

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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COMMISSION

In the Matter of:

ADJUSTMENT OF RATES)
OF CUMBERLAND VALLEY) CASE NO. 2005-00187
ELECTRIC, INC.)

BRIEF

* * * * *

Comes now the Petitioner, Cumberland Valley Electric, Inc., (hereinafter referred to as "CVE") and for its brief in support of its application to change its retail electric power rates submits the following:

INTRODUCTION

CVE has filed an application to request permission from the Commonwealth of Kentucky Public Service Commission (hereinafter referred to as "Commission") to increase its basic rates effective for all electricity sold. This matter was originally on track to be scheduled for a hearing in November of 2005. The Attorney General of the Commonwealth of Kentucky (hereinafter referred to as "Attorney General") sought from the Commission the right to take the depositions of certain employees of CVE on December 19 and 20, 2005. The Commission then issued subpoenas for the following employees of CVE: Joe Carroll, Robert Tolliver, Teresa Gregory, Donald Lynch, Randall Campbell, Kermit Creech, John Ferguson, Dave Taylor, Denise Hart and William McQuen. The Attorney General then requested second amended Emergency Motion requesting additional subpoenas. The Commission issued subpoenas for the following:

Fred Bays, Jr., Mike Baird, Kenneth Wayne Bryant, Ernest Depan, Robert Prevatte and Mary Herren. On February 3, 2006, the Commission entered an Order placing CVE's proposed rates into effect. On March 14, 2006, the Commission entered an Order scheduling this matter for hearing on April 11, 2006. On April 4, 2006, the Commission granted the Attorney General's motion to issue subpoenas for the April 11, 2006 hearing. Subpoenas were issued for Joe Carroll, Drucilla Foley, Robert Tolliver and Teresa Williams. At the April 11, 2006 hearing, evidence and testimony was presented on behalf on CVE and the Attorney General's Office. The only subpoenaed witnesses who appeared at the hearing were Joe Carroll, Robert Tolliver and Teresa Williams. Of the three, the only subpoenaed witness called to testify by the Attorney General was Robert Tolliver.

ISSUES

I. DETERMINATION OF MARGINS ASSOCIATED WITH THE ADJUSTMENT FOR TEST YEAR END NUMBER OF CONSUMERS FOR RATE SCHEDULE IV-A.

Cumberland Valley Electric, Inc. ("CVE") conducts an annual review of its consumers to determine if consumers are classified in the proper rate class. This annual review is normally conducted near the end of a calendar year. During the test year of 2004, several consumers were changed to Rate Schedule IV-A from Rate II and were billed on the basis of Rate Schedule IV-A for the month of December. It should be noted that Rate Schedule II includes consumers with demands of 0 to 50 kW while Rate Schedule IV-A includes consumers with demands of 50 kW to 2500 kW. James Adkins testified at

the hearing (Hearing transcript, pages 61-64) that the development of an adjustment for the test year end number of consumers with only one month of information for these reclassified consumers would be distorted. The reason for this distortion is because these newly reclassified consumers have demands significantly less than the average demand for consumers in Rate Schedule IV-A. Attached as Exhibit A to this Brief is the actual billing data for Rate Schedule IV-A for 2005, the calendar year after the test year. This exhibit indicates a substantial decrease in the demand and the energy using 2005 billing data from what has been presented Item 5a, page 3 of 4 in the PSC Staff Request No. 2. The demand estimate decreases from 337.5 MW to 318.3 MW while energy decreases from 110,944,386 kWh to 98,502,783 kWh. These changes are significant and would decrease the margins estimate from the amount of \$172,715 to \$97,655. This change in margins is most important because it may change the revenue requirements by the same amount as this change. It should be noted that CVE did not have this 2005 billing data during the preparation of this rate application. CVE determined during the preparation of this rate application that an adjustment for Rate Schedule IV-A would not be made as it would be speculative without more data.

II. INTEREST EXPENSES.

Interest rates have been rising since the end of CVE's test year of 2004. CVE probably chose the low point in the interest rate cycle as its test year end which led to a very low interest expense in the development of its revenue requirements. The interest expense amount used in this rate application in the development of the revenue requirements was \$1,015,090. Presented in Exhibit B to this Brief is the application of current rates

(April 11, 2006) for these types of loans applied the amount of debt as of the end of the test year. This new annual interest amount is \$1,387,319 and represents a dramatic increase in interest rates over the test year end level of interest rates. Had the April 11, 2006 interest rates had been in effect at test year end, CVE would have requested an additional increase in revenue requirements by \$372,229. This increase in interest rates would also have caused an additional impact. This additional impact would have been in the form of an increase in the requested margins by \$372,229. The additional margins requirement is based on CVE's request for margins based on a Times Interest Earned Ratio ("TIER") of 2.0X. A TIER of 2.0X means that margins would be equal to the interest expense request. Therefore, a one dollar increase in interest expense equates to a two dollar increase in revenue requirements. In this situation, CVE would have increased its requested rate increase by \$744,458 which is over one half of CVE's requested increase in this application. Mr. Adkins attempted to bring out these facts at the hearing (Hearing transcript, pages 24 & 66).

