

BEFORE THE NEW MEXICO PUBLIC REGULATION COMMISSION

**IN THE MATTER OF KIT CARSON ELECTRIC)
COOPERATIVE, INC.'S ADVICE NOTICE NO. 57.)**

KIT CARSON ELECTRIC COOPERATIVE, INC.)

Applicant.)

Case No. 10-00379-UT)

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NEW MEXICO
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COMMISSION
FILED

PREPARED DIRECT TESTIMONY

OF

JOHN J. REYNOLDS

JUNE 23, 2011

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1 **Q. Please state your name and occupation and your business address.**

2 A. My name is John J. Reynolds. I am employed by the New Mexico Public
3 Regulation Commission (“NMPRC” or “Commission”) as a Utility Economist
4 in the Telecommunications Bureau of the Utility Division. My business address
5 is 1120 Paseo de Peralta, Santa Fe, NM 87501.

6

7 **Q. Please summarize your educational background.**

8 A. I earned a Bachelor of Arts degree in linguistics as well as a Masters in Business
9 Administration with a concentration in Finance from the University of Rochester
10 in Rochester, NY.

11

12 **Q. Please summarize your professional experience.**

13 A. From 1978 to 2002, I worked in the non-ferrous metals production and
14 manufacturing industry in internal auditing, purchasing of raw materials and
15 trading of commodity derivatives to manage exposure to price fluctuations.
16 More recently, I have worked as an analyst for individual income taxation with
17 the Commonwealth of Virginia and as a Federal Royalty Auditor in the Oil &
18 Gas Bureau of the State of New Mexico’s Taxation and Revenue Department. In
19 September 2008, I joined the Commission as a Utility Economist.

20

21 **Q. Have you previously testified before this Commission?**

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1 A. Yes. I testified orally and in writing as an expert witness in Case No. 07-00316-
2 UT which inquired into the rates and charges of institutional operator service
3 providers. My most recent testimony in that case was filed earlier this year in a
4 remand proceeding with a specific focus on rate of return.

5

6 **Q. What is the purpose of your testimony?**

7 A. The purpose of my testimony is to address concerns raised with respect to the
8 rate changes proposed by Kit Carson Electric Cooperative, Inc. (“KCEC” or
9 “Kit Carson”) in its Advice Notice No. 57 filed with the Commission on
10 November 15, 2010. Following the Commission’s Order¹, Kit Carson filed its
11 rate application on February 11, 2011, which included the testimony of Dr.
12 Martin J. Blake in support of his fully allocated class cost of service study. My
13 testimony will focus on the following issues in particular:

- 14 • KCEC’s financial condition as illustrated by financial ratios monitored
15 by KCEC’s primary lender
- 16 • The cost of service study presented by Dr. Blake and the extent to which
17 it supports higher customer charges
- 18 • The balancing of higher revenues proposed by KCEC with the prudent
19 containment of expenses
- 20 • The existing activities of KCEC outside of the provision of electric
21 service

¹ Order Suspending Rates and Appointing Hearing Examiner dated January 13, 2011. NMPRC

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1

2 **Q. What issues raised by protests to Kit Carson's Advice Notice No. 57 has the**
3 **Commission determined to be valid for review?**

4 A. The Commission has ordered² that this rate case shall include the following
5 issues:

- 6 • Whether the cost of service is accurately stated;
- 7 • Whether the cost of service reflects prudently incurred operating and
8 administrative expenses;
- 9 • Whether the proposed revenue requirement is reasonable in relation to
10 cost of service;
- 11 • Whether the cost of service reflects any cross-subsidization from the
12 electric utility to other services;
- 13 • Whether the cost of service is properly allocated to the residential class;
14 and
- 15 • Whether the proposed rate design for the residential class is just and
16 reasonable, including the allocation of costs between fixed charges and
17 kilowatt-hour charges, and whether Kit Carson should offer inclining
18 block rates.

19

20 **Q. How would Staff describe the trend of Kit Carson's operating results since**
21 **2004?**

² Order Granting in Part Motion to Narrow the Scope of Rate Hearing dated March 10, 2011; NMPRC

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1 A. Since 2008, the growth of Kit Carson’s electric business has stalled as measured
2 in a number of ways. Exhibit JJR-1 provides several salient financial statistics
3 that illustrate these changes since 2004. The statistics for 2009 are highlighted as
4 they represent the results for the test year which form the basis of Kit Carson’s
5 proposed rate increases. Sales of kilowatt hours have been declining since 2008
6 and in 2010 they were roughly equal to kilowatt hour (“kWh”) sales in 2004.
7 The number of consumers served has remained relatively flat since 2008 and
8 KCEC served 7.5% more consumers in 2010 than six years earlier in 2004.
9 Sales revenue also peaked in 2008 at \$34.8 million and has declined slightly
10 since. Stagnating sales and revenue after 2008 resulted in negative operating
11 margins in 2009 and 2010 following five years during which KCEC’s operating
12 margins exceeded \$2 million each year. Staff understands from Kit Carson that
13 KCEC is continuing to run at a deficit so far in 2011. The history of KCEC’s
14 operating results since 2004 suggests that Kit Carson is clearly suffering the
15 impact of the economic recession that has prevailed since 2008. From 2004 to
16 2008, Kit Carson experienced healthy growth as measured by consumers served,
17 kilowatt hours sold and revenues and was able to sustain healthy operating
18 margins. Since 2008, Kit Carson has been operating in an environment of
19 declining – sharply in 2009 – kilowatt hour sales and relatively flat number of
20 consumers served and revenues.

21
22 **Q. How has the Kit Carson’s balance sheet evolved since 2004?**

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1 A. Staff's review of Kit Carson's balance sheet shows that significant infrastructure
2 investments have been made by Kit Carson since 2004. These investments have
3 been largely financed with higher debt and member capital. Three balance sheet
4 accounts that have evolved significantly are highlighted in Exhibit JJR-1.
5 KCEC's Utility Plant has increased to \$121.2 million at the end of 2010 which
6 is \$38.6 million or 46.8% higher than six years earlier. This increase is
7 distributed among the following plant items:

Distribution	\$23.9 million
Transmission	\$ 9.1 million
All Other	\$ 5.7 million

8

9 To finance these investments, Kit Carson's Long-Term Debt has increased \$22.9
10 million or 57.3% more since 2004 while the contribution of its members' capital
11 has increased by \$10.2 million or 37.5% during the same time frame.

12

13 **Q. In light of flat or declining operating metrics and increasing debt and**
14 **member capital balances, what is Staff's perception of Kit Carson's**
15 **financial condition?**

16 A. While the significant investments undertaken by Kit Carson in its Utility Plant
17 suggest improved and expanded electricity service, Kit Carson has been
18 deprived of the opportunity to capitalize on these investments due to recently
19 falling kWh sales. Kit Carson therefore finds itself in a position of having to

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1 service \$22.9 million in additional debt while selling about the same number of
2 kWh as six years earlier. Assuming an interest rate of 5% without any obligation
3 to repay principal, the additional interest burden alone is over \$1.1 million
4 annually. Should the trend of falling kWh sales remain in effect, Kit Carson's
5 financial condition will inevitably worsen as its rising financial obligations
6 along with its relatively fixed expenses exceed its revenues. Kit Carson's deficit
7 operating margins in 2009 and 2010 illustrate this condition.

8

9 **Q. Who are Kit Carson's largest lenders?**

10 A. Beyond the capital contributions from members, Kit Carson secures debt
11 financing primarily from the following lenders: (1) Rural Utilities Service
12 ("RUS"), an agency of the United States Department of Agriculture, and (2)
13 CoBank, ACB ("CoBank"), a member bank of the Farm Credit System, a
14 federally chartered network of financial cooperatives. At the end of 2010, Kit
15 Carson had about \$48 million and \$13 million in loan balances outstanding with
16 RUS and CoBank, respectively. Included with the CoBank \$13 million are about
17 \$1.5 million designated specifically for Kit Carson's propane business. The
18 propane business will be addressed later in my testimony.

19

20 **Q. Do the lenders' loan agreements require Kit Carson to remain in stable and**
21 **viable financial condition?**

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1 A. Yes. Since RUS is an agency of the federal government, there are clear rules that
2 spell out the “general and pre-loan policies and requirements that apply to both
3 insured and guaranteed loans to finance the construction and improvement of
4 electric facilities in rural areas”.³ Among the requirements established by federal
5 regulations is the requirement to maintain certain financial “coverage” ratios.
6 While the regulations contemplate different ratios that may be contractually
7 agreed between RUS and a borrower, Staff has no information that indicates that
8 Kit Carson’s coverage ratio requirements differ from the standard requirements
9 in the regulations.

10

11 **Q. Please describe the financial “coverage” ratios monitored by RUS.**

12 A. There are four “coverage” ratios which are monitored by RUS and which appear
13 to be commonly tracked by rural electric cooperatives: (1) Times Interest Earned
14 Ratio (“TIER”), (2) Debt Service Coverage (“DSC”), (3) Operating Times
15 Interest Earned Ratio (“Operating TIER”) and, (4) Operating Debt Service
16 Coverage (“Operating DSC”).⁴ The TIER is meant to convey the extent to which
17 the borrower’s margins cover the interest on its long-term debt while DSC
18 indicates the extent to which the borrower is able to cover its debt service, i.e.
19 interest and repayment of principal. Operating TIER and Operating DSC mirror

³ §1710.1(a) General Statement, 7 CFR Ch. XVII (1-1-10 Edition) [hereinafter CFR]. Provided herewith is Exhibit JJR-3, Part 1710 – General and Pre-Loan Policies and Procedures Common to Electric Loans and Guarantees, Subpart A – General, CFR (pp. 77-84).

⁴ These “coverage” ratios are defined in §1710.2, CFR, and Staff will not repeat these definitions in this testimony. Staff’s calculations of these “coverage” ratios for KCEC in this testimony were computed in accordance with these federal definitions.

