COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

* * * * *

In the Matter of:

ADJUSTMENT OF RATES FOR WHOLESALE ELEC-)
TRIC POWER TO MEMBER COOPERATIVES OF) CASE NO. 8400
EAST KENTUCKY POWER COOPERATIVE, INC.)

O R D E R

On December 10, 1981, East Kentucky Power Cooperative, Inc., ("East Kentucky") filed an application with this Commission requesting authority to increase its revenue by $24,110,886 annually, or 12.8 percent, effective 12:01 a.m., Eastern Standard Time, January 1, 1982. East Kentucky stated that the proposed rate adjustment was required because of the effects of inflation, the impact of high interest rates, the costs of additional facilities, and the effects of the termination of the Kentucky-Indiana Pool Agreement. Based on the determination herein, East Kentucky has been granted an increase in revenue of $14,951,106.

On December 11, 1981, the Commission suspended the proposed rate increase until June 1, 1982, in order to conduct public hearings and investigations into the reasonableness of the proposed rates. A hearing was scheduled for January 13, 1982, for the purpose of filing the testimony of East Kentucky's witnesses, and East Kentucky was directed to give notice to its consumers of the proposed rates and the scheduled hearing pursuant to 807 KAR 5:025, Section 7.

On December 16, 1981, the Consumer Protection Division in the Office of the Attorney General ("AG") moved to intervene in this proceeding pursuant to KRS 367.150(8). On February 4, 1982, Grethel Bock and others, by counsel, moved to intervene as residential consumers on the East Kentucky system. At the hearing of January 13, 1982, Mr. Charles Cook, a residential consumer on the East Kentucky system, requested that he be allowed to intervene in this proceeding. These motions were granted by the Commission and no other parties appeared to formally intervene herein. However, another residential consumer, Mrs. Sarah Bowers, made her opposition to the proposed rate increase known through correspondence with the Commission and through her appearance and statement at the public hearing of this case.

Hearings were held in the Commission's offices in Frankfort, Kentucky, on April 27, 1982, for cross-examination of East Kentucky's witnesses and on April 28, 1982, for cross-examination of any intervenors' witnesses and for rebuttal by East Kentucky. Briefs were filed on May 17, 1982.

COMMENTARY

East Kentucky is a cooperative corporation engaged in the generation and transmission of electric energy to 18 member distribution cooperatives which jointly own East Kentucky. These member cooperatives serve approximately 267,000 customers in over 90 central and eastern Kentucky counties. Although the increase in rates requested by East Kentucky would be borne directly by the 18 member cooperatives the impact of any increase by East

Kentucky is ultimately felt by the customers of the distribution cooperatives. The 18 distribution cooperatives have filed applications with the Commission requesting authority to flow-through any increase granted East Kentucky in this matter. Appendix B contains 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 12-month period ending September 30, 1981, as the test period for determining the reasonableness of the proposed rates. In utilizing the historic test period the Commission has given full consideration to appropriate known and measurable changes.

ADDITIONAL GENERATING CAPACITY REQUIREMENTS

Effective March 31, 1982, East Kentucky ceased to make firm power sales under the Kentucky-Indiana Pool Agreement, which has had the effect of increasing East Kentucky's reserve capacity. This brings to the forefront the continuing issue of the reasonableness and appropriateness of East Kentucky's existing and planned generating capacity, an issue raised by the AG and counsel for Grethel Bock and others.

In Case No. 7809 before this Commission's predecessor, the Energy Regulatory Commission ("ERC"), East Kentucky requested authority to construct the J. K. Smith Station consisting of two 600 megawatt generating units. On December 19, 1980, the ERC issued its Order approving the proposed construction, recognizing the need for additional capacity for the future. However, circumstances which existed at the time of planning for the additional capacity appear to have changed substantially, enough to cause East Kentucky to slip the commercialization date of J. K. Smith Unit No. 1 thirty-three months to October 1987 and to postpone indefinitely the addition of J. K. Smith Unit No. 2.

