COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF KENERGY CORPORATION	)	
FOR REVIEW AND APPROVAL OF	)	CASE NO.
EXISTING RATES	)	2003-00165

O R D E R

On June 24, 2003, Kenergy Corporation ("Kenergy") filed a rate application in accordance with a prior directive of the Commission. Kenergy's application requested approval of its existing retail electric rates. By this Order, the Commission reduces Kenergy's revenues by $162,347 or a 0.06 percent decrease over normalized test-year operating revenues.

BACKGROUND

Kenergy is a consumer-owned rural electric cooperative corporation, organized under KRS Chapter 279, engaged in the distribution and sale of electric energy to approximately 51,300 member-consumers in the Kentucky counties of Breckinridge, Caldwell, Crittenden, Daviess, Hancock, Henderson, Hopkins, Livingston, Lyon, McLean, Muhlenberg, Ohio, Union, and Webster. Kenergy has no electric generating facilities and purchases its total power requirements from Big Rivers Electric Corporation ("Big Rivers").

Kenergy is the successor to Green River Electric Corporation ("Green River") and Henderson Union Electric Corporation ("Henderson Union"). The Commission approved the consolidation on July 1, 1999 in Case No. 1999-00136.[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 rate reduction, known as a consolidation credit rider to be effective for a 5-year period for all non-direct-serve customers.[2]

In Case No. 1999-00162,[3] Kenergy made such application. In approving Kenergy's consolidation credit rider, the Commission found that both the rider and the mark-up (or adder) charged to direct-serve customers should be revisited in Kenergy's next rate case. Kenergy was directed to file a rate application no later than January 1, 2001 and to support its proposed rates with a detailed cost-of-service study.

As directed, Kenergy filed its rate application, Case No. 2000-00395,[4] on August 18, 2000. After conducting an investigation and hearing, the Commission found that Kenergy's cost-of-service study failed to address the costs related to serving its direct-serve customers and directed Kenergy to file another rate application with an adequate cost-of-service study no later than July 1, 2003. This is the filing currently being considered.

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[1] Case No. 1999-00136, The Application of Green River Electric Corporation and Henderson Union Electric Cooperative Corporation for Approval of Consolidation, final Order dated June 18, 1999.

[2] Kenergy has approximately 51,300 non-direct-serve customers who receive power through Kenergy's distribution system. Kenergy also has 19 direct-serve customers who receive power at transmission voltage levels directly from Big Rivers, Kenergy's wholesale power provider.

[3] Case No. 1999-00162, The Application of Green River Electric Corporation and Henderson Union Electric Cooperative Corporation for Approval of Rate Decrease for Kenergy Corp., Consolidation Successor, final Order dated June 13, 2000.

[4] Case No. 2000-00395, The Application of Kenergy Corporation for a General Adjustment in Existing Rates (Rate Reduction), final Order dated June 29, 2001.

The Attorney General ("AG"), by and through his Office of Rate Intervention, and Kentucky Industrial Utility Customers, Inc. ("KIUC") sought, and were granted, intervention in this case. A public hearing was conducted on November 12, 2003. All information requested during the hearings has been submitted.

TEST PERIOD

Kenergy proposed and the Commission has accepted the 12-month period ending December 31, 2002 as the test period for determining the reasonableness of Kenergy's rates. In utilizing the historical test year, the Commission has considered appropriate known and measurable changes.

VALUATION

Rate Base

Kenergy did not propose a net investment rate base. The Commission has determined a net investment rate base of $152,527,515 based on the adjusted test-year-end value of plant in service, the 13-month average balances for materials and supplies and prepayments, and excluding the adjusted accumulated depreciation and the test-year-end level of customer advances for construction. The Commission also included working capital based on one-eighth of adjusted operating expenses, exclusive of purchased power, depreciation, taxes, and other deductions.

