COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

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| THE APPLICATION OF FARMERS RURAL ELECTRIC COOPERTIVE CORPORATION FOR AN ORDER AUTHORIZING A BASIC RATE INCREASE AND CHANGES IN ITS BILLING AND COLLECTING POLICY COMBINED IN THE RULES AND REGULATIONS OF SERVICE | ) | CASE NO. 9446 |

O R D E R

Farmers Rural Electric Cooperative Corporation ("Farmers") filed an application on November 21, 1985, for an adjustment of rates to increase its annual revenue by $733,494, or 6.08 percent, citing the need that it is essential to maintain financial stability to maintain solvency and to meet the mortgage requirements of the Rural Electrification Administration ("REA") and National Rural Utilities Cooperative Finance Corporation ("CFC").

Farmers is a consumer-owned rural electric cooperative engaged in the distribution and sale of electric energy to approximately 14,917 member-consumers in the Kentucky counties of Barren, Hart, Metcalfe, Adair, Green, Larue, Grayson, and Edmonson.

After timely notice, a hearing was held on March 12, 1986. Based upon the adjustments, modifications and determination herein, Farmers has been granted an increase of $318,246, or 2.6 percent.

## DICKERSON LUMBER

Dickerson Lumber, a customer of Farmers, appeared at the hearing and requested to intervene and participate in the rate proceeding. Farmers objected to the intervention as being untimely. The presiding hearing officer requested Dickerson to file a written motion to intervene and granted Farmers time to respond. Dickerson was allowed to participate in the hearing subject to a later ruling by the Commission on its intervention.

On March 12, 1986, Dickerson filed its formal motion to intervene alleging that it was not aware of this case until March 1986, when it received notice of the hearing as published in the Rural Kentuckian magazine. Dickerson's motion states that it has installed a qualified small power production facility capable of producing a minimum of 600 kilowatts of power and 432,000 kilowatt hours per month of energy which has been offered for sale to Farmers. However, Dickerson claims that it is uneconomical to operate its generation facility due to the absence of any capacity payment in Farmers' tariff. The motion further alleges that the Commission should reduce Farmers' purchased power cost by $23,844, the minimum annual savings that would result if power and energy had been purchased from Dickerson at its proposed rates.

Farmers' response, filed on March 31, 1986, objects to Dickerson's intervention as untimely since notice of the rate case had been published in the newspaper for 3 consecutive weeks during November 1985. Farmers further alleges that although Dickerson participated in the hearing, it did not produce any evidence and, consequently, there is no basis for the Commission to make any findings of potential savings in purchased power costs.

The Commission is of the opinion that while its regulation requires motions to intervene to be filed within 30 days after publication of the notice of rate changes, 807 KAR 5:011, Section 8(3), this regulation must be applied in a pragmatic manner to protect the rights of both applicants and intervenors. In this case, Dickerson appeared and participated in the scheduled hearing without any attempt to delay or disrupt the proceedings. Dickerson's motion to intervene should be granted with the limitation that it must accept the status of the proceedings as of the date of its appearance at the hearing.

A review of the substantive relief requested by Dickerson, a downward adjustment to Farmers' purchased power costs based on its potential purchase of cogenerated power, indicates that Dickerson's intent is to object to Farmers' existing tariff for purchase of power from a cogenerator. This is evidenced by Dickerson's calculation of its proposed adjustment utilizing a rate significantly higher than that approved by the Commission. However, even if Dickerson's adjustment was accepted, Farmers would be under no obligation to modify its cogeneration tariff. The Commission finds that this rate proceeding is not an appropriate forum for Dickerson to pursue its individual challenge to Farmers' existing cogeneration tariff. Such a challenge involves issues related to Dickerson's generation facility and Farmers' avoided purchased power costs, such issues being separate and distinct from those in a general rate adjustment.

