COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF GRAYSON RURAL ELECTRIC COOPERATIVE CORPORATION FOR AN ADJUSTMENT OF RATES	)))	CASE NO. 98-455

O R D E R

On November 25, 1998, Grayson Rural Electric Cooperative Corporation (Grayson) applied for a $1,021,201 increase in retail electric service rates. The requested increase is 8.02 percent over normalized test-year operating revenues. Grayson stated that the proposed increase was required to cover increased operating costs, improve its financial condition, and provide the margin necessary to meet the requirements of its mortgage agreement. By this Order, the Commission grants Grayson an increase in revenues of $862,178 or a 6.71 percent increase over normalized test-year operating revenues.

The Commission granted the motion to intervene filed by the Office of Rate Intervention of the Office of the Attorney General (AG). A public hearing was conducted on April 14, 1999, and all information requested during the hearing has been submitted.

COMMENTARY

Grayson is a consumer-owned rural electric cooperative corporation, organized under KRS Chapter 279, engaged in the distribution and sale of electric energy to approximately 14,532 member-consumers in the Kentucky counties of Carter, Elliott, Greenup, Lawrence, Lewis, and Rowan. Grayson has no electric generating facilities and purchases its total power requirements from the East Kentucky Power Cooperative, Inc. (East Kentucky).

TEST PERIOD

Grayson proposed and the Commission has accepted the 12-month period ending May 31, 1998 as the test period for determining the reasonableness of the proposed rates. In utilizing the historical test year, the Commission has considered appropriate known and measurable changes.

VALUATION

Grayson proposed a net investment rate base of $28,814,952 based on the test-year-end value of plant in service, the 13-month average for materials and supplies and prepayments, and excluding the adjusted accumulated depreciation and the test-year-end level of customer advances for construction. Grayson also proposed to include working capital based on one-eighth of adjusted operating expenses, exclusive of purchased power, depreciation, taxes, and other deductions. The Commission concurs with this proposal with the exception that it has corrected an error in the amount of adjusted accumulated depreciation and that working capital has been adjusted to reflect the pro forma adjustments to operating expenses found reasonable herein.

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

Utility Plant in Service	$ 32,403,634
Construction Work in Progress	271,193
Total Utility Plant	$ 32,674,827
ADD:	
Materials and Supplies	$ 212,306
Prepayments	101,240
Working Capital	381,197
Subtotal	$ 694,743

DEDUCT:	
Accumulated Depreciation	$ 4,497,713
Customer Advances for Construction	57,084
Subtotal	$ 4,554,797
NET INVESTMENT RATE BASE	$ 28,814,773

Capital Structure

The Commission finds that Grayson s capital structure at test-year-end for rate-making purposes was $26,859,618. This capital structure consisted of $7,524,260 in equity and $19,335,358 in long-term debt. The Commission has excluded generation and transmission capital credits (GTCCs) in the amount of $1,957,299.

REVENUES AND EXPENSES

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

Fuel Adjustment Clause Roll In

Grayson s application as filed was based on the then existing cost of fuel embedded in its base rates. Subsequently, on March 22, 1999 in Case No. 98-573,[1] the Commission adjusted Grayson s base rates to reflect an additional .87 mills of fuel per KWH. The revenue requirements, the awarded increase in revenues, and the rates contained in Appendix A reflect the most recent roll in of this fuel cost into base rates, as authorized in Case No. 98-573.

[1] Case No. 98-573, An Examination of the Application of the Fuel Adjustment Clause of Grayson Rural Electric Cooperative Corporation from November 1, 1996 to October 31, 1998.

Customer Growth Adjustment

Grayson proposed no adjustments to its revenues or expenses to reflect the growth in the number of customers served as of the end of the test year. The AG proposed a $60,962 increase in revenue to compensate for Grayson s customer growth. The AG s witness testified that Grayson had experienced significant growth in the number of customers it serves in the test year, but had failed to include an end of test year adjustment. The AG proposed an adjustment based on the last month of the test year. In previous electric cooperative cases, the Commission has found this adjustment to be reasonable and the record supports such an adjustment here. Using the test-year-end number of customers, Grayson s test year revenue would be increased $60,962 to compensate for customer growth.

Labor and Labor-Related Costs

Grayson proposed adjustments to increase test-year operating expenses by $6,702 for labor and labor-related costs. The adjustment consisted of increases to wages and salaries and payroll taxes.

Wages and Salaries. In its application, Grayson proposed an adjustment to normalize total wages and salaries in the amount of $9,551, of which $3,534 was capitalized and $6,017 was expensed. Full-time employees were assumed to work 2,080 hours. Part-time employees were assumed to work the number of hours actually worked during the test year. Employees terminated during the test year were excluded from the calculations. The test-year actual overtime hours were included at 1.5 times the test-year-end wage rates. In calculating its adjustment to normalize wage and salary costs, Grayson excluded three types of payments made to employees during the test year: bonus in lieu of wage increase, Christmas bonus, and accumulated vacation payout.

