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PUBLIC SERVICE COMMISSION

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF OWEN ELECTRIC	)	
COOPERATIVE, INC. FOR ADJUSTMENT	)	**Case No. 2008-00154**
OF RATES	)	

ATTORNEY GENERAL'S POST HEARING BRIEF

Comes now the intervenor, the Attorney General of the Commonwealth of Kentucky, by and through his Office of Rate Intervention, and files his Post Hearing Brief concerning the above referenced case.

INTRODUCTION

Owen Electric Cooperative ("Owen" or the "company") filed its application for an increase in its base rates on August 27, 2008. Owen's application proposed the use of a historical test year ending December 31, 2007, including any known and measurable adjustments.[1]In the application, Owen stated that it required an increase in its rates due to increases in the cost of power, materials, equipment, labor, taxes, interest, debt service and other fixed and variable costs.[2] Owen further noted that its financial condition had deteriorated substantially over the past few years[3] such that its Times Interest Earned Ratio (TIER) was 0.78 for the historical test year.[4] Owen notes that its mortgage agreements require it to maintain an operating TIER of 1.25 based

[1] See Application, Paragraph 4, Page 1.
[2] See Application, Paragraph 5a, Page 1.
[3] See Application, Paragraph, 5b, Page 1.
[4] See Application, Paragraph 5c, Page 1.

on an average of two of the three most current years[5] and that the requested adjustment in rates is required for Owen to comply with the terms of its mortgage agreements.[6]

Using the historical test year ending December 31, 2007, Owen requested an increase to its base rates totaling $4,064,395.00.[7] The company proposes to allocate the increase in three main areas: 1) Schedule I – Farm and Home, where the entire increase is assigned to the customer charge; 2) Schedule I – Small Commercial, where the entire increase is assigned to the customer charge; and 3) Schedules III, OLS and SOLS wherein the costs were increased by 30% to obtain the remaining revenue requirement.[8] For Schedule I – Farm and Home, the company proposes to nearly double the fixed customer charge from its current charge of $5.64 per month to $11.20 per month.[9] For Schedule II – Small Commercial, the company proposes to more than double its fixed customer charge from its current charge of $5.64 per month to $13.48 per month.[10]

The proposed changes to its fixed customer charge for farm and home customers (residential customers) make up the bulk of the proposed increase with the company expecting the proposed rate to increase its revenues by $3,539,796.00[11] from this customer class. For the small commercial customers, the proposed increase is expected to increase Owen's revenues by $221,880.00[12] and the proposed increase in outdoor lighting rates is expected to increase revenues by $301,443.00.[13]

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[5] See Application, Paragraph 5c, Page 1.
[6] See Application, Paragraph 5d, Page 2.
[7] See Application, Exhibit S, Page 2.
[8] See Application, Exhibit G, Page 2.
[9] See Application, Exhibit D, Page 2.
[10] See Application, Exhibit D, Page 2.
[11] See Application, Exhibit D, Page 1.
[12] See Application, Exhibit D, Page 1.
[13] See Application, Exhibit D, Page 1.

A hearing was scheduled in the case to be held February 3, 2009 at the offices of the Public Service Commission but on January 27, 2009, Owen filed the testimony of Mark Stallons, Owen's new CEO, to substitute for the testimony of Robert Hood, Owen's previous CEO. However, Mr. Stallons' testimony contained additional information that had not been subject to discovery by the Attorney General or any other intervenor in the case. Therefore, the Attorney General moved the Commission to either strike that portion of Mr. Stallons' testimony that contained the additional information or in the alternative to allow his office to propound additional data requests concerning the new testimony. The Commission's Order of February 3, 2009 granted the Attorney General's motion to propound additional data requests and set a new hearing date of March 25, 2009 in the matter.

