COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

NOTICE AND APPLICATION FOR ADJUSTMENT OF RATES FOR JACKSON PURCHASE ELECTRIC COOPERATIVE CORPORATION	)	CASE NO. 8863

O R D E R

On August 4, 1983, Jackson Purchase Electric Cooperative Corporation ("Jackson Purchase") filed an application with this Commission requesting an adjustment of rates which would decrease its annual revenues by $601,825, or 3.2 percent. The proposed decrease reflected a $1,243,625 reduction in Jackson Purchase's wholesale power cost netted against a proposed $641,800 increase in retail rate revenues. Jackson Purchase stated that the wholesale rate reduction was due to a change in wholesale power suppliers from Kentucky Utilities Company to Big Rivers Electric Corporation ("Big Rivers"). Jackson Purchase further stated that the proposed rate increase was required due to increased salaries and wages, increased maintenance and depreciation expenses, and to meet its debt service and mortgage requirements.

On August 9, 1983, the Consumer Protection Division in the Office of the Attorney General moved to intervene in this proceeding pursuant to KRS 367.150(8), which motion was granted. No other parties appeared to formally intervene herein although a consumer's group, "We the People of Jackson Purchase," appeared with a spokesperson, Mrs. Betsy Irby, to voice its concerns about the management of the cooperative. The Commission scheduled a hearing on the matter and directed Jackson Purchase to give notice to its consumers of the proposed rates and the hearing scheduled for December 8, 1983.

This Order addresses the Commission's findings and determinations on issues presented and disclosed in the hearing and investigation of Jackson Purchase's revenue requirements and rate design. The rates granted herein reduce Jackson Purchase's annual revenues by $973,123. This reduction is the result of a $1,243,625 decrease in wholesale power costs and a rate increase of $270,502.

COMMENTARY

Jackson Purchase is a consumer-owned rural electric cooperative engaged in the distribution and sale of electric energy to approximately 18,630 member-consumers in the western Kentucky counties of Ballard, Carlisle, Graves, Livingston, Marshall and McCracken. As of January 1, 1984, Jackson Purchase obtains all its electric energy from Big Rivers.

TEST PERIOD

Jackson Purchase proposed and the Commission has accepted the 12-month period ending April 30, 1983, as the test period for determining the reasonableness of the proposed rates. In utilizing the historic test period, the Commission has given full consideration to appropriate known and measurable changes.

VALUATION

Net Investment

Jackson Purchase proposed a net investment rate base of $24,763,916. The Commission concurs with this determination with the exception of the provision for working capital which has been adjusted to reflect the pro forma adjustments to operation and maintenance expenses allowed herein and the reserve for depreciation which has been adjusted to reflect the allowed pro forma adjustment to depreciation expense. Based on these adjustments, Jackson Purchase's net investment rate base found reasonable for rate-making purposes is as follows:

Utility Plant in Service	$ 27,931,395
Construction Work in Progress	1,024,142
Total Utility Plant	$ 28,955,537
Add:	
Materials and Supplies	$ 408,881
Prepayments	79,479
Working Capital	367,847
Subtotal	$ 856,207
Deduct:	
Depreciation Reserve	$ 4,972,880
Customer Advances for Construction	9,806
Subtotal	$ 4,982,686
Net Investment	$ 24,829,058

Capital Structure

The Commission finds from the evidence of record that Jackson Purchase's capital structure at the end of the test year was $25,888,730 and consisted of $6,880,414 in equity and $19,008,316 in long-term debt. In this determination of the capital structure the Commission has excluded generation and transmission capital credits in the amount of $682,831.

REVENUES AND EXPENSES

Jackson Purchase proposed several pro forma adjustments to revenues and expenses to reflect more current and anticipated operating conditions. The Commission finds the proposed adjustments are generally proper and acceptable for rate-making purposes with the following exceptions:

Employee Compensation

In its original application Jackson Purchase proposed several adjustments which totaled $102,526 in order to normalize expenses related to employee compensation. Since the end of the test year Jackson Purchase had undergone a personnel reorganization and a re-negotiation of the labor agreement with its unionized employees. These events have resulted in additional increases in Jackson Purchase's operating costs of $67,430. These increases are specifically due to a greater number of non-union, inside employees and a lesser number of outside, union employees which results in a larger percentage of labor-related costs being expensed rather than capitalized; the recognition of increased FICA expenses beginning January 1, 1984; and the unionized employees received full funding of their retirement plan by Jackson Purchase in lieu of a wage increase. The Commission is concerned about Jackson Purchase's increasing labor expenses; however, Mr. John Ferguson, Jackson Purchase's manager, appears well prepared to deal with these issues. Therefore, the Commission is of the opinion that these changes are just and reasonable, and therefore has made an adjustment to increase

Jackson Purchase's operating expenses by $169,956 to reflect its current level of expense for employee compensation.

