COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF LICKING VALLEY RURAL	)	
ELECTRIC COOPERATIVE CORPORATION	)	CASE NO. 98-321
TO ADJUST ELECTRIC RATES	)	

O R D E R

On August 18, 1998, Licking Valley Rural Electric Cooperative Corporation (Licking Valley) applied for a $810,221 increase in retail electric service rates. The requested increase is 6.20 percent over normalized test-year operating revenues. Licking Valley stated that the proposed increase was required to cover increased operating costs, improve its financial condition, and provide the margin necessary to meet the requirements of its joint mortgage agreement. By this Order, the Commission grants Licking Valley an increase in revenues of $727,526 or a 5.44 percent increase over normalized test-year operating revenues.

The Commission granted motions to intervene filed by the Office of Rate Intervention of the Office of the Attorney General (AG) and the Kentucky CATV Association, Inc., d/b/a The Kentucky Cable Telecommunications Association (KCTA).

An informal conference was held on October 15, 1998, to discuss the cost-of-service model used and the resulting study supplied in this rate proceeding. A public hearing was conducted on December 16, 1998, and all information requested during the hearing has been submitted.

COMMENTARY

Licking Valley is a consumer-owned rural electric cooperative corporation, organized under KRS Chapter 279, engaged in the distribution and sale of electric energy to approximately 21,193 member-consumers in the Kentucky counties of Breathitt, Elliott, Lee, Magoffin, Menifee, Morgan, and Wolfe. Licking Valley has no electric generating facilities and purchases its total power requirements from the East Kentucky Power Cooperative, Inc. (East Kentucky).

TEST PERIOD

Licking Valley proposed and the Commission has accepted the 12-month period ending March 31, 1998 as the test period for determining the reasonableness of the proposed rates. In utilizing the historical test year, the Commission has considered appropriate known and measurable changes.

VALUATION

Licking Valley proposed a net investment rate base of $24,695,039 based on the test-year-end value of plant in service, the 13-month average for materials and supplies and prepayments, and excluding the adjusted accumulated depreciation and the test-year-end level of customer advances for construction. Licking Valley also proposed to include working capital based on one-eighth of adjusted operating expenses, exclusive of purchased power, depreciation, taxes, and other deductions. The Commission concurs with this proposal with the exception that working capital has been adjusted to reflect the pro forma adjustments to operating expenses found reasonable herein.

Based on these adjustments, Licking Valley s net investment rate base for rate-making purposes is as follows:

Utility Plant in Service	$ 30,633,866
Construction Work in Progress	323,318
Total Utility Plant	$ 30,957,184
ADD:	
Materials and Supplies	$ 335,090
Prepayments	223,000
Working Capital	379,097
Subtotal	$ 937,187
DEDUCT:	
Accumulated Depreciation	$ 7,133,748
Customer Advances for Construction	319,706
Subtotal	$ 7,453,454
NET INVESTMENT RATE BASE	$ 24,440,917

Capital Structure

The Commission finds that Licking Valley s capital structure at test-year-end for rate-making purposes was $26,301,907. This capital structure consisted of $10,075,743 in equity and $16,226,164 in long-term debt. The Commission has excluded generation and transmission capital credits (GTCCs) in the amount of $2,502,416.

REVENUES AND EXPENSES

Licking Valley proposed several adjustments to revenues and expenses to reflect current and expected operating conditions. The Commission finds the proposed adjustments are generally proper and acceptable for rate-making purposes, with the following modifications:

Customer Growth Adjustment

The AG proposed a $44,897 increase in revenue to compensate for Licking Valley s customer growth. The AG s witness testified that Licking Valley had experienced significant growth in the number of customers it serves in recent years, but had failed to include an end of test year adjustment. The AG proposed an adjustment based on the average number of customers for each rate class for the test year and the three previous years. In previous electric cooperative rate cases, the Commission has found that a customer growth adjustment based on the last month of the test year is more reasonable. Using the test-year-end number of customers, Licking Valley s test year revenue would be increased by $72,996 to compensate for customer growth. The AG agreed with the use of test-year-end customers and, therefore, the Commission will adopt this adjustment.[1]

Labor and Labor-Related Costs

Licking Valley proposed adjustments to increase the test-year operating expenses by $30,767 for labor and labor-related costs. The adjustment consisted of increases to wages and salaries, payroll taxes, and post-retirement benefits.