From the original requested increase of $4,064,395.00, there were several adjustments that Owen conceded as necessary in its responses to data requests and which were confirmed through the testimony of Owen's witnesses at the March 25, 2009 hearing. These adjustments are summarized as follows:

1.	Expand End of Test Year Customer Adjustment[14]	$(130,171)
2.	Remove Other Deductions Expenses[15]	$(33,349)
3.	Remove Acct 912 Promotional Expenses[16]	$(16,071)
4.	Remove Miscellaneous Other Expenses[17]	$(12,178)
5.	Directors Travel Expenses[18]	$(7,146)
6.	Sub-Total	$(198,915)

[14] See Owen's Response to Data Request AG-1-7.
[15] See Owen's Response to Data Request AG-1-35.
[16] See Owen's Responses to Data Requests AG-1-10 and AG-2-2.
[17] See Owen's Responses to Data Requests PSC-3-13, AG-1-25, AG-1-26 and AG-2-10.
[18] See Owen's Response to Data Request AG-2-8.

The adjustments Owen conceded reduce the total amount requested to $3,865,480. These reductions do not include items which the Attorney General maintains are not in keeping with long-standing PSC rate making principles and policies. The additional reductions as proposed by the Attorney General are discussed more fully herein below.

ARGUMENT

Owen's application includes a number of expenses and adjustments which the PSC has traditionally removed for ratemaking purposes or which utilize amounts that are outside the test year proposed by Owen.

The first item is the Short Term Debt Interest Expense. Reviewing the company's responses to AG-1-32, 1-33, AG-2-14 and PSC-3-4, the determination of Owen's proposed pro forma short-term debt interest expenses is based on assumptions that are completely inconsistent with Owen's proposed pro forma long-term debt interest expense determination. Owen has proposed to increase its actual test year long-term debt interest expense by $479,000. Owen has confirmed in its responses that almost all of this long-term debt expense increase is the result of the interest annualization for a new RUS loan of $13 million which Owen obtained on November 30, 2007. In its responses, Owen confirmed that $10.1 million from this new RUS loan was used to reduce the test year average short-term debt balance of $15.8 million to a new December 31, 2007 test year end balance of $5.7 million. Since Owen has annualized its long-term debt interest expenses based on the long-term balances at the December 31, 2007 test year end (which included the new RUS loan of $13 million), in order to be consistent, Owen should have annualized its short-term debt interest expenses based on the short-term debt balance at the December 31, 2007 test year end of $5.7 million. The appropriate annualized short term debt

interest rate at Owen's actual short-term debt interest rate of 6.4% on December 31, 2007 should, therefore, be $5.7 million multiplied by the 6.4%, or approximately $366,000. By contrast, Owen has proposed that test year short-term debt interest expense should be $689,738, which is the interest expense associated with a test year average short-term debt balance of $15.8 million. Obviously, this is incorrect and is inconsistent with the approach Owen used to determine its pro forma annualized long-term debt interest expense. Therefore, the short-term debt interest determination in this case should be $366,140 as opposed to the $689,738 proposed by Owen.

Next, Owen has made the assumption that half of its short term debt balance would be repaid as a result of the rate increase resulting from the instant rate case. The Commission should use the same assumption. Thus, while Owen proposes its short term debt interest expenses are $344,869 (50% of $689,738), the correct pro forma short term debt interest expense is actually $183,070 (50% of $366,140). This results in a short term debt interest expense adjustment of $161,799. From its responses to the data requests, Owen seems to agree with the Attorney General and the Commission that the starting point for its short term debt interest expense should be the annualized December 31, 2007 expense of $366,140.[19] However, Owen now wishes to abandon its assumption that this expense should be halved as a result of the rate increase paying off half of its short term debt. The Commission should reject this approach as it is merely an attempt by Owen to end up with a pro forma short term debt expense ($366,140) that is even higher than its originally proposed pro forma short term debt expense of $344,869. However, when Owen's witness, Alan Zumstein, was questioned regarding this inconsistent treatment of the short term debt interest expense, his only justification was that Owen had increased its borrowing outside of the test year.[20] Clearly, events outside the test year are not allowable as test

[19] See Owen's Responses to Data Requests PSC-3-4, AG-1-32, AG-1-33 and AG-2-14.
[20] March 25, 2009 Hearing Video, Witness - Alan Zumstein, 2:17 pm.

year adjustments and an adjustment of ($161,799) is required to treat short term and long term debt interest expenses consistently within the application.

