

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF CUMBERLAND VALLEY)	
ELECTRIC, INC. FOR A GENERAL)	CASE NO
ADJUSTMENT OF RATES)	2016-00169

ORDER

On June 6, 2016, Cumberland Valley Electric, Inc., ("Cumberland Valley") tendered for filing its application for a proposed \$1,975,812 increase in its electric base rates and a \$22,450 increase in nonrecurring charges. Cumberland Valley stated that the proposed increase was required in order to meet the terms of its mortgage agreement, maintain its financial stability, and cover increases in fixed and variable costs for power, materials, equipment, labor, and taxes. By letter dated June 10, 2016, the Commission notified Cumberland Valley that its application was rejected as deficient. On June 23, 2016, Cumberland Valley tendered an amended application, and the amended application was deemed filed as of that date. In the amended application, Cumberland Valley proposed that the new rates become effective on July 25, 2016. Finding that an investigation would be necessary to determine the reasonableness of Cumberland Valley's proposed increase, the Commission suspended the rates for five months, up to and including December 24, 2016.

BACKGROUND

Cumberland Valley is a member-owned rural electric cooperative corporation, organized under KRS Chapter 279, and engaged in the distribution and sale of electric

energy to approximately 23,596 member-consumers in Bell, Clay, Harlan, Knox, Laurel, Leslie, Letcher, McCreary, Whitley counties, Kentucky.¹ Cumberland Valley has no electric generating facilities; it purchases its total power requirement from East Kentucky Power Cooperative, Inc. ("EKPC").²

The Commission granted a motion to intervene filed by the Attorney General of the Commonwealth of Kentucky, by and through his Office of Rate Intervention ("AG"). A procedural schedule was issued which provided for discovery upon Cumberland Valley, intervenor testimony, discovery upon intervenors, and a public hearing. Cumberland Valley responded to four rounds of discovery from Commission Staff ("Staff"), two rounds of discovery from the AG, one round of post-hearing requests for information issued by Staff, and one round of post-hearing requests for information issued by the AG. No intervenor testimony was filed. A public hearing was conducted on November 30, 2016. Cumberland Valley submitted its responses to post-hearing information requests on December 16, 2016. The AG and Cumberland Valley filed respective notice that they would forego further briefing and submit the matter to the Commission for a decision based on the existing record, which includes, but is not limited to, written testimony, responses to requests for information, and hearing testimony.

TEST PERIOD

Cumberland Valley proposed, and the Commission accepted, a historical 12-month period ended November 30, 2015, as the test period for determining the

¹ Cumberland Valley 2015 Annual Report (filed Mar. 9, 2016), at 46 and 54.

² *Id.* at 41 and 44.

reasonableness of the proposed rates. In utilizing the historical test year, the Commission considered appropriate known and measurable changes.

VALUATION

Rate Base

Cumberland Valley determined a net investment rate base of \$66,070,122³ based on the adjusted test-year-end value of plant in service and construction work in progress (“CWIP”), the 13-month average balances for materials and supplies, and prepayments, plus a cash working capital allowance, minus the adjusted accumulated depreciation and the test-year-end level of customer advances for construction.

The Commission concurs with Cumberland Valley’s proposed rate base with the exception that working capital has been adjusted to reflect the pro forma adjustments to operation and maintenance expenses. With this adjustment, Cumberland Valley’s net investment rate base for ratemaking purposes is as follows:

Utility Plant in Service	\$100,581,010
CWIP	<u>229,395</u>
Total Utility Plant	\$100,810,405
ADD:	
Materials and Supplies	\$ 444,962
Prepayments	158,454
Working Capital	<u>978,633</u>
Subtotal	\$ 1,582,049
DEDUCT:	
Accumulated Depreciation	\$36,252,248
Customer Advances for Construction	<u>83,281</u>
Subtotal	\$36,335,529
 NET INVESTMENT RATE BASE	 <u>\$66,056,925</u>

³ Response to Commission Staff’s Third Request for Information (“Staff’s Third Request”), Item 9, at 3 of 12.

Capitalization and Capital Structure

The Commission finds that Cumberland Valley’s capital structure at test-year-end was, for ratemaking purposes, \$67,827,210. This capital structure consisted of \$19,903,297 in equity and \$47,923,913 in long-term debt. The Commission excluded generation and transmission capital credits (“GTCCs”) in the amount of \$23,066,206. Using this capital structure, Cumberland Valley’s year-end ratio of equity to total capitalization was 29 percent.⁴

REVENUE AND EXPENSES

Cumberland Valley proposes several adjustments to revenues and expenses to reflect current and expected operating conditions. The Commission finds that ten of the adjustments proposed by Cumberland Valley and not opposed by the AG are reasonable and should be accepted without change. Those adjustments are shown in the following table:

<u>Description</u>		<u>Adjustments</u>
Normalize Revenues	\$	(2,830,652)
Normalize Purchased Power Costs	\$	(2,835,633)
Depreciation	\$	214,741
Interest on Long-Term Debt	\$	397,503
Advertising	\$	(1,144)
Donations	\$	(12,632)
Professional Fees	\$	(17,212)
G&T Capital Credits	\$	(2,489,156)
Non-recurring Charges	\$	22,498
Year-End Customer Adjustment	\$	(29,433)

The Commission makes modifications to the remaining proposed adjustments as discussed below.

⁴ Response to Staff’s Third Request, Item 9, at 8 of 12.

