COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF INTER-COUNTY ENERGY COOPERATIVE CORPORATION FOR A GENERAL ADJUSTMENT OF EXISTING RATES	))))	CASE NO. 2018-00129

ORDER

On May 29, 2018, Inter-County Energy Cooperative Corporation (Inter-County Energy) filed an application seeking approval for a proposed increase in its base electric rates and to create a regulatory asset for expenses arising from storm damage. Inter-County Energy's application proposed that its new rates go into effect June 24, 2018.[1] By Order dated June 13, 2018, the Commission determined that the earliest that Inter-County Energy's proposed rates can become effective was June 28, 2018. The June 13, 2018 Order also suspended the proposed effective date for five months, up to and including November 27, 2018. The June 13, 2018 Order further established a procedural schedule for the processing of this matter, providing for, among other things, a deadline for intervention requests and two rounds of discovery upon Inter-County Energy's application.

On July 13, 2018, Inter-County Energy filed a motion seeking a deviation from the notice requirements of 807 KAR 5:001, Section 17. As a basis for the deviation request, Inter-County Energy discovered that it had failed to provide notice to all of its customers

[1] Inter-County Energy's revised tariffs; however, indicate a proposed effective date of June 28, 2018.

while preparing the proof of publication for this matter. Inter-County Energy stated that customer notice had not been printed in the June edition of the *Kentucky Living* magazine but would be printed in the August edition, which would be mailed to customers on or about July 28, 2018.[2] Inter-County Energy indicated in its motion that it would not oppose a 60-day extension of the suspension period to be placed into effect, based on the approximate 60-day delay in providing proper customer notice, if the Commission were to grant the deviation.

On August 28, 2018, the Commission issued an Order granting in part and denying in part Inter-County Energy's motion for a deviation. Among other things, the August 28, 2018 Order found that Inter-County Energy's application should not have been accepted for filing until July 27, 2018, the date when the customer notice was properly published. The August 28, 2018 Order also determined that the proposed rates should be suspended until January 25, 2019. Thus, the initial suspension deadline of November 27, 2018, was changed to January 25, 2019.

There are no intervenors in this matter. Inter-County Energy responded to four rounds of requests for information from Commission Staff and provided written responses to inquiries made by Commission Staff at an informal conference on October 24, 2018. On September 11, 2018, Inter-County Energy filed a motion requesting that this matter be decided on the written record and arguing that there had been no interveners and that the record had been sufficiently developed through its responses to written requests for information. Having reviewed the record and being otherwise sufficiently advised, the Commission finds that a public hearing is not necessary for the public interest or for the

[2] The customer notice in the *Kentucky Living* magazine was published on July 27, 2018. *See* Affidavit of Publication (filed August 6, 2018).

protection of substantial rights, and therefore, this matter is before the Commission on the evidentiary record.

BACKGROUND

Inter-County Energy is a member-owned rural electric cooperative corporation, organized under KRS Chapter 279. It is engaged in the distribution and sale of electric energy to 26,245 member-consumers in Boyle, Casey, Garrard, Larue, Lincoln, Madison, Marion, Mercer, Nelson, Rockcastle, Taylor, and Washington counties, Kentucky.[3] Inter-County Energy does not own any electric generating facilities but purchases its total power requirements from East Kentucky Power Cooperative, Inc.[4] Inter-County Energy's last general rate adjustment was filed in 2006,[5] and its existing general rates went into effect on May 31, 2007.[6]

Inter-County Energy indicated that since its last rate case inflationary pressures, competition for skilled workers, and other factors have combined to increase its costs of doing business. Inter-County Energy asserted that those increased costs have made it impossible to satisfy its targeted financial metrics despite its cost reduction efforts.[7] Specifically, Inter-County Energy determined that it had a Times Interest Earned Ratio (TIER) of 1.06 in 2016 and 0.187 in 2017. For the test year, the TIER, including proposed

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[3] Annual Report of Inter-County Energy Rural Electric Cooperative Corporation to the Public Service Commission of the Commonwealth of Kentucky for the Calendar Year Ended December 31, 2017 (filed Mar. 29, 2018), at 44 and 52.

[4] *Id.* at 39 and 42.

[5] Case No. 2006-00415, *Application of Inter-County Energy Cooperative for an Adjustment in Rates* (Ky. PSC May 31, 2007).

[6] Application at paragraph 4.

[7] *Id.*

pro forma adjustments, is calculated to be 0.110. Inter-County Energy noted that its lenders require it to maintain a TIER of 1.25 for two of the last three years.[8] Inter-County Energy requested a rate increase based on a TIER of 2.0 and argued that a TIER of 2.0 was reasonable because it would allow it to maintain the margin required by its lenders and to improve its equity position, which is currently below federal and state averages for electric cooperatives.[9]

Inter-County Energy calculated its proposed rate increase based on a test year ending October 31, 2017, with pro forma adjustments for known and measurable changes. Excluding long-term interest expense, as it is included in the margin requirement, Inter-County Energy calculated its actual operating expenses in the test year to be $46,358,106 and pro forma operating expense to be $43,260,940.[10] Based on the proposed pro forma operating expenses and a proposed TIER of 2.0, Inter-County Energy calculated its margin requirement to be $3,243,388.[11] Inter-County Energy calculated its actual operating revenue in the test year to be $45,911,450 and its pro forma operating revenue to be $43,305,860.[12] Thus, Inter-County Energy determined that it required a $3,198,468 increase in operating revenue, or $46,504,328 in total revenue, to achieve its proposed TIER of 2.0.[13]

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[8] Application, Exhibit 9, Direct Testimony of Sheree Gilliam (Gilliam Testimony) at 16.