Uncertain growth in demand for electricity, loss of firm power sales, the extremely high cost of additions to generating capacity, the impact on consumers' bills of additions to capacity, and the current outlook for reserve margins at least through the 1980s in the Commonwealth and the region are some of the considerations which cause the need for additional generating capacity to be a matter of ongoing concern to the Commission and to others. Although that issue found expression in this proceeding, the Commission's concern extends beyond East Kentucky to all of the electric generating utilities within its jurisdiction. Therefore, the Commission finds that a thorough, independent study of such issues as state-wide planning for generation and transmission should be undertaken, and should encompass all of the electric generating utilities within the Commission's jurisdiction. The Commission will address such an undertaking in a separate generic proceeding.

VALUATION

Net Investment

East Kentucky presented a net investment rate base of $691,342,379 based on the outstanding account balances at the end of the test year, as reflected on Exhibit VI of the application. East Kentucky also proposed an adjusted net investment rate base of $778,141,912 which reflects projected levels of plant in service and construction work in progress and increases in the allowance for working capital and the depreciation reserve.

The Commission will accept East Kentucky's year-end net investment rate base with the following modifications:

The Commission has adjusted the allowance for working capital to reflect the accepted pro forma adjustments to East Kentucky's operation and maintenance expenses.

East Kentucky proposed an adjustment of $4,213,389 to the year-end amount of the depreciation reserve to reflect the proposed adjustment to depreciation expense. The Commission will allow only $3,556,431 of the proposed adjustment. This modification reflects the normalized level of depreciation based on plant in service at the end of the test year without any adjustments for plant additions subsequent to the test period.

The Commission has made no adjustment for additions to utility plant in service or construction work in progress occurring after the test year. This determination of net investment rate base is in accordance with the concept of a historical test year for the purpose of setting rates. The Commission is of the opinion that adjustments such as those proposed by East Kentucky are not in accordance with this concept, and therefore, they have not been accepted in this determination of the rate base.

In accordance with past policy the Commission will exclude $414,862 of non-utility property from the rate base inasmuch as this investment is of little or no value to East Kentucky's ratepayers.

Based on these adjustments, the Commission finds East Kentucky's net investment rate base to be as follows:

Utility Plant in Service	$ 575,709,482
Construction Work in Progress	151,947,780
Fuel Stock	20,939,582
Materials and Supplies	10,162,626
Prepayments	62,293
Working Capital	11,684,875
Subtotal	$ 770,506,638
Less	
Accumulated Depreciation	$ 82,051,772
Non-Utility Property	414,862
Net Investment	$ 688,040,004

Capital Structure

East Kentucky proposed an adjusted capital structure of $772,281,005 which consisted of $21,881,851 of equity, $747,574,154 of long-term debt and $2,825,000 of short-term debt. Both the equity and long-term debt included projections beyond the end of the test period.

East Kentucky presented no evidence in support of including short-term debt in the capital structure. Thus, the Commission will adhere to past policy and allow only the year-end equity level. The Commission is of the opinion that long-term debt should be reflected at the actual year-end level as this is consistent with the use of a historical test year as part of the rate-making process. Furthermore, to adjust long-term debt in this instance would drastically distort the balance between net investment and the capital structure because of the large amount of loan funds received but not yet devoted to construction.

Based on this adjustment and the use of year-end levels for debt and equity, East Kentucky's capital structure for rate-making purposes is $677,218,951 and consists of $15,861,707 of equity and $661,532,244 of long-term debt.

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

REVENUES AND EXPENSES

As Exhibit I of its application East Kentucky presented a statement of operations for the 12 months ended September 30, 1981. East Kentucky proposed several pro forma adjustments to revenues and expenses to reflect more current and anticipated operating conditions. After a thorough review of the proposed adjustments, the Commission is of the opinion that they are generally proper and acceptable for rate-making purposes with the following modifications:

Revenue Normalization

East Kentucky proposed to increase operating revenue by $12,331,564 in order to normalize revenue to reflect a full year's sales at the rates in effect at the end of the test year. This adjustment consisted of two parts: an increase to base rate revenue of $14,813,478 and a decrease in fuel revenue of $2,481,914.

