COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF KENERGY CORPORATION FOR REVIEW AND APPROVAL OF EXISTING RATES	)))	CASE NO. 2003-00165

O R D E R

On May 17, 2004, Kenergy Corporation ("Kenergy") filed an application for clarification or, alternatively, for rehearing of three issues set forth in the Commission's April 22, 2004 Order. That Order reduced Kenergy's revenues by $162,347 and allocated the entire reduction to its five largest direct-serve customers, all of whom were represented by Kentucky Industrial Utility Customers, Inc. ("KIUC"): Alcan Aluminum, Century Aluminum, Weyerhaeuser Paper, Commonwealth Aluminum, and Kimberly Clark. Based on Kenergy's application for rehearing and the response thereto filed by KIUC, the Commission makes the following findings on the issues raised by Kenergy, plus one additional issue that was reflected but inadvertently not discussed in the April 22, 2004 Order.

Consolidation Credit Rider

The April 22, 2004 Order found that Kenergy's 4 percent consolidation credit rider, which is applicable to non-direct-serve customers, will automatically expire on September 2, 2004. Noting that Kenergy's earnings are expected to increase substantially when the credit expires, the Commission directed Kenergy to file an application no later than December 31, 2004 either to extend the credit to all customers or to propose an alternative methodology to pass the increase in earnings to all ratepayers. In addition, Kenergy was to address in this new application the disparity between customer classes as revealed in the cost-of-service study filed in this case.

In its rehearing application, Kenergy argues there is no evidence in the record to support a directive that all customers should participate in a future extension of the consolidation credit or a rate reduction based on an alternative methodology. Kenergy notes that the direct-serve customers represented by KIUC have received rate reductions in excess of $400,000 in this and Kenergy's previous rate case, while no other customers have received any reduction. Kenergy also suggests there may be valid reasons to propose the exclusion of other customer classifications in the future proceeding.

In its response, KIUC argues that Kenergy's proposal is unjust and unreasonable. KIUC states that Kenergy's cost-of-service study shows that all customers are paying revenues that are not consistent with their related cost of service. KIUC takes issue with Kenergy's attempt to exclude KIUC members from any further rate adjustment, and cites additional evidence in this case record that supports the inclusion of the KIUC members.

Currently, none of Kenergy's 19 direct-serve customers are participating in the consolidation credit rider. Kenergy's cost-of-service study revealed significant disparity between customer classes. While the revenues from direct-serve customers and non-direct-serve, three phase commercial and industrial customers exceeded their cost of service, the revenues from single phase and residential customers were insufficient to cover their cost of service.

The Commission is not persuaded by Kenergy's arguments. While the direct-serve customers represented by KIUC have received rate reductions, those reductions were fully justified by Kenergy's cost-of-service studies. In addition, none of Kenergy's direct-serve customers have received the consolidation credit. There is no reasonable basis to exclude any customer class from future participation in Kenergy's consolidation credit extension or alternative rate reduction. To do so would be inconsistent with Kenergy's cost-of-service study and inconsistent with the Commission's directive that Kenergy begin to address the disparity between customer classes paying their respective costs of service. Therefore, the Commission finds that Kenergy's request for rehearing on this issue should be denied. However, we recognize that it is within Kenergy's discretion to propose how the rate reduction in its next application should be allocated to each rate class. In determining that allocation, Kenergy will have to take into consideration each rate class's cost of service and the need to begin to address the disparity among classes in paying cost of service.

Interim Extension of Consolidation Credit

The April 22, 2004 Order does not expressly address whether Kenergy can make a tariff filing before September 2, 2004 to extend the existing consolidation credit rider until the Commission adjudicates the case to be filed by December 31, 2004. Kenergy seeks rehearing on this issue because it believes the April 22, 2004 Order could be construed as precluding such a filing. Due to the timing of the expiration of the current rider and the effective date of an Order in the new case, Kenergy believes ratepayers could be impacted by two changes in rates within a relatively short period of time, which would be contrary to the principle of rate stability. Kenergy requests that the April 22, 2004 Order be clarified to permit it to make a tariff filing for a temporary extension of the current consolidation credit.

KIUC opposes Kenergy's request, contending that a temporary extension of the consolidation credit would allow the significant disparity between each class's rates and its respective cost of service to continue for up to an additional 10 months. KIUC believes that Kenergy already has all of the information necessary to prepare and file the application required by December 31, 2004, and argues that the Commission should not allow Kenergy to file for a temporary extension of the consolidation credit rider.

The Commission finds Kenergy's request to be reasonable. Allowing Kenergy to extend the consolidation credit temporarily, until its application for an extension is adjudicated, will not adversely impact any class's rates or cost of service. Such a temporary extension will neither prejudice nor influence the outcome of Kenergy's next rate filing, but it will achieve some degree of rate stability for non-direct-serve customers. Therefore, the April 22, 2004 Order should be clarified to allow for such a filing at Kenergy's option.

