COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

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| THE APPLICATION OF KENERGY CORPORATION FOR A GENERAL ADJUSTMENT IN EXISTING RATES (RATE REDUCTION) | ) CASE NO. 2000-395 |

ORDER

This matter involves the application of Kenergy Corporation ("Kenergy") for a $2.5 million reduction in its general rates for retail electric service, for revisions to certain non-recurring charges and its rate for cable television pole attachments ("CATV charges"), and for certain other modifications to its tariff. By this Order, the Commission approves most of the proposed rates and other revisions, but reduces Kenergy's proposed distribution fees assessed to Kenergy's five largest direct serve customers as well as its proposed CATV charges.

BACKGROUND

Kenergy is a corporation organized pursuant to KRS Chapter 279 and is, therefore, subject to the Commission's "general supervision" and jurisdiction. KRS 279.210. It provides electric service to 49,111 customers in Daviess, Hancock, Henderson, Hopkins, McLean, Muhlenberg, Ohio, Webster, Breckinridge, Union, Crittenden, Caldwell, Lyon, and Livingston counties.

Kenergy is the successor to Green River Electric Corporation ("Green River") and Henderson Union Electric Corporation ("Henderson Union"). These cooperatives consolidated on July 1, 1999.[1] As part of their consolidation plan, Green River and Henderson Union agreed that Kenergy would apply to the Commission for approval of a 4 percent consolidation credit rider for all non-direct serve customers which was to be effective for a 5-year period.[2]

In Case No. 99-162,[3] Kenergy made such application. While we approved Kenergy's application, we stated the issues of the credit rider and adder for direct serve customers should be revisited at Kenergy's next rate adjustment proceeding and directed Kenergy to file an application for general rate adjustment to establish uniform rates no later than July 1, 2001. We further directed that Kenergy should support its proposed rates with a detailed cost-of-service study that examines in detail the costs of serving direct serve customers and, if possible, identify any merger savings that are directly related to serving this customer class.[4]

On August 18, 2000, Kenergy applied for authority to adjust its rates for retail electric service. According to its application, this proposed adjustment served two purposes: (1) to flow through lower power costs from the implementation of a 24-month discount adjustment rider by Big Rivers Electric Corporation, Kenergy's wholesale

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[1] For a discussion of various aspects of the consolidation, see Case No. 99-136, The Application of Green River Electric Corporation and Henderson Union Electric Cooperative Corporation for Approval of Consolidation (Ky.PSC June 18, 1999).

[2] "Direct serve customers" are those customers who receive power at transmission voltage levels directly from Big Rivers Electric Corporation, Kenergy's wholesale power provider.

[3] Case No. 99-162, The Application of Green River Electric Corporation and Henderson Union Electric Cooperative Corporation for Approval of Rate Decrease for Kenergy Corp., Consolidation Successor (Ky.PSC June 14, 2000).

[4] Id. at 11 – 12.

power provider; and, (2) to achieve uniform rates among its rate classes as required by the Green River-Henderson Union consolidation agreement. Kenergy requested that the rates be placed into effect on September 1, 2000 subject to change. On August 31, 2000, the Commission ordered that the proposed rates be suspended for one day and then become effective on September 2, 2000 subject to change.

In its application, Kenergy also requested that the Commission stay any action on its application until January 2001 to permit the utility to complete a cost-of-service study. Kenergy argued that such a study, which the Commission has directed to be prepared, could not be completed prior to that time. The Commission, having received no objections to Kenergy's request, established a procedural schedule that permitted only limited discovery until January 2001.

On January 4, 2001, Kenergy filed a cost-of-service study. It also amended its application to include proposed revisions to its existing tariff which, it asserted, were necessary to consolidate the Green River and Henderson Union tariffs. In its amended application, Kenergy also proposed increases in its non-recurring charges and CATV charges that, based upon Kenergy's test year operations,[5] would produce $428,000 in additional revenues. Kenergy subsequently revised these proposed charges to produce additional annual revenues of $384,000.

