,000	60,000
Other Interest	30,000		
	<u>1,030,000</u>	<u>1,000</u>	<u>60,000</u>
Operating Margins after Interest Charges	<u>2,199,000</u>	<u>(12,000)</u>	<u>120,000</u>
Patronage Capital assigned from:			
Kentucky Power Cooperative	0		
Other organizations	40,000		
	<u>40,000</u>		
Nonoperating Margins:			
Interest income	200,000		1,000
Subsidiary and others	80,000	123,000	2,000
	<u>280,000</u>	<u>123,000</u>	<u>3,000</u>
Net Margins	2,519,000	111,000	123,000
Patronage Capital - beginning of year	23,000,000	(743,250)	(200,000)
Retirements to capital credits and others	(500,000)	(27,750)	
Patronage Capital - end of year	<u>25,019,000</u>	<u>(660,000)</u>	<u>(77,000)</u>

Example 1

Kentucky Energy Cooperative and Subsidiaries
Consolidating Balance Sheet, December 31, 2006

Assets	Energy	Services	Propane
Utility Plant			
In service	54,000,000		2,080,000
Under construction	400,000		
	<u>54,400,000</u>		<u>2,080,000</u>
Accumulated depreciation	7,900,000		600,000
	<u>46,500,000</u>		<u>1,480,000</u>
Investments and Other Assets			
Associated organizations	7,400,000		
Goodwill, net	0		365,000
Subsidiary	720,000	783,000	
	<u>8,120,000</u>	<u>783,000</u>	<u>365,000</u>
Current Assets			
Cash and temporary investments	2,300,000	28,000	89,000
Accounts receivable, less allowance for Energy of \$400,000 and for Propane of \$6,000	3,100,000	160,000	180,000
Material and Supplies, avg cost	400,000		46,000
Prepayments	100,000		7,000
	<u>5,900,000</u>	<u>188,000</u>	<u>322,000</u>
Total	<u>60,520,000</u>	<u>971,000</u>	<u>2,167,000</u>
Members' Equities and Liabilities			
Members' and Stockholder's Equities			
Memberships and capital	0	1,380,000	860,000
Patronage capital and retained earnings	25,019,000	(660,000)	(77,000)
Minority interests and other equities	550,000	240,000	
	<u>25,569,000</u>	<u>960,000</u>	<u>783,000</u>
Long-term Debt	26,731,000		982,000
Accumulate post retirement Benefits	1,400,000		
Current Liabilities			
Accounts payable	2,700,000	11,000	162,000
Short-term borrowings	1,300,000		190,000
Current portion of long-term debt	1,100,000		50,000
Consumer deposits	420,000		
Accrued expenses	500,000		
	<u>6,020,000</u>	<u>11,000</u>	<u>402,000</u>
Consumer Advances for Construction	800,000		
Total	<u>60,520,000</u>	<u>971,000</u>	<u>2,167,000</u>

Information Required to be filed with Commission – Format (cont.)

- Example 2 - for a cooperative with one separate affiliate
 - Based on a cooperative that provides internet access

Example 2

Kentucky Energy Cooperative and Subsidiaries

Consolidating Statement of Revenue and Patronage Capital for the year ended December 31, 2006

	Energy	Services
Operating Revenues	57,000,000	510,000
Operating Expenses:		
Cost of power	47,200,000	
Cost of access and equipment		122,000
Distribution - operations	1,000,000	200,000
Distribution - maintenance	3,300,000	
Consumer accounts	1,400,000	21,000
Customer service	36,000	
Sales	46,300	2,600
Administrative and general	1,100,000	108,000
Depreciation, excluding \$165,000 charged to clearing accounts	2,200,000	187,000
Taxes	46,000	10,000
Other	8,600	500
	<u>56,336,900</u>	<u>651,100</u>
Operating Margins	<u>663,100</u>	<u>(141,100)</u>
Interest Charges:		
Interest on long term debt	1,300,000	50,000
Other Interest	125,000	
	<u>1,425,000</u>	<u>50,000</u>
Operating Margins after Interest Charges	<u>(761,900)</u>	<u>(191,100)</u>
Patronage Capital assigned by:		
Kentucky Power Cooperative	0	
Other organizations	60,000	
	<u>60,000</u>	
Nonoperating Margins:		
Interest income	45,000	
Subsidiary and other gains or losses	(194,000)	
	<u>(149,000)</u>	
Net Margins	(850,900)	(191,100)
Patronage Capital - beginning of year	23,556,900	(1,216,900)
Nonoperating margins to other equities	(43,000)	
Retirement to estates of deceased member	(163,000)	
Patronage Capital - end of year	<u>22,500,000</u>	<u>(1,408,000)</u>

Example 2

Kentucky Energy Cooperative and Subsidiaries
Consolidating Balance Sheet, December 31, 2006