[9] Application, Exhibit 11, Direct Testimony of Lance Schafer (Schafer Testimony) at 14–16.

[10] *Id.* at 12–13.

[11] *Id.* at 17.

[12] *Id.* at 13.

[13] *Id.* at 17.

TEST PERIOD

Inter-County Energy proposed, and the Commission accepts, a historical 12-month period ended October 31, 2017, as the test period for determining the reasonableness of the proposed rates. In utilizing the historical test year, the Commission considers appropriate known and measurable changes.

VALUATION

Inter-County Energy determined a net investment rate base of $92,376,455 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, plus a cash working capital allowance, minus the adjusted accumulated depreciation and the test-year-end level of customer advances for construction (Customer Advances).[14]

The Commission concurs with Inter-County Energy's proposed rate base with the exception that working capital is to be adjusted to reflect adjustments to operation and maintenance expenses as discussed below. With this adjustment, Inter-County Energy's net investment rate base for ratemaking purposes is as follows:

Utility Plant in Service	$ 127,572,796
Total Utility Plant	127,572,796
Add:	
Materials & Supplies	429,551
Prepayments	423,045
Cash Working Capital	1,239,807
Total Additions	129,665,199
Deduct:	
Accumulated Depreciation	(37,307,669)
Other Deferred Credits	(9,695)

[14] Inter-County Energy's Response to Commission Staff's First Request for Information (Response to Staff's First Request), Item 2.

Total Deductions:	(37,317,364)
Net Investment Rate Base	$ 92,347,385

REVENUE AND EXPENSES

Inter-County Energy proposed 14 adjustments to normalize its test-year operating revenues and expenses based upon Commission practice and precedent. The Commission finds that the adjustments proposed by Inter-County Energy, which result in a net reduction to its test-year operating expenses, are reasonable and should be accepted without change. The adjustments are shown in the following table:

Payroll Expense	$(50,423)
Retirement Plan & 401(k)	$9,825
Depreciation	$54,209
Property Taxes	$18,068
Interest Expense	$64,729
Donations, Promotional Advertising & Dues	$(5,930)
Professional Services	$(28,478)
Directors Fees	$(144,958)
Miscellaneous Expenses	$(13,658)
GTCC	$(2,283,094)
Purchased Power	$(2,994,554)
Fuel Adjustment Clause	$2,316,863
Environmental Surcharge	$(4,354,674)
Year-End Customers	$(567,778)

In addition to these adjustments, the Commission also finds that additional adjustments discussed below should be made.

REVENUE REQUIREMENT

The revenue requirement for rural electric cooperatives is generally determined by taking the sum of their reasonable operating expenses and a reasonable margin requirement during a historical test period adjusted for known and measurable changes.[15]

[15] *See e.g.* Case No. 2016-00367, *Application of Nolin Rural Electric Cooperative Corporation for a General Rate Increase* (Ky. PSC June 21, 2017) Final Order; *see also* Schafer Testimony at 7 (stating that "REVENUE REQUIREMENTS = OPERATING EXPENSE + MARGIN REQUIREMENTS).

Inter-County Energy calculated its revenue requirement in this manner by taking the sum of its adjusted operating expenses and margin requirement during the 12-month period ending October 31, 2017.[16] While Inter-County Energy's general methodology and test period are appropriate, the Commission must review the reasonableness of Inter-County Energy's proposed operating expense and margin, including any known and measurable changes, to ensure that its proposed rates are fair, just and reasonable.

Operating Expenses

Inter-County Energy proposed pro forma adjustments that resulted in a $3,097,166 decrease in its test-year operating expenses to $43,260,940 and, as noted above, those adjustments are reasonable.[17] However, the Commission finds that additional adjustments should be made to Inter-County Energy's claimed rate case expenses and its expenses for health insurance premiums and 401(k) retirement savings plans. Further, the Commission finds that Inter-County Energy's request for a regulatory asset for storm damage expenses should be granted, in part, which will affect its allowed expenses. Those adjustments are discussed below.

Rate Case Expense

Inter-County Energy estimated its rate case expense to be $248,295; proposed to amortize that expense over a three-year period; and included the amortization of that expense in its proposed revenue requirement.[18] Inter-County Energy's most recent

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[16] Schafer Testimony at 7–8.

[17] *See id.* at 8–13.

[18] Application, Exhibit 7, page 16.

update on October 22, 2018, indicated that its total rate case expense was $171,099.[19] The Commission finds this amount reasonable, but because Inter-County Energy incurred fewer expenses than expected, a three-year amortization of these expenses will result in a decrease in its operating expenses of $25,732.[20]

Healthcare and Retirement Expenses

Inter-County Energy provides health insurance to its employees and their families and pays 100 percent of the premiums.[21] Moreover, all full-time employees of Inter-County Energy are eligible for a defined benefit plan, identified as the RS plan, and a 401(k) retirement savings plan.[22] Inter-County Energy contributes two percent of an employee's base salary to the 401(k) retirement savings plan and requires its employees to contribute at least one percent of their base salary to the 401(k) plan.[23] Contributions to the RS plan amount to 1.6 percent of each employee's average effective base salary and are funded solely by Inter-County Energy.[24]

The Commission has explicitly held on numerous occasions recently that expenses for employee benefits are unreasonable if they exceed benefits that are market

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19 Inter-County Energy's Response to Commission Staff's Fourth Request for Information (Response to Staff's Fourth Request), Item 2 at 26.

