COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF LICKING VALLEY	)	
RURAL ELECTRIC COOPERATIVE CORPORATION FOR	)	CASE NO.
A GENERAL ADJUSTMENT OF RATES PURSUANT TO	)	2020--00338
STREAMLINED PROCEDURE PILOT PROGRAM	)	
ESTABLISHED IN CASE NO. 2018-00407	)	

LICKING VALLEY RECC'S COMMENTS IN SUPPORT OF APPLICATION FOR GENERAL RATE ADJUSTMENT

Comes now Licking Valley Rural Electric Cooperative Corporation ("Licking Valley" or "Cooperative"), by counsel, pursuant to the Commission's January 15, 2021 Order, accepting the case for streamlined treatment and providing a procedural schedule, and in further support of its Application requesting a general adjustment of its existing rates, respectfully offers the following comments:

LICKING VALLEY'S APPLICATION

Licking Valley is a not-for-profit member-owned, rural electric distribution cooperative organized under KRS Chapter 279. It is engaged in the business of distributing retail electric power to approximately 12,272 members in the Kentucky counties of Breathitt, Elliott, Lee, Magoffin, Morgan, Rowan and Wolfe.[1] Licking Valley is one of sixteen Owner-Members of East Kentucky Power Cooperative, Inc. ("EKPC"), which serves as the wholesale electricity provider for the Cooperative. Licking Valley owns and maintains approximately 2,076 miles of distribution

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[1] *See* Application, p. 1.

lines connecting ten substations.[2] During 2019, the test year in this case, Licking Valley's average residential customer used approximately 969 kWh of electricity per month.[3] As of December 31, 2019, Licking Valley had 16,187 residential meters and 1,085 commercial and industrial meters.[4] Licking Valley's current rates became effective on March 1, 2017, when the Commission approved an increase in the monthly residential customer charge from $9.32 to $14.00, creating additional revenues of $1,282,465, based on a Times Interest Earned Ratio ("TIER") of 2.00X, resulting in net income of $426,956. This increase in revenues equated to an Operating TIER ("OTIER") of 1.78.[5] In this case, Licking Valley seeks approval to increase its annual revenues by 2.21%, or $595,560, to achieve a TIER of 1.38, and an OTIER of 1.30.[6] Licking Valley also seeks approval to increase its monthly residential customer charge by $3.09 from $14.00 to $17.09, with no change in the residential energy charge.[7] The entire increase is requested to be placed on Licking Valley's Schedule A—Residential, Farm, Small Community Hall & Church Service, rate class and amounts to a 2.88% increase to that class.[8] The average residential customer would realize a $3.09 increase to their monthly bill.[9]

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[2] *See* Kerry Howard Testimony ("Howard Testimony"), Application Exhibit 7, p. 3.

[3] *See Id.,* p. 3-4

[4] *See Id.,* p. 4.

[5] *See Id.*; *See also* Case No. 2016-00174, *In the Matter of: Application of Licking Valley RECC for a General Adjustment of Rates.*

[6] *See* Application, p. 2-3.

[7] *See Id.*; *See also* Howard Testimony, p. 4.

[8] *See* Application, Exhibit 4.

[9] *See Id*.

In the Application, Licking Valley proposed that rates go into effect on January 18, 2021. However, in its January 15, 2021, Procedural Order, the Commission suspended the effective date of the proposed rates for five months, up to and including June 18, 2021.[10]

Combined, Commission Staff and the Kentucky Attorney General[11] submitted in excess of 150 Requests for Information (including subparts) on Licking Valley which filed its responses to same on February 11, 2021. The case will stand submitted for decision by the Commission on February 19, 2021.[12]

SEVERAL FACTORS CONTRIBUTE TO LICKING VALLEY'S NEED FOR THE REQUESTED RATE ADJUSTMENT

Since the 2016 rate case was concluded Licking Valley has experienced increased costs in many areas of its business. These increases have been mitigated to some degree by management-driven cost reductions in categories such as labor expense by holding the line on employee wage raises, cutting overtime and maintaining adequate but not excessive employee headcount, extending the lives of expensive vehicles such as digger and bucket trucks, re-purposing cost-intensive distribution equipment removed from the field such as regulators, transformers and breakers instead of buying new equipment, and improved right-of-way/vegetation management plan, deployment of an effective Advanced Metering Infrastructure ("AMI") and office communication systems, deployment of an efficient Outage Management system utilizing updated

[10] *See* Order, Jan. 15, 2021, p. 3.

