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December 28, 2010

**RECEIVED**

DEC 29 2010

PUBLIC SERVICE  
COMMISSION

Jeff Derouen, Executive Director  
Kentucky Public Service Commission  
211 Sower Boulevard  
P.O. Box 615  
Frankfort, Kentucky 40602

RE: Application of Meade County Rural Electric for an Adjustment of Rates  
Case No. 2010-00222

Dear Mr. Derouen:

Enclosed please find the original and ten (10) copies of the BRIEF that Meade County RECC agreed to submit to the Commission at the hearing on December 10, 2010.

Please contact me at (270) 756-2184 or Burns E. Mercer at (270) 422-2162 with any questions regarding this filing.

Respectfully submitted,



Thomas C. Brite  
Attorney for Meade County Rural Electric  
Cooperative Corporation

tcb/svh

enclosure

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

RECEIVED  
DEC 29 2010  
PUBLIC SERVICE  
COMMISSION

In the Matter of:

ADJUSTMENT OF RATES )  
FOR MEADE COUNTY RURAL ) CASE NO. 2010-00222  
ELECTRIC COOPERATIVE )  
CORPORATION )

BRIEF

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Comes now the Petitioner, Meade County Rural Electric Cooperative Corporation (hereinafter referred to as "MCRECC") and for its brief in support of its application to change its retail electric power rates submits the following:

INTRODUCTION

MCRECC has filed an application requesting permission from the Commonwealth of Kentucky Public Service Commission (hereinafter referred to as "Commission") to increase its base rates effective for all electric power sold, for its CATV charges and for its nonrecurring charges.

MCRECC filed an application for an increase in base rates of 5.73 percent which amounts to an increase in revenue of approximately \$1,783,000 based on the test year of April 2009 through March 2010. This amount of increase provides for a Times Interest Earned Ratio (hereinafter

referred to as "TIER") of 2.32X. MCRECC had a TIER of 1.79X for the test year and a TIER of 1.59X for the adjusted test year. Under its joint mortgage agreements, MCRECC is required to maintain a TIER of at least 1.25 based on an average of two of the three most recent years.

This increase in base rates has been applied to all rate classes on a proportional basis with all increases being proposed for the customer charges in all rate classes.

MCRECC is a financially prudent managed rural electric cooperative whose equity capitalization ratio has decreased to thirty-one percent at the end of the test year. The equity capitalization ratio has hovered around the thirty-one percent amount ever since the last rate case. MCRECC has continued to pay a general retirement of capital credits since its last increase in rates even with this low equity capitalization amount, except for 2009. To maintain its financial integrity and its compliance with its Capital Management Plan, MCRECC needs this rate increase to generate the cash, margins and equity levels to meet its mortgage agreements and to pay its capital credits. MCRECC's Capital Management Plan requires an equity capitalization ratio of thirty-two to forty percent with

capital credits paid on the basis of a twenty year rotation cycle.

### ISSUES

The main issues in this application, deals with the amount of margins requested and in the proposed rate design.

#### Margins:

MCRECC is requesting a TIER of 2.32X. With a TIER of 2.32X, MCRECC has a goal of reaching an equity level of forty percent (40%) in fifteen years. Meade County has the desire to increase its equity level to forty percent over this fifteen year timeframe and continue to pay capital credits based on a 20 year rotation cycle. This approach is a somewhat different one because it takes into consideration the capital growth needs of the cooperative, the rate of growth needed to build equity to the target amount, and the rate of equity payout. This approach also provides a rate of return on equity as a product of this process.

MCRECC is seeking a return on equity of 13.34 percent based on the criteria of achieving a forty percent equity level in fifteen years. The rate of return on capital

provided is 7.29 percent. MCRECC fully recognizes that this return on equity seems significantly high. However, it must be remembered that with a current equity amount of approximately \$24,400,000 MCRECC will provide payout an average annual amount of approximately \$1,220,000 on a twenty year rotation cycle. Provided below is the current capital structure and a pro forma capital structure.

