**LICKING VALLEY RURAL ELECTRIC COOPERATIVE CORPORATION
APPLICATION FOR AN INCREASE IN ELECTRIC UTILITY RATES
CASE NO. 2016-00xxx**

## DIRECT TESTIMONY OF KERRY K. HOWARD

**Q1. State your name, job title and business address.**

A1. I am Kerry K. Howard, General Manager/CEO for Licking Valley Rural Electric ("Licking Valley"), 271 Main St., West Liberty, KY 41472

**Q2. How long have you been employed by Licking Valley and what are your responsibilities?**

A2. I I have been employed by Licking Valley for eleven years and General Manager for ten years.

**Q3. What is your educational background?**

A3. I have a Bachelor of Science in Mining Engineering from Morehead State University.

**Q4. What is the main reason behind Licking Valley's request for an increase in rates?**

A4. The main reason for this request for an increase in rates is that Licking Valley has not met its mortgage requirements with the Rural Utilities Service ("RUS") for 2015 and will most probably not meet them in 2016. Licking Valley's financial situation continues to deteriorate at this present time.

**Q5. In your opinion, what is the primary reasons behind this financial situation that currently exists at Licking Valley?**

A5. Licking Valley has experienced significant decreases in revenue from all of its member rate classes while costs continue to increase. The overall economy of the area served by Licking Valley is very poor and any improvement is not foreseen for the immediate future.

**Q8. What steps has Licking Valley taken in regards to its current finLancial situation?**

A8. Licking Valley always strives to minimize its expenses and its capital investment. One area where Licking Valley considers that it has done an outstanding job is in the area of managing its debt. In this Application, Licking Valley has an adjusted interest expense of approximately $426,000 which represents a composite interest rate of 1.65%. Licking Valley's current long term debt is comprised of 68.2% with a variable interest rate and 31.8% at fixed interest rates.

**Q8. How long do you expect Licking Valley to maintain this level of long term debt at these very low variable interest rates?**

A8. Licking Valley is constantly monitoring how the variable Federal Financing Band ("FFB") interest rates are trending. Licking Valley is planning to continue this practice for the immediate future until it sees a change in the current trend on these variable interest rates.

Q10. Does this conclude your testimony?

**A10. Yes, it does.**

Affiant, Kerry K. Howard, states that the answers given by him in the foregoing questions are true and correct to the best of his knowledge and belief.

Kerry K. Howard

Subscribed and sworn to before me by the affiant, Kerry K. Howard, this 08th day of August, 2016.

Notary Public, Kentucky State at Large
# 556518

My Commission Expires 05/29/2020

# LICKING VALLEY RURAL ELECTRIC COOPERATIVE CORPORATION
# APPLICATION FOR AN INCREASE IN ELECTRIC UTILITY RATES
# CASE NO. 2016-00174

## DIRECT TESTIMONY OF JAMES R. ADKINS

**Q1. State your name and business address.**

A1. My name is James R. Adkins and my address is 2189 Roswell Dr., Lexington, KY 40513.

**Q2. What is your past experience in cost of service studies and rate design for electric utilities?**

A2. I have been dealing with electric utility cost of service studies, rate design, revenue requirements and many different types of projects in the accounting and financial aspects of an electric utility for over thirty-five years.

**Q3. What is your experience in the electric utility industry?**

A3. I spent twenty-five years as the rate/pricing manager for East Kentucky Power Cooperative ("EKPC") and the last thirteen years, I have provided similar consulting services to electric cooperatives.

**Q4. Have you ever appeared as a witness before this Commission?**

A4. I have appeared as a witness before this Commission many times for East Kentucky Power Cooperative and for all the distribution cooperatives of EKPC and for two of the distribution cooperatives of Big Rivers Electric Corporation.

**Q5. What is your education background?**

A5. I have a Bachelor of Science Degree in Finance and a Master's Degree in Accounting and both degrees are from the University of Kentucky.