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1 TIER and DSC but they are calculated on an operating basis before the impact
2 of any non-cash generation and transmission capital credits recorded by the
3 electric cooperative.

4

5 **Q. What are the minimum “coverage” ratios that RUS requires of electric**
6 **cooperatives?**

7 A. For electric distribution cooperative borrowers such as Kit Carson, the federal
8 regulations state that RUS requires the following minimum ratios for loans
9 approved on or after January 29, 1996:⁵

10	TIER	1.25
11	DSC	1.25
12	Operating TIER	1.10
13	Operating DSC	1.10

14 Staff believes that Kit Carson is subject to these minimum ratio requirements for
15 all of its outstanding RUS loans. Kit Carson “must design and implement rates
16 for utility service to provide sufficient revenue to pay all fixed and variable
17 expenses, to provide and maintain reasonable working capital and **to maintain**
18 **on an annual basis the coverage ratios required [above].**”⁶ (Emphasis added)

19 The regulations further state the retrospective requirement that the “average

⁵ §1710.114(b), CFR. Provided herewith is Exhibit JJR-4, §1710.114 TIER, DSC, OTIER and ODSC Requirements, CFR (pp. 94-95).

⁶ §1710.114(d)(1), CFR

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1 coverage ratios achieved by a borrower in the best 2 out of the 3 most recent
2 calendar years must meet the levels required [above].”⁷

3

4 **Q. What have been the financial “coverage” ratios of Kit Carson in recent**
5 **years?**

6 A. Exhibit JJR-2 is a table of financial ratios of Kit Carson since 2003 as calculated
7 by Staff. At the bottom of the table are the minimum ratios required by RUS.
8 Highlighted in bold are the Operating TIER and the Operating DSC for 2009
9 and 2010. These ratios are below the required minimum of 1.10. In the case of
10 KCEC’s Operating TIER, the ratios are well below 1.00 for the last two years
11 thus conveying that Kit Carson is generating margin that is insufficient to cover
12 its interest obligation. An Operating TIER of 1.00 indicates that a coop is
13 earning precisely enough to cover interest on long-term debt.

14

15 **Q. Is Kit Carson currently in compliance with the RUS minimum required**
16 **financial “coverage” ratio regulations?**

17 A. Given Staff’s calculations that KCEC’s operating ratios have been below the
18 required minimum for the last two calendar years, Staff believes that Kit Carson
19 is currently in technical default of its loan agreement with RUS.

20

21 **Q. What are the implications of Kit Carson’s technical default with the RUS?**

⁷ §1710.114(d)(2), CFR

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1 A. The federal regulations require that a RUS borrower in technical default “must
2 promptly notify RUS in writing. Within 30 days of such notification or of the
3 borrower being notified in writing by RUS, whichever is earlier, the borrower,
4 in consultation with RUS, must provide a written plan satisfactory to RUS
5 setting forth the actions that will be taken to achieve the required covered ratios
6 on a timely basis. Failure to develop and implement a plan satisfactory to RUS
7 shall be an event of default upon notice provided in accordance with the terms of
8 the borrower’s mortgage or loan contract.”⁸ Staff is unaware of the existence of
9 any such written plan that may address RUS’ concerns with KCEC’s financial
10 condition.

11
12 **Q. Does this technical default as determined by Staff mean that RUS is about
13 to take over the operations of Kit Carson?**

14 A. No. There is no information available to Staff that suggests an imminent
15 takeover by RUS of Kit Carson’s operations. In fact, federal regulations allow
16 for a deliberate and collaborative process precisely to avoid such a takeover.
17 Staff is aware of ongoing discussions between Kit Carson and RUS although it
18 is not clear to Staff whether these discussions relate to a plan as contemplated in
19 the regulations. Based on informal discussions with RUS, Staff understands that
20 RUS takeovers of electric cooperatives are extremely rare.

21

⁸ §1710.114(d)(2), CFR

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1 **Q. What is Kit Carson doing to improve its financial condition in order for its**
2 **financial “coverage” ratios to return above the required minimum?**

3 A. Kit Carson’s last rate increase was 25 years ago and, in light of recent negative
4 operating margins, it has seen fit to file for a rate increase that is the heart of this
5 case. Based on an adjusted 2009 test year, KCEC’s proposed rates would result
6 in increasing annual revenues by \$4.8 million or 14.65%. The largest
7 contributions to the increase would come from residential and seasonal classes
8 (\$2.1 million) and from KCEC’s largest single customer, Chevron (\$1.8
9 million). Kit Carson’s calculations suggest to Staff that, with the proposed rates,
10 KCEC’s Operating TIER and Operating DSC would be 1.63 and 1.57
11 respectively.⁹ In support of its proposed rate, Kit Carson has engaged the
12 services of Dr. Martin J. Blake to prepare and complete a study to analyze the
13 cost of providing electric service to its customers (“CoS Study”). Dr. Blake has
14 filed testimony in this case to present his CoS Study.¹⁰

15
16 **Q. Please describe your understanding of a cost of service study?**

17 A. Based on my review of Dr. Blake’s CoS Study, my understanding is that it
18 attempts to break down costs of providing electric service in three successive
19 steps. First, costs recorded based on accounting standards of the Federal Energy
20 Regulatory Commission (“FERC”) are aggregated in a number of functional

⁹ Lines 12-15, Page 8, Direct Testimony of Luis A. Reyes dated February 11, 2011, NMPRC Case No. 10-00379-UT [hereinafter Reyes Direct]

¹⁰ Direct Testimony of Dr. Martin J. Blake dated February 11, 2011, NMPRC Case No. 10-0079-UT [hereinafter Blake Direct]

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1 groups. Dr. Blake's CoS Study includes ten functional groups. Second, the
2 functionalized costs are split among up to three classifications: demand, energy
3 and customer. These classifications attempt to define the way in which the costs
4 are incurred. The following table summarizes these first two steps in Dr. Blake's
5 CoS Study.

		Demand	Energy	Customer
1	Production Plant	X		
2	Purchased Power	X	X	
3	Transmission	X		
4	Distribution Substation	X		
5	Primary & Sec Distribution Plant	X		X
6	Customer Services			X
7	Distribution Meters			X
8	Distribution Street & Cust Light			X
9	Meter Reading & Billing			X
10	Load Management			X

6
7 As the table makes clear, KCEC's costs that are functionalized in 8 out of the 10
8 groups used in the study are classified in a single class. The remaining costs
9 related to Purchased Power and Primary & Secondary Distribution Plant each
10 need to be split among two classifications. The third and final step of the CoS
11 Study is to allocate the functionalized and classified costs to the customer

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1 classes. The completed study provides the utility with information about the
2 nature of the costs that drive the provision of service to the various customer
3 classes and with a method to establish rates that reflect the manner in which
4 costs are incurred.

5

6 **Q. Please explain how Dr. Blake's CoS Study classifies KCEC's Purchased
7 Power and Primary & Secondary Distribution Plant.**

8 A. KCEC's total annual cost of service as determined by Dr. Blake's CoS Study is
9 \$34.4 million. Purchased Power cost is \$20 million or 58% of the total cost
10 while Primary & Secondary Distribution Plant cost is \$8.3 million or 24% of the
11 total cost. Kit Carson's purchased power is purchased from a single source: Tri-
12 State Generation and Transmission Association, Inc. ("Tri-State"). Since Tri-
13 State invoices Kit Carson energy and demand components for the power it
14 supplies to Kit Carson, the classification of Purchased Power cost between is
15 explicitly established based on Tri-State's invoices.

16 The methodology used by Dr. Blake to split Primary & Secondary Distribution
17 Plant is statistically driven based on the quantity, type and cost of distribution
18 equipment as recorded in the following FERC-based asset accounts: Account
19 364 – Poles, Towers and Fixtures, Account 365 – Overhead Conductors and
20 Devices, Account 367 – Underground Conductors and Devices, and Account
21 368 – Line Transformers. Based on the assumption of a linear relationship
22 between the type (i.e. size or capacity) of equipment and its cost, Dr. Blake

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1 extrapolates a zero-intercept value which he represents as the cost of a minimum
2 system necessary to establish a distribution grid for customers to connect with.
3 The relationship of such a minimum cost to the total asset cost in the related
4 account is purported to represent the proportion of related cost that are customer
5 related and thus do not vary with the volume of electricity distributed.

6
7 **Q. Does Staff have concerns about the relative split of Primary & Secondary**
8 **Distribution Plant related costs between customer and demand**
9 **classifications as determined by Dr. Blake?**

10 A. Yes. Staff has specific concerns with respect to (1) the use of proxy data when
11 the analysis of KCEC's data leads to a result that is inconsistent with Dr.
12 Blake's apparent preconception about the existence of relatively high fixed costs
13 in the distribution of electricity¹¹ and (2) the overstatement of statistical
14 confidence in the inferences drawn from the data.

15
16 **Q. What are Staff's concerns with respect to Dr. Blake's use of zero-intercept**
17 **methodology to determine the customer/demand split for costs related to**
18 **Account 364 – Poles, Towers and Fixtures and Account 365 – Overhead**
19 **Conductors and Devices?**

20 A. Dr. Blake's Exhibit MJB-5 indicates that he used proxy data for overhead
21 conductors (Account 365) at 10 unidentified electric cooperatives to determine a

¹¹ Dr. Blake's view about the high level of fixed costs in the electricity business was made clear in his presentation to Staff on October 21, 2010, entitled Electric Industry Trends, Cost of Service and Rates.

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1 split of 15.76% and 84.25% for customer/demand classification. Dr. Blake
2 provides no explanation in his Direct Testimony for this use of proxy data.
3 However, in response to Staff's interrogatory about the use proxy data, Dr.
4 Blake explained that, based on Kit Carson's overhead conductor data, "the
5 evaluation statistics from the weighted least squares analysis were inadequate"
6 and that "an impossibly high percentage of the costs were identified as demand
7 related."¹² Staff finds it difficult to accept that simply because the subject
8 utility's data yields an inconclusive or unacceptable result the data must be
9 replaced with unrelated proxy data that yields a result that may or may not be
10 more conclusive or acceptable.