The Commission finds most of Grayson s assumptions to be reasonable, except in two specific areas. First, the exclusion of the employee bonuses and vacation payments when normalizing wages and salaries in effect allowed the costs to remain in the test year. Grayson has contended that the Christmas bonus and accumulated vacation payout should not be considered part of employee compensation for rate-making purposes.[2] However, Grayson has not justified the exclusion of these items in normalizing its test year for rate-making purposes. While Grayson agrees that the bonus in lieu of wage increase was not an ongoing expense and should be included in the normalization,[3] this was not done.

Second, test-year overtime hours included 2,019 hours worked in conjunction with a February 1998 snow storm,[4] for which Grayson received reimbursement from the Federal Emergency Management Agency (FEMA). Since Grayson had been reimbursed for these hours, it should have excluded the hours from the test-year actual costs and the normalized costs, in order to avoid a double counting of the FEMA reimbursement. Grayson has not contended that these additional overtime hours are part of a reasonable, ongoing level of overtime hours.

Recalculating the adjustment based on these two changes results in a decrease in wages and salaries of $22,753. After applying the test-year capitalization rate of 37

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[2] Response to the Commission s January 12, 1999 Order, Item 13, page 1 of 2.

[3] Id.; also see Transcript of Evidence (T.E.), April 14, 1999, at 80.

[4] Response to the Commission s February 9, 1999 Order, Item 12, page 2 of 3.

percent, the Commission finds that an adjustment to decrease the expense by $14,334 is reasonable.

Payroll Taxes. Grayson proposed to increase its payroll taxes[5] by $993, based on the proposed normalized wages and salaries and reflecting an increase in the Federal Insurance Contribution Act (FICA) base wage limit from $65,400 to $68,400. Of this amount, $308 was capitalized and $685 was expensed.

The Commission has recalculated this adjustment, based on the level of normalized wages and salaries found reasonable and using the FICA base wage limit of $68,400. This results in a reduction in payroll taxes of $2,119. After applying the test-year capitalization rate, the reduction in payroll tax expense would be $1,462.

The Commission is also reducing the payroll tax expense by $250, related to FICA tax expense on life insurance coverage provided by Grayson to its employees. This adjustment is discussed in detail later in this Order. Therefore, the Commission will reduce operating expenses by $1,712.

Employee Life Insurance. Grayson provides its employees with two times their annual salary plus an additional $10,000 of life insurance coverage at no cost to its employees. Grayson has not performed any analyses or surveyed other cooperatives in order to determine that this level was an appropriate level of life insurance coverage. While Grayson has provided this benefit to employees for at least 20 years, it has not performed any formal compensation studies to support the practice.

While the Commission does not view the provision of life insurance coverage for a utility s employees unfavorably, we are concerned about Grayson s current practice.

[5] Payroll taxes include FICA, Medicare, and Federal and State Unemployment.

Under current federal law, the cost for insurance coverage in excess of $50,000 constitutes wages subject to FICA taxes.[6] Once the $50,000 coverage level is reached, Grayson incurs additional employer-share FICA tax expense. To include the expenses associated with employee life insurance coverage in excess of $50,000, utilities must clearly demonstrate the need for this additional compensation. Grayson has not done so. Therefore, the Commission has limited test-year life insurance premium expense to the cost to provide each Grayson employee up to $50,000 of coverage. This results in a reduction in operating expenses of $2,180. A corresponding reduction has also been made to test-year FICA tax expense, based upon the additional income provided to the employee as determined by Internal Revenue Service tables.

Rate Case Expense

Grayson estimated its rate case expense at $33,000. It proposed to recover this expense through a three-year amortization. This estimate did not include in-house labor. Throughout this proceeding, Grayson has been providing updates of the actual expenses incurred in presenting this rate case. As of the April 26, 1999 update, Grayson has expended $18,273 for this rate case. The Commission finds that a three-year amortization of these expenses is reasonable and will allow an increase in operating expenses of $6,091 to reflect the first year of the amortization.

Directors Fees and Expenses

During the test year Grayson paid its seven directors fees and expenses totaling $133,524. Grayson proposed to remove $78,197 in expenditures for rate-making purposes. Grayson s proposal removed all per diems paid to directors for attending

[6] 26 U.S.C § 79 (1992).

industry association meetings, health insurance coverage, post-retirement benefits, and directors Christmas gifts.[7]

The Commission notes that these items have been excluded for rate-making purposes in other cooperative rate case proceedings. The Commission agrees with Grayson s proposed adjustment. In addition, after reviewing all of the fees and expenses, the Commission finds that a further reduction of $6,877 should be made for the following items:

Christmas Gift Adjustment. Grayson s schedule of directors fees and expenses shows that its proposed adjustment to remove Christmas gifts to the directors was understated by $73.