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

Utility Plant in Service	$ 180,384,440
CWIP	3,822,762
Total Utility Plant	$ 184,207,202

ADD:		
Materials and Supplies	$	1,625,909
Prepayments		714,049
Working Capital		1,706,814
Subtotal	$	4,046,772
DEDUCT:		
Accumulated Depreciation	$	35,136,974
Customer Advances for Construction		589,485
Subtotal	$	35,726,459
NET INVESTMENT RATE BASE	$	152,527,515

Capital Structure

The Commission finds that Kenergy's capital structure at test-year-end for rate-making purposes was $156,895,004. This capital structure consisted of $56,042,437 in equity and $100,852,567 in long-term debt. Kenergy's capital structure does not include generation and transmission capital credits.

REVENUES AND EXPENSES

Kenergy proposes several adjustments to revenues and expenses to reflect current and expected operating conditions. The Commission finds that the following 19 adjustments proposed by Kenergy are reasonable and will be accepted without change:

- the removal of unbilled revenue, a decrease in revenues of $350,000;
- the normalization of Weyerhaeuser revenue and power cost, a reduction in revenue of $2,158,104 and a reduction in power cost of $2,148,859;
- the removal of the Breckinridge Mine, a reduction in revenue of $1,994,395 and a reduction in power cost of $1,798,503;
- the normalization of Ohio County Coal revenue and power cost, an increase in revenue of $164,955 and an increase in power cost of $147,021;
- the normalization of power cost for a prior period adjustment, an increase in power cost of $24,822;

- the normalization of labor, an increase in expense of $189,896;[5]

- the normalization of labor overheads, an increase in expense of $351,857;

- the normalization of depreciation expense, an increase in expense of $333,146;

- the normalization of interest on long-term debt, a reduction in expense of $461,750;

- the reduction to “Interest Charged to Construction – Credit,” a reduction of the credit balance of $23,839;

- the normalization of property tax expense, an increase in expense of $58,657;

- the removal of the non-recurring Organizational Effectiveness Study Costs, a reduction in expense of $56,048;

- the removal of non-recurring accrual for employees on long-term disability as of January 1, 2002, a reduction in expense of $90,687;

- the removal of non-recurring deferred compensation write-down to market value, an increase in expense of 228,107;

- the normalization of interest on deposit for Commonwealth Industries, an increase in expense of $25,644;

- the increase to contract right-of-way spraying, an increase in expense of $205,000;

- the increase to Rural Utilities Service Cushion of Credit interest income, an increase in revenue of $130,269;

- the reduction to non-cash capital credit allocations, a reduction in revenue of $17,090;

[5] Response to Commission Staff’s Second Data Request dated August 8, 2003, Item 3. Kenergy had originally calculated an increase in expense for labor and labor overheads of $209,826 and $356,544 by using 2,088 hours as a standard work year. See Application, Exhibit 5, page 11-12. Kenergy provided a revised adjustment using 2,080 as a standard work year resulting in an increase in expense for labor and labor overheads of $189,896 and $351,847, respectively.

- the removal of non-recurring adjustments relating to health insurance on retirees, a reduction in expense of $60,461.

The Commission makes the following modifications to the remaining proposed adjustments:

Directors' Fees and Expenses

During the test year, Kenergy reduced the size of its board of directors from 16 to 11 members. This reduction was previously agreed to by Kenergy and approved by the Commission as part of the consolidation. Total fees and expenses paid to Kenergy's directors during the test year were $211,963. Kenergy proposed to reduce directors' expenses by $25,500 to reflect the annual cost of the smaller board. However, Kenergy's proposed adjustment did not fully reflect 12 months of expenses for 11 directors.

The Commission has adjusted the directors' expenses to allow for the additional mileage and per diems of the directors elected to the board during the test year. In addition, the Commission has determined that per diems for three board committee meetings per director for the year is reasonable considering the level of involvement the directors have in Kenergy. After recognizing Kenergy's proposed adjustments and the other adjustments noted, the Commission has reduced directors' expenses by a net amount of $3,388.

In addition to the adjustments to normalize the directors' fees and expenses for a smaller board of directors, the Commission has reviewed all of the test-year fees and expenses and finds additional adjustments should be made for the following items:

Directors Emeritus. In previous electric cooperative rate cases, the Commission has not allowed expenses associated with directors emeritus to be included in rates.