**Q6. What has been your role in the preparation of this Application?**

A6. My role in this application has been to provide guidance, assistance and oversight in the development of revenue requirements including the preparation of the test year adjustments and determination of margin levels, the completion the cost of service study presented in this Application, and in the development of the proposals on the appropriate rate design,

**Q7. Please explain what provides the basis for the revenue requirements in this application and what is the basis for the amount of increase in rates that is being requested by Licking Valley Rural Electric Cooperative Corporation ("Licking Valley")?**

A7. The amount of increase requested in this case is based on an adjusted test year expenses plus margin requirements minus the actual revenues for the test year from base rates. The adjustment clauses for fuel adjustment clause ("FAC") and the environmental surcharge clause ("ESC") are not a part of the request in this application and the revenues and expenses associated with these clauses have been removed for rate-making purposes from the financial statements presented in this case. The adjusted test year presented in this case indicates that Licking Valley needs an increase in electric rate revenue of approximately $1.565 million. The results for the test year indicate an actual margin of $599,912 including the annual allocation of capital credits ("GTCCs") from its wholesale power supplier, East Kentucky Power Cooperative ("EKPC"). When the allocation of GTCCs received during the test year of $ 1,394,546 are removed from the actual financial statements for the test year, Licking Valley had a loss of $794,634. With the other test year adjustments included, Licking Valley has an adjusted test year with losses of $1,030,170.

**Q8. Why were the GTCCs removed from the actual test year financial statements which changes the actual results from a positive margin to a loss for this period?**

A8 It has been the normal policy of the Kentucky Public Service Commission ("Commission") to remove these EKPC capital credits from Licking Valley's financial statements for rate-making purposes. These capital credits are only a book entry at the current time since EKPC has never paid any of its capital credits.

**Q9. What are other adjustments has been make to the financial statements Licking Valley and what are these test year adjustments?**

A9. The other test year adjustments have been completed in a similar manner as the test year adjustments have been make in the rate applications of other distribution cooperatives in the state of Kentucky. The test year adjustments dealing with revenues consist of the following ones:

- Normalization of revenue from base rates in the amount of ($7,293);
- Removal of the FAC and ESC revenues received during the test year which totals $1,696,965;
- The adjustment for the end of test year number of customers in the amount of $10,006 which is a decrease.

The test year adjustment for expenses include the following ones:

- Normalization of wages and salaries for $72,487;

- Normalization of payroll taxes for $8,116;
- Normalization of depreciation expenses for $40,011;
- Normalization of interest expenses for $3,672;
- Normalization of 401k expenses of $7,065;
- Normalization of property taxes of $30,037;
- Normalization of professional fees of $493;
- Removal of donations for $25.737;
- Removal of specific expenses for directors that not acceptable for rate-making purposes in the amount of $1,995;
- Normalization of purchased power expenses and the removal of the FAC and ESC expenses from the test year in the amount of $$1,597,203;
- Normalization of purchased power costs of ($552);
- Inclusion of an estimate of the expenses that will be incurred for this rate application for $30,000; and,
- Exclusion from the test year the GTCCs form EKPC as mentioned earlier in this testimony in the amount of $1,394,546.

**Q10. What does the term normalization mean as used above in your description of the test year adjustments?**

A10. The term normalization as used in the above adjustments basically means that test year end data and test year end rates have been used to determine what the annual expense or annual revenue would be under these specific conditions. Depreciation expense is a good example. Throughout the test year, Licking Valley added new plant to its general plant and distribution plant accounts for a variety of reasons. Since depreciation expense is calculated on a monthly basis, the test year expense for depreciation is not representative of what the year-end depreciable plant balances would provide as annual depreciation expense. To determine the amount of the adjustment, the test year end depreciable plant balances are multiplied by their proper depreciation rates to determine the annual depreciation expense would be. The actual depreciation expense for the test year would then be subtracted from the above calculated annual depreciation to determine the amount of this adjustment for depreciation expense. The other normalized expenses would follow a very similar pattern.

