

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF BIG SANDY RURAL	)	
ELECTRIC COOPERATIVE CORPORATION	)	CASE NO.
FOR A GENERAL ADJUSTMENT OF	)	2017-00374
EXISTING RATES	)	

ORDER

On October 30, 2017, Big Sandy Rural Electric Cooperative Corporation (“Big Sandy”) filed an application seeking approval to adjust its base electric rates and to make changes to certain nonrecurring charges. Big Sandy proposes to adjust its base electric rates to increase its operating revenues by \$927,642.<sup>1</sup> Finding that an investigation would be necessary to determine the reasonableness of Big Sandy’s proposed increase, the Commission issued an Order on November 16, 2017, suspending the effective date of the proposed rates for five months, up to and including April 28, 2018, and establishing a procedural schedule for the processing of this matter.

The procedural schedule provided for, among other things, a deadline for intervention requests and two rounds of discovery upon Big Sandy’s application. There are no intervenors in this proceeding. Big Sandy responded to four rounds of discovery from Commission Staff (“Staff”), and one round of post-hearing requests for information issued by Staff. Pursuant to an Order issued on January 30, 2018, a formal evidentiary

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<sup>1</sup> Application at 2. Big Sandy filed Supplemental Direct testimony for John Wolfram (“Wolfram Supplemental Testimony”) on November 22, 2017, in which Big Sandy corrected two adjustments previously made that increased the revenue requirement to \$1,081,390. However, Big Sandy did not revise its rate request.

hearing was conducted on March 27, 2018. Big Sandy submitted responses to post-hearing information requests on April 6, 2018. The matter now stands submitted for a decision.

### BACKGROUND

Big Sandy is a member-owned rural electric cooperative corporation, organized under KRS Chapter 279. It is engaged in the distribution and sale of electric energy to 12,941 member-consumers in Breathitt, Floyd, Johnson, Knott, Lawrence, Magoffin, Martin, and Morgan counties, Kentucky.<sup>2</sup> Big Sandy does not own any electric generating facilities but purchases its total power requirements from East Kentucky Power Cooperative, Inc.<sup>3</sup> Big Sandy's last general rate adjustment occurred in 2012.<sup>4</sup>

### TEST PERIOD

Big Sandy proposed, and the Commission accepts, a historical 12-month period ended July 31, 2016, as the test period for determining the reasonableness of the proposed rates. In utilizing the historical test year, the Commission considers appropriate known and measurable changes.

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<sup>2</sup> Annual Report of Big Sandy Rural Electric Cooperative Corporation to the Public Service Commission of the Commonwealth of Kentucky for the Calendar Year Ended December 31, 2016 (filed Mar. 31, 2016), at 45 and 52.

<sup>3</sup> *Id.* at 39 and 42.

<sup>4</sup> Case No. 2012-00030, *Application of Big Sandy Rural Electric Cooperative Corporation for an Adjustment in Rates* (Ky. PSC Oct. 31, 2012).

## VALUATION

### Rate Base

Big Sandy determined a net investment rate base of \$34,044,017<sup>5</sup> based on the adjusted test-year-end value of plant in service and construction work in progress (“CWIP”), the 13-month average balances for materials and supplies and prepayments, plus a cash working capital allowance, minus the adjusted accumulated depreciation and the test-year-end level of customer advances for construction (“Customer Advances”).

The Commission concurs with Big Sandy’s proposed rate base with the exception that working capital has been adjusted to reflect the pro forma adjustments to operation and maintenance expenses. With this adjustment, Big Sandy’s net investment rate base for ratemaking purposes is as follows:

Utility Plant in Service	\$ 52,952,636
CWIP	<u>(73,568)</u>
Total Utility Plant	52,879,068
Add:	
Materials & Supplies	298,301
Prepayments	77,834
Cash Working Capital	<u>616,305</u>
Total Additions	992,440
Deduct:	
Accumulated Depreciation	(19,823,387)
Customer Advances	<u>(0)</u>
Total Deductions:	(19,823,387)
Net Investment Rate Base	<u><u>\$ 34,048,121</u></u>

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<sup>5</sup> Big Sandy’s response to Commission Staff’s First Request for Information (“Staff’s First Request”), Item 2.

