

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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PUBLIC SERVICE
COMMISSION

In the Matter of:

ADJUSTMENT OF RATES)
OF CUMBERLAND VALLEY) CASE NO. 2005-00187
ELECTRIC, INC.)

ATTORNEY GENERAL'S MOTION FOR A COMPLETE FINANCIAL,
OPERATIONAL AND MANAGEMENT AUDIT OR REVIEW

The Attorney General, by and through his Office of Rate Intervention, hereby moves the Commission to order a complete financial, operational and management review of Cumberland Valley Electric, Inc. ["CVE"]. In support of this motion, the Attorney General offers the following argument:

Evidence compiled in the record, together with cross-examination of CVE's General Manager, Ted Hampton, revealed numerous questionable business practices and conflicts of interest that cast significant doubt upon the reliability of CVE's test year accounting figures provided to this Commission. The record as it now stands provides credible, substantial and sufficient evidence to demonstrate that CVE's management has not only condoned and tolerated questionable practices, but actively fosters a culture and environment in which such practices flourish.

ARGUMENT

NON-ARMS LENGTH TRANSACTIONS RESULTING FROM NEPOTISM HAVE CAUSED HARM TO CVE'S MEMBERS.

CVE, a relatively small rural electric cooperative with over 20,000 customers, employs four (4) relatives of Ted Hampton: Steve Hampton, Karen Hampton, Jay Hampton and Elbert Hampton.¹ Another relative of Ted Hampton, Mr. Ken Lay, has received millions of dollars from CVE for performing its right-of-way maintenance, and has done so while incurring virtually no overhead.²

The record is replete with evidence that Ted Hampton's family dominates CVE's management, and that family members may well have used their influence to award contracts to other family members. The record also demonstrates an apparent propensity in CVE's management to either undercharge, or issue no charge for electrical work projects affecting family members, friends and associates. First, discovery responses indicated that CVE did not adequately charge for work done on a cabin that CVE identified as being located on "Flying Rooster Farm" near Red Bird Rd., purportedly owned in part by an assistant superintendent of the Whitley County School system.³ Materials provided in response to this discovery request indicate that only a few days after

¹ T.E., pp. 76-77.

² See AG Schedule 1, attached hereto, showing a five-year history of payments to Ken Lay totaling over \$3.5 million for ROW work. It is important to note that Ken Lay has held the CVE ROW contract for more than 25 years.

³ See Response to AG-3-4; in particular, "adjustment voucher" dated 12-27-2005.

receiving this request, the company retroactively made the appropriate charge. Second, the Attorney General has reason to believe that CVE either undercharged, or submitted no charge to the Whitley County School system when it laid an expensive underground line to a school system building. While it may be purely coincidental, one must note that Ted Hampton's wife⁴ and niece purportedly work for the Whitley County School system. Insufficient / non-existent pricing for projects, even those occurring before the test year, has a direct impact on CVE's financial picture and projected future rate requirements.

For many years, CVE's principal supplier of miscellaneous parts was a company named Knox Auto ("Knox"). Ted Hampton's brother John Rex Hampton was a director and registered agent of Knox.⁵ Although it is not entirely clear, there is some evidence that Elbert Hampton (Ted Hampton's other brother, ex-CVE employee, and current CVE Board of Directors member) played some sort of role with Knox's management or ownership.⁶ Elbert Hampton's son, Steve Hampton (currently a CVE employee) at that time worked at Knox. Information shared in confidence with the Attorney General's Office, the same which can be discovered through a Commission-ordered audit of CVE, will reveal that CVE monthly made purchases from Knox ranging up to several thousands of dollars, some of which purchases it appears may have been

⁴ Taylor depo., p. 22; Hart depo., p. 27.

⁵ See Kentucky Secretary of State Records, attached as Exhibit 5 to Carroll deposition.

