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RECEIVED

APR 05 2012

PUBLIC SERVICE
COMMISSION

VIA HAND DELIVERY

April 5, 2012

Mr. Jeff Derouen, Executive Director
Kentucky Public Service Commission
211 Sower Boulevard
Frankfort, Kentucky 40602

Re: Case No. 2011-00036

Dear Mr. Derouen:

Please find enclosed the original and ten (10) copies each of the DIRECT REHEARING TESTIMONY AND EXHIBITS OF LANE KOLLEN and STEPHEN J. BARON on behalf of the KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC. for filing in the above-referenced matter.

By copy of this letter, all parties listed on the Certificate of Service have been served. Please place these documents of file.

Very Truly Yours,

Michael L. Kurtz, Esq.
Kurt J. Boehm, Esq.
BOEHM, KURTZ & LOWRY

MLKkew
Attachment
cc: Certificate of Service
Richard Raff, Esq.
David C. Brown, Esq.

G:\WORK\KIUC\Kenergy - Big Rivers\2011-00036 (2011 Rate Case)\Derouen Ltr.docx

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing was served by electronic mail (when available) or by mailing a true and correct copy by overnight mail, unless other noted, this 5th day of April, 2012 to the following

Michael L. Kurtz, Esq.
Kurt J. Boehm, Esq.

Mark A Bailey
President CEO
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Henderson, KY 42419-0024

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Hogan Lovells US LLP
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COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

RECEIVED
APR 05 2012
PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF BIG RIVERS ELECTRIC CORPORATION FOR A GENERAL ADJUSTMENT IN RATES) CASE NO. 2011-00036

REHEARING TESTIMONY AND EXHIBITS OF LANE KOLLEN

ON BEHALF OF THE

KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC.

J. KENNEDY AND ASSOCIATES, INC.
ROSWELL, GEORGIA

March 2012

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**

REHEARING TESTIMONY OF LANE KOLLEN

Summary

Q. Please state your name and business address.

A. My name is Lane Kollen. My business address is J. Kennedy and Associates, Inc. ("Kennedy and Associates"), 570 Colonial Park Drive, Suite 305, Roswell, Georgia 30075.

Q. Please state your occupation and employer.

A. I am a utility rate and planning consultant holding the position of Vice President and Principal with the firm of Kennedy and Associates.

Q. Did you previously file testimony in this proceeding?

A. Yes. I previously filed Direct Testimony on behalf of KIUC summarizing all of the KIUC revenue requirement recommendations and addressing specific revenue requirement issues.

Q. What is the purpose of your Rehearing testimony?

A. The purpose of my testimony is to respond to three issues addressed by Company witnesses Mr. Mark Hite and Mr. John Wolfram in their Rehearing testimonies, all of which inappropriately would increase the rate increase already authorized by the Commission: 1) an increase in rate case expense amortization from the estimate included in the Company's requested rate increase, 2) an increase in depreciation expense to include construction work in progress ("CWIP") at the end of the test year that the Company claims actually was in-service, and 3) an increase in depreciation expense to include CWIP at the end of the test year that the Company claims was not in-service at that time, but actually was in-service prior to the effective date of new rates in this proceeding.

Q. Please summarize your testimony.

A. I recommend that the Commission reject all three requests. First, the Commission should limit the rate case expenses to the Company's initial estimate and reject the additional amount now claimed. Most of additional amount claimed is due to charges from the Company's two outside law firms, and primarily from Hogan & Lovells, the Company's Washington, D.C. law firm.

Second, the Commission should reject an increase in depreciation expense on CWIP at the end of the test year that the Company now claims was in-service even though it was reported as CWIP in accordance with Generally Accepted Accounting Principles ("GAAP") and the RUS Uniform System of Accounts

("USOA"). The Commission is entitled to rely on the accuracy of the Company's accounting records for ratemaking purposes, yet the Company's argument inescapably relies on the conclusion that its accounting records were in error and that amounts recorded in CWIP actually should have been recorded in plant-in-service. The Commission should not attempt to deconstruct the Company's accounting records and then reclassify CWIP to plant-in-service for ratemaking purposes.

Third, the Commission should reject an increase in depreciation expense on CWIP that was not in service until after the end of the test year even if it was in-service prior to September 1, 2011 when new rates went into effect. In its Order in this proceeding, the Commission adopted and strongly affirmed the traditional test year as the conceptual framework for its quantification of the revenue requirement and, on that basis, rejected all post-test year adjustments as a matter of ratemaking principle within that framework. The Company's request directly violates the conceptual framework set forth by the Commission. The Company failed to provide any compelling reason why the Commission should selectively adopt this single post test year adjustment to increase depreciation expense while ignoring other post test year adjustments that reduce expense. If the Commission nevertheless decides to adopt the Company's adjustment, then it also should revisit and adopt the post-test year adjustment to reduce interest expense on the prepayment of the RUS Series A Note proposed by KIUC and rejected in the Order.

Finally, I recommend that the Commission allow the Company recovery of its rate case expenses based on the initial estimate included in its rate increase request. The amount of this adjustment to the actual test year expense is $281,719. I also recommend that the Commission correct the error in depreciation expense identified by the Company and described by Mr. Wolfram in his Rehearing Testimony. The amount of the error is $450,000.

<u>**Rate Case Expenses**</u>

Q. Please describe the Company's request for an increase in rate case expense.

A. In its initial request, the Company estimated its rate case expenses at $893,390, which it proposed to defer and then amortize over three years. Based on this estimate, the Company included $299,643 for rate case expense in the revenue requirement ($17,924 already in historic test year plus $281,719 proforma adjustment). No party disputed this amount and the Commission should allow recovery of this amount.

However, the Company's actual rate case expenses through August 18, 2011 were $1,976,030, an increase of $1,082,640, or more than double the estimate included in its rate increase request. The Company now seeks $640,753 in annual rate case amortization expense, or an additional $341,110 rate increase to recover the actual expenses it incurred through August 18, 2011 in excess of the amount included in its initial request. If the additional amount is approved, the Company will recover an additional $341,110 each year unless and until the additional amount incurred is recovered and rates are reset.

Q. Has the Company prepared a schedule comparing its estimate in the rate increase request to the amount it now seeks in this rehearing proceeding?

A. Yes. In response to KIUC Rehearing 7(a), the Company provided a schedule comparing the amount estimated and the amount actually incurred through August 18, 2011 for each firm that provided professional services ("outside advisor") that were included in the rate case expenses. I have replicated the Company's entire response to KIUC Rehearing 7, including that schedule, as my Rehearing Exhibit___(LK-1) for ease of reference.

Q. What is the primary reason for the additional cost that the Company incurred?

A. Of the $976,052 in additional expense incurred, $809,587, or nearly 83%, was due to amounts billed by the Company's two outside law firms, Sullivan Mountjoy, its local regulatory law firm, and Hogan & Lovells, a Washington, D.C. law firm. Of the additional amounts billed by the Company's outside law firms, $723,270, or 89%, was due to amounts billed by Hogan & Lovells.

Q. Were you able to review the activities of the Company's outside attorneys to determine the reason for the additional charges?

