COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE ELECTRONIC APPLICATION OF FARMERS RURAL ELECTRIC COOPERATIVE CORPORATION FOR A GENERAL ADJUSTMENT OF RATES PURSUANT TO STREAMLINED PROCEDURE PILOT PROGRAM ESTABISHED IN CASE NO. 2018-00407	))))))	Case No. 2023-00158

FARMERS RURAL ELECTRIC COOPERATIVE CORPORATION
COMMENTS IN SUPPORT OF APPLICATION

Comes now Farmers Rural Electric Cooperative Corporation ("Farmers RECC"), by counsel, pursuant to the Commission's August 3, 2023 Procedural Order, and in further support of its Application requesting a general adjustment of its existing rates, respectfully offers the following comments:

Farmers RECC is a not-for-profit, member-owned, rural electric distribution cooperative organized under KRS Chapter 279 that provides retail electric service to approximately 26,452 metered accounts in eleven counties.[1] Approximately sixty-five (65%) percent of Farmers RECC's total energy usage is consumed by residential customers.[2] Using a historical, twelve-month test period ending on December 31, 2022, Farmers RECC seeks approval to increase its annual revenues by $2,415,704, or 3.99%, to achieve a Operating Times Interest Earned Ratio

[1] *See* Application, p. 1.

[2] *See* Exhibit 1, p. 13 (June 16, 2023).

("OTIER") of 1.51.[3] Farmers is proposing to increase the residential rate customer charge from $14.49 to $19.50 per month and to increase the energy charge from $0.087687 to $0.090673 per kWh. These changes also apply to the net metering rider.[4] Each of these rate design proposals is consistent with the Cost of Service Study ("COSS") prepared by Mr. John Wolfram.[5]

Farmers RECC filed its last general rate case in 2016.[6] With an average annual growth rate in membership of 0.7 percent, over a seven-year period, and a similarly flat increase in average energy sales,[7] inflationary pressures have continued to erode the cooperative's margins. The cost of interest expense, right-of-way maintenance, general labor and essential materials have increased tremendously.[8]

Also, a significant impact of the COVID-19 pandemic on Farmers has been the tremendous cost increases in essential materials utilized each day for the provision of reliable services to its members. These increases have occurred across virtually every expense category. Farmers RECC has been able to offset many of these costs and delay a base rate increase through prudent management practices, however, Farmers RECC's financial metrics are below what is necessary to continue to provide the safe and reliable service Farmers RECC's members have grown accustomed to.

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[3] *See* Application, p. 66. Based on the adjusted test year under the OTIER cap, the revenue deficiency is $3,116,333. However, pursuant to the total revenue increase cap, the increase is limited to an overall increase of 4.00 percent or $2,415,453. *See* John Wolfram Direct Testimony ("Wolfram Direct"), p. 7 (June 16, 2023). Should the Commission choose to disallow any costs included within Farmers RECC's test year, Farmers RECC respectfully requests the option to still award a 1.51 OTIER in order to still arrive at the overall 3.99% rate increase.

[4] *See* Wolfram Testimony, pp. 24-26.

[5] *See* Application, Exhibit JW-3 through JW-8.

[6] *See* Case No. 2016-00365, *In the Matter of the Application of Farmers Rural Electric Cooperative Corporation. for an Adjustment of Rates*, Order..

[7] *See* Moss Testimony, p. 5-6.

[8] *See* Phelps Testimony, p. 6.

Since Farmers RECC's last general rate increase, the cost of doing business and providing safe and reliable electric service has increased due to extraordinary inflationary pressures. However, Farmers RECC continues to focus on lowering or controlling expenses. Below is a list of cost-saving initiatives.

- On November 20, 2017, Farmers RECC refinanced its remaining Rural Utilities Services ("RUS") debt with National Rural Utilities Cooperative Finance Corporation ("CFC"). Principal transferred to CFC totaled $2,886,430. The debt was locked-in for 13 years at a fixed rate of 3.50%. It is estimated that the refinance with save Farmers RECC $502,393 in interest expense over the life of the loan;[9]
- Farmers RECC used its Cushion of Credit deposit amounts to prepay certain Federal Financing Bank ("FFB") loans without penalty on October 16, 2019 and July 22, 2020. It is estimated that the prepayment will save the cooperative, on average, $176,502 annually, over what would have been the lives of those loans;[10]
- Farmers introduced a new lower cost employee defined contribution retirement plan, to replace the higher cost defined benefit plan, for all new hires after January 1, 2012;[11]
- In 2013, Farmers participated in a prepayment program for its RS Plan that lowered future billing rates. For example, the prepayment reduced the RS billing rate from 31.37% to 23.57% in the 2022 test year;[12]

[9] *See* Case No. 2017-2017, Approved October 1, 2017.

[10] *See* Farmers RECC's Response to AG-DR-16.

[11] *See* Farmers RECC's Response to AG-DR-31.