Next, regarding customer deposit interest, Owen proposes that this expense not be removed for rate making purposes in this case. However, upon cross-examination Owen's witness conceded that the Commission's Order in Case No. 1999-176 provided that customer deposit interest be removed to provide consistent treatment.[21] Removing this expense from the application in a manner consistent with prior Commission Orders results in an adjustment of ($130,051).

With respect to the expenses for its AMR program, Owen has included $23,997 for consulting fees[22] for the program on a going forward basis. However, in its responses to AG-1-8 and AG-2-1, Owen acknowledges that these fees are non-recurring. In fact at the hearing, Owen's witness acknowledged that although Owen believes it will have some level of additional consulting fees associated with the AMR project, these costs will not equal the $23,997 that Owen includes in its application.[23] Since these fees are not known and measurable, they should clearly be removed from the application. The removal of the non-recurring consulting fees associated with Owen's AMR program results in an adjustment of ($23,997).

Owen has also included miscellaneous expenses in the application associated with items traditionally disallowed by the Commission. These include $10,000 for a billboard advertisement at the Kentucky Speedway. The company was questioned regarding this expense as part of the discovery process and in its responses to PSC-2-33 stated that the billboard contained Owen's name, the fact that Owen is a Touchstone Energy Cooperative and has general contact information for Owen and includes a link to its website. When Owen's witness at the hearing,

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[21] March 25, 2009 Hearing Video, Witness - Alan Zumstein, 2:10 pm.
[22] See Application, Exhibit 9, page 4.

Rebecca Witt, was asked to review her response to the Commission Staff's data request and whether such information was also available from other sources, Ms. Witt confirmed that the information contained on the billboard was also available in the telephone directory for Owen's service territory, and was also printed on the company's monthly bills.[24] Institutional expenses to promote the cooperative have traditionally been disallowed by the Commission. Clearly, the information contained on the billboard merely promotes Owen and does not provide any information beyond that available to customers in their phone book or on their monthly bill at no charge to the ratepayer. An avoidable expense of $10,000 to promote general contact information regarding the company represents an unreasonable burden to Owen's ratepayers who are already struggling to pay their bills, especially in light of the current state of the economy. Moreover, these expenses are impermissible as a matter of law, based on prior Commission precedent: ". . . expenses for promotional advertising are expressly disallowed for inclusion in ratemaking by 807 KAR 5:016 Sec. 4 (1)(b)."[25] Removal of the expense for the billboard at the Kentucky Speedway results in an adjustment of ($10,000) to the application.

Additionally, the company's application includes expenses for providing Owen's employees with coffee. In its response to AG-2-10, the company states that the purpose for the coffee expense is to allow its employees to get coffee, get their daily assignments and start work. The company states that if its employees were to stop and get coffee on their own each morning, then its line trucks, bucket trucks and service trucks would be attempting to get into small rural locations and would take extra time to get to work. However, Owen's employees could <u>clearly</u> get their own coffee prior to coming into work since employees do not drive their work vehicles

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[23] March 25, 2009 Hearing Video, Witness – Rebecca Witt, 1:38 pm.
[24] March 25, 2009 Hearing Video, Witness – Rebecca Witt, 1:17 pm.
[25] *In Re Application of Cumberland Valley for an Adjustment of Rates*, Case No. 2005-00187, Final Order dated May 2, 2006, p. 22.

home[26] and proper employee management should prevent these vehicles from making prohibited stops for personal errands at the ratepayers' expense. While the Attorney General notes the important jobs that the company's employees perform and applauds same, the costs for coffee before work breaks should not be borne by ratepayers who are already struggling to pay bills. Moreover, the Attorney General notes that the Commission has traditionally disallowed this type of expense for rate making purposes. The removal of employee coffee expenses would result in an adjustment of ($1,767). While this adjustment may seem nominal on its face in comparison to the overall increase requested by the company, every penny out of the ratepayers' pockets adds up quickly, especially in the current economy.