Salaries & Wages

Cumberland Valley proposed an adjustment of \$59,943⁵ to normalize total wages and salaries, of which \$19,933 was capitalized⁶ and \$40,010 was expensed. Cumberland Valley's calculations for full-time employees were based on 2,080 hours. The calculations for its part-time employees were based on the number of hours actually worked during the test year. Test-year actual overtime hours were multiplied by 1.5 times the test-year-end wage rates for employees who come under the current labor agreement.⁷ The Commission determined that the proposed adjustment includes \$23,311 in pay increases for salaried employees.

The Commission has several continuing concerns regarding the salaries and wages paid to Cumberland Valley employees, particularly the increases granted to its salaried employees. In Cumberland Valley's last rate case, Case No. 2014-00159, the Commission expressed concern about Cumberland Valley's method for determining pay increases for salaried employees.⁸ Stating that it shared the concerns of the AG and recognizing there was evidence that pay increases for union employees were properly determined through negotiations by both sides, the Commission expressed its concerns with Cumberland Valley's practice of automatically granting the same pay increase to

⁵ Application, Exhibit 1.

⁶ The capitalized portion reflects actual capitalized costs and payroll costs allocated to other accounts. The other accounts include amounts assigned to clearing, stores, transportation and employee sick leave. Unless otherwise noted, references in this Order to "capitalized" reflect this combination of actual capitalized costs and other costs.

⁷ Application, Exhibit 1.

⁸ Case No. 2014-00159, *Application of Cumberland Valley Electric, Inc. for an Adjustment of Rates* (Ky. PSC Jan. 16, 2015), Order ("Final Order") at 6–8.

salaried employees as that negotiated by union employees.⁹ In expressing its shared concern with the AG, the Commission also took note of the AG's recommendation that Cumberland Valley base pay increases for salaried employees on employee performance.¹⁰ The Commission informed Cumberland Valley that "future increases granted to or proposed for salaried employees will need to be fully justified and documented to show the basis for any proposed increases."¹¹

In September 2015, after the Commission issued its Order stating that it shared the AG's concerns about Cumberland Valley's method for determining salaried employees' pay increases,¹² Cumberland Valley again awarded the same wage-increase percentage to its salaried employees as was negotiated by its union employees.¹³ Cumberland Valley granted a 3.5 percent pay increase for salaried employees that was not based on performance, but instead was granted to "promote consistency" with the pay increase received by union employees, and because in 2012, the Cumberland Valley's Board of Directors had approved pay increase percentages through 2015.¹⁴ In response to a Staff request for information, Cumberland Valley asserted that it will "move away" from its decision to base its salaried employees' pay

⁹ *Id.* at 8.

¹⁰ *Id.*

¹¹ *Id.*

¹² *Id.* at 7.

¹³ Application, Exhibit 1, at 1.

¹⁴ Response to Commission Staff's Second Request for Information ("Staff's Second Request") (filed Aug. 10, 2016), Item 18.c.; Cumberland Valley's Response to Staff's Third Request (filed Sept. 8, 2016), Item 14.c.

increases on those provided in the union contract once Cumberland Valley's new wage and salary plan is adopted.¹⁵

The Commission finds that Cumberland Valley did not base the 2015 pay increase for salaried employees on employee performance or take into consideration any of the concerns shared by the Commission and the AG in Cumberland Valley's last rate case, but instead continued to award pay increases to salaried employees based on the amount awarded to union employees. This action is contrary to the Commission's directive "that any pay increase for salaried employees needs to be properly justified . . ." ¹⁶ and fails to fully consider Cumberland Valley's deteriorating financial condition and the significant economic decline in Cumberland Valley's service area. For the above reasons, the Commission further finds that including the test-year pay increase for salaried employees is not reasonable and should not be accepted for ratemaking purposes. The Commission recalculated the proposed adjustment to salaries and wages, excluding the pay increase for salaried employees, and has decreased the salaries and wages adjustment from \$40,010 to \$24,462.

The Commission is also concerned about the lack of information to evaluate salaries and wages paid to all Cumberland Valley employees, salaried and union, as compared to other businesses operating within Cumberland Valley's nine-county service area. Pursuant to the Final Order in Case No. 2014-00159, Cumberland Valley provided a salary and wage survey that analyzed Cumberland Valley's salaried non-

¹⁵ Response to Staff's Second Request, Item 18.c. The wage and salary plan was finalized but not funded or implemented at the time of the Nov. 30, 2016 hearing in this matter. Video Transcript of Nov. 30, 2016 Hearing ("HVT"), 10:16:29.

¹⁶ Final Order at 8.

union employees' salaries against salaries for national, regional, and state cooperative distribution systems located throughout the United States, and salaries for industries in Kentucky with annual revenues of \$48 million.¹⁷ However, Cumberland Valley did not provide salary and wage information specific to its service area. The Commission has begun placing more emphasis on evaluating salary and benefits provided by electric cooperatives as they relate to competitiveness in a broad marketplace, as opposed to wage and salary studies limited exclusively to electric cooperatives, electric utilities, or other regulated utility companies.¹⁸ Future rate applications filed by Cumberland Valley will be required to include a formal study that provides local wage and benefit information for the geographic area where Cumberland Valley operates and must include state data where available.

Payroll Taxes

Cumberland Valley proposed to increase its payroll taxes by \$6,229,¹⁹ based on the proposed normalization of wages and salaries and reflecting the Federal Insurance Contribution Act base wage limit of \$118,500 for 2015, and federal and state unemployment wage limits and rates in effect at the test-year-end. Of this amount, \$1,951 was capitalized and \$4,278 was expensed.²⁰ The Commission determined that the proposed adjustment includes \$1,588 attributable to the pay increases for salaried employees.