11 Staff's review of publicly available testimony filed by Dr. Blake and/or his
12 colleagues at his firm, The Prime Group LLC, suggests that they have been
13 prone to replacing the subject utility's data with proxy data. Staff has reviewed
14 the list of electric cooperatives to which The Prime Group LLC has provided
15 rate design assistance. Of the 54 electric cooperatives listed in Dr. Blake's
16 Exhibit MJB-4 only 3 of them were subject to the scrutiny of a state regulatory
17 commission akin to the NMPRC. The 3 cases in question concern Jackson
18 County REMC ("JCREMC") in Indiana (Case no. 43861) and Craig-Botetourt
19 Electric Cooperative ("CBEC") and Northern Neck Electric Cooperative
20 ("NNEC") in Virginia (Case Nos. PUE-2009-00065 and PUE-2008-00076
21 respectively). In both Virginia cases, the CoS Study submitted by The Prime

¹² Response to Staff 2-4, KCEC's Responses and Objections to Staff's Second Set of Interrogatories and Request for Production of Documents [hereinafter KCEC's Responses to Staff's Second]

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1 Group LLC on behalf of CBEC and NNEC included the use of proxy data to
2 determine the customer/demand split for overhead conductor related costs. In
3 fact, the proxy data used in these cases is identical to the proxy data used by Dr.
4 Blake in this case. Staff noted that different proxy data was also used by The
5 Prime Group LLC for CBEC to determine the customer/demand split for
6 underground conductor. Therefore, in the case of CEBC, the only CEBC data
7 that was used by The Prime Group LLC for its zero-intercept analysis was its
8 line transformer data. Staff has no way of knowing what data Dr. Blake or The
9 Prime Group LLC used for its analysis with respect to the other 51 electric
10 cooperatives listed in Dr. Blake's Exhibit MJB-11. Staff expects that the
11 analysis was presented to each cooperative's board of directors and that the
12 board had the authority to accept the analysis and adopt any proposed rates
13 without being subject to state regulatory commission scrutiny. If the 3 electric
14 cooperatives (not counting KCEC) that were subject to state regulatory
15 commission scrutiny are representative of all 54 of The Prime Group's clients
16 listed in Exhibit MJB-11, proxy data would have been used for two thirds of
17 these electric cooperatives.

18 In short, Staff is concerned about the use of proxy data to determine the
19 customer/demand split for overhead conductor related costs. While Staff
20 understands that the analysis of the subject coop's actual data may yield an
21 inconclusive or unacceptable result, e.g. a negative zero-intercept value, Staff
22 does not accept that the data can simply be replaced with proxy data that Dr.

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1 Blake or The Prime Group LLC has repeatedly used in unrelated cases. Instead,
2 Staff believes that KCEC's data should be followed to wherever it leads. If the
3 data yields a negative zero-intercept value, the customer/demand split for
4 overhead conductor related costs should be 0% and 100% respectively.

5 With respect to poles, towers and fixtures (Account 364), Staff was unable to
6 find any explanation in Dr. Blake's Direct Testimony about how the
7 customer/demand split was determined. Staff notes that the customer/demand
8 split used in the CoS Study for costs related to poles, towers and fixtures is
9 identical to the split of 15.76% and 84.25% determined for overhead conductor
10 related costs with proxy data. Staff assumes that Dr. Blake believes there are
11 enough underlying similarities between overhead conductor and pole, tower and
12 fixture data to apply the same customer/demand split to both. While Staff
13 accepts such similarities, Staff's concerns about the use of proxy data now
14 extend beyond overhead conductor and to tower, pole and fixture related costs.
15 Staff therefore believes that the customer/demand split for tower, pole and
16 fixture related costs should be 0% and 100% respectively as it should be for
17 overhead conductor related costs.

18
19 **Q. What are Staff's concerns with respect to Dr. Blake's use of zero-intercept**
20 **methodology to determine the customer/demand split for costs related to**
21 **Account 367 – Underground Conductors and Devices?**

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1 A. Staff believes that Dr. Blake's zero-intercept analysis with respect to
2 underground conductor (Account 367) overstates the predictive ability of the
3 curve generated by Kit Carson's data. Staff understands that Dr. Blake
4 performed a weighted regression analysis of the data with weights based on the
5 quantity of each type of conductor. Staff chose to replicate Dr. Blake's analysis
6 by creating the largest population possible¹³. As indicated in Dr. Blake's Exhibit
7 MJB-6, the total population of KCEC's conductor data is 6,114,849. Staff
8 assumes these represent linear feet of conductor. Staff divided all conductor data
9 points by 200 and Staff's resulting population was therefore populated with
10 30,572 data points.¹⁴ The result of Staff's zero-intercept analysis of KCEC's
11 underground conductor data is displayed in Exhibit JJR-5. Staff's analysis
12 generates slope and y-intercept values that are substantially identical to those in
13 Dr. Blake's analysis. However, Staff's analysis yields a dramatically lower R-
14 squared value of 0.2733 (instead of 0.7839 in Dr. Blake's analysis). The purpose
15 of R-squared is to quantify the predictive ability of a statistical model. The
16 closer R-squared is to 1 the better its predictability and the goodness of fit of the
17 statistical model to the data. An R-squared of 1 suggests flawless predictive
18 ability and perfect fit. Staff believes that Dr. Blake's analysis significantly
19 overstates the confidence level that the zero-intercept value of 1.2994 is an
20 accurate prediction. Staff's analysis suggests that such a prediction can only be

¹³ Staff used Excel for its statistical analysis and creation of charts. Excel limits the population size to be displayed in a scatter plot diagram to about 32,000.

¹⁴ The resulting total population is slightly less than 30,574.2 (6,114,849 / 200) as the results were rounded for each conductor type.

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1 made with a dramatically lower confidence level and that the predicted zero-
2 intercept value cannot be relied upon to determine an accurate customer/demand
3 of underground conductor related costs.

4 Staff proposes an alternate zero-intercept analysis of KCEC's underground
5 conductor data. Dr. Blake's analysis assumes a linear relationship between
6 conductor size and conductor unit cost yields a true zero-intercept. As Dr. Blake
7 points out, the Electric Utility Cost Allocation Manual (January 1992 edition)
8 published by the National Association of Regulatory Utility Commissioners
9 ("NARUC") describes the zero-intercept method as one of two accepted
10 methods for classifying distribution costs.¹⁵ Staff's review of NARUC's manual
11 finds nothing to suggest that linear relationship between conductor size and
12 conductor unit cost is the one and only relationship to be considered. In fact,
13 NARUC states that the "technique is to relate installed cost to current carrying
14 capacity or demand rating, create a **curve** for various sizes of the equipment
15 involved, using regression techniques, and extend the **curve** to a no-load
16 intercept."¹⁶ [Emphasis added]. NARUC's use of the term "curve" suggests to
17 Staff that relationships other than linear can be contemplated in this context. To
18 that end, Staff prepared an alternate zero-intercept analysis where the conductor
19 size values (x-axis) are square-rooted thus creating a non-linear relationship with
20 conductor unit costs. The resulting analysis is displayed in Exhibit JJR-6. The R-
21 squared for this non-linear analysis (0.2634) is only marginally lower than for

¹⁵ Lines 1-10, Page 16, Blake Direct

¹⁶ Page 92, Electric Utility Cost Allocation Manual (January 1992 edition)

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1 Staff's linear analysis (0.2733) but the zero-intercept of -0.2043 is sharply lower
2 than the linear zero-intercept of 1.2994. Staff is not suggesting that a negative
3 zero-intercept is appropriate in this instance. Rather, Staff is demonstrating that
4 an alternative non-linear zero-intercept analysis with a substantially equal R-
5 squared value can yield sharply different results. Dr. Blake's determination of a
6 customer/demand split for underground conductor related costs is therefore
7 suspect and cannot be relied upon to make a meaningful determination of the
8 customer/demand split. Under these circumstances, a customer/demand split of
9 0% and 100% for underground conductor related costs is appropriate in this
10 case.

11
12 **Q. What are Staff's concerns with respect to Dr. Blake's use of zero-intercept**
13 **methodology to determine the customer/demand split for costs related to**
14 **Account 368 – Line Transformers?**

15 A. As with his analysis with respect to the costs related to underground conductor
16 (Account 367), Staff believes that Dr. Blake once again overstates the predictive
17 ability of his zero-intercept analysis with respect to line transformers (Account
18 368). Staff understands that Dr. Blake performed a weighted regression analysis
19 of the data with weights based on the quantity of line transformers by type. As
20 indicated in Dr. Blake's Exhibit MJB-7, the total population of KCEC line
21 transformers is 16,186. Staff chose to replicate Dr. Blake's analysis by using the
22 actual population of 16,186 line transformers instead of weighing the

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1 regression.¹⁷ The result of Staff's zero-intercept analysis of KCEC's line
2 transformer data is displayed in Exhibit JJR-7. Staff's analysis generates slope
3 and y-intercept values that are substantially identical to those in Dr. Blake's
4 analysis. However, Staff's analysis yields a significantly lower R-squared of
5 0.6881 (instead of 0.8308 in Dr. Blake's analysis). As with his analysis of
6 Account 367, Dr. Blake overstates the predictive ability of his statistical model
7 and therefore of the accuracy of the zero-intercept value of 856.2. Staff's
8 analysis of the same data suggests a significantly lower confidence level in that
9 zero-intercept.

