SULLIVAN, MOUNTJOY, STAINBACK & MILLER PSC
ATTORNEYS AT LAW

August 11, 2011

RECEIVED
AUG 11 2011
PUBLIC SERVICE
COMMISSION

Jeff DeRouen
Executive Director
Public Service Commission
211 Sower Boulevard, P.O. Box 615
Frankfort, Kentucky 40602-0615

Re: In the Matter of: Notice and Application of Big Rivers Electric Corporation for a General Adjustment in Rates, PSC Case No. 2011-00036

Dear Mr. DeRouen:

Enclosed for filing on behalf of Big Rivers Electric Corporation ("Big Rivers") are an original and ten copies of the Post-Hearing Brief and Appendices for Big Rivers. I certify that copies of this letter and attachments have been served on each party of record.

Sincerely yours,

James M. Miller

James M. Miller

JMM/ej
Enclosures

cc: Mark A. Bailey
Albert Yockey
Douglas Beresford, Esq.
Service List

Telephone (270) 926-4000
Telecopier (270) 683-6694

100 St. Ann Building
PO Box 727
Owensboro, Kentucky
42302-0727

SERVICE LIST
BIG RIVERS ELECTRIC CORPORATION
PSC CASE NO. 2011-00036

Dennis G. Howard, II, Esq.
Lawrence W. Cook, Esq.
Assistant Attorneys General
1024 Capital Center Drive
Suite 200
Frankfort, KY 40601-8204

Michael L. Kurtz, Esq.
Boehm, Kurtz & Lowry
36 East Seventh Street
Suite 1510
Cincinnati, OH 45202
COUNSEL FOR KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC.

David C. Brown, Esq.
Stites & Harbison
1800 Providian Center
400 West Market Street
Louisville, KY 40202
COUNSEL FOR ALCAN PRIMARY PRODUCTS CORPORATION

J. Christopher Hopgood, Esq.
Dorsey, King, Gray, Norment & Hopgood
318 Second Street
Henderson, KY 42420
COUNSEL FOR KENERGY CORP.

Melissa D. Yates
Denton & Keuler, LLP
555 Jefferson Street
P.O. Box 929
Paducah, KY 42002-0929
COUNSEL FOR JACKSON PURCHASE ENERGY CORPORATION

Sanford Novick
President and CEO
Kenergy Corp.
3111 Fairview Drive
P.O. Box 1389
Owensboro, Kentucky 42302-1389

G. Kelly Nuckols
President and CEO
Jackson Purchase Energy Corporation
2900 Irvin Cobb Drive
P.O. Box 4030
Paducah, KY 42002-4030

Burns E. Mercer
President/CEO
Meade County R.E.C.C.
1351 Highway 79
P.O. Box 489
Brandenburg, KY 40108-0489

Commonwealth of Kentucky
Before the Public Service Commission of Kentucky

In the Matter of:

Application of Big Rivers Electric Corporation	)	Case No.
for a General Adjustment in Rates	)	2011-00036

Post-Hearing Brief of Big Rivers Electric Corporation

August 11, 2011

Table of Contents

Commonwealth of Kentucky

Before the Public Service Commission

In the Matter of:

Application of Big Rivers Electric Corporation for a General Adjustment in Rates	))	Case No. 2011-00036

Post-Hearing Brief of Big Rivers Electric Corporation

Comes Big Rivers Electric Corporation ("Big Rivers") and for its post-hearing brief, states as follows:

I. Summary

Big Rivers filed this case because declining wholesale power market prices and Big Rivers' current rates produce insufficient revenue for Big Rivers to meet its prospective financial obligations. Big Rivers continues to be mindful of the long-term financial health of the two large aluminum smelters on the Big Rivers system (the "Smelters"), and has a vested interest in their viability. But Big Rivers and its members are incapable of assuring the global competitiveness of the two Smelters, and should not be required to surrender to the Smelters the value of the "rate subsidies" that Big Rivers negotiated from the Smelters—and that the Kentucky Public Service Commission ("Commission") approved—in the Unwind Transaction[1] a mere two years ago.

[1] The "Unwind Transaction" unwound and terminated a series of agreements consummating Big Rivers' 1998 plan of reorganization, where subsidiaries or affiliates of what was then LG&E Energy Corp. assumed operational control of Big Rivers' owned or leased generating facilities. Application ¶ 6. The Unwind Transaction was approved by the Commission by Order dated

With commodity aluminum prices at historic highs and the Smelters' representative admitting that the Smelters are not "pleading poverty today,"[2] and since forward aluminum prices are projected to remain at current high levels for at least 27 months[3] the Smelters have the opportunity to pursue the long-term, statewide solution that the Smelters say is the only viable option for their future survival.

The Commission functions as a guardian—not only to protect consumers but to ensure the financial integrity of public utilities with rates that are fair, just and reasonable on a prospective basis. Big Rivers has been careful to seek only what it needs and no more. This rate request is fair, just and reasonable and should be approved by the Commission.

In connection with its acceptance of the conditions listed in the Unwind Order, Big Rivers committed that:

> [W]ithin 3 years of closing the Unwind Transaction, Big Rivers will file with the Commission for a general review of its financial operations and its tariffs. Big Rivers also commits to include with that filing a new depreciation study and an analysis of Big Rivers' financial condition and rates assuming the study's results are implemented.[4]

With this case Big Rivers has fulfilled these commitments, and the other applicable conditions and commitments in the Unwind Order.

March 6, 2009 (the "Unwind Order"), in *In the Matter of: The Applications of Big Rivers Electric Corporation for: (1) Approval of Wholesale Tariff Additions for Big Rivers Electric Corporation, (2) Approval of Transactions, (3) Approval to Issue Evidences of Indebtedness, and (4) Approval of Amendments to Contracts, and of E.ON US LLC, Western Kentucky Energy Corp., and LG&E Energy Marketing, Inc. for Approval of Transactions*, PSC Case No. 2007-00455. A copy of the Unwind Order is attached hereto as Appendix A..

[2] Testimony of Henry W. Fayne, July 28, 2011, Tr. 14:06'00.

[3] *See* Big Rivers Hearing Exhibit 3.

[4] *See* Unwind Order, Appendix A ¶ 12.

II. Introduction

Big Rivers is seeking an adjustment in rates (and related approvals) so that it will have the revenues necessary to prudently maintain its generating units while meeting the financial covenants in its loan agreements.[5] In Case No. 2007-00455 (the "Unwind Case"), Big Rivers filed financial models projecting that Big Rivers would not require a base rate increase until 2017.[6] However, even before the Commission issued the Unwind Order, it was becoming apparent that the economic downturn was severely impacting Big Rivers' projected off-system sales revenues, upon which Big Rivers is heavily dependent because its margins are derived exclusively from those off-system sales.[7]

To counteract the depressed off-system sales revenues since the closing of the Unwind Transaction, Big Rivers has deferred expenses as much as possible to meet the financial obligations contained in its loan agreements.[8] Much of Big

---

[5] Direct Testimony of Mark A. Bailey, Application Exhibit 48 ("Bailey Direct Testimony") at p. 4.
[6] Direct Testimony of C. William Blackburn, Application Exhibit 49 ("Blackburn Direct Testimony") at p. 23 (stating that, during the Unwind Proceeding, Big Rivers did not contemplate the need for a general rate case within the 2011-2012 time frame); Rebuttal Testimony of William Steven Seelye, Exhibit 67 ("Seelye Rebuttal Testimony") at p. 33 (noting that the "October Unwind Financial Model" assumed a rate increase in 2017).
[7] Blackburn Direct Testimony at p. 23 ("after the Unwind Proceeding hearing in December 2008, the current recession continued to weaken the economy and severely impacted the wholesale market for power"); Rebuttal Testimony of Mark A. Hite, Exhibit 66 ("Hite Rebuttal Testimony") at p. 6 (the primary cause of the difference between the revenue deficiency in this proceeding and the October 2008 Unwind Financial Model "is that the off-system sales price has been and continues to be significantly below what was forecast in the Unwind Model"); Rebuttal Testimony of Robert W. Berry, Exhibit 64 ("Berry Rebuttal Testimony") at p. 4 ("Big Rivers' margins are derived exclusively from its off-system sales").
[8] Bailey Direct Testimony at p. 4; *id.* at p. 16 ("Since the closing of the Unwind Transaction, Big Rivers has very closely managed its operations in order to purge unnecessary costs from the business.... Big Rivers has exhausted its options for further reducing or limiting costs while still maintaining its ability to reliably operate its generating facilities and now must seek an increase to its base rates"); Blackburn Direct Testimony at p. 34 ("However, Big Rivers has

Rivers' cost savings came from the deferral of maintenance on the Big Rivers generating units.[9] During the test year (November 1, 2009, through October 31, 2010), Big Rivers deferred $1,511,091 of planned non-outage maintenance expenses, $3,866,966 of planned outage maintenance, and $12,481,744 of planned capital projects, all totaling $17,859,801.[10] Between the end of the test year and June 30, 2011, Big Rivers deferred $149,000 in planned non-outage maintenance, $13,186,571 in planned outage maintenance, and $23,898,777 in planned capital expenses, all totaling $37,234,348.[11] Big Rivers has also reluctantly extended the current outage frequency on its units to range from 28 to 53 months compared to the industry standard for outage frequency of 18 to 24 months.[12] Continuing a minimal level of maintenance expenditures and an extended outage frequency is simply not prudent in terms of operating practice and its potential adverse impact on Big Rivers' credit ratings.[13]

Moreover, Big Rivers cannot afford to continue to defer maintenance. Big Rivers witness Robert W. Berry has over thirty years of experience with the Big Rivers generating units.[14] He served as Plant Manager at both the Coleman and Sebree stations and has served as Big Rivers' Vice President of Production since

---

deferred costs as much as possible and now must increase rates to allow it to perform necessary maintenance and meet its debt covenants").

[9] *See* Bailey Direct Testimony at p. 4, 16; Direct Testimony of Robert W. Berry, Application Exhibit 52 ("Berry Direct Testimony") at p. 11 ("In 2010 and 2011, Big Rivers was forced to defer certain maintenance expenses in order to achieve the MFIR needed to meet its loan covenants").

[10] Big Rivers' August 4, 2011, response to Item 3 of the information requested at the hearing in this matter (the "Hearing Information Requests").

[11] *Id.*

[12] Berry Rebuttal Testimony at p. 3-5.

[13] *Id.* at p. 4; Rebuttal Testimony of Alan Spen, Exhibit 62 ("Spen Rebuttal Testimony") at p. 6.

[14] Berry Rebuttal Testimony at 4.

2009.[15] According to Mr. Berry, "[i]f Big Rivers continues to defer scheduled outages, the condition of the generating units will deteriorate, Big Rivers will experience increased forced outages, and repair costs will increase since they will be performed more on an emergency basis than on a planned basis."[16] Additionally, since forced outages cannot be planned to take advantage of market conditions, Big Rivers' purchased power costs will almost certainly increase and its ability to generate off-system sales will almost certainly decrease.[17] That would be devastating to Big Rivers since its margins are derived exclusively from its off-system sales.[18]

Big Rivers has deferred maintenance on its generating plants at an accelerated level because of the importance to Big Rivers of achieving the financial metrics required by Big Rivers' loan agreements. Compliance with the terms of its loan agreements is important to Big Rivers, and is obviously important to Big Rivers' creditors. Big Rivers' witnesses explain in great detail in their testimonies the obligations of Big Rivers under its loan agreements, and the periodic financial tests Big Rivers is required to meet. For example, as those witnesses testify and as is discussed in this brief, Big Rivers' ability to make a required refinancing in 2012 and avoid a default under its principal note to the Rural Utilities Service ("RUS") is dependent upon Big Rivers achieving a 1.10 Margins for Interest Ratio ("MFIR"). It is only for these serious reasons that Big

[15] *Id.*.
[16] *Id.*
[17] *Id.*
[18] *Id.*; *see also* Blackburn Direct Testimony at p. 34 ("Proper and timely maintenance of Big Rivers' generating plants is important not only to assure that electricity is available to serve Big Rivers' members, but also for the off-system market sales that furnish Big Rivers' margins").

Rivers would defer maintenance at the level that has occurred over the last 18 months.

Big Rivers filed this rate case seeking only enough revenue to perform a prudent and necessary level of maintenance on its generating units, while still meeting the financial covenants in its loan agreements.[19] If Big Rivers does not get essentially the full amount of the increase it is seeking, it will be forced to continue to defer maintenance in anticipation that such action will be required to meet its minimum loan covenants, which will have an adverse impact on reliability and increase costs to Big Rivers in the long run.[20]

By contrast to Big Rivers' requested rate increase, the rate proposal offered by Kentucky Industrial Utility Customers, Inc. ("KIUC") is fundamentally inadequate to meet Big Rivers' need to perform the necessary maintenance on its generating units while meeting its financial covenants.[21] KIUC's support of Big Rivers' maintenance expense level[22] is an empty gesture when KIUC's other adjustments will force Big Rivers to continue to defer maintenance expenditures. The insufficiency of the KIUC proposal jeopardizes Big Rivers' investment grade credit ratings at a time when Big Rivers needs to refinance a significant amount of debt or face a default on its loan obligations.[23] KIUC's proposal also eliminates the financial flexibility that Big Rivers needs and that is provided by the Times Interest Earned Ratio ("TIER") Adjustment mechanism

[19] Berry Direct Testimony at p. 4, 12.
[20] Bailey Direct Testimony at p. 15, 21.
[21] Hite Rebuttal Testimony at p. 4-5; Rebuttal Testimony of C. William Blackburn, Exhibit 61 ("Blackburn Rebuttal Testimony") at p. 4; Berry Rebuttal Testimony at p. 3.
[22] Direct Testimony of Lane Kollen at p. 16.
[23] Spen Rebuttal Testimony at p. 5; Blackburn Direct Testimony at p. 10.

that the Smelters pay as part of their agreements that were entered into in the Unwind Transaction.[24]

Additionally, Big Rivers proposes to allocate its proposed revenue increase in a manner that takes a substantial step towards eliminating the current rate of return differential between the Rural and Large Industrial rate classes, but that does so in accordance with the principle of gradualism that has long been employed by the Commission.[25] As a result, Big Rivers' proposal increases base rates to the Rurals by 10.71 percent, to the Large Industrials by 5.94 percent, and to the Smelters by 5.47 percent,[26] with the Rurals obviously experiencing the largest percentage increase.

By contrast, the KIUC rate proposal is unfair to Big Rivers' Rural ratepayers, because it seeks to impose the entire burden of that portion of the rate increase that KIUC concedes is necessary on the Rural class, while actually *decreasing* rates to the Smelters and the Large Industrials.[27] This would economically nullify the bargained-for "subsidies" received by Big Rivers' members' Rural and Large Industrial customer classes from the Smelters in return for the concessions made by Big Rivers and its members to the Smelters in the Smelter agreements. Big Rivers' proposed revenue increase and revenue allocation are fair, just, and reasonable; KIUC's are not.

---

[24] Seelye Rebuttal Testimony at p. 33.
[25] Direct Testimony of William Steven Seelye, Application Exhibit 57 ("Seelye Direct Testimony") at p. 19.
[26] Seelye Rebuttal Testimony at p. 31.
[27] Direct Testimony of Stephen J. Baron, Exhibit SJB-6 (as revised June 30, 2011).

III. Summary of Big Rivers' Requests for Relief

Big Rivers requests the following:

1. Approval of the tariff revisions and associated rate adjustments described in Exhibits 7 and 8 of Big Rivers' Application, as amended by Big Rivers' response to Item 1a the Commission Staff's Second Request for Information,[28] and by the tariff sheets filed with Big Rivers' response to Item 1 of the Commission Staff's Fourth Information Request;[29]
2. Authorization to amortize its current Non-FAC Purchased Power regulatory liability through the application of a proposed Non-Smelter Non-FAC PPA adjustment clause;[30]
3. Authorization to reduce the Purchased Power Base used to calculate its Non-FAC Purchased Power Adjustment from $0.00175 per kWh to $0.000874 per kWh;[31]
4. Authorization to implement the Midwest Independent Transmission System Operator's ("Midwest ISO") Attachment O transmission formula rate as set forth in the Midwest ISO's Open Access Transmission, Energy and Operating Reserve Markets Tariff, and to update the inputs used in that transmission formula rate on an annual basis;[32]

---

[28] Big Rivers' April 15, 2011, response to Item 1a of the Commission Staff's Second Request for Information (PSC 2-1a).
[29] Application at p. 8; Big Rivers' April 15, 2011, response to Item 1a of the Commission Staff's Second Request for Information (PSC 2-1a); Big Rivers' July 1, 2011, response to Item 1 of the Commission Staff's Fourth Request for Information (PSC 4-1), which incorporates the roll-in of Fuel Adjustment Clause charges approved by the Commission by Order dated May 31, 2011, in *In the Matter of: An Examination of the Application of the Fuel Adjustment Clause of Big Rivers Electric Corporation from July 17, 2009 through October 31, 2010*, PSC Case No. 2010-00495.
[30] Application at p. 8.
[31] Seelye Direct Testimony at p. 26-27.
[32] Application at p. 8.

5. Approval of Big Rivers' 2010 depreciation study and authority to implement the depreciation rates contained in that study on the first day of the month, either coincident with or following the effective date of the new tariff rates in this case as ordered by this Commission;[33]

6. Approval of Big Rivers' proposal to change from calculating the demand charge for Rurals from Non-Coincident Peak to Coincident Peak;[34]

7. Denial of the KIUC request for the Commission to order Big Rivers to retire patronage capital;[35]

8. Denial of the KIUC request to reduce Transmission of Electricity by Others expense;[36]

9. Denial of the KIUC request to change Big Rivers' LICX tariff;[37]

10. Denial of the KIUC request to change Big River's Rural Economic Reserve tariff;[38] and

11. Approval of Big Rivers' one outstanding motion and three outstanding petitions for confidential treatment.[39]

Additionally, it should be noted that Big Rivers' Application in this matter describes Big Rivers' compliance with certain requirements found in the Unwind Order.[40] As explained in detail in Mr. Blackburn's direct testimony, Big

---

[33] Hite Direct Testimony at p. 21.
[34] *See infra* Section XII.
[35] *See infra* Section XV.
[36] *See infra* Section XVII.
[37] *See infra* Section XVI.
[38] *See infra* Section IX.
[39] *See infra* Section XVIII.
[40] Blackburn Direct Testimony at p. 12.

Rivers has satisfied all of those requirements that apply at this point in time.[41] Certain other requirements require Big Rivers to advise the Commission on a timely basis of any material changes to specific criteria or other items, which to date have not occurred.[42] Big Rivers remains committed to adhering to these open commitments on a prospective basis.[43]

IV. The Adjustment in Rates Proposed by Big Rivers is Fair, Just, and Reasonable.

Big Rivers proposes an increase in its rates and tariffs that will offset a base rate revenue deficiency of $39,324,089.[44] Big Rivers needs the full amount of the increase it is seeking in order to prudently maintain its generating units while meeting its minimum loan covenants.[45]

The financial covenants in Big Rivers' loan agreements[46] require Big Rivers to achieve a minimum 1.10 MFIR and to maintain two investment grade credit ratings.[47] More specifically, Big Rivers' Indenture requires Big Rivers to establish and collect rates that are reasonably expected to yield an MFIR for each fiscal

---

[41] *Id.* at p. 12–21.
[42] *Id.* at p. 12.
[43] *Id.*
[44] Big Rivers Hearing Exhibit 1, Revised Exhibit Wolfram Rebuttal-1. A copy of Big Rivers Hearing Exhibit 1 is attached hereto as Appendix B.
[45] Berry Direct Testimony at p. 4 (if Big Rivers "does not receive the full rate increase it is seeking, the only option available to Big Rivers to meet the required margin[s] for interest ratio...and maintain credit ratings as required in its long term debt agreements would be to reduce expenses, including plant maintenance, which would have an adverse impact on reliability and ultimately increase costs to Big Rivers").
[46] Big Rivers has financial covenant obligations under its First Mortgage Indenture to U.S. Bank National Association, Trustee, dated as of July 1, 2009 ("Indenture"), to the United States of America, acting through the Rural Utilities Service under the Amended and Consolidated Loan Contract dated as of July 16, 2009 ("RUS Loan Contract"), to the National Rural Utilities Cooperative Finance Corporation ("CFC") under the Revolving Line of Credit Agreement dated as of July 16,2009 ("CFC Revolving Credit Agreement"), and to CoBank, ACB ("CoBank") under the Revolving Credit Agreement dated as of July 16, 2009 ("CoBank Revolving Credit Agreement"). Blackburn Direct Testimony at p. 6.
[47] *Id.* at p. 6–8.

year equal to at least 1.10.[48] Under Big Rivers' RUS Loan Contract, Big Rivers must comply with the financial covenants in the Indenture, and it must maintain an investment grade credit rating from at least two rating agencies.[49] Under Big Rivers' $50 million CFC Revolving Credit Agreement, Big Rivers is required to maintain an MFIR of no less than 1.10.[50] To obtain an advance of funds under the CFC Revolving Credit Agreement, Big Rivers must certify that it is not in default in any material respect under any agreement to which it is a party and that no event or condition exists which constitutes a default, or with the giving of notice or lapse of time or both would constitute a default.[51] To obtain an advance of funds under Big Rivers' $50 million CoBank Revolving Credit Agreement, Big Rivers must certify that there is no change in the financial position of Big Rivers that could reasonably be expected to have a material adverse effect on the ability of Big Rivers to perform its obligations under any loan document to which Big Rivers is a party.[52]

As long as Big Rivers establishes and collects rates that are reasonably expected to yield an MFIR of at least 1.10, Big Rivers can avoid an Event of Default under the Indenture even if Big Rivers fails to achieve the minimum required MFIR of 1.10 in a fiscal year, by immediately seeking rates that will comply with its covenants in the Indenture.[53] However, that does not mean that the Commission can set rates that would produce less than a 1.10 MFIR without

[48] *Id.* at p. 6.
[49] *Id.* at p. 7.
[50] *Id.* at p. 7.
[51] *Id.* at p. 7.
[52] *Id.* at p. 7–8.
[53] *Id.* at p. 9.

dire consequences to Big Rivers. It must be remembered that a 1.10 MFIR is just a minimum requirement in Big Rivers' loan documents, as noted above. Big Rivers' base rate revenue deficiency, which is the amount required for Big Rivers' operations, can only be satisfied if Big Rivers' margins produce the significantly higher 1.24 Contract TIER. Still, the difference between a 1.24 Contract TIER and the 1.10 MFIR level at which Big Rivers risks defaulting on its obligations is a mere $6.9 million.[54]

If Big Rivers fails to achieve a 1.10 MFIR, it will face a very real, high risk of defaulting under its RUS 2009 Promissory Note Series A ("RUS Series A Note"), even if that failure has not resulted in an Event of Default under the Indenture. KIUC irresponsibly and cavalierly dismisses the seriousness of this risk, including the risk of bankruptcy. As Mr. Bailey and Mr. Blackburn explain, Big Rivers can be prohibited from borrowing money and securing it under the Indenture if it fails to achieve a 1.10 MFIR.[55] More specifically, before Big Rivers can issue "Additional Obligations" secured by the Indenture, Big Rivers must be able to deliver a certificate that the MFIR is not less than 1.10 for one of the following periods of time: (i) the fiscal year of Big Rivers immediately preceding the fiscal year in which the application to deliver Additional Obligations is made, or (ii) if the application to deliver Additional Obligations is made within ninety days after the end of the fiscal year, the second preceding Big Rivers' fiscal year, or (iii) any twelve consecutive calendar months during the period of

[54] Bailey Direct Testimony at p. 12.
[55] *Id.*; Blackburn Direct Testimony at p. 10.

fifteen calendar months immediately preceding the first day of the calendar month in which the application to deliver Additional Obligations is made.[56]

Big Rivers is required to refinance $60,000,000 of RUS debt prior to October 1, 2012, and another $200,000,000 of RUS debt prior to January 1, 2016.[57] These refinancing requirements are driven by reductions in the Maximum Allowed Debt Balance that occur under Big Rivers' July 16, 2009, RUS Series A Note.[58] For Big Rivers to be in a position to refinance this debt, it must be able to secure the refinanced debt under its Indenture.[59]

If Big Rivers cannot refinance the $60 million of RUS debt, it will unquestionably default on its obligations under the RUS Series A Note, which will essentially create an event of default under all of Big Rivers' credit agreements.[60] Whether that default would result in Big Rivers having to seek bankruptcy protection would depend entirely on the willingness of RUS to negotiate a different result.

That default would definitely be a material adverse event under Big Rivers' other credit agreements, essentially freezing Big Rivers' access to any credit. It is wrong to imply that these results are remote if Big Rivers fails to achieve a 1.10 MFIR in the year before it is required to refinance RUS debt. Putting at risk for any period Big Rivers' ability to borrow money on a long-term, secured basis is unacceptable for a utility the size of Big Rivers that will always have

---

[56] Blackburn Direct Testimony at p. 10.
[57] *Id.*
[58] *Id.*
[59] *Id.*
[60] *Id.* at p. 10-11.

periodic cash requirements for both anticipated and unanticipated needs.[61] In fact, in addition to the RUS refinancings already mentioned, Big Rivers expects to borrow an additional $52 million in 2012 to replenish its cash reserves,[62] and refinance its $58.8 million 1983 Series pollution control bonds by the current maturity date of June 1, 2013. And this does not include any financings that may be needed to fund pollution control equipment necessary to comply with pending Environmental Protection Agency ("EPA") regulations.

Additionally, Big Rivers relies on two $50 million revolving credit agreements with CoBank and CFC.[63] Access to funds under those agreements, and Big Rivers' ability to renew those agreements after they expire in 2012 and 2014, respectively, could clearly be adversely affected by Big Rivers failing to comply with its financial covenants under the Indenture and the RUS Loan Contract.[64] The availability of these revolving credit agreements is important to Big Rivers, and is viewed as a "credit positive" in the latest Moody's Investors Service ("Moody's") report on Big Rivers' credit.[65]

Further, the credit ratings agencies and potential investors will look unfavorably on a regulated Generation & Transmission cooperative with marginal investment-grade ratings that is struggling to meet its obligations under its credit agreements.[66] Not only is maintaining two investment grade credit ratings a requirement under its loan agreements, investment grade credit

[61] *Id.* at p. 11.
[62] Blackburn Rebuttal Testimony at p. 9.
[63] Blackburn Direct Testimony at p. 11.
[64] *Id.*
[65] KIUC Hearing Exhibit 12 at p. 5.
[66] Blackburn Direct Testimony at p. 10.

ratings are critical to Big Rivers' future.[67] The Commission has even described Big Rivers' investment grade credit ratings as a linchpin.[68] Losing those ratings could impact Big Rivers' ability to borrow and the interest rates at which money might be available to it, which would be devastating to Big Rivers, especially at a time when it must refinance a significant amount of debt over the next few years.[69]

KIUC offers no evidence to controvert the importance to Big Rivers of maintaining its investment grade credit ratings. The KIUC cross-examination at the hearing only questioned the factors that impact the ratings process, and incorporated the KIUC common theme that any problem can be fixed by Big Rivers filing another rate case (in which KIUC would undoubtedly be the most adversarial party).

The reports on Big Rivers' credit ratings issued in July of this year by Moody's[70] and Standard & Poor's Financial Services LLC ("S&P"),[71] offer stark validation of the points Big Rivers and its witness Alan Spen have argued are important to the ratings agencies, and rebuttal to the KIUC positions in this case, including:

- The concentration of smelter load is the number one negative identified by both agencies, and is a "significant constraint to Big

[67] *See id.* at p. 5-7.
[68] Unwind Order at p. 38.
[69] Blackburn Direct Testimony at p. 11; Direct Testimony of Alan Spen, Application Exhibit 50 ("Spen Direct Testimony") at p. 10, 14; Spen Direct Testimony, Exhibit Spen-3 (demonstrating that sharply higher yields would have to be paid by Big Rivers if it was not rated investment grade).
[70] The Moody's report is KIUC Hearing Exhibit 12. A copy of the Moody's report is attached hereto as Appendix C.
[71] The S&P report is KIUC Hearing Exhibit 13. A copy of the S&P report is attached hereto as Appendix D.

Rivers' Moody's rating.[72] Mr. Spen says this increases credit costs,[73] which obviously increases Big Rivers' cost of service.

- Moody's, in discussing the TIER Adjustment mechanism in the Smelter agreements, says that under current market conditions it would "expect that Big Rivers would file for rate relief as necessary, in the event that [contract] TIER drops below the 1.24x target."[74] This expectation would necessarily require Big Rivers to seek base rate relief sufficient to drive the TIER Adjustment Charge below the ceiling of the TIER Adjustment bandwidth to give Big Rivers flexibility within the bandwidth to sustain a 1.24 Contract TIER for a reasonable period of time.
- In S&P's opinion, the one-year notice for termination clause in the Smelter agreements weakens the favorable take-or-pay provisions of those agreements.[75] But KIUC wants to "fully eliminate" the take-or-pay provisions.[76]
- Both agencies are concerned that Big Rivers' regulated status, which is uncommon among generation and transmission cooperatives ("G&Ts"), could negatively impact the amount and timing of required rate relief, and both are watching for the outcome of this case.[77]

---

[72] KIUC Hearing Exhibit 12 at p. 2.
[73] Spen Direct Testimony at p. 14-15.
[74] KIUC Hearing Exhibit 12 at p. 3.
[75] KIUC Hearing Exhibit 13 at p. 2.
[76] Big Rivers Hearing Exhibit 2, page 6 of the Direct Testimony of Stephen J. Baron.
[77] KIUC Hearing Exhibit 12 at p. 3-4, 6; KIUC Hearing Exhibit 13 at p. 4.

- S&P is concerned that Big Rivers' Non-Smelter Non-FAC Purchased Power recovery arrangement is not automatic, like the Non-FAC Purchased Power clause in the Smelter agreements.[78] Big Rivers is proposing a new tariff mechanism in this case that would annually make that recovery.[79]
- Moody's and S&P are concerned, as is Big Rivers, about the upcoming refinancing of bullet debt maturities.[80] KIUC appears willing to risk putting Big Rivers in a position that it cannot accomplish those near-term refinancings.
- Maintenance of sound debt service coverage is important to the agencies.[81] Note that S&P cites Big Rivers' debt service coverage as the basis for its "stable" outlook.[82]
- Big Rivers' significant bank credit (revolving credit facilities) is viewed as a credit positive by Moody's.[83] KIUC seems indifferent to events that could threaten Big Rivers' access to that bank credit.
- Big Rivers not currently returning patronage capital to its members is regarded as a credit positive by Moody's.[84] In contrast, KIUC is seeking a Commission-ordered mandatory program to retire patronage capital to mitigate the impact on the Rurals of the unreasonable revenue

[78] KIUC Hearing Exhibit 13 at p. 6.
[79] Application at p. 8.
[80] KIUC Hearing Exhibit 12 at p. 5; KIUC Hearing Exhibit 13 at p. 3.
[81] KIUC Hearing Exhibit 12 at p. 7; KIUC Hearing Exhibit 13 at p. 5; *see also* Spen Rebuttal Testimony at p. 5.
[82] KIUC Hearing Exhibit 13 at p. 3.
[83] KIUC Hearing Exhibit 12 at p. 5.
[84] KIUC Hearing Exhibit 12 at p. 4-5.

allocation proposed by KIUC and to give the Smelters disproportionate access to Big Rivers' equity.[85]

As Mr. Spen testifies, based on his 20 years with Fitch Ratings as head of the firm's group that reviews electric cooperatives, Big Rivers needs a higher level of financial protection to protect its credit ratings.[86] He strongly believes that Big Rivers needs the full amount of its rate increase request to preserve its credit ratings.[87]

Big Rivers' proposed rate increase is fair, just, and reasonable because it will allow Big Rivers to prudently maintain its generating units, meet its minimum MFIR, and maintain its investment grade credit ratings. The Commission should approve the rate increase as proposed by Big Rivers.

V. The Adjustment in Rates Proposed by KIUC is not Fair, Just, and Reasonable.

KIUC proposes a base rate increase of $18,562,000 for Big Rivers or approximately 47.2 percent of the base rate revenue deficiency proposed by Big Rivers.[88] KIUC's proposal does not provide Big Rivers with sufficient revenues to be financially viable or to meet its financial obligations, including the minimum MFIR requirement, which threatens Big Rivers' ability to comply with its loan covenants.[89] In fact, under the KIUC proposal as modeled by Big Rivers, Big Rivers' MFIR would be less than the required 1.10 in 2011; Big Rivers' margins would be negative in both 2012 and 2014, resulting in both MFIR and

[85] Hite Rebuttal Testimony at p. 27-28.
[86] Spen Rebuttal Testimony at p. 4.
[87] *Id.* at p. 5.
[88] Direct Testimony of Lane Kollen at p. 3 (as revised June 30, 2011).
[89] Hite Rebuttal Testimony at p. 4–5; Blackburn Rebuttal Testimony at p. 4.

Conventional TIER being less than 1.00 in those years; and Big Rivers' MFIR and Conventional TIER would be less than 1.10 in all years modeled except 2013.[90]

Also, the KIUC proposal reduces Big Rivers' cash reserves by approximately $17 million annually, requiring additional new borrowings; and it would likely result in Big Rivers losing its investment grade ratings, two of which are at the minimum level (BBB-).[91] The most devastating short-term consequence of the KIUC proposal is that Big Rivers would likely default on its debt covenants in 2012 because it would be unable to make the $60 million required refinancing of a portion of its RUS debt by October of 2012.[92] Simply put, the KIUC proposal places Big Rivers' financial viability in great jeopardy.[93] Under the KIUC proposal the only option available to Big Rivers to meet its financial obligations would be to continue to defer maintenance expenses, which would have an adverse impact on reliability and which would increase costs to Big Rivers in the long run.[94]

Moreover, not even KIUC's own witnesses believe that their proposed increase is sufficient.[95] Mr. Kollen contends that a revenue increase of $18.679 million dollars will provide enough revenue to allow Big Rivers to earn a 1.24 Contract TIER.[96] However, as noted below, KIUC is concerned that if the TIER Adjustment Charge the Smelters pay is set in the middle of the bandwidth (as Big Rivers proposes), KIUC would immediately pay an additional $7.1 million

---

[90] Blackburn Rebuttal Testimony at p. 4; Hite Rebuttal Testimony at p. 4.
[91] Hite Rebuttal Testimony at p. 4-6; Blackburn Rebuttal Testimony at p. 4.
[92] Hite Rebuttal at p. 5.
[93] *Id.*
[94] Berry Rebuttal Testimony at p. 3.
[95] *See* Seelye Rebuttal Testimony at p. 44.
[96] *Id.*

through the TIER Adjustment Charge based on Big Rivers' financial projections.[97] Those projections show that even with the full rate increase proposed by Big Rivers,[98] Big Rivers will not earn a 1.24 Contract TIER outside the test year. If the Smelters TIER Adjustment Charge is in the middle of the bandwidth, the only way that charge would move to the top of the bandwidth is if Big Rivers' margins are at least $7.1 million less than is required to achieve a 1.24 Contract TIER.[99] Since KIUC apparently believes that Big Rivers' proposed rates will not produce a 1.24 Contract TIER, KIUC cannot seriously believe that its proposed revenue requirement is sufficient for Big Rivers' requirements.

KIUC has offered much testimony in this proceeding about the financial viability of the Smelters in the event of a future downturn in the economy and the consequences of the Smelters closing.[100] That testimony is irrelevant to Big Rivers' revenue requirement, a fact even KIUC has acknowledged.[101] Instead, the focus must be on establishing rates for Big Rivers that are non-confiscatory and that enable it "to operate successfully, to maintain its financial integrity, to attract capital and to compensate its investors for the risks assumed."[102]

---

[97] *See infra* Section VI.U.
[98] *Id.*
[99] Seelye Rebuttal Testimony at p. 44.
[100] *See* Seelye Direct Testimony at p. 4-5.
[101] *Id.*; Testimony of William Steven Seelye, July 27, 2011, Tr. 14:26'00.
[102] *Com. ex rel. Stephens v. South Central Bell Tel. Co.*, 545 S.W.2d 927, 930 (Ky. 1976); *see also Bluefield Waterworks & Imp. Co. v. Public Service Commission of W. Va.*, 262 U.S. 679, 690, 43 S. Ct. 675, 678 (1923) ("The question in the case is whether the rates prescribed in the commission's order are confiscatory and therefore beyond legislative power. Rates which are not sufficient to yield a reasonable return on the value of the property used at the time it is being used to render the service are unjust, unreasonable and confiscatory, and their enforcement deprives the public utility company of its property in violation of the Fourteenth Amendment"); Seelye Direct Testimony at p. 4-5.

VI. Big Rivers' Proposed Pro Forma Adjustments to the Historical Test Period are Known and Measurable and Produce Fair, Just, and Reasonable Rates.

As noted above, Big Rivers needs the full amount of its requested increase. Big Rivers' base rate revenue deficiency is based on meeting a 1.24 Contract TIER based upon the historical test year (the 12 months ending October 31, 2010), with known and measurable adjustments.[103] Each of the proposed adjustments is described below, and Big Rivers believes each of its proposed adjustment is reasonable, appropriate, and necessary. Adjustments to the historical test period can be known and measurable even if they cannot be determined with complete precision.[104] As one authority has explained, "When [a] commission for articulated reasons determines that its revenue and expense figures for a particular utility are reliable and finds that an adjustment is necessary to insure that test year data remain representative, [the] commission does not lack discretion to act solely because it cannot do so with complete precision."[105] And the Commission itself has explained:

> KIUC appears to have interpreted the commission's known and measurable standard in a manner similar to the known and certain description Mr. Henkes used in detailing some of his adjustments. While it would be helpful to the commission if all adjustments were certainties, such a scenario does not exist. The commission must address the relative accuracy of all adjustments taking into consideration the assumptions, if any, used in making the adjustment.[106]

---

[103] Direct Testimony of John Wolfram, Application Exhibit 51 ("Wolfram Direct Testimony") at p. 6-7.
[104] *See* 73B C.J.S. *Public Utilities* § 106 (2005).
[105] *Id.*
[106] Order dated December 4, 1984, in *In the Matter of: General Adjustment in Electric Rates of Kentucky Power Company*, PSC Case No. 9061, Order dated December 4, 1984.

