COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

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| THE APPLICATION OF INTER-COUNTY RURAL ELECTRIC COOPERATIVE CORPORATION, INC. FOR AN ADJUSTMENT TO ITS RETAIL ELECTRIC POWER TARIFFS | ) ) ) ) | CASE NO. 94-426 |

O R D E R

On December 2, 1994, Inter-County Rural Electric Cooperative Corporation, Inc. ("Inter-County") filed an application to reduce its rates for retail electric service by $961,859 annually effective January 1, 1995. The proposed rate reduction was designed to pass on to Inter-County's customers a decrease in power costs proposed by Inter-County'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 Inter-County'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 25, 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, Inter-County's power costs will decrease by an additional $243,672 annually for a total decrease of $1,205,531 annually. The manner in which this total decrease is passed on to Inter-County's customers through reduced rates is discussed below.

ALLOCATION AND RATE DESIGN ISSUES

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

The AG agrees with Inter-County that the decrease should 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 recommends that Inter-County'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 also questioned the continuation of the Electric Thermal Storage ("ETS") program and urged, if the program is continued, that retail ETS rates not be set below East Kentucky's wholesale off-peak energy rates.

In rebuttal, Inter-County 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. Inter-County was concerned that such changes would result in some customers receiving rate increases even though Inter-County 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. Inter-County also supported East Kentucky's ETS program and urged that the existing ETS rate structure be maintained.

Based on the evidence of record and being otherwise sufficiently advised, the Commission finds that the "equal reduction per Kwh" approach should be utilized 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.[2]

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 Inter-County or its customers. However, recognizing the concerns that such changes might result in rate increases for some customers and lower

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[2] The Commission has approved the equal reduction per KWH approach in all seventeen pass-through cases filed in conjunction with East Kentucky's rate application.

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 Inter County's existing rate design and the magnitude of its wholesale power cost decrease, this approach will result in its Schedule 4, Large Power Rate, being converted to a totally flat rate, while all other rates 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.

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, Inter-County 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. 94-426 DATED July 26, 1995.

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

SCHEDULE 1
FARM AND HOME SERVICE

Rate:

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|---|---|
| First 500 KWH Per Month | $0.06150 Per KWH |
| All Over 500 KWH Per Month | 0.05616 Per KWH |

SCHEDULE 1-A
FARM AND HOME MARKETING RATE

Rate:

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|---|---|
| All KWH Per Month | $0.03370 Per KWH |

SCHEDULE 2
SMALL COMMERCIAL AND SMALL POWER

Rate:

Energy Charge

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|---|---|
| First 1,000 KWH Per Month | $0.07075 Per KWH |
| All Over 1,000 KWH Per Month | 0.05826 Per KWH |

SCHEDULE 4
LARGE POWER RATE (LPR)

Rate:

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|---|---|
| All KWH Per Month | $0.04905 Per KWH |

## SCHEDULE 5
## ALL ELECTRIC SCHOOL (AES)

Rate:

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|---|---|
| All KWH Per Month | $0.05134 Per KWH |

## SCHEDULE 6
## OUTDOOR LIGHTING SERVICE - SECURITY LIGHT

Rate:

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|---|---|
| 7,000 Lumen Security Light | $ 6.09 Per Lamp Per Month |
| 4,000 Lumen Decorative Colonial | 8.32 Per Lamp Per Month |
| 27,000 Lumen Directional Floodlight | 8.27 Per Lamp Per Month |
| 50,000 Lumen Directional Floodlight | 11.29 Per Lamp Per Month |
| 27,500 Lumen Cobra Head | 7.66 Per Lamp Per Month |

## SCHEDULE B 1
## INDUSTRIAL RATE

Rate:

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|---|---|
| Energy Charge | $0.02773 Per KWH |

## SCHEDULE B 2
## INDUSTRIAL RATE

Rate:

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|---|---|
| Energy Charge | $0.02273 Per KWH |

## SCHEDULE B 3
## INDUSTRIAL RATE

Rate:

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|---|---|
| Energy Charge | $0.02173 Per KWH |

## SCHEDULE C 1
## INDUSTRIAL RATE

Rate:

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|---|---|
| Energy Charge | $0.02806 Per KWH |

## SCHEDULE C 2
## INDUSTRIAL RATE

Rate:

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| Energy Charge | $0.02306 Per KWH |

## SCHEDULE C 3
## INDUSTRIAL RATE

Rate:

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|---|---|
| Energy Charge | $0.02206 Per KWH |