10 As with Account 367, Staff prepared an alternate zero-intercept analysis of
11 KCEC's line transformer data where the line transformer size values (x-axis) are
12 square-rooted thus creating a non-linear relationship with line transformer unit
13 costs. The resulting analysis is displayed in Exhibit JJR-8. The R-squared for
14 this non-linear analysis (0.8356) is significantly higher than for Staff's linear
15 analysis (0.6881) but the zero-intercept of -475.71 is sharply lower than the
16 linear zero-intercept of 856.26. In the case of line transformers, Staff's alternate
17 non-linear analysis predicts a negative zero-intercept with a significantly higher
18 confidence level than the linear analysis of the same data. Once again, Dr.
19 Blake's determination of a zero-intercept is reached with overstated confidence
20 levels and an alternate approach with higher R-squared suggests a much lower
21 zero-intercept. Dr. Blake's determination of a customer/demand split for line

¹⁷ Staff used Excel for its statistical analysis and creation of charts.

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1 transformer related costs is therefore suspect and cannot be relied upon to make
2 a meaningful determination of the customer/demand split. Under these
3 circumstances, a customer/demand split of 0% and 100% for line transformer
4 related costs is appropriate in this case.

5
6 **Q. How would you summarize Staff's concerns about Dr. Blake's approach to**
7 **the determination of an appropriate customer/demand split for KCEC's**
8 **distribution costs?**

9 A. Staff does not dispute Dr. Blake's analysis with respect to the level of costs
10 incurred by KCEC to provide electricity. Staff's review of the CoS Study rather
11 raises concerns about how these costs are split between three classifications. The
12 extent to which costs are classified as customer related is central to KCEC's
13 determination of a proposed customer charge for residential customers. The use
14 of proxy data and the overstatement of his statistical models' predictive abilities
15 have resulted in determinations by Dr. Blake that suggest a proportion of fixed
16 costs that is higher than what KCEC's data may in fact suggest. Staff is
17 therefore concerned that KCEC's proposed customer charge for residential
18 customers is inadequately supported by the data.

19
20 **Q. What is KCEC's proposed customer charge for residential customers?**

21 A. Kit Carson is proposing to raise its monthly customer charge from \$10 to
22 \$20.50, an increase of 105%. Exhibit JJR-9 provides information about current

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1 and prior residential customer charges as well as residential kWh rates at New
2 Mexico electric cooperatives. While it currently has the second lowest charge,
3 KCEC's proposed customer charge would become the second highest in New
4 Mexico. While two other coop customer charge increases that took effect in
5 2009 were similar in percentage terms, most of the other increases have been
6 significantly lower. Most of the electric cooperatives in New Mexico are
7 currently operating with residential customer charges, even recently set
8 customer charges, which are significantly lower than what Kit Carson is
9 proposing.

10
11 **Q. Has Kit Carson provided any other data to make a judgment about the**
12 **reasonableness of its proposed residential customer charge?**

13 A. With his exhibit MJB-11, Dr. Blake provides a list of 54 electric cooperatives
14 and their residential customer charges. The overall average residential customer
15 charge for these 54 coops is \$27.27. As stated earlier in my testimony, only 3 of
16 these 54 cooperatives are subject to state regulation. Staff's review of the 3 rate
17 cases related to these coops indicates that the Commission ordered customer
18 charges that were significantly lower than those proposed by the coops based on
19 analysis done by Dr. Blake and The Prime Group LLC.¹⁸ The remaining 51
20 coops are self-governed and not subject to state regulatory authority. Given the

¹⁸ Staff's review of these 3 cases also reveals that Dr. Blake's Exhibit MJB-11 incorrectly states the customer charge for Jackson County REMC (should be \$18-20 phased in over 2 years instead of \$25) and Northern Neck Electric Cooperative (should be \$16 instead of \$22.23).

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1 attractiveness to coop boards to reducing the share of less predictable volumetric
2 revenues, Staff expects that many of these self-governed coops welcomed the
3 opportunity to justify an increase in customer charges with a CoS Study from
4 The Prime Group LLC. Further, it is not clear to what extent these 54 electric
5 cooperatives are representative of coops in general. It is also clear that increases
6 in customer charge by coops subject to state regulatory authority are far more
7 restrained than by self-governed coops. Staff has previously expressed its
8 concern about the use of proxy data as well as the overstatement of confidence
9 levels in this case. Assuming this kind of analysis was also done for some of the
10 51 self-governed coops listed in Exhibit MJB-11, Staff expects the same bias
11 toward a higher percentage of customer related costs would have been present
12 but less likely to have been detected by the coop board. Due to the circular
13 nature of the customer charge data presented by Dr. Blake that is in part the
14 result of proxy data chosen by Dr. Blake, Staff does not accept that the
15 comparison of KCEC's proposed customer charge of \$20.50 with his national
16 average for 54 coops of \$27.27 is determinative. Staff finds that the comparison
17 with other New Mexico electric cooperatives all subject to the NMPRC's
18 oversight is appropriate.

19
20 **Q. What is the impact of the proposed residential rate increase that includes a**
21 **higher customer charge of \$20.50?**

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1 A. Exhibit JJR-10 shows the impact of the proposed increase on residential
2 customers for a range of electric usage from 0 to 2500 kWh per month.¹⁹ The
3 proposed residential rate includes inclining block volumetric rates to provide
4 additional conservation incentives for customers that consume more energy.
5 While the average bill for 487 kWh will increase by \$2.77 or 4.5% more than at
6 current rates, the brunt of the increase in relative terms will be felt by consumers
7 who consume less than average. The monthly bills for customers who do not
8 consume any electricity will more than double simply because of the proposed
9 doubling of the customer charge. The average bill for LIHEAP customers for
10 633 kWh will increase by \$0.45 or 0.6% more than at current rates. For
11 customers who consume more than 661 kWh per month, their monthly bills will
12 decline by progressively larger amounts as they consumer more. The savings to
13 these customers from the proposed rates peak at about 5%. The impact of the
14 highest tier of proposed volumetric rates is evident as savings to those who use
15 more than 1,250 kWh per month flatten out. For these customers, each
16 additional 50 kWh consumed results in additional savings of about \$0.30 on
17 their monthly bill.

18
19 **Q. What is Staff's view concerning the proposed increase of Kit Carson's**
20 **residential monthly customer charge from \$10 to \$20.50?**

¹⁹ Dr. Blake's Exhibit MJB-12 presents similar information about the bill impact from the proposed new residential rates. However, the computation of the bill impact in Exhibit MJB-12 differs in part from Staff's computation. Dr. Blake's computation appears in part incorrect to Staff.

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1 A. Staff understands and conceptually supports Dr. Blake's view that a significant
2 portion of the costs to distribute electricity to residential customers are largely
3 insensitive to the volume of electricity being delivered and that KCEC's current
4 customer charge of \$10/month results in variabilizing the recovery of such costs
5 through volumetric kWh rates. Staff also agrees that the current rate structure
6 creates a misalignment of interests between the coop and its residential
7 customers whereby the loss to KCEC of margin resulting from conservation is
8 borne by residential customers who conserve less or not at all. It is clear to Staff
9 that KCEC's residential customer charge should increase but it is far less clear
10 that KCEC's customer charge should become the second highest in New
11 Mexico.

12 As expressed earlier, Staff has concerns about Dr. Blake's analysis in that it
13 appears to overstate the extent to which distribution related costs are insensitive
14 to the volume of electricity distributed. The potential impact of such an
15 overstatement with respect to overhead conductor was even quantified by Dr.
16 Blake.²⁰ The nature of Kit Carson's operations further does not suggest that Kit
17 Carson's residential customer charge should be the second highest in the state.
18 As Dr. Blake correctly points out, the "problem for cooperatives is that they
19 cannot spread their fixed cost over as many customers per mile as an investor-

²⁰ Dr. Blake ran his model assuming that overhead conductor related costs were 100% demand driven (0% customer driven) and it resulted in a reduction in the cost-based customer charge of \$1.60. See Response to Staff 2-4, KCEC's Responses to Staff's Second. As Staff noted earlier, the costs related to towers, poles and fixtures are split in the same way as overheard conductor costs and it does not appear that Dr. Blake took this account when he ran his model. If Dr. Blake had run his model assuming that both overhead conductor costs and tower, pole, and fixture costs were 100% demand driven, Staff suspects the reduction in the cost-based customer charge would have been larger than \$1.60.

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1 owned utility, resulting in higher customer charges for cooperatives compared to
2 investor owned utilities.”²¹ While Kit Carson has fewer customers per mile than
3 investor owned utilities in New Mexico, Kit Carson is the second largest coop in
4 New Mexico with the most consumers served per mile. Exhibit JJR-11 provides
5 some statistics to compare Kit Carson to other New Mexico coops. It does not
6 follow to Staff that the electric coop in New Mexico with the densest customer
7 distribution should have the second highest customer charge in the state. Nor
8 does it make sense that Kit Carson’s customer charge should be almost double
9 that of a neighboring coop that serves slightly more total customers but
10 substantially fewer customers per mile.²² There are a number of electric
11 cooperatives in New Mexico with significantly less dense customer distribution
12 and with customer charges significantly lower than \$20.50. Staff agrees that a
13 higher customer charge and a lower volumetric charge would send a more
14 accurate price signal to the residential customers and better align their interests
15 with those of the coop.

16 However, price signals work in both direction and Staff is concerned about the
17 price signal that a residential customer charge of \$20.50 sends to the coop. Dr.
18 Blake’s study finds that the underlying distribution costs that are insensitive to
19 electricity demand with a zero rate of return are equivalent to \$18.46 per month
20 per residential customer. Accepting Dr. Blake’s finding for the sake of this

²¹ Lines 10-13, Page 43, Blake Direct

²² The monthly customer charge of Jemez Mountains Electric Cooperative, Inc. for its residential customers is \$11.50. See Exhibit JJR-7.

