



# Rappahannock Electric Cooperative

A Touchstone Energy® Cooperative 

## ANNUAL BUSINESS AND FINANCIAL REPORT

For the year ended December 31, 2018

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247 Industrial Court  
Fredericksburg, Virginia 22408

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(540) 898-8500

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**Rappahannock Electric Cooperative  
2018 Annual Business and Financial Report**

**Table of Contents**

<b>Introduction .....</b>	<b>1</b>
<b>ITEM 1. BUSINESS OVERVIEW .....</b>	<b>2</b>
<b>ITEM 2. CONTRIBUTING FACTORS .....</b>	<b>15</b>
<b>ITEM 3. PROPERTIES.....</b>	<b>18</b>
<b>ITEM 4. LEGAL PROCEEDINGS .....</b>	<b>19</b>
<b>ITEM 5. CORE VALUES, CUSTOMER SATISFACTION, AND COMMUNITY INVOLVEMENT .....</b>	<b>19</b>
<b>ITEM 6. SELECTED FINANCIAL DATA .....</b>	<b>22</b>
<b>ITEM 7. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS .....</b>	<b>23</b>
<b>ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTAL DATA .....</b>	<b>32</b>
<b>ITEM 9. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE .....</b>	<b>33</b>
<b>ITEM 10. COMPENSATION .....</b>	<b>44</b>
<b>ITEM 11. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS.....</b>	<b>49</b>
<b>ITEM 12. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE.....</b>	<b>49</b>
<b>ITEM 13: IRS FORM 990 .....</b>	<b>50</b>

# **RAPPAHANNOCK ELECTRIC COOPERATIVE**

## **Introduction**

Rappahannock Electric Cooperative (REC) was formed in 1980 due to a consolidation of Virginia Electric Cooperative and Northern Piedmont Electric Cooperative. These two cooperatives were formed in the late 1930's as a result of Executive Order No. 7037, which created the Rural Electrification Administration (later RUS) making loan funds available to extend electric service to rural areas. To create greater economies of scale and improve member service, these two cooperatives consolidated into REC.

On June 1, 2010, REC acquired half of the Virginia distribution assets of Allegheny Power (AP), which included 102,000 customers across twelve counties. REC grew by 50% and went from serving 103,000 connections to serving 154,000 connections in 22 counties, becoming Virginia's largest electric cooperative by territory and third largest electric distribution utility. REC's density, services-per-mile-of-line, increased from 7.85 to 9.34.

## **ITEM 1. BUSINESS OVERVIEW**

REC is incorporated under the laws of the Commonwealth of Virginia as a not-for-profit electric distribution cooperative. The Cooperative was organized for the purpose of distributing electric power to its member-owners on a cost-effective basis. REC serves approximately 166,000 meters across 22 counties from the Blue Ridge Mountains to the tidal waters of the Chesapeake Bay between Richmond, Virginia and Washington, D.C.

REC is owned entirely by its members: residential, agricultural, commercial, and industrial. As a result of its proximity to the nation's and state's capital, REC's service territory has seen stable growth in terms of new members. REC continues to be one of the most progressive cooperatives in Virginia and across the country. The Cooperative has been and continues to be a leader in demand response, the implementation of smart grid technology and the use of advanced metering infrastructure. REC's focus is to enhance the lives of its members and the communities it serves by providing safe, reliable, affordable and sustainable energy solutions, while providing its members with the highest quality of customer service.

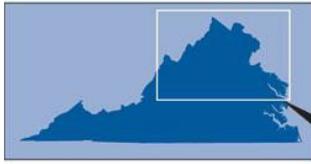
REC operates as a forward-thinking, innovative utility and is a nationwide leader in safety, reliability and member satisfaction. Among distribution cooperatives, REC benefits from its combination of stable growth; an excellent mix of residential, commercial and industrial members; affordable wholesale power costs; financial strength; and solid, experienced management and operational team members.

As a not-for-profit electric distribution cooperative, REC is exempt from federal income taxation under Section 501(c)(12) of the Internal Revenue Code of 1986, as amended.

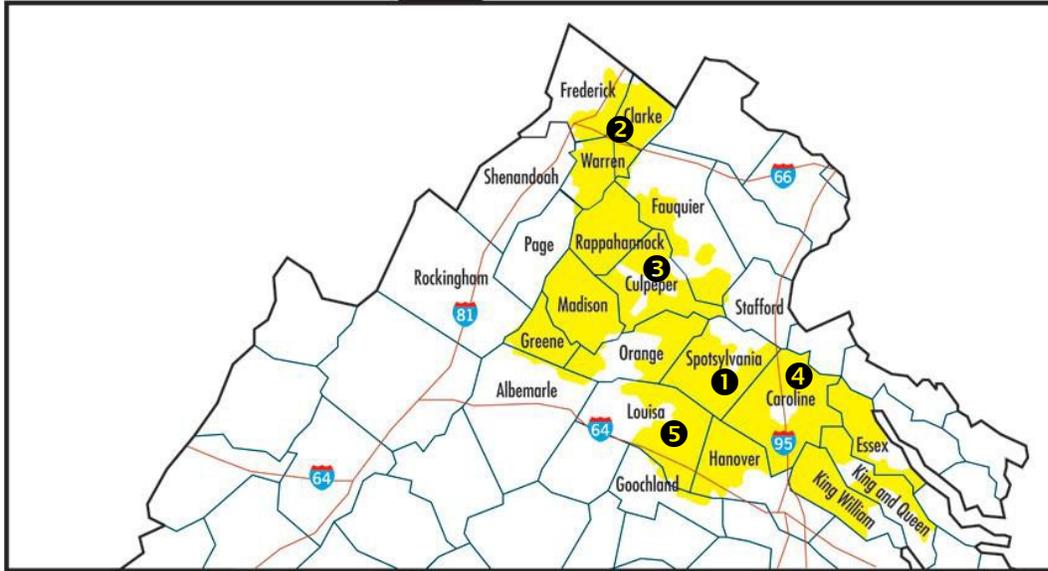
The Cooperative is not a party to any collective bargaining agreement. As of December 31, 2018, REC employed 404 people.

REC's principal executive offices are located at 247 Industrial Court, Fredericksburg, Virginia 22408 and its telephone number is 540-898-8500.

Member-ownership is a fundamental principle of the cooperative form of business, making equity management one of the most significant challenges faced by the Cooperative. Electric cooperatives raise capital to pay for utility plant by borrowing from lenders (debt) and by retaining earnings in the form of capital credits (equity). These earnings are returned to members in the form of capital credit retirements. Equity management entails determining the best mix of debt and equity to provide the level of capital needed, at the lowest cost to members, while maintaining a level of financial strength and stability.



## SERVICE TERRITORY



### Office Locations

**①** GENERAL OFFICE  
247 Industrial Court  
Fredericksburg, VA 22408

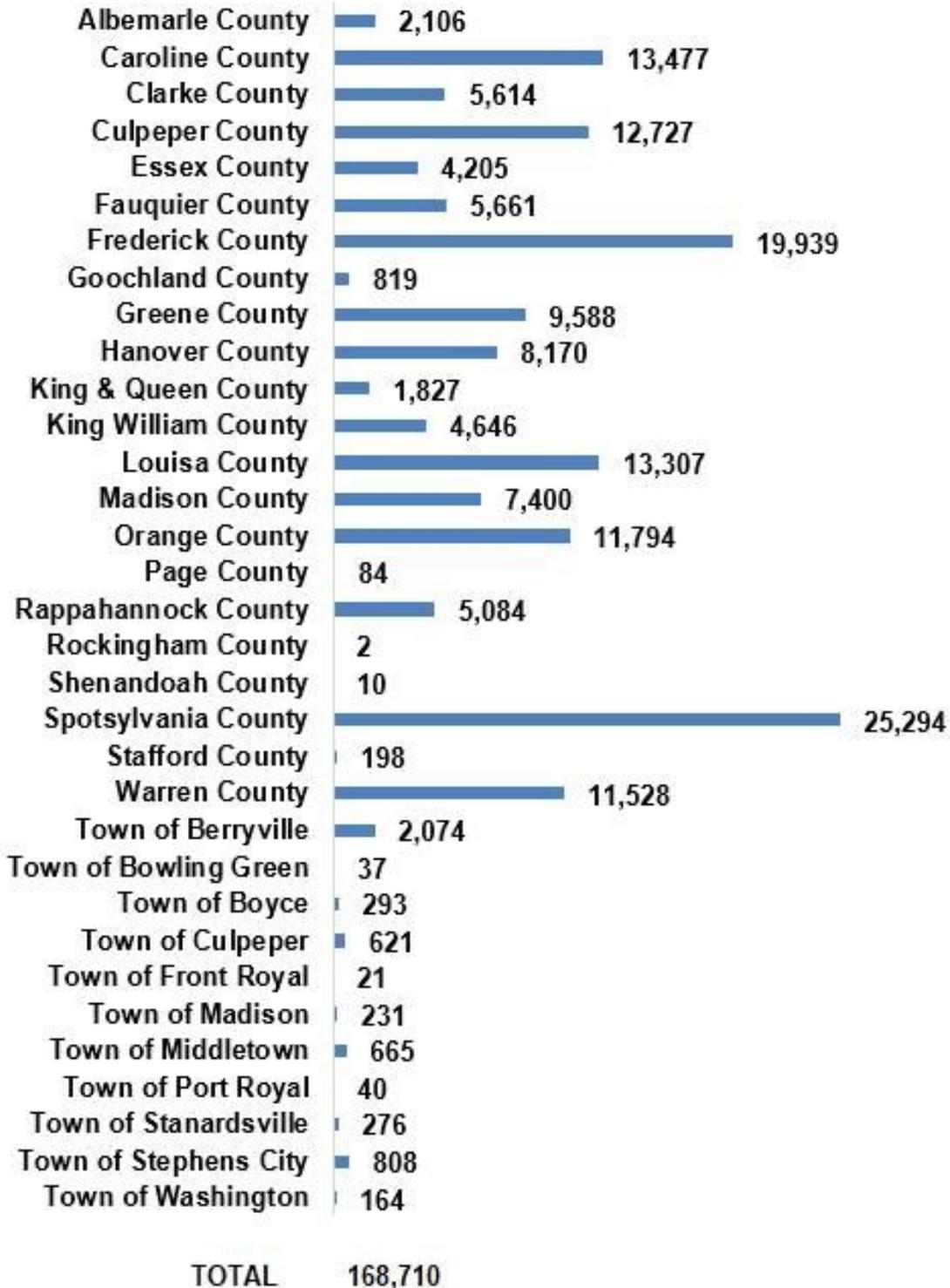
**②** BLUE RIDGE OFFICE  
137 Kelley Court  
Front Royal, VA 22630

**③** CULPEPER OFFICE  
13252 Cedar Run Church Road  
Culpeper, VA 22701

**④** BOWLING GREEN OFFICE  
14380 Fredericksburg Turnpike  
Woodford, VA 22580

**⑤** LOUISA SERVICE CENTER  
9661 Jefferson Highway  
Mineral, VA 23117

## REC Services by Locale on 12/31/2018



REC's certificated service territory includes portions of 22 Virginia counties and 11 towns in the heart of the Mid-Atlantic region. The service territory forms a rough semi-circle that begins in the southeastern corner of King and Queen County, moves westward to a point north of Charlottesville, continues north through the foothills of the Blue Ridge mountains, bordered by the Skyline Drive, into the Shenandoah Valley up to Winchester with a northern border against West Virginia, including much of the area between Richmond and Northern Virginia.

