BEFORE THE

WYOMING PUBLIC SERVICE COMMISSION

DIRECT TESTIMONY

OF

DAVID W. HEDRICK

C. H. GUERNSEY & COMPANY

OKLAHOMA CITY, OKLAHOMA

ON BEHALF OF

POWDER RIVER ENERGY CORPORATION

Docket No. 10014-168-CR-16

Q. Please state your name and business address.

A. My name is David W. Hedrick and my business address is 5555 North Grand Boulevard, Oklahoma City, Oklahoma 73112-5507.

Q. By whom are you employed and what is your position?

A. I am employed by C. H. Guernsey & Company, Engineers, Architects and Consultants. I work primarily in the area of Electrical Rate Analysis.

Q. Please summarize your educational and professional background.

A. I earned a Bachelor of Science degree from the University of Central Oklahoma and a M.B.A. degree from Oklahoma City University. I have been employed by C. H. Guernsey & Company since 1981.

Q. Have you previously testified before regulatory commissions?

A. Yes. I have testified and been accepted as an expert witness before the Arizona Corporation Commission, the Public Utility Commission of Texas, the Oklahoma Corporation Commission, the Arkansas Public Service Commission and the

Wyoming Public Service Commission. Exhibit DWH-1 is my resume, which provides a listing of the clients and experience.

Q. Whom do you represent in this proceeding?

A. I represent Powder River Energy Corporation (“Powder River” or "the Cooperative").

Q. Have you previously represented Powder River in proceedings before the Wyoming Public Service Commission?

A. Yes. I have represented Powder River in numerous rate filings and Cost of Power Adjustment filings over the past twenty-five years.

Q. What is the purpose of your testimony?

A. I will describe Powder River’s request and sponsor the schedules included in the rate filing in support of the Cooperative’s request.

Q. What is Powder River requesting in this proceeding?

A. Powder River is requesting approval of its proposed tariffs, which have been designed to accomplish the following goals:

- An increase in the system revenue requirement of $11,506,749, or 5.94%.
- Restatement of the base cost of power in the Cost of Power Adjustment (COPA) mechanism to reflect the current level of power cost.
- Revision of the existing base rates to reflect the appropriate recovery of COPA revenue based on the restated base cost of power.
- Revisions to rate classes to recognize changes in the cost of providing service.

Q. What criteria were used to establish the proposed revenue requirement?

A. As a not-for-profit electric Cooperative, Powder River's required revenue is determined based on the cash requirements necessary to meet the financial objectives established by the board of directors and the ability to satisfy lender mandated coverage requirements. The requested revenue requirement in this proceeding has been established with a goal of producing an RUS OTIER of 1.50.

Q. What are the lender requirements that must be satisfied?

A. Each of Powder River's lenders establishes minimum financial coverage ratios that must be met. Both the Rural Utilities Services (RUS) and the Cooperative Finance Corporation (CFC) mortgage requirements must be satisfied.

Table 1- Lender Mortgage Coverage Requirements

	Minimum Requirements	Adjusted Test Year	Proposed Test Year	Approved Last Rate Case
RUS OTIER	1.10	(.026)	1.50	1.15
RUS Net TIER	1.25	1.17	2.93	2.56
RUS ODSC	1.10	0.73	1.62	1.82
RUS DSC	1.25	1.45	2.34	2.57
CFC DSC	1.35	0.94	1.83	2.02

Powder River is required to meet the stated coverage requirement as reflected in the first column of Table 1 for two years out of every three year period. As reflected in the table, the Cooperative would satisfy only the RUS DSC requirement under the Adjusted Test Year conditions. The proposed rate increase should allow the Cooperative to meet the lender mortgage requirements.

Q. What are the consequences of not meeting the minimum requirements?

A. Not meeting the minimum coverage requirements puts the Cooperative in technical default of its mortgage. As a result of the default, the lender can impose restrictions on the Cooperative's ability to retire capital credits, limit or deny additional borrowing, increase the interest rate on future borrowing and take additional measures to control the management of the Cooperative if appropriate corrective action is not taken.

Q. Why has Powder River proposed a revenue requirement based on an RUS OTIER of 1.50 instead of the minimum RUS OTIER required of 1.10?

A. Rates are not designed based on an objective of meeting the minimum coverage requirement for several reasons. These include the regulatory delay in implementing new rates, the continuing increase in the cost of providing service, and in Powder River's case, a projected continuation of the decline in sales. Considering these reasons, establishing rates to meet a minimum coverage requirement would not actually provide sufficient revenues to meet that requirement by the time rates are implemented, requiring frequent additional rate filings by Powder River.