CAPITAL STRUCTURE				
	Current		Pro forma	
	<u>\$\$</u>	<u>%</u>	<u>\$\$</u>	<u>%</u>
Equity	24,382,615	31.10%	36,008,937	40.00%
Debt	<u>54,013,405</u>	<u>68.90%</u>	<u>54,013,405</u>	<u>60.00%</u>
Total	78,396,020	100.00%	90,022,342	100.00%

The pro forma capital structure indicates that MCRECC's current equity amount should be increased by about \$11,600,000. Note that MCRECC requires a TIER greater than 2.0X in order to increase its equity capitalization ratio to forty percent and to pay a general retirement of capital credits on a twenty year rotation cycle.

Provided below is a breakdown of the margins requested. There is a slight difference in the total amount requested in the Application and the amount listed due to the rounding of the TIER amount for the Application.

<b>BREAKDOWN OF PRO FORMA MARGINS</b>		
	<u>Percent</u>	<u>Amount</u>
Rate to Build Equity	5.04%	1,229,198
Rate for Normal Growth	3.29%	803,163
Rate for Equity Payout	5.00%	1,219,131
Return on Equity	13.34%	3,251,492

Of the requested margins, approximate \$1,220 million is to build MCRECC's equity to the target amount in a fifteen year period.

**Rate Design:**

MCRECC is proposing to place all of its increased revenue requirements on the customer charge. The rationale for this approach is the fact that the current customer charges for all rate classes is significantly less than the costs to serve. It is MCRECC's intent to eventually have its customer charge approximately equal to its customer related revenue requirements. Provided below is a comparison of the current and proposed customer charge and the customer related revenue requirements for all rate classes.

	<u>Rate Class</u>	<u>Consumer Related Costs Per Month</u>	<u>Proposed Customer Charge</u>	<u>Current Customer Charge</u>
1R	Residential	\$ 19.35	\$ 14.16	\$ 9.85
2R	Small Commercial	\$ 24.38	\$ 20.62	\$ 14.87
3R	General Service	\$ 108.78		
	0-100 KVA		\$60.47	\$34.70
	101-1000 KVA		\$133.20	\$34.70
	Over 1000 KVA		\$295.10	\$34.70
3A	TOD Gen Svc	\$ 92.15	\$53.68	\$60.74

The above schedule indicates that the current customer charge and the proposed customer charge will not recover the customer related revenue requirements.

Concern was raised at the hearing that the customer charge increase does not meet the gradualism concept because of over a forty percent increase in the increase for the customer charge for the residential rate class. However, the increase amount requested amounts to \$4.31 per month per customer. It also should be noted that no increase in the energy rate is being requested at this time. MCRECC feels that an increase of a \$4.31 a month per customer does not violate the gradualism concept.

#### CONCLUSION

MCRECC has prepared and filed an application for the adjustment of its rates with the Commission that is consistent with the Capital Management Policy of its Board of Directors and is in compliance with the mortgage requirements of its lenders. MCRECC has taken the financially prudent approach to adjust its electric rates

more often than many other utilities under the jurisdiction of this Commission as it has a desire to always be in compliance with its mortgage agreements and its desire to pay capital credits to its members. MCRECC does not wish to become engaged in crisis management that can result when a cooperative waits too long to seek an adjustment of rates and is in chronic violation of its mortgage agreements and in a cash shortfall situation.

MCRECC is a model cooperative in its desire to payback its members for its previous margins that it has extracted from them and has been a model cooperative in its execution of its Capital Management Policy. MCRECC has requested an increase in rates that will provide for the continuation of its policy on paying capital credits to its members and that will allow MCRECC to build its equity to the target amount of forty percent of its capital structure.

MCRECC has demonstrated that it needs the full amount of the increase requested and has utilized a Cost of Service Study to determine which rate classes are to receive increases along with the appropriate rate design for those rate classes.

MCRECC feels that its exemplary track record on the payment of capital credits to its members provides the necessary proof to the Kentucky Public Service Commission

("Commission") that MCRECC will do this in a voluntary manner without the need for any type of written agreement. MCRECC will file an annual report to the Commission on its payment of its capital credits for the previous year as well as how its equity capitalization ratio is improving.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Th. Brite", with a horizontal line extending to the right.

Thomas C. Brite  
Attorney for Meade County RECC