

1306 W 5th St. Ste 100
PO Box 3440
London, KY 40743-3440
Phone: 606-878-8844
Facsimile: 606-878-8850

J. Warren Keller
Clayton O. Oswald

Jacob M. Mills
Ashley P. Hoover



TAYLOR, KELLER & OSWALD .PLLC
ATTORNEYS AT LAW

Hamburg Place Office Park
1795 Alysheba Way, Ste 2201
Lexington, KY 40509
Phone: 859-543-1613

RECEIVED
Boyd F Taylor
(1924-2012)
MAR 25 2019

PUBLIC SERVICE
COMMISSION

March 25, 2019

Ms. Gwen R. Pinson
Public Service Commission
211 Sower Blvd.
Frankfort, KY 40602

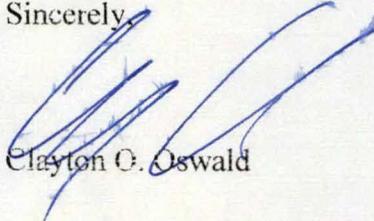
Re: In the Matter of Adjustment of Rates of Grayson Rural Electric Cooperative Corp.
Case No. 2018-00272

Dear Ms. Pinson:

Please find enclosed an original and ten copies of the post-hearing brief on behalf of my client, Grayson Rural Electric Cooperative Corporation.

Please feel free to contact me if you have any questions or concerns.

Sincerely,



Clayton O. Oswald

Cc: Justin M. McNeil, Esq.
Assistant Attorney General
700 Capital Ave.
Suite 20
Frankfort, KY 40601

RECEIVED

MAR 25 2019

PUBLIC SERVICE
COMMISSION

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF GRAYSON RURAL)
ELECTRIC COOPERATIVE CORPORATION) Case No. 2018-00272
FOR AN ADJUSTMENT OF RATES)

**POST-HEARING BRIEF ON BEHALF OF
GRAYSON RURAL ELECTRIC COOPERATIVE CORPORATION**

Comes now Grayson Rural Electric Cooperative Corporation (“Grayson”) by and through the undersigned counsel, pursuant to the Kentucky Administrative Rules and Order of this Commission and hereby submits this post-hearing brief in support of its application in this matter.

**I
FACTUAL BACKGROUND**

Grayson Rural Electric Cooperative is a rural electric cooperative corporation owned by its members and organized pursuant to KRS chapter 279.¹ Grayson is engaged in the business of distributing retail electric power to its members located in the counties of Carter, Elliott, Greenup, Lawrence, Lewis and Rowan.²

On September 20, 2018, Grayson filed its application in this matter, seeking an increase in its rates to allow it to attain a times interest earned ratio (TIER) of 2.0.³ The initial dollar amount of the increase sought was \$1,424,078, which would be an increase of 5.7% in total revenue.⁴ Since the filing of the application, however, Grayson has adjusted its proposed increase to

¹ Grayson’s application for an adjustment of rates, paragraph 1.

² Application, paragraph 1.

³ Application, paragraph 3.

⁴ Application, paragraph 3.

\$1,579,291 to reflect updated expenses including, without limitation, expenses for the development and presentation of the rate case and fluctuations in interest rates.⁵

Most of the increase in rates sought by Grayson in this matter is placed in the monthly customer charge for each rate class, with those amounts being fully supported by a recently completed cost of service study.⁶ The application also removed various items for rate making purposes based on Commission precedent.

Grayson's application, after the curing of a deficiency, was accepted for filing on October 3, 2018.⁷ The Kentucky Attorney General was the sole intervenor in this case. An evidentiary hearing was held in this matter on February 19, 2019. On that same date, the Commission entered an order setting forth a procedural schedule for the filing and responses to post-hearing data requests and for the filing of post-hearing briefs. A subsequent order granted Grayson's motion for an extension of time through March 25, 2019 in which to file its brief.

Grayson now files this brief to further expound upon the primary issues in this matter and to respond to the brief filed by the Attorney General.

II **ARGUMENT**

A. THE INCREASE IN RATES IS PROPERLY SUPPORTED BY THE TEST YEAR

In support of its application for an increase in rates, Grayson submitted the year ending December 31, 2017 as its test year.⁸ Grayson has demonstrated that its operating TIER (OTIER) for the test year was -1.27.⁹ Likewise, its OTIER for 2018 was .92.¹⁰ These results place Grayson

⁵ Updated Exhibit S to Grayson's application.

⁶ Exhibit J to Grayson's application.

⁷ Commission letter dated October 5, 2018.

⁸ Application, paragraph 1.

⁹ Grayson's response to Commission Staff's Post-Hearing Request for Information, Question 1.