Moreover, even if the Commission disagrees with some of Big Rivers' proposed adjustments as KIUC suggests, Big Rivers is still entitled to fair, just, and reasonable rates.[107] The Commission has broad authority to set rates.[108] The Commission's goal is "to establish fair, just and reasonable rates. There is no litmus test for this and there is no single prescribed method to accomplish the goal."[109] The "ultimate resulting rate should be a more important consideration than some specific, mandated method for determining it."[110] In other words, "it is the result reached not the method employed which is controlling.... It is not the theory but the impact of the rate order which counts."[111] As the U.S. Supreme Court has explained:

> The Constitution does not bind rate-making bodies to the service of any single formula or combination of formulas. Agencies to whom this legislative power has been delegated are free, within the ambit of their statutory authority, to make pragmatic adjustments which may be called for by particular circumstances."[112]

The Commission has stated that, in carrying out its rate-setting duties, it "should and will weigh carefully all the facts and circumstances, particularly those dealing with present and prospective cost levels to the end that rates will not be obsolete when made effective, and, therefore, conducive to frequent rate applications."[113] As discussed below, this rate case is based on a historical test year, yet given the unique circumstances of Big Rivers' present situation,

---

[107] KRS 278.030(1).
[108] *See National-Southwire Aluminum Co. v. Big Rivers Electric Corp.*, 785 S.W.2d 503, 512 (Ky. App. 1990).
[109] *Id.* at 513; *see also* KRS 278.030(1) ("Every utility may demand, collect and receive fair, just and reasonable rates for the services rendered or to be rendered by it to any person").
[110] *National-Southwire Aluminum Co.*, 785 S.W.2d at 511.
[111] *Federal Power Comm 'n v. Hope Natural Gas Co.*, 320 U.S. 591, 602, 64 S. Ct. 281, 287 (1944).
[112] *Federal Power Commission v. Natural Gas Pipeline Co.*, 315 U.S. 575, 586, 62 S. Ct. 736, 743 (1942).
[113] Order dated January 15, 1958, in *In the Matter of: Kentucky Utils.Co.*, PSC Case No. 3324, 22 P.U.R.3d 113.

namely that it took back control of its generating units upon the closing of the Unwind Transaction a mere two years ago and recently transferred functional control of its transmission system to the Midwest ISO in December, 2010, Big Rivers did not have sufficient information to prepare *pro forma* adjustments based on historical costs for its proposed adjustments for planned outage expenses, non-outage operations and maintenance expense, and Midwest ISO expenses. Test year numbers for those expense categories are not representative of a typical year on a going-forward basis; in fact, there were no expenses in the test year related to Big Rivers' full integration into the Midwest ISO as a transmission-owning member. However, given the unique and unprecedented circumstances of this case and Big Rivers' need to prudently maintain its generating units while meeting its financial covenants, Big Rivers believes it has shown good cause for the proposed adjustments.[114]

In the present case, Big Rivers must receive nearly the full amount of the revenue it is requesting to prudently maintain its generating units while meeting its financial covenants.[115] Big Rivers is entitled to rates that enable it "to operate successfully, to maintain its financial integrity, [and] to attract capital."[116] The Commission has even acknowledged the appropriateness of setting rates to allow a cooperative utility sufficient revenue to pay its

---

[114] Testimony of Mark A. Hite, July 27, 2011, Tr. 14:05'45.
[115] Bailey Direct Testimony at p. 21.
[116] *South Central Bell Tel. Co.*, 545 S.W.2d at 930.

operating costs and satisfy debt service.[117] Thus, Big Rivers' rate request is fair, just, and reasonable, and it should be granted in its entirety.

A. Big Rivers' proposed adjustment to annualize revenue and expenses for a new industrial customer is fair, just, and reasonable.

Big Rivers' proposed *pro forma* adjustments include a net increase of $92,165 to test year margins to reflect an annualization of the revenue and expenses related to a new industrial customer on the Big Rivers system.[118] The new industrial customer, the Armstrong-Equality mine, was added on March 16, 2010.[119] Originally, this proposed adjustment was based on an annualization of 7.5 months of test year revenues. As explained by Mr. Wolfram, the test year (the twelve months ending October 31, 2010) "reflects only 7.5 months of revenues and expenses associated with this customer, [and] both the revenues and the expenses are understated for a twelve month prospective period."[120] Mr. Wolfram goes on to explain how the revenues and expenses relating to the customer were annualized, and he calculates the proposed adjustment to test year revenues and expenses.[121] The revised adjustment uses actual revenues for the 12 months ended June 2011 instead.[122] As noted in Request No. 3 of the Commission Staff's Third Request for Information to Big Rivers, sales to the

---

[117] *See National-Southwire Aluminum Co.*, 785 S.W.2d at 516; Order dated August 10, 1987, in *In the Matter of: An Investigation of Big Rivers Electric Corporation's Rates for Wholesale Electric Service*, PSC Case No. 9885 at 29; *see also id.* at 14 ("The findings herein are that Big Rivers' existing rates are indeed unjust, unreasonable, and insufficient to cover operating costs and service its debt").
[118] Big Rivers Hearing Exhibit 1, Revised Exhibit Wolfram Rebuttal-1; *id.*, Revised Exhibit Wolfram Rebuttal-2, Reference Schedule 2.01.
[119] Wolfram Direct Testimony at p. 8.
[120] *Id.*
[121] *Id.* at p. 8-9; *id.*, Exhibit Wolfram-2, Reference Schedule 2.01.
[122] Big Rivers Hearing Exhibit 1, Revised Exhibit Wolfram Rebuttal-2, Reference Schedule 2.01.

Armstrong-Equality mine increased in October 2010; however, Big Rivers does not believe that sales and revenues associated with the Armstrong-Equality mine will increase materially above the levels experienced in October 2010.[123] No party has controverted this proposed adjustment. It is fair, just, and reasonable, and should be approved.

B. Big Rivers' proposed adjustment for a mismatch in fuel cost recovery is fair, just, and reasonable.

Big Rivers proposes an adjustment to test year revenues and expenses, consistent with Commission practice, to eliminate the timing mismatch between fuel costs and fuel cost recovery through Big Rivers' Fuel Adjustment Clause ("FAC").[124] This adjustment produces a net increase of $2,225,346 to Big Rivers' test year margins.[125] The Commission approved similar adjustments for Louisville Gas and Electric Company ("LG&E") and Kentucky Utilities Company ("KU") in Case Nos. 2003-00433 and 2003-00434 respectively.[126] No party has controverted this proposed adjustment.

C. Big Rivers' proposed adjustment to eliminate Environmental Surcharge revenues and expenses is fair, just, and reasonable.

Consistent with the Commission's practice of eliminating the revenues and expenses associated with full-recovery cost trackers, Big Rivers proposes an adjustment to remove Environmental Surcharge revenues and expenses from the test year because they are addressed by a separate rate mechanism.[127] Big

---

[123] Big Rivers' May 11, 2011, response to Item 3b of the Commission Staff's Third Request for Information (PSC 3-3b).
[124] Wolfram Direct Testimony at p. 9.
[125] *Id.*, Exhibit Wolfram-2 at p. 1, l. 12; *id.*, Exhibit Wolfram-2, Reference Schedule 2.02.
[126] Wolfram Direct Testimony at p. 9.
[127] *Id.*

Rivers' Environmental Surcharge tariff provides for full recovery of approved environmental costs that qualify for the surcharge, and therefore, such costs should be excluded from base rates.[128] This adjustment produces a net increase of $633,559 to Big Rivers' test year margins.[129] The Commission approved essentially similar adjustments for LG&E and KU in Case Nos. 2003-00433 and 2003-00434, respectively.[130] No party has controverted this proposed adjustment. It is fair, just, and reasonable, and should be approved.

D. Big Rivers' proposed adjustment to reflect temperature normalized sales volumes is fair, just, and reasonable.

Big Rivers proposes a temperature normalization adjustment that increases its test year margins by $126,318. Although the Commission has never approved an electric temperature normalization adjustment in a contested rate proceeding,[131] the Commission has routinely accepted temperature normalization adjustments in natural gas rate proceedings[132] and has expressed its willingness to consider temperature normalization adjustment proposals in electric rate proceedings.[133] Big Rivers submits that its proposed temperature normalization adjustment fully satisfies the criteria identified by the

---

[128] *Id.*
[129] *Id.*, Exhibit Wolfram-2 at p. 1, l. 13; *id.*, Exhibit Wolfram-2, Reference Schedule 2.03.
[130] Wolfram Direct Testimony at p. 9-10.
[131] The Commission has approved two electric rate case settlement agreements that incorporated temperature normalization adjustments, but explicitly stated that its approval of the settlements did not constitute approval or denial of the adjustment. *See* Big Rivers' April 15, 2011, response to Item 35a of the Commission Staff's Second Request for Information (PSC 2-35a) (discussing PSC Case Nos. 2008-00251 and 2008-00252).
[132] *See, e.g.*, Order dated September 17, 2000, in *In the Matter of: The Application of Louisville Gas and Electric Co. to Adjust its Gas Rates and to Increase its Charges for Disconnecting Service, Reconnecting Service and Returned Checks*, PSC Case No. 2000-080, Order dated September 17, 2000, 2000 WL 1791791 (Ky. P.S.C.); Order dated December 27, 1999, in *In the Matter of: An Adjustment of the Rates of Delta Natural Gas Co., Inc.*, PSC Case No. 99-176.
[133] *See* Seelye Direct Testimony at p. 50 (citing cases).

Commission in prior orders addressing electric temperature normalization adjustment proposals.[134] No party has opposed Big Rivers' proposal, and Big Rivers requests that the Commission approve this adjustment.

E. Big Rivers' proposed adjustment to remove Non-FAC PPA revenues and expenses is fair, just, and reasonable.

Similar to the proposed adjustment to remove Environmental Surcharge-related revenues and expenses, Big Rivers proposes to eliminate the expenses and revenues associated with its Non-FAC Purchased Power Adjustment ("Non-FAC PPA") because they are addressed by a separate full-recovery cost tracker mechanism.[135] This adjustment produces a net decrease of $427,156 to Big Rivers' test year margins.[136] No party has controverted this adjustment, it is reasonable, and it should be granted.

F. Big Rivers' proposed adjustment to reflect annual depreciation expenses is fair, just, and reasonable.

Big Rivers proposes a *pro forma* adjustment to test year expenses of $6,252,651 to reflect increased depreciation expenses ($42,532,089 *pro forma* vs. $36,279,438 test year).[137] This adjustment is based upon the Report on the Comprehensive Depreciation Study (January 2011) prepared by the engineering and consulting firm of Burns & McDonnell ("Depreciation Study").[138] KIUC proposes that Big Rivers' annual depreciation expense be increased by $325,941

---

[134] *See id.* at p. 44-51.
[135] Wolfram Direct Testimony at p. 10.
[136] *Id.*, Exhibit Wolfram-2 at p. 1, l. 15; *id.*, Exhibit Wolfram-2, Reference Schedule 2.05.
[137] *Id.*, Exhibit Wolfram-2, Reference Schedule 2.06.
[138] *Report on the Comprehensive Depreciation Study (January 2011)*, Application Exhibit 33; Direct Testimony of Ted J. Kelly, Application Exhibit 54 ("Kelly Direct Testimony"). After discussions with RUS, certain language in the Depreciation Study was modified from the version filed with Big Rivers' Application, but the recommended increase in annual depreciation expense was not changed. *See* Big Rivers' April 15, 2011, response to Item 33 of KIUC's Initial Request for Information (KIUC 1-33).

($36,605,379 vs. $36,279,438).[139] In summary, the depreciation rates proposed by KIUC result in $5,926,710 less in depreciation expense than the Depreciation Study. Big Rivers submits that KIUC's criticisms of the Depreciation Study and its recommendations are unfounded, and that the evidence demonstrates that Big Rivers' proposed increase in annual depreciation expenses and the resulting *pro forma* adjustment should be accepted.

As an initial matter, depreciation rates and expenses may seem less important in this rate case because if the proposed *pro forma* adjustment were denied, in whole or in part, the result would not affect Big Rivers' financial metrics (*i.e.*, MFIR and TIER).[140] However, the setting of appropriate depreciation rates is also important to address an ongoing problem, namely that Big Rivers' current depreciation rates and estimated useful lives, which have been in effect since 1998, are such that early retirements of assets have resulted in Big Rivers accumulating $68.8 million in losses. This is due to the more liberal capitalization policy followed by Western Kentucky Energy Corp. ("WKEC") prior to the return of Big Rivers' generating units to its operational control pursuant to the Unwind Transaction and the requirement under Section 3.15 of the Coordination Agreement that Big Rivers follow the WKEC capitalization practices.[141] Thus, regardless of the effect on Big Rivers' ability to meet MFIR and TIER, it is vital that Big Rivers' depreciation rates accurately reflect the current remaining useful lives of its generating facilities.

---

[139] Direct Testimony of Lane Kollen at p. 21; Direct Testimony of Charles W. King ("King Direct Testimony"), Exhibit CWK-1, Schedule 1 (as revised June 30, 2011).
[140] Testimony of Mark A. Hite, July 27, 2011, Tr. 13:58'00.
[141] Hite Rebuttal Testimony at p. 18-19; Testimony of Mark A. Hite, July 27, 2011, Tr. 14:13'40.

(i) Mr. King's criticisms of the Depreciation Study and depreciation analysis are based on selective use of data, not the application of engineering judgment.

The Commission has recognized that "a depreciation study involves the analysis of a significant amount of information and the preparer's judgment and experience."[142] Both Mr. Kelly and KIUC witness King agree that application of judgment is vital to the calculation of depreciation rates.[143] In calculating the remaining useful lives reflected in the Depreciation Study, Burns & McDonnell relied upon an Engineering Assessment that appears as Part II of the Depreciation Study.[144] With respect to the analysis of Big Rivers' production plant, which is the only aspect of the Depreciation Study in dispute in this proceeding, the Engineering Assessment was based on physical observation of Big Rivers' generating units, interviews with plant managers, and a comprehensive review of plant operating statistics.[145] In addition, Burns & McDonnell took into consideration a variety of reports and other information concerning plant maintenance, outages, and other factors that bear upon a determination of the useful life of production facilities.[146] Based upon the Engineering Assessment, and the quantitative and qualitative factors fully described in Mr. Kelly's rebuttal testimony, Burns & McDonnell calculated the remaining useful lives of Big Rivers' production facilities that underlie the

---

[142] Order dated December 22, 2005, in *In the Matter of: An Adjustment of the Gas Rates of the Union Light, Heat and Power Company*, PSC Case No. 2005-00042, at 32.

[143] Rebuttal Testimony of Ted J. Kelly, Exhibit 65 ("Kelly Rebuttal Testimony") at p. 5; King Direct Testimony at p. 5.

[144] *Report on the Comprehensive Depreciation Study (January 2011)*, Application Exhibit 33, Part II.

[145] Kelly Direct Testimony at p. 8-9.

[146] Kelly Rebuttal Testimony at p. 6.

proposed depreciation rates.[147] The depreciation rates presented in the Depreciation Study were approved by RUS.[148]

Mr. King's review of the Depreciation Study was limited. He was not employed to second guess Burns & McDonnell's engineering judgment,[149] and he was not retained to address Big Rivers' non-production plant accounts.[150] His substantive disagreements with Mr. Kelly are limited to the remaining useful lives for four plant accounts: Account 311 - Structures; Account 312 - Boiler Plant; Account 314 - Turbine, and Account 315 - Electric Equipment.[151] With respect to these accounts, Mr. King performed no independent analysis; rather, he cherry-picked data from the Depreciation Study, as well as subsequent data responses and workpapers, in order to arrive at the highest remaining useful lives possible (and thus the lowest depreciation rates possible) for these four accounts.[152] Further, if reasonable remaining useful lives for these four accounts are used in Mr. King's own analysis instead of the maximum remaining lives assumed by Mr. King, the annual depreciation expense would be $34.027 million, nearly identical to the $34.029 million proposed by Mr. Kelly.[153]

---

[147] *Id.*
[148] *See* Big Rivers' April 15, 2011, response to Item 36 of KIUC's Initial Request for Information (KIUC 1-36), KIUC 1-36.pdf at p. 7-8.
[149] Testimony of Charles W. King, July 28, 2011, Tr. 10:52'40.
[150] KIUC's June 23, 2011, response to Item 13 of the Commission Staff's First Request for Information.
[151] There is a negligible difference in the depreciation rates for Account 316 - Misc. Equipment. *Compare* Kelly Direct Testimony, Exhibit Kelly-1 at p. 1, *with* King Direct Testimony, Exhibit CWK-1, Schedule 1.
[152] Kelly Rebuttal Testimony at p. 4.
[153] *Id.*, p. 16-.

Mr. King asserted that Burns & McDonnell "arbitrarily selected account remaining lives at the lower end of the spectrum."[154] However, the selection of useful lives was in no way arbitrary, but was based upon numerous qualitative factors and quantitative analyses, including the Engineering Assessment and numerous reports and other information concerning specific production facilities.[155] Mr. Kelly then considered numerous alternative scenarios, and derived depreciation rates based on his analysis of these scenarios.[156] The analysis was not "arbitrary" in any sense; rather, it was based on a quantitative analysis and the application of judgment to the significant amount of information that necessarily was considered in order to derive depreciation rates.[157]

At the hearing, Mr. King asserted that Mr. Kelly's analysis was "inconsistent" because the alternative scenarios considered in preparing the Depreciation Study were not provided in that study.[158] This is irrelevant because the depreciation rates proposed in the Depreciation Study stand on their own; there was no need to provide the alternative scenarios that were considered in the selection of useful lives in that document. The detailed tables provided in Mr. Kelly's rebuttal testimony were assembled from workpapers provided to KIUC in response to data requests,[159] and were included merely to demonstrate that the remaining useful lives calculated by Mr. Kelly were reasonable, not

---

[154] King Direct Testimony at p. 3.
[155] Kelly Rebuttal Testimony at p. 6.
[156] *Id.*, Exhibits Kelly Rebuttal-1 through Kelly Rebuttal-6.
[157] Kelly Rebuttal Testimony at p. 6.
[158] Testimony of Charles W. King, July 28, 2011, Tr. 10:56'00.
[159] *See* Big Rivers' April 15, 2011, response to Item 8 of KIUC's Initial Request for Information (KIUC 1-8).

"arbitrary" as Mr. King asserted. Again, Mr. Kelly considered these alternative scenarios, and derived remaining useful lives based on the application of judgment.

In preparing the Depreciation Study, Mr. Kelly relied upon typical operating hours and a five year average of actual operating hours for the five year period ending December 2009 for each plant to estimate remaining useful lives, and then applied the resulting depreciation rates to Big Rivers' plant balances as of April 30, 2010.[160] At the hearing, much was made of a purported "disconnect" between these two dates.[161] However, the "disconnect" is irrelevant because the depreciation analysis is used to set fixed depreciation rates that are then applied to future plant balances that will always be changing over time. The important consideration in this analysis is the depreciation rates, because they are fixed and cannot change until Big Rivers seeks to change them in a future rate case.

Mr. King also criticized the interim retirement curves used in the Depreciation Study in developing interim retirement rates.[162] When questioned further, however, Mr. King conceded that interim retirements are not a major issue for steam production plants, the effect of their use on the depreciation rate calculation would not be significant, and he did not know whether the resulting depreciation rates would be higher or lower.[163]

---

[160] *Report on the Comprehensive Depreciation Study (January 2011)*, Application Exhibit 33, p. ES-6, Table ES-1.
[161] Testimony of Ted J. Kelly, July 27, 2011, Tr. 13:15'42; *id.* at Tr. 13:21'30.
[162] Testimony of Charles W. King, July 28, 2011, Tr. 10:58'50.
[163] *Id.* at Tr. 10:59'00.

While there were, as Mr. Hite testified, "bumps in the road along the way" as the Depreciation Study was prepared,[164] Big Rivers has confidence in the final Depreciation Study, regardless of the issues that arose during the course of its preparation.[165] Big Rivers' confidence in the soundness of the final study is supported by RUS' approval of the Depreciation Study.

(ii) The Smelters and Mr. King participated in the depreciation study process, and had ample opportunity to raise any concerns prior to this proceeding.

It bears noting that the Smelters had no reason to be surprised by the results of the Depreciation Study. Section 3.10(a) of the Coordination Agreement obligates Big Rivers to provide notice to the Smelters of any proposed change in depreciation rates, including "reasonably detailed documentation" describing any such change, and also provides the Smelters with the opportunity to discuss the proposed change with Big Rivers prior to any filing by Big Rivers seeking to implement such a change.[166] At the suggestion of Mr. Bailey, Big Rivers opted to offer a collaborative approach that went even further than was required under the Coordination Agreement, and invited the Smelters to participate in the internal working group that oversaw preparation of the depreciation study.[167] The Smelters took advantage of this opportunity.[168]

Thus, Smelter representatives urged Big Rivers to engage Burns & McDonnell to prepare the Depreciation Study, and participated actively in the development

[164] Testimony of Mark A. Hite, July 27, 2011, Tr. 13:42'52.
[165] *Id.* at Tr. 13:56'27.
[166] Blackburn Rebuttal Testimony, Exhibit Blackburn Rebuttal-3, § 3.10(a).
[167] Hite Rebuttal Testimony at p. 16.
[168] *Id.* at p. 17.

of the Depreciation Study.[169] Mr. King and his firm were engaged to participate in the working group as consultants for the Smelters, although they were paid by the J. Kennedy and Associates consulting firm,[170] and when asked which of the Smelters had hired him, Mr. King indicated that the question would be better directed to litigation counsel for KIUC.[171] Mr. King and the Smelters were granted unfettered access to the FTP (file transfer protocol) website on which Burns & McDonnell posted all of the information used to develop the Depreciation Study.[172] Mr. King and the Smelters were provided with a draft of the Depreciation Study, and based on Mr. King's comments on the draft, a mathematical error was corrected and Big Rivers agreed to adopt all changes recommended by Mr. King, including reflecting the maximum 65-year useful life for the Wilson Station in the analysis,[173] as opposed to the 58-year normal useful life that Burns & McDonnell initially suggested based upon their analysis and engineering judgment.[174]

In addition, Big Rivers provided a revised version of the Depreciation Study with the final proposed depreciation rates to Mr. King and the Smelters for their review before submitting it to RUS, and the Smelters notified Big Rivers on January 4, 2011 that they agreed to the revised Depreciation Study.[175] At the hearing, Mr. King recollected that he anticipated that the revised Depreciation

---

[169] *Id.*, p. 16-17.
[170] Testimony of Charles W. King, July 28, 2011, Tr. 10:50'29.
[171] *Id.* at Tr. 10:50'18.
[172] *Id.* at Tr. 10:52'17.
[173] Hite Rebuttal Testimony at p. 16; Testimony of Charles W. King, July 28, 2011, Tr. 10:53'05.
[174] *See* KIUC Hearing Exhibit 16 at p. 17.
[175] Hite Rebuttal Testimony at p. 17; Big Rivers' April 15, 2011, response to Item 36 of KIUC's Initial Request for Information (KIUC 1-16), KIUC 1-36.pdf at p. 96-97, 790. Copies of these emails are attached hereto as Appendix E.

Study would support a net decrease in depreciation expenses, and that he had not known until Mr. Kelly filed his direct testimony in this proceeding that the final Depreciation Study would recommend an increase.[176] However, on January 7, 2011, nearly two months before Big Rivers submitted its Application (including Mr. Kelly's direct testimony), Big Rivers provided Mr. King and Marlene Daniel of Rio Tinto Alcan a copy of the revised Depreciation Study with the final proposed depreciation rates via e-mail.[177] Whether or not Mr. King or the Smelters chose to review the final Depreciation Study at that time, they certainly had the opportunity to raise any concerns well before Big Rivers submitted the Depreciation Study for RUS approval and filed this rate case, *including the matters discussed in Mr. King's testimony*. They chose instead to wait to raise these concerns in a litigation context.

Procedural issues and questions of good faith collaboration aside, the basic question presented to the Commission is whether Big Rivers' proposed depreciation rates, and the resulting increase in depreciation expense will produce rates that are fair, just and reasonable. The KIUC proposal is not based on any kind of independent analysis, but rather reflects the use of data that does not correspond with the date on which the new rates go into effect,[178] and assumes maximum remaining useful lives for the four large plant accounts. Additionally, KIUC's proposal to decrease depreciation rates would exacerbate the losses Big Rivers has suffered on asset retirements as a result of its *current*

---

[176] Testimony of Charles W. King, July 28, 2011, Tr. 10:55'30; *id.* at Tr. 11:01'35.
[177] Big Rivers' April 15, 2011, response to Item 36 of KIUC's Initial Request for Information (KIUC 1-36), KIUC 1-36.pdf at p. 94. A copy of this email is attached hereto as Appendix F.
[178] *See* Kelly Rebuttal Testimony at p. 14.

depreciation rates being too low. By contrast, the Depreciation Study relies upon current information and normal remaining useful life assumptions and is more consistent with Big Rivers' experience with asset retirements. The recommended depreciation rates contained therein are accordingly more reliable than those proposed by KIUC. The Commission should adopt the depreciation rates, and the resulting *pro forma* adjustment for depreciation expenses, proposed by Big Rivers.

G. Big Rivers' proposed adjustment to reflect increases in labor and labor overhead expenses is fair, just, and reasonable.

Big Rivers proposes a *pro forma* adjustment to labor and labor overhead expenses to reflect known and measurable changes, including the number of employees of record as of December 31, 2010 (excluding those on long-term disability for whom replacements have been hired), step increases and contract increases for the bargaining employees since the test year, qualification increases for non-bargaining employees, and shift premiums.[179] This adjustment is determined based upon the most current information available (FICA, FUTA, SUTA, workers compensation, retirement/401(k), life, LTD, dental and medical, post-employment and post-retirement costs, including the most recent premium rates available, and the most recent FAS 87 and 106 estimates).[180] No incentive pay or bonus pay is included in the *pro forma*

[179] Hite Direct Testimony at p. 21-22; Wolfram Rebuttal Testimony, Exhibit Wolfram Rebuttal-2, Reference Schedule 2.07.
[180] Hite Direct Testimony at p. 22; Wolfram Rebuttal Testimony, Exhibit Wolfram Rebuttal-2, Reference Schedule 2.07.

amount.[181] Note that the originally proposed adjustment was understated to the extent that known pay rates were not normalized.[182]

Big Rivers' labor expenses are reasonable. For example, as part of its recent cost-containment efforts, non-bargaining employees received no annual wage increase in 2010, and the 2011 non-bargaining wage increase was 2 percent.[183] Big Rivers' salary increases have been based on salary studies and surveys.[184]

Although Mr. Bailey received a substantial increase in 2009, it was because his duties increased substantially upon the closing of the Unwind Transaction (where, overnight, Big Rivers went from a being a company with 116 employees and expenditures of $142 million per year to a company with 580 employees and expenditures of $533 million per year). His salary was brought in line with comparable positions at comparable utilities, and was based upon an executive salary study commissioned by the Big Rivers Board of Directors.[185] The Attorney General has propounded data requests regarding executive salaries, and has cross-examined Mr. Bailey regarding the amount and timing of his salary increase, but he has offered no evidence that that the salary increase is inappropriate for any reason.

In its rebuttal testimony, Big Rivers revised the proposed adjustment to remove from its *pro forma* expenses $1,047,200 associated with capitalized

---

[181] Hite Direct Testimony at p. 22; Wolfram Rebuttal Testimony, Exhibit Wolfram Rebuttal-2, Reference Schedule 2.07.
[182] Big Rivers' May 11, 2011, response to Item 7 of the Commission Staff's Third Request for Information (PSC 3-7).
[183] Hite Direct Testimony at p. 22.
[184] *See* Big Rivers' March 18, 2011, response to Item 35 of the Commission Staff's Initial Request for Information (PSC 1-35); Testimony of Mark A. Bailey, July 26, 2011, Tr. 12:10'45.
[185] Big Rivers' April 15, 2011, response to Item 19 of the Attorney General's Initial Request for Information (AG 1-19).

labor based on its test year capitalized labor percentage.[186] KIUC witness Lane Kollen suggests this revision in his testimony, although his calculation was not performed on Big Rivers' revised *pro forma* amount for total normalized labor and labor overheads.[187] The revised adjustment increases Big Rivers' test year expenses by a total of $450,215.[188] The revised proposed adjustment is known and measurable, is reasonable, and should be approved.

H. Big Rivers has withdrawn its proposed adjustment to reflect current interest on construction (CWIP), and KIUC's proposal to reduce Big Rivers' base rate revenue deficiency for a 1.24 TIER on interest charged to construction should be rejected.

In its application, Big Rivers proposed an adjustment to reflect current interest on Construction Work In Progress ("CWIP"); however, Big Rivers no longer seeks such an adjustment.[189] Although Big Rivers does not agree with KIUC witness Lane Kollen's position that such an adjustment is inappropriate since such recovery is permissible in Kentucky and results in lower rates over time, Big Rivers does agree with Mr. Kollen that the adjustment would exert greater financial pressure on it.[190] As noted by Mr. Wolfram, foregoing the adjustment "is more advantageous for Big Rivers at this time than the CWIP approach from the standpoint of enhancing margins and improving Big Rivers' MFIR."[191] Therefore, Big Rivers is no longer seeking this adjustment.

---

[186] Hite Rebuttal Testimony at p. 13; Wolfram Rebuttal Testimony, Exhibit Wolfram Rebuttal-2, Reference Schedule 2.07; Wolfram Rebuttal Testimony at p. 6.
[187] Hite Rebuttal Testimony at p. 13.
[188] Wolfram Rebuttal Testimony, Exhibit Wolfram Rebuttal-2 at p. 1, l. 17; *id.*, Exhibit Wolfram Rebuttal-2, Reference Schedule 2.07.
[189] *Id.*, Exhibit Wolfram Rebuttal-2 at p. 1, l. 18; *id.*, Exhibit Wolfram Rebuttal-2, Reference Schedule 2.08; Wolfram Rebuttal Testimony at p. 6-7.
[190] Wolfram Rebuttal Testimony at p. 7.
[191] *Id.*

KIUC proposes a $123,784 reduction in Big Rivers' revenue requirement based on the assertion that TIER should be calculated net of interest charged to construction – credit, where he computed a 1.24 TIER on the $515,767 of interest charged to construction – credit, amounting to the $123,784.[192] However, that argument is flawed.[193] Big Rivers, an RUS borrower, is subject to the definition of TIER provided in the RUS Uniform System of Accounts, in particular 7 CFR Section 1710.2, Definitions and Rules of Construction.[194] That definition generally defines TIER as (A+B)/A, where A equals Section A, Line 22 of RUS Form 12a; and B equals Section A, Line 36 of Form 12a.[195] That is precisely how Big Rivers and other RUS G&T cooperative borrowers have historically computed Conventional TIER.[196] Accordingly, KIUC's proposed adjustment to reduce Big Rivers' revenue requirement for a 1.24 TIER on interest charged to construction is inconsistent with the RUS Uniform System of Accounts and incorrect, and therefore should be rejected.[197]

I. Big Rivers' proposed adjustment to eliminate RRI Domtar Cogen Backup revenue and expenses is fair, just, and reasonable.

Big Rivers proposes an adjustment to eliminate the revenues and expenses associated with Big Rivers' contract with RRI Energy, Inc. to provide backup services for the Domtar Cogenerator because the contract was not renewed once it expired in March 2011.[198] Big Rivers will instead rely on the Midwest ISO

[192] Direct Testimony of Lane Kollen at p. 11; *see also* Hite Rebuttal Testimony at p. 12.
[193] Hite Rebuttal Testimony at p. 12.
[194] *Id.*
[195] *Id.*
[196] *Id.*
[197] *Id.*
[198] Hite Direct Testimony at p. 23; Wolfram Direct Testimony at p. 11.

for backup services for the Domtar Cogenerator, with Domtar paying all associated costs.[199] Because the revenues and expenses associated with the RRI contract are nonrecurring, this adjustment removes them from the test year results.[200] This adjustment produces a net increase of $971,257 to Big Rivers' test year margins.[201] No party has controverted this adjustment, it is reasonable, and it should be approved.

J. Big Rivers' proposed adjustments to reflect a reasonable level of going-forward maintenance-related expenses are fair, just, and reasonable.

Big Rivers proposes two critical adjustments to test year expenses relating to maintenance expenses on its generating units, one for non-outage operations and maintenance ("O&M") expense and the other for planned outage expense. The proposed *pro forma* adjustment for Production Fixed O&M Expenses, Excluding Planned Outage Expenses increases test year expenses by $5,660,678.[202] (Revised) Exhibit Berry-3 contains a detailed list of planned expenses supporting the proposed O&M adjustment.[203] The proposed adjustment is necessary for Big Rivers to return to a level of O&M expense that will allow it to prudently maintain its generating units on a going-forward basis.[204]

---

[199] Hite Direct Testimony at p. 23; Wolfram Direct Testimony at p. 11.
[200] Wolfram Direct Testimony at p. 11.
[201] Hite Direct Testimony at p. 23; Wolfram Direct Testimony, Exhibit Wolfram-2 at p. 1, l. 19; *id.*, Exhibit Wolfram-2, Reference Schedule 2.09.
[202] Berry Direct Testimony at p. 11-12; Wolfram Direct Testimony, Exhibit Wolfram-2 at p. 1, l. 20; *id.*, Exhibit Wolfram-2, Reference Schedule 2.10; Wolfram Direct Testimony at p. 8.
[203] Big Rivers' May 11, 2011, response to Item 34 of KIUC's Second Request for Information (KIUC 2-34), (Revised) Exhibit Berry-3.
[204] Berry Rebuttal Testimony at p. 6.

The proposed *pro forma* adjustment for Planned Outage Expenses increases test year expenses by $2,726,965.[205] The optimal number of annual planned outage hours for the Big Rivers generating system is between 3,500 hours and 4,000 hours per year; Big Rivers' five-year (2005-2009) historical average of annual planned outages is approximately 3,718 hours, while the planned outage hours in 2010 and 2011 were 1,485 hours and 2,016 hours respectively, both significantly below the optimal and historical annual averages.[206] As shown in Exhibit Berry Rebuttal-1, the outage frequency on Big Rivers' generating units is not prudent on a going-forward basis.[207] The proposed adjustment will allow Big Rivers to return to a level of planned outage expenses that is prudent on a going-forward basis.[208]

Although the reliability of the Big Rivers generating facilities has been excellent since the closing of the Unwind Transaction, reliability will suffer in the long term without these proposed adjustments.[209] The high level of reliability experienced since the closing of the Unwind Transaction is a result of maintenance done on the generating units in previous years.[210] However, during the test year and since, Big Rivers has been required to reduce O&M expenditures and defer scheduled outages to be able to achieve the MFIR required by its loan documents.[211]

---

[205] Berry Direct Testimony, Exhibit Berry-2; Wolfram Direct Testimony, Exhibit Wolfram-2 at p. 1, l. 21; *id.*, Exhibit Wolfram-2, Reference Schedule 2.11.
[206] Berry Direct Testimony at p. 9.
[207] *See* Berry Rebuttal Testimony, Exhibit Berry Rebuttal-1.
[208] Berry Rebuttal Testimony at p. 6.
[209] Berry Direct Testimony at p. 4-5.
[210] *Id.* at p. 8-9.
[211] *Id.* at p. 4.