20 $248,295 - $171,099 = $77,196 / 3 = $25,732

21 Inter-County Energy's Response to Commission Staff's Second Request for Information (Response to Staff's Second Request), Item 7; Gilliam Testimony at 11–12.

22 Gilliam Testimony at 13–14.

23 *Id.*

24 *Id.*

competitive.[25] In every general rate case filed since 2016 in which a utility sought to recover its expenses for the payment of 100 percent of its employees' health insurance premiums, the Commission has reduced test-year expenses for health insurance premiums to levels based on national average employee contribution rates. Similarly, the Commission has held that it is unreasonable for utilities to pay the full contribution to a defined benefits retirement plan while simultaneously contributing to 401(k) retirement savings plans for its employees.[26]

While the Commission does not expect every utility to offer the same benefits package, the Commission does expect compensation and benefits offered to employees to be consistent with those offered by businesses that operate in a competitive market and to be justified with compensation and benefits studies or other similar evidence. Based on the current market, it is difficult to see any circumstance under which the payment of 100 percent of health insurance or for both a defined benefit and 401(k) plan

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[25] *See, e.g.,* Case No. 2016-00434, Application of Shelby Energy Cooperative, Inc. for an Increase in its Retail Rates, Final Order at 6–7 (Ky. PSC July 1, 2017); Case No. 2016-00367, *Application of Nolin Rural Electric Cooperative Corporation for a General Rate Increase*, Final Order at 10–11 (Ky. PSC June 21, 2017); Case No. 2016-00365, *Application of Farmers Rural Electric Cooperative Corporation for an Increase in Retail Rates*, Final Order at 6–7 (Ky. PSC May 12, 2017); Case No 2016-00174, *Electronic Application of Licking Valley Electric Cooperative Corporation for a General Rate Increase*, Final Order at 18 (Ky. PSC Mar. 1, 2017); Case No. 2017-00349, *Electronic Application of Atmos Energy Corporation for an Adjustment of Rates and Tariff Modifications*, Final Order at 19 (Ky. PSC May 3, 2018).

[26] *See* Case No. 2016-00434, Application of Shelby Energy Cooperative, Inc. for an Increase in its Retail Rates, Final Order at 6-7 (Ky. PSC July 1, 2017); Case No. 2016-00367, *Application of Nolin Rural Electric Cooperative Corporation for a General Rate Increase*, Final Order at 10–11 (Ky. PSC June 21, 2017); Case No. 2016-00365, *Application of Farmers Rural Electric Cooperative Corporation for an Increase in Retail Rates*, Final Order at 6–7 (Ky. PSC May 12, 2017); Case No 2016-00174, *Electronic Application of Licking Valley Electric Cooperative Corporation for a General Rate Increase*, Final Order at 18 (Ky. PSC Mar. 1, 2017); *see also Electronic Application of Atmos Energy Corporation for an Adjustment of Rates and Tariff Modifications*, Case No. 2017-00349, Order at 12 (Ky. PSC May 3, 2018) ("The Commission finds that, for ratemaking purposes, it is not reasonable to include both Atmos's defined benefit plan expense and matching contributions to employees' defined contribution plans.").

for the same employees could be justified[27] and the Commission questions why cooperative utilities continue to propose recovering the costs of such plans. Moreover, Inter-County Energy failed to establish that the payment of 100 percent of health insurance or for both a defined benefit and 401(k) plan for the same employees are justified in its case.

Inter-County Energy did not dispute that the benefits it offers are high as compared to other companies.[28] Rather, it argued that the Commission should look at its compensation and the benefits package as a whole in addressing the reasonableness of its benefits.[29] Further, Inter-County Energy asserted that it has difficulty retaining a highly trained and technically skilled workforce due to competition for personnel with other Kentucky utilities even with the current compensation and benefits offered.[30] Inter-County

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[27] *See* Bureau of Labor Statistics, Healthcare Benefits, Mar. 2018, Medical care benefits: Share of premiums paid by employer and employee, private industry workers, March 2018, Table 10 (https://www.bls.gov/ncs/ebs/benefits/2018/ownership/private/table10a.pdf) (last accessed January 18, 2019) (indicating that the average private sector employee contribution rate for insurance premiums is 21 percent for individual plans and 33 percent for family plans).

[28] *See* Application, Exhibit 8, Direct Testimony of Jerry Carter (Carter Testimony) at 11 ("Although our benefits may be slightly better than what is offered by others, it appears that our total compensation package is still undervalued. . . . This is one of those instances where the benefits offered by a utility may seem high compared to what other utilities are offering their employees, but the overall compensation package is too low to retain our linemen. . . . I think the Commission will agree that disallowing certain benefit and retirement costs will only serve to make a bad situation worse for Inter-County when it comes to retaining its technically skilled workforce"); *see also* Response to Staff's Fourth Request, Item 1(b) ("Inter-County concedes that 100% employer paid health care premiums is not the norm in the United States, however it is becoming more prevalent in our local area and Kentucky, especially in the utility world.").