**Q11. What is Licking Valley proposing for margins and what is the basis for the proposal?**

A11. Licking Valley is proposing a margin amount of $536,518 and is based on a Times Interest Earned Ratio ("TIER") of 2.25X. A TIER of 2.25X has been used in this application because of the deteriorating equity capitalization ratio of Licking Valley. The normal rate-making that has been authorized by this Commission in recent times is a TIER of 2.0X but this Commission authorized an amount greater than 2.10X in the most recent rate application of South Kentucky RECC. Licking Valley has the need for a larger TIER amount because of its extremely low interest expense.

**Q12. When did Licking Valley file its last application?**

A12. Licking Valley filed its rate application in July 2009 with a final order issued in early 2010.

**Q13. What proportion of Licking Valley's long term debt has a fixed interest rate and what percent has a variable interest rate?**

A13. Licking Valley's long term debt at the end of the test year was comprised of 68.2 percent with a variable interest rate and 31.8 percent has a fixed interest rate. Its composite interest cost as of the end of the test year amounts to approximately 1.65 percent which is low composite interest rate. Licking Valley is doing a remarkable job of managing its debt.

**Q14. When the Commission grants the full amount of increase that is requested in this application, how long would it be before Licking Valley would need to file an application for another increase?**

A14. I would expect Licking Valley would not have the need to file another application for an increase in base rates until sometime before 2020. It is heavily dependent upon two occurrences over which Licking Valley has no control. The first item is weather and extremely mild weather may cause Licking Valley to come in sooner than stated above. Weather worse than normal could postpone the need for a longer period of time. The other factor beyond the control of Licking Valley is the economy. Any further speculation about the need of increase requests in the future is a very subjective estimate.

**Q15. Are you responsible for the Cost of Service Study ("COSS") in this rate application?**

A15. I am responsible for the COSS in this case as I completed this study for Licking Valley.

**Q16. Please explain the purpose of the COSS.**

A16. The COSS was completed based on the methods and guidance provided in the National Association of Regulatory Utility Commission ("NARUC") Electric Utility Cost Allocation Manual (1992). The purpose of this study is to determine the costs and revenue requirements to provide service to each rate class. The revenue requirements for each rate class is then compared with the current revenue from rates for each rate class to determine an increase amount for a rate class if needed. The COSS provides a breakdown into the various cost components for each rate class including the demand related costs, the energy related costs and the customer/member related components. This breakdown of costs may be used by CVE in determining the appropriate rate design for each rate class.

**Q17. What is the process used in the COSS?**

A17. The process used is the normal three step process of the functionalization of expenses, the classification of expenses and the allocation of expenses to the rate classes of CVE. Before this part of the study begins, the actual test year expenses and all test year adjustments are integrated into an adjusted statement of operations. Additionally, the margin requirements are also included and these margin requirements are based on a TIER of 2.25X as previously discussed. These total adjusted expenses are functionalized into categories based on types of plant in place on CVE's system. These types of plants include the following ones:

1) Purchased Power substation, demand and energy components;
2) Stations;

3) Lines which includes poles, overhead conductor and underground conductor,
4) Transformers;
5) Services;
6) Meters;
7) Customer and accounting service; and,
8) Outdoor lighting.

The next step in the COSS is the classification of expenses into the demand, energy and consumer components. Listed below is a breakdown of the functions into the normal components:

| Category | Demand Related | Energy Related | Cons./Member Related | Outdoor Lighting |
|---|---|---|---|---|
| Purchased Power | XX | XX | | |
| Distribution Lines | XX | | XX | |
| Distribution Transformers | XX | | XX | |
| Services | | | XX | |
| Meters | | | XX | |
| Customer Service & Account. | | | XX | |
| Outdoor Lighting | | | | XX |

The final step in the COSS is the allocation of the expenses/revenue requirements to each rate classes. A different allocator is normally used for each type of expense to be allocated. Provided below is the allocators used to allocate the demand and energy related expenses/revenue requirements to the appropriate rate class.