Expenses Associated with Kentucky Telecommunications, Inc. (KTI). KTI is an unregulated affiliate of several Kentucky rural electric cooperatives, which provides satellite-delivered television services. The per diem and expenses for a director to attend KTI board meetings was to have been recorded in Account No. 417.10 Expenses for KTI. Through an oversight,[8] Grayson recorded a director s expense for KTI meetings in Account No. 930.60 Directors Expenses. In order to correct this oversight, we will exclude $337 from operating expenses.

Non-Recurring Special Committee Meetings. During the test year, Grayson s board of directors was involved in special committee meetings addressing the subjects of strategic planning and labor union negotiations. Grayson stated that the strategic

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[7] The AG proposed that the Christmas gifts to directors be disallowed; see Brown Kinloch Direct Testimony at 14. The AG testimony did not acknowledge that Grayson had already removed this expense.

[8] Response to the Commission s February 9, 1999 Order, Item 22(b).

planning meetings normally occur every two to three years, while the labor union negotiations occur every three years. The Commission finds that these special committee meetings are not of an annual recurring nature. Therefore, the Commission has reduced directors expenses by $4,315.

Insurance Benefits to Spouses and Dependents of Deceased Directors. During the test year, Grayson paid $2,152 in insurance expenses to provide health coverage for spouses and dependents of deceased directors. Grayson could not explain why this expense should be included for rate-making purposes.[9] The Commission will exclude this item for rate-making purposes, which is consistent with Grayson s proposal to exclude similar coverage for the directors.

Advertising Expenses

Grayson proposed a reduction of $700 in advertising expenses related to institutional advertising. The Commission will accept this adjustment since 807 KAR 5:016, Section 4, disallows institutional advertising for rate-making purposes. The AG proposed that an additional $21,469 in expenses related to the promotion of heat pumps, geothermal heat pumps, and electric thermal storage (ETS) systems should be excluded. The AG argued that these are marketing expenses and are not necessary for the provision of electric service to customers.[10]

The Commission does not agree with the AG s arguments. Heat pumps, geothermal heat pumps, and ETS systems are generally more efficient than other types of electric heating. The AG has acknowledged that from the perspective of the

[9] T. E., April 14, 1999, at 53.

[10] Brown Kinloch Direct Testimony at 14.

customer s heating system, a heat pump is more efficient.[11] In addition, ETS systems constitute a form of valley filling, which allows a utility to improve its load factor without increasing its peak demand. Although the AG contends that this is not an energy conservation approach,[12] he has produced no evidence to support this argument. Furthermore, the AG s argument appears to be contrary to the definition of demand-side management contained in the Kentucky statutes. KRS 278.010(17) states that demand-side management means any conservation, load management, or other utility activity intended to influence the level or pattern of customer usage or demand. The Commission finds these expenses are not properly classified as marketing programs since they produce a benefit to Grayson s system and to the participants through reduced electric bills. Therefore, the AG s proposed adjustment is denied.

Miscellaneous Expenses

The Commission believes that miscellaneous expenses should be reduced by a total of $9,493, to reflect the following adjustments:

Touchstone Energy Membership. The AG proposed to reduce miscellaneous expenses by $2,500 relating to Grayson s payment of dues to Touchstone Energy. The AG contended that Touchstone Energy is an attempt by rural cooperatives to develop a national brand identity for marketing purposes in anticipation that electric utilities may be deregulated in the future. As such, the expense is not necessary for the provision of electric service to consumers today, and should be disallowed.[13]

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[11] Response to the Commission s March 23, 1999 Order, Item 1(a).

[12] Id., Item 1(c).

[13] Brown Kinloch Direct Testimony at 13-14.

Grayson has agreed that the dues paid to Touchstone Energy should not be included for rate-making purposes.[14] Thus, the Commission will adopt the AG s proposal and will exclude the payment to Touchstone Energy.

<u>Account No. 930.30 Miscellaneous General Expenses.</u> During the test year, Grayson incurred $2,215 in expenses for counter giveaways, golf outings, employee gift certificates, and Christmas cards. Grayson has agreed that these expenses should not be included for rate-making purposes.[15] The Commission agrees and has reduced miscellaneous expenses by $2,215.

<u>Annual Meeting Expenses.</u> Grayson s annual meeting expenses included $2,800 for awarded scholarships and a provost fee of $3,572. Grayson has stated that the scholarships should have been removed and not included for rate-making purposes.[16] The Commission agrees with Grayson and has reduced the annual meeting expenses by $2,800.

During the directors election, the provost receives the mailed ballots, tabulates the ballots, and verifies the legitimacy of signatures on the ballots.[17] A review of the provost s invoice shows a charge for $1,292 in postage to mail ballots.[18] However, Grayson s analysis of its annual meeting expenses shows an expenditure of $2,534 in

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[14] Response to the Commission s January 12, 1999 Order, Item 8(h).

[15] <u>Id.</u>, Item 19.

[16] <u>Id.</u>, Item 20.

[17] <u>Id.</u>, Item 21.

