

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

NOTICE AND APPLICATION OF JACKSON)
PURCHASE ELECTRIC COOPERATIVE)
CORPORATION FOR PERMISSION TO FLOW)
THROUGH A WHOLESALE RATE INCREASE) CASE NO. 10277
FILED BEFORE THE KENTUCKY PUBLIC)
SERVICE COMMISSION BY BIG RIVERS)
ELECTRIC CORPORATION, DOCKET NO.)
10265)

O R D E R

On June 30, 1988, Jackson Purchase Electric Cooperative Corporation ("Jackson Purchase") filed with this Commission its notice of increase in rates for retail electric service to become effective on January 1, 1989. Jackson Purchase requested to flow-through the increase in wholesale rates proposed by Big Rivers Electric Corporation ("Big Rivers") in Case No. 10265, Big Rivers Electric Corporation's Notice of Changes in Rates and Tariffs for Wholesale Electric Service. The proposed rates to flow-through the increase proposed by Big Rivers would produce additional revenue of \$1,320,756 annually, an increase of 5.4 percent based on normalized test-year revenues. The proposed rates reflect Jackson Purchase's proposal to absorb \$566,818 of the increase from Big Rivers.

On July 26, 1988, the Commission issued a procedural Order suspending the proposed increase in rates for a period of 5

months, until January 1, 1989, in order to conduct public hearings and investigations into the reasonableness of the proposed rates. A hearing was scheduled for November 16, 1988 for the purpose of cross-examination of the witnesses of Jackson Purchase and the intervenors. Jackson Purchase was directed to provide statutory notice to its consumers of the proposed rate increase and the scheduled hearing pursuant to 807 KAR 5:011, Section 8.

The Commission granted the Motion to Intervene filed by the Utility and Rate Intervention Division of the Office of the Attorney General. There were no other intervenors in this proceeding.

The hearing was conducted in the Commission's offices in Frankfort, Kentucky, on November 16, 1988. The information requested during the hearing has been submitted.

COMMENTARY

Jackson Purchase is a consumer-owned rural electric cooperative corporation, organized under Chapter 279 of the Kentucky Revised Statutes, engaged in the distribution and sale of electric energy to approximately 20,027 member-consumers in the Kentucky counties of Ballard, Carlisle, Graves, Livingston, Marshall, and McCracken. Jackson Purchase has no electric generating facilities of its own, and purchases all of its power from Big Rivers, of which Jackson Purchase is one of four members.

TEST PERIOD

Jackson Purchase proposed, and the Commission has accepted, the 12-month period ending December 31, 1987 as the test period for determining the reasonableness of the proposed rates. To make the historical test period more reflective of expected future

needs, the Commission has given full consideration to appropriate known and measurable changes.

VALUATION

Net Investment

Jackson Purchase presented in its Exhibit 7 a net investment rate base of \$30,728,914 based on the test-year-end value of plant in service, the 13-month average for materials and supplies, and prepayments, and excluding the proposed pro forma accumulated depreciation and customer advances for construction at the end of the test period. In addition, Jackson Purchase proposed to include working capital based on one-eighth of operation and maintenance expenses, exclusive of depreciation, taxes and other deductions. The Commission concurs with this determination with the exception that working capital has been adjusted to reflect the pro forma adjustments to operation and maintenance expenses found reasonable.

Based on these adjustments, Jackson Purchase's net investment rate base for rate-making purposes is as follows:

Utility Plant in Service	\$36,524,433
Construction Work in Progress	104,199
Total Utility Plant	<u>\$36,628,632</u>
ADD: Materials and Supplies	\$ 442,413
Prepayments	76,134
Working Capital	359,533
Subtotal	<u>\$ 878,080</u>
DEDUCT: Accumulated Depreciation	\$ 6,768,064
Customer Advances for Construction	22,586
Subtotal	<u>\$ 6,790,650</u>
NET INVESTMENT	<u><u>\$30,716,062</u></u>

Capital Structure

The Commission finds, from the evidence of record, that Jackson Purchase's capital structure at the end of the test period for rate-making purposes was \$35,582,261 and consisted of \$13,321,453 in equity and \$21,801,008 in long-term debt. In this determination of the capital structure, the Commission has excluded accumulated generation and transmission capital credits ("GTCCs") assigned from Jackson Purchase's wholesale power supplier in the amount of \$1,129,832. The Commission has also excluded \$2,475,882 in outstanding long-term debt which reflects debt to be assumed by Big Rivers for the purchase of transmission facilities from Jackson Purchase.

The Commission has given due consideration to these and other elements of value in determining the reasonableness of the proposed rate increase.

