

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF GREEN RIVER ELECTRIC)
CORPORATION AND HENDERSON UNION) CASE NO.
ELECTRIC COOPERATIVE CORPORATION FOR) 99-136
APPROVAL OF CONSOLIDATION)

ORDER

On April 19, 1999, Green River Electric Corporation ("Green River") and Henderson Union Electric Cooperative Corporation ("Henderson Union") jointly applied pursuant to KRS 278.020(4) and (5) for approval of their proposed merger and consolidation into a new utility to be named Kenergy Corp. ("Kenergy"). Green River and Henderson Union are nonprofit electric cooperatives, organized under KRS Chapter 279 and engaged in the retail distribution of electric power to member-consumers in western Kentucky. Green River serves approximately 30,378 customers in nine counties and Henderson Union serves approximately 18,099 customers in eight counties.

The Commission granted full intervention to Kentucky Industrial Utility Customers, Inc., who represented the interests of members Alcan Aluminum Corporation, Commonwealth Aluminum Corporation, and Kimberly Clark. A public hearing in this matter was held at the Commission's offices on May 20, 1999. Mr. Richard L. Liggett, a member-consumer of Henderson Union, offered public comments regarding the proposed consolidation.

BACKGROUND

The subject of consolidation was first raised in 1993 in a Commission sponsored management audit of Green River and Henderson Union. The audit was performed for the Commission by F.E. Jennings and Co. ("Jennings"), an independent management consulting firm. Jennings issued a comprehensive audit report in June 1993 that recommended further studies be performed to explore the feasibility of consolidating the entire Big Rivers Electric Corporation ("Big Rivers") system.¹ Although two members of the Big Rivers system declined to participate in any discussions of consolidation, Green River and Henderson Union agreed to such discussions and eventually procured a formal feasibility study.

A preliminary study was performed at no cost to the utilities by the National Rural Electric Cooperative Association ("NRECA") and the National Rural Utilities Cooperative Finance Corporation. This preliminary study, presented at a joint meeting of the Green River and Henderson Union Boards of Directors, recommended further in-depth analysis. This presentation became Phase I of a five-phase consolidation process. Eventually, Green River and Henderson Union engaged NRECA to perform a detailed study of the proposed consolidation.

The detailed NRECA Consolidation Study ("1996 Study"), completed in October 1996, reviewed virtually every element related to a consolidation of Green River and Henderson Union. Based upon the 1996 Study's extensive findings and recommendations, the two cooperatives entered into negotiations toward consolidation.

¹ The Big Rivers' system consists of four distribution cooperatives: Green River; Henderson Union; Jackson Purchase Electric Cooperative Corporation; and Meade County Rural Electric Cooperative Corporation.

On March 11, 1997, they executed a Consolidation Agreement to merge and form a new entity to be known as Kenergy Corp. On May 27, 1997, this Commission approved the proposed consolidation.² A majority of Henderson Union members who subsequently voted on the proposed consolidation, however, failed to approve the proposal.³

In November 1998, Green River and Henderson Union formed a Consolidation Committee to again explore consolidation. They retained Joseph Slatter, Jr., co-author of the 1996 Study, to revise and update that study. This revised study ("1999 Study") includes three scenarios relating to the economic benefits of consolidation. Scenario 1 reflects the immediate impact of consolidation from year one to year 10 of the forecast period and would result in savings of \$23.6 million. Scenario 2 reflects a phase-in period of 5 years to full realization and results in savings of \$19.9 million. Scenario 3 reflects a phase-in period of 10 years to full realization and results in savings of \$14.5 million.⁴

On January 23, 1999, Green River and Henderson Union executed a new consolidation agreement. This agreement provides that, subject to the Commission's approval, the two cooperatives will consolidate on July 1, 1999. It also addresses Kenergy's principal place of business, the composition of Kenergy's board of directors, the naming of Kenergy's principal officers, the retention of all current employees, the new cooperative's capital credits policy, and the cooperatives' intention to request a four

² Case No. 97-156, *The Application of Green River Electric Corporation and Henderson Union Corporation for Approval of Consolidation* (May 27, 1997).

