COMMONWEALTH OF KENTUCKY

BEFORE THE ENERGY REGULATORY COMMISSION

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In the Matter of:

ADJUSTMENT OF RATES FOR WHOLESALE ELECTRIC POWER TO MEMBER COOPERATIVES OF EAST KENTUCKY POWER COOPERATIVE, INC.	)))	CASE NO. 7981

O R D E R

On September 29, 1980, East Kentucky Power Cooperative, Inc. (Applicant or East Kentucky) filed an application with this Commission requesting authority to increase its revenue by \$25,631,320 annually or approximately 15.7%, effective 12:01 a.m., Eastern Standard Time, October 20, 1980. Applicant stated that the proposed rate adjustment was required due to (a) the effects of inflation; (b) compliance with environmental laws; and, most importantly, (c) the commercialization of Spurlock Station Unit No. 2.

On September 30, 1980, the Commission ordered the proposed rate increase suspended until March 20, 1981, in order to conduct public hearings and investigations on the reasonableness of the proposed rates. Hearings were scheduled for February 2, 1981, for cross examination of Applicant's witnesses and for cross examination of Intervenor's witnesses on February 4, 1981, at the Commission's offices in Frankfort, Kentucky. Applicant was directed to give notice to its consumers of the proposed rates and the scheduled hearing pursuant to 807 KAR 50:025 Section 7.

On October 8, 1980, the Consumer Intervention Division in the Department of Law filed a motion to intervene in these proceedings pursuant to KRS 367.150 (8). This motion to intervene was sustained by the Commission's Order dated October 22, 1980. No other parties appeared to formally intervene herein.

On October 31, 1980, the Commission, by Order, sustained Applicant's motion of October 30, 1980, to reschedule the February 2, 1981, hearing for January 21, 1981, and the February 4, 1981, hearing for January 23, 1981. The January 23, 1981, hearing was subsequently cancelled by the Commission's Order of December 30, 1980, since the intervenor did not file prepared testimony.

On November 18, 1980, the Commission entered an Order setting out extensive requests for information from the Commission staff. By an Order dated December 4, 1980, the Commission extended the filing date for responses to these requests to December 15, 1980.

The hearing was conducted as scheduled on January 21, 1981, for the cross examination of Applicant's witnesses.

COMMENTARY

East Kentucky Power is a non-profit electric cooperative corporation established pursuant to KRS Chapter 279 and is in the business of generation and transmission of electric energy to its eighteen member distribution cooperatives who jointly share in the ownership of East Kentucky. These distribution cooperatives serve approximately 1,000,000 consumers in over 90 counties in central and eastern Kentucky. Although the increase in rates requested by East Kentucky is directly to the 18 member distribution cooperatives the impact of any increase to East Kentucky is indirectly borne by the consumers of the distribution cooperatives. Accordingly, these distribution cooperatives have filed applications with the Commission requesting authority to flow-through any increase granted East Kentucky in this matter. Contained in Exhibit "B" attached hereto is a listing of the member distribution cooperatives and the impact of the revenue increase granted herein on their annual purchased power costs.

TEST PERIOD

East Kentucky proposed, and the Commission has accepted, the twelve-month period ending June 30, 1980, as the test period herein. In utilizing the historic test period the Commission has given due consideration to known and measurable adjustments, where found reasonable.

VALUATION

Net Investment

Applicant proposed a net investment rate base of $551,746,107 based on the outstanding account balances at the end of the test period, as reflected on Exhibit VI of the application. Applicant also proposed an adjusted net investment rate base of $653,568,893, which reflects the projected plant in service and construction work in progress. A major portion of the plant additions included in the adjusted net investment is the Spurlock Generating Unit No. 2.

The Commission will accept the projected net investment rate base for East Kentucky with these exceptions:

(1) East Kentucky proposed to adjust the value of materials and supplies to include the additional inventory for the Spurlock Unit 2. The Commission will disallow this adjustment for rate making purposes and will utilize the value of materials and supplies at the end of the test period.

(2) The Commission will exclude $414,862 of non-utility property for rate making purposes inasmuch as the investment is of little or no value to the rate payer.

(3) The Commission has adjusted the allowance for working capital to reflect the accepted pro forma adjustments to operation and maintenance expenses.

Based on these adjustments, Applicant's net investment rate base would be as follows:

Plant in Service	$570,528,089
Construction Work in Progress	115,778,415
Fuel Stock	19,081,587
Materials & Supplies	8,994,808
Prepayments	1,107,023
Working Capital	8,607,381
Subtotal	$724,097,303
Less:	
Accumulated Depreciation	71,843,824
Non-Utility Property	414,862
Net Investment	$651,838,617

Capital Structure

East Kentucky proposed an adjusted capital structure of $668,788,239 consisting of $15,845,170 of Equity, $1,000,000 in short-term debt, and $651,943,069 of long-term debt which included funds that had not yet been advanced at the end of the test period.