The AG proposed to modify each of these adjustments in order to better match revenues and expenses. The AG's proposed adjustment to base rate revenue for projected sales growth is addressed in the following section of this Order as it applies to growth rather than normalization.

In adjusting fuel revenue the AG contended that East Kentucky's adjusted fuel revenue was understated by $483,002 due to the delayed recovery lag built into East Kentucky's fuel adjustment clause and the roll-in of 1.05 mills of fuel costs into the base rates on April 1, 1981. In support of its adjustment the AG maintained that test year fuel revenue should be shifted back by 1 month in order to properly match fuel cost and fuel revenue. The AG further contended that the fuel cost roll-in of April 1, 1981, would result in a double recovery of costs and a misstatement of revenue due to the lag in the recovery of fuel costs through the fuel adjustment clause.

The Commission has reviewed the adjustments proposed by both East Kentucky and the AG and concludes that East Kentucky's adjustment to fuel revenue is proper and acceptable for rate-making purposes. We agree with the AG that a proper matching of fuel revenues and fuel costs is desirable; however, the delayed recovery clause authorized by this Commission cannot produce such an ideal matching. Furthermore, the intent of a revenue normalization adjustment is to restate revenues as if the rates in effect at the end of the test year had been in effect for the entire period. We find that East Kentucky's adjustment best fulfills that intent and, therefore, should be accepted for rate-making purposes.

Sales Growth

East Kentucky did not propose an adjustment to reflect any growth in sales above the test year level. However, the AG did propose an adjustment to revenues and expenses based on growth projections for the 12 months ended September 30, 1982.

The Commission is of the opinion that the AG's proposed adjustment, which reflects projected sales, is speculative in nature, particularly considering the state of the economy and trends of reduced annual load growth in the electric utility industry in general, and therefore should not be utilized for rate-making purposes.

In major electric utility rate cases in which the utility generates electricity and sells it to retail consumers, the Commission typically adjusts revenues and expenses to reflect sales based on the growth in the number of customers during the test year. However, in this case East Kentucky is strictly a wholesale supplier of electricity. Based on the record in this matter the Commission cannot accurately determine the increase in sales due to the increase in consumers. Therefore, an adjustment cannot be made herein.

The Commission is of the opinion that, in future rate cases, such an adjustment should be made. Furthermore, East Kentucky should propose an adjustment to revenues and expenses to reflect the normalization for year-end consumers, or explain to the Commission why an adjustment of that nature should not be made.

Maintenance Normalization

East Kentucky proposed three adjustments to normalize production and transmission maintenance costs. Two of these, for turbine overhauls and the utility pole treatment program, are acceptable. However, the costs of these overhauls should be closely monitored because they continue to escalate; the extension of the service lives of utility poles should be examined to determine if any changes in depreciation rates are necessary. The results of this examination will be reviewed in East Kentucky's next rate application.

The third adjustment proposed by East Kentucky reflected $280,163 in additional expense for right-of-way maintenance. In calculating this adjustment, East Kentucky used a 4-year work cycle for performance of right-of-way maintenance work, a decrease from the 5-year cycle previously utilized. East Kentucky offered little support for this change other than to state that it was the result of a judgmental decision. The Commission finds that decisions of this type are in conflict with our recent directive in which we implored utilities to take steps to reduce or defer costs as a means of reducing rate increases. In accordance with the intent of the directive and taking note of the amount of right-of-way maintenance historically performed by East

Kentucky, the Commission has utilized the historical 5-year maintenance cycle and reduced the proposed adjustment by $118,480 to $161,683.