Q. How does the RUS OTIER for Powder River compare to that of other cooperatives?

A. Exhibit DWH-2 provides data from the Cooperative Finance Corporation (CFC) 2014 Key Ratio Trend analysis. Powder River's OTIER has been at or just above the minimum required level the last five years. In 2014, the OTIER was 1.20. The average OTIER for the 813 CFC cooperative borrowers in 2014 was 1.93. That ranked Powder River 756 out of 813. The average OTIER for the other eleven cooperatives in Wyoming in 2014 was 1.88. Cooperatives of the same size had an average OTIER in 2014 of 2.09. Powder River's OTIER has been considerably lower in comparison to the national average, state average or other cooperatives of a similar size.

Q. In previous rate filings, Powder River has requested a lower operating margin and lower coverage requirements. What has caused the change in this current application?

A. In Powder River's last rate case, the cooperative was granted an operating margin of $650,034 which was intended to produce an RUS OTIER of 1.15. Those rates became effective in May 2014, yet the additional revenues from that rate change have not been sufficient to allow the Cooperative to operate above the required minimum coverage ratios. The revenue requirement in the last rate case was developed based on the method used in previous filings. For the past fifteen years, Powder River has been primarily in a continuing high growth mode with each successive year reflecting a progressively higher level of revenues. The explosive growth of Coal Bed Methane (CBM) production created significant facility requirements and additional risk to the Cooperative in the provision of service. Powder River implemented various rates, line extension policy provisions and other programs over the past fifteen years to mitigate the risk. Powder River has also historically received cash capital credit payments from its power supplier as well as periodic refunds from its power supplier which were available for use in meeting its financial coverage requirements. As a result of these conditions, the Cooperative was able to request and operate with a lower level of margins.

Conditions have changed at Powder River. The Cooperative is now experiencing a decline in not only CBM load but also a decline in coal mine load, general service load and residential load. This decline in load is projected to continue as CBM production continues to decline and coal production also declines. Powder River's power supplier has also provided notice that cash capital credit retirements will no longer occur on a regular basis and year-end refunds previously made as a result of excess margins, will no longer be available.

As a result of these changes, Powder River no longer has any cushion with regard to operating margin previously created from growth and the cash provided from the power supplier. Powder River must rely more substantially on the operating margin created from rates charged to members. The higher margin requested in this application should provide the needed cushion to maintain the financial integrity of the Cooperative by satisfying the lender's mortgage coverage requirements and providing sufficient cash to meet the Cooperative's financial objectives.

Q. What are the Cooperative's financial objectives?

A. The Cooperative's financial objectives include:

- Provide sufficient cash margins to maintain and provide slow growth in the equity position of the Cooperative.
- Provide sufficient cash margins to maintain the current capital credit retirement program that includes a projected $2,325,000 annual retirement.
- Provide sufficient cash margins to pay principal payments on long-term debt.

- Provide sufficient cash operating general funds.

Q. What is the Cooperative's current equity position?

A. Schedule D-2.0 shows the system capitalization position and equity as a percent of assets position for the test year and the previous five years. The Cooperative's total capitalization is the sum of long-term debt and the member's equity. The equity as a percent of capitalization is a reflection of the percentage of investment in facilities financed with member-owner contributions.

The top half of Schedule D-2.0 provides the data for the Powder River system including all patronage provided from Powder River members through rates and also capital credit allocations received from Basin Electric Generation and Transmission (Basin) and other capital credit allocations received from other organizations. The equity as a percent of capitalization for the test year is 59.40% and the equity as a percent of assets is 48.96%.

The bottom half of Schedule D-2.0 provides the data for the Powder River system excluding Basin and other organization patronage capital. The Basin capital credits represent the overwhelming majority of the patronage capital excluded. The Basin capital credits are assigned by Basin to Powder River annually and are reflected on the Cooperative's balance sheet. These Basin allocations are not cash but rather an accounting entry to represent Powder River's equity in Basin. Removing the Basin and other patronage capital from the equity calculation provides a more accurate reflection of Powder River's equity position based on the revenues provided by only the Cooperative's members and the Cooperative's own operations. The equity as a percent of capitalization excluding Basin and other organization patronage capital has declined over the past four years to 38.80% in the test year. The equity as a percent of assets excluding Basin and other capital patronage capital declined over the past three years to 29.36% in the test year.

Q. Why is the equity position important?

A. The equity position as reflected in the equity as a percent of capitalization or equity as a percent of assets is a key indicator of the financial health of a cooperative. The equity represents the level of margins (retained earnings) provided by members through rates to finance the utility plant additions that have been made over the course of the cooperative's history. The equity ratio indicates the percentage of plant assets financed by cash from current member rates. An equity ratio that is set too low results in a higher level of debt financing, which results in higher interest costs. An equity ratio that is maintained at too high a level results in a higher level of costs being recovered from current rate payers. The objective is to establish an appropriate balance between equity and debt financing.