³ Application at 3. By a vote of 478 to 170, Green River's members approved the proposed consolidation. Henderson Union's members, however, voted 230 against and 217 in favor.

⁴ National Rural Electric Cooperative Association, *Green River Electric Corporation and Henderson Union Electric Cooperative Consolidation Study* (Jan. 1999) at 77 – 85.

percent rate reduction for five years for non-direct serve members. Both cooperatives have submitted the proposed consolidation to their members. The majority of members voting on the proposed consolidation from each cooperative have approved the proposal.⁵

DISCUSSION

Based upon a review of the record, the Commission finds that the proposed consolidation should provide significant long-term benefits to the member-consumers of Green River and Henderson Union. The Commission is convinced that the positive financial impact and economies of scale achievable through consolidation will allow Green River and Henderson Union to best serve their member-consumers in the future. The evidence conclusively demonstrates that the consolidated organization, Kenergy, will have the financial, technical and managerial abilities to provide reasonable service to its member-consumers. Kenergy should be able to provide electric service at a total cost that is lower than otherwise achievable without a consolidation.

The record also demonstrates that Green River and Henderson Union have developed a reasonable plan to consummate the consolidation. It is apparent, however, that all issues have not been finalized. The Commission views this consolidation effort as a "work in progress." For example, Green River and Henderson Union are committed to effectuate the consolidation without terminating any employees.⁶ Consequently, since a substantial portion of the economic benefits of consolidation are from reduced staffing levels, it will take five to seven years to realize the full potential savings. Similarly, there are numerous organizational and personnel decisions having long-term economic

⁵ Application at 7. Green River's members voted 11,346 to 1,283 in favor of the proposed consolidation. Henderson Union's vote was 4,478 to 3,182.

⁶ Exhibit 4 of Application (Testimony of Dean Stanley) at 2.

implications that must await resolution by Kenergy and its Board of Directors. While many of these issues were identified in the 1999 Study, there will likely be others that arise as Kenergy begins serving its member-consumers.

The Commission further finds that it has an obligation to monitor the progress of this consolidation and the decisions made by Kenergy on the numerous outstanding issues which will impact the cost and delivery of electric service. The Commission also recognizes that, in the near-term, Kenergy may be in a position to adopt technological innovations that are feasible and cost effective. Such measures also warrant serious consideration if cost effective.

To facilitate the Commission's monitoring of this consolidation and the outstanding issues enumerated in the 1999 Study and this Order, Green River and Henderson Union should file periodic reports describing their progress on these issues and in achieving the benefits of the consolidation. The first such progress report should be submitted one year after the consolidation has been consummated. The need for and the timing of subsequent progress reports will be determined after review and analysis of the first report.

The Commission commends Green River and Henderson Union for seriously considering consolidation and then pursuing it once the benefits became apparent. In summary, we find this consolidation to be in accordance with the law, for a proper purpose, and consistent with the public interest. We encourage Green River and Henderson Union to complete the consolidation in the most practical, efficient and cost-effective manner.

The Commission notes that this matter represents the second proposed consolidation of electric distribution cooperatives that has won the approval of cooperative members within the last two years.⁷ The Commission urges other electric cooperatives to consider consolidations and other forms of strategic alliances that will achieve economic benefits and enhance the economies of scale necessary to continue to provide high quality service at reasonable costs to their member-consumers.

IT IS THEREFORE ORDERED that:

1. The consolidation of Green River and Henderson Union into a new electric distribution cooperative to be known as Kenergy is approved.
2. Within five days after consummation of the consolidation, Kenergy shall file a written notice with the Commission setting forth the date of consolidation.
3. Twelve months after the consolidation Kenergy shall file a report detailing the progress in achieving the benefits of consolidation, the status of all unresolved issues discussed in the 1999 Study, and an analysis of additional technological Improvements.

Done at Frankfort, Kentucky, this 18th day of June, 1999.

By the Commission

ATTEST:

Executive Director

⁷ See Case No. 97-424, The Application of Blue Grass Rural Electric Cooperative Corporation and Fox Creek Rural Electric Cooperative Corporation for an Order Approving Consolidation of the Two (2) Named Rural Electric Cooperatives (Dec. 12, 1997).