Dickerson's proposed adjustment must be rejected without prejudice to its right to initiate a complaint proceeding pursuant to KRS 278.260. However, the Commission reminds Dickerson that the methodology underlying its proposed adjustment was previously considered and rejected in Case No. 8566, Setting Rates and Terms and Conditions of Purchase of Electric Power From Small Power Producers and Cogenerators by Regulated Electric Utilities. The rejection was based on the finding that:

> The Commission would agree with Dickerson Lumber if the "full-requirements" section of FERC Rule 69 did not require the supplying utilities to be in the same financial condition after the purchase of QF power as before its purchase. To the extent that the energy rate in the wholesale contract contains fixed cost components, EKP or Farmers would under-recover revenue lost due to the purchase of QF power and hence, other consumers would assume additional costs. Therefore the Commission does not accept Dickerson Lumber's proposed methodology.[1]

## TEST PERIOD

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

## VALUATION

The Commission has adopted Farmers' proposed net investment rate base of $14,871,944 with the exception that Farmers' proposed inclusion of an allowance for working capital of 1/8 of adjusted

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1 Case No. 8566, p. 30.

test-year operation and maintenance expenses, exclusive of depreciation, taxes and other deductions, has been recalculated to reflect the pro forma adjustments found reasonable herein.

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

| | |
|---|---|
| Utility Plant in Service | $19,774,415 |
| Construction Work in Progress | 108,512 |
| Total Utility Plant | $19,882,927 |
| Add: | |
| Materials and Supplies | $ 178,215 |
| Prepayments | 29,105 |
| Working Capital | 213,436 |
| Subtotal | $ 420,756 |
| Deduct: | |
| Accumulated Depreciation | $ 5,295,931 |
| Customer Advances for Construction | 135,770 |
| Subtotal | $ 5,431,701 |
| Net Investment | $14,871,982 |

Capital Structure

Farmers reported a year-end capital structure of $17,264,774, consisting of $5,167,749 in equity, exclusive of Generation and Transmission Capital Credits ("GTCCs"), and $12,097,025 in long-term debt. Farmers proposed to add $405,451 to year-end equity to reflect the proposed net revenue and expense adjustments being requested in this application. This resulted in a proposed capital structure of $17,670,225. In its determination of rate base and capital structure, the Commission attempts to match revenues, investment and capital based on the test year end. The equity adjustment proposed by Farmers goes beyond the end of the test period and should not, therefore, be included for rate-making purposes, as it would create a mismatch between rate base capital, revenues and expenses.

The Commission finds, from the evidence of record, that Farmers' capital structure for rate-making purposes was $17,264,774, and consisted of $5,167,749 in equity and $12,097,025 in long-term debt. In this determination of the capital structure, the Commission has excluded GTCC assignments in the amount of $1,722,737.

## REVENUES AND EXPENSES

Farmers proposed several adjustments to revenues and expenses to reflect current and anticipated operating conditions. The Commission finds the proposed adjustments are generally proper and acceptable for rate-making purposes, with the following modifications:

### Fuel Synchronization Adjustment

Farmers did not normalize its operating revenues nor its purchased power expenses because Fuel Adjustment Clause ("FAC") 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 FAC. Therefore, the Commission has made a normalization adjustment of $47,350, which reduces operating revenues from $12,266,981 to $12,219,631. Additionally, the Commission has made a normalization adjustment of $45,285, which reduces purchased power expenses from $8,942,561 to $8,897,276.

Directors Fees and Expenses

Farmers incurred $26,895 in directors fees and expenses during the test period. The Commission has disallowed, for rate-making purposes, $1,350 paid by Farmers 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 per diem allowances for discretionary meetings advance these objectives.

Charitable Contributions

During the test period, Farmers contributed $689 to charities and civic groups within its service area. While the Commission believes that these contributions are good for community relations, they are not related to the provision of reliable electric service to the members of Farmers. The Commission finds that the rates charged consumers for utility services should reflect only the cost of providing those services. Therefore, the Commission has excluded these expenses for rate-making purposes herein.

Advertising Expense

Farmers' test period expenses included advertising costs of $6,453 for institutional and promotional purposes. Farmers proposed an adjustment to exclude $1,236 of this expense. Inasmuch as 807 KAR 5:016 specifically disallows the full amount of this type of advertising, the Commission has reduced operating expenses of $6,453 to reflect the full exclusion of institutional and promotional advertising.

Insurance Expense

Farmers proposed an adjustment of $10,502 to insurance expense to reflect the estimated increase in insurance effective November 1, 1985. The adjustment proposed by Farmers did not take into account capitalized insurance costs and, additionally, the subsequent actual insurance premium was greater than the estimated amount.

In determining the allowable insurance expense adjustment the Commission has used the actual November 1, 1985, billing and has capitalized 31.5 percent of the increase, the amount equal to wages capitalized to total wages, to reflect non-expensed insurance costs. This results in an insurance expense adjustment of $10,810.