## **Strategic Planning**

REC operates under a strategic plan that is reviewed annually and undergoes a comprehensive update at least every three years. The five-year plan provides a dynamic and flexible roadmap to effectively address the issues and demands of a changing environment, while also enabling REC to proactively focus on continuous improvement in all functional areas. The most recent plan was approved by the Board in June 2018 and includes the following strategic themes:

- **Business continuity and cooperative strength** – Developing strategies to preserve critical business functions is core to the long-term success of an enterprise. REC will maintain, improve and strengthen business processes and the Cooperative culture to best serve its members and accomplish its mission well into the future. This strategic theme includes safety, reliability and resiliency, financial strength, facilities planning, workforce development, policy and process improvement, proactive legislative and regulatory engagement and risk assessment and mitigation.
- **Member and community engagement** – REC exists to serve its members. Through continuous communication, the Cooperative will continue to enhance trust via education, transparency, accountability, visibility, economic and social opportunities. This strategic theme includes the following areas of focus: prominent community visibility, exemplary member communication, expanded energy services, economic development and community support opportunities.
- **Affordability** – Affordability is always top-of-mind and a key performance metric in the members' satisfaction with their cooperative. REC will increase value through efficient operations, sound business decisions, and beneficial options for its members. This strategic theme includes the following areas of focus: wholesale cost management, cost containment and options delivering member value.
- **Technology optimization** – Technology holds great promise for electric cooperatives in overcoming the challenges of rural service territories. REC will investigate and adopt processes, tools and systems that optimize operations, energy delivery, workforce productivity and member access to information. This

strategic theme includes the following areas of focus: comprehensive technology planning, distribution modernization, analytics and a fiber utility network.

- Environmental stewardship – With a large territory and over 17,000 miles of distribution lines, REC understands that the decisions it makes each day can impact the environment. The Cooperative will minimize the ecological impact of its operations while supporting environmental sustainability. This strategic theme includes the following areas of focus: environmental consideration in daily operations, energy resource options, and beneficial electrification.

## **Annual Meeting**

Article III, Section 1 of REC's Bylaws provides the following details regarding the purpose and procedures for conducting the annual meeting:

*“The annual meeting of the members shall be held during the month of August at such place and time within the general area served by the Cooperative, as selected by the Board of Directors and which shall be designated in the notice of the meeting, for the purpose of electing Board members, receiving reports for the previous fiscal year and transacting such other business as may come before the meeting. It shall be the responsibility of the Board of Directors to make adequate plans and preparations for the annual meeting. Failure to hold the annual meeting at the designated time shall not work a forfeiture or dissolution of the Cooperative. At all meetings of the Cooperative, both annual and special, “Robert’s Rules of Order” newly revised (10th Edition, November 14, 2000) shall be followed.”*

## **Rural Utilities Service (RUS)**

REC participates in the U.S. Department of Agriculture Rural Utilities Service (RUS) loan or guarantee programs. Through provisions in their loan documents, RUS exercises control and supervision over participating distribution cooperatives, including areas such as accounting, issuance of securities, rates and charges for the sale of power, construction or acquisition of facilities, and the purchase and sale of power. Financial covenants in these loan documents require us to design rates to achieve a specified times interest earned ratio (TIER) and debt service coverage (DSC) ratio.

## **State Corporation Commission (SCC)**

Electric distribution cooperatives in Virginia, including REC, are subject to rate regulation by the Virginia State Corporation Commission (SCC). Changes in REC's wholesale power rates and costs are passed directly to its members by way of a formulary Power Cost Adjustment rider. Virginia electric distribution cooperatives may also adjust their distribution rates by a maximum net increase or decrease of 5%, on a cumulative basis,

in any three-year period without filing a rate case with the SCC (as part of the aforementioned Acquisition, REC temporarily waived this authority through December 31, 2019). The SCC has the authority to audit the Cooperative at any time and generally does so during a rate filing.

## **POWER SUPPLY**

### **Old Dominion Electric Cooperative (ODEC)**

Old Dominion Electric Cooperative (ODEC) is an electric generation and transmission (G&T) cooperative and a member of PJM Interconnection (PJM), a regional transmission operator that coordinates the movement of wholesale power in much of the Mid-Atlantic area. ODEC was formed in 1948 as a regional, member-owned wholesale power supplier to provide power to a consortium of electric distribution cooperatives. REC is a member of ODEC, along with 10 other cooperatives in Virginia, Maryland and Delaware. ODEC is governed by a 23-member board of directors, including two directors from each of its member cooperatives. Darlene H. Carpenter, REC Board member, and Kent

D. Farmer, REC President and CEO, each serve on the ODEC Board of Directors, with Farmer serving as the Vice Chairman of the ODEC Board. In 2018, ODEC named Marcus Harris as President and CEO. Mr. Harris most recently served as Executive Vice President and CEO of Kansas Electric Power Cooperative in Topeka, Kansas.

ODEC's power is generated through a balanced portfolio that includes a mix of natural gas, coal, nuclear, renewable resources, and fuel oil. As of December 31, 2018, ODEC's net capacity entitlement for the assets it owns equated to 2,632 megawatts. Wildcat Point Generation Station – ODEC's newest resource – became operational in the 2nd quarter of 2018. This station generates approximately 1,000 megawatts (MW) and is one of the cleanest natural gas facilities of its size on the east coast. In 2015, ODEC entered into long-term power purchase agreements to buy 30 MW of solar power from two utility-scale projects in Virginia. Both solar facilities became operational in 2018 and their combined generation will provide enough clean energy to power over 6,000 homes. To provide greater value to member cooperatives and their retail members, ODEC worked with several member cooperatives to develop a program, Cooperative Sunshare, where interested retail members can purchase at a fixed rate a greater share of electricity generated from these renewable resources.

In 2018, ODEC's 11 members served over 560,000 retail electric consumers (meters), representing approximately 1.4 million people along 59,000 miles of line. The service territories served by ODEC's members cover large portions of Virginia, Maryland and Delaware ranging from the extended suburbs of Washington, D.C. to the Atlantic shores of these three states to the Appalachian Mountains and the North Carolina border.

## **REC's Wholesale Power Contract (WPC)**

As a member of ODEC, REC receives essentially all of its power requirements from ODEC via a long-term Wholesale Power Contract (WPC). REC's "all-requirements" wholesale power contract with ODEC obligates REC to purchase and receive all power required for the operation of its system, with two exceptions, to the extent that ODEC has the power and facilities available.

The first exception is unlimited, allowing REC to purchase hydroelectric power, allocated to it, from Southeastern Power Administration (SEPA). The second, which is a limited exception, allows REC to purchase the greater of up to 5% of its own power requirements or 5 MW from owned generation or other suppliers. Approval for exercising this option must be given by ODEC's Board of Directors. In 2015, REC received ODEC board approval and entered into an agreement with Morgan Stanley Capital Group for the purchase of 51 megawatts (5% of REC's peak system demand requirement in 2015). This agreement has been very beneficial to REC members, realizing a savings of over \$2.7 million dollars in 2018. Kilowatt-hours purchases occurring under these exceptions constituted approximately 2.1% and 10.8%, respectively, of REC's total 2018 energy requirements.

REC is required to pay ODEC monthly for the power furnished under its wholesale power contract in accordance with a formulary rate. This formulary rate, which is administered under the jurisdiction of the Federal Energy Regulatory Commission (FERC), is designed to recover ODEC's total cost of service and create a firm equity base. It is intended to meet all of ODEC's costs, expenses, and financial obligations associated with its ownership, operation, maintenance, repair, replacement, improvement, modification, retirement, and decommissioning of its generating plants, transmission system, or related facilities, services provided to its member distribution cooperatives, and the acquisition and transmission of power or related services, including the following:

- Generation capacity costs
- Generation energy costs
- Transmission costs
- Administration costs
- Margins to meet TIER requirements

Per the contract, the ODEC Board of Directors shall review the rate formula at least every three years to determine if it reflects and recovers all such costs and expenses and if it represents the best way to allocate such costs and expenses. If deemed necessary, the ODEC Board may adopt a new formula, subject to regulatory approvals. Written notice must be given to member cooperatives no less than 30 days and no more than 90 days before the effective date of the revised formula. The rate formula was most recently

modified in 2013. The new formula was submitted to FERC in the fall of 2013 and implemented on an interim basis on January 1, 2014. In March of 2018, FERC and ODEC agreed upon a revised rate design and FERC approved the rate change.

### **PJM Interconnection (PJM)**

REC receives transmission services from PJM via its membership in ODEC. PJM is a regional transmission organization (RTO) that coordinates the movement of wholesale electricity in all or parts of Delaware, Illinois, Indiana, Kentucky, Maryland, Michigan, New Jersey, North Carolina, Ohio, Pennsylvania, Tennessee, Virginia, West Virginia and the District of Columbia.

- Acting as a neutral, independent party, PJM operates a competitive wholesale electricity market and manages the high-voltage electricity grid to ensure reliability for more than 65 million people.
- PJM's long-term regional planning process provides a broad, interstate perspective that identifies the most effective and cost-efficient improvements to the grid to ensure reliability and economic benefits on a system wide basis.
- An independent Board oversees PJM's activities. Effective governance and a collaborative stakeholder process help PJM achieve its vision: "To be the electric industry leader – today and tomorrow – in reliable operations, efficient wholesale markets and infrastructure development."

### **Southeastern Power Administration (SEPA)**

Southeastern Power Administration (SEPA), headquartered in Elberton, Georgia, is responsible for marketing electric power and energy generated at reservoirs operated by the United States Army Corps of Engineers in the southeastern United States. REC, as well as other distribution cooperatives, has been allotted a certain amount of monthly capacity from the Kerr-Philpott system in southern Virginia and northern North Carolina. Along with this constant demand comes a varied amount of energy, which is dependent upon the water flow through the dam. Although these wholesale power rates have increased over the last few years, they are still more attractive than other wholesale power rates.

### **Renewable Energy**

In August 2018, the SCC approved a community solar pilot program so that REC's retail members will be able to purchase a greater share of renewable, solar energy without having to install solar panels at their homes. As a result of the approval, REC began offering its Cooperative Sunshare program to residential consumers in September 2018.

REC follows the Virginia state regulations for Net Metering. Net Metering is a member's installation of a renewable energy generation facility used primarily to supplement their electricity needs. This generation can consist of solar, wind, or biomass to name a few. At the end of 2018, REC had 629 Net Metering member-owners for a total of 7,021 kilowatts (kW) of connected generation.

REC interconnects with several landfill gas-to-energy facilities and two small hydroelectric generating facilities operating in its territory. These facilities each use REC's distribution network to carry their power to the market and do not sell directly to ODEC or REC.

REC, through its purchased power agreement with ODEC, receives approximately 10MW of its power supply from solar generated electricity.

## **Environmental**

When planning additions or maintaining utility plant, REC always considers the environment. Not only does REC follow all local, state, and federal guidelines, but also many times the Cooperative meets or exceeds what those regulations mandate. Through continued respect for the environment, REC contributes to cleaner and safer communities for the future. REC's environmental stewardship is demonstrated by the recognition of receiving the National Arbor Day Foundation certification of Tree Line USA for 16 consecutive years.

## **Operating Results**

From 2014 through 2018, REC has maintained an average Equity to Total Capitalization Ratio of 46.1%. The debt service coverage ratio has remained very strong. Over the five-year period, REC has returned \$20,771,039 in capital credits to its members.

