

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

NOTICE AND APPLICATION FOR)
ADJUSTMENT OF RATES FOR) CASE NO. 8544
JACKSON PURCHASE ELECTRIC)
COOPERATIVE CORPORATION)

O R D E R

On July 1, 1982, Jackson Purchase Electric Cooperative Corporation ("Jackson Purchase") filed an application with this Commission requesting to increase its annual revenue by \$778,550, or 4.21 percent. Jackson Purchase stated that the proposed rate adjustment was required due to increases in interest rates and capital costs, as well as increases in the cost of labor and materials. Based on the determination herein, Jackson Purchase has been granted an increase in revenue of \$389,794 annually, or 2.11 percent.

On September 10, 1982, the Commission scheduled a public hearing on the matter and directed Jackson Purchase to give notice to its consumers of the proposed rates and the hearing scheduled for October 28, 1982. On September 21, 1982, Jackson Purchase amended its application to reflect a change in its industrial service tariff, which reduced the requested increase to \$717,006, or 3.88 percent.

On July 13, 1982, the Consumer Protection Division in the office of the Attorney General moved to intervene in this proceeding pursuant to KRS 367.150(8), which motion was granted. No other parties formally intervened herein.

COMMENTARY

Jackson Purchase is a consumer-owned rural electric cooperative engaged in the distribution and sale of electric energy to approximately 18,600 member-consumers in the Kentucky counties of Ballard, Graves, Livingston, Marshall and McCracken. Jackson Purchase obtains all of its power from Kentucky Utilities Company ("KU") under a wholesale power contract in effect through December, 1983. Jackson Purchase has become a member of Big Rivers Electric Corporation ("Big Rivers") and will begin receiving its power from Big Rivers upon the expiration of the KU contract.

TEST PERIOD

Jackson Purchase proposed and the Commission has accepted the 12-month period ending February 28, 1982, 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.

VALUATION

Net Investment

Jackson Purchase proposed a net investment rate base of \$23,957,164. The Commission concurs with this determination with the following exceptions:

The Commission has adjusted working capital to reflect the level of operating expenses allowed herein for rate-making purposes. The Commission has further adjusted the proposed rate base to reflect the pro forma adjustment to depreciation expense in the calculation of the accumulated provision for depreciation.

Based on these adjustments, Jackson Purchase's net investment rate base for rate-making purposes is as follows:

Utility Plant in Service	\$ 26,727,377
Construction Work in Progress	767,266
Total Utility Plant	<u>\$ 27,494,643</u>
Add:	
Materials and Supplies	\$ 350,628
Prepayments	74,580
Working Capital	326,119
Subtotal	<u>\$ 751,327</u>
Deduct:	
Depreciation Reserve	\$ 4,344,511
Customer Advances for Construction	8,235
Subtotal	<u>\$ 4,352,746</u>
Net Investment	<u><u>\$ 23,893,224</u></u>

Capital Structure

The Commission finds from the evidence of record that Jackson Purchase's capital structure at the end of the test year was \$24,837,208 and consisted of \$6,116,936 in equity and \$18,720,272 in long-term debt. In the determination of this capital structure, the Commission has excluded accumulated generation and transmission capital credit assignments in the amount of \$570,550.

REVENUES AND EXPENSES

Jackson Purchase proposed several adjustments to revenues and expenses to reflect more current and anticipated operating conditions. The Commission finds the proposed adjustments are generally proper and acceptable for rate-making purposes with the following modifications:

Revenue Normalization

Jackson Purchase proposed an adjustment of \$2,576,996 to normalize its test year revenue from electric sales to reflect a full year's sales at the rates in effect at the time the application was filed. Since the filing of the application, Jackson Purchase has incurred an increase in its wholesale power cost from KU's Phase I rate, approved by the Federal Energy Regulatory Commission ("FERC") under Docket No. ER-82-673. In order for Jackson Purchase to recover this additional cost, the Commission approved a rate increase, effective September 23, 1982, in Case No. 8617. To reflect that increase, the Commission has increased annual operating revenue by an additional \$1,438,418.

Purchased Power Adjustment

In order to normalize its purchased power cost for the test year, Jackson Purchase proposed an adjustment of \$2,220,804 based on the wholesale power rate in effect at the time the application was filed. To reflect the increase in Jackson Purchase's power cost from KU's Phase I wholesale rate increase the Commission has increased the proposed adjustment by \$1,426,740.