No evidence has been presented in this case to persuade the Commission that ratepayers should pay the expenses for former directors. Therefore, $4,564 in expenses associated with Kenergy's directors emeritus will be excluded for rate-making purposes.

State and National Association Annual Meetings. Kenergy paid the expenses for several of its directors to attend the state and national electric cooperative association annual meetings. In previous electric cooperative rate cases, the Commission has excluded any expenses for attendance by directors who were not the designated delegate or alternate. No evidence has been presented in this case to persuade the Commission to depart from prior precedent, which allows for rate recovery of only the expenses for the designated delegate and alternate delegate. Kenergy had also included these expenses for directors no longer serving on the board and the Commission has removed the expenses for those directors as well. Therefore, $16,434 in expenses for the other directors' attendance at state and national association annual meetings will be excluded for rate-making purposes.

Extra Per Diem for Board Chairman. Kenergy's directors have adopted a policy to pay the Chairman an additional monthly per diem for the time involved in carrying out official duties. In previous electric cooperative rate cases, the Commission has excluded this extra per diem payment, and no evidence has been presented in this case to justify a change in this rate-making treatment. Therefore, the extra per diem payments of $1,200 to the Chairman of Kenergy's board are excluded for rate-making purposes.

Per Diem for Other Meetings. Kenergy's directors have adopted a policy providing for the payment of travel expenses and per diems for director attendance at meetings other than the Kenergy board. In previous electric cooperative rate cases, the Commission has limited the payment of per diems to board and committee meetings of the board. Kenergy is paying its directors actual expenses for attending these other meetings. No evidence has been presented in this case to persuade the Commission to treat Kenergy differently. Therefore, the per diem payments of $18,400 for meetings other than the Kenergy board are excluded for rate-making purposes.

Life Insurance. Kenergy provides life insurance coverage for its board members. Although Kenergy pays for this coverage, it is not the beneficiary of the policies. Kenergy has not demonstrated that the compensation provided to its directors is so inadequate to justify the additional cost to provide this insurance coverage. Kenergy has also not persuaded the Commission that the provision of life insurance coverage for its directors is reasonable. Therefore, the life insurance premiums of $801 for the directors' coverage have been excluded for rate-making purposes.

Monthly Retainer. In addition to the per diems paid to directors, Kenergy's board also pays each director a monthly retainer of $650 per month. Kenergy contends that this additional monthly payment is necessary in order to attract and retain qualified individuals on its board.

At the request of the Commission, Kenergy provided an analysis of the compensation paid to the directors of other electric cooperatives in Kentucky. The analysis showed that only two other cooperatives pay their directors a retainer and per diems. The Commission wishes to express its appreciation to the other cooperatives for providing the requested information.

This is the first rate case in which an electric cooperative requested recovery of both per diems and retainers. The record before us does not adequately justify the payment of the retainer. Kenergy's directors are also members of the cooperative, and the payment of the retainer, in addition to the per diem and reimbursement of other expenses, appears to be excessive and inconsistent with the principle that members of a non-profit cooperative share responsibilities for the common good. Consequently, the retainer payments of $85,800 have been excluded for rate-making purposes.

After normalizing the directors' fees and expenses to reflect an 11 member board and considering the adjustments described above, the Commission has reduced Kenergy's operating expenses by $156,087. After applying the appropriate test-year cost allocation rates to the $156,087, the Commission will include an adjustment to decrease the directors' expenses by $110,385.

Rate Case Expense

Kenergy did not propose an adjustment to recover its costs associated with this rate case. When requested to identify its rate case expenses, Kenergy filed a March 19, 2004 response that identified expenses of $189,108. The Commission has reviewed this response and notes that it included expenses for staff labor and overheads of $114,352. In previous cases, the Commission has not included staff labor and overhead in an adjustment for rate case expenses since these expenses are already reflected in the total labor and overhead expenses included in rates. Kenergy's response also included a $4,276 invoice for legal services that has been excluded because the services do not relate to this rate case. Finally, Kenergy's response included a reimbursement of $246 for an employee's canceled vacation airfare. Since no explanation was included to justify recovery of this expense, it has been excluded from the total updated rate case expenses. Based on these findings, the Commission has determined that Kenergy's reasonable rate case expenses are $70,234.[6]

In previous electric cooperative rate cases, the Commission has amortized the reasonable rate case expenses over a period of 3 years, and included the first year's amortization for rate-making purposes. The Commission finds that a 3-year amortization of these expenses is reasonable and will include an increase in operating expense of $23,411 to reflect the first year amortization.