III. ADJUSTMENT FOR SALARIES AND WAGES AND FOR EMPLOYEE BENEFITS.

The process that CVE used in the adjustment of salaries and wages was to determine the base annual payroll costs for all employees employed as of the end of the test year and based upon the wages in effect at that time. It should be noted that one employee, a new engineer, had been hired at test year end but did not begin work until the first business day of 2005. The actual overtime experience for the test year was applied to the test year wage rates to determine the overtime amount overtime payroll. Base

payroll plus overtime payroll equals total payroll. The actual total payroll expenses for the test year of 2004 are subtracted from this normalized total payroll expense. The change in payroll expense totals is then allocated to expense, construction, clearing accounts, etc. based on the actual experience for the test year. The expense amount is the amount used to determine revenue requirements. CVE also developed its adjustment for employee benefits in a similar manner. Benefit costs and rates effective at the end of the test year or at the beginning of 2005 were applied to appropriate CVE data for normalized payroll costs or number of employees to determine the annual benefit costs. The actual benefit costs for 2004 were subtracted from the normalized amount to find the change in amounts with appropriate allocations to expense, construction, clearing accounts, etc. The amount for expense is the amount used in the determination of revenue requirements. For this rate application, the adjustment for employee benefits resulted in a decrease in revenue requirements. Mr. Adkins testified to this process at the hearing. This process is much more appropriate than using some type of average based on some experience from calendar years prior to the test year. This approach is more appropriate as it relies on actual data for the test year and rather than on manufactured data. (Hearing transcript, pages 32-37).

IV. ADJUSTMENT FOR PROPERTY TAXES.

Mr. Adkins testified (Hearing transcript, pages 30-31) that he was in agreement with the new adjustment amount for property taxes since the original calculation did not contain all necessary data.

V. RATE DESIGN.

The ETS rate and its costs for Rate Schedules I and II can be developed on the basis of more than one approach. The approach presented by CVE in this application is based on a marginal cost approach in the cost of service study and a rate equal to sixty (60) percent of the base energy rates in Rate Schedules I and II has been proposed. This approach is basically the approach originally approved by the Commission in the late 1980s as testified to by Mr. Adkins (Hearing transcript, pages 54-57). A rate based on an approach more representative of a fully allocated cost approach has been developed by Mr. Adkins in response to an interrogatory question from the Attorney General (Hearing transcript, page 59). The Attorney General's expert witness, Mr. David Brown-Kinloch has recommended that the rate resulting from this fully allocated cost approach be approved by this Commission. CVE concurs with this rate recommendation of the Attorney General's expert witness and fully recommends the approach used in the development of this rate. CVE fully understands that this recommendation is a change in the ETS program as originally developed in the 1980s but the change is fully warranted because it allows for the ETS rate to be based on a better estimate of the cost to serve.

VI. MANAGEMENT ISSUES.

As the Commission is aware, the Attorney General took the depositions of former and present employees of CVE prior to the hearing held on April 11, 2006. The focus of those depositions was that of the management practices of CVE. At the hearing,

questions were asked of Mr. Ted Hampton, CVE's Manager, again regarding this topic (Hearing transcript, pages 76-119). There was no evidence produced which would indicate an increased cost on the part of CVE which would affect the requested rate increase. In fact, Mr. Hampton testified that this was the first requested rate increase since 1980 and that CVE had the lowest rates, on a 1,000 kilowatt hour basis, of any electric cooperative in the Commonwealth of Kentucky (Transcript of Evidence, pages 125-126 and see attached Exhibit C, a comparison of Residential Electric Bills as of 07/01/05 prepared by the Commission).

Presuming the hearing in this matter would have taken place in November of 2005, CVE could well have had its new rates in effect on or about January 1, 2006. The delay in scheduling the hearing until April 11, 2006 has cost CVE lost rate income in the amount of \$192,000.00.

