COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF OWEN ELECTRIC COOPERATIVE, INC. FOR ADJUSTMENT OF RATES	)))	CASE NO. 2008-00154

O R D E R

On August 27, 2008, Owen Electric Cooperative Inc. ("Owen") filed an application requesting approval to increase its electric rates and to make changes to certain nonrecurring charges. Owen proposes to adjust its electric rates to increase its operating revenues from $125,997,488 to $130,061,883, an increase of $4,064,395.[1] Owen's application provided for the new rates to become effective for services rendered on or after September 27, 2008. By this Order, the Commission approves the proposed nonrecurring charges and establishes electric rates that will produce annual revenues of $129,832,928, an increase of $3,835,440 over normalized revenues of $125,997,488.

Owen is a consumer-owned rural electric cooperative organized pursuant to KRS Chapter 279 and engaged in the sale of electric energy to approximately 56,794 customers in the Kentucky counties of Boone, Campbell, Carroll, Gallatin, Kenton,

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[1] Owen's application did not incorporate the pass-through increase from East Kentucky Power Cooperative, Inc. ("EKPC"). Therefore, these amounts do not include the $6,462,157 pass-though amount authorized by the Commission on March 31, 2009 in Case No. 2008-00409. Operating revenues of $125,997,488 exclude Fuel Adjustment Clause revenues, environmental surcharge revenues, and other electric revenues.

Owen, Pendleton, and Scott.[2] It is one of sixteen member distribution cooperatives that own and receive wholesale power from EKPC.

Pursuant to an Order dated September 15, 2008, the Commission suspended Owen's proposed rates for a period of five months, from September 27, 2008 up to and including February 26, 2009, in order to investigate the reasonableness of Owen's application. The Attorney General of the Commonwealth of Kentucky, by and through his Office of Rate Intervention ("AG"), and Gallatin Steel Company were granted full intervention in this proceeding.

Following extensive discovery, the Commission held a public hearing on the proposed rate adjustment on March 25, 2009. The following persons pre-filed Direct Testimony and testified at the hearing on behalf of Owen: Mark Stallons, President and Chief Executive Officer ("CEO"); Rebecca Witt, Senior Vice President for Corporate Services and the Chief Financial Officer; Alan M. Zumstein, Certified Public Accountant; and James R. Adkins, Consultant.[3]

TEST PERIOD

Owen proposes to use the 12-month period ending December 31, 2007 as the test period to determine the reasonableness of its proposed rates. The Commission

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[2] Annual Report of Owen to the Public Service Commission of the Commonwealth of Kentucky for the Calendar Year Ended December 31, 2008 at 13 and 19.

[3] Robert A. Hood filed Direct Testimony with the application because he was Owen's President and CEO when the application was filed. On January 5, 2009, Mr. Hood retired and was replaced by Mr. Stallons. On January 27, 2009, Owen submitted the Direct Testimony of Mr. Stallons.

finds the use of this test period to be reasonable. In using an historic test period, the Commission gives full consideration to appropriate known and measurable changes.

VALUATION

Rate Base

Owen proposed a net investment rate base of $129,193,682[4] based on the test-year-end value of plant in service, the 13-month average balances for materials and supplies and prepayments, the cash working capital allowance, minus the adjusted accumulated depreciation and the test-year-end level of customer advances for construction. Neither intervenor stated a position on Owen's rate base.

The Commission concurs with Owen's proposed rate base with the exception that working capital has been adjusted to reflect the pro forma adjustments to operation and maintenance expenses found reasonable herein. Based on this adjustment, Owen's net investment rate base for rate-making purposes is as follows:

Utility Plant in Service	$ 187,716,197
ADD:	
Materials and Supplies	$ 1,141,357
Prepayments	483,537
Working Capital	1,780,333
Subtotal	$ 191,121,424
DEDUCT:	
Accumulated Depreciation	$ 61,301,494
Customer Advances for Construction	637,286
Subtotal	$ 61,938,780
NET INVESTMENT RATE BASE	$ 129,182,644

[4] Application, Exhibit K, page 1 of 7.

Capitalization and Capital Structure

The Commission finds that Owen's capitalization at test-year-end for rate-making purposes was $124,461,923[5] and consisted of $40,870,668 in equity[6] and $83,591,255 in long-term debt. Using this capital structure, Owen's equity to total capitalization ratio is 32.84 percent.

REVENUES AND EXPENSES

Owen proposed several adjustments to revenues and expenses to reflect current and expected operating conditions. Those adjustments are contained in Table 1 below.

Table 1: Owen's Proposed Adjustments		
Descriptions		Adjustments
Payroll – Salaries	$	156,846
Payroll Taxes	$	230
Normalize Depreciation	$	(1,175,664)
Normalize Property Taxes	$	108,157
Normalize Interest Exp. Long-Term Debt	$	478,648
Financial Accounting Standards 106 Costs	$	40,590
Donations	$	(68,267)
Professional Services	$	(853)
Directors Fees	$	(154,035)
Miscellaneous Expense	$	6,279
Normalize Nonrecurring revenues	$	235,087
Rate Case Amortization	$	24,000
Normalize Expenses	$	(15,151,053)
Normalize Revenues	$	(15,219,861)

The Commission finds that these 14 adjustments proposed by Owen and not opposed by the intervenors are reasonable and should be accepted.