Regulatory Assessment Expense

Jackson Purchase proposed an expense adjustment of \$4,894 to reflect an increase in regulatory assessment expense resulting from the revenue increases that have taken place since it was last assessed based on its calendar year 1981 revenue. The 1981 Kentucky General Assembly made a modification to KRS 278.150 which results in a new calculation of the annual PSC assessment. Under the revised statute the assessment for rural electric cooperatives will be based on total intrastate revenues less one-half of the purchased power costs. The net effect of this modification will result in Jackson Purchase paying its assessment on a lower base revenue figure. At this time the new assessment rate can not be determined and the exact impact of this change can not be measured. Therefore, the Commission has disallowed the adjustment proposed by Jackson Purchase to increase the assessment expense.

Right-Of-Way Maintenance

Jackson Purchase proposed an adjustment of \$48,935 to reflect a decrease in maintenance expense resulting from the use of chemical spray treatment rather than mechanical tree trimming. Mr. William Dalton, interim manager of Jackson Purchase, testified that the chemical spray treatment was proving to be inadequate as the number of power outages caused by tree contacts was steadily increasing. In order to maintain service reliability Jackson Purchase has returned to tree trimming resulting in additional expense of \$7,065 above what was incurred during the test year.

The Commission is of the opinion that maintaining service reliability is of paramount importance and therefore has increased the expense for right-of-way maintenance by \$7,065 to allow Jackson Purchase to continue the level of tree trimming currently being performed.

FICA Tax Expense

Jackson Purchase proposed an adjustment of \$4,470 to reflect the additional FICA expense resulting from the wage and salary increases granted to its employees. In calculating this adjustment Jackson Purchase applied the new FICA tax rate to its gross payroll without adjusting the payroll for wages which would be above the FICA ceiling and thus not subject to the FICA tax. In response to an information request from the Commission, Jackson Purchase recalculated the adjustment with those wages above the FICA ceiling excluded from the calculation. The revised calculation reflects an adjustment of \$2,250, which has been accepted herein.

PCB Capacitor Testing and Inspection

Based upon EPA regulations requiring that all line equipment containing PCB be removed from service and disposed of, Jackson Purchase initiated a testing and inspection program to test its equipment for the contaminant PCB. This program revealed that Jackson Purchase needed to remove some of its equipment from storage immediately or risk incurring heavy penalties from EPA. Mr. David Stiles, Jr., Director of Office Services for Jackson Purchase, testified that the amount involved with the

testing and inspection program is a one-time expense which should not recur after all equipment has been inspected. Therefore, the Commission has reduced Jackson Purchase's operating expenses by \$13,985 to eliminate this item for rate-making purposes.

PCB Capacitor Disposal

Jackson Purchase proposed an adjustment of \$12,500 to amortize the estimated cost to dispose of and replace all capacitors containing PCB. Jackson Purchase proposed to amortize the total cost of \$125,000 over a period of 10 years which was the original disposal time allowed by EPA. Testimony in this case reflects that the time required by EPA for the disposal of contaminated capacitors has been shortened to 6 years. The total cost for the disposal and replacement plan is \$6,000 to dispose of capacitors in storage, \$33,000 to dispose of capacitors now in service, and \$86,000 for replacement of the capacitors, based on current cost.

The Commission is of the opinion that the disposal cost of the PCB capacitors is an appropriate expense for rate-making purposes; however, we find that the cost to replace the capacitors is a capital expenditure which should be charged to plant accounts and depreciated over the useful life. Therefore the Commission will allow amortization of the \$39,000 expense associated with disposal of the capacitors in storage and in service over a 6-year period, which results in an adjustment of \$6,500.

Wholesale Power Negotiations

Jackson Purchase incurred expenses of \$73,444 during the test year in connection with its intervention in the KU rate filing before the FERC. After December 1983, Jackson Purchase will no longer purchase power from KU, and will begin to purchase from Big Rivers. Accordingly, Jackson Purchase will no longer incur expenses for wholesale power negotiations after calendar year 1983.

The Commission is of the opinion that this will not be an annual recurring expense and the full amount thereof should not be included for rate-making purposes herein. Therefore, Jackson Purchase's operating expenses have been reduced by \$36,722 to reflect the amortization of this cost over a 2-year period.

Computer Terminal Purchase

During the test year Jackson Purchase acquired nine computer terminals which it had previously leased. Purchasing these terminals rather than leasing results in a net annual savings of \$8,395 to Jackson Purchase. The Commission therefore has made an adjustment of \$8,395 to reduce Jackson Purchase's operating expenses to recognize this savings.