¹⁰ Id.

in violation of its covenants with its lenders, including the Rural Utilities Service (RUS), which generally requires an OTIER of 1.10. Grayson's application and exhibits thereto also demonstrate that its other financial metrics have fallen below key levels. However, Grayson has continued to operate its business without interruption in service and has continued to honor all its obligations.

As part of its application, Grayson submitted a full cost of service study prepared by Mr. James Adkins.¹¹ That study fully supported the assertion that Grayson's current rate structure, and in particular, its monthly customer service charge, is insufficient to meet the cooperative's financial needs.¹² In fact, the cost of service study supports a much higher fixed customer charge per month than Grayson is seeking in its application.¹³ Grayson's application is further supported by a full depreciation study that has previously been filed with the Commission.

In sum, there is no question that Grayson has properly supported the financial need for the increase in revenue sought in its application. The amount sought is not excessive and would not result in margins in excess of a 2.0 TIER which has previously been recognized by the Commission as fair, just and reasonable.

B. THE REQUESTED INCREASE IN THE MONTHLY CUSTOMER CHARGE IS FAIR, JUST AND REASONABLE

As stated previously, the majority of the increase in revenue sought by Grayson in this matter is in the monthly customer charge as opposed to the energy charge. In its post-hearing brief, the Attorney General has challenged this methodology, arguing that setting monthly customer charges too high would decrease the incentive of members to conserve electricity usage.

Grayson has filed a fully supported cost of service study in support of its application. Since the majority of its members are on residential rates, this portion of the brief will focus on the costs

¹¹ Grayson application, Exhibit R.

¹² *Id.*

¹³ Grayson application, Exhibit R, page 51.

to serve that class of members and the rates proposed for that class. The cost of service study has determined that the monthly fixed cost to serve a residential member is \$41.93 per month.¹⁴ In other words, Grayson must recover this amount each month from each residential member just to cover its fixed overhead which includes, without limitation, poles, transformers, wires, right of way clearing, maintenance and employee costs. All amounts in excess of that fixed monthly expense are due to costs for the usage of electricity which is purchased from Grayson's generation and transmission cooperative, East Kentucky Power.

The Commission has previously addressed this particular facet of rate design and reached the following conclusion:

The Commission concludes that, for an electric cooperative that is strictly a distribution utility, there is merit to the argument that there is a need for a means to guard against the revenue erosion that often occurs due to the decrease in sales volume that accompanies poor regional economics, changes in weather patterns, and the implementation or expansion of demand-side management and energy-efficiency programs. Farmers' proposed increase in the residential customer charge from \$9.35 to \$14.00 results in a 50 percent increase, which supports the general principal of gradualism. All proposed customer charges are approved.¹⁵

In the case at bar, Grayson seeks to raise the monthly customer charge for residential members from \$15.00 to \$22.50, which is an approximate 50% increase.¹⁶ The Commission specifically approved an increase in the monthly customer charge in the Farmers case of 50%. However, even if Grayson were granted the requested increase in the monthly customer charge, it would still be far less than the sum of \$41.93 which the cost of service study has determined to be

¹⁴ Grayson application, Exhibit R, page 51.

¹⁵ Commission Order in Case No. 2016-00365, Application of Farmers Rural Electric Cooperative Corporation for an increase in retail rates.

¹⁶ Application, Exhibit D.

the actual cost per month to serve each residential member. The requested increase is both gradual and far less than the actual required amount.

Much has been written in the utility industry about rate design and how a utility can determine the fairest methodology for setting its rates. Allowing Grayson to raise its monthly customer charge as requested would allow it to better match member related costs to a fixed monthly income.¹⁷ Furthermore, many facets of modern society now promote energy efficiency and conservation ranging from increased standards in construction building codes to efficient appliances. Allowing Grayson to increase its monthly customer charge raises the floor of revenue for Grayson and more closely aligns the interests of the consumers in conservation with the interests of the utility.¹⁸ Finally, like many electric utilities, and in particular, rural electric cooperatives, Grayson's revenue is largely dependent on the weather.¹⁹ When an electric utility has a monthly customer charge that is less than its fixed costs to serve a customer, it is victim to fluctuations in its revenues which are largely dependent on the weather, a factor over which the utility obviously has no control. More closely matching the utility's monthly fixed income to its costs will reduce volatility and uncertainty in the utility's margins.²⁰

The primary thrust of the Attorney General's argument is that increased customer charges have a disproportionate impact on ratepayers who use less electricity than the system average. This assertion is correct, however, there are two logical responses to this argument. First, the extent of the disproportionate impact is minimal. The average Grayson member uses 1,063 kwh of electricity per month.²¹ The proposed rates would result in an increase of \$7.96 per month for

¹⁷ Grayson application, Exhibit H-3.