Ice Storm Expense

In January 1983 the Jackson Purchase service area experienced a severe ice storm which resulted in interrupted service to approximately one-half of Jackson Purchase's membership for periods of up to 7 days. Restoring this service caused Jackson Purchase to incur non-recurring, extraordinary expenses of $240,507 which it proposed to amortize over 2 years for rate-making purposes. The record herein indicates that at no time in the past 5 years has Jackson Purchase incurred storm-related expenses of this magnitude, and in fact, it was 5 years ago that Jackson Purchase last incurred ice storm-related expenses of any significance. These historical data would indicate that Jackson Purchase's test year expense should be amortized over a period substantially longer than the 2 years it proposed. However, the Commission recognizes that such an expense imposed a severe drain on Jackson Purchase's reserves which should be restored to insure the cooperative's financial integrity. Therefore, the Commission is of the opinion that the test year ice storm expense should be amortized over a period of 3 years which requires an adjustment to decrease Jackson Purchase's operating expenses by $160,338.

Extraordinary Expense - Interim Manager

During the 4 months of the test year from September through December 1982, Jackson Purchase employed an interim manager. Due to such items as travel and lodging expenses the cost to Jackson Purchase for an interim manager was $20,705 greater than what would have been incurred during the test year for a full-time manager under normal circumstances. In the original application Jackson Purchase proposed an adjustment of $5,049 to amortize $10,097 over a 2-year period. During the course of these proceedings it was found that the amount used by Jackson Purchase as the excess cost was understated by $10,608. Inasmuch as the circumstances leading to the hiring of an interim manager were extremely unusual and the expense incurred was relatively small, the Commission is of the opinion that a relatively short amortization period is appropriate so as not to extend a one-time expense such as this over several future periods. Therefore, in order to amortize the extra expense of $20,705 over a period of 2 years, the Commission has made an adjustment which reduces Jackson Purchase's operating expenses by $10,353.

Legal Expense - Labor Negotiations

The employees of Jackson Purchase, represented by union negotiators, went on strike in December 1982. During the course of the strike, Jackson Purchase, represented by legal counsel, conducted extensive negotiations with the bargaining agent for its employees. The total cost incurred by Jackson Purchase for legal work during these negotiations was $41,926. The Commission is of the opinion that the strike and extensive negotiations that occurred during the test year should not be annual recurring events and the costs thereof should not be treated as annual recurring expenses. Therefore, the test year expense of $41,926 has been amortized for rate-making purposes over a period of 3 years which results in a downward adjustment to Jackson Purchase's test year operating expenses of $27,951.

There were various other expenses, for legal work and advertising, which Mrs. Irby claimed were incurred by the cooperative in actions against its members. Although some of the advertising expenses were questionable, they were incurred after the test year and, therefore, have no bearing on this case.

Legal Assistance to Interim Manager

During the test year Jackson Purchase's general counsel provided legal and other assistance to the interim manager during his tenure with the Cooperative. For these services Jackson Purchase incurred an extraordinary, non-recurring expense of $7,064. The Commission is of the opinion that this expense is not representative of normal operating conditions, and therefore, has amortized this amount over 3 years for rate-making purposes, which results in a downward adjustment to Jackson Purchase's test year operating expenses of $4,709.

Depreciation Expense

Jackson Purchase proposed an adjustment of $174,910 to increase its test year depreciation expense. Of that amount, $60,752 was attributable to changes in depreciation rates which were recommended as a result of a recent depreciation study performed by the public accounting firm of Williams, Williams and Lentz. The Commission notes that Jackson Purchase followed the guidelines of Rural Electrification Administration ("REA") Bulletin 183-1 which furnishes a method to be used by borrowers to appraise the adequacy of their depreciation reserves. If a periodic review using these procedures indicates an inadequate depreciation reserve, REA recommends a detailed study to determine the adequacy of the individual rates. However, Bulletin 183-1 specifically allows deviations from REA depreciation procedures and prescribed rates if a utility is under the jurisdiction of a regulatory agency. Data filed in response to the Commission's information request show that the depreciation reserve ratio has been below the minimum level recommended by REA since 1978 and is still trending downward. However, the study furnished to justify the new rates requested is inadequate. Service lives and salvage values were selected almost entirely from employee estimates rather than actual accounting data. In some cases, REA recommended rates were used even though the study indicated other rates were appropriate. The Commission is of the opinion that the issue of whether Jackson Purchase's depreciation rates are adequate requires further consideration and will be addressed separately from this rate case. Therefore, the proposed adjustment of $60,752 attributable to changes in depreciation rates will be disallowed. For guidance, Jackson Purchase is directed to the procedure recently established by the Commission for telephone utilities.