Wages and Salaries. In its application, Licking Valley proposed an adjustment to normalize total wages and salaries in the amount of $35,042, of which $11,915 was capitalized and $23,127 was expensed. Full-time employees were assumed to work 2,088 hours. Part-time employees were assumed to work the number of hours actually worked during the test year. Employees terminated during the test year were excluded from the calculations. The test-year actual overtime hours were included at 1.5 times the test-year-end wage rates.

The Commission finds most of Licking Valley s assumptions to be reasonable, except in three specific areas. First, rather than using 2,088 hours, the Commission

[1] AG s Response to the Commission s November 13, 1998 Order, Item Nos. 1 and 2.

used 2,080 because this reflects the normal hours in a standard work year.[2] Second, the Commission excluded the bonuses and a vacation payout made to three salaried employees from test-year expenses when determining the wage and salary adjustment because these payments were of a non-recurring nature.[3] Finally, overtime hours worked in conjunction with a February 1998 snow storm were removed from the test-year-end level of overtime hours. This adjustment is necessary in order to establish a reasonable, on-going level of overtime to be recognized in rates.

Recalculating the adjustment based on these three changes results in a decrease in wages and salaries of $77,024. After applying the test-year capitalization rate of 34 percent, the Commission finds that an adjustment to decrease the expense by $50,836 is reasonable.

Payroll Taxes. Licking Valley proposed to increase its payroll taxes[4] by $4,225, based on the proposed normalized wages and salaries and reflecting an increase in the Federal Insurance Contribution Act (FICA) base wage limit from $65,400 to $68,400. Of this amount, $1,099 was capitalized and $3,126 was expensed.

---

[2] 8 hours per day X 5 days a week X 52 weeks = 2,080 hours.

[3] Response to the Commission s September 2, 1998 Order, Item 3 and Response to the Commission s October 1, 1998 Order, Item 1. The vacation payout was a one-time payment for vacation time not taken due to extra work required due to the absence of an Office Manager at Licking Valley. One bonus was awarded to a salaried employee who was also performing additional duties normally performed by the Office Manager. The other bonus was awarded to a salaried employee in recognition of extra work performed during the February 1998 snow storm, and was identified as a one-time payment.

[4] Payroll taxes include FICA, Medicare, and Federal and State Unemployment.

The Commission has recalculated this adjustment, based on the level of normalized wages and salaries found reasonable and using the FICA base wage limit of $68,400. This results in a reduction in payroll taxes of $8,203. After applying the test-year capitalization rate, the reduction in payroll tax expense would be $6,070.

The Commission is also reducing the payroll tax expense by $704, related to FICA tax expense on life insurance coverage provided by Licking Valley to its employees. This adjustment is discussed in detail later in this Order. Therefore, the Commission will reduce operating expenses by $6,774.

Post-Retirement Benefits. Licking Valley proposed an increase in its annual accrual for post-retirement benefits of $6,638. Of this amount, $2,124 was capitalized and $4,514 was expensed. Licking Valley determined the level of increase by applying the percentage increase in its medical and life insurance cost between 1997 and 1998 to the annual accrual.

Licking Valley accounts for its post-retirement benefits in accordance with the requirements of Statement of Financial Accounting Standards No. 106, which it adopted in 1994. Licking Valley originally determined its annual accrual to be $77,880 and has continued to use this accrual without a recalculation. In response to a Commission Order,[5] Licking Valley recalculated its annual accrual as of test-year-end. This recalculation indicated that the annual accrual should have been $96,900, an increase of $19,020 over the test year accrual. Licking Valley indicated that it would be more accurate to use the recalculated annual accrual in this rate proceeding.[6]

---

[5] Response to the Commission s September 2, 1998 Order, Item 11.

[6] Transcript of Evidence (T.E.), December 16, 1998, at 40 41.

The Commission agrees with Licking Valley that the recalculated annual accrual should be the amount recognized in the adjustment to this operating expense. After applying the test-year capitalization rate to the $19,020 increase, the Commission will include an adjustment to increase the expense by $12,934.