A. No. Throughout the course of the proceeding, the Company provided copies of the invoices from the outside law firms in response to Staff 1-52(c). However, the activities described on these invoices were redacted. Although the activities were redacted, the hourly rates for the Sullivan Mountjoy partners ranged from $125 to $220. The hourly rates for the Hogan & Lovells partners ranged from $650 to $740, although these rates were discounted by 5% in the early months and by 10% in the later months.

In response to the Company's rehearing request for additional rate case expense, KIUC sought to review the activities of the law firms to determine the basis for the extraordinary increase in expense and requested copies of the invoices that had been provided in response to Staff 1-52(c) in unredacted form. KIUC requested this information only for the activities and charges related to the rate case. The Company refused to provide the information requested, citing attorney-client and attorney work product privilege, in response to KIUC Rehearing 10. I have attached a copy of the Company's response to this request for ease of reference as my Rehearing Exhibit___(LK-2).

Q. Should the Commission allow recovery of the Company's actual rate case expenses in excess of the amount included in its requested rate increase?

A. No. The Company has failed to justify the increase in excess of its estimate. It has failed to demonstrate that the increase is just and reasonable or that it should be recovered from ratepayers. The Company's claim is based on nothing more than the fact that it was charged more than its estimate, citing the "amount of work that had to be performed" in response to KIUC Rehearing 8. The Company blamed this additional "work" on "the actions of the intervenors and the Commission, not Big Rivers," according to its response to KIUC Rehearing 8. I have attached a copy of the entire response to KIUC Rehearing 8 as my Rehearing Exhibit___(LK-3).

The result itself is evidence that the Company failed to adequately manage its rate case expenses or oversee the activities performed by its professional advisors. Among other lapses, the Company failed to control the exorbitant charges from Hogan & Lovells. The Company failed to provide any evidence in response to KIUC Rehearing 7(b) and (c) that it had performed any contemporaneous variance analyses, other than a tally of the amounts actually billed compared to the estimated amounts for each outside advisor. The Company provided no documents in response to KIUC 8(c) related to the Company's control over the scope of work and cost of outside services. The Company provided no documents in response to KIUC Rehearing 8(f) and (g), which sought copies of any correspondence with the outside advisors or internal correspondence regarding the Company's evaluation of or satisfaction with each outside firm's performance. The Company refused to provide copies of the unredacted invoices from its law firms for rate case activities in response to KIUC Rehearing 10, thus precluding KIUC, Staff and all other parties from reviewing the charges from the outside law firms in order to determine if, in fact, any of the additional charges were just and reasonable, let alone necessary

Q. Should the Commission simply accept the Company's actual rate case expenses based on its precedent of using actual expenses rather than estimated expenses?

A. No. The Commission's precedent is not a ratemaking principle or standard and is more akin to a ratemaking tool or approach. If the utility had managed its rate case expenses, the actual expense prior to the date of the Order arguably would be less than the total estimated cost to prosecute a rate case because the actual expenses necessarily would not include the expenses incurred after the date of the Order. The Commission's precedent is a tool or approach that provides a practical limit on the use of improperly inflated utility estimates, and should not now be turned inside out and used as the basis to recover actual expenses that far exceed the estimate. If the Commission allows its precedent to be misused in this manner, then other utilities also may view such a change in approach as an opportunity to revise and increase their rate increase requests after their initial estimates.

The other concern if the Commission allows its precedent to be misused in this manner is that it denies the Staff and intervenors the opportunity to investigate excessive expenses that are not even known until shortly before the Commission issues its Order in a rate case proceeding. At that stage of the procedural schedule, discovery has been completed, intervenors have filed their testimony, and hearings have been completed. The only reason that the Staff and intervenors could engage in discovery on the additional rate case expenses in this proceeding is that the Commission agreed to consider the Company's claim that the Commission had not included *any* recovery of its estimated expenses, let alone the much greater actual expenses.

Q. If the Commission limits the rate case expenses to the amount estimated by the Company, will the Company be required to writeoff any deferred amounts?

A. No. The Company did not defer its rate case expenses. The Company expensed the rate case costs as they were incurred, according to its response to KIUC Rehearing 7(e). That means that the Company expensed $1,976,030 through August 18, 2011 and likely expensed additional amounts since then. Thus, the rate case expense reduced the Company's Margins for Interest Ratio ("MFIR") and Debt Service Coverage Ratio ("DSC") in 2010 and in 2011, and the ongoing expenses continue to reduce these critical ratios in 2012.

The amounts expensed in 2010 and 2011 will be reversed this year, at least in part, by the amount of rate case expense that are allowed recovery by the Commission. The accounting entry will be to record a negative rate case expense (credit to expense) and a regulatory asset (debit) for any amount of rate case expense that the Commission authorizes in this proceeding. This will increase the MFIR and DSC this year.

Instead of a writeoff, the Company will record a "writeup" that will increase income this year based on the total amount of recovery the Commission allows. Thus, as a practical matter, any self-inflicted damage to the MFIR and DSC from the excessive rate case expenses in 2010 and 2011 cannot be avoided for those years and the effect in those years should not be a factor in the amount of rate case expense that is allowed in this proceeding.

<u>Depreciation Expense on CWIP Claimed to be In-Service on October 31, 2010</u>

Q. Please describe the Company's request for additional depreciation expense on CWIP claimed to be in-service on October 31, 2010, the end of the test year in this proceeding.

A. The Company seeks recovery of an additional $359,678 in depreciation expense based on its claim that $18,654,607 of its CWIP balance at October 31, 2010 was actually in-service.

Q. In its Order in this proceeding, did the Commission set forth a conceptual framework for the test year as the basis for its determination of the Company's revenue requirement?

A. Yes. The Commission adopted the historic test year as the conceptual framework for the revenue requirement and rejected the post-test year adjustments proposed by the Company and KIUC. More specifically, on the depreciation expense proforma adjustment proposed by the Company, the Commission stated:

> **[W]e will approve and authorize Big Rivers' use, on a going-forward basis, of the depreciation rates proposed in its application. However, we will not authorize a level of depreciation expense that reflects the accrual of depreciation on Big Rivers' test-year-end CWIP balance. Going beyond the end of test year plant-in-service balances is inconsistent with the concept of a historical test year and a violation of the broad "matching principle" described previously in this Order. For this reason, we will limit the adjustment to the amount derived by applying Big Rivers' proposed depreciation rates to its test-year-end plant in service balances.**

Q. Does the Company maintain its accounting records in accordance with GAAP and the RUS USOA?

A. Yes. In response to KIUC Rehearing 1(a) and (d), the Company confirmed that it maintains its accounting books and records in accordance with GAAP and the RUS USOA. In addition, in response to KIUC Rehearing 1(b), the Company confirmed that its auditors did not find any exceptions or make any recommendations in their audit opinions or their management letters. I have attached a copy of the Company's entire response to KIUC Rehearing 1 as my Rehearing Exhibit___(LK-4).

Q. Is the Company required to maintain its accounting records in accordance with GAAP and the RUS USOA in any loan covenants or loan agreements?

A. Yes. In response to KIUC Rehearing 1(c) and (f), the Company confirmed that it was required to maintain its accounting records in accordance with GAAP and the RUS USOA by the terms of its Indenture, Amended and Consolidated Loan Contract, CFC Revolving Line of Credit Agreement, and CoBank Revolving Credit Loan Facility.