Interest on Long Term Debt

Jackson Purchase proposed an adjustment of \$183,445 to annualize interest expense on long-term debt. The proposed adjustment reflected interest on \$324,000 to be advanced from REA subsequent to the test year plus the interest on one-half of the \$2,650,000 approved in Case No. 8558, its most recent construct

and finance case, for the 1982-1983 workplan. In accordance with past policy the Commission will allow an adjustment of \$58,852 based on annual interest on the balance of long-term debt outstanding as of October 31, 1982.

Capital Credits

Jackson Purchase proposed to exclude from non-operating income all capital credits assigned from associated organizations but not received in cash during the test year. The Commission has, in past cases, excluded generation and transmission capital credits from non-operating income in determining revenue requirements, however, we have consistently included other capital credits from associated organizations as income in the year in which they are assigned. In accordance with this practice the Commission has adjusted non-operating income to include capital credits assigned during the test year exclusive of generation and transmission capital credits as income for rate-making purposes.

The effect of the revised pro forma adjustments on net income is as follows:

	<u>Actual Test Period</u>	<u>Pro Forma Adjustments</u>	<u>Adjusted Test Year</u>
Operating Revenues	\$ 15,898,404	\$4,015,414	\$19,913,818
Operating Expenses	14,352,642	3,747,542	18,100,184
Operating Income	<u>\$ 1,545,762</u>	<u>\$ 267,872</u>	<u>\$ 1,813,634</u>
Interest on Long-Term Debt	1,044,635	58,852	1,103,487
Other Income and (Deductions)-Net	<u>260,251</u>	<u>(102,217)</u>	<u>158,034</u>
Net Income	<u>\$ 761,378</u>	<u>\$ 106,803</u>	<u>\$ 868,181</u>

REVENUE REQUIREMENTS

The actual rate of return on Jackson Purchase's net investment rate base established herein for rate-making purposes was 6.47 percent. After taking into consideration the accepted pro forma adjustments, Jackson Purchase would realize a rate of return of 7.59 percent. In its amended application, Jackson Purchase requested a rate of return of 10.97 percent and a Times Interest Earned Ratio ("TIER") of 2.14 based upon an "equity growth formula"⁽¹⁾ designed to achieve a target equity ratio of 40 percent within a period of 5 years. Jackson Purchase's witness, Mr. Jack Gaines, testified at the hearing that the equity growth formula was modified in order that the requested TIER would approximate the TIER that the Commission has historically allowed. Mr. Gaines further testified that the equity growth formula was presented primarily for informative purposes to show how equity growth would be achieved with the additional revenue requested herein.⁽²⁾ While equity growth is desirable, the Commission is of the opinion that the components of the formula, namely the target equity ratio, the capital growth rate, and the planning horizon, are, as Mr. Gaines stated, basically informative. For this reason, the Commission has given limited consideration to the equity growth formula in determining revenue requirements for Jackson Purchase.

(1) Application Exhibit 8.

(2) Transcript of Evidence, October 28, 1982, pages 76-78

The Commission is of the opinion that Jackson Purchase's adjusted rate of return is inadequate and a more reasonable rate of return would be 9.22 percent. In order to achieve this rate of return, Jackson Purchase should be allowed to increase its revenue by \$389,794 which should result in a TIER of 2.14, the TIER requested by Jackson Purchase. This additional revenue will provide net income of \$1,257,975 which should be sufficient to meet the requirements in Jackson Purchase's mortgages securing its long-term debt.

REVENUE ALLOCATION AND RATE DESIGN

Jackson Purchase proposed to allocate the increase in revenue to each rate class by a constant percentage increase. Within the rate classes Jackson Purchased proposed that the greatest increase be on the service charge with declining percentage increases on each descending energy rate block. Since the filing of the application, the rates and charges of Jackson Purchase have been adjusted for the negotiated wholesale rates in Case No. 8223, for a previous flow-through from KU, and the Phase I rates in Case No. 8617.

The Commission is of the opinion that the proposed revenue allocation to the rate classes is reasonable and should be approved; however, the Commission finds that the proposed allocation within the rate classes is not supported by the evidence of record and should not be approved. The Commission is of the opinion that a uniform percentage increase to service, energy, and demand charges

is more equitable for the consumers of Jackson Purchase and it has adjusted the rates accordingly.

OTHER ISSUES

Utility Management

Both Jackson Purchase and the Commission are concerned about increasing costs and their impact on electric rates. Of principal concern is what can be done by management and the Commission to reduce these increases. Mr. William Dalton indicated several areas in which the utility could take steps that will work toward this goal. During his first 6 weeks as interim manager, Mr. Dalton began an operations audit through which he was able to isolate areas with potential for cost savings and overall efficiency improvements. These areas include union labor costs, accounting procedures for transportation costs, and inventory management. Mr. Dalton indicated that he would complete his audit and submit his report to the board of directors by the first of the year. Inasmuch as the audit results and Mr. Dalton's report will ultimately affect Jackson Purchase's rates, we will require that the report be filed with the Commission.