Owen has included in its application expenses for temporary employees of $9,379. However, Owen's application already included a full complement of full time employees working 2080 hours per year and, in addition, included an allowance for one part-time employee. Owen stated at the hearing that this expense is to cover for shortages in its call center or mail room[27] but this cost is already built into to its expenses under the application. Employee sick and/or vacation benefits are included and accounted for in the application. Clearly, with a full compliment of employees, the inclusion of $9,379 for temporary employees is unreasonable. Removing the expense for temporary employees results in an adjustment of ($9,379).

Finally, Owen has included expenses for its directors to attend the NRECA Annual Meeting beyond those allowable under prior Commission practice. In its previous decisions, the Commission has only allowed expenses for the cooperatives' NRECA representative or their alternate.[28] Owen has included expenses of $8,500 for non-qualifying directors.[29] These expenses

[26] March 25, 2009 Hearing Video, Witness – Rebecca Witt, 1:22 pm.
[27] March 25, 2009 Hearing Video, Witness – Rebecca Witt, 1:24 pm.
[28] See Owen's Response to Data Request AG-1-28 and PSC-3-3(b).
[29] See Owen's Response to Data Request AG-1-27 and AG-2-6.

should be disallowed and removed from the application, which results in an adjustment of ($8,500).

Summarizing all the adjustments conceded by Owen with those traditionally disallowed by the Commission as discussed above, the total adjustments to Owen's request equals ($544,408). These disallowances from Owen's claimed rate increase of $4,064,395 results in a maximum increase of $3,519,987, not accounting for any for adjustments which the Commission might order in addition hereto.

Owen proposes that the majority of the increase be allocated to increases in its customer charge for residential and small commercial users and proposes no change to its energy charge for those customer classes. Owen's CEO, Mark Stallons, offered many reasons why Owen believes this is appropriate. Among those reasons, Mr. Stallons stated that allocating the increase to the customer charge will allow the utility to participate in DSM programs, will reduce the throughput incentive of the company, prepares the company for climate change legislation that may be coming at some point in the future, reduces the company's exposure under net metering and cogeneration scenarios and prevents the subsidization of low usage members.

The Attorney General disputes the contentions of Owen as articulated by Mr. Stallons at the hearing and states that, while it is appropriate to allow some increase in Owen's customer charge for residential and small commercial users, a greater portion of the proposed increase should be allocated to the energy charge to encourage customers to save energy. The Attorney General attempted to illustrate the relationship between the fixed customer charge and the energy charge at the hearing of the matter. While Mr. Stallons was reluctant to answer questions regarding the relationship between customer charges/energy charges and customer

usage/behavior directly[30], it is obvious that the energy portion of a customer's bill is the only portion over which that customer has any control. To allow the customer charge to climb too high simply discourages customers from any individual conservation efforts they may undertake as no matter what actions they take to conserve energy, the effect on their monthly bill is insignificant. To use the example proposed to Mr. Stallons at the hearing, with all things being equal, which scenario allows a customer to save more money: A high customer charge with a low energy charge wherein the customer reduces his usage by 15% or a low customer charge with a higher energy charge wherein the customer reduces his usage by the same 15%?[31] Clearly, from a ratepayer standpoint, the latter scenario offers more benefit to ratepayers.

Owen also claims that increasing the customer charge will allow it to participate in DSM programs. However, at the hearing, Mr. Stallons admitted that Owen was not proposing any specific DSM programs under this application and had not included any funds for DSM programs in this application.[32] Further, Mr. Stallons admitted that he was unaware of any DSM programs that Owen was unable to pursue due to its current rate structure.[33] Upon further examination, Mr. Stallons admitted that, being recently employed by Owen, he was unfamiliar with KRS 278.285 which is Kentucky's Demand Side Management statute.[34] Further, Mr. Stallons was unaware that the statute already provides Owen and any other Kentucky utility the opportunity to design and submit for approval demand side management and energy conservation programs which address the needs articulated by Mr. Stallons.[35] Additionally, the statute provides Owen with the opportunity to recover its costs associated with DSM/energy