Q. The Company's request is based on the claim that $18,654,607 of CWIP at October 31, 2010 actually was not CWIP, but was in service. Please respond.

A. The Commission should reject the Company's request. The Commission is entitled to rely on the Company's accounting records, which the Company and its auditors determined were maintained in accordance with GAAP and the RUS USOA. The Company's claim is based upon a deconstruction of those accounting records and an after-the-fact determination that the CWIP it actually recorded in those accounting records and reported previously to the Commission, the RUS, and its creditors, was not actually CWIP, but plant-in-service. Yet, this claim would be applicable only for ratemaking purposes. The Commission should reject the disparate results for accounting and ratemaking purposes.

Q. The Company claims that its accounting records were not in error and that the projects remain in CWIP even after they are in-service to collect additional charges. Please respond.

A. The Company made this claim in response to KIUC Rehearing 2. In this response, the Company provided a description of its CWIP accounting process, which it claims incorporates or may incorporate a lag in transferring CWIP to plant-in-service after the project is in-service. I have attached a copy of this response as my Rehearing Exhibit___(LK-5)

If this is correct, then both the Company and its auditors have determined that this is an acceptable accounting practice and that its accounting records do not need to correct for this lag. If this is correct and it were not an acceptable accounting practice, then the Company could or should reform its accounting practice to transfer CWIP amounts to plant-in-service when the projects actually are placed in-service. There is no requirement in accounting to hold open work orders beyond in-service dates to collect additional charges.

In short, the Commission should not take upon itself the obligation to do something that neither the Company nor its auditors consider necessary or appropriate.

Q. Does the Company's request for this depreciation expense violate the conceptual framework for the historic test year set forth by the Commission in its Order in this proceeding?

A. Yes. If the Company's arguments regarding its accounting are rejected, as they should be, then the Company's request is based on nothing more than a selective post-test year adjustment. The Commission was unequivocal on the "four corners" of the historic test year and rejected attempts to incorporate post test year adjustments, both those proposed by the Company and those proposed by KIUC, including a known and measurable adjustment to reduce interest expense and the related TIER margin for the Company's prepayment of the RUS Series A Note.

Depreciation Expense on CWIP Not In-Service on October 31, 2010, but Claimed to be In-Service Prior to September 1, 2011

Q. Please describe the Company's request for additional depreciation expense on CWIP not in-service on October 31, 2010, but claimed to be in-service prior to September 1, 2011, the effective date of the new rates in this proceeding.

A. The Company seeks recovery of an additional $1,284,476 in depreciation expense based on its claim that $16,109,062 of its CWIP balance at October 31, 2010 was placed in-service after that date, but prior to September 1, 2011.

Q. Should the Commission reverse itself on this issue in this Rehearing proceeding and adopt this selective post-test year adjustment?

A. No. As I noted previously, the Commission was unequivocal on the "four corners" of the historic test year and rejected attempts to incorporate post test year adjustments.

Furthermore, even if the Commission had adopted selective post-test year adjustments in its Order, the Company's proposed increase in depreciation expense on projects placed in-service after the test year, but prior to September 1, 2011, could not have been known and measurable, at least in its entirety, at the time of the Company's filing. They are known and measurable today in their entirety only because of the passage of time and the fact that there is a Rehearing proceeding.

The Commission should be careful not to upend the conceptual framework of its Order in which it rejected selective post-test year adjustments, and even more careful if it does consider this proposed adjustment that it does not accept the Company's adjustment as "known and measurable" today when it could not have accepted it on that basis, at least in its entirety, when the issue was originally decided.

Q. If the Commission does adopt either of the Company's proposed post-test year adjustments to increase depreciation expense, should it also revisit the KIUC proposed adjustment to reduce interest expense and the related TIER to reflect the Company's actual prepayment of the RUS Series A Note?

A. Yes. The Commission should not selectively choose post-test year adjustments without setting forth some standard for such adjustments and then applying that standard on a consistent basis. Although the Company has not articulated a standard for adopting its proposed post test year adjustments to increase depreciation expense, the Commission stated in its Order that adjustments to a historical test year must be "known and measurable," and that consequently, "adjustments based on events occurring beyond the end of the test year are rarely accepted due to their inability to meet the requisite evidentiary standard."

I noted previously that the Company's post test year adjustments to increase depreciation expense adjustments did not meet the "known and measurable" standard, except retroactively due to the passage of time. However, the reduction in interest expense was "known and measurable" during the course of the proceeding. Thus, if the Commission does adopt the Company's proposed selective post test year adjustments to increase depreciation expense, then it also should adopt the post test year adjustment to reduce interest expense and the related TIER.

Q. Does this complete your testimony?

A. Yes.

AFFIDAVIT

STATE OF GEORGIA)

COUNTY OF FULTON)

LANE KOLLEN, being duly sworn, deposes and states: that the attached is his sworn testimony and that the statements contained are true and correct to the best of his knowledge, information and belief.

Lane Kollen

Sworn to and subscribed before me on this
3rd day of April 2012.

Jessica K. In

Notary Public

JESSICA K INMAN
MY COMMISSION EXPIRES
NOTARY PUBLIC
JULY 31, 2015
CHEROKEE COUNTY, GEORGIA

REHEARING

EXHIBIT ____ (LK-1)

BIG RIVERS ELECTRIC CORPORATION

APPLICATION OF BIG RIVERS ELECTRIC CORPORATION
FOR A GENERAL ADJUSTMENT IN RATES
CASE NO. 2011-00036

Response to Kentucky Industrial Utility Customers' Initial Rehearing Request for Information dated March 9, 2012

March 22, 2012

Item 7) *Refer to Exhibit Hite Rehearing-1, which provides a summary table of rate case expenses incurred through August 2011.*

a. Please reconcile the amounts through August 2011 to the amounts requested in the Company's filing.

b. Please provide a copy of any variance analysis performed by the Company comparing the actual to the estimated amounts requested in the Company's filing prepared prior to the receipt of this request. If the Company did not prepare such an analysis prior to the receipt of this request, then please explain why it did not do so.

c. For each variance identified in response to part (a) of this question, please provide a detailed explanation of why the actual cost was greater than the estimated cost included in the Company's filing.

d. Please provide a copy of all engagement letters and purchase orders for each outside firm retained to assist the Company in its rate case, including all subsequent modifications and revisions, if any.

e. The summary table indicates that rate case expense was charged to account 928. Please indicate whether the Company expensed the rate case expenses or deferred them as they were incurred. Please provide a copy of the monthly journal entries for each month during which rate case expenses were incurred showing the accounts and amounts, including any journal entries for deferrals.

Response)

a. The rate case expense amounts through August 2011 are the amounts Big Rivers requested in its rate case filing, because Big Rivers requested its actual rate case expenses. See Big Rivers' August 11, 2011, Brief, page 48. This request was made consistent with customary Commission practice. Per the March 2011 Application, the initial estimate of the third-party rate case expense cost was $898,930.

The changes in actual rate case expenses incurred are documented in the record of this case. In response to Information Request PSC 1-52, Big Rivers provided details concerning the costs of preparing this case. Big Rivers' March 18, 2011, response to that information request shows rate case costs from September 2010 through February 2011 of $264,128.91. The response states that Big Rivers' "preliminary estimate of [its] third-party engineering, legal and consulting expenses" is $898,930.