Q. What requirements do the cooperative's lenders have with regard to the equity ratio?

A. The equity position of each individual cooperative borrower is important to both the Rural Utilities Services (RUS) and the Cooperative Finance Corporation (CFC), the two groups that provide the debt financing for the Cooperative. The RUS imposes limits on a cooperative's ability to retire capital credits and borrow additional funds if the equity level is below 20%. CFC utilizes the portfolio of its member borrowers when accessing funds in the market, therefore it is important for each member borrower to maintain an adequate equity level.

Q. How does Powder River's equity position compare to other cooperatives?

A. Exhibit DWH-2 provides data from CFC's 2014 Key Ratio Trend analysis. Powder River's distribution equity has declined over the past three years to 29.36%. The average distribution equity of the 813 CFC cooperative borrowers across the U.S. in 2014 was 36.31%. The average distribution equity for all eleven cooperatives in the state of Wyoming for 2014 was 30.77%. It is interesting to note that the distribution equity for Wyoming cooperatives dropped significantly in 2014 from an average of roughly 36% and higher during the previous four years. The distribution equity for the group of cooperatives of a similar size is 36.77%.

Q. How does the level of plant additions made by the Cooperative to serve its' members affect the equity position?

A. The level of plant additions is a primary driver in the determination of the equity position of the Cooperative. As the level of plant additions required to provide service changes, the level of cash required from member rates used to finance those plant additions and maintain an equity position also changes. Schedule D-1.0 Growth Rate in Net Plant, shows the plant additions made since 2005 and the projected plant additions for the next five years. The plant additions have been lower during the period of 2011 – 2014 than the prior period from 2005 – 2010. However, the required plant additions for the next five years are projected to be higher. The projected plant additions include not only the facilities to connect new customers but also system improvements and upgrades necessary to continue providing safe and reliable service to the existing customers. The plant additions shown for 2015 are the plant additions made during the period. For the years 2016 through 2019 the projected plant additions are from the Cooperative's work plan. To grow the equity level from the current level requires sufficient cash produced from rates charged to members to fund the equity portion of future plant additions. The plant additions not financed by cash from member rate revenue must be financed by debt.

Q. Why do the financial objectives include funding for capital credit retirements?

A. As a member-owned electric Cooperative, margins earned in excess of the cost of providing service are assigned in proportion back to the member-owners on an annual basis. These assigned margins accrue to the individual patronage capital accounts of the member. The sum of these accounts is reflected as the margin and equity on the balance sheet. To maintain its tax-exempt status as a member owned cooperative, the assigned patronage must be returned to members in cash payments on a periodic basis. Schedule D-5.0 Capital Credits Retired, provides a schedule of the patronage retirements made to members since 2005. Powder River has a consistent history of retiring capital credits to members.

Q. Please describe the development of the cash principal payment amount required to meet the financial objective.

A. The total projected principal payment to be funded is $6,402,944. This amount is the sum of the actual 2015 principal payment of $5,468,619 shown on Schedule D-3.0 Long-Term Debt and the projected principal payments on new borrowings of $934,325 shown on Schedule D-6.0 Additional Principal Payments.

Q. Please describe the cash operating general funds requirement.

A. One of the financial objectives of the Cooperative is to maintain an adequate level of cash general funds to operate the Cooperative. Schedule E-1.0 Calculation of Desired General Funds show a calculation of the projected cash requirements for three sample scenarios in comparison with the estimated general funds level at the end of the test year. The estimated general funds available for use in operations at the end of the test year of $25,149,950 is equal to 49 days of the estimated cash required or 7.13% of total utility plant. The Cooperative has determined that the existing level of general funds is sufficient and there is no need to increase the revenue requirement to provide additional operating cash.

Q. In addition to providing sufficient margins to satisfy the lender's mortgage coverage requirements, does the proposed revenue requirement provide sufficient cash to fund the Cooperative's financial objectives?

A. Yes. While the revenue requirement has been developed to produce a RUS OTIER of 1.50, the revenue requirement should provide sufficient cash to meet the financial objectives. Schedule E-2.0 Revenue Requirement in the rate filing package provides a summary of the projected use of the cash produced. The right-side of Schedule E-2.0 reflects a calculation of additional cash-general funds. As indicated previously, the Cooperative has determined that the existing level of cash general funds is sufficient, therefore there is no additional cash required to meet the general funds requirement. The left-side of Schedule E-2.0 shows the development of required cash, the cash provided from existing operations and the additional cash required compared to the proposed rate change. The plant additions shown are the five year average of the projected plant additions for 2015-2019. The proposed revenue requirement should provide sufficient cash to finance roughly 56% of plant additions for the next five years from equity contributions. This results in a cash requirement for plant additions of $8,768,058. In addition to the cash required to fund plant additions, the projected capital credit retirements of $2,325,000 and the projected principal payments of $6,402,944 are added to calculate a total cash revenue requirement of $17,496,003.