Interest Income

During the test period Jackson Purchase had interest earnings on its investments of $92,299. Jackson Purchase proposed an adjustment of $22,187 to reduce interest income based on recent reductions in interest rates. The Commission is of the opinion that such an adjustment can not be properly made based on changes in interest rates while ignoring the amounts invested and the length of time of the investments. Therefore, the Commission has rejected the proposed adjustment and has included the actual test year interest income in the determination of revenue requirements.

Interest on Long-Term Debt

Jackson Purchase proposed an adjustment to increase annual interest expense on long-term debt by $99,266. The proposed adjustment was based on annual interest expense on the level of long-term debt projected to be outstanding at the end of December 1983.

The past practice of the Commission in rural electric cooperative cases has been to allow interest expense on long-term debt issued subsequent to the test period, when documentation has been provided to show that the funds have been drawn down and are actually outstanding at the time the Order is issued. This practice began in rural electric cooperative cases in 1980 while the Energy Regulatory Commission was serving as the utility regulatory body. This practice was implemented in part to provide an additional cushion to offset the high rate of inflation during that time, and to obviate the need for annual rate increases. The additional interest costs in the revenue requirements determination resulted in increased revenues and better enabled the rural electric cooperatives to achieve the earnings requirements of their primary lendors.

The practice of updating interest expense for post-test period debt issues for rural electric cooperatives is not consistent with the rate-making treatment afforded other utilities and is in direct conflict with the matching concept of the rate-making procedure. This Commission uses the historical test period, adjusted for known and measurable changes, as the basis for determining the revenue requirements for all utilities under its jurisdiction. Revenues are approved based on test year usage to provide for the normal recurring annual operating costs, including depreciation and taxes, and a reasonable return is provided to the ownership of the utility. In determining the annual operating costs of the utility a matching of expenses to invested capital and normalized test year revenues must occur. Therefore, in determining the level of invested capital a definite point in time is established, which is the last date of the historical test period. In order to achieve the matching of annual revenues, operating costs and invested capital, adjustments should not be made for changes which have occurred since the end of the test period, except in extraordinary circumstances when one factor changes without causing corresponding changes in the other factors.

The past practice of the Commission in allowing the interest on debt drawn down subsequent to the end of the test period creates a mismatch of projected revenues and expenses because no adjustments to update revenues for additional customers have been made. Therefore, the Commission put Jackson Purchase on notice in this proceeding that it would reconsider its past practice on this issue and gave Jackson Purchase the opportunity to present evidence on why this practice should not be discontinued.

The evidence presented by Jackson Purchase on this issue reflects that $988,245 of the new construction will be to provide service to new customers while other construction costs total $1,067,755. There is no evidence that these additional facilities will not result in either additional revenues or operating efficiencies which will partially offset the additional interest costs. The Commission is not persuaded by the evidence presented by Jackson Purchase on this issue and therefore is of the opinion and finds that the adjustment to include post test period debt in the determination of interest expense on long-term debt should be denied. The Commission has included in the determination of revenue requirements Jackson Purchase's annual interest expense based on the test year-end debt balances which reduces interest expense by $29,970.

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

	Actual Test Year	Pro Forma Adjustments	Adjusted Test Year
Operating Revenues	$ 17,744,164	$ 1,049,620	$ 18,793,784
Operating Expenses	16,539,450	<922,659>	15,616,791
Operating Income	$ 1,204,714	$ 1,972,279	$ 3,176,993
Interest on Long-Term Debt	1,089,116	<29,970>	1,059,146
Other Income and (Deductions) - Net	291,490	<112,281>	179,209
Net Income	$ 407,088	$ 1,889,968	$ 2,297,056

REVENUE REQUIREMENTS

The actual rate of return on Jackson Purchase's net investment rate base established herein for the test year was 4.85 percent. After taking into consideration the pro forma adjustments Jackson Purchase would realize a rate of return of 12.80 percent. The Commission is of the opinion that the adjusted rate of return is excessive and a more reasonable rate of return would be 8.88 percent. To achieve this rate of return Jackson Purchase's annual revenue should be decreased by $973,123 which would result in a Times Interest Earned Ratio of 2.25. This reduction to revenue will produce net income of $1,323,933, which should be sufficient to meet the requirements in Jackson Purchase's mortgages securing its long-term debt.

REVENUE ALLOCATION AND RATE DESIGN

Jackson Purchase proposed to allocate the revenue increase and decrease in cost of power by different methods in this case. In the matter of the revenue increase, Jackson Purchase proposed to increase the rates and charges of each schedule by the percentage of increase requested in revenue. Jackson Purchase further proposed that the reduction in the cost of power be decreased on a cents per kwh basis to each energy charge of the retail rates, except for Industrial Power schedule which tracked the Big Rivers' energy and demand charges. Jackson Purchase proposed no changes in the rate design. The Commission is of the opinion that the methods proposed by Jackson Purchase in this case are fair, just and reasonable. Therefore the Commission has applied the reduction of $371,298 to the requested increase in this case, which alters Jackson Purchase's proposed percentage factor from 3.32182 percent to 1.40358 percent.