## REC 2018 AND HISTORICAL FINANCIAL RESULTS

	2018	2017	2016	2015	2014
Equity (annual)	\$406,204,510	\$392,122,403	\$379,610,008	\$367,768,597	\$355,344,092
Capital Credits	\$6,375,725	\$5,859,530	\$2,904,787	\$2,836,001	\$2,794,996
TIER	2.2	2.0	1.8	1.9	1.9
DSC	2.4	2.1	2.0	2.1	2.1
Current Ratio	1.6	1.2	1.4	1.6	1.0
Unencumbered Cash	\$5,565,307	\$2,702,875	\$4,545,663	\$3,520,998	\$4,826,954
Equity to Total Capitalization	47.0	47.4	45.9	44.4	45.9

### Historical Sales and Revenue Data

Since 2014, REC's total operating revenue has increased by 2.72%. During the past five years, Residential revenues have increased 13.72%, and Commercial and Industrial (excluding Closed Heavy Industrial) revenues have increased by 4.29%. Kilowatt-hour (kWh) sales increased 4.53% over the past five years in the Residential class and increased 2.19% in the Commercial and Industrial class (excluding Closed Heavy Industrial). Operating revenue and kWh sales in the Closed Heavy Industrial class decreased significantly over this five-year period due to the only member served in this rate class choosing to receive their electricity service from another power supplier<sup>1</sup>. This member's change in electricity service also attributed to total energy sales decreasing 10.10% since 2017. In 2018, REC continued to bill this member for relative taxes that are due to the county and state, as well as other charges agreed upon in an operating contract between the member and the Cooperative.

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<sup>1</sup> Virginia law provided the option for this consumer to purchase from a competitive supplier. Due to REC's contract with that consumer, revenue for distribution service was unaffected, and wholesale power costs were reduced by an amount equal to the reduction in energy revenue from that consumer.

### Historical Revenues and Sales by Class

	2018	2017	2016	2015	2014
<b>Sales in Dollars</b>					
Residential	\$295,734,126	\$238,733,004	\$259,454,757	\$275,191,895	\$260,047,689
C&I, less than 50 KVA	36,615,822	32,848,279	34,314,737	32,878,797	32,645,516
C&I, more than 50 KVA	103,365,967	93,282,103	102,562,735	112,392,361	101,572,613
Outdoor Lighting	192,879	245,279	512,251	534,934	524,440
Other Public Authorities	4,699,310	3,032,682	3,213,347	3,276,857	2,572,096
Closed Heavy Industrial	305,906	305,882	12,554,804	31,854,126	32,071,099
<b>Total Energy Revenues</b>	<b>\$440,914,010</b>	<b>\$368,447,229</b>	<b>\$412,612,631</b>	<b>\$456,128,970</b>	<b>\$429,433,453</b>
Other Electric Revenue	5,742,127	5,390,204	5,552,132	5,738,213	5,415,080
<b>Total Revenue</b>	<b>\$446,656,137</b>	<b>\$373,837,433</b>	<b>\$418,164,763</b>	<b>\$461,867,183</b>	<b>\$434,848,533</b>
<b>Sales in KWH</b>					
Residential	2,373,413,757	2,168,898,430	2,210,130,998	2,237,890,211	2,270,493,279
C&I, less than 50 KVA	313,947,827	300,682,570	303,268,918	301,049,833	309,768,036
C&I, more than 50 KVA	1,204,971,304	1,212,049,807	1,210,976,227	1,198,044,482	1,176,646,360
Outdoor Lighting	819,034	1,052,469	2,169,826	2,115,314	1,991,345
Other Public Authorities	41,156,053	28,490,934	27,752,449	26,726,636	21,988,279
Closed Heavy Industrial	0	0	264,870,312	605,318,049	595,362,957
<b>Total Energy Sales</b>	<b>3,934,307,975</b>	<b>3,711,174,210</b>	<b>4,019,168,730</b>	<b>4,371,144,525</b>	<b>4,376,250,256</b>

### Load Growth Forecast

Load projections for REC are updated annually through a Power Requirements Study (PRS) prepared jointly by REC and ODEC. The most recent PRS was completed in 2018 and forecasts load growth through 2032. The PRS employs econometric analysis to forecast the number of consumers and electricity sales for both the residential and small commercial classes. It is prepared in accordance with the RUS 7 CFR 1710 and the ODEC PRS work plan, as approved by the RUS. ODEC uses revised statistics from NPA Data Services, Inc. and accounts for county weights within the REC service area as a basis for the PRS projections.

This study projects growth for residential and small commercial members to be 1.1% annually through 2032. Specifically, REC anticipates adding approximately 24,906 residential consumers by the year 2032.

## **Products and Services**

The Cooperative exists to serve its members. Its primary responsibility is to provide members with safe, reliable, and affordable electric service. In addition, REC is committed to offering its members a range of energy-related products and services to meet their individual needs. These optional, unregulated products and services are listed below.

### **Energy Advice**

Keeping a home as energy efficient as possible can save money year round. REC offers a variety of tools online at [www.myrec.coop](http://www.myrec.coop). In addition to the tools found on the website, REC's energy experts are trained to provide phone consultations and in-person energy audits. Most services are provided at no direct costs to the consumer, but a nominal fee is applied to cover the costs of advanced testing.

### **Individual Outage Notification (ION)**

Whether a power outage affects everyone in a neighborhood or just the line delivering electricity to an individual home, ION notifies REC's dispatch center. Even when no one is home, REC knows when there is a power outage and may be able to address it before it impacts a member. ION is maximum peace of mind for just pennies a day.

### **Outdoor Lighting**

Outdoor lighting automatically turns on at dusk and off at dawn, making it easy and convenient to keep homes and businesses safe and secure. The risk of accidents is reduced by lighting steps and other areas that can be hazardous in the dark. In addition, outdoor lighting is an effective way to deter intruders. Standard lights installed are energy efficient LED fixtures that are also dark-sky friendly.

### **REC Electrical Services**

Getting small electrical jobs done is easy when trained professionals at REC are called upon. Certified master electricians are available to do all the jobs other electrical contractors don't have time for, and at competitive rates. Work can be arranged to accommodate even the busiest of schedules.

### **SurgeAssist**

SurgeAssist helps cover the costs of repairing or replacing electrically powered devices in the home that have been damaged by an electrical surge. This financial protection is available exclusively to enrolled members of REC who pay a nominal monthly fee.

## **Water Heater Replacement**

Water heating is typically a home's third largest energy expense. A new, more efficient water heater can cut that cost, especially if the current water heater is more than seven years old, leaking or constantly needing repair. REC can arrange delivery and installation of a new water heater and, in many cases, provide up to 36 months to pay for it – interest free.

## **REGULATION**

### **General**

REC is democratically controlled by its member-owners. Beyond the governance of REC's board, REC is subject to regulation by the Virginia State Corporation Commission (SCC), and to the rules and specifications of the United States Department of Agriculture's Rural Utilities Service (RUS).

### **Rate Regulation**

Rates and Terms and Conditions for the provision of retail electric service are regulated by the SCC. Electric cooperatives in Virginia are subject to a hybrid regulatory structure in which, once Rates and Terms and Conditions are approved by the SCC, they may be adjusted within certain parameters, without the need for additional SCC approval. Per § 56-585.3 of the Code of Virginia, an electric cooperative may, with only the affirmative resolution of its Board of Directors, adjust its distribution rates by no more than a cumulative total of 5% up or down in a three-year period, adjust its Fees and Charges, and make any adjustment to the Terms and Conditions that do not affect revenues from the distribution or supply of electric energy. As a condition of approval of REC's 2010 acquisition of a portion of the service area and assets of Allegheny Power, REC has waived this right to self-adjust rates through December 31, 2019, while maintaining the ability to adjust Fees and Charges and Terms and Conditions.

### **2018 Rate Increase**

On January 9, 2018, the Virginia SCC issued a final order in Case No. PUR-2017-00044 approving REC's application for an increase in base distribution rates. The approval included an annual revenue increase of \$18 million effective for billings on or after March 1, 2018. As part of the SCC's approval, REC's monthly residential fixed access fee increased from \$10.00 to \$14.00. The order also approved a seasonal power supply rate differential and an updated depreciation rates schedule.

## **Power Cost Adjustment (PCA)**

The Cooperative uses an SCC-approved, formulary Power Cost Adjustment (PCA) rider to fully recover wholesale power costs. The PCA factor is adjusted at least annually to recover from or return to members changes to wholesale power costs. By having this rider in place, wholesale power costs, which make up the electricity supply service of the retail rates, is a 100% pass through where members pay no more or less than what REC is billed for the electricity used.

## **Prepaid Service**

REC has had an SCC-approved Prepaid Electric Service tariff available to its members since September 2013. At the end of 2018, REC had more than 1,100 members taking advantage of the Prepaid option.

## **Other Regulation**

In addition to electric service, the SCC also regulates the borrowing activities of Virginia's public service companies in accordance with Chapter 3 of Title 56 of the Code of Virginia, and relations with affiliated interests per Chapter 4 of the same title.

REC's utility facilities are built and operated in compliance with the National Electrical Safety Code (NESC) and utility construction activities (installation of overhead and underground power lines and substations) must comply with applicable state and local regulations. The placement of major utility facilities, such as sub-transmission lines and substations, are subject to approval by either the SCC or the localities in which those facilities are to be located.

## **ITEM 2. CONTRIBUTING FACTORS**

### **Safety**

At REC, safety is the Cooperative's first priority. REC takes measures to protect the public, its employees and the environment from hazards associated with the electric distribution system. Safety guidelines and construction and maintenance standards are followed. Employee positions that require hands-on construction and maintenance of the electric system are placed in apprenticeship programs of various lengths and complexity to become fully qualified to perform the work. REC maintains a proactive safety program that ensures compliance through training, inspections, job safety assessments, and performing thorough investigations when incidents do occur and communicating lessons learned.

In fulfilling its responsibility to the communities in which it serves, REC participates in outreach to schools, first responders and the general public at various community events, as this presents the greatest opportunity for REC to educate the public. As an example, REC uses safety demonstration tools that present real life situations and shows what occurs when contact is made with energized facilities.

### **Cybersecurity**

REC has identified numerous cyber related risk/threats that could result in varying degrees of severity if fully realized. Some threats such as Distributed Denial of Service (DDoS) can cause short to mid-term loss of key business systems while others such as unauthorized intrusion or data loss (exfiltration) could have legal ramifications, member identity monitoring expenses and long term public image damage. To aid in mitigating these risks, REC maintains an active Cybersecurity Plan and Incident Response Plan, performs employee awareness and training, and executes annual 3rd party cybersecurity penetration testing and auditing.

### **Physical Security**

Security of REC's patrons, employees, and facilities is paramount. Facilities and all non-public entranceways are equipped with access controls (e-card based readers). Public and employee areas are separated with access controls. Facilities are protected with after-business hour alarm and monitoring services.

### **Technology**

The effective and efficient use of technology is key to the ongoing success of REC. At the same time, REC's technology solutions must be affordable, reliable, secure and scalable to meet REC's needs both today and tomorrow. To meet this need, REC has selected National Information Solutions Cooperative (NISC) and their Enterprise Solutions Suite along with other electric industry recognized solutions to meet most of its Information Technology (IT) needs. In addition, REC has partnered with Lockheed Martin Energy (LME) to provide REC with an onsite Service Desk, Datacenter, Cybersecurity, Networking, Business Analysts, IT Management and Infrastructure support via a long-term services agreement. LME resources are onsite and fully dedicated to REC.

## **Changes in Fuel and Purchased Power Costs**

REC does not generate electricity. All electricity that is distributed and sold to its members is purchased, with nearly all acquired from ODEC. REC's purchased power costs are subject to changes within the wholesale power market, which can affect the costs of generating, purchasing, or transmitting power. The wholesale market prices may fluctuate over relatively short periods of time due to factors such as

- Weather
- Generation supply and electricity demand
- The availability of competitively priced alternative energy sources
- Price competition among fuels used to produce electricity, including natural gas, coal, and crude oil
- Energy transmission and natural gas capacity constraints
- Increased investment in transmission facilities
- The transportation of fuels
- Implementation of new technologies in the power industry
- Federal, state, and local energy regulation and legislation
- Natural disasters, war, terrorism, and other catastrophic events

An order issued by the Virginia State Corporation Commission states customers served by “a more diverse portfolio of assets via the Cooperatives’ contractual relationship with ODEC” experience a benefit compared to being served “at power supply prices that are subject solely to the vagaries of the wholesale market.” (ORDER of the Virginia State Corporation Commission dated May 14, 2010, Case No. PUE-2009-00101; page 8.)