Following the submission of Kenergy's cost-of-service study, the Commission established a procedural schedule to permit additional discovery. Following discovery

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[5] Kenergy proposed the period from July 1, 1999 through June 30, 2000 as its test year of operations.

by the parties, the Commission conducted a hearing in this matter on May 15, 2001.[6] The parties submitted briefs on June 6, 2001.

Kentucky Industrial Utility Customers, Inc. ("KIUC), a nonprofit corporation that represents the interests of large industrial electricity users, intervened in this proceeding on behalf of Kenergy's five largest direct serve customers. These customers are Alcan Aluminum Corporation ("Alcan"), Century Aluminum ("Century"), Commonwealth Industries ("Commonwealth"), Kimberly Clark Corporation ("Kimberly Clark"), and Willamette Industries ("Willamette").

## DISCUSSION

### Parties' Positions

The principal point of contention in this proceeding is the reasonableness of the distribution fees, or adders, that Kenergy charges to its direct serve customers. Kenergy currently imposes upon Alcan and Century an energy adder of .1 mill per Kwh and upon Willamette and Commonwealth an energy adder of .3 mills per Kwh. It assesses Kimberly Clark a demand adder of $.05 per KW and an energy adder of .5 mills. During the test year, those adders produced revenues of approximately $1,040,000. Based on its cost-of-service study, Kenergy proposed no changes to these charges.

KIUC proposed that these charges be restructured and reduced. It contends that Kenergy's cost-of-service study does not support the current structure or level of these

[6] At the hearing, the following persons testified: Dean Stanley, Kenergy's President and Chief Executive Officer; Steve Thompson, Kenergy's Vice President of Finance and Accounting; Jack D. Gaines, Manager of the Utility Rate and Financial Services Department of Southern Engineering Company; and Russell L. Klepper of Energy Services Group, LLC.

charges. It notes that Kenergy's cost-of-service study assigns only purchased power costs and PSC assessment costs to the direct serve customer class while Kenergy's present rates produce revenues significantly in excess of these costs. KIUC further contends that Kenergy's adders are unreasonable and unreasonably discriminatory.[7] In lieu of Kenergy's current rate structure, KIUC proposed a two-part rate structure consisting of fixed customer charges and variable cost surcharges calculated as a percentage of the sum of the other components of the individual customer's bill. Based on the test year consumption levels of KIUC's members, KIUC's proposed rates would produce annual revenues of approximately $318,000, or approximately $722,000 less than Kenergy's present adders. KIUC has submitted a cost-of-service study in support of this proposal.

Kenergy offered 6 arguments against the KIUC proposal. First, it argues that the favorable treatment afforded the direct serve customers in previous rate proceedings precludes any rate reduction in this proceeding. Second, it contends that, by failing to object in earlier Commission proceedings to the provisions of the consolidation agreement that require a 4 percent rate reduction to non-direct serve customers only, KIUC has waived any right to advance a rate structure that would require modifications to that rate reduction by allocating more costs to non-direct serve customers. Third, Kenergy contends that it cannot absorb the $1.65 million reduction in annual revenues that would result from the rates proposed by KIUC if applied to all direct serve

[7] In support of this claim, KIUC notes that Willamette paid distribution fees of nearly the same amount as that paid by Alcan during the test year while using only one-third of the quantity of energy that Alcan used. KIUC also notes that Kimberly Clark paid more than twice the amount that Commonwealth paid for energy even though its load and energy consumption were nearly identical to that of Commonwealth.

customers. Fourth, it contends that KIUC's cost-of-service study failed to include all costs that could reasonably be allocated to the direct serve customer class. Fifth, Kenergy notes that KIUC's proposal fails to consider significant non-cost factors. Finally, it asserts that its financial position, based upon only one year of consolidated operations, does not allow for any reductions in its existing margins (net revenues).

