STATE OF NEBRASKA
NEBRASKA POWER REVIEW BOARD

IN THE MATTER OF THE APPLICATION OF THE CITY OF NELIGH, NEBRASKA, TO MODIFY THE EXISTING RETAIL SERVICE AREA AGREEMENT 400 BETWEEN NELIGH AND ELKHORN RURAL PUBLIC POWER DISTRICT.	))))))	SAA 400-16-A **ORDER**

On the 28th day of September, 2018, the above-captioned matter came on for consideration before the Nebraska Power Review Board (the Board). The Board, being fully advised in the premises, and upon reviewing said application and the evidence presented to the Board, HEREBY FINDS AS FOLLOWS: (references to testimony are designated by a "T" followed by the volume, transcript page, then the lines upon which the testimony appears, while references to exhibits are designated by "Exh." followed by the exhibit number and, where applicable, the page number.

FINDINGS OF FACT

1. The Board adopts the Findings of Fact contained in the order issued by the Board on March 27, 2017.

2. In the March 27, 2017 order the Board made several determinations pertaining to the transfer of the service area rights for the territory annexed by Ordinances 578 ad 579, and the compensation owed by the City of Neligh (Neligh) to the Elkhorn Rural Public Power District (Elkhorn RPPD) for the customers and facilities in the

annexed territory or affected by the annexed territory. One of the Board's findings was that Neligh was not required to pay compensation to Elkhorn RPPD to relocate substation 71-18 as a result of the annexation in Ordinance 579 (south annexation). Following the issuance of the Board's March 27, 2017 order Elkhorn RPPD appealed the Board's decision to the Nebraska Court of Appeals. Out of the determinations issued in the Board's March 27, 2017 order, the issue upon which the appeal was predicated was the Board's decision that Neligh did not owe any additional compensation to Elkhorn RPPD based on the effect of the south annexation in Ordinance 579 on substation 71-18. The Nebraska Supreme Court (Supreme Court) removed the case to its docket.

3. On March 30, 2018 the Supreme Court issued a decision in which it reversed the Board's decision and remanded the matter for further proceedings. *In re Application of City of Neligh,* 299 Neb. 517 (2018). On April 16, 2018, the Supreme Court issued its mandate returning jurisdiction over the matter to the Board.

4. On April 30, 2018, the hearing officer met with both parties' counsels to discuss the procedures that would be followed to address the remand proceedings. Both counsels agreed that conducting a new evidentiary hearing would not be the best course. Both counsels agreed it would be appropriate for the Board to submit a limited number of questions to the parties to address the issues that would be raised in the remanded proceedings, followed by submittal of briefs. The Board subsequently issued an order presenting the parties with seven questions for the parties to address through whatever expert each party believed was most qualified to address the questions. (Exh. 20).

Elkhorn RPPD submitted two affidavits responding to the Board's questions. (Exh. 22). The City of Neligh (Neligh) submitted a sworn declaration. (Exh. 23). After submission of the answers to the Board's questions, each party submitted a brief.

5. On September 28, 2018, the Board heard oral arguments from both counsels and took the matter under advisement.

CONCLUSIONS OF LAW

6. Pursuant to Neb. Rev. Stat. §§ 70-1008 and 70-1010 the Board has jurisdiction to conduct a hearing and approve applications to transfer retail service territory that is the subject of an annexation. Pursuant to § 70-1010(2), if the parties involved in a proposed service area transfer based on an annexation cannot agree on the value of the service area, facilities and customers in the annexed area, the Board has the jurisdiction to determine the total economic impact on the selling supplier and establish the compensation accordingly.

7. Neb. Rev. Stat. § 70-1010(2)(a) provides that the annexing municipality will pay cash consideration to the power supplier with distribution facilities located inside the affected area, to include "the current reproduction cost if the facilities being acquired were new, less depreciation computed on a straight-line basis at three percent per year not to exceed seventy percent. . . ." Neb. Reb. Stat. § 70-1010(2)(b) provides that a municipal utility acquiring service area as the result of an annexation must pay cash compensation in "an amount equal to the nonbetterment cost of constructing any facilities

necessary to reintegrate the system of the supplier outside the area being transferred after detaching the portion to be sold . . . ."

