COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

GENERAL ADJUSTMENT OF ELECTRIC RATES OF EAST KENTUCKY POWER COOPERATIVE, INC.	)))	CASE NO. 2006-00472

O R D E R

On December 5, 2007, the Commission issued an Order authorizing East Kentucky Power Cooperative, Inc. ("EKPC") to increase its rates to generate additional annual revenues of $19.0 million. The Commission approved EKPC's proposal to allocate the revenue increase to its rate classes based on the total revenue currently recovered from the classes.[1]

On December 13, 2007, the Kentucky Industrial Utility Customers, Inc. ("KIUC") filed a petition for rehearing. KIUC sought rehearing on the approach utilized to allocate the increase in revenues to rate classes and advocated that the Commission adopt, on a prospective basis, a demand-related revenue allocation approach as proposed by KIUC during this proceeding. The Commission granted KIUC's petition on December 27, 2007.

An informal conference was held on February 26, 2008 to discuss the rehearing issue and develop a procedural schedule. At the informal conference, KIUC agreed to file written testimony supporting its hearing proposal. EKPC agreed to provide an analysis of the effects of using a demand-related revenue allocation approach for the

[1] December 5, 2007 Order at 38.

$19.0 million revenue increase to EKPC's rate classes and the corresponding effect on the 16 member distribution cooperatives. KIUC's rehearing testimony and EKPC's analysis were filed on March 18, 2008. The Commission issued a procedural schedule on April 4, 2008 that provided for data requests and the opportunity for the parties to either file comments on the rehearing issue or request a public hearing on the rehearing issue. KIUC and EKPC filed responses to data requests; however, no party in this proceeding filed comments or requested a public hearing. The case is now ready for decision.

KIUC PROPOSAL

KIUC argued that allocating the $19.0 million increase using total revenues was not reasonable because 50 percent of EKPC's base revenue is comprised of fuel and purchased power costs and the revenue deficiency that caused EKPC's need for a rate increase was largely unrelated to the cost of fuel and purchased power. KIUC contended that using total revenues to allocate the increase overstates the cost responsibility for those rate classes whose energy-related revenues in relation to their total base revenues are above the system average. KIUC noted that EKPC's rate increase was driven by the need for EKPC to build equity, which is a component of fixed cost recovery. KIUC stated that, as the need for the rate increase was primarily related to fixed cost recovery, the more appropriate allocation approach should be based on each rate class's demand-related revenues, which are more directly related to fixed costs than are total base revenues.[2]

[2] Higgins Supplemental Direct Testimony at 4.

KIUC also suggested that the revenue increase allocated to Gallatin Steel ("Gallatin"), a special contract customer, should be allocated separately from the other special contract customers, given Gallatin's size and unique load characteristics.[3] KIUC proposed that the remaining special contract customers should be aggregated into a single group for allocation purposes.[4]

KIUC noted, that while EKPC had originally proposed a total revenues allocation approach, EKPC had agreed in data responses that the overall rate increase was more oriented to demand-related cost and that an apportionment of the increase on the basis of demand-related revenue or non-fuel revenue would be another way to reasonably apportion the increase. KIUC also stated that EKPC had acknowledged in its rebuttal testimony that the demand-related revenue allocation approach was a feasible alternative.[5]

KIUC determined that moving from the total revenues allocation approach to the demand-related revenues allocation approach would produce the following net changes in the allocation of the $19.0 million revenue increase to EKPC's rate classes:[6]

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[3] Id. at 11-12. Unlike the other special contract customers, most of the service to Gallatin is interruptible. Gallatin takes service under three different demand charges: one for firm service, another for interruptions on 90 minutes' notice, and a third for interruptions on 10 minutes' notice.

[4] Id. at 12.

[5] Id. at 6.

[6] Id. at 13 and Exhibit KCH Rehearing 1, page 1 of 3.

Rate B	$72,200 decrease
Rate B – Interruptible	$55,100 decrease
Rate C	$13,300 decrease
Special Contract – Gallatin	$663,257 decrease
Special Contract – All Others	$28,343 decrease
Rate E	$832,200 increase

Rates B, B – Interruptible, and C generally apply to the large commercial and large industrial customers of the 16 member distribution cooperatives. Rate E generally applies to the residential customers of the 16 member distribution cooperatives, as well as any other customers who are not eligible for Rates B, B – Interruptible, and C.