<u>Wages and Salaries</u>

<u>Overtime</u>

East Kentucky proposed an adjustment of $2,391,634 to reflect the additional expense resulting from wage increases that occurred during the test year and subsequent to the test year, plus the addition of 6 new employees since the end of the test year. In calculating this adjustment East Kentucky utilized an overtime factor equal to 10.02 percent of base wages and salaries, which was the actual experience during the test year. The AG proposed that this adjustment be reduced to reflect only a 6.02 percent overtime factor as that was the percentage used in East Kentucky's last general rate case. Over the 5 most recent calendar years, East Kentucky's overtime has fluctuated greatly, ranging from 7 to 14 percent of base wages and salaries; therefore, the Commission finds that the AG's adjustment reflects an abnormally low level of overtime and should not be accepted for rate-making purposes herein. After reviewing the evidence of record, the Commission is of the opinion that the test year overtime factor is reasonable and acceptable for rate-making purposes.

<u>Wage and Salary Allocation</u>

Also utilized in East Kentucky's proposed adjustment was 69.80 percent as the percentage of gross wages and salaries charged to expense. This percentage reflects the portion of gross wages and salaries charged to expense during the final month of the test year, September 1981. East Kentucky contended that the percentage of wages and salaries actually expensed of 65.21 for the entire test year was inappropriate because it reflected the lower than normal level of wages and salaries charged to expense for the first part of the test year prior to the commercialization of the Spurlock No. 2 generating unit.

The Commission has reviewed the monthly allocation of wages and salaries charged to expense during the test year and finds as follows:

The September 1981 percentage of 69.80 was the highest for any month of the test year.

Apart from the 69.80 percent experienced in September 1981, the next highest percentages of wages and salaries charged to expense occurred in December 1980 and January 1981 during the construction of Spurlock No. 2.

The percentage of salaries and wages charged to expense was greater during the months prior to the commercialization of Spurlock No. 2 than during the unit's operating months of March through September 1981.

Based on these findings and knowledge of the status of East Kentucky's construction program, the Commission is of the opinion that East Kentucky's adjustment should not be accepted as proposed but should be modified to reflect the actual test year allocation of wages and salaries of 65.21 percent charged to expense. Therefore, the proposed adjustment has been reduced by $695,449 to $1,696,185 to reflect that modification.

Wage Increases

Wage increases were granted to East Kentucky employees in November 1980 of 10 percent, in early 1981 of 6.7 percent and on November 1, 1981, of 7.25 percent. East Kentucky's President, Mr. Norris, testified that the wage increases were necessary to bring East Kentucky's salaries to a level comparable to that of related industries in the East Kentucky service area and further that studies were made of nearby utilities and of comparable professional positions in the area. As a result, East Kentucky developed and has implemented a compensation plan based on performance. The Commission finds this to be a desirable method of awarding wage increases and one which should improve overall employee performance and productivity. However, wage increases of the magnitude of those granted from November 1980 to November 1981 are hardly conducive to controlling costs and are especially suspect considering the low turnover of employees historically experienced by East Kentucky. Therefore, East Kentucky is herein advised that with inflation at a level substantially lower than in recent years and considering the overall state of the economy, the Commission expects minimal, if any, increases in East Kentucky's overall salaries and wages throughout the remainder of the year.

Employee Benefits

East Kentucky proposed an adjustment of $579,468 to reflect increases in employee benefits due to increased wages and salaries and the addition of new employees since the test year. In calculating the adjustment, East Kentucky utilized 69.80 percent as the percentage of employee benefits to be charged to expense. As stated in the preceding Wage and Salary Allocation subsection, this was the percentage of labor-related expenses charged to expense for the month of September 1981. For the reasons previously cited, the Commission has not accepted the use of only 1 month's allocation of costs between expense and capitalization in adjusting labor-related expenses. Therefore, the Commission has used the allocation for the entire test year of 65.21 percent to modify the adjustment proposed by East Kentucky. The result of this modification is to reduce the adjustment by $144,588 to $434,880.