As to Kenergy's first argument that prior Commission decisions that were viewed as favorable to direct serve customers preclude any reductions to the rates of direct serve customers in this proceeding, we find it devoid of any merit. Our decisions were based upon the record presented in those proceedings. Kenergy's predecessors did not appeal our determinations regarding those rates nor did they contend that the resulting rates were unjust or unreasonable. Our review of those decisions does not indicate any intent upon our part to restrict or limit our review of future rate applications. Clearly a utility's rates must be based upon current conditions and costs, not those in the distant past.

As to its second argument, we find no merit to the contention that KIUC or its members have waived any right to advance their claims to lower adders in rate adjustment proceedings. The records of Cases No. 99-136 and No. 99-162 do not reflect any express or implied waiver. Moreover, this Commission expressly noted in Case No. 99-162 that it reserved "the right to adjust the Consolidation Credit Rider at such future rate proceedings upon review of the results of the detailed cost-of-service study."[8]

[8] Case No. 99-162, Order of June 14, 2000 at 12.

As its third argument, we find that Kenergy has misinterpreted KIUC's proposal. Kenergy's claim of a revenue decrease of $1.65 million assumes that KIUC's rate reduction proposal will be applied to all direct serve customers. KIUC has expressly stated that its rate proposal applies only to its members.

The Commission, however, finds merit to Kenergy's remaining arguments. Kenergy identified various categories of costs that it claimed should be allocated to the direct serve customer class. It made no attempt, however, to quantify those costs, contending they were no more quantifiable than the administrative and general costs. Although these costs are not quantified, the Commission agrees with Kenergy that some portion of such costs would be assignable to the direct serve class. We also agree with Kenergy's argument that non-cost factors should also be taken into consideration when setting rates. Kenergy terms these factors as "financial impacts" and "customer impacts." While the terminology is different, Kenergy's argument clearly embraces the concepts of revenue stability, rate continuity, and gradualism that we have long recognized as integral to the rate-making process.

The Commission further recognizes that Kenergy's financial position is somewhat tenuous, as reflected in its adjusted Times Interest Earned Ratio ("TIER") of 1.30 for the test period.[9] We note, however, that the test period includes various one-time costs directly associated with the consolidation while reflecting few of the anticipated savings associated therewith. We further note that the additional revenues

[9] The terms of the consolidation incentives provided by the Rural Utilities Service reduce Kenergy's minimum TIER requirement to 1.0 through 2003. Beginning in 2004, the minimum TIER requirement increases to 1.25, measured as the average of the best two of the three most recent calendar years.

produced by the proposed increases in miscellaneous and CATV charges increase the adjusted test year TIER to 1.41.

Cost-of-Service

We express at the outset our disappointment with Kenergy's efforts to comply with our Order of June 14, 2000 in Case No. 99-162. In that Order we directed Kenergy to "support its proposed rates with a detailed cost-of-service study" that examines "in detail the costs of serving direct serve customers and, if possible, [to] identify any merger savings that are directly related to serving this customer class." Our review of the record leads to the conclusion that, by not assigning any costs to the direct serve customer class other than purchased power and the PSC assessment, Kenergy failed to address in its cost-of-service study the costs associated with serving the direct serve customer class. The Commission expects Kenergy to comply more carefully with our Orders in the future.

We next turn to KIUC's cost-of-service study. The KIUC study, which builds on the Kenergy study by assigning certain costs to the direct serve class, is useful, to a degree. While it does not include all costs that could reasonably be assigned to the direct serve class, it does provide a clear indication that the class is being charged rates that are excessive compared to the costs associated with serving that class. Based on the results of the KIUC study, we find that some decrease in rates is warranted. Any reduction in rates for KIUC's members, however, must be tempered by non-cost factors. As the test year represents Kenergy's first year of operation as a consolidated entity, it is likely not fully representative of Kenergy's future operations. Moreover, a decrease of the magnitude proposed by KIUC may adversely affect Kenergy's financial position unless offset by increases in revenue from other sources. Likewise, the effect of increasing rates for other customers to offset a reduction for the KIUC members, so soon after consolidation and the implementation of the 4 percent consolidation credit, must also be taken consideration.