[29] Carter Testimony at 10–11 ("[W]e have to look at the total value that we offer as an employer to our employees. . . . While the Commission has tended to be more assertive in recent cases on issues affecting compensation, I appreciate that it looks at each utility's financial situation and crafts its Order to that specific situation. This is one of those instances where the benefits offered by a utility may seem high compared to what other utilities are offering their employees, but the overall compensation package is too low to retain our linemen."); *see also* Gilliam Testimony at 11 ("Maintaining a competitive total compensation and benefit package is crucial in meeting Inter-County's goal of providing safe and reliable service to its owner-members.").

[30] Gilliam Testimony at 10–11.

Energy indicated that three linemen left in 2018, in part, because they were offered higher compensation by another employer.[31] Thus, Inter-County Energy contended that, at a minimum, the compensation and benefits it currently offers are necessary to attract and retain a technically skilled workforce.[32]

However, while the three linemen referenced by Inter-County Energy indicated that they left, in part, due to compensation, many Inter-County Energy employees that have left in the last five years indicated in their exit interviews that they felt the compensation offered by Inter-County Energy was good.[33] Further, while Inter-County Energy indicated that competition for employees with other Kentucky utilities' necessitates the offering of the benefits discussed above, the Commission has been consistent in recent rate cases, as noted above, in prohibiting Kentucky utilities from recovering expenses for the payment of 100 percent of health insurance premiums and expenses for the payment of both a 401(k) retirement saving plan and a defined benefit retirement plan.[34] Given this consistent treatment, an order prohibiting Inter-County Energy from recovering those amounts through rates should not place it at a disadvantage as compared to other Kentucky utilities. Additionally, Inter-County Energy's compensation study did not even address the benefits it offers and did not indicate a significant disparity between the wages

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[31] *Id.*

[32] *See* Carter Testimony at 11 (indicating that Inter-County still has difficult retaining employees despite its "overall compensation package"); Gilliam Testimony at 10.

[33] *See* Response to Staff's Second Request, Item 3 and Exit Interview Questionnaires.

[34] *See, e.g.* Case No. 2016-00367, *Application of Nolin Rural Electric Cooperative Corporation for a General Rate Increase*, (Ky. PSC June 21, 2017), Final Order at 10–11; *see also* Response to Staff's Fourth Request, Item 1(b) (in which Inter-County Energy indicated that Kentucky Utilities did not pay the entirety of employee health plans).

it offers and the wages offered by others.[35] Thus, the Commission is not able to find that it is necessary for Inter-County Energy to pay 100 percent of health insurance premiums or for both a 401(k) and defined benefit retirement plan in order to compete with other companies for employees.

Further, the retention issues Inter-County Energy identified pertain to its inability to retain highly trained and technically skilled employees.[36] In fact, when Inter-County Energy's representatives discussed their retention issues, they nearly always referenced the difficulty that Inter-County Energy has had retaining linemen.[37] Thus, even assuming that the payment of benefits in excess of those offered by other employers would solve the reported retention issues, Inter-County Energy's solution would be inefficient and unreasonable in that it would involve offering benefits that are not market competitive to all employees as opposed to targeting specific employees or classes of employees it is having difficulty retaining with higher compensation.

The Commission also observes that Inter-County Energy represented that it "aggressively sought" to manage expenses.[38] Yet, it continued to pay 100 percent of

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[35] Inter-County Energy's compensation study indicated that the regional average compensation for linemen first class working for distribution cooperatives was approximately $70,000 and that the Kentucky average was slightly lower than that regional number. *See* Tan, Winston, *Inter-County Energy Cooperative Compensation Plan Report* at 7 (October 2018). Most of Inter-County Energy's Linemen earn base compensation, including vacation pay, in that range, and many earn significantly higher than that with overtime time. Response to Staff's First Request, Item 55.

[36] *See* Gilliam Testimony at 11 ("Inter-County does experience challenges in retaining a highly trained and technical workforce.").

[37] *See* Carter Testimony at 11 ("[T]he overall compensation package is too low to retain our linemen."); Gilliam Testimony at 11 (providing the example of the three linemen when discussing Inter-County Energy's difficulty retaining highly trained and technical employees and singling out linemen as one of the positions that is difficult to fill with qualified employees); *see also* Response to Staff's Fourth Request, Item 1(b) (in which Inter-County Energy provided the wages paid to linemen only when asked to identify the utilities with which it competed for employees and the benefits offered by those utilities).

[38] Carter Testimony at 6–7.

employee health insurance premiums and for two retirement plans for certain employees in a manner contrary to national trends and inconsistent with the recent orders of this Commission. This is particularly troubling since Inter-County Energy failed to meet the margin requirement established by its lender. Moreover, Inter-County Energy's failure to manage the cost of employee benefits partially undermines its claims regarding the effect of the March 2018 storm on its financial position because those costs could have offset a large portion of Inter-County Energy's storm damage expense.