## **Energy Efficiency**

Increased efficiency standards for appliances and more stringent building codes have combined to help members reduce their energy usage. REC and its professional energy advisors stand ready to assist members with even greater energy efficiencies through phone consultations and energy audits. Members can learn more about energy consumption in their homes by utilizing “My Usage” at MyREC SmartHub.

## **Distributed Generation**

Advances in technology and reductions in the cost of on-site generation, particularly photovoltaic systems, combined with tax incentives and consumer sustainability desires have resulted in the growth of distributed generation (DG). Unlike central station electric service, in which power is generated at a central location and consumers are dependent on the utility to deliver electricity over the distribution grid, DG occurs when at least a

portion of the electricity is generated at the consumer's location, reducing the amount purchased from the utility. Because of the intermittent nature of many DG resources, the grid (both transmission and local distribution systems) and utility supply require planning for peak conditions where DG may or may not be available. This, in effect, means even though utility sales may be reduced, certain capacity costs may remain.

### **Environmental Regulation May Limit Operations and Increase Costs**

REC is committed to conducting its operations in a manner that demonstrates concern for the natural environment. Rapidly changing and increasing environmental regulations, specifically the Federal Environmental Protection Agency's proposals regarding power plant emissions, as well as state and local regulations relative to preserving the Chesapeake Bay, may impact costs and operational flexibility.

## **ITEM 3. PROPERTIES**

### **Miles of Line**

REC owns approximately 17,274 miles of distribution and transmission lines. Of this total, approximately 17,064 miles is 12.5-kilovolt (kV) distribution line, which serves 162,275 active meters. The distribution lines consist of about 7,608 miles of underground and 9,456 miles of overhead lines. Transmission lines account for about 94 miles of 115 kV transmission line and 116 miles of 34.5 kV sub-transmission line. This transmission system is only used to serve REC's own load/substations and is not used for interstate transmission purposes. REC's meters-per-mile of line is 9.39.

### **Offices and Substations**

REC's General Office is located in Spotsylvania County on 42 acres, just south of Fredericksburg, Virginia. The four building complex houses corporate management, finance, engineering, member services, contact center, safety, human resources, IT, public relations and operational center departments. There are three operational offices across the service territory. They are located in the County of Caroline, County of Culpeper and Town of Front Royal. These operational offices house the operations and maintenance departments, distribution line design, and field member service functions, as well as payment and member service centers. In addition, the Louisa Service Center is used as a centrally located warehouse and operations center.

REC has 101 combined substations, Distribution Step-down Points (DSPs) and switching stations that are spread across the service territory. These range in size from fractions of an acre to five acres.

## **Fiber Utility Network**

A study was completed in first quarter 2018 detailing options for REC to construct a fiber utility network to support the grid and to extend that construction to a fiber to the home (FTTH) network. The study determined that a FTTH is only financially feasible with significant funding assistance. The estimated cost for a build out of FTTH with competitive adoption rates is in the range of \$600-\$800 million. As a result of the high cost of providing FTTH, REC has chosen not to enter into the retail fiber business, but will facilitate the expansion of broadband by leasing excess capacity dark fiber to local governments, schools, or telecommunications companies. The fiber utility network option is designed to provide high-speed data communications to REC offices, substations, DSPs and towers.

The fiber utility network could support future open access and other broadband initiatives. In Virginia, any electric cooperative that elects to provide FTTH can only do so through an SCC approved competitive affiliate and cannot be subsidized by the Cooperative's revenue from electricity sales to member-owners.

In October 2018, a team of REC employees presented to the Board of Directors a plan to complete a "ring" around the cooperative's electric network connecting approximately 130 locations at a cost of \$30.6 million. The Board approved the project and design work began in January 2019. The project is expected to be completed in 2024.

## **ITEM 4. LEGAL PROCEEDINGS**

On July 26, 2018, three REC members ("the Petitioners") filed a petition with the Virginia State Corporation Commission (the "Commission"), docketed as Case No. CLK-2018-00009, seeking a declaratory judgment and injunctive relief against REC in which the validity of certain portions of the Cooperative's bylaws were challenged. On February 25, 2019, the Commission issued its Order on Certified Question dismissing the petition citing jurisdictional issues that were beyond the scope of its authority, which focuses on utility rates, reliability, and quality of service. The Commission further found that since the Petitioners claims addressed allegations of management-related issues, the petition would be more properly addressed before an appropriate circuit court.

## **ITEM 5. CORE VALUES, CUSTOMER SATISFACTION, AND COMMUNITY INVOLVEMENT**

### **Company Core Values**

REC's four core values underpin all member and public interactions:

- “Service” is meeting member needs by providing reliable electricity and quality products.
- “Integrity” means being honest, responsible and ethical throughout every undertaking, making sure actions always match words.
- “Caring” is demonstrating compassion and concern for members and their communities through small gestures, like safety demonstrations, and through larger gestures, like awarding grants and scholarships.
- “Respect” is honoring each person as an individual and being mindful of the impact that actions can have on others.

## **Customer Satisfaction**

A highly satisfied and engaged membership is imperative for successful Cooperative operations. REC conducts ongoing market research utilizing the American Customer Satisfaction Index (ACSI) and the J.D. Power Electric Utility Residential Customer Satisfaction Study. The insights and analysis generated by each survey methodology aid the Cooperative in identifying what members want, determining what attitudes, opinions and beliefs they hold to be true, and assist in enhancing members’ experiences with the Cooperative resulting in continuously improving member satisfaction and engagement.

The ACSI is the only national cross-industry measure of customer satisfaction in the United States, allowing REC to compare its member satisfaction to peers in the electric industry as well as other service providers that members measure their overall experiences against. In 2018, REC achieved an ACSI score of 80 out of 100, which significantly outperformed the Touchstone Energy Cooperatives benchmark of 77 and the Investment Owned Energy Utilities average score of 75.

JD Power is a well-known and recognized industry benchmark for consumer satisfaction, insights, research and analytics that annually surveys over 100,000 customers nationwide from over 130 electric utility brands in the Electric Utility Residential Customer Satisfaction Study. In 2018, REC achieved an Overall Customer Satisfaction Index score of 751 out of 1,000 and ranked 28<sup>th</sup> in the nation out of 138 utility brands included in the study.

## **Community Involvement**

REC supports the communities in its 22-county service area through corporate financial support, employee volunteer activities and community education efforts.

Since 1996, the Cooperative has provided grants to non-profit, educational and emergency services organizations and scholarships to those seeking to attend or who are

currently attending a college or trade school. In 2018, those scholarships and grants totaled \$38,000.

In addition to scholarships, REC contributes to community education efforts by hosting electrical safety and energy conservation seminars at local businesses, trade shows and meetings of various civic organizations. The Cooperative supports efforts by local United Way chapters through annual employee contributions and by employee participation in the United Way's Day of Action activities.

REC established Operation Round Up<sup>®</sup> in 2006. This program's name has since been rebranded to The Power of Change. This program allows members to volunteer to have their electric bills rounded up to the next whole dollar, with the extra change benefitting charitable causes. The Community Awareness of Rappahannock Electric Charity, Inc. (C.A.R.E. Charity, Inc.) is the charitable corporation established by REC to administer the donations collected. An independent, volunteer board of REC members reviews applications and awards funding. In 2018, C.A.R.E Charity Inc. awarded \$62,462 of donated funds to seventeen local non-profit organizations.

REC also supports the volunteer and fundraising efforts of employees through their own charitable organization, Project Big Heart. In 2018, combined donated funds totaled more than \$49,000 and provided support to more than 50 organizations.

Below are some of the many organizations and events that REC assisted through financial and volunteer support in 2018:

- Alzheimer's Association
- American Cancer Society
- Angel Tree Program
- Boy Scouts
- Fauquier Cops for Children
- Habitat for Humanity
- Project Santa
- Ronald McDonald Foundation
- Safe Harbor
- Salvation Army (various programs)
- Various emergency food pantries and Social Service Agencies
- VCU Massey Cancer Center

## ITEM 6. SELECTED FINANCIAL DATA

Financial data for the five years ended December 31, 2018 are derived from audited financial statements, the related notes to the financial statements, and the discussion of this information in “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in Item 7.

	<b>Year Ended December 31</b>				
	<b>2018</b>	<b>2017</b>	<b>2016</b>	<b>2015</b>	<b>2014</b>
<b>Statement of Operations Data</b>			(Thousands)		
Operating revenues	446,656	373,837	418,165	461,867	434,848
Operating margins	15,327	6,076	5,625	8,329	8,515
Net margins	21,335	17,763	14,975	15,269	14,949
	<b>Year Ended December 31</b>				
	<b>2018</b>	<b>2017</b>	<b>2016</b>	<b>2015</b>	<b>2014</b>
<b>Balance Sheet Data</b>			(Thousands)		
Utility plant	680,747	671,765	657,207	648,571	632,871
Total investments	139,237	134,857	129,851	125,561	121,205
Total current assets	102,647	75,994	88,446	101,241	67,616
Total deferred charges	13,367	15,304	16,253	16,663	18,678
Total assets	935,998	897,920	891,757	892,036	840,370
Patronage capital	406,630	392,105	379,767	367,854	355,452
Long-term debt	458,056	420,852	434,538	448,315	407,412
Total Capitalization	864,686	812,957	814,305	816,169	762,864
Equity Ratio <sup>1</sup>	43.40%	43.65%	42.57%	41.23%	42.28%

<sup>1</sup> The Equity Ratio calculations include Membership Fees and Accumulated Comprehensive Loss.

	Year Ended December 31				
	2018	2017	2016	2015	2014
<b>Capital Expenditures</b>			(Thousands)		
Distribution Plant	44,303	39,019	35,128	39,717	35,587
General Plant	5,114	7,795	5,335	5,505	7,678
Total Capital Expenditures	49,417	46,814	40,463	45,222	43,265

## **ITEM 7. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

### **Caution Regarding Forward Looking Statements:**

Management’s Discussion and Analysis of Financial Condition and Results of Operations contains forward looking statements regarding matters that could have an impact on its business, financial condition, and future operations. These statements, based on expectations and estimates, are not guarantees of future performance and are subject to risks, uncertainties, and other factors that could cause actual results to differ materially from those expressed in the forward-looking statements. These risks, uncertainties, and other factors include, but are not limited to, general business conditions, demand for energy, federal and state legislative and regulatory actions and legal and administrative proceedings, changes in and compliance with environmental laws and policies, weather conditions, the cost of commodities used in the industry, and unanticipated changes in operating expenses and capital expenditures. These results may vary materially from those discussed in the forward-looking statements as a result of these and other factors. Any forward-looking statement speaks only as of the date on which the statement is made, and undertake no obligation to update any forward-looking statement or statements to reflect events or circumstances after the date on which the statement is made even if new information becomes available or other events occur in the future.

### **Overview**

REC is an electric distribution utility engaged in the retail sale of electricity to residential, commercial, industrial, and non-jurisdictional (local, state, and federal government entities) member-consumers in 22 Virginia counties. The rates charged to member-consumers of the Cooperative are regulated by the Virginia State Corporation Commission.

## **Critical Accounting Policies**

The preparation of REC's financial statements in conformity with generally accepted accounting principles (GAAP) requires that management make estimates and assumptions that affect the amounts reported in its financial statements. These estimates and assumptions are based on information available as of the date of the financial statements and they are not necessarily indicative of the results to be expected for the year. The following are considered to be critical accounting policies due to the estimation involved in each.