The Commission is of the opinion that the projected long-term debt should be reduced by $31,349,787 to exclude the amount of unadvanced loan funds associated with the construction of Spurlock Unit 2. The testimony of Applicant reflected that these funds would not be acquired until completion of the pollution control facilities which has been delayed until late 1981, and that the proceeds of the pollution control bonds have been utilized for this construction on an interim basis.

Based on this adjustment and the test year end actual equity, Applicant's capital would be $628,233,082 and consists of $7,639,800 of equity and $620,593,282 of long-term debt.

The Commission has given consideration to these and other elements of value in determining the reasonableness of the proposed rates and charges.

REVENUE AND EXPENSES

East Kentucky presented a consolidated Statement of Operations for the twelve-month period ending June 30, 1980, in Exhibit II. Applicant proposed numerous pro forma adjustments to revenue and expenses to reflect more current and anticipated operating conditions.

After a thorough review of the proposed adjustments, the Commission finds that they are generally acceptable and will include all of the adjustments with these modifications:

(1) On Exhibit II, Schedule h, East Kentucky proposed a pro forma adjustment to reduce other power supply expense by $16,411,200. Applicant stated that the proposed adjustment was necessary to reduce the expense that would no longer be incurred after the addition of the Spurlock Unit 2. In accordance with the Kentucky-Indiana Pool (KIP) Agreement, East Kentucky would terminate its purchase of unit power capacity and become a seller of unit power capacity beginning April 1, 1981.

In calculating the adjustment, East Kentucky determined a normalized cost of purchased power based on the volume of capacity purchases during the first quarter of 1981. Likewise, Applicant determined a normalized level of revenue based on the unit power capacity sales commencing April 1, 1981. The net effect of these adjustments would reduce other power supply expense by $16,411,200.

The Commission is of the opinion that the adjustment proposed by East Kentucky is erroneous and should be modified. The record reflects that the actual test year expense for unit power purchases under the KIP agreement was $6,662,329 net of interchange in. To reduce the expense by $10,732,800 as proposed by Applicant would overstate the impact of the reduction of purchased power cost under the KIP agreement by $4,070,471. Therefore, the Commission will reduce the proposed adjustment by $4,070,471.

(2) On Exhibit II, Schedule b, East Kentucky proposed adjustments to reflect the increased operation and maintenance expense associated with Spurlock Unit 2. In determining this adjustment Applicant applied an approximate cost per kw for water treatment and miscellaneous expense, and projected maintenance material cost based on the approximate kw capacity of the new Spurlock Unit. In using the approximate costs and kw capacity rather than actual, East Kentucky overstated the pro forma cost for these expenses by $59,040. Therefore, the Commission has reduced the proposed adjustment by $59,040.

(3) The Commission has reduced the proposed adjustment to interest on long-term debt by $3,448,477 to exclude the interest on unadvanced loan funds of $31,349,787 in accordance with the determination to reduce total capital herein.

(4) In response to the request for additional information, Item 16c, East Kentucky indicated that during the test year they had incurred $88,372 of extraordinary expenses relating to a penalty on prior year's sales tax of $42,626.51 and a write off of an abandoned project of $45,746. The Commission is of the opinion that these items should be excluded for rate making.

(5) The Commission has adjusted operation and maintenance expense by $990 and other income deductions by $2,836 to exclude a portion of the dues and all charitable contributions for the test year. The Commission is of the opinion that these costs are not

essential to the operation of an electric utility and should not be borne by the rate payers.

After consideration of the accepted pro forma adjustments Applicant's statement of operations would appear as follows:

	Actual Exhibit I	Accepted Pro forma Adjustments	Adjusted Test Year
Operating Revenues			
Member Sales	$83,871,745	$ 10,194,553	$ 94,066,298
Sales Others	9,572,358	-	9,572,358
Other Revenues	522,790	-	522,790
Total	$93,966,893	$ 10,194,553	$104,161,446
Operating Expenses			
Operation	$66,199,134	$ (9,044,543)	$ 57,154,591
Maintenance	3,621,523	3,206,032	6,827,555
Depreciation	8,651,773	8,978,453	17,630,226
Taxes	1,419,240	728,374	2,147,614
Total	$79,891,670	$ 3,868,316	$ 83,759,986
Net Operating Income or Margins	$14,075,223	$ 6,326,237	$ 20,401,460
Other Income	$ 536,493	-	$ 536,493
Other Income Deductions	$ 2,299,242	$ (91,208)	$ 2,208,034
Interest on Long-Term Debt-Net	$11,628,979	$ 24,324,751	$ 35,953,730
Net Income or Margins	$ 683,495	$(17,907,306)	$(17,223,811)

REVENUE REQUIREMENTS

The actual rate of return on East Kentucky's net investment established herein for the test year was 2.16%. After taking into consideration the allowed pro forma adjustments, Applicant's rate of return is 3.13%.