¹⁸ Id.

¹⁹ Id.

²⁰ Id.

²¹ Grayson application, Exhibit I.

the average residential member which equates to an increase of 6.2%. Comparing the average usage to one who uses much less reveals that the actual dollar change in monthly billing is minimal, and in fact, only differs by a few cents. Thus, while the increase is disproportionate, the actual difference in the dollar amount per month is minimal and is unlikely to have any meaningful effect upon a member's incentive to implement conservation and efficiency measures.

Second, any increase in rates will have a disproportionate effect on some portion of a member class. For example, if Grayson's proposal were to increase only the energy charge rather than the customer charge, the members who use greater amounts of electricity each month would be affected far more so than the members who use less. However, Grayson's fixed costs to serve the members who use less than average per month would remain the same, which would result in the high users subsidizing, to some extent, the low users. Finally, low income members of Grayson on average use more electricity per month than other members.²² Increasing the energy charge rather than the customer charge would disproportionately impact those members who can least afford it. This is readily explained by the fact that low income members have less capital available to upgrade heating and air systems, add insulation to their homes or take other actions to reduce their usage.

The Commission has largely approved of recent rate proposals which have sought increases in the customer charges of rural electric cooperatives. There are a number of rural electric cooperatives in Kentucky whose monthly customer charge now exceeds \$15.00 per month.²³

The Attorney General also argues that there is no logical reason to allow a utility to recover its fixed costs by a fixed charge since allowing such would reduce the incentive of the utility to operate at its greatest efficiency and to mirror the operation of businesses that operate in

²² Grayson's response to Commission Staff's Post-Hearing Request for Information, Question 17.

²³ Grayson's response to Commission Staff's Post-Hearing Request for Information, Question 21.

competitive environments. Grayson humbly suggests that this argument is incorrect, inasmuch as utilities are quite dissimilar from typical businesses which operate competitively. An electric utility must have sufficient plant and infrastructure to serve all its members whether the temperature is a moderate 70 degrees or an extreme 30 degrees below zero. This requires the utility to invest in plant that is quite expensive and which requires routine maintenance. In addition, an electric cooperative is as dissimilar from a competitive business as one could image. A cooperative has no profit motive and exists only to provide its members with affordable and reliable electricity. If a cooperative is allowed to match its fixed costs to a fixed income, it would have a strong incentive to encourage less usage by its members, since the cooperative's revenue is not dependent on the members' usage. This aligns the members' interests with the cooperative's interests. As in any monopolized industry, the Commission is tasked with the job of ensuring that the utility is operating as efficiently as possible under the unique circumstances of the utility.

C. GRAYSON HAS TAKEN AFFIRMATIVE STEPS TO CONTROL ITS EMPLOYEE-RELATED EXPENSES

The Attorney General next argues that Grayson has granted unreasonably large raises to its employees, which have averaged 3.77% per year from 2013 – 2017.²⁴ As stated during the hearing in this matter and in exhibits to Grayson's application, from 2013 – 2017, Grayson granted its unionized (outside) employees a yearly wage increase of \$1.25 per hour.²⁵ These increases were granted pursuant to a contract with the union, and, in an effort to achieve fairness, the non-unionized employees were given similar raises.

Much testimony was offered at the hearing in this matter concerning the importance of retaining employees. Mrs. Fraley specifically noted that there is an extensive amount of training

²⁴

²⁵ Grayson application, Exhibit 1.

involved in replacing any employee of the cooperative and in particular, an outside lineman. Grayson also engaged the services of an outside vendor to perform a wage and salary survey to ensure that its raises were fair and appropriate. Furthermore, this attorney would submit that a comparison of Grayson's salaries to those of other electric utilities and contractors in the area would reveal that Grayson's pay scale is not exorbitant. This would explain why the percentage of increase may appear larger, but the actual dollar amount of the increases is quite modest.

Finally, Grayson's rates of pay and increases in those rates for its unionized employees are set years in advance by contract. However, that contract has recently come up for renewal and after negotiations, Grayson has agreed to a yearly increase of \$.50 per hour per year beginning in 2018. This is less than half the amount of increase previously granted and clearly demonstrates that the management and Board of Grayson is doing its best to control employee wages while addressing the concerns of the immediate and long-term costs associated with employee turnover.

