COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF MEADE COUNTY RURAL ELECTRIC COOPERATIVE CORPORATION FOR AN ADJUSTMENT OF RATES	)))	CASE NO. 2006-00500

O R D E R

On March 27, 2007, Meade County Rural Electric Cooperative Corporation ("Meade") applied for a $1,953,112 increase in retail electric service rates. The requested increase is 7.2 percent over normalized test-year operating revenues. Meade stated that the proposed increase was required in order to maintain its financial integrity, cover operating costs, and to improve its equity to levels required by its capital management plan.

BACKGROUND

Meade is a consumer-owned rural electric cooperative corporation, organized under KRS Chapter 279, engaged in the distribution and sale of electric energy to approximately 26,900 member-consumers in the Kentucky counties of Breckinridge, Grayson, Hancock, Hardin, Meade, and Ohio. Meade has no electric generating facilities and purchases its total power requirements from Big Rivers Electric Corporation ("Big Rivers").

The Commission granted a motion to intervene filed by the Attorney General, by and through his Office for Rate Intervention ("AG"). A public hearing was conducted on August 1, 2007. All information requested during the hearings has been submitted.

TEST PERIOD

Meade proposed and the Commission has accepted the 12-month period ending October 31, 2006 as the test period for determining the reasonableness of the proposed rates. In utilizing the historical test year, the Commission has considered appropriate known and measurable changes.

VALUATION

Rate Base

Meade determined a net investment rate base of $60,249,766[1] based on the adjusted test-year-end value of plant in service and construction work in progress ("CWIP"), 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. The AG did not state a position on Meade's rate base determination.

The Commission has reviewed Meade's determination of its rate base and agrees with the calculation, with the following exceptions. The Commission has used the test-year-end balances for utility plant in service and CWIP and the operating expenses used in the working capital calculation reflect the adjustments to operating expenses discussed in this Order.

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

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

Utility Plant in Service	$77,441,864
CWIP	1,000,337
Total Utility Plant	$78,442,201
ADD:	
Materials and Supplies	$ 425,650
Prepayments	217,261
Working Capital	894,234
Subtotal	$ 1,537,145
DEDUCT:	
Accumulated Depreciation	$19,209,421
Customer Advances for Construction	603,043
Subtotal	$19,812,464
NET INVESTMENT RATE BASE	$60,166,882

Capital Structure

The Commission finds that Meade's capital structure at test-year-end for rate-making purposes was $66,095,833. This capital structure consisted of $20,744,557 in equity[2] and $45,351,276 in long-term debt.

REVENUES AND EXPENSES

Meade proposed several adjustments to revenues and expenses to reflect current and expected operating conditions. The Commission finds that nine of the adjustments proposed by Meade and not opposed by the AG are reasonable and will be accepted. These nine adjustments are set forth in detail in Appendix B.

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

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

Labor and Labor-Related Costs

Meade proposed adjustments to increase test-year operating expenses by $128,520 for labor and labor-related costs.[3]

Wages and Salaries. Meade proposed an adjustment of $168,292 to normalize total wages and salaries, of which $51,596 was capitalized[4] and $116,696 was expensed. Full-time employees were assumed to work 2,080 hours. Part-time employees were assumed to work the number of hours actually worked during the test year. Overtime was normalized utilizing the actual test-year hours of overtime at 1.5 times the test-year-end wage rates. Meade's proposed adjustment included a performance bonus at the levels awarded during the test-year.

The Commission has reviewed Meade's calculations and finds that the calculations are consistent with the approach the Commission has normally used to determine this adjustment. The Commission agrees with Meade that the performance bonus should be included for rate-making purposes, given Meade's description of the nature and purpose of the performance bonus. However, we have included the bonus level earned in 2006 and paid in February 2007[5] rather than the test-year level, as the

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[3] The proposed increase reflects two adjustments: one for wages and salaries of $116,696 and the other for payroll taxes of $11,824. See Application Exhibits F, Exhibits 1 and 2. Proposed adjustments for post-retirement benefits and the retirement plan have been accepted by the Commission, as shown in Appendix B.

[4] The capitalized portion reflects actual capitalized costs and payroll costs allocated to various clearing accounts. Unless otherwise noted, references in this Order to "capitalized" reflect this combination of actual capitalized costs and allocations to various clearing accounts.

[5] Meade's Response to Public Hearing Information Request filed August 21, 2007, Item 4.

February payment reflects the on-going level of this cost. The Commission has recalculated the adjustment, and after applying the test-year capitalization rate of 30.66 percent, finds that an adjustment to increase test-year operating expenses by $100,006 is reasonable.