¹⁷ Application, Exhibit 19.

¹⁸ See Case No. 2015-00312, *Application of Kenergy Corp. for a General Adjustment in Rates* (Ky. PSC Sept. 15, 2016), at 15.

¹⁹ Application, Exhibit 2.

²⁰ *Id.*

For the reasons discussed above regarding the salary increases awarded in the test year, the Commission finds that including the proposed test-year increase for payroll taxes attributable to the salary increase is not reasonable and should not be accepted for ratemaking purposes. The Commission recalculated the proposed adjustment to payroll taxes to exclude the increase attributable to the increase in salaries and has decreased the payroll tax adjustment from \$4,278 to \$3,219.

Retirement

Cumberland Valley proposed to increase its retirement expense by \$25,986,²¹ based on the proposed normalization of wages and salaries and the 2016 contribution rate. Of this amount, \$8,137 was capitalized and \$17,849 was expensed.²² Cumberland Valley participates in the National Rural Electric Cooperative Association's Retirement security program.²³ Cumberland Valley contributes to a defined-benefit pension plan for salaried employees and 401(k) plans for salaried and union employees. Employee contributions to the 401(k) plans are not required.²⁴ The Commission determined that the proposed adjustment includes \$16,726 attributable to the pay increases for salaried employees.

For the reasons previously discussed regarding the salary increases awarded in the test year, the Commission finds that including the test-year increase for retirement expense attributable to the increase in salaries is not reasonable and should not be accepted for ratemaking purposes. The Commission recalculated the proposed

²¹ Application, Exhibit 5.

²² *Id.*

²³ *Id.*

²⁴ Response to Staff's Second Request, Item 20.

adjustment to retirement expense to exclude the increase attributable to the increase in salaries and has decreased the retirement expense adjustment from \$17,849 to \$1,123.

The Commission is concerned that Cumberland Valley has failed to take more aggressive steps to control compensation and benefit costs. The Commission believes all employees should have a retirement benefit, but finds it excessive and not reasonable that Cumberland Valley continues to contribute to both a defined-benefit pension plan as well as a 401(k) plan for salaried employees. The Commission will allow Cumberland Valley to recover only the costs of the more expensive defined-benefit plan for the salaried employees and the 401(k) plan for union employees. Accordingly the Commission will remove for ratemaking purposes Cumberland Valley's test-year 401(k) contributions for salaried employees. Cumberland Valley's test-year expense for 401(k) contributions to the salaried employee plan was \$51,628.²⁵ Recognizing the portion that would be capitalized, the Commission will remove \$36,759 from the test year for salaried employee 401(k) plan expense.

Based on these findings, the Commission has reduced Cumberland Valley's retirement expense by \$53,485.

Employee Contribution for Health, Dental, and Life Insurance

Cumberland Valley currently pays 100 percent of the monthly premiums for health insurance for its employees, their spouses, and dependents, and 100 percent of supplemental Medicare insurance premiums for retirees, their spouses, and dependents. Cumberland Valley currently pays 100 percent of the monthly premiums for dental insurance for its employees. For employees with a family dental insurance

²⁵ Response to Attorney General's Second Request for Information, Item 9, at 8 and 9 of 9.

plan, Cumberland Valley currently pays 100 percent of the employee's portion of the monthly premium, and 50 percent of the family portion, with the employee paying the remaining 50 percent of the family portion. Cumberland Valley also pays 100 percent of life insurance premiums for its employees.²⁶ Cumberland Valley explained that, in the past, employees paid a portion of their health insurance premiums, but that practice was changed as a result of previous union contract negotiations.²⁷ Cumberland Valley also acknowledged that the majority of businesses do not pay 100 percent of employees' health insurance costs, but instead require employees to contribute some portion of the monthly premiums.²⁸ Cumberland Valley indicated that, in the first quarter of 2017, it will begin an analysis of requiring employees to contribute to health insurance premiums as part of its overall evaluation of reducing expenses.²⁹

The Commission expects Cumberland Valley to increase its efforts to reign in expenses for employee benefits by re-establishing a policy of limiting Cumberland Valley's contribution to health insurance premiums and requiring that employees pay some portion of the premium. The Commission also recognizes that benefits provided to Cumberland Valley's union employees are determined by negotiations by both sides, and that Cumberland Valley is currently in the midst of contract negotiations with its unions.³⁰ For the above reasons, the Commission finds that Cumberland Valley should limit its contributions to its employees' health care and dental plans to percentages

²⁶ *Id.*

²⁷ HVT at 11:32:26, 1:31:28.

²⁸ *Id.* at 9:48:36.

²⁹ *Id.* at 1:31:28.

³⁰ The current union contract expired August 31, 2016. Response to Staff's Third Request, Item 15.

more in line with those of other businesses in order to reduce its expenses. This finding is limited to salaried employees, because only the salaried employees receive a benefit package that is determined solely by, and within the sole control of, the Cumberland Valley Board of Directors, with input from Cumberland Valley executive staff.

Accordingly, the Commission will for ratemaking purposes adjust test-year health and dental insurance expense for salaried employees based on national average employee contribution rates. The Commission has reduced health insurance expense for salaried employees \$33,616, based on a 32 percent employee contribution rate.³¹ The Commission has also reduced dental insurance expense for salaried employees in the amount of \$3,859 based on a 60 percent employee contribution rate.³² The Commission will accept the test-year expense for life insurance for salaried employees in this case. However, any future Cumberland Valley rate increase request for cooperative paid life insurance will be capped at the lesser of an employee's annual salary or \$50,000.