[11] The Kentucky Attorney General's Office of Rate Intervention was granted intervention by Order of the Commission on Dec. 21, 2020.

[12] *See* Order, 01/15/21, p. 4.

Global Positioning System ("GPS") mapping of the Cooperative's service territory, and reductions in advertising and donation expense.[13]

Despite these measures, stagnant customer and load growth directly related to the poor economy in Licking Valley's service territory has resulted in financial measures that are below what is needed to keep pace with costs and ensure financial integrity. In addition, as in the 2016 case, Licking Valley's existing rate structure does not align with its cost of providing service, resulting in margins that are more susceptible to volatility. The requested increase is necessary to ensure Licking Valley is able to maintain its loan covenants and provide safe and reliable service to its owner-members.[14]

Virtually all of Eastern Kentucky, including Licking Valley's eight county service territory, has been in the midst of an economic crisis for several years which has only increased in severity since Licking Valley's last rate case.[15] This poor economic climate is clearly reflected in the Cooperative's comparative energy sales from 2010 to 2019. During this ten-year period Licking Valley has experienced a 12% decline in residential sales and a 14% decline in Commercial and Industrial sales that has resulted in a 13% overall decline in total energy sales.[16] Since the 2016 rate case, Licking Valley's member growth has remained stagnant, overall economic conditions in the service territory have remained very challenging, and both net and operating margins, as well as key financial ratios have declined.[17]

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[13] *See* Howard Testimony, p. 5.

[14] *See Id*.

[15] *See* Licking Valley's response to AG-DR-01, where the average poverty rate for the eight counties in its service territory is 28.4%.

[16] *See* Howard Testimony, p. 6.

[17] *See* Howard Testimony, p. 6, and Exhibit KKH-2; *See also,* Application Exhibit 31.

Licking Valley's retail load of approximately 240 MW is primarily residential. As of December 31, 2019, Licking Valley's residential load accounted for approximately 78% of the Cooperative's total energy usage and represented approximately 75% of total revenue from energy sales.[18] Licking Valley also serves a number of commercial customer loads, although those have been declining in recent years. Cumulatively, those commercial customers account for approximately 22% of Licking Valley's total energy usage and represent approximately 25% of revenue from energy sales.[19]

It is against this very challenging economic backdrop that Licking Valley has tried to both mitigate its loss of sales by concentrating on a strategy of cost-containment and delay any increase in residential rates.

LICKING VALLEY HAS CONTINUED ITS COMMITMENT TO CONTAINING COSTS WHEREVER POSSIBLE

Licking Valley's management and Board of Directors work diligently to identify and implement cost-saving measures wherever possible, and have done so for many years. In spite of this Licking Valley has experienced increases in labor, depreciation and materials.[20] Yet, considering these and other challenges Licking Valley has done a remarkable job in managing its costs, which has resulted in a temporary postponement of the rate increase being requested in this case. Below are a few examples of these efforts:

- **WAGES AND SALARIES—**Because Licking Valley is non-union there is not a collective bargaining agreement mandating periodic annual raises. Historically,

[18] *See* Sandra Bradley's testimony ("Bradley Testimony"), Application Exhibit 8, p. 5.

[19] *See Id*.