D. GRAYSON'S DIRECTORS' FEES AND EXPENSES ARE REASONABLE

The Attorney General further argues that Grayson's Directors' fees are unreasonably high, without offering any particular support for that assertion. Grayson's current fees per Director are \$300 per meeting plus \$637.63 per month in lieu of health insurance that was previously received. Grayson has worked diligently to reduce its expenses by changing its policies concerning the eligibility for health insurance of Directors and former Directors. This is a difficult issue that has been confronted by rural electric cooperatives throughout the nation. Grayson has further offered information to demonstrate that its fees are not excessive and are, in fact, less than the fees paid to Directors by a number of other Kentucky electric cooperatives.²⁶ Grayson has also supplied its Board minutes back to 2013 and has fully documented all expenses of its Directors.²⁷ In addition,

²⁶ Grayson's response to Commission Staffs Post-Hearing Information Request, Question 7.

²⁷ Grayson's response to the Attorney General's Post-Hearing Data Requests, Question 1.

Grayson has removed all Director-related expenses from its rate base that the Commission typically disallows.

As the Attorney General has noted, Grayson's Board has considered the possibility of combining Director districts in the future in an effort to reduce the size of the Board and the resultant Director expenses. Grayson continues to evaluate this possibility and may implement this initiative in the future.

It should certainly go without saying that serving as a director of a rural electric cooperative is time consuming and requires the director to be responsible for making decisions for a multi-million dollar business engaged in the distribution of a highly dangerous product. Directors are given a directive under the law to be educated and informed concerning the electric business. The responsibility is great and the commitment is significant. It is imperative that cooperatives have the ability to adequately compensate directors to ensure that they are able to find qualified individuals to serve on their boards.

E. GRAYSON'S HEALTH INSURANCE COSTS ARE REASONABLE

The Attorney General next argues that Grayson should require its employees to pay some portion of the premiums for their health insurance. While the Attorney General is correct that Grayson does not require its employees to pay a portion of their health insurance premiums, this argument overlooks the more important issue of the actual cost of such benefits.

In 2013, Grayson transitioned the vast majority of its employees from a preferred provider organization (PPO) health insurance plan to a high deductible PPO plan. The total estimated cost savings from this change is \$280,420.²⁸ In other words, rather than reduce its expenses by passing them along to its employees, Grayson chose to analyze its insurance plans to determine if it could

²⁸ Grayson's response to Commission Staff's Post-Hearing Request for Information, Question 6.

reduce its expenses while still offering a different, though valuable benefit to its employees. While Grayson certainly could have chosen the alternate path of keeping the same benefit plan, but forcing its employees to reduce their take home pay by deducting portions of health insurance premiums from their paychecks, Grayson forged a fair compromise that would reduce costs to members, but still protect its employees' health and the morale of the cooperative.

Furthermore, Grayson is not seeking recovery through this rate case for any amounts for health insurance premiums that the Commission typically disallows. Grayson has filed a revised statement of operations which has removed those expenses from the test year.

The Attorney General has also taken issue with health insurance premiums paid by Grayson on behalf of its former legal counsel. However, the Attorney General's brief misstates the amount paid for this coverage as \$34,161.63, when in fact the actual amount paid was \$24,165.63, of which Mr. Scott paid \$3,900, for the test year.²⁹ Furthermore, Grayson has removed this expense from its test year, so it is irrelevant for rate making purposes. Grayson entered into a contact with the attorney at issue many years ago when such arrangements were presumably less controversial, and Grayson feels bound to honor its commitment. However, Grayson has testified that it will not offer such health insurance to its recently-retained legal counsel.

F. GRAYSON HAS CONTINUED TO PAY CAPITAL CREDITS TO DECEASED ESTATES

Grayson's Bylaws provide that so long as the Cooperative's financial status allows, it will retire allocated capital credits to the estate of a deceased member upon that member's death. The Attorney General has noted that Grayson had, during its previous rate case, fallen behind on payments to such estates, due to its shaky financial condition. However, the Attorney General has

²⁹ Grayson's response to the Attorney General's Post-Hearing Data Requests, Question 4.

also correctly noted that Grayson has continued to make such payments to estates since its last rate case and has not fallen behind in doing so.

The Attorney General also notes that Grayson has not had a general retirement of capital credits in a number of years. This assertion is correct and is based on Grayson's desire to keep its rates as low as possible. As an electric cooperative, any revenue Grayson receives in excess of its margins is allocated to each member's patronage account and retained as capital until such time as the Board may determine that a general retirement is in order. Grayson's Board, like many other electric cooperatives, has determined that its members would be best served by focusing on reasonable rates, rather than requesting larger rate increases to increase margins so that accrued capital credits could then be retired.

