COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC INVESTIGATION INTO THE MANAGEMENT AND OPERATION OF GRAYSON RURAL ELECTRIC COOPERATIVE CORPORATION	))))	CASE NO. 2019-00101

NOTICE OF FILING OF MANAGEMENT AUDIT REPORT

Notice is hereby given that the attached Management Audit of Grayson Rural Electric Cooperative Corporation by Vantage Energy Consulting, L.L.C, has been filed in the record of the above-styled proceeding.

John E.B. Pinney
Acting General Counsel
Public Service Commission
P. O. Box 615
Frankfort, KY 40602

DATED FEB 07 2020

cc: Parties of Record

Management Audit of

Grayson Rural Electric Cooperative

Corporation

February 4, 2020

Vantage Energy Consulting, LLC

Management Consulting and Energy Services

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I. EXECUTIVE SUMMARY

A. PURPOSE OF AUDIT

Pursuant to Case number 2019-00101, the Kentucky Public Service Commission ("KPSC" or "Commission") ordered that a management audit of the Grayson Rural Electric Cooperative Corporation ("Grayson" or "Grayson RECC") be conducted. Case 2019-00101 is the result of two consecutive rate proceedings, Cases 2012-00426 and 2018-00272, in which the Commission found that Grayson RECC, confronted with severe financial constraints, continued to act ineptly by failing to develop and implement viable management strategies to resolve its dire financial situation. In each instance, the KPSC advised Grayson that its managerial approach was deficient and inadequate, and directed the utility to adopt and implement best practices. However, Grayson repeatedly either failed or intentionally ignored the Commissions' directives to control costs, reduce waste and strategically address those factors identified during the two rate cases. It appeared to the Commission that Grayson was incapable of implementing the corrective actions the KPSC identified as being necessary to meet its primary mandate, to provide safe and reliable electric service at a fair, just and reasonable rate.

The objective of this audit is to perform a detailed review of Grayson RECC's efforts to manage its business, including financial management, budgeting and accounting processes, cost controls, procurement practices, field and office operations, and strategically develop plans and policies. The role, responsibility and effectiveness of Grayson RECC's Board of Directors, and their duties to provide effective oversight, play an integral part in its operation and will be included in this review.

The scope of this audit, which is detailed below, includes a review and evaluation of the effectiveness of Grayson RECC management's efforts to develop and undertake strategies, policies, and procedures to operate effectively, contain its costs and maintain its financial integrity, especially as the Commission initially encouraged it to do in its July 31, 2013 Order in Case No. 2012-00426. The scope was specified through the specific requirements in the RFP and by our initial and detailed work plan. The main focus of this project should be on the ability of Grayson RECC's management, and that of its Board of Directors, to strategically plan for the future, formulate policies to carry out the plan, as well as their ability to execute those policies as they apply to all areas of management. Our objective is that this report provides the Commission and Grayson RECC solutions in which both the Board of Directors' role and management's effectiveness can be improved in the short term and then maintained in the long run.

Vantage Energy Consulting ("VEC" or "Vantage") reviewed many aspects of Grayson RECC's management's and its Board of Directors' strategic planning, financial management and decision-making as related to the financial health and viability of the cooperative. We also addressed policies and management actions focused on safe and reliable electric service at fair, just and reasonable rates.

We will explore the potential benefits to Grayson of either merging with, or being acquired by, another rural electric cooperative or investor-owned utility (IOU). Our focus will be on opportunities for operational efficiency and economies of scale that implementation of best – or at least better – practices for strategically addressing Grayson's financial struggles would bring.

Our Work Plan refers to Case Number 2019-00101, in which the KPSC ordered the performance of a management audit of Grayson, as well as the other Cases referenced above.

B. AUDIT APPROACH

Our audit approach for this engagement includes a four step process:

1. **Information gathering and analysis** - VEC submitted to Grayson a set of information requests and inquiries seeking explanations or commentary on specific questions. Such inquiries included organizational charts, staff resumes, reliability statistics, planning reports and financial studies.
2. **On-site interviews and meetings** were held with Grayson's management team, staff members, the Board of Directors and other key stakeholders.
3. **Internal reviews of the documents and interview notes** were conducted that entail the vetting of findings and observations, supportive information and the collective experience of the VEC team.
4. **Report and recommendations development** - Vantage consultants considered the information gained during the first three processes, developed our report and offered recommendations to address and resolve deficiencies, and to provide future corrective courses of action. Vantage offers recommendations that are based on sound business practices and at a cost commensurate with the value or benefit of the expected results.

C. REPORT LAYOUT

Chapter I – Executive Summary

Chapter II – Organization and Board of Directors

Chapter III – Strategic and Resource Plannning

Chapter IV – Staffing, Human Resources and Compensation

Chapter V – System Operations

Chapter VI – Merger Consideration

D. SCOPE OF AUDIT

Based on our proposal, which included reviews of all applicable orders, discussions with the KPSC Staff and initial interviews, the scope of the audit was defined as:

1. Evaluate Grayson RECC's organizational structure, including the role and the effectiveness of the Board of Directors in carrying out its fiduciary responsibility in providing direction and oversight to Grayson RECC's management.

2. Evaluate Grayson RECC's strategic plan and planning process, including the roles and responsibilities of the Board of Directors and management. Consider the effectiveness of strategic plan execution as it relates to all other areas of Grayson RECC's business, especially its managing cost containment and the overall financial health of Grayson RECC's business.

3. Evaluate all aspects of Grayson RECC's financial management, budgeting, and accounting processes. Specific areas of focus should include but not be limited to review of internal controls, management oversight of these financial process functions, prioritizing competing goals and making any mid-course adjustment to ensure Grayson RECC's future financial integrity.

4. Evaluate Grayson RECC's policies and procedures and the effectiveness of the member services, human resources and support functions.

5. Evaluate the efficacy of a possible merger between Grayson RECC and another electric distribution cooperative or investor owned utility by examining the outcomes, including customer impact, of other distribution cooperative mergers in Kentucky.

E. OVERALL CONCLUSION

Vantage has proposed twenty recommendations in our report. These are largely operational and management oversight recommendations needed to assure proper management. They are provided under a scenario in which Grayson RECC continues to operate as a standalone utility. We state this because, should Grayson merge with another utility, it would likely adopt policies, procedures and operating agreements developed by the combined utility. We present three overall conclusions/suggestions here.

First, we recommend that Grayson continue to pursue merger opportunities with either an adjacent or, if feasible, a non-contiguous utility. Other Kentucky electric cooperatives have successfully carried out mergers and Grayson can build on this experience. In Chapter VI of this report we discuss the pros and cons of a merger and provide the basis for our conclusion. Why do we make this recommendation? It is likely that Grayson will continue to limp along and need rate support from the KPSC on a periodic basis. A merger would provide financial stability, a stronger management team, and a broader based organization. A merger will also infuse new management, a stronger financial structure, and improved policies and procedures for the newly merged utilities.

Second, we recommend that Grayson implement all of the recommendations in this report, with particular emphasis on formal policies and procedures. Implementing the recommendations will help provide a firm foundation should the utility merge. However, should Grayson not merge, implementing the recommendations will allow the utility to become more effective and efficient going forward. A detailed review of Grayson's engineering, facilities planning, construction, and maintenance practices was beyond the scope of the management audit. In light of Grayson's recent history of management and financial issues, a further review of these areas may be warranted.

Third, the current CEO at Grayson is eligible for retirement at any time. Setting the wheels in motion for Grayson to become a more efficient and financially stronger utility would be a lasting legacy. While retirement timing is the CEO's decision, knowing that it will occur gives the Board the opportunity for succession planning by identifying a replacement who would be well trained and ready to take over immediately upon her retirement. Further, we would suggest that the proposed replacement be given responsibility for implementation of all of the recommendations emanating from this audit. By following that path, two things would be assured. First, the heir apparent, through direct involvement in implementing the recommendations, would understand areas of concern that the audit identified. Second, the heir apparent would have had an opportunity to work with all departments within Grayson RECC and potential merger partners during the implementation process.

F. SUMMARY OF RECOMMENDATIONS

We provide a summary of each recommendation statement in the Executive Summary. Details of each recommendation, including supporting findings and implementation details are provided within each chapter.

II-R1 **Develop or purchase a financial model that provides detailed and actionable information on Grayson's financial picture. (Priority: Medium)**

In order to manage its business and prevent recurring financial difficulties it is crucial that Grayson develop the tools and processes to enable visibility into and management of their finances.

Currently, Grayson is exploring a financial model which is provided by National Rural Utilities Cooperative Finance Corporation ("CFC"). This model is certainly a step forward but does not provide the monthly management information that is necessary to manage Grayson's finances.

Grayson needs to develop a financial model that tracks all expenses on a monthly basis and ties directly to the CFC and also can provide the basis for at least a four-year plan. This model does not need to be elaborate or expensive. The model could easily be developed in house using Excel and available information.

II-R2 **Identify a regulatory liaison and communicate to the KPSC. (Priority: Low)**

Provide clarity as to the formal means of communicating between company and regulatory bodies.

II-R3 **Improve process for evaluating and determining causes of outages. (Priority: Medium)**

Additional forensic or root cause analysis is warranted in evaluating outages. This evaluation is needed, because knowing the cause of outages is essential for setting budgets and establishing priorities.

II-R4 **Develop a formal procedure for the tracking and resolution of complaints. (Priority: Medium)**

The process currently used by Grayson RECC is dependent on the experience of current personnel at the Cooperative. In this arrangement, there is always the concern that a change in personnel could change the process. In order to have an equitable and consistent treatment of complaints a formal procedure is needed. The function should be centralized in one area to assign tracking numbers and maintain the files, including all documentation associated with the resolution of the complaint. The procedure should identify the personnel that need to be involved in the resolution of the complaint. The procedure should also specify the time for resolution in order to ensure the timely resolution of the complaint. The procedure should specify how a complaint will be ultimately resolved if there is no clear resolution by the assigned department.

II-R5 **As the opportunities arise, Grayson should strive to include more diversity on its Board. (Priority: High)**

Currently, the Board of Directors ("BOD") consists of all white males. As opportunities arise, Grayson should encourage and actively support a more diverse Board but with the priority of ultimately engaging the most qualified individuals. The more diverse views will lead to better understanding of the views of all of its members.

II-R6 **Create a more transparent process of governance. (Priority: High)**

There seems to be some pressure within rural cooperatives to have an understanding of the decision-making processes and the budgetary impact of those processes on the members of the cooperative. Grayson, with its significant focus on caring for its employees, should extend that to more fully engage all the members by having open board meetings so the membership can see how the Directors are responsible and accountable for the decisions they make. This process could inspire others to pursue membership on the Board and expand the diversity and experience of the Board members.

Vantage recommends that BOD meetings be open, except where confidential information, contracts or compensation are discussed.

II-R7 **Directors' fees and expenses should be carefully monitored and managed jointly by both the Board and Grayson management. (Priority: Medium)**

Grayson's financial challenges are real, and the Board has an opportunity to serve as real leaders in the community and Cooperative by establishing pay guidelines for itself that model the reality of the economics of the service territory. At a minimum, they should consider re-instituting the original per diem and reducing the cash in lieu of health care to the $3250/year that employees receive. Since the majority of the members have been on the board for many years and attendance at training sessions has long since diminished, the miscellaneous expenses should be scrutinized and substantive limitations put in place.

II-R8 **Increase involvement by the Board in the strategic planning process with a focus on actions that have an impact on TIER. (Priority: High)**

The Strategic Planning section of this audit report discusses in detail a planning process focused primarily on Times Interest Earned Ratio ("TIER"). The Board's involvement in that process could be accomplished by including an additional agenda item for the monthly Board meetings or preferably a quarterly or six-month meeting devoted entirely to strategic planning. Specifically, the strategic planning sessions should focus on financial and operational goals and the detailed steps to accomplish those goals.

II-R9 **The Board of Directors should take the lead in meaningful cost savings measures, to assure Grayson's members have affordable electricity now and in the future. (Priority: Medium)**

The Board should be the driver in streamlining Grayson's operations and reducing costs to make it competitive. This is an experienced BOD and it has adequate current and historical information needed to make meaningful changes. As a new management team is instituted, the Board should work with the management team to move forward with bold plans that reduce costs and assure financial stability.

III-R1 **Initiate a new strategic plan that includes re-defining Grayson's primary mission "To Maintain a TIER of 1.25 or Greater" along with other key operational targets. (Priority: High)**

All other business attributes such as safety, reliability, and customer service should be defined as strategic goals that support the TIER based mission. Since this strategic plan focuses on financial issues, it can probably be performed with little or no outside support costs.

Each major Expense and Capital budget initiative should be evaluated and ranked in terms of priority based on benefit/cost, risk of not achieving strategic goals and impact on TIER computation. An illustrative prioritization scheme would identify Priority 1 projects as having the highest priority and must be performed regardless of TIER impact. Priority 2 projects are generally necessary however can be deferred or other lower cost solutions be substituted even at the risk that it does not achieve the same benefit-cost ratio. Finally, Priority 3 projects must be deferred until the TIER is projected to equal or exceed 1.25.

III-R2 **Review the TIER status report and certify that Grayson's TIER will equal or exceed 1.25 at each monthly board meeting for the following 12-month period. (Priority: Medium)**

If the current month or forecasted 12-month TIER fall below 1.25, the Board will require, from management, by the next monthly meeting an action plan to consider the deferment or substitution of Priority 3 and if necessary, Priority 2 expenditures and capital projects in order to achieve the 1.25 target TIER. If after three consecutive months, the Board still cannot certify that the projected TIER will equal or exceed 1.25, the KPSC should be notified by letter from the Grayson CEO and Board Chairman that the TIER is either currently or projected to be below 1.25 during the course of the proceeding 12-month period. In this letter, Grayson should detail the steps taken pursuant to the strategic plan to mitigate the decline in the TIER.

IV-R1 **Establish an annual process to determine appropriate pay increases for non-union employees that is equitable, defensible, and transparent. (Priority: Low)**

Vantage recognizes that a compensation study is expensive; however, it is beneficial to create a program that will serve the system for some time into the future. While Vantage does not recommend a below-market pay structure or program that would foster an employee exodus to greener pay pastures, it is concerning that Grayson lacks a formal documented process that governs employee promotion through the pay ranges could lead to pay levels that exceed current market rates. Coupled with the lack of transparency in the Board's decisions and minutes, the process provides no opportunity for the members of Grayson to be certain that all employees are treated equitably and in a fiscally-responsibly manner.

IV-R2 **Accelerate and amplify Grayson's plan for employee contributions for health care. (Priority: Medium)**

Research conducted by the Kaiser Family Foundation indicated that the typical employee contribution for health care across industries was 20%.[1] Grayson could restructure their health care plan to include an employee contribution closer to the market but combine it with a choice of plans that employees can select based on their personal needs. Additionally, Grayson could consider adding dental and vision benefits at no cost to employees. These, with appropriate benefit limitations, are lower cost items that can offset employees' out-of-pocket expenses for medical services. There may also be ways to reduce costs through creating/participating in pools with other cooperatives or organizations. Small business organizations frequently offer health care options for members. Options should be explored with their benefits consultant. Employees could be solicited for input prior to any decision.

