

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

RATE ADJUSTMENT OF OWEN)
COUNTY RURAL ELECTRIC) CASE NO. 8618
COOPERATIVE CORPORATION)

O R D E R

On September 9, 1982, Owen County Rural Electric Cooperative Corporation ("Owen County") filed an application with the Commission requesting authority to increase its revenue by \$2,084,825 annually, an increase of 13.4 percent over normalized annual revenue. Pursuant to KRS 278.190, Owen County also requested that the Commission grant an interim increase in revenue of the same amount effective October 13, 1982. The proposed rates were suspended until March 13, 1983, pursuant to the provisions of KRS 278.190. After a hearing on October 13, 1982, the interim increase was denied by the Commission's Interim Order of November 18, 1982. Based on the determination herein the revenue of Owen County will increase by \$2,073,206 annually, an increase of 13.4 percent.

On September 20, 1982, the Consumer Protection Division of the Attorney General's Office filed a motion to intervene in this proceeding, which was sustained. A hearing concerning permanent rate relief was held at the Commission's offices in Frankfort, Kentucky, on January 11, 1983.

COMMENTARY

Owen County is a consumer-owned rural electric cooperative engaged in the distribution and sale of electric energy to approximately 21,835 member-consumers in the Kentucky counties of Owen, Grant, Pendleton, Gallatin, Scott, Boone, Kenton, Campbell and Carroll. Owen County purchases all of its power from East Kentucky Power Cooperative, Inc.

TEST PERIOD

Owen County proposed and the Commission has adopted the 12-month period ending June 30, 1982, as the test period for determining the reasonableness of the proposed rates. In utilizing the historical test period, the Commission has given full consideration to appropriate known and measurable changes.

VALUATION

Net Investment

Owen County proposed a net investment rate base of \$23,341,725. The Commission concurs with this proposal with the following modifications:

Owen County did not include construction work in progress ("CWIP") in its calculation of the net investment rate base. In accordance with past practice, the Commission has included the amount of CWIP reflected on the balance sheet at the end of the test period.

The allowance for working capital has been adjusted to include the pro forma level of operating expenses allowed herein.

The Commission has further adjusted the proposed rate base to reflect the allowed pro forma adjustment to depreciation expense in the calculation of the accumulated provision for depreciation.

Based on the Commission's adjustments, Owen County's net investment rate base for rate-making purposes is as follows:

Net Investment

Utility Plant in Service	\$26,207,794
Construction Work in Progress	337,530
Total Utility Plant	<u>\$26,545,324</u>

Add:

Materials and Supplies	\$ 525,589
Prepayments	38,305
Working Capital	331,989
Subtotal	<u>\$ 895,883</u>

Deduct:

Accumulated Depreciation	\$ 3,705,940
Customer Advances for Construction	63,612
Subtotal	<u>\$ 3,769,552</u>

Net Investment	<u><u>\$23,671,655</u></u>
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Capital Structure

The Commission finds that Owen County's capital structure at the end of the test period was \$26,305,502 and consisted of \$5,726,557 in equity and \$20,578,945 in long-term debt. In the determination of this capital structure the Commission has excluded accumulated capital credit assignments from Owen County's wholesale power supplier in the amount of \$740,795.

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

REVENUES AND EXPENSES

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

Revenue Normalization

Owen County proposed an adjustment of \$1,080,198 to normalize its test year revenue from electric sales to reflect the full year's sales at the rates in effect at the time the application was filed based on the test year volume of sales. In Case No. 8415-N, effective June 3, 1982, Owen County was allowed to pass on to its customers an increase in its wholesale power costs.

Owen County has a provision in its fuel adjustment clause which allows total recovery of fuel costs. Therefore, the Commission has adjusted revenue by \$325,054 to exclude the fuel revenue actually included in the test year. An adjustment has been made to increase revenue by \$1,722 as a result of the reclassification of certain customers under the public lighting classification.

Based on the revised rates approved in Case No. 8415-N to flow through Owen County's increased power cost, the exclusion of the fuel revenue and increase in revenue resulting from the reclassification of the customers under the public lighting classification, the Commission has decreased the proposed revenue normalization adjustment by \$323,332.

Purchased Power Adjustment

In order to normalize its purchased power cost for the test year, Owen County proposed an adjustment of \$1,138,131 based on the wholesale power rate in effect at the time the application was filed. The Commission has reduced this adjustment by \$337,463 to exclude the fuel cost actually incurred during the test year. This adjustment is made to be consistent with the adjustments to revenues in the preceding section of this Order.