[20] *See* Bradley Testimony, p. 6.

wages and salaries were set and maintained according to a pay scale which considered both local wages and what similar jobs paid at other like-sized Kentucky distribution cooperatives. These wages and salaries struck a balance between a fair wage to the employee without overpaying at the owner-member's expense. Recognizing that this method of setting pay was somewhat subjective, the Commission recommended in the 2016 rate case Order that Licking Valley should prepare a detailed wage and salary and benefits survey to re-set any wages that were problematic. Licking Valley complied with this recommendation and has employed a respected and experienced wage and salary consultant who has provided an empirically-based wage and salary study which incorporated local wage information where available for the geographic area of Licking Valley's operations and included state data where available.[21] Licking Valley's management and Board of Directors have been exceedingly frugal in dispensing employee raises as well. Between 2015 and 2020, the average annual salaried and non-salaried employee raise has been a very modest 1.75%.[22] This average annual raise doesn't even amount to a traditional cost-of-living adjustment given by most every other employer in the United States. Of equal importance is Licking Valley's commitment to holding the line on employee headcount through attrition. Between 2010 and 2020 Licking Valley's employee roster decreased from 48 to 41, where it

[21] *See* Licking Valley's response to PSC-DR-01-07 for a copy of this wage and salary survey. It has been recently implemented and will be periodically reviewed and refreshed by Licking Valley's consultant to insure it remains current.

[22] *See* Licking Valley's response to AG-DR-01-23, pp. 6-8

remains today.[23] In a further effort to reduce costs, Licking Valley has also eliminated part-time employment.[24]

- **RETIREMENT, HEALTH, AND OTHER BENEFITS—**Licking Valley maintains a reasonable suite of employee benefits necessary to attract and maintain a skilled work force consistent with those offered by similarly sized distribution cooperatives. It offers a defined-contribution plan (401(k)) for both salaried and non-salaried employees, with employee contributions to the plan being non-mandatory. Under the retirement plan an employee must contribute a sum equal to at least four percent (4%) of his/her wages before Licking Valley is required to make a match equal to eleven percent (11%) of wages.[25] This is the only match Licking Valley makes to the employee's retirement regardless of how much additional the employee might choose to voluntarily contribute. As of the test year, Licking Valley contributed 100% of health insurance premiums for single coverage. For family coverage an employee contributed 10.37%, with Licking Valley paying the rest of the premium.[26] However, Licking Valley is mindful of the line of recent Commission orders in distribution cooperative rate cases requiring greater employee contribution levels, and beginning September 1, 2020, all Licking Valley employees began paying 10.37% toward their health insurance premiums

[23] *See* Licking Valley's response to AG-DR-01-12.

[24] *See* Licking Valley's response to AG-DR-01-18.

[25] *See* Licking Valley's response to AG-DR-01-19.

[26] *See* Bradley Testimony, p. 7.

regardless of coverage-type.[27] This decision will further reduce Licking Valley's costs for employee health insurance.[28] Besides retirement and health, Licking Valley also provides modest life insurance and long-term disability coverage for its employees.[29]

- **DIRECTOR'S FEES AND EXPENSES**—In the past several distribution cooperative rate cases the Commission has emphasized the importance of holding the line on the annual fees and expenses paid to directors. Licking Valley could be the model among Kentucky distribution cooperatives in this category. The Cooperative's directors only receive $300.00 for attendance at board meetings, with the Secretary-Treasurer receiving $600.00 in consideration of the extra duties and time spent addressing financial and other ministerial responsibilities. Directors do not receive health, dental or vision insurance, retirement benefits or traditional life insurance. The only added benefit for directors is accidental death and dismemberment coverage which costs Licking Valley less than $15.00 annually per director.[30] For the test year directors' fees and expenses were only $32,700.00.[31] This is a testament to Licking Valley's philosophy of company-wide cost control.
- **INTEREST EXPENSE**—The two principal cost drivers at any distribution cooperative are the cost of wholesale electricity and interest expense. East

[27] *See Id*, p. 8.