a) Purchased power demand related costs are allocated proportionally on the basis of each rate class's contribution to EKPC's coincident peak during the

EKPC's on-peak hours for each season. EKPC bills its demand on the basis of its coincident peak.

b) Purchased power substation costs are allocated proportionally on the basis of the sum of the monthly peak demands of each rate class.

c) Purchased power energy costs are allocated proportionally on the basis of each rate class's retails energy sales for the test year.

d) Distribution station and line demand related costs are allocated proportionally on the basis of the sum of the monthly peak demands for each rate class.

e) Distribution transformer demand related costs are allocated proportionally on the sum of the monthly peak demand for each rate class.

The consumer related components are allocated on the following basis:

a) Consumer related line costs are allocated proportionally on the number of individual accounts in each rate class.

b) Consumer related transformer costs are allocated proportionally on the basis of the minimum size transformer cost for each class weighted by the number of accounts in rate class.

c) Consumer related services costs are allocated proportionally on the cost of the minimum service and the number accounts within each rate class.

d) Meter costs are all consumer related and are allocated proportionally on the basis of the cost of the standard meter for each rate class and the number of accounts within each rate class.

e) Consumer and accounting services are allocated proportionally on the basis of the number of accounts weighted by the complexity of the bills, meter reading data and an estimate of the time that may be spent dealing with a consumer matter. The more complex the bill and the size of the bill have entered into the development of this allocation.

**Q18. How is revenue from other sources other than from electric rates handled in the COSS?**

A18. These revenues have been allocated to Schedules A, B and SL. This allocation has been made proportional on the basis of the revenue from rates for these rate classes. These revenues have the effect of reducing the need of revenue from rates for these rate classes and the lessening of the increase amount needed for these rate classes.

**Q19. Provide a summary of the results of the COSS.**

A19. The results of the COSS indicates that three rate classes do not provide enough revenue from rates to cover their revenue requirements. These rate classes are Schedule I – Residential, Schools & Churches (single phase), Schedule 1 – Marketing Rate and Schedule II – Small Commercial and Small Power (three phase) and Schedule VI – Outdoor Lighting. The results of the COSS for these four rate classes is provided below:

| COSS RESULTS OR RATE CLASSES WITH REVENUES LESS THAN COSTS | | | |
|---|---|---|---|
| | Schedule A Residential & Prepay | Schedule B Small Commercial | Schedule SL Security Lights |
| Revenue from Rates | $19,587,514 | $1,041,363 | $ 977,576 |
| Total Cost to Serve | 20,914,889 | 1,143,601 | 1,260,445 |
| Margins from Rate Revenue | ($1,327,375) | ($102,238) | ($282,869) |
| Other Revenue | 391,812 | 20,831 | 19,555 |
| Net Margins | ($935,563) | ($81,408) | ($263,315) |

All other rate classes are providing rate revenue that does recover the costs to serve.

**Q20. Are these the rate classes that you are proposing to have increases in their electric rates?**

A20. I am proposing an increase in rates for all rate classes with most of the increase being placed on the customer charges for all rate classes that have a customer charge plus increases in the rates for all lights. The energy rates for some classes are also being proposed for an increase in rates. The rationale for this approach is to keep the overall increase in Schedule I – Residential, Schools, and Churches to a reasonable amount. More importantly, it should be noted that the customer charges for most rate classes do not recover in full the consumer related costs. The above stated reasons are the primary ones for the proposals that are presented in this application.