Within 60 days of the date of this Order, Cumberland Valley should file a report setting forth the employer and employee contribution amounts and percentages Cumberland Valley will implement for health and dental insurance offered to salaried employees, along with the date the revised contribution schedule will be implemented. Within 30 days of the date that the revised employer/employee health and dental

³¹ Bureau of Labor Statistics, Healthcare Benefits, March 2016, Table 4, private industry workers. (<https://www.bls.gov/ncs/ebs/benefits/2016/ownership/private/table10a.pdf>)

³² The Willis Benefits Benchmarking Survey, 2015. (http://willis.com/mwg-internal/de5fs23hu73ds/progress?id=lozsydmbJ6UUSxKxrjVJW5NDCRkgZEEps6-AgHEvm_Y.)

insurance contribution schedule is implemented, Cumberland Valley shall file evidence of its implementation.

Miscellaneous Expenses

Cumberland Valley proposes to reduce test-year expenses by \$2,169 to remove certain annual meeting expenses not normally included for ratemaking purposes. The Commission agrees with the reductions proposed by Cumberland Valley. However, the Commission has identified an additional adjustment that should be made. Cumberland Valley included in its test-year annual meeting expense payments to the board of directors for mileage and meeting fees in the amount of \$3,571 for attending the annual meeting. These same amounts were also included in Cumberland Valley's test-year directors fees and expenses. Cumberland Valley agreed this was a duplication of expenses and that they should be removed from annual meeting expense.³³ Adding this additional item to Cumberland Valley's adjustment of \$2,169, the Commission has reduced miscellaneous expenses by a total of \$5,740.

Directors' Fees and Expenses

During the test year, Cumberland Valley paid its seven active directors and two retired directors fees and expenses totaling \$179,483. Cumberland Valley proposed an adjustment to reduce this expense by \$68,173 to exclude certain expenses for ratemaking purposes.³⁴ The Commission agrees with the exclusions identified by Cumberland Valley.

³³ Response to Staff's Third Request, Item 24.

³⁴ Application, Exhibit 9. The \$68,173 adjustment comprised health and dental insurance premiums, meeting fees paid to retired directors, and director attendance at a legislative conference.

The Commission has identified three additional adjustments that should be made to the directors' fees and expenses. Cumberland Valley included \$1,600 for directors' Christmas gifts and \$5,100 for per diems which the Commission has historically not allowed for ratemaking purposes. Accordingly the Commission will reduce director fees and expenses by an additional \$6,700.

As noted above in the discussion of Miscellaneous Expenses, the Commission identified certain expenses for directors that were included in both the annual meeting and directors' expenses. The board members were paid meeting fees of \$3,300 to attend Cumberland Valley's annual meeting at which board members were subject to re-election. In previous cases the Commission has found that compensation in the form of fees paid to board members for attendance at meetings other than the board of directors' regular meetings is excessive and should not be borne by the cooperative's customers. The Commission has determined that \$3,300 paid to directors as fees for attending Cumberland Valley's annual meeting should be removed from test-year expenses.

Based on these findings, the Commission has reduced Cumberland Valley's directors' fees and expenses by \$78,173.

Rate Case Expense

Cumberland Valley estimated its rate case expense at \$105,000. It proposed to recover this expense through a three-year amortization. This estimate did not include in-house labor. Throughout this proceeding, Cumberland Valley has been providing updates of the actual expenses incurred in presenting this rate case. As of November

30, 2016, Cumberland Valley had expended \$133,159³⁵ to prepare and process this rate case, and estimated it would incur an additional \$18,517³⁶ in legal fees for a total rate case expense of \$151,676. The Commission finds that a three-year amortization of these expenses is reasonable and will allow an increase in operating expense of \$50,559 to reflect the first year of the amortization for ratemaking purposes.

Property Taxes

Cumberland Valley did not include an adjustment for property taxes in the detailed schedule of adjustments filed with the application. However in response to an information request, Cumberland Valley provided an adjustment amount of \$49,153 to normalize property taxes for the test year.³⁷ The Commission agrees with Cumberland Valley's response to the information request and finds that the property taxes should be increased by an additional \$49,153.

PSC Assessment

Cumberland Valley did not propose an adjustment to its PSC Assessment to reflect the effects of normalizing revenues and purchased power expense or the impact of its proposed revenue increase. The Commission has determined that an adjustment to the PSC Assessment to reflect the normalization of revenue and purchased power expense found reasonable herein is appropriate. Based on the 2016–2017 assessment rate, the adjustment results in a \$3,619 decrease in the PSC Assessment for the test

³⁵ Response to Commission Staff's Post-Hearing Request for Information (" Staff's Post-Hearing Request"), Item 21.

³⁶ In the response to Staff's Fourth Request, Item 23, Cumberland Valley estimated additional costs to be incurred of \$45,000. In its response to Staff's Post-Hearing Request, Cumberland Valley indicated that \$26,483 of the \$45,000 was included in the actual rate case expenses incurred through November 30, 2016, leaving a balance of \$18,517 to be incurred after November 30, 2016.

³⁷ Response to Staff's First Request, Item 24.

year. The Commission has determined that an adjustment to the PSC Assessment based on the revenue increase being granted herein should also be calculated. This calculation results in an increase in the PSC Assessment Fee of \$3,254. The total result of these adjustments is a decrease of \$365 in the PSC Assessment Fee.

