

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF BLUE GRASS RURAL)
ELECTRIC COOPERATIVE CORPORATION, INC.)
FOR AN ADJUSTMENT TO ITS RETAIL ELECTRIC) CASE NO. 94-394
POWER TARIFFS)

O R D E R

On December 2, 1994, Blue Grass Rural Electric Cooperative Corporation, Inc. ("Blue Grass") filed an application to reduce its rates for retail electric service by \$1,780,083 annually effective January 1, 1995. The proposed rate reduction was designed to pass on to Blue Grass's customers a decrease in power costs proposed by Blue Grass's wholesale power supplier, East Kentucky Power Cooperative, Inc. ("East Kentucky").¹ The decrease in power costs proposed by East Kentucky became effective January 1, 1995, subject to further modification, and Blue Grass's proposed rates became effective simultaneously under the same condition.

Intervening in this matter was the Attorney General of the Commonwealth of Kentucky, by and through his Public Service Litigation Branch ("AG"). A public hearing was held April 27, 1995 at the Commission's offices in Frankfort, Kentucky.

On July 25, 1995, the Commission approved a rate decrease for East Kentucky which was greater than it had proposed.

¹ Case No. 94-336, The Application of East Kentucky Power Cooperative, Inc. for an Adjustment to Its Wholesale Power Tariffs.

Consequently, Blue Grass's power costs will decrease by an additional \$350,864 annually for a total decrease of \$2,130,947 annually. The manner in which this total decrease is passed on to Blue Grass's customers through reduced rates is discussed below.

ALLOCATION AND RATE DESIGN ISSUES

Blue Grass proposed to reduce its rates to reflect the full amount of East Kentucky's wholesale rate reduction. Blue Grass utilized an "equal reduction per Kwh" methodology which provides retail customers the same reduction per Kwh for all energy charges. This approach results in a straight pass-through of the East Kentucky decrease with no change to Blue Grass's existing rate design and no impact on its financial condition. Blue Grass was one of fourteen customers of East Kentucky utilizing this methodology while three others utilized the "equal percentage of revenue" methodology.

The AG recommends that the decrease be allocated on an equal percentage of revenue approach. The AG contends that this is the most equitable approach and its use here, in the absence of a cost-of-service study, is analogous to its use by the Commission in general rate cases when no cost-of-service studies are acceptable for revenue allocation purposes.

The AG also recommends that Blue Grass's declining block rates now be converted to flat rates. The AG argues that implementing a rate decrease is the ideal time to make such a change because any resulting harm will be less than if implemented with a rate increase. The AG argues that the Commission has made such changes

without the benefit of cost-of-service studies in previous cases and that now is the time to eliminate declining block rate structures which encourage inefficient and wasteful use of electricity. The AG questioned the continuation of the Electric Thermal Storage ("ETS") program and urged that if it continues retail ETS rates not be set below East Kentucky's wholesale off-peak energy rates. Noting that some Blue Grass rate schedules contained demand charges that were less than East Kentucky's proposed wholesale demand charges, the AG recommended that all retail demand charges be at or above the wholesale demand charges.

In rebuttal, Blue Grass contended that both revenue allocation methodologies are reasonable and that one should not be favored over the other. It maintained that the AG's proposed rate design changes should not be done within a pass-through proceeding, nor should they be done without the benefit of a cost-of-service study. Blue Grass was concerned that such changes would result in some customers receiving rate increases even though Blue Grass had filed for a rate decrease. It also expressed concern about the potential impact on its revenues if customers reduce consumption due to changes in rate design. Blue Grass supported East Kentucky's ETS program and urged that the existing ETS rate structure be maintained. Blue Grass indicated that, through the combination of its retail demand and energy charges, it was adequately recovering wholesale demand charges. It also noted differences in measuring demand at the wholesale and retail levels, i.e. coincident versus non-coincident peak, and that many of East Kentucky's cooperatives

have historically priced retail demand charges below the corresponding wholesale demand charge.

Based on the evidence of record and being otherwise sufficiently advised, the Commission will approve the "equal reduction per Kwh" approach for allocating the decrease to retail rate classes for the following reasons. (1) The wholesale rate decrease from East Kentucky consists of decreased energy charges (per Kwh); therefore, an equal reduction per Kwh is a reasonable approach for the retail pass-through of the wholesale power cost decrease. (2) When a change in retail rates is caused by a change in only one expense item, purchased power, it is neither necessary nor appropriate to use a "percentage of revenue" allocation methodology. The Commission has at times utilized such a methodology where revenues are adjusted to reflect changes in multiple expenses. Here, however, revenues are being changed to reflect only one expense, purchased power. Under these circumstances, it is logical and reasonable that a change in cost be identified and reflected in the resulting change in retail rates.

The Commission finds merit in the AG's recommendation to implement changes in rate design. While a cost-of-service study may be essential properly to redesign certain categories of rates, it is not a prerequisite to eliminating declining block electric rates. Declining block rates send an inappropriate price signal to consumers, one that tends to promote the use of electricity in a manner that does not always result in an efficient use of

resources. While there may be some justification for seasonal, off-peak use of declining block rates, the Commission generally favors flattening rates for energy consumption.