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1 argument, Kit Carson is seeking to cover its distribution costs plus a return of
2 \$2.04 each month regardless of the amount of electricity it delivers. The
3 proposed rate structure therefore provides no incentive to Kit Carson to contain
4 its costs in the face of stagnant economic conditions. Rhetorically, what business
5 would not wish for a guaranteed recovery of its costs regardless of the amount of
6 services it delivers. In the context of coops, the members/owners providing the
7 coop's equity are also the customers from whom the coop's costs are recovered.
8 Therefore, any rate restructuring is a zero sum game to the extent revenues are
9 recovered from customers. Nevertheless, Staff's view is that any rate increase
10 borne by ratepayers should be tempered with cost containment efforts driven by
11 the appropriate price signal.

12
13 **Q. What is Staff's recommendation with respect to Kit Carson's residential**
14 **customer charge?**

15 Staff recommends that the residential customer charge be \$17/month, \$7 Or 70%
16 more than the current rate of \$10/month. Dr. Blake's determination of Kit
17 Carson's zero return distribution cost is \$18.46 per month. Staff has provided its
18 own analysis that suggests an overstatement of the proportion of customer
19 driven distribution costs. Dr. Blake has quantified such a potential overstatement
20 as up to \$1.60. A \$17 residential customer charge is equal to what 4 other coops
21 in New Mexico are currently charging and is the third highest customer charge

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1 in the state. Staff's proposed customer charge is also more consistent with a
2 gradual approach to rate increases in order to avoid bill shock to customers.

3
4 **Q. What would be the impact of Staff's residential customer charge?**

5 A. Staff requested that Dr. Blake run a number of new residential rate scenarios
6 based various hypothetical customer charges. One of these was based on Staff's
7 recommended customer charge of \$17/month and with inclining block
8 volumetric kWh rates analogous to those proposed by KCEC. This new scenario
9 kindly provided by Dr. Blake raises the same amount of additional residential
10 revenue as originally proposed by Kit Carson (\$1.7 million) and is also based on
11 the 2009 Test Year. It results in volumetric rates that are \$0.00765/kWh higher
12 across the board than proposed by KCEC in February with the \$20.50 customer
13 charge. Exhibit JJR-12 shows the impact of Staff's recommended rates and
14 Exhibit JJR-13 compares the impact of KCEC's proposed residential rates with
15 Staff's recommended rates. Staff's recommended residential rate reduces the
16 significant impact on below average users while above average users will
17 generally continue to pay very nearly what they are currently paying.

18
19 **Q. Please describe the pro-forma adjustments proposed by Kit Carson to the
20 2009 Test Year.**

21 A. Kit Carson made two adjustments to the 2009 Test Year to reflect known costs
22 beyond those actually incurred in 2009 that it expects to incur in the future. One

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1 set of adjustments is an increase in purchased power costs for Chevron, KCEC's
2 largest customer, which is offset dollar-for-dollar by an increase in revenue from
3 Chevron for the additional purchased power. The Chevron adjustment increases
4 both expenses and revenues by \$1,615,045 and therefore has no net impact on
5 the Test Year results. The other pro-forma adjustment to the 2009 Test Year is
6 for a 3% increase in labor costs which increases expenses by \$155,299.

7

8 **Q. What is Staff's view about the pro-forma adjustment for a 3% increase in**
9 **labor costs?**

10 A. Staff recommends that this adjustment to increase expenses by 3% over actual
11 2009 expenses be disallowed. The adjustment equals \$155,299. Staff's
12 recommendation is not to restrain Kit Carson from increasing the salaries of any
13 of its employees. Staff's review does not suggest that its labor costs are
14 excessive. Rather Staff believes that the increased revenue requirement of \$4.8
15 million requested by Kit Carson should be balanced with the containment of
16 expenses. Today's economic conditions dictate that salary increases are
17 currently rare and marginal and that businesses are cutting expenses in general –
18 not just labor expenses. Opportunities to restructure labor related expenses as
19 well as other expenses surely exist within Kit Carson.

20

21 **Q. Does Staff have concerns about any other expenses that are being incurred**
22 **by Kit Carson?**

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1 A. Staff has examined the board expenses of New Mexico electric cooperatives as
2 reported in their annual reports. Exhibit JJR-14 details the board expenses of
3 these coops in the last 3 years. In 2009, Kit Carson's board expenses were
4 \$197,958. While there is one coop that spends far more on its board than Kit
5 Carson, Kit Carson's expenses were higher than average. The expenses of Kit
6 Carson's board of trustees are governed by Article III, Section 5 of its By-Law
7 which states in part the following:

8 "A Trustee shall not receive a salary for his service as such
9 unless approved by the members. Regardless of whether a salary
10 is approved, the Board of Trustees may by resolution authorize a
11 fixed per diem for each day or portion thereof spent by a Trustee
12 in attendance at meetings of the Board and its committees and
13 for the performance of other Co-operative business, including
14 without limitation, meetings, conferences and training programs,
15 when such has had prior approval by the Board."
16

17 Staff understands that a significant portion of board expenses relate to travel,
18 hotel, meals and conference and training fees for its trustees. Staff has found that
19 the National Rural Electric Cooperative Association ("NRECA") holds a Pre-
20 Annual Meeting Education Program. In 2011, the program took place from
21 Thursday, March 3 to Sunday, March 6 in Orlando, Florida. Next year's
22 program takes place in San Diego, California.

23 The training required of each trustee is spelled out in Article III, Section 2 of its
24 By-Law which states in part the following:

25 "In order for a newly elected Trustee to be qualified to run for
26 re-election to the Board of Trustees, he or she must be certified
27 within the first four (4) years after his or her election to the
28 Board, under the credentialed cooperative director (CCD)

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1 program of the National Rural Electric Cooperative Association,
2 unless because of circumstances beyond the reasonable control
3 of the Trustee such certification could not be accomplished, in
4 which event certification must be completed within the next four
5 (4) year term of his or her re-election, otherwise the Trustee
6 cannot again stand for re-election to the Board of Trustees.
7 Effective at the District Meetings and Elections scheduled to be
8 held in 2012, no Trustee elected at such meetings shall serve
9 more than two terms of four (4) years each.”
10

11 The above By-Law effectively creates a requirement that a newly elected Kit
12 Carson trustee must be trained during his or her first term. Further, in light of the
13 2-term limitation stated above, this will result in a trustee being trained at least
14 every 8 years. Since Kit Carson’s board consists of 11 trustees, about 1.4
15 trustees ($11 / 8 = 1.375$) will need to be trained every year. This assumes that all
16 trustees are re-elected and serve two complete 4-year terms. To the extent that
17 the re-election rate is less than 100% or a trustee serves less than his or her
18 complete 4-year term, the rate at which trustees are trained increases
19 accordingly. Given the requirement by Kit Carson’s By-Law with respect to
20 training, Staff proposes that Kit Carson develop alternatives to its current
21 method of reimbursement of trustees’ expenses.

22 While the above By-Law regarding compensation gives the board the authority
23 to establish a “per diem” for any day spent at meetings, conferences and training
24 programs, Staff has found no information to suggest that a “per diem” policy
25 even exists for time spent at meetings, conference or training programs or limits
26 a “per diem” to days actually spent in training and not on social activities that
27 are frequently a part of such meetings, conferences or training programs. Staff’s

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1 review of some of Kit Carson's itemized credit card statements suggests that
2 actual expenses related to such meetings, conferences or training programs are
3 directly paid by Kit Carson and that a "per diem" does not appear to apply to
4 such travel. A clear "per diem" policy would limit the risk of incurring variable
5 travel expenses while setting clear guidelines about KCEC's share of the
6 trustee's or employee's travel expenses. A clear "per diem" policy would further
7 reduce the administrative burden associated with the review and verification of
8 expense reports and associated receipts. This is one of a number ways to reduce
9 board expenses without impacting the board ability to govern the coop. While
10 Staff's proposal to establish a clear "per diem" policy addresses travel expenses
11 in general and trustee training in particular, today's technology provides other
12 ways to reduce travel with online and web training. Any reduction in board
13 expenses should be in addition to \$155,299 in disallowed expenses mentioned
14 earlier.

15
16 **Q. Is it reasonable for Staff to insist that Kit Carson contain its expenses to
17 balance its request for \$4.8 million additional revenues?**

18 A. Dr. Blake states that "the Commission has no basis for disapproving the
19 Cooperative's rates based on a general desire by protestors that the
20 Cooperative's expenses be less."²³ Staff's view is that the Commission does
21 have the authority to order rates that recover only expenses that it deems to be

²³ Lines 3-5, Page 53, Blake Direct

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1 reasonable. The unchallenged acceptance of Dr. Blake's view that expenses are
2 largely fixed or cast in stone would result in the Commission's role being
3 reduced to simply rubber-stamping higher rates. Staff's takes the views of the
4 protesters seriously. They may have valid and constructive suggestions to reduce
5 expenses without materially affecting service. The protesters are also members
6 of KCEC and they came out in significant numbers. Their views must therefore
7 be considered.

8 There is another reason for Staff to examine expenses and insist on containment
9 of those expenses. This rate case is driven in large part by the financial condition
10 of Kit Carson as described early in this testimony. Kit Carson is currently in
11 technical default of its loan agreements with RUS as its Operating TIER and
12 Operating DSC were below the minimum required by RUS for 2009 and 2010.
13 Federal regulations contemplate a number of actions to correct such a situation
14 as stated below:

15 "RUS may withhold the advance of loan funds until the
16 borrower has adopted an annual financing plan and operating
17 budget satisfactory to RUS and taken such other action as RUS
18 may require to demonstrate that the required coverage ratios will
19 be maintained in the future and that the loan will be repaid with
20 interest within the time agreed. Such other action may include,
21 for example, **increasing system operating efficiency and**
22 **reducing costs** or adopting a rate design that will achieve the
23 required coverage ratios, and either placing such rates into effect
24 or taking action to obtain regulatory authority approval of such
25 rates."²⁴ [Emphasis added]
26

²⁴ §1710.114(e)(1), *Requirements for advance of funds*, CFR

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1 It is clearly contemplated by Kit Carson's major lender which requires minimum
2 "coverage" ratios be maintained that adjusting rates is not the only course of
3 action available to Kit Carson to restore its financial condition. It therefore
4 makes sense to Staff that costs should be examined in the context of this rate
5 case and that higher rates should be balanced with cost containment.