Pro Forma Adjustments Summary

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

	<u>Actual Test Period</u>	<u>Pro Forma Adjustments</u>	<u>Adjusted Test Period</u>
Operating Revenues	\$45,667,042	\$ (2,837,587)	\$42,829,455
Operating Expenses	<u>45,600,247</u>	<u>(2,685,130)</u>	<u>42,915,117</u>
Net Operating Income	66,795	(152,457)	(85,662)
Interest on Long-Term Debt	506,126	397,503	903,629
Interest Expense-Other	3,795		3,795
Other Income and (Deductions) – Net	<u>2,709,445</u>	<u>(2,489,156)</u>	<u>220,289</u>
NET INCOME	<u>\$ 2,266,319</u>	<u>\$ (3,039,116)</u>	<u>\$ (772,797)</u>

REVENUE REQUIREMENTS

The actual rate of return earned on Cumberland Valley’s net investment rate base established for the test year was 0.43 percent.³⁸ Cumberland Valley requests rates that would result in a Times Interest Earned Ratio (“TIER”) excluding GTCCs of 2.26X³⁹ and a rate of return of 3.10 percent on its proposed rate base of \$66,070,122.⁴⁰

³⁸ Application, Exhibit K, at 3 of 7.

³⁹ Cumberland Valley originally requested a TIER of 2.41, which was revised to 2.26 due to a correction to interest on long term debt.

⁴⁰ Response to Staff’s Third Request, Item 9, at 2 of 12.

Cumberland Valley proposes an increase in revenues of \$1,975,812⁴¹ to achieve the 2.26X TIER excluding GTCCs.

Cumberland Valley's actual TIER excluding GTCCs for the test period was 0.56X.⁴² For the calendar years 2013 and 2014, it was 1.21X and 1.71X, respectively.⁴³ After taking into consideration pro forma adjustments, Cumberland Valley would achieve a 0.14X TIER excluding GTCCs without an increase in revenues.

Cumberland Valley's Operating Times Interest Earned Ratio ("OTIER") for the test period was 0.12, and for the calendar years 2013 and 2014, it was 0.71X and 1.08X, respectively.⁴⁴ Cumberland Valley stated that the main reason for filing this rate increase request was that it had failed to meet the RUS mortgage requirement of an OTIER of 1.10 for the years 2012 through 2015.⁴⁵

Cumberland Valley noted that the TIER method for determining margins has been the approach used by the Commission in electric distribution cooperative rate cases. They stated the Commission has normally authorized a TIER of 2.00, but has authorized higher TIERS. They noted that the Commission's order in Case No. 2011-00096⁴⁶ authorized a higher TIER to South Kentucky RECC because of declining equity

⁴¹ Cumberland Valley's application indicates an increase of \$1,998,262 which reflects non-recurring income of \$22,498.

⁴² Response to Staff's Third Request, Item 9, at 7 of 12.

⁴³ *Id.*

⁴⁴ Response to Staff's Second Request, Item 2.

⁴⁵ Application, Exhibit H-1, Direct Testimony of Robert D. Tolliver, at 2 of 8.

⁴⁶ Case No. 2011-00096, *Application of South Kentucky Rural Electric Cooperative Corporation for an Adjustment of Rates* (Ky. PSC May 11, 2012).

levels. Cumberland Valley stated that it has also experienced declining equity levels for several years due to low margins or losses.⁴⁷

The Commission finds that the use of a 2.26X TIER is not reasonable for Cumberland Valley. Based upon the pro forma adjustments found reasonable herein, the Commission has determined that an increase in Cumberland Valley's revenues of \$1,679,680 would result in a TIER of 2.00X. This additional revenue should produce net income of \$903,629. The Commission has determined that the above increase in revenues should result in an operating TIER of 1.76, which should allow Cumberland Valley to meet its mortgage requirements and service its mortgage debts. Based on the net investment rate base of \$66,056,925 found reasonable herein, this additional revenue should result in a rate of return on rate base of 2.74 percent.

PRICING AND TARIFF ISSUES

Cost of Service

Cumberland Valley filed a fully allocated cost-of-service study ("COSS") in order to determine the cost to serve each customer class and the amount of revenue to be allocated to each customer class. Cumberland Valley corrected certain errors and revised its COSS in response to Staff's second and third requests for information. Having reviewed Cumberland Valley's revised COSS, the Commission finds it to be acceptable for use as a guide in allocating the revenue increase granted herein.⁴⁸

⁴⁷ Application, Exhibit H-2, Direct Testimony of James R. Adkins ("Adkins Testimony"), at 5 and 6 of 17.

⁴⁸ The final revised COSS was filed in Response to Staff's Third Request, Item 10.

Revenue Allocation

Cumberland Valley states that, based on the results of the COSS, the following rate classes are not providing sufficient revenue to cover their revenue requirements: Residential, Schools, and Churches (including the Electric Thermal Storage (“ETS”) Marketing rate); Small Commercial and Small Power – Three Phase; and Outdoor Lighting.⁴⁹ However, Cumberland Valley proposes to allocate the increase to all of its rate classes in order to keep the overall increase to the Residential, Schools, and Churches (“Residential”) rate class to a reasonable level.