As it made clear in the orders discussed above, the Commission expects all utilities to be cognizant of controllable costs incurred at unreasonable levels, including expenses associated with employee benefits. The Commission finds that Inter-County Energy's payment of 100 percent of employee health insurance premiums is unreasonable for the reasons discussed above. Since it proposed no reasonable alternative, the Commission further finds that Inter-County Energy should limit its contributions to its employees' health plans to percentages that are market place competitive, and therefore, the Commission will adjust the test-year health insurance premiums based on the national average employee contribution rates of 33 percent for family plans and 21 percent for individual plans in a manner consistent with other recent cases.[39] Recognizing the portion of that

[39] *See* Bureau of Labor Statistics, Healthcare Benefits, Mar. 2018, Medical care benefits: Share of premiums paid by employer and employee, private industry workers, March 2018, Table 10 (https://www.bls.gov/ncs/ebs/benefits/2018/ownership/private/table10a.pdf) (last accessed January 18, 2019) (indicating that the average private sector employee contribution rate for insurance premiums is 21 percent for individual plans and 33 percent for family plans); *see also* Case No. 2016-00367, *Application of Nolin Rural Electric Cooperative Corporation for a General Rate Increase*, (Ky. PSC June 21, 2017), Final Order at 10–11 *citing* Bureau of Labor Statistics, Healthcare Benefits, Medical care benefits: Share of premiums paid by employer and employee, private industry workers, Mar. 2016, Table 10 (https://www.bls.gov/ncs/ebs/benefits/2016/ownership/private/table10a.pdf) (last accessed January 18, 2019) (adjusting rates based on national averages of 32 percent and 21 percent).

expense that would be capitalized, Inter-County Energy's health insurance expense should be decreased by $174,269.

Similarly, the Commission finds that it would be unreasonable for Inter-County Energy to continue to pay for the entire RS defined benefit retirement plan while simultaneously contributing to a 401(k) retirement savings plan for the same employees. The Commission will allow Inter-County Energy to recover only the costs of the more expensive defined benefit plan for employees who participate in both plans. Accordingly, the Commission will remove for ratemaking purposes Inter-County Energy's test-year 401(k) contributions for employees who participated in both plans. Inter-County Energy's test-year expense for 401(k) contributions to these employees was $83,945. Recognizing the portion that would be capitalized, the Commission will remove $54,202 from the test year for employee 401(k) plan expense. Given the precarious financial position Inter-County Energy has presented to the Commission, it is incomprehensible why Inter-County Energy's management would continue to pay above market benefits and pension costs for its employees.

Storm Restoration Expense

Lastly, the Commission finds that Inter-County Energy may create a regulatory asset for expenses arising from the March 2018 storm.[40] Inter-County Energy experienced a severe snowstorm that resulted in nearly half of its customers losing power.[41] This outage required Inter-County Energy to utilize significant resources that were extraordinary in nature. The recovery involved approximately half of Inter-County

[40] Application at 4; *see also* Response to Staff's Fourth Request, Item 4.

[41] Response to Staff's Fourth Request, Item 4(a).

Energy's employees working overtime; 35 lineman from other cooperatives; and five crews from Davis H. Elliot.[42] Moreover, because Inter-County Energy is a distribution cooperative, the bulk of its operating expense goes towards purchased power, therefore, as compared to a fully integrated utility, it is more difficult for it to absorb unexpected storm damage costs.[43] Inter-County Energy has also not claimed any extraordinary expense for storm damage since before its last rate case in 2006. Thus, the Commission finds that the expenses Inter-County Energy incurred as a result of the March 2018 storm may be treated as a regulatory asset and recovered through base rates.[44]

However, the Commission observes that Inter-County Energy's claimed storm damage expense includes both regular pay and overtime pay for its employees for hours in which they worked to restore service following the storm.[45] The Commission notes that amounts incurred for regular work hours would have been incurred even absent the storm, and therefore, are not extraordinary. Moreover, the test period operating expenses already include amounts for the regular work hours of employees such that the inclusion of regular work hours from 2018 for the same or similarly situated employees would result in a portion of that expense being recovered twice. Thus, the Commission finds that those

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[42] *Id.*

[43] *See* Application at Exhibit 28 (indicating $28,722,595 of Inter-County Energy's operating expense of $44,954,682, before any adjustments by the Commission, is allocated to the purchase of power).

[44] *Cf.* Case No. 2008-00436, *Application of East Kentucky Power Cooperative, Inc. for an Order Approving Accounting Practices to Establish a Regulatory Asset Related to Certain Replacement Power Costs Resulting From Generation Forced Outages* (Ky. PSC Dec. 23, 2008) Final Order at 3–4 (discussing when a utility may be permitted to capitalize extraordinary expenses and recover them through base rates).

[45] Inter-County Energy's Response to Commission Staff's Informal Conference Request for Information (Response to Staff's Fifth Request), Item 2.

portions of the storm damage expense attributable to employees regular work hours should not be included in the regulatory asset requested by Inter-County Energy.

Inter-County Energy indicated that its total storm damage expense for the March 2018 storm was $418,927.[46] That amount included expenses in the amount of $44,387 for regular hours worked by Inter-County Energy's employees.[47] Thus, the Commission finds that the proposed regulatory asset should be approved in the amount of $374,540 and that it should be amortized over three years as proposed by Inter-County Energy at a rate of $124,847 per year.

Summary of Adjustments to Operating Expense and Revenue

The chart below shows the effect of the Commission's adjustments along with the proposed and accepted adjustments of Inter-County Energy:

[46] Response to Staff's Fourth Request, Item 4(a).