The cash provided from existing operations includes the non-cash expenses of depreciation and post-retirement benefits reflected on the income statement, the operating margins (deficit) reflected on the income statement for the adjusted test year plus the cash from non-operating interest and cash capital credits. The cash from existing operations totals $5,988,218.

The proposed rate change should produce an additional $11,506,749 of additional cash. This increase in cash should be sufficient to fund the cash requirements shown on Schedule E-2.0 which will allow the cooperative to meet its financial objectives.

Q. Why is it necessary to revise the base power cost in the COPA mechanism, and what impact does this have on the rates charged to members?

A. Powder River has continued to experience increases in the cost of power from their wholesale power provider, Basin Electric Cooperative (Basin). As a result, the COPA has continued to increase as well. It is therefore appropriate to periodically re-base the COPA mechanism and revise the retail rate tariffs to appropriately include the increased power costs in the demand and energy components of the base rates. The proposed base power cost in the COPA mechanism is calculated on Schedule N-3.0. The re-base of the COPA does not increase or decrease the proposed revenue requirement. The proposed base rates reflect a recovery of the adjusted purchased power costs based on the 2016 Basin rates and the proposed COPA factor will be reduced accordingly. Future COPA factors will be calculated using the updated base power cost shown on Schedule N-3.0.

Q. Please describe the changes proposed for each rate class.

A. The proposed revenue change by rate class is as follows:

	Change $	Change %
Residential	$1,512,887	7.83%
Seasonal	145,975	9.40%
Irrigation	44,742	12.03%
General Service	1,055,992	8.45%
General Service CBM	797,505	17.12%
Large Power	2,248,608	5.88%
Large Power CBM	5,419,443	16.71%
LP Transmission	260,423	0.35%
LP Transmission CBM	4,088	0.08%
LP Transmission General	(4,143)	(0.84%)
LP Compression CBM	55	0.00%
Lighting	21,176	7.00%
Total	$11,506,749	6.01%
Other Revenue	0	0.00%
Total Revenue	$11,506,749	5.94%

The proposed changes move the rate classes closer to cost of service as shown on the summary of the Cost of Service Study shown in Section H.

Q. What is the test year for the rate filing?

A. The test year is the twelve months ending December 31, 2014. The 2014 test year period provided the available data for the development of the study. Adjustments for known and measurable changes have been made to reflect current levels of revenues and expenses.

Q. Please describe the schedules in the rate filing.

A. Schedule A-1.0 is the Income Statement. Column (a) reflects the Actual Test Year. Adjustments for known and measurable changes have been made to revenues and expenses in column (b). Column (c) reflects the Adjusted Test Year with adjustments and represents the projected financial condition of the Cooperative including all of the known and measurable changes. Column (d) reflects the rate change, which includes the revisions to re-base the COPA tariff. The revenue that was previously recovered through the COPA will now be recovered in the base rates.

Q. Please describe the adjustments made to base operating revenue.

A. The adjusted test year base revenue is calculated on Schedule F-5.0. The billing units (number of consumers, kWh sold and billing demand) used on Schedule F-5.0 reflect an adjustment to the test year level of kWh sales based on actual sales through July of 2015 and additional reductions in sales for specific large consumers anticipated in the second half of 2015. This development of billing units is in contrast to what was done in previous rate filings where the billing units for all classes were based on forecasted consumption. While Powder River does anticipate that billing units are likely to continue to decrease, the additional reduction is difficult to project. The Cooperative believes that this approach will provide a higher level of confidence among all parties with regard to the billing units used to calculate revenue. The change in kWh sales by rate class is reflected in the following table.

	Actual 2014	Adjusted 2014	Change in Sales	Percent Change
Residential	219,548,449	209,408,374	(10,140,075)	(4.62%)
Seasonal	8,629,837	8,675,705	45,868	0.53%
Irrigation	3,234,036	3,381,585	147,549	4.56%
General Service	142,949,998	139,503,117	(3,446,881)	(2.41%)
General Service – CBM	57,654,301	48,701,747	(8,952,554)	(15.53%)
Large Power	512,994,691	535,706,517	22,711,826	4.43%
Large Power – CBM	442,524,976	409,115,473	(33,409,503)	(7.55%)
LPT – Coal	1,244,870,031	1,200,539,212	(44,330,819)	(3.56%)
LPT/LPC – CBM	111,861,192	116,058,618	4,197,426	3.75%
LPT – General	35,000	9,800,000	9,765,000	N/A
Black Hills	1,001,535	1,084,005	82,470	8.23%
Lighting	3,034,755	3,042,878	8,123	0.27%
Total	2,748,338,801	2,685,017,231	(63,321,570)	(2.30%)

The adjustments for consumers and kWh sold are shown on Schedules F-1.0 and F-2.0, respectively. Overall, the adjustment to kWh sales for all rate classes is a reduction of 63,321,570 kWh. The adjusted base revenue on Schedule F-5.0 is calculated by applying the existing rates to the adjusted billing units. The adjusted base revenue reflects an increase of $459,338 from the test year actual base revenue. The adjustment to base revenue reflects both the reduction in projected kWh sales and the additional revenue as a result of annualizing the rate increase that became effective in May 2014.