### **Uniform System of Accounts**

The accounts of the Cooperative are maintained in accordance with the Uniform System of Accounts as prescribed by the United States of America – Rural Utilities Service. The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America.

The Cooperative follows the accounting practices set forth in Statement of Financial Accounting Standards (SFAS) No. 71, *Accounting for the Effects of Certain Types of Regulations*, as amended. This standard requires entities to capitalize or defer certain costs or revenues based on the Cooperative's ongoing assessment that it is probable that such items will be recovered through future revenues.

### **Old Dominion Electric Cooperative (ODEC)**

REC is a member of ODEC, a not-for-profit wholesale power supply cooperative. REC is required to purchase substantially all of its power from ODEC under a contract through 2054. The terms of this contract cannot be terminated by either party unless three years written notice is given. ODEC also performs various power-supply related services for its member cooperatives, such as arranging for transmission service and assisting with information for REC's future power requirement study and forecasting system load. Purchases from ODEC amounted to \$261,054,475 in 2018 and \$223,687,591 in 2017.

On September 30, 2013, ODEC submitted, pursuant to section 205 of the Federal Power Act, a superseding cost-of-service rate schedule, which amends ODEC's existing cost-of-service rate schedule for all requirements service, provided to its 11 distribution members. FERC accepted the proposed rate schedule revisions for filing to become effective January 1, 2014, subject to refund, and establishing hearing and settlement judge procedures. During the hearing process, some items in the rate filing were found not to be just and reasonable. As a result, ODEC did revise the rate design and, as of March 2018, FERC approved ODEC's rate change.

## Deferred Energy

Deferred energy consists of expenses related to energy and capacity charges REC incurs from its wholesale power suppliers. REC pays those expenses as they are billed and then recovers those costs from its members over time via its retail rates. The energy adjustment balance sheet accounts, asset or liability, represent the under or over collection of those charges from its members.

REC uses a Power Cost Adjustment (PCA) rider, which is an adjustment that is designed to recover purchased power cost on a dollar for dollar basis. It includes an over- and under-recovery mechanism that tracks the difference between purchased power costs recovered from sales and actual purchased power expense. Some of the charges from ODEC are annualized, capacity-related expenses that are billed in 12 equal monthly installments. Naturally occurring seasonal fluctuations in retail energy sales result in the deferral balance rising and falling from month-to-month and season-to-season. Any over- or under-recovery is deferred as a liability or an asset. The PCA provides that the balance of any over- or under-recovery be rolled into the PCA factor at least once per year. It further provides that the billing factor is to be adjusted at any time that there is a change in the rates charged by or capacity allocations from ODEC or SEPA, or a price or volume change in a non-ODEC or non- SEPA power supply contract, but may be adjusted at any time based on prevailing estimates of costs relative to the deferred energy balance. The PCA ensures that energy revenue will equal purchased power costs.

The PCA has two primary components:

1. Differential between projected annual power costs and projected annual base Energy Supply Service (ESS) revenue.
2. Differential factor to return or recover any amount over- or under-collected in the previous 12 months.

The sum of these two components becomes the annual PCA billing factor that is added to each kWh of energy sold by REC, except for sales to members served on a tariff that provides for a complete and direct monthly pass through of the individual member's wholesale power costs, including line losses, energy and capacity allocations. When REC receives charges or credits on its wholesale power bill under the provisions of an energy adjustment clause or changes in energy allocations included in a rate or contract, a third component to reflect the change in the wholesale rate is added to the PCA. In addition to the PCA adjustments that occur at least annually and when there is a change in wholesale power costs, REC may at any time re-calculate the PCA to minimize over- or under-recovery of power costs if actual data and more current information for the remainder of the year warrant a change.

## **Margin Stabilization**

The Margin Stabilization Plan approved by ODEC allows them to maintain their margins within a predetermined range. REC increases or decreases its cost of power when recording credits or expenses resulting from ODEC Margin Stabilization activities. Changes in power costs resulting from ODEC margin stabilization must be reflected in the PCA calculation and passed through directly to retail members. At the end of 2018, REC booked margin stabilization of \$4,903,022 to be passed to its members resulting in a reduction in the PCA for 2019.

## **PATRONAGE CAPITAL**

### **Allocation of Margins**

Net margins are allocated to the member's capital credit account based on billed sales revenue by rate class for the year in which REC earns the margins. All margins (profits) that REC earns revert to its members in the form of capital credits. For the 2018 fiscal year, the allocation amount is \$21,334,844. ODEC patronage, assigned to REC, is allocated to members' accounts separately from all other margins; however, REC will not retire these capital credits until ODEC retires them. REC's Board of Directors determines the amounts, annually, that will be retired to its members via general, estate and special retirements.

### **General Retirement**

The Cooperative's Board of Directors annually determines the percentage of capital credits to be retired to the members, the minimum refund amount for an inactive account and the General Retirement credit issue date. General Retirements are based on a percentage of the prior year's net margins. In the 2018 fiscal year, REC retired \$6,254,392 to its member-owners in the form of a General Retirement. The retirement was greater this year than in the past due to the retirement of ODEC patronage. ODEC patronage was retired fully for fiscal years 1988-1990, as was a portion of patronage for fiscal year 1991. REC has not received notification for any subsequent ODEC retirements.

### **Estate Retirement**

Estate retirements are those paid to the estate of a deceased member or deceased joint members. Estates have the option to receive a discounted payment of the outstanding REC balance, or continue to receive annual retirements as part of the General Retirement process when approved by the Board of Directors. Estate retirements, payable to beneficiaries on the behalf of deceased members, totaled \$1,690,420 in 2018.

## Special Retirement

Occasionally when it is financially feasible, the Board of Directors may approve a special retirement to active and/or inactive members to recognize a special circumstance.

## Total Retirements to Date

As of December 31, 2018, REC has retired \$104,849,633 since the late 1930s when Virginia Electric Cooperative and Northern Piedmont Electric Cooperative were formed and later consolidated to become REC.

## Donation of Capital

REC receives donated capital and retains this as permanent equity. This occurs via unclaimed general retirements and estate retirements. When estate retirements are processed, the total amount of REC allocations are discounted based upon the following discount schedule.

Year	Discount %	Year	Discount %	Year	Discount %
2017	58.80%	2012	44.63%	2007	25.59%
2016	56.29%	2011	41.26%	2006	21.06%
2015	53.63%	2010	37.68%	2005	16.25%
2014	50.81%	2009	33.89%	2004	11.15%
2013	47.81%	2008	29.86%	2003	5.74%

Estates are paid out for the present value of the capital credits, which is total REC allocations, less the discount amount. This discount is transferred to REC as donated capital and retained by REC as permanent equity. It is important to note, this is a 15-year sliding schedule and REC equity retired from years prior to 2003 are retired at 100%. Donated equity from discounted estates totaled \$313,114 in fiscal year 2018.

## CONTROLS AND PROCEDURES

### Management's Analysis of Internal Controls over Financial Reporting

REC's management states that as of December 31, 2018, its system of internal controls over financial reporting was properly designed and operating effectively based upon adherence to the policies and procedures established by management. REC has not identified any material weaknesses in their internal controls over financial reporting. Its external auditors, Adams, Jenkins and Cheatham, do not express an opinion on the effectiveness of REC's internal control over financial reporting, however they did state that their analysis did not identify any deficiencies that were considered to be a material weakness.

Management is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is comprised of policies, procedures, and reports designed to provide reasonable assurance to management and the Board of Directors that the financial reporting and the preparation of the financial statements for external reporting purposes have been handled in accordance with accounting principles generally accepted in the United States. Internal control over financial reporting includes those policies and procedures that (1) govern records to accurately and fairly reflect the transactions and dispositions of assets; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles and that receipts and expenditures are being made only in accordance with authorizations of management and directors; and (3) provide reasonable safeguard against or timely detection of material unauthorized acquisition, use or disposition of assets.

### **Changes in Internal Controls over Financial Reporting**

There have been no significant changes in REC's internal controls over financial reporting that could significantly affect such controls during the previous fiscal year.

### **Inherent Limitations on Internal Control**

There are inherent limitations to the effectiveness of any system of internal control over financial reporting. No control system can provide absolute assurance that all control issues and instances of error or fraud, if any, have been detected. Even the best designed system can only provide reasonable assurance that the objectives of the control system have been met. Because of these inherent limitations, internal controls over financial reporting may not prevent or detect all misstatements. Additionally, projections as to the effectiveness of controls to future periods are subject to the risk that controls may not continue to operate at their current effectiveness levels due to changes in personnel or in its operating environment.

### **Transparency**

Due to REC's status as a U.S. corporation that is a recipient of loan funds from the Rural Utilities Service (RUS), an agency of the U.S. Department of Agriculture, the Cooperative must meet multiple auditing standards. REC's independent auditors, Adams, Jenkins & Cheatham, must audit the Cooperative in accordance with both the Generally Accepted Auditing Standards (GAAS) applicable to most businesses, as well as the Government Auditing Standards issued by the Comptroller General of the United States. Compliance with these dual standards requires significant due diligence, thorough records, and accuracy. As a Commonwealth of Virginia regulated utility, the Cooperative is subject to State Corporation Commission oversight requiring numerous approvals and disclosures.

## **Financial Condition of the Company**

REC finished the year with \$21,334,844 in net margins compared with a budgeted figure of \$21,169,568. Operating revenues were 3.1% greater than budget, purchased power cost was 1.9% greater, and total expenses were 2.9% higher than budget, resulting in operating margins of \$15,326,593. TIER was 2.2 for budget and actual; Operating TIER was 2.2, compared to a budget of 1.8; and Modified TIER was 2.2, compared to a budget of 1.9. REC's debt service coverage (DSC) ratio was 2.4 for budget and actual.

**RAPPAHANNOCK ELECTRIC COOPERATIVE**

**Significant Change in Statement of Operations**

**From December 31, 2017 to 2018**

	(thousands)			
	2017	2018	%Change	Explanation
<b>Operating Revenue</b>	\$373,837	\$446,656	19.50%	Sales higher due to increased kWh sales across all revenue classes.
<b>Purchased Power</b>	243,983	293,833	20.40%	Cost of power higher due to increased kWh purchases.
<b>Other Operating Expenses</b>	74,905	81,566	8.20%	Expenses increased due to major storm restoration efforts and labor and labor related costs adjusted for market increases
<b>Interest Income</b>	592	1,171	49.40%	Income increased due to excess cash used for investing.
<b>Other Income</b>	1,094	-868	-226.12%	Other income decreased due to higher losses on the disposal of assets.

**Significant Change in Balance Sheet Accounts**

**From December 31, 2017 to 2018**

	(thousands)			
	2017	2018	%Change	Explanation
<b>CURRENT ASSETS</b>				
<b>Short-term investments</b>	78	31,726	40455.38%	Investment balance increased due to excess funds used for short-term investing.
<b>Other</b>	14,300	5,113	-64.24%	REC received notice, and recorded as a receivable, \$10.4 million and \$4.9 million ODEC Margin Stabilization allocation for 2017 and 2018, respectively.
<b>DEFERRED CREDITS</b>				
<b>Power Cost Adjustment</b>	10,564	10,685	1.15%	Over collection of wholesale power cost adjustment slightly increased in 2018. This adjustment fluctuates between over and under collection on a month to month basis.
<b>LONG TERM LIABILITIES</b>				
<b>Notes Payable</b>	420,849	443,717	5.43%	Long term debt increase due to a new loan draw in 2018.

## **Asset Retirement Obligations**

In accordance with GAAP and FERC Order 631 as adopted by the RUS, the Cooperative has determined that it has no material legal asset retirement obligations for the years ended December 31, 2018 and 2017. Regarding non-legal retirement obligations, the Cooperative follows the regulatory principle of inter-generational cost allocation by including net salvage (gross salvage less cost of removal) as a component of depreciation rates.