[47] Response to Staff's Fifth Request, Item 2.

Description	Test-Year Actual	Pro Forma Adjustments	Pro Forma Test Year
<u>Operating Revenue</u>	($)	($)	($)
Rate Schedules	44,505,395	(2,605,590)	41,899,805
Other	1,406,055		1,406,055
Total Operating Revenue	45,911,450	(2,605,590)	43,305,860
<u>Operating Expenses</u>			
Cost of Purchased Power	31,717,149	(2,994,554)	28,722,595
Transmission - O & M	-	-	-
Distribution - Operation	2,841,415	(55,288)	2,786,127
Distribution - Maintenance	2,933,871	(26,722)	2,907,149
Consumer Accounts	1,796,458	(48,675)	1,747,783
Consumer Service & Information	420,852	(20,510)	400,342
Sales	-	-	-
Administrative & General	2,311,649	(234,598)	2,077,051
Depreciation & Amortization	4,199,990	153,324	4,353,313
Taxes - Property	-	-	-
Taxes - Other	68,323	-	68,323
Interest on Long-Term Debt	1,629,013	64,729	1,693,742
Other Interest Expense	33,998	-	33,998
Other Deductions	34,402	-	34,402
Total Operating Expenses	47,987,119	(3,162,293)	44,824,826
Patronage Capital & Operating Margins	(2,075,670)	556,703	(1,518,967)
Non Operating Margins - Interest	86,949		86,949
Allowance for Funds Used During Construction	-		-
Income (Loss) from Equity Investments	-		-
Non Operating Margins - Other	(1,781)		(1,781)
Generation and Transmission Capital Credits	2,283,094	(2,283,094)	-
Other Capital Credits and Patronage Dividends	58,930		58,930
Extraordinary Items	-		-
Patronage Capital or Margins	351,521	(1,726,391)	(1,374,870)

<u>Operating Margin</u>

Inter-County Energy's actual TIER, excluding GTCCs, for the test period was -0.19. Accounting for the proposed pro forma adjustments, it increased to 0.11. Inter-County Energy's Operating Times Interest Earned Ratio (OTIER) for the test period was -0.27.[48] The TIER method for determining margins has been the approach used by the

[48] Schafer Testimony at 14.

Commission in rate cases to calculate the revenue requirement for electric distribution cooperatives. Moreover, the Commission has generally found that a TIER of 2.0 provides electric cooperatives a reasonable margin to meet the requirements imposed by its lenders and other financial obligations.[49] A TIER of 2.0 also appears to be reasonable in the case of Inter-County Energy based on its deteriorating financial position and its obligations to lenders. Thus, the Commission finds a TIER of 2.0, as proposed by Inter-County Energy, should be used to calculate a reasonable margin for Inter-County Energy, and therefore, Inter-County Energy's margin requirement should be $3,243,388.

Based upon the operating expenses and margin found reasonable herein, Inter-County Energy's revenue requirement from base rates is $46,374,472. This level of revenue will permit Inter-County Energy to recover its reasonable operating expenses of $43,131,084, excluding interest expense, and a net margin of $3,243,388. Based on its current adjusted revenues, Inter-County Energy will need an increase in revenues of $3,068,612 to recover its revenue requirement. This increase should also result in a TIER of 2.0 and an OTIER of 1.91, which should allow Inter-County Energy to meet its mortgage requirements and service its mortgage debts. Based on the net investment rate base of $92,347,835 found reasonable herein, this additional revenue should result in a rate of return on rate base of 3.51 percent.[50]

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[49] *See, e.g.* Case No. 2016-00367, *Application of Nolin Rural Electric Cooperative Corporation for a General Rate Increase* (Ky. PSC June 21, 2017).

[50] $1,693,742 (Granted Margin) + $1,693,742 (Normalized Interest on Long-Term Debt) = $3,243,388 ÷ $92,347,835 (Net Investment Rate Base) = 3.51 percent.

PRICING AND TARIFF ISSUES

Cost of Service

Inter-County Energy filed a fully allocated cost-of-service study (COSS) in order to determine the cost to serve each customer class and the amount of revenue to be allocated to each customer class. Inter-County Energy states that this COSS study utilized an average embedded COSS approach reflecting the principles of cost causation and is consistent with the National Association of Regulatory Utility Commissioners Cost Allocation Manual.[51] Having reviewed Inter-County Energy's COSS, the Commission finds it to be acceptable for use as a guide in allocating the revenue increase granted herein.

Revenue Allocation

Inter-County Energy's COSS demonstrates that at the current rates, the LPR Large Power (LPR), the Large Industrial (IND-B1) and Outdoor Lighting Service (OLS) rate classes provide revenues greater than the cost to serve, while the other rate classes produce revenues less than their class cost to serve.[52] Inter-County Energy proposes to allocate the increase to all rate classes and use the COSS as a basis for the rate class revenue increase allocation. The Commission has reviewed Inter-County Energy's proposed allocation of the increase and finds the allocation to be acceptable.

Rate Design

Inter-County Energy proposes to increase the Customer Charges and Demand Charges in greater proportion relative to the Energy Charges to better align the rate

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[51] Application, Exhibit 10, the Direct Testimony of Richard J. Macke (Macke Testimony) at 7.