Maintenance of Right-of-Way

Farmers proposed a $100,000 adjustment to reflect the cost of hiring a maintenance contractor to clear rights-of-way. The maintenance to be done by this contractor was to be in addition to the normal annual maintenance performed by Farmers' full-time five-man crew.

The Commission examined this proposal extensively in an attempt to determine if this additional maintenance was needed and to determine if the adjustment is known and measurable.

In its response to Item 1 of the first information request, Farmers indicated that the basis for the proposed adjustment was the estimated cost per hour, $63, multiplied by the estimated number of hours, 1,587. Subsequently, Farmers supported the estimated number of hours as being determined by dividing the amount requested, $100,000, by the cost per hour. The Commission is of the opinion that the method of justification presented by Farmers is unsound. The argument that $100,000 was arrived at by multiplying 1,587 x 63, and that at the same time the 1,587 was obtained by dividing $100,000 by 63 is circuitous and, therefore, inappropriate as support for this adjustment.

Moreover, the only study of the need for additional maintenance presented by Farmers to justify this adjustment is one resulting from an inspection performed by a right-of-way clearing contractor in 1984. At that time 600 "cases" requiring right-of-way clearance were reported. The record reflects that in 1985, 462 "cases" were corrected by Farmers and that "a big portion"[2] of these cases were the same as included in the 1984 inspection report. The Commission must conclude from this testimony that Farmers has been successful in its maintenance efforts without additional work by an outside contractor.

Additionally, Farmers has indicated that it has made no estimates as to how much work a contracting crew could perform if paid $100,000 annually. In the absence of a comprehensive plan detailing the benefit of a $100,000 adjustment, this amount is arbitrary. Furthermore, Farmers made reference that additional revenues and cost savings would be generated by the additional

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2 Transcript of Evidence, March 12, 1986, p. 65.

right-of-way maintenance; however, these amounts were not quantified and included as part of the adjustment. Therefore, the adjustment is incomplete as to its total effect and impact on expenses on a prospective basis and has not been included herein for rate-making purposes.

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

| | Actual Test Year | Pro Forma Adjustments | Adjusted Test Year |
|---|---|---|---|
| Operating Revenues | $12,266,981 | $ <47,350> | $12,219,631 |
| Operating Expenses | 11,369,195 | <13,892> | 11,355,303 |
| Operating Income | 897,786 | <33,458> | 864,328 |
| Interest on LTD | 601,715 | 49,960 | 651,675 |
| Other Income/ (Deductions) Net | 271,347 | <150,571> | 120,776 |
| Net Income | $ 567,418 | $ <233,989> | $ 333,429 |

REVENUE REQUIREMENTS

The actual rate of return on Farmers' net investment rate base established herein for the test period was 5.8 percent. Farmers requested rates that would produce a rate of return of 10.58 percent and a Times Interest Earned Ratio ("TIER") of 2.5X. Farmers indicated that these earning levels were required in order to comply with REA and CFC mortgage agreements. Farmers further stated that it requested this level of TIER because it was advised to do so by REA and CFC representatives, the median TIER for all cooperatives in the state is 2.32X, and because REA may be phased out.

Farmers' actual TIER for the test year was 1.94X and its TIER was 1.04X and 1.98X for the calendar years 1983 and 1984, respectively. After taking into consideration the pro forma adjustments in this case, Farmers would achieve a 1.51X TIER without an increase in revenues. Farmers' equity to total asset ratio is 29.9 percent based on the capital structure approved herein. Farmers' Debt Service Coverage ratio for the test year and calendar years 1983 and 1984 was .65X, 1.91X and 1.94X, respectively. All of these ratios are based on the earnings of Farmers exclusive of the GTCCs assigned to Farmers by East Kentucky Power Cooperative, Inc.