## **Revenues**

The majority of REC's revenue is from the sale of electricity. Total revenue for 2018 was \$446,656,135, with \$440,914,007 from the sale of electricity (approximately 99%). The additional 1% of revenue is related to other electric revenue such as late payment fees, rent on electric property, trip fees, connection fees, and returned check charges. Late payment fees account for approximately 18.4% of other electric revenue, which is an increase from 12.3% in 2017. Administrative and trip fees combined account for 19.1% of other revenues, which is a decrease from 25.1% in 2017. Rent on electric property accounted for 17.4% of other revenues in 2018, down minimally from 17.5% in 2017.

## **Coverage Ratios**

REC's loan contracts with Rural Utilities Service (RUS), which is a USDA Rural Development Utilities program, require the Cooperative to comply with specific affirmative covenants. One of those covenants requires the average TIER achieved by REC in the two best years out of the three most recent calendar years must not be less than 1.25. TIER is calculated as follows:

$$\text{(Interest on Long-term Debt + Net Margins) / Interest on Long-Term Debt}$$

Another ratio is Operating TIER (OTIER). It has the same achievement requirements as TIER except that the minimum is 1.1. OTIER is calculated as follows:

$$\text{(Interest on Long-term Debt + Operating Margins + Patronage Cash) / Interest on Long-Term Debt}$$

Another ratio is Debt Service Coverage (DSC). It has the same achievement requirements as TIER with the same minimum of 1.25. DSC is calculated as follows:

$$\text{(Interest on Long-term Debt + Net Margins + Depreciation Expense) / Interest on Long-Term Debt + Principal Paid}$$

## **Financial Banking & Lending**

REC maintains financial relationships with three lending institutions. REC receives its primary long term funding from RUS. This program helps rural cooperatives provide reliable, affordable electricity essential to the economic well-being and quality of life for the nation's rural residents. The USDA Electric Programs provide leadership and capital to upgrade, expand, maintain and replace America's vast rural electric infrastructure. Under the authority of the Rural Electrification Act of 1936, the USDA Electric Programs make direct loans and loan guarantees to electric utilities to serve customers in rural areas. The loans and loan guarantees finance the construction of electric distribution, transmission and generation facilities, including system improvements and replacement required to furnish and improve electric service in rural areas.

REC receives its secondary financing for long term and short-term debt through relationships with National Rural Utilities Cooperative Finance Corporation (CFC) and CoBank. These lending institutions specialize in financing for cooperatives, RUS borrowers and customers, which serve rural agricultural communities.

## **Private Rating**

Fitch Ratings, Inc. is one of the top three credit rating services used to guide investors. REC received a very positive initial rating from Fitch Ratings, Inc. on January 3, 2013. This initial rating was accepted and converted to a private rating. This keeps the rating out of the public domain, but allows it to be shared with a limited number of outside entities including lenders, ODEC and other significant organizations, which may have an interest in REC's credit. On an ongoing basis, REC will provide Fitch Ratings, Inc. with the annual report, audited financials, Form 7 and announcements of materially positive or negative events as they become available. Under a private rating, Fitch is to perform a surveillance review of this documentation every 2 years. REC last received a Fitch rating affirmation on January 18, 2018.

## **ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTAL DATA**

### *Report of Management on REC's Internal Control over Financial Reporting*

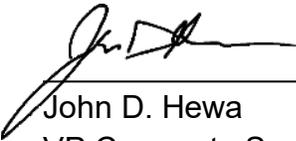
Management of REC has assessed its internal control over financial reporting as of December 31, 2018, based on criteria for effective internal control over financial reporting described in Generally Accepted Accounting Principles (GAAP). Based on this assessment, REC's management believes that as of December 31, 2018 its system of internal control over financial reporting was properly designed and operating effectively based upon the specified criteria.

Management of REC is responsible for establishing and maintaining adequate internal control over financial reporting. REC's internal control over financial reporting is comprised of policies, procedures and reports designed to provide reasonable assurance to REC's management and Board of Directors that the financial reporting and the preparation of the financial statements for external reporting purposes has been handled in accordance with accounting principles generally accepted in the United States. Internal control over financial reporting includes those policies and procedures that (1) govern records to accurately and fairly reflect the transactions and dispositions of assets of REC; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles and that receipts and expenditures of REC are being made only in accordance with authorizations of the management and directors of REC; and (3) provide reasonable safeguards against or timely detection of material unauthorized acquisition, use or disposition of REC's assets.

Internal controls over financial reporting may not prevent or detect all misstatements. Accordingly, even effective internal control can provide only reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP.

Date October 1, 2019

  
\_\_\_\_\_  
Kent D. Farmer  
President and CEO

  
\_\_\_\_\_  
John D. Hewa  
VP Corporate Services

**See Independent Auditors' Report, Consolidated Financial Statements and IRS Form 990.**

## **ITEM 9. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE**

### **Directors**

As of December 31, 2018, REC was governed by a board of nine Directors. The Board of Directors consists of one (1) member from each of the nine geographical regions. Pursuant to its Bylaws, each of the board members shall be bona fide residents of the particular region, which they represent. All Directors are elected for three-year terms by the Cooperative's membership regardless of the region that they represent. Their terms are staggered and are limited to five consecutive full terms. REC's Board of Directors sets policy and provides direction to its President and Chief Executive Officer (CEO). Pursuant

to the Bylaws, the Board of Directors annually holds, at minimum, six regular meetings.

The Board of Directors elects a Chairman and Vice Chairman at the first meeting of the Board held after the Annual Meeting. This meeting took place during the Board's regular monthly meeting held September 19, 2018. The Chairman, or the Vice Chairman in the Chairman's absence, presides over the meetings of the membership and the meetings of the Board of Directors. The Chairman appoints the members and chairman of each Board committee.

Current information concerning current directors is listed below.

**Michael W. Lindsay**

*Vice Chairman*

Region I - the counties of Frederick, Shenandoah & portions of Page, Warren & Rappahannock



Mike Lindsay has been a director since 2010, served as Treasurer from 2016-2018, and is currently Vice Chairman. He brings over 30 years of experience in the areas of finance and accounting; corporate governance, ethics, and audit to the REC Board. He Chairs the Finance Committee, serves on the HR Committee, and is Board Chairman for RE Communications, a subsidiary of REC.

Mike serves on the Virginia board of the Action Committee for Rural Electrification, a national political action committee focused on needs of electric cooperatives and their Members. Mike served over 20 years in senior Finance positions, including Controller, of a large division of a major international environmental and engineering firm. He is also a small business owner specializing in residential rentals.

His background includes work for the government and large professional service firms concentrating on major operations/maintenance, engineering, solar, geothermal and environmental remediation projects.

Mike's career carried him to Texas, Saudi Arabia, Okinawa, and California before he was able to return to his beloved native Virginia. His numerous professional awards include a Superior Accomplishment Commendation from the Army and Air Force Exchange Service (AAFES) for efforts on behalf of military members in Saudi Arabia and Kuwait during Operation Desert Storm.

Mike is a Credentialed Cooperative Director and a recipient of the Board Leadership Certificate. He holds a B.A degree from Emory and Henry College. Mike and his wife Becky

reside in Frederick County.

Mike serves as Treasurer of the Families Reaching Out Group, an organization focused on the needs of Foster Families. He served six years on the Board of the Winchester Youth Development Center (including two years as Board President) and in county government as a representative on the Public Safety Committee. He is a member of the Frederick County Farm Bureau and the NRA.

**Christopher G. Shipe**

*Chairman*

Region II - the counties of Clarke, Fauquier, Stafford & portions of Warren & Rappahannock



Christopher Shipe believes strongly in the cooperative business model for the delivery of essential services. For most of his professional career he has worked with mutual insurance companies, where he has been directly involved in the leadership and governance of cooperatives. His career milestones include becoming CEO of Loudoun Mutual Insurance Company and serving in various capacities on insurance cooperative boards and industry committees, including his time as the chairman of the National Association of Mutual Insurance Companies' Property Casualty Conference. Since joining the REC Board of Directors, he has continued his education by completing the course work to obtain the Credentialed Cooperative Director certification.

Shipe is involved in his community and his church. He is a volunteer with the John H. Enders Fire and Rescue Company in Berryville, Va., where he continues to run calls and serve on the Board of Directors. He also is a lay servant and chairman of the Administrative Council of the Duncan Memorial United Methodist Church.

**Darlene H. Carpenter**

Region III - the counties of Albemarle, Madison, Green, Rockingham and a portion of Page County



Darlene Carpenter was elected to the REC board in 1984. Carpenter serves on several Committees of the Virginia, Maryland Delaware Association of Electric Cooperatives and is REC's current director to the Board of Old Dominion Electric Cooperative. She is a past Region 1 director of the National Rural Utilities Corporate Finance Corporation. She has completed all director certification courses of the National Rural Electric Cooperative Association, which includes the basic, leadership and credential certificates.

Carpenter spent 37 years in banking, where she retired as vice president and area manager of the Wachovia Corp., and is a Realtor for Century 21 New Millennium in Culpeper. She is a member of Culpeper Business Women, Culpeper Toastmasters and serves on the board of the Culpeper Homeless Shelter. Carpenter was a past president of the Culpeper Chamber of Commerce.

Carpenter is a graduate of Germanna Community College, the Virginia Bankers School of Bank Management at the University of Virginia and the American Institute of Banking. She holds a certificate in nonprofit management from UVA. She is married to Edward D. Carpenter, and they have two daughters and three grandchildren. They reside on a small farm in the Reva area of Madison County and are members of Bethsaida United Methodist Church.

### **Sanford Reaves, Jr.**

Region IV - the counties of Culpeper and Orange



Sanford Reaves Jr. is a lifelong native of Culpeper and a 26-year member of REC. Reaves is a 1974 graduate of Culpeper County High School and a 1976 graduate of Smithdeal-Massey Business College of Richmond. In 2005, Reaves graduated from the Virginia Union University School of Theology (master of divinity). He is a member of the Antioch Baptist Church of Culpeper, and has been pastor of the Mt. Zion Baptist Church for 10 years.

Since 1995, Reaves has been the owner and president of Sanford and Sons Construction and Janitorial Services. He has also worked as operations manager for Federal Express for 7 1/2 years and general manager for Omni Services Inc., Sanis Division of Culpeper for 8 1/2 years

Reaves is also a local Realtor, has served on the Culpeper County Planning Commission for 25 years, and holds the position of chairman.

Reaves serves on the Board of Directors for the Prison Re-Entry, Chamber of Commerce and Salem Educational Foundation as well as Culpeper Jaycees and NAACP (past president) and Wayland Blue Ridge Union (past moderator).

Reaves lives in the Salem District of Culpeper with his wife of 40 years, Lorraine. They have three children and four grandchildren.

## **Randy Thomas**

*Treasurer*

Region V - Spotsylvania County



A resident of Spotsylvania County for 25 years, Randy Thomas has served his community for many years. His contributions include being a charter member and board member of the Stafford Rotary Club as well as serving on the Fredericksburg Area Builders Association board.

Additionally, Thomas served on the board of the Fredericksburg Country Club (past president) and its Finance Committee. Thomas volunteers as a member of REC's C.A.R.E. Charity, Inc. Board and is a member of the Lake Anna Civic Association.

Thomas graduated from Stafford High School and attended Radford University. He was a partner and vice president of Washington Chichester and Clarke Insurance in Fredericksburg, and has over 25 years of experience in finance, budgeting, planning and acquisitions. His career experience includes working as an insurance agent for REC from 1993-1999, providing liability, worker's compensation, auto and property lines. Thomas is vice president of Danaher-Skewes and Associates, employed since 2007.