Payroll Taxes. Meade proposed to increase its payroll taxes by $17,039, based on the proposed normalization of wages and salaries and the reflection of the Federal Insurance Contribution Act ("FICA") base wage limit of $94,200 at the test-year end. Of this amount, $5,215 was capitalized and $11,824 was expensed.[6]

The Commission has recalculated this adjustment, based on the level of normalized wages and salaries found reasonable and the current FICA base wage limit of $97,500. This results in an increase in test-year payroll taxes of $15,270. After applying the test-year capitalization rate of 30.66 percent, the increase to test-year payroll tax expense would be $10,588.

Professional Services Expenses

Meade proposed to remove $3,758 in professional services expenses for items not normally included for rate-making purposes and certain non-recurring items. The AG proposed to reduce Meade's professional services expenses by an additional $1,896 by removing the expense paid to Meade's attorney to attend the National Rural Electric Cooperative Association ("NRECA") annual meeting. The AG argued that the expense for Meade's attorney to attend the NRECA annual meeting should be excluded

[6] Application Exhibit 2, page 1 of 4. Payroll taxes include FICA, Medicare, and Federal and State Unemployment.

for rate-making purposes, as this was consistent with the Commission's treatment of these items in previous cases.[7]

Meade acknowledged that the Commission has normally excluded expenses paid to cooperative attorneys to attend the NRECA annual meeting. However, Meade argued that the attorney's attendance at these meetings was necessary and provided the opportunity for the attorney to become better educated on legal matters pertaining to cooperatives.[8]

The Commission agrees with Meade's initial adjustment and the AG's further adjustment. The Commission is not persuaded by Meade's argument that the attorney's attendance at NRECA annual meetings is necessary. In addition, the Commission has reviewed the professional expenses and determined that the magazine subscription for the attorney should also be excluded. Therefore, the Commission will reduce Meade's operating expenses by $5,695.

Directors' Fees and Expenses

During the test year Meade paid its seven directors fees and expenses totaling $88,915. Meade proposed adjustments to reduce this expense by $7,807, to exclude certain expenses for rate-making purposes.[9]

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[7] AG's Post Hearing Brief at 1.

[8] Response to the AG's First Data Request dated April 20, 2007, Item 3.

[9] Application Exhibit 10. The $7,807 adjustment was comprised of life insurance premiums, awards and gifts, Kentucky Association of Electric Cooperatives ("KAEC") annual meeting expenses for directors who were not the delegate or alternate delegate, and a per diem for the KAEC delegate to the annual meeting.

The Commission agrees with the exclusions identified by Meade. In addition, the Commission has identified further adjustments that should be made to the directors' fees and expenses. Several directors other than Meade's delegate or alternate delegate attended the NRECA annual meeting or the Region III meeting. In previous distribution cooperative rate cases, the Commission has excluded the expenses associated with directors attending these meetings who were not the delegate or alternate delegate. Meade has not persuaded the Commission a different approach should be applied in this case. The Commission has determined that an additional $7,147 should be excluded for rate-making purposes.

Based on these findings, the Commission has reduced Meade's operating expenses by $14,954.

Miscellaneous Expenses

Meade proposed to exclude $16,590 in miscellaneous expenses for items the Commission normally has not included for rate-making purposes.[10] The Commission agrees with the exclusions identified by Meade. The Commission has also identified three additional expenses that should be excluded for rate-making purposes.

First, an additional sponsorship was identified which Meade agreed should be removed.[11] Second, during the test year, Meade sent an employee to the NRECA annual meeting and did not indicate why it was reasonable or necessary for the employee to attend. Meade justified including this expense by stating it believed it was

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[10] Application Exhibit 11. These expenses included promotional advertising, sponsorships, employee picnic, retirement gifts, and nominating committee expenses.

[11] Response to the Commission Staff's Second Data Request dated April 24, 2007, Item 15(c).

a legitimate expense for rate-making purposes. The Commission disagrees and believes that Meade's justification does not adequately support the inclusion of these expenses for rate-making purposes. Third, test-year expenses for a pair of conferences included sessions associated with Touchstone Energy.[12] The Commission has in previous distribution cooperative rate cases excluded expenses associated with Touchstone Energy for rate-making purposes, and Meade agreed these expenses should be excluded.[13]

Based on these findings, the Commission has reduced Meade's operating expenses by $18,856.[14]

Rate Case Expense

Meade estimated its rate case expense at $27,000. It proposed to recover this expense through a 3-year amortization. This estimate did not include in-house labor. Throughout this proceeding, Meade has been providing updates of the actual expenses incurred in presenting this rate case. As of August 21, 2007, Meade has expended $29,902 for this rate case. The Commission finds that a 3-year amortization of these expenses is reasonable and will allow an increase in operating expense of $9,967 to reflect the first year of the amortization for rate-making purposes.

