COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

APPLICATION BY HARRISON COUNTY RURAL ELECTRIC COOPERATIVE CORPORATION FOR AN ADJUSTMENT OF RATES	)))	CASE NO. 9342

O R D E R

Harrison County Rural Electric Cooperative Corporation ("Harrison") filed an application on August 29, 1985, for an adjustment of rates to increase its annual revenue by $347,585, or 5.02 percent, citing increases in interest, depreciation and other expenses which have eroded the margins and its overall financial condition.

Harrison is a consumer-owned rural electric cooperative engaged in the distribution and sale of electric energy to approximately 8,878 member-consumers in the Kentucky counties of Harrison, Bourbon, Pendleton, Bracken, Scott, Nicholas, Grant and Robertson.

After timely notice, a hearing was held on December 17, 1985. Based upon the adjustments, modifications and determination herein, Harrison has been granted an increase of $295,944, or 4.27 percent.

TEST PERIOD

Harrison proposed and the Commission has accepted as a test period for calculating required revenue and rates the 12-month period ending May 31, 1985. In utilizing this historic test period, the Commission has given full consideration to appropriate known and measurable changes.

VALUATION

Net Investment

The Commission has adopted Harrison's proposed net investment rate base of $10,196,878, with the following modifications:

Harrison included $159,741 for prepayments and materials and supplies at its actual test year end levels. Harrison contended that the test year end balance for materials and supplies is not significantly different from the 13-month averages and that the test year end balance for prepayments is more representative of the current situation. However, Harrison's monthly financial statements show the 13-month average for these accounts to be $154,267.

In most instances, the Commission uses a 13-month average to determine the level of prepayments, and materials and supplies, to be included in the net investment. This averaging method is used to reflect the changing levels for these accounts throughout the test year. The Commission finds that the 13-month averages are more representative of future levels and therefore a 13-month average has been used to determine net investment rate base.

We adopt Harrison's proposed inclusion of an allowance for working capital of 1/8 of adjusted test-year operation and maintenance expenses, exclusiva of depreciation, taxes and other deductions, after adjusting operation and maintenance expenses to reflect the pro forma adjustments found reasonable herein.

With these adjustments, Harrison's net investment rate base for rate-making purposes is as follows:

Utility Plant in Service	$12,247,931
Construction Work in Progress	251,947
Total Utility Plant	$12,499,878
Add:	
Materials and Supplies	$ 138,795
Prepayments	15,472
Working Capital	149,412
Subtotal	$ 303,679
Deduct:	
Accumulated Depreciation	$ 2,509,965
Customer Advances for Construction	86,988
Subtotal	$ 2,596,953
Net Investment	$10,206,604

Capital Structure

Harrison reported a year-end capital structure of $12,315,536, consisting of $3,550,202 in equity (exclusive of generation and transmission capital credits) and $8,765,334 in long-term debt; and to that amount, proposed to add $347,585 to equity to reflect the additional revenues being requested in this application. This resulted in a proposed capital structure of $12,663,121. The Commission, in its determination of rate base and capital structure, attempts to match revenues, investment and capital based on the test year end. The equity adjustment proposed by Harrison goes beyond the end of the test period and should not, therefore, be included for rate-making purposes, as they would create a mismatch between rate base capital, revenues and expenses.

The Commission finds, from the evidence of record, that Harrison County's capital structure for rate-making purposes was

$12,315,536, and consisted of $3,550,202 in equity and $8,765,334 in long-term debt. In this determination of the capital structure, the Commission has excluded generation and transmission capital credit assignments in the amount of $852,310.

REVENUES AND EXPENSES

We find Harrison's adjustments to test period revenues and expenses acceptable, for rate-making purposes, as reflecting current and anticipated operating conditions with only the following modifications:

Fuel Synchronization Adjustment

Harrison did not normalize its operating revenues nor its purchased power expenses because Fuel Adjustment Clause revenues and expenses were included. The Commission is of the opinion that normalization adjustments should be made to operating revenues and purchased power expenses to remove any effect of the Fuel Adjustment Clause. Therefore, the Commission has made a normalization adjustment of $27,848,[1] which reduces operating revenues from $7,065,905 to $7,038,057. Additionally, the Commission has made a normalization adjustment of $32,055,[2] which reduces purchased power expenses from $4,702,978 to $4,670,923.