Determination of Other Income and (Deductions) – Net

The third and final issue raised by Kenergy is whether the Commission has correctly calculated Kenergy's net income. The April 22, 2004 Order, page 14, contains a schedule of Pro Forma Adjustments Summary, which includes a line item labeled "Other Income and (Deductions) - Net." Kenergy asserts that the correct pro forma adjustment for this line should be $308,496, rather than the $371,262 shown in the Commission's Order. Carrying Kenergy's correction to the adjusted test period column results in a total for this line item of $479,327, compared to the $533,120 shown in the

Order. Kenergy claims that the difference in these numbers, $53,793, should be recognized by lowering the overall reduction in its revenues from $162,347 to $108,554.

KIUC objects to Kenergy's request, stating that even if an error exists in the computations, the record in this case justifies the amount of the revenue reduction authorized for the industrial customers served under Schedules 32 and 34. KIUC also argues that fairness in the rate-making process dictates that the revenue reduction granted in this case not be modified due to a "de minimis computational mistake." KIUC suggests that this error should be considered, if at all, during Kenergy's application to continue the consolidation credit, which will be filed by December 31, 2004.[1]

The Commission finds that Kenergy's revenues were reduced based on a determination of its total revenue requirements under the Times Interest Earned Ratio ("TIER"), not the results of the cost-of-service study for a particular class or classes of customers. The amount now questioned by Kenergy represents approximately one-third of the total revenue reduction authorized by the April 22, 2004 Order. If the rates authorized by that Order are to satisfy the statutory criteria of being "fair, just and reasonable," they must produce the correct amount of revenue needed by Kenergy. If the Commission's calculation of Kenergy's revenue requirement is in error, that calculation should be reviewed and corrected now, not deferred to a future rate proceeding as suggested by KIUC.

The Commission has reviewed the supporting workpapers and determined that the amount of $371,262, shown in the April 22, 2004 Order, page 14, is incorrect. A number of errors were made, including a typographical error, the omission of certain

[1] KIUC Response at 6.

adjustments discussed in the Order, and mathematical errors in the handling of adjustments associated with Kenergy's non-regulated business activities. The Commission has corrected these errors and recalculated the "Other Income and (Deductions) – Net" section, determining the total to be $344,886, which results in an adjusted test-period total of $515,717. This is $17,403[2] less than the amount included in the April 22, 2004 Order. The calculations are shown on Appendix B to this Order. The revised Pro Forma Adjustments Summary is as follows:

	Actual Test Period	Pro Forma Adjustments	Adjusted Test Period
Operating Revenues	$286,800,623	$(4,024,588)	$282,776,035
Operating Expenses	278,994,354	(2,427,936)	276,566,418
Net Operating Income	7,806,269	(1,596,652)	6,209,617
Interest on Long-Term Debt	3,853,856	(461,750)	3,392,106
Other Income and (Deductions) – Net	170,831	344,886	515,717
NET INCOME	$ 4,123,244	$ (790,016)	$ 3,333,228

These revised calculations result in a lower annual reduction in revenues for Kenergy than that set forth in the April 22, 2004 Order. Based on these revised calculations, Kenergy's total annual revenue reduction should be $144,911, which is $17,436 less than the original reduction. This lower reduction reflects the corrections discussed previously, plus recognizes the impact on the amount included for the PSC Assessment. The Commission finds that Kenergy's revenues should have been

[2] The omissions from the calculations result in a net positive impact of $952. The mathematical errors result in a net negative impact of $18,356. These two items total a negative $17,404 ($952 - $18,356). The remaining difference of a dollar is due to rounding differences.

reduced by $144,911 to produce net income of $3,188,580.[3] This amount of net income should be sufficient for Kenergy to meet its mortgage requirements and service its mortgage debts, as well as result in a TIER of 1.94X. Consequently, the rates for Schedules 32 and 34 should be revised accordingly. Appendix A shows the impact on the rates charged to the affected industrial customers.

Correction to Text of April 22, 2004 Order

During the review of the April 22, 2004 Order in response to Kenergy's application for rehearing, the Commission discovered that a narrative discussion of one adjustment related to Operating Expenses had inadvertently been omitted. The adjustment excluded for rate-making purposes Christmas bonuses and perfect attendance awards totaling $45,375 paid to Kenergy employees during the test year. The adjustment to exclude this expense was included in the Commission's determination of Kenergy's net income, but was not discussed in the Order. An explanation of that adjustment is set forth herein.

During the test year, Kenergy had undertaken a wage study finding that its pay structure was substantially in line with the external market place and at the same time had internal pay equity. In attempting to justify the inclusion of the Christmas bonuses and perfect attendance awards for rate-making purposes, Kenergy argued that the wage study did not look at total compensation. Kenergy further argued for the inclusion of these expenses for rate-making purposes because they were for the benefit of the

[3] As a result of the reduction, the PSC Assessment is reduced by $263. The net reduction is $144,648 ($144,911 - $263). The Adjusted Test Period Net Income of $3,333,228 less the net reduction of $144,648 results in the final net income of $3,188,580.

members. In previous cooperative rate cases, especially when a wage study has recently been prepared, the Commission has not allowed these additional employee bonuses and awards for rate-making purposes. Here, the evidence provided by Kenergy has not persuaded us to adopt a different rate-making treatment.