[5] Id.

[6] The Commission normally excludes generation and transmission capital credits ("GTCCs") from equity and the capital structure. During the test year, Owen had no GTCCs.

In reviewing Owen's responses to the information requests, the AG identified several items included in Owen's pro forma operating expenses that the Commission has traditionally removed for rate-making purposes. Owen agreed that these expenses, which total $67,571, are contrary to past Commission decisions and, therefore, should be removed from its operating expenses for rate-making purposes.[7] These expenses are contained in Table 2 below.

Table 2: Owen's Agreed-to Expense Adjustments		
Advertising - Key Account Golf	$	850
Key Account Outings & Sponsorships	$	15,221
KAEC Meeting - Hotel	$	1,780
Congressional Meeting - Airfare	$	1,079
Congressional Meeting - Hotel	$	4,287
Advertising - Home Town Coop.	$	1,267
Advertising - Balloon Glow	$	1,267
Washington Youth Tours	$	4,800
Sponsorships for Communities	$	1,000
Dues – Civic Organizations	$	693
Advertisement - Halloween Safety	$	800
Dues & Subscriptions - Civic	$	1,078
Donations	$	100
Scholarships Awarded by Owen	$	27,000
Insurance - Retired Executive	$	745
Penalty - Late Sales Tax Penalty	$	5,604

The Commission finds that the above adjustments totaling $67,571 are reasonable and should be accepted. Accordingly, the Commission has decreased Owen's pro forma operating expenses by $67,571.

Year-End Customer Annualization Adjustment

Owen proposes to increase revenue by $61,939 to reflect the annualization of the end-of-period customer levels for the following customer classifications: Schedule 1

[7] Brief for Owen at 10 and Owen's response to the Initial Request for Information of the AG, Item 35.

Farm and Home; Schedule 1 Small Commercial; Schedule II Large Power; Schedule XI Large Industrial Rate LPB1; Schedule XIII Large Industrial Rate LPB2; Schedule XIV Large Industrial Rate LPB; and Schedule 2A Large Power T-O-D.[8]

The AG requested that Owen expand its year-end annualization adjustment to include Schedule III Security Lights, Schedule OLS, and Envirowatts in the net revenue calculations. In its response, Owen determined that if these customer classifications are included in the calculation then the proposed adjustment would be $192,110,[9] an increase of $130,171 above the $61,939 increase proposed by Owen. The AG recommended that the Commission increase Owen's pro forma other electric revenue by $130,171 to reflect all customer classifications in the annualization adjustment.[10]

The Commission finds that it is reasonable to adjust all customer classes to reflect the end-of-period customer levels. Accordingly, the Commission will increase Owen's proposed adjustment of $61,939 by an additional $130,171.

National Rural Electric Cooperative Association ("NRECA") Annual Meeting

The AG objects to Owen's inclusion of $8,500 in pro forma operating expenses for the cost of those non-qualifying directors who attended the 2007 NRECA Annual Meeting.[11] Six of Owen's seven directors attended the 2007 NRECA Annual Meeting at

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[8] Application, Exhibit 16.

[9] Owen's response to the Initial Request for information of the AG, Item 7.

[10] AG's Post Hearing Brief at 3.

[11] Id. at 8.

a total cost of $14,567.[12] The AG argues that the Commission has historically "only allowed expenses for the cooperatives' NRECA representative and their alternate."[13]

Owen claims that "the NRECA annual meeting is a combination of training and educational seminars for directors during the day and organizational activities in the evenings."[14] Owen further claims it is imperative that its directors attend these meetings in order to stay informed and keep abreast of issues facing the electric industry, particularly in light of changes in economic conditions, environmental and legal issues, technological advances, and the potential for deregulation.[15] Owen asserts that it should be allowed to recover the costs for all of its directors who attended the 2007 NRECA Annual Meeting, contending that its directors can make more informed and intelligent decisions as a result of the training received at the NRECA Annual Meetings–all to the benefit of Owen's members.[16]

In Case No. 1992-00560, the Commission found that, "for rate-making purposes, the practice of including the cost of sending all directors to meetings and conferences is excessive."[17] Accordingly, the Commission denied the expense for directors who were not the designated delegate or alternate, finding that most cooperatives send only two

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[12] Owen's Post Hearing Information Response, Item 2.

[13] AG's Post Hearing Brief at 8.

[14] Owen's response to the AG's Initial Request for Information, Item 28.

[15] Owen's response to the Commission Staff's Third Request for Information, Item 3(d).

[16] Id.