Salaries Expense

Owen County proposed to increase operating expenses by \$138,635 for increases in salaries expense. In determining the pro forma wage and salary expenses for rate-making purposes the Commission has considered the total projected wages and salaries based on the test year actual experience and the January, 1983, wage increase for non-union employees and the April, 1983, wage increase for union employees. Subsequent to cross examination at the hearing Owen County filed a new calculation of salaries and wages resulting in a revised adjustment of \$138,857, which the Commission has accepted for rate-making purposes.

Employment Taxes

Owen County proposed an adjustment of \$6,269 to increase employment taxes. Based on Owen County's revised schedule of salaries and wages the amount of employment taxes should be

adjusted to include the new salary amounts, the tax rates applicable to each of the three taxes, and the allowable maximums used in the calculations. The Commission has, therefore, decreased the adjustment by \$5,373 which results in a total pro forma employment tax of \$97,109.

Interest Expense

Owen County proposed an adjustment of \$153,081 to annualize interest expense on long-term debt based on long-term debt balances outstanding at the end of the test year. In determining the additional expense the Commission considered the interest rate on National Rural Utilities Cooperative Finance Corporation ("CFC") funds advanced subsequent to the test year. The Commission is of the opinion that Owen County's pro forma interest expense should reflect a full year's expense on the \$726,000 advanced subsequent to the test year. This will increase pro forma interest expense by \$36,300.

In calculating Owen County's interest expense the Commission has included a change from 9.5 to 13 percent in the interest rate on CFC note C-11. Owen County's witness testified that the interest rate would change March 1, 1983. Therefore, the Commission has increased the pro forma interest expense by \$19,044.

The net effect of the changes made herein is pro forma interest expense on long-term debt of \$1,266,033.

Directors Expenses

The directors of Owen County have adopted a policy of providing compensation for actual expenses while in attendance at industry association meetings. This compensation includes such costs as meeting fees, transportation, lodging and meals. In addition, Owen County provides a per diem allowance of \$75 for each director attending the association meetings. The Commission is of the opinion that only reasonable costs should be reimbursed and that the \$75 per diem allowance is excessive and unreasonable. Therefore, the Commission finds that Owen County should discontinue its practice of providing this per diem allowance and has reduced director's fees by \$12,975 to exclude the amount of this allowance during the test year.

Owen County spent \$651 for Christmas gifts for the directors in the test period. The Commission is of the opinion that this is an unnecessary expense and should not be allowed for rate-making purposes.

In June, 1982, two payments of \$995 were made to East Kentucky Power Cooperative, Inc., for director's health insurance. This resulted in the test year containing 13 monthly payments instead of 12. The Commission excluded the latter payment of \$995 from the test period to attain the actual expense to be incurred during a normal 12-month period of operations.

The net effect of the aforementioned adjustments is to decrease director fees expenses by \$14,621.

Institutional Advertising Expense

In response to a request for information regarding test year advertising expenses Owen County provided a schedule which included \$6,255 of advertising classified as institutional. In accordance with 807 KAR 5:016, the Commission has excluded this expense for rate-making purposes as it enhances the corporate image of the utility and provides no benefit to the consumer.

Outside Services Employed

Owen County incurred expenses of \$21,363 for outside services employed during the test year. Of this amount, \$5,884 was for legal costs associated with union contract negotiations. This expense will not be incurred on an annual basis. Therefore, the Commission is of the opinion that this cost should be amortized over the life of the contract, 2 years in this instance, which results in an adjustment of \$2,942 to the outside services employed expense.

Owen County also included \$3,010 for legal retainers in expenses for outside services employed. Effective January 1, 1983, the total monthly retainer paid by Owen County is \$300. Therefore, an adjustment has been made to increase legal outside services employed by \$590.

The net effect of the aforementioned adjustments is to decrease the test year expense for outside services employed by \$2,352.