Professional Services Expense

Kenergy did not propose any adjustments to its professional services expense. However, the Commission has identified two adjustments that should be made. Kenergy included expenses of $10,548 for the development of its Cost Allocation Manual ("CAM") and has stated that this expense is non-recurring.[7] As such, it is not reasonable for inclusion in Kenergy's revenue requirements. Kenergy also included $9,695, the cost of health insurance for its attorney, claiming the cost to be part of the

[6] Kenergy's March 19, 2004 response showed updated rate case expenses were $183,367, including $111,027 for in-house labor and overhead and $72,340 for outside vendors.

[7] Response to Commission Staff's Second Data Request dated August 8, 2003, Item 53 and Response to Commission Staff's Third Data Request dated September 5, 2003, Item 22.

attorney's compensation package.[8] The Commission finds no evidence that providing health insurance coverage for outside counsel is either reasonable or consistent with normal business practices. In this case, Kenergy has not persuaded the Commission that this expense is reasonable. In addition, in previous electric cooperative rate cases, the Commission has not allowed this expense for rate-making purposes.

Based on these findings, the Commission has reduced the professional services expense by $20,243. After applying the appropriate test-year cost allocation rates, the Commission will include an adjustment to decrease the professional services expense by $14,312.

Miscellaneous Expenses

Kenergy proposes to reduce operating expenses by $47,569 to remove certain miscellaneous expenses not normally included for rate-making purposes.[9] The Commission agrees with this adjustment, and has identified additional adjustments to the miscellaneous expenses.

Kenergy's test-year miscellaneous expenses included expenses associated with Touchstone Energy advertising, public relations expenditures, and institutional advertising totaling $29,224. Kenergy has agreed that the institutional advertising should be removed for rate-making purposes. The Commission finds that the Touchstone Energy advertising and public relations expenditures are designed to

[8] Response to Commission Staff's Second Data Request dated August 8, 2003, Item 37.

[9] These expenses include donations and civic activities. See Response to Commission Staff's First Data Request dated June 20, 2003, Item 30.

enhance the public image of Kenergy and are prohibited from recovery in rates by 807 KAR 5:016.

During the test year, Kenergy included expenses of $1,006 associated with its Election and Credentials Committee. The expenses included payment for services, mileage reimbursement, meals, and gifts for the committee. In previous electric cooperative rate cases, the Commission has excluded these expenses for rate-making purposes, noting that compensating members for such committees is not consistent with the cooperative spirit and shared responsibility that non-profit cooperatives embody.

Kenergy's test-year miscellaneous expenses of $17,402 also included expenses for scholarships, youth tour programs, basketball tickets, and Christmas gifts. In previous electric cooperative rate cases, the Commission has not allowed such expenses for rate-making purposes since they are not essential to the provision of electric service. Kenergy has not provided any evidence to support a different treatment in this case.

Based on these findings, the Commission has reduced miscellaneous expenses by $95,201. After applying the appropriate test-year cost allocation rates, the Commission will include an adjustment to decrease the miscellaneous expenses by $86,261.

PSC Assessment

Kenergy proposed an adjustment of $10,373 to its PSC Assessment to reflect the effects of its normalization of revenues and purchase power expense. The Commission has recalculated the adjustment to the PSC Assessment that reflects the normalization of revenues and purchased power found reasonable in this Order and applied the current PSC Assessment rate. This recalculation results in an increase in the PSC Assessment of $815. The Commission has also determined the impact of the revenue decrease granted herein and provided for a reduction to the PSC Assessment expense of $296.

Non-Regulated Activities

Kenergy operates several non-regulated businesses[10] and has elected to operate those businesses as part of Kenergy rather than establishing separate subsidiaries. Kenergy has partnered with other parties to provide these services and does not have a significant capital investment in any of the non-regulated businesses. Kenergy has developed and is utilizing a CAM to allocate expenses between the regulated and non-regulated businesses.