[30] March 25, 2009 Hearing Video, Witness – Mark Stallon, 10:52 am.
[31] March 25, 2009 Hearing Video, Witness – Mark Stallon, 10:52 am.
[32] March 25, 2009 Hearing Video, Witness – Mark Stallon, 10:34 am.
[33] March 25, 2009 Hearing Video, Witness – Mark Stallon, 11:22 am.
[34] March 25, 2009 Hearing Video, Witness – Mark Stallon, 10:35 am.
[35] March 25, 2009 Hearing Video, Witness – Mark Stallon, 10:36 am.

conservation programs, a portion of its lost sales revenue, and a monetary incentive for its participation in offering these programs. The lost sales component and incentive would clearly address Mr. Stallons' concerns as to the "throughput incentive." Although Owen has no current DSM/energy conservation programs approved under KRS 278.285 Mr. Stallon stated that Owen would likely come back to the Commission at some point to propose new DSM/energy conservation programs under the statute.[36] Therefore, it would be more appropriate for the Commission to consider any proposal from Owen for new DSM/energy conservations programs under the provisions of KRS 278.285.

Mr. Stallons also claims that allocating nearly the entire increase to the customer charge prepares the company and its ratepayers for climate change legislation that *may* be coming.[37] However, climate change legislation is a large unknown at this time to even those in Congress who would write such legislation, and while the EPA recently designated certain gases that are associated with coal fired generation as pollutants, most experts agree that any rule making in this area which would govern the removal of these gases by generation plants is years away. To begin to charge ratepayers now for requirements that haven't even been determined yet, and which would clearly fall outside of the test year established in the instant case is unreasonable and wholly contrary to existing law. Once climate change legislation has been written and regulations are in place, Owen is free to come back along with the rest of Kentucky's electrical generators to request relief to address the new laws.

Mr. Stallons also claimed that the increase in the customer charge reduces the company's exposure under net metering and distributed generation scenarios.[38] However, upon further questioning, he admitted that he was aware that the Commission had recently issued its

[36] March 25, 2009 Hearing Video, Witness – Mark Stallon, 10:41 am.
[37] March 25, 2009 Hearing Video, Witness – Mark Stallon, 10:29 am.

guidelines on net metering.[39] As a matter of record, the Commission's guidelines on net metering were the result of many meetings with the relevant stakeholders, including representatives of Kentucky electrical utilities, energy efficiency contractors and installers, the Attorney General and Commission staff. The Commission gave each electric utility the opportunity to participate in the process. Those guidelines address all of Mr. Stallons' concerns. They limit the exposure of a utility to the adverse effects of net metering by allowing a utility to "opt out" of serving net metering customers if the usage of those customers exceeds 1% of the utilities maximum peak in the previous 12 month period. However, Mr. Stallons stated that there has been no rush by Owen's customers to install solar panels or wind turbines.[40] In fact, Mr. Stallons stated that he had only received a few calls from a customer concerning distributed generation out of the approximately 57,000 Owen serves.[41]

Mr. Stallons also claimed that increasing the customer charge would prevent the subsidization of low usage members.[42] However, while Owen was able to define who these customers were, such as boat docks, electric fences, garages or barns, Mr. Stallons was unable to state how many of these customers Owen currently has on its system.[43] Moreover, in his testimony he confirmed that out of all the EKPC co-ops, Owen was the most urban.[44] Therefore, while these customers may be experiencing some slight subsidization, clearly those particular classes of ratepayers clearly do not comprise the bulk or even a majority of Owen's customers and any effects of subsidization are *de minimis*, at best.

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[38] March 25, 2009 Hearing Video, Witness – Mark Stallon, 11:02 am.
[39] March 25, 2009 Hearing Video, Witness – Mark Stallon 11:02 am.
[40] March 25, 2009 Hearing Video, Witness – Mark Stallon, 11:03 am.
[41] March 25, 2009 Hearing Video, Witness – Mark Stallon, 11:03 am.
[42] March 25, 2009 Hearing Video, Witness – Mark Stallon, 11:00 am.
[43] March 25, 2009 Hearing Video, Witness – Mark Stallon, 11:01 am.
[44] March 25, 2009 Hearing Video, Witness – Mark Stallon, 11:21 am.

