COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION FOR AUTHORITY FOR JACKSON ENERGY COOPERATIVE CORPORATION TO GUARANTEE A LINE OF CREDIT FOR JACKSON SERVICE PLUS, INC. WITH NATIONAL COOPERATIVE SERVICES CORPORATION	)))))	CASE NO. 2001-00188

O R D E R

On August 8, 2001,[1] Jackson Energy Cooperative Corporation (Jackson Energy) filed an application seeking Commission approval for it to guarantee a line of credit loan between its subsidiary, Jackson Service Plus, Inc.[2] (Service Plus), and the National Cooperative Services Corporation (NCSC). Under the terms of the line of credit, Service Plus can borrow up to $1,000,000 for a term of 60 months. On August 14, 1998, Jackson Energy s Board of Directors authorized its President and General Manager to execute an unconditional guaranty of all amounts due under the line of credit between NCSC and Service Plus. On August 19, 1998 Jackson Energy signed documents providing NCSC with the unconditional guaranty.[3]

[1] Jackson Energy originally filed its application on June 20, 2001. The Commission found the application had numerous deficiencies and rejected the filing by letter on July 11, 2001. Jackson Energy resubmitted its application on July 30, 2001. After providing additional information, Jackson Energy s application was accepted and declared filed on August 8, 2001.

[2] Service Plus is a wholly owned subsidiary of Jackson Energy that primarily provides home security systems, home monitoring systems, and tree trimming services.

[3] Service Plus signed the line of credit agreement with NCSC on August 19, 1998. See Application Exhibit 2, pages 5, 8, and 10 of 13.

Since securing the line of credit, Service Plus has borrowed $937,750 from NCSC. Service Plus has in turn loaned $855,000 to Jackson Energy Services Corp. (JE Services), which has used these funds to support its propane venture, Jackson Energy Propane Plus, LLC (Propane Plus).[4] As of the filing of the application, JE Services has not repaid any of the $855,000 and consequently Service Plus has not repaid any of the $937,750. The interest rates effective on Service Plus s borrowings from NCSC have ranged from 6.00 percent to 8.70 percent, while the interest rates effective on JE Services borrowings from Service Plus have ranged from 6.125 percent to 8.825 percent.[5]

In 1998, Jackson Energy and East Kentucky created JE Services as a holding company for the provision of propane gas services. Jackson Energy s initial investment in JE Services was $9,000. Propane Plus was created through the partnership of JE Services and the Williams Company, d/b/a Thermogas, with each partner having a 50 percent share. In December 1999, the Williams Company was acquired by Ferrellgas. After failing to reach an acceptable arrangement, JE Services bought out Ferrellgas s 50 percent share in Propane Plus.

During Jackson Energy s last general rate case, the Commission found that Jackson Energy s guarantee of the line of credit for Service Plus was not in compliance with the provisions of KRS 278.300(1). Jackson Energy was ordered to file its

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[4] Jackson Energy and East Kentucky Power Cooperative, Inc. (East Kentucky) jointly own JE Services. Jackson Energy owns 75 percent of JE Services while East Kentucky owns the remaining 25 percent. Propane Plus is a wholly owned subsidiary of JE Services.

[5] Response to the Commission Staff s First Data Request dated August 23, 2001, Items 2(c) and 3(a).

application seeking such approval within 30 days of the date of the final Order in Case No. 2000-00373.[6]

Jackson Energy has stated that JE Services has no means at this time to repay Service Plus. It believes JE Services will be able to repay Service Plus once Propane Plus has sufficient earnings to distribute back to JE Services.[7] Jackson Energy is contemplating the purchase of additional shares of stock in JE Services to provide funds for JE Services to repay Service Plus. East Kentucky has indicated to Jackson Energy that it is willing to make a corresponding purchase of JE Services stock that will preserve the 75/25 ownership mix. Jackson Energy plans to purchase 1,185 shares of additional stock in JE Services, valued at $1,000 per share, for an additional investment of $1,185,000.[8] In its application, Jackson Energy asked for the Commission s guidance and approval, if required, for this additional purchase of stock.

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 it has been authorized so to do by order of the commission.

Furthermore, KRS 278.300(3) states:

> The commission shall not approve any issue or assumption unless, after investigation of the purposes and uses of the proposed issue and the proceeds thereof, or of the proposed

[6] Case No. 2000-00373, The Application of Jackson Energy Cooperative Corporation for an Adjustment of Rates, final Order dated May 21, 2001, at 47 and 52.

[7] Response to the Commission Staff s First Data Request dated August 23, 2001, Item 6.

[8] Id., Item 4.

> assumption of obligation or liability, the commission finds that the issue or assumption is for some lawful object within the corporate purposes of the utility, is necessary or appropriate for or consistent with the proper performance by the utility of its service to the public and will not impair its ability to perform that service, and is reasonably necessary and appropriate for such purpose.

Requiring this prior approval by the Commission ensures that ratepayers will not be obligated to bear the cost of any financings or guarantees that are not necessary, appropriate, or consistent with the utility s provision of service to the public and will not impair the utility s ability to perform that service. Prior to the filing of this application, Jackson Energy had neither sought nor been granted the authority to be the guarantor of the NCSC line of credit. Once the Commission authorizes a financing or guarantee, it is a prudent operating expense and is recoverable in rates.