6

7 **Q. What is Staff's view with respect to the other major concern of protestors,**
8 **namely that the proposed rate increase is necessary to continue to support**
9 **Kit Carson's unprofitable diversified operations?**

10 A. A little more than 10 years ago, Kit Carson expanded beyond the provision of
11 electricity by starting two new businesses: propane and broadband.²⁵²⁶ Both of
12 these new businesses began operating as divisions of KCEC. In late 2009,
13 KCEC created a new wholly-owned subsidiary, Kit Carson Energy Inc.
14 ("KCEI"), as the segregated governing entity for its propane activities. The first
15 full year of KCEI's propane operations was 2010 and Staff was recently
16 provided with KCEI's first audited financial statements. KCEI was established
17 in late 2009 with an initial investment of \$5.6 million.²⁷ Kit Carson provided
18 Staff on a confidential basis the operating statements for its propane division
19 through 2009. Staff's review of these statements confirms that separate

²⁵ Further details about the history and purpose of KCEC's expansion into propane and broadband services are provided in the Direct GDP Testimony of Luis A. Reyes, Jr. filed in this case on February 25, 2011. [hereinafter Reyes GDP]

²⁶ Staff's use of the term "broadband" is interchangeable with various similar descriptive terms used by KCEC such as telecommunications, telecom or internet.

²⁷ Item 6, Page 6, Exhibit LAR GDP-1, Reyes GDP.

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1 accounting records were kept for propane activities and that the deficit
2 accumulated during those years equals approximately KCEC's initial investment
3 into KCEI. KCEC does not expect to make any further investments into KCEI.²⁸

4 The broadband business continues to operate as a division of KCEC. Through
5 2009, KCEC has invested \$2.1 million in its broadband business.²⁹ Kit Carson
6 provided Staff on a confidential basis the operating statements for its broadband
7 division through 2009. Staff's review of these statements confirms that separate
8 accounting records were kept for broadband activities and that the deficit
9 accumulated during those years equals approximately KCEC's stated investment
10 of \$2.1 million. KCEC does not indicate whether investments are expected to be
11 made in the broadband business beyond 2009. Staff has not received any further
12 operating statements for the broadband division.

13 In addition to its propane and broadband activities, KCEC financed the recently
14 completed construction of the \$2.8 million (\$2.3 million loan / \$0.5 million
15 grant) Taos Regional Command and Dispatch Homeland Security Center
16 ("Command Center"). Exhibit JJR-15 from Kit Carson's web site provides a
17 timeline for this project. About 10% of the Command Center is being used by
18 KCEC's dispatch operations. The remainder of the Command Center is
19 currently vacant. Kit Carson asserts that the Command Center does not represent

²⁸ Item 6, Page 6, Exhibit LAR GDP-1, Reyes GDP.

²⁹ Item 6, Page 6, Exhibit LAR GDP-1, Reyes GDP.

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1 a diversified activity.³⁰ Staff rejects Kit Carson’s assertion about the Command
2 Center. As the information in Exhibit JJR-15 makes clear, the Command Center
3 was clearly built to meet needs unrelated to Kit Carson’s provision of electric
4 service to its members. The use of 10% of the Command Center’s space in an
5 otherwise vacant building does not support, in Staff’s view, the claim that the
6 Command Center simply serves a utility function. The Command Center is not
7 included in Kit Carson’s general diversification plan (“GDP”). Staff
8 recommends that Kit Carson file a revised GDP that includes the Command
9 Center.

10 Based on information available to Staff through 2009 for KCEI and Kit Carson’s
11 broadband division and through earlier this year for the Command Center, Kit
12 Carson investments in diversified activities are:

Kit Carson Energy, Inc.	\$ 5.6 million
Kit Carson Telecom	\$ 2.1 million
Taos Command Center	\$ 2.3 million
Total	\$10.0 million

13
14 Staff accepts Dr. Blake’s assertion that the data used in the CoS Study originated
15 from the accounts related to the provision of electricity by Kit Carson which are
16 kept in accordance with FERC’s Uniform System of Accounts. Furthermore, Kit
17 Carson’s financial statements are audited annually and these audited annual

³⁰ ¶17, Page 15, KCEC’s Motion for Leave to File a Reply and Reply to Intervenors’ Responses to Motion to Compel filed on March 30, 2011. [hereinafter KCEC Reply to Motion to Compel]

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1 reports have been made available to Staff. Staff has found no information in
2 these audited annual reports that questions the accuracy or veracity of its
3 accounting records. Staff therefore accepts that Dr. Blake's CoS Study is driven
4 by Kit Carson's actual costs to provide electricity and not by costs related to its
5 diversified operations. However, a significant portion of the proposed rates
6 derived from the results of Dr. Blake's study are contributions by members of
7 capital to support the financial health of KCEC. Such contributions provide
8 equity to the cooperative and help minimize borrowing thus reducing the coop's
9 debt load. Patronage capital is generally retained by electric cooperatives to fund
10 capital projects related to the distribution of electricity **and, in this case, to**
11 **diversified operations.** To the extent that rates generate revenue that not only
12 cover actual costs incurred but also provide a return on a rate base, it is clear that
13 rates are central to the provision of capital that, to the tune of \$10 million, is
14 currently funding diversified activities. The simple bottom line at this point is
15 that Kit Carson's propane and broadband activities required investments of \$5.6
16 million and \$2.1 million respectively through 2009 and that the members now
17 have \$7.7 million of their capital tied up in those businesses. Members have
18 invested an additional \$2.3 million in the Command Center.

19 It is Staff's view that, without the existence of KCEC and the security of its
20 electricity revenue, these diversified activities could not have been sustained to
21 their current point. The manner and the timing of the return of this capital
22 invested in diversified activities to members is the subject of Reyes GDP. While

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1 the future of these diversified activities may result in the appreciation of
2 patronage capital, the existing patronage capital remains necessary to sustain
3 these activities for the time being and this patronage capital would not exist
4 without its incorporation in the rates paid by members.

5 Staff is aware that at an annual meeting on June 17, 2000 there was discussion
6 about "ByLaws [that] need to be changed to allow diversification"³¹ and that
7 "proposed changes to Article I, Membership"³² were reviewed. The membership
8 unanimously approved "the proposed changes to Article I [...] as presented."³³

9 Staff is unable to find any reference to diversification in Article 1 or elsewhere
10 in KCEC's By-Law. Staff is not aware of any approval at either an annual
11 meeting or a board of trustees meeting of the amount of patronage capital in
12 quantified dollar terms expressly authorized for investment in propane activities.

13 Staff is aware that the board of trustees at a meeting on August 30, 1999
14 unanimously authorized Mr. Reyes "to proceed to enter into negotiations and
15 explore which options are more flexible for Kit Carson Electric regarding
16 telecommunications."³⁴ Staff is not aware of any approval at either an annual

17 meeting or a board of trustees meeting of the amount of patronage capital in
18 quantified dollar terms expressly authorized for investment in broadband
19 activities. Staff is not aware of any member or trustee approval with respect to

³¹ 4th page of Attachment 1 to Exhibit LAR GDP-1, ByLaw Amendments, Reyes GDP

³² 4th page of Attachment 1 to Exhibit LAR GDP-1, ByLaw Amendments, Reyes GDP

³³ 4th page of Attachment 1 to Exhibit LAR GDP-1, ByLaw Amendments, Reyes GDP

³⁴ Page 4, Exhibit LAR GDP-1, Reyes GDP, and Page 7 of Attachment 2 thereto, Economic Development.

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1 the Command Center. The existence of unambiguous authority granted by either
2 the members or the board of trustees for Kit Carson to engage in diversified
3 activities is not evident to Staff. The absence of any approved measurable
4 investment or risk related to such activities suggests that members could not
5 have been informed about the extent of their exposure to activities beyond the
6 provision of electric service.

7 In light of the central role of patronage capital in sustaining diversified activities
8 and of the unclear extent in quantifiable dollar terms of the investment approved
9 by members or trustees, it is important that Kit Carson be accountable to
10 members in detail about the history of the members' investment in diversified
11 activities and maintain transparency in the future by provide regular updates
12 breaking down in detail how members' capital is invested among regulated and
13 unregulated operations. Staff therefore recommends that Kit Carson provide
14 members a history of patronage capital investments in the last 10 years and that
15 future annual patronage capital allocation statements that Kit Carson is
16 providing to its members provide a breakdown of where the capital is invested
17 as well as a comparison to how it was invested one year earlier.

18
19 **Q. Please summarize Staff's recommendations.**

20 A. Kit Carson's financial condition has reached a point where a higher revenue
21 requirement should be expeditiously approved by the Commission. It is clear to
22 Staff that Kit Carson cannot continue to sustain negative operating margins at

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1 the current rate. Staff's review of Dr. Blake's approach to splitting Kit Carson's
2 distribution costs between customer and demand driven classifications raises
3 questions about the inferences he has drawn. In short, Staff believes Dr. Blake
4 overstates the relative portion of those costs that are customer driven. Staff
5 supports Kit Carson's proposal to increase its annual revenue requirement by
6 \$4.8 million necessary to reach a TIER of at least 1.63 based on the 2009 test
7 year subject to the following conditions:

- 8 1) The customer charge for residential customers should be
9 \$17/month. Kit Carson's proposed volumetric kWh rates
10 should be increased by \$0.00765/kWh across the board to
11 generate \$1.7 million in additional residential revenue.
- 12 2) Budgeted expenses should be reduced by \$155,299 which
13 is equivalent to the proposed pro-forma adjustment to the
14 2009 Test Year to increase labor expenses across the board.
- 15 3) Further, Kit Carson should examine ways to reduce board
16 expenses by considering a clear "per diem" travel
17 reimbursement policy, if there is none, as well as
18 alternatives to travel such as online or web attendance to
19 meetings and conferences. Staff understands that board
20 expenses have dropped since 2009 and are expected to drop
21 to near \$120,000 in 2011.