[52] *Id.* at 18.

structures with the findings in the COSS.[53] Specifically, the table below shows the current Customer Charges, the proposed Customer Charges, and the Customer Charges that were supported by the COSS for those classes for which Inter-County Energy proposes to change the current charge:[54]

Rate Class	Current	Proposed	COSS
Schedule 1 Farm & Home Services	$8.97	$15.20	$34.18
Schedule 1 Prepay Service	$8.97	$15.20	$34.18
Schedule NM – Net Metering	$8.97	$15.20	$34.18
Schedule 2 Small Commercial and Small Power	$8.97	$15.20	$34.18
Schedule 4 Large Power	$12.54	$31.65	$72.48
Schedule 5 All Electric School	$0.00	$31.65	$72.48

In its application, Inter-County Energy proposed to remove the provision in Schedule 2 that it only charge customers served under that schedule for demand greater than 10 kW.[55] However, during the course of this proceeding, Inter-County Energy determined that the removal of this provision was administratively problematic because it would not be feasible to provide a demand meter to certain low demand customers in this class. Inter-County Energy, therefore, requested to withdraw the proposed revision.[56] It requested that the proposed Energy Charge for customers served under Schedule 2 be revised to allow the same level of revenue to be recovered from the Schedule 2 rate class as proposed in the application.[57] The Commission finds that the request to withdraw the proposed revision is reasonable, and that the revenue that would have been recovered

[53] Macke Testimony at 25.

[54] Application at Exhibit 13, pg. 2; Macke Testimony at 19.

[55] Inter-County Energy Response to Commission Staff's Third Request for Information (Response to Staff's Third Request), Item 10.

[56] IC Memo filed Dec. 21, 2018.

[57] Response to Staff's Fifth Request, Item 1.

through that charge should be recovered through the Energy Charge for Schedule 2 as proposed.

As shown in the table above, Inter-County Energy's proposed Customer Charge increases are supported by its COSS. The Commission also observes that, for an electric cooperative that is strictly a distribution utility, there is merit in providing a means to guard against revenue erosion that often occurs due to the decrease in sales volumes that accompanies poor regional economics and changes in weather patterns.[58] Thus, the Commission will approve an increase in Inter-County Energy's Customer Charges as proposed. As a result, the average bill for residential customers will increase by $8.99 from $108.65 to $117.64, or 8.3 percent.

Like the Customer Charges, the COSS indicated that the current Demand Charges are too low and the current Energy Charges are too high.[59] This indicates that those customers with a high load factor are subsidizing other customers with relatively lower load factors.[60] Inter-County Energy proposed to increase the Demand Charges to eliminate that subsidy in part, but applying the principle of gradualism, it only proposed to increase the Demand Charges by a portion of the amount justified by the COSS.[61] Thus, the Commission finds that Inter-County Energy's proposed increases in its Demand Charges are reasonable and should be approved.

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[58] Case No. 2017-00374, *Application of Big Sandy Rural Electric Cooperative Corporation for a General Adjustment of Existing Rates*, Final Order 11–12 (Ky. PSC Mar. 26, 2018).

[59] Macke Testimony at 26.

[60] *Id.*

[61] *Id.*

As noted above, the Commission found that Inter-County Energy's reasonable revenue requirement is lower than that proposed by Inter-County Energy, so the Commission's reduction in the revenue requirement must be applied to the proposed rate structure. Given that the COSS justified fixed charges that were higher than those proposed by Inter-County Energy, the most reasonable way to apply the decrease would be through the volumetric charges, with the decrease allocated proportionally across the rate classes based upon the proposed revenue allocation.

However, although it allowed Inter-County Energy a rate increase and used its COSS as a basis for its rate design, the Commission observes that Inter-County Energy and its members would benefit if Inter-County Energy's management proactively monitored its costs to ensure that they are not excessive and that it requests a rate adjustment when appropriate. Inter-County Energy should not wait until it is on the verge of defaulting on lender obligations to request an increase because it could result in additional costs and the necessary rate increase will be more difficult for customers to bear. The Commission is currently seeking to streamline the rate procedure for cooperatives and would encourage Inter-County Energy to take advantage of those procedures in the future when appropriate.[62]

SUMMARY

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

1. The rates proposed by Inter-County Energy would produce revenue in excess of that found to be reasonable herein and should be denied.

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[62] Case No. 2018-00407, *A Review of the Rate Case Procedure for Electric Distribution Cooperatives*, Order (Ky. PSC Dec. 11, 2018).

2. The rates set forth in the Appendix to this Order are the fair, just, and reasonable rates for Inter-County Energy to charge for service rendered on and after the date of this Order and should be approved.

3. The rate of return and TIER granted herein will provide for Inter-County Energy's financial obligations.

IT IS THEREFORE ORDERED that:

1. The rates proposed by Inter-County Energy are denied.

2. The rates set forth in the Appendix to this Order are approved for services rendered by Inter-County Energy on and after the date of this Order.

3. Within 20 days of the date of entry of this Order, Inter-County Energy shall file with this Commission, using the Commission's electronic Tariff Filing System, new tariff sheets setting forth the rates and charges approved herein and reflecting their effective date and that they were authorized by this Order.