Big Rivers' planned outage expense during the test year (November 1, 2009, through October 31, 2010) was $11.7 million compared to its historical five-year outage expense (2006-2010) of $14 million per year.[212] The reduced outage expenditures were the result of Big Rivers deferring $3,866,966 of planned outage expense originally scheduled for the test year.[213] Similarly, Big Rivers deferred $1,511,091 of non-outage O&M expense out of the test year.[214]

As a result of Big Rivers deferring maintenance that was initially planned to occur in the test year, it also became necessary for Big Rivers to defer maintenance initially planned for 2011 so that the maintenance deferred from the test year could be performed in 2011 and Big Rivers could still achieve the MFIR necessary to meet its loan covenants.[215] Because of that cascading effect of the test-year deferrals along with continuing concerns about achieving the minimum MFIR in 2011, Big Rivers was forced to defer additional maintenance expenses after the end of the test year, including $149,000 in non-outage O&M expense and $13,186,571 in planned outage expense that were originally scheduled for the period between November 1, 2010, and June 30, 2011.[216]

While the test year level of outage and O&M spending was adequate on a short-term basis, it would be imprudent on a long term basis.[217] If Big Rivers is unable, because of its financial condition, to return to a sustainable level of outage and O&M expenditures, the reliability of the units will suffer, increasing

---

[212] *Id.* at p. 8.
[213] Big Rivers' August 4, 2011, response to Item 3 of the Hearing Information Requests.
[214] *Id.*
[215] *See* Berry Direct Testimony at p. 8.
[216] Big Rivers' August 4, 2011, response to Item 3 of the Hearing Information Requests.
[217] Berry Direct Testimony at p. 4.

forced outages, repair costs, and purchase power expenses.[218] If Big Rivers continues with test year levels for scheduled outages and O&M activities, (1) the condition of the generating units will deteriorate, (2) Big Rivers will experience increased forced outages, (3) repair costs will increase since they will be done more on an emergency basis than on a planned basis, and (4) since forced outages cannot be planned to take advantage of market conditions, Big Rivers' purchased power costs will almost certainly increase and its ability to generate off system sales will almost certainly decrease, This will be devastating to Big Rivers' financial condition since Big Rivers' margins are derived exclusively from its off-system sales.[219] Thus, if Big Rivers continues to defer maintenance activities, Big Rivers' ability to provide safe, reliable and economic power to its members will be compromised.[220]

Big Rivers based its proposed maintenance-related adjustments on the average O&M and outage expenses it has planned over the four-year period 2011-2014.[221] Big Rivers is in a unique situation at the present time.[222] Prior to the Unwind Transaction, Big Rivers' generating assets were operated by affiliates of E.ON U.S. LLC ("E.ON U.S."), pursuant to lease agreements established in 1998.[223] The Unwind Transaction closed on July 16, 2009, and at that time Big Rivers resumed full control of the generation assets.[224] Approximately four months later, November 1, 2009, marked the beginning of

---

[218] *Id.* at p. 4-5.
[219] Berry Rebuttal Testimony at p. 4.
[220] *Id.*
[221] Berry Rebuttal Testimony at p. 5-6.
[222] Wolfram Rebuttal Testimony at p. 9.
[223] *Id.*
[224] *Id.*

the 12 month test year utilized in this rate case; the test year ended on October 31, 2010 and the case was filed on March 1, 2011.[225] As noted above, throughout the test year and since, Big Rivers deferred substantial amounts of maintenance. Thus, test year outage and O&M expenses are not representative of a typical year, and Big Rivers does not have the historical records necessary to develop the maintenance-related *pro forma* adjustment using historical costs.[226] However, Big Rivers does have a detailed plan of maintenance expenses for 2011 through 2014.[227] In light of this unique position, it is reasonable to use the planned expenses as the basis for the maintenance-related *pro forma* adjustments.[228]

The four-year period was chosen because that is the period for which Big Rivers has detailed plans.[229] Also, because of the 2010 and 2011 deferrals, Big Rivers anticipates nearly 7,500 hours of outage maintenance at an estimated cost of approximately $32 million over the next two years, which returns Big Rivers to the optimal range.[230] By the end of 2012, the maintenance work that was deferred during 2010 and 2011 will be completed, provided Big Rivers

---

[225] *Id.* at p. 9-10.
[226] Berry Rebuttal Testimony at p. 5-6; Wolfram Direct Testimony, Exhibit Wolfram-2, Reference Schedule 2.11.
[227] *See* Big Rivers' May 11, 2011, response to Item 4 of the Commission Staff's Third Request for Information (PPSC 3-4); Berry Direct Testimony, Exhibit Berry-2; Big Rivers' May 11, 2011, response to Item 34 of KIUC's Second Request for Information (KIUC 2-34), (Revised) Exhibit Berry-3.
[228] Berry Rebuttal Testimony at p. 6.
[229] *See* Big Rivers' May 11, 2011, response to Item 4 of the Commission Staff's Third Request for Information (PSC 3-4); Berry Direct Testimony, Exhibit Berry-2; Big Rivers' May 11, 2011, response to Item 34 of KIUC's Second Request for Information (KIUC 2-34), (Revised) Exhibit Berry-3.
[230] Berry Direct Testimony at p. 11.

receives the full rate increase it is requesting.[231] Because of the deferrals, 2011 represents a below-normal year of maintenance expenses, while 2012 represents an above-normal year for maintenance expenses, and using 2011 or 2012 alone as the basis for the adjustments would not produce a reasonable level of on-going expenses.[232] Using the four-year average not only averages out 2011 and 2012, but it also provides two additional years of more normal maintenance expenditures to provide a reasonable basis of prudent maintenance expenses on a going-forward basis.[233]

Moreover, even with all of the proposed maintenance-related *pro forma* adjustments, the average annual maintenance expense included in Big Rivers' current 2011-2014 Production Business Plan is approximately $2.3 million less than the average annual maintenance expense that was included in the financial model filed with the Commission in the Unwind Case.[234]

KIUC has not challenged Big Rivers' maintenance-related *pro forma* adjustments, except for the inclusion of some of the inflation used in calculating the adjustment for non-outage O&M expense.[235] In fact, KIUC does not challenge the inclusion of inflation for 2011, and on page 16 of his direct testimony, KIUC witness Lane Kollen states, "The Company's proposal to include specific incremental maintenance expenses in addition to the test year expense in and of itself provides a significant and reasonable increase in the

[231] *Id.*
[232] *See, e.g.,* Berry Direct Testimony, Exhibit Berry-2.
[233] *See* Berry Rebuttal Testimony at p. 5.
[234] Berry Direct Testimony at p. 12-13.
[235] Berry Rebuttal Testimony at p. 2; Wolfram Rebuttal Testimony at p. 8.

maintenance expense."[236] Mr. Kollen also "recognize[d] that there is a balance between rigid adherence to the cost structure in the historical test year and the need to provide revenue sufficient to cover the present and ongoing cost structure of the utility."[237]

The proposed *pro forma* maintenance-related adjustments do include an inflation factor, and such inclusion is reasonable.[238] First, the inflation factor was reasonably derived using the ten-year average Consumer Price Index ("CPI") from 2000 to 2010.[239] Second, maintenance expenses are subject to inflation.[240] Unless inflation is included, Big Rivers will not have sufficient funds to absorb the inevitable increase in the cost of goods and services and to operate its generating plants in a safe and reliable manner.[241] Third, the Commission has taken inflation into account in setting rates in other cases, even when the rate case application is based on a historical test year.[242]

KIUC argues that if the Commission allows Big Rivers' inflation adjustment, it should also take into account future revenues from the TIER Adjustment

---

[236] Direct Testimony of Lane Kollen at p. 15-16.
[237] KIUC's June 22, 2011, response to Item 15 of the Commission Staff's Initial Request for Information.
[238] Berry Rebuttal Testimony at p. 5-6; Wolfram Rebuttal Testimony at p. 8.
[239] Berry Rebuttal Testimony at p. 5.
[240] Wolfram Rebuttal Testimony at p. 10.
[241] Berry Rebuttal Testimony at p. 5.
[242] *See, e.g.,* Order dated June 30, 2004, in *In the Matter of: An Adjustment of the Gas and Electric Rates, Terms, and Condition of Louisville Gas and Electric Company*, PSC Case No. 2003-00433 (allowing inflation adjustment for storm damage expense and injuries and damages expense); Order dated January 18, 1984, in *In the Matter of: Notice of South Central Bell Telephone Company of an Adjustment in its Intrastate Rates and Charges and The Volume Usage Measured Rate Service and Multiline Service Bell Telephone Company Tariff Filing of South Central Bell Telephone Company*, PSC Case Nos. 8847, 8879 (disallowing certain proposed adjustments to the utility's corporate and community affairs expense but making an inflation adjustment to that expense).

Charge.[243] However, Big Rivers has only deviated from the historical test year where, because of Big Rivers' unique situation that is comparable to that of a start-up company, historical costs are not available.[244] Future revenue from the TIER Adjustment Charge, on the other hand, is predicted in Big Rivers' financial forecast; it is not known and measurable; and there is a significant difference between the financial forecast and Big Rivers' proposed adjustments.[245]

The proposed *pro forma* adjustments (including the effect of inflation, which was determined in a conventional manner using publicly-available data from an independent source) are necessary to allow Big Rivers to operate its generating plants in a safe and reliable manner, are reasonable, and should be approved.[246]

K. Big Rivers' proposed adjustment to reflect going-forward IT support services is fair, just, and reasonable.

Big Rivers proposes an adjustment to increase test year expenses by $292,194 to reflect the contractual levels of expense associated with Information Technology ("IT") support services in a seven-year service contract with HP (formerly EDS) for Oracle application and infrastructure support as identified in the Unwind Case filing, which was approved by this Commission.[247] During the test year, Big Rivers received IT support services from a subsidiary of LG&E and KU Energy LLC (formerly E.ON U.S.).[248] E.ON U.S. provided those

[243] Direct Testimony of Lane Kollen at p. 16.
[244] Testimony of Mark A. Hite, July 27, 2011, Tr. 14:01'20.
[245] *Id.* at 14:01'20; *id.* at 14:04'00.
[246] Wolfram Rebuttal Testimony at p. 10.
[247] Wolfram Direct Testimony at p. 12; Wolfram Direct Testimony, Exhibit Wolfram-2 at p. 1, l. 22; *id.*, Exhibit Wolfram-2, Reference Schedule 2.12.
[248] Hite Direct Testimony at p. 23.

services from the closing of the Unwind Transaction on July 16, 2009, until Big Rivers went "live" with its Oracle system on November 1, 2010.[249] Big Rivers engaged HP to expedite the transition from the two former business information systems of an E.ON U.S. subsidiary and Big Rivers to the new Oracle system for Big Rivers.[250] The amount of the adjustment represents the increase from Big Rivers' agreement with E.ON U.S. to the contract amount under Big Rivers' agreement with HP.[251] The HP agreement enables Big Rivers to have a known cost for its business information systems.[252] No party has controverted this proposed adjustment, it is fair, just, and reasonable, and it should be approved.

L. Big Rivers' proposed adjustment to reflect the amortization of rate case expenses is fair, just, and reasonable.

Consistent with Commission practice, Big Rivers proposes to amortize the costs incurred in conjunction with this base rate case over a three year period.[253] During the test year, Big Rivers incurred expenses totaling $17,924, and it anticipated it would incur a total of $1,500,000 in connection with this rate case.[254] Those costs include the cost of service and rate design study and the depreciation study filed in this proceeding.[255] This adjustment increases Big Rivers' test year expenses by $482,076, which is one third of the total

[249] *Id.*
[250] Wolfram Direct Testimony, Exhibit Wolfram-2, Reference Schedule 2.12.
[251] Hite Direct Testimony at p. 24.
[252] Wolfram Direct Testimony, Exhibit Wolfram-2, Reference Schedule 2.12.
[253] Hite Direct Testimony at p. 24; Wolfram Direct Testimony at p. 12.
[254] Big Rivers Hearing Exhibit 1, Revised Exhibit Wolfram Rebuttal-2, Reference Schedule 2.13.
[255] Hite Direct Testimony at p. 24.

anticipated costs less the test year amount.[256] The Commission recently approved a similar adjustment for Delta Natural Gas Company[257] and has approved similar adjustments in numerous other general rate case proceedings.[258]

Big Rivers' rate case expenses have been reasonable. This rate case was unusual for Big Rivers. It has been over 20 years since Big Rivers filed a general rate case.[259] Also, Big Rivers emerged from the Unwind Transaction a mere two years ago, and since that time, it has joined the Midwest ISO.[260] And, in accordance with the Unwind Order, this rate case involved a cost of service study and a depreciation study.[261]

Big Rivers has no in-house rate department or legal counsel. Big Rivers brought in legal counsel from Washington, D.C. because of their familiarity with Big Rivers' history, the Unwind Transaction, and the Smelter agreements; their experience in dealing with RUS and CFC borrowers; and their expertise with the Federal Energy Regulatory Commission ("FERC") in relation to Big Rivers' Midwest ISO membership. No party has controverted this proposed adjustment, it is reasonable, and it should be approved.

---

[256] Big Rivers Hearing Exhibit 1, Revised Exhibit Wolfram Rebuttal-2, Reference Schedule 2.13; Hite Direct Testimony at p. 24; Wolfram Direct Testimony, Exhibit Wolfram-2 at p. 1, l. 23; *id.*, Exhibit Wolfram-2, Reference Schedule 2.13.
[257] *See* Order dated October 21, 2010, in *In the Matter of: Application of Delta Natural Gas, Inc., for an Adjustment of Rates*, PSC Case No. 2010-00116, at 12-13.
[258] Wolfram Direct Testimony at p. 12.
[259] Testimony of Mark A. Hite, July 27, 2011, Tr. 14:17'50.
[260] *Id.*
[261] *Id.*

M. Big Rivers' proposed adjustment to reflect Midwest ISO related expenses is fair, just, and reasonable.

Big Rivers proposes an increase in test year expenses to reflect the on-going level of expenses related to Big Rivers' membership in the Midwest ISO.[262] Joining the Midwest ISO was the least-cost means available to enable Big Rivers to satisfy its Contingency Reserve obligations and avoid potential penalties for non-compliance from the North American Electric Reliability Corporation ("NERC") and the SERC Reliability Corporation ("SERC").[263] Big Rivers' membership in the Midwest ISO is necessary, and Big Rivers incurs and will continue to incur costs as a result.[264]

Big Rivers became a fully-integrated transmission-owning member of the Midwest ISO on December 1, 2010, after the end of the test year, and therefore, no costs associated with fully-integrated Midwest ISO membership are reflected in the test year.[265] As a member of the Midwest ISO, Big Rivers will incur costs pursuant to certain schedules of the Midwest ISO Open Access Transmission, Energy and Operating Reserve Markets Tariff ("Midwest ISO Tariff").[266] The costs that comprise this adjustment are limited to the administrative charges associated with Big Rivers' membership in the Midwest ISO for 2011,[267] and are derived from data provided to Big Rivers by the

---

[262] Direct Testimony of David G. Crockett ("Crockett Direct Testimony") at p. 4; Wolfram Direct Testimony at p. 12.
[263] Crockett Direct Testimony at p. 4.
[264] *Id.* at p. 11.
[265] Crockett Direct Testimony at p. 4; Wolfram Direct Testimony at p. 12-13.
[266] Crockett Direct Testimony at p. 7-8; Wolfram Direct Testimony at p. 13.
[267] Big Rivers will be subject to other charges (or credits) pursuant to the Midwest ISO Tariff that are not included in the proposed adjustment, including but not limited to Schedules 24 (Local Balancing Authority Cost Recovery) and 26 (Network Upgrade from Transmission Expansion

Midwest ISO.[268] Since Big Rivers did not become a member of the Midwest ISO until after the end of the test year, Big Rivers based its adjustment on cost projections from the Midwest ISO, which was the best information available to Big Rivers.[269]

In its rebuttal testimony, Big Rivers removed $61,556.38 of non-recurring test year expense from its *pro forma* amount identified in Big Rivers' May 11, 2011, response to Item 39 of KIUC's Second Request for Information.[270] The revised adjustment increases Big Rivers' test year expenses by a total of $5,353,444.[271] No party has controverted this adjustment, it is reasonable, and it should be approved.

N. Big Rivers' proposed adjustment to annualize interest on long-term debt is fair, just, and reasonable, and KIUC's proposal to reduce interest expense for the interest saved (plus the TIER thereon) by Big Rivers' $35 million prepayment of RUS debt should be denied.

Big Rivers proposes to increase test year expenses by $70,408 to annualize, on a GAAP basis, interest expense on long-term debt by applying the interest rates in effect at the end of the test year to Big Rivers' debt outstanding at that time.[272] This adjustment is known and measurable and reasonable, and it should be made.

Plans) of the Midwest ISO Tariff, and charges for Revenue Sufficiency Guarantee and Revenue Neutrality Uplift. Crockett Direct Testimony at p. 7-8; Wolfram Direct Testimony at p. 14.
[268] Wolfram Direct Testimony at p. 13.
[269] *Id.*
[270] *See* Wolfram Rebuttal Testimony at p. 8; *id.*, Exhibit Wolfram Rebuttal-2, Reference Schedule 2.14.
[271] *Id.*, Exhibit Wolfram Rebuttal-2 at p. 1, l. 24; *id.*, Exhibit Wolfram Rebuttal-2, Reference Schedule 2.14.
[272] Hite Direct Testimony at p. 24; Wolfram Direct Testimony, Exhibit Wolfram-2 at p. 1, l. 25; *id.*, Exhibit Wolfram-2, Reference Schedule 2.15.

KIUC argues that interest expense should be reduced to account for the interest saved (plus the TIER thereon) by Big Rivers' $35 million prepayment on the RUS Series A note from the Transition Reserve on April 1, 2011.[273] This is not appropriate because Big Rivers' base rate revenue deficiency is based on Big Rivers achieving a 1.24 Contract TIER.[274] The Smelter agreements provide that the calculation of Contract TIER is to exclude any Big Rivers' margin impact derived from use of the Transition Reserve.[275] That is precisely why Big Rivers' Application excluded the $271,105 actual interest income on the Transition Reserve from the calculation of the 1.24 Contract TIER.[276] Since Big Rivers' use of the Transition Reserve to prepay debt has no effect on the calculation of Contract TIER, and as Big Rivers' Application determined its base rate revenue deficiency for the purpose of establishing base rates based upon achieving a 1.24 Contract TIER, no change in Big Rivers' proposed revenue deficiency is warranted as a result of the use of the Transition Reserve to prepay debt. The Commission should reject KIUC's proposal.[277]

O. Big Rivers' proposed adjustment to reflect the removal of non-recurring rental expense is fair, just, and reasonable.

Big Rivers proposes to reduce test year expenses by $128,368 to remove non-recurring rental expense incurred during the test year to provide office space for certain employees that transferred from WKEC to Big Rivers.[278] The

---

[273] Direct Testimony of Lane Kollen at p. 7.
[274] Hite Rebuttal Testimony at p. 10.
[275] *Id.*
[276] *Id.*
[277] *Id.* at p. 11.
[278] Hite Direct Testimony at p. 25; Wolfram Direct Testimony at p. 14; *id.*, Exhibit Wolfram-2 at p. 1, l. 26; *id.*, Exhibit Wolfram-2, Reference Schedule 2.16.

additional office space was required until Big Rivers finished remodeling its headquarters building to accommodate the additional staff.[279] No party has controverted this proposed adjustment, it is reasonable, and it should be approved.

P. Big Rivers' proposed adjustment to remove non-recurring costs related to LEM Dispatch is fair, just, and reasonable.

Big Rivers proposes to decrease test year expenses by $936,815 to remove non-recurring costs associated with a now-expired agreement between Big Rivers and LG&E Energy Marketing Inc. ("'LEM") for LEM to provide dispatch services for the Big Rivers generation fleet upon the closing of the Unwind Transaction.[280] That agreement expired simultaneously with Big Rivers' integration into the Midwest ISO on December 1, 2010, and the Midwest ISO now provides dispatch services for the Big Rivers generation fleet.[281] No party has controverted this proposed adjustment, it is reasonable, and it should be approved.

Q. Big Rivers' proposed adjustment for costs related to APM is fair, just, and reasonable.

Big Rivers proposes to increase test year expenses by $205,090 to reflect an increase in the cost of services provided to Big Rivers by ACES Power Marketing ("APM") that went into effect January 1, 2011.[282] APM provides energy risk management and trading services to Big Rivers, and APM's efforts on behalf of

---

[279] Hite Direct Testimony at p. 25; Wolfram Direct Testimony at p. 14; *id.*, Exhibit Wolfram-2, Reference Schedule 2.16.
[280] Wolfram Direct Testimony at p. 15; *id.*, Exhibit Wolfram-2 at p. 1, l. 27; *id.*, Exhibit Wolfram-2, Reference Schedule 2.17.
[281] Wolfram Direct Testimony at p. 15; *id.*, Exhibit Wolfram-2, Reference Schedule 2.17.
[282] *Id.*, Exhibit Wolfram-2 at p. 1, l. 28; *id.*, Exhibit Wolfram-2, Reference Schedule 2.18.

Big Rivers have increased substantially since Big Rivers integrated into the Midwest ISO.[283] Under the contract between Big Rivers and APM, APM's fees increased effective January 1, 2011.[284] No party has controverted this proposed adjustment, it is reasonable, and it should be approved.

R. Big Rivers' proposed adjustments to eliminate WKEC Lease Expenses; to eliminate WKEC Unwind-related Expenses (Non-Labor); and to eliminate WKEC Unwind-related Expenses (Labor-related) are fair, just, and reasonable.

Big Rivers proposes an adjustment associated with several accounting entries made during the test year to true-up issues associated with the Unwind closing.[285] The proposed adjustment is to remove all such amounts included in the test year, resulting in a $4,969,813 decrease in test year expenses.[286] More specifically, the adjustment eliminates WKEC Lease expenses, which increases Big Rivers' test year expenses by $149,673; it eliminates WKEC Unwind-related expenses (Non-Labor), which increases Big Rivers' test year expenses by $2,357,097; and it eliminates WKEC Unwind-related expenses (Labor-related), which decreases Big Rivers' test year expenses by $7,476,583.[287] No party has controverted this proposed adjustment, it is reasonable, and it should be approved.

[283] Wolfram Direct Testimony at p. 15-16; Big Rivers' April 15, 2011, response to Item 14 of the Commission Staff's Second Request for Information (PSC 2-14).
[284] Wolfram Direct Testimony at p. 15.
[285] Hite Direct Testimony at p. 25; Wolfram Direct Testimony at p. 16.
[286] Hite Direct Testimony at p. 25.
[287] Wolfram Direct Testimony, Exhibit Wolfram-2 at p. 1, l. 29-31; *id.*, Exhibit Wolfram-2, Reference Schedule 2.19.

S. Big Rivers' proposed adjustment to remove non-recurring costs for SFPC membership is fair, just, and reasonable.

Big Rivers proposes to reduce test year expenses by $180,775 to remove the non-recurring costs associated with a now-terminated membership in Southeastern Federal Power Customers ("SFPC").[288] Big Rivers terminated its long-time membership as a necessary cost-cutting measure.[289] No party has controverted this proposed adjustment, it is reasonable, and it should be approved.

T. Big Rivers' proposed adjustment to amortize Midwest ISO Case-related expenses is fair, just, and reasonable.

For ratemaking purposes, Big Rivers proposes to decrease test year expenses to reflect the amortization of non-recurring costs incurred by Big Rivers during the test year associated with the *Application of Big Rivers Electric Corporation for Approval to Transfer Functional Control of its Transmission System to Midwest Independent Transmission System Operator, Inc.*, in Case No. 2010-00043 and FERC Docket Nos. ER11-15-000 and ER11-16-000.[290] As more fully described in Case No. 2010-00043, Big Rivers' membership in the Midwest ISO was the least-cost means available to enable Big Rivers to satisfy its Contingency Reserve obligations and avoid potential penalties for non-compliance from the NERC and SERC.[291]

---

[288] Hite Direct Testimony at p. 26; Wolfram Direct Testimony, Exhibit Wolfram-2 at p. 1, l. 32; *id.*, Exhibit Wolfram-2, Reference Schedule 2.20.
[289] Hite Direct Testimony at p. 26; Wolfram Direct Testimony at p. 16.
[290] Wolfram Direct Testimony at p. 17; *id.*, Exhibit Wolfram-2 at p. 1, l. 33; *id.*, Exhibit Wolfram-2, Reference Schedule 2.21.
[291] Crockett Direct Testimony at p. 4.

These Midwest ISO case-related expenses total $1,602,777, and Big Rivers proposes to amortize those costs in its rates over a three-year period, or $534,259 per year.[292] After removing the $1,305,377 of Midwest ISO case-related expenses incurred during the test year from the test year, the net effect of the proposed adjustment is to decrease Big Rivers' test year expenses by $771,118.[293]

The amortization of the Midwest ISO case-related expenses is reasonable and appropriate because such treatment is consistent with the Commission's practice of amortizing rate case expenses and other prudently incurred but extraordinary expenses over a three year period.[294] As Mr. Wolfram explained in his rebuttal testimony:

> As noted in Big Rivers' response to Item PSC 2-26, in Case No. 90-158, the Commission allowed LG&E to amortize certain "downsizing costs," which were included in test-year expenses. In its Order on Rehearing in Case No. 90-158, the Commission recognized the material nature of the costs, the future benefits of making the expenditure, and the matching of the benefits with the costs. (See Order on Rehearing, dated September 30, 1991, at 14.) The Commission determined that it was appropriate to amortize certain downsizing costs, consisting of severance payments offset by the gain on the pension annuities, over a three year period. (*Id.*, at 15.) The criteria used by the Commission to allow amortization of LG&E's downsizing expenses are equally applicable to the Midwest ISO expenditures incurred by Big Rivers, which Big Rivers is proposing to amortize over three years. First, the $1,602,777 in expenditures incurred in connection with the Midwest ISO case are material. Second, joining Midwest ISO is expected to result in future benefits to Big Rivers and its members. Third, amortizing these costs over the period between rate cases will provide for a reasonable matching of benefits of joining the Midwest ISO with the cost of the Midwest ISO case.

---

[292] Hite Direct Testimony at p. 26.
[293] Hite Direct Testimony at p. 26.
[294] Wolfram Rebuttal Testimony at p. 11.

> ...
> As noted in response to PSC 2-26, the premise that, on average, utilities file general rate applications once every three years is equally applicable to the costs associated with the Midwest ISO proceeding. Like the costs incurred for general rate cases or LG&E's downsizing expenses, the costs associated with the Midwest ISO proceeding were prudently incurred, provide ongoing benefits, and should be eligible for recovery. The proposed amortization period would permit the recovery of these costs over a three year period, after which the costs could be entirely removed from base rates in the next general rate case (which, consistent with the premise described above, would take place at that time).[295]

The proposed adjustment is fair, just, and reasonable, and it should be approved.

U. Big Rivers' proposed adjustment to reduce TIER Adjustment revenues is fair, just, and reasonable.

The TIER Adjustment Charge is a mechanism contained in the agreements between the Smelters and Big Rivers by which the Smelters make additional payments that are intended to help Big Rivers achieve a 1.24 Contract TIER each fiscal year.[296] Under the TIER Adjustment mechanism, the Smelters agreed to support Big Rivers' earnings by paying an amount above base rates (within a bandwidth that ranges from $0 to currently up to an additional $14.2 million (approximately)) if Big Rivers' base rate revenues are insufficient to provide a 1.24 Contract TIER.[297] The TIER Adjustment Charge acts as a "reserve," "buffer," "safety net," or "flywheel" if cost increases or revenue decreases (such as when wholesale market prices soften) threaten Big Rivers' ability to achieve a 1.24 Contract TIER.[298]

[295] Wolfram Rebuttal Testimony at p. 11-12.
[296] Seelye Rebuttal Testimony at p. 31.
[297] *Id.* at p. 31-32.
[298] *Id.* at p. 32.

During the test year, the Smelters were at the top of the bandwidth and paid $14,229,306 through the TIER Adjustment Charge.[299] Big Rivers' base rate revenue deficiency was established in this case such that with the additional revenue from the rate increase and with the known and measurable adjustments to the test year proposed by Big Rivers, Big Rivers would achieve a 1.24 Contract TIER based on the test year.[300] As a function of Big Rivers' proposed increase, the TIER Adjustment Charge will be reduced from the top of the bandwidth to the middle of the bandwidth (where the Smelters will pay $7,114,653 per year through the TIER Adjustment Charge based on the historical test year).[301] Positioning the Smelters in the middle of the bandwidth restores the buffer that was intended to be provided by the TIER Adjustment mechanism.[302]

That $7.1 million reduction in the TIER Adjustment Charge from the historical test year level is added to Big Rivers' base rate revenue deficiency to produce the total $39.3 million revenue deficiency and is allocated across all customer classes under Big Rivers' proposal.[303] Big Rivers believes that its proposal is a reasonable balancing of all interests.[304]

First, it balances the Smelters' interest because it reduces the TIER Adjustment Charge the Smelters pay by $7.1 million based on the test year, whereas the Smelters are requesting to stay at the top of the bandwidth and

---

[299] Seelye Direct Testimony at p. 24.
[300] Wolfram Direct Testimony at p. 6-7.
[301] Seelye Direct Testimony at p. 6-7, 24; Seelye Rebuttal Testimony at p. 32.
[302] Seelye Rebuttal Testimony at p. 32.
[303] Seelye Rebuttal Testimony at p. 32; Big Rivers Hearing Exhibit 1, Revised Exhibit Wolfram Rebuttal-1.
[304] Seelye Direct Testimony at p. 25.

continue to pay the maximum TIER Adjustment Charge of $14.2 million based on the historical test year despite their contentions that any increase in their rates makes it more likely that they will not be able to stay in business.[305] On the other hand, based on the *pro forma* test year, it also caps the Smelters' TIER Adjustment Charge at $7.1 million rather than the $14.2 million exposure that would have resulted had Big Rivers requested an additional $7.1 million base rate increase to force the TIER Adjustment Charge to the bottom of the bandwidth.[306]

Second, it balances the interest of the Rural and Large Industrial customer classes because it only puts one-half of the TIER Adjustment Charge into base rates.[307] Had Big Rivers proposed to reduce the TIER Adjustment Charge to the bottom of the bandwidth, it would have increased Big Rivers' base rate revenue deficiency by another $7.1 million to a total of approximately $46.3 million, which would have been the total increase spread across all customer classes.[308]

Third, it balances the interests of Big Rivers by returning the TIER Adjustment Charge to a level that allows for a buffer to protect Big Rivers as intended by the Smelter agreements entered into in the Unwind Transaction.[309] Restoring the buffer reinstates a key benefit to Big Rivers that the Smelters agreed to provide as part of the Unwind Transaction.[310] Within the severe constraints of the Smelter agreements, the TIER Adjustment mechanism gives

[305] *See* Direct Testimony of Henry W. Fayne at p. 7, 11.
[306] Seelye Direct Testimony at p. 25.
[307] *Id.*
[308] *See id.*
[309] *See* Seeley Rebuttal Testimony at p. 32.
[310] *Id.* at p. 33-34.

Big Rivers a small amount of financial flexibility—but still far less flexibility than is available to almost any other utility. Restoring this flexibility is also important for Big Rivers to keep its investment grade credit ratings.[311]

Big Rivers' has a very narrow financial window within which to operate.[312] Big Rivers had an operating margin in 2010 of $4,256,517, which made it 30th out of 59 listed G&Ts listed in the Annual Directory of the G&T Accounting & Finance Association.[313] Big Rivers' total operating revenues for that year were $527,324,452, making Big Rivers' operating margin less than one percent, which leaves very little room for error.[314] Moreover, under the Smelter agreements, Big Rivers cannot earn more than a 1.24 Contract TIER, which caps Big Rivers' margins at approximately $11.4 million for Contract TIER.[315] The difference between a 1.24 Contract TIER and Big Rivers' minimum 1.10 MFIR obligation is only $6.9 million.[316] Additionally, even if Big Rivers gets the full amount of its request, its Conventional TIER will still be very low compared to other G&Ts.[317] Big Rivers' 2010 Conventional TIER of 1.15 put it 45th out of the 48 G&Ts listed in the Annual Directory of the G&T Accounting & Finance Association.[318] Even with Big Rivers' full rate increase request, Big Rivers' Conventional TIER will be only 1.30 on a test year basis, which would still place

---

[311] *See id.* at p. 40.
[312] Rebuttal Testimony of Mark A. Bailey, Exhibit 60 ("Bailey Rebuttal Testimony") at p. 9.
[313] *Id.*
[314] *Id.*
[315] *Id.*
[316] Bailey Direct Testimony at p. 12.
[317] Bailey Rebuttal Testimony at p. 8.
[318] *See id.*

Big Rivers only 41st out of 48 G&Ts in the G&T Accounting & Finance Association directory mentioned above.[319]

Given the narrow window Big Rivers operates in, the protection provided by the TIER Adjustment Charge bandwidth is essential for Big Rivers to have the flexibility to address the many challenges that could arise, such as continued depressed off-system sales, forced outages, and new requirements from the EPA.[320] Restoring half of the TIER Adjustment buffer will provide $7.1 million in available funds for Big Rivers to meet any differences that could arise between *pro forma* operating results developed in this proceeding and actual operating results that occur once the rates go into effect.[321]

If Big Rivers' *pro forma* test year assumption were that the Smelter TIER Adjustment Charge started out at the top of the TIER Adjustment Charge bandwidth, the next dollar of increased expense would result in Big Rivers earning less than a 1.24 Contract TIER. That is the point at which Moody's expects Big Rivers to file another rate case.[322]

KIUC's concern that Big Rivers will not have an incentive to control expenses if the TIER Adjustment is reduced to the middle of the bandwidth is misplaced because increases in expenses were not a primary driver for this rate case.[323] The primary reason that Big Rivers is filing this rate case earlier than was anticipated in the financial models supplied in the Unwind Proceeding is the

[319] *Id.*
[320] *Id.* at p. 10.
[321] Seelye Direct Testimony at p. 24.
[322] KIUC Hearing Exhibit 12 at p. 3.
[323] Seelye Rebuttal Testimony at p. 42.

deterioration in its margins on off-system sales.[324] In 2010, Big Rivers' off-system sales revenues were approximately $55.7 million lower than projected in the Unwind models.[325] If the power market turns around, causing Big Rivers to generate margins in excess of the margin required for a 1.24 Contract TIER, the Smelters benefit. If the Smelters' TIER Adjustment Charge is at the top of the TIER Adjustment Charge bandwidth when that occurs, the Smelters get the first $14.2 million in additional margins through a reduction in their TIER Adjustment Charge. If Big Rivers continues to achieve a Contract TIER greater than 1.24 after the TIER Adjustment Charge reaches the bottom of the bandwidth, then the Smelters and Big Rivers' members both will receive rebates or other benefits.[326]

KIUC argues that Big Rivers' base rate revenue deficiency should be reduced by $7.1 million to keep the Smelters at the top of the bandwidth because the Smelters are projected to be at the top of the bandwidth under Big Rivers' financial forecast, even if Big Rivers is given its full request.[327] However, KIUC's argument is circular and ignores the fact that Big Rivers' base rate revenue deficiency is based upon a historical test year.[328] Mr. Seelye explained this distinction at the hearing:

> MR. KURTZ: So you understand that the KIUC position on just that one adjustment is that the rate increase on all customers should be $32 million and not $39 million because in the real world it's our belief that the Smelters are to continue to pay at the top of the TIER adjustment just as Mr. Blackburn yesterday testified they will.

---

[324] *Id.*
[325] *Id.*
[326] *Id.* at p. 42-43.
[327] *See* Direct Testimony of Henry W. Fayne at p. 7.
[328] Seelye Rebuttal Testimony at p. 43.

MR. SEELYE: The real world in terms of this rate case is that we are dealing with a historical test year that establishes the basis for the going forward rates. That's what we are dealing with. We are not dealing with the forecast that might occur. We did not file a forecasted test year. We filed a historical test year. Therefore, *vis à vis* that historical test year the $7.1 million has simply been shifted to the base rates in order to restore the operation of the Smelter agreements.

. . .

MR. KURTZ: Now, let's go to your Exhibit 6, the KIUC number 7. The base rate increase on the Smelters is $22.5 million? Right?

MR. SEELYE: Correct.

MR. KURTZ: Now. That's what they are going to pay unless on September 1 they get a reduction through TIER Adjustment. But we know that's not what's going to happen?

MR. SEELYE: We don't know that.

MR. KURTZ: Mr. Blackburn knows that it's not going to happen. The financial forecast knows that it's not going to happen. The whole Big Rivers rebuttal case is that Big Rivers can barely earn a 1.10 MFIR even if you get every penny of this case. How in the world is Big Rivers going to reduce the Smelter's rate $7.1 million?

MR. SEELYE: If everything turns out down the road over the next three years exactly what was proposed in the rate case then they will get back $7.1 million. Now, what you are doing is taking and looking out into the future, and looking at financial projections. This is not a forecasted test year. What we are working with is a historical test year and if you want to use the financial forecast we would be looking at a $50 million increase rather than a $38 million increase. Therefore, you're picking one element and saying "we like that" but ignoring the other elements which would result in a $50 million increase. Therefore, you've got apples and oranges.[329]

KIUC relies on historical test year costs to establish a revenue requirement but looks to forecasted results to argue that the Smelters' TIER Adjustment

[329] Testimony of William Steven Seelye, July 27, 2011, Tr. 15:28'15.

Charge should stay at the top of the bandwidth.[330] However, based on Big Rivers' proposal, if Big Rivers' actual operating results turn out exactly like the *pro forma* operating results developed for the test year in this proceeding, then Big Rivers would bill a TIER Adjustment Charge of $7.1 million to the Smelters.[331] If Big Rivers' expenses are higher or revenues are lower than what was developed in the test year, but with everything else equal, then Big Rivers would be able to increase the TIER Adjustment Charge to the Smelters by up to an additional $7.1 million.[332] On the other hand, if Big Rivers' expenses are lower or revenues are higher than what was developed in the test year, but again with everything else equal, then Big Rivers would lower the $7.1 million TIER Adjustment Charge billed to the Smelters.[333]

KIUC's proposal to set Big Rivers rates so that the TIER Adjustment Charge stays at the top of the bandwidth leaves Big Rivers with insufficient financial flexibility, and it needlessly risks Big Rivers' viability. If the financial forecast is accurate, Big Rivers will need more revenue than it will get even with the full $39.3 million increase; in fact, as noted in Mr. Seelye's testimony, if Big Rivers' rate case were based on a forecasted test year, the revenue increase needed by Big Rivers would have been around $50 million.[334] So, even with Big Rivers' full request, Big Rivers projects that it will need the full amount provided by the TIER Adjustment mechanism in the near term. Without the flexibility provided by the Smelters being in the middle of the bandwidth, Big Rivers will have no

[330] Seelye Rebuttal Testimony at p. 43.
[331] Seelye Direct Testimony at p. 24.
[332] *Id.*
[333] *Id.*
[334] Testimony of William Steven Seelye, July 27, 2011, Tr. 15:30'27.

choice but to defer maintenance on its generating units so that it will meet its minimum MFIR.[335] KIUC's proposal to set base rates with the TIER Adjustment Charge at the top of the bandwidth would negate the use of the TIER Adjustment Charge as a financial "buffer" as contemplated in the Smelter agreements and would therefore nullify this key provision of the Smelter agreements. If the TIER Adjustment Charge is established at the top of the bandwidth in this and future rate case proceedings, Big Rivers will effectively be *permanently* deprived of the contractual benefits of the TIER Adjustment Charge as a financial buffer in the event that Big Rivers has difficulty meeting the Contract TIER following the implementation of new rates. Big Rivers' approach, on the other hand, restores the original purpose of the TIER Adjustment Charge provisions of the Smelter agreements.

Setting Big Rivers' rates to a level that moves the Smelters to the middle of the TIER Adjustment bandwidth appropriately balances the interests of all parties, gives Big Rivers essential financial flexibility, is consistent with the bargain struck by the parties (including the Smelters) in the Unwind Transaction, and is an appropriate basis for ratemaking.[336] Big Rivers' proposal is fair, just, and reasonable, and should be approved.

Also, if the Commission reduces Big Rivers' proposed base rate revenue deficiency in this case, Big Rivers asks that a corresponding reduction be made

---

[335] *See* Berry Rebuttal Testimony at p. 3.
[336] *See* Seelye Rebuttal Testimony at p. 33-36; Order dated August 10, 1987, in *In the Matter of: An Investigation of Big Rivers Electric Corporation's Rates for Wholesale Electric Service*, PSC Case No. 9885 at 8 ("We concluded that our fundamental responsibility was to seek a solution that would fairly balance the interests of all parties. This approach has longstanding support among the courts").

in test year TIER Adjustment revenues (up to a total reduction of $14,229,306, which would put the Smelters at the bottom of the bandwidth). This request is based on Big Rivers' need for the full increase requested in this case so that it will be able to address any unforeseen cost increase or revenue decrease that could jeopardize its ability to meet the MFIR provisions of its long-term debt agreements.[337] Note again that setting the TIER Adjustment Charge to either the middle or the bottom of the bandwidth will not result in a risk of over earning, because any margins Big Rivers earns above the 1.24 Contract TIER level would be returned to the Smelters and to Big Rivers' members for their non-Smelter sales (the "Non-Smelter Members").[338] The Smelter agreements require Big Rivers to rebate any margins in excess of the 1.24 Contract TIER first to the Smelters until the TIER Adjustment Charge goes to zero, and then to both the Smelters and the Non-Smelter Members, subject to the approval of the Commission and Big Rivers' Board of Directors.[339] Therefore, from a TIER perspective, it is impossible for Big Rivers to over-earn.[340]

V. Big Rivers' proposed adjustment to eliminate advertising, lobbying, donation and economic development expenses is fair, just, and reasonable.

Big Rivers proposes to remove all promotional/institutional advertising expenses, political/lobbying expenses, donations, penalties, and economic development expenses from the test year consistent with 807 KAR 5:016 and

---

[337] Seelye Rebuttal Testimony at p. 46.
[338] Seelye Rebuttal Testimony at p. 36.
[339] *Id.* at p. 36-37.
[340] *Id.* at p. 37.

Commission practice.[341] Big Rivers revised the original adjustment in accordance with its April 15, 2011, response to Item 50 of the Commission Staff's Second Request for Information to remove an additional $24,172 of lobbying expenses from the test year.[342] This revised adjustment decreases Big Rivers' test year expenses by $531,388.[343] No party has controverted this proposed adjustment. It is reasonable, and it should be approved.