The approved base rate increase of \$1,679,680 results in an overall increase of 4.08 percent in base rate revenue. This is approximately 85 percent of the increase Cumberland Valley requested in its application. The Commission has reviewed Cumberland Valley’s proposal to allocate the increase and finds that an adjustment should be made to this allocation. The Commission notes that the Small Commercial and Small Power – Single Phase rate class is providing twice the rate of return as the system average and finds that this rate class should not receive an increase as large as that proposed by Cumberland Valley.⁵⁰ The Commission’s approved base rate increase of \$1,679,680 is \$296,132 less than proposed by Cumberland Valley. After making the above-referenced adjustment to lower the increase for the Small Commercial and Small Power – Single Phase rate class, the balance of the decrease in

⁴⁹ This argument is supported by the COSS filed with the Application; however, the final revised COSS shows this no longer to be true for the Small Commercial and Small Power – Three Phase, as this class is shown as providing a rate of return above the system average rate of return.

⁵⁰ The revised COSS shows that the Small Commercial and Small Power – Single Phase rate class is providing a 6.69 percent return compared to the system average rate of return of 3.08 percent. See Cumberland Valley’s response to Staff’s Third Request, Item 10, at 38–39 of 40.

requirement will be allocated generally in proportion to the increase proposed by Cumberland Valley.

Rate Design

Cumberland Valley is proposing to allocate the proposed increase to all its rate classes with most of the increase being placed on the customer charges. Cumberland Valley's COSS shows that the current customer charges are insufficient to cover the consumer-related costs incurred to provide service for all rate classes.⁵¹

Upon consideration of this issue, the Commission concludes that, for an electric cooperative that is strictly a distribution utility, there is merit to the argument that there is need for a means to guard against the revenue erosion that often occurs due to the decrease in sales volumes that accompanies poor regional economics, changes in weather patterns, and the implementation or expansion of demand-side management and energy-efficiency programs. However, the Commission believes that Cumberland Valley's proposed 62 percent increase in the residential customer charge from \$8.73 to \$14.10 does not support the general principle of gradualism. For this reason, the Commission will approve a customer charge for the Residential rate class of \$12.00, an increase of 37.5 percent. In addition, the Commission will make changes to the proposed customer charges for the Small Commercial and Small Power – Single Phase and Three Phase customers in the course of allocating the reduction in the increase as discussed above for the Small Commercial and Small Power – Single Phase rate class. The table below shows the current, proposed, and approved customer charges along with the amounts supported by the COSS.

⁵¹ Application, Direct Testimony of James R. Adkins, at 12 of 17.

	Current	Proposed	Approved	COSS Results
Residential, Schools and Churches	\$ 8.73	\$ 14.10	\$ 12.00	\$ 26.31
Small Commercial and Small Power	\$ 8.96	\$ 15.00	\$ 14.00	\$ 33.25
Small Commercial and Small Power Service - 3 Phase	\$ 8.96	\$ 25.00	\$ 25.25	\$ 76.80
3-Phase Schools and Churches	\$ 25.00	\$ 45.00	\$ 45.00	\$ 50.98
Large Power 50 kW - 2500 kW	\$ 40.00	\$ 65.00	\$ 65.00	\$ 112.50
Large Power Industrial Over 2500 kW	\$ 50.00	\$ 100.00	\$ 100.00	\$ 134.29

Because it is proposing increases in the customer charges, Cumberland Valley is proposing no change to demand charges for all classes with a demand charge. Allocation of the Outdoor Lighting class's share of the revenue increase yields an approximate 8.6 percent increase for each of the lights. Based on Cumberland Valley's average residential usage of 1,147 kilowatt hours ("kWh"), the average bill for residential customers will increase by \$5.40, from \$106.91 to \$112.31, or 5.05 percent.

ETS Rate and Proposed New Tariffs.

Cumberland Valley is proposing to discontinue its ETS Marketing rate which is imbedded within the Residential rate class. Cumberland Valley states that EKPC, its wholesale supplier, discontinued the ETS rebate to the distribution cooperatives several years ago, that EKPC no longer stocks the units or parts for those units, and that Cumberland Valley is unable to determine if the ETS units are operating properly.⁵² Because Cumberland Valley is recommending discontinuance of the ETS Marketing Rate, it is proposing a new Residential Time-of-Day ("TOD") tariff which would be an option for those affected by this elimination.⁵³

Customers with ETS units are currently being served under the Residential tariff, and therefore would have to elect to be switched to the proposed Residential TOD tariff.

⁵² November 30, 2016 Hearing at 3:37:25 through 3:46:38.

⁵³ Cumberland Valley recalculated its proposed Residential TOD on-peak energy rate in response to Commission Staff's Post-Hearing Request, Item 17.

Because the discontinuance of the ETS Marketing Rate could result in a larger than average increase for those customers who stay on the Residential tariff and it may be beneficial for those customers to switch to the Residential TOD tariff, the Commission finds that Cumberland Valley should provide notice to each ETS customers of the ETS Marketing Rate discontinuance and the availability of the Residential TOD tariff. The Commission also finds that Cumberland Valley should include in the notice a comparison of an average monthly bill for an ETS customer at the approved Residential tariff and at the Residential TOD tariff, as well as information on how to change to the Residential TOD tariff if the customer chooses. Accordingly, the Commission finds that the proposed Residential TOD tariff should be approved.

The Commission also notes that, for lower usage customers, Cumberland Valley is proposing a new Inclining Block Rate tariff wherein rates increase in steps as the customer uses more energy. The Commission finds that this proposed new tariff should be approved.

Nonrecurring Charges

Cumberland Valley proposed an increase in its remote disconnect/reconnect charge from \$20 to \$25. The Commission has reviewed the supporting calculation, as revised through discovery, and finds that the increase in the remote disconnect/reconnect charge should be approved.⁵⁴ Approval of this increase will result in an additional \$22,450 in miscellaneous service revenues for Cumberland Valley.