By the Commission

ENTERED

JAN 25 2019

KENTUCKY PUBLIC
SERVICE COMMISSION

ATTEST:

Gwen R. Pinson

Executive Director

APPENDIX

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2018-00129 DATED JAN 25 2019

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

SCHEDULE 1 FARM & HOME

Customer Charge (per month)	$ 15.20
Energy Charge (per kWh)	$ 0.09426

SCHEDULE 1 - PREPAY SERVICE

Customer Charge (per month)	$ 15.20
Energy Charge (per kWh)	$ 0.09426
Prepay Service Fee	$ 8.20

SCHEDULE NM - NET METERING

Customer Charge (per month)	$ 15.20
Energy Charge (per kWh)	$ 0.09426

SCHEDULE 1-A-FARM & HOME MARKETING RATE (ETS)

Energy Charge (per kWh)	$ 0.06199

SCHEDULE 2 SMALL COMMERCIAL AND SMALL POWER

Customer Charge (per month)	$ 18.00
Demand Charge (>10kW/per month)(per kW)	$ 5.85
Energy Charge (per kWh)	$ 0.08576

SCHEDULE 4 LARGE POWER SERVICE (LPR)

Customer Charge (per month)	$ 31.65
Demand Charge (per kW)	$ 5.85
Energy Charge (per kWh)	$ 0.06814

SCHEDULE 5 – ALL ELECTRIC SCHOOL RATE

Customer Charge per month	$ 31.65
Energy Charge per kWh	$ 0.08576

SCHEDULE 6 – OUTDOOR LIGHTING SERVICE – SECURITY LIGHTS (unmetered)

107,800 Lumen Directional Floodlight	$ 38.69
50,000 Lumen Directional Floodlight	$ 20.72
27,500 Lumen Directional Floodlight	$ 14.58
27,500 Lumen Cobra Head Light	$ 13.62
9,550 Lumen Decorative Colonial Post	$ 17.18
9,500 Lumen Security Light	$ 10.67
7,000 Lumen Lamp	$ 10.98
4,000 Lumen Decorative Colonial Post	$ 13.24
6,000 Lumen Security LED Light	$ 9.67
Pole Charges/Add. Pole Rqrd.	$ 5.61

SCHEDULE B-1 LARGE INDUSTRIAL RATE – Contract 500

Customer Charge (per month)	$ 604.77
Demand Charge	
Contract Demand (per kW)	$ 7.17
Excess Demand (>500kW) (per kW)	$ 9.98
Energy Charge (per kWh)	$ 0.04879

SCHEDULE B-1 LARGE INDUSTRIAL RATE – Contract 1300

Customer Charge (per month)	$ 604.77
Demand Charge	
Contract Demand (per kW)	$ 7.17
Excess Demand (>1300kW) (per kW)	$ 9.98
Energy Charge (per kWh)	$ 0.04879

SCHEDULE B-1 LARGE INDUSTRIAL RATE – Contract 700

Customer Charge (per month)	$ 604.77
Demand Charge	
Contract Demand (per kW)	$ 7.17
Excess Demand (>700kW) (per kW)	$ 9.98
Energy Charge (per kWh)	$ 0.04879

SCHEDULE B-1 LARGE INDUSTRIAL RATE – Contract 1600

Customer Charge (per month)	$ 604.77
Demand Charge	
Contract Demand (per kW)	$ 7.17
Excess Demand (>1600kW) (per kW)	$ 9.98
Energy Charge (per kWh)	$ 0.04879

SCHEDULE B-1 LARGE INDUSTRIAL RATE – Contract 1200

Customer Charge (per month)	$ 604.77
Demand Charge	
Contract Demand (per kW)	$ 7.17
Excess Demand (>1200kW) (per kW)	$ 9.98
Energy Charge (per kWh)	$ 0.04879

SCHEDULE B-1 LARGE INDUSTRIAL RATE – Contract 2000

Customer Charge (per month)	$ 604.77
Demand Charge	
Contract Demand (per kW)	$ 7.17
Excess Demand (>2000kW) (per kW)	
(Before 10/1 of test year)	$ 9.98
Energy Charge (per kWh)	$ 0.04879

SCHEDULE B-2 LARGE INDUSTRIAL RATE

Customer Charge (per month)	$1,208.42
Demand Charge	
Contract Demand (per kW)	$ 7.17
Excess Demand (>1300kW) (per kW)	$ 9.98
Energy Charge (per kWh)	$ 0.04319

SCHEDULE B-3 LARGE INDUSTRIAL RATE

Customer Charge (per month)	$1,208.42
Demand Charge	
Contract Demand (per kW)	$ 7.17
Excess Demand (>1300kW) (per kW)	$ 9.98
Energy Charge (per kWh)	$ 0.04205

SCHEDULE C-1 LARGE INDUSTRIAL RATE

Customer Charge (per month)	$ 604.77
Demand Charge (per kW)	$ 7.17
Energy Charge (per kWh)	$ 0.04921

SCHEDULE C-2 LARGE INDUSTRIAL RATE

Customer Charge (per month)	$1,208.42
Demand Charge (per kW)	$ 7.17
Energy Charge (per kWh)	$ 0.04356

SCHEDULE C-3 LARGE INDUSTRIAL RATE

Customer Charge (per month)	$1,208.42
Demand Charge (per kW)	$ 7.17
Energy Charge (per kWh)	$ 0.04243

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