Discrimination

While the adders currently assessed to KIUC members may have been reasonable when first established, Kenergy has provided no reasonable argument for the continuation of such a wide array of adders. Many of the different adders were established at different points in time as the result of negotiation between Kenergy's predecessors and individual customers. Circumstances, in terms of competitive issues and cost structures, however, have changed for those customers. These changes, particularly the focus on costs, make continued use of widely differing adders among customers of the same customer class unreasonable. Therefore, consistent with KIUC's proposal, we find that the five KIUC members served by Kenergy should be segregated from the rest of the direct serve class for rate-making purposes, and further, that Commonwealth, Kimberly Clark, and Willamette should be established as a separate class unto themselves based on their size and load characteristics.[10] We further find that the rate structure for the five customers should be modified to include a fixed monthly customer charge along with an energy adder, based on Kwh usage.

[10] Alcan and Century have historically been considered separately from the rest of the direct serve class due to the size of their loads and extremely high load factors.

Tariffs, Non-Recurring Charges, CATV Charges

As amended, and subsequently revised, Kenergy's proposed tariff modifications and non-recurring charges are reasonable and should be approved. However, its proposed CATV charges require further modification to be consistent with the formula established in Administrative Case No. 251[11] and to comply with the Commission's decisions in recent electric cooperative cases regarding the appropriate calculation of CATV charges. Kenergy inappropriately included both an interest expense percentage and a rate of return percentage in the cost-of-money component included in the formula calculation on which it based its proposed CATV charges. Rate of return on investment, with its calculation based on operating income before deduction of interest expense, includes both the return on debt and the return on equity. Inasmuch as rate of return already includes the return on debt (interest expense), including an additional component for interest expense along with a rate of return component results in a double counting of interest expense. Eliminating the interest expense component reduces the proposed CATV charges so that the total additional revenues generated from the increased non-recurring charges and CATV charges are approximately $370,000 annually.

## SUMMARY

Consistent with our conclusion that a decrease in rates is warranted for the KIUC customers but that such a decrease should take into consideration relevant non-cost factors, the Commission finds that a decrease for the KIUC members of an amount less

[11] Administrative Case No. 251, The Adoption of a Standard Methodology for Establishing Rates for CATV Pole Attachments (Ky.PSC Sept. 17, 1982).

than has been proposed is reasonable at this time. Taking into consideration the shortcomings in KIUC's cost-of-service study, Kenergy's less-than-robust financial position, and the recent occurrence of the Green River and Henderson Union consolidation, we find that a decrease of approximately $252,000 in rates for the KIUC members is appropriate. We further find that this decrease should be implemented through the establishment of a two-part rate with the rates for the KIUC members structured in a manner similar to that proposed by KIUC, except that the variable portion of the rates should be energy adders, rather than be calculated as a percentage of revenue, as KIUC had proposed.[12]

In consideration of Kenergy's financial position, it is important to note that a decrease in revenues from the KIUC members that is less than the amount of additional revenues produced by the approved increases in miscellaneous and CATV charges produces a TIER greater than Kenergy's adjusted test year TIER of 1.30. The matter of Kenergy's financial position is an important issue, one that in our view is long-term in nature, particularly considering the multi-year period over which it expects to realize the savings to be derived as a result of the consolidation.[13] Given the outstanding issues related to Kenergy's financial position and the long-term nature of its anticipated consolidation savings, the Commission finds that Kenergy should file a rate application no later than July 1, 2003 in order that its revenue requirements and rate levels can be

[12] The rates are set forth in Appendix A. Alcan and Century will be charged one set of rates while the other three customers will be charged a different set of rates, but one that is identical for the three customers.