Data Processing

Harrison proposed an adjustment of $9,205, so as to reflect the full annual cost of additional computer service from

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1 Application, Exhibit B.

2 Staff Data Request No. 2, Item No. 16.

Central Area Data Processing (commencing in December 1984) based upon the additional $1,534 cost per month for this service.

The record not only shows that this service will provide improved and more efficient service to the ratepayers, but also that it will produce off-setting cost savings equaling, or exceeding, the additional monthly cost.[3] The new computer system has eliminated the need to manually post accounts and check records, among other things, freeing up resources which may be applied to reducing costs in other areas of administration. Harrison's failure to quantify and offset expenses with these cost savings in its adjustment makes allowance of this expense adjustment inappropriate for rate-making purposes in this case. The Commission has, therefore, disallowed it.

Directors Fees and Expenses

Harrison incurred $24,042 in directors fees and expenses during the test period. We have disallowed, for rate-making purposes, $161 incurred as reimbursement for spouses' attendance at board meetings and $3,235 paid by Harrison as a per diem allowance to directors attending industry-associated meetings other than its own board meetings.

The Commission is aware that non-profit cooperatives must have dedicated and competent directors at the board level, but no showing has been made that reimbursement for spouses' travel or per diem allowances for discretionary meetings advance these objectives.

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3 Staff Data Request No. 3, Item No. 3.

Interest Income

Harrison proposed an adjustment to reduce interest income by $35,143 to reflect the drop in interest rates occurring since the beginning of the test period. They attempted to establish an average investment balance during the test year in Exhibit B, Schedule 7, of the application, and concluded that $518,166 should be used to calculate the adjustment. This amount is equal to the summation of each investment note purchased during the test year divided by 12 months. The Commission finds no sound basis for this methodology. An average daily investment balance would be a more appropriate basis to be used in calculating this adjustment, but the Commission's attempt to obtain this from Harrison was not responded to in a manner that would allow this amount to be determined. Moreover, selection of an appropriate interest rate to estimate future income is so conjectural that even a computation on average daily balances would be highly speculative and of little value. Therefore, the Commission has not included the proposed interest income adjustment for rate-making purposes herein.

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

	Actual Test Year	Pro Forma Adjustments	Adjusted Test Year
Operating Revenues	$ 7,050,094	$<12,037>	$7,038,057
Operating Expenses	6,420,866	<12,391>	6,408,475
Operating Income	$ 629,228	$ 354	$ 629,582
Interest on Long-Term Debt	478,608	44,803	523,411
Other Income/(Deductions)Net	121,282	-0-	121,282
Net Income	$ 271,902	$<44,449>	$ 227,453

REVENUE REQUIREMENTS

The actual rate of return on Harrison's net investment rate base established herein for the test period was 6.20 percent. Harrison has requested rates that would produce a rate of return of 9.45 percent and a Times Interest Earned Ratio ("TIER") of 2.0X. The TIER requested by Harrison is reasonable and consistent with levels granted in recent electric cooperative proceedings and should therefore be allowed.

In order to achieve this TIER, Harrison should be allowed to increase its annual revenue by $295,944, which would result in a rate of return of 9.1 percent. This additional revenue will produce net income of $523,411, which will be sufficient to meet the requirements in Harrison's mortgages securing its long-term debt and provide for reasonable equity growth.

COST OF SERVICE

Harrison offered a cost of service study through its witness, Mr. James Atkin, and proposes to use it in determining class revenue requirements and designing retail rates.

The Commission strongly urges the use of cost of service studies as a useful tool in rate proceedings, but statistically acceptable load research is a necessary input in preparing accurate cost of service studies. Since acceptable load research data was not included, the Commission is unable to utilize Harrison's proposed cost of service study in this case. The studies may be useful in future proceedings when the load information that is being compiled by East Kentucky Power Cooperative is made available to them.

