BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF DELAWARE

IN THE MATTER OF THE APPLICATION OF THE DELAWARE ELECTRIC COOPERATIVE, INC., FOR APPROVAL OF CHANGES IN DEPRECIATION RATES FOR ELECTRIC PLANT PURSUANT TO *26 DEL. C. § 313* (FILED MAY 28, 2004)	))))))	PSC DOCKET NO. 04-202

ORDER NO. 6438

This 22nd day of June, 2004, the Commission finds, determines, and Orders the following:

1. The Delaware Electric Cooperative, Inc. ("DEC" or "the Cooperative") has obligations under the loan agreements with its major lenders to maintain certain minimum operating ratios between its revenues and the interest payable on its debt. In an application filed May 28, 2004, the Cooperative reports that it is in danger of failing to meet these TIER and OTIER requirements, which failures would put DEC into technical default under the loan obligations. DEC traces these operating ratio difficulties in large part to increased charges for power purchased from its generating cooperative (Old Dominion Electric Cooperative), and, in particular, a purchase power rate increase by Old Dominion which became effective April 1, 2004. With its unbundled retail supply rates frozen until April 2005 under the Electric Restructuring Act regime,[1] the Cooperative has no easy method to "pass through" its increased power costs to its subscribers.

[1]See 26 Del. C. § 1006(b)(1)a. (2002 Supp.) (retail market prices for electric supply may not be changed during transition period). Compare *26 Del. C. § 1006(b)(1)b.* (Commission may change non-supply rates during transition period to allow for recovery of extraordinary costs).

2. To attempt to forestall any TIER and OTIER failures, DEC has filed an application with this Commission – not to change its retail rates – but to change the depreciation rates it utilizes for its accounting purposes. DEC said that it was going to propose these new depreciation rates when it filed its "end of transition period" distribution and transmission rate filing called for by the Restructuring Act.[2] However, DEC says the shadow of the TIER failure has forced it to file its request now. If its proposed depreciation rate adjustments could now be implemented – for accounting purposes – it could then book decreased depreciation expenses (counterbalancing DEC's increased power costs), leading to operating ratios sufficient to meet the TIER and OTIER thresholds called for in its loan agreements. At the same time, because the new depreciation rate package would now be utilized only for accounting purposes, DEC's subscribers would see no present change in the frozen rates they now pay.[3]

3. The rate depreciation package proposed by DEC in its May 28, 2004 filing has two facets. First, DEC proposes to change its depreciation rates for its electric plant in service. While in particular plant categories the relevant rates might rise, or fall, the overall composite depreciation rate would, under DEC's proposal,

[2]See *26 Del. C. § 1006(b)(2)d. (2002 Supp.)* (DEC shall file by September 2004 a rate case quality cost of service study along with a proposal to reset its regulated rates to be applicable during the post-transition period).

[3]DEC reports that its compliance with TIER and OTIER ratios is measured on averages within a three-year window. Given that, DEC says, if the depreciation adjustments are now approved and implemented, its operating ratios for fiscal year 2004 would overcome any past year deficiencies and thus avoid default.

fall to 4.19%. That is down from the overall composite of 5.59% now in use for more than a decade. DEC supports its adjustments with an electric plant and depreciation study commissioned by it in 2001 (and updated in 2004). As a second change, DEC proposes to recognize an "overstatement" in its present depreciation reserve that flows from the use of the present depreciation rates since 1988. Under DEC's proposal, this $17,679,000 overstatement would be "recaptured" - on a going forward basis – by reducing its annual depreciation expense by $1,263,000.[4] The net result, over the composite life of DEC's plant in service, would be the same as if the "new" 4.19% overall depreciation rate had been applied consistently since 1988. Of course, the Cooperative wants the Commission to approve these changes now, rather than later, so that it can begin booking the new rates and expense deduction and steer clear of TIER failure under its loans. At the same time, it points out that the Commission will have the opportunity to revisit these depreciation rates in scrutinizing DEC's "end of the transition period" regulated rate proposal due to be filed within a few months.

4. Staff has only had a short time to review the new depreciation rates, and DEC's supporting study. Based on its initial review, Staff concludes that the Cooperative's depreciation rates do need to be adjusted. In fact, Staff suggests that DEC's new depreciation rates may, in some instances, require still further adjustment. Staff does not oppose the prompt implementation of DEC's

[4]DEC arrives at this amount by amortizing the overstated amount over the remaining composite life of DEC's plant in service. DEC projects that remaining composite life to be 14 years.

proposed new rates (and its past "overstatement" adjustment method) given that such changes (implemented only for accounting purposes) will not have a direct present impact on subscribers and will probably prevent the Cooperative from falling into technical default under its major loan obligations.

5. Time, or the absence of it, is the crucial factor in this matter. Under the provisions of *26 Del. C. § 313*, this Commission is empowered to ascertain and determine, and by Order fix, the proper and adequate rates for depreciation of the several classes of property for each utility. And, in the past, the Commission has entertained and approved requests by a particular utility to change its depreciation rates, even if that request was not accompanied by a concurrent filing to change the utility's retail rates. See, e.g., PSC Orders Nos. 3307 (Aug. 27, 1991) (Diamond State Telephone Co.) & 4486 (April 29, 1997) (DP&L).[5] However, in the past, most Orders approving changes in depreciation rates have come only after the Commission has provided public notice of the proposed changes and allowed the opportunity for hearings. Here, DEC's need to promptly implement – for accounting purposes – its new depreciation rates in order to avoid possible technical default under its loans puts a severe crimp on the ability to provide notice and conduct full-blown hearings before taking action on DEC's depreciation rate proposal.