## REVENUE AND EXPENSES

Big Sandy proposed eighteen adjustments to normalize its test year operating revenues and expenses based upon Commission practice and precedent. The Commission finds that fifteen adjustments proposed by Big Sandy are reasonable and should be accepted without change. Those adjustments are shown in the following table:

Wages & Salaries	\$22,900
Payroll Taxes	\$1,624
Depreciation	\$(27,206)
Property Taxes	\$(2,521)
Retirement Plan & 401(k)	\$(23,479)
Donations, Promotional Advertising & Dues	\$25,867
Professional Services	\$3,920
Directors Fees	\$16,601
Miscellaneous Expenses	\$1,307
GTCC	\$(1,400,000)
Misc Service Charges	\$5,370
Fuel Adjustment Clause	\$(23,836)
Environmental Surcharge	\$67,220
Year-End Customers	\$(30,553)
Employee Healthcare	\$156,584

The Commission finds that the remaining three proposed adjustments should be modified as discussed below.

### Rate Case Expense

Big Sandy estimated its rate case expense at \$185,735 in its application.<sup>6</sup> It proposed to recover this expense through a three-year amortization period. In a supplemental response to Staff's First Request, Item 34, filed on April 6, 2018, Big Sandy stated that its total rate case expense as of that date was \$188,542.<sup>7</sup> Big Sandy also

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<sup>6</sup> Application, Direct Testimony of John Wolfram ("Wolfram Testimony"), Exhibit JW-2, Reference Schedule 1.11.

<sup>7</sup> Big Sandy's Fourth and Final Supplemental Response to Commission Staff's First Request for Information, Item 34 at 2.

stated that it anticipates additional expenses of \$5,000 would be incurred to complete the case.<sup>8</sup> The Commission finds this amount reasonable and that a three-year amortization of these expenses will result in an increase in operating expense of \$2,602<sup>9</sup> over the \$61,912 proposed in the application.

#### Interest Expense

Big Sandy made an adjustment of \$78,803 for interest expense on long-term debt in its application.<sup>10</sup> Big Sandy failed to include the adjustment in the actual calculations determining its revenue requirement. However, Wolfram Supplemental Direct acknowledged the mistake and corrected the revenue requirement calculation.<sup>11</sup> The effect of the adjustment is to decrease the revenue requirement by \$157,606, which is twice the amount of the originally proposed adjustment. The Commission accepts the adjustment as reasonable.

#### Federal Emergency Management Agency (“FEMA”) Adjustment

In 2015, Big Sandy experienced a severe flood that was determined to be eligible for FEMA disaster relief. The flood took place before the test year but the reimbursement from FEMA took place during the test year. Because this was nonrecurring revenue to Big Sandy, the original adjustment removed \$155,175 of revenue from the test year. However, Big Sandy in preparing responses to Commission data requests discovered that the FEMA reimbursements were not recorded as revenue but as a receivable that

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<sup>8</sup> *Id.* at 1.

<sup>9</sup>  $\$188,542 + 5,000 = 193,542 / 3 = 64,514 - 61,912 = 2,602$

<sup>10</sup> Application, Wolfram Testimony, Exhibit JW-2, Reference Schedule 1.05.

<sup>11</sup> See Wolfram Supplemental Testimony at 4-5 and Revised Exhibit JW-2.

reduced operations and maintenance expenses.<sup>12</sup> Therefore, operations and maintenance expenses were overstated in the test year and should be reduced by \$155,175 and revenue would be unaffected during the test year. The net effect of the adjustment is to increase the revenue requirement by \$310,350.

In addition to the adjustments proposed by Big Sandy, the Commission finds that an adjustment should be made with respect to expenses related to dental insurance. Big Sandy provides single coverage dental insurance to ten office employees at no cost to those employees. Other employees of Big Sandy may purchase single or family coverage dental insurance on their own. In those situations wherein a company's employees have not been required to contribute to their dental insurance premiums, the Commission has determined that those employees should contribute 60 percent of the total premium.<sup>13</sup> The Commission finds that Big Sandy dental insurance expense should be decreased by \$7,957 to reflect this finding.

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<sup>12</sup> *Id.* at 3-4.

<sup>13</sup> The Willis Benchmarking Survey, 2015, pp. 62-63. ([http://willis.com/mwg-internal/de5fs23hu73ds/progress?od=lozsydmbJ6UUSxKxrjVJW5NDCRkgZEEps6-AgHEVM\\_Y](http://willis.com/mwg-internal/de5fs23hu73ds/progress?od=lozsydmbJ6UUSxKxrjVJW5NDCRkgZEEps6-AgHEVM_Y)).