Big Rivers filed updates to that information request in accordance with the direction of PSC 1-52c. Those updates show actual rate case expenses of $577,199.73 through March 2011 (Big Rivers' May 11, 2011, Second Supplemental Response); actual rate case expenses of $647,199.19 through April 2011 (Big Rivers' June 24, 2011, Third Supplemental Response); and actual rate case expenses of $890,985.29 through May 2011 (Big Rivers' July 18, 2011, Fourth Supplemental Response). As Mr.

Wolfram acknowledged on behalf of Big Rivers at the hearing in this matter on cross-examination by Commission counsel, Mr. Raff, while at the time of the filing the rate case Big Rivers' total anticipated costs were estimated at roughly $890,000, by the end of May the actual costs incurred were roughly $890,000. See transcript of hearing, testimony of John Wolfram, July 27, 2011, 11:33:00-11:35:00. Revised Exhibit Wolfram Rebuttal-1 and page 6 (Reference Schedule 2.13) of revised Exhibit Wolfram Rebuttal-2, filed at the hearing on July 27, 2011, show the original and updated pro forma adjustments for rate case expenses as $281,719 and $482,076, respectively. As noted in the revised Reference Schedule 2.13, the $482,076 adjustment is based on anticipated rate case costs of $1,500,000, which is based on actual costs through June 2011 and estimated expenses for July and August 2011. Big Rivers' final update to PSC 1-52 was filed August 18, 2011, and shows actual rate case costs of $1,976,029.71 through August 15, 2011. The attached table compares the actual such cost incurred through the August 15, 2011, to the original cost estimate.

b. Please see the response to part 7a above.

c. Big Rivers' rate case was the first it had filed in approximately 20 years that involved its generation costs. Big Rivers underestimated the level of time commitment that would be required of its consultants and professionals in the case. Big Rivers does not have a rates and tariffs department or in-house counsel. When Big Rivers began to prepare the rate case filing, Big Rivers was still working through the complex transition that resulted from the Unwind, including increasing the size of the company and converting to Oracle R12. It was also in the process of integrating into the Midwest Independent Transmission System Operator, Inc. Many of the additional demands resulting from the hundreds of information requests in the rate case were necessarily assigned to outside consultants and professionals. The complexity of the case, the large volume of the data requests and the information sought through them (that required thorough review), and preparations for the hearing were among the reasons that the costs were higher than Big Rivers originally projected. In addition, Big Rivers mistakenly thought that involving the smelters in the development of its depreciation study would reduce the amount of time that Big Rivers and its consultants would have to devote to that subject during the case, but that assumption proved incorrect. Once Big Rivers started down the path that resulted in the filing of the rate case, it concluded, due to the case's importance to Big Rivers' financial health, that it must do what was required to effectively prosecute the case, and that involved more extensive use of outside consultants and professionals than was originally anticipated.

d. Please see the CD that accompanies Big Rivers' March 18, 2011, response to PSC 1-42.

e. Big Rivers expensed these amounts because it was required to do so by the RUS USOA pending action by the Commission. As an RUS borrower, Big Rivers is subject to the accounting prescribed by RUS Bulletin 1767B-1, Uniform System of Accounts - Electric. Accordingly, Big Rivers currently expenses (expense as incurred) all such costs until such time as (a) there is an "action" by this Commission (an order) approving the deferral of all or a portion of such costs in a regulatory asset and the associated accounting, including the related inclusion in rates (generally based on a three-year amortization), and (b) a determination is made by Big Rivers that it is probable that the RUS will approve its request (in writing) to establish such regulatory asset and the associated accounting.

Pending such specific Commission action in an order, as well as a Big Rivers conclusion that it was probable that RUS written approval would be forthcoming, any attempt to defer all or a portion of such costs in a regulatory asset would be improper and an item of accounting uncertainty. Big Rivers contends that currently expensing such costs until the aforementioned matters are resolved is not only required by RUS and GAAP, but is consistent with the accounting principle of conservatism. Potential uncertainties associated with such costs being incurred over multiple calendar years, the potential for the Commission disallowing all or a portion of such costs, etc., further justify the prudency of Big Rivers' accounting treatment of currently expensing such costs. The accounting treatment is to expense (debit) the rate case expenses as incurred to account 928 – Regulatory Commission Expenses and to credit account 131 – Cash.

Witness) Mark A. Hite

Big Rivers Electric Corporation

Case No. 2011-00036

Reconciliation of Rate Case Expenses through August 2011 versus Amounts Requested in Big Rivers' Application

Line No.	Vendor	August 18, 2011 Submittal	Original Estimate	Difference	Description
1	Burns & McDonnell	$ 187,151.58	$ 120,000.00	$ 67,151.58	Engineering
2	GDS Associates	4,341.66	5,000.00	(658.34)	Engineering
3	The Prime Group	399,971.50	300,000.00	99,971.50	Consulting
4	Sullivan Mountjoy Stainback & Miller	386,316.92	300,000.00	86,316.92	Legal
5	Hogan & Lovells	897,199.84	173,930.00	723,269.84	Legal
6	D.R. Eicher Consulting	1,160.00	0.00	1,160.00	Consulting
7	American Management Consulting	18,281.25	0.00	18,281.25	Consulting
8	Orrick Herrington & Sutcliffe	2,440.92	0.00	2,440.92	Legal
9	Public Financial Management	79,166.04	0.00	79,166.04	Consulting
10	**Total**	**$ 1,976,029.71**	**$ 898,930.00**	**$ 976,051.50**	

Case No. 2011-00036
Witness: Mark A. Hite
Attachment for Response to KIUC Rehearing Item 7a

REHEARING

EXHIBIT ____ (LK-2)

BIG RIVERS ELECTRIC CORPORATION

APPLICATION OF BIG RIVERS ELECTRIC CORPORATION
FOR A GENERAL ADJUSTMENT IN RATES
CASE NO. 2011-00036

Response to Kentucky Industrial Utility Customers' Initial Rehearing Request for Information dated March 9, 2012

March 22, 2012

Item 10) *Please refer to the Company's response and updated responses to Staff 1-52(c). Please provide copies of the invoices from the outside attorneys with the descriptions of the activities related to the rate case unredacted. The non-rate case activities may remain redacted.*

Response) Redacted invoices are provided in Big Rivers' original and supplemental responses to PSC 1-52. Big Rivers objects to providing un-redacted invoices on the ground that such documents are protected by the attorney-client and attorney work product privileges.