W. Big Rivers' proposed adjustment to reflect the going-forward level of income taxes is fair, just, and reasonable.

Big Rivers proposes to increase test year expenses by $183,084 to reflect Big Rivers' prospective level of income taxes.[344] The adjustment removes all federal income tax expenses from the test period.[345] While Big Rivers anticipates having no federal income tax liability beyond 2011, it will incur a minor amount of state income tax expenses in connection with its APM membership.[346] Accordingly, Big Rivers is removing all test year tax expenses except for the state taxes associated with the APM membership.[347] As the test year amount was actually a credit, the effect of this *pro forma* adjustment is to increase revenue requirements by $183,084.[348] No party has controverted this adjustment, it is reasonable, and it should be approved.

---

[341] Hite Direct Testimony at p. 26-27; Wolfram Direct Testimony at p. 17; *id.*, Exhibit Wolfram-2, Reference Schedule 2.23.
[342] Big Rivers Hearing Exhibit 1, Revised Exhibit Wolfram Rebuttal-2, Reference Schedule 2.23.
[343] *Id.*, Revised Exhibit Wolfram Rebuttal-1.
[344] Hite Direct Testimony at p. 27; Wolfram Direct Testimony at p. 18; *id.*, Exhibit Wolfram-2 at p. 1, l. 36; *id.*, Exhibit Wolfram-2, Reference Schedule 2.24.
[345] Wolfram Direct Testimony at p. 18.
[346] Hite Direct Testimony at p. 27; Wolfram Direct Testimony at p. 18.
[347] Hite Direct Testimony at p. 27.
[348] *Id.*

X. *Big Rivers' proposed adjustment to reflect going-forward level of Outside Services is fair, just, and reasonable.*

Big Rivers proposes to reduce test year expenses by $1,000,000 to eliminate expenses associated with outside/professional services that were incurred in the test year that exceed the level of expenses anticipated for these services on a going-forward basis.[349] Because of the significant change in Big Rivers' operations upon the July 2009 closing of the Unwind Transaction, Big Rivers does not believe its pre-Unwind expenses are comparable to what will be its on-going level of post-Unwind expenses for outside/professional services, and it does not have sufficient historical data to reflect this post-Unwind expense.[350] Additionally, given the short time since the Unwind Transaction closing, Big Rivers does not have sufficient historical data upon which to form the basis of its proposed adjustment.[351] Instead, Big Rivers bases the proposed reduction on the professional judgment of its Senior Vice President Financial & Energy Services and Chief Financial Officer, C. William Blackburn.[352] No party has controverted this proposed adjustment, it is reasonable, and it should be approved.

Y. *Big Rivers' proposed adjustment to reflect its commitment to Energy Efficiency programs is fair, just, and reasonable.*

Big Rivers proposes to increase test year expenses by $1,000,000 to reflect Big Rivers' commitment to implement Energy Efficiency and Demand-Side Management ("DSM") programs as outlined in the Big Rivers 2010 Integrated

[349] Wolfram Direct Testimony at p. 18; *id.*, Exhibit Wolfram-2 at p. 1, l. 37; *id.*, Exhibit Wolfram-2, Reference Schedule 2.25.
[350] Blackburn Direct Testimony at p. 32.
[351] *Id.*
[352] *Id.* at p. 3, 32.

Resource Plan, and/or any subsequent program filings, to create and promote incentives for a number of consumer energy efficiency measures.[353] The amount of the proposed adjustment is reasonable because Big Rivers has committed to spend that amount annually on Energy Efficiency and DSM programs (assuming the proposed adjustment is granted)[354] and because it represents the program potential portfolio identified in the *Demand-Side Management (DSM) Final Potential Study for Big Rivers Electric Corporation* ("DSM Potential Report") prepared by GDS Associates, Inc. and included as Appendix B in Big Rivers' Integrated Resource Plan filed with the Commission on November 15, 2010.

During the test year, Big Rivers did not have sufficient funds to support any substantial programs and still meet its debt covenant TIER requirements.[355] However, Big Rivers budgeted to spend $544,000 in 2011, when the programs will be launched.[356] Big Rivers expects that level to rise to approximately $1.1 million in 2012 when the program ramp-up is complete, and the annual spend will remain at that level for 2013.[357] Providing cost-effective Energy Efficiency and DSM programs to its Members is a high priority for Big Rivers, and the proposed adjustment will allow Big Rivers to implement these programs without requiring its Members to incorporate another rate mechanism with a separate line item on customer bills.[358]

---

[353] *Id.* at p. 32; Blackburn Rebuttal at p. 18; Wolfram Direct Testimony at p. 18; *id.*, Exhibit Wolfram-2 at p. 1, l. 38; *id.*, Exhibit Wolfram-2, Reference Schedule 2.26.
[354] Blackburn Direct Testimony at p. 32.
[355] *Id.* at p. 33.
[356] *Id.*
[357] *Id.*
[358] Blackburn Rebuttal Testimony at p. 18.

KIUC argues that this adjustment should not be included in base rates because the Smelters should not be subject to charges for such programs.[359] However, these programs will reduce Big Rivers' total system demand, which will benefit all rate classes, and therefore, it is reasonable and appropriate for these costs to be shared among all rate classes.[360]

The Commission has allowed known and measurable changes based on a commitment to spend funds.[361] In the *River Bluffs, Inc.* case, Commission Staff had originally recommended that a proposed adjustment relating to the installation of a telephone line be rejected since the utility "was unable to commit to a date certain for installing its commercial telephone line."[362] In response, the utility committed to a date certain, and the staff changed its recommendation: "Given this commitment and the previously submitted cost documentation, Staff believes that an adjustment to reflect the installation of the commercial telephone line now meets rate-making criteria of being both known and measurable."[363] The Commission adopted the amended staff recommendation to approve the proposed adjustment.[364] Big Rivers has committed to spending the funds necessary to implement a more robust Energy Efficiency and DSM program, but it can only do so if it is permitted to recover

[359] *See* Direct Testimony of Stephen J. Baron at p. 35-36.
[360] Blackburn Rebuttal Testimony at p. 19.
[361] *See, e.g.,* Order dated July 29, 2002, in *In the Matter of: The Application of River Bluffs, Inc. for a Rate Adjustment Pursuant to the Alternative Rate Filing Procedure for Small Utilities*, PSC Case No. 2001-00252, Amended Staff Report On River Bluffs Disposal, Inc., Attachment B, recommendation a.
[362] *Id.*
[363] *Id.*
[364] *Id.*, Order dated July 29, 2002, at 1-2.

those costs. Big Rivers' proposed adjustment is a reasonable means of recovering those costs, and it should be approved.

Although Big Rivers' preference would be to recover its proposed energy efficiency expenses through base rates, Big Rivers does not have a strong objection to recovering these costs through a DSM cost recovery mechanism.[365]

VII. Big Rivers' Proposed Revenue Allocation is Fair, Just, and Reasonable.

Big Rivers' rates reflect differences in rates of return for the various customer classes that it serves. Big Rivers proposes to allocate revenues among the customer classes in a manner that takes a substantial step towards eliminating the rate of return differential between the Rural and Large Industrial classes, but that does so in accordance with the principle of gradualism that has long been employed by the Commission. As a result, Big Rivers' proposal would increase rates for the Rurals, Large Industrials, *and* Smelters, but the Rurals would experience the largest percentage increase. By contrast, the KIUC rate proposal seeks to impose virtually all of the rate increase on the Rurals and would, if adopted in full, result in a rate *decrease* for the Large Industrials and Smelters. In addition, the KIUC proposal is crafted to effectively nullify the economic subsidies that the Smelters agreed to provide to the Rurals and Large Industrials when they signed the Smelter agreements a mere two years ago. Unlike the KIUC proposal, Big Rivers' proposed revenue allocation produces rates that are fair, just and reasonable, and should be adopted.

---

[365] Big Rivers' May 11, 2011, response to Item 3 of the KIUC's Second Request for Information (KIUC 2-3).

A. The Commission should accept Big Rivers' cost of service study, including Big Rivers' use of the 12 CP methodology to allocate production demand costs.

Big Rivers presented a fully allocated, embedded cost of service study based on *pro forma* operating results for the 12 months ended October 31, 2010.[366] The cost of service study employed the standard approach used in the electric utility industry: costs were (1) functionalized between production and transmission costs, (2) classified as commodity-related or demand-related, and (3) allocated to the rate classes (Rurals, Large Industrials, and Smelters).[367] Big Rivers allocated production and transmission demand-related costs using a 12 CP methodology, in which all demand-related costs are allocated on the basis of average demand for each rate class at the time of Big Rivers' system peak.[368] KIUC witness Baron agreed with Big Rivers' approach to cost functionalization and classification,[369] but disagreed with Big Rivers' use of the 12 CP methodology to allocate production demand-related costs to the rate classes and presented an alternative cost of service study using the 6 CP methodology.[370] The Commission should accept Big Rivers' proposal because it is more consistent with Big Rivers' load profile.

Big Rivers does not disagree that the 6 CP methodology can appropriately be used to allocate production demand-related costs, and Mr. Seelye agreed that

[366] Seelye Direct Testimony at p. 10.
[367] *Id.* at p. 11, 14.
[368] *Id.* at p. 14-15.
[369] Direct Testimony of Stephen J. Baron at p. 11. Mr. Baron agreed, however, with Big Rivers' use of the 12 CP methodology to allocate transmission demand-related costs. *Id.*
[370] *Id.* at p. 12. Mr. Baron also presented a revised cost of service study using the 12 CP methodology (but excluding Big Rivers' $7.1 million adjustment relating to TIER), as well as an "Average and Excess Demand" study, which he did not recommend that the Commission adopt. *Id.* at p. 21-p. 23.

both the 12 CP approach and the 6 CP approach are "within...a zone of reasonableness."[371] Just as Mr. Seelye has testified in favor of the 6 CP methodology in other proceedings, so has Mr. Baron testified that the 12 CP methodology is reasonable in other proceedings.[372] Big Rivers employed the 12 CP methodology in this case because Big Rivers' load profile is relatively flat from month to month, which is a consequence of the fact that a large percentage of Big Rivers' load is comprised of the Smelters and other industrial customers.[373]

Mr. Baron argued that even though the Smelter loads have nearly a 100 percent load factor, the 6 CP methodology more appropriately reflects that Big Rivers' system peaks that occur in the three summer and three winter months are predominant.[374] He further asserts that using the 6 CP methodology will promote economic efficiency by signaling to customers that loads during the peak winter and summer months are the primary drivers of generation resource costs on the Big Rivers system.[375] However, Mr. Baron also acknowledges that Big Rivers has high system peaks during the off-peak months,[376] and he does not explain why the relatively modest differences between loads in the peak and off-peak months render the 6 CP methodology preferable to the 12 CP methodology. Kenergy Corp. witness Jack D. Gaines believes the 12 CP

---

[371] Seelye Rebuttal Testimony at p. 29.
[372] *Id.* at p. 29-30; *see also* Seelye Rebuttal Testimony, Exhibit Seelye Rebuttal-3; Testimony of Stephen J. Baron, Tr. 15:21'16.
[373] Seelye Rebuttal Testimony at p. 30-31.
[374] Direct Testimony of Stephen J. Baron at p. 12.
[375] *Id.* at p. 14.
[376] *Id.* at p. 12-.

methodology is more appropriate in Big Rivers' case because of the large Smelter load.[377]

As a further consideration with respect to the 12 CP-6 CP issue, it is important to note that, as Mr. Seelye explained, Big Rivers is proposing to increase base rates to the Rurals by 10.71 percent, to the Large Industrials by 5.94 percent, and to the Smelters by 5.47 percent.[378] Regardless of whether the 12 CP methodology or the 6 CP methodology is used to allocate production demand-related costs, Big Rivers does not believe that it would be reasonable to propose a larger percentage rate increase to the Rurals, which renders moot the question of which methodology is superior.[379]

Finally, Big Rivers believes the Commission should adopt Mr. Seelye's cost of service methodology.[380] While Mr. Gaines' approach provides useful insights into the effect the Smelters Unwind Commitments have on cost of service, Big Rivers' cost of service study should be adopted by the Commission in this proceeding.

B. Big Rivers' proposed revenue allocation methodology, which appropriately reflects a gradual approach to the elimination of the rate of return differential between the Rural and Large Industrial classes, should be adopted.

In setting rates, the Commission employs the principle of gradualism to temper the impact of large rate increases on customers.[381] The Commission has

---

[377] Testimony of Jack D. Gaines, July 27, 2011, Tr. 16:00'40.
[378] Seelye Rebuttal Testimony at p. 31.
[379] *Id.*
[380] *See* Testimony of William Steven Seelye, July 27, 2011, Tr. 14:57'58.
[381] Order dated December 22, 2005, in *In the Matter of: An Adjustment of the Gas Rates of the Union Light, Heat and Power Company*, PSC Case No. 2005-00042, at 64.

noted that gradualism is "integral to the rate-making process."[382] Gradualism also applies in the revenue allocation process: "Within rate classes, when determining the allocation of a rate increase, the Commission has long employed the principle of gradualism."[383] Big Rivers' proposed revenue allocation fully reflects a gradual approach to eliminating the rate of return differential that exist on its system at this time between the Rural and Large Industrial rate classes; the KIUC rate proposal does not, and instead simply shifts the entire burden of the proposed KIUC rate increase to the Rurals. Mr. Gaines likewise applies the principle of gradualism is his cost of service study.[384] The Commission should accept the revenue allocation proposed by Big Rivers as resulting in rates that are fair, just and reasonable.

In developing its proposed revenue allocation in this proceeding, Big Rivers recognized that its rates reflect differences in rates of return for the various customer classes that it serves - Rurals, Large Industrials, and Smelters.[385] These differences arise from two sources: first, the revenues collected from the Rurals are approximately $11.1 million less than the actual cost of providing service to the Rurals, thus reflecting a subsidy by the Large Industrials (and by the Smelters, whose rates by contract are calculated based upon the Large Industrial rate) to the Rurals;[386] and, second, the Smelter agreements provide for

---

[382] Order dated June 29, 2001, in *In the Matter of: The Application of Kenergy Corporation for a General Adjustment in Existing Rates (Rate Reduction)*, PSC Case No. 2000-395, Order dated June 29, 2001, 2001 WL 1154073 at * 3.
[383] Order dated February 17, 2011, in *In the Matter of: Application of Meade County Rural Electric Cooperative Corporation to Adjust Electric Rates*, PSC Case No. 2010-00222, at 11-12.
[384] Rebuttal Testimony of Jack G. Gaines at p. 12.
[385] *See* Seelye Direct Testimony at p. 16; Seelye Rebuttal Testimony at p. 18.
[386] Seelye Direct Testimony at p. 18-19.

the payment of various amounts that represent additional contractual subsidies to the Rurals and Large Industrials.[387]

Big Rivers proposes to allocate the revenue increase in a manner designed to narrow the gap between the rate of return shown in the cost of service study for the Rurals and that for the Large Industrials,[388] but to do so in a manner consistent with the principle of gradualism.[389] Specifically, Big Rivers proposes to move the rates for the Rurals $1.9 million closer to the actual cost of service, thereby reducing the subsidy to the Rurals from $11.1 million to $9.2 million,[390] and narrowing the gap in the rate of return between the Rurals and Large Industrials by approximately 22 percent.[391] The proposed allocation of the rate increase is shown in Exhibit Seelye-6.[392]

KIUC responded to Big Rivers' proposed revenue allocation with an alternative proposal which reflects the stated intention to "fully eliminate the present rate subsidies received by the Rural rate class[.]"[393] KIUC witness Baron asserted that the actual rate subsidy to the Rurals is $18.3 million, rather than the $11.1 million reflected in Big Rivers' cost of service study; the difference arises in part because of his use of the 6 CP allocation methodology for production demand-related costs, and in part because of his proposed rejection of Big Rivers' $7.1 *pro forma* adjustment to place the Smelters at the

---

[387] Seelye Rebuttal Testimony at p. 18-19.
[388] Seelye Direct Testimony at p. 18. No explicit consideration was given to the rate of return for the Smelters because the Smelter rates are linked to the Large Industrial rate. *Id.*
[389] *Id.* at p. 19.
[390] *Id.* at p. 18-19.
[391] *Id.* at p. 20.
[392] Seelye Direct Testimony, Exhibit Seelye-6 at p. 1. A revised version of this exhibit was provided on July 1, 2011, in Big Rivers' response to Item 1 of the Commission Staff's Fourth Request for Information (PSC 4-1).
[393] Direct Testimony of Stephen J. Baron at p. 6.

middle of the TIER Adjustment Charge bandwidth.[394] According to his calculations, Mr. Baron's proposal would reduce the subsidy to the Rurals from $18.3 million to $6.1 million, while actually increasing the subsidy to the Large Industrials from $50,000 to $1.6 million.[395]

At the hearing, Mr. Baron claimed that reducing the subsidy to the Rurals in the manner he proposed would reflect a gradual approach.[396] The KIUC rate proposal is "gradual" only in the sense that the Smelters appear to acknowledge some contractual constraints on their ability to "fully eliminate" subsidies to the Rurals at this time. Specifically, Mr. Baron stated that "[t]he Smelter Agreement requires that Smelter rates be tied to Large Industrial rates. As a result, the KIUC proposal reflects a continuation of some subsidies being paid by the Smelters to the Rural rate class."[397] Mr. Baron's claim that this "reflects a measure of ratemaking gradualism"[398] has no basis in reality, because eliminating one hundred percent of all but the contractually-specified subsidies is in no way gradual, especially given the magnitude of the cost shift to the Rurals that would result from the KIUC revenue allocation proposal.

Nor does it reflect gradualism for Mr. Baron to propose to "offset" the adverse effects on the Rurals by robbing the Rural Economic Reserve ("RER") and suggesting that Big Rivers can simply distribute patronage capital.[399] The impropriety of both of these proposals is discussed in detail elsewhere in this

---

[394] *Id.* at p. 24- 25. As discussed previously, Big Rivers opposes both of these elements of Mr. Baron's approach.
[395] *Id.* at p. 32, Table 4, l. 4, 12.
[396] Testimony of Stephen J. Baron, July 27, 2011, Tr. 17:07'22.
[397] Direct Testimony of Stephen J. Baron at p. 33.
[398] *Id.*
[399] *Id.*

brief, but it is clear that the purpose of these proposals is to temporarily postpone the rate shock to the Rurals that would result if KIUC's rate proposal were adopted to be effective September 1, 2011. Mr. Baron has asserted that his proposal to tap the RER would accelerate the depletion of that fund by approximately one year,[400] but whenever the fund is depleted, the Rurals would be exposed to the full measure of the cost shift resulting from the KIUC rate proposal, and this exposure would be abrupt, not gradual. Moreover, the practical effect of the proposed use of the RER is simply to benefit the Smelters and Large Industrials at the expense of the Rurals, by offsetting a portion of the rate increase that the Smelters and Large Industrials should be paying.[401]

The impact of the KIUC rate proposal is starkly illustrated by Mr. Baron's Exhibit SJB-6. Whereas Big Rivers proposes to increase the rates for all customer classes, but to reduce the difference between the class rates of return by increasing the share of cost responsibility borne by the Rurals, KIUC proposes to increase rates to the Rurals by 12.26 percent, while *decreasing* rates to the Large Industrials and Smelters.[402] If the KIUC proposals regarding use of the RER and patronage capital are rejected, as Big Rivers recommends that they should be, the KIUC proposal would increase the Rural rates by $18.4 million, while increasing rates for the Large Industrials and Smelters by a *total* of approximately $175,000.[403]

---

[400] KIUC's June 23, 2011, response to Item 21c of the Commission Staff's First Request for Information.
[401] Seelye Rebuttal Testimony at p. 28-29.
[402] Direct Testimony of Stephen J. Baron, Exhibit SJB-6 (as revised June 30, 2011).
[403] *Id.*

Mr. Fayne contends that the KIUC rate proposal "benefits all constituencies."[404] It does not. As discussed previously, the KIUC rate proposal, including the revenue allocation proposal advanced by Mr. Baron, is simply designed to enable the Smelters to avoid any rate increase whatsoever, while shifting the entire burden of increased rates to the Rurals.[405]

C. The KIUC proposal economically nullifies portions of the Smelter agreements.

The KIUC proposal would, if adopted, impose a rate increase solely on the Rurals, while the Large Industrials and Smelters would experience a rate decrease.[406] This would economically nullify the bargained-for subsidies received by Big Rivers' members' Rural and Large Industrial customer classes from the Smelters in return for the concessions made by Big Rivers to the Smelters in the Smelter agreements in connection with the negotiation of the Unwind Transaction. As Mr. Fayne noted in his testimony in the Unwind Case[407] and confirmed in his testimony at the hearing in this case,[408] the Smelters received a commitment for 850 MW of service "in return" for, among other things, the Smelters' agreement to pay the Base Energy Charge equivalent to $0.25/MWh above the large industrial rate, the TIER Adjustment Charge and "several additional surcharge amounts to offset fuel and environmental charges

[404] Direct Testimony of Henry W. Fayne at p. 11.
[405] Bailey Rebuttal Testimony at p. 13.
[406] Direct Testimony of Stephen J. Baron, Exhibit SJB-6 (as revised June 30, 2011).
[407] *See* Big Rivers Hearing Exhibit 5 at p. 6.
[408] *See* Testimony of Henry W. Fayne, July 28, 2011, Tr. 11:38'20.

to the non-smelter members."[409] Big Rivers refers to these charges as the "Smelter Unwind Commitments."

The Smelter Unwind Commitments were part of the "protections" Big Rivers and its members negotiated to "mitigate perceived risks" and balance out the "protections" received by the Smelters in the Smelter agreements, as described on pages 20 through 32 of a presentation made by Big Rivers to the Commission staff at an informal conference in the Unwind Case on February 19, 2008, which was attended by Mr. Fayne.[410] As Mr. Fayne testified at the hearing in the Unwind Case, the "protections" negotiated for the Rural class and agreed to by the Smelters were in response to concern that the members did not want rates to Rural class retail customers to "go up."[411]

In the Unwind Case, the Smelters acknowledged that the Smelter agreements provided for the payment of subsidies beyond what any other customer would pay.[412] In their brief supporting Commission approval of the Unwind Transaction, the Smelters stated that "[t]he exposure of the Rural customers to fuel and environmental costs will be mitigated by two factors: (i) $327 million in subsidies provided by the Smelters; and (ii) the Economic Reserve of $157 million."[413] KIUC witness Fayne testified on behalf of the Smelters in the Unwind Case that "although the Smelter rates are higher than a traditional cost-based tariff, the contract provides an energy supply based on cost, which will limit the Smelters' exposure to market prices and provide a reasonable opportunity for

---

[409] Big Rivers Hearing Exhibit 5 at p. 6-7.
[410] Big Rivers Hearing Exhibit 6, presentation pages 20-32.
[411] Testimony of Henry Fayne, July 28, 2011, Tr. 11:26'00.
[412] Seelye Rebuttal Testimony, Exhibit Seelye Rebuttal-2 at p. 17.
[413] *Id.* at p. 4.

continued operation beyond the current contract terms."[414] He went on to note, "Because of the Smelter Surcharge payments and the Economic Reserve, an increase in rates to the non-smelter members is substantially mitigated and rates for the long term are projected to remain low."[415]

So the contribution to Big Rivers' revenue requirement following the Unwind closing that would otherwise have had to come from a rate increase to the Rural and Large Industrial classes, was generated through additional charges to the Smelters in the form of the Smelter Unwind Commitments. The charges paid by the Smelters under their agreements were part of the total revenue stream received by Big Rivers that established a cost of service relationship among Big Rivers' customer classes as of the Unwind closing. The Rural class received protection from a rate increase at the Unwind closing solely because the Smelters funded a portion of the Big Rivers cost of service revenue requirement by paying the charges required by the Smelter Unwind Commitments. In the Unwind Case, Mr. Blackburn calculated the amount of the Smelter Unwind Commitments to be $327 million over the life of the Smelter agreement.[416]

The Smelters, through KIUC, now seek to "fully eliminate" the economic protection the Rural class received from the Smelter Unwind Commitments in the Smelter agreements. At the hearing, KIUC witnesses Baron and Fayne repeatedly insisted that the KIUC rate proposal was not intended in any way to

---

[414] Big Rivers Hearing Exhibit 5 at p. 13.
[415] *Id.*
[416] *See* Seelye Rebuttal Testimony at p. 20.

tamper with the contractual commitments contained in the Smelter Agreements.[417] This was not apparent from Mr. Baron's direct testimony, in which he contended that "it is appropriate to fully eliminate the present rate subsidies received by the Rural rate class[,]" and provided various examples of provisions in the Smelter Agreements that he appeared to suggest should be eliminated, including "excess charges to the Smelters."[418] Nor was it apparent from the testimony of KIUC witness Leblanc, who acknowledged at the hearing that Alcan is trying to get to a "true cost of service rate."[419] Nor was it consistent with Mr. Baron's statement at the hearing that he set out to "eliminate the present rate subsidies for the Rural class."[420]

What is clear is that KIUC wants to reallocate cost of service revenue responsibility essentially to what it would have been immediately after the Unwind closing if the Smelter agreements had not included the Smelter Unwind Commitments. This is nothing short of outrageous.

The Smelter agreements prohibit the Smelters from arguing Smelter cost of service in a Big Rivers rate proceeding. In Section 13.1.1(b) of the Smelter Retail Agreement[421] and Section 3.8(b) of the Smelter Coordination Agreement,[422] Big Rivers, Kenergy and each Smelter agree that they will not support or seek, directly or indirectly, from the Commission, "any challenge to or change in":

---

[417] *See, e.g.*, Testimony of Stephen J. Baron, July 27, 2011, Tr. 16:31'50; Testimony of Henry W. Fayne, July 28, 2011, Tr. 11:24'00. Mr. Fayne also asserted this in his direct testimony. Direct Testimony of Henry W. Fayne at p. 14.
[418] Direct Testimony of Stephen J. Baron at p. 6.
[419] Testimony of Stephane Leblanc, July 28, 2011, Tr. 15:49'52; *id.* at Tr. 15:50'04.
[420] Testimony of Stephen J. Baron, July 27, 2011, Tr. 16:36'02.
[421] Blackburn Rebuttal Testimony, Exhibit Blackburn Rebuttal-1, Section 13.1.1(b) of the Smelter Retail Agreement.
[422] Big Rivers Hearing Exhibit 4, Section 3.8(b) of the Smelter Coordination Agreement.

- The rate formula in the Smelter agreements;
- Other terms and conditions in the Smelter agreements; or
- The relationship of the Large Industrial Rate to amounts payable by a Smelter under its retail agreement.

The Smelters incorrectly contend that the following last sentence in each of those sections permits their cost of service challenge in this case:

> For the avoidance of doubt, [the Smelter's] intervention and participation in a regulatory proceeding involving cost of service issues relating to the rates of the Non-Smelter Ratepayers shall not be considered a challenge to the rate formula.

This exculpatory language applies only to cost of service issues relating to the rates of the Non-Smelter Members. KIUC has argued almost exclusively about Smelter cost of service. How, for example, can the charges paid by the Smelters under the Smelter Unwind Commitments be considered part of the rates of the Non-Smelter Members? Furthermore, why should the preponderance of the $18 million in "subsidies" that the KIUC is proposing to eliminate include subsidies to the Smelters, particularly those related to the Smelter Unwind Commitments? It is important to recognize that the $18 million of "subsidies" that the Smelters are trying to claw back from the Rurals relate to the Unwind Commitments that the Smelters agreed to provide over the life of the agreements.

Even without the contractual prohibitions that Big Rivers believes bar KIUC and the Smelters from supporting the full elimination of subsidies from the Smelters, the Commission can still find that, in light of all the circumstances, the KIUC revenue allocation proposal would result in rates that are unfair, unjust and unreasonable, and reject it. The revenue allocation plan proposed by Big Rivers through Mr. Seelye is reasonable, consistent with the policy of gradualism, and should be adopted by the Commission in this case.

KIUC's proposed restructuring of the RER also would effectively circumvent the Smelter agreements. Creation of the RER was a critical element of the Unwind Order. Its purpose was to extend for an additional 24 months the credits to the Rurals that were to be provided under the Member Rate Stability Mechanism to offset increases in fuel and environmental costs, and not to offset increases in base rates.[423] Mr. Baron acknowledges that purpose, but suggests that the Commission should simply redirect a portion of those funds to serve the Smelters' purposes in this proceeding.[424] The Smelters agreed to the conditions identified in the Unwind Order, including the structure of the RER, when they signed the Smelter agreements, and the RER should not now be used to permit the Smelters to burden the Rurals with the entire rate increase proposed by KIUC.[425] This is particularly so given that the effect will be to deny the long-term benefit of the RER to the Rurals for the short-term benefit of the Smelters, who may very well close their operations regardless of anything that happens in this rate case.[426]

In addition, as discussed more fully above, the KIUC proposal to set the TIER Adjustment Charge at the top of the bandwidth is fundamentally contrary to the purpose of this element of the Smelter agreements. As Mr. Seelye explained,

[423] Unwind Order at 25-26; *see also* Seelye Rebuttal Testimony at p. 29.
[424] Testimony of Stephen J. Baron, July 27, 2011, Tr. 17:02'12.
[425] Seelye Rebuttal Testimony at p. 29.
[426] *Id.* at p. 28.

the primary purpose of the TIER Adjustment mechanism is to provide financial flexibility to Big Rivers in the event that Big Rivers' base rate revenues are insufficient to provide a 1.24 Contract TIER.[427] Establishing the TIER Adjustment Charge at the middle of the bandwidth, as proposed by Big Rivers, permits Big Rivers to recover $7.1 million of test-year TIER Adjustment Charge revenues through base rates, and $7.1 million of such revenues through the TIER Adjustment Charge to the Smelters in the event that Big Rivers needs extra revenue from the Smelters to achieve a 1.24 Contract TIER.[428] If the TIER Adjustment Charge is set at the top of the bandwidth, as proposed by KIUC, there would be no opportunity for Big Rivers to draw on the TIER Adjustment mechanism to support its margins in the event that the revenues produced by the rates established in this proceeding are insufficient for Big Rivers to achieve a 1.24 Contract TIER, and the purpose of the TIER Adjustment mechanism would be frustrated.[429]

Even if the Commission were to conclude that the KIUC rate proposal does not circumvent the commitments made by the Smelters in agreeing to the Unwind Transaction, the Commission should nonetheless recognize that the proposal does not produce rates that are fair, just and reasonable. Whether or not the Smelters are "pleading poverty," KIUC has advanced no justification for imposing the entire impact of the rate increase needed by Big Rivers on the Rural class, or for using the RER to pay portions of a rate increase that should

---

[427] *Id.* at p. 32.
[428] *Id.*
[429] *Id.* at p. 36.

be paid by the non-Rural customers. By contrast, Big Rivers' revenue allocation proposal embraces gradualism, produces rates that are fair, just and reasonable, and should be adopted by the Commission.

D. The Smelters' competitive positions in the world aluminum commodity market do not support the KIUC revenue allocation proposal in this case.

KIUC argues unconvincingly that the long-term solution to the Smelters' cyclical exposure to a decline in the world commodity price of aluminum must begin by shifting responsibility for the entire KIUC revenue proposal to the Big Rivers Rural rate class.[430] The Smelters are not "pleading poverty today" in this case, according to KIUC witness Fayne.[431] In fact, the London Metal Exchange ("LME") reports that as of July 26, 2011, the price of aluminum is a strong $2,612 per metric tonne, and the forecasted price curve rises steadily to a 27-month forward price of $2,790 per metric tonne.[432]

The relief sought by the Smelters in this case would provide no assurance of Smelter survival. The Smelters' goal in this case, as stated by Alcan plant manager Leblanc in his direct testimony, is to "stabilize the smelters' position in the world-wide aluminum market, but ultimately in order for Sebree to be at the average total cost curve world wide a broader solution beyond the repetitious process of rate cases will be required."[433]

This theme was echoed by Century consultant Fayne in his direct testimony, where he acknowledges "that the size of Big Rivers in relationship to the size of the smelter load limits the extent to which a long term solution can be

[430] *See generally*, Direct Testimony of Henry W. Fayne.
[431] Testimony of Henry W. Fayne, July 28, 2011, Tr. 14:06'00.
[432] Big Rivers Hearing Exhibit 3.
[433] Direct Testimony of Stephane Leblanc at p. 9.

developed through the regulatory process."[434] In his testimony at the hearing, Mr. Fayne agreed that in the states where a smelter has obtained economic relief through a regulatory commission, the utilities were much larger than Big Rivers, and only one smelter was involved.[435] He contends that adoption of the KIUC position would provide "a window of time to develop a long term solution, which we believe must be a statewide solution."[436]

But if the "long-term" solution that must involve the entire state is so significant to the Smelters, why has so little been done to date to achieve that long-term solution? There is currently no Smelter plan for that long-term solution,[437] and consequently no justification for allocating the cost of the Big Rivers rate increase to the Rural customer class purportedly to give the Smelters "a window of time" to develop that long-term solution. At this point the long-term solution effort is principally a project of Rio Tinto Alcan,[438] and Rio Tinto Alcan does not talk about a solution.[439] The focus at this point is education regarding the Smelters' power rates and business.[440]

Big Rivers submits that the healthy state of the world commodity price of aluminum, and the 27-month future forecast of current high aluminum prices, gives the Smelters the "window" they require to pursue the long-term, statewide solution they envision. The primary aluminum business always has

---

[434] Direct Testimony of Henry W. Fayne at p. 22.
[435] Testimony of Henry W. Fayne, July 28, 2011, Tr. 11:40'45.
[436] Direct Testimony of Henry W. Fayne at 23.
[437] Testimony of Henry W. Fayne, July 28, 2011, Tr. 11:11'30; Testimony of Stephane Leblanc, July 28, 2011, Tr. 16:03'28.
[438] Testimony of Stephane Leblanc, July 28, 2011, Tr. 15:59'50.
[439] *Id.* at Tr. 16:06'00.
[440] *Id.*

been and always will be a cyclical business.[441] All evidence in the record of this case is that the Smelters are entering the rising side of a cycle. Perhaps that window would be longer if the Smelters had set aside a portion of the funds they received from Big Rivers and E.ON U.S. at the closing of the Unwind Transaction to offset expenses during the next downturn of the aluminum market.[442]

Mr. Bailey points out in his rebuttal testimony that the KIUC proposal would weaken Big Rivers financially and impose a burden on Big Rivers' Non-Smelter Members, making all of them less able to deal with the challenges that KIUC says Big Rivers and its members will face if the Smelters shutter their operations.[443] KIUC spends much effort in this case raising the alarm about the long-term survival of the Smelters. Mr. Leblanc sees no prospect for Smelter survival if the pending environmental regulations become effective, and the Smelters must share in the cost of expensive pollution control facilities that Big Rivers could be required to add to its generating plants.[444] Under these circumstances, the Commission should be more concerned about Big Rivers being financially strong enough to deal with the pending EPA regulations and to handle Smelter closures.

While there is no doubt that the Smelters are important to Big Rivers[445] and the western Kentucky region,[446] Big Rivers has taken steps to protect itself

---

[441] Testimony of Henry W. Fayne, July 28, 2011, Tr. 11:13'40.
[442] *Id.* at Tr. 11:43'17; Testimony of Stephane LeBlanc, July 28, 2011, Tr. 16:24'35.
[443] Bailey Rebuttal Testimony at p. 13-14.
[444] Testimony of Stephane Leblanc, July 28, 2011, Tr. 16:04'50.
[445] Seelye Direct Testimony at p. 5. Also, one of the principal reasons Big Rivers entered into the Unwind Transaction was to try to help preserve the Smelters. Bailey Rebuttal Testimony at p. 10-11.

against the potential closure of one or both Smelters to counteract the risk it took on when it agreed to the Smelter power agreements in the Unwind Transaction. Big Rivers is increasing capacity on its transmission system so that when the Phase II transmission constructions projects are completed by the end of this year, Big Rivers will be able to export energy equivalent to the full Smelter load and withstand the potential loss of both Smelters.[447] Big Rivers established the $35 million Transition Reserve Account to be available to offset any temporary reduction in cash flow that could occur if one or both Smelters ceased operations.[448] Big Rivers retained its transmission reservation and rights for 100 MW of power to be wheeled across the Tennessee Valley Authority transmission system.[449] And Big Rivers petitioned the Kentucky General Assembly for, and won passage of, an amendment to KRS 279.120 in 2006 that enables a cooperative like Big Rivers that finds itself with a sudden, large drop in system load to remarket that capacity to non-members without endangering its cooperative status under state law.[450]

KIUC witnesses Mr. Strong and Dr. Coomes offered testimony on the general theme that the Smelters closing their operations would likely have a negative impact on western Kentucky and Big Rivers, but neither of them offered any opinion on the merits of Big Rivers' or KIUC's positions in this case. While Big Rivers agrees that closure of the Smelters is likely to have a negative impact on the region, the extent and duration of that impact is arguable depending upon

---

[446] Seelye Direct Testimony at p. 5.
[447] *See* Crockett Direct Testimony at p. 11.
[448] Blackburn Direct Testimony at p. 29.
[449] *Id.*
[450] *Id.* at p. 30.

the factors that exist at the time. The limited scope of the opinions expressed by each (Mr. Strong conceded that his opinion was just a "guess"[451]), and the flaws inherent in Dr. Coomes' study as disclosed on cross-examination[452] constrain the value of their testimonies.