8. In its Order issued on March 27, 2017, addressing the merits of the dispute, the Board set out in paragraph 34 the following:

> "34. Protestant asserts that the statutory language in § 70-1010(2)(b) entitles it to compensation for relocating substation 71-18. Applicant argues that any effect on the total economic impact is captured by the compensation Applicant will pay to Protestant for the loss of the customers and facilities located inside the south annexation that will be transferred to Applicant. (Vol. III, 16:11-19). The Board agrees with Applicant's position."

The Board acknowledges that its statement that "any effect on the total economic impact is captured by the compensation Applicant will pay to [Elkhorn RPPD] for the loss of the customers and facilities located inside the south annexation that will be transferred to [Neligh]" was erroneous. As the Supreme Court clarified in its opinion in the *Neligh* decision, the compensation awards under subsections (a), (b) and (c) of Neb. Rev. Stat. § 70-1010(2) are separate and distinct. *Neligh* at 525.

9. In its *Neligh* decision, the Supreme Court stated that "reintegration costs are based on the amount needed to compensate [Elkhorn RPPD] for the impact to its physical asset – the substation – and are not related to the loss of revenue or loss of facilities, which are provided for separately under § 70-1010(2)." *Id.* at 524. The Court went on to say "We held as much in *In re Application of City of Lexington*. In that case, we affirmed

the Board's decision, made on similar facts, that compensation was owed for surplus property – a transmission line substation and feeder circuits – lying outside of an annexed area." *Id.* at 524 (footnote omitted). As the Supreme Court indicated in *Neligh*, the facts in the present situation are almost a mirror image of the facts presented in *In re Application of City of Lexington*, 244 Neb. 62 (1993). In both instances, a municipality annexed territory and within one year filed an application with the Board to transfer the annexed territory to the municipality's retail service area. The transmission or distribution assets owned by the public power district was located outside, but near to, the annexed areas. The transmission assets outside the annexed area were directly and adversely affected by the annexation because a portion of the substation involved would be idled due to the loss of the customers in the annexed area. The loss of the load and affect on the substation therefore required compensation on the part of the municipality to the public power district. In fact, the overall effect on the assets involved were virtually identical. In both instances the impact on the affected transmission assets amounted to a loss of the use of 26% of the public power districts' assets in both *Lexington* and the present proceeding due to the loss of the load in the annexed areas. *Neligh* at 521 and 522; *Lexington* at 72.

10. In the *Lexington* case, the Supreme Court noted that the Board adopted the public power district's figure as the value of the substation, but reversed the Board on the portion of the Board's decision relating to the compensation owed to the public power district. The basis for the reversal was that the Board failed to calculate depreciation or

the potential adaptation of the substation to a reduced load. *Lexington* at 73. The Court remanded the proceeding to the Board "with directions to the Board to calculate the depreciated value of the substation based on the 3-percent-per-year statutory formula and to determine what share, if any, of that depreciated value is represented by equipment which has actually been rendered useless by the transfer." *Id.*

11. Under the direction of the Supreme Court's decision in *Lexington*, and pursuant to the remand in the present proceeding, it is the Board's understanding that it must determine the value of the substation. The Board must then "consider depreciation or the potential adaptation of the substation to a reduced load" in order to be consistent with the formula contained in § 70-1010(2). *Id.*

12. In its response to the questions posed by the Board, Elkhorn RPPD's expert witness determined the replacement value of substation 71-18 in 2016 dollars (the date when the application was filed) to be $690,834.97. (Exh. 22, pages 12-13). The Board accepts this as the replacement value of the substation as of the date of the filing of Neligh's application.

13. It is uncontested that the substation was built in or around 1998. *Neligh* at 520; Elkhorn RPPD's brief at 3. Thus, the substation was 18 years old at the time the application was filed in 2016.