[17] Case No. 1992-00560, *Salt River Electric Cooperative Corp.* (Ky. PSC Sep. 28, 1993) at 11.

to three directors and that these directors then share the information learned at the meeting with the other directors upon their return.[18]

Six of Owen's directors attended the NRECA Annual Meeting. Because Owen's original designated delegate was unable to attend, the alternate attended the 2007 NRECA meeting on his behalf. In its post-hearing responses, Owen did not identify any of the other five directors who attended the 2007 NRECA meeting as being the new alternate. The Commission is not persuaded by Owen's argument concerning the benefit provided to the ratepayers when several directors receive identical training. The Commission finds that Owen's pro forma operating expenses should be reduced by $12,460 to remove the expense for those directors who had not been designated as the alternate delegate to attend the 2007 NRECA meeting.

In its post-hearing responses, Owen stated that it paid $3,962 in 2007 for its directors to attend the 2008 NRECA Annual Meeting. The Commission will further reduce Owen's pro forma operating expenses by $3,962 to eliminate the test-period expenses incurred for directors to attend the 2008 NRECA Annual Meeting. This results in a total adjustment for the NRECA Annual Meetings of $16,422.

Billboard at the Kentucky Speedway

Owen included in its pro forma operating expenses $10,000 for the cost of a billboard at the Kentucky Speedway.[19] According to the AG, the general contact information contained on the billboard clearly promotes Owen and does not provide any information beyond what is available to the ratepayers contained in the telephone book

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[18] Id.

[19] AG's Post Hearing Brief at 6.

or in their monthly bills.[20] The AG argues that the expenses for promotional advertising are contrary to past Commission precedent in that they are expressly disallowed for inclusion in rates pursuant to 807 KAR 5:016, Section 4(1)(b). Accordingly, the AG argues that Owen's *pro forma* operating expenses should be reduced by $10,000 to remove the cost of the billboard.

807 KAR 5:016, Section 1, states that the purpose of this regulation "is to insure that no direct or indirect expenditures may be includable in a gas or electric utility's cost of service for rate-making purposes which are for promotional advertising, political advertising or institutional advertising." 807 KAR 5:016, Section 2(1), further provides that "[n]o advertising expenditure of a utility shall be taken into consideration by the commission for the purpose of establishing rates unless such advertising will produce a material benefit for the ratepayers."

Based upon the requirements of the above-mentioned regulations, the Commission is in agreement with the AG in that Owen has failed to show that the information contained on the billboard provides material benefit to its ratepayers. Accordingly, the Commission is reducing Owen's *pro forma* operating expenses by $10,000 to eliminate the cost of the billboard.

Retirement and Security Expense

Using normalized wages of $7,172,880 and a composite rate of 18.08 percent, Owen calculated a pro forma retirement and security expense of $1,296,857, which is an increase of $151,534 above the test-period level.[21] In response to an information

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[20] Id. at 7.

[21] Application, Exhibit 7, Retirement and Security.

request, Owen calculated a revised retirement and security expense of $1,294,957 using the pro forma base wages for non-union and union employees and the actual rates of 18.64 percent for non-union employees and 17.23 percent for union employees.[22] The AG recommended that the Commission reduce Owen's pro forma operating expenses by $1,900 to reflect the revised amount. Upon review of Owen's response, the Commission finds that the revised retirement and security expense is reasonable and further finds that Owen's pro forma retirement and security expense of $1,296,857 should be reduced by $1,900.

Automated Meter reading ("AMR") Consulting Fees

The AG objects to Owen's request to include $23,997 in pro forma operating expense for consulting fees associated with the AMR program.[23] Owen acknowledges that the AMR consulting fees are nonrecurring but maintains that some additional level of consulting fees will occur in the future. The AG argues that Owen has not shown that the level of future costs will equal the reported test-period amount.[24] The AG concludes that, since future consulting fees are not currently known and measurable, the $23,997 of consulting fees recorded in the test period should be removed.[25]

The Commission is in agreement with the AG that the consulting fees should be removed from Owen's pro forma operating expenses; however, the Commission views

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[22] Owen's response to the Commission Staff's Third Request for Information, Item 13.

[23] AG's Post Hearing Brief at 6.

[24] Id.

[25] Id.

the consulting fees as an overhead construction cost that should be capitalized and depreciated over the useful life of the automated meters. Depreciating the AMR consulting fees of $23,997 over a 15-year depreciation life will result in an increase to depreciation expense of $1,601.[26] Therefore, the Commission is reducing Owen's pro forma operating expenses by a net amount of $22,396.

Employee Coffee

Included in Owen's operating expenses is the cost of providing coffee to its employees of $1,767. Owen contends that providing coffee promotes workforce efficiency and productivity.[27] Owen argues that if its "outside employees were to stop and get coffee on their own each morning, then line trucks, bucket trucks, and service trucks would be attempting to get in small rural locations and take extra time to get to work, thus being very inefficient every day."[28]

According to the AG, Owen's employees could get their own coffee on their way to work since they do not drive work vehicles home.[29] The AG argues that proper employee management should prevent the utility vehicles from making prohibited stops for personal errands at the ratepayers' expense.[30] The AG states that the cost of coffee before work breaks should not be borne by ratepayers and that the Commission has

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[26] $23,997 (AMR Consulting Fees) x 6.67% (Depreciation Rate) = $1,601.