UTILITY MANAGEMENT

During the past 18 months Jackson Purchase has experienced a great deal of change and unrest in addition to physical problems beyond its control. All these events--the change of managers, the labor dispute, the ice storm and the changes in the board of directors--have resulted in heightened interest and awareness on the part of Jackson Purchase's members concerning the operation of their utility and increased efforts on the part of management to provide efficient, reliable service at the lowest possible cost. The Commission is encouraged by these efforts and expects to see continued efforts by management to improve the operations of Jackson Purchase and do everything within its power to keep costs down and thereby keep the electric rates of its customers down. An aggressive program of cost controls is needed by all utilities in order to contain rising utility prices, and the Commission expects Jackson Purchase to carry out its stewardship and management duties at all times.

SUMMARY

The Commission, after consideration of the evidence of record and being advised, is of the opinion and finds that:

1. The rates in Appendix A are the fair, just and reasonable rates for Jackson Purchase and will provide net income sufficient to meet the requirements in Jackson Purchase's mortgages securing its long-term debt.

2. The rates and charges proposed by Jackson Purchase differ from those found reasonable herein and should be denied upon application of KRS 278.030.

IT IS THEREFORE ORDERED that the rates in Appendix A be and they hereby are approved for service rendered on and after January 1, 1984.

IT IS FURTHER ORDERED that the rates proposed by Jackson Purchase be and they hereby are denied.

IT IS FURTHER ORDERED that Jackson Purchase shall file with the Commission within 30 days from the date of this Order its revised tariff sheets setting out the rates approved herein.

Done at Frankfort, Kentucky, this 29th day of December, 1983.

PUBLIC SERVICE COMMISSION

Chairman

Vice Chairman

Commissioner

ATTEST:

Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 8863 DATED DECEMBER 29, 1983

The following rates and charges are prescribed for the customers in the area served by Jackson Purchase 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 date of this Order.

<u>Rates: Monthly</u>

<u>Schedule R - Residential</u>

<u>Service Charge:</u>	Minimum per month $ 6.15
<u>Energy Charge:</u>	
First 400 KWH	Per KWH per month 6.594¢
Next 600 KWH	Per KWH per month 4.831¢
Over 1000 KWH	Per KWH per month 4.480¢

<u>Schedule CSL - Community & Public Authority Street Lighting</u>

Each 175 Watt Mercury Vapor Lamp	Per month per lamp $ 7.08
Each 400 Watt Mercury Vapor Lamp	Per month per lamp 10.80

<u>Schedule C - Small Commercial</u>

<u>Service Charge:</u>	Minimum per month $ 6.15
<u>Energy Charge:</u>	
First 500 KWH	Per KWH per month 6.607¢
Next 500 KWH	Per KWH per month 5.847¢
Next 5,000 KWH	Per KWH per month 5.379¢
Over 6,000 KWH	Per KWH per month 4.494¢

<u>Schedule D - Commerical and Industrial Service & Three Phase Service</u>

<u>Service Charge:</u>	Minimum per month $15.00
<u>Energy Charge:</u>	
First 200 KWH	Per KWH per month 3.370¢
Over 200 KWH	Per KWH per month 3.136¢

Demand Charge:
Over 25 KW of billing demand per month, per KW per month $4.50

Schedule SP - Seasonal Power Service

Rate Per Year:

First 1,500 KWH	Per KWH per year 11.185¢
Next 500 KWH/H.P.	Per KWH per year 8.133¢
All Additional KWH	Per KWH per year 4.963¢

MINIMUM ANNUAL CHARGE:
The minimum annual charge under the above rate shall be:

A. First 25 connected horsepower or less (minimum) $309.00
Balance of connected horsepower Per H.P. per year 9.99

SCHEDULE I - Industrial Service

Rates Monthly:

Demand Charge:

First 3,000 KW of billing demand	Minimum per month $20,412
All additional KW	Per KW per month $ 6.804

Energy Charge:

All KWH	Per KWH per month $ .021939¢

SCHEDULE SL - Mercury Vapor Security Lighting

175 Watt mercury vapor lamp	Per month per lamp $ 7.08
400 Watt mercury vapor lamp	Per month per lamp 10.80

SCHEDULE ND - Commercial & Industrial & All Other Three Phase Service (under 25 KVA)

Service Charge: Minimum per month $ 7.00

Energy Charge:

First	500	Per KWH per month 6.607¢
Next	500	Per KWH per month 5.847¢
Next	5,000	Per KWH per month 5.379¢
All Over	6,000	Per KWH per month 4.494¢