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 Period</u>
Operating Revenues	\$14,753,643	\$ 756,866	\$ 15,510,509
Operating Expenses	<u>13,990,738</u>	<u>933,773</u>	<u>14,924,511</u>
Operating Income	\$ 762,905	\$(176,907)	\$ 585,998
Interest on Long-Term Debt	1,083,194	182,839	1,266,033
Other Income and (Deductions)- Net	285,570	(96,200)	189,370
Net Income	<u>\$ (34,719)</u>	<u>\$(455,946)</u>	<u>\$ (490,665)</u>

REVENUE REQUIREMENTS

The actual rate of return on Owen County's net investment rate base established herein for the test year was 3.2 percent. After taking into consideration the pro forma adjustments Owen County would realize a rate of return of 2.5 percent. The Commission is of the opinion that the adjusted rate of return is inadequate and a more reasonable rate of return would be 11.2 percent. In order to achieve this rate of return Owen County should be allowed to increase its annual revenue by \$2,073,206 which would result in a Times Interest Earned Ratio, of 2.25. This additional revenue will provide net income of \$1,582,541 which should be sufficient to meet the requirements in Owen County's mortgages securing its long-term debt.

Rate Design and Revenue Allocation

Owen County proposed to allocate the revenue increase in approximately equal percentages to all rate classes, but proposed

a reallocation of revenue within the rate classes. It proposed to increase the customer charge in Schedule I from \$4.17 to \$6.00 and the customer charge in Schedule II from \$4.17 to \$25.00. Owen County's witness, Mr. Jim Blackburn, testified that these customer charges were substantiated by a calculation done for Owen County by Central Associated Engineers, Inc.; however, a cost of service study was not performed. The Commission concurs with Owen County's proposal for larger customer charges but is of the opinion that increases of such magnitude are not appropriate in the course of a single rate case. Therefore, the Commission is of the opinion that customer charges of \$5.50 for Schedule I and \$20.00 for Schedule II are more reasonable and should be accepted.

Owen County also proposed a larger percentage increase in the demand charge for Schedule II. Mr. Blackburn testified that the increase in the demand charge was proposed in order to keep Owen County's demand charge within 60 percent of the wholesale demand charge of East Kentucky Power Cooperative. Taking into consideration that Owen County would be allowed to further adjust its demand charge by its request in Case No. 8701 to flow-through any increase granted East Kentucky Power, which is now before us in a general rate case, the Commission is of the opinion that an increase in the demand charge of the same percentage as the percentage of increase in revenue granted herein is more reasonable and should be accepted.

Owen County proposed a reallocation of revenue to the charges for security lights in Schedule III with a uniform increase to the rate for a single security light of \$1.50 for each additional pole. Owen County also proposed a reclassification of its customers under the public lighting classification to include them under the small commercial classification of Schedule I, and as a part of that reclassification, has proposed to delete the energy charge from the Schedule III tariff. The Commission is of the opinion that the deletion of the energy charge on Schedule III and the proposed revenue allocation methods are reasonable and should be accepted.

SUMMARY

The Commission, after consideration of the evidence of record, finds that:

(1) The rates in Appendix A are the fair, just and reasonable rates for Owen County and will provide net income sufficient to meet the requirements in Owen County's mortgages securing its long-term debt.

(2) The rates and charges proposed by Owen County differ from those found reasonable herein and should be denied upon application of KRS 278.030.


IT IS THEREFORE ORDERED that the rates in Appendix A be and they hereby are approved for service rendered on and after March 13, 1983.

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

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

Done at Frankfort, Kentucky, this 15th day of March, 1983.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:

Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC
SERVICE COMMISSION IN CASE NO. 8618 DATED
MARCH 15, 1983

The following rates and charges are prescribed for the customers in the area served by Owen County Rural 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.

SCHEDULE I
FARM AND HOME*

Rates:

Customer Charge	\$5.50	Per Month
All KWH	\$.06215	Per KWH

SCHEDULE I
SMALL COMMERCIAL*

Rates:

Customer Charge	\$5.50	Per Month
All KWH	\$.06215	Per KWH

SCHEDULE II
LARGE POWER*

Rates:

All KW Demand	\$5.12	Per KW of Billing Demand
Customer Charge	\$20.00	Per Month
All KWH	\$.04248	Per KWH

SCHEDULE III
SECURITY LIGHTS*

Rates:

Installed on existing pole where 120 volts are available	\$ 4.80
One Pole Added	\$ 6.30
Two Poles Added	\$ 7.80
Three Poles Added	\$ 9.30
Four Poles Added	\$10.80

Where a transformer is required, there is an additional charge of \$0.50 per month.

*The monthly kilowatt hour usage shall be subject to plus or minus an adjustment per KWH determined in accordance with the "Fuel Adjustment Clause."