




Cumberland Valley Electric

A Touchstone Energy Cooperative 

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COMMISSION

November 25, 2014

Mr. Jeff Derouen
Executive Director
Kentucky Public Service Commission
211 Sower Boulevard
P.O. Box 615
Frankfort, Kentucky 40602-0615

RE: Application of Cumberland Valley Electric Cooperative
Corporation for an Adjustment of Rates
Case No. 2014-00159

Dear Mr. Derouen:

Enclosed please find for the proper filing thereof an original and ten (10) copies of the Brief of Cumberland Valley Electric Inc. in the above referenced matter. We are also providing a copy of this filing to all counsel of record.

Should you have any questions or need further information, please let me know.

Respectfully Submitted,



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**Attorney for
Cumberland Valley Electric, Inc.**

Enclosures

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the matter of:

ADJUSTMENT OF RATES)
FOR CUMBERLAND VALLEY) CASE NO. 2014-00159
ELECTRIC)

BRIEF

*** *** *** ***

Comes now the Petitioner, Cumberland Valley Electric (therein referred to as "Cumberland Valley") and for its brief in support of its application to change its retail electric power rates submits the following:

INTRODUCTION

Cumberland Valley has filed an application requesting permission from the Commonwealth of Kentucky Public Service Commission (hereinafter referred to as "Commission") to increase its base rates effective for all electric power sold, and for its CATV charges.

Cumberland Valley filed an application for an increase in base rates of 3.95 percent which amounts to an increase in revenue of approximately \$1,605,000 based on a test year of January through December 2013. This amount of increase will

provide Cumberland Valley with sufficient revenue to meet its mortgage requirements for the near term and until the period when the interest rates on its loans begin to rise based on market conditions.

The primary issues in this application are the following ones:

- Cumberland Valley not in compliance with its mortgage agreement for 2012 and 2013;
- The amount of increase requested;
- The basis for the determination of the appropriate amount of margins and revenue requirements;
- Rate design especially in regards to the customer charge for Schedule I - Farm, Home and School Rate; and
- Cumberland Valley's remarkable debt management.

Cumberland Valley is in a very unique situation. It has not met its mortgage agreements for the calendar years of 2012 and 2013. It did not meet its Operating Times Interest Earned Ratio ("OTIER") of 1.10 for these two years. Cumberland Valley did not meet its mortgage requirements primarily due to a significant decrease in energy sales due to the loss and or

reduction of energy sales to coal companies in the Appalachian coal fields served by Cumberland Valley.

Cumberland Valley would most probably have needed to file for an increase in rates several years sooner if it had not been able to remarkably manage its debt. Cumberland Valley was able to reduce its annual interest expense from over \$1.6 million in 2007 to \$354,342 for 2013. This remarkable feat was accomplished through the very astute management of very low; short term interest rates on approximately 85 percent of its debt.

Cumberland Valley is a financially prudent managed electric cooperative whose electric rates are among the lowest in the Commonwealth and will remain such even if it is granted its complete increase requested amount. The application of the traditional method of determining revenue requirements for a rural electric cooperative needs to be altered in this situation. If Cumberland Valley had used the traditional method of determining its amount of increase, it would be seeking an increase in an amount of less than \$500,000. This amount of increase applied to a twelve month period ending September would still leave Cumberland Valley in noncompliance with its mortgage agreement.

ISSUES

Mortgage Agreement Noncompliance

The issue that created the immediate need for an increase in rates for Cumberland Valley was its noncompliance with its mortgage agreement with its lenders, primarily the Rural Utilities Service ("RUS") for the years of 2012 and 2013. Cumberland Valley had an OTIER of 0.71 for each of those years. This situation has not turned around for Cumberland Valley in 2014. Please see the Statement of Operations for the twelve month period ending September 30, 2014 identified as Exhibit I and indicates an operating loss of almost \$600,000 for the period which has an OTIER of (0.69). **The year of 2014 is a further deterioration of the financial situation of Cumberland Valley and clearly demonstrates the need for rate relief.**

Amount of Increase:

If Cumberland Valley used the traditional approach in determining its revenue requirements using actual interest rates and a TIER of 2.0X, the amount of increase it would have requested from the Commission would have amounted to \$491,611. Cumberland Valley and its consultant felt like this amount of increase would be completely insufficient on an ongoing basis when this case was being developed early in the second quarter

of the test year. An alternative approach was needed and it was determined that the use of an interest rate for all debt based on a period much longer than the very low interest rates that Cumberland Valley is experiencing on its current short term debt was reasonable. It was decided to use the interest rate for a seven year period in the middle of April 2014 in the amount of approximately 2.17 percent and apply it to all debt including the current long term debt priced at a much higher interest rate. This approach for interest expense plus margins based on a TIER of 2.0X for the above interest expense became the basis for requested increase of approximately \$1,605,000.

A cursory review of the Statement of Operations in Exhibit I provide clear evidence that the traditional approach to determining revenue requirements for an electric distribution cooperative is not applicable in this situation and indicates a major shortcoming with the TIER approach. Cumberland Valley feels that its approach is reasonable and very understandable in this situation. A better approach is one that would be based on the idea of a return on equity as the basis for establishing a margin level for a distribution cooperative's determination of revenue requirements.

The Capital Growth Method is by and far the best approach for determining a return on equity amount for a distribution

cooperative. It is the best model because it does integrate the current equity position of a cooperative, its target date to arrive at its optimal equity level, its cycle for the payment of capital credits to its members and other factors. Cumberland Valley used this model to validate the results from its approach to revenue requirements and this approach indicated a larger increase amount could be justified. A copy of the application of the Capital Growth Method to Cumberland Valley's situation is attached as Exhibit II to this document.

Rate Design

Cumberland Valley is proposing to place this increase on the customer charge component of each rate class with one exception where a slight increase in an energy rate is justified. Three of Cumberland Valley's current rate classes have no customer charge whatsoever while the other two classes have very low customer charges. Cumberland Valley is suggesting the below customer charge changes for its proposed rate design.

CUSTOMER CHARGE INFORMATION				
Schedule	Description	Current Customer Charge	Customer Charge	Customer Revenue Requirements
I	Residential, Farm & Church	\$ 5.74	\$ 10.70	\$ 23.41
II	Small Commercial -Energy	\$ 5.74	\$ 11.04	\$ 25.06
II	Small Commercial w/Demand	\$ 5.74	\$ 11.04	\$ 51.24
III	3 Phase Schools & Churches	\$ -	\$ 40.00	\$ 48.89
IV	Large Power > 2500 kW	\$ -	\$ 50.00	\$ 53.81
IV-A	Large Power - 50-2500 kW	\$ -	\$ 40.00	\$ 51.34

Cumberland Valley has very low customer charge rates for all of its rate classes and Cumberland Valley believes it is reasonable and appropriate to approve them as proposed. Many other cooperatives under the jurisdiction of the Commission have customer charge rates much higher than those proposed by Cumberland Valley. The above table on customer charge information clearly depicts that Cumberland Valley's proposal on customer charge changes are very prudent as well as cost justified.

Debt Management

Cumberland Valley's financial management team has demonstrated a most laudable performance in its debt management since Cumberland Valley's most recent rate application. It has been able to reduce its annual interest expense from in excess of \$1.6 million in 2007 to approximately \$350,000 during the test year 2013 while its debt has increased during this same

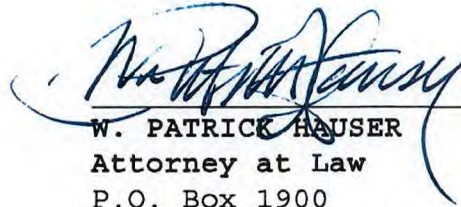
period from \$31 million to approximately \$43 million. A remarkable performance of exemplary debt management has been demonstrated by the Cumberland Valley financial team.

CONCLUSION

Cumberland Valley has prepared and filed an application for the adjustment of its rates with the Commission that is consistent with the Capital Management Policy of its Board of Directors and is needed for Cumberland Valley to be in compliance with its mortgage agreements. Cumberland Valley has taken a financially prudent approach to adjust its electric rates. If the amount of increase requested is not granted, then Cumberland Valley will most likely have the need to file a rate application early in the second quarter of 2015 with a test year of calendar year 2014.