The AG proposed an adjustment of $355,021 to eliminate East Kentucky's cost for the portion of the employee's retirement benefits that was intended to be funded through employee contributions. The record reflects that East Kentucky contributes 16.2 percent of the employees' base wages for retirement, although the retirement plan requires employees to pay 4 percent of the 16.2 percent. In comparison with other utilities and general industry practices, the Commission finds this contribution to be unreasonable. East Kentucky should begin requiring its employees to contribute the 4 percent. Furthermore, as a part of its continuing evaluation of wage and benefit practices, East Kentucky should consider an overall reduction in its portion of retirement contributions. Therefore, we have accepted the AG's proposed adjustment, modified to reflect the expense allocation of 65.21 percent cited in the preceding paragraph. This modification reduces the adjustment proposed by the AG by $23,346 to $331,675.

During the cross-examination of Mr. Norris, it was revealed that a study of East Kentucky's employee benefits program would be performed this fall. Of particular interest to the Commission is the possibility of self insurance of East Kentucky's long-term disability program. During the test year the long-term disability premiums paid were greatly in excess of the benefits provided. Inasmuch as the employee benefits program will affect East Kentucky's costs, and ultimately its rates, the Commission will require that the study of the employee benefits program be filed with the Commission and that East Kentucky include as a part of that study an analysis of the funding of long-term disability benefits.

Energy Control Center

East Kentucky proposed to increase its operating expenses by $875,891 to reflect the projected operating costs of its new energy control center. The AG recommended the adjustment not be allowed inasmuch as East Kentucky had included no offsetting dollar benefits as a part of the adjustment and because the projected in-service date was 8 months after the test year.

Through cross-examination of Mr. Norris, it was revealed that the in-service date of the energy control center would be delayed for a period of 3 to 4 months, or until approximately 3 months after the date of this Order. While changes occurring during the suspension period of a rate application are generally considered by this Commission, it is not our policy nor is it in accordance with general rate-making practices to allow changes that will occur at some approximate future date, particularly when the proposed adjustment does not fully reflect the effects of those changes. It is our opinion that by failing to quantify the projected benefits of the energy control center East Kentucky's adjustment does not fully reflect the effects of the center on its operations. Furthermore, the delay of the in-service date beyond the date of this Order effectively eliminates the adjustment from consideration for rate-making purposes. Therefore, the proposed adjustment has not been allowed in this proceeding for the purpose of determining East Kentucky's revenue requirements.

Payroll Taxes

East Kentucky did not propose an adjustment for payroll taxes; however, the AG recommended an adjustment be made in the amount of $140,818. The Commission has reviewed the AG's recommendation and has determined that such an adjustment is necessary and should be made. However, as in the adjustments to wages and salaries expense and employee benefits expense, the Commission has modified the AG's proposed adjustment to reduce the allocation of the increase in payroll taxes charged to expense from

69.80 percent to 65.21 percent. This modification results in the adjustment being reduced by $44,839 to $95,979.

Kentucky-Indiana Pool Transactions

East Kentucky proposed an adjustment of $2,051,242 to increase other power supply expense due to the termination of the Kentucky-Indiana Pool ("KIP") Agreement on March 31, 1982. As provided in the KIP Agreement, East Kentucky was a net seller of power to other KIP members during the test year. In accordance with the Uniform System of Accounts the KIP power sales were recorded as a reduction to other power supply expense.

The AG recommended that this adjustment be disallowed due to East Kentucky's failure to document the status of future power sales to KIP members and other potential customers. The AG also maintained that the proposed adjustment was improper as it did not reflect the KIP power sales which occurred from October 1981 through March 1982.

The Commission is of the opinion that East Kentucky has adequately documented the status of future power sales outside its system, limited as they may be. We urge East Kentucky to make every possible effort to increase its sales to other systems as a means of reducing the financial burden on the retail consumers of its members.