Employee Life Insurance. Licking Valley provides its employees with $80,000 of life insurance coverage at no cost to its employees. Licking Valley has not performed any analyses or surveyed other cooperatives in order to determine that $80,000 was an appropriate level of life insurance coverage. While Licking Valley has provided this benefit to employees for at least 25 years, and at this level since 1992, it has not performed any formal compensation studies to support the practice.

While the Commission does not view the provision of life insurance coverage for a utility s employees unfavorably, we are concerned about Licking Valley s current practice. Under current federal law, the cost for insurance coverage in excess of $50,000 constitutes wages subject to FICA taxes.[7] Once the $50,000 coverage level is reached, Licking Valley incurs additional employer-share FICA tax expense. To include the expenses associated with employee life insurance coverage in excess of $50,000, utilities must clearly demonstrate the need for this additional compensation. Licking Valley has not done so. Therefore, the Commission has limited test-year life insurance premium expense to the cost to provide each Licking Valley employee with $50,000 of coverage. This results in a reduction in operating expenses of $4,150. A corresponding reduction has also been made to test-year FICA tax expense, based upon the additional income provided to the employee as determined by Internal Revenue Service tables.

[7] 26 U.S.C § 79 (1992).

PSC Assessment

Licking Valley proposed an increase in its PSC Assessment of $2,006 to reflect the effects of its normalization of revenues and purchased power expense, as well as the impact of its proposed revenue increase. Licking Valley followed the methodology normally used to determine the assessable revenues and applied the PSC Assessment rate in effect for 1998. However, Licking Valley s revenue figure did not agree with its total adjusted revenues and the purchased power figure did not recognize Licking Valley s proposed normalization adjustments.

The Commission has recalculated the adjustment to reflect the normalization of revenue and purchased power found reasonable in this Order and applied the current PSC Assessment rate. This calculation results in an increase in the PSC Assessment of $3,921. The Commission has also determined the impact of the revenue increase granted herein and provided for an additional PSC Assessment expense of $1,330. Finally, in accordance with the Uniform System of Accounts, the Commission has reclassified the expense, recording it in Account No. 408 Taxes Other Than Income Taxes, rather than in Account No. 928 Regulatory Commission Expense.[8]

Rate Case Expense

Licking Valley estimated its rate case expense at $33,000. It proposed to recover this expense through a three-year amortization. This estimate did not include in-house labor. Throughout this proceeding, Licking Valley has been providing updates of the actual expenses incurred in presenting this rate case. As of the November 28,

[8] The reclassification will impact the calculation of the working capital included in Licking Valley s net investment rate base.

1998 update, Licking Valley has expended $20,058 for this rate case. The Commission finds that a three-year amortization of these expenses is reasonable and will allow an increase in operating expense of $6,686 to reflect the first year of the amortization.

Advertising Expenses

Licking Valley proposed a reduction of $820 in advertising expenses related to promotional and institutional advertising. During the proceeding, an additional $2,852 in advertising expenses were examined because the advertisements appeared to be of an institutional or political nature.[9] Licking Valley agreed that the majority of the questioned advertisements were of an institutional or political nature and should be excluded for rate-making purposes. However, Licking Valley noted that a portion of some of the advertisements included its telephone number for reporting outages and contained its office hours. Licking Valley contended that a portion of the advertisement expense related to providing this information to consumers should be included for rate-making purposes.

The AG disagreed with Licking Valley, arguing that if consumers needed to report outages, the telephone book listing would be consulted rather than a newspaper or magazine advertisement. The AG contended that these advertisements in total provided no benefit to the consumer and the $2,852 expense should be excluded for rate-making purposes.[10]

The Commission agrees with the AG. The inclusion of Licking Valley s telephone number or office hours on promotional, institutional, or political advertising does not

[9] Response to the Commission s October 1, 1998 Order, Item 18.

[10] Brown Kinloch Direct Testimony at 16-17.

change the nature of the advertisement. This information is readily available from other sources, and its inclusion on these advertisements does not benefit Licking Valley s consumers. Therefore, the Commission has reduced advertising expenses by a total of $3,672.