Thomas participates in community activities such as manager and coach in the Cal Ripken and Babe Ruth Baseball Association, coach in the parks and recreation league youth football, and volunteers with the athletic programs at Fredericksburg Christian School. He resides in Spotsylvania County with his wife and two children.

## **Linda R. Gray**

Region VI - Caroline County



Linda Gray has served on the REC Board of Directors since 1998. She has completed the NRECA Credentialed Cooperative Director, Board Leadership, and Director Gold certifications. Linda currently represents REC on the Board of the Virginia, Maryland & Delaware Association of Electric Cooperatives, where she serves on the Educational Services, Finance, Human Resources committees, and the Education Scholarship Foundation. She serves on REC's Human Resources Committee and chairs the Annual Meeting Committee.

After 32 years of federal government service, Linda retired from the Federal Aviation Administration in Washington, D.C. She is a 1971 graduate of Virginia State College (now Virginia State University) with a bachelor of arts degree in sociology.

Gray was appointed as Caroline County's first and only mentoring coordinator for Rappahannock Big Brothers/Big Sisters and has been a Big Sister to two young girls in Fredericksburg and Bowling Green. Linda is the chapter vice president of the National Active and Retired Federal Employees Association, and a Board member of the Caroline County Foundation for Education, Recreation, & Wellness, a charitable organization that benefits Caroline residents.

Gray resides in the Sparta community of Caroline. She is a longstanding active member of St. James Baptist Church in Milford. For 30 years, she served as president of the Women's Ministry. She serves as chair of the Trustee Ministry and sings on several choirs.

**J. Mark Wood**

*Secretary*

Region VII - Louisa County



J. Mark Wood has resided in Louisa County for over 48 years and is Virginia Department of Transportation's (VDOT) area land-use engineer for Fluvanna, Louisa and Orange counties. After graduating high school, Wood worked full time in the surveying and engineering fields while attending college. He earned an associate of applied science degree in civil engineering technology from J. Sargeant Reynolds Community College and a bachelor of science degree in civil engineering technology from Old Dominion University.

Wood is licensed as a professional engineer and a land surveyor in the Commonwealth of Virginia. Wood oversees land development and permitting activities for VDOT and serves on the Fluvanna County Technical Review Committee, the Louisa County Development Review Committee and the Orange County Application Review Committee. Wood graduated from VDOT's leadership development program.

Wood worked for the Virginia Department of Game and Inland Fisheries for 23 years and received national recognition from the States Organization for Boating Access for his professionalism in boat access design.

He has worked extensively on environmental permitting for construction projects from the Department of Environmental Quality, Virginia Marine Resources Commission, Army Corps of Engineers and the U.S. Fish and Wildlife Service.

Wood is a lifetime member of the Louisa County Historical Society. He coached and managed Louisa Little League Baseball, and served as a VDOT Adopt-a-Highway Volunteer,

Louisa County Agriculture Fair Board of Directors, notary public, Sunday school teacher and superintendent, AWANA worker, church treasurer, deacon and chairman of the deacons.

Since elected to the REC Board, Wood has earnestly sought to be fully credentialed and informed of regulations and operations of electric cooperatives, earning the NRECA Credentialed Cooperative Director and the Board Leadership Certificate designations. Wood currently serves as the REC Board Secretary. Mark and his wife Becky live in the Cuckoo area of Louisa County.

### **William C. Frazier**

Region VIII - the counties of Hanover and Goochland



William Frazier has served on the REC Board of Directors since 1981. He also served on the Old Dominion Electric Cooperative Board of Directors and on its Power Supply Committee and Executive Committee. He has earned both the Credentialed Cooperative Director and Board Leadership Certificates.

Frazier served 16 years on the Hanover County Board of Supervisors and was chair of that board three times. He also served as chair of Hanover County Social Services, the Richmond Regional Economic Development Council, and both the Pamunkey and James River Regional Water Study committees. He served four years as moderator on the Board of Trustees of Humana Hospital.

Frazier is a member of St. Peter's United Methodist Church, where he has chaired nearly every committee in the church and has taught Sunday school. He has served as a certified lay speaker on the Ashland District of the United Methodist Church, speaking at Methodist, Baptist and Christian churches. He is the owner of Associates Insurance Agency in Ashland. Frazier has one daughter and lives in the Montpelier area of Hanover County.

### **Eugene L. Campbell Jr.**

Region IX - the counties of Essex, King and Queen, and King William



Eugene Campbell, Jr., a lifelong resident of King William County, joined REC's Board of Directors in January of 2018. Mr. Campbell serves on REC's Bylaws Committee and the Annual Meeting Committee.

Campbell volunteers with both service-driven and economic development organizations. He chairs the King William Economic Development Authority and is a part of the King William Internet Connectivity Initiative. Campbell was appointed to the County Electoral Board, where he serves as chairman.

As a Ruritan since 1979, Campbell has volunteered many hours in service and has held

leadership positions within the organization. His past affiliations include Businessmen Associations, Bon Secours Memorial

Regional Medical Center Community Advisory Board and the County Recreation Commission. Campbell is a volunteer writer and photographer for the local Country Courier newspaper and is a member of the King William Historical Society. He is a lifelong member of McKendree United Methodist Church.

Mr. Campbell holds a bachelor of science in civil engineering from Virginia Polytechnic Institute and State University and worked as a project engineer and manager throughout his career. Campbell retired in 2014.

### **Board Qualifications, Requirements and Structure**

REC's Board of Directors are the members' neighbors, and they are elected to work on their behalf. Directors are elected by the membership at their annual membership meeting.

In 2018, all directors were in attendance at the annual membership meeting.

Director qualifications are listed in REC's Bylaws, Article IV, Section 3 and are further defined in the Board Policy below:

- Possesses an understanding of basic financial matters and fiduciary responsibilities of a board member;
- Be recognized as a leader in their industry and community because of their strong record of accomplishment;
- Be experienced in serving on a board or reporting directly to a board;
- Be committed to learning about the Cooperative and its diverse membership and willing to devote 24 to 44 days per year in order to be a meaningful contributor on behalf of all members;
- Be willing and capable of articulating points of view that may challenge the thinking of the board and management;
- Place a high value on personal and corporate integrity and ethical behavior;
- Have an understanding of cooperatives;
- Be willing and able to successfully complete the National Rural Electric Cooperative Association Credentialed Cooperative Director program within five years of becoming a director;
- Be willing and able to participate in the Cooperative's New Director Orientation program;
- Be financially secure (not motivated by director compensation).

Directors are also appointed to serve on one or more board committees. Currently, the five standing board committees are the Executive Committee, Finance Committee, Human Resources Committee, Annual Meeting Committee and the Bylaws Committee. These committees are defined below:

**Executive Committee:** (1) is a Board committee; (2) may exercise all Board authority granted by the Board and permitted under these Bylaws; and (3) at the next Board meeting following an exercise of Board authority, must report to the Board regarding the Executive Committee's exercise of Board authority. Except as otherwise provided by the Board, the Executive Committee is comprised of the Chairman, Vice-Chairman, Secretary and Treasurer.

**Finance Committee:** shall consist of members of the Board of Directors. The Chairman of the Board and the Board Treasurer shall be voting members of the Finance Committee ex officio. The primary function of the Finance Committee shall be to make recommendations relative to the auditor, review audit reports, and to consider and recommend to the Board policies to insure proper accounting and finance controls.

**Human Resources Committee:** shall consist of members of the Board of Directors. The Chairman of the Board shall be a voting member of the committee ex officio. The primary function of the Human Resources Committee shall be to consider and make recommendations to the Board relative to Cooperative employees' policies, procedures, compensation and/or benefits.

**Annual Meeting Committee:** shall consist of members of the Board of Directors. The Chairman of the Board shall be a voting member of the committee ex officio. The primary function of the Annual Meeting Committee shall be to consider and make recommendations to the Board for the organization and planning of the Cooperative's annual membership meeting.

**Bylaws Committee:** shall consist of members of the Board of Directors. The Chairman of the Board shall be a voting member of the committee ex officio. The primary function of the Bylaws Committee shall be to consider and recommend Bylaw amendments to the Board and to periodically review the Bylaws and report its analysis and recommendations to the Board.

The Cooperative does not have a standing nominating committee.

Nominations for Directors shall be made by written petition executed by twenty-five (25) or more members who are in good standing with the Cooperative. The Secretary shall make nomination petitions available at all REC offices. Said written nomination petitions must be delivered to the office of the President not less than one hundred (100) days prior

to the next annual meeting. The Secretary shall mail with the Notice of Meeting a statement of the number of Directors to be elected and all the nominations made for said Directorships. All nominees shall be listed in the member publication in the issue prior to the annual members' meeting. No additional nominations shall be made from the floor at the meeting of members. Advance notification to the membership of the nominations procedure shall be published in the member publication, prior to the annual meeting.

## **Executive Officers**

The executive officers of the cooperative are also elected each year at a meeting of the Board after the annual meeting. These include the President and CEO, three Vice Presidents, Secretary, Assistant Secretary, Treasurer, Assistant Treasurer and such other officers as may be determined from time to time.

REC's executive officers, their positions and recent business experience are listed below

### **Kent D. Farmer**

President and Chief Executive Officer



Kent D. Farmer became president and chief executive officer of REC on Feb. 1, 2004. He is also president of Rappahannock Electric Communications, Inc., REC's wholly owned subsidiary. Mr. Farmer holds bachelor's degrees in business management from Radford University, and accounting and finance from the University of Mary Washington. Joining REC in 1979, Farmer held progressive management positions throughout his career including vice president and COO. Farmer was recently elected chairman of the Old Dominion Electric Cooperative Board of Directors and is vice chairman of Regional Headquarters, Inc. He is also on the board of directors of the Virginia, Maryland & Delaware Association of Electric Cooperatives.

Since 2014, Mr. Farmer has served as District 1 director of the National Rural Utilities Cooperative Finance Corporation (CFC) and he is the chairman of CFC. A native of Caroline County, Farmer serves the Greater Fredericksburg region by volunteering and serving on the board of several organizations. He and his wife live in Caroline County.

## **Ronald W. Harris**

Vice President of Engineering and Operations



Ronald W. Harris became vice president of engineering and operations on July 1, 2015. Harris had been serving as manager of engineering and power supply at REC. In that role, he provided leadership and managerial oversight for system planning, engineering and technical services. With other senior managers, he shared the responsibility of defining the Cooperative's goals and objectives to ensure the successful implementation of the Cooperative's strategic plan. Harris also oversaw the development of the Cooperative's long-range construction work plan.

Since beginning his career as a planning engineer in 1987, Harris has continued his professional development through education and industry training. He holds a bachelor's of science degree from Virginia Tech, an MBA from Strayer University, and in 2011, he completed his professional engineer license in Virginia. Most recently, Harris completed the Robert I. Kabat Management Internship Program through the National Rural Electric Cooperative Association. Harris is an active member in the Duncan Memorial Methodist Church and the local YMCA in Ashland, Va. He and his wife, Cheryl, live in Hanover County.

## **John D. Hewa**

Vice President of Corporate Services



John D. Hewa joined REC in July 2017, and is responsible for several functional areas including Finance and Accounting, Human Resources, Safety and Security, and Information and Technology Services. Hewa has more than 20 years of leadership experience in the electric utility industry and a broad knowledge of the cooperative business model. He has served as CEO of electric cooperatives in Texas and Florida, and as vice president of research, engineering, and technical services at the National Rural Electric Cooperative Association (NRECA) in Arlington, Va. At NRECA, Hewa worked to advance the adoption of beneficial technologies among the nation's electric cooperatives and worked to address technical regulatory matters at the federal level. Prior to his cooperative career, Hewa managed the utilities department for the City of Manassas, Va.

Hewa holds a bachelor of science in electrical engineering and a master of science in Engineering management from the University of Tennessee. He is a registered professional engineer.