The Commission has further reviewed the AG's recommendation and finds no reason for including the KIP power sales from October 1981 through March 1982 in calculating the adjustment to other power supply expense inasmuch as these sales have been discontinued. Absent the continuance of these sales, the Commission concludes that the proposed adjustment is proper and that it accurately reflects the prospective level of other power supply expense exclusive of transactions under the KIP Agreement.

Interest on Long-Term Debt

East Kentucky proposed an adjustment of $25,622,610 to reflect the interest on all debt outstanding at the end of the test year plus the interest on additional debt projected to be incurred subsequent to the test year but prior to the date of this Order. The AG proposed to reduce East Kentucky's adjustment by $3,631,633 to reflect actual interest rates rather than the rates East Kentucky had projected.

The Commission has used the data supplied by East Kentucky subsequent to the public hearings of April 27 and 28, 1982, and has calculated the adjustment to long-term interest to be $24,469,246. This adjustment reflects the balance of total long-term debt outstanding as of April 30, 1982, including Spurlock and Smith Station pollution control bonds. In addition, the interest allowed on 2-year notes from the Federal Financing Bank ("FFB") has been determined by using the composite cost rates on debt outstanding at the end of the test year and the actual interest rates on funds advanced since the end of the test year.

East Kentucky had projected an interest rate of 15 percent for all 2-year FFB notes. While FFB interest rates exceeded 15 percent in September and October of 1981, they have since returned to the levels most consistently experienced during the test year. The Commission finds no compelling reason to rely on projected interest rates in order to adjust interest expense. Therefore, actual interest rates have been used in determining the amount of the adjustment to East Kentucky's gross interest expense.

Interest Charged to Construction

East Kentucky proposed an adjustment of $6,915,015 to increase the $23,875,181 of interest charged to construction work in progress ("CWIP"). This results in a direct offset to gross interest which was addressed in the preceding section of this Order. Based on the level of CWIP at April 30, 1982, and the debt cost of pollution control bonds which will be charged to construction, the Commission has increased the proposed adjustment by $1,105,901 to $8,020,916. This adjustment largely reflects the $20 million increase in the outstanding balance of Spurlock pollution control bonds and the issuance of $50 million in Smith Station pollution control bonds. The cost of these funds will continue to be capitalized until construction on the related pollution control equipment is complete. Inasmuch as the Spurlock construction will not be completed until early 1983, with the Smith Station construction to be completed later, the Commission concludes that the adjusted level of interest charged to construction of $31,896,097 will continue for the duration of the rates approved herein.

Interest on Short-Term Debt

East Kentucky did not propose an adjustment to its test year interest on short-term debt of $3,331,810. However, the AG proposed an adjustment to reduce short-term interest expense by $2,433,902 based on East Kentucky's projection of $897,908 in annual short-term interest.

East Kentucky contended that its projection reflected an abnormally low level of short-term interest due to abnormally low short-term borrowings. East Kentucky indicated it was presently using $10,500,000 in surety bond proceeds to reduce its short-term borrowings. These proceeds were the result of the settlement with the contractor which had defaulted on its work on the pollution control equipment at Spurlock Unit No. 2. East Kentucky will have the use of these proceeds until construction on the Spurlock No. 2 pollution control equipment is complete. Inasmuch as East Kentucky plans to implement its next rate increase to concide with the completion of this construction, East Kentucky will have the use of the surety bond proceeds for the duration of the rates approved herein. In addition, East Kentucky's interest on short-term debt during the test year was substantially greater than the amount incurred in any previous year and was more than twice the amount incurred in 1980. Therefore, in our opinion an adjustment to interest on short-term debt is necessary. The adjustment proposed by the AG is proper and should be accepted for rate-making purposes.