⁵⁴ Response to Commission Staff's Post-Hearing Request for Information, Item 1.

OTHER ISSUES

Formal Plan to Reduce Expenses

Cumberland Valley stated that its financial condition has deteriorated significantly, with an increase in expenses and a substantial decrease in revenue from its members. Cumberland Valley stated that its fixed and variable costs for power, materials, equipment, labor, and taxes have increased.⁵⁵ Revenue from the commercial and large industrial sectors has decreased 47 percent between 2011 and 2015, due primarily to the decline in the coal industry in southeastern Kentucky.⁵⁶ Revenue from the residential rate class is down by 1.08 percent for the same time period.⁵⁷ In addition to the decline in the coal industry, the Cumberland Valley service area is experiencing significant levels of unemployment, which Cumberland Valley believes may lead to a continued decrease in the number of residential members it serves.⁵⁸

In this proceeding, Cumberland Valley has provided information on actions taken to minimize costs and improve efficiency, such as employee attrition, improvements to its telephone system and network infrastructure, purchasing reconditioned vehicles, and mechanizing right-of-way maintenance.⁵⁹ However, given its financial condition, it is imperative that Cumberland Valley develop a robust, systematic plan to evaluate all costs in order to reduce its expenses and improve efficiency. The Commission finds

⁵⁵ Application, paragraph 5.a.

⁵⁶ Application, Tolliver Testimony, at 2.

⁵⁷ *Id.*

⁵⁸ *Id.* at 3.

⁵⁹ Responses to Commission Staff's First Request for Information ("Staff's First Request") (filed June 21, 2016), Item 8.c.

that Cumberland Valley should conduct a formal study of its expenses and, within six months of the date of this Order, file with the Commission a formal plan to reduce Cumberland Valley's expenses. The formal plan filed with the Commission should include a discussion of the advantages and disadvantages of a merger between Cumberland Valley and another electric utility, with the ultimate goal of achieving cost savings through economies of scale.

Cumberland Valley Personnel Policy Nepotism Exception

Cumberland Valley has a nepotism policy that prohibits it from employing persons who are related by blood or marriage, with a kinship closer than that of a second cousin, to a board member, manager, supervisor, or other employee of Cumberland Valley ("Nepotism Policy").⁶⁰ The Nepotism Policy includes a provision that exceptions to the policy "can be made by Board Resolution upon recommendation by the CEO" ("Nepotism Policy Exception").⁶¹ Cumberland Valley currently employs four persons who are related to the Cumberland Valley CEO, Ted Hampton: a board member, who is Mr. Hampton's brother and was a former employee of Cumberland Valley; a superintendent, who is Mr. Hampton's first cousin; an assistant superintendent, who is Mr. Hampton's nephew; and a bookkeeper, who is Mr. Hampton's sister-in-law.⁶² Aside from the board member who is Mr. Hampton's brother, there is a second board member who is related to a current Cumberland Valley

⁶⁰ Response to AG's First Request for Information ("AG's First Request") (filed Aug. 10, 2016), Item 31, Attachment "Policy Statement No. 42, Nepotism."

⁶¹ *Id.*

⁶² *Id.* at Item 32; H.V.T. at 1:17:55.

employee who is employed as a serviceman.⁶³ Additionally, there are 12 current employees who are related to other Cumberland Valley employees.⁶⁴

At the November 30, 2016 hearing, Mr. Hampton indicated he would discuss eliminating the Nepotism Policy Exception with the board.⁶⁵ The Commission finds that the Nepotism Policy Exception should be eliminated. The Nepotism Policy Exception is especially disconcerting given the number of employees who are related to the CEO or to a board member. As Cumberland Valley notes in its Nepotism Policy, it is bad business practice to employ relatives, especially relatives of management or board members, because there is a natural tendency to favor relatives. So long as the Nepotism Policy Exception is in effect, there will be an appearance of a conflict, especially when those who make compensation decisions are related to employees who are subject to and may benefit from such decisions. Current employees to whom the nepotism policy would otherwise apply should be grandfathered under the existing policy exception, and the revised nepotism policy should be applied on a prospective basis after the date of this order.

SUMMARY

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

1. The rates proposed by Cumberland Valley would produce revenues in excess of the amount found reasonable herein and should be denied.

⁶³ Response to AG's First Request, Item 32.

⁶⁴ *Id.*

⁶⁵ H.V.T. at 1:20:52.

2. The rates set forth in the Appendix to this Order are the fair, just and reasonable rates for Cumberland Valley to charge for service rendered on and after the date of this order and should be approved.

3. The rate of return and TIER granted herein will provide for Cumberland Valley's financial obligations.

4. As provided previously in this order,

a. Future rate applications should include a formal study that provides local wage and benefit information for the geographic area where Cumberland Valley operates and must include state data where available.

b. Within 60 days of the date of this Order, Cumberland Valley should file a report setting forth the employer and employee contribution amounts and percentages Cumberland Valley will implement for health and dental insurance premiums offered to salaried employees, along with the date the revised contribution schedule will be implemented. Within 30 days of the date that the revised employer/employee health and dental insurance premium contribution schedule is implemented, Cumberland Valley should file evidence of its implementation.

c. Within six months of the date of this Order, Cumberland Valley should file a formal plan to reduce Cumberland Valley's expenses, which should include a discussion of the advantages and disadvantages of a merger between Cumberland Valley and another electric utility, with the ultimate goal of achieving cost savings through economies of scale.

d. Within 30 days of the date of this Order, Cumberland Valley should file evidence that it eliminated the Nepotism Policy Exception to its Nepotism Policy.