[18] April 14, 1999 Hearing Information Response, Item 1.

postage to mail ballots.[19] This situation leads the Commission to conclude that there has been a double counting of the postage expense for mailing the ballots. Therefore, the Commission will exclude the postage portion of the provost fee and reduce annual meeting expenses by $1,292.

Gifts to Independent Contractors. During the test year, Grayson retained an independent contractor to clear its rights-of-way. As a token of its appreciation, Grayson expended $686 to provide the work crews of the independent contractor with gift certificates and gloves. However, Grayson has indicated that this expense should not be included for rate-making purposes.[20] The Commission agrees and will exclude the $686 expense for gifts to the contractor.

Non-Recurring Expenses

During the test year Grayson converted its billing system, going from a billing card to a billing statement. The test-year expense for the conversion was $38,349.[21] In addition, Grayson began offering its customers the options of paying electric bills through bank check drafting and credit cards. The test-year start-up expense for these options was $1,130.[22] Grayson has acknowledged that the test-year billing conversion expense and the start-up expenses for the bill payment options should be considered non-recurring transactions.[23] The Commission agrees with Grayson that these are non-

[19] Application Exhibit S, page 39 of 113, line 30.

[20] Response to the Commission s February 9, 1999 Order, Item 4.

[21] Id., Item 7.

[22] Id., Item 8.

[23] T. E., April 14, 1999, at 46-47.

recurring items, which should be excluded for rate-making purposes, and finds that operating expenses should be reduced by $39,479.

Professional Services Expense

During the test year, Grayson incurred expenses to provide its attorney with health insurance coverage and post-retirement benefits, to send him to cooperative association seminars and annual meetings, to provide subscriptions to legal publications, to pay for meals in conjunction with Grayson s Strategic Planning Committee, and miscellaneous items.[24] Grayson acknowledged that the Christmas gift should not be included for rate-making purposes. However, Grayson contends that the seminars, annual meetings, and publications are educational in nature and are essential to the attorney carrying out his duties. Grayson further contends that providing health insurance coverage and post-retirement benefits are an important part of the total compensation package that will ensure a high commitment to the cooperative and its members.[25] The Commission finds no evidence that these expenses are either reasonable or consistent with normal business practice. The Commission has excluded $9,684 for rate-making purposes.

Grayson is a member of the Grayson Chamber of Commerce. During the test year, Grayson paid its regular membership dues and, in addition, funded the part-time executive director s position for the Chamber of Commerce. This additional funding

[24] The miscellaneous items included Christmas cards, a Christmas gift and calendar, and a portrait. See Application Exhibit 9, page 3 of 4.

[25] Response to the Commission s January 12, 1999 Order, Item 33.

totaled $3,000.[26] Grayson stated that it considered the funding of this position to be an economic development activity. The Commission believes it to be inappropriate for Grayson to both pay regular membership dues and fund a staff position with the same organization. Therefore, the $3,000 staffing expense has been excluded for rate-making purposes.

PSC Assessment

Grayson did not propose an adjustment to its PSC Assessment to reflect the effects of its normalization of revenues and purchased power expense or the impact of its proposed revenue increase. Grayson did agree at the public hearing that this was a proper adjustment.[27]

The Commission has calculated an adjustment to the PSC Assessment that reflects the normalization of revenue and purchased power found reasonable in this Order and applied the current PSC Assessment rate. This calculation results in an increase in the PSC Assessment of $4,473. The Commission has also determined the impact of the revenue increase granted herein and provided for an additional PSC Assessment expense of $1,576.

Pro Forma Adjustments Summary

The effect of the pro forma adjustments on Grayson s net income is as follows:

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[26] Id., Item 33(d) and Response to the Commission s February 9, 1999 Order, Item 25.

[27] T. E., April 14, 1999, at 60.

	Actual Test Period	Pro Forma Adjustments	Adjusted Test Period
Operating Revenues	$11,989,717	$ 862,509	$12,852,226
Operating Expenses	11,098,477	646,608	11,745,085
Net Operating Income	891,240	215,901	1,107,141
Interest on Long-Term Debt	943,463	69,414	1,012,877
Other Income and (Deductions) Net	(186,738)	244,747	58,009
NET INCOME	$ (238,961)	$ 391,234	$ 152,273

REVENUE REQUIREMENTS

Revenue Increase

The actual rate of return earned on Grayson s net investment rate base established for the test year was 2.44 percent. Grayson requested rates that would result in a Times Interest Earned Ratio (TIER) excluding GTCCs of 2.00X and a rate of return of 6.83 percent on its proposed rate base of $28,814,952.

Grayson s actual TIER excluding GTCCs for the test period was 0.75X. For the calendar years 1996 and 1997, it was 1.66X and 1.37X, respectively. After taking into consideration pro forma adjustments, Grayson would achieve a 1.15X TIER excluding GTCCs without an increase in revenues. Grayson s equity to total capitalization ratio is 28.01 percent based on the approved capital structure.