[1] Kaiser Family Foundation research; Wall Street Journal source. 2019

IV-R3 **<u>Develop an appropriate path to reduce the ongoing pension and post-retirement healthcare liabilities. (Priority: Medium)</u>**

Grayson should develop a strategy and implementation plan to rein in the future costs of retirees. This should be a two-fold effort that includes a longer service requirement for pension eligibility as well as including a requirement of retiree contributions for health care. Caps on health care costs, caps on percentage increases absorbed by Grayson, different contributions for pre-Medicare and supplemental insurance, as well as other market benchmarked strategies should be considered. Vantage is aware this is a difficult process, but the ongoing, increasing cost burden to the Cooperative members warrants serious discussions with the unions and Board.

V-R1 **<u>Grayson should establish a Disaster Recovery location. (Priority: Medium)</u>**

Grayson needs to establish a location or locations from which they can operate in the event of a disaster. It needs to be:

- Scalable
- Within the service territory.
- Part of a plan
- Does not need to be a one size fits all (systems and customer service locations can be different).

V-R2 **<u>Grayson should explore opportunities for shared purchasing and consolidations of processes with other Distribution Cooperatives. (Priority: Medium)</u>**

At a minimum, the following areas should be explored:

- Purchasing, materials (all of the supply chain)
- Information Technology
- Training
- Service Call outs using bordering Distribution Cooperatives

None of these opportunities require an actual merger to achieve savings. All can be cooperative arrangements. Also, there is no need for all sharing to be accomplished with any one entity.

V-R3 **<u>Grayson should explore alternative means of obtaining the necessary IT skill sets. (Priority: Medium)</u>**

Some alternatives might include:

- Position sharing with another Cooperative.
- Remote access

- Outsourcing

See also consolidation recommendation

V-R4 **Explore opportunities to improve or control costs in line operations. (Priority: High)**

Grayson should explore opportunities to better manage costs in the line area including:

- Reduced line crew sizes
- Performing hot work with internal resources
- Reducing overtime
- Better balancing in-house and contractor use

None of these opportunities can be fully realized before the next negotiated contract with the line crew bargaining unit; however, data can be gathered, and analysis performed before that time. At a minimum:

- Perform and document an informal survey of other East Kentucky Power Cooperative (EKPC) distribution cooperatives as to their policies regarding line crew size, hot work and overtime.
- Research available studies on these same topics from industry sources such as NRECA, Touchtone, EKPC and others.

V-R5 **Explore opportunities to reduce overtime. (Priority: Medium)**

The current procedure which permits some overtime decisions to be made by the field crew itself is not within industry standards. While the rationale makes sense, a more focused control should be instituted. Proper planning can help to determine manpower needs and hours necessary to complete any assignment. Better planning regarding parts carried and bucket truck inventory can also help facilitate more efficient work.

VI-R1 **Explore potential merger opportunities with both adjacent utilities and other nearby utilities should they arise. (Priority: Medium)**

While mergers may be difficult, there have been successful Kentucky cooperative mergers in the recent past. Grayson, unless it merges, will continue to find it difficult to reduce costs significantly and expand operational flexibility by a significant degree. Therefore, Grayson is faced with a paradox: Even though a merger is unlikely, though not impossible, the achieved efficiencies and cost savings would be of value to both merging utilities' customers.

Grayson should pursue a two-part strategy. First, if no merger be possible, a plan should be developed that reviews all cost categories and determine if there is potential for combining processes with other cooperatives; then develop plans and action steps to actively pursue any opportunities for cost savings or operational enhancements through joint processes; and finally report the results to the Commission every 6 months.

Second, investigate opportunities for merger, including minimization of restraints. Explore a merger with another EKPC cooperative that is not contiguous. Determine whether the service territory can be split between two or more coops. Does the near term retirement of the Grayson's CEO provide a window for merger opportunities? Some specific steps should include:

1. The Board should develop an ad hoc committee to study merger options.

2. The committee should include Board and Management personnel, supported as needed by outside legal and technical support.

3. A decision process should be developed to select potential merger candidates. Criteria should include geography; operating philosophy; size; complementary management talents; and other positive driving attributes.

II. ORGANIZATION AND BOARD OF DIRECTORS

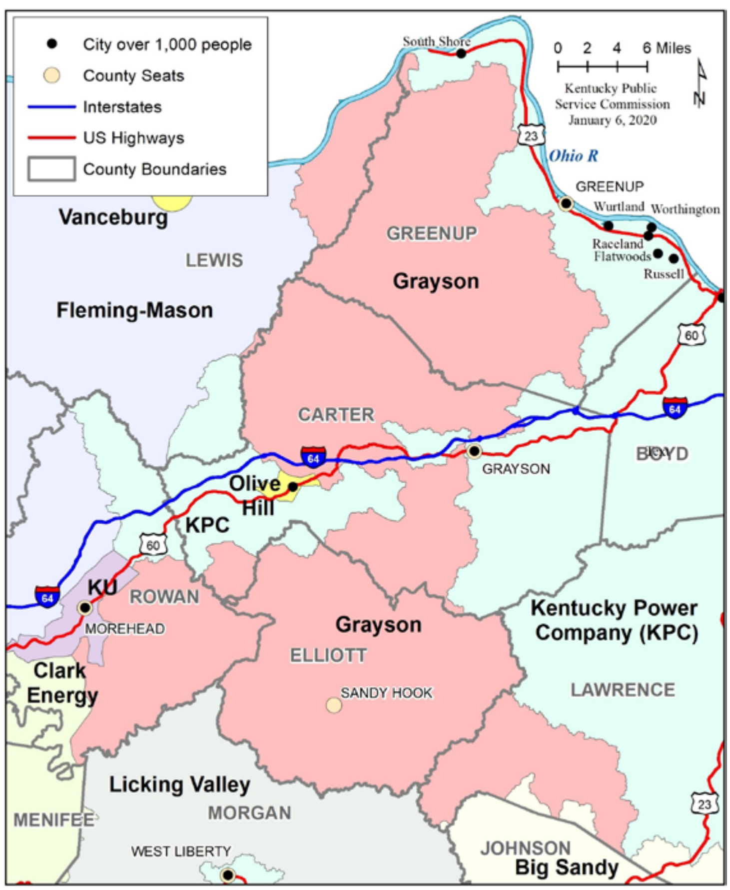
A. GENERAL CORPORATE INFORMATION

Grayson RECC, headquartered in Grayson, Kentucky, is an electric distribution cooperative that serves members in six counties in Kentucky, including:

- Carter
- Greenup
- Elliot
- Rowan
- Lawrence
- Lewis

The map below shows Grayson's service area.

Exhibit II-1
Grayson RECC Service Area



B. ORGANIZATIONAL REVIEW

The organization chart below illustrates the relationship of the Members, Board of Directors, and corporate organization.

II-F1 **<u>The overall organization of Grayson RECC, as a standalone Cooperative, is reasonable.</u>**

The relationship between the President & CEO and the three Managers is direct.[2] They are all located in the same building, facilitating day-to-day communications. Twenty-one employees work in the Operating Department, seven are in the Technical Service Department, six in the Finance and Accounting Department, six in the Member Services Department.

While the Manager of Technical Services seems to have a large span of control, the actual functioning of the group did not indicate any issues.[3]

According to Grayson's Employee List as of August, 2019, there were 41 employees identified.[4]

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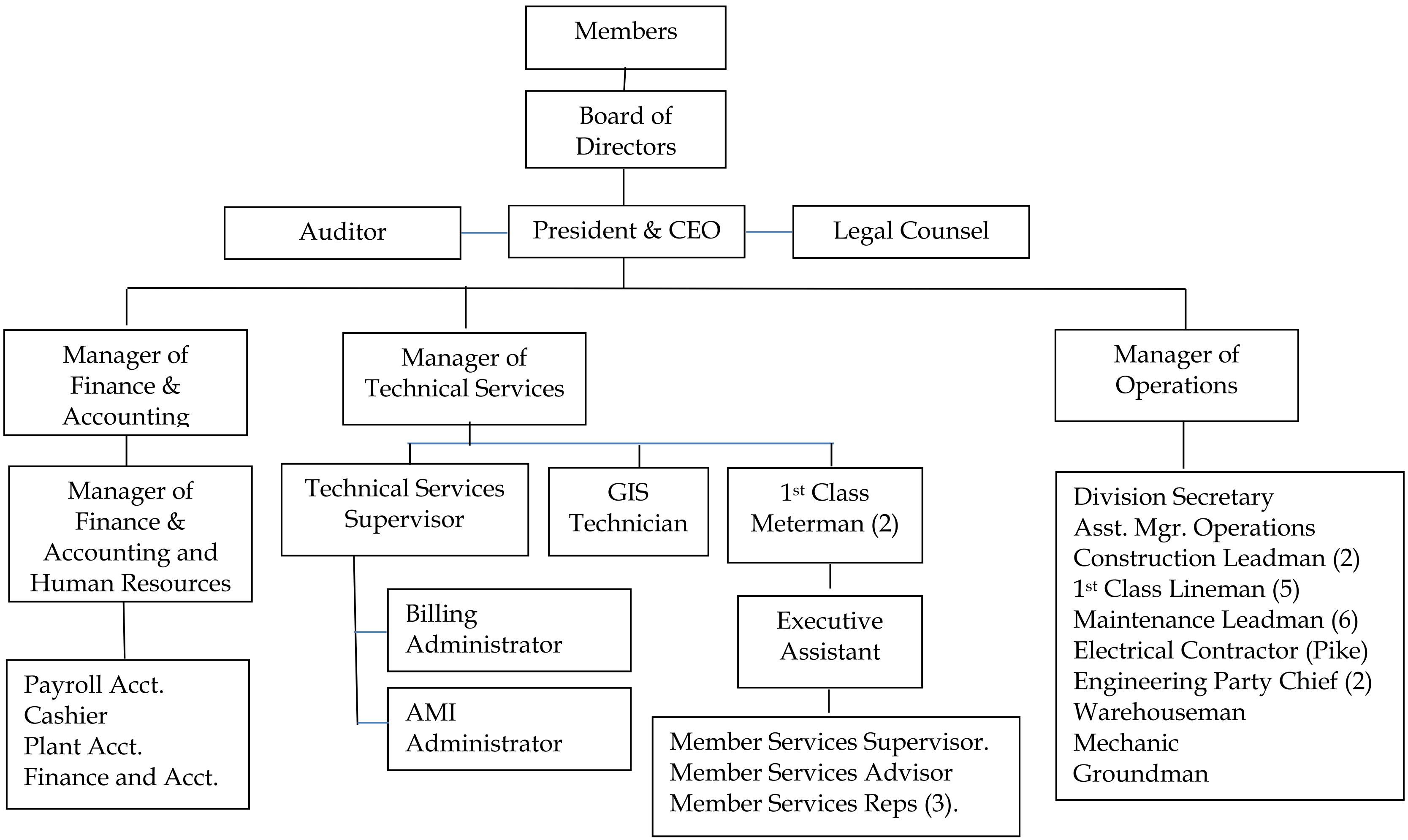
[2] DR 109

[3] Please note, the number of employees stated in this report varies slightly due to changes over the course of the audit period.

[4] DR 18 Employee List as of August 2019

Exhibit II-2
Grayson Organization Chart



II-F2 **Grayson RECC successfully covers positions during vacations, illnesses or vacancies through successful cross training.**

We found that all positions had cross-trained employees to cover vacancies. This cross training was also part of a training and job progression program. In our interviews, we found little evidence that there were weaknesses in the Company's ability to adapt to vacancies, etc.

II-F3 **Grayson RECC responded to the Kentucky PSC concerns with a number of initial steps.**

On March 28, 2019 Grayson RECC responded to the KPSC order, with a press release stating that it was reviewing the KPSC's recent order which includes a rate increase and a management audit of the cooperative and that specific attributes of its service area, such as challenging terrain and many economically disadvantaged members are contributing reasons for many problems. Grayson also stated that since the previous KPSC order in 2013, it has taken a number of steps to more efficiently provide its members with safe, reliable and affordable electricity, including:[5]

- Shifting all employees to a high-deductible health insurance plan. This action saved approximately $280,000 initially and continues to help minimize health insurance costs.
- Reducing staff through attrition. The co-op now has 41 employees, down from 45 in 2013.
- Through negotiations with the union that represents some employees, reducing by more than half the amount of the annual wage increase, from $1.25 per hour to $.50 per hour.
- Strategic investments in maintenance, infrastructure and response such as:
  - Pole covers that lengthen the lifespan of utility poles,
  - Mapping system that reduces response time and cost to members,
  - Tablets for line technicians and service crews to more efficiently coordinate service calls.

Grayson also asserted that:

- Grayson RECC has taken numerous actions to reduce costs, and to address specific concerns that are cited in the order.
- In a 1985 agreement that predates the current management and board of Grayson RECC, the attorney for the cooperative was provided health insurance by Grayson RECC. This attorney is no longer associated with Grayson RECC and the Cooperative is exploring whether it can discontinue this previous agreement.

[5] From Grayson March 28, 2019 response to KPSC re. rate case issues

- Contrary to the KPSC's order, at no time did Grayson RECC provide health insurance to an attorney for union members. Grayson union employees are represented by business agents from IBEW Local 317 in Huntington, W. VA.
- A wage and salary plan conducted by an outside specialist found that Grayson RECC wages were on level both with comparative co-ops and with skilled trades salaries in the market served by Grayson RECC.
- Because the costs to recruit and train new employees, particularly linemen, outweighs the cost of wage increases in line with industry standards, Grayson RECC has worked to retain employees with normal pay increases within budget.
- No current member of the Grayson RECC Board of Directors receives health insurance from the co-op. An allowance that reflects health insurance costs is included in the stipend for board members, yet the average compensation for Grayson RECC board members is below the national average.
- The 6.09 percent rate increase granted by the KPSC is necessary for Grayson RECC to meet its loan obligations.

Vantage addressed all of these issues, where appropriate, in our audit.

C. FINANCE AND RATES

II-F4 **<u>Grayson uses Excel spreadsheets[6] to manage its distribution operations.</u>**

The Excel documents used are not a formal financial model, but tools utilized in documenting expenses related to the work plan, the associated budgets and the management of ongoing operations. They are directly related to the work plan and as such touch on few of the controversial areas such as management salaries, Board of Directors payments or benefits. Grayson also uses other spreadsheets to manage ongoing operations.

II-F5 **<u>Grayson lacks the tools necessary to manage or even understand the impact of variables on their financial positions.</u>**

At present, the only forward-looking tool used by Grayson is a four-year work plan. This plan, while thorough, only focuses on Capital Projects covered by RUS loans. There is no monthly variance analysis, financial targeting or financial management of controllable costs. Without a financial tool, Grayson will continue to reactively respond to pressure on the TIER with requests for rate increases when the financial situation becomes dire. This is addressed further in the report and a recommendation is provided.

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[6] DR 108

II-F6 **<u>The CFC Compass financial forecasting model is under consideration for analysis of financial strategies.</u>** [7]

The following is a description of the Compass model as provided by CFC:

CFC Compass 4.0 is a 10-year financial forecasting software model designed to help rural electric distribution cooperatives analyze a variety of financial strategies.