[28] However, this decision has recently resulted in two employees leaving Licking Valley to take jobs for other employers which pay 100% of health insurance premiums. *See* Licking Valley's response to AG-DR-01-20.

[29] *See* Bradley Testimony, p. 7; Licking Valley's response to AG-DR-01-19.

[30] *See* Licking Valley's supplemental response to AG-DR-01-24.

[31] *See Id*., p. 2.

Kentucky Power Cooperative's wholesale power rates are among the lowest of any generation and transmission cooperative in the United States and are closely monitored by the Commission. Regarding interest expense, as of the end of the test year the outstanding principal balance on Licking Valley's long-term debt was $31,678,482.[32] Of this amount only about 10% is at fixed interest rates with a blended rate of 5.18%, and 90% is at variable interest rates with a blended rate of only1.77%.[33] Licking Valley has historically taken advantage of any refinancing opportunities that made good financial sense for it. These decisions are reflected in Licking Valley's very favorable composite blended interest rate of 2.12%.[34] However, because Licking Valley has been required to borrow more money for its construction work plan and other needs, total interest expense has increased substantially. In summary, Licking Valley has been very attentive and successful in reducing its overall blended interest rate; however, its interest expense has risen because reduced margins have resulted in the need to borrow more money for usual and customary business activities. While the savings realized by Licking Valley's excellent debt and interest rate stewardship have not been formally calculated, they have been substantial. In the current environment of eroding sales coupled with increased costs in most other aspects of its operations, Licking Valley's focus on a low interest debt portfolio has been a godsend.

[32] *See* Bradley Testimony, p. 6.

[33] *See Id*.

[34] *See Id*.

THE COST OF SERVICE STUDY DEMONSTRATES THAT THE PROPOSED INCREASE IN BASE RATES IS NECESSARY TO MAINTAIN LICKING VALLEY'S FINANCIAL HEALTH

Rate consultant John Wolfram has presented numerous cost of service studies that have been accepted by the Commission in other dockets, and has sponsored expert testimony on other rate-related matters in many cases before the Commission. In this case he has presented a very detailed Cost of Service Study and almost 30 pages of substantive testimony to support it.[35]

The revenue requirement was determined as the difference between (i) Licking Valley's net margins for the adjusted test period without reflecting a general adjustment in rates, and, (ii) the cap of the lower of (a) an OTIER of 1.85, and, (b) to the overall rate increase of three times 0.75 percent, or 2.25 percent, based on the three years that have transpired since Licking Valley's last base rate change, pursuant to the requirements of the Streamlined Rate Order.[36] Based on the adjusted test year under the OTIER cap, the revenue deficiency is $1,095,880. However, pursuant to the annual rate increase cap, the increase is limited to an overall increase of 2.25 percent, or $596,421. Due to rate rounding, Licking Valley's request is for an increase of $595,560, which yields an OTIER of 1.30.[37]

Mr. Wolfram's Exhibit JW-2 to his Application Exhibit 9 is the key evidence supporting Licking Valley's rate adjustment request in this case. The TIER, OTIER, Margins at Target TIER, and Revenue Deficiency amounts are calculated at the bottom of page one of Exhibit JW-2. At an OTIER of 1.85 the calculated revenue deficiency is $1,095,880.[38] However, since Licking Valley

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[35] Specific reference is made to all of Mr. Wolfram's testimony (Application Exhibit 9) and his Application exhibits. Because of the highly detailed nature of his work only a summary of the most important findings is offered here.

[36] *See* Case No. 2018-00407, *A Review of the Rate Case Procedure for Electric Distribution Cooperatives*, Order 12/20/19; *See Also,* Wolfram Testimony pp. 7-8.

[37] *See* Wolfram Testimony, p. 8.