Revenue requirements calculated to produce a TIER excluding GTCCs of 2.00X should be approved. To achieve the 2.00X TIER, Grayson should be allowed to increase its annual revenues by $862,178. This increase includes an additional $1,576 to reflect the associated increase in Grayson s PSC Assessment. This additional revenue should produce net income of $1,012,875, which should be sufficient for Grayson to meet its mortgage requirements and service its mortgage debts.

PRICING AND TARIFF ISSUES

ETS Rate

The AG proposed eliminating the ETS rate, characterizing it as only a marketing program designed to sell more electricity. The Commission addressed the ETS issue in Case No. 10306[28] and found that such a discounted rate is a favorable off-peak load building technique that improves load factor. The AG also averred that Grayson s cost-of-service study was in conflict with the National Association of Regulatory Utility Commissioners Electric Utility Cost Allocation Manual for failing to allocate any demand costs to ETS. The Commission agrees with Grayson s position that ETS usage is off peak and should not be allocated any demand costs. Therefore, Grayson s existing ETS tariff should continue in effect unchanged.

Rate Schedule 1 And 2 Charges[29]

Grayson s present customer charge for Rate Schedule 1 is $7.86. The cost-of-service study filed with the application justified a customer charge of $10.17, but Grayson proposed a charge of $8.50. The AG filed testimony that modified Grayson s cost-of-service study and showed that the customer charge should be $8.99. However, the AG pointed out that Grayson s customer charge was one of the highest among the distribution cooperatives served by East Kentucky, and recommended the present charge of $7.86 be retained. The Commission finds that by approving Grayson s

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[28] Case No. 10306, The Notice of Grayson Rural Electric Cooperative Corporation of Grayson, KY, for a Revision to Its Retail Tariffs to Implement a Retail Marketing Rate for Special Retail Applications, final Order dated September 9, 1988.

[29] Grayson s Rate Schedule 1 is Domestic Farm and Home Service, while Rate Schedule 2 is Commercial and Small Power less than 50 KVA, including Public Buildings, Schools, Churches, etc.

proposed energy charge, as modified by the fuel adjustment clause roll in, the customer charge will need to be increased only a minimum amount, to $7.98, to produce the required class revenue requirement.

The present customer charge on Rate Schedule 2 is also $7.86. Grayson s cost-of-service study justified a charge of $8.66, but Grayson only proposed a charge of $8.50. The AG calculated a $7.45 charge, but he again proposed that the present $7.86 charge remain in place. Neither Grayson nor the AG have adequately explained why the customer charge for these two rate schedules should be set at the same level, especially in light of the significantly different results from Grayson s and the AG s cost-of-service studies. The Commission finds that Grayson s proposal to have the same energy charge for Rate Schedule 2 and for Rate Schedule 1 should be approved. Utilizing an energy charge of $.06326 per KWH, the Rate Schedule 2 customer charge will need to be $7.92. The small difference in the two customer charges partially implements the cost-of-service study finding that the Rate Schedule 1 customer charge should be higher than Rate Schedule 2.

<u>Cable TV Attachment Fees, Returned Check, Collection and Reconnect-Disconnect Charges</u>

Grayson proposed to increase its charges for these services, based on costs associated with providing the services. Proposed Cable TV Attachment Fees and the Returned Check Charge were not challenged by the AG and are accepted as proposed. Grayson lowered its proposed Collection and Reconnect-Disconnect Charges after correcting an error questioned by the PSC Staff. The AG proposed even lower rates citing previous cases where the Commission had gradually moved rates toward full cost of service to soften the rate shock to customers. In this case, however, the Commission is not persuaded that recovering the full cost of service in non-recurring charges would have a significant adverse effect on Grayson s ratepayers. In addition, setting these non-recurring charges at cost of service eliminates the existing subsidy from ratepayers who do not incur these charges.

OTHER ISSUES

Loan Guarantees

Since 1995, Grayson has maintained a guarantee arrangement with two local banks for loans to acquire geothermal heat pumps. In the event the customer defaults on the loan, Grayson has guaranteed payment to the bank. The guaranty against loss on each loan is an amount not to exceed $5,000.

KRS 278.300(1) states No utility shall issue any securities or evidences of indebtedness, or assume any obligation or liability in respect to the securities or evidences of indebtedness of any other person until is has been authorized so to do by order of the commission. Grayson has neither sought nor been granted the authority to be the guarantor of these loans.[30]

The Commission finds that Grayson s guarantee agreement is not in compliance with the provisions of KRS 278.300(1). Grayson should immediately suspend its program of guaranteeing these loans until such time as it has received authorization to do so from this Commission.

[30] Grayson had initially indicated that it had filed an application with the Commission, but later acknowledged that no filing had been made. Grayson has indicated it plans to make a filing after the completion of this proceeding. See Response to the Commission s January 12, 1999 Order, Item 6(d), and Response to the Commission s February 9, 1999 Order, Item 2(c).