In 1982, Farmers was granted a rate of return of 8.53 percent, which provided a TIER of 2.25X. Recognizing the lowering of interest rates and the overall improvement in economic conditions from those that existed in 1982, the Commission has lowered the rates of return allowed in certain cases involving other utilities under its jurisdiction. Recent decisions involving electric cooperatives have resulted in allowed TIER levels of 2.00X reflecting the Commission's opinion that rates of return and TIER should be reduced. The REA, Farmers' principal lender, requires its borrowers to maintain an average TIER of at least 1.5X for 2 out of the most recent 3 calendar years. The TIER as calculated by REA for purposes of meeting the minimum mortgage requirements includes GTCCs assigned during the calendar year. The Commission recognizes that a cooperative may not actually achieve a TIER of 1.5X if the revenue requirements were based on a 1.5X TIER, and provides an allowance by basing the revenue requirement on a 2.00X TIER. The Commission is of the opinion that Farmers' revenue requirement should be based on a TIER of 2.00X in this case.

The Commission has noted that Farmers' capital structure as of test year-end consisted of 29.9 percent equity and 70.1 percent debt after removal of accumulated GTCCs. The equity level achieved by Farmers is viewed by the Commission as an indication of Farmers' stable financial condition. A basic principle of a cooperative is that the customers of the cooperative who are actually the owners should be allowed to benefit from strong financial performance of the cooperative by receiving a refund of capital credits or by realizing a reduction in the cost of electric service. With the improving equity level, the Commission expects Farmers to seriously consider as a part of its financial planning methods whereby the consumer-owners of the cooperative will receive the maximum benefits of the cooperative form of organization.

Based on the evidence of record and the reasons cited herein, the Commission has determined that a TIER of 2.00X should be granted in this case. In order to achieve this TIER, Farmers should be allowed to increase its annual revenue by $318,246, which would result in a rate of return of 7.95 percent. This additional revenue will produce net income of $651,675, which should be sufficient to meet the requirements in Farmers' mortgages securing its long-term debt.

REVENUE ALLOCATION AND RATE DESIGN

Farmers proposed to allocate the revenue and rate design increases to each rate class by the percent of revenue increase.

In this case, the Commission agrees with Farmers' methodology and used the same methodology to allocate the final revenue and rate design increases.

## 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 Farmers and will provide net income sufficient to meet the requirements in Farmers' mortgages securing its long-term debt.

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

IT IS THEREFORE ORDERED that:

1. Dickerson's motion to intervene be and it hereby is granted.

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

3. The rates proposed by Farmers be and they hereby are denied.

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

Done at Frankfort, Kentucky, this 15th day of May, 1986.

PUBLIC SERVICE COMMISSION

Chairman

Vice Chairman

Commissioner

ATTEST:

Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 9446 DATED MAY 15, 1986

The following rates and charges are prescribed for the customers in the area served by Farmers 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 R
RESIDENTIAL SERVICE *

Rates:

| | | | |
|---|---|---|---|
| First | 50 KWH | (Minimum Charge) | 14.012¢ Per Month |
| Next | 150 KWH | | 8.421¢ Per KWH |
| Remaining | KWH | | 5.877¢ Per KWH |

Minimum Charges:

The minimum monthly charge to customers billed under the above rate shall be $7.01 for single-phase service. Payment of the minimum charge shall entitle the consumer to the use of the number of KWH corresponding to the minimum charge in accordance with the foregoing rate. The minimum monthly charge for three-phase service shall be $.75 per KVA of installed transformer capacity.

SCHEDULE R T-O-D
RESIDENTIAL SERVICE T-O-D*

Rates

On-Peak Rate:

| | |
|---|---|
| Service Charge | $2.80 |
| Under 200 KWH/Mo. | 8.421¢/KWH |
| Service Charge | $7.88 |
| Over 200 KWH/Mo. | 5.877¢/KWH |

Off-Peak Rate:

| | |
|---|---|
| Under 200 KWH/Mo. | 5.053¢/KWH |
| Over 200 KWH/Mo. | 3.526¢/KWH |

SCHEDULE C
COMMERCIAL AND INDUSTRIAL SERVICE*

Rates Per Month:

For all consumers whose kilowatt demand is less than 50 KW:

Kilowatt Demand Charge: None

| | | | | |
|---|---|---|---|---|
| First | 50 | KWH | (Minimum Charge) | 14.012¢ Per KWH |
| Next | 150 | KWH | | 8.639¢ Per KWH |
| Remaining | | KWH | | 6.373¢ Per KWH |

For all consumers whose kilowatt demand is 50 KW or above:

Kilowatt Demand Charge: Per KW $4.93

Energy Charge:

| | | | |
|---|---|---|---|
| First | 10,000 | KWH | 5.205¢ Per KWH |
| Next | 20,000 | KWH | 5.035¢ Per KWH |
| Remaining | | KWH | 4.890 Per KWH |

Minimum Monthly Charge:

The minimum monthly charge under the above rates shall be $7.01 for single-phase service. Payment of the minimum charge shall entitle the consumer to the use of the number of kilowatt hours corresponding to the minimum charge in accordance with the foregoing rate.