REVENUES AND EXPENSES

Jackson Purchase proposed several 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 modifications:

Payroll

Jackson Purchase proposed to increase its test-year labor expense by \$37,692. The proposal reflected a 3.5 percent pay-rate increase for union employees effective November 3, 1987 and a 2.6 percent cost of living increase for non-negotiating employees effective January 1, 1988. Jackson Purchase calculated the

increase by applying the percentage increase to the test-year payroll costs for the two groups as of the date of the increase. This amount was then reduced by the calculated capitalized cost, determined by applying a 33.82 percent capitalization rate, to arrive at the increase in payroll expense.

The Commission is of the opinion that this adjustment should be calculated by using the annualized work hours and the actual overtime hours, multiplied by the January 1, 1988 hourly wage rates. Terminated employees were removed from the calculations and part-time employees were calculated using the test-year actual hours worked. Annualized work hours are determined as 8-hour days, at 5 days a week for 52 weeks or 2,080 hours. Jackson Purchase has conceded that this methodology would be a fair and appropriate way to calculate the payroll adjustment.¹

Based on the above, the Commission has determined Jackson Purchase's pro forma payroll cost to be \$2,049,300 and has applied the 33.82 percent capitalization rate to calculate the adjustment to payroll expense. As a result, the Commission is of the opinion that Jackson Purchase should be allowed to increase the actual test-year payroll expense of \$1,336,984 by \$19,243 to \$1,356,227.

FICA Tax

Jackson Purchase proposed to increase its test-year FICA tax expense by \$4,960. The proposal reflected an increase in FICA rate from 7.15 percent to 7.51 percent and in the applicable base wage from \$43,800 to \$45,000.

¹ Hearing Transcript, pages 70-72.

The Commission has determined that Jackson Purchase should be allowed to increase the actual test-year FICA tax expense of \$94,962 by \$6,476 to \$101,438. The Commission's calculation was based on the application of the 7.51 percent rate and \$45,000 base wage limit to the pro forma payroll cost determined in the payroll section of this Order. The resulting FICA tax cost was adjusted by applying the capitalization rate of 33.82 percent to the cost.

Insurance Expense

Jackson Purchase proposed to increase its test-year insurance expense by \$15,760. In the Second Information Request, Jackson Purchase supplied a correction to the insurance costs which revised the increase in expense to \$15,442. The proposal reflected the increase in insurance expense for the 1987-88 insurance policies over the expense incurred during the test year.

At the hearing, Jackson Purchase was requested to supply the costs for the insurance policies in effect for the 1988-89 period. Jackson Purchase filed this information on November 29, 1988. A comparison of Jackson Purchase's 1988-89 insurance policy expense to its test-year insurance policy expense, revealed a decrease in the insurance expense of \$19,364. The Commission is of the opinion that the 1988-89 insurance policy expense more accurately represents future insurance costs. Therefore, test-year insurance expense should be decreased by \$19,364 to reflect the known and measurable change in the insurance policy expense.

National Rural Electric Cooperative Association ("NRECA") Retirement Expense

Jackson Purchase proposed to increase its test-year retirement benefits expense by \$34,178. The proposal reflected 6 months of NRECA retirement benefit expense which was not reflected on Jackson Purchase's books during the test year due to a temporary moratorium placed on the payments by NRECA. The moratorium had been declared to keep the NRECA retirement program from moving ahead of its funding schedule. The moratorium, which began in July 1987, will be continued at least until December 31, 1989.

In a November 1987 Bulletin, NRECA instructed all participating cooperatives on pension plan disclosure requirements, pursuant to Statement of Financial Accounting Standards No. 87. On the subject of the moratorium, the NRECA advised, "A moratorium on contributions imposed by the full funding limitation should be noted but not expensed nor recognized as cost during the period."² For rate-making purposes, the Commission is of the opinion that no expense for retirement payments should be included while the moratorium is still in effect. It is not reasonable to include for recovery through rates an expense which actually is not incurred. In addition, the Commission is of the opinion that the retirement expense incurred in the first half of the test year should be deducted from test-year expenses. Since rates are established prospectively, those rates should not include expenses which will be non-recurring. Jackson Purchase will not pay any retirement

² Response to the Second Information Request, Item No. 20(d), page 6 of 9.

costs in 1988 or 1989. It is uncertain when the retirement payments will resume.

Therefore, the Commission has determined that the proposed increase to the retirement benefits expense should be rejected and that \$34,178 should be deducted from the test-year expenses, which reflects the expense for the first 6 months of 1987.

Interest Expense

Jackson Purchase proposed to increase its interest expense on long-term debt by \$68,875. The proposal reflected additional interest expense for two loans which were drawn down during the test year, but were not outstanding during the entire test year.