[13] The long-term nature of this matter is highlighted by the fact that Kenergy is only half way through the 5-year period of time in which it enjoys a reduced consolidation TIER requirement of 1.0. Its TIER requirement increases to 1.25 in 2004.

re-established, if necessary, by the beginning of calendar year 2004 when its minimum TIER requirement increases to 1.25. Such a filing would be based on a test year that should more accurately reflect the savings realized through consolidation. To adequately address the matter of the assignment of costs to the direct serve customer class, Kenergy should make all necessary changes to its record keeping and cost accounting in order to track any costs it believes are associated with serving such customers.

Based on the evidence of record and being otherwise sufficiently advised, the Commission finds that:

1. The rates set forth in Kenergy's original application, with the exception of those proposed for Alcan, Century, Commonwealth, Kimberly Clark, and Willamette, are reasonable and should be approved as Kenergy's permanent rates effective for service rendered on and after the date of this Order.

2. Kenergy's proposed rates for Alcan, Century, Commonwealth, Kimberly Clark, and Willamette are unreasonable and should not be charged as of the date of this Order. The rates set forth in Appendix A to this Order are the fair, just, and reasonable rates that should be assessed for service to those customers effective for service rendered on and after the date of this Order.

3. Kenergy's proposed non-recurring charges and consolidated tariffs, except those provisions related to CATV charges, as filed with the Commission on January 4, 2001 and amended on April 2 and May 8, 2001, are fair, just, and reasonable and should be approved for service rendered on and after the date of this Order.

4. The CATV charges effective for service rendered on and after the date of this Order should be the charges set out in Appendix A to this Order.

5. Kenergy should file with the Commission no later than July 1, 2003 an application for general rate adjustment.

IT IS THEREFORE ORDERED that:

1. The rates set forth in Kenergy's original application, with the exception of those proposed for Alcan, Century, Commonwealth, Kimberly Clark, and Willamette, are approved for service rendered on and after the date of this Order.

2. Kenergy shall cease charging its proposed rates for Alcan, Century, Commonwealth, Kimberly Clark, and Willamette as of the date of this Order and shall assess the rates set forth in Appendix A to this Order for service rendered to those customers on and after the date of this Order.

3. Kenergy's proposed non-recurring charges and consolidated tariffs, except those provisions related to CATV charges, as filed with the Commission on January 4, 2001 and amended on April 2 and May 8, 2001, are approved for service rendered on and after the date of this Order.

4. Kenergy's proposed CATV charges are denied.

5. Kenergy shall assess the CATV charges set out in Appendix A to this Order for service rendered on and after the date of this Order.

6. Kenergy shall file with the Commission no later than July 1, 2003 an application for general rate adjustment.

7. Within 20 days from the date of this Order, Kenergy shall file with the Commission its revised tariffs showing the date of issue and that they were issued by authority of this Order.

Done at Frankfort, Kentucky, this 29th day of June, 2001.

By the Commission

ATTEST:

Executive Director

# APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2000-395 DATED June 29, 2001.

The following rates and charges are prescribed for the customers in the area served by Kenergy Corp. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of the Commission prior to the effective date of the Order.

Alcan Aluminum
Century Aluminum

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| Customer Charge | $6,500 per month |
| Energy Charge | $.00005 per Kwh |

Commonwealth Industries
Kimberly-Clark Corporation
Willamette Industries

| | |
|---|---|
| Customer Charge | $2,500 per month |
| Energy Charge | $.0002 per Kwh |

MISCELLANEOUS CHARGES:

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| Returned Check | $10.00 |
| Meter Reading | $25.00 |
| Collection | $25.00 |
| Reconnect | $25.00 |
| Meter Tests | $40.00 |
| Reconnect-Overtime | $70.00 |

CATV ATTACHMENTS:

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|---|---|
| 2-Party Pole | $ 4.47 |
| 3-Party Pole | $ 3.64 |
| 2-Party Anchors | $ 7.77 |
| 3-Party Anchors | $ 5.13 |