The Commission commends this approach by Kenergy. By partnering with knowledgeable vendors in the unregulated businesses, Kenergy has minimized its risks. By avoiding the need for significant capital investment, Kenergy has lowered its exposure to losses from failed businesses. The utilization of the CAM has allowed Kenergy to minimize the risk of cross-subsidization between the regulated and non-regulated businesses.

Kenergy's revenue requirement in this case is determined by using the Times Interest Earned Ratio ("TIER"), which considers the total net income of the cooperative

[10] During the test year, Kenergy's non-regulated businesses included the sale of geothermal systems, amusement park tickets, point-to-point fiber services, telephone/Internet service, wireless Internet service, and home security services.

in the calculations.[11] The determination of the revenue requirement for Kenergy's regulated operations should not be impacted by the results from the non-regulated businesses. However, Kenergy did not propose to remove its non-regulated income and expense from the determination of its total net income. Therefore, the Commission has removed the net effect of the non-regulated businesses from the determination of total net income for Kenergy. During the test year, Kenergy's net income from all non-regulated businesses was $42,025.[12] After applying the appropriate allocation factors to the adjustments described in this Order, the non-regulated net income is $31,383. The Commission has removed this amount from Kenergy's operating statement for rate-making purposes.

Pro Forma Adjustments Summary

The effect of the pro forma adjustments on Kenergy's net income is as follows:

	Actual Test Period	Pro Forma Adjustments	Adjusted Test Period
Operating Revenues	$286,800,623	$(4,024,588)	$282,776,035
Operating Expenses	278,994,354	(2,427,936)	276,566,418
Net Operating Income	7,806,269	(1,596,652)	6,209,617
Interest on Long-Term Debt	3,853,856	(461,750)	3,392,106
Other Income and (Deductions) – Net	170,831	371,262	533,120
NET INCOME	$ 4,123,244	$ (763,640)	$ 3,350,631

[11] TIER is the sum of net income plus interest on long-term debt expense divided by interest on long-term debt expense.

[12] Response to Commission Staff's Second Data Request dated August 8, 2003, Item 55, page 7 of 7.

REVENUE REQUIREMENTS

In setting the revenue requirements for electric cooperatives, the Commission has in the past several years authorized a TIER of 2.00X. Kenergy's actual test-year TIER was 2.07X. After reflecting the adjustments Kenergy proposed to its test-year operations, TIER was 1.94X. While Kenergy noted that a TIER of 2.00X is required to provide financial strength and stability necessary for its operations,[13] it did not propose to increase its revenues to bring its adjusted TIER up to 2.00X.

After including the adjustments described in this Order, the Commission has determined the adjusted test-year TIER is 1.99X. Based on Kenergy's position that a TIER of 1.94X is adequate at the present time, the Commission will determine Kenergy's revenue requirements using a TIER of 1.94X. Utilizing a TIER of 1.94X, Kenergy should be required to reduce its annual revenues by $162,347. This decrease reflects an associated decrease in Kenergy's PSC Assessment of $296 due to the reduction in revenues. This reduced revenue should produce net income of $6,047,566, which should be sufficient for Kenergy to meet its mortgage requirements, service its mortgage debts, and result in a TIER of 1.94X.

PRICING AND TARIFF ISSUES

History

In 2001 Kenergy filed a rate application, including a cost-of-service study, which was docketed as Case No. 2000-00395. KIUC intervened and filed a cost-of-service study to support its claim that Kenergy's rates for direct-serve customers produced revenues significantly in excess of the costs to serve those customers. While the

[13] Stanley Rebuttal Testimony at 3.

Commission did not agree with all aspects of KIUC's study, it found that the study clearly indicated that direct-serve customers were being charged excessive rates compared to the costs related to serving them. In its final Order, the Commission found that Kenergy's cost-of-service study failed to address the costs related to serving its direct-serve customers and that some decrease in the rates charged the KIUC direct-serve customers was warranted. The Commission also found that any rate decrease for those customers must be tempered by non-cost factors.