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1 4) Kit Carson should file a revised GDP that includes the
2 Command Center.

3 5) Kit Carson should enhance transparency about where its
4 members' patronage capital is invested by providing a
5 breakdown in its annual allocation statements of where
6 among its regulated and unregulated activities it is invested.
7 Historical information about this breakdown should also be
8 provided.

9

10 **Q.** **Does this conclude your testimony?**

11 **A.** Yes.

BEFORE THE NEW MEXICO PUBLIC REGULATION COMMISSION

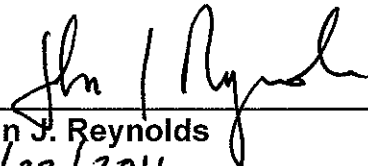
IN THE MATTER OF KIT CARSON ELECTRIC)
COOPERATIVE, INC.'S ADVICE NOTICE NO. 57,)
KIT CARSON ELECTRIC COOPERATIVE, INC.,) Case No. 10-00379-UT
Applicant.)
_____)

AFFIDAVIT OF JOHN J. REYNOLDS

STATE OF NEW MEXICO)
COUNTY OF SANTA FE)ss.
)

I, John J. Reynolds, do hereby swear, depose and state as follows:

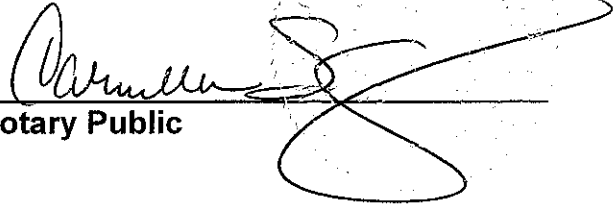
I hereby attest that I have read the foregoing **Prepared Direct Testimony of John J. Reynolds**, and the statements contained therein are true and accurate to the best of my knowledge and information.



John J. Reynolds
6/23/2011
Date

SUBSCRIBED AND SWORN to before me this 23rd day of June, 2011.

My Commission/
Expires: 7/15/2013



Notary Public

KCEC - Historical Summary Statistics

	<u>2010</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>	<u>2004</u>
Meters-Avg	28,227	28,123	28,099	27,892	27,449	26,786	26,259
kWh Sold	294,207,887	303,035,265	346,450,532	332,600,672	328,813,349	305,002,833	291,508,320
Revenue	\$33,752,052	\$33,063,165	\$34,796,456	\$32,125,735	\$30,620,784	\$28,009,034	\$25,301,361
Patronage Capital & Oper Margins	(\$875,296)	(\$992,312)	\$2,267,763	\$2,103,293	\$2,017,250	\$2,087,919	\$2,488,273
Utility Plant	\$121,220,557	\$117,416,022	\$110,382,542	\$101,481,601	\$96,297,640	\$88,965,869	\$82,598,261
Long-Term Debt	\$62,952,701	\$62,057,503	\$59,964,340	\$48,935,494	\$46,812,104	\$45,753,317	\$40,011,035
Patronage Capital	\$37,262,950	\$36,618,752	\$33,347,830	\$31,792,520	\$30,535,580	\$28,778,262	\$27,103,839
% Change v Prior Year							
Meters-Avg	0.4%	0.1%	0.7%	1.6%	2.5%	2.0%	
kWh Sold	-2.9%	-12.5%	4.2%	1.2%	7.8%	4.6%	
Revenue	2.1%	-5.0%	8.3%	4.9%	9.3%	10.7%	
Patronage Capital & Oper Margins	11.8%	-143.8%	7.8%	4.3%	-3.4%	-16.1%	
Utility Plant	3.2%	6.4%	8.8%	5.4%	8.2%	7.7%	
Long-Term Debt	1.4%	3.5%	22.5%	4.5%	2.3%	14.4%	
Patronage Capital	1.8%	9.8%	4.9%	4.1%	6.1%	6.2%	
Change v 2004							
Meters-Avg	1,968	1,864					
kWh Sold	2,699,567	11,526,945					
Revenue	\$8,450,691	\$7,761,804					
Patronage Capital & Oper Margins	(\$3,363,569)	(\$3,480,585)					
Utility Plant	\$38,622,296	\$34,817,761					
Long-Term Debt	\$22,941,666	\$22,046,468					
Patronage Capital	\$10,159,111	\$9,514,913					
% Change v 2004							
Meters-Avg	7.5%	7.1%					
kWh Sold	0.9%	4.0%					
Revenue	33.4%	30.7%					
Patronage Capital & Oper Margins	-135.2%	-139.9%					
Utility Plant	46.8%	42.2%					
Long-Term Debt	57.3%	55.1%					
Patronage Capital	37.5%	35.1%					

Financial "Coverage" Ratios

<u>Year</u>	<u>TIER</u>	<u>DSC</u>	<u>Operating</u>	
			<u>TIER</u>	<u>DSC</u>
2003	1.71	1.60	2.37	1.96
2004	1.99	1.82	2.45	2.08
2005	1.89	1.59	2.03	1.67
2006	1.75	1.56	1.86	1.62
2007	1.67	1.42	1.89	1.54
2008	2.66	2.17	1.92	1.74
2009	1.28	1.34	0.66	1.00
2010	1.37	1.38	0.71	1.04
RUS Minimum	1.25	1.25	1.10	1.10

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has expired. The Agency shall make full use of available authority and procedures, including but not limited to those available under 7 CFR part 3015, subpart N.

§§ 1709.602-1709.999 [Reserved]

PART 1710—GENERAL AND PRE-LOAN POLICIES AND PROCEDURES COMMON TO ELECTRIC LOANS AND GUARANTEES

Subpart A—General

- Sec.
- 1710.1 General statement.
- 1710.2 Definitions and rules of construction.
- 1710.3 Form and bulletin revisions.
- 1710.4 Exception authority.
- 1710.5 Availability of forms.
- 1710.6 Applicability of certain provisions to completed loan applications.
- 1710.7-1710.49 [Reserved]

Subpart B—Types of Loans and Loan Guarantees

- 1710.50 Insured loans.
- 1710.51 Direct loans.
- 1710.52 Loan guarantees.
- 1710.53-1710.99 [Reserved]

Subpart C—Loan Purposes and Basic Policies.

- 1710.100 General.
- 1710.101 Types of eligible borrowers.
- 1710.102 Borrower eligibility for different types of loans.
- 1710.103 Area coverage.
- 1710.104 Service to non-RE Act beneficiaries.
- 1710.105 State regulatory approvals.
- 1710.106 Uses of loan funds.
- 1710.107 Amount lent for acquisitions.
- 1710.108 Mergers and consolidations.
- 1710.109 Reimbursement of general funds and interim financing.
- 1710.110 Supplemental financing.
- 1710.111 Refinancing.
- 1710.112 Loan feasibility.
- 1710.113 Loan security.
- 1710.114 TIER, DSC, OTIER and ODSC requirements.
- 1710.115 Final maturity.
- 1710.116 [Reserved]
- 1710.117 Environmental considerations.
- 1710.118 [Reserved]
- 1710.119 Loan processing priorities.
- 1710.120 Construction standards and contracting.
- 1710.121 Insurance requirements.
- 1710.122 Equal opportunity and non-discrimination.

- 1710.123 Debarment and suspension.
- 1710.124 Uniform Relocation Act.
- 1710.125 Restrictions on lobbying.
- 1710.126 Federal debt delinquency.
- 1710.127 Drug free workplace.
- 1710.128-1710.149 [Reserved]

Subpart D—Basic Requirements for Loan Approval

- 1710.150 General.
- 1710.151 Required findings for all loans.
- 1710.152 Primary support documents.
- 1710.153 Additional requirements and procedures.
- 1710.154-1710.199 [Reserved]

Subpart E—Load Forecasts

- 1710.200 Purpose.
- 1710.201 General.
- 1710.202 Requirement to prepare a load forecast-power supply borrowers.
- 1710.203 Requirement to prepare a load forecast-distribution borrowers.
- 1710.204 Filing requirements for borrowers that must maintain a current RUS approved load forecast on an ongoing basis.
- 1710.205 Minimum requirements for all borrower load forecasts.
- 1710.206 Requirements for load forecasts prepared pursuant to RUS approved load forecast work plans.
- 1710.207 RUS approval criteria for approval of load forecasts by distribution borrowers not required to maintain a current load forecast on an ongoing basis.
- 1710.208 RUS approval criteria for load forecasts submitted by all power supply borrowers and by distribution borrowers required to maintain a current load forecast on an ongoing basis.
- 1710.209 Requirements for load forecast work plans.
- 1710.210 Waiver of requirements or approval criteria.
- 1710.211-1710.249 [Reserved]

Subpart F—Construction Work Plans and Related Studies

- 1710.250 General.
- 1710.251 Construction work plans—distribution borrowers.
- 1710.252 Construction work plans—power supply borrowers.
- 1710.253 Engineering and cost studies—addition of generation capacity.
- 1710.254 Alternative sources of power.
- 1710.255-1710.299 [Reserved]

Subpart G—Long-Range Financial Forecasts

- 1710.300 General.
- 1710.301 Financial forecasts—distribution borrowers.

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- 1710.302 Financial forecasts—power supply borrowers.
1710.303 Power cost studies—power supply borrowers.
1710.304-1710.349 [Reserved]

Subpart H [Reserved]

Subpart I—Application Requirements and Procedures for Insured and Guaranteed Loans

- 1710.400 Initial contact.
1710.401 Loan application documents.
1710.402-1710.403 [Reserved]
1710.404 Additional requirements.
1710.405 Supplemental financing documents.
1710.406 Loan approval.
1710.407 Loan documents.