The model, which is free to CFC owners, provides a tool for preparation of long-range financial forecasts accommodating various scenarios, incorporating CFC's current loan and equity policies to aid in providing support for new loan applications, budgeting and strategic planning.

This new version differs from Compass 3.0 in that a member will receive it with prepopulated data (11 years of historical data) specific to their system. Ten years of future data is automatically calculated based on a weighted method using your historical performance.

Key Features

- Complete system redesign using Microsoft Excel.
- Elimination of the manual entry of historical data (Form 7, Plant, Power, Revenue, Expense, KRTA, and CFC, NCSC and Farmer Mac loans).
- Increased number of historical data years from three to ten years, providing the capability to develop trending of historical results over a significantly longer period of time to forecast future behavior.
- Graphical representation of historical and projected results.

II-R1 **<u>Develop or purchase a financial model that provides detailed and actionable information on Grayson's financial picture. (Priority: Medium)</u>**

In order to manage its business and prevent recurring financial difficulties it is crucial that Grayson develop the tools and processes to enable visibility into and management of their finances.

Currently, Grayson is exploring the Compass 4.0 financial model which is provided by CFC. This model is certainly a step forward but does not provide the monthly management information that is necessary to manage Grayson's finances.

Grayson needs to develop a financial model that tracks all expenses on a monthly basis and ties directly to the CFC and also to provide at least a four-year plan. This model does not

[7] DR 109

need to be elaborate or expensive. The model could easily be developed in house using Excel and available information.

The following Exhibits are examples of reports that can be generated by the Compass 4.0 model based upon historical data through 2018. Note that the Exhibits do not reflect the results of Grayson's general rate case Order issued March 28, 2019. Exhibits II-3 and II-4 below provide current financial, asset and debt, projections. Exhibits II-5 and II-6 below provide projections related to load and energy cost.

Exhibit II-3
Grayson RECC Key Financial Projections[8]

FINANCIAL FORECAST - RATIOS - RUS FORM 325 A
KY061

Grayson Rural Electric Cooperative Corporation

ITEM	Historical 2016	Historical 2017	Historical 2018	Future 2019	Future 2020	Future 2021	Future 2022	Future 2023
Ratios with Additional Revenue								
1. Equity	34.55%	33.13%	33.46%	33.27%	32.09%	30.07%	27.27%	23.37%
2. Debt Service Coverage (DSC)	2.05	0.90	1.72	1.71	1.49	1.25	1.03	0.75
3. Times Interest Earned Ratio (TIER)	2.78	(0.57)	1.90	1.21	0.28	(0.38)	(0.86)	(1.39)
Revenue Comparison								
4. Average Revenue per MWH	$120.52	$118.51	$119.20	$119.02	$118.79	$118.67	$118.59	$118.48
5. Increase in Average Revenue (Annual)				-0.15%	-0.20%	-0.10%	-0.06%	-0.10%
6. Total Utility Plant per MWH Sold	$307.26	$348.81	$313.29	$324.62	$337.49	$348.68	$358.28	$369.98
Ratios to Total Utility Plant								
7. Net General Funds			0.21%	-0.41%	-2.27%	-5.21%	-9.06%	-13.99%
8. Depreciation and Amortization Reserve	28.27%	30.13%	31.35%	33.07%	34.76%	36.43%	38.10%	39.76%
Ratios to Consumers								
9. Operations and Maintenance Expense	$309.98	$333.72	$327.28	$344.38	$362.09	$380.59	$399.85	$420.12
10. Administrative and General Expense + Other Deductions	$136.14	$140.58	$139.84	$147.12	$153.01	$160.15	$167.73	$175.47
Rate Information								
11. Plant Revenue Ratio	5.98	7.56	6.03	6.55	7.21	7.84	8.44	9.26
12. Rate of Return on Rate Base/1000 = 104% Net Utility Plant/1000	1.77%	-2.27%	1.72%	-0.11%	-2.40%	-4.42%	-6.21%	-8.34%
13. Rate Base/1000 = 104% Net Utility Plant/1000	$56,179	$56,614	$57,239	$57,605	$57,917	$58,181	$58,394	$58,556
14. Require Rate Increase over Present Rates				0.00%	0.00%	0.00%	0.00%	0.00%
Modified Ratios								
15. Modified Debt Service Coverage (MDSC)	1.57	0.72	1.40	1.28	0.91	0.54	0.21	(0.17)
16. Modified Times Interest Earned Ratio (MTIER)	1.21	(0.99)	0.90	(0.00)	(1.13)	(1.98)	(2.59)	(3.23)
17. Operating Times Interest Earned Ratio (OTIER)	1.19	(1.23)	0.92	(0.03)	(1.16)	(2.00)	(2.61)	(3.25)
18. Operating Debt Service Coverage Ratio (ODSC)	1.55	0.70	1.38	1.26	0.89	0.52	0.19	(0.20)

[8] DR109

Exhibit II-4
Grayson RECC Asset and Debt Projections

PRO FORMA BALANCE SHEET - RUS FORM 325 B KY061	Grayson Rural Electric Cooperative Corporation							
	Historical 2016	Historical 2017	Historical 2018	Future 2019	Future 2020	Future 2021	Future 2022	Future 2023
ASSETS AND OTHER DEBITS								
1. Total Utility Plant in Service	73,873,883	76,908,490	79,352,218	82,761,575	85,356,726	87,998,062	90,710,966	93,469,152
2. Construction Work in Progress	1,429,300	1,002,088	814,042					
3. Total Utility Plant (1+2)	**75,303,183**	**77,910,578**	**80,166,260**	**82,761,575**	**85,356,726**	**87,998,062**	**90,710,966**	**93,469,152**
4. Accum. Provision for Depreciation and Amort	21,285,230	23,474,155	25,128,553	27,372,547	29,667,170	32,054,815	34,562,811	37,165,492
5. Net Utility Plant (3-4)	**54,017,953**	**54,436,423**	**55,037,707**	**55,389,028**	**55,689,556**	**55,943,247**	**56,148,155**	**56,303,660**
6. Nonutility Property - Net	0	0	0	**0**	0	0	0	0
7. Investment in Subsidiary Companies	0	0	0	0	0	0	0	0
8. Invest. in Assoc. Org. - Patronage Capital	15,210,342	15,704,261	16,744,944	18,021,734	19,655,890	21,643,856	23,988,981	26,695,330
9. Invest. in Assoc. Org. - Other - General Funds	0	0	0	**0**	0	0	0	0
10. Invest in Assoc. Org. - Other - Nongeneral Funds	639,230	637,607	635,940	635,940	635,940	635,940	635,940	635,940
11. Investments in Economic Development Projects	0	0	0	0	0	0	0	0
12. Other Investments	99	99	99	**99**	99	99	99	99
13. Special Funds	0	0	0	**0**	0	0	0	0
14. Total Other Property & Investments (6 thru 13)	**15,849,671**	**16,341,967**	**17,380,983**	**18,657,773**	**20,291,929**	**22,279,895**	**24,625,020**	**27,331,369**
15. Cash-General Funds	139,462	213,727	167,198	(335,928)	(1,935,123)	(4,580,415)	(8,222,620)	(13,077,987)
16. Cash-Construction Funds-Trustee	0	0	0					
17. Special Deposits	0	0	0					
18. Temporary Investments	0	0	0					
19. Notes Receivable - Net	0	0	0					
20. Accounts Receivable - Net Sales of Energy	6,076,407	4,001,469	3,357,557					
21. Accounts Receivable - Net Other	72,386	495,553	495,788					
22. Renewable Energy Credits	0	0	0					
23. Materials & Supplies - Electric and Other	287,319	283,605	1,483,900					
24. Prepayments	49,217	51,439	53,821					
25. Other Current & Accrued Assets	7,548	7,548	7,548	6,720,372	6,720,372	6,720,372	6,720,372	6,720,372
26. Total Current & Accrued Assets (15 thru 25)	**6,632,339**	**5,053,341**	**5,565,812**	**6,384,444**	**4,785,249**	**2,139,957**	**(1,502,248)**	**(6,357,615)**
27. Regulatory Assets	0	0	0					
28. Deferred Debits	1,308,874	1,467,380	1,321,758					
29. Total Assets & Other Debits (5+14+26+27)	**77,808,837**	**77,299,111**	**79,306,260**	**80,431,245**	**80,766,734**	**80,363,100**	**79,270,926**	**77,277,413**
LIABILITIES AND OTHER CREDITS								
30. Memberships	153,285	154,655	154,255					
31. Patronage Capital	27,421,138	25,683,142	26,579,673	26,760,567	25,918,849	24,165,383	21,617,273	18,059,498
32. Operating Margins - Prior Years	0	0	0					
33. Operating Margins - Current Year	0	0	0					
34. Non-Operating Margins	0	0	0					
35. Other Margins & Equities	(692,937)	(228,613)	(200,167)					
36. Total Margins & Equities (29 thru 34)	**26,881,486**	**25,609,184**	**26,533,761**	**26,760,567**	**25,918,849**	**24,165,383**	**21,617,273**	**18,059,498**
Long-Term Debt CFC (Net)	18,003,121	16,364,384	15,366,046	9,393,572	11,188,727	13,102,630	15,137,859	17,249,319
Long-Term Debt RUS (Net)	0	0	0	26,395,215	25,893,453	25,377,919	24,848,233	24,305,896
Long-Term Debt RUS - Econ. Devel. (Net)	0	0	0					
Long-Term Debt FFB - RUS - Guaranteed	20,104,514	23,157,831	27,356,947					
Long-Term Debt - Other RUS Guaranteed	0	0	0					
Long-Term Debt RUS - Unapplied (Cushion)	0	0	0	0	0	0	0	0
Long-Term Debt - Other (Net)	0	0	0	0	0	0	0	0
43. Total Long-Term Debt minus Unapplied	**38,107,635**	**39,522,215**	**42,722,993**	**35,788,787**	**37,082,180**	**38,480,548**	**39,986,092**	**41,555,214**
44. Obligations Under Capital Leases - Non current	0	0	0					
45. Accumulated Operating Provisions - Asset Retirement Obligations	3,330,597	3,085,624	3,173,788					
46. Total Other Noncurrent Liabilities (39+40)	**3,330,597**	**3,085,624**	**3,173,788**					
47. Notes Payable	3,149,525	2,185,000	525,000					
48. Accounts Payable	2,480,018	2,496,842	2,442,573					
49. Consumers Deposits	1,210,055	1,197,900	1,185,769					
50. Current Maturities Long-Term Debt	1,944,363	2,264,892	1,856,391	1,644,728	1,528,541	1,480,005	1,430,398	1,425,537
51. Current Maturities Long-Term Debt-Economic Dev.	0	0	0					
52. Current Maturities Capital Leases	0	0	0					
53. Other Current & Accrued Liabilities	534,554	570,319	618,333	16,237,164	16,237,164	16,237,164	16,237,164	16,237,164
54. Total Current & Accrued Liabilities (42 thru 48)	**9,318,515**	**8,714,953**	**6,628,066**	**17,881,891**	**17,765,705**	**17,717,169**	**17,667,561**	**17,662,701**
55. Regulatory Liabilities	0	0	0					
56. Deferred Credits	170,604	367,135	247,652					
57. Total Liabilities & Other Credits (35+38+41+49+50)	**77,808,837**	**77,299,111**	**79,306,260**	**80,431,245**	**80,766,734**	**80,363,100**	**79,270,926**	**77,277,413**

Exhibit II-5
Grayson RECC Load Projections[9]

STATEMENT OF OPERATIONS - RUS FORM 325 C
KY061

Grayson Rural Electric Cooperative Corporation

ITEM	Historical 2016	Historical 2017	Historical 2018	Future 2019	Future 2020	Future 2021	Future 2022	Future 2023
A1. Additional Revenue to meet Drivers Goals				0	0	0	0	0
1. Operating Revenue and Patronage Capital	30,511,143	27,461,142	31,593,287	31,490,661	31,255,717	31,216,060	31,347,959	31,311,441
2. Power Production Expense	0	0	0	0	0	0	0	0
3. Cost of Purchased Power	17,917,378	17,151,603	18,299,724	18,848,716	19,414,177	19,996,603	20,596,501	21,214,396
C. Operating Revenue less Cost of Power	**12,593,765**	**10,309,539**	**13,293,563**	**12,641,945**	**11,841,540**	**11,219,458**	**10,751,458**	**10,097,045**
4. Transmission Expense	0	0	0	0	0	0	0	0
5. Regional Market Operations Expense	0	0	0	0	0	0	0	0
6. Distribution Expense - Operation	1,262,833	1,299,965	1,397,788	1,467,677	1,541,061	1,618,114	1,699,020	1,783,971
7. Distribution Expense - Maintenance	3,500,339	3,424,805	3,635,745	3,817,532	4,008,409	4,208,829	4,419,271	4,640,234
8. Consumer Accounts Expense	1,080,016	1,070,977	1,192,896	1,228,683	1,265,543	1,303,510	1,342,615	1,382,893
9. Customer Service and Informational Expense	256,835	260,150	197,463	203,387	209,488	215,773	222,246	228,914
10. Sales Expense	21,391	22,103	16,510	0	0	0	0	0
11. Administrative and General Expense	2,013,625	1,955,130	2,137,120	2,243,976	2,356,175	2,473,984	2,597,683	2,727,567
12. Total Operation & Maintenance Expense (2 thru 11)	**26,052,417**	**25,184,733**	**26,877,246**	**27,809,971**	**28,794,854**	**29,816,813**	**30,877,335**	**31,977,975**
13. Depreciation & Amortization Expense	3,341,888	3,477,092	3,589,787	3,730,579	3,863,011	3,993,118	4,126,838	4,262,875
14. Tax Expense - Property & Gross Receipts	40,662	41,074	35,026	0	0	0	0	0
15. Tax Expense - Other	0	0	(139)	0	0	0	37	41
16. Interest on Long-Term Debt	895,352	980,167	1,160,828	1,074,899	1,175,934	1,267,239	1,373,493	1,490,979
17. Interest Charged to Construction (Credit)	0	0	0	0	0	0	0	0
18. Interest Expense - Other	4,513	7,941	95,596	0	0	0	0	0
19. Other Deductions	78,323	35,148	13,634	13,812	(11,147)	(22,116)	(31,212)	(44,393)
20. Total Cost of Electric Service (12 thru 19)	**30,413,155**	**29,726,155**	**31,771,978**	**32,629,261**	**33,822,652**	**35,055,054**	**36,346,492**	**37,687,478**
21. Patronage Capital & Operating Margins (1 minus 20)	**97,988**	**(2,265,013)**	**(178,691)**	**(1,138,601)**	**(2,566,935)**	**(3,838,994)**	**(4,998,533)**	**(6,376,037)**
22. Non Operating Margins - Interest	29,393	33,944	30,589	60,989	62,329	63,916	65,414	66,986
23. Allowance for Funds Used During Construction	0	0	0	0	0	0	0	0
24. Income (Loss) from Equity Investments	0	0	0	0	0	0	0	0
25. Non Operating Margins - Other	102,306	94,790	42,836	0	0	0	0	0
26. Generation & Transmission Capital Credits	1,223,640	504,926	927,350	1,274,134	1,622,522	1,971,642	2,324,237	2,678,657
27. CFC & Other Capital Credits & Patronage Dividends	138,681	87,794	219,099	30,283	40,367	49,969	60,772	72,619
28. Extraordinary Items	0	0	0	0	0	0	0	0
29. Patronage Capital or Margins (21 thru 28)	**1,592,008**	**(1,543,559)**	**1,041,183**	**226,806**	**(841,718)**	**(1,753,466)**	**(2,548,110)**	**(3,557,775)**
2. Cash Basis								
A. Cash from Operations before Debt Service				3,727,867	2,534,338	1,485,280	567,212	(555,197)
B. Total Debt Service				2,943,323	2,820,662	2,795,780	2,853,498	2,921,377
C. Cash Margins After Debt Service				**784,544**	**(286,323)**	**(1,310,500)**	**(2,286,285)**	**(3,476,574)**

