

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

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| APPLICATION OF BLUE GRASS ENERGY |) | |
| COOPERATIVE CORPORATION AND HARRISON |) | |
| COUNTY RURAL ELECTRIC COOPERATIVE |) | CASE NO. |
| CORPORATION FOR AN ORDER APPROVING |) | 2001-246 |
| CONSOLIDATION OF THE TWO NAMED RURAL |) | |
| ELECTRIC COOPERATIVES AND REDUCTION OF |) | |
| RESIDENTIAL RATES OF HARRISON RECC |) | |

ORDER

On August 7, 2001, Blue Grass Energy Cooperative Corporation (“Blue Grass”) and Harrison County Rural Electric Cooperative Corporation (“Harrison”) filed a joint application pursuant to KRS 278.020(4) and (5) for approval of their proposed consolidation into a new utility to be named Blue Grass Energy Cooperative Corporation (“Blue Grass Energy”). In addition, they request that if the consolidation is approved that the Commission approve a 2 percent reduction in the residential rates of Harrison. Blue Grass and Harrison are non-profit electric cooperatives, organized under KRS Chapter 279 and engaged in the retail distribution of electric power to member-consumers in Kentucky. To date, no public comments or requests for intervention have been filed with the Commission.

BACKGROUND

The proposed consolidation developed as a result of Harrison’s efforts to share services and reduce costs. Harrison began its efforts by contacting four sister cooperatives to determine if there was any interest in consolidation. It requested the

National Rural Utilities Cooperative Finance Corporation (“CFC”) to perform a study to analyze a possible consolidation with one of these four cooperatives. CFC’s preliminary analysis indicated that meaningful savings could be provided by the consolidation of Harrison and Blue Grass. After reviewing the results of the preliminary analysis, Harrison and Blue Grass commissioned the Rural Utilities Service (“RUS”) to do a more in-depth study of the possible benefits, which they state provided additional evidence that significant savings could be achieved.¹ The two cooperatives jointly commissioned Mark A. Harper of Harper Consulting (“Harper”) to perform a consolidation study.

The detailed Harper Consulting Consolidation Study (“Consolidation Study”) examined the financial impacts and economic benefits of consolidating Blue Grass and Harrison. Both Harrison and Blue Grass submitted prepared up-to-date 10-year financial forecasts to Harper, which he used to determine the economic benefits of the proposed consolidation. The results of the Consolidation Study revealed an estimated savings over the study period exceeding \$10,000,000 by the proposed consolidation.

The boards of directors of Blue Grass and Harrison approved the consolidation on May 29, 2001 and May 30, 2001 respectively. The members of both cooperatives overwhelmingly approved the consolidation by mail ballot in August 2001.² On May 30, 2001, Blue Grass and Harrison entered into a Consolidation Agreement wherein they agreed that subject to Commission approval the consolidation would become effective on January 1, 2002. The Consolidation Agreement provides, inter alia, Blue Grass

¹ Carpenter Testimony at 2 of 7.

² Blue Grass’s members voted 5,946 to 425 in favor of the proposed consolidation and Harrison’s vote was 3,161 to 367 in favor. See Response to the Commission Staff’s 1st Data Request dated August 27, 2001, Item 1.

Energy's principal place of business, the names and addresses of its initial Board of Directors, its capital credits policy, and the intention to request a 2 percent rate reduction in residential rates of Harrison.

DISCUSSION

Based upon a review of the record, the Commission finds that the proposed consolidation should provide significant long-term benefits to the member-consumers of Blue Grass and Harrison. The Commission is convinced that the financial impact and the economies of scale achievable through consolidation will allow Blue Grass and Harrison to best serve their member-consumers in the future. Blue Grass Energy should be able to provide electric service at a total cost that is lower than otherwise achievable without a consolidation.

KRS 278.020(4) requires that the Commission determine if the acquiring party has the financial, technical, and managerial abilities to provide reasonable service. The evidence conclusively demonstrates that the consolidated organization, Blue Grass Energy, meets the requirements of KRS 278.020(4). The Commission notes, however, that the By-laws of the new consolidated organization have not yet been adopted. Blue Grass Energy should provide the Commission with copies of the approved By-laws within 5 days of finalization.

During its review of the application, the Commission has become aware of certain benefits and compensation being provided to the directors of Blue Grass and Harrison. The Consolidation Agreement dated May 30, 2001 states that, "All directors on the new consolidated cooperative, not having twenty (20) years of service on either the BGEC or the HEC board will receive twenty (20) years of vested interest and

receive all benefits available to the directors as provided by the policies in effect at that time.”³ Blue Grass and Harrison have indicated that 3 of the 10 directors on the new board have more than 20 years of service, while the remaining directors have between 3 to 14 years of service.⁴

The Consolidation Agreement also states that there will be 10 directors on the board of the consolidated cooperative: 7 directors from Blue Grass and 3 from Harrison.⁵ The Harrison board of directors currently has 7 directors. The Harrison board determined that 4 of its current directors would retire and the remaining directors would serve on the consolidated cooperative board.⁶ The 4 retiring directors will receive \$10,000 each and medical insurance.⁷

In previous cooperative general rate proceedings, the Commission has excluded from the cooperative’s rates the expense for directors’ medical insurance and retirement compensation and benefits.⁸ The Commission realizes that the rate-making treatment

³ Application Exhibit A at 2.