Witness) Mark A. Hite / Counsel

REHEARING

EXHIBIT ____ (LK-3)

Item 8) *Please describe how the Company managed its rate case expenses, including, but not limited to, the following:*

a. Overall control of the case and the cost of outside services. In addition to the general description, please identify the names and positions of the people responsible for each aspect of this process, and describe specifically how each such person managed the case and the cost of outside services.

b. Control over the scope of work and cost of individual firms and attorneys/consultants employed by those firms. Please identify the names and positions of the people responsible for each aspect of this process, and describe specifically how each such person managed the scope of work and the cost of each firm and its employees.

c. Copies of all documents related to the Company's control over the scope of work and cost of outside services, including, but not limited to, reports used for this purpose and all correspondence between the Company and individual firms and all correspondence internally within the Company.

d. Please describe in detail the Company's decision criteria applied to select each individual firm and the attorneys/consultants applied by those firms. Provide a copy of all documents that address these criteria and the weighting that was applied, if any.

e. *Please indicate if the Company engaged in competitive bids for its attorneys and consultants. If so, then please provide a copy of all bid documents. If not, then please explain why it did not do so.*

f. *Please provide a copy of all correspondence between the Company and individual outside firms regarding the Company's evaluation of or satisfaction with the firm's performance.*

g. *Please provide a copy of all internal correspondence regarding the Company's evaluation of or satisfaction with each outside firm's performance and/or individual attorney/consultant performance.*

h. *Please provide a copy of the Company's written policies and guidelines addressing the retention of outside services, and more specifically, professional outside services.*

Response)

a - h. Mark Hite, Vice President Accounting & Interim Chief Financial Officer, is responsible for the work of Burns & McDonnell on the Depreciation Study and for the work of D.R. Eicher and The Prime Group on the Cost of Service and Rate Design Study. Both studies were competitively bid. Copies of the bidder proposals are provided on the CD accompanying these responses. The evaluation worksheet for each study is also provided on the CD. The expertise of D.R. Eicher was utilized solely to assist in drafting the Request For Quotes ("RFQ") for the Cost of Service and Rate Design Study. C. William Blackburn (Chief Financial Officer for Big Rivers at the time of the filing but since having retired from Big Rivers in February 2012) had primary responsibility for the remainder of the consultants and professionals.

Professionals that were not selected through a bidding process were retained because of their institutional knowledge of Big Rivers and their expertise. For example, Big Rivers chose Mr. Spen to testify regarding the credit rating process because of his experience and superior reputation in that area. Hogan Lovells was selected to assist with the case as co-counsel because Big Rivers required additional counsel with expertise in rate-making issues. The attorneys with that firm who performed services in the rate case had long experience with Big Rivers, knew the company well, had previously represented Big Rivers with respect to Midwest ISO issues, had worked as co-counsel with Big Rivers' corporate counsel in the unwind transaction, and had knowledge of the smelter contracts and smelter issues. Because that experience related directly to many of the issues in the rate case, Big Rivers engaged that firm to assist. When the volume of work in the case expanded significantly, primarily due to the hundreds of data requests, the lawyers of that firm enabled Big Rivers to respond in a timely manner. Big Rivers did not hire other Kentucky regulatory counsel for this role because of limited options due to conflicts of interest, lack of expertise in the field, and lack of basic knowledge about Big Rivers and cooperatives in general.

Sullivan, Mountjoy, Stainback & Miller is Big Rivers' regular corporate counsel. That firm is Big Rivers' regular counsel for regulatory matters and had considerable knowledge about and experience with the issues that were involved in the rate case.

The Prime Group was selected because it has extensive experience with cooperative rate-making, experience with regulation in Kentucky, a local presence, experience with Big Rivers in previous proceedings, availability of personnel and rates that were more competitive than out-of-state consulting firms Big Rivers had employed in the past.

The rate case costs attributable to Big Rivers' consultants and professionals were driven by the amount of work that had to be performed, which was heavily impacted by the actions of the intervenors and the Commission, not Big Rivers. Big Rivers did take what steps it reasonably could to monitor and control costs. As the documents filed with Big Rivers' responses to PSC 1-42 and 1-52 show, there were caps on certain tasks performed by Burns & McDonnell and Mr. Spen, and discounts on invoices from Orrick, Herrington & Sutcliffe and Hogan Lovells. Because the Hogan Lovells attorneys were located in Washington, DC, under the terms of Big Rivers' engagement agreement with that firm, Big Rivers was not billed for travel time between Washington and Kentucky.

Big Rivers kept track of rate case expenses, and that information was provided in the record of this case in the form of the updates to Big Rivers' response to PSC 1-52. Those expenses were reflected in various routine management reporting, including the monthly Departmental Actual vs. Budget Variance Reports, the monthly Re-Forecast, the monthly Financial Forecast, and the monthly Financial Report. Big Rivers' management was acutely aware of the magnitude of the outside professional costs being incurred in connection with this case in part because overruns in those expenses were met by deferring or cancelling other budgeted expenditures in order for the company to meet its lender MFIR requirements. The expenses for outside consultants and professionals in the rate case was a topic of regular discussion between and among members of management, at the monthly Internal Risk Management Committee meetings, and at the monthly board of directors meetings.

There is no correspondence or documents involving evaluation of the performance of outside consultants or professionals that has not been filed in the record of this case.

Witness) Mark A. Hite

REHEARING

EXHIBIT ____ (LK-4)

APPLICATION OF BIG RIVERS ELECTRIC CORPORATION
FOR A GENERAL ADJUSTMENT IN RATES
CASE NO. 2011-00036

Response to Kentucky Industrial Utility Customers'
Initial Rehearing Request for Information
dated March 9, 2012

March 22, 2012

Item 1) *Refer to page 8 lines 7-8 of Mr. Hite's Rehearing Testimony regarding the CWIP amount at the end of the test year for which the Company sought depreciation expense.*

a. Please confirm that the Company maintains its accounting books in accordance with Generally Accepted Accounting Principles ("GAAP").

b. Please provide a copy of the Company's most recent audited financial statements along with the auditor's opinion and management's representations that the financial statements comply in all material respects with GAAP.

c. Please identify all loan agreements and/or covenants that require the Company to maintain its accounting books in accordance with GAAP, if any.

d. Please confirm that the Company maintains its accounting books in accordance with the requirements of the RUS Uniform System of Accounts ("USOA").

e. Please provide a copy of the Company's most recent annual Form 7 along with the auditor's opinion and management's representations that the financial statements comply in all material respects with the RUS USOA.

f. Please identify all loan agreements and/or covenants that require the Company to maintain its accounting books in accordance with the RUS USOA, if any.

Response)

a. Yes. As noted in Big Rivers' April 15, 2011, response to Item 13 of the Attorney General's Initial Request for Information, "Big Rivers maintains its books on the basis of the RUS Uniform System of Accounts and GAAP..."

b. Big Rivers' most recent audited financial statements were provided on a CD in Big Rivers' June 24, 2011, supplemental response to Item 8 of the Attorney General's Initial Request for Information. A paper copy was filed in the record on June 29, 2011. The two most recent management letters from external auditors (2009 from Deloitte & Touche and 2010 from KPMG) are attached to Big Rivers' April 15, 2011, response to Item 14 of the Attorney General's initial request for information. As noted in that response, "No recommendations were noted [in those letters] by the external auditors."

c. The following agreements between Big Rivers and its creditors require Big Rivers to maintain its accounting books in accordance with GAAP and USOA:
   i. Indenture;
   ii. Amended and Consolidated Loan Contract;
   iii. CFC Revolving Line of Credit Agreement; and
   CoBank Revolving Credit Loan Facility.

d. Yes. As noted in Big Rivers' April 15, 2011, response to Item 13 of the Attorney General's initial request for information, "Big Rivers maintains its books on the basis of the RUS Uniform

System of Accounts and GAAP..."; and in Big Rivers' March 18, 2011, response to Item 6 of Commission Staff's initial request for information, which states, "Big Rivers' accrual basis accounting policies follow the Uniform System of Accounts prescribed by the Rural Utilities Service ('RUS')...."

e. RUS Form 7 is for distribution cooperatives. Big Rivers, as a generation and transmission cooperative, files the RUS Form 12. Big Rivers' 2010 Annual RUS Form 12 is provided on the CD accompanying these responses. Please see Big Rivers' response to part 1b, above.

f. Please see Big Rivers' response to part 1c, above.