The Commission is also concerned about the change in Jackson Purchase's industrial tariff for service to Shell Pipeline Corporation ("Shell"). While the Commission is aware of the circumstances that led to reducing the rate for Shell, we are of the opinion that Jackson Purchase's information and analysis of this problem were not as thorough as they could have been. This

is evident by the fact that the reduced rate was put into effect without the approval of this Commission. We are mindful of the depressed state of the economy and its impact on industrial sales; however, in a decision of this magnitude all possibilities must be thoroughly explored before a decision is reached. For Jackson Purchase's new management to do any less would be a failure to execute its managerial responsibility.

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 Jackson Purchase and will produce gross annual revenue sufficient to pay its operating expenses, service its debt and provide a reasonable surplus for equity growth.

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

3. Mr. Dalton's report to the board of directors on the results of his operations audit should be filed with the Commission as soon as available.

IT IS THEREFORE ORDERED that the rates in Appendix A be and they hereby are approved for service rendered by Jackson Purchase on and after the date of this Order.


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

IT IS FURTHER ORDERED that Mr. Dalton's report to the board of directors on the results of his operations audit should be filed with the Commission as soon as available.

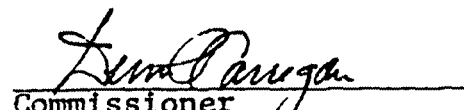
IT IS FURTHER ORDERED that within 30 days from the date of this Order Jackson Purchase shall file with the Commission its revised tariff sheets setting out the rates approved herein.

Done at Frankfort, Kentucky, this 22nd day of December, 1982.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:

Secretary

APPENDIX "A"

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 8544 DATED DECEMBER 22, 1982

The following rates and charges are prescribed for the customers in the area served by Jackson Purchase Electric Cooperative Corporation. 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.

Rates: Monthly

Schedule R - Residential

Service Charge: Minimum per month \$ 6.05

Energy Charge:

First	400 KWH	Per KWH per month	7.297¢
Next	600 KWH	Per KWH per month	5.561¢
Over	1000 KWH	Per KWH per month	5.213¢

Schedule CSL - Community & Public Authority Street Lighting

Each 175 Watt Mercury Vapor Lamp	Per month per lamp	\$ 7.57
Each 400 Watt Mercury Vapor Lamp	Per month per lamp	11.99

Schedule C - Small Commercial

Service Charge: Minimum per month \$ 6.05

Energy Charge:

First	500 KWH	Per KWH per month	7.310¢
Next	500 KWH	Per KWH per month	6.561¢
Next	5,000 KWH	Per KWH per month	6.099¢
Over	6,000 KWH	Per KWH per month	5.226¢

Schedule D - Commercial and Industrial Service & Three Phase Service

Service Charge: Minimum per month \$15.00

Energy Charge:

First	200 KWH	Per KWH per month	4.115¢
Over	200 KWH	Per KWH per month	3.884¢

Demand Charge:

Over 25 KW of billing demand per month, per KW per month \$ 4.45

Schedule SP - Seasonal Power Service

Rate Per Year:

First 1,500 KWH	Per KWH per year	11.825¢
Next 500 KWH/H.P.	Per KWH per year	8.815¢
All Additional KWH	Per KWH per year	5.689¢

MINIMUM ANNUAL CHARGE:

The minimum annual charge under the above rate shall be:

A. First 25 connected horsepower or less (minimum)	\$305.00
Balance of connected horsepower Per H.P. per year	9.85

SCHEDULE I - Industrial Service

Rates Monthly:

Demand Charge:

First 3,000 KW of billing demand	Minimum per month	\$23,499
All additional KW	Per KW per month	\$ 7.833

Energy Charge:

All KWH	Per KWH per month	2.623¢
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SCHEDULE SL - Mercury Vapor Security Lighting

175 Watt mercury vapor lamp	Per month per lamp	\$ 7.57
400 Watt mercury vapor lamp	Per month per lamp	11.99

SCHEDULE ND - Commercial & Industrial & All Other Three Phase Service
(under 25 KVA)

<u>Service Charge:</u>	Minimum per month	\$ 6.90
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Energy Charge:

First 500	Per KWH per month	7.310¢
Next 500	Per KWH per month	6.561¢
Next 5,000	Per KWH per month	6.099¢
All Over 6,000	Per KWH per month	5.226¢