[38] *See* Wolfram Testimony, p. 9; *See also* Exhibit JW-2, p. 1 of 15.

is required to limit the increase it seeks to 2.25% overall, the above revenue deficiency is automatically reduced from $1,095,880 to $595,560 (after rate rounding).[39] The calculation resulting in this amount can be reviewed on the last two lines of Exhibit JW-2, page 1 of 15. This revenue deficiency was used by Mr. Wolfram in the Cost of Service Study and in designing Licking Valley's new rates.[40] Should the Commission make any downward adjustments to the rate request here, Licking Valley requests that consideration by given to the difference between the revenue requirement at the 1.85 OTIER and 2.25% cap. At the filed rates, a downward adjustment of $500,320 could be made (i.e., $1.095,880 less $595,560) without impacting Licking Valley's overall requested rate increase.[41]

Mr. Wolfram was careful to make necessary and recognized pro forma adjustments which remove revenues and expenses addressed in other rate mechanisms, are ordinarily excluded from rates, or are non-recurring prospectively, consistent with standard and long-established Commission practice, and which are to be excluded at the Commission's direction in Case No. 2018-00407.[42]

Mr. Wolfram next prepared a detailed Cost of Service Study based on the pro forma operating results for the test year.[43] The Cost of Service findings demonstrate "that existing rates foster a relatively high degree of subsidization between [Licking Valley's] rate classes," and "an

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[39] *See* Wolfram Testimony, pp. 9-10.

[40] *See* Wolfram Testimony, p. 10; *See also* Exhibit JW-2.

[41] *See* Wolfram Testimony, p. 10.

[42] *See* Case No. 2018-00407, *A Review of the Rate Case Procedure for Electric Distribution Cooperatives; See also* Wolfram testimony, p. 10. A detailed discussion of the most important and impactful pro forma adjustments made by Mr. Wolfram in his analysis can be found at pages 11-15 of his testimony.

[43] *See* Wolfram Testimony, p. 15. A detailed description of the steps employed in performing the Cost of Service Study is found at pages 15-24 of Mr. Wolfram's testimony, and summarized in Exhibit JW-3.

imbalance within the current rate structure between the recovery of fixed costs and variable costs, particularly within the residential class."[44] Importantly, the Cost of Service Study results indicate that rates for the residential class are insufficient and should be increased; and, there is clear support for a fixed monthly charge of $19.07 for the residential class.[45] Licking Valley's current monthly customer charge is only $14.00 and the mismatch between this number and what the Cost of Service Study shows the monthly charge should be is stark. Clearly, Licking Valley's current customer charge is well below cost-based rates which means that the current rate structure places too little recovery of fixed costs in the customer charge, which results in significant under-recovery of fixed costs. Mr. Wolfram referred to this situation as a "fundamental challenge" facing Licking Valley from a cost recovery perspective, particularly because residential members make up the vast majority of Licking Valley's membership.[46]

<u>LICKING VALLEY'S REQUEST FOR RELIEF</u>

Licking Valley's proposed rate increase and rate design are fair, just and reasonable. Licking Valley's management and board of directors have labored diligently to contain recurring costs in order to delay and mitigate the effect of this rate adjustment on its residential customers. As shown by Mr. Wolfram's comprehensive rate analysis, Licking Valley seeks to align its rates so that the customer class causing it to incur costs is the same class that pays those costs. While this rate adjustment, if granted, will not fully and finally address this disparity, the proposed rate design change will reduce the current misallocation of cost/cost-causer in accordance with the Commission's stated preference towards gradualism.

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[44] *See* Wolfram Testimony, p. 23.

[45] *See* Id., p. 24. Even though the $19.07 fixed monthly charge for the residential class could be supported, Licking Valley is only requesting a $17.09 fixed monthly charge.

[46] *See* Id, p. 24; *See also* Licking Valley's response to AG-DR-01-03, p. 2. At $14.00, Licking Valley's current customer charge is tied for the fifth lowest among all of Kentucky's electric distribution cooperatives.