Exhibit II-6
Grayson RECC Energy Cost Projections[10]

ITEM	Historical 2016	Historical 2017	Historical 2018	Future 2019	Future 2020	Future 2021	Future 2022	Future 2023	
1. A. Total MWHs Required	261,944	250,858	270,302	275,854	273,651	273,068	273,941	273,350	27
B. Cost per MWH Purchased	68.40	68.37	67.70	68.33	70.95	73.23	75.19	77.61	
C. Flow Through Adjustment - MWH									
D. Cost of Purchased Power	17,917,378	17,151,603	18,299,724	18,848,716	19,414,177	19,996,603	20,596,501	21,214,396	21,85
2. A. Consumer Accounts Expense	1,358,242	1,353,230	1,406,869	1,432,070	1,475,032	1,519,283	1,564,861	1,611,807	1,66
B. Cost per Consumer Served	88.39	95.58	91.47	93.31	96.24	99.23	102.27	105.41	1
C. Average Number of Consumers	15,366	14,158	15,380	15,347	15,326	15,310	15,301	15,292	1
3. A. Operations and Maintenance Expense	4,763,172	4,724,770	5,033,533	5,285,210	5,549,470	5,826,944	6,118,291	6,424,205	6,74
B. Ratio to Total Utility Plant	6.33	6.06	6.28	6.39	6.50	6.62	6.74	6.87	
4. A. Administration and General Expense	2,013,625	1,955,130	2,137,120	2,243,976	2,356,175	2,473,984	2,597,683	2,727,567	2,86
B. Ratio to Total Utility Plant	2.67	2.51	2.67	2.71	2.76	2.81	2.86	2.92	
5. A. Depreciation & Amortization Expense	3,341,888	3,477,092	3,589,787	3,730,579	3,863,011	3,993,118	4,126,838	4,262,875	4,40
B. Ratio to Total Utility Plant	4.44	4.46	4.48	4.51	4.53	4.54	4.55	4.56	
6. A. Tax Expense	40,662	41,074	34,887	0	0	0	37	41	
B. Ratio to Total Utility Plant	0.05	0.05	0.04	0.00	0.00	0.00	0.00	0.00	
7. A. Discount on Debt				28,467	0	0	0	0	
8. A. Total Utility Plant	75,303,183	77,910,578	80,166,260	82,761,575	85,356,726	87,998,062	90,710,966	93,469,152	96,25

[9] DR109

[10] DR109

REGULATORY CONCERNS

Over the past seven years, Grayson RECC has filed for and received rate increases from the Kentucky Public Service Commission in two consecutive rate cases. The first case was filed in December 2012 and a final Order was issued July 13, 2013.[11] The second case was submitted on September 20, 2018 and a final Order was issued March 28, 2019.[12] The filing of both cases was necessitated because Grayson RECC was unable to meet its minimum TIER requirements consistent with its RUS loan obligations. However, during the pendency of these cases the Commission expressed significant concern regarding the lack of urgency on the part of the management and Board of Directors to pursue aggressive cost-saving measures to mitigate Grayson's financial deterioration. The Commission's frustration with Grayson was best expressed in the final Order in Case No. 2018-00272 at page 4. The Order states:

> "Grayson RECC has offered no evidence in this rate case to show that it has addressed the areas of concern that the Commission highlighted in the July 31, 2013 Order. The Commission is unsure whether Grayson RECC's failure to properly manage its operations and control its expenditures stems from a lack of management, from Grayson RECC's Board of Directors' inability to make the necessary systemic changes, or from Grayson RECC making a calculated decision to disregard the July 31, 2013 Order. It is not fair, just, and reasonable to allow Grayson RECC to ignore the clear management deficiencies that continue to negatively affect the financial state of the cooperative and to burden the ratepayers who ultimately suffer the consequences of systemic mismanagement."

Exhibit II-7 below lists the Commission's concerns as expressed in the Orders and the corresponding finding from our audit that addresses the highlighted concern.

[11] Case No. 2012-00426 Application of Grayson Rural Electric Cooperative For An Adjustment of Electric Rates

[12] Case No. 2018-00272 Application of Grayson Rural Electric Cooperative For An Adjustment of Electric Rates

Exhibit II-7
KPSC Concerns and Vantage Findings[13]

COMMISSION CONCERN	VANTAGE FINDINGS/RECOMENDATIONS
Wage and Salary Expense	II-F3, II-R1, IV-F3, IV-F4, IV-R1, IV-R2, IV-R3
Board of Directors' Fees and Expenses	II-F3, II-F14, II-F15, II-F16, II-R7
Lack of Urgency to Confront Critical Financial Situation	II-F3, II-F15, II-F16, II-F19, II-R7, II-R8, II-R9, III-F1, III-F2, III-R1, IV-F3, V-F4
Management's Ability to Identify and Implement All Cost Savings Measures Possible	II-F3, II-F6, II-R1, II-R7, II-R9, III-F1, III-F2, III-R1, V-F4, V-R2, V-R4, V-R5
Board of Directors' Involvement in Financial and Strategic Planning Process	II-F19, II-R7, II-R8, II-R9, III-F2, III-R2

Although the Commission's Orders discuss several other ratemaking matters, the concerns in Exhibit II-7 above were the focus of this audit and appear to have been the driving force for the Commission's demand for a management audit. The Vantage Findings are discussed in more detail in the appropriate sections of the audit report.

II-F7 **<u>Grayson does not have a specific individual or individuals to act as a liaison with regulatory bodies.</u>**

At a minimum this position(s) would:

- Identify all actions necessary to comply with Commission orders
- Assign responsibility for compliance, including writing of responses and of the actual actions necessary to respond.
- Track the status of all requests and responses.
- Coordinate with KPSC Staff as needed on status

II-R2 **<u>Identify a regulatory liaison and communicate to the KPSC.</u> (Priority: Low)**

Provide clarity as to the formal means of communicating between company and regulatory bodies.

[13] DR109

D. ELECTRIC OPERATIONS

SYSTEM RELIABILITY

Grayson, as well as all Kentucky utilities, report to the KPSC every year with a summary of their key reliability results. We reviewed the report for 2018 and summarize the following results.[14]

Exhibit II-8
KPSC Reliability Statistics

Total customers for 2018 – 15,318

Total Circuits in Grayson Service Area – 42

	Reliability Excluding MED[15]	
	5 Year Average	All of 2018
SAIDI	426.2	378.4
SAIFI	3.32	3.03

	Reliability Including MED	
	5 Year Average	All of 2018
SAIDI	1150.0	378.4
SAIFI	3.74	3.03

II-F8 **<u>An evaluation of outages for 2018 indicates that the largest percentage are unidentified or unknown.</u>**

According to 2018 statistics, Cause Unknown accounted for 29.8% of all outages. This indicates an ineffective root cause analysis process.

[14] 2019 Annual Reliability Report for Grayson Electric Cooperative Corporation dated 3/13/2019

[15] SAIDI (System Average Interruption Duration Index) are to be reported in units of minutes; SAIFI (System Average Interruption Frequency Index) in number of occurrences. IEEE 1366 (latest version) issued to define SAIDI, SAFI

Exhibit II-9
Outage Causes (2018)

Cause unknown	29.8%
Tree Failure-off ROW	27.7%
Maintenance	8.5%
Small animal/bird	8.5%
Tree failure from overhang or dead tree without ice/snow	6.4%
Lightning	4.3%
Motor vehicle	4.3%
Other	4.3%
Other planned	2.1%
Decay/age of material/equipment	2.1%
Weather, other	2.1%

II-R3 **<u>Improve process for evaluating and determining causes of outages. (Priority: Medium)</u>**

Additional forensic or root cause analysis is warranted in evaluating outages. This evaluation is needed, because knowing the cause of outages is essential for setting budgets and establishing priorities.

LOAD FORECAST

The load forecast[16] is prepared every two years as part of the overall planning cycle at EKPC and Grayson RECC. Grayson asserts that cooperation helps to ensure that the forecast meets both parties' needs. Grayson RECC uses the forecast in developing three-year work plans, long-range work plans, and financial forecasts. EKPC uses the forecast in areas of marketing analysis, transmission planning, generation planning, demand-side planning, and financial forecasting.

This load forecast report contains Grayson RECC's long-range forecast of energy and peak demand. Grayson RECC and its power supplier, EKPC, work jointly to prepare the load forecast. Factors considered in preparing the forecast include the national and local economy, population and housing trends, service area industrial development, electric price, household income, weather, and appliance efficiency changes. EKPC prepared a preliminary load forecast, which was reviewed by Grayson RECC for reasonability. Final projects reflect an analysis of historical data combined with the experience and judgment of the President/CEO and staff of Grayson RECC.

II-F9 **<u>Low load growth for the foreseeable future limit many options for Grayson.</u>**

According to the 2018 forecast, total sales are projected to grow by 0.7% per year for the period 2018-2038, compared to a 0.6% growth projected in the 2016 load forecast for the period 2016-2036. Winter and summer peak demand for 2018-2038 indicate an annual

[16] Grayson RECC 2018 Load Forecast data 11/18

growth of 0.4% and 0.6%, respectively. Load factor increases from 40.2% to 41.9% for the forecast period.[17] The Exhibit below illustrates the low growth.

Exhibit II-10
Load Projections

Year	Resid. Sales (MWh)	Small Commercial Sales (MWh)	Large Com Sales (MWh)	Public Street. Hwy Ltg Sales (MWh)	Total Sales (MWh)	% Loss	Purchased Power (MWh)
2020	174,278	45,849	31,685	51	251,863	5.7	266,954
2021	175,682	45,917	31,908	51	253,558	5.7	268,750
2022	175,758	46,145	32,131	51	254,085	5.7	269,309
2023	175,836	46,384	32,354	51	254,626	5.7	269,882
2024	176,854	46,763	32,577	51	256,246	5.7	271,599
2025	177,739	46,914	32,801	51	257,505	5.7	272,933
2026	178,627	47,232	33,024	52	258,935	5.7	274,449
2027	179,520	47,602	33,247	52	260,421	5.7	276,024
2028	179,655	48,139	33,470	52	261,316	5.7	276,973
2029	179,790	48,456	33,693	52	261,991	5.7	277,688
2030	180,149	48,814	33,916	52	262,932	5.7	278,685

E. COMPLAINT RESOLUTION

II-F10 **<u>The time required to resolve customer complaints was raised by the Attorney General's Office during a meeting.</u>**

During the audit, members of the Office of the Attorney General's ("AG") were interviewed by the Vantage consultants. The members of the AG's Office raised a concern about the resolution of complaints by Grayson RECC. It was explained that when the AG's Office intervened in the Grayson rate case, their Office received several complaints from customers of Grayson. The AG's concern related to the time it took to get responses to the complaints from Grayson. In addition, there was a concern that many of the complaints went to Grayson's CEO for resolution. In response to this concern, we requested Grayson's process and/or procedures for tracking and resolving complaints.

[17] DR 74

The response to our data request explained the process currently used by Grayson RECC for complaints directly from customers to Grayson; complaints from the Commission; and complaints from the AG's Office.[18] The process described in the response, though not a formal procedure, appeared to be effective but lacked the expected detail typically used by other utilities. It also appeared that the CEO was unnecessarily overly involved in the resolution of complaints, which could potentially slow the process. The tracking and careful resolution of complaints is important as these complaints can result in serious legal liabilities and regulatory concerns in some instances.

II-F11 **Grayson has no means of tracking responses to Commission Orders.**

Utilities generally consider any direct Orders or even suggestions by State Commissions and Staff to be extremely high priority items. These are generally the responsibility of the Regulatory Staff within the utility. Grayson is too small to maintain a regulatory staff and Vantage is not suggesting Grayson add such. However, the process of tracking and responding to Orders and Staff requests still must be performed in a more formal manner

II-R4 **Develop a formal procedure for the tracking and resolution of complaints. (Priority: Medium)**

The process currently used by Grayson RECC is dependent on the experience of current personnel at the Cooperative. In this arrangement, there is always the concern that a change in personnel could change the process. In order to have an equitable and consistent treatment of complaints a formal procedure is needed. The function should be centralized in one area to assign tracking numbers and maintain the files including all documentation associated with the resolution of the complaint. The procedure should identify the personnel that need to be involved in the resolution of the complaint. The procedure should also specify the time for resolution in order to ensure the timely resolution of the complaint. The procedure should specify how a complaint will be ultimately resolved if there is no clear resolution by the assigned department.

F. BOARD OF DIRECTORS

The Grayson Board of Directors currently has six members. They are elected from various regions of the Coop's service territory. At this time all of the Board members are male. To accomplish the work of the Board, two primary subcommittees have been established. These subcommittees focus on key functions within the Coop. They include Planning and Review as well as Negotiating.[19] On occasion, a special subcommittee may be formed to address an issue. The responsibilities of the subcommittees are established in Grayson policies. The policies are quite detailed and clearly delineate the roles and responsibilities of the subcommittee.

[18] DR 110 Complaint Process

[19] DR 3 - Subcommittees

Directors are elected to four-year terms. They receive a monthly stipend for attendance at the monthly board meetings. Board members may also be required to attend special meetings of the Board as well as attend assigned subcommittee meetings. The Directors are reimbursed for mileage expenses and a $200 per day travel per diem. Any out-of-pocket expenses are reimbursed when accompanied by a receipt.[20] The Board-related fees and expenses for the last 3 years were reviewed.[21]

New Board members receive training to prepare them for their new responsibilities with courses available through the National Rural Electric Cooperatives Association ("NRECA"). Existing Board members are kept current on utility cooperative issues and other training through NRECA as well as other industry groups such as Kentucky Association of Electric Cooperatives ("KAEC").[22]

Grayson RECC provided the minutes of the Board meetings for the last five years[23] including the attachments provided to the Board members in preparation for the meeting. This response consisted of several thousands of pages. The minutes were considered confidential, so we will not get into some of the specifics. For instance, the minutes reflect there were regular reports from each department to provide the latest information on projects or on-going operations. More specifically the operations department would provide a review of the safety meetings that occurred during the previous month. There are reports on the progress of the installation of new meters usually on a year to date basis. There are budget updates. Current TIER measures are provided. This information is good and very useful, but it is all provided on a retrospective basis. There was little to no information projecting where Grayson RECC may be headed in the next 3, 5 or 10 years.