SCHEDULE D
LARGE COMMERCIAL/INDUSTRIAL SERVICE
OPTIONAL TIME-OF-DAY RATE

Rates Per Month

Kilowatt Demand Charge: $4.93 Per KW

Energy Charge:

| | | | | |
|---|---|---|---|---|
| First | 10,000 | KWH | @ | 5.205¢ Per KWH |
| Next | 20,000 | KWH | @ | 5.035¢ Per KWH |
| Remaining | | KWH | @ | 4.890¢ Per KWH |

SCHEDULE OL
OUTDOOR LIGHTING SERVICE*

Rate Per Fixture:

| Type of Lamp | Watts | Monthly KWH Usage | Monthly Charge Per Lamp |
|---|---|---|---|
| Mercury Vapor | 175 | 70 | $6.41 |
| Mercury Vapor | 250 | 98 | 7.19 |
| Mercury Vapor | 400 | 156 | 10.90 |
| Mercury Vapor | 1000 | 378 | 18.44 |
| Sodium Vapor | 100 | 42 | 6.88 |
| Sodium Vapor | 150 | 63 | 7.91 |
| Sodium Vapor | 250 | 105 | 10.61 |
| Sodium Vapor | 400 | 165 | 13.43 |
| Sodium Vapor | 1000 | 385 | 28.92 |

*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.

RULES AND REGULATIONS

## Consumer Billing and Collecting Policy

Bills are to be mailed on or about the first day of each month covering service rendered during the month ending at the first of the preceding month except the final bill may be rendered as soon as possible after service is disconnected.

Final bills shall be for service used in the month in which disconnect is made and the preceding month.

Electric energy bills are due and payable from first through fifteenth of each month afterwhich the gross amount will be 10% higher, not to exceed $5.00, on the unpaid amount. Failure to receive bill shall not release the obligation to pay.

Delinquent notices are to be sent out as soon as possible after the 15th of each month. Field collection date for delinquent accounts shall be 10 days after mailing of notice and at least 27 days after the mailing of the original bill.

A $15 fee is to be collected on first call and on all subsequent calls for purposes of collecting delinquent accounts during regular working hours. Thirty dollars ($30.00) will be collected for trips made other than during regular working hours.

No consumer is to be reconnected at any location without first having paid all previous indebtedness to the Cooperative. Service to a consumer is not to be connected in another name in order to avoid payment of an unpaid bill.

A service charge of $15.00 shall be applied to each reconnect requiring a trip.

Reminder letter or invoice statement to be issued 15 days after final bill is rendered to unpaid accounts of disconnected consumers.

Periodically, all delinquent accounts are to be turned over to an attorney or competent collecting agency for further proceedings, provided such amount exceeds the membership fee and consumer deposit.

A $5.00 fee is to be collected when checks are returned from bank marked "Insufficient Funds." The drawer of said check is to be notified by letter and his service placed on the cut-off list, along with other delinquent accounts and handled in the same manner as outlined above.

All consumers are to be members of the Cooperative. Cases of failure to pay membership fee shall be treated in the same manner as outlined above on delinquent accounts.

A deposit or suitable guarantee not exceeding two-twelfths (2/12) of the estimated annual bill may be required of any member or customer before electric service is supplied. These deposits shall accrue interest at 6% per annum. Upon termination of service, the deposit and accrued interest may be applied against unpaid bills and the remainder of such balance shall be paid to the consumer.

A budget billing plan is available to consumers who desire it. The estimated amount of twelve-months usage will be determined by the Cooperative with the budget payments being 1/12 of this amount. Any difference between the amount paid and the amount owed during the twelve-month period will be adjusted by adding or crediting the difference on the regular electric service bill payable July 1. The budget payment plan will continue from year to year unless terminated by either party giving a one-month notice to the other. Payments shall be adjusted each year as near to expected billing as possible. The budget billing plan may be terminated at any time the consumer's bill becomes delinquent.