Jackson Purchase's actual test-year interest expense was \$1,126,056. This amount had been adjusted to reflect the pending assumption of certain loans by Big Rivers in payment for transmission facilities purchased from Jackson Purchase. Until final approval by REA is received, Jackson Purchase is liable for the loan and interest payments. These payments accrued to an accounts receivable account due from Big Rivers. Because the interest expense will be recovered from Big Rivers, Jackson Purchase adjusted the test-year expense to reflect only the interest it was actually liable for. The Commission has determined that the proposed adjustment is reasonable.

In determining Jackson Purchase's revenue requirements, the Commission has included the annual interest expense based on the balance of long-term debt outstanding at the end of the test year, adjusted for the outstanding balances of the assumed loans, and the current interest rates supplied by Jackson Purchase at the

hearing. Therefore, the Commission has determined that Jackson Purchase should be allowed to increase its actual test-year interest expense of \$1,126,056 by \$28,019 to \$1,154,075.

Regulatory Assessment Adjustment

Jackson Purchase proposed two adjustments to its expense for the regulatory assessment. The adjustments were made to recognize the additional amount of \$2,772 related to the revenue normalization adjustment and \$532 to reflect the additional assessment associated with flow-through adjustments, after Jackson Purchase's proposed absorption.

Jackson Purchase applied the 1987 Assessment Rate of .001411 to the revenue subject to the assessment in its determination of the above amounts. At the hearing, Jackson Purchase accepted that the current assessment rate is .001351, but noted that if the current rate was used, there would be a number of items that also should be adjusted in the test year. The Commission is of the opinion that the current assessment rate of .001351 is more representative of the cost to be incurred by Jackson Purchase during the time these rates will be in effect, and should be used in the determination of this expense. However, Jackson Purchase has proposed, and the Commission has accepted, the use of the most current cost rates in the adjustments for postage and FICA taxes. The Commission has also utilized the most current costs for the insurance expense and the current interest rates in the interest expense adjustments.

Therefore, the Commission has applied the current rate of .001351 to the revenues subject to assessment to calculate an

allowable expense of \$22,140, which is \$4,352 above the \$17,788 actual test-year expense. This calculation includes the effects of the normalization and flow-through adjustments after the proposed \$566,818 absorption. A further assessment expense adjustment associated with the final absorption determination is addressed in the Revenue Requirements Section of this Order.

Tree Trimming

At the hearing, Jackson Purchase requested that the Commission consider an adjustment to increase to its test-year tree trimming expense by \$127,518. The adjustment was proposed because Jackson Purchase had not completed all budgeted tree trimming work scheduled in the test year, and thus the test-year expense did not accurately reflect a true year of expenses. The proposal had been overlooked in Jackson Purchase's preparation of its original application. Jackson Purchase's actual test-year tree trimming expense, recorded in Account No. 593.3, Maintenance of Overhead Lines - Tree Trimming, was \$262,926.

In determining an adjustment for tree trimming expenses, the Commission generally reviews the levels of this expense incurred over the prior 4 or 5 years in order to arrive at a normal level for the expense. This is necessary because the expense may vary from year to year, due to management decisions, ability to secure necessary contracts for the work, and the weather conditions. In addition to the historical review, the supporting documentation, in the form of cost estimates, contract bids, and actual contracts, is analyzed to determine the reasonableness of the proposed adjustment. The record in this proceeding contains only

2 years of actual expense information and is devoid of any supporting documentation. The Commission is of the opinion that Jackson Purchase has failed to meet its burden of proof to show that the proposed \$127,518 increase is reasonable, known, and measurable. It is therefore not included for rate-making purposes.

Directors' Fees

Jackson Purchase reimburses the actual expenses of its directors when attending industry-associated meetings. In addition, directors receive a fee of \$75 or \$55 per day depending on whether the day's activities were official business sessions. In previous cases, the Commission has found that compensation in the form of fees paid to board members for attendance at meetings other than the board of directors' regular meetings is excessive and should not be borne by the cooperative's customers. Jackson Purchase has not advanced any argument to support a change in this position. The Commission has determined that \$8,500 paid to directors as fees for attending meetings other than regular board meetings should be removed from test-year expenses.

Civic Contributions

Included in Jackson Purchase's test-year expenses are a \$1,500 contribution to the Greater Paducah Economic Development Council and a \$1,000 contribution to Action, Inc. Both groups are involved with economic development and business retention in the area served by Jackson Purchase. While these contributions may benefit Jackson Purchase's customers in some tenuous way, these

contributions are not related to the provision of reliable electric service. The Commission is of the opinion that the rates of the cooperative should reflect only the cost of providing electric service. The Commission has been constant in this position for several years. Jackson Purchase has not advanced any arguments to warrant its reversal. Therefore, the Commission has determined that \$2,500 should be deducted from test-year expenses.