AUTHORITY: 7 U.S.C. 901 *et seq.*, 1921 *et seq.*, 6941 *et seq.*

SOURCE: 57 FR 1053, Jan. 9, 1992, unless otherwise noted.

Subpart A—General

§ 1710.1 General statement.

(a) This part establishes general and pre-loan policies and requirements that apply to both insured and guaranteed loans to finance the construction and improvement of electric facilities in rural areas, including generation, transmission, and distribution facilities.

(b) Additional pre-loan policies, procedures, and requirements that apply specifically to guaranteed and/or insured loans are set forth elsewhere:

(1) For guaranteed loans in 7 CFR part 1712 and RUS Bulletins 20-22, 60-10, 86-3, 105-5, and 111-3, or the successors to these bulletins; and

(2) For insured loans in 7 CFR part 1714 and in RUS Bulletins 60-10, 86-3, 105-5, and 111-3, or the successors to these bulletins.

(c) This part supersedes those portions of the following RUS Bulletins and supplements that are in conflict.

7 CFR Ch. XVII (1-1-10 Edition)

- 20-5 Extensions of Payments of Principal and Interest
20-20 Deferment of Principal Repayments for Investment in Supplemental Lending Institutions
20-22 Guarantee of Loans for Bulk Power Supply Facilities
20-23 Section 12 Extensions for Energy Resources Conservation Loans
60-10 Construction Work Plans, Electric Distribution Systems
86-3 Headquarters Facilities for Electric Borrowers
105-5 Financial Forecast-Electric Distribution Systems
111-3 Power Supply Surveys
120-1 Development, Approval, and Use of Power Requirements Studies

(d) When parts 1710, 1712, and 1714 are published in final form, the bulletins cited in paragraph (b) of this section will be rescinded, in whole or in part, or revised.

[57 FR 1053, Jan. 9, 1992, as amended at 58 FR 66262, Dec. 20, 1993]

§ 1710.2 Definitions and rules of construction.

(a) *Definitions.* For the purpose of this part, the following terms shall have the following meanings:

Administrator means the Administrator of RUS or his or her designee.

Approved load forecast means a load forecast that RUS has determined is current for RUS purposes and has been approved by RUS pursuant to 7 CFR part 1710, subpart E.

Approved load forecast work plan means a load forecast work plan that RUS has determined is current for RUS' purposes and has been approved pursuant to 7 CFR part 1710, subpart E.

APRR means Average Adjusted Plant Revenue Ratio calculated as a simple average of the adjusted plant revenue ratios for 1978, 1979 and 1980 as follows:

$$APRR = \frac{A + B}{C - D}$$

where:

A=Distribution (plant), which equals Part E, Line 14(e) of RUS Form 7;

B=General Plant, which equals Part E, Line 24(e) of RUS Form 7;

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C=Operating Revenue and Patronage Capital, which equals Part A, Line 1 of RUS Form 7; and

D=Cost of Power, which equals the sum of Part A, Lines 2, 3, and 4 of RUS Form 7.

Area Coverage means the provision of adequate electric service to the widest practical number of rural users in the borrower's service area during the life of the loan.

Borrower means any organization that has an outstanding loan made or guaranteed by RUS for rural electrification, or that is seeking such financing.

Bulk Transmission Facilities means the transmission facilities connecting power supply facilities to the subtransmission facilities, including both the high and low voltage sides of the transformer used to connect to the subtransmission facilities, as well as related supervisory control and data acquisition systems.

Call provision has the same meaning as "prepayment option".

Consolidation means the combination of 2 or more borrower or nonborrower organizations, pursuant to state law, into a new successor organization that takes over the assets and assumes the liabilities of those organizations.

Consumer means a retail customer of electricity, as reported on RUS Form 7, Part R, Lines 1-7.

Demand side management (DSM) means the deliberate planning and/or implementation of activities to influence consumer use of electricity provided by a distribution borrower to produce beneficial modifications to the system load profile. Beneficial modifications to the system load profile ordinarily improve load factor or otherwise help in utilizing electric system resources to best advantage consistent with acceptable standards of service and lowest system cost. Load profile modifications are characterized as peak clipping, valley filling, load shifting, strategic conservation, strategic load growth, and flexible load profile. (See, for example, publications of the Electric Power Research Institute (EPRI), 3412 Hillview Avenue, Palo Alto, CA 94304, especially "Demand-Side Management Glossary" EPRI TR-101158, Project 1940-25, Final Report, October 1992.) DSM includes energy

conservation programs. It does not include sources of electrical energy such as renewable energy systems, fuel cells, or traditionally fueled generation, such as fossil or nuclear fueled generators.

Distribution Borrower means a borrower that sells or intends to sell electric power and energy at retail in rural areas.

Distribution Facilities means all electrical lines and related facilities beginning at the consumer's meter base, and continuing back to and including the distribution substation.

Distributed generation is the generation of electricity by a sufficiently small electric generating system as to allow interconnection of the electric generating system near the point of service at distribution voltages including points on the customer side of the meter. A distributed generating system may be operated in parallel or independent of the electric power system. A distributed generating system may be fueled by any source, including but not limited to renewable energy sources. A distributed generation project may include one or more distributed generation systems.

DSC means Debt Service Coverage of the borrower calculated as:

$$DSC = \frac{A+B+C}{D}$$

Where:

All amounts are for the same calendar year and are based on the RUS system of accounts and RUS Forms 7 and 12. References to line numbers in the RUS Forms 7 and 12 refer to the June 1994 version of RUS Form 7 and the December 1993 version of RUS Form 12, and will apply to corresponding information in future versions of the forms;

A=Depreciation and Amortization Expense of the borrower, which equals Part A, Line 12 of RUS Form 7 (distribution borrowers) or Section A, Line 20 of RUS Form 12a (power supply borrowers);

B=Interest expense on total long-term debt of the borrower, which equals Part A, Line 15 of RUS Form 7 or Section A, Line 22 of RUS Form 12a, except that interest expense shall be increased by 1/4 of the amount, if any, by which restricted rentals of the borrower (Part M, Line 3 of RUS Form 7 or Section K, Line 4 of RUS Form 12h) exceed 2 percent of the borrower's equity (RUS Form 7, Part C, Line 36 [Total

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Margins & Equities] less Line 26 [Regulatory Assets] or RUS Form 12a, Section B, Line 38 [Total Margins & Equities] less Line 28 [Regulatory Assets];

C=Patronage Capital or Margins of the borrower, which equals Part A, Line 28 of RUS Form 7 or Section A, Line 35 of RUS Form 12a; and

D=Debt Service Billed (RUS + other), which equals the sum of all payments of principal and interest required to be made on account of total long-term debt of the borrower during the calendar year, plus 1/4 of the amount, if any, by which restricted rentals of the borrower (Part M, Line 3 of RUS Form 7 or Section K, Line 4 of RUS Form 12h) exceed 2 percent of the borrower's equity (RUS Form 7, Part C, Line 36 [Total Margins & Equities] less Line 26 [Regulatory Assets] or RUS Form 12a, Section B, Line 38 [Total Margins & Equities] less Line 28 [Regulatory Assets]);

DSM activities means activities of the type referred to in § 1710.354(f).

DSM plan means a plan that describes the implementation at the distribution level of the DSM activities identified in the integrated resource plan as having positive net benefits. See § 1710.357.

Electric system means all of the borrower's interests in all electric production, transmission, distribution, conservation, load management, general plant and other related facilities, equipment or property and in any mine, well, pipeline, plant, structure or other facility for the development, production, manufacture, storage, fabrication or processing of fossil, nuclear, or other fuel or in any facility or rights with respect to the supply of water, in each case for use, in whole or in major part, in any of the borrower's generating plants, including any interest or participation of the borrower in any such facilities or any rights to the output or capacity thereof, together with all lands, easements, rights-of-way, other works, property, structures, contract rights and other tangible and intangible assets of the borrower in each case used or useful in such electric system.

Equity means total margins and equities, which equals Part C, Line 33 of RUS Form 7 (distribution borrowers) or Section B, Line 34 of RUS Form 12a (power supply borrowers).

Final maturity means the final date on which all outstanding principal and

accrued interest on an electric loan is due and payable.

Five percent hardship rate means an interest rate of 5 percent applicable to a hardship rate loan.

Fund advance period means the period of time during which the Government may advance loan funds to the borrower. See 7 CFR 1714.56.

Generation Facilities means the generating plant and related facilities, including the building containing the plant, all fuel handling facilities, and the stepup substation used to convert the generator voltage to transmission voltage, as well as related energy management (dispatching) systems.

Hardship rate loan means a loan made at the 5 percent hardship rate pursuant to 7 CFR 1714.8.

Insured Loan means a loan made pursuant to Section 305 of the RE Act, and may include a direct loan made under Section 4 of the RE Act.

Integrated Resources Plan (IRP) means a plan resulting from the planning and selection process for new energy resources that evaluates the benefits and costs of the full range of alternatives, including new generating capacity, power purchases, DSM programs, system operating efficiency, and renewable energy systems.

Interest rate cap means a maximum interest rate of 7 percent applicable to certain municipal rate loans as set forth in § 1710.7.

Interest rate term means a period of time selected by the borrower for the purpose of determining the interest rate on an advance of funds. See 7 CFR 1714.6.

Load forecast means the thorough study of a borrower's electric loads and the factors that affect those loads in order to determine, as accurately as practicable, the borrower's future requirements for energy and capacity.

Load forecast work plan means the plan that contains the resources, methods, schedules, and milestones to be used in the preparation and maintenance of a load forecast.

Loan means any loan made or guaranteed by RUS.

Loan Contract means the agreement, as amended, supplemented, or restated from time to time, between a borrower