⁶ Carroll depo., p. 39.

imprudent and/or questionable.⁷ In fact, one witness provided sworn testimony that he overheard Elbert Hampton, on CVE's property during normal business hours, advise Steve Hampton (who then worked at Knox), to sell CVE a piece of equipment at twice the price that Elbert had just negotiated with a salesman.⁸

The record also shows that CVE purchased a used bulldozer from 5-C Construction Company, a company owned by ex-CVE employee Ronnie Corey.⁹ CVE paid over \$60,000 for this equipment.¹⁰ Simple research will show that at the time this purchase was made, that piece of equipment, with similar hour usage, could have been purchased for a considerably lower price. Furthermore, evidence in the record indicates this bulldozer is used almost exclusively for ROW work. This is yet another example of how CVE subsidizes its contractors' work expenses.¹¹

In its response to AG-2-29, CVE states that it does not maintain any contracts with vendors whose principals are in any manner related, by blood or marriage, to CVE's officers or members of its Board. When asked whether he wanted to amend the company's response accordingly, Mr. Hampton's response

⁷ The evidence of these costs related to times and occurrences outside of the test year was precluded from introduction in the hearing by the Commission's order dated 4 April 2006.

⁸ Carroll depo., at pp. 45-47.

⁹ The Attorney General discusses below in greater detail the numerous conflicts of interest between CVE and 5-C Construction Co.

¹⁰ See Response to AG-3-1, together with documents depicting the extensive maintenance that CVE had to perform on this vehicle after the purchase. See also McCuen depo., pp. 57-58, depicting the bulldozer's rusted radiator.

¹¹ See *infra* the discussion on contracts between CVE and Lay Tree and Brush, and CVE and its two construction contractors.

was equivocal, at best.¹² The company's response thus stands, and is clearly contrary to all evidence of record.

Although CVE purportedly has an anti-nepotism policy,¹³ Ted Hampton testified that he can't remember whether the CVE Board of Directors ever made any formal exceptions to the policy when it came to employing Hampton family members.¹⁴ However, he was certain that no such formal exceptions were made at least during the test year, with regard to employees, managers, and members of the Board of Directors.¹⁵ There is therefore no evidence that the CVE Board ever exercised its responsibility and mandate to make formal exceptions to the purported anti-nepotism policy. Even if the Board had made any such formal exceptions, it is clear that no just cause could exist for granting exceptions to the Hampton family management. The CVE Board's failure to exercise its responsibility in this regard provides ample proof that it is not an independent body, but is rather just another extension of the Hampton family, and is accountable solely to it.¹⁶

CVE's anti-nepotism policy is a meaningless fiction. The history of nepotism long enshrined in CVE is highly detrimental to ratepayers. CVE is not just another company which, like many others, employs family members. The real danger of nepotism is that family members will use their influence to reward

¹² T.E., p. 103-104.

¹³ See Response to AG-2-37.

¹⁴ T.E. at 77; see also Response to AG-2-37.

¹⁵ Id. at 80-81.

¹⁶ The fact that two (2) members of the Hampton family sit on CVE's board provides even stronger proof of this assertion.

family and friends, and that by failing to pursue arm's-length transactions, a company's family-dominated management will not pursue the company's best interests. The Attorney General opines this is exactly what has happened with CVE.

The Attorney General believes that in the case of CVE, nepotism's inherent danger is no longer latent – it is in fact patent and active. Given the facts that: (a) CVE's bidding processes are, at best, heavily weighted toward retaining incumbent contract holders; and (b) CVE's most expensive contracts have been held by only three contractors with varying levels of connections to the Hampton family for scores of years, it is impossible to escape the conclusion that the Hampton family's best interests control over those of the company they manage, a company which is funded in part by federal debt instruments.

The well-demonstrated history of lack of arm's length contracts, and a Board of Directors that is apparently Ted Hampton's alter-ego, inescapably leads one to seriously question whether CVE has achieved the best business deals. These practices not only paint a negative image of CVE's managerial practices, but also raise questions about CVE's finances and revenue streams that can only be addressed through means of a comprehensive management, operations, and financial audit. The audit should also identify any other projects completed for family and friends, and determine whether appropriate revenue from these projects was received and deposited.

Well-established principles of corporate governance require management personnel in any business entity, when engaging in transactions with their own personal families, to exercise a high duty of care and due diligence to prevent unjust enrichment and harm to the entity's constituents.