[27] Owen's response to the AG's Second Request for Information, Item 10.

[28] Id.

[29] AG's Post Hearing Brief at 7-8.

[30] Id.

traditionally disallowed this type of expense for rate-making purposes.[31] For these reasons the AG argues that Owen's pro forma expenses should be reduced by $1,767 to eliminate this employee fringe benefit.[32]

The Commission agrees with the AG's position concerning recovery of the cost of providing coffee to Owen's employees. In Case No. 1995-00554, the Commission found that these types of employee-related expenses may benefit employer/employee relations; however, such costs should not be borne by the ratepayer.[33] The practice used by many employers is to provide their employees with coffee but require the employees to pay for their coffee through contribution to a coffee fund. Therefore, the Commission will eliminate the employee coffee fringe benefit by reducing pro forma operating expenses by $1,767.

Temporary Labor

Owen included $9,379 in its pro forma operating expenses for temporary labor. According to Owen, the temporary labor is required to cover shortages at its call center and mail room.[34] The AG states that Owen has included a full complement of full-time employees that are working 2,080 hours per year as well as one part-time employee.[35] Because employee sick and vacation benefits are included in the pro forma operating

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[31] Id.

[32] Id.

[33] Case No. 1995-00554, *Kentucky-American Water Co.* (Ky. PSC Sep. 11, 1996) at 43.

[34] March 25, 2009 hearing video, Witness - Rebecca Witt, 1:24 pm.

[35] AG's Post Hearing Brief at 8.

expenses, the AG contends that the costs for the employee shortages are accounted for in the application.[36]

The Commission disagrees with the AG's position. If an employee is absent from work due to illness or vacation, the duties of that employee must still be performed. Therefore, including the cost of temporary labor and employee sick or vacation time is not double recovery. Accordingly, the Commission accepts Owen's inclusion of temporary labor in pro forma operating expenses.

Short-Term Interest Expense

Owen reports test-period short-term interest expense of $689,738.[37] Owen estimated that its requested rate increase would be sufficient to allow it to repay one-half of the outstanding short-term note payable and, therefore, it proposed to reduce short-term interest expense by one-half or $344,869.[38] However, Owen later agreed that since $10 million of the proceeds of the November 2007 Rural Utilities Service ("RUS") loan was used to reduce short-term debt, it would be more appropriate to use the short-term debt balance as of December 31, 2007 to calculate the pro forma short-term interest expense.[39] Using its December 31, 2007 short-term debt balance, Owen calculated revised short-term interest expense of $366,140, an increase of $21,271 above the amount it originally requested.[40]

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[36] Id.

[37] Application, Exhibit 5 at 3.

[38] Id.

[39] Owen's response to the AG's Second Request for Information, Item 4.

[40] Id.

The AG argues that Owen's test-period short-term interest expense should be reflected at $366,140 as opposed to the $689,738 reported by Owen.[41] According to the AG, Owen assumed that one-half of its short-term debt would be repaid from the rate increase resulting from this instant rate case and that the Commission should also use this assumption.[42] Adopting this assumption, the AG argues that the pro forma expense should be one-half of $366,140, or $183,070, which results in a reduction to Owen's pro forma short-term interest expense of $161,799.

The Commission finds that the methodology used by Owen in its original adjustment is based upon budgetary assumptions. There are numerous factors that impact a utility's short-term debt balance. Owen's original adjustment only considers the expected impact the proposed rate increase could have on its future short-term debt balance without taking into consideration the effective date of the new rates or the impact future construction projects will have on its short-term debt issuances. For these reasons the Commission finds that adjusting short-term interest expense based on budget projections fails to meet the rate-making criteria of known and measurable. Therefore, the Commission will deny both Owen's original adjustment and the AG's recommended revision. The Commission finds that using Owen's end-of-period short-term debt balance is reasonable. This will increase Owen's pro forma short-term interest expense by $21,271, from $344,869 to $366,140.

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[41] AG's Post Hearing Brief at 5.

[42] Id.

Interest on Customer Deposits

Owen reports test-period interest expense on customer deposits of $130,051. Relying upon Case No. 1999-00176,[43] the AG argues that the interest on customer deposits should be removed from Owen's pro forma operating expenses.[44]

Owen contends that the case relied upon by the AG is distinguishable from the instant case. Owen points out that Case No. 1999-00176 involved an investor-owned gas utility that was not subject to the RUS and the National Rural Utilities Cooperative Finance Corporation requirements to which Owen is subject as a non-profit rural electric cooperative.[45] Owen states that its customer deposits are recorded as a current liability rather than income, as the customer deposits are intended to serve as security and not as a prepayment of income.[46] Owen further states that it is not aware of any proceeding involving an electric cooperative where the Commission has disallowed rate recovery of interest on customer deposits.[47]

Given that Owen's revenue requirement is based upon a Times Interest Earned Ratio ("TIER") rather than a return on rate base, the Commission finds that the matching principle contained in the case cited by the AG does not apply. Furthermore, unlike investor-owned utilities, interest income is included in the revenue requirement

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[43] Case No. 1999-00176, *Delta Natural Gas Company, Inc.* (Ky. PSC Dec. 27, 1999).