Regulatory Commission Expense

During the test year, Jackson Purchase incurred \$24,809 in expenses associated with proceedings before the Commission. In the Second Information Request, Item No. 11, Jackson Purchase stated that amortization of rate case expenses was not proposed due to the fact that the cases relating to the incurred costs had effectively spread these costs over 2 years, which was the period when the costs had actually occurred. Jackson Purchase also felt that with another flow-through case occurring in 1988, the test-year incurred costs should not be spread beyond 1987.

To allow the full test-year amount would permit Jackson Purchase to recover non-recurring expenses which were actually recovered during the period incurred. The Commission recognizes that Jackson Purchase's regulatory expenses have been higher due to Big Rivers' financial difficulties, and the Commission anticipates that such expenses should decrease as a result of the formalization of the Restructuring Agreement and Workout Plan. There is no reasonable basis to expect Jackson Purchase's regulatory expenses to be as great during the next 2 years as they were during the test year. The Commission expects the rates to be

granted in this proceeding to be effective for 2 years, since it is anticipated that Jackson Purchase will file a flow-through proceeding in conjunction with Big Rivers' next request for a rate increase.

Therefore, the Commission is of the opinion that the test year should be adjusted to include a more reasonable level of regulatory commission expenses. The test-year expenses of \$24,809 should be deducted as non-recurring expenses of Jackson Purchase. However, Jackson Purchase should be allowed to recover the costs associated with this proceeding over the 2-year period which these rates are expected to be in effect. In its determination of the allowable regulatory expenses, the Commission has amortized over 2 years the \$25,928 estimated costs of this proceeding as identified in the First Information Request, Item No. 22. This calculates to an annual expense of \$12,964 for the 2-year period. As a result of these adjustments, the Commission has reduced Jackson Purchase's actual test-year regulatory commission expense of \$24,809 by \$11,845 to a more reasonable level of \$12,964.

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

	<u>Test Period Reported</u>	<u>Pro Forma Adjustments</u>	<u>Test Period Adjusted</u>
Operating Revenues	\$21,406,219	\$4,375,624	\$25,781,843
Operating Expenses	<u>19,072,581</u>	<u>4,161,767</u>	<u>23,234,348</u>
Operating Income	\$ 2,333,638	\$ 213,857	\$ 2,547,495
Interest on Long-Term Debt	1,126,056	28,019	1,154,075
Other Income and <Deductions> - Net	<u>186,598</u>	<u>92,829</u>	<u>279,427</u>
NET INCOME	<u>\$ 1,394,180</u>	<u>\$ 278,667</u>	<u>\$ 1,672,847</u>

REVENUE REQUIREMENTS

The actual rate of return earned on Jackson Purchase's net investment rate base established herein for the test period was 7.60 percent. In the application, Jackson Purchase requested rates that would result in a Times Interest Earned Ratio ("TIER") of 2.25X and a rate of return of 7.83 percent.

Jackson Purchase's actual TIER for the test period was 2.24X and was 2.01X and 2.60X for the calendar years 1985 and 1986, respectively. After taking into consideration the pro forma adjustments in this case, Jackson Purchase would achieve a TIER of 2.45X, assuming the acceptance of its proposed absorption of \$566,818. Jackson Purchase's equity to total asset ratio is 32.31 percent based on the capital structure approved herein. Jackson Purchase's Debt Service Coverage for the test period and calendar years 1985 and 1986 was 1.97X, 2.84X and 2.13X, respectively. All of these ratios are based on the earnings of Jackson Purchase exclusive of the GTCCs assigned by Jackson Purchase's wholesale supplier, Big Rivers.

In 1983, Jackson Purchase was granted a rate of return of 7.55 percent which provided a TIER of 2.25X. In this proceeding, Jackson Purchase based the amount of its proposed absorption on maintaining a TIER of 2.25X. In order to achieve a TIER of 2.25X, Jackson Purchase should be required to absorb an additional \$230,564 of the \$1,887,574 increase in purchased power expense, which results in an overall rate of return of 7.54 percent. The additional absorption reflects a decrease of \$311 in regulatory assessment expense, due to the additional absorption. Therefore,

the Commission has determined that Jackson Purchase should absorb a total of \$797,382 of the \$1,887,574 increase in purchased power expense. This adjustment to revenue should produce net income of \$1,442,594, which should be sufficient to meet the requirements in Jackson Purchase's mortgages securing its long-term debt.