Witness) Mark A. Hite

REHEARING

EXHIBIT ____ (LK-5)

Item 2) *Refer to page 8 lines 9-12 of Mr. Hite's Rehearing Testimony wherein he states that $18,654,607 of the CWIP balance at the end of the test year was in-service.*

a. Were the Company's accounting books in error at the end of the test year for GAAP accounting purposes? Please explain your response and provide a copy of all authorities relied on to support your response.

b. Were the Company's accounting books in error at the end of the test year for RUS USOA accounting purposes? Please explain your response and provide a copy of all authorities relied on to support your response.

c. Please identify and describe the test the Company applied to determine that $18,654,607 of the CWIP balance at the end of the test year was in service for purposes of the Company's rehearing request.

d. Is the test identified and described in response to part (c) of this question for purposes of the Company's rehearing request different in any respect than the test the Company applied for GAAP accounting purposes? If so, then please describe each such difference and how the Company applied this difference so that it resulted in a different result for the rehearing request than the Company recorded on its accounting books.

e. Is the test identified and described in response to part (c) of this question for purposes of the Company's rehearing

request different in any respect than the test the Company applied for RUS USOA purposes? If so, then please describe each such difference and how the Company applied this difference so that it resulted in a different result for the rehearing request than the Company recorded for RUS accounting purposes.

Response)

a. and b. No. When a project has been completed and is performing its intended function, the project manager reports the project as complete and provides the in-service date and a list of retirement units (assets) installed and retired. The project status is changed from active to complete, but remains open to capture any remaining costs that are yet to be received. The project costs are monitored for such additional costs. If, after a few months, no charges have been made to the project and the costs charged are comparable to the estimate, the project is then closed to completed plant and depreciation expense is adjusted retroactive to the in-service date. It is not unusual to have completed projects remain in CWIP for a period of time after completion to ensure all expenditures are captured in the final project cost. Big Rivers' employment of the aforementioned (long-standing) process of closing and transferring CWIP to plant in service has not resulted in a material misstatement of the financial statements and is therefore not inconsistent with USOA and GAAP. Please see Big Rivers' response to KIUC Rehearing 1-1b and e.

c. The "test" applied is the completion date of each project, also referred to as in-service date, as described in the response to parts 2a and 2b, above. When the in-service date is used, a total of $18,654,607 of the 10/31/10 CWIP balance was in service for purposes of Big Rivers' rehearing request. Please see Big Rivers' responses to parts 2a and 2b, above.

d. No.

e. No.

Witness) Mark A. Hite

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

RECEIVED

APR 05 2012

PUBLIC SERVICE
COMMISSION

IN THE MATTER OF:

APPLICATION OF BIG RIVERS ELECTRIC CORPORATION FOR A GENERAL ADJUSTMENT IN RATES	)))	CASE NO. 2011-00036

DIRECT REHEARING

TESTIMONY

AND EXHIBITS

OF

STEPHEN J. BARON

ON BEHALF OF

KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC.

J. KENNEDY AND ASSOCIATES, INC.
ROSWELL, GEORGIA

April 2012

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**

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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**

DIRECT REHEARING TESTIMONY OF STEPHEN J. BARON

I. INTRODUCTION

Q. Please state your name and business address.

A. My name is Stephen J. Baron. My business address is J. Kennedy and Associates, Inc. ("Kennedy and Associates"), 570 Colonial Park Drive, Suite 305, Roswell, Georgia 30075.

Q. Did you previously file testimony in the proceeding?

A. Yes. I filed Direct Testimony and Surrebuttal Testimony in this case.

Q. On whose behalf are you testifying in this proceeding?

A. I am testifying on behalf of Kentucky Industrial Utility Customers, Inc. ("KIUC"), a group of large industrial and Smelter customers of Big Rivers Electric Corporation, ("Big Rivers" or the "Company"). These customers are Alcan Primary Products

Corporation, Century Aluminum of Kentucky, General Partnership, Domtar Paper Co., LLC, Kimberly-Clark Corporation and Aleris International, Inc.

Q. What is the purpose of your testimony?

A. I am providing testimony in support of KIUC's request for rehearing on the apportionment of the Commission approved revenue increase ("Revenue Allocation") to Rural, Large Industrial and Smelter customers. In the Commission's November 17, 2011 Order, the Commission found that the Rural rate class, comprised of residential, commercial and small industrial customers, was receiving annual subsidies (at present rates) of $13.5 million based on the Commission approved 12 CP methodology. The Commission agreed with KIUC that the $13.5 million subsidy should be eliminated, but determined that it should be eliminated gradually and only by $2.4 million in this rate case.

KIUC is requesting that the Commission reconsider its November 17th Order on the revenue allocation issue and require that all subsidies paid to the Rural class be eliminated in this proceeding. As I will discuss in this testimony, there are unique circumstances in this case that make the immediate removal of the Rural subsidy in the best interest of Big Rivers and all customers; not just the Smelters..

II. THE COMMISSION'S DETERMINATION THAT THE RURAL SUBSIDY BE ELIMINATED GRADUALLY IS NOT APPROPRIATE IN THIS SPECIAL CIRCUMSTANCE

Q. Can you briefly summarize the Commission's findings with regard to cost of service?

A. The Commission Order adopted a 12 CP cost study and reflected "the exclusion of Big Rivers' proposed Smelter TIER adjustment" and the inclusion of an adjustment to allocate the $1 million of DSM expenses directly to the Rural rate class. Using this cost of service methodology, the Commission found that the Rural class subsidy was $13.5 million. This subsidy was being paid to Rural by the Smelters.

Q. Did the Commission allocate the approved revenue increase in a manner that would fully eliminate these Rural class subsidies?

A. No. While the Commission agreed with KIUC that the subsidy paid by the Smelters to the Rurals should be eliminated, it determined that it should be done gradually.[1] The Commission reduced the Rural subsidies by $2.4 million from the present rate level of $13.5 million. The Order requires that the Smelters maintain an $11.1 million subsidy payment to the Rural customer class.[2] While the Commission's

[1] See November 17, 2011 Order at 29-30.

[2] The Smelters will make total subsidy payments of $11.7 million, $11.1 million of which goes to the Rural class.

decision reduced the rate gap between the Rural class and the Large Industrial and Smelter classes, Rural customers continue to pay rates significantly below the cost to serve them. Smelter customers thus continue to pay rates in excess of cost of service to fund these continuing Rural subsidies.

Q. Would you please explain the reasons why the Commission should fully eliminate Rural subsidies in this Rehearing Case?

A. There are a number of unique and special circumstances that distinguish Big Rivers from other Kentucky electric utilities that make the elimination of the Rural subsidy urgent and in the best interest of not only the Smelters, but also the Rural customers and Big Rivers. The uniqueness of the Smelters and Big Rivers justifies such a policy (elimination of all Rural subsidies) in this case while preserving the Commission's ratemaking flexibility on revenue allocation in other Kentucky electric utility rate cases.