CONCLUSION

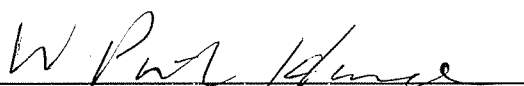
It is abundantly clear that some changes in revenue requirements would be made if this rate application were prepared with the knowledge we have today in regards to new information due to the passage of time and to newly discovered information after the original filing of this application in late July, 2005. There would be a decrease in revenue requirements as a result of the adjustment for test year end number of consumers applied to all rate classes and that exact number or amount is subject to argument. Developing this adjustment for Rate Schedule IV-A in the normal manner would significantly overstate the amount of margins. The use of data for some period of time may be appropriate. Changes might also be made to the wages and

salaries and to the employee benefit adjustments resulting in some change to revenue requirements. The same can also be said for the adjustment to property taxes as the adjustment amount for it would change due to new information. However, it is with interest rate changes where the most significant difference exists from the original application. If CVE could use current day interest rates applied to test year end debt, then its rate increase request would have been increased by an almost \$750,000. Even with all other needed changes and any other possible recommended changes, the interest rate changes of record indicate that CVE should be granted an increase amount substantially greater than requested. However, since that is an impossibility, CVE should be granted the full amount of its initial request of \$1,394,876.00 as a basis for its requested rate increase.

Respectfully submitted,

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CERTIFICATE OF SERVICE

Counsel certifies that an original and ten photocopies of the Brief was served by hand-delivery to Beth O'Donnell, Executive Director, Public Service Commission, 211 Sower Boulevard, Frankfort, Kentucky 40601; furthermore, it was served by mailing a true and correct copy of the same, first class postage prepaid, to Hon. Dennis G. Howard, II, Hon. Elizabeth E. Blackford, Hon. Lawrence W. Cook, Assistant Attorneys General, 1024 Capital Center Drive, Suite 200, Frankfort, Kentucky 40601-8204, all on this 10th day of May, 2006.


W. PATRICK HAUSER
ATTORNEY AT LAW

SCHEDULE IV-A LOAD DATA FOR 2005

<u>Month</u>	<u># of Consumers</u>	<u>Demand kW</u>	<u>Energy kWh</u>
Dec-04	73		
Jan-05	73	26,655	7,419,413
February	76	26,396	8,048,459
March	76	25,288	7,268,295
April	74	26,383	8,592,019
May	74	25,882	7,653,262
June	74	27,703	8,494,369
July	74	27,102	9,636,677
August	75	27,626	8,991,545
September	77	26,909	9,620,216
October	75	27,416	7,566,198
November	75	28,456	7,772,642
December	77	30,504	9,930,781
Total	973	326,320	100,993,876
Average	75	27,193	8,416,156
Average per Average Number of Consumers		363	112,446
Test year end Number of Consumers	73.00		
Billing Quantities based on test year end number of consumers		318,271	98,502,763
Actual test year billing quantities		288,468	94,811,272
Increase in billing units		29,803	3,691,491
Rates		3.68	0.04283
Increase in revenue per billing quantity		109,675	158,107
Total increase in revenue for the rate class			267,782
Increase in wholesale power costs			170,127
Increase in margins			97,655

IMPACT OF CURRENT INTEREST RATES UPON TEST YEAR END DEBT

CURRENT INTEREST RATES ON LONG TERM DEBT

RUS DEBT				
<u>Note</u>	4/11/2006 Current Interest Rate %	12/31/2004 Balance	Annual Interest Expense	
4170	-	5,698	-	
0B180	2.00	44,789	896	
1B190	5.00	108,008	5,400	
1B200	5.00	158,861	7,943	
1B210	5.00	226,828	11,341	
1B220	5.00	261,748	13,087	
1B230	5.00	405,450	20,273	
1B240	5.00	438,935	21,947	
1B250	5.00	922,486	46,124	
1B260	5.00	835,364	41,768	
1B270	5.00	1,086,351	54,318	
1B280	5.00	2,386,813	119,341	
1B290	5.37	1,528,155	82,062	
1B295	5.00	1,518,927	75,946	
1B300	2.75	1,316,295	36,198	
H0010	4.62	3,934,456	181,772	
H0015	4.62	4,725,276	218,308	
H0020	4.62	2,200,000	101,640	
Total for RUS debt			<u>1,038,364</u>	
Loans for 2005				
H0025	Jan-05	4.62	2,000,000	
H0030	Oct-05	4.62	3,000,000	

IMPACT OF CURRENT INTEREST RATES UPON TEST YEAR END DEBT
CFC DEBT

<u>Note</u>	<u>Current Intrest Rate %</u>	<u>12/31/2004 Balance</u>	<u>Annual Interest Expense</u>
9001	7.00	20,805	1,456
9003	7.00	54,618	3,823
9004	7.00	79,554	5,569
9007	6.90	115,394	7,962
9008	6.90	129,307	8,922
9010	5.75	213,138	12,255
9012	5.90	228,160	13,461
9014	6.45	487,617	31,451
9017	6.90	433,307	29,898
9018	6.90	482,906	33,321
9019	6.90	1,003,577	69,247
9020	6.90	1,319,536	91,048
9021	6.90	587,543	40,540
Total for CFC Debt			<u><u>348,955</u></u>

Total for All Debt

Total for RUS debt	1,038,364
Total for CFC Debt	<u>348,955</u>
Total	<u><u>1,387,319</u></u>