Rate Issues

Kenergy filed a detailed cost-of-service study that showed that the revenues from the direct-serve customers exceed their cost of service. The study also showed that the revenues from the non-direct-serve, three-phase commercial and industrial customers exceed their cost of service, while the revenues from the single phase and residential customers are insufficient to cover their cost of service. Despite this study, Kenergy proposed no adjustment to any of its rates. Kenergy recognized that any rate adjustment based strictly on cost of service would increase its rates for residential customers and reduce its rates for three-phase commercial and industrial non-direct-serve customers and direct-serve customers. Kenergy did not favor increasing rates for residential customers at this time because of its prior commitment to reduce residential rates through September 2, 2004 by its adoption of the consolidation credit rider.

Kenergy has 19 direct-serve customers. KIUC represents the five largest of those customers: Alcan Aluminum; Century Aluminum; Weyerhaeuser Paper ("Weyerhaeuser"); Commonwealth Aluminum; and Kimberly Clark. Alcan Aluminum and Century Aluminum are engaged in the aluminum smelting business and are

Kenergy's two largest customers. The two aluminum smelters are served under Kenergy's Schedule 34, while the other three direct-serve customers have dedicated delivery points and are served under Schedule 32. Kenergy has no other customers served under either of these schedules.

KIUC accepted Kenergy's cost-of-service study, with the exception of a $2,546 interest expense-related adjustment. KIUC stated that Kenergy's request to not reduce the rates for Schedules 32 and 34 was unreasonable and contrary to Kenergy's cost-of-service study. Relying on that study and advocating a strict adherence to the principle of cost-based rates, KIUC proposed a $496,874 decrease for those two schedules.[14] KIUC proposed that the reduction in rates for Schedules 32 and 34 be reflected by reducing both the energy charges and the monthly customer charges in each schedule.

In Kenergy's last rate case, Case No. 2000-00395, the Commission found that the cost-of-service study filed by KIUC supported a rate decrease for Schedules 32 and 34, but that the results of any such study must be tempered by non-cost factors. Based on the Kenergy study in this case, some level of rate reduction should be implemented for Schedules 32 and 34. The customers served under those two schedules are unique to Kenergy's system both in their size and the nature of their service. While recognizing these factors, the Commission has also considered non-cost factors, such as revenue stability, rate continuity, and gradualism, as we have historically done in prior rate cases. Considering both the cost and non-cost factors discussed herein, as well as the need for Kenergy to make a further filing by the end of this year to address its earnings

[14] Response of KIUC to the First Request of Commission Staff, dated October 17, 2003, Item 4(a).

after the consolidation credit rider has expired (discussed below), the Commission finds that the $162,347 rate reduction approved herein should be allocated to rate Schedules 32 and 34. After reflecting this rate reduction, the level of margins provided by the distribution adder for Schedules 32 and 34 are fair, just, and reasonable. Absent a significant change in Kenergy's circumstances, there is no basis for any further reductions to these distribution adders.

Due to the significantly high levels of energy purchased by the customers served under Schedules 32 and 34, and the modest reduction found reasonable herein, attempting to adjust the energy charge would be burdensome and require adding another decimal place to the rate. The most administratively efficient manner in which to allocate the reduction is by reducing the monthly customer charges. Therefore, the reduction in rates for Schedules 32 and 34 found reasonable herein is applied in full to the customer charges as set forth in Appendix A to this Order. Since the rate reduction is being passed through the customer charges rather than the energy charges for reasons of administrative efficiency, the Commission is setting no precedent as to the appropriate levels of the customer charges based on cost of service.