[44] AG's Post Hearing Brief at 6.

[45] Brief for Owen at 9.

[46] Id.

[47] Id. at 10.

calculation for electric cooperatives. A mismatch will occur if the interest expense paid by Owen to its customers is removed from expenses while the interest income earned on those customer deposits remains in Owen's operating revenues. For these reasons, the Commission finds no basis to adjust Owen's pro forma operating expenses as argued by the AG.

Summary

Based on the pro forma adjustments found reasonable herein, the Commission finds that Owen's pro forma operations should be as follows:

	Test-Period Operations	Pro Forma Adjustments	Pro Forma Operations
Operating Revenues	$ 142,992,351	$ (14,792,664)	$ 128,199,687
Operating Expenses	139,642,989	(16,139,124)	123,503,865
Net Operating Income	$ 3,349,362	$ 1,346,460	$ 4,695,822
Interest on Long-Term Debt	3,823,761	478,648	4,302,409
Interest Expense-Other	819,788	(323,598)	496,190
Other Income and (Ded.)-Net	468,130	101,616	569,746
Net Income	$ (826,057)	$ 1,293,026	$ 466,969

REVENUE REQUIREMENTS

The rate of return earned on Owen's net investment rate base established for the test year was 2.51 percent.[48] Owen requested rates that would result in a TIER of 2.00X, excluding GTCCs and a rate of return of 6.66 percent on its proposed rate base of $129,193,682.[49] Owen proposes an increase in revenues of $4,064,395 to achieve the 2.00X TIER excluding GTCCs.[50]

[48] Application Exhibit K at 1.

[49] Id.

[50] Id. Exhibit S at 2.

Owen's TIER excluding GTCCs for the test period was 0.78X.[51] For the calendar years 2005 and 2006, Owen's TIERs were 1.28X and 2.39X, respectively.[52] After taking into consideration the allowable pro forma adjustments, Owen would achieve a 1.109X TIER excluding GTCCs without an increase in revenues.

Neither the AG nor Gallatin offered a position on the use of the 2.00X. The Commission finds that the use of a 2.00X TIER is reasonable for Owen. In order to achieve the 2.00X TIER, Owen would need an increase in annual revenues of $3,835,440.

Based upon the pro forma adjustments found to be reasonable, the Commission has determined that an increase in Owen's revenues of $3,835,440 would result in a TIER of 2.00X. The additional revenue should produce net income of $4,302,409 and, based on the net investment rate base of $129,182,644 found reasonable herein, should result in a rate of return on rate base of 6.66 percent.

PRICING AND TARIFF ISSUES

Cost of Service

Owen filed a fully allocated cost-of-service study ("COSS") for the purpose of determining the cost to serve as well as the revenue allocation for all rate classes. The COSS indicates that the Farm and Home, Small Commercial, Security Lights, Outdoor Lighting Service and Special Outdoor Lighting Service customer classes all produce revenues insufficient to meet the costs to serve those classes, while the large power and industrial rate classes produce revenues in excess of the costs Owen incurs to

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[51] Id. at 6.

[52] Id.

serve those classes. Neither intervenor filed a COSS nor argued that the COSS filed by Owen was unreasonable.

Having reviewed Owen's COSS, the Commission finds it to be acceptable for use as a guide in allocating the revenue increase awarded herein.

<u>Revenue Allocation and Rate Design</u>

Owen proposes an overall revenue increase of $4,064,395, or 3.2 percent, with increases of six percent for the Farm and Home and Small Commercial classes, 37.9 percent for the Security Lights class, 5.5 percent for the Outdoor Lighting class, and 30.0 percent for the Special Outdoor Lighting class. Owen proposes no increase in revenues for its other classes.

Owen proposes increases only to the customer charges of both the Farm and Home and Small Commercial classes with no changes in energy charges. Owen proposes an increase from $5.64 to $11.20 in the Farm and Home customer charge and from $5.64 to $13.44[53] in the Small Commercial customer charge. Owen argues that this change in rate design will better match its revenues with its costs of service and will align the interests of the cooperative and its members with regard to energy innovation, efficiency, conservation, demand response and distributed generation. Because a large portion of its member-related fixed costs are currently recovered through its energy charges, Owen asserts that it will not be able to fully recover its fixed costs when there is a reduction in kWh sales due to the potential implementation of any energy efficiency

[53] The proposed Small Commercial customer charge was stated as $13.48 in the application and in Owen's brief filed on April 22, 2009; however, in response to Item No. 7 in Staff's Third Data Request, Owen agreed that the amount should have been $13.44.

programs. Owen states that it is not reasonable to pursue such programs when the resulting reduction in sales has a negative financial impact on the utility. This issue will be addressed in more detail in the next section of this Order.