[12] *See* Farmers RECC's Response to AG-DR-38.

- In June 2019, Farmers RECC began using a lockbox service via a local bank. By outsourcing this service, the cost/benefit analysis estimated an annual savings of $7,100;[13]
- In July 2019, Farmers RECC moved away from a consulting service and hired a full-time employee to manage its right-of-way program. The cost/benefit analysis estimated an annual savings of $13,200;[14]
- In December 2020, Farmers created a new position for a Purchasing Manager. Focusing exclusively on materials and inventory, the Purchasing Manager has implemented better strategies for competitively quoting bids, minimizing waste and improving the utilization of material work flow.[15]

While Farmers RECC has had several cost-saving initiatives since its last general rate increase, its financial metrics have generally deteriorated. In 2017, Farmers RECC's OTIER was 1.25; however, it fell to 1.01 during the test year.[16] Farmers RECC's financial metrics through July 31, 2023 are even worse with an OTIER of 0.35[17]

Right-of-way management, a critical aspect of our operations, has become a significant source of increased costs. Similar to other vendors, right-of-way contractors have experienced cost increases as inflation and market fluctuations continue to trend upward. The price per mile has risen by 32% since Farmers RECC's last rate case was finalized in 2017. Then, in 2017, Farmers RECC paid $2,251 per mile and in test year 2022, the cost totaled $2,982 per mile.[18]

[13] *See* Farmers RECC's Response to AG-DR-21.

[14] *See* Farmers RECC's Response to AG-DR-21.

[15] *See* Farmers RECC's Responses to AG-DR-21 and AG-DR-32.

[16] *See* Farmers RECC's Response to AG-DR-17.

[17] *See* Farmers RECC's Responses to AG-DR-17 and AG-DR-34.

[18] *See* Farmers RECC's Responses to AG-DR-25.

Farmers RECC absorbs this significant cost surge without increasing its rates to members. However, in doing so, Farmers RECC had to reduce the right-of-way trimming to preserve margins and try to meet long term lender financial requirements.

From 2019 to 2022, the total cost expended for right-of-way, including circuit work, removal work, hourly work and herbicide, averaged $1,406,971 per year. From 2019 to 2022, Farmers RECC averaged trimming 313 miles of line annually.[19] Farmers RECC's ultimate goal is to maintain a right-of-way maintenance cycle of 7-8 years. Achieving that target requires Farmers RECC to increase its right-of-way circuit trimming to between 400 and 500 miles per year. In the fall of 2022, Farmers RECC requested quotes for circuit work to be performed in 2024 and contracts were much higher than past per circuit-mile rates.[20] Therefore, to maintain safe and reliable service and member satisfaction, Farmers RECC has proposed a $2.3M pro forma right-of-way maintenance expense in its rate case.[21] This increase will better position Farmers RECC to work to achieve its 7-8 year right-of-way cycle, all else being equal.

Farmers RECC has always strived to find a balance between maximizing savings on interest rates and maintaining stability to lessen the impact on electric rates.[22] Increasing interest expense is a significant factor in driving Farmers RECC's financial performance. For years, Farmers RECC took advantage of the historically low 3-month variable interest rates by FFB.[23] However, the Fed has continued to raise interest rates, multiple times, and therefore it was no longer feasible to leave the variable rate loans on 3-month FFB rates.[24] Given the existing

[19] *See* Farmers RECC's Response to Staff-DR-2e.

[20] *See* Farmers RECC's Response to Staff-DR-2d.

[21] *See* Farmers RECC's Response to Staff-DR-2 and Farmers RECC's Responses to AG-DR-25 and AR-DR-29.

[22] *See* Phelps Testimony, p 6-7.

[23] *See* Farmers RECC's Response to Staff-DR-6.

[24] *See* Farmers RECC's Response to Staff-DR-6b.

interest rate environment and rising interest cost, the current interest rates are higher than the interest rates used in the Application and therefore, if we were to "normalize" the interest expense, based on the current rates, the pro forma adjustment would be greater than $284,255.[25]

Consistent with the Commission's streamlined rate case guidelines and general ratemaking principles, Farmers RECC made adjustments to the test year expense to account for: the fuel adjustment clause, the environmental surcharge, rate case expense, year-end customer normalization, generation and transmission capital credits, non-recurring items, depreciation expense normalization, advertising and donations, Director's expenses, interest expense, and life insurance premiums. Farmers RECC also followed the requirements set forth in the streamlined rate case order dated December 20, 2019, Appendix A, pages 5 and 6, under "E. Items Excluded for Ratemaking Purposes", Item 2, which states, "If employee health care insurance premium contribution is zero, for ratemaking purposes the pro forma income statement should reflect healthcare insurance premiums adjusted for employee contributions based on the national average for coverage type." Since Farmers RECC does not meet the stated criteria, no adjustment is required.