OTHER ISSUES

Continuation of the Consolidation Credit Rider

As discussed previously, Kenergy's tariffs include a 4 percent consolidation credit rider that is applied to all non-direct-serve customers. Of Kenergy's 51,313 customers, 51,294 are non-direct-serve. Kenergy indicated it was uncertain if the consolidation credit rider will automatically expire on September 2, 2004 or if it will continue in effect until Kenergy files to modify or discontinue it.[15] The Commission's previous Orders on this subject are clear; the consolidation credit rider will automatically expire on September 2, 2004. Kenergy previously stated that after the credit expires, it intends "to establish base rates reflecting most of the efficiencies gained from consolidation."[16] The record now before us shows that Kenergy's earnings will increase substantially after the consolidation credit rider has expired. Based on these considerations, the Commission finds that Kenergy should file an application no later than December 31, 2004 to either extend the rider to all customers or propose an alternative methodology to pass the increase in earnings to all ratepayers. Kenergy's proposal in this next application should also begin to address the disparity between customer classes and cost of service. Kenergy need not conduct a new cost-of-service study for this next application but may rely upon the study filed herein.

Weyerhaeuser Contract

KIUC has requested that Kenergy's rates to Weyerhaeuser be adjusted to eliminate the distribution fee imposed on the energy that is self-generated by Weyerhaeuser. This charge is part of the contract executed by Kenergy and Weyerhaeuser's predecessor, Willamette Inc. ("Willamette"), in 2001. The contract was necessitated by Willamette's installation of a cogeneration facility that uses its wood waste products as fuel to produce electricity. Kenergy claims that KIUC's position is in direct violation of a provision of the contract, which has a term of 10 years. Kenergy states that the charge on self-generated energy was included in the contract as a result

[15] Transcript of Evidence, November 12, 2003, at 7-9 and 33-38.

[16] Case No. 1999-00162, final Order dated June 14, 2000, footnote 15.

of arms-length negotiations and was intended to keep its revenues at the same level they were prior to the self-generation.

The contract expressly states that the customer "agree[s] that it shall not assert, as a basis for reducing the amount of the Distribution Fee, the fact that the Distribution Fee is imposed on self-generation power in addition to purchase power…." Despite this contract provision, KIUC now claims that there is no cost-of-service justification to impose this fee on the self-generation power and that Kenergy incurs no cost in conjunction with power that is self-generated. KIUC has also calculated the savings to Weyerhaeuser if the fee is not imposed on self-generated power.

Although the contract allows a challenge to the amount of the distribution fee, the challenge must be on a basis other than the agreed-to imposition of the fee on self-generated power. In this instance, KIUC's challenge is essentially to the imposition of the fee on the self-generated power and this challenge clearly violates the terms of the contract. Therefore, the Commission finds that KIUC's request should be denied.

SUMMARY

The Commission, after consideration of the evidence of record and being otherwise sufficiently advised, finds that:

1. The rates set forth in Appendix A are the fair, just, and reasonable rates for Kenergy to charge the Schedule 32 and 34 direct-serve customers for service rendered on and after the date of this Order.

2. The TIER granted herein is fair, just, and reasonable and will provide for Kenergy's financial obligations.

3. The rates proposed by Kenergy for the Schedule 32 and 34 direct-serve customers would produce revenue in excess of that found reasonable herein and should be denied.

4. KIUC's challenge to the distribution fee charged to Weyerhaeuser is in violation of the terms of its contract and should be denied.

IT IS THEREFORE ORDERED that:

1. The rates proposed by Kenergy for all customers, with the exception of Schedules 32 and 34, are approved. The rates proposed by Kenergy for Schedules 32 and 34 are denied.

2. The rates in Appendix A are approved for the Schedule 32 and 34 direct-serve customers for service rendered by Kenergy on and after the date of this Order.

3. Kenergy shall file, within 30 days of the date of this Order, its revised tariff sheets setting out the rates approved herein for Schedules 32 and 34.

4. KIUC's request to challenge the Distribution Fee charged to Weyerhaeuser is in violation of the terms of its contract and is denied.

5. Kenergy shall file an application no later than December 31, 2004 to either extend the rider to all customers or propose an alternative methodology to pass the increase in earnings to all ratepayers.

Done at Frankfort, Kentucky, this 22nd day of April, 2004.

By the Commission

ATTEST:

Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2003-00165 DATED April 22, 2004

The following rates and charges are prescribed for the customers in the area served by Kenergy Corporation. 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

Customer Charge	$2,200 per month

Commonwealth Industries
Kimberly-Clark Corporation
Willamette Industries

Customer Charge	$ 860 per month