Discontinuance of Required Capital Credit Rotation

Under the terms of the 1988 Supplemental Settlement Agreement (Settlement Agreement) reached in Grayson s last general rate case, Case No. 9980,[31] all total margins in excess of a 2.00X TIER are to be used to retire capital credits to Grayson s members. The revenue requirements established in that Settlement Agreement were based on a 2.50X TIER.

Grayson has now requested that this provision of the Settlement Agreement be eliminated because it finds the provision to be contrary to its intent to refund capital credits to its members. This is due to the constraints within its mortgage agreement with the Rural Utilities Service (RUS) that requires Grayson to have a Current Ratio above 1.0 before and after capital credits are refunded. The Current Ratio is the ratio of current assets to current liabilities. Grayson also noted that the margins earned in future years will be needed to restore its financial stability, after years of declining margins. The continuation of the required rotation would not permit Grayson to devote future years margins to the restoration of its financial stability. The AG expressed no position on Grayson s proposal.

Grayson s financial condition over the past three calendar years has been steadily deteriorating. The net margins, rate of return on rate base, achieved TIER, and debt service coverage ratio have all been in a steady decline.[32] The Commission finds that under the current circumstances, it is reasonable to eliminate the requirement that

[31] Case No. 9980, The Application of Grayson Rural Electric Cooperative Corporation for an Adjustment of Rates, final Order dated March 11, 1988.

[32] Application Exhibit K.

all margins in excess of a 2.00X TIER be used to retire capital credits to members. As noted previously in this Order, the Commission found that Grayson s equity to total capitalization ratio is 28.01 percent. If GTCCs were included in the capital structure and equity, Grayson s equity would be 32.90 percent of the total capital structure.[33] The Settlement Agreement required that when Grayson s total equity exceeded 40 percent it would retire capital credits in an amount sufficient to reduce total equity to 40 percent calculated after the retirement. In addition, in this proceeding Grayson has requested, and the Commission is authorizing, a TIER of 2.00X. The revenue requirement approved in this Order is not designed to generate revenues in excess of a 2.00X TIER.

By eliminating this provision of the Settlement Agreement, the Commission reminds Grayson that it still has the obligation to retire capital credits to its members as it is financially able to do so. Addressing this obligation should be an integral part of Grayson s comprehensive equity management plan, which is discussed later in this Order. In addition, the elimination of this requirement does not relieve Grayson of its obligation concerning its 1993 capital credit retirement that was the subject of Case No. 94-392,[34] and is discussed below.

1993 Capital Credit Retirement

In 1994, Grayson filed a request for authority to deviate from its obligation to retire capital credits in the amount of its 1993 margins in excess of 2.00X TIER.

[33] Total capital structure of $26,859,618 plus GTCCs of $1,957,299 equals $28,816,917. Equity including GTCCs equals $9,481,559. $9,481,559 divided by $28,816,917 equals 32.90 percent.

[34] Case No. 94-392, The Request of Grayson Rural Electric Cooperative Corporation for a Deviation from its 1988 Settlement Agreement, final Order dated August 8, 1995.

Grayson had calculated that its capital credit retirement obligation from 1993 operations to be $111,159. In its August 8, 1995 Order in Case No. 94-392, the Commission granted Grayson a delay in making its 1993 retirements until its Current Ratio exceeded 1.0. The Commission noted that Grayson was required by its lenders to maintain a Current Ratio of 1.0 or higher after the retirement of capital credits. The Commission advised Grayson that it should make every reasonable effort to improve its Current Ratio by achieving a proper balance of loan funds, short-term borrowings, and general funds. [35]

To date, Grayson has not paid any of the 1993 capital credits retirement.[36] Since the Order in Case No. 94-392 was issued on August 8, 1995 through the test-year end, Grayson s Current Ratio has not exceeded 1.0.[37] Grayson s approach to improving its Current Ratio has been to cut operating costs and streamline operations.[38] When asked about how it planned to pay the outstanding capital credit retirement, Grayson indicated that it would make the payments in accordance with the final Order in Case No. 94-392.[39] In addition, Grayson acknowledges that its financial condition has deteriorated substantially since 1993, but waited until 1998 to file a rate case.[40]

[35] Case No. 94-392, August 8, 1995 Order, at 3.

[36] Response to the Commission s January 12, 1999 Order, Item 35(c).

[37] Response to the Commission s February 9, 1999 Order, Item 28(a).

[38] T. E., April 14, 1999, at 10-15.

[39] Response to the Commission s January 12, 1999 Order, Item 35(c).

[40] Application Exhibit H, pages 2, 5, and 8 of 9 and T. E., April 14, 1999, at 9.

While Grayson s commitment to pay the 1993 capital credit retirement appears to be sincere, its efforts to date have been minimal. Cutting operating costs and streamlining operations in and of themselves will not resolve Grayson s Current Ratio problems. As the Commission noted in the August 8, 1995 Order, the improvement of Grayson s Current Ratio will require achieving the proper balance of loan funds, short-term borrowings, and general funds. In this proceeding, Grayson has shown that its additions to utility plant in service have outpaced its long-term debt advances by approximately $2 million.[41] While the Commission recognizes that there are delays in securing RUS debt financing for plant, the funding needs during the interim period are financed through short-term borrowings and general funds. Having to fund approximately $2 million worth of utility plant through short-term borrowings and general funds negatively impacts Grayson s Current Ratio, making it doubtful that the minimum level of 1.0 will be achieved.