## Pro Forma Adjustments Summary

The effect of the pro forma adjustments on Big Sandy's net income is as follows:<sup>14</sup>

Description	Present Rates	Pro Forma	Present Rates
	Unadj Test Yr	Adjustment	Pro Forma Test Yr
Operating Revenues			
Total Sales of Electric Energy	22,538,001	(1,336,864)	21,201,137
Other Electric Revenue	778,953	-	778,953
Total Operating Revenue	23,316,955	(1,336,864)	21,980,091
Operating Expenses:			
Purchased Power	16,010,784	(1,355,065)	14,655,719
Distribution Operations	1,094,553	5,955	1,100,508
Distribution Maintenance	1,516,304	165,989	1,682,294
Customer Accounts	887,246	2,659	889,904
Customer Service	29,781	2,322	32,103
Sales Expense	5,403	-	5,403
A&G	1,364,315	(144,087)	1,220,229
Total O&M Expense	20,908,387	(1,322,227)	19,586,160
Depreciation	2,272,704	776	2,273,481
Taxes - Other	33,861	2,521	36,382
Interest on LTD	701,164	(78,803)	622,361
Interest - Other	62,878	-	62,878
Other Deductions	19,500	-	19,500
Total Cost of Electric Service	23,998,494	(1,397,732)	22,600,762
Utility Operating Margins	(681,540)	60,868	(620,672)
Non-Operating Margins - Interest	173,911	-	173,911
Non-Operating Margins - Other	13,496	-	13,496
G&T Capital Credits	1,400,000	(1,400,000)	-
Other Capital Credits	46,851	-	46,851
Net Margins	952,718	(1,339,132)	(386,414)

<sup>14</sup> Staff participated in a telephonic informal conference on April 23, 2018 with Big Sandy in which a discussion was held to verify the present revenue from rates. The result revealed that there was an error in Big Sandy's filed exhibits; those errors are corrected in the table.

## REVENUE REQUIREMENTS

Big Sandy's actual Times Interest Earned Ratio ("TIER") excluding Generation and Transmission Capital Credits ("GTCCs") for the test period was 1.15X. Big Sandy's Operating Times Interest Earned Ratio ("OTIER") for the test period was 0.83X.<sup>15</sup> Big Sandy states that it requests this rate adjustment in order to properly maintain and operate its distribution system, meet the terms of its mortgage agreement, and to maintain its financial stability and integrity.<sup>16</sup> Big Sandy requests rates that would result in a TIER, excluding GTCCs, of 2.0X.<sup>17</sup> Big Sandy proposes an increase in base electric rates of \$927,642 to achieve a 2.0X TIER excluding GTCCs.

The TIER method for determining margins has been the approach used by the Commission in rate cases to calculate the revenue requirement for an electric distribution cooperative. Big Sandy states that it is requesting a 2.0X TIER because of its deteriorating financial position, and due to cost increases in its vegetation management program, labor costs, construction materials, maintenance costs, property taxes, and depreciation.<sup>18</sup>

Big Sandy's mortgage agreements with the Rural Utilities Service ("RUS") require the cooperative to maintain a TIER of 1.25X, and an OTIER of 1.10X using the best ratios for two years out the three most recent years. Big Sandy has complied with its RUS

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<sup>15</sup> Application, Wolfram Testimony, Exhibit JW-2, at 1.

<sup>16</sup> Application, Direct Testimony of Billy O'Brian Frasure, at 15.

<sup>17</sup> Application, Wolfram Testimony at 6.

<sup>18</sup> *Id.*

mortgage covenants, however, the test year TIER and OTIER were below the thresholds required by RUS.

Based upon the pro forma adjustments found reasonable herein, the Commission has determined that an increase in Big Sandy's revenues from base rates of \$ 1,008,775 would result in a TIER of 2.0X. This additional revenue should produce net margins of \$622,361. The Commission has determined that the above increase in revenues should result in an OTIER of 1.64X, which should allow Big Sandy to meet its mortgage requirements and service its mortgage debts. Based on the net investment rate base of \$34,048,121 found reasonable herein, this additional revenue should result in a rate of return on rate base of 3.66 percent.<sup>19</sup>

## PRICING AND TARIFF ISSUES

### Cost of Service

Big Sandy filed a fully allocated cost-of-service study ("COSS") in order to determine the cost to serve each customer class and the amount of revenue to be allocated to each customer class. Having reviewed Big Sandy's COSS, the Commission finds it to be acceptable for use as a guide in allocating the revenue increase granted herein.