KIUC witness Dr. Morey alleges that Big Rivers will lose $83 million in margins if the Smelters cease operations.[453] His analysis and assignment in this case, however, were limited to assessing what the impact would be on Big Rivers' margins if both Smelters ceased operations, and Big Rivers did nothing but attempt to sell 850 MW of energy into the Midwest ISO at an assumed depressed price. He did not consider numerous viable alternatives that Big Rivers has at its disposal and that are outlined in Mr. Seelye's rebuttal testimony.[454] As Dr. Morey testified at the hearing in this case, he would expect Big Rivers to pursue those alternatives if the Smelters gave notice that they were going to close their operations.[455]

Further, Dr. Morey's analysis is flawed because it suggests that Big Rivers' generating units are frequently "out of the market," which is contrary to Big Rivers' actual experience since joining the Midwest ISO.[456] The "out of market" percentage of 57.5 percent that Dr. Morey uses in his analysis is significantly lower than the 92.1 percent of Big Rivers' available generation that has *actually* cleared the market since Big Rivers joined the Midwest ISO even during a time

[451] Testimony of Gene Strong, July 28, 2011, Tr. 10:16'07.
[452] *See, e.g.*, Testimony of Dr. Paul A. Coomes, July 28, 2011, Tr. 15:03'22.
[453] Direct Testimony of Dr. Mathew J. Morey at p. 5.
[454] *See* Seelye Rebuttal Testimony at p. 10.
[455] Testimony of Dr. Mathew J. Morey, July 28, 2011, Tr. 15:23'20.
[456] Seelye Rebuttal Testimony at p. 13.

of depressed wholesale market prices.[457] Given these fundamental flaws, Dr. Morey's analysis should be rejected. Whether and to what extent Big Rivers will suffer losses if the Smelters close will depend on the conditions at that time, and while Big Rivers' margins may be negatively impacted, Big Rivers could actually have increased margins.[458]

VIII. Big Rivers' Proposal to Modify its MRSM and RER Tariffs is Fair, Just, and Reasonable.

Big Rivers proposes modifications to the Member Rate Stability Mechanism ("MRSM") and the RER to eliminate the fluctuation in rates that would otherwise occur when the RER begins operation.[459] The MRSM was implemented for the purpose of distributing a $157 million Economic Reserve that was established in the Unwind Case to the Rurals and the Large Industrials to offset any net billing impacts related to the FAC and Environmental Surcharge.[460] The RER was ordered by the Commission in the Unwind Order to be recorded as a regulatory liability of $60.9 million and used only as a credit against the rates of the Rurals once the Economic Reserve is depleted.[461]

Big Rivers is proposing to modify its MRSM tariff in order to specify how the mechanism will operate if it remains in place beyond the original 48 months that were anticipated when the mechanism was originally established.[462] Current projections indicate that the Economic Reserve is likely to last beyond the 48

[457] *Id.* at p. 14.
[458] Testimony of Mark A. Bailey, July 26, 2011, Tr. 13:06:30.
[459] Application ¶ 9c.
[460] Seelye Direct Testimony at p. 7.
[461] *Id.*
[462] Direct Testimony of Albert M. Yockey ("Yockey Direct Testimony") at p. 6; Seelye Direct Testimony at p. 33.

month horizon originally anticipated.[463] Specifically, Big Rivers is proposing to add two additional Expense Mitigation Factors ("EMF's") for the period beyond the first 48 months of the mechanism because there is currently no EMF beyond the first 48 months.[464]

Big Rivers is also proposing to modify the RER to eliminate the existing 24 month schedule and replace it with a mechanism which is designed to use the credit as intended by the Commission, but at the same time revise the RER to operate seamlessly with the MRSM.[465] Specifically, Big Rivers is proposing that the RER operate in the same manner as the MRSM, except applicable only to the Rurals, thereby offsetting the impact of the FAC and Environmental Surcharge on the Rurals after taking into account the credits received from the Unwind Surcredit and the Rebate Adjustment. Thus, once the Economic Reserve is exhausted by the application of the MRSM, the EMFs identified in the MRSM will be adopted by the RER so that there will not be a discontinuity in the amounts credited to the Rurals between the two mechanisms.[466] Big Rivers' proposal is reasonable and should be approved.

IX. KIUC's Proposal to Modify the RER Tariff Should be Denied.

As discussed above, KIUC proposes to restructure the RER fund so that it could be used to offset the sizable rate increase to the Rurals proposed by Mr. Baron.[467] It is "an attempt to make its proposed allocation of the increase to the

---

[463] Seelye Direct Testimony at p. 33.
[464] *Id.*
[465] Yockey Direct Testimony at p. 6.
[466] Seelye Direct Testimony at p. 36.
[467] Seelye Rebuttal Testimony at p. 28.

Rurals [by KIUC] more palatable."[468] Under KIUC's proposal, the Rurals would be forced to give up the long-term benefit of the RER to provide short-term benefits to the Large Industrials and the Smelters, which may close their operations regardless of anything that results from this rate case.[469] The RER was a fundamental element of the Unwind Transaction included in the Commission's Order approving the transaction, and it was specifically designed to offset higher rates to Rural customers that were expected to arise as a result of Big Rivers entering into the Unwind Transaction.[470] While Big Rivers is proposing minor adjustments to the RER to eliminate discontinuities as a result of transitioning from the Economic Reserve to the RER, KIUC is proposing a wholesale makeover of the mechanism and the purpose of the RER.[471] Using the RER to offset base rate increases contravenes the original purpose and design of the mechanism, which was to extend for an additional 24 months the credits to the Rurals that were to be provided under the MRSM.[472]

In the Unwind Order, the Commission held that the offset against higher Rural rates caused by the Unwind Transaction that the RER would provide was necessary to make the Unwind Transaction in the public interest.[473] While KIUC has proposed nothing in this case to diminish the benefits the Smelters received from the Unwind Transaction, KIUC's proposal takes away some of the benefit the Rural customer class received and uses it to try to justify burdening

[468] *Id.*
[469] *Id.*
[470] *See* Unwind Order at 25.
[471] Seelye Rebuttal Testimony at p. 28-29.
[472] *Id.* at p. 29.
[473] Unwind Order at 25.

the Rurals with the full rate increase proposed by KIUC in this proceeding.[474] The Smelters agreed to the conditions identified in the Commission's Order approving the Unwind Transactions – including the structure of the RER – when they signed the Smelter agreements.[475] They should not be allowed to now nullify part of the benefit the Rurals received in the Unwind Transaction.

The KIUC proposal will necessarily exhaust the funds in the RER sooner that they would otherwise be exhausted.[476] Thus, the KIUC proposal merely shifts the effect of increasing the Rurals' rates from the present to the future.[477] Any benefit to the Rurals in this instance is illusory. Under the KIUC proposal, the Rurals ultimately incur a greater risk of rate shock resulting from premature exhaustion of the RER funds.[478] The RER should not be modified to accommodate the Smelters' proposal to burden the Rurals with the entire KIUC rate increase proposal.

X. Big Rivers' Proposed Non-Smelter Non-FAC PPA Tariff is Fair, Just, and Reasonable.

Currently, Big Rivers has in place two different Non-FAC PPA mechanisms: (i) a Non-FAC PPA for the Smelters, which provides for a monthly calculation of a Non-FAC PPA factor that is charged or credited monthly in the Smelter bills; and (ii) a Regulatory Account Charge, through which the Non-FAC PPA charges or credits applicable to Big Rivers' Non-Smelter Members are recorded in a

[474] *See supra* Section VII.C.
[475] Seelye Rebuttal Testimony at p. 29.
[476] Bailey Rebuttal Testimony at p. 14.
[477] *Id.*
[478] *Id.*

deferred asset or deferred liability account (which was approved in the Unwind Case) to be amortized at a later date.[479]

As of June 30, 2011, a liability balance of $7,041,523 had been accrued in the non-Smelter regulatory account (the "Non-Smelter Non-FAC PPA Regulatory Account").[480] This means that as of June 30, 2011, the Rurals and Large Industrials are owed $7,041,523.

Big Rivers is proposing a "Non-Smelter Non-FAC PPA" tariff mechanism that will allow it to amortize any balances in the Non-Smelter Non-FAC PPA Regulatory Account for the Rurals and Large Industrials every 12 months rather than waiting until the next general rate case to amortize the balances.[481] Under that new tariff, in the bills for September service each year for the Rurals and Large Industrials, Big Rivers will establish a per kWh credit (or charge) to return (or collect) the Non-FAC PPA Regulatory Liability (or Asset) balance as of June 30 over the upcoming 12 month period, except for the initial implementation of this mechanism, for which Big Rivers is proposing to return the liability as of June 30, 2011, over a 24 month period.[482] Each year, any remaining under- or over-recovery will be transferred to the Non-FAC PPA Regulatory Account for the subsequent period.[483] Because the initial implementation will be over 24 months, it will overlap the second implementation, and there will be two kWh

[479] Seelye Direct Testimony at p. 33-37.
[480] Big Rivers' August 4, 2011, response to Item 4 of the Hearing Data Requests.
[481] Seelye Direct Testimony at p. 6.
[482] *Id.* at p. 37.
[483] *Id.* at p. 38.

factors in place for the second implementation period (September 2012 through August 2013).[484]

Establishing a mechanism to clear the Non-Smelter Non-FAC PPA Regulatory Account balance every 12 months ensures that any charges or credits are dealt with in a timely manner and ensures that the Smelters do not receive any additional credits or charges associated with the account, which is appropriate since a separate Non-FAC PPA mechanism contained the Smelter agreements provides automatic monthly rate adjustments to the Smelters to reflect changes in purchased power costs.[485] Since the Smelter rate is contractually tied to the Large Industrial rate, recovering Non-FAC PPA costs through base rates would result in inappropriately double crediting or double charging the Smelters for the Non-FAC PPA costs.[486]

No party has opposed this proposed mechanism. The Big Rivers Non-Smelter Non-FAC PPA proposal is reasonable and should be approved.

XI. Big Rivers' Proposal to Reduce the Non-FAC PPA Base is Fair, Just, and Reasonable.

Currently, the Non-FAC PPA amount embedded in Big Rivers' base tariff energy rate is $1.75/MWh.[487] Big Rivers proposes to lower the Purchased Power Base used to calculate the Non-FAC PPA to reflect a more representative level of purchased power expenses on a going-forward basis.[488] Specifically, Big Rivers is proposing to reduce the Purchased Power Base from $0.00175 per

[484] *Id.*
[485] *Id.* at p. 39.
[486] *See id.*
[487] Hite Direct Testimony at p. 14.
[488] Seelye Direct Testimony at p. 26.

kWh to $0.000874 per kWh.[489] The proposed Purchased Power Base reflects the average purchased power costs for June 2010, which is reasonably close to the average cost of $0.00082 per kWh for the test year (as shown on Exhibit Seelye-5).[490] Determining the Base on the basis of the cost for a single month is consistent with the Commission's normal practice of determining the FAC Base on the basis of fuel costs for a particular month.[491] Changing the Purchased Power Base is a revenue neutral "roll in" and will result in a corresponding reduction in the energy charges for the three rate classifications.[492] No party has opposed this proposal. The proposed change is reasonable and should be approved.

XII. Big Rivers' Proposal to Change from Calculating the Demand Charge for Rurals from Non-Coincident Peak to Coincident Peak is Fair, Just, and Reasonable.

Big Rivers proposes to change the basis on which the demand charge for the Rural Delivery Service class of customers is billed from non-coincident peak ("NCP") demand to coincident peak ("CP") demand to send a more accurate price signal to the Rural customers.[493] Because production and transmission facilities are designed to meet maximum aggregated loads on system, a CP rate design more accurately reflects cost causation on the Big Rivers system.[494] This

---

[489] *Id.* at p. 27.
[490] *Id.*
[491] *Id.*
[492] *Id.* at p. 6.
[493] *Id.*
[494] *Id.* at p. 21.

change is revenue neutral.[495] No party has controverted this proposed change. Big Rivers' proposal is fair, just, and reasonable, and should be approved.

XIII. Big Rivers' Proposal for Approval of the Midwest ISO Attachment O Rate Formula is Fair, Just, and Reasonable.

Big Rivers is requesting that the Commission authorize Big Rivers to determine its transmission rates using the cost-based Midwest ISO Attachment O formula rate on an ongoing basis. Consistent with the conditions set forth by the FERC in FERC Docket No. ER11-15-000, Big Rivers is seeking Commission authorization to adjust its Commission-approved transmission rates to use the Midwest ISO Attachment O formula rate, to become effective when the retail rates approved by the Commission in this proceeding become effective, and to update the inputs used in the transmission formula on an annual basis.[496] Commission approval of this proposal will permit Big Rivers to use the FERC-approved Attachment O formula to update its transmission revenue requirement annually, as contemplated under the Midwest ISO Tariff, without the need to seek Commission approval of such updates. As explained by Mr. Seelye, adoption of the Attachment O transmission formula rate will not affect the base rates charged to Big Rivers' members.[497] No party opposed Big Rivers' use of the Midwest ISO Attachment O formula rate, and the Commission should grant Big Rivers' request.

---

[495] *See* Big Rivers' April 15, 2011, response to Item 128 of the Attorney General's Initial Request for Information (AG 1-128).
[496] Seelye Direct Testimony at p. 43.
[497] *Id.* at p. 44.

XIV. Big Rivers' Proposed Reorganization of its Tariff is Fair, Just, and Reasonable.

The proposed tariff reflects a reorganization of the contents of Big Rivers' existing tariff, with very few changes other than as described above.[498] The principal purpose of the reorganization was to place the contents of the tariff in a more logical, ordered sequence.[499] The reorganization involved adding a General Index and dividing the tariff into four major sections to facilitate finding information.[500] No party opposed the proposed reorganization. The reorganization of the tariff is fair, just, and reasonable, and should be approved.

XV. The Commission Should Reject KIUC's Proposal for Big Rivers to Rotate Patronage Capital.

KIUC witness Lane Kollen proposes that Big Rivers distribute (in other words, pay in cash) 25 percent of its net margins from the prior year to its members.[501] Patronage capital is essentially a G&T cooperative's members' equity interest in the assets of the cooperative.[502] Patronage capital is not some separate cash account.[503] As Mr. Hite explains, "It is the equity portion of the equity to total capitalization measure used by credit rating agencies in

---

[498] *See* Yockey Direct Testimony at p. 6.
[499] *Id.*.
[500] *Id.* Section 1 of the reorganized tariff contains standard rate schedules (such as the rate schedules for Rural Delivery Service and Large Industrial Customers), Section 2 contains adjustment clauses and service riders (such as the Fuel Adjustment Clause and the Environmental Surcharge), Section 3 contains general terms and conditions (such as contract demand, metering, substations, notice of meter reading or test, right of access, and payment of bills), and Section 4 includes a listing of abbreviations and acronyms. *Id.* at p. 7-8.
[501] *See* Hite Rebuttal Testimony at p. 23, 25.
[502] *Id.* at p. 22.
[503] *Id.* at p. 24.

evaluating the creditworthiness of an electric cooperative."[504] Generally speaking, it is within the discretion of the board of directors of a G&T cooperative as to when the G&T should distribute or retire patronage capital to its members, in cash, so long as the G&T is able to meet its financial obligations and remain on a sound financial footing.[505]

Mr. Kollen's proposal is not reasonable.[506] Patronage capital should only be distributed if there is no adverse impact on the financial soundness of the electric cooperative.[507] In the present case, the KIUC proposal for patronage capital would hinder Big Rivers' cash flow, increase Big Rivers' need for borrowings, and jeopardize Big Rivers' investment grade credit ratings.[508]

KIUC's proposal hinders Big Rivers cash flow because patronage capital is not cash on deposit.[509] It is the equity in the assets of the cooperative allocated to the cooperative's members.[510] Big Rivers is already cash strapped.[511] The KIUC rate proposal would exacerbate the cash flow problem even before considering the patronage capital issue.[512] KIUC's patronage distribution recommendation would make Big Rivers' cash reserve position even worse.[513]

KIUC's proposal increases the need for additional borrowings because Big Rivers does not have sufficient cash to make a distribution of patronage

---

[504] *Id.* at p. 22.
[505] *Id.*
[506] *Id.* at p. 24.
[507] *Id.* at p. 23.
[508] *Id.*
[509] *Id.* at p. 24.
[510] *Id.*
[511] *Id.*
[512] *Id.* at p. 24-25.
[513] *Id.* at p. 25.

capital.[514] The KIUC proposal effectively would require that Big Rivers borrow money to make a patronage capital distribution.[515] Big Rivers already anticipates the need to borrow an additional $52 million in 2012, in addition to its need to refinance existing debt.[516] This additional borrowing will be necessary even if Big Rivers is granted its full rate adjustment request.[517]

KIUC's proposal jeopardizes Big Rivers' investment grade credit ratings because of the additional borrowing needed.[518] It must be recalled that Big Rivers not currently returning patronage capital to its members is regarded as a credit positive by Moody's.[519] Equity to total capitalization is one of the primary measures used by credit rating agencies in evaluating the creditworthiness of an electric G&T cooperative.[520] Increased debt would definitely adversely impact Big Rivers' risk profile.[521] As Mr. Spen explains in his rebuttal testimony, credit analysts have recognized that serving the Smelter load requires Big Rivers to have a higher equity percentage than typical G&T cooperatives.[522] The additional equity is necessary in order to manage the risk associated with the potential loss of a large portion of Big Rivers' revenue in the event of the closure of one or both of the Smelter operations.[523] If Big Rivers must borrow money to make

---

[514] *Id.* at p. 23.
[515] *Id.*
[516] *Id.*
[517] *Id.*
[518] *Id.* at p. 24-25.
[519] KIUC Hearing Exhibit 12 at p. 4-5.
[520] Hite Rebuttal Testimony at p. 24-25.
[521] *Id.* at p. 24.
[522] Spen Rebuttal Testimony at p. 4.
[523] Hite Rebuttal Testimony at p. 24.

the patronage capital retirements proposed by KIUC, Big Rivers' equity will decline and its investment grade credit ratings will be at risk.[524]

Mr. Kollen's proposal is based on a CFC Capital Credits Task Force Report.[525] However, that report was expressly prepared for distribution cooperatives.[526] The report does not purport to advise G&Ts on capital credit decisions, or consider the unique circumstances faced by Big Rivers that bear on such decisions.

KIUC's proposal should be denied and the decision of when to retire patronage capital should be left to Big Rivers' Board of Directors at a time when they believe retirement of patronage capital is warranted by Big Rivers' financial condition.[527]

XVI. The KIUC Proposal to Change Big Rivers' LICX Tariff Should be Denied.

KIUC proposes to exclude existing industrial customers from Big Rivers' LICX tariff, which prices new or expanding loads of more than 5 MW at market price.[528] Essentially, KIUC proposes that existing customers be permitted to take expansion service for an unlimited level of load increases under the LIC rate on the ground that the LICX rate discourages economic development.[529] However, despite KIUC's assertions to the contrary, there is no evidence that requiring customers that expand their loads by more than 5 MW deters economic development, and in fact, Big Rivers is currently in serious negotiations to add a

[524] *Id.*
[525] *Id.* at p. 26.
[526] *Id.*
[527] *Id.* at p. 27.
[528] *See* Baron Direct Testimony at p. 38-39; Seelye Rebuttal Testimony at p. 46, 48.
[529] *See* Seelye Rebuttal Testimony at p. 46.

new large industrial customer under the LICX tariff.[530] There is also no testimony in the record from any existing customer subject to the LICX tariff that the terms of the tariff impose a burden on the expansion plans of existing customers.

More importantly, however, KIUC's proposal places a significant financial risk on Big Rivers stemming from the cost to serve such expansion load.[531] To serve significant load additions, Big Rivers may have to add transmission facilities, add generation resources, or enter into costly purchased power agreements.[532] If Big Rivers is required to provide service to unlimited load additions at its LIC rate, Big Rivers might incur unrecoverable costs to meet the incremental demand that far exceed the revenues provided from that load under the LIC rate.[533] Due to its size, Big Rivers' obligation to serve new loads at embedded cost rates cannot be unlimited and should not place a significant burden on current customers.[534] Other utilities that are much larger than Big Rivers have similar caps to mitigate their cost exposure.[535] Therefore, Big Rivers' LICX tariff is reasonable, and KIUC's proposed change to that tariff should be rejected.

---

[530] *Id.* at p. 48.
[531] *Id.* at p. 46.
[532] *Id.* at p. 48.
[533] *Id.*
[534] *Id.* at p. 48–49.
[535] *Id.* at p. 49.

XVII. KIUC'S Proposal to Reduce Transmission of Electricity by Others Expense Should be Denied.

KIUC proposes that Big Rivers' Transmission of Electricity by Others expense should be reduced to reflect post test year expense reductions.[536] This expense is primarily in support of Big Rivers' off-system sales activities.[537] Big Rivers has not proposed a *pro forma* adjustment for its off-system sales activities, so it is not appropriate and in violation of the matching principle to use one item of expense from those activities reflected in Big Rivers' financial forecast to make the test year adjustment proposed by KIUC.[538] The Commission should reject this proposed adjustment.

XVIII. The Outstanding Motion for a Deviation and Petitions for Confidential Treatment Filed by Big Rivers Should be Granted.

No ruling has been made on the following motion and petitions for confidential treatment filed by Big Rivers. For the reasons stated in the motion and in each petition, those requests should be granted.

1. Big Rivers' petition for confidential treatment filed on or about April 15, 2011, relating to its responses to Item 16 of the Commission Staff's Second Request for Information, and to Items 43, 44, 45, 46, 65, 112, 129, and 132 of KIUC's First Data Request.[539]

---

[536] Direct Testimony of Lane Kollen at p. 20.
[537] Hite Rebuttal Testimony at p. 15; Big Rivers' May 11, 2011, response to Item 28 of KIUC's Second Request for Information (KIUC 2-28).
[538] Hite Rebuttal Testimony at p. 15.
[539] Big Rivers' April 15, 2011, petition for confidential treatment also initially included a request for confidential treatment of information contained in its responses to Items 19 and 35 of the Attorney General's First Information Request, and to Item 121 of KIUC's First Data Request. However, Big Rivers withdrew its petition with respect to those three responses by letter dated June 1, 2011. Big Rivers' petition for the remaining responses identified in the April 15 petition remains outstanding.

2. Big Rivers' petition for confidential treatment filed on or about May 11, 2011, relating to its updated responses to Items 112 and 132 of KIUC's First Data Request.

3. Big Rivers' motion for deviation filed on or about June 29, 2011, requesting a deviation from the requirement to file 11 hardcopies of its supplemental responses filed on June 24, 2011.

4. Big Rivers' petition for confidential treatment filed on or about July 6, 2011, regarding Exhibit Berry Rebuttal-1.

XIX. Conclusion

For the foregoing reasons, Big Rivers' proposed revenue increase should be granted in its entirety, along with the other associated relief requested by Big Rivers.

On this the 11th day of August, 2011.

James M. Miller

____

James M. Miller
Tyson Kamuf
SULLIVAN, MOUNTJOY, STAINBACK
& MILLER, P.S.C.
100 St. Ann Street, P. O. Box 727
Owensboro, Kentucky 42302-0727
(270) 926-4000

Douglas L. Beresford
HOGAN LOVELLS U.S., LLP
Columbia Square
555 Thirteenth Street, NW
Washington, D.C. 20004
(202) 637-5600

Counsel for Big Rivers Electric
Corporation

Commonwealth of Kentucky
Before the Public Service Commission of Kentucky

In the Matter of:

Application of Big Rivers Electric Corporation	)	Case No.
for a General Adjustment in Rates	)	2011-00036

Appendices to the
Post-Hearing Brief of Big Rivers Electric Corporation

August 11, 2011

Commonwealth of Kentucky
Before the Public Service Commission of Kentucky

In the Matter of:

Application of Big Rivers Electric Corporation for a General Adjustment in Rates	))	Case No. 2011-00036

Appendices to the
Post-Hearing Brief of Big Rivers Electric Corporation

APPENDIX A

Order dated March 6, 2009, in *In the Matter of: The Applications of Big Rivers Electric Corporation for: (1) Approval of Wholesale Tariff Additions for Big Rivers Electric Corporation, (2) Approval of Transactions, (3) Approval to Issue Evidences of Indebtedness, and (4) Approval of Amendments to Contracts, and of E.ON US LLC, Western Kentucky Energy Corp., and LG&E Energy Marketing, Inc. for Approval of Transactions*, PSC Case No. 2007-00455

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATIONS OF BIG RIVERS ELECTRIC CORPORATION FOR: (1) APPROVAL OF WHOLESALE TARIFF ADDITIONS FOR BIG RIVERS ELECTRIC CORPORATION, (2) APPROVAL OF TRANSACTIONS, (3) APPROVAL TO ISSUE EVIDENCES OF INDEBTEDNESS, AND (4) APPROVAL OF AMENDMENTS TO CONTRACTS; AND OF E.ON U.S., LLC, WESTERN KENTUCKY ENERGY CORP. AND LG&E ENERGY MARKETING, INC. FOR APPROVAL OF TRANSACTIONS	)	CASE NO. 2007-00455

O R D E R

On October 9, 2008, Big Rivers Electric Corporation ("Big Rivers"), E.ON U.S. LLC ("E.ON"), Western Kentucky Energy Corp. ("WKEC"), and LG&E Energy Marketing, Inc. ("LEM") filed a joint amended application requesting approval of the early termination of a 1998 lease under which generating plants owned or controlled by Big Rivers have been operated by WKEC. (E.ON, WKEC, and LEM are referred to collectively as "E.ON Entities," while Big Rivers and the E.ON Entities are referred to collectively as "Applicants.") Approval is also requested for dozens of transaction documents, tariffs, and financing arrangements necessary to implement the early termination of the lease, which is referred to as the "Unwind Transaction."

PARTIES

Big Rivers is a rural electric cooperative corporation organized pursuant to KRS Chapter 279. Big Rivers owns electric generation and transmission facilities and purchases, transmits, and sells electricity at wholesale, and it is a utility subject to the Commission's jurisdiction under KRS Chapter 278. Big Rivers exists for the principal purpose of providing the wholesale electricity requirements of its three member distribution cooperatives, Jackson Purchase Energy Corporation ("Jackson Purchase"), Kenergy Corp. ("Kenergy"), and Meade County Rural Electric Cooperative Corporation ("Meade County"). Big Rivers is owned by these three member cooperatives and they in turn provide retail electric service to approximately 110,000 customers located in 22 western Kentucky counties.

E.ON is a U.S.-based holding company whose subsidiaries include WKEC and LEM. WKEC is engaged in the business of leasing and operating electric generation assets owned or leased by Big Rivers or the city of Henderson, Kentucky, while LEM is currently engaged in the business of purchasing and selling electric power in wholesale markets, including the power produced by WKEC. None of these E.ON Entities are utilities subject to the Commission's jurisdiction under KRS Chapter 278.

In addition to the Applicants, intervention was requested by and granted to the following parties: Alcan Primary Products Corporation ("Alcan"); Century Aluminum of Kentucky General Partnership ("Century"); the Attorney General of the Commonwealth of Kentucky, by and through his Office of Rate Intervention ("AG"); City of Henderson Utility Commission d/b/a Henderson Municipal Power and Light ("HMPL"); Kentucky

Industrial Utility Customers, Inc. ("KIUC"); International Brotherhood of Electrical Workers ("IBEW"); Jackson Purchase; Kenergy; and Meade County.

Alcan, which is located in Sebree, Kentucky, and Century, which is located in Hawesville, Kentucky, both operate aluminum smelters and are the largest electric customers on the Big Rivers system. Due to the nature of the aluminum smelting process, they operate 24 hours a day, 7 days a week, at a 98-percent load factor. Alcan's load is approximately 368 MW, while Century's load is approximately 482 MW. Alcan and Century are both retail customers of Kenergy and they are referred to collectively as the "Smelters."

HMPL is an electric utility owned by the city of Henderson, Kentucky. HMPL owns generation, transmission, and distribution facilities and also provides broadband service. IBEW is the bargaining representative for the union employees at the Big Rivers-owned generating plants.

PROCEDURAL HISTORY

The Applicants filed their initial joint application on December 28, 2007, and the Commission held informal conferences on January 10, 2008 and January 22, 2008. By Order dated January 22, 2008, a procedural schedule was established for the further processing of this case. The schedule provided for discovery on the joint application, Intervenor testimony, discovery on Intervenor testimony, rebuttal testimony, a hearing, and an opportunity for the parties to file post-hearing briefs.

Additional informal conferences were held at the Commission's offices on February 19, 2008; March 24, 2008; May 9, 2008; May 15, 2008; June 19, 2008; June

26, 2008; October 20, 2008; and November 25, 2008. A public hearing was held on December 2 and 3, 2008, and briefs were filed on or before December 31, 2008.[1]

During the course of this proceeding, Big Rivers filed numerous motions requesting authority to amend its application. All of those motions have been granted except the one filed on November 25, 2008. That motion, which seeks to provide supplemental and updated information into the record, will be granted.

1998 LEASE AGREEMENT

Big Rivers owns seven coal-fired generating units with a total net capacity of 1,379 MW and one oil/gas-fired combustion turbine with a net capacity of 65 MW. HMPL owns two coal-fired generating units, known as "Station Two," with a net capacity of 310 MW. Since the HMPL units became operational in the 1970s, Big Rivers has operated and maintained them pursuant to a contractual agreement. In general terms, HMPL reserves a quantity of power from Station Two for use on its own system and pays a proportionate share of the costs, while Big Rivers is entitled to the rest of the power and is responsible for the rest of the costs.

In 1998, Big Rivers emerged from a Chapter 11 bankruptcy under the terms of a reorganization plan involving the E.ON Entities. Under that plan, Big Rivers entered into a 25-year lease of its generating facilities (and those it operated under lease from

[1] The AG's brief was titled "Comments."

HMPL) to WKEC.[2] Under the terms of the 1998 lease, WKEC leases and operates Big Rivers' (and HMPL's) generation facilities through 2023, while Big Rivers (and HMPL) retain ownership of their respective generating facilities both during the term of the lease and after its expiration. Since 1998, WKEC has operated and maintained the generating facilities and has been entitled to the power produced by those facilities.

Throughout the lease term, LEM is obligated to supply fixed quantities of power to Big Rivers pursuant to a purchase power agreement. The power supplied by LEM has been sufficient for Big Rivers to meet substantially all of its system requirements. Big Rivers continues to operate its transmission facilities and charges LEM tariffed transmission rates for the delivery of the energy produced by WKEC and consumed by LEM's customers. In addition to purchasing power from LEM, Big Rivers has a long-term agreement to purchase fixed quantities of power from the Southeastern Power Authority ("SEPA").

Under the 1998 lease arrangement, Big Rivers provides power for its three members, excluding Kenergy's requirements to serve the Smelters, through the power purchase agreements with LEM and SEPA. When economically feasible, Big Rivers

[2] Initially, the 1998 lease was conditionally approved in principle by the Commission in Case No. 1997-00204, The Application of Big Rivers Electric Corporation, Louisville Gas and Electric Company, Western Kentucky Energy Corp., Western Kentucky Leasing Corp., and LG&E Station Two Inc. for Approval of Wholesale Rate Adjustment for Big Rivers Electric Corporation and for Approval of Transaction (Ky. PSC April 30, 1998). Due to numerous revisions of the various documents comprising the lease transaction, a subsequent proceeding was established for a determination of whether material changes had been made to the structure of the transaction. The Commission ultimately and unconditionally approved the 1998 lease in Case No. 1998-00267, The Application of Big Rivers Electric Corporation for Approval of the 1998 Amendments to Station Two Contracts Between Big Rivers Electric Corporation and the City of Henderson, Kentucky and the Utility Commission of the City of Henderson (Ky. PSC July 14, 1998).

buys power in wholesale markets to supply its load, and it sells power at a profit into those markets. Even though the Smelters are retail customers of Kenergy, the 1998 lease eliminated Big Rivers and substituted LEM as the wholesale power supplier for the Smelters, with Big Rivers providing the Smelters' supplemental power at market-based rates.

As agreed to by the parties to the 1998 lease, LEM has one contract with Century and one with Alcan to supply power at fixed prices in fixed quantities that provide approximately 70 percent of the Smelters' total loads. The rest of the Smelters' loads are met by power purchased for them by Kenergy on the wholesale market at market-based prices. At times, Big Rivers has been the supplier of this market power. The LEM contract to supply Century expires at the end of 2010 and the contract to supply Alcan expires at the end of 2011. Thereafter, 100 percent of the Smelters' loads will be met by market power purchases.

In addition to leasing its generating units, Big Rivers transferred its responsibility to operate the two HMPL-owned units at Station Two. WKEC ultimately assumed Big Rivers' contractual rights and obligations to perform operation and maintenance service with respect to Station Two. Further, WKEC ultimately assumed Big Rivers' contractual rights and obligations regarding the purchase of power generated from Station Two in excess of the needs of the city of Henderson.

PROPOSED UNWIND TRANSACTION

In early 2003, representatives of E.ON approached Big Rivers to see if it would entertain a proposal to take back operational responsibility for its generating facilities and Station Two, and the corresponding entitlement to all the power generated from those assets, other than the Station Two power reserved by HMPL. Big Rivers viewed this proposal as an opportunity to improve its financial position for the benefit of itself and its members, as a means to obtain financing on more favorable terms, and as a way to better manage its long-term power supply. After analyzing the risks associated with supplying power to the Smelters, including operating and maintaining generation, load concentration, fuel supply, and financial risks, Big Rivers decided to enter into discussions to terminate, or "unwind," the 1998 lease transactions and agreements, with the intent of obtaining significant compensation for assuming those risks.

Big Rivers first negotiated with E.ON and then with the Smelters. In December 2005, Big Rivers, Kenergy, and E.ON announced they had signed a letter of intent to negotiate the Unwind Transaction, and Big Rivers and the Smelters announced agreement on a memorandum of understanding to negotiate a power supply arrangement for the Smelters. On March 26, 2007, Big Rivers and the E.ON Entities executed the Termination Agreement, which established the terms and conditions whereby the 1998 lease transactions and agreements would terminate and unwind.

On December 28, 2007, Big Rivers and the E.ON Entities filed a joint application seeking approval of the Unwind Transaction to position Big Rivers so that it can resume operational control and responsibility of its generating facilities and those at Station Two. More specifically, the application seeks approval of: (1) the Termination Agreement; (2) the transfer of control of Big Rivers' generating units from the E.ON Entities back to Big Rivers; (3) rate and tariff changes; (4) new contracts for service to the Smelters; (5) wholesale power contract extensions; (6) evidences of indebtedness;

and (7) the termination of the pending review of Big Rivers' Integrated Resource Plan ("IRP") and the establishment of November 2010 as the filing date for a new IRP.[3]

The December 28, 2007 application included various documents needed, or descriptions of the documents in process, to accomplish the Unwind Transaction. A financial model to demonstrate the financial feasibility of the Unwind Transaction was also included. The Applicants have submitted multiple amendments to the original application to address a number of significant issues that have developed during the course of this proceeding. One of those issues was a revised forecast of fuel prices which reflected much higher fuel costs through 2013. This necessitated revising the Financial Model to reflect increases in the annual projected fuel costs to be recovered through the Fuel Adjustment Clause ("FAC") component of rates. To offset those higher fuel costs, the E.ON Entities agreed to increase their cash compensation paid at closing for the benefit of both non-Smelter customers and the Smelters.

Another major issue requiring application amendments was the credit downgrading of Ambac Assurance Corporation ("Ambac") to below investment grade. Ambac was providing credit support for the two leveraged leases Big Rivers entered into in 1999 and 2000 with Bank of America ("BoA") and Philip Morris Credit Corporation ("PMCC").[4] Due to the credit downgrade, Big Rivers needed to either provide alternative credit support or terminate the leveraged leases. With financial assistance

---

[3] Case No. 2005-00485, *The 2005 Integrated Resource Plan of Big Rivers Electric Corporation.*

[4] Case No. 1999-00450, Big Rivers Electric Corporation's Application for Approval of a Leveraged Lease of Three Generating Units (Ky. PSC Nov. 24, 1999 and Jan. 28, 2000).

from the E.ON Entities and the Smelters, Big Rivers elected to proceed with the least costly option, which was to buy out both of the leveraged leases. These buy-outs also necessitated revisions to the Financial Model to reflect the need to increase rates to recover the costs of the two buy-outs.

On October 9, 2008, the Applicants filed substantial amendments to the application, including revised transaction documents, a revised financial model, and revised testimony.

UNWIND FINANCIAL MODEL

Big Rivers submitted a financial model to support the reasonableness of the Unwind Transaction. The Unwind Financial Model projects Big Rivers' financial performance through 2023, assuming the Unwind Transaction closes. The model projects annual financial statements, including an income statement, cash flows, and a balance sheet, as well as schedules of projected energy sales, energy production and related costs, fixed costs, capital expenditures and depreciation, taxes, and projected debt service. The Unwind Financial Model also presents detailed projections of wholesale rates to be paid annually by Big Rivers' three member cooperatives and by the Smelters.[5] The Unwind Financial Model has been modified several times to reflect changes as the Unwind Transaction has evolved since the initial application was filed on December 28, 2007.

IMPACT OF BOA AND PMCC BUY-OUTS

As previously discussed, Big Rivers elected to buy out the leveraged leases with BoA and PMCC as the least costly solution to the loss of requisite credit support for

[5] Direct testimony of Robert S. Mudge, December 28, 2007, Exhibit 9, at 4-5.

those leases. The buy-outs were necessitated solely by the credit crisis, not by the Unwind Transaction. However, they have a significant financial impact on Big Rivers.

The cost to terminate the BoA lease was approximately $6 million, with the buy-out supported by a Cost Share Agreement among Big Rivers, the E.ON Entities, and the Smelters. Under that agreement, the E.ON Entities advanced the full cost of the buy-out. Upon closing the Unwind Transaction, the E.ON Entities will receive a reimbursement of $1 million from Big Rivers and $1 million from the Smelters collectively.[6]

The cost to terminate the PMCC lease was almost $122 million. Big Rivers gave PMCC $109 million in cash and an unsecured note for $12.38 million. The note bears interest at 8.5 percent and is payable upon closing the Unwind Transaction or December 15, 2009, whichever occurs first. The E.ON Entities have agreed that, if the Unwind Transaction closes, they will reimburse Big Rivers one-half of the $121.38 million, plus one-half of a $332,868 shortfall payment that had to be made to CoBank ACB ("CoBank") in conjunction with this buy-out. Thus, if the Unwind Transaction closes, the E.ON Entities will reimburse Big Rivers almost $60.9 million in conjunction with the PMCC buy-out.[7]

[6] Motion to Amend and Supplement Application, June 11, 2008, Exhibit 5.

[7] Third Supplemental Testimony of C. William Blackburn, Exhibit 78, at 10.

FINANCIAL CONSIDERATION TO BIG RIVERS FROM E.ON ENTITIES

Big Rivers has calculated that the Unwind Transaction will result in its receipt of the following cash and non-cash benefits from the E.ON Entities:[8]

	$ Millions
Cash	387.7
Waiver of Residual Value Payment	141.4
LG&E Rental Income Advance	11.2
Fuel Inventory & Other	51.0
Settlement Promissory Note	15.7
Coleman Scrubber	98.5
SO_2 Allowance & Other	2.0
Leveraged Leases	65.0
Expense Unamortized Marketing Payment	(15.1)
Assurances Agreement Payment	(1.5)
Total	$755.9

The $387.7 million cash payment to Big Rivers will be used for several purposes. Big Rivers will set aside $157 million in an Economic Reserve account to offset future wholesale power cost increases for non-Smelter customers due to increases in fuel, environmental, and other costs. The E.ON Entities' cash payment initially included only $75 million for the Economic Reserve; but, while this case was pending, they agreed to increase that payment by $82 million to offset more recent projections of higher fuel costs.[9] Big Rivers will set aside $35 million as a Transition Reserve to be used as an

[8] Third Supplemental Testimony of C. William Blackburn, Exhibit 78, Exhibit CWB-15.

[9] Second Supplemental Testimony of C. William Blackburn, Exhibit 7, at 3-4.

emergency fund to offset the loss of revenue should one or both Smelters close until alternative buyers are found for the power.[10] Big Rivers will also use funds from the cash termination payment to prepay $140.2 million on its Rural Utilities Service ("RUS") note at the close of the transaction.[11] Big Rivers has also projected that cash termination funds will be used to pay PMCC just over $6 million, which represents one-half of the PMCC loan established with the PMCC buy-out.

