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

ORDER

Grayson Rural Electric Cooperative Corporation, (Grayson RECC) is a non-profit member-owned rural electric cooperative corporation, organized under KRS Chapter 279. It is engaged in the distribution and sale of electric energy to 14,158 member-consumers in Carter, Elliott, Greenup, Lawrence, Lewis, and Rowan counties, Kentucky.[1] Grayson RECC does not own any electric generating facilities but purchases its total power requirements from East Kentucky Power Cooperative, Inc.[2] On September 20, 2018, Grayson RECC submitted an application for an adjustment of its existing rates based on a historic test year.[3] On March 28, 2019, the Commission issued a final Order in Case No. 2018-00272 (Final Rate Order) in which the Commission noted several troubling practices and behaviors of Grayson RECC that called into question the management and

[1] Annual Report of Grayson Rural Electric Cooperative Corporation to the Public Service Commission of the Commonwealth of Kentucky for the Calendar Year Ended December 31, 2017 (filed April 4, 2018), at 45 and 53.

[2] *Id.* at 40 and 43.

[3] Case No. 2018-00272, *Application of Grayson Rural Electric Cooperative Corporation For an Adjustment of Rates*, (Ky. PSC Mar. 28, 2019).

operation of the Grayson RECC and concluded that a management audit should be opened.[4] By this Order, the Commission opens a management audit of Grayson RECC.

The Commission, prior to Case No. 2018-00272, previously took notice of Grayson RECC's management and operation deficiencies. In Case No. 2012-00426,[5] the Commission explicitly determined that Grayson RECC needed to address fundamental financial planning and operational policy decisions that led to the deteriorated financial state Grayson RECC found itself in at that time. Although alarming deficiencies in management decisions were brought to light during the pendency of that rate case, Grayson RECC offered no evidence in Case No. 2018-00272 to show that it has addressed the areas of concern that the Commission highlighted in the July 31, 2013 Order. In Case No. 2012-00246, the Commission discussed, *inter alia,* the following concerns, which Grayson RECC had not addressed in the over five years between the final order in Case No. 2012-00246 and the filing of its rate application in Case No. 2018-00272: Grayson RECC chose to continue to increase its wage and salary expense despite actual notice that its financial condition had deteriorated and while Grayson RECC has failed to meet its required Times Interest Earned Ratio (TIER);[6] and the "magnitude" of Grayson RECC's directors' fees and expenses. The Commission admonished Grayson RECC in the July 31, 2013 Order to "evaluate its priorities when making discretionary spending in order to minimize the potential for both negative financial impacts and negative operational impacts."[7] The Commission clearly stated that

[4] Final Rate Order at 32.

[5] Case No. 2012-00426; July 31, 2013 Order.

[6] July 31, 2013 Order at 14.

[7] July 31, 2013 Order at 15.

management and the Board of Directors "has not been prudent in awarding wage and salary increases during a time of difficult financial circumstances."[8]

Further, the July 31, 2013 Order clarified that:

> [T]he amount and time of Grayson's wage and salary increases, in addition to other factors discussed herein, have eroded Grayson's TIER, debt-service coverage ratios, and equity position. During poor economic conditions, management and the board of directors must exercise sound judgment in making financial decisions to avoid the type of financial situation Grayson [RECC] finds itself in.[9]

And finally, the Commission "strongly" recommended Grayson RECC improve its financial condition before considering further wage and salary increases for its employees.[10]

Grayson RECC took no steps to address the concerns raised by the Commission in Case No. 2012-00246, and, as the Commission noted in the Final Rate Order:

> Grayson RECC's current application and evidence now presented shows that it did not improve its financial condition before considering additional wage and salary increases . . . Grayson RECC applied for an adjustment of its existing rates without addressing or offering a valid response to the Commission's concerns from the July 31, 2013 Order. When questioned, Grayson RECC presented no quantifiable measures that its management and Board of Directors planned, studied, or implemented to address the Commission's concerns contained in the July 31, 2013 Order.[11]

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[8] *Id.* at 14.

[9] *Id.*

[10] *Id.*

[11] Final Rate Order at 7 (citations omitted).

Although failure to take any steps to address the concerns in Case No. 2012-00246 establishes grounds for a management audit, several other issues identified by the Commission in Case No. 2018-00272 lend additional weight to the urgency. Those additional issues, as discussed in more detail below, indicate mismanagement that has led to Grayson RECC's poor financial condition.

Of particular concern were Grayson RECC's employee benefits. The Commission questioned payment of 100 percent of employees' health insurance.[12] The Commission noted that the presentation that Grayson RECC submitted as a compensation study to support the level of employee benefits focused solely on wages, did not address the benefits it offers, and did not indicate a significant disparity between the wages it offers and the wages offered by others.[13] Although Grayson RECC represented that it implemented cost-saving measures to manage expenses, the Commission noted that those "cost savings measures" had been in place before Case No. 2012-00246 and that Grayson RECC continued to pay 100 percent of employee health insurance premiums.[14] The Commission also observed that Grayson RECC admitted that it never seriously considered asking its employees to contribute to health insurance premiums.[15] The Commission stated that the failure to reduce wages and benefit expenses was particularly troubling because Grayson RECC failed to meet the margin requirement established by its lender.[16]

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[12] Final Rate Order at 10-13

[13] *Id.* at 12.

