COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF EAST KENTUCKY POWER COOPERATIVE, INC. TO ADJUST ELECTRIC RATES	)))	CASE NO. 94-336

O R D E R

On August 14, 1995, the Attorney General of the Commonwealth of Kentucky ("AG") filed an application for rehearing of certain issues decided in the Commission's July 25, 1995 Order. The AG claims that the Commission inconsistently applied the known, measurable, and reasonable criteria in accepting some post-test-year adjustments but rejecting others. Specifically, he requests rehearing on adjustments to interest income, interest expense, other post-test-year adjustments, off-system sales, and advertising expense. The AG raises the point that if the credit mechanism established for the Combustion Turbine ("CT") costs does not include a Times Interest Earned Ratio ("TIER") component, East Kentucky Power Cooperative, Inc. ("East Kentucky") would receive an unwarranted windfall. Finally, he states he was unable to reconcile the summary amounts contained on page 19 of the July 25, 1995 Order and requests a detailed breakdown of the summary.

East Kentucky responded to the application for rehearing on August 25, 1995.

The July 25, 1995 Order, at pages 2-5, discussed the unique circumstances surrounding this case and noted that both the AG and

East Kentucky had proposed post-test-year adjustments which did not meet the known and measurable criteria and violated the matching principle. However, for several of these adjustments, East Kentucky and the AG agreed to a dollar amount which was accepted by the Commission. There is no basis for the AG to now criticize the Commission's acceptance of adjustments with which he concurred.

The Commission, after consideration of the evidence of record and being otherwise sufficiently advised, finds as follows:

Interest Income

The AG raises two issues related to the adjustment to interest income. First, he argues that the adjustment must reflect post-test-year changes in the applicable interest rates to be consistent with the Commission's acceptance of an interest expense adjustment which reflected post-test-year interest rate changes. The AG claims the Commission should use the interest rate as of November 30, 1994. East Kentucky supports updating the interest rates for both adjustments and urges the Commission to clarify or correct the apparent inconsistency.

Second, the AG argues that the balance used for short-term investments is understated because the Commission improperly deducted a non-recurring gain on investment. He also claims that the short-term investment balance should be increased to reflect funds invested in the CT project. He argues that the Commission has recognized the impact of the CT project long-term debt, which results in a reimbursement to short-term investments. East Kentucky agrees that it may have been inappropriate to reduce the short-term investment balance by the non-recurring gain on investment. However, it objects to the AG's attempts to include long-term debt funds for the CTs in the interest income calculation as being speculative and requests additional explanation from the Commission on this issue.

The Commission has reexamined the calculation of the adjustment to interest income and concludes that rehearing is justified. The issues of an appropriate interest rate and the balance of funds to be used in the calculations need further review. However, the appropriate level of interest income should be analyzed by reviewing all the components included in the calculations, not solely short-term investments. Appendix A to this Order contains a data request to East Kentucky addressing these issues.

Interest Expense

The AG again urges the Commission to accept his proposed interest expense adjustment reflecting East Kentucky's 1995 repricing of long-term debt, the amortization of the repricing premium, and estimated 1994 principal payments. He notes that East Kentucky agreed with that part of the adjustment which reflected the 1995 long-term debt repricing and argues that adopting the total adjustment would be consistent with other post-test-year adjustments adopted by the Commission. East Kentucky relies on the Commission's rationale for rejecting this adjustment in its original decision.

The Commission stated in the July 25, 1995 Order that the components of this adjustment were interrelated, and that one part could not be adopted without the other two. This adjustment was not similar to the post-test-year adjustments upon which East Kentucky and the AG agreed. The repricing occurred far beyond test-year end and estimated principle payments were used instead of actual. Given the circumstances underlying this case, the decision on this adjustment was not inconsistent.

Other Post-Test-Year Adjustments

The AG argues that if the Commission refuses to recognize post-test-year changes in interest rates, it should also reject other adjustments reflecting changes that are no more known, measurable, or reasonable. He only identifies two specific adjustments: wheeling expense and pension expense.

Wheeling Expense. East Kentucky originally proposed an increase of $2,024,780 for its Kentucky Utilities Company ("KU") wheeling expense. This amount was based on rates the Federal Energy Regulatory Commission ("FERC") had authorized subject to refund, pending an investigation and hearing. Subsequently, East Kentucky and KU negotiated a settlement under which the wheeling expense would increase only $673,284. Based on the doctrine of federal preemption and this settlement, it was reasonable for the Commission to accept the $673,284 increase.

Pension Expense. The AG and East Kentucky agreed that this expense should be increased by $2,369,189 to reflect an increase in retirement costs. Having agreed to the adjustment, the AG cannot now persuasively claim that it was an improper post-test-year adjustment.