In fact, the Attorney General urges the Commission to draw an analogy to KRS 278.2201, et. seq., the Commission's affiliate transaction rules. These rules are designed to prevent non-arms length transactions between members of an investor-owned utility's corporate family that could potentially unjustly enrich the utility's shareholders to the detriment of its captive ratepayers. While IOUs thus owe this fiduciary duty to their ratepayers, until recently there was no similar duty under Kentucky's utility regulatory framework owed by RECs.¹⁷

The Attorney General urges the Commission to recognize and specifically find that RECs such as CVE owe a duty to prevent harm to ratepayers when the REC engages in non-arms length transactions with relatives (whether by blood or marriage) of the REC's management or board of directors, or with other business entities that either do or could create conflicts of interest.¹⁸

In the case of CVE, a credible and actively implemented anti-nepotism policy would address this consequence. While on the surface CVE's purported

¹⁷ During the Kentucky General Assembly's 2006 (Regular) Session, HB 568 was passed and ultimately signed by the Governor. The new law will require cooperative companies operating under KRS Chapter 279 to abide by affiliate transaction rules.

¹⁸ For example, an REC entering a contract with a business controlled in whole or in part by a close friend or associate of the REC's management or board could pose a conflict of interest that should be avoided, absent special measures designed to avoid any conflict (e.g., exercising bidding procedures controlled wholly by an independent entity).

adoption of an anti-nepotism policy is a tacit admission of the need to prevent this problem from occurring, nonetheless CVE's managerial, financial and operational actions appear to be carried out in either negligent or willful derogation of that policy, thereby unjustly enriching CVE's management and their family members and associates, all to the detriment of its members.

CVE's issues contracts for right-of-way maintenance and line construction. These functions are CVE's single-greatest expense apart from paying East Kentucky Power Company for electricity feeds. As will be set forth below in greater detail, the record amply demonstrates the possibility, if not the likelihood, that the Hampton family management have used their influence to steer company contracts to other family members and friends, in such a manner as to eliminate the benefits of cost-competitive bidding.

a. Right-of-Way Contract

Ted Hampton's cousin, Ken Lay, has held CVE's right-of-way ("ROW") contract for approximately 25 years.¹⁹ Ken Lay's father and Ted Hampton's father were first cousins.²⁰ Ken Lay was an employee of CVE for almost 25 years, from 1956-1980.²¹ Immediately after Ken Lay left as an employee of CVE, he set up Lay Tree & Brush and was awarded CVE's ROW contract in 1981.²² The contractor that Lay Tree & Brush replaced in 1981 was Asplund & Townsend, which used the Construction Unit compensation method. When Lay Tree &

¹⁹ See Response to AG-2-21.

²⁰ See response to AG-2-51.

²¹ Id.

²² See Response to AG-2-21.

Brush took over the contract, it did so using the hourly basis compensation method, which method CVE and Lay Tree & Brush continue to employ today.²³ CVE provides equipment for Ken Lay's crews, including service trucks, chipper truck, chipper, and bulldozer (for use in bush-hogging).²⁴ In previous discovery, CVE testified that it reimburses Ken Lay for his ROW cutting equipment expenses; however, the same response indicates that during the test year, CVE paid \$67,000, up front, for ROW equipment.²⁵ Apparently, Mr. Lay has no expenses to front, other than labor and insurance.^{26 27}

Despite the fact that CVE provided all the equipment for Mr. Lay's use on ROW work, CVE's request for bids on ROW work to be performed during the test year specified that companies wishing to submit bids also had to include their equipment costs.²⁸ Since Ken Lay knew his equipment costs were covered by CVE, he could underbid any other companies, thus insuring he kept the contract, while preserving the artifice that CVE's bidding process was impartial. When asked whether CVE ever informed companies submitting ROW bids that CVE provides all the necessary equipment, Mr. Hampton would only say, "If a company was in visiting with me, then I would explain to them our procedures

²³ Mr. Hampton testified that CVE has never considered paying for ROW work on a per-job basis (T.E., p. 104, l. 24); see also Response to AG-1-42b.

²⁴ See T.E., pp. 105-106, and p. 110 l. 12-13; Response to AG-3-1; and response to AG-2-21.

²⁵ See response to AG-2-21-(e)(3); and T.E. p. 145, l. 7.