This is not the first time the Commission has been asked by an electric cooperative to approve a cooperative s guarantee of a loan between a third party and a lending institution. In Case No. 1999-00412,[9] Grayson Rural Electric Cooperative Corporation (Grayson) sought authorization to guarantee the financing by local banks of geothermal heat pump systems and Electric Thermal Storage units purchased and installed in members homes. Grayson started this loan guarantee program in 1995 and, as is the case here, it was discovered during Grayson s last general rate case that Commission approval of the program had not been sought. The Commission directed Grayson to suspend its loan guarantee program until it received authorization from the Commission. In Case No. 1999-00412, the Commission determined that this equipment

[9] Case No. 1999-00412, Application for the Assumption of Securities by Grayson Rural Electric Cooperative Corporation.

constituted viable demand-side management alternatives and that it was appropriate for an electric utility to encourage demand reductions through the use of such technologies. The Commission further found that bank loans were made only to members who met the bank s credit standards and that Grayson had taken reasonable precautions to limit its potential exposure in the event of a member s default on the equipment loans.[10] Consequently, the Commission authorized Grayson s loan guarantee program.

The situation presented by Jackson Energy in this case is significantly different from the circumstances in the Grayson proceeding. Jackson Energy has guaranteed a 60-month, $1,000,000 line of credit to Service Plus, its wholly owned non-regulated subsidiary. Service Plus has in turn loaned this money to JE Services, another non-regulated subsidiary of Jackson Energy that is jointly owned with East Kentucky. JE Services has not repaid any of the amounts loaned to it by Service Plus, and Service Plus has not repaid any of the line of credit from NCSC. Furthermore, JE Services does not have funds available to repay Service Plus, unless Jackson Energy and East Kentucky purchase additional stock in JE Services.

The Commission has considered the evidence presented and finds that Jackson Energy s request for authority to guarantee its subsidiary s line of credit should be denied. Unlike Grayson, Jackson Energy has not demonstrated that the guarantee of the line of credit for a non-regulated propane business is necessary or appropriate for or consistent with the proper performance of its provision of electric service to its members, will not impair its ability to perform that service, and is reasonably necessary and appropriate for such purpose. Jackson Energy has not shown that Service Plus

[10] Case No. 1999-00412, March 22, 2000 Order, at 3-4.

qualified for the line of credit absent Jackson Energy s guarantee nor taken precautions to limit its potential exposure in the event of a default by Service Plus. The risk of default is compounded by the financial condition of JE Services and the likelihood that JE Services will fail to repay Service Plus.

The proposed purchase of additional stock in JE Services is not subject to the approval of this Commission. However, the Commission has concerns related to this proposed stock purchase. First, while Jackson Energy has indicated the funds provided from the sale of stock would be available and adequate for JE Services to repay Service Plus, there is no guarantee that JE Services will in fact devote those proceeds to paying off the loans to Service Plus. If JE Services does use the stock sale proceeds to repay Service Plus, there is no guarantee that Service Plus would use the repayment to pay down the outstanding amount on the NCSC line of credit. If either JE Services or Service Plus utilizes these funds to expand its business activities instead of repaying loans, Jackson Energy could confront a situation in which it has invested an additional $1,185,000 in one subsidiary and must also pay off a $1,000,000 line of credit for its other subsidiary.

Second, the $1,185,000 investment is to be funded from Jackson Energy s General Fund. Thus, Jackson Energy will be using funds generated from members that should be available to meet its regulated operating expenses and construction needs to invest in a non-regulated subsidiary. Since the establishment of JE Services in 1998 through December 2001, Jackson Energy s share of losses associated with its investment in JE Services totals $484,992.[11]

In the May 21, 2001 Order in Case No. 2000-00373, the Commission expressed its concerns about the ability of Propane Plus to continue as a going concern and the impact a possible failure would have on Jackson Energy s financial condition. We encouraged Jackson Energy to review the situation concerning Propane Plus, and if conditions warranted, consider the divestiture of the propane operations. Jackson Energy has undertaken such a review, resulting in the updating of the business plans for JE Services and Propane Plus, the preparation of a comprehensive financial forecast for Propane Plus, and the development of an exit strategy as part of the business plans for JE Services and Propane Plus.[12] While Jackson Energy has concluded that Propane Plus will operate in a profit mode beginning in 2003, this conclusion is based upon the assumption that Jackson Energy and East Kentucky purchase additional stock in JE Services.

If Jackson Energy and East Kentucky proceed with the purchase of additional stock in JE Services, it should be with the understanding and guarantee of JE Services and Service Plus that the proceeds from the stock sale will first be utilized to repay the

[11] Response to the Commission Staff s First Data Request dated August 23, 2001, Item 4(b) and Response to the Commission Staff s Second Data Request dated December 4, 2001, Item 6(a). In the response to Item 4(b), Jackson Energy indicates that its share of JE Services losses through December 2000 to be $342,305. In the response to Item 6(a), Jackson Energy shows the total JE Services losses for 2001 to be $190,250. Jackson Energy s share of these losses equals $142,687 ($190,250 x 75%). The $484,992 is the result of adding the $342,305 and $142,687.

[12] Response to the Commission Staff s Second Data Request dated December 4, 2001, Items 5(b) and 5(c).

subsidiaries outstanding debts. The Commission will not view favorably any additional stock purchase by Jackson Energy unless it is made contingent upon securing such guarantees.

The Commission acknowledges that the distribution cooperatives in Kentucky are evaluating and/or participating in numerous non-regulated business ventures. Generally, this is a new area of activity for these cooperatives. Numerous questions will likely arise concerning the relationship between the regulated cooperatives and these non-regulated activities. The Commission and its Staff are available to work with the regulated distribution cooperatives in seeking answers to these questions.

IT IS THEREFORE ORDERED that Jackson Energy s request for authorization to guarantee the line of credit between Service Plus and NCSC is denied.

Done at Frankfort, Kentucky, this 28th day of March, 2002.

ATTEST:

Wm H Bowker

Deputy Executive Director