The revised nepotism policy should be applied on a prospective basis after the date of this order.

IT IS THEREFORE ORDERED that:

1. The rates proposed by Cumberland Valley would produce revenues in excess of the amount found reasonable herein and are hereby denied.

2. The rates set forth in the Appendix to this Order are approved for services rendered by Cumberland Valley on and after the date of this Order.

3. Within 20 days of the date of this Order, Cumberland Valley shall file with this Commission, using the Commission's electronic Tariff Filing System, new tariff sheets setting forth the rates and charges approved herein and reflecting their effective date and that they were authorized by this Order.

4. In future rate applications, Cumberland Valley shall perform a formal study that provides local wage and benefit information for the geographic area where Cumberland Valley operates, which shall include state data where available.

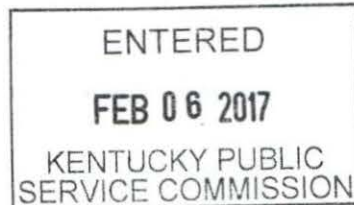
5. Cumberland Valley shall file a report, within 60 days of the date of this Order, setting forth the employer and employee contribution amounts and percentages Cumberland Valley will implement for health and dental insurance premiums offered to salaried employees, along with the date the revised contribution schedule will be implemented. Within 30 days of the date that the revised employer/employee health and dental insurance premium contribution schedule is implemented, Cumberland Valley shall file evidence of its implementation.

6. Cumberland Valley shall file a report within six months of the date of this Order setting forth Cumberland Valley's formal plan to reduce its expenses. The report

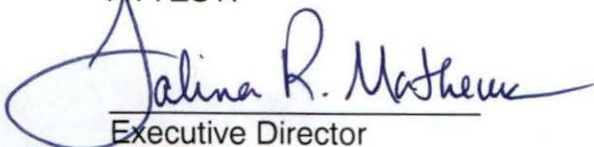
shall include a discussion of the advantages and disadvantages of a merger between Cumberland Valley and another electric utility, with the ultimate goal of identifying potential cost savings that might be attained through economies of scale.

7. Cumberland Valley shall file a report within 30 days of the date of this Order demonstrating that Cumberland Valley has eliminated the Nepotism Policy Exception to its Nepotism Policy. The revised nepotism policy shall be enforced on a prospective basis after the date of this Order.

By the Commission



ATTEST:


Executive Director

APPENDIX

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2016-00169 DATED **FEB 06 2017**

The following rates and charges are prescribed for the customers in the area serviced by Cumberland Valley Electric, Inc. All other rates and charges not specifically mentioned in this Order shall remain the same as those in effect under authority of this Commission prior to the effective date of this Order.

SCHEDULE I
RESIDENTIAL, SCHOOLS, AND CHURCHES

Customer Charge	\$ 12.00
Energy Charge per kWh	\$ 0.08749

PREPAY SERVICE

Customer Charge	\$ 12.00
Energy Charge per kWh	\$ 0.08749
Prepay Service Fee	\$ 3.00

SCHEDULE II
SMALL COMMERCIAL AND SMALL POWER SERVICE, SINGLE PHASE

Customer Charge	\$ 14.00
Energy Charge per kWh first 3,000 kWh	\$ 0.09200
Energy Charge per kWh over 3,000 kWh	\$ 0.08839

SCHEDULE II
SMALL COMMERCIAL AND SMALL POWER SERVICE, THREE PHASE

Customer Charge	\$ 25.25
Demand Charge per kW	\$ 4.22
Energy Charge per kWh first 3,000 kWh	\$ 0.09200
Energy Charge per kWh over 3,000 kWh	\$ 0.08839

SCHEDULE III
THREE PHASE SCHOOLS AND CHURCHES

Customer Charge	\$ 45.00
Energy Charge per kWh	\$ 0.07982

SCHEDULE IV
LARGE POWER INDUSTRIAL

Customer Charge	\$100.00
Demand Charge per kW	\$ 6.55
Energy Charge per kWh	\$ 0.05112

SCHEDULE IV-A
LARGE POWER 50-2,500 KW

Customer Charge	\$ 65.00
Demand Charge per kW	\$ 4.22
Energy Charge per kWh	\$ 0.06078

SCHEDULE VI
OUTDOOR LIGHTING

175W Mercury Vapor	\$ 9.31
400W Mercury Vapor	\$ 13.86
100W Open Bottom	\$ 9.33
100W Colonial Post	\$ 10.51
100W Directional Flood	\$ 11.32
400W Directional Flood	\$ 18.00
400W Cobra Head	\$ 18.00
LED Open Bottom	\$ 9.04
LED Cobra Head	\$ 15.41
LED Directional	\$ 18.92

RESIDENTIAL TIME-OF-DAY

Customer Charge	\$ 20.00
On-Peak Energy Charge per kWh	\$ 0.10166
Off-Peak Energy Charge per kWh	\$ 0.06000

INCLINING BLOCK RATE

Customer Charge	\$ 9.90
Energy Charge per kWh first 200 kWh	\$ 0.08842
Energy Charge per kWh next 300 kWh	\$ 0.09342
Energy Charge per kWh over 500 kWh	\$ 0.09842

NONRECURRING CHARGES

Remote Disconnect Charge	\$ 25.00
Remote Reconnect Charge	\$ 25.00

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