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[12] Touchstone Energy is a national organization established by rural electric cooperatives to develop a national brand identity for marketing purposes.

[13] Response to the Commission Staff's Third Data Request dated May 21, 2007, Item 6.

[14] The reduction includes Meade's proposed reduction plus an additional $2,266 for the three additional types of expenses. The Touchstone Energy portion of the adjustment is based on comparing the program topics associated with Touchstone Energy with the total of all program topics.

Pole Attachment Rates

Meade proposed increases in its cable television attachment charges ("CATV") that resulted in additional revenues of $11,514. In response to a hearing data request, Meade revised its CATV rates reflecting a revised rate of return and carrying charge. The Commission has reviewed the approach used by Meade to determine its CATV rates and finds it to be consistent with previous Commission decisions and is reasonable. The Commission believes that the CATV rate calculations should reflect the most current rate of return and carrying charge. Therefore, the Commission finds that Meade's CATV rates should be recalculated reflecting the rate of return and carrying charge approved in this Order, resulting in an increase in revenues of $15,472.

PSC Assessment

Meade did not propose an adjustment to its PSC Assessment to reflect the effects of its normalization of revenues and purchase power expense or the impact of its proposed revenue increase.

The Commission has calculated an adjustment to the PSC Assessment that reflects the normalization of revenue and purchase power found reasonable in this Order and applied the current PSC Assessment rate. This calculation results in an increase in the PSC Assessment of $1,630.

Maintenance of Overhead Lines

In his post-hearing brief, the AG proposed a reduction to maintenance of overhead lines expense of $128,220, reflecting a 5-year average of the expense level for this account. The AG noted that the test-year level of maintenance expense was significantly greater than the previous 12-month period. After examining the maintenance expense levels for the previous 5 years, the AG argued that a 5-year average of the maintenance expense was appropriate.[15]

Meade disagreed with the AG's proposed adjustment. Meade contended that a 3-year average may be more appropriate than a 5-year average. Meade noted that the AG's proposed adjustment did not recognize increased right-of-way maintenance costs that were being experienced by it and other utilities. Meade stated that the AG had selectively chosen an account with an increase while ignoring expense accounts experiencing decreases. Meade argued that the proper way to view distribution operation and maintenance ("O&M") expenses was in total and not on a piecemeal basis.[16]

The Commission disagrees with Meade's position that O&M expenses should be examined in total only. In previous electric cooperative rate cases, the Commission has consistently examined individual O&M expense accounts to determine the level of expenses that should be included for rate-making purposes. The Commission also disagrees with the AG's proposal to substitute the test-year actual maintenance expense with an arbitrary 5-year average of expense levels. The AG's reliance on a simple mathematic average to determine the reasonable, on-going level of maintenance expense is not consistent with the Commission's treatment of O&M expenses in previous electric cooperative rate cases.

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[15] AG's Post-Hearing Brief at 2.

[16] Meade's Brief at 3-4.

The Commission notes that during the test year more of Meade's labor costs were expensed than in the previous period,[17] and labor expenses are allocated to the various O&M expense accounts as required by the Rural Utilities Service Uniform System of Accounts. Meade had noted that part of the test-year increase in this expense account was due to more employee time being recorded to this account. Based on these factors, the Commission finds that the test-year level of maintenance expense is reasonable and that the AG's proposal should be rejected.

Office Supplies and Expenses

In his post-hearing brief, the AG proposed a reduction to office supplies and expenses of $20,706, reflecting a 5-year average of the expense level for this account. The AG noted Meade's acknowledgement that the "purchasing patterns reflects irregular purchases." Given Meade's agreement that these expenses were expected to continue fluctuating in the future, the AG contended that an expense level based on the 5-year average expense level was appropriate for rate-making purposes.[18]

Meade opposed using the 5-year averaging approach and noted "as all areas increase, your cost of purchasing will also increase, with fuel and anything else that your suppliers decide to pass on to you, and you don't know that at this point."[19] Meade also stated that this expense would continue to increase due to increases in paper costs, postage, and the number of customers and the information delivered to them.[20]

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[17] Application Exhibit 1, page 1 of 8.

[18] AG's Post-Hearing Brief at 1-2.

[19] Transcript of Evidence ("T.E."), August 1, 2007, at 32.

[20] Response to the AG's First Data Request dated April 20, 2007, Item 5.