East Kentucky placed little emphasis on the rate of return on Net Investment in this matter and no testimony was entered in opposition of the determination of the net investment rate base or the proposed returns. Instead, the main emphasis was concerning the required times interest earned ratio (TIER) which is the financial indicator contained in Applicant's mortgages securing its long-term debt.

The times interest earned ratio is a measure of the ability of the utility to cover its annual interest on long-term debt and is calculated by adding the net income to the interest on long-term debt and dividing by the interest on long-term debt. East Kentucky requested additional revenue in this matter sufficient to produce a TIER of 1.176.

East Kentucky has failed to achieve the minimum times interest earned ratio for the past three calendar years and only slightly exceeded the 1.0 benchmark for the test year. East Kentucky requested in this matter additional revenue to provide a net income of $8,888,865. After taking into consideration the adjusted interest expense of $46,919,197 allowed herein for rate making purposes, this net income would produce a TIER of 1.189. However, based on the adjusted operating statement, the total increase requested of $25,631,320 would produce net income of $8,407,509 which yields a TIER of 1.179.

Although a TIER of 1.179 exceeds the 1.176 requested by Applicant, the net income will fall below the objective herein. Therefore, the Commission is of the opinion that a TIER of 1.179 is not unreasonable in this instance. To achieve the 1.179 TIER allowed herein, East Kentucky would need additional revenue of approximately $25,631,320 which is the total amount requested herein. This additional increase would result in a rate of return based on the net investment established herein of 7.06%.

SUMMARY

The Commission, after due consideration and being advised, is of the opinion and finds that the rates set out in Appendix "A" attached hereto are the fair, just, and reasonable rates for East Kentucky Power Cooperative, Inc. and will produce gross annual revenue of $123,625,312.

IT IS THEREFORE ORDERED, that the rates set out in Appendix "A" attached hereto and made a part hereof are approved for service rendered on and after March 1, 1981.

IT IS FURTHER ORDERED, that East Kentucky Power Cooperative Inc. shall file with the Commission within thirty (30) days from the date of this Order its revised tariff sheets setting out the rates approved herein.

Done at Frankfort, Kentucky this the 26th day of February, 1981.

ENERGY REGULATORY COMMISSION

Chairman

Vice Chairman

Commissioner

ATTEST:

Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY ENERGY REGULATORY COMMISSION IN CASE NO. 7981 DATED FEBRUARY 26, 1981

The following rates and charges are prescribed for the customers in the area served by East Kentucky Power Cooperative, Inc. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of this commission prior to the date of this order.

Wholesale Power Rate Schedule

AVAILABILITY

Available to all cooperative associations which are or shall be members of the Seller. The electric power and energy furnished hereunder shall be separately metered for each point of delivery.

MONTHLY RATE - PER SUBSTATION OR METERING POINT

Substation Charge:
$590 per month for each energized substation. In the event of joint utilization, this charge shall be divided equally.

Demand Charge:
$5.85 per KW of billing demand.

Energy Charge:
All Kwh $.01999 per Kwh

Minimum Monthly Charge:
The minimum monthly charge under the above rate shall not be less than $590 to each member of each energized substation (metering point).

APPENDIX "B"

APPENDIX TO AN ORDER OF THE ENERGY REGULATORY COMMISSION IN CASE NO. 7981 DATED FEBRUARY 26, 1981

The following eighteen (18) rural electric distribution cooperatives (RECC's) are the owners and member-consumers of East Kentucky Power Cooperative, Inc. The RECC's purchase all of their electric requirements from East Kentucky Power and provide service to approximately one million (1,000,000) citizens in the Commonwealth.

NAME OF RECC	POWER COST INCREASE APPROVED IN THIS ORDER
Big Sandy	$ 949,525
Blue Grass	1,065,599
Clark	1,184,883
Cumberland	1,626,063
Farmers	1,393,822
Fleming-Mason	1,574,895
Fox Creek	585,805
Grayson	772,384
Harrison Co.	697,335
Inter Co.	1,162,559
Jackson Co.	2,558,062
Licking Valley	1,046,428
Nolin	1,569,619
Owen Co.	1,972,753
Salt River	2,533,276
Shelby	736,063
South Kentucky	2,788,313
Taylor Co.	1,413,936
TOTALS	$ 25,631,320