The AG states that the energy portion of the bill is the only portion over which the customer has any control. He claims that to allow the customer charge to climb too high would discourage customers from individual conservation efforts. The AG states that with a higher customer charge, the customer loses the incentive to conserve energy because no matter what actions a customer takes to do so, the effect on the bill would be insignificant. The AG further argues that, by allowing Owen to increase its customer charge as proposed, the utility is guaranteed its income whether management operates the utility prudently or not. The AG concludes his argument by calling for gradualism with respect to the increase in customer charges.

The difference between the $4,064,395 proposed by Owen and the $3,835,440 approved in this Order is $228,955. The COSS shows that, at Owen's proposed rates, the Farm and Home class and Small Commercial class would provide rates of return of 5.38 and 4.97 percent, respectively, while combining the results for the three lighting schedules shows that the lighting class as a whole would provide a rate of return of negative 0.7 percent. Based on these results, the Commission finds that the increases for the lighting classes should be allocated as proposed by Owen while the proposed increases to the Farm and Home and Small Commercial classes should be adjusted downward, proportionately, to generate the revenue increase approved herein. The Commission, based on the results of Owen's COSS and mindful of the throughput incentive which is inherent in Owen's existing rate design, accepts Owen's proposal to allocate the Farm and Home and Small Commercial class revenue increases entirely to their respective customer charges.

In Case No. 2008-00421,[54] Owen requested a pass-through of its increase in wholesale rates from EKPC on a COSS basis. Owen's pass-through was not approved on a COSS basis because the Commission could not rule on the reasonableness of the COSS in that case. Accordingly, the pass-through was approved in that proceeding on a proportional basis in the Commission's Interim Order entered March 31, 2009. Concurrent with this Order, the Commission is issuing a final Order in that case, which, based on its decision in this proceeding to accept Owen's COSS as a guide for allocating the increase granted herein, will approve Owen's pass-through of wholesale power expenses on a COSS basis. Accordingly, the rates approved herein reflect the approval of $6,462,157 in increases to all classes to recover Owen's increase in wholesale power costs plus the $3,835,440 approved in this general rate case to those classes whose revenues are insufficient to meet cost of service.

OTHER ISSUES

Energy Efficiency and Demand-Side Management ("DSM")

As previously stated, on January 27, 2009, shortly after being employed as Owen's President and CEO, Mr. Stallons submitted pre-filed testimony. Although his testimony supported the overall need for the rate increase requested, the major focus of Mr. Stallons' testimony addressed the need for modifications to Owen's rate design.

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[54] Case No. 2008-00421, *Owen Electric Cooperative Corporation* (Ky. PSC March 31, 2009).

Mr. Stallons testified that "Owen's current retail rate design does not align the interests of the Cooperative and its members with respect to energy innovation, efficiency, conservation, and demand response efforts."[55] Mr. Stallons described the results of Owen's COSS, which indicated that the residential customer charge should be $21.92 per month rather than the current charge of $5.64 per month and which does not cover member-related costs or any margins. Thus, according to Mr. Stallons, Owen must recover "all of its margins and a significant portion of its member related fixed costs through an energy charge assessed on a kWh basis"[56] and "any reduction in kWh sales due to energy innovation, efficiency, conservation, and demand response efforts results in the Cooperative recovering less of its fixed cost and margin, which financially harms the Cooperative."[57] This results in the "thoughput incentive" where, between rate cases, a utility has a financial incentive to maximize sales and increase its profits.[58] According to Mr. Stallons, the simplest way to mitigate the throughput incentive is to increase the customer charge to a level that is justified based on the cost of service to ensure that the revenue stream is not linked to sales.[59]

Owen's current energy-efficient programs consist of distributing compact fluorescent light bulbs, performing residential and commercial energy audits, offering rebates on energy efficient home building practices and appliances, and conducting

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[55] Direct Testimony of Mark A. Stallons, at 4.

[56] Id.

[57] Id.

[58] Id. at 5.

[59] Id.

energy efficiency seminars and workshops.[60] In addition, Owen began offering direct load control of water heaters and air conditioners in October 2008 as part of EKPC's efforts to implement a direct load control program for its member systems.[61] Owen's energy efficiency programs' budget for 2007 was $118,967 and for 2008 was $200,654.[62] This represents an annual expenditure of approximately of $2.12 for 2007 and $3.55 for 2008 for each of Owen's residential and small commercial customers.[63]

In response to an AG information request, Owen responded that it is in the process of developing an energy innovation plan which it intends to present to its Board of Directors by November 1, 2009. According to Owen, the plan will align its culture and business model to meet its members' need to manage their energy costs, preserve resources, and consume energy wisely by implementing a culture of energy innovation. Among other things, Owen plans to decouple its revenue from kWh sales; increase its customer charge to cover fixed costs; investigate and develop progressive rate designs that encourage energy innovation (this includes consideration of reduced energy charges, time of use rates, and inclining energy block rates); investigate technological opportunities and develop a plan and pilot project to provide members with energy

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[60] Id. at 12.