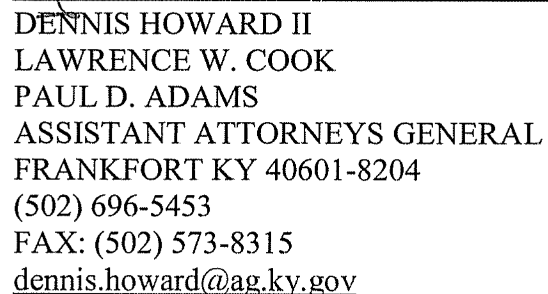
The Commission faces a paradoxal question which has existed for years and has now come to a head. The company maintains that without some incentive it will not engage in any conservation efforts because it will lose revenues from the reduced sales assumed to occur as a result of conservation initiatives. By contrast, the end-user/consumer advocates that unless there is any reduction on the ultimate bill, there is no incentive to conserve electricity. While the AG agrees that Energy Efficiency must be addressed head-on, it should be implemented with compromises on both ends and certainly should not be imposed on the ratepayers in the "flash cut" manner proposed by Owen in this case. It should always be kept in mind that Owen is a monopoly service provider with ratepayers being the captive customers. For that reason, the regulatory compact under which Owen is operating dictates that the utility must provide safe, adequate and reliable service and is allowed an opportunity to earn a reasonable TIER and return on investment, while the ratepayers are required to pay rates that are fair, just and reasonable and represent the lowest possible cost. Thus, the regulatory compact calls for a *balancing of the interests* of both the utility and its ratepayers with any benefits or detriments to be shared in an appropriate manner. An imbalance occurs when all of a rate increase is placed on the customer charge because the company virtually eliminates its financial risk while the ratepayer is trapped with a bill over which he has no control. Stated another way, the company is guaranteed its income whether its management prudently operates the company to provide safe, adequate and reliable service at the lowest cost possible or fails miserably in that task. The customer, however, is penalized by having to bear avoidable costs by reducing energy consumption thus leaving him with costs that are not otherwise the lowest possible as required in the regulatory compact. In practical terms, it is axiomatic that at the end of the proverbial day it is customers that dictate

how much energy will be used. Unless an incentive exists for customers as well as the utility, energy efficiency will not be accomplished.

However, should the Commission entertain the concept that more costs be moved to the customer charge than have historically been approved, the balancing of the stakeholders' interests would call for *gradualism* in the move from energy charges to fixed customer charges as opposed to the "flash cut" approach proposed by Owen in this case. Owen's proposal to recover 100% of the requested rate increase assigned to its Schedule I customers through the fixed customer charge, all at once in this case, does not properly balance the interests of the utility and the ratepayers and should be rejected by the Commission. Instead, if the Commission in this case is inclined to move more of the total ratepayer charges into the fixed monthly customer charge, it should do so in a gradual manner that appropriately balances the interests of Owen and the ratepayers.

Respectfully submitted,

JACK CONWAY
ATTORNEY GENERAL OF KENTUCKY



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CERTIFICATE OF SERVICE AND NOTICE OF FILING

I hereby give notice that this the 23rd day of April 2009, I have filed the original and ten copies of the foregoing with the Kentucky Public Service Commission at 211 Sower Boulevard, Frankfort, Kentucky, 40601 and certify that this same day I have served the parties by mailing a true copy of same, postage prepaid, to those listed below.

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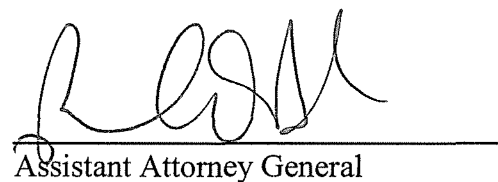

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