Interest Income

East Kentucky did not propose an adjustment to its test year interest income of $537,069. The AG contended that interest earned on the excess portion of pollution control bonds should be recorded as interest income rather than credited to CWIP as has been the practice of East Kentucky. The AG maintained that since the interest cost of these funds is recorded as interest expense, consistent accounting treatment required that the interest earned by the investment of these funds should be recorded as interest income. East Kentucky argued that its accounting treatment for interest earned on excess loan funds was proper and in accordance with the Uniform System of Accounts while the AG claimed that East Kentucky's accounting treatment was not supported by the Uniform System of Accounts nor by generally accepted accounting principles.

The Commission has reviewed this matter and is of the opinion that East Kentucky's treatment of the interest earned on excess loan funds is inconsistent with its treatment of the interest cost of these funds. We are aware of the pending ruling by the Rural Electrification Administration ("REA") on the proper accounting treatment of these interest costs and earnings which requires that neither the costs nor earnings from these funds be recorded as an expense or income item but that both be charged directly to construction without appearing on the income statement. However, rate-making treatment and accounting treatment are not always the same. In our opinion, if gross interest costs are recorded as expense, gross interest earnings must be recorded as income. Therefore, for rate-making purposes, East Kentucky's interest income has been increased by $2,031,509 which was the amount of interest earned on pollution control funds invested during the test year.

Write-off of Obsolete Equipment

East Kentucky proposed an adjustment of $69,082 to eliminate for rate-making purposes the non-recurring cost of the disposal of obsolete facilities. The AG proposed an additional adjustment of $41,948 to exclude, for rate-making purposes, the cost of the write-off of obsolete substation material as a non-recurring item. Under cross-examination, Mr. James Adkins, East Kentucky's accounting witness, agreed that the write-off of the substation material was a non-recurring cost for which an adjustment should be made. Therefore, the Commission has accepted the AG's adjustment and reduced miscellaneous income deductions by $41,948.

Capital Credits

East Kentucky proposed an adjustment of $201,933 to reduce non-operating margins for the amount of non-cash capital credits assigned during the test year. East Kentucky contended that these credits should not be treated as income for rate-making purposes inasmuch as they increased margins without providing a corresponding inflow of cash. The AG recommended rejection of the adjustment merely because the actual receipt of cash was not immediate.

The cash receipts from these credits, while not realized immediately, will be realized at some point in the future. In addition, total credits assigned are included by REA as revenue at the time they are assigned, and East Kentucky offered no evidence that the level of credits assigned during the test year would not continue in the future. The Commission is of the opinion that these credits should be recognized as income in the year they are assigned, and therefore, the proposed adjustment has not been accepted for rate-making purposes.

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

	Actual Test Year	Pro Forma Adjustments	Adjusted Test Year
Operating Revenues	$140,761,557	$12,331,564	$153,093,121
Operating Expenses	103,952,893	9,511,756	113,464,649
Operating Income	$ 36,808,664	$ 2,819,808	$ 39,628,472
Other Income and (Deductions) - Net	$ (2,675,063)	4,576,441	$ 1,901,378
Interest on Long-Term Debt - Net	28,505,184	16,448,330	44,953,514
Net Income	$ 5,628,417	$(9,052,081)	$ (3,423,664)

REVENUE REQUIREMENTS

The actual rate of return on East Kentucky's net investment rate base established herein for the test year was 5.35 percent. After taking into consideration the allowed pro forma adjustments, East Kentucky's rate of return was 5.76 percent. East Kentucky placed little emphasis on the rate of return on net investment, and no testimony was entered in opposition to the determination of the net investment rate base or the proposed return. The greatest emphasis was placed on the requested times interest earned ratio ("TIER"), which is the primary earnings indicator contained in the mortgages securing East Kentucky's long-term debt.

TIER is a measure of a utility's ability to cover the annual interest expense on its long-term debt. East Kentucky requested additional revenue in this matter sufficient to produce a TIER of 1.15. With net income of $5,628,521 East Kentucky achieved a TIER of 1.11 during the test year and has exceeded the required TIER of 1.0 during the past 2 calendar years. East Kentucky requested in this matter additional revenue to provide net income of $11,648,561, an increase of $3,241,052 above the net income granted East Kentucky in its last general rate case.