RATE DESIGN

The increased power cost resulting from the rate increase granted to Big Rivers, Jackson Purchase's wholesale power supplier, will be allocated by the method proposed by Jackson Purchase in its initial application for revised rates for electric service.

OTHER ISSUES

Kentucky Telecommunications, Inc. ("KTI")

During the course of its investigation in this proceeding, the Commission was made aware of Jackson Purchase's entry into the non-utility business of satellite telecommunications by joining KTI, a corporation originally formed as a subsidiary of Green River Electric Corporation ("Green River"). During the hearing, Jackson Purchase's general manager was extensively questioned about Jackson Purchase's decision to join KTI. Subsequently, the Commission was advised that Jackson Purchase's directors had voted to withdraw for the time being from KTI, and to seek the approval of the cooperative's membership prior to rejoining KTI. This action addressed a major concern raised during the hearing.

As it may later seek to rejoin KTI, Jackson Purchase's action does not render this issue moot. The Commission has determined that a formal investigation should be initiated into the issue

surrounding the entry of Green River and the other rural electric cooperatives into the non-utility business of satellite telecommunications. Therefore, the issues raised in this proceeding will be deferred for review in the Commission's administrative proceeding.

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, attached and incorporated hereto, are the fair, just, and reasonable rates for Jackson Purchase and will produce gross annual revenues based on normalized test-year sales of approximately \$25,551,279.

2. The rate of return and TIER granted herein is fair, just, and reasonable and will provide for the financial obligations of Jackson Purchase.

3. The adjustments as determined herein indicate that Jackson Purchase should absorb \$797,382 of the purchased power increase from Big Rivers.

4. The rates proposed by Jackson Purchase would produce revenue in excess of that found reasonable herein and should be denied upon application of KRS 278.030.

IT IS THEREFORE ORDERED that:

1. The rates in Appendix A be, and they hereby are, approved for service rendered by Jackson Purchase on and after January 1, 1989.

2. The rates proposed by Jackson Purchase be, and they hereby are, denied.

3. Within 30 days from the date of this Order, Jackson Purchase shall file with this Commission its revised tariff sheets setting out the rates approved herein.

Done at Frankfort, Kentucky, this 27th day of December, 1988.

PUBLIC SERVICE COMMISSION

Chairman

Robert M. Davis

Vice Chairman

Spencer W. Williams

Commissioner

ATTEST:

Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 10277 DATED 12/27/88

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.

Rates: Monthly

SCHEDULE R - RESIDENTIAL

<u>Service Charge:</u>	Minimum per month \$ 6.15
<u>Energy Charge:</u>	
First 400 KWH	Per KWH per month .07795
Next 600 KWH	Per KWH per month .05620
Over 1,000 KWH	Per KWH per month .05187

SCHEDULE CSL - COMMUNITY & PUBLIC AUTHORITY STREET LIGHTING

Each 175 Watt Mercury Vapor Lamp	Per month per lamp \$ 6.89
Each 400 Watt Mercury Vapor Lamp	Per month per lamp 10.29

SCHEDULE C - SMALL COMMERCIAL

<u>Service Charge:</u>	Minimum per month \$ 6.15
<u>Energy Charge:</u>	
First 500 KWH	Per KWH per month \$.07810
Next 500 KWH	Per KWH per month .06873
Next 5,000 KWH	Per KWH per month .06296
Over 6,000 KWH	Per KWH per month .05204

SCHEDULE D - COMMERCIAL AND INDUSTRIAL SERVICE & THREE
PHASE SERVICE

<u>Service Charge:</u>	Minimum per month \$15.00
<u>Energy Charge:</u>	
First 200 KWH	Per KWH per month \$.03818
Over 200 KWH	Per KWH per month .03530

Demand Charge:
Per KW Per Month

\$4.50

SCHEDULE SP - SEASONAL POWER SERVICE

Rate Per Year:

First 1,500 KWH	Per KWH per year	\$.13456
Next 500 KWH/H.P.	Per KWH per year	.09693
All Additional KWH	Per KWH per year	.05783

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	\$27,294
All additional KW	Per KW per month	\$ 9.098

Energy Charge:

All KWH Per KWH per month \$.019389

SCHEDULE SL - MERCURY VAPOR SECURITY LIGHTING

175 Watt mercury vapor lamp	Per month per lamp	\$ 6.89
400 WATT MERCURY VAPOR LAMP	PER MONTH PER LAMP	10.28

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	\$.07810
Next 500	Per KWH per month	.06873
Next 5,000	Per KWH per month	.06296
All Over 6,000	Per KWH per month	.05204