<u>Off-System Sales</u>

The July 25, 1995 Order inadvertently omitted any reference to the proposals made by the AG and East Kentucky to reduce off-system sales margins from 1993 to 1994 levels. However, as noted in the AG's petition, the adjustment proposed by East Kentucky was used to determine normalized revenues. Although the AG originally proposed an adjustment to reduce test-year margins on off-system sales, he withdrew that proposal during the hearing. The AG now contends that he did not concur with East Kentucky's proposal and argues that the adjustment should not be permitted because additional CTs have been added since the test year which will enable East Kentucky to make off-system sales at test-year levels.

East Kentucky's responds that the adjustment was initially proposed by the AG and that he linked this adjustment to his proposed adjustment to reflect year-end customer levels. East Kentucky acknowledges that the AG subsequently withdrew his adjustment, but notes that he then proposed a "totally unsupported new adjustment" for which he "offered no coherent explanation."

The record indicates that the AG incorrectly based his adjustment on a comparison of <u>total</u> off-system sales in 1994 to <u>interstate</u> off-system sales in 1993. Thus, the Commission concluded that the proper adjustment, as proposed by East Kentucky, reflected <u>total</u> off-system sales for both 1993 and 1994.

Further, while the new CTs do increase East Kentucky's capacity, this argument is unpersuasive in light of the Commission's acceptance of certain other adjustments recommended by the AG which reduce the capacity available for off-system sales. Those adjustments, which reflect East Kentucky's reduced capacity to make off-system sales, include: (1) recognizing new load from year-end customers; (2) recognizing new load from the addition of Gallatin Steel on the East Kentucky system; and (3) eliminating all purchased power capacity costs, except from SEPA.

Advertising Expense

The AG reiterates his opposition to East Kentucky's advertising expenses for the Electric Thermal Storage ("ETS") program. He argues that ETS is counter-productive to demand side management ("DSM") efforts, and urges the Commission to adopt such a finding.

As stated in the July 25, 1995 Order, based on the definition of DSM contained in KRS 278.010(15), the Commission concluded that ETS is a legitimate DSM program. Neither the statute nor the Commission's conclusion has changed.

Combustion Turbine Credit

On July 10, 1995, East Kentucky proposed to modify its Fuel Adjustment Clause ("FAC") to reflect temporarily a credit of the CT costs included in this rate case. This proposal, in which the AG concurred, was due to an unexpected and extended delay in the CT project and assumed that the Commission would recognize the CTs in rates.

The AG now states that this credit must include not only the direct CT costs but also the related TIER component to prevent East Kentucky from receiving a "windfall." East Kentucky responds that the revenue requirements figure of $13,710,601 used to calculate the CT credit includes $1,288,885 of margins, equivalent to the 1.15 TIER approved by the Commission in the July 25, 1995 Order. This calculation was detailed in an exhibit attached to East Kentucky's July 10, 1995 notice. Since the CT credit already includes a TIER component as noted by East Kentucky, no further action by the Commission is necessary.

Reconciliation of Revenue Requirements Adjustments

To further assist the parties in determining how certain summary amounts contained on page 19 of the July 25, 1995 Order were developed, a detailed listing of the adjustments accepted is set forth as Appendix B to this Order.

IT IS THEREFORE ORDERED that:

1. The AG's request for rehearing on the issue of calculating East Kentucky's interest income adjustment is granted.

2. The AG's requests for rehearing on all other issues are denied.

3. East Kentucky shall file responses to the information request set forth in Appendix A, attached hereto and incorporated herein, by no later than September 15, 1995.

4. The procedural schedule set forth as Appendix C, attached hereto and incorporated herein, shall be followed.

Done at Frankfort, Kentucky, this 1st day of September, 1995.

PUBLIC SERVICE COMMISSION

Chairman

Vice Chairman

Commissioner

ATTEST:

Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 94-336 DATED SEPTEMBER 1, 1995

East Kentucky shall file by September 15, 1995 an original and 10 copies of the following information with this Commission, with a copy to all parties of record. Each copy of the data requested should be placed in a bound volume with each item tabbed. When a number of sheets are required for an item, each sheet should be appropriately indexed, for example, Item 1(a), Sheet 2 of 6. Include with each response the name of the witness who will be responsible for responding to questions relating to the information provided in the event that a hearing is held. Careful attention should be given to copied material to ensure that it is legible.

1. Prepare a revised Exhibit A, Schedule 3, page 3 of 3, reflecting the test-year-end actual balances for the nine categories of investments listed and the applicable interest rates as of:

a. Test-year end.

b. January 1, 1995.

2. Explain why East Kentucky used normalized balances based on a historical analysis for the short-term investments and the bond funds shown on Exhibit A, Schedule 3, page 3 of 3.

3. Identify any adjustments East Kentucky believes should be made to the test-year-end actual balances provided in the response to Item 1 above. Explain the reason(s) supporting any adjustment.