Hewa serves as treasurer for the Board of Directors of the Smart Electric Power Alliance

(SEPA), an educational non-profit headquartered in Washington, DC, working to advance the integration of clean energy solutions and smart technologies into the grid. Hewa also serves on the Board of Directors of the Energy Storage Association (ESA), a non-profit organization in Washington, working with utilities, industry, and stakeholders to promote the adoption of beneficial energy storage technologies.

**David F. Koogler**

Vice President of Member Services & External Affairs



David F. Koogler is the vice president of member services and external affairs for REC, where he is responsible for the oversight of all member support activities, including the contact center, billing and collections, key accounts, demand response, energy efficiency and renewable energy programs, regulatory and government affairs, and communications and public relations. Koogler joined

REC in March 2011, and has more than 38 years of experience in Virginia’s electric utility business. He graduated Magna Cum Laude with a bachelor of science in physics/engineering from Washington and Lee University, in Lexington, Va. and obtained a master of business administration from Virginia Commonwealth University, in Richmond, Va.

Koogler serves as chairman for the Board of Directors of the Virginia Energy Efficiency Council. He also serves on the Board of Directors of GridWise Alliance and the Central Virginia Partnership for Economic Development. David and his wife, Margie, reside in Hanover County.

**Member Communication with the Board of Directors and Executive Leadership**

Members of the Cooperative can contact their Board of Directors and executive leadership team in person at the annual meeting, by phone at 1-800-552-3904, by using the “Communicating with the Board” option on myrec.coop or by mail at:

Rappahannock Electric Cooperative Leadership

PO Box 7388

Fredericksburg, VA 22404-7388

**ITEM 10. COMPENSATION**

**General Philosophy**

REC’s compensation philosophy has four objectives:

- Attract and retain a qualified, diverse workforce through a competitive compensation program.
- Provide equitable and fair compensation.
- Support its business strategy.
- Ensure compliance with applicable laws and regulations.

### **Total Compensation Package**

REC compensates its President and Chief Executive Officer (CEO) and other senior management through the use of a total compensation package, which includes base salary, competitive benefits and the potential for an incentive. The CEO's base salary is derived from salary data provided by third parties for positions of similar responsibilities. The compensation of the CEO is reviewed by the Executive Committee of the Board of Directors and this committee provides a recommendation to the entire Board of Directors. The entire Board of Directors approves the CEO's compensation.

### **Targeted Overall Compensation**

REC's compensation program utilizes detailed job descriptions for all of its employees, including senior management with the exception of the CEO, as an instrument to establish benchmarked positions. The market compensation information for each position is derived from salary data provided by third parties through national compensation surveys and includes salary data for positions within the determined competitive labor market. Job descriptions are reviewed annually and include essential and non-essential responsibilities, required knowledge, skills and abilities, and formal education and experience necessary to accomplish the requirements of the position, which in turn helps the Cooperative achieve its operational goals. Using this information, the human resources department, along with a third party compensation consultant, determines a market-based salary for each position based upon salary survey data provided by third parties. The market-based salary data compiled is reviewed annually for reasonableness and fairness. REC's Board of Directors has defined market-based salary as the 75<sup>th</sup> percentile of the market, excluding new hires that may be hired at the lower range of the market grade until a learning period is complete.

### **Process**

REC's Board of Directors Executive Committee recommends all compensation and awards for the CEO to the entire Board of Directors for approval. The Board of Directors has delegated to the CEO the authority to establish and adjust compensation for all employees other than himself. The compensation for all other employees, other than members of senior management, is approved by the CEO based upon market-based

salary data. This is reviewed annually by the Board of Directors. On an annual basis, the Board of Directors reviews the performance and compensation of the CEO and the CEO reviews the performance and compensation of the remaining senior management.

### **Base Salaries**

As a not-for-profit electric cooperative, REC does not issue stock and therefore does not have any equity-based compensation programs. For this reason, substantially all compensation to its executive officers is provided in the form of base salary commensurate with the duties and responsibilities of each position. These salaries are determined based on market data and internal structure for positions with similar responsibilities.

### **Bonuses**

REC's practice has been to, on infrequent occasions, award cash bonuses related to a specific event, such as the consummation of a significant transaction. At the discretion of its Board of Directors, the CEO may be awarded an annual bonus; and at the discretion of the CEO, other members of the senior management and staff/employees may be awarded an annual bonus.

### **Incentive Compensation Plan**

REC also has an Incentive Compensation Plan (Results-Based Variable Pay). The award takes the form of a cash (lump-sum) payment, and is based on REC's success in achieving Key Performance Indicators (KPIs) – Safe & Secure Operations, Customer Service and Financial Performance. Payout takes place in April based on the KPI results as of December of the previous year. The percentage payout for 2018 was 4.84%.

This incentive is paid only if the Board approves the annual financial audit and the Cooperative is in a financial position to do so. Modified TIER *after* the payout must be greater than 1.5 and total payout cannot exceed Patronage Capital paid to members. The maximum potential payout, achieved by meeting the stretch-level KPI goals, is 10% of an employee's base pay, plus overtime.

### **Severance Benefits**

The Employment Agreement defines contractual severance benefits for the President and CEO based on the reason of termination. No other members of senior management have any contractual severance benefits.

## **PLANS**

### **Defined Benefit Plan**

REC has elected to participate in the NRECA Retirement Security Program (the “RS Plan”), a noncontributory, defined benefit, multiple-employer, master pension plan maintained and administered by the NRECA for the benefit of its member systems and their employees. The RS Plan is a qualified pension plan under Section 401(a) of the Internal Revenue Code of 1986. Benefits which accrue under the RS Plan are based upon the base annual salary as of November of the previous year. As a result of changes in Internal Revenue Service regulations, the maximum base annual salary for determining these benefits increased to \$275,000 in 2018. REC also participates in a pension restoration plan, which is intended to provide supplemental benefit for employees who would have a reduction in their pension benefit from the RS Plan due to limitations within the IRS code.

### **Deferred Benefit Plan**

REC offers an NRECA sponsored 401(k) plan, which is available to all eligible employees. Under the 401(k) plan for 2018, employees may elect to have up to 100% or \$18,500, whichever is less, of their salary withheld on a pre-tax basis, subject to Internal Revenue Service limitations, and invested on their behalf. REC matches the first 1% at 100% and the next 2% at 50% each. Also, a catch-up contribution is available for participants in the plan once they attain age 50. The maximum catch-up contribution for 2018 was \$6,000.

In addition, REC has a non-qualified executive deferred compensation plan. The Board of Directors, at its discretion, determines who may participate in the plan as well as an annual contribution, if any, up to the maximum amount allowed by regulations. Currently the Board of Directors has determined that this plan is only available to the CEO and the Vice Presidents.

### **Pension Prepayment Plan**

On April 29, 2013, REC paid \$18,843,890 to participate in the NRECA pension prepayment plan, amortizing the prepayment over a 16-year period. This reduced REC’s monthly pension expense from 27.54% to 20.69% of salaries, effective January 1, 2013 retroactively.

### **Pension Restoration Plan**

REC participates in a pension restoration plan, which is intended to provide a supplemental benefit for employees who would have a reduction in their pension benefit

because of the Internal Revenue Code limitations. The CEO is the only participant in this plan. This type of plan is no longer available for new participants.

### **Executive Benefit Restoration Plan**

REC participates in a new type of pension restoration plan called the executive benefit restoration plan (ERB), which is also intended to provide supplemental benefit to those employees who would experience a reduction in their pension benefits due to limitations within the Internal Revenue Code. In 2018, this plan had only one eligible participant.

### **Other Benefits**

REC offers other benefits that are available to all employees of the Cooperative. These benefits include medical, dental and vision insurance, health savings accounts, life insurance, flexible spending plans for medical and dependent care, reimbursement for health club membership, supplemental life insurance, supplemental accidental death and dismemberment, tuition reimbursement, educational bonuses, vacation, holiday, and sick leave.

### **Change in Control**

If a change of control occurs, the Employment Agreement defines provisions for employment for the President and CEO until the expiration of the Agreement term and sets forth in detail the facts and circumstances for termination payments. No other members of senior management have any contractual terms for Change in Control.

### **Employment Agreement**

In January 2011, REC entered into an employment agreement with Kent D. Farmer to serve as Rappahannock's President and CEO. The original agreement was amended to continue through August 15, 2017 and included an annual automatic renewal unless Mr. Farmer or the Cooperative gives written notice three months prior to the expiration of the agreement.

The agreement provides that the President and CEO receive a minimum annual base salary subject to annual adjustment by the Board. Mr. Farmer is entitled to participate in all benefit plans available to all other employees.

Under the agreement, if Mr. Farmer voluntarily terminates his employment following material breach by the Cooperative or the Cooperative terminates him without specific cause, the Cooperative will pay Mr. Farmer a salary at the rate in effect on the date of termination for one year, plus medical insurance benefits. The amendment also included an additional termination benefit to include the value of the benefit payable under the

Pension Restoration Plan. Both parties may exercise the election not to renew the contract at the expiration of term without termination payments due.

Under the employment contract with Mr. Farmer, “cause” is defined as (i) a willful and deliberate material violation of the Executive’s obligations by the Executive; (ii) deliberate dishonesty of the Executive with respect to the Cooperative’s assets, business, prospects or reputation; (iii) commission of a felony or a misdemeanor involving fraud, breach of trust, or misappropriation.

### **Board of Directors Compensation**

The Board exercises a similar general compensation philosophy when establishing Board compensation. It seeks to attract qualified, diverse business professionals who have the knowledge to support the Cooperative’s business strategy. Compensation is derived from data of similar entities provided by a third party. Using this information, the Board determines fair and equitable compensation for directors. The Cooperative expects directors to enroll in educational courses that provide knowledge of the Cooperative business model and current business practices.

REC directors are compensated by a monthly retainer of \$2,000 and are also paid a per diem of \$500 for each day spent on Cooperative business such as regular and special board meetings, off-site meetings and conferences, training, etc. Directors receive an additional \$250 for attending in-person a committee meeting that occurs on a day other than the monthly meeting. REC reimburses all directors for out-of-pocket expenses incurred while attending these meetings.

### **ITEM 11. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS**

Not applicable.

### **ITEM 12. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE**

Because REC is a cooperative, all of its directors are members and represent all of its member-owners, which are their customers.

Rappahannock Electric Cooperative’s Board of Directors are independent of the organization. Any member seeking to serve on the Board must certify and agree to comply with Board Policy on Conflicts of Interest, agree that the Cooperative may request a criminal background and credit report and affirm they have not been convicted of a felony or a crime of moral turpitude. Annually, incumbent directors and officers of the

organization must restate, sign and certify compliance as part of the annual audit process. Directors must disclose, fully and promptly, any current or future situation that might involve, or appear to involve, him or her in any conflict of interest with the Cooperative.

Under filing guidelines of Internal Revenue Service Form 990, directors must disclose any conflicting business relationships, direct or indirectly, while doing business with REC, and disclose any relationships with other officers, directors, trustees or key employees. REC's employment policy excludes from consideration for employment a relative of a current employee or current member of the board of directors. A relative is defined as a spouse; a parent (also mother- or father-in-law); a child (also daughter- or son-in-law); sibling (also half sister or brother, sister or brother-in-law); a grandparent; or a grandchild.

### **ITEM 13: IRS FORM 990**

The IRS Form 990 is REC's tax return and all tax-exempt organizations are required to file using the Form 990. The Form 990 includes, among other things, a summary of the organization (mission, number of employees, etc.), its revenue, its expenses and its assets; a statement of the Cooperative's accomplishments; and information about the Cooperative's management team and governing body.

To access the Form 990 please visit the Cooperative's website at:

<https://www.myrec.coop/aboutus/Document-Center.cfm>