⁴ Response to the Commission Staff’s 1st Data Request dated August 27, 2001, Item 3.

⁵ Application Exhibit A at 2.

⁶ Carpenter Testimony at 4 of 7.

⁷ Response to the Commission Staff’s 1st Data Request dated August 27, 2001, Item 7.

⁸ See Case No. 98-321, Application of Licking Valley Rural Electric Cooperative Corporation to Adjust Electric Rates, final Order dated February 16, 1999 at 13-14 and 21-22; Case No. 98-455, Application of Grayson Rural Electric Cooperative Corporation for an Adjustment of Rates, final Order dated July 8, 1999 at 7-9; Case No. 2000-373, The Application of Jackson Energy Cooperative Corporation for an Adjustment of Rates, final Order dated May 21, 2001 at 18-20.

of these expenses is not part of this proceeding. However, the Commission places Blue Grass and Harrison on notice that the approval of the proposed consolidation should in no way be construed as approval of the benefits Blue Grass and Harrison intend to provide their respective directors. The appropriate rate-making treatment for the directors' expenses will be addressed in the consolidated cooperative's next general rate case.

The boards of directors of Blue Grass and Harrison have agreed to offer their employees a special early retirement plan. The specifics of the plan have not been determined or approved by the boards of directors. The cooperatives anticipate that up to 6 employees may participate in the plan; however, as many as 15 employees could be eligible. The cooperatives estimate that the early retirement plan could cost between \$250,000 and \$350,000.⁹ Blue Grass and Harrison state that since the particulars of the early retirement plan have not been determined, the potential impact of the plan was not incorporated in the Consolidation Study or the forecasted savings. Blue Grass and Harrison believe that the savings from the early retirement program will be greater than the cost because the participating employees will probably not be replaced.¹⁰

The fact that the potential impacts of an early retirement plan were not included in the consolidation analysis causes some concern about the reasonableness and accuracy of the forecasted savings determined by the Consolidation Study. If Blue Grass and Harrison were considering an early retirement plan as part of the

⁹ Response to the Commission Staff's 1st Data Request dated August 27, 2001, Item 10.

¹⁰ Id., Item 15.

consolidation effort, such a plan should have been modeled in the analysis. However, given the estimated participation in the plan, the expected cost of the plan, and Blue Grass's and Harrison's statements concerning the potential savings to the consolidated cooperative from the plan, the Commission believes it will be unlikely that the final effects of an early retirement plan will significantly alter the forecasted savings as determined in the Consolidation Study.

The Commission views this consolidation effort as a work in progress. The record demonstrates that all issues have not been finalized. Blue Grass and Harrison have agreed to reduce the residential rates of Harrison by 2 percent and have agreed that no member of Blue Grass will experience a rate increase as a result of the consolidation. The Consolidation Agreement states that it shall be an objective of the consolidated cooperative to provide rate parity for all its members within a period of 9 years from the effective date of the consolidation.¹¹ However, the companies were unable to provide a schedule of the consolidated cooperative's implementation of rate parity over the 9-year period because any attempts at parity will be based on the consolidated cooperative's financial condition and its ability to reduce costs. The Commission commends Blue Grass Energy for its commitment to achieve rate parity, but encourages it to explore the possibility of achieving parity more rapidly than the proposed 9-year period.

¹¹ Blue Grass Energy also committed itself to achieving rate parity among its members after its consolidation with Fox Creek in 1997. 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, Order dated December 12, 1997.

The Commission believes that Blue Grass and Harrison should also be commended for their actions in seriously considering a consolidation and then pursuing consolidation once the benefits became apparent. We find this consolidation to be in accordance with the law, for a proper purpose, and consistent with the public interest.

To facilitate the Commission's monitoring of this consolidation, Blue Grass and Harrison should file periodic reports describing the status of the consolidation and their progress in achieving the benefits of the consolidation. The first such progress report should be submitted one year after the consolidation has been consummated. The Commission encourages Blue Grass and Harrison to complete the consolidation in the most practical, efficient, and cost-effective manner possible.

As noted in our final Orders in Case Nos. 97-424 and 99-136,¹² the Commission urges all electric cooperatives to seriously consider consolidations and other forms of strategic alliances to maintain the economies of scale necessary to continue to provide high quality service at reasonable costs to your member-consumers.

IT IS THEREFORE ORDERED that:

1. The consolidation of Blue Grass and Harrison into a new electric distribution cooperative to be known as Blue Grass Energy is approved.
2. Within 5 days after consummation of the consolidation, Blue Grass Energy shall file a written notice with the Commission setting forth the date of consolidation.

¹² Case No. 99-136, The Application of Green River Electric Corporation and Henderson Union Electric Cooperative Corporation for Approval of Consolidation, Order dated June 18, 1999.

3. Within 5 days of the date of the approval of the By-laws, Blue Grass Energy shall file seven copies of said By-laws with the Commission.

4. One year after the consolidation, Blue Grass Energy shall file a report detailing the status of the consolidation.

5. The 2 percent reduction in residential rates of Harrison is approved and shall be implemented upon consummation of the consolidation.

6. Blue Grass Energy shall file, within 30 days after consummation of the consolidation, its revised tariff sheets.

Done at Frankfort, Kentucky, this 4th day of October, 2001.

By the Commission

ATTEST:


Executive Director