Miscellaneous Expenses

Licking Valley proposed a reduction of $1,732 in miscellaneous expenses for the cost of flowers for employees and an employee cookout. The Commission has reviewed the proposed adjustment and accepts it. The AG proposed a further reduction of $3,752 in miscellaneous expenses relating to the payment of dues to Touchstone Energy, the awarding of scholarships at the annual meeting, and payments made to Licking Valley s directors nominating committee.[11] The AG contended that Touchstone Energy is an attempt by rural cooperatives to develop a national brand identity for marketing purposes if electric utilities are deregulated in the future. As such, the expense is not necessary for the provision of electric service to consumers today, and should be disallowed. The AG also noted that the Commission has traditionally excluded scholarships and nominating committee expenses, and argued that the Commission should do so in this proceeding.

Licking Valley has agreed that the dues paid to Touchstone Energy and the scholarships should not be included for rate-making purposes.[12] Concerning the payments to the nominating committee, the Commission has concluded in other

[11] Id. at 15. The AG did not acknowledge in his testimony that Licking Valley had already removed flowers for employees and the employee cookout.

[12] Response to the Commission s September 2, 1998 Order, Items 13 and 14.

cooperative rate proceedings that such payments are not consistent with the cooperative spirit and shared responsibility which non-profit cooperatives embody. While Licking Valley has stated that the nominating committee is required by its bylaws, it has offered no other evidence to support the practice. In addition, this payment is not of a recurring nature since Licking Valley elects all its directors in the same year, for three year terms. The Commission agrees with the AG and will exclude the payments to the nominating committee. Therefore, miscellaneous expenses have been reduced by a total of $5,483.

Federal Emergency Management Agency (FEMA) Adjustment

During February 1998, Licking Valley experienced a severe snow storm throughout its service territory. FEMA declared the counties in the service territory to be disaster areas and eligible for emergency funds. Licking Valley estimated that it would receive $208,102 from FEMA as reimbursement for storm-related expenses. Licking Valley proposed to recognize the FEMA reimbursement as a reduction to its operating expenses.

During the test year, Licking Valley s hourly employees earned 4,111 hours of overtime associated with the February 1998 storm.[13] Licking Valley included the cost of these overtime hours in its FEMA reimbursement request. As noted previously in this Order, the Commission s normalization of wages and salaries did not include the effects of these overtime hours. Because of this exclusion, it is appropriate to adjust the estimated FEMA reimbursement by the overtime expense related to the February 1998 storm.

[13] Id., Item 5, page 3 of 3.

Using the appropriate hourly wage rates, the Commission has determined that these overtime hours reflect a cost of $95,683, with a corresponding payroll tax impact of $7,320. After applying the appropriate test-year capitalization rates, the overtime expense would be $63,151 and the related payroll tax expense would be $5,417. Therefore, the Commission will recognize an operating expense reduction of $139,534, which reflects Licking Valley s estimated FEMA expense reimbursement net of the overtime and payroll tax expense previously excluded.

Professional Services Expense

These expenses include legal and accounting services provided to Licking Valley.

Legal Expenses. During the test year, Licking Valley incurred expenses to send its attorney to cooperative association seminars and annual meetings, provided a subscription to an industry publication, and paid a Christmas gift. Licking Valley acknowledged that the Christmas gift should not be included for rate-making purposes. However, Licking Valley contends that the seminars, annual meetings, and industry publication provide its attorney with electric industry information and allow for discussion of legal issues unique to the electric industry. The Commission finds no evidence that these expenses are either reasonable or consistent with normal business practice. The Commission has excluded these expenses for rate-making purposes.

Licking Valley also paid an attorney to serve as provost for its 1998 annual meeting. Under Licking Valley s bylaws, the provost supervises the directors election in conjunction with the annual meeting. However, this expense is a non-recurring item, since the scheduled directors election occurs only once every three years. Therefore, the Commission has also excluded this expense for rate-making purposes.

Accounting Expenses. Licking Valley retained professional accounting services to assist it with the implementation of functional accounting procedures. Licking Valley has indicated that this expense should not be of a recurring nature. Therefore, the Commission has excluded this expense for rate-making purposes.