Cumberland Valley has taken a different approach in the determination of its revenue requirements in order that it does not become engaged in crisis management that could result if a substantial reduction of its increase request is not granted by the Commission. Cumberland Valley has demonstrated that it needs the full amount of the increase requested and has utilized a cost of service study to justify the amount of increase for each class and the application of the increase to the customer charge rates for all rate classes.

Respectfully submitted,



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ELECTRIC COOPERATIVE

CERTIFICATE OF SERVICE AND FILING

Counsel hereby certifies than an original and ten photocopies of the foregoing were hand-delivered on November 25th, 2014 to Jeff Derouen, Executive Director, Public Service Commission, 211 Sower Boulevard, Frankfort, Kentucky 40601; counsel further states that a true and correct copy of the foregoing was mailed via First Class U.S. Mail, postage pre-paid, to:

Hon. Angela M. Goad
Assistant Attorney General
1024 Capital Center Drive, Suite 200
Frankfort, KY 40601-8204

This the 25th day of November, 2014.



W. PATRICK HAUSER

CUMBERLAND VALLEY ELECTRIC

CASE NO. 2014-00159

STATEMENT OF OPERATIONS

FOR THE TWELVE MONTHS ENDING SEPTEMBER 30, 2014

Exhibit I

October 2013 Thru
September 2014

Operating Revenue	47,446,093
Cost of Purchased Power	36,631,903
Gross Margin	<u>10,814,190</u>
Distribution Operations	1,466,340
Distribution Maintenance	2,738,813
Consumer Accounts	1,866,986
Consumer Serv & Infor	156,751
Sales	-
Admin & General Expense	1,480,624
Total Oper & Maint Expense	<u>7,709,514</u>
Depreciation Expense	3,220,023
Tax Expense	107,619
Interest on Long Term Debt	352,190
Interest Expense - Other	2,433
Other Deductions	17,957
Total Cost of Distribution Service	<u>11,409,736</u>
Operating Margins	(595,546)
Non-Operating Margins Interest	121,296
Other Capital Credits	98,173
GTCC's	2,957,019
Other Income (Expenses)	-
Net Margins	<u><u>2,580,942</u></u>

CUMBERLAND VALLE ELECTRIC
CASE NO. 2014-00159

CAPITAL GROWTH METHOD APPLIED TO CUMBERLAND VALLEY ELECTRIC

Formula

$RORE = (Rng + Rbe + Rep)$

Rng=Normal rate of capital growth

Rbe=rate of growth required to build equity

Rep=Rate of Equity payout

Capital

Equity \$ 19,517,122

Debt 42,813,061

Total Capital \$ 62,330,183

Results - Margins

$Rbe = (1 + Rng)(A/E)$

A= Target Equity a:

I= Current Dollar A

n= years to achieve

E= Current dollar A

Equity Target & Time Line	Rbe	Rng	Rep	Total	Margins
40% - 10 yr	0.0555	0.030	0.0300	0.1155	\$ 2,254,856
40% - 20 Yr	0.0427	0.030	0.0300	0.1027	\$ 2,004,173
35% - 10 Yr	0.0415	0.030	0.0300	0.1015	\$ 1,981,597
35% - 20 Yr	0.0357	0.030	0.0300	0.0957	\$ 1,868,756
35% - 15 Yr	0.0377	0.030	0.0300	0.0977	\$ 1,906,307
40% - 15 yr	0.0470	0.030	0.0300	0.1070	\$ 2,087,410

Results - Increase Amount

Equity Target & Time Line	TIER	Normalized TY Margins	Amount of Increase
40% - 10 yr	7.36	(137,289)	2,392,145
40% - 20 Yr	6.66	(137,289)	2,141,462
35% - 10 Yr	6.59	(137,289)	2,118,886
35% - 20 Yr	6.27	(137,289)	2,006,045
35% - 15 Yr	6.38	(137,289)	2,043,596
40% - 15 yr	6.89	(137,289)	2,224,699

Test Year Interest
\$ 354,342