II-F12 **The Grayson Board of Directors is currently composed of all males.**

The Board of Directors for Grayson had traditionally had seven members, who have served for significant periods of time. Currently there is a vacant seat on the Board. As a cost-saving measure this seat may be left vacant.[24] Board terms are four (4) years, and there is no limit to the number of terms a member can serve. Voting for Board members takes place at Grayson's annual meetings where members cast their votes.

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[20] DR 32 – Board members

[21] DR 103 – Board Fees and Expenses

[22] DR 9 – Board Training

[23] DR 8

[24] DR 43 – Cost saving measures

Exhibit II-11
Tenure of Directors of Grayson RECC Board[25]

Director	Service Year
Director Roger Trent	1994
Chair Harold Dupuy	1999
Director Kenneth Arrington	2001
Director Jimmy Whitt	2004
Director Eddie Marten	2005
Director Jim Bentley	2014

II-R5 **<u>As the opportunities arise, Grayson should strive to include more diversity on its Board.</u> (Priority: Medium)**

Currently, the Board consists entirely of white males. As opportunities arise, Grayson should encourage and actively support a more diverse Board. The more diverse views will lead to better understanding of the views of all of its members. Board members of different age, race, gender and/or employment experience will be of value.

II-R6 **<u>Create a more transparent process of governance.</u> (Priority: High)**

While the consultants recognize that Kentucky is not an open meetings state with respect to electric cooperatives, there seems to be some pressure within rural cooperatives to have an understanding of the decision-making processes and the budgetary impact of those processes on the members of the cooperative. Grayson, with its significant focus on caring for its employees, should extend that more fully to all the members by having open board meetings so the membership can see how the Directors are responsible, and accountable, for the decisions they make. This process could inspire others to pursue Board membership on the Board and expand the diversity and experience of the Board members.

Vantage recommends that BOD meetings be open, except where confidential information, contracts or compensation are discussed.

II-R7 **<u>Directors' fees and expenses should be carefully monitored and managed jointly by both the Board and Grayson management.</u> <u>(Priority: Medium)</u>**

Grayson's financial challenges are real, and the Board has an opportunity to serve as real leaders in the community and Cooperative by establishing pay guidelines for itself that model the reality of the economics of the service territory. At a minimum, they should consider re-instituting the original per diem and reducing the cash in lieu of health care to the $3250/year that employees receive. Since the majority of the members have been on the board for many years and attendance at training sessions has long since diminished, the miscellaneous expenses should be scrutinized and substantive limitations put in place.

[25] DR 32

II-R8 **Increase involvement by the Board in the strategic planning process with a focus on actions that have an impact on TIER. (Priority: High)**

The Strategic Planning section of this audit report discusses in detail a planning process focused primarily on TIER. The Board's involvement in that process could be accomplished by including an additional agenda item for the monthly Board meetings or preferably a quarterly or six-month meeting devoted entirely to strategic planning. Specifically, the strategic planning sessions should focus on financial and operational goals and the detailed steps to accomplish those goals.

II-F14 **Both new and existing Board members receive appropriate training enabling them to perform their responsibilities as Board members adequately.**

As discussed above the new Board members attend training provided by the NRECA. Existing members can attend conferences and training on ongoing cooperative issues. As a cost control measure the Board is considering limiting the number of conferences that a Board member can attend.

II-F15 **The benefits for members of the Board of Directors are generous and don't seem to adequately reflect the gravity of the financial position of the Cooperative.**

Until the Commission raised concerns about the fully-paid health care for Board members, the compensation for each member was comprised of a per-meeting stipend and per-conference stipend ranging from $4800 - $12,300 per year, cash in lieu of health care, mileage, and a generous miscellaneous fund, as detailed in the chart below. The cash in lieu of insurance for Directors was 235% of the amount the Grayson employees receive as cash in lieu of insurance.

In response to the Commission's concerns raised in its recent order, a decision was made to amend the overall compensation package by eliminating the payment in lieu of health care and moving the majority of that amount into the per diem. The Cooperative claims a $20,600, or 15.07 percent, annual saving; the cost of total compensation to the Board was $116,249 as illustrated. This shift results in some cost savings but does not reflect the gravity of the financial position of the Cooperative.

II-F16 **The fees and expenses incurred by Board members are controllable expenses that should be managed jointly by the Board and Grayson management.**

The Board-related fees and expenses are significant. There have been recent changes that reduce the Board benefits package, but this change was initiated as a response to the Commission's concerns in Grayson's 2018 rate case.

The Board members have traditionally received a per diem, or stipend, for each of their 12 meetings per year as well as travel costs to the meetings, conferences, or trainings, and reimbursement for reasonable costs. Their compensation and benefits are shown in two charts below: The first depicts the data prior to cost-saving measures implemented following a 2013 KYPSC report, and the second shows the effects of their cost-saving efforts. As a cost-saving initiative, they have intentionally not filled a position after Director Rice retired.

Exhibit II-12
Revised Compensation Plan for BOD Members[26]

PRIOR						
	Per Diem	**Cash in Lieu**	**Mileage**	**Visa[27]**	**Misc**	**Total**
Kenneth Arrington	$4,800	$7,657	$796	$539	$458	$14,251
Jim Bentley	$5,100	$7,665	$443	$2,698	$(944)	$14,962
Harold Dupuy	$9,000	$7,659	$2,103	$6,180	$565	$25,508
Eddie Martin	$5,400	$7,665	$468	$2,330	$139	$16,002
William T. Rice (6)	$2,100	$3,829	$153	$65	$19	$6,166
Roger Trent	$9,900	$7,657	$2,287	$6,280	$521	$26,645
Jimmy Whitt	$12,300	$7,665	$3,911	$9,014	$460	$33,349
	$48,600	**$49,798**	**$10,159**	**$27,106**	**$1,220**	**$136,883**

REVISED							
	Per Diem	**Cash in Lieu**	**Mileage**	**Visa**	**Misc**	**Total**	**Savings**
Kenneth Arrington	$11,000	$	$796	$540	$458	$12,794	$1,457
Jim Bentley	$11,400	$	$443	$2,698	$(943)	$13,598	$1,365
Harold Dupuy	$13,800	$	$2,103	$6,180	$565	$22,648	$2,860
Eddie Martin	$11,400	$	$468	$2,330	$139	$14,337	$1,665
William T. Rice (6)							
Roger Trent	$14,400	$	$2,287	$6,280	$521	$23,488	$3,157
Jimmy Whitt	$16,000	$	$3,911	$9,014	$460	$29,385	$3,965
	$78,000	$	$10,007	$27,041	$1,201	**$116,249**	**$14,468**
TOTAL ANNUAL SAVINGS							**$20,634**
TOTAL ANNUAL PERCENT SAVINGS							**15.07%**

The shift in dollars from the cash in lieu of health insurance, since no members elected to take advantage of the health insurance, to the per diem, as well as the continued high

[26] Data Request 35

[27] Company provided credit card

mileage, VISA, and miscellaneous costs offer little in real relief to the Cooperative's bottom line.

II-F17 **The lack of openness and transparency in the Board of Directors' actions is of concern.**

Board meetings are closed except for the administrative employees who provide standard reports. If someone else wants to attend, they need to ask approval from the Board to be put on the agenda. A lack of transparency and hence, understanding, can lead to members' loss of confidence that the utility is being managed effectively.

II-F18 **Subcommittee related policies are quite detailed and clearly delineate the roles and responsibilities of the BOD subcommittees.**

Vantage reviewed all BOD Subcommittee related polices and found that they were adequately documented.

II-F19 **Most of the information presented and discussed at the Board meetings focuses on the past or current situations. There is not adequate attention given to where the Coop is headed.**

As discussed above, at the Board meetings there is considerable information provided on a retrospective basis. The information is provided for a monthly change or year-to-date comparisons. There is little to no information provided on where the Cooperative is projected to be in the future relative to stated financial and operational goals.

II-R9 **The Board of Directors should take the lead in meaningful cost savings measures, to assure Grayson's members have affordable electricity now and in the future. (Priority: Medium)**

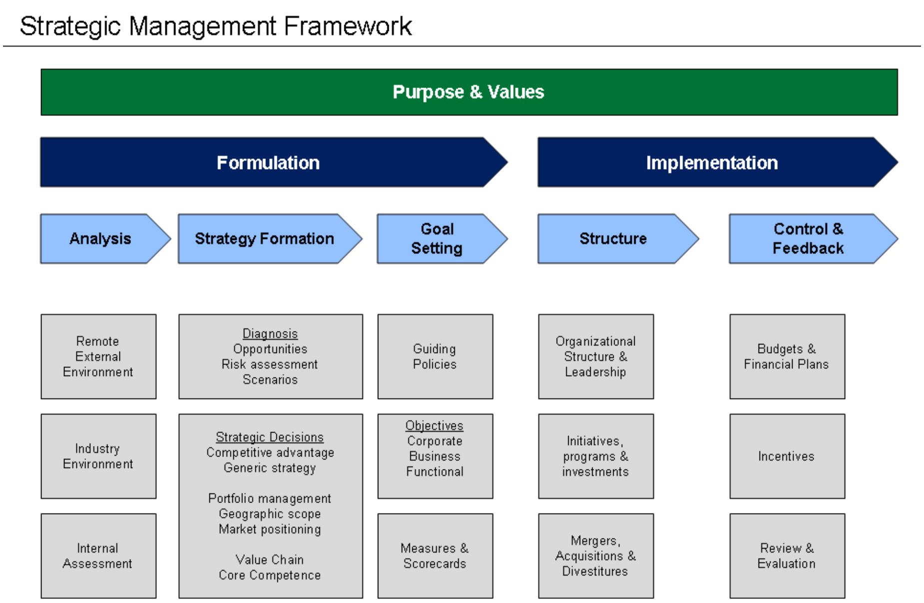
The Board should be the driver in streamlining Grayson's operations and reducing costs to make it competitive. This is an experienced BOD and it has adequate current and historical information needed to make meaningful changes. As a new management team is instituted, the Board should work with the management team to move forward with bold plans that reduce costs and assure financial stability.

III. STRATEGIC AND RESOURCE PLANNNING

A. INTRODUCTION

The strategic plan and its associated building processes have become a common practice among all types of businesses including educational institutions, manufacturing and, of course, regulated utilities. First popularized in the early 1970s, the planning process, which included the participation of a wide range of stakeholders including management, staff, boards of directors, and customers, sought to define the mission and vision of the business entity, its goals that would be defined by its agreed-upon mission statement and quantifiable objectives that served as guideposts and measures of success. The practice of assessing SWOTs[28] became a valued exercise where the business strengths, weaknesses, opportunities and threats were evaluated and factored into the plan. A contemporary depiction of the strategic process is illustrated below:

Exhibit III-1
Strategic Management Framework[29]



Some would argue the process describe above itself is a "best practice" Strategic Management Framework as it engaged all levels of the organization to define and then

[28] S.W.O.T. = Strengths, Weaknesses, Opportunities, Threats

[29] DR 35

support the agreed upon mission and vision statements. Other attributes include social and environmental values, and standards for personnel.

B. GRAYSON'S STRATEGIC PLANNING PROCESS

Grayson RECC, as a small electric distribution utility located in eastern Kentucky, must deal with strategic planning in a stagnant service area. As of March 2019, Grayson employment stood at 43[30], serving some 14,000 customers. By most measures the communities served by Grayson are economically struggling; demand for electricity has declined over the 2007 to 2017 period and is expected to remain substantially flat for the foreseeable future.[31] In fact, peak loads are not expected to return to the 2007 levels until 2034. Historically, it has been well documented that electric consumption is highly correlated with economic output, albeit to a lesser extent in recent years due to the advent of aggressive demand management strategies and consumer-owned distributed generation. Needless to say, no- or slow-growth industries must be highly innovative to maintain their financial performance via productivity gains and enhanced value-based service offerings. Otherwise, revenues cannot keep up with rising costs. We note that the Grayson CEO Fraley, in her explanation to the USDA, specifically identified declining sales as the cause for its deteriorating and adverse TIER and the reason Grayson had not been able to maintain a minimum Operating Times Interest Earned Ratio (OTIER) level of 1.10 during 2012.[32]

GRAYSON'S GREATEST CHALLENGE

Grayson must maintain its TIER performance measure of at a minimum 1.25 and its OTIER of 1.10 for two of every three years.[33] Per Case No. 2018-00272, in its rate Order to Grayson, the Commission noted that the utility had only achieved a TIER of 1.09 and 1.1 for years 2017 and 2018, respectively. As Grayson was informed by the USDA in 2012, a failure to achieve the 1.1 TIER could place Grayson in "an Event of Default, as described in Article VII, Section 7.1 (d) of the Loan Contract."[34]

Distribution borrowers require minimum coverage ratios, whether applied on an annual or average basis, of a TIER of 1.25, a DSC of 1.25, an OTIER of 1.1, and an ODSC of 1.1. OTIER and ODSC shall apply to distribution borrowers that receive a loan approved on or after January 29, 1996. Following the previous 2013 rate increase, Grayson sought and received a

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[30] At the time of this report the total staffing was 41

[31] 2018 Load Forecast prepared by East Kentucky Power Cooperative, dated November 2018

[32] Letter dated March 26, 2013 from the USDA Director – Northern region Division, Joseph Badin

[33] The times interest earned ratio (TIER) ratio is a measure of a company's ability to meet its debt obligations based on its current income. The formula for a company's TIER number is earnings before interest and taxes (EBIT) divided by the total interest payable on bonds and other debt. The result is a number that shows how many times a company could cover its interest charges with its pretax earnings. OTIER means Operating Times Interest Earned Ratio of the electric system; DSC means Debt Service Coverage of the borrower; ODSC means Operating Debt Service Coverage of the electric system

[34] ibid

4.6 percent rate increase in 2018 designed to boost its TIER to 2.0. Since nearly 60 percent of Grayson's base rates are for production costs which are automatically adjusted, the effective increase was approximately 10.1 percent. In the 2018 Order, the Commission raised considerable concern that Grayson had accomplished little to address a number of issues raised in the 2013 rate proceeding and directed its staff to initiate this focused management audit with a focus on how strategies and planning procedures are executed by Grayson's management.

In general, Vantage found that Grayson management does not conduct, on a routine basis, a formal strategic planning process. Per the utility's response to a data request, we received two prior strategic plans, one dated in February 1998 and the other dated November 4, 2004. Furthermore, in our initial on-site interviews with the CEO, in response to questions relating to Grayson's strategic planning process, she noted that none had been performed since 2004. Her reasoning was that the cost of outside consultants to facilitate the planning process and the value perceived from the prepared plan did not justify its cost. She noted that Grayson's internal capital budgeting process provided the management team with an opportunity to consider strategies during this planning exercise.[35]

Our greatest concern was not that Grayson hadn't performed an updated strategic plan per se since 2004, but that it failed to strategically address its near financial default as the TIER fell well below1.25. Further, the RUS had informed Grayson in writing of its concern and yet we found little evidence that faced with this potentially catastrophic event, real action was taken.

III-F1 **<u>There should be concern that because of flat or declining sales and revenues, Grayson is potentially subject to a death spiral, where declining sales will drive higher unit rates which will in turn further drive down electric sales and revenues.</u>**

Without a dramatic change in the economic condition of the region served by Grayson or the manner in which costs are controlled, a cycle of rising costs followed by the decline in TIER to the point of an "Event of Default," will necessitate KPSC intervention by raising rates.