As previously noted, the AG's reliance on a simple mathematic average to determine the reasonable, on-going level of office supplies and expenses is not consistent with the Commission's treatment of O&M expenses in previous electric cooperative rate cases. The types of expense changes noted by Meade are valid reasons for the fluctuation and increase in the overall level of expense for this account. Therefore, the Commission finds the test-year actual level of office supplies and expenses should be included for rate-making purposes and the AG's proposed adjustment should be rejected.

Pro Forma Adjustments Summary

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

	Actual Test Period	Pro Forma Adjustments	Adjusted Test Period
Operating Revenues	$27,490,406	$ 661,957	$28,152,363
Operating Expenses	25,228,035	839,483	26,067,518
Net Operating Income	2,262,371	(177,526)	2,084,845
Interest on Long-Term Debt	1,962,294	225,799	2,188,093
Other Income and (Deductions) – Net	316,738	72,056	388,794
NET INCOME	$ 616,815	$ (331,269)	$ 285,546

REVENUE REQUIREMENTS

The actual rate of return earned on Meade's net investment rate base established for the test year was 4.28 percent. Meade requested rates that would result in a Times Interest Earned Ratio ("TIER") excluding GTCCs of 2.00X and a rate of return of 7.26 percent on its proposed rate base of $60,249,766.[21] Meade proposes an increase in revenues of $1,953,112 to achieve the 2.00X TIER excluding GTCCs.

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

Meade's actual TIER excluding GTCCs for the test period was 1.31X. For the calendar years 2004 and 2005, it was 1.93X and 1.71X, respectively. After taking into consideration pro forma adjustments, Meade would achieve a 1.13X TIER excluding GTCCs without an increase in revenues. Meade's equity to total capitalization ratio is 31.39 percent based on the approved capital structure.

Meade proposed that a 2.00X TIER be used to determine its revenue requirement and the AG offered no position on the use of the 2.00X. The Commission finds that the use of a 2.00X TIER is reasonable for Meade. In order to achieve the 2.00X TIER, Meade would need to increase its annual revenues by $1,905,793. This increase includes an additional $3,166 to reflect the associated increase needed for Meade's PSC Assessment.

Based upon the pro forma adjustments found reasonable, the Commission has determined that an increase in Meade's revenues of $1,905,793 would result in a TIER of 2.00X. The additional revenue should produce net operating income of $3,987,472, and based on the net investment rate base found reasonable of $60,166,882, result in a rate of return on rate base of 6.63 percent. The additional revenue should also produce net income of $2,188,173, which should allow Meade to meet its mortgage requirements and service its mortgage debts.

PRICING AND TARIFF ISSUES

Cost of Service

Meade filed a fully allocated, embedded cost-of-service-study ("COSS") in order to determine the contribution that each customer class was making toward its overall rate of return and as an indicator of whether its rates reflect the cost to serve each customer class. Meade's COSS indicates that two rate classes, Schedule 1 applied to residential, farm, non-farm, school and church customers and Schedule 2, applied to commercial customers, produce revenues insufficient to meet their revenue requirements. The AG did not file any testimony and did not address the COSS in his post-hearing brief. The Commission finds the methodology is consistent with that approved in the past, is reasonable and should be approved.

Revenue Allocation and Rate Design

Meade has proposed electric rates that will generate an additional $1,953,112 in revenues. It proposes to allocate the increase to Schedule 1 and Schedule 2. The AG did not file testimony and did not address the allocation issue in his post hearing brief. The Commission finds that the proposed allocation is reasonable and that it should be approved.

Tariff Changes

Meade has proposed two additional tariffs: 1) a "Helping Hand" Fund and 2) a provision allowing receipt of customer bills by electronic mail. The "Helping Hand Fund" allows a cooperative member to round up their monthly payment to the next highest dollar amount, with the funds used to help families and communities throughout the cooperative. All Meade customers are given the opportunity to make voluntary contributions to the Helping Hand Fund. This contribution will be included on the monthly billing statement. The amount rounded up is not subject to disconnection or service for non-payment. Members may participate in the program by notifying Meade. The electronic mail provision provides customers with another way of receiving their bills, with customers choosing electronic bills not receiving a paper bill. Customers will still receive a paper notice for disconnection and action.

The AG did not raise any objection to Meade's proposal in its post hearing brief. The Commission finds that the new tariffs are reasonable and should be approved.

OTHER ISSUES

Hardinsburg Office Building

Between August 2005 and May 2006, Meade demolished an existing branch office building in Hardinsburg and constructed a new office building on the same site. The new building has 7,410 square feet and the total cost of the new building, exclusive of the land, was $1,133,136. As a result of the construction of the new branch office building in Hardinsburg, Meade consolidated and closed a branch facility in Fordsville.