### Revenue Allocation

Based on the results of the COSS, at current rates, the Farm & Homes ("A-1"), LPR Large Power ("LPR"), and Industrial ("IND-1B") rate classes provide revenues less than the cost to serve, while the other rate classes produce revenues in excess of their

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<sup>19</sup> \$622,361 (Granted Margin) + \$622,361 (Normalized Interest on Long-Term Debt) = \$1,244,722 ÷ \$34,048,121 (Net Investment Rate Base) = 3.66%.

class cost to serve.<sup>20</sup> Big Sandy proposes to allocate the increase to all rate classes except lighting. Big Sandy stated the proposed allocation is in greater proportion to the rate classes whose returns are more negative. However, the LPR and IND-B rate classes are being subsidized to a greater degree than the residential class, yet Big Sandy is proposing that most of the rate increase be applied to the residential class. Big Sandy stated that to have any significant impact on revenues, an increase to the LPR and IND-1B rates would have to be quite large as their contribution to total revenue is small, and Big Sandy wished to keep the rate increase to the LRP and IND-1B rate classes smaller for economic development reasons.<sup>21</sup>

The Commission has reviewed Big Sandy's proposed allocation of the increase and finds the allocation to be acceptable, with one additional adjustment. Big Sandy's proposed allocation results in the IND-1B class's contribution to total revenue to decrease from 1.75 percent at present rates to 1.67 percent at the proposed rates. The Commission finds that this class's proposed contribution toward total revenue is not an accurate representation of the class's revenue contribution. We further find that this class's revenue requirement should be increased to reflect a 1.75 percent contribution to total revenue. To account for this increase, the Commission will reduce the revenue requirement for the Commercial and Small Power ("A-2") as this rate class is providing the largest subsidy to the other rate classes.<sup>22</sup>

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<sup>20</sup> Application, Wolfram Testimony at 21.

<sup>21</sup> Big Sandy's Response to Staff's Third Request for Information, Item 3.

<sup>22</sup> Application, Exhibit 10 at 21.

## Rate Design

Big Sandy is proposing to increase the customer charge for the A-1 and A-2 rate classes to reflect more closely the costs to serve these classes. The table below shows the current, proposed, and approved customer charges, along with the amounts supported by the COSS for those classes for which a change is proposed.

	<u>Current</u>	<u>Proposed</u>	<u>Approved</u>	<u>COSS Results</u>
Schedule A1, Farm and Home	\$15.00	\$21.25	\$21.25	\$37.95
Schedule A2, Comm. & Small Pow	\$24.64	\$30.00	\$30.00	\$37.96
Schedule LP, Large Power	\$93.28	\$93.28	\$93.28	\$54.51
Schedule LPR, Large Power	\$107.68	\$107.68	\$114.50	\$130.29
Schedule IND-1B, Industrial	\$173.33	\$173.33	\$173.33	\$51.32

As shown in the table, Big Sandy's proposed customer charges are supported by its COSS.

Big Sandy states that the current rate structure places too little recovery on fixed costs in the customer charge resulting in an under-recovery of fixed costs.<sup>23</sup> Increasing the customer charge better matches the customer-related costs, but the increase in the customer charge is still significantly less than the full cost recovery of the customer-related costs. Additionally, the Commission notes that Schedule LPR is below its cost to serve and, therefore, in an effort to move all classes closer to their true cost to serve, Schedule LPR's customer charge should be increased to \$114.50. The Commission concludes that, for an electric cooperative that is strictly a distribution utility, there is merit to the argument that there is a need for a means to guard against the revenue erosion that often occurs due to the decrease in sales volumes that accompanies poor regional

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<sup>23</sup> Application, Exhibit 10 at 23.

economics, changes in weather patterns, and the implementation or expansion of demand-side management and energy-efficiency programs. For these reasons, the Commission will approve the increases in the customer charges for rate classes A-1, A-2, and LPR. Based on Big Sandy's average monthly residential usage of 1,088 kWh, the average monthly bill for residential customers will increase by \$7.42, from \$109.10 to \$116.52, or 6.80 percent.

The classes whose energy rate is increased are A-1, LPR, and IND-1B. A decrease in the energy rate for rate class A-2 results from the increase in the customer charge and the lowering of the class revenue requirement as noted above. Additionally, due to the additional revenue requirement, the energy charge for Rate Class LP Large Power Service slightly increases. Big Sandy is also proposing to increase its demand rates for rate classes LP, LPR, and IND-1B moving these rates closer to the COSS results.<sup>24</sup>

#### Tariff Changes

Big Sandy proposed, for all rate classes, an increase from 15 to 20 days, the time in which payment is due from the date of the bill for the current month. Big Sandy also proposed additional language to be added to the Schedule YL-1 tariff including approximately equivalent lumens for each light listed. The Commission has reviewed Big Sandy's proposals and finds both to be reasonable.