It is widely accepted that as far as customers are concerned, there is never a good time to increase rates. Licking Valley anticipates that the Attorney General will argue that now is not the time for residential customers to pay more. Licking Valley has always been mindful of the effect of any requested rate increase on its customers, and this situation is no different. As discussed in these Comments, Licking Valley has pulled every possible lever to cut costs and run its business as lean as possible. However, the reality is that there are simply not enough savings available to offset the reduction of customers and economic difficulties in the service territory demonstrated by loss of both residential and commercial/industrial energy sales.[47]

Furthermore, Licking Valley's proposal to revise rates limits the overall increase to a nominal amount, consistent with the Commission's stated aims in the streamlined orders to "encourage Distribution Cooperatives to make more frequent, smaller rate adjustments as needed" and "avoid, or at least diminish, rate shock that may result from large infrequent rate increases."[48] Licking Valley sought this rate revision pursuant to the streamlined rate case procedure in order to balance the need to increase cooperative margins with the economic challenges facing our members in eastern Kentucky. The requested increase was limited to 2.25% (although technically an increase of 3.00% could be permissible under the streamlined process if the rates were put into effect after March 1, 2021, given that the last rate increase became effective on March 1, 2017). In its January 15, 2021, Order sustaining Licking Valley's request to proceed under the streamlined rate case procedure, the Commission stated, "…the rates that Licking Valley RECC proposes in its application, or even the maximum rate increase allowed under the streamlined procedure, barely

[47] *See* Howard Testimony, Exhibit KKH-2, demonstrating the downward trends of kWh sales, electric revenue, margins and financial ratios between 2010-2019.

[48] *See* Case No. 2018-00407, *A Review of the Rate Case Procedure for Electric Distribution Cooperatives,* Order 12/11/18, pp. 1-2.

provide sufficient revenue to allow Licking Valley RECC to meet its [TIER and OTIER]. While the Commission is accepting this application under the streamlined procedure, it does so with some trepidation, and the expectation that Licking Valley RECC's rates may need additional study in subsequent proceedings."[49] Licking Valley understands the Commission's concern and pledges to closely monitor its key financial metrics so as not to veer into sustained mortgage default territory. If that were to occur, Licking Valley would come back to the Commission for additional rate relief.

Licking Valley's proposal in this case is both measured and necessary for its continued financial health. It is based entirely upon a comprehensive and reliable Cost of Service Study employing known and measurable changes during the test year. It is fair, just and reasonable both in terms of the revenue request and the rate design chosen to implement it.

The requested customer charge increase is needed to keep moving Licking Valley's rate structure towards cost-based rates, in order to reduce the revenue erosion that results from having too great a portion of utility fixed cost recovery embedded in the variable charge. For an electric cooperative that is strictly a distribution utility, there is need to guard against the revenue erosion that often occurs due to the decrease in sales volumes that accompanies poor regional economies, changes in weather patterns, and continued demand-side management and energy-efficiency programs.[50] If granted, the rate adjustment requested by Licking Valley here will allow continuation down that path begun in its 2016 rate case.

Licking Valley appreciates the Commission's decision to allow this case to proceed under the streamlined process and believes the modest increase requested is wholly consistent with the

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[49] *See* Order, 1/15/21, pp. 1-2.
[50] *See* Wolfram Testimony, pp. 28-29.

Commission's original philosophy and purpose in enacting it. Licking Valley likewise appreciates the questions and constructive participation of the Kentucky Attorney General in the case.

Licking Valley respectfully asks that the Commission enter a final rate order adopting this rate adjustment request in full, including recovery of rate case expense amortized over a three-year period.

This 18th day of February, 2021.

Respectfully Submitted,

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CERTIFICATE OF SERVICE

The undersigned certifies that the foregoing is a true and accurate copy of the same document filed in paper medium, that the electronic filing was filed with the Commission on February 18, 2021; that there are currently no parties that the Commission has excused from participation by electronic means in this proceeding; and that the original in paper medium of the foregoing will be filed with the Commission within thirty days of the state of emergency for COVID-19 being lifted.

Mark David Goss

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