Q: Please explain the adjustments made to the COPA revenue.

A: The calculation of the adjusted COPA revenue is shown on Schedule F-6.0. The COPA revenue has been restated to reflect the amount allowed to be recovered per the COPA tariff. The adjusted COPA revenue is based on the adjusted kWh sold and the adjusted test year purchased power expense based on the wholesale rates effective in 2016. The total adjustment to the COPA revenue is a reduction of $604,077. The adjustment to the COPA revenue reflects the increase in wholesale power cost, the reconciliation for over/under recovery in prior periods, and the annualized changes in base cost resulting from the rate change that became effective in May 2014.

Q: Please explain the Deferred Revenue adjustment.

A: For the test year 2014 period, Powder River had sufficient revenue and margins to make a revenue deferral of $4,200,000. This is reflected as a reduction to revenue in column (a) of Schedule A-1.0. For rate making purposes, an adjustment of $4,200,000 was made to reverse the test year revenue deferral. The total revenue deferred in prior periods that remains available for Powder River to recognize is roughly $7.2 million. Powder River anticipates the use of $4 million of deferred revenue in 2015 and the remainder in 2016 to meet the lender requirements. The proposed revenue requirement has been developed to meet the lender coverage requirements and meet the financial objectives of the Cooperative without the use of deferred revenue. With the appropriate revenue requirement and margins, the Cooperative would not require the use of the deferred revenue program in the future. Further, considering that Powder River anticipates using the remainder of the total revenue deferred in prior periods in 2015 and 2016, Powder River will no longer have deferred revenue available to offset losses beginning in 2017.

Q. Please explain the adjustment made to CCR revenue.

A. Capital Cost Recovery revenue (CCR) is the recovered from CBM customers as part of the line extension amount paid by the customer. The agreements for recovery of CCR have expired and there will be no further recovery of CCR in the future. The test year amount of CCR billed during the test year was $3,105,427. An adjustment of ($3,105,427) has been made to reflect that no CCR will be billed in the future.

Q. Please explain the adjustment made to other revenue.

A. The adjustment to other revenue is calculated on Schedule F-7.0. The adjustment was made to annualize the impact of the miscellaneous service charges that went into effect with the rate change in May of 2014. The total increase in other revenue resulting from these changes is $5,450.

Q. What is the net effect of all of the revenue adjustments made to the test year?

A. The total of all revenue adjustments increases the test year operating revenue by $955,370.

Q. Please describe the major adjustments made to expenses.

A. The largest expense adjustment was made to purchased power cost. The summary of the adjusted purchased power expense is shown on Schedule G-3.0. The adjusted purchased power expense reflects the wholesale rates for 2016 and the adjusted billing units as discussed previously. Schedule A-5.0 shows the total adjustment to purchased power cost of $6,524,516.

Q: Please describe the adjustments made to payroll and benefits expense.

A: Payroll expense has been adjusted to reflect 150 full time employees and 7 part time employees at 2015 wage rates with a 3% Cost of Living Adjustment (COLA) wage increase implemented in October 2015. Schedule A-7.0 shows the calculation of the payroll adjustments. The payroll expensed and overtime ratios used in the calculation of the payroll expense adjustment on Schedule A-7.0 are the five-year averages as shown on Schedule C-6.0. The total adjustment to payroll expense is an increase of $169,286. The payroll expense adjustment is spread to the individual expense accounts on Schedule A-3.1.

The benefits expense adjustment is summarized on Schedule A-8.0 and includes changes to medical insurance, dental insurance, life insurance, disability insurance, retirement plans, 401k and FASB 106 funding. The adjustments for these items are shown on Schedules A-8.1 through A-8.6. The adjustments are based on the 2015 premium rates, adjusted number of employees, and adjusted wages. The benefits expense ratio is developed based on the difference between the five-year average payroll expense ratio and the test year payroll expense ratio applied to the test year benefits ratio. This calculation is made on Schedule C-6.1. The total adjustment for benefits is an increase of $700,815. The benefits expense is spread to the individual expense accounts on Schedule A-3.2.

Q: Please describe the adjustment for other insurance.