Declining block rates should be converted to flat rates to the greatest extent possible without undue disruption to Blue Grass or its customers. However, recognizing the concerns that such changes might result in rate increases for some customers and lower revenues to the utility due to reduced consumption, rates will be flattened to the extent possible without increasing any rate above the level in effect prior to this case. This will ensure that no customers experience a rate increase as a result of this case. Due to Blue Grass's existing rate design and the magnitude of its wholesale power cost decrease, this approach will result in rate GS-1 being converted to a flat rate while all others will be flattened with the declining block structure still intact but less pronounced.

The ETS rate issue is essentially moot due to the Commission's decision in East Kentucky's rate case to set the wholesale off-peak energy rates well below the retail ETS rate. The Commission, therefore will approve the continuation of the existing ETS rate structure. Finally, on the issue of pricing retail and wholesale demand charges, the Commission recognizes that retail demand should not be priced below its wholesale cost. However, due to differences in measuring retail and wholesale demand, i.e. non-coincident versus coincident peak demands, below cost pricing cannot be presumed. There is no evidence to demonstrate that Blue

Grass is not fully recovering its demand cost in retail demand rates. In addition, several of East Kentucky's distribution cooperatives indicated that they would be performing cost-of-service studies in the relatively near future. Blue Grass's next cost-of-service study should address the issue of retail recovery of wholesale demand cost.

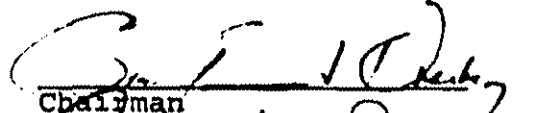
IT IS THEREFORE ORDERED that:

1. The rates in Appendix A, attached hereto and incorporated herein, are approved for service rendered on and after the date of this Order.

2. Within 20 days of the date of this Order, Blue Grass shall file with the Commission revised tariff sheets setting out the rates approved herein.

Done at Frankfort, Kentucky, this 26th day of July, 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. 94-394 DATED JULY 26, 1995.

The following rates and charges are prescribed for the customers in the area served by Blue Grass 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 effective date of this Order.

GS-1 (RESIDENTIAL, FARM AND NON-FARM)
Rate:

All KWH Per Month	\$.05275 Per KWH
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C-1 - COMMERCIAL AND INDUSTRIAL LIGHTING & POWER SERVICE

Energy Charge (Under 50 KW)

First	3,000 KWH	\$.05700 Per KWH
All Over	3,000 KWH	.05220 Per KWH

LP - #1 - LARGE POWER

Energy Charge (51-500 KW)

First	10,000 KWH	\$.04192 Per KWH
Next	15,000 KWH	.03522 Per KWH
Next	50,000 KWH	.02962 Per KWH
Next	75,000 KWH	.02732 Per KWH
All Over	150,000 KWH	.02562 Per KWH

LP - #2 - LARGE POWER

Rate:

Energy Charge (Over 500 KW)

First	3,500 KWH	\$.04275 Per KWH
Next	6,500 KWH	.03448 Per KWH
Next	140,000 KWH	.02935 Per KWH
Next	200,000 KWH	.02780 Per KWH
Next	400,000 KWH	.02688 Per KWH
Next	550,000 KWH	.02596 Per KWH
All Over	1,300,000 KWH	.02069 Per KWH

SECURITY LIGHTS

Rate Per Light Per Month:

175 Watt Mercury Vapor	\$4.54
400 Watt Mercury Vapor	6.50
100 Watt High Pressure Sodium	4.86
250 Watt High Pressure Sodium	6.73

STREET LIGHTING

Rate Per Light Per Month:

70 Watt High Pressure Sodium (ornamental)	\$5.04
100 Watt High Pressure Sodium (ornamental)	6.47
250 Watt High Pressure Sodium (ornamental)	8.47
70 Watt High Pressure Sodium (colonial) (15' Mounting Height)	7.82

GS-2 OFF-PEAK RETAIL MARKETING RATE
(ETS)

Rate:

All KWH Per Month	\$.03165 Per KWH
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LARGE INDUSTRIAL RATE
SCHEDULE C-1

Monthly Rate:

Energy Charge	\$.02794 Per KWH
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LARGE INDUSTRIAL RATE
SCHEDULE C-2

Monthly Rate:

Energy Charge \$.02294 Per KWH

LARGE INDUSTRIAL RATE
SCHEDULE C-3

Monthly Rate:

Energy Charge \$.02194 Per KWH

LARGE INDUSTRIAL RATE
SCHEDULE B-1

Monthly Rate:

Energy Charge \$.02813 Per KWH

LARGE INDUSTRIAL RATE
SCHEDULE B-2

Monthly Rate:

Energy Charge \$.02313 Per KWH