[61] Owen Electric tariff, Sheet No. 124A, Direct Control of Water Heaters Program, Direct Control of Air Conditioners Program, Issued October 22, 2008, Effective October 2, 2008.

[62] Response to the AG's Third Request for Information, Item 2 at 2.

[63] In its 2007 Annual Report, Owen reported an average of 54,003 residential customers and 2,016 small commercial customers (56,019 total). In its 2008 Annual Report, Owen reported an average of 54,427 residential customers and 2,086 small commercial customers (56,513 total).

usage data and pricing information that enables them to manage their kWh consumption, their monthly energy bill, and their home comfort; develop rate and pricing strategies to minimize rate class subsidization; and to promote distributed generation where it is economically and technically feasible.[64] At the hearing, Mr. Stallons stated that he would be a "strong advocate" on the EKPC board for DSM programs that reduce peak load.[65]

In his post-hearing brief, the AG indicates support for energy efficiency but does not support the requested increase to the residential customer charge proposed by Owen. The AG recommends that the Commission employ the principle of "gradualism" in applying an increase to the customer charge and balance stakeholder interests rather than utilize the "flash cut" approach proposed by Owen.[66]

The Commission recognizes the concerns of both the AG and Owen. As we noted in several recent Orders,[67] the Commission believes that conservation, energy efficiency and DSM programs are very important and such programs will become more cost-effective as additional restrictions are placed on coal-fired generation. Although Owen has a number of DSM programs in place, the Commission believes that it is appropriate to encourage Owen, and all other electric energy providers, to make a

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[64] Response to the AG's Third Request for Information, Item 3 at 2.

[65] Transcript of Evidence at 65.

[66] AG's Post Hearing Brief at 13-14.

[67] Case No. 2008-00254, *Grayson Rural Electric Cooperative Corporation* (Ky. PSC June 3, 2009); Case No. 2008-00401, *Big Sandy Rural Electric Cooperative Corporation* (Ky. PSC June 3, 2009); Case No. 2008-00030 *Farmers Rural Electric Cooperative* (Ky. PSC June 10, 2009).

greater effort to offer cost-effective DSM and other energy efficiency programs. As stated in his prefiled testimony, responses to data requests, in his direct testimony at the public hearing, and as noted earlier in this Order, Mr. Stallons plans to develop an "energy innovation" plan to supplement Owen's 2010 strategic plan for presentation to the Board of Directors by November 1, 2009. The Commission expects Mr. Stallons to follow through on the development of this plan and directs Owen to submit a detailed report addressing its future plans for energy efficiency and demand response to the Commission no later than December 31, 2009.

As discussed earlier in this Order, with the exception of the difference between the increase requested by Owen and the increase authorized herein, the Commission has accepted the rate design changes proposed by Owen based on its COSS. If, after developing its "energy innovation" plan, Owen still believes that its rate design does not support energy efficiency and DSM activities, it should consider filing an application to adopt a DSM surcharge or to revise its rate design.

SUMMARY

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

1. The rates set forth in the Appendix to this Order are the fair, just, and reasonable rates for Owen to charge for service rendered on and after the date of this Order.

2. The rate of return and TIER granted herein are fair, just, and reasonable and will provide for Owen's financial obligations.

3. The rates proposed by Owen would produce revenue in excess of that found reasonable herein and should be denied.

4. Owen should prepare a detailed report addressing its future plans for energy efficiency and demand and submit its report to the Commission no later than December 31, 2009.

IT IS THEREFORE ORDERED that:

1. The rates proposed by Owen are denied.

2. The rates in the Appendix to this Order are approved for service rendered by Owen on and after the date of this Order.

3. Within 20 days of the date of this Order, Owen shall file new tariff sheets setting forth the rates and charges approved herein and reflecting their effective date and that they were authorized by this Order.

4. Owen shall prepare a detailed report addressing its future plans for energy efficiency and demand and shall submit its report to the Commission no later than December 31, 2009.

By the Commission

ENTERED
JUN 25 2009
KENTUCKY PUBLIC
SERVICE COMMISSION

ATTEST:

Executive Director

APPENDIX

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2008-00154 DATED JUN 25 2009

The following rates and charges are prescribed for the customers in the area served by Owen Electric Cooperative, Inc. 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 this Order.