The Commission finds that the management and board of directors of Grayson have not adequately addressed a resolution of the outstanding capital credit retirement. Therefore, the Commission will require Grayson to develop a formal, written plan of action to pay the outstanding retirement. This plan should address specifically how Grayson will improve its Current Ratio to a level of 1.0 after the retirement is paid, how the payment is to be funded, and a timetable for the achievement of these items. Grayson should contact the RUS and the supplemental lenders, the National Bank for Cooperatives and the National Rural Utilities Cooperative Finance Corporation (CFC),

[41] Response to the Commission s February 9, 1999 Order, Item 28(c) and T. E., April 14, 1999, at 57-59.

for assistance in developing the plan. Grayson should submit the detailed plan, with a resolution from its board of directors adopting the plan, to the Commission for its review and approval within 60 days from the date of this Order.

Equity Management Plan

Grayson originally adopted its current equity management plan in 1985. The terms of the Settlement Agreement in Case No. 9980 required Grayson to modify the plan to provide for a rotation of capital credits on a 10-year cycle. However, the current plan only addresses the capital credit rotation cycle and how Grayson would pay capital credits once the rotation cycle was achieved.[42] Grayson has indicated that it is aware that CFC has been assisting other cooperatives in addressing equity and capital management issues. Grayson plans to seek CFC s assistance after the completion of the equity management plans of other cooperatives.[43]

The Commission finds unacceptable Grayson s intention to wait until other cooperatives equity management plans are completed. The Commission has encouraged the development of comprehensive equity management plans in order to promote the financial stability of the cooperatives. Such plans address appropriate equity levels, targeted earnings levels, the overall management of the cooperative s equity, and the payment of member capital credits. The Commission finds that Grayson should seek the assistance of CFC and develop a comprehensive equity management plan within three years of the date of this Order or by the filing of its next rate case, whichever occurs first. Grayson should inform the Commission of its progress by

[42] Application Exhibit 14.

[43] Response to the Commission s February 9, 1999 Order, Item 27(b).

including a report on the status of the plan s development along with its annual report filed with the Commission. Upon the adoption of the equity management plan, Grayson should file a copy of the plan with the Commission.

Depreciation Study

Grayson indicated that it had never performed a detailed depreciation study. It also indicated that it was aware that the RUS was developing a depreciation study program that cooperatives could use in-house, and stated that it would consider performing a depreciation study when the RUS program became available.[44] Most of the cooperatives that the Commission regulates have periodically performed depreciation studies to determine that the depreciation rates in use are adequate and reasonable. The Commission finds that Grayson should perform a detailed depreciation study, completing the study within three years of the date of this Order or the filing of its next rate case, whichever event comes first. Grayson should also file a copy of the completed study with the Commission at the time of its adoption.

Tree Trimming Expenses

During the hearing, Grayson addressed questions concerning its tree trimming program. Grayson noted that for the past five years, it had performed extensive tree trimming in its rights-of-way to correct for prior years of only minimal efforts. Grayson stated that this effort had resulted in a significant increase in its tree trimming expense, but it anticipated the expense would be lower in 1999.[45]

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[44] Response to the Commission s January 12, 1999 Order, Item 15(b).

[45] T. E., April 14, 1999, at 30.

The Commission concurs with the importance of performing an adequate level of tree trimming each year. Grayson has testified that it is at the end of an intensive catch-up tree trimming cycle, and that this expense should be lower in the future. While all costs should be minimized to the extent possible, reductions in tree trimming expense should not be used by a utility to improve the bottom line on its income statement. The Commission believes that it is necessary to monitor these expenses closer in the future. Therefore, Grayson should establish a specific subaccount in its chart of accounts to record all tree trimming expenses. Grayson should also file an annual narrative discussion of the status of its tree trimming efforts and an explanation of why the expense increased or decreased from the previous period.

Cost Reduction Efforts

Another area of discussion at the hearing was the efforts of Grayson to achieve economies of scale through a consolidation or shared services agreements with other cooperatives. While Grayson has been utilizing independent contractors to perform its tree trimming, it has not attempted to jointly secure these services with other neighboring cooperatives. In fact, Grayson repeatedly stated at the public hearing that it had not entered into any agreements with other cooperatives to share any services. However, Grayson also stated it was always looking for ways to be more cost efficient.