14. Following the Supreme Court's direction set out in the *Lexington* case, the Board must calculate the depreciation on substation 71-18 as set out in § 70-1010(2)(a). To do so, the Board takes the $690,834.97 fair market value and multiplies that figure by

three percent. The resulting figure is an annual depreciation of $20,725.05. The annual depreciation must then be multiplied by 18 (the number of years the substation had been in existence at the time application SAA 400-16-A was filed). The resulting figure is $373,050.90. This is the amount of depreciation using a straight-line basis, which does not exceed seventy percent of the value of the substation. The Board must subtract the depreciation on the substation ($373,050.90) from the fair market value of the substation ($690,834.97), which results in a remaining replacement value for the substation of $317,784.07. As a result of Neligh's annexation, substation 71-18 will lose twenty-six percent of its load. The final calculation is therefore to determine the compensation owed to Elkhorn RPPD for the loss of twenty-six percent of the substation. Twenty-six percent of $317,784.07 equals $82,623.86. Following the Supreme Court's precedent in *Lexington*, the Board finds that $82,623.86 is the amount Neligh must pay Elkhorn RPPD for the economic impact of the loss of the use of twenty-six percent of substation 71-18 as a result of Neligh's annexation accomplished by Ordinance 579.

15. In its *Neligh* decision, the Nebraska Supreme Court cited to *City of Cookeville v. Upper Cumberland Electric Membership Corp.*, 484 F.3d 380 (6th Cir. 2007). In the *Cookeville* case, a municipal utility annexed territory that was part of the service area of the adjoining cooperative. The controlling Tennessee statute was very similar to section 70-1010(2). Under the Tennessee statute, a municipality can acquire the service area rights of the newly annexed territory, but the municipality is required to

compensate the cooperative for any facilities acquired by the municipality. The Court in *Neligh* quoted the following from the *Cookeville* decision:

> [Subsection (a)(2)(A) of the statute] provides for replacement costs for any facilities acquired by the municipality whereas [subsection (a)(2)(B)] then provides for the cost of constructing "necessary facilities to reintegrate the system of the cooperative." This scheme suggests that the reintegration costs are those necessary to reconnect the replaced facilities into the cooperative's existing electrical system. To bring the system back to "unity" would involve placing the system in as integrated a condition as existed prior to the annexation."

Neligh at 523.

It is crucial to point out that in *Cookeville*, the substation was located inside the annexed territory. In *Neligh*, as with *Lexington*, the substation involved was located outside the annexed territory. As the 6th Circuit explained in *Cookeville*,

> Tennessee law requires as part of the compensation that an annexing municipality must pay to an electric cooperative "[a]n amount equal to the cost of constructing any necessary facilities to reintegrate the system of the cooperative outside the annexed area after detaching the portion to be sold." Tenn. Code. Ann. § 6-51-112(a)(2)(B).

Cookeville at 392. The fact that substation 71-18 is located outside the annexed territory is an important distinction from the facts in the *Cookeville* case. If substation 71-18 were located inside the south annexation territory acquired by Neligh, the city would need to

compensate Elkhorn RPPD for the reproduction cost of the facilities, less depreciation computed on a straight-line basis at three percent per year, as set out in § 70-1010(2)(a), and then the city would also need to pay the nonbetterment costs to construct any facilities necessary to reintegrate the system of the supplier outside the area being transferred after detaching the portion to be sold, as required by § 70-1010(2)(b). Just as in *Lexington*, the substation involved in the present proceeding is located outside the annexed territory. Thus, under the Supreme Court's precedent in *Lexington*, the substation essentially becomes surplus property, and the municipality must compensate the adjoining public power district or cooperative by applying the formula set out in § 70-1010(2)(a). Thus, the Board's calculations set out above follow the precedent established in *Lexington*.

16. The language in the *Cookeville* case indicates the 6th Circuit believed that compensation was owed to the cooperative under the equivalent of 70-1010(2)(b) because the substation would need to be removed from the municipality's newly annexed territory that would become part of the municipality's retail service area. The substation would therefore necessarily be removed from the cooperative's distribution system as a result of the annexation. Thus, the substation had to be moved to a new location inside the cooperative's remaining retail service area. The court in *Cookeville* stated "This scheme suggests that the reintegration costs are those necessary to reconnect the replaced facilities into the cooperative's existing electrical system." *Cookeville* at 392. Substation 71-18 does not need to be "reconnected" to Elkhorn's existing system, as the

substation is currently, and will remain, part of Elkhorn's transmission and distribution grid system inside Elkhorn's service area. Of course, 26% of the substation will be idled and no longer needed due to the annexation, requiring Neligh to compensate Elkhorn for the loss of that 26% of the substation.