The E.ON Entities have agreed to waive the Residual Value Payment for shared incremental and non-incremental capital additions, representing a current value of $141.4 million to Big Rivers.[12] Without this waiver, at the end of the lease Big Rivers would have to pay for its share of certain leasehold improvements constructed by E.ON.[13] Big Rivers estimates that this payment would be approximately $377 million in 2023 at the end of the lease.[14]

Additional non-cash consideration to Big Rivers includes inventories, consisting of fuels, reagents, personal property, and material and supplies, in an amount currently estimated to be $51 million. At closing, the difference between the actual value of the inventories and $55 million will be reflected as an adjustment to the cash

---

[10] Direct Testimony of C. William Blackburn, Exhibit 10, at 85.

[11] Third Supplemental Testimony of C. William Blackburn, Exhibit 78, at 12-13.

[12] Third Supplemental Testimony of C. William Blackburn, Exhibit 78, at 47 and Exhibit CWB-15.

[13] Direct Testimony of Michael H. Core, Exhibit 14, at 16.

[14] Transcript of Evidence, December 3, 2008, C. William Blackburn at 140.

consideration.[15] Big Rivers also benefits from a new scrubber, valued at $98.5 million, installed by the E.ON Entities on the Coleman plant.[16]

Significant other non-cash contributions to Big Rivers include: recognition of an LG&E Rental Income Advance of $11.2 million, which represents deferred lease revenue from the E.ON Entities;[17] forgiveness of a Settlement Promissory Note, valued at $15.7 million, owed to the E.ON Entities;[18] and receipt of 14,000 SO_2 allowances with an approximate market value of $2.0 million.[19] Also reflected by Big Rivers, separate and apart from the cash termination payment, is $65 million representing the E.ON Entities' payment of one-half of the costs of the BoA and PMCC buy-outs.[20]

There are also two items identified by Big Rivers which offset the Transaction Benefits: an unamortized $15.1 million marketing payment to the E.ON Entities that was being amortized by Big Rivers over the life of the lease which will now be

---

[15] Direct Testimony of C. William Blackburn, Exhibit 10, at 13 and 72.

[16] Third Supplemental Testimony of C. William Blackburn, Exhibit 78, Exhibit CWB-15.

[17] Id.

[18] Direct Testimony of Michael H. Core, Exhibit 14 at 16, and Third Supplemental Testimony of C. William Blackburn, Exhibit 78, Exhibit CWB-15.

[19] Third Supplemental Testimony of C. William Blackburn, Exhibit 78, Exhibit CWB-15.

[20] Third Supplemental Testimony of C. William Blackburn, Exhibit 78, at 10.

expensed;[21] and Big Rivers' assumption of an E.ON Entities liability that will require it to make a $1.5 million Assurances Agreement payment to the Smelters.[22]

SMELTER SERVICE AGREEMENTS

The Smelters' existing service agreements were negotiated in conjunction with Big Rivers' bankruptcy reorganization and its 1998 lease transaction with the E.ON Entities. The Smelters receive about 70 percent of their power requirements from LEM at a fixed price of about $25/MWh, with the rest of their power requirements being supplied by market purchases at prices of $50-$60/MWh. This results in the Smelters paying a blended rate of approximately $35/MWh. Once the existing service agreements expire at the end of 2010 for Century and 2011 for Alcan, the Smelters would have to meet all of their power requirements by market purchases.

When the existing service agreements were negotiated in 1998, the Smelters expected that, by now, market purchases of power would be priced at or below their contract prices. However, due to unforeseen increases in fuel prices, higher environmental costs, and changed market parameters following the California power crisis of 2000-2001, market power purchases are now priced significantly higher than the Smelters' contract prices.

The aluminum smelting process is highly energy-intensive, with the cost of electricity comprising approximately one-third of the cost of production for the Smelters. Unlike many other businesses, the Smelters are unable to simply raise their selling

---

[21] Third Supplemental Testimony of C. William Blackburn, Exhibit 78, at 48 and CWB-15.

[22] Id.

prices to compensate for higher costs of electricity. Aluminum is a commodity traded worldwide at a market price which is based on global supply and demand. Consequently, significant increases in the price of power for the Smelters would render their operations uneconomic and they would be forced to close. Terminating the Smelters' operations would have a devastating negative economic impact in the area served by Big Rivers. The Smelters directly employ 1,400 workers, who earn an average wage of $54,000 annually.[23] The collective wages, salaries, and benefits paid by the Smelters total $115 million annually.[24] In addition to the direct level of employment by the Smelters, there are approximately 2.5 indirect jobs created by each direct job.[25] Thus, if both of the Smelters were to terminate their operations, close to 5,000 jobs could potentially be lost in the western Kentucky region. The economic impact of these job losses would be devastating to the affected employees from lost wages, as well as to the state from lost income and sales taxes, and to county governments and school districts from lost tax revenues.

Although it would not be possible to guarantee the future financial health of the Smelters, providing them with a long-term supply of power priced at below market prices should enable them to maintain their current competitive positions and continue in operation over the long term. It was for this reason that Big Rivers entered into negotiations with the Smelters on new service agreements that will provide them power at competitive prices while providing protections to Big Rivers and its non-Smelter

---

[23] Direct Testimony of Paul A. Coomes at 2.

[24] Id.

[25] Id. at 3-4.

customers against the risks inherent in resuming the role of power supplier to the Smelters.

The new service agreements negotiated by Big Rivers and the Smelters provide that Big Rivers will supply 368 MW to Alcan and 482 MW to Century upon payment of the following amounts:

1. A base energy rate of $0.25 per MWh above Big Rivers' wholesale power rate to its members for resale to dedicated delivery point large industrial customers (subject to future adjustment by the Commission) at a 98-percent load factor.

2. An FAC charge.

3. An Environmental Surcharge.

4. A TIER guarantee through 2023, starting at $12.8 million annually in 2009 and increasing to $34.7 million annually in 2021, to ensure that Big Rivers maintains a TIER of 1.24.

5. A non-FAC purchase power adjustment charge.

6. Two annual surcharges consisting of:

    a. Surcharge One -- a fixed rate of $0.70 per MWh in 2009-2011, $1.00 per MWh in 2012-2016, and $1.40 per MWh in 2017-2023.

    b. Surcharge Two – a fixed rate of $0.60 per MWh each year, subject to a $200,000 monthly credit for the first 96 months; plus an additional rate of $0.60 per MWh contingent on actual fuel costs exceeding a base line.

The Smelters will also be entitled to an Equity Credit, to be paid by Big Rivers in any year that it earns a TIER in excess of 1.24 and does not elect to make a credit of the excess TIER to all customers.

In recognition of the significantly higher forecast of fuel prices, Big Rivers will make a one-time payment of $7 million to the Smelters, rather than establish an

Economic Reserve account as Big Rivers will do for the non-Smelter customers, in order to moderate the higher fuel costs. Big Rivers has also agreed to make a payment to the Smelters to reflect unanticipated delays in closing the Unwind Transaction. This payment will be based on the higher market power prices the Smelters now pay versus the lower prices to be paid under the new agreements. This payment is estimated to be $2.84 million if the Unwind Transaction closes at the end of March 2009.

The Smelters will also receive substantial compensation from the E.ON Entities. To offset the higher projected fuel costs, the E.ON Entities will deposit $70 million in an escrow account for withdrawal by the Smelters when the FAC exceeds a certain index. The E.ON Entities will deposit another $17.5 million into escrow to offset higher operating costs for the Smelters. The $17.5 million will be dispersed to the Smelters at intervals of 6, 12, and 18 months following the closing of the Unwind Transaction. In addition to these payments, the E.ON Entities have also agreed to make a lump-sum payment to the Smelters upon closing in exchange for their consent to terminate their current power contracts with the E.ON Entities. The amount of this payment has been granted confidential treatment at the request of the E.ON Entities.

These new service agreements also provide the Smelters two levels of load curtailment and a termination of service. The first level of curtailment is for 115 MW, which would essentially cover the power requirements of one potline, and would be allowable for up to 48 months. Under this curtailment, Big Rivers would resell the 115 MW and credit the entire proceeds to the Smelter experiencing the curtailment. The second level of curtailment would be for more than one potline, up to total operations. Under this curtailment, Big Rivers would resell the power not taken by the Smelters and credit the Smelters with the net proceeds but only up to the prices for power under their service agreements. Finally, under a worst-case scenario, the Smelters have the right to permanently close their operations, but only upon one year's advance notice and not before January 1, 2011.

The AG has expressed concern that the Smelters may close down even if the Commission approves the Unwind Transaction.[26] Thus, the AG urges that the Commission "review the proposed transaction with an abundance of caution."[27] The Commission believes that it has proceeded very cautiously and deliberately in this case and has developed an extensive evidentiary record to support the findings and conclusions herein. While the Commission cannot predict the future economic viability of the Smelters, the power prices set forth in the new service agreements should provide a reasonable opportunity for the Smelters to continue operating in Kentucky for the long term and to preserve the jobs and tax base which support the economy of western Kentucky. The Smelters have recently made millions of dollars in new capital investments to improve their production capabilities and efficiencies. While world market prices of aluminum may cause the Smelters to close, these capital investments by the Smelters clearly demonstrate their good faith efforts to maintain their operations in Kentucky for the long term.

UNWIND RATES FOR NON-SMELTER CUSTOMERS

Big Rivers intends to continue to charge its current base rates for wholesale power sold to its three member cooperatives for use by the non-Smelter customers. Big

---

[26] AG's Comments at 17-20.

[27] Id. at 20.

Rivers is also requesting to establish a number of rate adjustment clauses to track specific expenses or to flow back as credits the reserve fund accounts and the Smelters' surcharge payments. In addition to these adjustment clauses, Big Rivers has proposed numerous other tariff changes to properly reflect its operations after the Unwind Transaction is completed. All of these changes are set forth in an amended tariff filed October 9, 2008. The Commission finds all of these tariff changes to be reasonable. Big Rivers' proposed rate adjustment clauses are discussed below.

Fuel Adjustment Clause

Big Rivers' purchased power costs for its non-Smelter customers are largely fixed under the terms of its 1998 power purchase agreement with LEM. Consequently, Big Rivers eliminated its FAC upon executing the 1998 lease with the E.ON Entities. With a resumption of control and operation of its generating assets, changes in fuel costs will be an important economic consideration. Therefore, Big Rivers proposes to implement an FAC for all its customers to timely track changes in fuel costs consistent with the Commission's FAC regulations.[28]

Environmental Surcharge

Big Rivers is also proposing to implement for all customers an Environmental Surcharge to recover future environmental costs not included in its existing rates. The Environmental Surcharge is based on recovering the costs of three separate environmental programs (SO_2, NOx, and SO_3) included in the Big Rivers Environmental Compliance Plan ("Environmental Compliance Plan").[29] Big Rivers' proposed

[28] Direct Testimony of C. William Blackburn, Exhibit 10 at 90-92.

[29] Id. at 93-94.

Environmental Compliance Plan and Environmental Surcharge Mechanism were previously reviewed and approved by the Commission last year in Case No. 2007-00460, with implementation conditioned upon closing the Unwind Transaction.[30]

Purchased Power Costs

Big Rivers anticipates incurring costs to purchase power on the wholesale market from time to time. Under the Smelter Service Agreements, the Smelters have agreed to pay for their portion of purchased power costs, not recoverable through the FAC, through a Non-FAC Purchased Power Adjustment ("PPA") mechanism. For the non-Smelter customers, Big Rivers is requesting approval to establish two regulatory accounts, a deferred asset and a deferred liability, to account for any charges or credits related to the portion of the costs of purchased power that are not recoverable under the FAC and are attributable to the non-Smelter customers. Through a tariff called the Regulatory Account Charge, the Non-FAC PPA charges and credits applicable to non-Smelter customers will then be amortized over a period of time after review, and subject to approval, in a general rate case.[31]

Economic Reserve

Upon closing the Unwind Transaction, Big Rivers will use $157 million of the cash contribution from the E.ON Entities to fund the non-Smelter Economic Reserve account. These funds will be flowed back to the non-Smelter customers over approximately five years through a new tariff called the Member Rate Stability

[30] Case No. 2007-00460, The Application of Big Rivers Electric Corporation for Approval of Environmental Compliance Plan and Environmental Surcharge Tariff (Ky. PSC June 25, 2008).

[31] Direct Testimony of C. William Blackburn, Exhibit 10, at 80-84.

Mechanism ("MRSM"). Through use of the MRSM, Big Rivers predicts that it will be able to offset all cost increases for two years and partially offset cost increases for the following three years. While Big Rivers' rates will increase starting in year three due to cost increases tracked by its FAC and Environmental Surcharge, no general rate increase is projected until 2017.[32]

Unwind Surcredit

Big Rivers is requesting to adopt an Unwind Surcredit that will appear as a credit on the bills of non-Smelter customers. This credit will be equal to the surcharges paid annually by the Smelters to offset increases in fuel costs for non-Smelter customers.[33]

TIER Rebate

Big Rivers is proposing to adopt a TIER-related rebate ("TIER Rebate") to annually flow back to non-Smelter customers, as well as the Smelters, earnings in excess of a 1.24 TIER. The rebate will be made only if Big Rivers determines it is appropriate to do so in a particular year and Commission approval is obtained.

RUS DEBT PAYMENTS

Big Rivers plans to prepay $140.2 million on its RUS note at the close of the transaction utilizing a portion of the cash contribution from the E.ON Entities. Big Rivers will then pay an additional $60 million to RUS on or before 2012 and an additional $200 million no later than January 2016.[34]

---

[32] October 2008 Unwind Financial Model, Exhibit 79, page 3, line 17 and page 15, lines 13 and 30.

[33] Direct Testimony of C. William Blackburn, Exhibit 10, at 9 and 80.

[34] Third Supplemental Testimony of C. William Blackburn, Exhibit 78, at 12-13.

BENEFITS OF THE UNWIND TRANSACTION

The Unwind Transaction will produce very significant benefits for Big Rivers, the Smelters, and the non-Smelter customers that would not exist with a continuation of the 1998 lease. While the unique benefits to the Smelters are discussed under the heading "Smelter Agreements," the following discussion details the benefits to Big Rivers, its member cooperatives and all customers.

The first of these benefits is the significant financial contribution to be made by the E.ON Entities to Big Rivers, now valued at $755.9 million. Big Rivers' equity will dramatically improve from a negative $139 million (-11 percent) to a positive $372 million (+26 percent).[35] Big Rivers will also have an investment grade credit rating and will be able to access capital markets when necessary to do so, such as to refinance existing high-interest rate pollution control bonds and to fund future upgrades and replacements of existing facilities. Additionally, Big Rivers' lines of credit, now limited to $15 million, will increase to $100 million with the two new credit agreements now being proposed.

A long-term supply of power will be available for the Smelters at prices below those in the market. This should allow the Smelters to maintain their operations in western Kentucky; preserve hundreds of good-paying jobs; and avoid an erosion of the tax base, which would be devastating to area school districts and local and state governments. Further, the Unwind Transaction will remove the E.ON Entities as the generation operator and supplier to Big Rivers. Although this arrangement has worked

[35] Supplemental Direct Testimony of Michael H. Core, Exhibit 102 at 11, and Exhibit MHC-2.

successfully to date, the relatively fixed prices under the power agreements will likely lead to major disputes and possibly litigation regarding cost responsibility for future environmental and other upgrades. In addition, restoring Big Rivers as the generation operator and supplier will allow future decisions to be made solely in its own best interest, with a renewed emphasis on economic development in western Kentucky.

UNWIND IMPACT ON RURAL CUSTOMERS

The Unwind Transaction will cause rates for non-Smelter customers to rise, not immediately but over time, to projected levels that are higher than would exist under a continuation of the 1998 lease. However, Big Rivers indicated that, absent the Unwind, it will need an immediate rate increase of 20 to 25 percent, although not likely on a permanent basis, to reestablish its financial condition as a result of the expenditure of almost $122 million for the PMCC buy-out. In fact, Big Rivers filed on March 2, 2009 an application to increase its rates by $24.9 million, an increase of 21.6 percent.[36]

One of the major concerns expressed by the AG was the increase in rates for the Rural Customers now projected under the Unwind Transaction. (The Rural Customers consist of all customers on Big Rivers' system except the Smelters and the 20 large industrial customers directly served from substations.) The projected rates for the Rural Customers have increased over the past 12 months due substantially to higher forecasts of fuel prices, leading the AG to conclude that "without further mitigation of the

[36] Case No. 2009-00040, Application of Big Rivers Electric Corporation for a General Adjustment in Rates.

unfavorable rate impacts that are projected to occur," he cannot now support the Unwind Transaction.[37]

While the Commission recognizes and appreciates the AG's concerns relating to the projected rate increases for the Rural Customers, those increases must be considered in light of both the benefits to be achieved by the Unwind Transaction and the level to which rates would rise absent the Unwind Transaction. The record shows that with the Unwind Transaction, Big Rivers' wholesale rates for the Rural Customers are projected to increase incrementally each year from their existing level of $37.22/MWh to $48.80/MWh in 2014, representing a weighted average increase of 14.8 percent.[38] Absent the Unwind Transaction, and assuming Big Rivers sells 200 MW to the Smelters at below market rates to help preserve their operations, Rural Customer rates will increase immediately for one year, from $37.22/MWh to $44.36/MWh, then alternately decline and increase almost annually, reaching $45.62/MWh in 2014, representing a weighted average increase of 21.7 percent.[39] Alternatively, absent the Unwind Transaction and with all Big Rivers' excess power sold at market rates, Rural Customer rates will still increase immediately for one year, from $37.22/MWh to $44.36/MWh, then decline and later increase to $40.80/MWh by 2014, representing a weighted average increase of 9.6 percent.[40]

---

[37] AG Comments at 28.

[38] Big Rivers Hearing Exhibit #4.

[39] Id.

[40] Id.

The Commission also recognizes that the 1998 lease provides Big Rivers a fixed-price supply of power through 2023 at rates projected to be less than those under the Unwind Transaction. But, at the end of the 1998 lease, Big Rivers would have to pay approximately $377 million to the E.ON Entities for the value of the capital additions to Big Rivers' generating units, a payment that will be eliminated by the Unwind Transaction. The Commission is acutely aware of the current economic and financial crisis now facing our great nation and the people of this Commonwealth. Utility service is a necessity of life, not a luxury, and it needs to be available at the lowest reasonable rates for the Rural Customers of Big Rivers.

Unfortunately, under the Unwind Transaction, a combination of higher fuel costs and exhaustion of the Economic Reserve account in 2013 will result in rate increases for Rural Customers that are simply too high. Thus, Big Rivers' reacquisition of control of its generating units will be consistent with the public interest only if some mitigation is provided to offset the projection of higher rates for the Rural Customers.

Since the Applicants have indicated that time is of the essence in completing the Unwind Transaction, the Commission finds that, rather then delaying this case to allow the Applicants time to fashion a remedy, we will create a reasonable remedy and condition this Order upon the Applicants' acceptance thereof. The E.ON Entities have agreed to reimburse Big Rivers for one-half of the cost of the PMCC buy-out, amounting to approximately $60.9 million.[41] The Commission finds that the E.ON Entities should reimburse Big Rivers 100 percent of that cost, with the additional $60.9 million being held by Big Rivers in a new reserve account to be known as the Rural Economic

[41] Third Supplemental Testimony of C. William Blackburn, Exhibit 78 at 10.

Reserve. This account will be recorded as a regulatory liability and used over 24 months only as a credit against the rates of the Rural Customers upon exhaustion of the Non-Smelter Economic Reserve. This additional $60.9 million should be invested in interest-bearing U.S. Treasury securities, with all interest credited to the Rural Economic Reserve. Big Rivers will need to revise its tariffs to include a new rate mechanism, to be known as the Rural Economic Reserve, to flow back to the Rural Customers the funds in the Rural Economic Reserve Account.

ACCOUNTING TREATMENT

The terms of the Termination Agreement between Big Rivers and E.ON provide for a number of transfers and other issues that require separate accounting considerations.[42] Therefore, Big Rivers is seeking approval for various journal entries and the establishment of certain regulatory accounts.

Big Rivers has proposed specific journal entries to record the assets transferred and the value received from the E.ON Entities, to record Big Rivers' payments to the RUS and the Smelters, to establish deferred liabilities for the Economic Reserve and the Transition Reserve accounts,[43] and to establish both a deferred asset and deferred liability for the non-Smelter, non-FAC PPA.

[42] Direct Testimony of C. William Blackburn, Exhibit 10, at 71.

[43] Third Supplemental Testimony of C. William Blackburn, Exhibit 78, at Exhibit CWB-14.

Big Rivers intends to currently expense all costs of the BoA and PMCC buy-outs on a "netted" basis. Big Rivers will record a net loss of $16.1 million on its books as a result of this proposed accounting treatment.[44]

FINANCING AND LINES OF CREDIT ISSUES

Big Rivers requests approval to issue two unsecured lines of credit with its traditional supplemental lenders, the National Rural Utilities Cooperative Finance Corporation ("CFC") and CoBank. The CFC line of credit will be for up to $50 million with a five-year term and the funds will be used to finance capital expenditures and for general corporate use. CFC will make loans and issue Letters of Credit upon request up to the $50 million limit. The interest rates on funds drawn on this line of credit will be either the London Interbank Offered Rate ("LIBOR") plus an applicable margin tied to Big Rivers' credit rating or the greater of: (1) the prime rate; or (2) the federal funds effective rate plus 50 basis points.[45]

The CoBank line of credit is also for $50 million with a three-year term and will be used for the same purposes. The interest rates on the CoBank funds will be either the LIBOR plus an applicable margin tied to Big Rivers' credit rating or the prime rate published in the *Wall Street Journal*.[46]

Big Rivers proposes to replace its current Third Restated Mortgage and Security Agreement ("Mortgage") with an Indenture between Big Rivers and a trustee to be named later. To accomplish this transaction, Big Rivers requests approval of both the

---

[44] Third Supplemental Testimony of C. William Blackburn, Exhibit 78, at 14.

[45] First Amendment and Supplement to Application filed March 31, 2008, at 4-5.

[46] Id. at 5-6.

Indenture and a Termination of Mortgage Agreement. The Indenture is similar to the Mortgage in many ways, but there is no lien or security interest in cash, most contracts, or stock of any subsidiary. The Indenture will also allow Big Rivers to issue debt without requiring the approval of existing senior secured creditors.[47] Thus, the Indenture should benefit Big Rivers by providing greater operating and financial flexibility.

Big Rivers has also requested authority to issue a Pollution Control Bonds Series 2001A Note to refinance an existing note payable to the County of Ohio, Kentucky ("Ohio County"). The note was issued in consideration of Ohio County's issuance of certain pollution control bonds. The terms of the new note are essentially the same as the original note. This refinancing is necessitated by the replacement of the Mortgage securing the current note with the Indenture in connection with the Unwind Transaction.[48]

Authorization has also been requested to issue an Ambac Municipal Bond Insurance Policy Series 1983 Note. This note will also replace an existing note issued and approved in connection with the BoA and PMCC leases for the repayment of any amounts Ambac must pay under its guarantee to repay certain pollution control bonds issued by Ohio County. The terms of the new note are essentially the same as the original note and are necessitated by the substitution of the Indenture for the Mortgage securing the original note.[49]

---

[47] Second Amendment and Supplement to Application filed April 11, 2008, at 2-3.

[48] Id. at 7.

[49] Id.

Big Rivers requests authority to issue a Standby Bond Purchase Agreement Note (Series 1983 Bonds) to replace a note payable to Dexia Credit Local ("Dexia"). The note was issued in connection with the BoA and PMCC leases for the repayment of unpaid principal and interest when due on certain pollution control bonds issued by Ohio County and purchased and held by Dexia. The terms of the new note are essentially the same as the original note and are necessitated by the substitution of the Indenture for the Mortgage securing the original note.[50]

Big Rivers requests approval of the issuance of the Termination of the Third Amended and Restated Subordination, Nondisturbance, Attornment and Intercreditor Agreement. This agreement is necessary to facilitate the termination and release of the existing Intercreditor Agreement.[51] Big Rivers requests approval to enter into the Creditor, Consent, Termination and Release Agreements under which the principal creditors give the necessary consents to terminate the 1998 lease with the E.ON Entities. This agreement terminates both the Mortgage and the existing Intercreditor Agreement.[52] Finally, Big Rivers requests approval of the two letter agreements in which Big Rivers, the Smelters, and the E.ON Entities agreed to the payment terms of the BoA leveraged lease buy-out. Pursuant to these agreements, Big Rivers and the Smelters will each reimburse the E.ON Entities $1 million when the Unwind Transaction is closed.[53]

---

[50] Id. at 8.

[51] Id. at 8-9.

[52] Motion to Amend and Supplement Application, October 9, 2008, Exhibit 96.

[53] Motion to Amend and Supplement Application, October 9, 2008, at 8-9.

In addition to the credit arrangement discussed above, Big Rivers identified a number of financing documents that it does not believe require Commission approval but asks the Commission to approve each document should the Commission disagree. Since these documents are integral parts of the Unwind Transaction, the Commission finds it appropriate to approve these documents, except those that are subject to the supervision and control of the RUS.[54]

DEPRECIATION STUDY

Big Rivers' last depreciation study was performed over ten years ago. Big Rivers indicated that its preference was to resume operation of the generating assets prior to conducting a new depreciation study. The Commission finds this approach to be reasonable. However, Big Rivers' proposal to wait another seven years, until 2016, to file a new depreciation study is not reasonable. Depreciation is an important part of a utility's operation, particularly when the utility is not owned by private investors. Since Big Rivers has committed to filing within three years for a general review of its operations and tariffs, a new depreciation study should be submitted as part of the filing, along with an analysis of the impacts of implementing the results of the depreciation study on Big Rivers' financial operations and its rates.

GENERATING PLANT DUE DILIGENCE

One of the conditions precedent to closing the Unwind Transaction is a determination by Big Rivers that each generating plant is in good condition and state of repair. This determination by Big Rivers is of critical importance for a number of

[54] The financing documents to be modified between Big Rivers and RUS are an Amended Consolidated Loan Contract; an RUS 2008 Promissory Note, Series A; and an RUS 2008 Promissory Note, Series B.

reasons. First, there are no guarantees provided by the E.ON Entities as to the condition of the generating plants after the Unwind Transaction is completed. Second, the Smelters' need for a highly reliable power supply at a 98-percent load factor leaves little room for meeting load if there are unplanned outages. Third, since Big Rivers' generation is all relatively low-cost, purchasing replacement power in the event of an unplanned outage will likely be very expensive. Fourth, Big Rivers' ability to meet all of its operational and financial projections is tied to its ability to achieve a relatively high level of reliability from its generating units, including the HMPL Station Two.

The components of Big Rivers' due diligence plan include:

1. Inspection of Operation & Maintenance records at each generation plant;

2. Engineering evaluation of the condition of each plant by Big Rivers and Stanley Consultants;

3. Review of WKEC's operating plans; and

4. Physical testing of operating capability of each generating unit, to be conducted prior to closing.

Big Rivers stated that it does not intend to compile a comprehensive due diligence report just prior to closing the Unwind Transaction because of its longstanding, intimate knowledge of the condition of the generating plants. Big Rivers operated all of the plants up until mid-1998, and it is knowledgeable of all the repairs and maintenance performed since that time. Big Rivers has had its own employees at the generating plants weekly to monitor their operations and it also retained a consulting engineer, Stanley Consultants, to provide annual reports of each unit's repair and maintenance record. Since March 2007, Stanley Consultants has also had personnel at the generating plants full-time. The E.ON Entities have provided Big Rivers and Stanley

Consultants unfettered access to plant maintenance records and relevant financial information compiled since the 1998 lease transaction.

Big Rivers was also actively engaged in the approval and financing of several construction enhancements that were planned and completed by the E.ON Entities over the past ten years. Additionally, it appears that, since leasing the generating units, WKEC has used engineering best-practices in an endeavor to maximize unit reliability and productivity. In fact, for the last ten years, the plants have ranked in either the top quartile or second quartile of generating plants for the standard industry performance metrics of equivalent forced outage rates, equivalent availability factor, and net capacity factors.[55]

The Smelters also retained a consulting engineer, Stone & Webster Management Consultants, Inc. ("Stone & Webster"), to perform a due diligence study. Stone & Webster stated that, even though the base load generating units are 23 to 40 years old, they are in good, if not better, shape than comparable units of similar age and size. Stone & Webster concluded that, with proactive scheduled maintenance, the Big Rivers generation fleet can perform on a reliable basis consistent with industry standards and deliver the expected power output.[56]

The AG's post-hearing comments suggest, for the first time, that the Commission consider hiring its own consulting engineer and conducting an on-site inspection of the generating units.[57] Based on the extensive evidentiary record, including three

---

[55] Transcript of Evidence, December 2, 2008, Robert Berry, at 184-185.

[56] Smelters' Response to AG's Supplemental Data Request, Item 4.

[57] AG's Comments, at 28.

engineering reports, the Commission finds that there is substantial evidence to demonstrate that the generating plants are in reasonable condition for their age and that they can perform reliably, consistent with industry standards. An on-site visit as suggested by the AG, absent engineering testing and instrumented measurement, would reveal no useful information relative to the capacity of the plants to operate reliably in the future. Although a number of generating plant deficiencies have been identified by the existing engineering reports, those deficiencies have not been shown to impact the reliability of the generating plants. In addition, all necessary actions to correct the deficiencies are scheduled to be performed as part of Big Rivers' 2009-2011 Production Work Plan. Thus, the existence of deficiencies at the generating plants is not a basis upon which to deny approval of the Unwind Transaction.

BIG RIVERS STAFFING LEVELS

The IBEW urges the Commission to adopt the AG's recommendation that Big Rivers be required to maintain "the same level of workforce, with comparable if not better skill and expertise, as it currently does, or notify the Commission if [Big Rivers] has concluded it would be imprudent to do so, stating the reason why [Big Rivers] believes it to be imprudent."[58]

In response to this recommendation, Big Rivers has provided a commitment to continue to employ the level of workforce necessary to safely and professionally operate its facilities. Big Rivers criticizes the AG's workforce recommendation, arguing that with such a requirement the Commission would have to exercise its jurisdiction to review the prudence of every workforce reduction but remain indifferent to any staffing-level

[58] Direct Testimony of David Brevitz, at 52.

increases. Big Rivers maintains that the commitment it has provided is consistent with the Commission's jurisdiction and representative of the expectations that the Commission and Big Rivers' customers should have of Big Rivers.

The Commission finds it reasonable in this case, where Big Rivers seeks to reacquire control of assets it previously controlled, to allow Big Rivers the flexibility to determine its future workforce levels, consistent with good utility practice. Big Rivers is organized as a cooperative and is owned by its three member distribution cooperatives that, in turn, are owned by their 110,000 electric customers. There is no reason to believe that Big Rivers will be driven by a profit motive to reduce its workforce below the levels necessary to maintain highly reliable service expected and needed by all of the 110,000 customers it serves.

OPEN ISSUES

HMPL Consent

The AG asserts that there are a number of outstanding conditions that should be brought to a conclusion before the Commission rules on the reasonableness of the Unwind Transaction. One of those conditions is the absence of the requisite consent to the Unwind Transaction by HMPL. Under the terms of the 1998 lease transaction, any termination of the lease requires the affirmative consent of HMPL. Although Big Rivers and the E.ON Entities have been engaged in discussions with HMPL for over three years in an effort to obtain HMPL's consent, no agreement has yet been reached. The AG argues that, until HMPL consents to the Unwind Transaction, the Commission cannot approve the documents that require HMPL's signature because such documents are merely proposals and not yet agreements.

HMPL is a party to this case. It filed responses to requests for information and attended informal conferences and the hearing, but did not file testimony. HMPL claims that its two generating units that comprise the Station Two complex have not been properly operated and maintained by the E.ON Entities under the lease and that the E.ON Entities should be responsible for paying approximately $13.5 million toward the cost of future maintenance and repairs. HMPL bases its claim on the engineering reports from its own consulting engineers, Exothermic Engineering Co., LLC ("Exothermic"), as well as those from Big Rivers' consulting engineers, Stanley Consultants; and the Smelters' consulting engineers, Stone & Webster. HMPL's consultant, Exothermic, performed a condition assessment ("Exothermic Report") dated October 30, 2007. The Exothermic Report consists of "a visual condition assessment as opposed to a technical condition assessment."[59] The Exothermic Report was a visual inspection through photographs of the external condition of the plant and did not include any testing or instrumented measurement.[60] HMPL also asserts that, under the terms of its 1970 Station Two contracts with Big Rivers, the payments HMPL receives for energy and capacity reserved but not taken ("excess energy") are insufficient and need to be increased.

The Applicants acknowledge that the external condition of Station Two needs corrective action, but they assert that there are no known deficiencies that would adversely affect the reliability of those units. Stone & Webster concluded that, although Station Two has been in service for over 30 years, the units, for the most part, have

[59] Exothermic Report at 3.

[60] Id.

been reliable and have experienced the usual maintenance history of other units of this vintage.[61] Stone & Webster further stated that those generators were in good condition during their 2003 and 2004 overhauls and that their next scheduled overhauls will be in 2011 and 2012.

The Applicants have offered a number of financial incentives to HMPL to obtain its consent to the Unwind Transaction. The incentives coming from the E.ON Entities include the payment of $1 million for HMPL's consent, $3 million for future repairs at Station Two, and the reimbursement of HMPL's fees incurred in connection with the Unwind Transaction, up to $1.4 million. Big Rivers has also agreed to increase the payments to HMPL under their 1970 Station Two contracts from $1.50/MWh to $2.50/MWh for the excess energy, even though there is no provision in those agreements for renegotiating that payment. Big Rivers has also committed that it will resubmit for Commission review any agreement entered into with HMPL that would provide a level of compensation from Big Rivers in excess of what it has already offered.

The Commission finds no merit in the AG's argument regarding HMPL. Big Rivers is a jurisdictional utility subject to our regulation. The Unwind Transaction includes changes in rates and the issuance of evidences of indebtedness and other financing documents, all of which are subject to our review and approval. Big Rivers' agreements with HMPL are integral parts of the Unwind Transaction. In connection with the 1998 lease transaction, we reviewed and approved the documents to which Big Rivers and HMPL were parties, including the amendment to the Station Two contracts.

---

[61] Stone & Webster Report, filed March 11, 2008, at 5.

Although HMPL has not yet agreed to the current amendments now proposed by Big Rivers, the Commission has reviewed those amendments and finds that they are reasonable. In the event that there are any revisions to those amendments that would increase the amount of compensation to be paid by Big Rivers to HMPL, Big Rivers has committed to resubmit the revisions for our additional review. Under these circumstances, we find no basis to delay or defer a decision on these documents.

The record shows that numerous repairs of an exterior nature are needed to Station Two, including many in the categories of both safety and cosmetic. However, there is no credible evidence that the reliability of those units is presently compromised as a result of inadequate or improper maintenance or repairs. In addition, the uncontradicted evidence of record supports our finding that the compensation to be provided to HMPL by the Applicants is reasonable. This finding is based on the physical condition of Station Two, as well as the fact that, but for the Unwind Transaction, HMPL would have no right to any additional payments from Big Rivers for excess energy. Further, to the extent that HMPL believes that E.ON has not properly maintained Station Two, terminating the E.ON lease now rather than waiting until it expires in 14 years will remove E.ON from the picture and restore operational control of Station Two to Big Rivers.

Big Rivers' Credit Rating

Another of the conditions precedent to closing the Unwind Transaction is that Big Rivers have an investment grade credit rating so that it will be able to issue public debt at reasonable costs in the future.[62] The AG argues that, since Big Rivers is in the

[62] Application filed on December 28, 2007, Exhibit 3, at 64 of 622.

process of obtaining, but has not yet received, a credit rating for its debt, the Commission should defer a decision on the Unwind Transaction until a credit rating is obtained. The Applicants assert that an investment grade credit rating is just one of dozens of conditions precedent to closing the Unwind Transaction; that satisfaction of all such conditions, including approval of the Commission, should be pursued simultaneously; and that any material changes to the terms of the Unwind Transaction (or additional compensation from Big Rivers to HMPL) after the date of approval by the Commission will be resubmitted to the Commission for its review.

The Commission well recognizes that an investment grade credit rating for Big Rivers is a linchpin of the financial model. Absent such a credit rating, neither Big Rivers' proposed financing plans nor the Unwind Transaction will be successful. However, despite the importance of the credit rating to the Unwind Transaction, we find no need to defer our decision in this case until after that credit rating has been issued. The Commission frequently reviews transactions before the requisite approvals from other entities have been obtained and before all conditions precedent have been satisfied. In these situations, if the Commission finds that the transaction should be approved and that there are conditions precedent which are of critical importance, the transaction can be approved with appropriate conditions to insure that the conditions precedent are satisfied.[63] In recognition of both the Applicants' desire to complete the

[63] Case No. 2000-00095, Joint Application of PowerGen plc, LG&E Energy Corp., Louisville Gas and Electric Company and Kentucky Utilities Company for Approval of Merger, Order dated May 15, 2000, and Case No. 2001-00104, Joint Application for Transfer of Louisville Gas and Electric Company and Kentucky Utilities Company in Accordance with E.ON AG's Planned Acquisition of PowerGen plc, Order dated August 6, 2001.

Unwind Transaction as soon as reasonably possible and the Commission's finding that there is no reason to delay its review, the approvals granted by this Order will be conditioned upon Big Rivers receiving the investment grade credit rating as specified in the Transaction Termination Agreement.

ADDITIONAL TRANSACTION CONDITIONS

As of April 3, 2008, the AG recommended approval of the Unwind Transaction, but on a provisional basis and with certain conditions, since there were still unresolved issues, including the consent from HMPL and the credit ratings. The AG enumerated 17 recommended conditions that should be imposed on Big Rivers or other parties if the Commission approves the Unwind Transaction. Subsequently, the AG's position changed. As of November 21, 2008, the AG no longer recommended approval of the Unwind Transaction, but he still recommended consideration of his conditions if the Commission decided to approve the Unwind Transaction.

At an informal conference held at the Commission's offices on June 19, 2008, Big Rivers presented a response to the AG's recommended conditions and to a number of other issues identified through discovery. That response included numerous commitments that were intended to satisfy many of the AG's conditions and the other issues identified.

Based on a review of the AG's recommended conditions and the response thereto, the Commission finds that most of the commitments offered by Big Rivers are, in general, reasonable and should be adopted with some modifications and additions. A list of those revised commitments is attached hereto as Appendix A.

INTEGRATED RESOURCE PLAN

In late 2005, Big Rivers filed an IRP based on the assumption that it would continue to purchase its power supply from the E.ON Entities.[64] Shortly thereafter, Big Rivers requested, and the Commission allowed, that case to be held in abeyance due to Big Rivers' expectation that it would cease purchasing power and regain operating control of its generating units. Big Rivers now requests that case be terminated since the reacquisition of its generation renders the information in that IRP obsolete and it has not yet initiated a new load forecast. Big Rivers commits to filing a new IRP no later than November 2010.

