FLEMING-MASON ENERGY
COOPERATIVE, INC.

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April 3, 2009

Mr. Jeff Derouen
Executive Director
Kentucky Public Service Commission
211 Sower Boulevard
Frankfort, KY 40602-0615

RE: Case 2008-00408

Dear Mr. Derouen,

I want to submit to the record my responses to the recent data request in the Case 2008-00408.

Thank you for assistance in this case.

Sincerely,

Christopher S. Perry
President and CEO

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In re the Matter of:

CONSIDERATION OF THE NEW FEDERAL	)	
STANDARDS OF THE ENERGY	)	CASE NO. 2008-00408
INDEPENDENCE AND SECURITY ACT OF	)	
2007	)	

RESPONSE TO QUESTIONS 56-63 IN PSC REQUEST

CHRISTOPHER S. PERRY
PRESIDENT AND CHIEF EXECUTIVE OFFICER
FLEMING-MASON ENERGY

FILED: APRIL 3, 2009

Q. State whether Fleming-Mason believes that its rate Schedule RSP for residential service with a customer charge and flat energy charge, rate Schedule SGS for small general service and rate Schedule LGS for small commercial service, with a customer charge, demand charge and flat energy charge support energy efficiency. Explain why or why not.

A. Current rate design for Fleming-Mason Energy (FME) does support energy efficiency, but it does not align the interests of all parties toward a common goal. The current design does offer incentives for the customer to make investments and as energy prices continue to increase the investments become more valuable. However, FME does lose margins when the end user reduces usage due to the recovery of fixed costs through a variable rate. This reduction in usage simply creates a cycle of rate increases and increases in the energy charge to cover the fixed costs.

This is consistent across all rate structures for different classes. FME believes that energy efficiency is a critical part of energy delivery in the future. It is very important that rate structures support the recovery of costs and offer the incentive to use energy wisely. FME does not support rate designs with inclining or declining block structures. Alternative rate designs that will be more widely adopted in the future include enhanced time of use rates (TOU) and real-time rate design. With East Kentucky Power and the other distribution cooperatives, we are pursuing alternatives.

Q. State whether Fleming-Mason supports inclining block rates. Explain your answer.

A. FME does not support inclining block rates because it harms the low-income, inefficient energy users. FME has done research into the usage patterns for our members that receive

LIHEAP assistance from the state to pay electric bills during the winter months. In our research, these members usage was 36% more than the average FME residential member. An incline block rate structure would place a greater burden on these customers by applying a higher energy charge to the additional usage. Our experience is that a large portion of our high usage residential customers live in homes that use energy inefficiently.

Q. With reference to the discussion about recovery of fixed costs through fixed charges and that variable costs should be recovered through variable charges and the statement that Fleming-Mason's current retail rate design does not align the interests of the cooperative with respect to energy efficiency in the Testimony of Christopher S. Perry ("Perry Direct"), pages 2 and 3, address the following:

a. When did Fleming-Mason perform its most recent cost of service study?

b. Describe the relationship of Fleming-Mason's current rates and charges to the level of rates and charges indicated from the results of its most recent cost of service study.

c. When was Fleming-Mason's last general rate case filed?

d. What amount and percent increase die Fleming-Mason request in its residential customer charge?

e. What amount and percent increase in Fleming-Mason's customer charge was granted?

A. a. The most recent cost of service study was conducted in conjunction with the last rate case in April of 2007. The Case number was 2007-00022 and was filed in May of 2007 based on the test year ending 12/31/2006.

b. The most recent cost of service study results in a customer charge of $22.79 for the residential class and an energy charge of $.0595/KWh. In the rate case, FME was granted a

$9.75 customer charge and an energy charge of $.0756/KWh. The discrepancy in these figures indicates that the low-usage customer is not paying their portion of the fixed costs and is actually being subsidized by high-usage residential customers. This also highlights some of the potential problems with energy conservation and wide-spread adoption of renewable resources. FME loses $.0161/KWh for every KWh that a member does not use or generates. The net metering requirement even makes this problem greater, because not only do we lose the additional revenue from lost sales but we are paying those margins back to the customer. FME does support renewable resources, but is concerned about rate design related to these resources.

c. The case was filed on 5/18/2007. The Case number was 2007-00022.

d. The amount requested for the residential customer charge was $9.93 with a 59% increase in that charge.

e. The amount granted for the residential customer charge was $9.75 with a 56% increase in that charge.

Q. Explain why Fleming-Mason has not sought approval to implement a DSM surcharge per KRS 278.285 for any DSM offering.

A. FME fully supports DSM programs and typically works with EKP on these programs. The Button-Up program, load control, and offering of compact fluorescent light-bulbs have all been coordinated with EKP. FME will continue to work with other cooperatives to effectively offer DSM programs. In the past, the costs for these programs were recovered through base rates. However, FME does believe that the DSM surcharge will be used in the future as efforts are increased to help our members reduce energy usage and help us to offset new investments in generation.