G. THERE ARE MANY FACTORS THAT EXPLAIN GRAYSON'S RELATIVELY HIGH COSTS AND EXPENSES

Both the Commission and the Attorney General have been critical of Grayson's costs noting that its total expense per consumer is the highest of any electric cooperative in the State of Kentucky. While this is correct, this does not naturally lead to the conclusion that Grayson's operations are inefficient or mismanaged, but rather, there are many factors outside the control of Grayson that account for these relatively high costs.

The following statistics are important to this analysis:³⁰

	<u>Number of Consumers</u>	<u>Consumers per Mile of Line</u>
Grayson RECC:	14,158	5.7
KY Coop Avg.:	37,361	9.5

These numbers clearly demonstrate that Grayson is unique among cooperatives in the State. Its number of consumers per mile of line is far less than average. In fact, Grayson has the fewest

³⁰ Grayson application, Exhibit 18.

number of consumers per mile of line of any cooperative in the State.³¹ Grayson has to string wires, set poles and transformers and incur the capital costs to procure those items and the ongoing costs to maintain them with less consumers per mile over which to spread those fixed costs. It would certainly be surprising if a cooperative with such numbers did not have the highest cost per member.

Not only does Grayson have the lowest density of any cooperative in the State, this problem is compounded by the fact that Grayson is the second smallest cooperative in the State by number of members. There are certain unavoidable costs of any utility including management, facilities, etc. that must be incurred regardless of the number of consumers to be served and Grayson has few members over which to spread these costs.

Finally, there is an inherent difference in the territory served by Grayson verses the territory served by other utilities in this State. Grayson's territory is located in eastern and northeastern Kentucky and is characterized by forests and mountainous terrain. The costs associated with maintaining rights of way through mountainous forests verses the horse country of the bluegrass or the farming areas of western Kentucky will naturally be exponentially higher.

Much was made at the hearing in this matter as to how Grayson's costs compare to those of a neighboring cooperative, Big Sandy. Big Sandy's total expense per consumer is \$405, while Grayson's total cost is \$568.³² While both cooperatives' costs exceed the State average, Grayson's cost is higher. However, this difference is a result of the comparative densities of the cooperatives. At 12 consumers per mile of line, Big Sandy has one of the highest member densities in the State, while Grayson has the lowest density. As discussed above, this results in increased costs to be spread among fewer members.

³¹ Id.

³² Grayson application, Exhibit 18.

While recognizing that there are certain inherent challenges in its business and in its service territory, Grayson has taken substantive steps to reduce and control its expenses. Grayson has supplied iPads for each of its service trucks, so that trips may be planned to avoid unnecessary time in driving and transportation costs. The expected savings totals \$28,457 annually.³³ Grayson has begun installing pole top covers to increase the useful life of its poles with an expected annual savings of \$65,798, and it has implemented the use of blanket purchase orders with an expected annual savings of \$19,139.³⁴

Grayson's management and Board continually evaluate all avenues of savings on an ongoing basis. As opportunities arise, Grayson fully intends to reduce expenses where possible.

III **CONCLUSION**

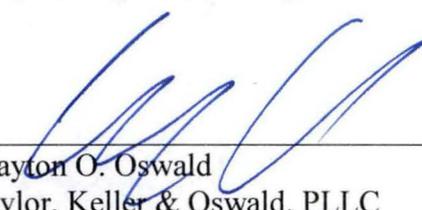
At the hearing in this matter, Grayson's management exhibited a genuine care and concern for its members and their ability to pay their electric bills. Grayson has diligently worked with its members on an ongoing basis to help them with energy conservation projects and other ways of affording electricity.

Based upon its application in this matter, the responses to data requests and its testimony in this matter, Grayson respectfully requests that the Court grant an increase in rates and revenue in the amount set forth in its revised Exhibit S.

³³ Grayson's responses to Commission Staff's Post-Hearing Request for Information, Question 5.

³⁴ Id.

Respectfully submitted by,



Clayton O. Oswald
Taylor, Keller & Oswald, PLLC
P.O. Box 3440
1306 W. 5th St., Ste. 100
London, KY 40743-3440
(606) 878-8844
Fax: (606) 878-8850
E-mail: coswald@tkolegal.com
Attorney for Grayson Rural Electric

CERTIFICATE OF SERVICE

The undersigned counsel certifies that this document was served via hand delivery as follows:

Original and Ten Copies:

Ms. Gwen R. Pinson
Executive Director
Public Service Commission
211 Sower Blvd.
Frankfort, KY 40601

Copy To:

Justin M. McNeil, Esq.
Assistant Attorney General
700 Capital Ave., Suite 20
Frankfort, KY 40601-8204

On this 25th day of March 2019.



Attorney for Grayson Rural Electric