<u>Effective Date of Revised Rates</u>

The Commission's April 22, 2004 Order approved reductions in the rates for 5 industrial customers served under Kenergy's rate Schedules 32 and 34, with the new rates effective for service rendered on and after the date of that Order. In our May 25, 2004 Order, we determined that the rates approved in the April 22, 2004 Order should be considered interim rates to be charged subject to refund or surcharge, pending a final decision on Kenergy's rehearing request. Having now found that the revenue reduction in the April 22, 2004 Order was overstated due to a calculation error on our part, we also find that approving a smaller revenue reduction requires that the rates approved on April 22, 2004 be revised upward. We further find that the revised rates approved herein are the rates that should have been approved in the April 22, 2004 Order, but for our mathematical error. Therefore, consistent with our May 25, 2004 ruling, the effective date of the rates approved herein should be April 22, 2004, and Kenergy should be permitted to recover the difference between the amounts billed under the rates approved in the April 22, 2004 Order and the amounts that should have been billed under the correct rates approved herein.

IT IS THEREFORE ORDERED that:

1. Kenergy's request for rehearing to remove the requirement that all customers participate in a continuation of the consolidation credit rider is denied.

2. The April 22, 2004 Order is clarified as follows:

a. Kenergy may make a tariff filing to temporarily continue the existing consolidation credit rider until a decision is rendered on Kenergy's application, to be filed no later than December 31, 2004, to extend the credit to all customers.

b. The Pro Forma Adjustment Summary on page 14 is corrected as shown on page 6 of this Order and in Appendix B attached hereto.

c. The discussion of the adjustment to exclude for rate-making purposes Kenergy's expenses for Christmas bonuses and perfect attendance awards is set forth in the findings above.

3. All provisions of the April 22, 2004 Order that do not conflict with this Order shall remain in full force and effect.

4. The rates in Appendix A, attached hereto, are the correct rates approved for service rendered by Kenergy on and after April 22, 2004, and they shall replace and supersede the rates set forth in Appendix A to the April 22, 2004 Order.

5. Kenergy shall file, within 20 days of the date of this Order, its revised tariff sheets setting out the rates approved herein.

6. Kenergy shall, on the first month's bills after the date of this Order, impose surcharges on the customers served under rate Schedules 32 and 34 in order to recover the difference between amounts already billed under the rates approved in the April 22, 2004 Order and amounts that should have been billed under the correct rates set forth in Appendix A hereto.

Done at Frankfort, Kentucky, this 7th day of June, 2004.

By the Commission

ATTEST:

Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2003-00165 DATED JUNE 7, 2004

The following rates and charges are prescribed for the customers in the area served by Kenergy Corporation. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of the Commission prior to the effective date of the Order.

Alcan Aluminum
Century Aluminum

Customer Charge	$2,650 per month

Commonwealth Aluminum
Kimberly Clark
Weyerhaeuser Paper

Customer Charge	$1,050 per month

APPENDIX B

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2003-00165 DATED JUNE 7, 2004

Corrected Schedule of Other Income and (Deductions) – Net

Description	Test Year Actual	Adjusted	Total
Interest Charged to Construction	$108,004		
Kenergy proposed		($23,839)	$84,165
Interest Other	(101,422)		
Kenergy proposed		(25,644)	(127,066)
Other Deductions	(47,569)		
Kenergy proposed		47,569	
Miscellaneous Expense net of allocations (Order, pages 11-12) Note 1		40,118	
Subtotal		87,687	40,118
Non-Operating Margins – Interest	111,631		
Kenergy proposed		365,981	
Removal of Non-Regulated Net Income (Order, page 14) Note 2		(34,205)	
Subtotal		331,776	443,407
Non-Operating Margins – Other	8,779		
Kenergy proposed		(8,809)	
Additional reduction to Board expenses, non-regulated allocation (Order, pages 6-9)		704	
Reduction to Professional Expenses non-regulated allocation (Order, pages 10-11)		101	
Subtotal		(8004)	775
Non-Cash Capital Credits	91,408		
Kenergy proposed		(17,090)	74,318
Total – Other Income (Deductions) – Net	$170,831	$344,886	$515,717

(notes on following page)

Note 1 – Miscellaneous Expenses – net of allocations
(April 22, 2004 Order, pages 11-12)

Kenergy proposed	$47,569
Removal of advertising expenses	29,224
Removal of Election & Credential Committee expenses	1,006
Removal of miscellaneous expenses	17,402
Total	$95,201
Allocations:	
Capitalized	$7,109
Accounts Receivable	221
Non-Regulated	184
Expensed	87,687
Total	$95,201

Note 2 – Removal of Non-Regulated Net Income
(April 22, 2004 Order, page 14, footnote 12)

Test Year Actual Non-Regulated Revenues	$505,798
Test Year Actual Non-Regulated Expenses	(463,773)
Test Year Actual Non-Regulated Net Income	42,025
Allocation to Non-Regulated – Commission adjustments to expenses	(7,820)
Adjusted Non-Regulated Net Income	$34,205