The Commission finds Big Rivers' request to be reasonable. Its new IRP should be filed by November 15, 2010 to allow sufficient time for the preparation of a new load forecast and to properly reflect the reacquisition of generation. However, the Commission believes that certain critical information required to be included in an IRP needs to be filed on an interim basis for review pending the November 15, 2010 filing of a complete new IRP. This information, which needs to be filed by September 15, 2009 and again by March 15, 2010, is set forth in 807 KAR 5:058, Section 8(2). In addition, the assessment of economic opportunities for coordination with other utilities, which is required by Section 8(2)(c), must include, but not be limited to, transmission lines and other infrastructure, as well as generating units. The "other utilities" to be considered in this assessment must include, but not be limited to, Tennessee Valley Authority and E.ON and its subsidiaries. Further, these interim filings must include specific details of

[64] Case No. 2005-00485, The 2005 Integrated Resource Plan of Big Rivers Electric Corporation.

the economic development efforts by Big Rivers to benefit the service area of its three member cooperatives.

OUTSTANDING PETITIONS

Pending before the Commission are a number of petitions filed by Big Rivers requesting confidential protection of information related to a negotiated payment from the E.ON Entities to the Smelters and Big Rivers' lines of credit. Also pending is a Big Rivers petition for rehearing of the Commission's earlier denial of confidentiality of information relating to the lines of credit and the terms of Big Rivers' agreement with BoA regarding the leveraged lease buy-out.

Confidentiality was previously granted by letter dated April 29, 2008 to the details of the E.ON Entities' payment to the Smelters. Therefore, for the reasons set forth in that letter, which is incorporated herein by reference, confidentiality is granted to that portion of Big Rivers' December 12, 2008 petition relating to the E.ON Entities' payment to the Smelters.

With respect to the lines of credit, Big Rivers requests to withhold from public disclosure the details of the terms and conditions of its proposed lines of credit with CFC and CoBank, including the costs and fees to be paid to each lender for each line of credit. Big Rivers maintains that the public disclosure of this information will result in competitive injury by allowing other lenders to know what it is willing to pay for a line of credit. However, Big Rivers acknowledged that its proposed CFC and CoBank lines of credit will be in place for five and three years, respectively, and that, "[t]he market always has an impact on how [lines of credit] are structured."[65] Thus, as market

[65] Transcript of Evidence, December 3, 2008, C. William Blackburn, at 88.

conditions change over time, it is reasonable to expect that the terms for a line of credit will also change. As a public utility, the terms and conditions of its financings should be publicly available except in extraordinary circumstances where there is a clear and strong showing of competitive injury. Big Rivers has not satisfied that burden of proof on this issue. Therefore, the Commission will affirm its earlier decision to deny confidentiality for the terms of Big Rivers' lines of credit. Big Rivers' petition for rehearing is denied, as well as its November 25, 2008 and December 1, 2008 confidentiality petitions, and that portion of its December 12, 2008 confidentiality petition, all relating to its lines of credit.

With respect to the terms of the BoA leveraged lease buy-out, all of the significant terms of that transaction are already publicly available in the record of this case.[66] Therefore, that portion of Big Rivers' petition for rehearing relating to the BoA buy-out is denied.

OBSOLETE COMMITMENTS

The Applicants have also requested to be relieved from certain commitments that were imposed in connection with the Commission's approval of the 1998 lease or were subsequently imposed but are relevant only to that transaction. The commitments which Big Rivers seeks to eliminate arise from the Commission's April 30, 1998 Order in

[66] Third Supplemental Testimony of C. William Blackburn, Exhibit 78, CWD-9.

Case No. 1997-00204,[67] and July 14, 1998 Order in Case No. 1998-00267,[68] requiring a 50/50 sharing methodology for the reporting and recovery of unforeseen changes in transmission costs due to the Smelters' load, requiring Big Rivers to file annual updates to its 1998 lease transaction financial model, requiring Big Rivers to file a report of its arbitrage sales and other sales, and requiring Big Rivers to file an annual report on its plant maintenance. The E.ON Entities' commitments that are requested to be eliminated were imposed in conjunction with its prior mergers, and include merger commitment nos. 5, 6, and 9 relating to the PowerGen merger case,[69] and merger commitment nos. 40, 41, and 44 in the E.ON merger case.[70] The Commission agrees that these merger commitments will no longer be relevant after the Unwind Transaction is completed. Therefore, these commitments will be eliminated upon closing the Unwind Transaction.

[67] Case No. 1997-00204, The Application of Big Rivers Electric Corporation, Louisville Gas and Electric Company, Western Kentucky Energy Corp., Western Kentucky Leasing Corp., and LG&E Station Two, Inc. for Approval of Wholesale Rate Adjustment for Big Rivers Electric Corporation and for Approval of Transaction.

[68] Case No. 1998-00267, The Application of Big Rivers Electric Corporation for Approval of the 1998 Amendments to Station Two Contracts Between Big Rivers Electric Corporation and the City of Henderson, Kentucky and the Utility Commission of the City of Henderson.

[69] Case No. 2000-00095, Joint Application of PowerGen plc, LG&E Energy Corp., Louisville Gas and Electric Company and Kentucky Utilities Company, for Approval of Merger (Ky. PSC May 15, 2000).

[70] Case No. 2001-00104, Joint Application for Transfer of Louisville Gas and Electric Company and Kentucky Utilities Company in Accordance with E.ON AG's Planned Acquisition of PowerGen plc (Ky. PSC Aug. 6, 2001).

SUMMARY OF FINDINGS

The Commission finds that the change in control of generating units from the E.ON Entities to Big Rivers is for a proper purpose and is consistent with the public interest, subject to Big Rivers' accepting the commitments set forth in Appendix A and the E.ON Entities accepting the commitment set forth in Appendix B. Within seven days of the date of this Order, the chief executive officers of Big Rivers and of the E.ON Entities should file written notices stating that they either accept and agree to be bound by or reject their respective commitments as set forth in Appendices A and B. The Termination Agreement and all other transaction documents, new power contracts, the rate and tariff changes, and the financing documents, filed in support of the Unwind Transaction and listed in Appendix C, are reasonable and should also be approved subject to the Applicants' acceptance of the commitments.

The Commission further finds that the issuance of the proposed evidences of indebtedness, notes, and Indenture as set out in Big Rivers' application is for lawful objects within the corporate purposes of Big Rivers' utility operations, is necessary and appropriate for and consistent with the proper performance of its service to the public, will not impair its ability to perform that service, is reasonably necessary and appropriate for such purposes, and should therefore be approved.

IT IS THEREFORE ORDERED that:

1. The change in control of generating units from the E.ON Entities to Big Rivers is approved subject to Big Rivers' receipt of an investment grade credit rating and the filing within seven days of the date of this Order of written notices signed by the chief executive officers of Big Rivers and the E.ON Entities that each agrees to accept

and be bound by their respective commitments set forth in Appendices A and B to this Order.

2. All of the documents relating to the Unwind Transaction, as listed in Appendix C hereto, including but not limited to the Termination Agreement, the new power agreements, the financing documents, and the revised tariffs, are approved subject to the filing of the notices of acceptance of commitments referenced in Ordering Paragraph No. 1.

3. In the event that both Big Rivers and the E.ON Entities file a notice of acceptance of commitments as described in Ordering Paragraph No. 1, the Applicants shall, individually or jointly, file with the Commission reports on the status of closing the Unwind Transaction, with the first report due 45 days after the date of this Order and subsequent reports due every 15 days thereafter until the closing takes place.

4. Big Rivers shall, upon closing the Unwind Transaction, establish the journal entries and regulatory accounts, including, but not limited to, the regulatory liability to establish the Rural Economic Reserve, and shall deposit $60.9 million in the Rural Economic Reserve, all in accordance with the findings above.

5. Big Rivers shall, within 20 days of the date of closing the Unwind Transaction, file with the Commission its revised tariff sheets, including, but not limited to, a rate mechanism to implement the Rural Economic Reserve, as approved herein, showing their date of issue and that they were issued by authority of this Order.

6. Big Rivers shall file a new IRP no later than November 15, 2010 and it shall file, on September 15, 2009 and again on March 15, 2010, reports setting forth the

information required by 807 KAR 5:058, Section 8(2), and the details of its economic development activities as more fully described in the findings above.

7. Within 20 days of the date of closing the Unwind Transaction, Case No. 2005-00485, which was established to review Big Rivers' 2005 IRP, shall be terminated.

8. Big Rivers' November 25, 2008 motion to amend, and that portion of its December 12, 2008 confidentiality petition relating to the E.ON Entities' payment to the Smelters, are granted.

9. The Commission's earlier denial of confidentiality to Big Rivers' information related to its lines of credit and the BoA buy-out is affirmed and Big Rivers' rehearing request for reversal of those decisions is denied. Big Rivers' pending confidentiality petitions, filed on November 25, 2008 and December 1, 2008, and that portion of its December 12, 2008 petition, all relating to its lines of credit, are denied.

10. Big Rivers is authorized to issue evidences of indebtedness, issue and sell notes, and enter into the Indenture, all upon the terms set forth in its application.

11. Big Rivers is authorized to use the proceeds arising from the issuance and sale of the subject evidences of indebtedness and notes for only the lawful purposes set forth in its application.

12. Big Rivers shall, within 30 days of the date of each issuance, file with the Commission a statement setting forth the date of issuance and terms of the evidences of indebtedness, notes, and Indenture authorized herein, including the interest rate.

Nothing contained here shall be construed as a finding of value for any purpose or as a warranty on the part of the Commonwealth of Kentucky or any agency thereof as to the securities authorized herein.

Done at Frankfort, Kentucky, this 6th day of March, 2009.

By the Commission

ATTEST:

Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2007-00455 DATED MARCH 6, 2009

1. Big Rivers commits to use the actual expenses reported by WKEC to calculate the fuel adjustment clause charges and the environmental surcharge for the period until Big Rivers' actual costs are available.

2. Big Rivers commits that the Economic Reserve will be funded at closing of the Unwind Transaction by an amount no less than $157 million.

3. Big Rivers commits to not sell SO_2 allowances in its inventory (excluding the 14,000 SO_2 allowances acquired in conjunction with the Unwind Transaction) unless the sale is cost-effective based on a written policy which reflects short- and long-term allowance needs and prices.

4. Big Rivers will account on its books for emission allowances it acquires in the Unwind Transaction in accordance with the RUS Uniform System of Accounts.

5. Big Rivers commits to not close the Unwind Transaction until the Commission has reviewed and approved any change to the Station Two Contract amendments filed on October 9, 2008, if the change will result in: (a) Big Rivers providing, directly or indirectly, to HMPL, the city of Henderson, or a third party, anything of value that differs in form, substance, or amount from the value to be provided by Big Rivers under the amendments filed on October 9, 2008; or (b) the need to revise the Unwind Financial Model to properly reflect the change to the amendments filed on October 9, 2008.

6. Big Rivers commits to maintaining a sound and constructive relationship with those labor organizations that may represent certain employees of WKEC.

7. Big Rivers commits to bargain in good faith with IBEW during any collective bargaining sessions.

8. Big Rivers commits to continue to employ in the conduct of its business the level of workforce required to safely and professionally operate its facilities.

9. Big Rivers commits to finalize its due diligence on the generating facilities and sites using all resources available to it. Big Rivers also commits to not waive any of its rights under the Termination Agreement, Sections 10.3(dd) or 10.3(ee), to require that the generating facilities be in good condition and that there is a proper demonstration of their capability.

10. Big Rivers commits that, within 24 hours of closing the Unwind Transaction, a written notice will be filed with the Commission setting forth the date of closing.

11. Big Rivers commits to file a report with the Commission within 10 days after the closing of the Unwind Transaction stating that all of the conditions precedent to the closing of the Unwind Transaction have been satisfied or, if any of the conditions have been waived, the terms on which each waiver was granted.

12. Big Rivers commits that, within 3 years of closing the Unwind Transaction, Big Rivers will file with the Commission for a general review of its financial operations and its tariffs. Big Rivers also commits to include with that filing a new depreciation study and an analysis of Big Rivers' financial condition and rates assuming the study's results are implemented.

13. Big Rivers commits that it will file an IRP, in accordance with the Commission's regulations, for the Big Rivers system no later than November 15, 2010.

Big Rivers also commits to file by September 15, 2009 and again by March 15, 2010, the information listed in 807 KAR 5:058, Section 8(2) and the details of economic development activities, all as specified in the IRP section of the attached Order.

14. Big Rivers commits, in connection with the filing of its IRPs, to advise the Commission of any material changes to the RUS's criteria for the financing of both new coal-fired plants, and existing coal-fired plants, on a timely basis. In the event of any such changes, Big Rivers commits to supply a plan for assessing the impact and ramifications, if any, and how Big Rivers will address those changes.

15. Big Rivers commits to filing with the Commission, within 60 days of closing the Unwind Transaction and by April 30 of each year thereafter, through the date on which it files a case for a general adjustment of its rates, and thereafter as may be required by the Commission, the "Big Rivers New Financial Model." The Big Rivers New Financial Model will supplement the Big Rivers monthly filing of its RUS Form 12, its Financial and Statistical Report (Annual Report) and the Big Rivers annual report (containing audited financial statements), all of which are filed with the Commission. The Big Rivers New Financial Model will contain actual financial results for the prior year, the current year's budget, three forecasted years beyond the current year, and an explanation of all assumptions.

16. Big Rivers commits to fund, initiate and maintain a risk management plan and program, which would include the ability to identify and address the impact of contingencies including, but not limited to, fuel prices, cost exposure for environmental remediation programs (both existing and contemplated), and any other material risks pertaining to Big Rivers. Big Rivers commits to have the risk management plan and program in effect no later than 3 months after the date of closing the Unwind Transaction

and to be prepared, in connection with the review of its financial operations in 3 years, and again in its next application for a general adjustment in rates, to respond to questions regarding identified risks and steps taken under its Risk Management program to address or mitigate those risks.

17. Big Rivers commits to provide to the Commission, upon its request and in 3 years in connection with the review of Big Rivers' financial operations, a copy of any reports, recommendations or other documents produced by the Coordinating Committee or either Smelter, and that is provided to the Big Rivers board of directors.

18. Big Rivers commits, in connection with the review of its financial operations in 3 years, to advise the Commission in the event of any material changes in its collective bargaining agreements with labor unions.

19. Big Rivers commits to advise the Commission and the Attorney General's Office of any material changes in the evidences of indebtedness that comprise its financing arrangements, on a timely basis.

20. Big Rivers commits to advise the Commission of any material changes to the smelter-related retail and wholesale contracts, on a timely basis.

21. Big Rivers commits to timely advise the Commission and the Attorney General's Office in the event of any material changes in its agreements with HMPL after the closing of the Unwind Transaction.

22. Big Rivers commits to complete construction of the transmission system additions and improvements for which the Commission issued a Certificate of Public Convenience and Necessity in P.S.C. Case No. 2007-00177, and commits to advise the Commission and the Attorney General's Office on a timely basis of the date those transmission facilities become fully operational and of any material events related to the

Big Rivers transmission system that impact Big Rivers' long-term ability to wheel excess power to its border for sale into other markets.

23. Big Rivers commits that its chief executive officer and relevant members of its senior staff will meet informally with the Commission and the Attorney General's Office at least annually to advise them regarding: (i) general operations and finances of Big Rivers; (ii) transition activities; (iii) regulatory and industry developments that may affect Big Rivers in the future; (iv) the status of Big Rivers' plans for addressing the $200 million reduction in the Maximum Allowed Balance in the RUS 2008 Promissory Note, Series A before the end of 2015; (v) changes in the competitiveness of the Smelters in the world aluminum market of which Big Rivers is aware and which could materially affect the commitment of the Smelters to continue operations; and (vi) the work of the Coordinating Committee.

24. Big Rivers commits that a Rural Economic Reserve account will be established and funded at closing of the Unwind Transaction in an amount no less than $60.9 million to be used exclusively to credit the bills rendered to the Rural Customers over a period of 24 months commencing upon depletion of all funds in the Economic Reserve. All funds in the Rural Economic Reserve shall be invested in interest-bearing United States Treasury notes, with all interest earned credited to the Rural Economic Reserve. Big Rivers commits that no funds in the Rural Economic Reserve escrow account will be spent, pledged, or otherwise used for any purpose other than as credits on the future bills of Rural Customers in accord with the terms of this commitment.

APPENDIX B

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2007-00455 DATED MARCH 6, 2009

The E.On Entities commit to pay to Big Rivers at the time of closing the Unwind Transaction an additional $60.9 million in cash to reimburse Big Rivers for one-half of the cost of the PMCC buy-out that, but for this commitment, would be the responsibility of Big Rivers.

APPENDIX C

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2007-00455 DATED MARCH 6, 2009

AGREEMENTS AND DOCUMENTS TO BE APPROVED

1. Termination Agreement (including all related documents and transactions and termination of all the agreements from the 1998 Transactions as contemplated in the Termination Agreement); Approval of the First Amendment to Transaction Termination Agreement; Approval of Letter Agreement; Approval of Second Amendment to Transaction Termination Agreement; Approval of Third Amendment to Transaction Termination Agreement.

2. Generation Dispatch Support Services Agreement.

3. Information Technology Support Services Agreement.

4. Station Two Agreements and Amendments, including:

   a. Second Amendatory Agreement;

   b. Amendments to 1970 Station Two Power Sales Contract;

   c. Station Two Termination and Release Agreement;

   d. Station Two G&A Allocation Agreement; and

   e. Agreement for Assignment of Responsibility for Complying with Reliability Standards.

5. Alcan Wholesale Agreement, Retail Agreement, Lockbox Agreement, and Guaranty.

6. Century Wholesale Agreement, Retail Agreement, Lockbox Agreement, and Guaranty.

7. Smelter Coordination Agreements.

8. Amendments to Big Rivers' Member Wholesale Power Contracts.

9. All of Big Rivers' Proposed Tariff Revisions, Including the Revised Open Access Transmission Tariff.

10. Revolving Line of Credit Agreement between Big Rivers Electric Corporation and National Rural Utilities Cooperative Finance Corporation.

11. Revolving Credit Agreement by and between Big Rivers Electric Corporation and CoBank ACB, including note by and between Big Rivers Electric Corporation and CoBank ACB.

12. PCB Series 2001A Note from Big Rivers Electric Corporation to the County of Ohio, Kentucky.

13. Ambac Municipal Bond Insurance, Policy Series 1983 Note from Big Rivers Electric Corporation to Ambac Assurance Corporation.

14. Standby Bond Purchase Agreement Note (Series 1983 Bonds), from Big Rivers Electric Corporation to Dexia Credit Local, acting by and through its New York Branch.

15. Termination of Third Amended and Restated Subordination, Nondisturbance, Attornment and Intercreditor Agreement among (a) Big Rivers Electric Corporation; (b) LG&E Energy Marketing Inc., and Western Kentucky Energy Corp.; (c) The United States of America, acting through the Administrator of the Rural Utilities Service; (d) Ambac Assurance Corporation; (e) National Rural Utilities Cooperative Finance Corporation; (f) Dexia Credit Local, New York Branch; (g) U.S. Bank Trust National Association, as trustee under the Trust Indenture dated as of August 1, 2001;

(h) PBR-1 Statutory Trust; (i) PBR-2 Statutory Trust; (j) PBR-3 Statutory Trust; (k) FBR-1 Statutory Trust; (l) FBR-2 Statutory Trust; (m) PBR-1 OP Statutory Trust; (n) PBR-2 OP Statutory Trust; (o) PBR-3 OP Statutory Trust; (p) FBR-1 OP Statutory Trust; (q) FBR-2 OP Statutory Trust; (r) Bluegrass Leasing; (s) Bank of America Leasing Corporation; (t) AME Investments, LLC; (u) CoBank, ACB; and (v) Ambac Credit Products, LLC.

16. Termination of Third Restated Mortgage and Security Agreement among (a) Big Rivers Electric Corporation; (b) The United States of America, acting through the Administrator of the Rural Utilities Service; (c) Ambac Assurance Corporation; (d) National Rural Utilities Cooperative Finance Corporation; (e) Dexia Credit Local, New York Branch; (f) U.S. Bank Trust National Association, as trustee under the Trust Indenture dated as of August 1, 2001; (g) PBR-1 Statutory Trust; (h) PBR-2 Statutory Trust; (i) PBR-3 Statutory Trust; (j) FBR-1 Statutory Trust; (k) FBR-2 Statutory Trust; and (l) Ambac Credit Products, LLC.

17. Creditor Consent, Termination and Release Agreement by and among (a) Big Rivers Electric Corporation; (b) E.ON U.S. LLC, LG&E Energy Marketing Inc., and Western Kentucky Energy Corp.; (c) The United States of America, acting through the Administrator of the Rural Utilities Service; (d) Ambac Assurance Corporation; (e) National Rural Utilities Cooperative Finance Corporation; (f) Dexia Credit Local, New York Branch; (g) U.S. Bank Trust National Association, as trustee under the Trust Indenture dated as of August 1, 2001; (h) PBR-1 Statutory Trust; (i) PBR-2 Statutory Trust; (j) PBR-3 Statutory Trust; (k) PBR-1 OP Statutory Trust; (l) PBR-2 OP Statutory Trust; (m) PBR-3 OP Statutory Trust; (n) Bluegrass Leasing; (o) Bank of America

Leasing Corporation; (p) AME Investments, LLC; (q) CoBank, ACB; (r) AME Asset Funding, LLC; and (s) Ambac Credit Products, LLC.

18. Amendment of Operating and Support Agreement (Wilson Operating Agreement).

19. Letter Agreements regarding "Funding of Certain Amounts to be Paid to the Bank of America" and "Payment Regarding the Buy-Out of the Bank of America."

20. Indenture from Big Rivers Electric Corporation, Grantor to **[Name of Trustee].**

APPENDIX B

Big Rivers' Hearing Exhibit 1
(Revised Exhibits Wolfram Rebuttal-1 and Wolfram Rebuttal-2)

Big Rivers Electric Corporation

Case No. 2011-00036

Exhibit Wolfram Rebuttal-1

Reconciliation of Revenue Requirement

Exhibit Wolfram Rebuttal-2

Calculation of Revenue Deficiency & Updated Reference Schedules

Revised July 26, 2011

Appendix B to the Post-Hearing Brief
of Big Rivers Electric Corporation
P.S.C. Case No. 2011-00036

BIG RIVERS ELECTRIC CORPORATION
12 Months Ended October 31, 2010

Reconciliation of Revenue Requirement
Revised July 26, 2011

Line No.	Description	Reference Schedule (1)	Big Rivers Original Amount (2)	Big Rivers Updated Amount (3)	Variance (4)
1	**Filed Revenue Deficiency**		$ 39,952,927	$ 39,952,927	$ -
2					
3	**Adjustments**				
4	To annualize revenue & expenses for new industrial customer	2.01	$ 39,145	$ 92,165	$ 53,020
5	To adjust mismatch in fuel cost recovery	2.02	2,225,346	$ 2,225,346	-
6	To eliminate Environmental Surcharge	2.03	633,559	$ 633,559	-
7	To reflect temperature normalized sales volumes	2.04	(126,318)	$ (126,318)	-
8	To adjust for Non-FAC PPA	2.05	(427,156)	$ (427,156)	-
9	To reflect annualized depreciation expenses	2.06	(6,252,651)	$ (6,252,651)	-
10	To reflect increases in labor and labor overhead expenses	2.07	(624,894)	$ (450,215)	174,679
11	To reflect current interest on construction (CWIP)	2.08	(515,767)	$ -	515,767
12	To eliminate RRI Domtar Cogen Backup revenue & expenses	2.09	971,257	$ 971,257	-
13	To reflect levelized production O&M expenses	2.10	(5,660,678)	$ (5,660,678)	-
14	To reflect levelized planned outage expenses	2.11	(2,726,965)	$ (2,726,965)	-
15	To reflect going forward IT support services	2.12	(292,194)	$ (292,194)	-
16	To reflect amortizaton of rate case expenses	2.13	(281,719)	$ (482,076)	(200,357)
17	To reflect Midwest ISO related expenses	2.14	(5,415,000)	$ (5,353,444)	61,556
18	To annualize interest on long-term debt	2.15	(70,408)	$ (70,408)	-
19	To reflect leased property (Soaper Building Rent)	2.16	128,368	$ 128,368	-
20	To adjust for costs related to LEM Dispatch	2.17	936,815	$ 936,815	-
21	To adjust for costs related to APM	2.18	(205,090)	$ (205,090)	-
22	To eliminate WKEC Lease Expenses	2.19	(149,673)	$ (149,673)	-
23	To eliminate WKEC Unwind-related Expenses (Non-Labor)	2.19	(2,357,097)	$ (2,357,097)	-
24	To eliminate WKEC Unwind-related Expenses (Labor-related)	2.19	7,476,583	$ 7,476,583	-
25	To eliminate costs for SFPC membership	2.20	180,775	$ 180,775	-
26	To adjust for Midwest ISO Case-related expenses	2.21	771,118	$ 771,118	-
27	To adjust for Smelter TIER Adjustment Charge	2.22	(7,128,947)	$ (7,128,947)	-
28	To eliminate advertising, lobbying, donation and econ dev	2.23	507,216	$ 531,388	24,172
29	To reflect going forward level of income taxes	2.24	(183,084)	$ (183,084)	-
30	To reflect going forward level of Outside Services	2.25	1,000,000	$ 1,000,000	-
31	To reflect commitment to Energy Efficiency Programs	2.26	(1,000,000)	$ (1,000,000)	-
32	Total		$ (18,547,460)	$ (17,918,623)	$ 628,838
33					
34	Difference in Total Pro Forma Adjustments		$ -	$ 628,838	$ 628,838
35					
36	**Revenue Deficiency**		**$ 39,952,927**	**$ 39,324,089**	**$ (628,838)**

BIG RIVERS ELECTRIC CORPORATION
12 Months Ended October 31, 2010

Calculation of Revenue Requirement
Based on Revenues and Expenses
Revised July 26, 2011

Line No.	Description	Reference Schedule (1)	Witness (2)	Revenue (3)	Expense (4)	Margin (Deficit) (5)
1	**Total Per Books**					
2	Total Operating Revenues & Patronage Capital			$ 522,923,675		$ 522,923,675
3	Total Cost of Electric Service				$ 527,945,092	(527,945,092)
4	Interest Income			401,668		401,668
5	Other Non-Operating Income (Net)			1,703,337		1,703,337
6	Other Capital Credits/Patronage Dividends			22,965		22,965
7	Extraordinary Items	Page 1, Line 42		(6,794,566)		(6,794,566)
8	Total Per Books			$ 518,257,079	$ 527,945,092	$ (9,688,013)
9						
10	**Adjustments**					
11	To annualize revenue & expenses for new industrial customer	2.01	Wolfram	$ 352,586	$ 260,421	$ 92,165
12	To adjust mismatch in fuel cost recovery	2.02	Wolfram	(107,815,177)	(110,040,523)	2,225,346
13	To eliminate Environmental Surcharge	2.03	Wolfram	(22,834,232)	(23,467,791)	633,559
14	To reflect temperature normalized sales volumes	2.04	Seelye	(421,610)	(295,293)	(126,318)
15	To adjust for Non-FAC PPA	2.05	Wolfram	7,785,109	8,212,265	(427,156)
16	To reflect annualized depreciation expenses	2.06	Hite		6,252,651	(6,252,651)
17	To reflect increases in labor and labor overhead expenses	2.07	Hite		450,215	(450,215)
18	To reflect current interest on construction (CWIP)	2.08	Hite		-	-
19	To eliminate RRI Domtar Cogen Backup revenue & expenses	2.09	Hite	(1,115,159)	(2,086,416)	971,257
20	To reflect levelized production O&M expenses	2.10	Berry		5,660,678	(5,660,678)
21	To reflect levelized planned outage expenses	2.11	Berry		2,726,965	(2,726,965)
22	To reflect going forward IT support services	2.12	Hite		292,194	(292,194)
23	To reflect amortizaton of rate case expenses	2.13	Hite		482,076	(482,076)
24	To reflect Midwest ISO related expenses	2.14	Wolfram		5,353,444	(5,353,444)
25	To annualize interest on long-term debt	2.15	Hite		70,408	(70,408)
26	To reflect leased property (Soaper Building Rent)	2.16	Hite		(128,368)	128,368
27	To adjust for costs related to LEM Dispatch	2.17	Wolfram		(936,815)	936,815
28	To adjust for costs related to APM	2.18	Wolfram		205,090	(205,090)
29	To eliminate WKEC Lease Expenses	2.19	Hite	(149,673)	-	(149,673)
30	To eliminate WKEC Unwind-related Expenses (Non-Labor)	2.19	Hite	(2,357,097)	-	(2,357,097)
31	To eliminate WKEC Unwind-related Expenses (Labor-related)	2.19	Hite	7,476,583	-	7,476,583
32	To eliminate costs for SFPC membership	2.20	Hite		(180,775)	180,775
33	To adjust for Midwest ISO Case-related expenses	2.21	Hite		(771,118)	771,118
34	To adjust for Smelter TIER Adjustment Charge	2.22	Seelye	(7,128,947)	-	(7,128,947)
35	To eliminate advertising, lobbying, donation and econ dev	2.23	Hite		(531,388)	531,388
36	To reflect going forward level of income taxes	2.24	Hite		183,084	(183,084)
37	To reflect going forward level of Outside Services	2.25	Blackburn		(1,000,000)	1,000,000
38	To reflect commitment to Energy Efficiency Programs	2.26	Blackburn		1,000,000	(1,000,000)
39	To reflect Interest on Long Term Debt adjustment	NA	Hite		(2,045,750)	2,045,750
40	To reflect Interest Income Adjustment	NA	Hite	(271,105)		(271,105)
41	Total			(126,478,723)	(110,334,745)	$ (16,143,978)
42						
43	**Adjusted Net Margin (Deficit)**			$ 391,778,357	$ 417,610,347	$ (25,831,991)

BIG RIVERS ELECTRIC CORPORATION
12 Months Ended October 31, 2010

Calculation of Revenue Requirement
Based on Revenues and Expenses
Revised July 26, 2011

Line No.	Description	Reference		Amount
1	Contract TIER Target			1.24
2	Interest on Long Term Debt	Updated Statement	$	45,647,368
2a	Interest on Long Term Debt Adjustment	Updated Statement	$	2,045,750
2b	Interest on Long Term Debt Adjusted	Line 2 + Line 2a	$	47,693,118
3	Adjusted Net Margin(Deficit) before Conventional TIER	Page 1, Line 43	$	(25,831,991)
4	Interest Income on Transition Reserve	Acct 419.040 Updated	$	-
5	Adjusted Net Margin(Deficit) before Contract TIER	Line 3 - Line 4 - Line 2a	$	(27,877,740.72)
6	Margins Required for Contract TIER	Line 2b x (Line 1 - 1)	$	11,446,348
7	Margins Required for Conventional TIER	Line 2a + Line 4 + Line 6	$	13,492,098
8	**Revenue Deficiency for Contract TIER**	Line 6 - Line 5	$	39,324,089
9	Contract TIER	1 + (Line 6 / Line 2b)		1.24
10	Conventional TIER	1 + (Line 7 / Line 2)		1.30

BIG RIVERS ELECTRIC CORPORATION
12 Months Ended October 31, 2010

New Industrial Customer

	Kenergy - Equality Mine	Reference		Original Amount		*07/26/11 Updated Amount*
1	Historical Test Year Revenue		$	252,566	$	252,566
2	Number of Months Served			7.5		NA
3	Number of Months in Test Year			12		NA
4	Annualization Factor	Line 3 / 4		1.59		NA
5	Annualized Revenue	Line 1 x 4	$	402,318	$	605,152
6	**Revenue Adjustment**	Line 5 - 1	**$**	**149,752**	**$**	**352,586**
7	Operating Ratio	Line 16		0.74		0.74
8	**Expense Adjustment**	Line 6 x 7	**$**	**110,607**	**$**	**260,421**
9	Net Revenue Adjustment		$	39,145	$	92,165
	Calculation of Electric Operating Ratio					
10	Total Electric Operating Expenses		$	445,926,841		
11	Less Wages and Salaries		$	58,335,396		
12	Less Pensions and Benefits		$	169,663		
13	Less Regulatory Commission Expense		$	1,188,958		
14	Net Expenses		$	386,232,825		
15	Total Electric Operations Revenues (as billed)		$	522,923,675		
16	Operating Ratio	Line 14 / 15		0.74		

Updated to utilize 12 months ended June 2011 actual revenues in place of annualized test year revenues per the response to PSC 3-3c

BIG RIVERS ELECTRIC CORPORATION
12 Months Ended October 31, 2010

Labor & Labor Overheads Expenses

1	Proforma Year	68,534,218
2	Historical Year	68,084,003
3	Proforma Adjustment	450,215

Description: The proforma amount for labor/labor overheads includes employees of record as of December 31, 2010, excluding those on long-term disability (LTD) for whom replacements have been hired. This results in a total of 606 employees, 249 non-bargaining and 357 bargaining. As appropriate, base labor includes step increases and contract increases for the bargaining employees, and qualification increases for non-bargaining employees. Shift premiums were appropriately included. Overtime pay was based upon the amount currently expected for 2011. The most current information available was used to determine labor overhead cost (FICA, FUTA, SUTA, workers compensation, retirement/401(k), life, LTD, dental and medical, post-employment and post-retirement costs, including the most recent premium rates available, and the most recent FAS 87 and 106 estimates. No incentive pay or bonus pay is incuded in the proforma amount.

Updated to remove $1,047,200 of capitalized labor

BIG RIVERS ELECTRIC CORPORATION
12 Months Ended October 31, 2010

Interest on Construction Work In Progress

1	Proforma Year	(515,767)
2	Historical Year	(515,767)
3	Proforma Adjustment	0

Description: To reflect current interest on construction work in progress (CWIP)

Updated to forego recovery of current interest on CWIP
per Rebuttal Testimony of John Wolfram

BIG RIVERS ELECTRIC CORPORATION
12 Months Ended October 31, 2010

Rate Case Expenses

		Original Amount	*07/26/11 Updated Amount*
1	Proforma Year	299,643	500,000
2	Historical Year	17,924	17,924
3	Proforma Adjustment	281,719	482,076

Description:
To normalize the legal and consulting costs anticipated to be incurred by the Company in connection with this general rate case before the KPSC. Note that this estimated cost includes the cost of service and rate design study and the depreciation study. During the test year, expense of $17,924 was incurred in connection with the cost of service and rate design study and the depreciation study.

Updated to reflect anticipated rate case costs of $1,500,000 based on actual costs through June 2011 plus estimated expenses for July & August 2011

*** Big Rivers will continue to provide updates of actual costs via supplemental responses to Item PSC 1-52*

BIG RIVERS ELECTRIC CORPORATION
12 Months Ended October 31, 2010

Midwest ISO (Member) Cost

1	Proforma Year	5,353,444
2	Historical Year	0
3	Proforma Adjustment	5,353,444

Description: Big Rivers integration into Midwest ISO took place on December 1, 2010. Big Rivers is now subject to the Midwest ISO's charges assessed under the Midwest ISO Tariff Schedules 10, 16 and 17.

Updated to remove $61,556.38 of non-recurring test year expense per the response to KIUC 2-39.

BIG RIVERS ELECTRIC CORPORATION
12 Months Ended October 31, 2010

Promotional / Institutional Advertising, Lobbying, Donations and Economic Development

		Original Amount	*07/26/11 Updated Amount*
1	Proforma Year	0	0
2	Historical Year	507,216	531,388
3	Proforma Adjustment	(507,216)	(531,388)

Description: To remove all promotional/institutional advertising expenses, political/lobbying expenses, donations, penalties and economic development expenses from the test year.

Updated to remove an additional $24,172 of lobbying expenses from the test year per the response to PSC 2-50.

APPENDIX C

Moody's Investors Service's July 18, 2011, Report from Big Rivers' July 21, 2011, supplemental response to Item 56 of the Commission Staff's Initial Request for Information

MOODY'S
INVESTORS SERVICE

ISSUER COMMENT

Big Rivers Electric Corporation

Table of Contents:

Analyst Contacts:

NEW YORK 1.212.553.1653

Kevin G. Rose 1.212.553.0389
Vice President-Senior Analyst
Kevin.Rose@moodys.com

Chee Mee Hu 1.212.553.3665
Managing Director – Project and Infrastructure Finance
CheeMee.Hu@moodys.com

Key Indicators [1]

Big Rivers Electric Corporation

	2010	2009	2008	3-Year Avg
TIER [2]	1.2x	0.9x	1.5x	1.2x
DSCR [2]	1.5x	0.9x	1.2x	1.2x
FFO / Debt	2.5%	59.1%	5.9%	22.5%
FFO + Interest / Interest	1.4x	9.1x	1.8x	4.2x
Equity / Capitalization	31.8%	30.8%	-17.4%	15.1%

[1] All ratios calculated in accordance with Moody's Electric G&T Cooperative Rating Methodology using Moody's standard adjustments
[2] Moody's definitions may differ from indenture covenants

Rating Drivers

» Stronger balance sheet resulting from deleveraging following the unwinding of 1998 vintage transactions, which was completed in 2009

» Ownership of competitively advantaged coal-fired generation plants

» High industrial concentration to two aluminum smelters

» Rates subject to regulation by the Kentucky Public Service Commission (KPSC); General rate case pending

» Revenues from electricity sold under long-term wholesale power contracts with member owners

Corporate Profile

Big Rivers Electric Corporation is an electric generation and transmission cooperative (G&T) headquartered in Henderson, Kentucky and owned by its three member system distribution cooperatives— Jackson Purchase Energy Corporation; Kenergy Corp; and Meade County Rural Electric Cooperative Corporation. These member system cooperatives provide retail electric power and energy to more than 112,000 residential, commercial, and industrial customers in 22 Western Kentucky counties.

Appendix C to the Post-Hearing Brief
of Big Rivers Electric Corporation
P.S.C. Case No. 2011-00036

Summary Rating Rationale

The Baa1 senior secured rating considers the financial benefits of several steps taken by Big Rivers to unwind a lease and other transactions in 2008 and 2009 wherein its prior deficit net worth turned substantially positive, cash receipts were utilized to reduce debt, and two committed bank credit facilities aggregating $100 million were established to improve liquidity. Revenues generated from competitively priced power sold under long-term wholesale contracts with the three member owners should continue to support Big Rivers financial performance in keeping with its current rating level, while allowing capital expenditures to be largely met with internally generated funds.

A significant constraint to Big Rivers' rating is that one of its member owners, Kenergy Corp., makes a high concentration of its sales to two aluminum smelters (Century Aluminum Company: Corporate Family Rating B3; stable outlook and Rio Tinto Alcan: senior unsecured rating A3; stable outlook), both of whom face credit challenges due to the significant volatility in both metal prices and demand. In addition, these smelters have the option to terminate their respective power purchase arrangements, subject to a one-year notice and other conditions. Big Rivers' rating is further constrained because its rates are regulated by the KPSC, which is atypical for the G&T coop sector.