Meade did not seek a certificate of public convenience and necessity ("CPCN") for the new Hardinsburg office building. Based upon its review of the Commission's Order in Case No. 2003-00403,[22] Meade concluded that the construction of the new office building was in the ordinary course of business and a CPCN was not necessary.[23]

The Commission has reviewed the April 15, 2007 Order in Case No. 2003-00403 and notes differences between the circumstances in that case and those associated with the Hardinsburg office building. The branch offices proposed to be built by Kenergy Corporation ("Kenergy") were significantly smaller than the Hardinsburg

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[22] Case No. 2003-00403, Application of Kenergy Corporation for a Certificate of Convenience and Necessity to Construct New Branch Offices in Hartford and Hanson, final Order dated April 15, 2004.

[23] T.E., August 1, 2007, at 22-24.

building. The total cost of the Hardinsburg building was significantly more than the two Kenergy buildings combined.

The Commission has reviewed Meade's construction of the Hardinsburg office building and the costs associated therewith, and finds that the costs are reasonable and should be included for rate-making purposes. However, it is evident to the Commission from the facts of the cited Kenergy case and the construction subject to review herein, that there is still confusion among jurisdictional utilities as to whether or not a CPCN is necessary when constructing a headquarters or branch office buildings. Therefore, the Commission places Meade and all other jurisdictional utilities on notice that when considering the construction of a headquarters or branch office building, the utility should also consider requesting a staff opinion as to the need for a CPCN prior to commencing the construction of the building.

Effective Date

During the public hearing Meade requested that the effective date for its new rates be timed so as to minimize the need for pro rating its billing cycles.[24] In response to a hearing data request, Meade provided its billing cycle dates.[25] Based upon the information provided concerning Meade's billing cycles, an effective date of December 24, 2007 would correspond with the beginning of two of Meade's four billing cycles. Therefore, the Commission finds that the rates approved and set forth in Appendix A to this Order should be effective for service rendered on and after December 24, 2007.

[24] T.E., August 1, 2007, at 71-75.

[25] Meade's Response to Public Hearing Information Request filed August 21, 2007, Item 7.

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 Meade to charge for service rendered on and after December 24, 2007.

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

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

IT IS THEREFORE ORDERED that:

1. The rates in Appendix A are approved for service rendered by Meade on and after December 24, 2007.

2. Within 30 days from the date of this Order, Meade shall file its revised tariff sheets setting out the rates approved herein.

Done at Frankfort, Kentucky, this 19th day of December, 2007.

By the Commission

ATTEST:

Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2006-00500 DATED December 19, 2007

The following rates and charges are prescribed for the customers served by Meade County Rural Electric Cooperative Corporation. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of this Commission prior to the effective date of this Order.

Schedule 1, Residential, Farm and Non-Farm, Schools & Churches

Customer Charge	$ 9.85
Energy Charge	$00.06001

Schedule 2, Commercial Rate

Customer Charge	$ 13.24
Energy Charge	$ 00.05838

Cable Television Attachment Charges

2 Party Pole Attachments	$7.21
3 Party Pole Attachments	$5.98
Grounding Attachments	$00.27
Pedestal Attachments	$00.17
2 Party Anchor Attachments	$5.67
3 Party Anchor Attachments	$3.74

APPENDIX B

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2006-00500 DATED December 19, 2007

SCHEDULE OF ADJUSTMENTS

The following adjustments were proposed by Meade in its application, and have been found reasonable and accepted by the Commission. The "+" indicates an increase while "-" indicates a decrease.

	Description	Application Reference Exhibit S	Change to Revenues	Change to Expenses
1.	Normalize Depreciation Expense	Exhibit 3	0	+$129,058
2.	Normalize Property Taxes	Exhibit 4	0	+$51,526
3.	Normalize Interest Expense On Long-Term Debt	Exhibit 5	0	+$225,799
4.	Adjustment to Post-Retirement Benefits Expense	Exhibit 6	0	+$14,269
5.	Adjustment to Retirement Plan Expenses	Exhibit 7	0	+$29,954
6.	Remove Donations	Exhibit 8	0	-$22,919
7.	Remove Revenues and Expenses Associated With Non-Regulated Activities	Exhibit 13	-$176,099	-$225,236
8.	Remove Effects of Big Rivers Discount Adjustment from Revenues and Expenses	Exhibits 15 & 16	+$559,249	+$530,055
9.	Year-End Customer Adjustment	Exhibit 17	+$201,730	+$114,494