SCHEDULE I
FARM AND HOME

Customer Charge per Month	$	10.87
Energy Charge per kWh	$	.08063

SCHEDULE I
FARM AND HOME – OFF-PEAK MARKETING RATE

Energy Charge per kWh	$	.04838

SCHEDULE I
SMALL COMMERCIAL

Customer Charge per Month	$	12.83
Energy Charge per kWh	$	.08055

SCHEDULE I – OLS
OUTDOOR LIGHTING SERVICE

Monthly Rates:		
100 Watt High Pressure Sodium	$	9.69
Cobrahead Lighting		
100 Watt High Pressure Sodium	$	12.62
250 Watt High Pressure Sodium	$	17.02
400 Watt High Pressure Sodium	$	20.99
Directional Lighting		
100 Watt High Pressure Sodium	$	11.81
250 Watt High Pressure Sodium	$	14.37
400 Watt High Pressure Sodium	$	18.09
Rate for One Additional Pole if Required	$	4.69

SCHEDULE II – SOLS
SPECIAL OUTDOOR LIGHTING SERVICE

Traditional Light with Fiberglass Pole	$	12.47
Holophane Light with Fiberglass Pole	$	14.84

SCHEDULE III – SOLS
SPECIAL OUTDOOR LIGHTING SERVICE

Energy Rate for each type of light per kWh	$	.053274

SCHEDULE II
LARGE POWER

Customer Charge per Month	$	20.50
Demand Charge per Month per kW	$	5.90
Energy Charge per kWh	$	.05831

SCHEDULE III
SECURITY LIGHTS

Flat rate per light per month as follows:		
On Existing Pole where 120 Volts is available	$	7.91
One Pole Added	$	9.65
Two Poles Added	$	11.39
Three Poles Added	$	13.13
Four Poles Added	$	14.88
Transformer Required	$	.67

SCHEDULE VIII
LARGE INDUSTRIAL RATE – LPC1

Customer Charge per Month	$	1,464.04
Demand Charge per Month per kW - Contract	$	6.81
Energy Charge per kWh		
For all kWh, first 425 hrs per kW of billing demand	$	.04383
For all kWh in excess of 425 hrs per kW of billing demand	$	.03975

SCHEDULE IX
LARGE INDUSTRIAL RATE – LPC2

Customer Charge per Month	$	2,927.05
Demand Charge per Month per kW - Contract	$	6.81
Energy Charge per kWh		
For all kWh, first 425 hrs per kW of billing demand	$	.03908

For all kWh in excess of 425 hrs per kW of billing demand	$	.03750

SCHEDULE X
LARGE INDUSTRIAL RATE – LPC1-A

Customer Charge per Month	$	1,464.04
Demand Charge per Month per kW - Contract	$	6.81
Energy Charge per kWh		
For all kWh, first 425 hrs per kW of billing demand	$	.04146
For all kWh in excess of 425 hrs per kW of billing demand	$	.03872

SCHEDULE XI
LARGE INDUSTRIAL RATE – LPB1

Customer Charge per Month	$	1,464.04
Demand Charge per Month per kW - Contract	$	6.81
Demand Charge per Month per kW - Excess	$	9.47
Energy Charge per kWh		
For all kWh, first 425 hrs per kW of billing demand	$	.04383
For all kWh in excess of 425 hrs per kW of billing demand	$	.03975

SCHEDULE XII
LARGE INDUSTRIAL RATE – LPB1-A

Customer Charge per Month	$	1,464.04
Demand Charge per Month per kW - Contract	$	6.81
Demand Charge per Month per kW - Excess	$	9.47
Energy Charge per kWh		
For all kWh, first 425 hrs per kW of billing demand	$	.04146
For all kWh in excess of 425 hrs per kW of billing demand	$	.03872

SCHEDULE XIII
LARGE INDUSTRIAL RATE – LPB2

Customer Charge per Month	$	2,927.05
Demand Charge per Month per kW - Contract	$	6.81
Demand Charge per Month per kW - Excess	$	9.47
Energy Charge per kWh		
For all kWh, first 425 hrs per kW of billing demand	$	.03908
For all kWh in excess of 425 hrs per kW of billing demand	$	.03750

SCHEDULE XIV
LARGE INDUSTRIAL RATE – LPB

Customer Charge per Month	$	1,464.04
Demand Charge per Month per kW - Contract	$	6.81

Demand Charge per Month per kW - Excess	$	9.47
Energy Charge per kWh	$	.04537

SCHEDULE 1B
FARM AND HOME – TIME OF DAY

Customer Charge per Month	$	17.69
On-Peak Energy Charge per kWh	$	.094950
Off-Peak Energy Charge per kWh	$	.049244

SCHEDULE 1C
SMALL COMMERCIAL – TIME OF DAY

Customer Charge per Month	$	23.58
On-Peak Energy Charge per kWh	$	.091450
Off-Peak Energy Charge per kWh	$	.049244

SCHEDULE 2A
LARGE POWER – TIME OF DAY

Customer Charge per Month	$	59.00
On-Peak Energy Charge per kWh	$	.095320
Off-Peak Energy Charge per kWh	$	.053543

NONRECURRING CHARGES

Return Check	$	25.00
Collection	$	30.00
Disconnect	$	60.00
Meter Test	$	50.00
Overtime	$	80.00

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