Without the Kentucky Public Service Commission's approval of a rate increase, Grayson would have entered into default in 2013 and again in 2018 with its lenders.

III-F2 **<u>Grayson's lenders require it to maintain an average OTIER [36] of 1.10 and a TIER of 1.25 for two of the past three years.</u>**

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[35] Interview with CEO

[36] The times interest earned ratio (TIER) ratio is a measure of a company's ability to meet its debt obligations based on its current income. The formula for a company's TIER number is earnings before interest and taxes (EBIT) divided by the total interest payable on bonds and other debt. The result is a number that shows how many times a company could cover its interest charges with its pretax earnings.

Given the critical nature of TIER compliance requirements, we found little evidence that a strategic action plan was adopted and implemented by Grayson's management or its Board of Directors which helped the utility continuously monitor and adjust its operating practices to either increase operating revenues, decrease expenses or decrease interest charges to mitigate trends leading to the decline of the TIER to the 1.25 threshold.

We agree with the Grayson CEO that a typical strategic planning exercise is not well suited to Grayson's more critical needs and that the retention of outside consultation to facilitate this activity is not cost justified. However, as an alternative, we will recommend that management, for the foreseeable future, develop a crisis management focus by adopting both strategic and risk management techniques to develop and then implement its expense and capital budgets in accordance to its primary goal to maintain a TIER of 1.25 or more.

In reviewing the monthly minutes of the Board of Director meetings we found that TIER performance was not identified or segregated as a stand-alone "strategic" issue. While TIER may have been a subtopic in the Finance and Accounting Report, we found no evidence that the status of the TIER calculation was a priority discussion or whether the Board was presented with tactical options that management proposed to mitigate its decline.

It appears from correspondence between Grayson and the USDA (RUS)[37] during 2012 and 2013 that as of early 2012, Grayson was informed that it had not met its minimum TIER requirements during 2011 and a year later it was informed that it would again fail to meet its minimum requirements during 2012. USDA noted that Grayson would not be filing a rate application to the KPSC until late 2012 with an expected increase resolution by mid-2013. While it is unclear exactly when the KPSC was first notified of the USDA's warnings of non-compliance to the TIER minimum target and the potential for default, the pace by which Grayson sought to resolve this issue via a rate increase did not reflect a level of urgency and degree of crisis to resolve this matter other than to seek rate relief.

III-R1 **Initiate a new strategic plan that includes redefining Grayson's primary mission to maintain a TIER as required by lenders along with other key operational targets.**

All other business attributes such as safety, reliability, and customer service should be defined as strategic goals that support the TIER-based mission. Since this strategic plan focuses on financial issues, it can probably be performed with little or no outside support expenditures.

Each major Expense and Capital budget initiative should be evaluated and ranked in terms of priority based on benefit-cost, risk of not achieving strategic goals and impact on TIER computation. An illustrative prioritization scheme would identify Priority 1 projects as those having the highest priority and that must be performed regardless of TIER impact. Priority 2 projects are generally necessary but may be deferred or other lower cost solutions

[37] Letters dated March 26, 2013 and May 24 2012 from the USDA to Grayson CEO Fraley

be substituted even at the risk that it does not achieve the same benefit-cost ratio. Finally, Priority 3 projects must be deferred until the TIER is projected to equal or exceed 1.25.

III-R2 **Review the TIER status report and certify that Grayson's TIER will equal or exceed 1.25 at each monthly board meeting for the following 12-month period. (Priority: Medium)**

If the current month or forecasted 12-month TIERS fall below 1.25, the Board will require, from management, by the next monthly meeting, an action plan to consider the deferment or substitution of Priority 3 and, if necessary, Priority 2 expenditures and capital projects in order to achieve the 1.25 target TIER. If after three consecutive months, the Board still cannot certify that the projected TIER will equal or exceed 1.25, the Kentucky PSC should be notified by letter from the Grayson CEO and Board Chairman that the TIER is either currently or projected to be below 1.25 during the course of the proceeding 12 month period. In this letter, Grayson should detail the steps taken pursuant to the strategic plan, to mitigate the decline in the TIER.

IV. STAFFING, HUMAN RESOURCES AND COMPENSATION

Grayson RECC exhibits a small-town style of congeniality and focus on service. The CEO has encouraged personalized decorations in employees' work areas and fosters a culture of caring for each other and their customers. Sharing food is a shared value, and employees cook and come together to celebrate with each other as well as to feed employees and members who are struggling through severe weather challenges. It is a warm environment that invites customers to come in – and they do so frequently to pay their bills in person rather than through the other payment options offered.

The President and CEO has a hands-on approach to the management of the Grayson. She is heavily involved in all Board meetings, agendas, preparation, and reporting, participates in all interviews, approves all performance evaluations and approves proposed pay increases.[38] The president and CEO is the chief labor negotiator and also serves as the grievance officer in the event of a dispute that moves to Step 2 of the grievance process.[39]

A. STAFFING

There are many things that the Cooperative does well with respect to managing its human resources. Some of the positive activities were communicated in a March 28, 2019 statement in which, the President and CEO reported a number of actions the RECC has taken since 2013 to address efficient affordable service, including three that impact their human resources directly. Specifically, she states:[40]

- "Shifting all employees to a high-deductible health insurance plan. This action saved approximately $280,000 initially and continues to help minimize health insurance costs.
- Reducing staff through attrition. The co-op now has 41 employees, down from 45 in 2013.
- Through negotiations with the union that represents twenty-one employees, reducing by more than half the amount of the annual increase, from $1.25 per hour to $.50 per hour."

[38] Interview with C. Fraley, August 26, 2019 and interview with B. Cherry, August 26, 2019

[39] Interview with C. Fraley, August 26, 2019 and DR 22

[40] Graysonrecc.com/content/grayson-recc-statement-concerning-psc-rate-case

Exhibit IV-1
Staffing levels for the past three years[41]

2019	41
2018	44
2017	44
2016	45

The 41 employees who do the work of the Cooperative tend to be educated and long tenured. The turnover rate is extremely low as indicated by the listing below showing the turnover and reason for the past three years.[42] The culture, as well as the economic challenges of the area, likely play a role in the stability of the workforce.

Exhibit IV-2
Turnover data for past three years [43]

Turnover data for past three years by employee category or classification

Year	Position	Department	Reason
2019	Technical Services Supervisor	Technical Services	New Job Opportunity
2019	Construction Leadman	Construction	New Job Opportunity
2019	1st Class Lineman	Construction	New Job Opportunity
2019	1st Class Lineman	Construction	New Job Opportunity
2019	Executive Assistant	Administration	Long Term Disability
2019	Member Services Rep	Member Services	Retirement
2018	Division Assistant - Member Services	Member Services	New Job Opportunity
2017	Division Assistant – Operations	Operations	Retirement

[41] DR 21

[42] DR 23

[43] DR 21

When vacancies occurred and were filled, there is little evidence of difficulty in replacing those employees with skilled individuals .[44]

Most open positions are filled through internal promotion. The size and integration of the organization allows employees to know each other and their skills well, and provides opportunities for employees to learn other processes in advance of opportunities. This cross-training prepares employees for future opportunities and provides the skills necessary to cover work during vacations, etc.[45]

Twenty-one employees are members of IBEW Local 317[46]. All open union positions are posted for seven days, and positions are awarded to qualified applicants based on seniority. Non-union positions are not posted. Instead, employees are provided opportunities to learn new skills and take on additional responsibilities in preparation for promotional opportunities and career growth.[47] Administrative employees frequently begin their Grayson Electric careers at entry level cashier or service positions. Trades or operations employees may begin as laborers or as linemen. The company believes it is currently staffed appropriately but recognizes that there may be a future need for a skilled IT position in response to changes in technology and security.

To Grayson's benefit, the pattern of openings over the years has resulted in an employee population that is representative of different age groups. This spread should protect Grayson from risk due to concentrated retirements at given points in time.

Exhibit IV-3
Union Employee Distribution by Age

Age	Number of employees	Percent
20s	2	9.5
30s	5	23.8
40s	6	28.6
50s	7	33.3
60s	1	4.8
	21	

[44] DR #34

[45] Phone interview with B. Cherry 9/24/19

[46] DR #24 and RFP

[47] Phone interview 9/26/19 with B. Cherry, et al

B. COMPENSATION

The 21[48] operations and trades employees are organized under the IBEW; the administrative employees are not part of a bargaining unit. Both the administration and the union leader speak of the cordial relationship between the entities, with no issues of significance arising in recent years.[49]

In 2017 Grayson Electric engaged the services of NRECA Management Services, a firm specializing in strategic, operational, and compensation consulting to electric co-ops, to conduct a wage and salary survey and make recommendations as to competitive market positioning and pay scales. The Board of Directors approved the salary structure and wage increases shown in the following tables at a closed Board of Directors meeting.

The updated salary schedule is shown below.

[48] DR 50

[49] Interview with B. Cherry, August 26, 2019

Exhibit IV-4
Salary Schedule of Salary Ranges
(Union positions in bold) [50]

Position	**Grade**	**Min**	**Lower Third**	**MidPoint**	**Upper Third**	**Maximum**
CSR/Cashier	4	$30,984	$35,341	$37,520	$39,698	$44,055
Groundman (15 year svc)	5	$34,872	$39,855	$42,346	$44,837	$49,820
Member Service Rep	6	$38,793	$44,424	$47,240	$50,055	$55,686
Division Asst - Acct & Fin	6	$38,793	$44,424	$47,240	$50,055	$55,686
Division Asst – Operations	6	$38,793	$44,424	$47,240	$50,055	$55,686
Division Asst - Member Svs	6	$38,793	$44,424	$47,240	$50,055	$55,686
Billing Administrator	7	$42,747	$49,049	$52,200	$55,351	$61,654
Meterman 2nd Class	7	$42,747	$49,049	$52,200	$55,351	$61,654
AMI Administrator	8	$46,732	$53,729	$57,228	$60,726	$67,723
Plant Accountant	8	$46,732	$53,729	$57,228	$60,726	$67,723
Energy Advisor	8	$46,732	$53,729	$57,228	$60,726	$67,723
Payroll Bookkeeper	8	$46,732	$53,729	$57,228	$60,726	$67,723
Apprentice/Third Year	8	$46,732	$53,729	$57,228	$60,726	$67,723
Executive Assistant	9	$50,749	$58,465	$62,322	$66,180	$73,896
Apprentice/Fourth Year	9	$50,749	$58,465	$62,322	$66,180	$73,896
Mechanic	10	$54,797	$63,255	$67,484	$71,713	$80,171
Meterman 1st Class	10	$54,797	$63,255	$67,484	$71,713	$80,171
Lineman 1st Class	10	$54,797	$63,255	$67,484	$71,713	$80,171
Warehouseman	10	$54,797	$63,255	$67,484	$71,713	$80,171
Engineering Party Chief	11	$58,876	$68,100	$72,713	$77,325	$86,550
Maintenance Leadman	11	$58,876	$68,100	$72,713	$77,325	$86,550
Construction Leadman	11	$58,876	$68,100	$72,713	$77,325	$86,550
Technical Services Supv.	12	$62,984	$73,000	$78,009	$83,017	$93,033
GIS Technician	12	$62,984	$73,000	$78,009	$83,017	$93,033
Manager of Marketing & Member Services	14	$71,290	$82,964	$88,801	$94,639	$106,313
Manager of Accounting & Human Resources	14	$71,290	$82,964	$88,801	$94,639	$106,313
Manager of Finance & Acct	18	$88,241	$103,541	$111,191	$118,841	$134,141
Assistant Manager of Oper	18	$88,241	$103,541	$111,191	$118,841	$134,141
Manager of Tech Services	18	$88,241	$103,541	$111,191	$118,841	$134,141
Manager of Operations	19	$92,547	$108,820	$116,956	$125,092	$141,365

[50] DR 19 Union positions are in bold

The width, or spread, of the salary ranges – the difference between the minimum and maximum – is generally determined based on the compensation philosophy of an organization. The philosophy is normally a result of considerations such as turnover, unemployment rates in the areas from which employees are recruited, the availability of necessary skills in the market, and emerging demographic and technological issues. In Grayson's case, the salary ranges were built using these market rates as the midpoint with 50% spread between minimum and maximum.

Pay and pay movement for union employees is governed by their labor contract.[51] Employees new to a position, either as a new hire or through promotion, begin at a Step 1 pay level as defined in the contract (unless a promotion requires starting at a higher step due to the employee's pre-promotional pay rate) and move up one step each year.

In addition to competitive pay and annual step increases, most union employees have significant overtime earnings. The overtime costs for union employees have been relatively consistent and are a significant percent of regular payroll, averaging 19%, over the past five years, as depicted in the chart below.

The philosophy behind the continued overtime cost for union employees is based on the length and terrain of the system. Due to the length of the system, it is more efficient for a crew to finish a job in an outlying county than it is to load up and be at the office by 4:00 p.m. Returning to the job the next day for an hour or so of finish time requires at least one and one half hours of travel time, tailgate safety session time and preparation for completing the job. Grayson believes it is cost-effective for a crew to complete the job, clean up the area and then return to headquarters, even if it means a short overtime period, rather than return in the future.[52] This is a reasonable argument based on our review of the geography and visits to crew quarters and selected work locations.

[51] DR 22 Labor Contract January 1, 2018 – January 1, 2024

[52] Interview B. Poling August 27, 2019

Exhibit IV-5
Pay Steps for Union Employees[53]

Job Title	2020	2021	2022	2023
Mechanic 1st Class	$35.43	$35.93	$36.68	$37.43
Maintenance Leadman	$38.22	$38.72	$39.47	$40.22
Construction Leadman	$38.97	$39.47	$40.22	$40.97
Meterman 1st Class	$36.37	$36.87	$37.62	$38.37
Maintenance Leadman	$38.22	$38.72	$39.47	$40.22
2nd Yr Apprentice Lineman	$33.17	$35.48	$38.10	$38.85
Maintenance Leadman	$37.97	$38.47	$39.22	$39.97
Maintenance Leadman	$38.22	$38.72	$39.47	$40.22
Warehouseman	$38.11	$38.61	$39.36	$40.11
Groundman	$34.30	$34.80	$35.55	$36.30
1st Class Lineman	$36.85	$37.35	$38.10	$38.85
Meterman 1st Class	$36.37	$36.87	$37.62	$38.37
Maintenance Leadman	$37.97	$38.47	$39.22	$39.97
1st Class Lineman	$36.85	$37.35	$38.10	$38.85
Maintenance Leadman	$37.97	$38.47	$39.22	$39.97
1st Class Lineman	$36.85	$37.35	$38.10	$38.85
Engineering Party Chief	$37.14	$37.64	$38.39	$39.14
Engineering Party Chief	$37.14	$37.64	$38.39	$39.14
1st Class Lineman	$36.85	$37.35	$38.10	$38.85
1st Class Lineman	$36.85	$37.35	$38.10	$38.85
Construction Leadman	$38.97	$39.47	$40.22	$40.97

Exhibit IV-6
Regular and Overtime Expenditures

	REGULAR	OVERTIME	TOTAL	PERCENT
2015	$1,479,982.60	$318,125.00	$1,798,107.60	21.50
2016	$1,537,509.38	$265,809.62	$1,803,319.00	17.29
2017	$1,584,441.85	$294,470.44	$1,878,912.29	18.59
2018	$1,621,058.70	$336,387.38	$1,957,446.08	20.75
2019 (YTD)	$1,030,558.71	$208,186.95	$1,238,745.66	20.20
Total	$11,356,395.20	$2,163,343.98	$13,519,739.18	19.04

If overtime was evenly distributed over the 21 union employees, each would receive an average of an additional $14,000 in pay for each of those years.