In allocating the proposed rate increase, Mr. Wolfram prepared a COSS using standardized procedures whereby: (1) costs were functionalized to the major functional groups; (2) costs were classified as energy-related, demand-related, or customer-related; and then (3) costs were allocated to the rate classes.[26] Mr. Wolfram's detailed analysis demonstrated that Farmers RECC is not recovering its costs from the residential rate classes while it is over-recovering its costs with regard to other customer classes. As explained by Mr. Wolfram: (1) the COSS demonstrates a

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[25] *See* Wolfram Testimony, Exhibit JW-2, Schedule 1.03 and Farmers RECC's Response to Staff-DR-6.

[26] *See* Wolfram Testimony, p. 14.

need to increase the rates for residential customers; and (2) the COSS supports a fixed monthly Facility Charge of $25.50 for Schedule R while the current charge is only $14.49.[27] The proposed increase to residential rates amounts to a gradual change that eliminates approximately 16 percent of the subsidization of Schedule R by the other rate classes.[28] This is not only gradual but it is also fair, just, and reasonable. Because the proposed reduction is relatively small, and since doing so would not align with the COSS results, revising the proposed rate to reduce subsidization by any smaller amount is not needed. In fact, doing so, would unfairly require members who are already paying more than their fair share to carry an even greater rate burden and it would send a price signal to residential members that is well below cost.[29] Schedule R is the only class that merits an adjustment, and this is consistent with previous Commission orders when the utility COSS yields results similar to those in the instant case.[30]

Throughout the discovery process, the AG requested information on Farmers RECC's salary and benefits. Farmers RECC believes that its salary and benefits are reasonable and comparable to other cooperatives in the state. Although employees hired prior to 2012 participate in two retirement plans, only one was included in the revenue requirement in this proceeding. Farmers RECC responded to these issues in more detail in responses to the AG's requests for information.[31] Farmers RECC believes its salary and benefits are reasonable and should be accepted by the Commission in this proceeding.

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[27] *See* Wolfram Testimony, p. 23.
[28] *See* Farmers RECC's Response to Staff-DR-10.
[29] *Ibid.*
[30] *See* Farmers RECC's Response to Staff-DR 4c.
[31] *See* Farmers RECC's Response to AG-DRs 3 through 6.

Farmers RECC is mindful of the timing of its rate case filing and of the fact that no increase is ever welcomed by customers. However, as the Commission has opined regularly, a cooperative has a duty to safeguard its financial integrity for the benefit of its members who are also its customers.[32] In this particular case, based on the adjusted test year under the OTIER cap, the revenue deficiency is $3,116,333. However, pursuant to the total revenue increase cap, the increase is limited to an overall increase of 4.00 percent or $2,415,453. Should the Commission choose to disallow any costs up to $700,880 included within Farmers RECC's test year, Farmers RECC respectfully requests the option to still award a 1.51 OTIER in order to still arrive at the overall 3.99% rate increase.

In summary, Farmers RECC's proposal is fair, just, and reasonable both in regard to the amount of the revenue request and the rate design. Farmers RECC is grateful to the Commission for allowing this case to proceed under the streamlined rate case procedures and appreciates the Attorney General's constructive participation in the case. For the reasons set forth above, Farmers RECC respectfully requests the Commission to approve its Application, and authorize the new rates.

This 14th day of September 2023.

[32] *See*, *e.g.*, Case No. 2008-00371, *In the Matter of the Application of South Kentucky Rural Elec. Coop. Corp. for A Certificate of Pub. Convenience & Necessity to Construct A New Headquarters Facility in Somerset, Kentucky*, Order, (Ky. P.S.C. May 11, 2010) ("South Kentucky's board of directors owes a fiduciary duty to its customers to safeguard the financial and operational viability of the cooperative. This fiduciary duty is heightened given the fact that South Kentucky's customers are also the owners of the cooperative."); Case No. 2006-00472, *In the Matter of the General Adjustment of Electric Rates of East Kentucky Power Cooperative, Inc*., Order, , pp. 26-27 (Ky. P.S.C. Dec. 5, 2007):

> Unlike an investor-owned utility where the equity owners of the utility may or may not also be customers of the utility, an RECC is governed and owned by its members, who are also its customers. While members of the 16-member systems have an interest in keeping their distribution cooperative's rates as low as possible, they also have an interest in keeping their distribution cooperative's equity position in EKPC viable. The directors of EKPC — who generally are also officers and directors of the 16-member systems — have an obligation to either seek an increase or decrease in EKPC's base rates when the balance between low rates for end users and sufficiently high rates to keep EKPC viable falls out of equilibrium. Though there is a constant friction between these interests, it is one EKPC's board members voluntarily undertake.

Respectfully submitted,

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CERTIFICATE OF SERVICE

This is to certify that a true and accurate copy of the foregoing electronic filingwas transmitted to the Commission on September 14, 2023 and that there are currently no parties that the Commission has excused from participation by electronic means in this proceeding.

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