Q. With reference to EISA 2007, Section 5329(a)(17)(B)(i), under which the Commission shall consider removing the throughput incentive, address the following:

a. State whether or not Fleming-Mason supports decoupling. Explain your answer in detail.

b. Current literature describes a myriad of decoupling mechanisms. If applicable, describe specifically the form of decoupling to support energy efficiency.

A. It is understood that there are many decoupling mechanisms that are being offered and may be considered. FME does support decoupling rates. The current rate structures encourage the cooperative to desire more usage by customers. In the new world of energy, FME understands that this is not beneficial to the end-user of energy. FME is committed to serving our members and in the future this must be done by educating our members and helping them to reduce energy usage through efficiency. The optimal way to do this is for our rates to be independent of the throughput incentive described in earlier testimony.

FME believes that decoupling of rates will be an important rate design consideration in the future. We are not committed to any structure, but it is believed that any new decoupled rate design should consider a number of important features. First, the fixed customer charges should be recovered through the customer charge for the rate class. Second, there needs to be a mechanism for periodic review by the Commission to allow recovery of increases in these fixed costs. This is possible through a annual review and adjustment of these costs by the Commission and then an adjustment is granted based on TIER requirements.

Q. Explain whether or not Fleming-Mason believes the Commission should implement decoupling to support energy efficiency.

A. FME believes that the Commission should implement a decoupled rate structure as soon as possible. The energy environment is becoming more and more difficult for customers and utilities. The uncertainty over the future of electric generation and a federal cap-and-trade program on the horizon make it more important than ever that rates be decoupled. The energy portion of electric bills to our members continues to increase. This increase in energy costs causes members to look for ways to reduce energy usage and thereby financially harming the cooperative due to our dependence on usage to recover fixed costs. FME does not believe that costs will decrease for energy in the future and may in fact increase quickly. For that reason, it is important that the rate structure that encourages the cooperative, member, and regulator to use energy wisely be implemented. FME believes that the only way to align all parties is through a decoupled rate structure.

Q. With reference to Perry Direct, page 4, lines 5 and 6, explain why the revenue impact of electricity sales reduction is larger for utilities without generation resources.

A. For a distribution cooperative, the recovery of fixed costs is dependent on the usage of members. This is similar for other utilities with generation resources with one exception. When members reduce usage and eliminate the usage of one kilowatthour (KWh), then it is gone forever. There is no other way for a distribution company to recover the lost revenue. A company with generation assets does have alternatives for the energy that is not used. First, the utility may make the decision to sell that same energy to other utilities that may be in need of additional generation. Second, the utility may make a decision on the generation mix that may be used. The reduction in usage may allow this utility to eliminate the need to run higher priced generation assets. This would allow the utility to reduce the average costs

of the energy generated. FME does not have this option. Energy lost equates to fixed cost recovery lost.

Q. With reference to the discussion about a $2.00 per meter charge and a higher TIER in Perry Direct, page 12, lines 4 though 20, address the following:

a. Does Fleming-Mason prefer a $2.00 per meter charge rather than a DSM Surcharge to support investments in energy efficiency? Explain you answer in detail.

b. Does Fleming-Mason prefer a higher authorized TIER rather than a DSM Surcharge to support investments in energy efficiency? Explain you answer in detail.

c. What TIER did Fleming-Mason request in the last rate case?

d. What TIER was granted?

A. Fleming-Mason supports any structure that will help to encourage energy efficiency in the future. I am not opposed to the DSM Surcharge and believe that in the future FME will be working with the Commission to implement it. The $2.00 per meter discussion was meant to get the discussion and thoughts directed toward alternative ways of billing customers. FME is not advocating any one mechanism at this time, but does have the desire to have an open conversation concerning this topic.

The discussion concerning a higher authorized TIER is also meant to start a dialogue between the cooperative and the Commission concerning rate recovery. The Commission was very willing to work with FME on the last rate case and I am very appreciative. However, for FME to continue to make the necessary investments for reliability and encouraging energy efficiency, it is important that FME is financially strong. The average TIER and equity of cooperatives across the country is consistently in the 2.5 range for TIER and 40+% for equity. FME is sensitive to the impact of rates on our members and their

families and therefore believe that it is important to work with the Commission and members to balance the need for financial health of the cooperative and affordable energy in the future. I believe that the role for FME in the future is to help educate and deliver innovative energy solutions for our members. This is done by offering incentives for DSM, partnering with community groups helping low-income members, educating residential and industrial users, and becoming the energy resource for our community.

In our last rate case, FME requested a TIER of 2.0 and was granted a TIER of 1.9.