[53] DR 22 Labor Contract January 1, 2018 – January 1, 2024 20.75

Pay and pay movement for non-unionized employees does not follow as regimented a process. There are currently two employees who fall below the minimum of the salary ranges. Other employees are, or are able to be, paid above the maximums. Budgetary impact of pay increase options is determined by the Manager of Finance and Accounting. All employees get an increase each year, with no salary range cap. Additionally, there is a discretionary pot of $5,000 that the president can use to reward special performance. The president makes the decision and the recommendations are taken for budgetary approval to the Board of Directors.[54]

Consideration is given to an employee's performance evaluation when determining an annual increase amount. The performance evaluations are in a narrative format and include discussion of professional goals as well as current performance.

C. BENEFITS

Grayson offers its employees a typical mix of health and welfare benefits along with tool and clothing allowances for employees in union positions that require these to do their work effectively. The benefits are defined in the following chart.[55]

[54] Interview C. Fraley August 26, 2019

[55] DR 31

Exhibit IV-7
Employee Health and Welfare Benefits

Benefit[56]		Description
Medical/RX Plan		PPO - Those covered with Medicare eligible participants
		HDPPO
		Humana - Retirees that are Medicare eligible - Supplement Plan
HSA'		$3,250
Life Insurance		2X Base Salary
Long Term Disability		66 2/3% Benefit. Eligible after 13 weeks.
Short Term Disability		Coop Self Funded. 66 2/3% Social Security Offset, after exhaustion of Sick Leave
Business Travel		$100,000 Coverage
RS Plan		2.0 Benefit Level - Age 62
401K		Co-Op Contribution equal to LTD Premium
Holidays		9 Paid Holidays
Vacation		10 Days beginning Year 2.
		1 Additional Day per year after 8 Years. Max of 26 days per year
Sick Leave		Accrue 8 hours per month
Safety Incentive		Day of Pay with No Lost Time Accident
Tool Allowance		$250/year
FR Clothing		5 Short Sleeve Shirts
		5 Long Sleeve Shirts
		5 Long Sleeve Button-Up Shirts
		5 Pairs of Pants

All employees who are not Medicare-eligible or have dependents who are Medicare-eligible are covered by the Coop-paid high deductible health insurance PPO to save money on health care plans[57]. To offset the cost of the deductibles, all employees receive a $3250 contribution to their HSA. Health Savings Account (HSA) contributions are non-taxable as income for employees. Employees who opt out of health insurance receive an annual payment of $3250.

D. EMPLOYEE DEVELOPMENT AND SUCCESSION PLANNING

Vantage raised concerns regarding having employees with necessary skills in the future, yet there is no evidence that staffing or employee development is at risk. The ease with which open positions, including those that may have a more limited available applicant base, as

[56] DR 31

[57] Phone interview with B. Cherry September 24, 2019

well as the efforts and success the Coop has had in preparing employees for upcoming responsibilities, should give the Cooperative and its members comfort. One area of repeated concern is succession in the Information Technology department due to Grayson's use of technology and drones.[58]

Grayson actively cross-trains employees across the organization in preparation for promotional opportunities and to provide appropriate coverage for vacations, etc.[59]

Grayson covers all fees and tuition costs for continuing education for its employees, a very generous benefit that has resulted in a skilled and educated workforce. Preparation for senior-level future opportunities and needs are achieved through the Management Internship Program sponsored by NRECA.[60] Recently two employees completed this program.

Grayson's focus on employees and their safety is evident in their emphasis on weekly safety training meetings and is borne out by the low injury rate. Grayson's Workers Compensation experience is the lowest in the state.[61] Only one employee was hurt on the job between 2009 and 2019. The individual hurt in 2016 missed only one work day.[62]

All safety incidents are duly reported and are reviewed by the Safety Committee. A review of a sample of incident reports show an interesting lack of accountability assessed to the employee; the findings of the sample included recommendations that the employee should be more careful in the future but do not indicate a violation of safe practices occurred, even where there were vehicular accidents due to inattention.

The Safety Committee does not track these safety incidents, which provides little opportunity to determine any trend analyses and prevention strategies.[63]

IV-F1 **<u>There is a lack of formality for some Human Resource processes used at Grayson.</u>**

In addition to the business processes discussed previously, the HR policies and procedures addressing the issues below are not well documented.[64]

- Safety tracking and trend analysis
- Market data for health and welfare benefits

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[58] Interview 3 B. Poling August 26, 2019

[59] Interview 3 B. Poling August 26, 2019

[60] DR 82

[61] Interview 1 with C. Fraley August 26, 2019

[62] DR 27

[63] Interview 4 with K. Clevenger August 26, 2109

[64] Interview B. Poling August 27, 2019

- Documented pay practices
- Documented promotional practices

E. COMPENSATION

IV-F2 **The compensation program for non-union employees at Grayson RECC appears reasonable.**

However, it lacks a foundation of articulated and transparent pay philosophy and pay practices. For union employees, the overtime costs add significant pay to the affected employees beyond the pay ranges and market rates. One fear is that if employees come to expect a certain level of overtime, it is considered part of base pay and if reduced through addition of staff or new technology, can be problematic.

The Grayson RECC compensation study was professionally conducted, and a review of the work papers supporting the market study indicates a sound business process for establishing a new salary structure. Local, state, regional and national data from ERI and NCS compensation surveys[65] was collected for 24 of the 30 positions (80%) within the employee population.[66] This percentage is well beyond an acceptable standard of 35% of positions and is indicative of the diligence of the consultant. The specific survey and data points selected to establish the ranges were chosen based on the recruiting market for each specific job; this is in line accepted business practice. Grayson states that "the Cooperative requires higher levels of education, training, and work experience. Those jobs would be compared to college professors and instructors, business agents, and top employees of skilled trades."[67] Market data for administrative positions was drawn from the local market, lower-certification-based technical positions from state-wide data, journeymen positions were tracked to market data for a four-state region, and management positions were based on national data. However, the lack of available information relative to the specific data cuts that were used as comparable data raises questions since the pay rates can differ significantly for different market sectors and organization size. As those pay rates are used to determine the salary ranges, inequitable matches can have an impact on the salary structure.

The updated salary structure positioned the employees for growth in the future. Midpoints of salary ranges are typically set at the current market averages and it would be expected that employees who are fully functional in their position – rather than in a learning curve – be at or near that midpoint. A measurement of how employees are being paid relative to the market, as depicted in the updated salary structure is to determine the comparatio – the calculation of the employees' actual pay compared to the midpoint of the salary range.

[65] DR 34

[66] DR 19 & 34

[67] DR 64

Prior to the update, the average comparatio – the comparison of the individual's salary relative to the salary range midpoint-- for non-union employees was 1.23%, indicating employees were paid above the midpoint of the ranges, which would be typical for long-tenured employees operating under older salary structures. The current comparatio is 0.92%.[68] This means that on average employees are paid near but below the midpoint, a slightly lower-than-expected average since these are long-tenured employees and two years have passed during which employees received pay increases. It's unclear, since there are no documented processes uniformly followed for pay increases, if that is due to conservative increases or because the ranges are set on the slightly high side.

Employee movement along the salary ranges differs by employee group. Unionized employees receive negotiated annual steps until the maximum of the range is reached. Pay increases for non-union employees follow a different process. These employees' pay increases are dependent upon performance, approval by the CEO, and final approval by the Board of Directors as part of the budgetary approval process.[69]

Of some concern is the fact that employees may receive pay increases that result in pay that is above the maximum of the new salary ranges. [70] Three employees are currently very slightly below the range minimum, one employee is more significantly below the minimum, and one employee is above the range maximum.

It is unusual that pay scales, particularly ones that have currently been put in place through a costly consulting process, would not be used as a means to assure equitable treatment for all employees as well as assure members that the employees are paid within current market rates as reflected in a comprehensive salary structure. Further, we would note that the wage study used to establish the salary structure was performed by a firm specializing in electric co-ops without any other benchmarking, i.e. local, state or national general wages. A review of the raw data indicated that non-cooperative firms in Kentucky were also included.

Grayson serves five counties in rural Kentucky and provides some of the best-paying job opportunities in the area. As discussed above, the Cooperative has experienced very low employee turnover, has an internal process to train and develop employees as feeder groups for positions, and has been able to easily fill positions as they open. While Grayson currently experiences some turnover due to the higher wages offered by contractors, its benefits, retirement plan, and the ability of employees to be home rather than traveling extensively, have contributed to high employee retention.[71] Additionally, employee demographics serve to somewhat insulate the organization from risk due to numerous retirements at once. The conditions that might drive a more aggressive pay position relative

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[68] DR 19, 20, 100 and consultant analysis

[69] Interview 2, B. Cherry

[70] Phone interview with B. Cherry

[71] Interview 4, K. Clevenger 8/27/19

to the market appear to be absent and would likely support a more conservative pay posture, especially given Grayson's dire financial condition.

As cited above, the average annual overtime pay per union employee is $14,000, the equivalent of an additional $6.80/hour. While Grayson says this is due to the work required during power outages, the consistently high levels of overtime suggest that opportunities may exist to reduce this through different planning or strategies.

IV-R1 **Establish a process to determine appropriate pay increases for non-union employees each year that is equitable, defensible, and transparent and reduce overtime costs for union employees. (Priority: Low)**

Vantage recognizes that a compensation study is expensive and it is beneficial to create a program that will serve the system for some time into the future. While Vantage does not recommend a pay structure or program that would foster an employee exodus to greener pay pastures, it is concerned that the lack of a process that governs employee movement through the ranges could lead to pay levels that exceed current market rates. Coupled with the lack of transparency in the Board's decisions and minutes, the process provides no opportunity for the members of Grayson to be certain that all employees are treated equitably and in a fiscally-responsibly manner.

F. BENEFITS

IV-F3 **The health care insurance program, with company fully paid premiums, is generous compared to market and does not reflect urgency in controlling costs.**

Grayson states that "data on [their] health and welfare benefits compared to their market's benefits are not available to us" due to the discontinuation of their association's conduct of such surveys. "However, through informal discussions, we feel that our health and welfare benefits are in the upper tier compared to our market."[72]

The health benefits afforded to Grayson employees include medical insurance but not dental or vision insurance. The medical insurance for employees is fully paid by Grayson. This is highly unusual in an industry in which employee contributions to health care premiums can average as high as 31%.[73] Current market data through Grayson's state association have been unavailable for the last few years.[74] Fully-paid employer health care plans are a rarity in today's market, with employees contributing from 10% to 31% of premium costs.

In an effort to control costs, Grayson, in 2012, began a review of its health benefits offerings. The result of this was the shift to a high deductible PPO (HDPPO) plan; all non-Medicare

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[72] DR 65

[73] 2019 Kaiser Family Foundation study

[74] DR 65

employees were moved into this plan from their existing PPO. Medicare eligible employees were covered under the Humana plan. It is also unusual that an organization selects only one plan for all employees, though this may be reflective of a limited health care market in the Grayson service territory.

Exhibit IV-8
Description of Current Health Care Insurance Plans[75]

		Deductible		Out of Pocket Max		Co Pay	
Plan	**Description**	**Single**	**Family**	**Single**	**Family**	**In Network**	**Out of Network**
PPO	Network PPO Plan	$300*	$600*	$900*	$1,800*	$20	10%
HDPPO	High Deductible Network PPO Plan	$3,000*	$6,000*	$3,000*	$6,000*	No Charge+	20%
Humana[76]	Medicare Advantage	$100	N/A	$3,000	NA	No Charge+	No Charge+

Exhibit IV-9
Current Costs of Health Care Premiums [77]

	2019		2018		2017	
	Single	**Family**	**Single**	**Family**	**Single**	**Family**
PPO	$985.76	$2,251.57	$935.44	$2,137.94	$898.72	$2,078.26
HDPPO	$811.17	$1,593.96	$761.69	$1,496.70	$754.27	$1,450.28
Humana	$298.06		$325.61		$318.24	

Exhibit IV-10
2018 Accrued liability for employee health benefits as of 2018[78]

Medical	$ 804,822.10
Employer HSA	$ 130,000.00
SFAS 158	$ 418,635.00
FASB	$ 3,170,252.54

In an effort to mitigate some costs, each employee has $3250 deposited into a Health Savings Account (HSA) to mitigate some of the increased costs. The cost of this contribution for Grayson is approximately $139,750 per year. The costs borne by Grayson are approximately

[75] DR 30

[76] Is offered for employees eligible for Medicare

[77] DR 30

[78] DR 46

$60,000 per month, with the breakdown shown in the charts above which detail the two plans as well as the premium costs.[79] The combined annual cost for health care premiums and HSA contributions is nearly $860,000.

Grayson is currently planning on implementing an employee contribution to health care premiums beginning January 2020. While the contribution is not yet announced, their goal is to reach a 12% contribution level.[80]

Grayson is also unusual in that it does not offer employees either dental or vision insurance. The issue had been raised during the last labor contract negotiations, but ultimately was dropped.[81]

IV-R2 **<u>Accelerate and amplify Grayson's plan for employee contributions for health care. (Priority: Medium)</u>**

Research conducted by the Kaiser Family Foundation indicated that the typical employee contribution for health care across industries was 20%.[82] Grayson could restructure their health care plan to include an employee contribution closer to the market, but combine it with a choice of plans that employees can select based on their personal needs. Additionally, Grayson could consider adding dental and vision benefits at no cost to employees. These, with appropriate benefit limitations, are lower cost items that can offset employees' out-of-pocket expenses for medical services.

IV-F4 **<u>The pension plan and health insurance for retirees is extremely generous and somewhat unusual.</u>**

The retirement eligibility requirements at Grayson are minimal. Employees can retire with a minimum age of 62 years with only one year of service.[83] Retirees receive a multiplier of 2.0% based on the average of five highest paid years of service. While the multiplier is within a normal range, the one year of service requirement is extremely unusual in this consultant's experience.

Retirees also receive fully paid health insurance, including a Medicare supplement for those Medicare-eligible. This ongoing cost to the Cooperative membership is expensive and highly unusual in an industry where shifts to employee and retiree contributions for health care became increasingly common following the adoption of FASB 106 and FAS 158.[84]

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[79] Interview with B. Cherry August 28, 2019

[80] DR 44 & 65 and interview with B. Cherry August 26, 2019; Details should be known in January 2020

[81] Interview with Bradley on September 25, 2019

[82] Kaiser Family Foundation research; Wall Street Journal source. 2019

[83] Interview 5 with S. Buckler September 26, 2019

[84] FASB 106 addresses Employer's Accounting for Postretirement Benefits Other Than Pensions. FASB 158 addresses Employer's Accounting for Defined Benefit Pension and Other Postretirement Plans

IV-R3 **<u>Develop an appropriate path to reduce the ongoing pension and post-retirement healthcare liabilities. (Priority: Medium)</u>**

Grayson should develop a strategy and implementation plan to rein in the future costs of retirees. This should be a two-fold effort that includes a longer service requirement for pension eligibility as well as the possibility of retiree contributions for health care. Caps on health care costs, caps on percentage increases absorbed by Grayson, different contributions for pre-Medicare and supplemental insurance, as well as other strategies should be on the table for consideration. Vantage is aware this is easier said than done, but the on-going, increasing cost burden to the cooperative members warrants serious discussions with the unions and Board.