The Commission has reduced Licking Valley s operating expenses by $2,221, which reflects the exclusion of legal and accounting professional services expense discussed above.

Directors Fees and Expenses

During the test year Licking Valley paid its eight directors fees and expenses totaling $49,403. The AG proposed to reduce these expenses by $726, to remove Christmas gifts paid to the directors and the costs associated with a director attending the Congressional breakfast, which the AG contends is a lobbying activity.[14] Licking Valley agreed that the Christmas gifts should not be included for rate-making purposes. The Commission agrees with the AG and will exclude these items for rate-making purposes. In addition, after reviewing all of the fees and expenses, the Commission finds that a further reduction of $5,662 should be made for the following items:

NRECA, KAEC, and East Kentucky Annual Meetings.[15] Licking Valley paid the expenses for several of its directors to attend these annual meetings. In previous

---

[14] Brown Kinloch Direct Testimony, at 16.

[15] National Rural Electric Cooperatives Association (NRECA) and Kentucky Association of Electric Cooperatives (KAEC).

cooperative rate cases, the Commission has found it to be excessive to include annual meeting expenses for directors who were not the designated delegate or alternate. In this case, Licking Valley has failed to persuade us that the attendance by these other directors is necessary and reasonable. Therefore, the Commission has reduced directors expenses by $1,835.

Extra Per Diem for Secretary/Treasurer. Licking Valley s directors had adopted a policy where the Secretary/Treasurer is paid an additional monthly per diem for the time involved in carrying out official duties.[16] Licking Valley claimed it was necessary for the Secretary/Treasurer to be available during normal business hours to sign various legal documents and checks. The Commission finds that Licking Valley has not adequately demonstrated that this practice is necessary or reasonable. We will exclude $3,600 from expenses for this item.

Director s Board Room Picture. During the test year, Licking Valley paid $227 to have a director s picture taken and framed for its board room. The Commission finds that this expense is not of a recurring nature, and will exclude it for rate-making purposes.

Pro Forma Adjustments Summary

The effect of the pro forma adjustments on Licking Valley s net income is as follows:

[16] Exhibit 10 of the Application, page 3 of 15, Policy Number 108.

	Actual Test Period	Pro Forma Adjustments	Adjusted Test Period
Operating Revenues	$12,693,111	$ 690,397	$13,383,508
Operating Expenses	11,821,358	464,899	12,286,257
Net Operating Income	871,753	225,498	1,097,251
Interest on Long-Term Debt	765,390	173,711	939,101
Other Income and (Deductions) Net	17,907	36,845	54,752
NET INCOME	$ 124,270	$ 88,632	$ 212,902

REVENUE REQUIREMENTS

Revenue Increase

The actual rate of return earned on Licking Valley s net investment rate base established for the test year was 3.63 percent. Licking Valley requested rates that would result in a Times Interest Earned Ratio (TIER) excluding GTCCs of 2.00X and a rate of return of 7.61 percent on its proposed rate base of $24,695,039.

Licking Valley s actual TIER excluding GTCCs for the test period was 1.16X. For the calendar years 1995 and 1996, it was 1.79X and 1.66X, respectively. After taking into consideration pro forma adjustments, Licking Valley would achieve a 1.23X TIER excluding GTCCs without an increase in revenues. Licking Valley s equity to total capitalization ratio is 38.31 percent based on the approved capital structure.

Revenue requirements calculated to produce a TIER excluding GTCCs of 2.00X should be approved. To achieve the 2.00X TIER, Licking Valley should be allowed to increase its annual revenues by $727,526. This increase includes an additional $1,330 to reflect the associated increase in Licking Valley s PSC Assessment. This additional revenue should produce net income of $939,098, which should be sufficient to meet the requirements of servicing Licking Valley s mortgage debts.

PRICING AND TARIFF ISSUES

Cost-of-Service Study

Licking Valley filed an allocated cost-of-service study using a model developed by East Kentucky. The purpose of this study is to determine the cost and revenue requirements for each rate class. Five schedules comprise this study. Schedule A contains the functionalization of the test-year plant investment. Schedule B is the functionalization of the normalized test-year results into categories that will allow the most appropriate classification of costs. Schedule C classifies the results derived in Schedule B into demand-related, energy-related, or customer-related components. Schedule D allocates the results from Schedule C and assigns those costs to each rate class. Finally, Schedule E compares the revenue from current rates with the cost to serve each rate class. In addition, Schedule E provides the change in revenue required to obtain a specific financial target.