Detailed Rating Considerations

Financial Flexibility Improved Following Completion Of Unwind Of Historical Transactions In 2009

In 2008, Big Rivers bought out two leveraged lease transactions and in 2009 completed a series of other steps to terminate another lease and other long-term transactions previously involving E.ON U.S. LLC (formerly known as: LG&E Energy Marketing Inc.) and Western Kentucky Energy Corp. These entities previously leased and operated the generating units owned by Big Rivers. In turn, Big Rivers was purchasing the power from these units at generally fixed below market rates to use in servicing the requirements of its three members, exclusive of the load requirements of Kenergy's two large aluminum smelters. At the same time, Big Rivers terminated other agreements and entered into various new arrangements whereby it now sells to Kenergy 850 MW in aggregate for resale to the two aluminum smelters. This arrangement reintroduced a concentration of load risk for Big Rivers. Key credit positives resulting from consummation of all the unwind transactions were as follows: elimination of Big Rivers' deficit net worth, with equity of $379.4 million at December 31, 2009, which increased to $386.6 million as of December 31, 2010 compared to a negative $155 million at 12/31/2008, and partial utilization of the $505.4 million in cash payments received from E.ON to repay about $140.2 million of debt owed to the Rural Utilities Service (RUS) and to establish $252.9 million of reserves. The reserves were comprised of: a $157 million Economic Reserve for future environmental and fuel cost increases; a $35 million Transition Reserve to mitigate potential costs if the smelters decide to terminate their agreements or otherwise curtail their load due to reduced aluminum production; and a $60.9 million Rural Economic Reserve, which would be used over two years to provide credits to rural customers upon full utilization of the Economic Reserve.

As part of the unwind process, Big Rivers completed the buyout of leveraged leases with Bank of America and Phillip Morris Capital Corporation (PMCC) during 2008. Among the positive credit effects of the buyouts were removal of $922 million of defeased obligations (about $735 million of which was off-balance sheet), and removal of exposure to Ambac, albeit at a net cost of $120 million, including a $12 million PMCC note. We note, however, that part of the cash payment from E.ON upon consummation of unwinding all the various transactions included full reimbursement of Big Rivers' lease buyout costs, and the $16 million remaining deferred loss on reacquired debt was written off.

Under a contract times interest earned ratio (TIER) arrangement with the two smelters, Big Rivers is targeting a minimum TIER of 1.24x, which would leave ample cushion under its financial covenants and positioning itself favorably among its similarly rated peers. Under current market conditions, we expect that Big Rivers would file for rate relief as necessary, in the event that TIER drops below the 1.24x target.

Coal-Fired Plants Represent Valuable Assets Even As Environmental Costs Loom

Big Rivers owns generating capacity of about 1,444 megawatts (MW) in four substantially coal-fired plants. Total power capacity is about 1,824 MW, including rights to about 202 MW of coal-fired capacity from Henderson Municipal Power and Light (HMP&L) Station Two and about 178 MW of contracted hydro capacity from Southeastern Power Administration. The economics of power produced from these sources enables Big Rivers to maintain a solid competitive advantage in the Southeast and even more so when compared to other regions around the country. The consistently high capacity factors and efficient operations of the assets results in average system wholesale rates to members around $36 per MWh (including the beneficial effects of the member rate stability mechanism), which translates to member retail rates to residential customers around 8 cents per kWh.

Because Big Rivers is substantially dependent on coal-fired generation, it faces a high degree of uncertainty with regard to future environmental regulations, including the form and substance those will take, the timing for implementation, and the amount of related costs to comply. We note that the Economic Reserve should help mitigate some of the need for initial rate increases to cover future compliance costs.

Regulatory Risk Exists; However, Offsets Are Present

Big Rivers is subject to regulation for rate setting purposes by the KPSC, which is atypical for the sector and can pose challenges in getting timely rate relief if and when needed. We view the existence of certain fuel and purchased power cost adjustment mechanisms available to Big Rivers as favorable to its credit profile since they can temper risk of cost recovery shortfalls if there is a mismatch relative to existing rate levels. Although Big Rivers did not file for a general rate increase in 2010, additional revenues were generated under the fuel adjustment clause and through use of a portion of the various reserve funds. In keeping with the KPSC order issued on March 6, 2009 requiring Big Rivers to file for a general review of its financial operations and rates by July 16, 2012 (i.e. three years from the closing of the unwind transaction), Big Rivers filed a wholesale tariff rate case with the KPSC on March 1, 2011. The rate case is intended to bolster wholesale margins, while also addressing increased depreciation costs, administrative costs tied to joining the Midwest Independent Transmission System Operator (MISO) as outlined in more detail below, and maintenance costs incurred during scheduled generation plant outages. According to the filing, the requested increase in member wholesale tariff rates would equate to an estimated 6.85% (approximately $30 million) increase in total member revenue. Hearings have been scheduled for July 26th and 27th and a decision is expected in August 2011, with new rates to be effective September 1, 2011. If the case is not decided in this time line, the regulatory process allows for interim rates to be put into effect, subject to refund. According to management at Big Rivers, the cooperative has not had a wholesale tariff rate increase in 20 years and its existing depreciation study and tariffs have been in place since July 1998. We will continue to monitor the proceedings in the pending case to determine the degree of supportiveness the KPSC provides for this request. Significant shortfalls that compromise Big Rivers ability to achieve timely and full recovery of its costs of service and anticipated financial results could pressure its credit quality. The timing of future rate cases is likely to be influenced primarily by the outcome of future environmental assessments.

Wholesale Power Contracts Are A Linchpin To Sound Credit Profile

The substantial revenues derived under Big Rivers' long-term wholesale contracts with its members will continue as the contracts were extended by an additional 20 years to December 31, 2043 when the unwind of transactions were completed in 2009. The low cost power provided under the contracts makes member disenchantment unlikely, even in the face of potential rate increases in the near term associated with the pending rate case and, in the medium to longer term, due to environmental compliance costs. The currently overall sound member profile provides assurance of this revenue stream, which is integral to servicing Big Rivers' debt. The potential for degradation in the creditworthiness of the smelters is a particular credit concern, only tempered in part by assurances of two month's worth of payment obligations covered by letters of credit from an A1 rated financial institution (or some other form acceptable to Big Rivers) under certain circumstances.

Big Rivers' net margins for 2010 reflected improvement over 2009 results (exclusive of the effects of the unwind transactions on 2009 results) as fundamental results in 2009 were negatively affected by costs related to a planned generation plant outage at the D.B. Wilson plant in Centertown, Kentucky, which included a turbine overhaul. Also, during 2010 a considerable reduction in annual interest expense in line with substantially reduced debt following the unwind and non-operating margins resulting from accounting treatment for certain materials and supplies more than compensated for the effects of lower market prices for off-system sales during 2010 compared to 2009.

On a historical basis, Big Rivers dramatically improved its equity position whereby its equity to total capitalization is now over 30% thanks to significant debt reductions following the unwind. At this level, Big Rivers equity to total capitalization maps to the A category for this metric under the rating Methodology. Based on expected continuation of management's current practice of not returning patronage capital back to members (a credit positive strategy in our view) we anticipate that the equity ratio should continue to improve as net margins are fully retained and little if any new debt is added over the next couple of years. We also note that Big Rivers' historical three-year average metrics such as funds from operations (FFO) to debt and FFO to interest are particularly strong due to the one time effects of the unwind, and are therefore not sustainable at those levels. Assuming the KPSC is supportive of Big Rivers' pending request for an increase in member wholesale tariff rates, then we anticipate that Big Rivers should map on average to the A or Baa ranges for other key metrics, such as the times interest earned, the debt service coverage, FFO to interest and FFO to debt ratios. We would view a lack of substantial support for timely and full recovery of costs of service in rate case proceedings as a credit negative, which could cause downward pressure on the ratings for Big Rivers.

Concerns About Potential Loss Of Smelter Load Cannot Be Ignored

Under historical operating conditions, the two smelters served by Kenergy can be expected to consume over 7 million MWh of energy annually, representing a substantial load concentration risk. As noted above, this risk is a significant constraint to Big Rivers' rating, making its operating and risk profile rather unique compared to peers. With Big Rivers' ongoing transmission capacity upgrade projects nearing completion (expected by Q-4 2011), either of the two smelters could serve a one-year notice of termination of their contract at any time. Given the cost effective power being provided by Big Rivers to allow Kenergy to service this load, we do not currently expect the smelters to exercise this option. Moreover, in December 2010 Big Rivers became a transmission owning member of the Midwest Independent Transmission System Operator (MISO), thereby enhancing its reliability and ensuring compliance with mandated emergency reserve requirements established by regulators. This step, the anticipated completion of expansion of its own transmission lines in Q-4 2011 and legislation to permit sales to non-members, when coupled with the low cost of the power, should enhance Big Rivers' ability to move excess power off system in the event that the smelters cancel their contracts or otherwise reduce load due to curtailment of aluminum production due to market and economic conditions. To the latter point, during 2009, Century Aluminum of Kentucky arranged for the orderly curtailment of one of its five potlines, pending improvement in economic conditions. Following improved economic and market conditions, Century completed its restart of the fifth potline in May 2011. During the period of time that Century Aluminum's potline was shut down, Big Rivers moved to sell into the open market the approximately 87 megawatts of capacity it would otherwise have been providing to Kenergy for service to the one Century Aluminum pot line.

Liquidity

Big Rivers supplements its internally generated funds with $100 million of unsecured committed revolver capacity, with National Rural Utilities Cooperative Finance Corporation (NRUCFC) and CoBank providing $50 million each. The NRUCFC and CoBank facilities, which expire on July 16, 2014 and July 16, 2012, respectively, replaced the smaller $15 million facility previously provided by NRUCFC, which was terminated upon completion of the unwind transactions in 2009. The $50 million NRUCFC facility provides for issuance of up to $10 million of letters of credit. We view the significant increase in available bank credit as credit positive. As of May 31, 2011 Big Rivers had approximately $67 million of unrestricted cash and equivalents on its books, and had substantial unused capacity under the two credit facilities as the only usage related to $5.6 million of letters of credit outstanding with NRUCFC. Assuming little change to future usage of the bank facilities and the cash position, as well as no change to management's current policy of not returning patronage capital back to members, we anticipate that Big Rivers should be able to largely fund its anticipated short-term working capital needs, capital expenditures of about $52 million, and current maturities of long term debt of around $7 million during 2011 without the need for new debt. Big Rivers does, however, face a more material RUS long-term debt maturity of about $76 million in 2012, most of which we anticipate will be refinanced and the balance retired. We also note that the CoBank facility expires within the next 12 months and we anticipate that Big Rivers will renew the facility well ahead of the expiration date.

The quality of the alternate liquidity provided by the bank revolvers benefits from the multi-year tenor at the time they were arranged and the absence of any onerous financial covenants, which largely mirror the financial covenants in existing debt documents. Big Rivers is in compliance with those covenants and we expect that to remain so in the foreseeable future. Additionally, the NRUCFC facility benefits from no ongoing material adverse change (MAC) clause; however, the CoBank facility is considered of lesser quality because of the ongoing nature of its MAC clause related to each drawdown. We would view an amendment to the CoBank revolver to eliminate the ongoing applicability of the MAC clause as part of the renewal and extension process to be a credit positive step. There are no applicable rating triggers in any of the facilities that could cause acceleration or puts of obligations; however, a ratings based pricing grid applies.

Structural Considerations

As part of the unwinding of various transactions completed in 2009, Big Rivers replaced the previously existing RUS mortgage with a new senior secured indenture. Under the current senior secured indenture RUS and all senior secured debt holders are on equal footing in terms of priority of claim and lien on assets. The current senior secured indenture provides Big Rivers with the flexibility to access public debt markets without first obtaining a case specific RUS lien accommodation, while retaining the right to request approval from the RUS for additional direct borrowings under the RUS loan program, if they choose to do so. Given persistent questions about the availability of funds under the federally subsidized RUS loan program, we consider the added flexibility of the current senior secured indenture to be credit positive.

Rating Outlook

The stable rating outlook is based on Big Rivers' successful completion of the unwind transactions, thereby improving its financial profile and repositioning itself to continue efficiently meeting the needs of its members in the future.

What Could Change the Rating - Up

Given the rating constraints linked to customer load concentration at Kenergy, rate regulation, and looming pressures tied to environmental issues, a rating upgrade is unlikely in the foreseeable future. Changes to eliminate rate regulation of cooperatives in Kentucky could contribute to a positive action, especially if it coincides with improvement in market conditions for the aluminum smelters and sustained improvement of FFO to interest and debt metrics to near 2.3x and 8%, respectively, on average.

What Could Change the Rating - Down

Loss of significant load (i.e. the smelters) that is not otherwise compensated for through off system power sales could contribute to a negative action, as would lack of regulatory support for substantial and timely recovery of costs. In terms of credit metrics, if FFO to interest and debt falls below 2x and 5%, respectively, for a sustained period of time, then rating pressure could result.

Other Considerations

Mapping To Moody's U.S. Electric Generation & Transmission Cooperatives Rating Methodology

Big Rivers' mapping under Moody's U.S. Electric Generation &Transmission Cooperative rating Methodology appears below and is based on historical data through December 31, 2010. The Indicated Rating for Big Rivers' senior most obligations under the Methodology is currently A2 and relies on the aforementioned historical quantitative data and qualitative assessments. In particular we note that the A2 Indicated Rating reflects improvement over the Baa2 Indicated Rating level from historical published reports, which were based on historical data only through 2008. We note that the improvement in the Indicated Rating under the Methodology largely stems from better scores for the factors relating to dependence on purchased power and financial metrics such as equity as a percentage of capitalization, FFO to debt and FFO to interest, all of which improved upon completion of the unwind transactions. Notwithstanding a currently higher Indicated Rating for Big Rivers under the Methodology compared to its actual rating, the unique risks relating to Big Rivers load concentration to the smelters and the fact that it is subject to rate regulation by the KPSC will likely persist and continue to constrain its rating level in the future.

Rating Factors:

Big Rivers Electric Corporation

U.S. Electric Generation & Transmission Cooperatives	Aaa	Aa	A	Baa	Ba	B
Factor 1: Wholesale Power Contracts & Regulatory Status (20%)						
a) % Member Load Served & Regulatory Status			X			
Factor 2: Rate Flexibility (20%)						
a) Board Involvement / Rate Adjustment Mechanism				X		
b) Purchased Power / Sales %		19%				
c) New Build Capex (% Net PP&E)		X				
d) Rate Shock Exposure						X
Factor 3: Member / Owner Profile (10%)						
a) Residential Sales / Total Sales						16%
b) Members' Consolidated Equity / Capitalization				36%		
Factor 4: 3-Year Average Financial Metrics (40%)						
a) TIER				1.2x		
b) DSC			1.2x			
c) FFO / Debt	22.5%					
d) FFO / Interest	4.2x					
e) Equity / Capitalization				15.1%		
Factor 5: Size (10%)						
a) MWh Sales (Millions of MWhs)			12.0			
b) Net PP&E ($billions)			$1.1			
Rating:						
a) Indicated Rating from Methodology			A2			
b) Actual Rating Assigned (Senior Secured)				Baa1		

Report Number: 134388

Author
Kevin Rose

Production Associate
Cassina Brooks

MOODY'S
INVESTORS SERVICE

APPENDIX D

Standard & Poor's Financial Services LLC's July 6, 2011, Report from Big Rivers' July 18, 2011, supplemental response to Item 56 of the Commission Staff's Initial Request for Information

STANDARD
&POOR'S

Global Credit Portal®
RatingsDirect®

July 6, 2011

Big Rivers Electric Corp., Kentucky Ohio County; Rural Electric Coop

Primary Credit Analyst:
David Bodek, New York (1) 212-438-7969; david_bodek@standardandpoors com

Secondary Credit Analyst:
Jeffrey Panger, New York (1) 212-438-2076; jeff_panger@standardandpoors com

Table Of Contents

Appendix D to the Post-Hearing Brief
of Big Rivers Electric Corporation
P.S.C. Case No. 2011-00036

Big Rivers Electric Corp., Kentucky Ohio County; Rural Electric Coop

Credit Profile		
Big Rivers Electric Corp ICR		
Long Term Rating	BBB-/Stable	Affirmed
Ohio Cnty, Kentucky		
Big Rivers Electric Corp , Kentucky		
Ohio Cnty (Big Rivers Electric Corp) poll ctrl rfdg rev bnds (Big Rivers Elec Corp Proj) ser 2010A		
Long Term Rating	BBB-/Stable	Affirmed

Rationale

Standard & Poor's Ratings Services has affirmed its 'BBB-' issuer credit rating on Big Rivers Electric Corp., Ky., and its 'BBB-' long-term rating on Ohio County, Ky.'s $83.3 million pollution control refunding revenue bonds, series 2010A (Big Rivers Electric Corp. Project). The outlook is stable.

Ohio County sold the bonds for the benefit of Big Rivers, which used bond proceeds to refund auction rate securities. We understand that the financing structure obligates the utility to unconditionally pay the county's bonds' debt service. Big Rivers issued a note to the county that provides it with a security interest in Big Rivers' assets under its mortgage indenture. The county's bonds' security interest is on par with the utility's senior-secured debt. Big Rivers' long-term debt totaled $817 million as of December 31, 2010.

The ratings reflect our view of the following credit weaknesses:

- We believe that the utility's extreme level of customer concentration and its leading customers' credit profiles represent meaningful credit exposures. The cooperative relies on two customers for about 65% of energy sales to members and 53% of total member and non-member energy sales. These two customers are aluminum smelters whose operations are vulnerable to economic cycles.
- In our opinion, the take-or-pay features of the retail power sales contracts between Big Rivers' distribution cooperative, Kenergy Corp., and the smelters are weak because the smelters can terminate their obligations with one-year's notice.
- The cooperative and its member distribution cooperatives are subject to state rate regulation that distinguishes Big Rivers from many other cooperatives that have autonomous ratemaking authority. Rate regulation could potentially expose the utilities' financial performance to delayed rate relief or cost disallowances, particularly if Big Rivers needs to reallocate the smelters' shares of fixed costs to its nonsmelter customers.
- Surplus energy sales in volatile wholesale markets account for about 16% of energy sales, are important to the utility's revenue stream, and help support its financial obligations.
- The cooperative is adding transmission capacity to increase physical access to wholesale markets. However, even with the additions, we believe the utility lacks the certainty of firm contractual transmission arrangements, which could frustrate the surplus power sales Big Rivers would need to make if the smelters reduce operations meaningfully or close.
- Nearly one-third of the utility's debt either does not amortize before maturity or has limited amortization, which

produces highly uneven debt service coverage ratios (DSCRs) and presents refinancing risk.
- In July 2009, Big Rivers regained operational control over generation assets it had not operated for more than a decade and has a limited track record of generation operations.

We believe these strengths temper the exposures:

- The long-term wholesale power contracts between the utility and its three member distribution cooperatives provide a measure of revenue stream security.
- Members have exclusive rights to sell electricity in defined territories.
- We believe that Big Rivers' members' retail rates are competitive and they could contribute to financial flexibility. However, members' favorable rates depend on the smelters' operating at high load factors that help absorb high fixed costs. Rate levels also benefit from the subsidies that more than $200 million of rate mitigation reserves provide.

Henderson, Ky.-based Big Rivers is a generation and transmission cooperative that produces and procures electricity for sale to three member distribution cooperatives and their more than 112,000 retail customers. It relies on two aluminum smelters for more than half of operating revenues, which erodes revenue stream stability and predictability and distinguishes the utility from most cooperative utilities that generally earn the bulk of revenues from residential customers. Moreover, Big Rivers projects that it needs to sell surplus energy into competitive wholesale markets to support its financial obligations. Nonmember revenues accounted for about 16% of 2010's operating revenues. We believe that reductions in the smelters' operations and electricity consumption could increase market reliance. Also, declines in wholesale market electricity prices due to weak natural gas prices or abundant supplies could erode margins from market sales and place upward pressure on the costs that the utility's nonsmelter customers bear.

Outlook

The stable outlook reflects our expectations that the sound debt service coverage Big Rivers projects could provide a financial cushion to service debt obligations under adverse conditions that could arise from the operational, financial and regulatory challenges the utility faces. We believe management needs to actively oversee these challenges to preserve credit quality. In our view, the ratings' upward potential is limited in the near term because the utility must refinance considerable bullet maturities, depends on volatile smelter loads for substantial revenues, and relies on volatile wholesale energy markets for meaningful portions of its revenue requirements.

Customer Concentration Creates Concerns

We believe Big Rivers faces an extreme level of customer concentration and it leading customers' credit profiles represent meaningful credit exposures. In 2010, two of the more than 112,000 end-use customers accounted for more than half of operating revenues. These two, Rio Tinto Alcan Inc. (Alcan; A-/Stable/A-2) and Century Aluminum Co. (B/Stable/--), are aluminum smelters whose operations and financial performance are exposed to extreme commodity price volatility. We believe these companies' economic viability hinges on aluminum prices and the economy's strength, among other things. Big Rivers expects Century's electricity purchases to provide about 36% of its revenues, which meaningfully exposes the cooperative's financial performance to a single speculative-grade customer's cash flows.

If Alcan or Century reduces or ceases operations at their Kentucky facilities, Big Rivers would need to sell surplus electricity in competitive wholesale markets in a bid to recover substantial portions of its fixed costs. The several agreements that Big Rivers, Kenergy, and the smelters signed provide that certain profits from market sales following curtailment inure to the smelters' benefit. The agreements also provide that the smelters must cover the cooperative's losses resulting from market sales following curtailment.

Given Century's weak credit quality, its ability to make up shortfalls is questionable. If the smelters terminate operations, their Big Rivers obligations end. While the cooperative might retain profits from off-system sales in this scenario it will also bear the risk of losses.

We believe that selling electricity in wholesale markets to cover debt service presents meaningful credit challenges because wholesale market sales represent speculative and unpredictable revenue streams. Wholesale markets expose utilities to volatile prices, competing market participants, operational uncertainties such as acquiring physical access to transmission capacity, and potentially higher liquidity needs.

Retail Power Sales Contracts

We believe that the take-or-pay features of the retail power sales contracts between Kenergy and the smelters are weak.

Kenergy is one of Big Rivers' three member distribution cooperatives. It resells the cooperative's electricity to the smelters under power supply contracts expiring in 2023. These contracts have take-or-pay elements that require the smelters to pay for specific quantities of energy, irrespective of whether they need it. Yet we believe that these contracts' take-or-pay features are weak and do not provide meaningful credit protections. For example, the smelters can terminate their contracts on one year's notice without penalties if they close their Kentucky facilities.

Financial Performance

We believe Big Rivers' financial performance could suffer if the Kentucky Public Service Commission (PSC) does not provide timely rate relief or disallows costs, particularly if the utility needs to reallocate the smelters' shares of fixed costs to its nonsmelter customers.

In our view, if the smelters close their operations and Big Rivers cannot fully recoup the smelters' share of fixed costs through surplus electricity sales in competitive wholesale markets, its nonsmelter retail customers might need to bear substantial additional costs. The cooperative will not have control over revenues from electricity sales in competitive wholesale markets to compensate for eroded smelter activity. Moreover, it can only recover shortfalls from the nonsmelter retail customers if it and its distribution cooperative members can obtain rate relief from the Kentucky PSC.

Big Rivers and its member distribution cooperatives are unlike many other cooperative utilities because they cannot autonomously raise rates to respond to increasing costs or to reallocate costs. The Kentucky PSC regulates these utilities' wholesale and retail electricity rates. Rate regulation presents credit concerns because rate proceedings can be lengthy and delay cost recovery. Moreover, rate-regulated utilities do not have cost recovery guarantees. Nevertheless, in recent rate proceedings, the Kentucky PSC provided Big Rivers' distribution cooperatives with rate relief that was closely aligned with the utilities' requests. Also, the commission took steps in connection with the

E.ON generation asset lease termination that we view as supporting credit quality, including directing E.ON to fund rate-stabilization accounts benefiting the cooperative members' nonsmelter, retail customers.

We believe that Big Rivers' 2010 nonsmelter member wholesale rates of $36 per megawatt-hour (MWh) indicate capacity for further rate increases as necessary to reallocate costs to the cooperative's nonsmelter customers. Big Rivers applied in March 2011 for rate increases effective Sept. 1, 2011. The filing requests a 5.94% rate increase for large industrial customers and a 5.47% rate increase for the smelters. Big Rivers is requesting a 10.71% increase for the nonsmelter, nonindustrial customers. The blended requests represent a 6.85% rate increase. The utility expects that lower purchase power adjustment factor costs will reduce the blended effective rate increase to 6.17%.

Debt Service Coverage

Based on Big Rivers' fiscal 2010 financial statements, Standard & Poor's calculated accrual and cash from operations debt service coverage of 1.4x, which was strong but about 20 basis points below projected coverage levels. While off-system sales volumes exceeded expectations, the sales were made at lower-than-expected prices due to weak wholesale electricity markets. Big Rivers' experience with low wholesale markets in 2010 underscores the considerable risks of wholesale market activity.

The cooperative achieved 2010's DSCR by reducing expenses, including deferring maintenance. It also applied reserve monies to the prepayment of a portion of its Rural Utility Service debt to reduce interest expense inasmuch as the benefits of maintaining reserves in a low interest rate environment paled in comparison to the cost of servicing debt.

Based on Big Rivers' financial forecast, we have calculated accrual-basis DSCRs that fluctuate considerably through 2013. The variability reflects the cooperative's use of nonamortizing debt that underlies highly uneven 2011-2013 debt service. Our calculations indicate DSCRs of 2.6x in 2011, 1.3x in 2012, and 2013 and 2.3x in 2014. The forecast assumes Big Rivers receives the full rate relief it requested earlier this year.

About one-third of debt is nonamortizing. Scheduled principal repayments for 2011 are a low $7 million, but jump to $76 million in 2012 and $79 million in 2013 before returning to a more moderate $22 million in 2014 and $23 million in 2015. Consequently, the imminent bullet maturities highlight the relative importance of market access for refinancing compared to debt service coverage as important credit factors through 2013.

Generation Assets Could Pose Problems

We believe that Big Rivers' few vintage, coal-fired generation assets present operational exposures that can affect financial performance. The cooperative sells the electricity it produces at its seven owned coal plants and the two coal plants it operates that Henderson's Municipal Power and Light utility own. Big Rivers operates and has contractual rights to nearly 1,800 megawatts (MW) of generation capacity. Its and Henderson's power plants range in age from 24-41 years, with a weighted average age of 32 years, based on contributions to overall generating capacity.

Big Rivers' wholesale electric rates include automatic fuel and purchased power cost adjustment mechanisms that we believe mitigate some credit concerns surrounding the mature fleet's ability to serve native load customers reliably. These true-up mechanisms shift some of the operational risks of operating older units to the smelter and nonsmelter customers by making them responsible for replacement power costs if units are not running.

While the fuel adjustment is an automatic, formulaic, monthly adjustment, the purchased power cost adjustment is only automatic for the smelters. Before they are eligible for recovery in rates, the PSC must review the power purchase costs Big Rivers incurs on behalf of its nonsmelter customers. All costs recoverable under the adjustment mechanisms are subject to PSC prudence reviews.

There is a two-month lag for the fuel adjustment clause between when costs are incurred and when the cooperative recovers the member portion through rates. Similarly, the purchase power adjustment for the smelters also entails a two-month cost recovery lag. The purchase power adjustment covering the smelters applies to only approximately two-thirds of the costs. The remaining third of is deferred as a regulatory account for recovery in base rates in a general rate case.

Some of Big Rivers' plants have what we believe are high heat rates. Its fleet's heat rates range from 10,600-13,382 BTU per kilowatt-hour with a weighted average heat rate of 11,100, reflecting the small percentage of the fleet with the highest heat rates. We are concerned that portions of the fleet might not dispatch to support market sales that compensate for losses of smelter sales.

Big Rivers projects using coal to produce 95% of the electricity it sells, exposing the utility and its customers to potentially higher operating costs as the regulation of carbon and other emissions progresses. The plants' heat rates contribute to carbon intensity in the range of 1.1 tons of coal per MWh. Their ages, heat rates, and carbon intensity raise questions about their ability to compete against potentially more efficient and less carbon-intensive units in wholesale markets if the smelters reduce or end their cooperative electric purchases. In our view, the extent of carbon regulation will determine the effects of this level of carbon intensity on Big Rivers' production facilities' economics.

Because aluminum smelting is a carbon-intensive process, we believe a combination of costly carbon constraints on aluminum production and carbon charges levied on the smelters' electricity purchases could impair their operations and heighten the likelihood that the cooperative's generating assets might have to compete in wholesale markets.

Transmission Expansion Plans

Big Rivers' expects to complete transmission upgrades in the fall of 2011. Until completed, the utility lacks sufficient capacity to market the smelters' power if both sharply reduce or discontinue operations. Even once completed, we believe that the cooperative's lack of firm contractual access rights could frustrate its ability to move power across others' transmission systems, including, the Tennessee Valley Authority (TVA) system.

Big Rivers only has contracts for 100 MW of firm transmission capacity across the TVA system. Management views the high cost of securing firm transmission access for a contingent exposure as unwarranted. The utility has physical interconnections with other power markets beyond TVA, such as the Midwest Independent System Operator and E.ON. However, Big Rivers' electricity needs to cross TVA's transmission system to access key markets such as Southern Co. and Entergy Corp. Lack of transmission access due to fully loaded lines during peak periods could frustrate the cooperative's ability to capture the most robust power prices for surplus power it might need to sell if it loses smelter loads.

Power Contracts Provide Some Revenue Stability

In our opinion, the long-term wholesale power contracts between Big Rivers and its three member distribution cooperatives provide a measure of revenue stream security.

The cooperative and its members extended their wholesale power sales contracts 20 years to 2043 in connection with the E.ON generation asset lease unwind transaction. We view this long tenor as contributing to credit quality because we understand that terms of wholesale power contracts between the utility and its three members require the members to purchase their electricity needs from Big Rivers. Furthermore, the members have exclusive rights to sell electricity within defined service territories, which shields the cooperative and its members from competition.

Big Rivers' long-term wholesale power contracts also contribute to credit quality because they extend beyond its debt's final maturity. Debt outstanding matures by 2031. However, about 11% of debt matures after the contracts with the smelters expire in 2023. Debt that matures after the smelter contracts roll off could lead to heightened wholesale market exposure, which we view as a credit weakness. Furthermore, Big Rivers expects that imminent refinancings of bullet maturities could extend debt even further beyond the smelter contracts' expiration.

Generally, lengthy requirements contracts, such as those of the cooperative, provide meaningful revenue predictability and credit support. However, the members' substantial reliance on two industrial loads that are vulnerable to commodity price cycles erodes the contracts' credit support and distinguishes Big Rivers from most other cooperative utilities. Rate regulation also dilutes the benefits of the long-term wholesale power contracts since the cooperative, unlike most others, cannot unilaterally impose additional costs on its captive customers, which could frustrate a reallocation of fixed costs if it loses smelter loads. Also, Big Rivers lacks control over prices for market sales it may need to make if the smelters' operations falter, tempering the wholesale power contracts' benefits.

Highly Competitive Rates

We view Big Rivers' members' retail rates as highly competitive, and they could contribute to financial flexibility.

Energy Information Administration data shows that the cooperative's members' retail rates compare very favorably with average rates for the residential, commercial, and industrial sectors in Kentucky. Members' 2009 average residential and commercial rates were about 15% below the state's average. Industrial rates for Kenergy, the member with the smelter, and other industrial loads were about 25% below the state's in 2009.

We believe the smelters' high load factors are likely contributors to the favorable rate competitiveness across the system because their high electricity consumption provides a robust platform for spreading fixed costs over many MWh. Here too, the exposure to the smelters can become a liability if commodity prices or economic conditions compromise the smelters' operations.

Rates also benefit from the more than $200 million of rate mitigation reserves from the proceeds of the E.ON lease unwind transaction. The utility plans to deploy an average $24 million of the reserves' balances each year through 2017 to subsidize rate levels. The cooperative's forecast shows that this will enhance operating revenues by about 5% each year and we believe that there could be meaningful upward rate pressure once the reserves are exhausted.

Related Criteria And Research

USPF Criteria: Applying Key Rating Factors To U.S. Cooperative Utilities, Nov. 21, 2007

APPENDIX E

E-mail messages from Big Rivers' April 15, 2011, response to Item 36 of KIUC's Initial Request for Information (KIUC 1-16), KIUC 1-36.pdf at p. 96-97, 790

Bill Blackburn

From:	Mark Hite
Sent:	Thursday, January 06, 2011 2:52 PM
To:	Bill Blackburn; Mark Bailey
Subject:	Burns & McDonnell Depreciation Study Report - final
Attachments:	FINAL Consolidated Big Rivers Report 1-6-11.pdf

Attached hereto is the final B&M Depreciation Study Report. There's been no further change to what was last reported to you. During the Tuesday 1/4/11 smelter meeting at Big Rivers, following a depreciation study status update, the smelter representatives agreed for Big Rivers to promptly direct B&M finalize their report. Bill directed me to contact B&M accordingly, which was done. Bound copies are in transit from B&M.

Suppose this needs to be a 1/21/11 Board agenda item, seeking approval. Then, we'll wish to quickly send to RUS requesting their approval.

Upon your approval, will forward a pdf copy of the final report to each member of the depreciation study working group.

Comments welcome.

Thanks,
Mark

Mark A. Hite, CPA
VP Accounting
Big Rivers Electric Corporation
201 Third Street
Henderson, KY 42420
Corporate: 270-827-2561
Office Direct: 270-844-6149
Cell: 270-577-6815
Fax: 270-827-2558
Home: 812-853-0405

Bill Blackburn

From:	Mark Bailey
Sent:	Tuesday, January 04, 2011 6.38 PM
To:	Bill Blackburn
Cc:	Albert Yockey
Subject:	RE: Summary of Meeting with Smelters

Thanks Bill. I thought the 11.75 % increase we were considering actually left the smelters at the top of the bandwidth?
Mark

Sent from my Samsung Jack™, a Windows Mobile® smartphone from AT&T

From: Bill Blackburn <Bill.Blackburn@bigrivers.com>
Sent: Tuesday, January 04, 2011 7:12 PM
To: Mark Bailey <Mark.Bailey@bigrivers.com>
Cc: Albert Yockey <Albert.Yockey@bigrivers.com>
Subject: Summary of Meeting with Smelters

Mark,

This afternoon Al and I met with Allan Eyre, Jeremy Jenkins and Pat Schneider from Alcan and Matt Powel and Henry Fain (Henry by phone) from Century. The Smelter had requested the meeting to discuss several items in Big Rivers' upcoming rate case. The items discussed were:

1. Review of the depreciation study and the current results: We shared with them the outcome of the most recent adjustments in the depreciation study. The study reflects an effective depreciation rate of 2.14% compared to the 2008 Unwind Model for 2011 of 2.13%. Matt indicated he was pleased that the results from the study and the model we were so close, while Allan had a few follow up questions. I ask Mark Hite to step into the room and review changes in this third report from Burns & McDonald. After some discussion Allan indicated he understood why we were making the adjustments and we had answered his questions. I indicated Big Rivers would request the final report from Burns & McDonald and file the final report with RUS requesting their approval. Both Allan and Matt indicated agreement.

2. Cost of Service: I carefully stated that Big Rivers was in the developmental mode of its Cost of Service report. It was indicated that Big Rivers is looking at moving from the present 12 monthly non-coincidental peaks approach to a 12 monthly coincidental peak approach. Allan indicated the Smelters are doing a cost of service study and they are using Steve Barren to perform that work. They also raised the question if Steve could work with Big Rivers' consultant to compare major assumptions. The Smelters are having an internal meeting on Friday and will notify Big Rivers if they want to move forward in this regard. Allan stated twice the Smelters were not pleading poverty, but were trying to get in position to withstand the next economic downturn.

   They clearly stated it was their objective to minimize cost increases to the Smelters. While we clearly stated Big Rivers needed share cost between the rural and industrial classes of customers in an equable manner.

3. The question was asked if we were going to include the MISO expenses in base rates. Allan also stated they had supported that concept during the MISO hearing at the Commission. We stated that we were looking at

Archived: Friday, April 08, 2011 4:45:05 PM
From: Kelly, Ted
Sent: Tuesday, January 04, 2011 3:22:14 PM
To: Jeremy Garrett; Summerville, Jon
Cc: Mark Hite; Ralph Ashworth
Subject: Re: Final Draft Report Request
Importance: Normal

Jeremy,

Thanks for the update. As we just discussed on the phone, we will send an updated report for your review and complete our final quality review. When we receive any final comments we will incorporate and issue the final report.

Talk to you soon. Don't hesitate to call with any questions.

Ted

Sent from HTC Smartphone.
Ted J. Kelly, Principal
Burns & McDonnell
816-822-3208 Office
816-835-9688 Cell

----- Reply message -----
From: "Jeremy Garrett" <Jeremy.Garrett@bigrivers.com>
Date: Tue, Jan 4, 2011 2:24 pm
Subject: Final Draft Report Request
To: "Kelly, Ted" <tkelly@burnsmcd.com>, "Summerville, Jon" <jsummerville@burnsmcd.com>
Cc: "Mark Hite" <Mark.Hite@bigrivers.com>, "Ralph Ashworth" <Ralph.Ashworth@bigrivers.com>

Guys,

The smelters have agreed to the latest proposed depreciation rates so proceed with issuing a final report as soon as possible. I am hoping we have identified and corrected all grammatical errors and such in our prior revisions but please give it a final thorough combing.

I appreciate all your work to bring this study to an agreeable conclusion

APPENDIX F

E-mail message from Big Rivers' April 15, 2011, response to Item 36 of KIUC's Initial Request for Information (KIUC 1-36), KIUC 1-36.pdf at p. 94

Bill Blackburn

From: Jeremy Garrett
Sent: Friday, January 07, 2011 11:06 AM
To: Bob Berry; Wayne O'Bryan; Ron Gregory; Jim Garrett; Tim Tapp; Larry Baronowsky; Travis Siewert; Mark Hite; Ralph Ashworth
Cc: Bill Blackburn; 'Daniel, Marlene (RTA)'; 'charlieking@snavely-king.com'
Subject: 2010 Depreciation Study Final Report
Attachments: FINAL Consolidated Big Rivers Report 1-6-11.pdf

All,

Attached is the final report from B&M. I appreciate everyone's input and effort to make this study as accurate as possible.

Mark/Bill,

I have bound copies at my desk when you are ready to submit the report to the RUS.

Thanks,

Jeremy Garrett

Jeremy Garrett
Accountant
Big Rivers Electric Corporation
201 Third Street
Henderson, KY 42420
270-844-6144