4. Provide the following information concerning East Kentucky's test-year-end balances for short-term borrowings (i.e. short-term debt, line of credit loans, etc.):

a. The test-year-end actual balance for the borrowings.

b. The amount of outstanding borrowings related to financing the CT project, as of test-year end.

c. The interest rate in effect at test-year end for the borrowings.

d. The test-year level of interest expense for short-term borrowings.

e. The date funds from long-term debt financing were received for the CT project.

5. Explain how funds from long-term debt financing for the CT project were utilized, using the following categories:

a. Reimburse outstanding short-term borrowings.

b. Reimburse general cash balances.

c. Reimburse temporary cash investments.

d. Other (specify).

Include the amounts related to the different categories.

APPENDIX B

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 94-336 DATED SEPTEMBER 1, 1995

JULY 25, 1995 ORDER - DETAILED PRO FORMA ADJUSTMENTS

OPERATING REVENUES:	
Normalize Member Sales Revenues, EK Sch 1	$ 5,682,711
Net Margins from Gallatin Steel, EK Sch 18	2,567,412
Rate Schedule Switch - Dravo, EK Sch 25	(409,238)
Rate Schedule Switch - Hartco Tibbals & Clay County Prison, EK Sch 26	(41,267)
Year End Customer Adjustment, Revenues, AG Sch 2	3,483,262
Reduce Off-System Sales, Revenues, AG Sch 3	(1,726,104)
Adjustment to EDR, DHBK-1	296,522
TOTAL OPERATING REVENUES	$ 9,853,298
OPERATING EXPENSES:	
Remove FAC Credit, EK Sch 2	$ 5,314,537
Normalize Wages & Salaries, EK Sch 7	655,282
Normalize Payroll Taxes, EK Sch 8	166,225
Employee Benefits, Normalized, EK Sch 9	589,000
Normalize Depreciation, EK Sch 10	1,365,938
Normalize Property Taxes, EK Sch 11	101,057
Debt Issuance Costs - Administrative Fees, EK Sch 14	33,808
CT Adjustment, excluding Interest, EK Sch 15	3,829,148
Wheeling Charge Increase, EK Sch 16	673,284
Increase Purchase Power SEPA, EK Sch 17	505,179
Remove Promotional Advertising, EK Sch 19	(376,367)
Adjust Director's Fees & Expenses, EK Sch 20	(161,588)
NRECA Retirement Costs, EK Sch 22	2,369,189
Abnormal Item - Property Tax from Audit, EK Sch 23	(138,613)
Year End Customer Adjustment, Expenses, AG Sch 2	1,331,978
Off-System Sales, Expenses, AG Sch 3	(105,442)
Non-SEPA Capacity Costs, AG Sch 6	(1,043,205)
Reduce SFAS 106 Accrual, AG Sch 10	(1,166,865)
Excessive Employee Benefits, AG Sch 12	(34,521)
Remove SERP Expense, AG Sch 13	(42,134)
Adjustment to PSC Assessment, AG Sch 23	68,728
Remove Non-Recurring Items, AG Sch 24	(227,894)
Two-Times Salary Life Insurance	(68,285)
TOTAL OPERATING EXPENSES	$13,638,439
INTEREST ON LONG-TERM DEBT:	
Interest on CTs, EK Sch 15	$ 8,357,542
Normalize Interest Expense, with Agreed To Adjustment	(10,766,316)
TOTAL INTEREST ON LONG-TERM DEBT	$(2,408,774)
OTHER INCOME AND DEDUCTIONS - NET:	
Normalize Interest Income, EK Sch 3	$(7,305,702)
Remove Non-Recurring Gain, EK Sch 4	(13,275,745)
Normalize AFUDC, EK Sch 5	36,433
Remove Expenses - Smith Project, EK Sch 6	85,937,729
Debt Issuance Costs, EK Sch 14	(513,221)
Remove Charitable Contributions, EK Sch 21	40,954
Remove Interest, Property Tax Audit, EK Sch 24	15,497
TOTAL OTHER INCOME AND DEDUCTIONS - NET	$64,935,945

References are to party originally making proposal. Differences in amounts from original proposals reflect either East Kentucky/AG "agreed to" items or are described in the July 25, 1995 Order.

APPENDIX C

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 94-336 DATED SEPTEMBER 1, 1995

All requests for information to East Kentucky shall be due no later than....................................09/22/95

East Kentucky shall mail or deliver responses to the requests for information no later than.................10/06/95

Any motion for a public hearing or to file written briefs shall be filed by................................10/16/95

Public Hearing, if Ordered by the Commission, shall begin at 10:00 a.m., Eastern Standard Time, in Hearing Room 1 of the Commission's offices at 730 Schenkel Lane, Frankfort, Kentucky.....................11/02/95