17. *Cookeville* is very useful to demonstrate why the Board's statement in paragraph 34 of its March 27, 2017 order was erroneous. As stated in paragraph 8 of this order, the compensation owed under 70-1010(2)(c) by a municipality to a public power district or cooperative which loses revenue due to the loss of customers in an annexed territory is separate and distinct from the compensation owed for the costs associated with the impact on facilities under 70-1010(2)(a) and (b). However, *Cookeville* does nothing to diminish the Nebraska Supreme Court's precedent established in *Lexington* that when faced with a situation where a municipality must compensate a public power district or cooperative for facilities located outside the annexed territory, compensation will be calculated under 70-1010(2)(a) by determining the reproduction costs of the facilities if they were new, less depreciation computed on a straight-line basis at three percent per year, not to exceed seventy percent. In *Cookeville*, the 6th Circuit noted that "Cookeville agreed to pay UCEMC $1,136,325.25 for the present-day reproduction cost, new, less depreciation of UCEMC's electric distribution properties located in the annexed areas." *Cookeville* at 385.

18. The only issue on appeal was the determination of what compensation Neligh owes to Elkhorn RPPD due to the effect of the annexation in Ordinance 579 on

substation 71-18. It is the Board's belief that the remaining portions of the Board's Conclusions of Law and Order issued on March 27, 2017 remain intact. However, to avoid any possible uncertainty, those portions of the Board's order that were not involved in the appeal will be restated in this order.

ORDER

The City of Neligh has the right to acquire the retail service area rights, customers and facilities in the territory annexed by Ordinances 578 and 579.

The retail service area rights to the territory annexed by Ordinance 578 (north annexation) is hereby transferred from Elkhorn Rural Public Power District to the City of Neligh. The Baker and Bomgaars customers located in the annexed territory are already being lawfully served by the City of Neligh, and therefore no transfer of those two customers needs to take place. The City of Neligh is not required to provide any compensation to the Elkhorn Rural Public Power District for the loss of revenue for these two customers as a result of annexation 578, as the customers are not "existing customers" of Elkhorn Rural Public Power District under Nebraska law and the District has no revenues from sales of electricity to those customers.

The retail service area rights to the territory annexed by Ordinance 579 (south annexation) is hereby transferred from Elkhorn Rural Public Power District to the City of Neligh. The customers and distribution facilities in the territory annexed by Ordinance 579 shall be transferred from the Elkhorn Rural Public Power District to the City of Neligh upon payment of the amounts owed by Neligh to the Elkhorn RPPD. The amount

owed shall consist of the agreed-upon sum of $490,445.90, plus the compensation for the effect of the annexation on substation 71-18, consisting of the loss of twenty-six percent (26%) of the substation's load, which amounts to $82,623.86. The total amount owed by Neligh to the Elkhorn RPPD is therefore $573,069.76. If the City of Neligh has already paid $490,445.90 to the Elkhorn Rural Public Power District, the City of Neligh is only responsible for the remaining $82,623.86. If the City of Neligh should fail to make the appropriate payment to Elkhorn Rural Public Power District within one year after the date this order is issued, its right to acquire the existing customers and distribution facilities is waived.

Upon making full payment to the Elkhorn Rural Public Power District for the customers and distribution facilities affected by or in the area annexed by Ordinance 579 as set out in this order, the City of Neligh shall provide written certification to the Board, with a copy provided to the Elkhorn Rural Public Power District, that payment has been accomplished. The Board's staff will then update the Board's certified service area records to reflect that Neligh has acquired the applicable customers and facilities.

Reida (Chair), Morehouse (Vice Chair), Grennan, Hutchison and Moen.

BY: _____
Frank J. Reida
Board Chairman

DATED: November 16th, 2018.

CERTIFICATE OF SERVICE

I, Timothy J. Texel, Executive Director and General Counsel for the Nebraska Power Review Board, hereby certify that a copy of the foregoing **ORDER** has been served on the following persons at the addresses indicated via certified U.S. mail to the following parties on the 16th day of November, 2018.

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