A: Schedule A-10.0 shows the calculation of the increase in expense for Powder River's risk and liability insurance. The adjustment reflects 2015 premium levels and the expense ratio is the actual test year expense ratio used by Powder River to expense these insurance costs.

Q. Please describe the rate case expense adjustment.

A. It is budgeted that the cost in this rate proceeding will be $130,000, and that this amount will be amortized over three years. The test year included consulting expenses for the previous rate case of $81,720. This results in an adjustment to reduce expenses by $38,386, as reflected on Schedule A-11.0.

Q. Please describe the depreciation adjustment on Schedule A-12.0.

A. The plant balances shown on Schedule A-12.0 reflects total utility plant as of the end of the test year. No adjustments were made to include plant additions made subsequent to the test year. The applicable depreciation rate has been applied to each account to determine the adjusted test year depreciation expense. The depreciation adjustment is a reduction of $559,046.

Q. Please describe the adjustment to taxes.

A. The property tax adjustment is calculated on Schedule A-13.0. An effective tax rate was determined and applied to plant in service as December 31, 2014. The property tax adjustment is an increase of $6,401. Payroll tax adjustments are calculated on Schedules A-14.1 through A-14.4 utilizing the adjusted payroll amounts, the appropriate tax rate and the payroll tax expense ratio. The adjustment for workers compensation is calculated on Schedule A-9.0 and reflects the application of the appropriate premium rate to the adjusted outside and inside employee wages and the benefits expense ratio. Schedule A-14.0 provides a summary of the adjustment for payroll taxes and workers compensation insurance. The total adjustment for these items is $28,031.

Q: Please explain the adjustments to regulatory debits and credits.

A: Schedule A-15.0 reflects the adjustment to regulatory debits and credits. These accounts reflect the over/under recovery of COPA revenue. The adjustments to revenue include a true-up of the COPA revenue thereby eliminating any COPA over or under recovery.

Q. Please describe the adjustment to interest expense shown on Schedule A-16.0.

A. Schedule A-16.0 shows the development of the adjustment to interest on long term debt. The first column reflects the adjusted principal outstanding. The development of the adjusted principal outstanding for existing loans is shown on Schedule D-3.0. The test year principal outstanding was adjusted to reflect outstanding principal at December 31, 2014 by taking the final principal payment made in the test year and annualizing the principal payments for the next twelve months. In addition to annualizing the principal outstanding, two advances on long-term debt were included in the adjusted principal outstanding. A draw-down of $31,957,000 occurred in January of 2015, and another draw of $17 million is anticipated to occur in the first quarter of 2016. The applicable interest rate is applied to the outstanding balances to determine the total adjusted interest expense. The total adjustment to interest on long term debt is $788,642. The draw-down of the $31,957,000 amount from the Rural Utility Services (RUS) was made and deposited in the RUS cushion of credit account. The RUS established the cushion of credit program as a funding mechanism from which cooperatives are required to make debt-service payments. By participating in the program, Powder River is paid interest on the account balance. This additional interest income is reflected on Schedule A-17.0 Interest Other and Other Income. As a result of the net difference between the interest earned on the cushion of credit account versus the interest paid on the long-term note, participation in the program provides a net benefit to the Cooperative. The draw-down in the first quarter of 2016 of $17 million is to finance plant additions.

Q. What adjustment was made to other interest?

A. An adjustment was made to reflect a change in the customer deposit policy. The change will result in an increase balance of customer deposits on which interest is paid to members at a rate of 1.73% as mandated by the commission. The adjusted amount of customer deposits received by Powder River is $8,030,535, which results in an adjustment to other interest of $138,928. This adjustment is reflected on Schedule A-17.0.

Q. Please explain the adjustment made to other income.

A. As a result of the change in the customer deposit policy, an adjustment was made to other income to reflect the investment of the additional customer deposits of $8,030,535 which will be invested with Basin and earn a projected return of 1%. The return earned on the deposits results in an adjustment of $80,305.

An adjustment was also made to reflect interest earned on the adjusted RUS cushion of credit balance. With the additional draw of long-term debt in January of 2015, Power River anticipates that the cushion of credit account will be maintained at $40 million. The cushion of credit account will earn an interest rate of 3.50% resulting in an adjustment to other income of $1,400,000. These adjustments are also reflected on Schedule A-17.0.

Q. Please explain the adjustment made to Other Deductions.

A. All amounts related to charitable contributions were removed from the test year. This adjustment of ($136,659.80) is shown on Schedule A-18.0.

Q. What affect do these adjustments have on the financial condition of the Cooperative?

A. Column (c) on Schedule A-1.0 reflects the incorporation of the adjustments that were made to the test year. Operating revenue has been increased by $955,370 and operating expenses have been increased by $8,540,312. Interest expense and other deductions have been increased by $788,642. The operating margin is reduced by $8,375,852. The adjusted test year operating deficit is $8,339,852.