The primary findings of the cost-of-service study are that the rates for Class A Residential, Farm, Small Community Halls, and Church Service, Class B Commercial and Small Power Service, Large Power Service, and Security Lights and/or Rural Lighting do not recover the cost to serve these rate classes. The rates for the Large Power Rate Class do provide revenue in excess of the cost to service this class.

According to the 1992 Electric Utility Cost Allocation Manual of the National Association of Regulatory Utility Commissioners (NARUC Manual), the Minimum-Intercept method[17] yields the most accurate allocation to the customer component. The Minimum-Intercept method uses regression techniques to identify the portion of plant

[17] Also referred to as the Y-Intercept method or Zero-Intercept method.

related costs to a hypothetical no-load or zero-intercept situation.[18] Licking Valley s cost-of-service study did not use this method, but instead used what it referred to as the Minimum Investment method.[19] The NARUC Manual states that the use of the Minimum-Size or Minimum Investment method generally produces a larger customer component that the Minimum-Intercept method.[20]

Licking Valley stated that the Minimum-Intercept method was not used in its study because the regression line that was produced yielded a negative Y-intercept in two of the three equations. Since this was an unreasonable result, the method was abandoned and the Minimum Investment method used.[21] The Minimum Investment method was then used to classify the costs for Poles and Conductors, Transformers, and Services in Schedule C. While the model results for Transformers yielded a positive Y-intercept under the Minimum-Intercept method, Licking Valley elected to use the Minimum Investment method. When asked the reason, Licking Valley stated that the Minimum Investment method was used for consistency, and contended that the R-squared value was not reasonable.[22]

---

[18] NARUC Manual at 92.

[19] T.E., December 16, 1998, at 53. The Minimum Investment method is consistent with the NARUC Manual s Minimum-Size method. See NARUC Manual at 90-91.

[20] NARUC Manual at 91 and 95.

[21] T.E., December 16, 1998, at 53-54. However, the NARUC Manual states that when an unreasonable result occurs using the Minimum-Intercept method, a review of the accounting data must be made and suspect data deleted. See NARUC Manual at 95. It appears that this procedure was not performed.

[22] T.E., December 16, 1998, at 60.

The Commission finds that the Minimum Investment method used in Licking Valley s cost-of-service study is consistent with the NARUC Manual. While acknowledging that this method generally results in a larger customer component cost allocation than the Minimum-Intercept method, and thus higher customer charges, the Commission notes that the proposed customer charges for Licking Valley are the subject of a proposed settlement agreement in this proceeding. Therefore, the Commission finds that Licking Valley s cost-of-service study is acceptable.

Customer Charges

Reflecting the results of its cost-of-service study, Licking Valley proposed to increase the customer charge for Schedule A Residential, Farm, Small Community Halls, and Church Service, and Schedule B Commercial and Small Power Service. The AG disagreed with the proposed customer charges, contending that they were too high, even after considering the fact that Licking Valley s proposed charges were lower than the charges calculated in the cost-of-service study.[23] At the December 16, 1998 public hearing, Licking Valley and the AG filed a settlement agreement, which included the customer charges. The Commission finds that the charges proposed in the settlement agreements are reasonable and should be accepted. Appendix B contains a comparison of Licking Valley s present customer charges, its proposed customer charges, and the customer charges contained in the settlement agreements.

[23] Brown Kinloch Direct Testimony at 6-7.

Cable TV Attachment Fees, Returned Check, Collection and Reconnect-Disconnect Charges

Licking Valley proposed to increase its charges for these services based on costs associated with providing the services. Subsequent filings by the AG and KCTA proposed lower charges. At the December 16, 1998 public hearing, Licking Valley, the AG, and KCTA filed proposed settlement agreements for all of these charges. The Commission finds that the charges proposed in the settlements are reasonable and should be accepted. Appendix B contains a comparison of Licking Valley s current charges for these services, its proposed charges, and the charges contained in the settlement agreements.