REVENUE ALLOCATION AND RATE DESIGN

Since Harrison's cost of service study is not supported by adequate load research, we have determined that the revenue increase would be better allocated proportionally to the total revenue produced by each rate class. Therefore, the revenue increases have been allocated to the rate classes by approximately the following percentages:

Rate Class	Percent
Farm and Home Service	80.02
Commercial and Small Power	3.45
Large Power (50-500 KW)	7.39
Large Power (Over 500 KW)	6.14
Outdoor Lighting Service	3.00

Moreover, the large percentage increases in consumer charges proposed by Harrison are not in keeping with the principle of rate continuity. It is our experience that a gradual increase of the consumer charges, approximately equal to the overall percentage increase in revenue, is a more reasonable approach. Finally, Harrison proposed to increase its demand rate to equal the demand rate of its wholesale supplier, East Kentucky Power. The Commission is of the opinion that Harrison's proposed demand rate is reasonable.

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 Harrison and will provide net income sufficient

to meet the requirements in Harrison's mortgages securing its long-term debt.

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

3. Harrison's proposed tariffs are not fair, just and reasonable and should be rejected.

4. Harrison's proposed revenue allocation and rate design methodologies are not fair, just and reasonable and should be rejected.

5. Harrison's proposed cost of service study should not be approved.

IT IS THEREFORE ORDERED that:

1. The rates in Appendix A be and they hereby are approved for service on and after the date of this Order.

2. The rates proposed by Harrison be and they hereby are denied.

3. Harrison shall file with the Commission within 30 days from the date of this Order its revised tariff sheets setting out the rates approved herein.

4. The tariffs proposed by Harrison be and they hereby are denied.

Done at Frankfort, Kentucky, this 10th day of March, 1986.

PUBLIC SERVICE COMMISSION

Richard D. Heman, Jr.
Chairman

Vice Chairman

Jim N. Williams, Jr.
Commissioner

ATTEST:

Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 9342 DATED 3/10/86

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

SCHEDULE A - RATE 1
FARM AND HOME SERVICE*

Rates:

Consumer Charge	$6.26 Per Month
All KWH used	.06701 Per KWH

SCHEDULE A - RATE 1 - T-O-D
FARM AND HOME SERVICE T-O-D*

Rates:

On-Peak Rate:	
Customer Charge	$6.26 Per Month
All KWH/Month	.06701 Per KWH
Off-Peak Rate:	
All KWH/Month	.04021 Per KWH

RATE 2
COMMERCIAL AND SMALL POWER SERVICE (0 - 50 KW DEMAND)*

Rates:

Consumer Charge	$11.47 Per Month
All KWH Used	.05423 Per KWH
All KW Demand Used	7.82 Per KW

RATE 8
LARGE POWER SERVICE (50 TO 500 KW DEMAND)*

Rates:

Consumer Charge	$28.68 Per Month
All KWH Used	.04362 Per KWH
All KW Demand Used	7.82 Per KW

LPR-1, RATE 8
LARGE POWER SERVICE OVER 500 KW DEMAND*

Rates:

Consumer Charge	$40.16 Per Month
All KWH Used	.03982 Per KWH
All KW Demand Used	7.82 Per KW

SECURITY LIGHTS
OUTDOOR LIGHTING SERVICE*

Rate Per Fixture:

Type of Fixture	Lamp Size	Monthly Charge
Mercury Vapor	175 Watts (73 KWH/lamp)	$6.03 Per Month
Mercury Vapor	400 Watts (154 KWH/lamp)	$9.61 Per Month

*Fuel Clause Adjustment

All rates are applicable to the Fuel Adjustment Clause and may be increased or decreased by an amount per KWH equal to the fuel adjustment amount per KWH as billed by the Wholesale Power Supplier plus an allowance for line losses. The allowance for line losses will not exceed 10% and is based on a twelve-month moving average of such losses. This Fuel Clause is subject to all other applicable provisions as set out in 807 KAR 5:056.