Q. Was the Cost of Service Study included with the rate filing developed using the same methodology as utilized in previous cost of service studies filed with the Commission?

A. Yes. The same methodology has been utilized.

Q. Please describe the general development of the Cost of Service Study.

A. The adjusted usage data and billing units have been utilized to develop the allocation factors by rate class. The Cost of Service Study recognizes that a significant amount of utility plant investment has been made by Powder River to serve individual large customers and CBM customers. This plant investment is assigned directly to those classes. Powder River conducts an extensive review of the plant investment providing service to determine the appropriate direct plant assignments for each rate class. A summary of the direct assignments of plant investment is shown on Schedule J-3.0. The Cost of Service Study also recognizes that a significant level of customer contributions have been made for plants constructed to serve the CBM rate classes. These contributions are recognized in the allocation of operating expenses to each rate class. The summary of contributions is shown on Schedule J-3.1. Direct assignments of power cost have been made to both the Large Power Transmission and the Large Power Transmission CBM rate classes. The calculation of the directly assignable power cost is shown on Schedules G-2.1, G-2.2 and G-2.3.

Q. What are the results of the Cost of Service Study?

A. Schedule H-1.0 summarizes the results of the cost of service study under existing rates. Schedule H-2.0 summarizes the results of the cost of service study under proposed rates. The following table summarizes the rates of return and relative rates of return by class.

	COSS Existing Rates		COSS Proposed Rates	
Class	ROR	RROR	ROR	RROR
Residential	0.475%	(0.655)	4.479%	0.904
Gen Service	1.502%	(2.072)	5.924%	1.195
Large Power	(0.173%)	0.239	4.952%	0.999
Irrigation	(5.151%)	7.102	(0.561%)	(0.113)
Lighting	0.761%	(1.050)	6.077%	1.226
LP Trans-Coal	3.536%	(4.875)	4.970%	1.003
LP Trans-General	54.627%	(75.314)	45.401%	9.159
GS CBM	(3.791%)	5.229	4.927%	0.994

LP CBM	(3.808%)	5.252	4.948%	0.998
LPT CBM	5.027%	(6.934)	5.296%	1.068
Total CBM	(3.563%)	4.914	4.955%	1.000
Total System	(0.725%)	1.000	4.957%	1.000

Based on the results of the Cost of Service Study under existing rates, adjustments are recommended for all of the rate classes. Schedule N-1.0 reflects the proposed changes by rate class. The objective and result of the proposed rates was to move all of the classed to a relative rate of return of 1.00.

Q. **Please describe the proposed changes for the Residential class.**

A. The proposed rates will increase the monthly customer charge from $22.50 to $25.00. The Total Customer cost component of $28.16 is shown on Schedule M-1.0 page 1 of 8. The energy charge is also being adjusted to achieve the required revenue requirement from the class. The proposed increase to this class is 7.83%.

Q. **Please describe the proposed changes to the Irrigation rate class.**

A. The proposed increase for the Irrigation rate class is 12.03%. As reflected on Schedule H-1.0 Cost Allocation Summary under Existing Rates, the ability to recover the costs of providing service to the Irrigation class continues to be an issue. As a result, Powder River has again proposed a significant increase for the Irrigation rate class to move the rates for this class toward the cost of service. Schedule H-2.0 Cost Allocation Summary under Proposed Rates reflects that an additional 12.7% increase would be needed to produce a rate of return for the Irrigation rate class equal to that of the total system. The Cooperative believes that approval of the proposed increase in this application will put the Cooperative in a position to address the remaining revenue deficiency for this class in the next rate filing. The fixed horsepower charge has been increased from $18.50 to $20.75 per horsepower. The combination of the Irrigation system demand and customer cost components (both fixed cost components) as reflected on Schedule M-1.0 page 1 of 8, are higher than the fixed horsepower charge. With consideration to member impact, movement toward a closer recovery of fixed charges through the horsepower charge will continue to be an objective.

Q. Please describe the proposed changes to the General Service rate class.

A. The proposed basic charge for the General Service rate class is increased from $30 to $35 for single-phase and from $35 to $40 for three-phase. These charges are still in line with the Total Customer cost component on Schedule M-1.0 of $44.79. The kWh charge has been modified to rebase the COPA and achieve the total class revenue requirement. The total increase for this class is 8.45%.

Q. Please describe the proposed change for the Large Power Class (LP).

A. The monthly customer charge has been increased from $132.50 to $150.00. The monthly demand charges have been increased from $2.75 to $3.00 for the first block, and from $5.45 to $6.00 for the second block. The kWh charges have been changed to reflect the rebasing of the COPA and to produce an overall 5.88% increase for the class.