OTHER ISSUES

Depreciation Study

Licking Valley indicated that it had never performed a detailed depreciation study. It also indicated that it had not performed any limited-scope reviews of its depreciation rates since 1983. Most of the cooperatives that the Commission regulates have periodically performed depreciation studies to determine that the depreciation rates in use are adequate and reasonable. The Commission finds that Licking Valley should perform a detailed depreciation study, completing the study within three years of the date of this Order or the filing of its next rate case, whichever event occurs first. Licking Valley should also file a copy of the completed study with the Commission at the time of its adoption.

Equity Management Plan

Licking Valley had originally indicated that it did not have an equity management plan, but later indicated that one had been adopted in 1993.[24] However, the policy adopted in 1993 only addressed how Licking Valley would allocate and pay capital credits. Licking Valley has never paid any of its capital credits to members. In addition, Licking Valley s bylaws appear to contain restrictions concerning the circumstances under which capital credits can be paid to members.[25] Licking Valley has indicated that it needed to review and update its bylaws concerning the payment of capital credits. Licking Valley also indicated that it will contact the National Rural Utilities Cooperative Finance Corporation (CFC) for assistance in developing a new equity management plan, but had no timetable established to do so.[26]

The Commission has encouraged the development of comprehensive equity management plans in order to promote the financial stability of the cooperatives. Such plans address appropriate equity levels, targeted earnings levels, the overall management of the cooperative s equity, and the payment of member capital credits. The Commission finds that Licking Valley should seek the assistance of CFC and develop a comprehensive equity management plan within three years of the date of this Order or by the filing of its next rate case, whichever event occurs first. Licking Valley should inform the Commission of its progress by including a report on the status of the

[24] Response to the Commission s June 23, 1998 Order, Item 15 and Response to the Commission s September 2, 1998 Order, Item 32.

[25] Exhibit 7 of the Application, Article VIII.

[26] Response to the Commission s October 1, 1998 Order, Item 16 and T.E., December 16, 1998, at 20.

plan s development along with its annual report filed with the Commission. Upon the adoption of the equity management plan, Licking Valley should file a copy of the plan with the Commission. It is possible that the new equity management plan could require changes in Licking Valley s bylaws. Licking Valley should consider this possibility as it proceeds with a review of its bylaw provisions concerning capital credits.

Director Terms

Licking Valley currently elects all eight of its directors in the same year to three-year terms. The Commission has observed that, for most cooperatives, the directors elections are staggered, so that the possibility of a significant turnover, and loss of cooperative experience, does not occur. The retention of such experience is important to cooperatives, especially in light of the continuing debate over electric industry restructuring. The Commission encourages Licking Valley to review this practice; any changes made will be reviewed as part of its next rate case.

Payments to Retired Directors

In 1987, Licking Valley adopted a policy which provides retiring directors with 25 years or more of service a one-time payment based on a formula of life expectancy and the monthly per diem being paid at the time of retirement. In 1995 and 1996, Licking Valley made payments to retiring directors of $26,912 and $38,952, respectively.[27] Licking Valley stated that the board of directors elected to compensate retiring directors in this manner since neither health nor life insurance coverage was provided to the directors.

[27] Response to the Commission s September 2, 1998 Order, Item 29.

The Commission puts Licking Valley on notice that the payment of health or life insurance for directors has been disallowed in prior cases and had this payment of retirement benefits occurred during the test year it would have similarly been disallowed. The Commission is concerned that Licking Valley s board of directors has provided itself with such a generous benefit without the approval of its membership. In addition, Licking Valley expensed this payment in the year paid, rather than setting up an accrual to lessen the impact on its financial condition in the year paid.

The Commission finds that Licking Valley should inform its membership about the cost of this retirement benefit and the fact that the Commission does not allow this cost to be recovered in electric rates. In addition, Licking Valley should establish a policy of accruing some portion of the expected retirement payment at least three years prior to the completion of the director s 25th year.

SUMMARY

The Commission, after consideration of the evidence of record and being otherwise sufficiently advised, finds that:

1. The settlement agreements filed in this case between Licking Valley and the AG, and Licking Valley and KCTA are reasonable and should be adopted.