Based on the adjusted gross interest expense of $76,849,611 allowed herein for rate-making purposes a TIER of 1.15 would produce net income of $11,527,442. In order to produce this level of net income East Kentucky's revenue should be increased by $14,951,106. The Commission is of the opinion that this additional revenue will be sufficient to meet East Kentucky's operating needs as well as to meet the requirements of the mortgages securing East Kentucky's long-term debt. The increase in revenue will result in a rate of return on the net investment established herein of 7.93 percent.

RATE DESIGN

East Kentucky proposed that the increase in revenue be distributed to its member cooperatives by increasing the current energy charge. The Commission finds that East Kentucky's proposal is reasonable in this instance and should be adopted to distribute the increase in revenue granted herein.

SUMMARY

The Commission, having considered the evidence of record and being advised, is of the opinion and finds that:

1. The rates in Appendix A are the fair, just and reasonable rates for East Kentucky and will produce gross annual revenue of $168,044,227 which should be sufficient to pay its operating expenses, service its debt, and provide a reasonable surplus for equity growth.

2. The rates proposed by East Kentucky would produce revenue in excess of that found reasonable herein and should be denied upon application of KRS 278.030.

3. East Kentucky should discontinue paying the 4 percent employees' portion of contributions to its retirement plan, and East Kentucky's employees should make this contribution.

4. East Kentucky should file with the Commission the upcoming study of the employee benefits program including an analysis of possible long-term disability self insurance.

IT IS THEREFORE ORDERED that the rates in Appendix A be and they hereby are approved for service rendered by East Kentucky on and after June 1, 1982.

IT IS FURTHER ORDERED that the rates proposed by East Kentucky be and they hereby are denied.

IT IS FURTHER ORDERED that East Kentucky shall discontinue payment of the portion of retirement contributions that rightfully should be made by its employees, and that East Kentucky's employees should begin making this contribution.

IT IS FURTHER ORDERED that East Kentucky shall file with the Commission, as soon as it is available, the upcoming study of the employee benefits program including an analysis of possible long-term disability self insurance.

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

Done at Frankfort, Kentucky, this 3rd day of June, 1982.

By the Commission

ATTEST:

Secretary

IT IS FURTHER ORDERED that the rates proposed by East Kentucky be and they hereby are denied.

IT IS FURTHER ORDERED that East Kentucky shall discontinue payment of the portion of retirement contributions that rightfully should be made by its employees, and that East Kentucky's employees should begin making this contribution.

IT IS FURTHER ORDERED that East Kentucky shall file with the Commission, as soon as it is available, the upcoming study of the employee benefits program including an analysis of possible long-term disability self insurance.

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

Done at Frankfort, Kentucky, this 3rd day of June, 1982.

PUBLIC SERVICE COMMISSION

Marlin M. Volz
Chairman

Katherine Randall
Vice Chairman

Linda Carrigan
Commissioner

ATTEST:

Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE PUBLIC SERVICE COMMISSION IN CASE NO. 8400 DATED JUNE 3, 1982

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: $.02504 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 PUBLIC SERVICE COMMISSION IN CASE NO. 8400 DATED JUNE 3, 1982

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

NAME OF RECC	POWER COST INCREASE APPROVED IN THIS ORDER
Big Sandy	$ 572,960
Blue Grass	638,200
Clark	682,792
Cumberland	939,744
Farmers	783,740
Fleming-Mason	973,896
Fox Creek	330,680
Grayson	460,408
Harrison County	406,928
Inter-County	668,660
Jackson County	1,554,940
Licking Valley	611,376
Nolin	885,136
Owen County	1,127,084
Salt River	1,446,308
Shelby	442,068
South Kentucky	1,627,512
Taylor County	803,268