Q. Would you please discuss the first of the four unique circumstances on the Big Rivers' system supporting the elimination of all Rural subsidies in this case?

A. The first of these unique attributes of the Big Rivers' system is the most important – it is the exceptionally large concentration risk associated with serving the two Smelter customers. The two Smelters constitute 68% of the Big Rivers mWh sales and about 65% of its revenues. This is a highly unique circumstance that does not prevail on any other Kentucky electric utility system. What makes this concentration risk so problematic is that both of the Smelter customers are aluminum smelters whose profitability and survivability is tied directly to the price of aluminum and the cost of the primary production input factor – electricity.

As discussed in the original direct testimony of KIUC witness Henry Fayne, the economic viability of the aluminum smelters on the Big Rivers' system are highly sensitive to the London Metal Exchange ("LME") price of aluminum. It is a straightforward economic fact of life that at a certain LME price, it will simply be uneconomic to continue production. All else being equal the higher the cost of electricity to the Smelters the lower the margin for error. If the LME aluminum price drops and a primary input factor (electricity) in the Smelting process increases, the risk of failing to maintain economic viability increases. While the Commission cannot control the LME price the Commission does have complete control over its public policy determinations with regard to imposing charges on the Smelters to subsidize Rural residential, commercial and small industrial customers.

Q. How does the Commission's imposition of a subsidy charge to the Smelters increase the overall concentration risk on the Big Rivers' system?

A. The imposition of millions of dollars of subsidy charges in the Smelter rates has two effects. First, since it raises the cost of electricity to the Smelters, it increases the potential for the Smelters to become uneconomic, for any given level of LME price. This means that the inclusion of these subsidies contributes to the potential loss of the Smelter load and revenues to the Big Rivers' system. The consequences of this loss would be borne entirely by Big Rivers and its remaining customers. The second consequence of this subsidy policy is that it increases the overall concentration risk by recovering a greater proportion of overall system revenues from two customers who have relatively similar production processes and cost structures and who are driven by the same basic input factors (labor and electricity).

Q. You discussed the added risk to Smelter economic viability from drops in the LME aluminum price. What is the recent history of the LME price?

A. As reported by KIUC witness Henry Fayne, the LME aluminum price was $2,500 per metric ton at the time of the filing of his original direct testimony in this case.[3] Today, the LME aluminum price has fallen to $2,081 per metric ton, a $419 per ton (17%) drop [see Baron Exhibit__(SJB-1)], and has fallen to as low as $1,950 per ton since the Commission's November 17, 2011 Order. This LME aluminum price drop occurred at the same time that a significant Smelter production cost (electricity) increased as a result of the Commission ordered revenue allocation in this case. While I am not attempting to predict the level of future LME aluminum prices, the volatility of these prices contributes significantly to the risk of uneconomic operation

[3] Fayne Direct Testimony at page 10.

for the Smelters (all else being equal). When combined with the Smelter concentration risk on the Big Rivers' system, the LME aluminum price volatility increases the overall risk of adverse rate and financial consequences for Big Rivers and its remaining customers. Compounding this problem by requiring the Smelters to make non-cost based subsidy payments to the Rural rate class is not an optimal ratemaking policy. Again, this is a unique circumstance that exists on the Big Rivers' system that is not present on other Kentucky electric utility systems.

Q. How would the loss of the Smelter loads impact Rural customers?

A. KIUC provided evidence through its witnesses Dr. Mathew J. Morey and Henry Fayne that if the Smelters were to curtail operations the rate impact on Rural customers would be staggering. According to Dr. Morey, the net margin contribution from the Smelters averages $162 million per year.[4] Absent sales to the Smelters, Big Rivers would need to seek replacement revenues through a similar level of sales within regional wholesale markets. Thus, the issue is whether Big Rivers, as a merchant generator, could achieve a level of margin contribution from off-system sales in the wholesale energy market equivalent to the margin it receives from the Smelters.

[4] Morey Direct Testimony at p. 16.

Dr. Morey's analysis concludes that due to high operating costs at some Big Rivers' plants and the frequently low locational marginal price ("LMP"), Big Rivers would only manage to sell into the wholesale market an average of about 4.2 million MWh per year of the 7.3 million MWh per year of lost Smelter sales. Dr. Morey concludes that Big Rivers' margins would deteriorate by approximately $83 million per year if the Smelters shut down and Big Rivers were forced to sell the excess energy in the wholesale market.[5] Making up the shortfall would have to be borne by the remaining, primarily Rural customers whose rates would increase by more than 55%.[6]

Q. Given the predicted 55% rate increase that Rural customers would experience if the Smelters were to shut down operations, is it in the best interest of Rural customers for the Smelters to pay them a rate subsidy?

A. No. The subsidy paid to the Rural class by the Smelters is penny-wise and pound-foolish from the perspective of Rural customers. It may currently save the Rural class a small amount on each bill, but it puts the Smelters at significantly greater risk of shutting down. If such a scenario were to take place, the Rural customers would suffer tremendous financial harm, that would far exceed any benefit they currently receive from the subsidy paid by the Smelters.

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[5] Morey Direct Testimony at pp. 4-5.

[6] Fayne Direct Testimony at p. 12.

Q. Is the Rural subsidy necessary to prevent Big Rivers' Rural customers from paying high electric rates relative to customers served by other utilities?

A. No. Big Rivers' Rural residential rates are relatively low compared to other Kentucky electric utilities. Based on data provided in this case (KIUC Cross Exhibit 10, based on December 2010 data), Big Rivers' proposed Rural residential rates were among the lowest rates in Kentucky and significantly lower than the national average residential rate.

Q. Does this remain the case today?

A. Yes. Based on the most recent U.S. Energy Information Administration ("EIA") data, Kentucky residential rates in 2011 ranked 7th lowest in the nation [see Baron Exhibit__(SJB-2)] at 9.09 cents/kWh. Following the Commission authorized increase in this case, residential customers on the Kenergy system (one of the two Big Rivers' members) paid average rates of 7.9 cents/kWh. The fact that Big Rivers' Rural residential rates are among the lowest in Kentucky and that Kentucky residential rates are among the lowest in the nation provides additional support to KIUC's recommendation to fully eliminate Rural subsidies in this case.

Q. Does the existence of the Rural Economic Reserve ("RER") provide an even greater assurance that Big Rivers' Rural customers will continue to enjoy relatively low electric rates even if the subsidy is eliminated in this case?

A. Yes. Big Rivers' Rural customers are in a unique and favorable position given the existence of the RER that provides a future cushion for rural residential and small business customers from the impacts of higher electric rates. The Commission established the RER in its Order in Case No. 2007-00455 for the purpose of providing rate mitigation for Rural customers. The Commission Order intended that the fund be used to mitigate the impact of future FAC and Environmental Surcharge increases for the sole benefit of Rural rate class customers. Based on Big Rivers' response to KIUC 1-64, the balance in the RER fund was expected to be $63 million by September 2011 (this is equivalent to about 7 months of no cost electric service from Big Rivers to the Rural class).

The RER is expected to begin to mitigate Rural residential and small business rates in 2015 and continue until early 2018. While the Commission rejected KIUC's original proposal to specifically utilize a portion of the RER to offset the elimination of Rural subsidies, the RER will continue to be available in the future to mitigate the effects of higher electric rates to Rural customers through its intended operation.