²⁶ See T.E., p. 106, l. 16-22.

²⁷ Although Mr. Hampton acknowledged allowing contractors to use CVE equipment, he apparently would have the Commission believe that CVE does not cover contractors' overhead (T.E. p. 107, l. 15-17).

²⁸ See Id., p. 108. Ted Hampton testified that the RFP letter were the only documents sent to companies from which CVE sought bids for test year ROW work. Id.

on right-of-way bids."²⁹ Significantly, Mr. Hampton never provided any testimony or other evidence suggesting that CVE ever attempted to inform bid-submitting companies that in reality, CVE would cover their equipment costs, despite the RFP letter's statements to the contrary.

b. Construction Contracts with 5-C Construction Co. and Shelton Construction Co.³⁰

Ronnie Corey, another ex-CVE employee,³¹ is the owner of 5-C Construction Company. He is the son of ex-CVE Board member, Harry Corey, who retired during the test year.³² Ronnie Corey's company performs construction work for CVE.³³ CVE has not provided any evidence explaining how the company's use of Ronnie Corey's company can be reconciled with its alleged anti-nepotism policy, which provides (in pertinent part):

"The cooperative shall not, in the future [*policy was adopted effective 2/17/83*] employ any person or persons who are kin either by blood or by marriage, to be closer than a second cousin, to any Board member, manager, supervisor, or other employee of the cooperative. Exceptions to this policy can be made by the Board resolution upon recommendation by manager." [Emphasis added]

Additional significant ties exist between CVE and 5-C Construction.

Ronnie Corey's brother-in-law, Mark Abner, is a CVE management-level

²⁹ T.E., p. 109, l. 11-15.

³⁰ The Attorney General has strong reason to believe that Shelton Construction Co.'s owner, Eskridge Shelton, is a close friend of Ted Hampton.

³¹ See Response to AG-2-49; T.E., p. 86.

³² See Response to AG-2-49 and PSC-1-33.

³³ T.E., pp. 89-90. See also the attached AG Schedule-2, depicting a 5-year history of CVE payments to 5-C Construction Co.

employee.³⁴ Ronnie Corey's wife, Brenda, has a cousin (Wayne Bryant) who was CVE's accountant. Brenda Corey, together with Wayne Bryant, also performed accounting work for 5-C. Wayne Bryant allegedly would prepare and submit 5-C's bills to CVE, and then in his role as CVE accountant would end-up approving payment of those invoices which he prepared.³⁵

CVE provided trucks for use by contracted construction crews in the work they perform for CVE.³⁶ Despite this fact, CVE's request for bids on construction work to be performed during the test year specified that companies wishing to submit bids also had to include costs of equipment, including trucks.³⁷ Significantly, the requests for bids did not specify that CVE would provide any equipment / trucks for the winning bidder's use. Since 5-C and Shelton Construction Co.³⁸ apparently were well-aware that significant portions of their equipment costs would be covered by CVE, they could underbid any other companies, thus retaining their contracts, while preserving the artifice that CVE's bidding process was impartial.

When asked whether CVE ever informed companies submitting bids for construction work that CVE provides all the necessary equipment, Mr. Hampton testified, ". . . whether I discussed that with all contractors or not, I cannot make

³⁴ Id., pp. 86-87.

³⁵ See Tolliver deposition, p. 23; Prevatte deposition, p. 22.

³⁶ T.E., p. 122, l. 9-18; and p. 120, l. 19-21.

³⁷ See T.E., p. 94. Ted Hampton testified that the RFP letters were the only documents sent to companies from which CVE sought bids for test year construction work. Id. at 93.

³⁸ See the attached AG Schedule-3, depicting a 5-year history of payments by CVE to Shelton Construction Co.

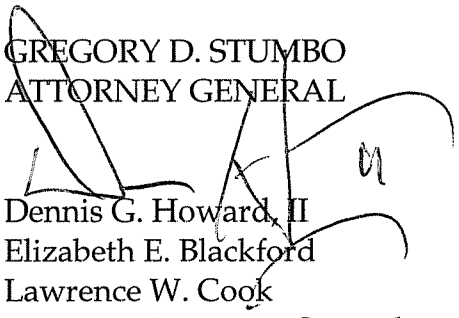
that statement blanketly [sic], but I have discussed that with some of them in the past³⁹ Merely holding discussions with some bidders does not cure a bidding process that appears to be tainted. There is no testimony or other evidence suggesting that CVE ever attempted to inform all bid-submitting companies that in reality, CVE would cover their equipment costs, despite the RFP letter's statements to the contrary.