6. At the same time, the Commission is convinced that the public interest would not be served if the Cooperative would fall into

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[5]Of course, in most of those instances, the depreciation rate changes resulted in increased depreciation expenses. Here, DEC's proposals would result in decreased depreciation expenses.

default under its loan obligations, even if labeled technical. Thus, the Commission will approve, on a temporary and interim basis, DEC's proposed changes to its depreciation rates and its "overstatement" adjustment methodology. This interim approval is limited to the use of these rates (and overstatement recapture method) for accounting purposes only. In addition, it does not mean that the Commission will necessarily endorse, accept, or use these rates in DEC's retail rate-setting proceeding set to begin no later than September 1, 2004. Indeed, the Commission expects that in that proceeding, Staff and other interested parties will have the further opportunity to scrutinize and challenge these depreciation rates and the method for recovering the "overstatement" accumulated since 1988. Some of the rates, as Staff suggests in its memorandum, may be in need of further adjustment. Rather, the purpose for granting this interim approval is to allow the Cooperative to begin booking its new rates and its amortized depreciation adjustment so that it can avoid loan default. The Cooperative can begin doing that in June 2004.

7. For similar reasons, the Commission will not, at this time, direct any further proceedings in this docket. The electric distribution and transmission rate filing called for by the Restructuring Act is due to be filed by DEC in a little over two months. It is doubtful that this proceeding could be completed, or even move forward in any significant way, before then. Instead, as outlined above, the Commission expects that any issues surrounding the rates (and overstatement adjustment) advanced in this filing will be "rolled into" and resolved as part of that retail distribution rate

proceeding.[6] So too, because this interim approval for accounting purposes will not change the rates actually charged DEC's subscribers, the Commission does not believe that public notice of this application by DEC is necessary <u>at this time</u>. The public notices made in conjunction with the imminent retail rate filing should offer subscribers adequate notice of the effect of any the changes in depreciation rates. The Commission expects to have such notices include references to the changes approved here on an interim basis.

Now, therefore, **IT IS ORDERED:**

1. That the Delaware Electric Cooperative, Inc., is hereby authorized, on an interim basis and for accounting purposes only, to implement the revised depreciation rates set forth in Exhibit "A" to this Order for its electric plant in service as of May 1, 2004.

2. That the Delaware Electric Cooperative, Inc., is hereby authorized, on an interim basis and for accounting purposes only, to decrease its annual depreciation expense by the amount of $1,263,000.00 per year as outlined in its application filed on May 28, 2004. Such decrease reflects the purported present overstatement of its depreciation reserve amortized over the remaining composite life of the utility's plant.

3. That the approvals granted in Ordering paragraphs 1 and 2 above are interim and applicable for accounting purposes only. Those approvals shall not control, except if later accepted by the

[6] Of course, after the end of the transition period in April 2005, DEC (if it chooses) can also seek Commission approval to change its "retail market/standard offer service price." *26 Del. C. § 1006(b)(2)c. (2002 Supp.).*

Commission, in any subsequent rate-making proceeding instituted under *26 Del. C. § 1006(b) (2002 Supp.)*.

4. That the Delaware Electric Cooperative, Inc. may begin booking the adjustments approved in Ordering paragraphs 1 and 2 above in June 2004.

5. That the Commission reserves the jurisdiction and authority to enter such further Orders in this matter as may be deemed necessary or proper.

BY ORDER OF THE COMMISSION:

/s/ Arnetta McRae
Chair

/S/ Joshua M. Twilley
Vice Chair

/s/ Joann T. Conaway
Commissioner

/s/ Jaymes B. Lester
Commissioner

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Commissioner

ATTEST:

/s/ Karen J. Nickerson
Secretary

E X H I B I T "A"

DEPRECIATION RATES

Account		Life	Composite Rate*	Average Salvage Ratio
Transmission:				
354	Towers and fixtures (fully depreciated)			
355	Poles and fixtures	36.2	3.90%	-41.19%
356	Overhead conductors and devices	34.6	4.08%	-41.22%
Distribution:				
362	Station equipment	28.3	4.40%	-24.40%
362	Station equipment – load management	16.1	6.21%	0.00%
364	Poles, towers and fixtures	31.7	4.40%	-39.49%
365	Overhead conductors and devices	25.5	5.39%	-37.32%
366	Underground conduit	49.9	2.80%	-39.93%
367	Underground conductor and devices	39.8	3.52%	-40.09%
368	Line transformers	37.6	2.78%	- 4.40%
369	Services	33.0	4.54%	-49.72%
370	Meters	33.0	2.99%	+ 1.35%
371	Installations on customer premises	16.2	9.11%	-47.57%
373	Street lights and signal systems	20.2	5.27%	- 6.49%

*The resulting composite rate is calculated as (1/L) – (SR/L) where L = life and SR = average salvage ratio.