[14] *Id.* at 13.

[15] *Id.*

[16] *Id.* at 13.

Despite the Commission's admonitions in the Case No. 2012-00246,[17] Grayson RECC continued to increase its wage and salary expense while its financial condition deteriorated and while Grayson RECC failed to meet its required TIER.[18] Regarding these salary increases, the Commission stated that:

> It is unclear whether Grayson RECC has an accurate understanding of the critical state of its finances and the correlation between perpetuating self-serving policies that involve expenses not allowed for ratemaking purposes and how they erode Grayson RECC's TIER, debt-service coverage ratios, and equity position.[19]

The Commission concluded that:

> For these reasons, the Commission questions the choices that the Board of Directors and management have made and whether Grayson RECC has made any meaningful attempt to improve its financial situation that would address the concerns the Commission had in its July 31, 2013 Order. The Commission continues to have the same concerns for the future of Grayson RECC.[20]

Perhaps even more egregious than Grayson RECC's unwillingness to properly manage employee salaries and benefits expenses is Grayson RECC's provision of benefits to its Board of Directors and former attorney. In the Final Rate Order, the Commission noted that Ms. Carol Hall Fraley (Grayson RECC's President and CEO) testified that Grayson RECC has not made any attempt to address the high amount of

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[17] The Commission's July 31, 2013 Order explained that Grayson RECC 'has not been prudent in awarding wage and salary increases during a time of difficult financial circumstances.' The July 31, 2013 Order further stated that the Commission 'strongly recommends that Grayson improve its financial condition before consideration of further wage and salary increases for its employees. Final Rate Order at 6–7 (citations omitted).

[18] *Id.* at 16.

[19] *Id.* at 19.

[20] *Id.*

directors' fees since its last rate case.[21] Grayson RECC provides, at a high cost, directors' training fees and health insurance for its directors and, in some cases, the directors' spouses or families.[22] Grayson RECC and its Board of Directors have taken no demonstrative steps to review or address these expenses even in light of deteriorating financial conditions in the last two years.

However, the most blatant disregard for controlling costs is Grayson RECC's payment of health insurance for its former outside counsel, Jeffrey W. Scott, and Mr. Scott's spouse, for the remainder of their lives. Although Mr. Scott was never an employee of Grayson RECC and he no longer provides legal services to Grayson RECC, Grayson RECC is contractually bound to provide his and his wife's health insurance for the rest of their lives. It is unconscionable that an attorney with his own private practice, and whom the Commission presumes was adequately paid for his representation of Grayson RECC, should have the luxury of a lifetime of health insurance paid for by Grayson RECC's ratepayers.

As we expressed in the Final Rate Order:

> These practices are outrageous and are evidence of gross mismanagement. It is not clear whether management or the Board of Directors is unaware that unsophisticated individuals are negotiating the contracts and have not taken responsibility to address the negative impacts or that they are not equipped with an understanding of fundamental management practices in order to recognize the problems and to put better policies and contracts in place. Much more concerning is the possibility that the Board of Directors and management are not addressing the policies that are having a negative impact on Grayson RECC because those policies perpetuate the self-serving culture that has historically benefitted the very

[21] Final Rate Order at 20 (citations omitted).

[22] *Id.* at 21–22.

> individuals put in charge of budgeting and allocating Grayson RECC's resources.[23]

For all the reasons discussed above, and pursuant to the authority in KRS 278.255(2), the Commission finds that a management audit is appropriate and should be performed. The management audit will review all aspects of Grayson RECC's management, including its strategies and planning procedures, and its organizational structure, as well as the role of Grayson RECC's Board of Directors. The management audit will also review all aspects of Grayson RECC's member services organization, its financial management, and human resource and support functions. Finally, the management audit will also examine the necessity and feasibility of Grayson RECC merging with another electric utility.

IT IS THEREFORE ORDERED that:

1. This proceeding is initiated to investigate and examine the condition of Grayson RECC.

2. The electronic filing procedures set forth in 807 KAR 5:001, Section 8, shall be used in the processing of this matter.

3. Pursuant to KRS 278.255, a competent, qualified, and independent firm shall be retained to perform a full and comprehensive audit of the management and operational efficiency of Grayson RECC.

4. Pursuant to KRS 278.255(3), Grayson RECC shall bear the cost of this audit.

[23] Final Rate Order at 23 (citations omitted).

5. Consistent with 807 KAR 5:013, Commission Staff shall take all actions necessary for the selection and retention of a competent, qualified and independent firm to conduct the audit of Grayson RECC and for the performance of such audit.

6. Upon completion of the audit, Commission Staff shall file with the Commission a written report of the auditing firm's findings and conclusions and all documents that were assembled or produced as a result of the audit.

7. Until the completion and filing of the final report of the auditing firm's findings and conclusions, Commission Staff shall file with the Commission on the fifteenth day of each month a report on the audit's status.

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By the Commission

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KENTUCKY PUBLIC SERVICE COMMISSION

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