2. The rates set forth in Appendix A are the fair, just, and reasonable rates for Licking Valley to charge for service rendered on and after the date of this Order.

3. The rate of return and TIER granted herein are fair, just, and reasonable and will provide for Licking Valley s financial obligations.

4. The rates proposed by Licking Valley would produce revenue in excess of that found reasonable herein and should be denied.

IT IS THEREFORE ORDERED that:

1. The rates in Appendix A are approved for service rendered by Licking Valley on and after the date of this Order.

2. The rates proposed by Licking Valley are denied.

3. The settlement agreements referred to in Finding No. 1 are adopted.

4. Pursuant to Licking Valley s commitments as set forth in the settlement agreements, Licking Valley shall file within 14 days of this Order its revised tariff sheets setting out the rates approved herein.

5. Within three years from the date of this Order, or the filing of Licking Valley s next rate case, whichever occurs first, Licking Valley shall perform a detailed depreciation study. Licking Valley shall file a copy of the depreciation study with the Commission upon its adoption.

6. Within three years from the date of this Order, or the filing of Licking Valley s next rate case, whichever occurs first, Licking Valley shall develop a comprehensive equity management plan. Licking Valley shall inform the Commission of its progress on the plan by including a status report with its annual report to the Commission and a copy of the plan shall be filed upon its adoption.

Done at Frankfort, Kentucky, this 16th day of February, 1999.

By the Commission

ATTEST:

____

Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 98-321 DATED FEBRUARY 16, 1999

The following rates and charges are prescribed for the customers in the area served by Licking Valley Rural Electric Cooperative Corporation. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of this Commission prior to the effective date of this Order.

SCHEDULE A
RESIDENTIAL, FARM, SMALL COMMUNITY HALLS AND CHURCH SERVICE

Monthly Rate:

Customer Charge	$7.00
Energy Charge	$0.057138 Per KWH

SCHEDULE B
COMMERCIAL AND SMALL POWER SERVICE

Monthly Rate:

Customer Charge	$14.50
Energy Charge	$0.057073 Per KWH

SCHEDULE LP
LARGE POWER SERVICE

Monthly Rate:

Demand Charge	$6.51
Energy Charge	$0.042458

SCHEDULE SL
SECURITY LIGHTS AND/OR RURAL LIGHTING

Monthly Rate:

Service for the unit will be unmetered and will be a 175 watt mercury vapor type at $6.36 each, per month.

NON-RECURRING CHARGES

Rates:

Return Check	$	13.00
Meter Reading		24.00
Collection		24.00
Meter Resetting Charge		24.00
Reconnection and Name Change		24.00
Meter Reading Charge		24.00
Overtime		48.00

CATV ATTACHMENTS

Annual Rates:

2 Party Attachments	$	4.01
3 Party Attachments		3.85
Anchor Attachments, 2 Party		3.84
Anchor Attachments, 3 Party		2.53
Ground Attachments, 2 Party		.30
Ground Attachments, 3 Party		.19

APPENDIX B

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 98-321 DATED

	Present Charge	Proposed by Licking Valley	Settlement Amount
Customer Charge			
Schedule A	$ 5.25	$ 8.45	$ 7.00
Schedule B	12.00	15.00	14.50
Schedule LP	45.00	45.00	45.00
Schedule LPR	90.00	90.00	90.00
Non-Recurring Charges			
Return Check	$ 10.00	$ 15.00	$ 13.00
Meter Reading	18.00	30.00	24.00
Collection	18.00	30.00	24.00
Meter Resetting	18.00	30.00	24.00
Reconnect	18.00	30.00	24.00
Meter Reading	18.00	30.00	24.00
Overtime	48.00	60.00	48.00
CATV Attachment			
2 Party Attachment	$ 1.93	$ 4.40	$ 4.01
3 Party Attachment	2.08	4.23	3.85
Anchor Attach. 2 Party	1.85	4.21	3.84
Anchor Attach. 3 Party	1.22	2.78	2.53
Ground Attach. 2 Party	.32	.33	.30
Ground Attach. 3 Party	.20	.21	.19