V. SYSTEM OPERATIONS

V-F1 **Grayson does not have a defined and well planned disaster recovery plan for its information systems.**

Utilities, like most industries in 2019, are increasingly reliant upon information systems technology for their business processes. Utilities require information systems for operational controls, billing, operational status, management of work and customer interfaces. Given the importance of information systems in particular, utilities must have operational and information technology redundancy. The level of redundancy is influenced by the utility resources, the critical nature of the process or system and vulnerability.

Grayson has no physical or virtual backup location in the event of a disaster. It currently uses its headquarters as an emergency site. The Grayson Emergency Response plan primarily deals with the details of external crew logistics. While this is a necessary part of an emergency response plan, it is only one component.

Grayson does back up computer servers to a DR server in its metering shop. Each night those files are copied to a Data Center in Lexington owned by Netgain Technologies. The SEDC[85] server containing all the CIS data, Billing data and General Accounting data is replicated to SEDC in Atlanta several times per day. Should a disaster occur, requiring retrieval of data from either facility, it would be placed on a server [SEDC] or drive(s) [Netgain] Grayson personnel to pick up.

Grayson also maintains a contact list, but there are no exercises, tabletop or other formal activities needed to keep employees ready. In the recent past, most of Grayson's emergencies were due to ice storms.

V-R1 **Grayson should establish a Disaster Recovery location. (Priority: Medium)**

Grayson needs to establish a location or locations from which they can operate in the event of a disaster. It needs to be:

- Scalable
- Within the service territory.
- Part of a plan
- Does not need to be a one-size-fits-all (systems and customer service locations can be different).

[85] SEDC was formed by Cooperatives. It provides billing, accounting, cybersecurity, bill printing , mapping and other services - https://www.sedata.com/

V-F2 **Grayson combines procurement with other utilities for a few selected items.**

Purchasing Materials: Grayson participates in a transformer group that allows for the use of specific transformers that are stored in a central location and then replenished by the coop after their use.

Training: Group trainings programs are utilized by the cooperatives on issues that they feel are important or necessary.

Legal Support: Cooperatives will jointly utilize legal support and representation on legal and regulatory issues that affect all of the coops.

CRC: After-hour call center that is utilized by several cooperatives to handle after-hour calls and dispatching

V-R2 **Grayson should continue to explore opportunities for shared purchasing and consolidations of processes with other Distribution Cooperatives. (Priority: Medium)**

At a minimum the following areas should be explored:

- Purchasing, materials (all of the supply chain)
- Information Technology
- Training
- Service Call-outs using bordering Distribution Cooperatives

None of these opportunities require an actual merger to achieve savings. All can be cooperative arrangements. There is no need for all sharing to be accomplished with any one entity; the areas should be considered mix and match.

V-F3 **Grayson faces significant challenges in recruiting and retaining expertise in the information technology area.**

There are a number of reasons for this problem, including:

- The skill set required does not diminish with the size of the organization. Grayson must perform almost all of the same IT functions as a large utility.

- Certain skills are becoming even more critical, such as information security. Cybersecurity is an ever increasing issue with utilities that requires specific expertise.

- The characteristics of the local area workforce mean that recruitment of the required skill sets may prove difficult.

V-R3 **<u>Grayson should explore alternative means of obtaining the necessary IT skill sets. (Priority: Medium)</u>**

Some alternatives might include:

- Position sharing with another Cooperative.
- Remote access
- Outsourcing

See also consolidation recommendation

V-F4 **<u>Grayson lacks the tools necessary to manage or even understand the impact of variables on their financial positions.</u>**

At present, the only forward-looking tool used by Grayson is a four-year work plan. This plan, while thorough, only focuses on Capital Projects covered by RUS loans. There is no monthly variance analysis, financial targeting or financial management of controllable costs. Without a financial tool, Grayson will continue to reactively respond to pressure on the TIER with requests for rate increases when the financial situation becomes dire.

V-F5 **<u>Opportunities may exist to reduce operating costs within the line department.</u>**

Grayson operates with a very small line department consistent with their customer base. The normal contingent is two four-man crews. Four-man crews are unusual in most utilities which have found they can operate with smaller crews while maintaining safety. Grayson does mix and match crew sizes as opportunities arise.

Vantage toured the operating area and is familiar with operating difficulties faced by Grayson, which are beyond the norm for typical rural cooperatives. These include the need for flagging on very narrow and often blind stretches of road as well as rough terrain. However, opportunities may exist to better manage crew sizes. Grayson has based its decision to utilize four man crews for field work based on the following:

1. Difficulty of Terrain
2. Grayson uses a working foreman
3. Flaggers are often required
4. Compensate for the possibility of a crew member being off work for illness or vacation

These factors may be contributing to the large amount of overtime that is experienced in the line area. Here again, there are mitigating factors that drive overtime at Grayson, most notably the service territory and associated windshield time. If crews are on a worksite and the job can be completed with minimal overtime then this is economical when balanced against windshield time, set up and tear down time. None the less, overtime presents another opportunity for cost reduction or at least control.

Grayson crews do not perform "hot" work on lines. Hot work[86] on lines can reduce work times and the need to shut power off for customers. This work is currently outsourced to contractors when projects are planned in advance. While hot work may provide an opportunity for cost savings in the long term as well as reduced outages, we hesitate to make a recommendation to move in that direction. Grayson needs to be comfortable with the level of technical work they do and the current procedure of using contractors is appropriate.

V-R4 **<u>Explore opportunities to improve or control costs in line operations. (Priority: High)</u>**

Grayson should explore opportunities to better manage costs in the line area including:

- Reduced line crew sizes
- Performing hot work with internal resources
- Reducing overtime
- Better balancing in-house and contractor use

None of these opportunities can be fully realized before the next negotiated contract with the line crew bargaining unit, however, data can be gathered, and analysis performed before that time. At a minimum:

- Perform and document an informal survey of other EKP distribution cooperatives as to their policies regarding line crew size, Hot work and overtime.
- Research available studies on these same topics from industry sources such as NRECA, Touchtone, East Kentucky Power and others.

V-F6 **<u>Overtime levels are higher than one would expect but are based on a philosophy that puts restoration of service first.</u>**

The philosophy behind the continued overtime cost for union employees is based on the length and terrain of the system. Due to the length of the system, it is more efficient for a crew to finish a job in an outlying county than it is to load up and be at the office by 4:00 p.m. Returning to the job the next day for less than an hour or so of finish time requires at least one and one half hours of travel time, tailgate safety session time and preparation for completing the job. Grayson feels it is more efficient to complete the job, clean up the area and then return to headquarters, even if it means a short overtime period.

[86] Hot Work involves performing work on energized lines operating at high voltage.

V-R5 **<u>Explore opportunities to reduce overtime. (Priority: Medium)</u>**

The current procedure which relies on some overtime decisions on the field crew itself is not within industry standards. While the rationale makes sense, a more focused control should be instituted. Proper planning can help to determine manpower needs and hours necessary to complete any assignment. Better planning regarding parts carried and bucket truck inventory can also help facilitate efficient work.

V-F7 **<u>Procurement of outside services from third parties involved 22 companies and reasonably provides services that Grayson does not and should not include as internal skills</u>**

Grayson, given its size, uses subcontractors for technical services appropriately. The list below identifies the firms used and in most cases the services provided are not readily performed internally.

Exhibit V-1
Subcontractor List

Luthan:	Meter testing and disposal during RF meter change outs.
Silent Guard:	Security system monitoring, keyless entry
Radian Research:	Testing - Meter test board standards yearly.
ESR-OCI:	Maintains our truck and office radios
Leidos:	Assists with Construction Work Plans, Long Range Work Plan, coordination studies. They also have helped with implementation of GIS mapping system.
NetGain Technologies:	Assists in server migrations, network implementation, DR (disaster recovery), software license/maintenance renewals, data recovery and Help Desk for users.
Landis + Gyr:	Hosts metering server for meter data collections.
Halbert Pole Testing:	Pole Testing Program
Pike:	Work Plan, Hot Work, Pole Changes and Reconductor
Well Excavating	Aid in getting trucks to poles in bad locations
John A Sparks Dozer & Backhoe:	Aid in getting trucks to poles in bad locations
Womack Excavating:	Aid in getting trucks to poles in bad locations
Torco Dial Electric:	Testing of trucks, sticks, and rubber cover ups
Kinmar:	Test rubber gloves and sleeves
Cintas:	Test and Maintain fire extinguishers, defibrillators, and first aid kits
Arista:	Consumer bill printing and mailing
Vebridge:	Hosting of scanned documents with Image Silo (board minutes, row agreements, work orders, time sheets)
CRC	After hours dispatching

VI. MERGER CONSIDERATION

It is curious that the Commission chose to include, for this project, a task to address the topic of a merger of Grayson RECC with another cooperative or utility. The inclusion of this task is curious because the preceding rate case Orders mention the issue of a merger only as an aside. It could be suggested that this task was included as a way for the Commission to alert Grayson RECC that the Commission would no longer be a lifeline for the Coop to provide rate increases to prop up TIER and rescue Grayson RECC from default with RUS. The Commission could be expecting Grayson RECC to take more control and better management of its financial future. Typically, the Commission gives consideration to mergers in instances of dire financial, operational, management or safety issues.

Grayson is aware of past mergers of Fox Creek RECC and Harrison RECC with Bluegrass RECC. However, Grayson does not have any specific details on these mergers, except those that affected the EKPC Board and who the President and CEO would be. [87]

The President and CEO of Grayson has had informal conversations with managers from other cooperatives in Kentucky that are currently on the EKPC system and indicates that no interest in merging has been expressed. No written details on these discussions exist; only recollections of casual conversation during which there appeared to be no interest.

Argument for a merger by Grayson

There are a number of both general and specific benefits that Grayson and the merging utility would receive if it merged with an adjacent utility, including:

- A reduction in management staffing is the greatest source of savings. It would be likely that the CEO, CFO, IT, and Operations management positions could be eliminated.
- A number of technical support positions such as purchasing, IT, finance, accounting, regulatory etc. could be significantly reduced as well.
- A broader terrain would lead to minimization of load fluctuation due to weather. Storms or severe weather in one area might be offset by mild weather in another part of the system.
- A broader base of employees and first line supervisors provide for a higher quality pool for promotion into management.
- A larger number of operating crews would provide more operational flexibility and a potential to reduce contractor expenses.

[87] Interview with CEO

Potential savings of a merger

Vantage has not conducted a thorough analysis of specific savings that might occur if Grayson merged with an adjacent utility, however a rough estimate suggests:

- Management staffing: Most senior staff could be eliminated, leaving one VP of operation. Assume six employees at a loaded cost of $120,000, equaling $720,000.
- More talented management team.
- Reduction of inventory and associated carrying costs.
- Elimination of redundant headquarter offices.
- Larger number of crews and service personnel.
- Potential for small reduction in number of crews.
- Reduced cost of overtime for weekend and holiday coverage.

Argument against a merger by Grayson

Here the arguments are less financial and operational and more related to community involvement and historic relationships. Some argue that a smaller utility has a closer relationship with its community. Given that Grayson would, as a minimum, be organized as a separate division, this is not likely a major argument. Similarly, the argument that the utility crews know the service area best is not very strong since crews would likely have similar geographic responsibilities.

Is a merger of Grayson RECC with another coop or utility reasonable? Likely not, at least in the short run. Grayson RECC does not bring much to the table for any merger discussions. It has a stagnant to declining customer base. Like its neighbors, it provides service in a rural and sparsely populated service territory. Neither Grayson's management nor its Board of Directors has expressed any interest in pursuing a merger.[88] None of the neighboring coops have expressed any interest in pursuing merger discussions with Grayson.[89] Although mergers can be accomplished, there are very significant cultural, financial and legal issues to be overcome.[90]

A positive course of action would be for Grayson RECC to actively pursue opportunities for operational and economic efficiencies with neighboring coops or utilities. These could include for example: purchasing of materials as well as other supply chain activities; Information Technology; training; after hours call centers; service call-outs with bordering distribution cooperatives; and other joint opportunities. None of these opportunities require an actual merger to achieve the savings. All can be accomplished through

[88] DR 59 – Interest in mergers

[89] DR 69 – Details of any merger discussions

[90] DR 60 – Other mergers

cooperative arrangements. The goal to be accomplished by pursuing these cooperative arrangements is to focus on cost control and TIER management.

It should be noted that the integration of efforts to reduce costs can itself lead to a merger, as was the case in the Bluegrass-Fox Creek merger. Here, the added longer term benefit is two organizations' utility personnel learning about each other's corporate culture, developing and becoming comfortable with joint operating procedures, and, if a merger does occur, making the transition easier. Further, if Grayson is able to better control its costs and has tightened up its operations, it becomes a more attractive merger partner.

VI-F1 **<u>Given all related circumstances, a merger of Grayson with another Cooperative would likely be difficult, though not impossible.</u>**

Given the lack of interest by Grayson management and the Grayson Board, the stagnant customer base, the rural sparsely populated service territory and the financial and legal obstacles involved, a merger of Grayson RECC with another cooperative or utility is unlikely unless the Commission feels compelled to impose it or another utility believes merger synergies are available.

VI-F2 **<u>As discussed throughout this report, some cost savings can be achieved without a merger.</u>**

Many of the potential operational and cost savings expected to result from a merger can be accomplished through the aggressive pursuit of joining Grayson processes with those of other cooperatives or utilities through formal agreements.

VI-R1 **<u>Explore potential merger opportunities with both adjacent utilities and other nearby utilities should they arise. (Priority: Medium)</u>**

While mergers may be difficult, there have been successful Kentucky cooperative mergers in the recent past. Grayson, unless it merges, will continue to find it difficult to reduce costs significantly and expand operational flexibility by a significant degree. Therefore, Grayson is faced with a paradox: Even though a merger is unlikely, though not impossible, the achieved efficiencies and cost savings would be of value to both merging utilities' customers.

Grayson should pursue a two-part strategy. First, should no merger be possible, develop a plan that reviews all cost categories and determine if there is potential for combining processes with other cooperatives; then develop plans and action steps to actively pursue any opportunities for cost savings or operational enhancements through joint processes; and finally, report the results to the Commission every 6 months.

Second, investigate opportunities for merger, including minimization of restraints. Explore a merger with another EKPC cooperative that is not continuous. Determine if the service territory can be split between two or more coops. Does the near term retirement of the Grayson CEO provide a window for merger opportunities? Some specific steps should include:

1. The Board should develop an ad hoc committee to study merger options.

2. The committee should include Board and Management personnel, supported as needed by outside legal and technical support.

3. A decision process should be developed to select potential merger candidates. Criteria should include geography; similarity of operating philosophy; size; complementary management talents; and other positive driving attributes.

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