CONCLUSION

For these reasons, the Attorney General urges the Commission to grant its motion and order a comprehensive financial, operational and management audit of CVE. Furthermore, in the event the Commission discovers that any imprudent spending is a result of malfeasance, and not misfeasance, any costs for the audit should be borne by the wrongdoers, and not the company's members.

Respectfully submitted,

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³⁹ Id. at 95, l. 4-9.

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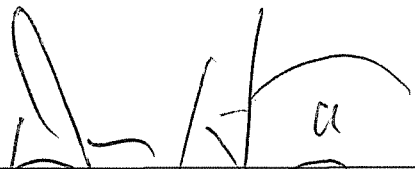
Counsel certifies that an original and ten photocopies of the foregoing Attorney General's Motion were served and filed by hand delivery to Beth O'Donnell, Executive Director, Public Service Commission, 211 Sower Boulevard, Frankfort, Kentucky 40601; furthermore, it was served by mailing a true and correct copy of the same, first class postage prepaid, to

Ted Hampton
Cumberland Valley Electric, Inc.
P.O. Box 440
Gray, Kentucky 40734

Mr. Pat Houser
P.O. Box 1900
Barbourville, KY 40906

Hon. Gillard B. Johnson, III
Hon. Eric Lycan
Cox Bowling & Johnson, PLLC
P.O. Box 910810
Lexington, KY 40591 -0810

all on this 10th day of May, 2006.


Assistant Attorney General

**AG SCHEDULE 1
 CVE'S PAYMENTS TO LAY TREE AND BRUSH
 2000 - 2004**

	Acct 593 Maint. of O/H Lines <u> </u> (1)	Acct 593.01 ROW <u> </u> Cutting (2)	Acct 593.03 Bush <u> </u> Hogging (3)	<u> </u> Total
2000		685,769		685,769
2001	19,162	763,144	13,661	795,967
2002	6,303	711,883	12,964	731,150
2003		661,937	21,877	683,814
2004		<u>627,026</u>	<u>38,533</u>	<u>665,559</u>
5-Yr Total	<u>25,465</u>	<u>3,449,759</u>	<u>87,035</u>	<u>3,562,259</u>

(1) Response to AG-1-40

(2) Response to AG-1-41

(3) Response to AG-2-20

AG SCHEDULE 2
CVE'S PAYMENTS TO 5-C CONSTRUCTION Co., 2000 - 2004

	Acct 583 O/H Lines <u> </u> (1)	Acct 593.04 ROW Contract <u> </u> (2)	<u>Total</u>
2000	28,943	32,720	61,663
2001	35,303	37,576	72,879
2002	37,673	34,298	71,971
2003	54,578	65,782	120,360
2004	<u>48,941</u>	<u>69,649</u>	<u>118,590</u>
5-Yr Total	<u>205,438</u>	<u>240,025</u>	<u>445,463</u>

(1) Response to AG-1-39

(2) Response to AG-2-20

**AG SCHEDULE-3
 CVE'S PAYMENTS TO SHELTON CONSTRUCTION Co.,
 2000 – 2004**

	Acct 583 O/H Lines <u> </u> (1)	Acct 593.03 Bush <u> </u> Hogging (2)	Acct 593.04 ROW <u> </u> Contract (2)	<u> </u> Total
2000	11,141		15,985	27,126
2001	16,660	60,816	22,206	99,682
2002	12,196	47,524	25,564	85,284
2003	17,401	52,037	24,753	94,191
2004	<u>26,059</u>	<u>78,132</u>	<u>30,551</u>	<u>134,742</u>
5-Yr Total	<u><u>83,457</u></u>	<u><u>238,509</u></u>	<u><u>119,059</u></u>	<u><u>441,025</u></u>

(1) Response to AG-1-39

(2) Response to AG-2-20