Q. Please describe the proposed change for the General Service Coal Bed Methane (GS CBM) rate class.

A. The proposed increase for the GS CBM rate class is 17.12%. The proposed increase for the GS CBM rate class is justified based on the results of the cost of service study as shown on Schedule H-1.0, page 2 of 2. The customer charge has been maintained at the existing level to match the proposed customer charges for the General Service class. The Cooperative believes that it is important to keep the customer charges the same for these rate classes in the likely event that that the decline in the GS CBM class load results in the elimination of the GS CBM rate class and the combination with the standard GS rate class. Keeping the customer charges the same will make the merging of the two rates easier to accomplish.

Q. **Please describe the proposed change for the Large Power Coal Bed Methane (LP CBM) rate class.**

A. The proposed increase for the LP CBM rate class is 16.71%. The proposed increase is justified based on the results of the cost of service study as reflected on Schedule H-1.0, page 2 of 2. The customer charges have been increased by $10 and the demand charges have been increased by $0.20 per kWh. The proposed changes in the customer charge and demand charges for the LP CBM rate class have been set at a level that remains similar to the charges in the LP rate class. As with the GS CBM rate class, the Cooperative believes that it is important to keep the customer and demand charges for the LP CBM class similar to the LP class in the likely event that the decline in LP CBM class load results in the combination of these two rate classes.

Q. Does the cooperative's proposed rate design consider the direction provided by the commission in the last rate filing?

A. In the last rate filing, the primary issue of contention was the level of change in the customer charges and demand charges in the Large Power and LP CBM rates. In the final order in the last rate filing, the commission approved rates which included increases in the customer and demand charges for these rate classes and further provided that additional increases in these components of the rate could and should be accomplished in future rate filings. The cost of service cost components do support increases in the fixed components of the rate. The proposed rates for these two rate classes do include increases in these components of the rate. One factor to be considered in determining the increases in the fixed component of the rates was whether the existing LP and LP CBM rate classes required further sub-division due to the disparity of load factor of the customers within these rate classes.

Powder River does not believe that there is a need to sub-divide these rate classes based on load factor. It is not uncommon at other cooperatives for Large Power rate classes, such as these for Powder River, to include customers with a wide range of load factors. The rate structure of both the LP and LP CBM rates include a bifurcated demand charge and an hour-use demand/energy charge. The bifurcated demand recognizes the differences between small and larger consumers while the hour-use demand/energy charge is employed specifically to recognize load factor. This rate structure has been utilized for many years and the cooperative continues to believe that it provides a fair and equitable pricing structure.

An issue of more concern to the Cooperative is the continuing decline of the CBM industry and the reduction of load in the CBM rate classes. The energy billing units for the LP CBM rate class in this application are roughly 18% less than in the last rate filing. The Cooperative anticipates that this decline in load will continue.

Ultimately, the Cooperative believes that the LP and LP CBM rate classes will need to be consolidated. Instead of sub-dividing the classes, it is more probable the rate classes will be combined. In anticipation of this, Powder River believes the best approach is to keep the fixed components of the LP and LP CBM rates similar in order to facilitate the merging of the rates.

Q. Please describe the proposed change to the LPT-CBM rate class.

A. The only change to the LPT-CBM class is the re-basing the COPA. The overall change to the class of 0.08% is only a result of rounding the charges.

Q. Please describe the change proposed for the LPT rate class?

A. The cost of service shows a very slight increase is needed for this class. This was achieved by an increase in the basic charge from $600 to $1,000, and and a slight increase in the retail demand charge from $0.80 to $0.88.

Q. The rate of return for the LPT-General class is 45.502%. Are any changes proposed for the LPT-General rate class?

A. There are no proposed changes to the retail charges. The only changes are from re-basing the COPA. The rate of return is higher for this class because there was a minimal amount of plant investment made by Powder River for this class. When there is little rate base for a class, it is appropriate to use margin as percent of revenue as a measure for class performance. Under the proposed rates, the margin as percent of revenue for the LPT-General class is 3.691%.

Q. What schedule in the rate filing provides the calculation of the proposed rates?

A. Schedule N-2.0 provides the calculation of the adjusted test year revenue and the proposed revenue under the proposed rates for all rate classes. The proposed rates developed on Schedule N-2.0 are reflected in the Proposed Tariffs.

Q. Have billing comparisons been developed for each of the major rate classes?

A. Yes. Section O contains the billing comparisons for each rate class. The billing comparisons provide the calculation of the billing under the existing rate and proposed rate at various usage levels. As reflected on Schedule O-2.0, the change for an average Residential customer using 1,206 kWh per month is an increase of $8.67 or 7.80%. The overall revenue requirement for the Residential class reflects an increase of 7.83%.

Q. Does this conclude your testimony?

A. Yes, it does.