EVALUATION

The Commission has considered the evidence and arguments presented by KIUC concerning the allocation issue. The Commission notes that neither EKPC, the Attorney General, nor the Cumberland Chapter of the Sierra Club have filed any comments in support of or in opposition to KIUC's proposal.

The Commission is not persuaded by KIUC's argument that a demand-related revenue allocation approach is supported by the fact that EKPC's rate case was driven by the need to build equity and the need to provide for fixed cost recovery. This is not a unique situation, as utility rate cases generally are filed seeking increases in revenues in order to build equity and provide for fixed cost recovery. The uniqueness of EKPC's rate case was the urgency with which it needed the increase implemented. The fact that EKPC needed to build equity and provide for fixed cost recovery in and of itself does not warrant the utilization of a demand-related revenue allocation approach.

The Commission notes that KIUC appears to place significance on EKPC's acknowledgement that the demand-related revenue allocation approach is a feasible and reasonable alternative approach. A review of the record shows that, while EKPC

did agree the approach was feasible and reasonable, EKPC did not withdraw its proposal to utilize the total revenue allocation approach.

The Commission has concerns about the shift in the allocation of the $19.0 million increase in revenues resulting from the use of the demand-related revenue allocation approach. The reductions in the allocation of the $19.0 million for Rates B, B – Interruptible, and C are relatively minor. However, for all special contract customers, the allocation percentage decreases from 10.56 percent to 6.92 percent,[7] with the allocation percentage for Gallatin decreasing from 6.83 percent to 3.34 percent.[8] These reductions in the allocation of the $19.0 million are borne by Rate E customers, who would experience an increase from 80.05 percent to 84.43 percent.[9] In light of these allocation shifts, the Commission questions why it is reasonable to change the allocation of the revenue increase for the benefit essentially of one customer, Gallatin.

Lastly, the Commission notes that in previous base rate cases, when it has been determined that the submitted cost-of-service study was not reasonable or there were other sufficient reasons not to rely on the cost-of-service study, the Commission has usually applied the total revenue allocation approach to assign the increase or decrease in revenues to the rate classes. This was the approach proposed by EKPC in its rate case.

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[7] Id., Exhibit KCH Rehearing 1, pp. 2 and 3 of 3.

[8] Id. The 6.83 percent share of the $19.0 million reflects the division of the $1,297,857 allocated to Gallatin by $19,000,000. For Special Contracts – All Others, the allocation percentage decreases from 3.73 percent to 3.58 percent.

[9] Id. The 84.43 percent share of the $19.0 million reflects the division of the $16,041,700 to be allocated to Rate E by $19,000,000.

Therefore, the Commission finds that KIUC has not adequately explained or supported its proposal that the $19.0 million revenue increase should be allocated to the EKPC rate classes utilizing the demand-related revenue allocation approach. Consequently, KIUC's proposal to change allocation approaches is denied.

The Commission acknowledges that Gallatin does have load characteristics that are different from those of the average EKPC customer. However, the appropriate way to recognize those differences when determining revenue allocation and rate design is through the utilization of a complete and thorough cost-of-service study. EKPC is required by administrative regulations to include a complete cost-of-service study as part of the filing requirements in its next base rate case. The Commission notes that the December 5, 2007 Order requires EKPC to file its next base rate case no later than 9 months after the Spurlock 4 generating station goes into service.

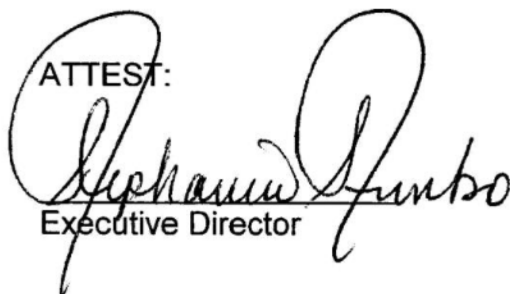
IT IS THEREFORE ORDERED that KIUC's proposal to utilize the demand-related revenue allocation approach to allocate the $19.0 million revenue increase is denied.

Done at Frankfort, Kentucky, this 7th day of July, 2008.

By the Commission

Vice Chairman Gardner abstains

ATTEST:



Executive Director