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<sup>24</sup> Application, Exhibit JW-3 at 2.

## Nonrecurring Charges

Big Sandy proposed increases for several of its miscellaneous charges. The table below shows the current and proposed/approved miscellaneous charges along with the increased amount.

<b><u>Miscellaneous Service Charges</u></b>	<b><u>Current</u></b>	<b><u>Proposed</u></b>	<b><u>Increase</u></b>
Membership Fee	\$25.00	\$25.00	----
Second Service Connect Fee	\$30.00	\$40.00	\$10.00
Temporary Disconnect/Reconnect	\$30.00	\$35.00	\$5.00
Meter Reading Fee	\$30.00	\$30.00	----
Meter Test Fee	\$30.00	\$40.00	\$10.00
Returned Check Fee	\$20.00	\$25.00	\$5.00
Collection Fee	\$30.00	\$35.00	\$5.00
Reconnection Fee – Regular Hours	\$35.00	\$35.00	----
Reconnection Fee – After Hours	\$52.50	\$65.00	\$12.50

The Commission has reviewed the supporting calculations provided by Big Sandy in responses to discovery and finds that the proposed increases in the miscellaneous charges should be approved. Approval of these increases will result in an additional \$5,370 in miscellaneous service revenues for Big Sandy.<sup>25</sup>

### SUMMARY

The Commission, after consideration of the evidence of record and being otherwise sufficiently advised, finds that:

1. The rates proposed by Big Sandy would not produce sufficient revenues for the amount found reasonable herein and should be denied.
2. The rates set forth in the Appendix to this Order are the fair, just, and reasonable rates for Big Sandy to charge for service rendered on and after the date of this Order and should be approved.

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<sup>25</sup> Application, Exhibit JW-2 at 29.

3. The rate of return and TIER granted herein will provide for Big Sandy's financial obligations.

IT IS THEREFORE ORDERED that:

1. The rates proposed by Big Sandy are denied.
2. The rates set forth in the Appendix to this Order are approved for services rendered by Big Sandy on and after the date of this Order.
3. Within 20 days of the date of entry of this Order, Big Sandy shall file with this Commission, using the Commission's electronic Tariff Filing System, new tariff sheets setting forth the rates and charges approved herein and reflecting their effective date and that they were authorized by this Order.

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By the Commission



ATTEST:

  
Executive Director

APPENDIX

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE  
COMMISSION IN CASE NO. 2017-00374 DATED **APR 26 2018**

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

SCHEDULE A-1  
FARM & HOME

Customer Charge per month	\$ 21.25
Energy Charge per kWh	
On-peak	\$ .08756
Off-peak	\$ .05190

SCHEDULE A-2  
COMMERCIAL AND SMALL POWER

Customer Charge per month	\$ 30.00
Energy Charge per kWh	\$ .06913
Demand Charge per kW	\$5.50

SCHEDULE LP  
LARGE POWER SERVICE

Customer Charge per month	\$93.28
Energy Charge per kWh:	
Secondary Meter	\$.05869
Primary Meter	\$.05257
Demand Charge per kW	\$ 6.27

SCHEDULE LPR  
LARGE POWER SERVICE

Customer Charge per month	\$ 114.50
Energy Charge per kWh	
Secondary Meter	\$ .05820
Primary Meter	\$ .05213

Demand Charge per kW	\$ 6.47
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SCHEDULE IND 1-B  
INDUSTRIAL

Customer Charge per month	\$ 173.33
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Energy Charge per kWh:

Secondary Meter	\$ .05339
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Primary Meter	\$ .05269
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Demand Charge per kW:

Contract Demand	\$ 6.44
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Excess Demand	\$ 9.34
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Miscellaneous Service Charges

Membership Fee	\$ 25.00
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Second Service Connect Fee	\$ 40.00
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Temporary Disconnect/Reconnect Fee	\$ 35.00
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Meter Reading Fee	\$ 30.00
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Meter Test Fee	\$ 40.00
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Returned Check Fee	\$ 25.00
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Collection Fee	\$ 35.00
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Reconnection Fee – During Office Hours	\$ 35.00
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Reconnection Fee – After Hours	\$ 65.00
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