**Q21. What are the proposed increase amounts for each rate class in this application?**

A21. The increase amounts and important ratios for each rate class are presented below:

| | | | | | |
|---|---|---|---|---|---|
| Schedule A -Residential & Prepay | $1,372,032 | -1.41 | 2.29 | (2.13) | 1.11 |
| Schedule B - Small Commercial | $88,193 | -2.35 | 1.35 | -3.21 | 0.42 |
| Schedule SL - Security Lights | $48,795 | -8.36 | -8.53 | -9.05 | -7.32 |
| Schedule LPS - Large Power Service | $53,112 | 4.79 | 7.07 | 4.79 | 5.85 |
| Schedule LPR - Large Power Rate | $527 | 9.10 | 11.22 | 9.10 | 9.18 |

**Q22. Provide a comparison of the present and the proposed rate designs and the consumer related cost for each rate class that has a customer charge.**

A22. Listed below is the requested comparison.

| RATE CLASS | Customer Charge | | Consumer |
|---|---|---|---|
| | Current | Proposed | Costs |
| Schedule A - Resid.& Prepay | $ 9.32 | $ 15.00 | $ 27.88 |
| Schedule B - Small Comm. | $ 20.71 | $ 28.75 | $ 28.91 |
| Schedule LPS -Lareg Power | $ 50.94 | $ 71.55 | $ 97.92 |
| Schedule LPR - Large Power | $ 101.89 | $ 110.00 | $ 110.14 |

**Q23. Does Licking Valley need to receive the complete amount of increase that it is requesting?**

A23. Licking Valley most certainly does need the complete amount requested in this case with one major reason being that it needs to meet its mortgage requirements. Another significant reason is to keep from having the need to come back before this Commission after very short periods of time. CVE needs the complete increase amount.

**Q24. Licking Valley has filed with this for a Certificate of Public Convenience and Necessity ("CPCN") for new AMI metering. Since this type of metering is already a part of the separate prepay rate, would it not be reasonable for this rate be reduced?**

A24. With this change it is reasonable to assume that the prepay rate can be reduced.

**Q25. How much can the prepay fee be reduced by providing AMI meters for all members?**

A.25. The prepay fee/rate can be reduced by $1.40 per month. Licking Valley is proposing to reduce this rate by $1.40 per month. The reason that Licking Valley is proposing this $1.40 per month change is that it justified a charge of $5.42 in Case No. 2014-00256 – Application of Licking Valley RECC for Approval of a Prepay Metering Tariff and feels that a new rate of $3.60 per month is very reasonable in this situation. Provided below is a table that shows the development of the $1.82 reduction and the proposed rate of $3.60.

| PREPAY SERVICE FEE CHANGE | | |
|---|---|---|
| Data from Original Filing | Original Per Member | Remove |
| Equipment Costs | | |
| Software | | |
| Smart Hub | $ 15.00 | |
| Prepay Software | 28.86 | |
| Meter Differential | 90.37 | $ 90.37 |
| CSR Setup | 7.68 | |
| Field Representative | 23.80 | 23.80 |
| Total | $ 165.71 | $ 114.17 |
| | | |
| Annual Expenses | | |
| Depreciation Expense * 6.67% | $ 11.05 | $ 7.62 |
| Interest & Margins - 4.52% | 7.49 | 5.16 |
| Software O&M - 20% of $43.86 | 8.77 | |
| Hardware O&M - 10% of $90.37 | 9.04 | 9.04 |
| Total Annual Expenses | $ 36.35 | $ 21.82 |
| Monthly | $ 3.03 | $ 1.82 |
| Other Monthly Expenses | | |
| Smarthub Monthly Support | 1.12 | |
| Prepay Software Monthly Support | 0.87 | |
| Communication Fees | 0.40 | |
| Monthly Expense Per Member | $ 5.42 | $ 1.82 |
| | | |
| Proposed Prepay Service Fee | $ 3.60 | |

**Q26. Does this conclude your testimony?**

A26. Yes, this concludes my testimony.

Affiant, James R. Adkins, states that the answers given by him in the foregoing questions are true and correct to the best of his knowledge and belief.

James R. Adkins

James R. Adkins

Subscribed and sworn to before me by the affiant, James R. Adkins, this

05th day of August, 2016.

Suzanne Camber Vance
# 556518
Notary Public, Kentucky State at Large.

My Commission Expires 05/29/2020