Assets	Energy	Services
Utility Plant		
In service	64,000,000	1,400,000
Under construction	900,000	
	<u>64,900,000</u>	<u>1,400,000</u>
Accumulated depreciation	<u>17,000,000</u>	<u>400,000</u>
	47,900,000	1,000,000
Investments and Other Assets		
Associated organizations	13,000,000	
Subsidiary	92,000	
	<u>13,092,000</u>	<u>0</u>
Current Assets		
Cash and temporary investments	385,000	2,500
Accounts receivable, less allowance for Energy of \$37,000 and Services of \$0	7,000,000	30,000
Material and Supplies, avg cost	235,000	55,000
Prepayments	225,000	
	<u>7,845,000</u>	<u>87,500</u>
Total	<u>68,837,000</u>	<u>1,087,500</u>
Members' Equities and Liabilities		
Members' Equities		
Memberships and common stock	225,000	1,500,000
Patronage capital and retained earnings	22,500,000	(1,408,000)
Donated Capital	5,000	
	<u>22,730,000</u>	<u>92,000</u>
Long Term Liabilities		
Long-term Debt	31,600,000	800,000
Obligations under capital lease	22,000	1,000
Accumulate post retirement Benefits	1,700,000	
	<u>33,322,000</u>	<u>801,000</u>
Current Liabilities		
Short term borrowings	4,000,000	
Current portion of long-term debt	1,000,000	
Current portion of capital lease	65,000	7,500
Accounts payable	5,800,000	172,000
Consumer deposits	600,000	
Accrued expenses	1,300,000	
	<u>12,765,000</u>	<u>179,500</u>
Deferred Credits	20,000	15,000
Total	<u>68,837,000</u>	<u>1,087,500</u>

Information Required to be filed with Commission – Format (cont.)

- Notes to Financial Statements for Example 1 only

**Kentucky Energy Cooperative
Nonregulated Business Info – Notes to Financial Statements - 2006**

Business Activity

Kentucky Energy owns 75 percent and Eastern Energy owns 25 percent of Kentucky Energy Services Corporation's ("Kentucky Services") outstanding stock. Kentucky Services owns 100 percent of the outstanding stock of Cooperative Energy Propane Plus ("Cooperative Propane Plus").

Cooperative Propane Plus sells propane, and related accessories, to residential and commercial customers in central Kentucky. Cooperative Propane Plus purchases all of its propane requirements from an unrelated party through State Propane Plus, LLC, a related party. Propane is delivered to bulk tanks owned by Cooperative Propane Plus, then delivered to customers on an as needed basis.

Net Margins

	2006	2005
Cooperative Propane Plus	\$123,000	\$20,000
Kentucky Services	\$111,000	\$4,000

Management Services

State Propane Plus provides the management and administrative services to Cooperative Propane Plus as well as for 3 other propane companies. One individual manages the day to day operations of each propane company and arranges for the purchase of bulk propane. State Propane Plus provides the cost for the labor, benefits and other costs of this manager. State Propane Plus is then reimbursed by the other propane companies so that all management costs are shared on an equal basis.

Kentucky Services provides overall business direction to Cooperative Propane Plus.

Utility Plant

Cooperative Propane Plus's fixed assets consist primarily of propane tanks located on customers' premises, bulk tanks and trucks used in the delivery of propane. Depreciation is computed using the straight-line method over the useful lives of assets.

The major classifications of plant in service consist of:

	2006	2005
Propane tanks on customers' premises	1,192,000	1,192,000
Bulk tanks	250,000	250,000

Delivery and other trucks	280,000	280,000
Land and buildings	300,000	300,000
Office and other equipment	<u>58,000</u>	<u>58,000</u>
Subtotal propane plant	<u>2,080,000</u>	<u>2,080,000</u>

Goodwill

Cooperative Propane Plus was originally incorporated by Kentucky Services (50 percent owned), and Another Company (50 percent owned). Goodwill was recorded in connection of the purchase of Another Company's interest on June 30, 2000. The excess of the payment price over the value of the assets acquired has been recorded as goodwill. Kentucky Energy is applying SFAS No. 142, Goodwill and Other Intangible Assets, with goodwill being tested for impairment.

Capital Stock

Kentucky Services has authorized 2,000 shares of common stock, with no stated or par value. Kentucky Energy owns 75 percent of the issued and outstanding stock. The issued and outstanding stock for Kentucky Services was 1,800 shares and 1,600 shares as of 2006 and 2005, respectively.

Note Payable to Related Party

On September 12, 2000, Eastern Energy issued a "Commercial Note With Guaranty" in the amount of \$1,000,000 to Cooperative Propane Plus. The interest rate is variable, with the rate being the "Index Rate," as published in the Wall Street Journal, minus one half percent (0.50 percent). The rate as of December 31, 2006 was 4.75 percent and at 2005 was 3.50 percent.

Short Term Borrowings

At December 31, 2006, Cooperative Propane Plus had a short term line of credit of \$150,000 available from Peoples Bank. Collateral for the line of credit is the trucks and equipment. The interest rate is prime plus two points, with a floor of 7.5 percent. Advances against this line of credit were repaid during the audit period.

Cooperative Propane Plus has been advanced unsecured funds from Another RECC Propane Plus in the amount of \$30,000 at an interest rate of 5.0 percent at December 31, 2006. In addition, Cooperative Propane Plus has been advanced funds from Kentucky Services in the amount of \$160,000 at December 31, 2006, using interest rates that are 1.0 percent less than prime. The interest rate at December 31, 2006 was 4.75 percent.

Pension Plan

Cooperative Propane Plus has a profit sharing plan of 10 percent of net profits before the pension amount, where managers receive 5 percent of the plan amount and the remaining employees sharing 5 percent. The pension amount for 2006 was \$6,000 and 2005 was \$7,000.

Information Required to be filed with Commission – Format (cont.)

- Provision of audited financial statements
 - May continue
 - Calendar year basis
- Voluntary Guidelines
 - Still in effect