During the past two years, the Commission has approved two consolidations of electric distribution cooperatives.[46] In the final Orders in both cases, the Commission

[46] See Case No. 97-424, The Application of Blue Grass Rural Electric Cooperative Corporation and Fox Creek Rural Electric Cooperative Corporation for an Order Approving Consolidation of the Two (2) Named Rural Electric Cooperatives; and Case No. 99-136, The Application of Green River Electric Corporation and Henderson Union Electric Cooperative Corporation for Approval of Consolidation.

urged other electric cooperatives to consider consolidations and other forms of strategic alliances that would achieve economic benefits and enhance the economies of scale necessary to continue to provide high quality service at reasonable costs to their member-consumers. Grayson s expressed desire to limit costs, while at the same time admitting that it has not attempted to secure shared services, leads the Commission to find that firmer measures are required. Therefore, the Commission finds that Grayson should investigate the possibility of sharing services with other cooperatives, and also investigate the potential for a consolidation with one or more cooperatives. In those instances where economically feasible, the Commission will expect Grayson to enter into such agreements. Grayson should report on its progress in this area within three years of the date of this Order, or at the filing of its next rate case, whichever event comes first.

SUMMARY

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

1. The rates set forth in Appendix A are the fair, just, and reasonable rates for Grayson to charge for service rendered on and after the date of this Order.

2. The rate of return and TIER granted herein are fair, just, and reasonable and will provide for Grayson s financial obligations.

3. The rates proposed by Grayson would produce revenue in excess of that found reasonable herein and should be denied.

IT IS THEREFORE ORDERED that:

1. The rates in Appendix A are approved for service rendered by Grayson on and after the date of this Order.

2. The rates proposed by Grayson are denied.

3. Grayson shall file within 30 days of the date of this Order its revised tariff sheets setting out the rates approved herein.

4. Grayson shall suspend its program of guaranteeing heat pump loans as of the date of this Order.

5. Grayson s request to eliminate the requirement in the Settlement Agreement adopted in Case No. 9980 to use all margins in excess of 2.00X TIER to retire capital credits to members is approved.

6. Within 60 days of the date of this Order, Grayson shall submit to the Commission for its review and approval a formal, written plan of action approved by its board of directors, which details how Grayson will pay the 1993 retirement of capital credits owed to its members.

7. Within three years from the date of this Order, or the filing of Grayson s next rate case, whichever occurs first, Grayson shall develop a comprehensive equity management plan. Grayson shall inform the Commission of its progress on the plan by including a status report with its annual report to the Commission and a copy of the plan shall be filed upon its adoption.

8. Within three years from the date of this Order, or the filing of Grayson s next rate case, whichever occurs first, Grayson shall perform a detailed depreciation

study. Grayson shall file a copy of the depreciation study with the Commission upon its adoption.

9. Grayson shall establish a separate subaccount within its chart of accounts for recording all tree trimming expenses.

10. As a supplement to its Annual Report, Grayson shall file a narrative discussion of the status of its tree trimming efforts. The discussion shall also include an explanation of why the expense increased or decreased from the previous year.

11. Within three years of the date of this Order, or the filing of Grayson s next rate case, whichever comes first, Grayson shall file a written report on its efforts and progress in the areas of shared services with other cooperatives and consolidation.

Done at Frankfort, Kentucky, this 8th day of July, 1999.

By the Commission

ATTEST:

Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 98-455 DATED JULY 8, 1999

The following rates and charges are prescribed for the customers in the area served by Grayson 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
DOMESTIC FARM & HOME SERVICE

Rate:

Customer Charge	$7.98 Per Month
Energy Charge	$.06326 Per KWH

SCHEDULE 2
COMMERCIAL AND SMALL POWER 50 KVA OR LESS,
INCLUDING PUBLIC BUILDINGS, SCHOOLS, CHURCHES, ETC.

Rate:

Customer Charge	$7.92 Per Month
Energy Charge	$.06326 Per KWH

SCHEDULE 3
OFF-PEAK MARKETING RATE

Rate:

On-Peak Rate	
All KWH/Month	$.06326 Per KWH
Off-Peak Rate	
All KWH/Month	$.03796 Per KWH

SCHEDULE 5
STREET LIGHTING SERVICE

Base Rate Per Light Per Year:

For the following monthly charges, the Cooperative will furnish, install and maintain the lighting fixtures and accessories, including hardware, control, lamps. Overhead wiring, etc., and the energy required.

Lamp Size	Mercury Vapor Lamps
7,000 Lumens	$6.71

SCHEDULE 6
OUTDOOR LIGHTING SERVICE SECURITY LIGHTS

Rate Per Light Per Month:

7,000 Lumens Mercury Vapor Lamp	$6.62
10,000 Lumens Mercury Vapor Lamp	$8.46

MISCELLANEOUS CHARGES

Returned Check	$15.00
Meter Reading	24.00
Collection	24.00
Installation and Reconnect	24.00
Overtime	58.00

CATV POLE ATTACHMENTS

2 Party Pole Attachments	$5.02
3 Party Pole Attachments	4.57
2 Party Anchor Attachments	4.24
3 Party Anchor Attachments	2.80
2 Party Ground Attachments	.32
3 Party Ground Attachments	.20