The RER's rate mitigation benefit to Rural customers provides a unique cushion against the impact of future rate increase for these smaller customers that does not exist on other Kentucky electric utility systems. No other Kentucky electric utility has such a residential and small business customer rate mitigation mechanism.

Q. Does your recommendation to fully eliminate the Rural subsidies in this case create a policy precedent for the Commission that would be applicable in other Kentucky electric utility rate cases?

A. No. The Rural subsidies, to the extent that it increases the unprecedented level of concentration risk associated with the two Smelter customers may only temporarily lower rates to the Rural rate class if it ultimately causes the loss of either or both of the Smelter customers. This is a unique circumstance in Kentucky that only applies to Big Rivers and therefore any Commission precedent adopted in this case regarding the elimination of subsidies can easily be distinguished on a policy basis from other utilities regulated by the Commission (LGE, KU, KPCo, East Kentucky Cooperative). This will not set an adverse precedent for Commission policy in other Kentucky utilities because there are no other utilities in which a failure to eliminate subsidies (and reduce and mitigate large industrial rates) could ultimately result in higher rates, and potentially much higher rates through the loss of 65% of the utility's revenues in the event that two single customers shut down.

In this unique case, the Commission should adopt a public policy that reduces concentration risk and the related cost consequences by fully eliminating the Rural subsidies.

Q. What is your specific recommendation in this Rehearing Case on revenue allocation?

A. I am recommending that all of the remaining Rural rate class subsidies be eliminated in this proceeding. Table 1 shows the adjustments to the Commission Ordered rate class revenue increases to accomplish this Rural subsidy elimination.

Table 1
Big Rivers Electric Corporation
KIUC Recommended Revenue Allocation to Remove Rural Subsidies

	Total System	Rurals	Large Industrials	Smelters
Rate Base - Commission Adjusted 12 CP	1,175,239,849	360,953,693	99,688,642	714,597,513
Net Utility Operating Margin	31,612,553	(3,825,556)	2,453,136	32,984,973
Return on Rate Base	2.69%	-1.06%	2.46%	4.62%
Subsidy at Present Rates	-	(13,534,781)	(228,370)	13,763,150
Total Increase Approved	26,744,776	10,597,930	1,969,615	14,177,231
Income at Proposed Rates	58,357,329	6,772,374	4,422,751	47,162,204
Return on Rate Base - Proposed Rates	4.97%	1.88%	4.44%	6.60%
Subsidy at Proposed Rates	-	(11,151,026)	(527,355)	11,678,381
Revenue Increase to Eliminate Rural Subsidies	-	11,151,026	(1,360,218)	(9,790,808)
KIUC Recommended Revenue Allocation	**26,744,776**	**21,748,955**	**609,397**	**4,386,423**
Income at KIUC Recommended Rates	58,357,329	17,923,400	3,062,533	37,371,396
Return on Rate Base - KIUC Recommended Rates	4.97%	4.97%	3.07%	5.23%
Subsidy at KIUC Recommended Rates	-	-	(1,887,573)	1,887,573

Q. Table 1 shows that the Rural class subsidies have been eliminated, but the Large Industrial subsidies continue. Would you explain why this occurs?

A. Because of the contractual linkage between the Smelter rates and the Large Industrial rates, pursuant to the Smelter Agreements, it is necessary for the Smelters to continue paying subsidies to the Large Industrial class. However, as shown in Table 1, the subsidies paid by the Smelters have been reduced from $13.8 million to $1.9 million.

III. THE COMMISSION'S ORDER UNINTENTIONALLY ASSIGNS A PORTION OF RURAL DSM COSTS TO THE SMELTERS

Q. Are there any additional issues that you would like to address that support the elimination of all Rural subsidies in this case?

A. The Commission Order clearly states that it is the Commission's intention to assign 100% of the test year DSM expense ($1,000,000) allowed by the Commission in this case to the Rural rate class that will receive the benefits of such programs, and none of these costs to the Smelters or the Large Industrial Class.[7] While I agree that all of the DSM expenses should be assigned to the Rural rate class, the Commission's Order does not fully accomplish its own stated objective.

Specifically, while the Commission has adjusted Big Rivers' class cost of service study to directly assign 100% of the $1 million in DSM expense to the Rural rate class, this specific assignment is only effective in the event that the Rural rate class actually pays its full cost of service without subsidies. As I discussed previously, the Commission Order does not fully eliminate the subsidies received by the Rural class. The Rural class continues to receive $11.1 million in subsidies (see Table 1), which means that the Rural class is not paying 100% of all of the costs for which it is

[7] Commission Order of November 17, 2011 at page 22; "For that reason, in allocating the revenue increase granted herein, we will incorporate an adjustment to ensure that none of the $1 million will be recovered from the Smelters. Also at page 29; "the Commission will make an adjustment to reflect the assignment of the full $1 million cost for Big Rivers' energy efficiency programs to the Rural rate class."

responsible (including, by definition, 100% of the DSM expenses assigned by the Commission). While the cost of service study cannot tell us specifically which costs the Rural rate class is not paying, it is reasonable to assume that the $11.1 million in subsidies (the amount by which rates are under-recovering cost of service) is proportionately distributed among all categories of cost, including the DSM expenses. As a result, by virtue of the Rural class not paying all of its assigned costs, the Commission Order results in a portion of DSM expenses being paid by the Smelter class (the Large Industrial class, as shown in Table 1, is also receiving a small amount of subsidy payments).

This inconsistency is easily cured. First, if the Commission eliminates the Rural subsidy per KIUC's request, the issue regarding the allocation of DSM expenses will fix itself because it is the subsidy that is causing the misallocation of DSM expenses. Or second, DSM charges can be recovered from the Rurals through a surcharge mechanism. This would directly assign the responsibility of these costs to the class of customers identified in the Commission's Order.

Q. In the event that the Commission authorizes an additional revenue increase for Big Rivers (above the $26,744,776 amount), how should this additional increase be allocated among rate classes?

A. If the Rural subsidy is eliminated entirely as I am recommending, then any additional revenue increase should be allocated proportionately to all rate classes. If the Rural class subsidy is not fully eliminated, then any additional increase should be assigned to the Rural class, in order to not make the subsidy paid by the Smelters even greater.

Q. Does that complete your testimony?

A. Yes.

AFFIDAVIT

STATE OF GEORGIA)

COUNTY OF FULTON)

STEPHEN J. BARON, being duly sworn, deposes and states: that the attached is his sworn testimony and that the statements contained are true and correct to the best of his knowledge, information and belief.

Stephen J. Baron

Stephen J. Baron

Sworn to and subscribed before me on this 3rd day of April 2012.

Jessica K. I

Notary Public

JESSICA K INMAN
MY COMMISSION EXPIRES
NOTARY
PUBLIC
JULY 31, 2015
CHEROKEE COUNTY, GEORGIA

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

REHEARING CASE

EXHIBITS

OF

STEPHEN J. BARON

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

IN THE MATTER OF:

APPLICATION OF BIG RIVERS	)	
ELECTRIC CORPORATION FOR A	)	**CASE NO. 2011-00036**
GENERAL ADJUSTMENT IN RATES	)	

REHEARING CASE

EXHIBIT__(SJB-1)

OF

STEPHEN J. BARON

LONDON METAL EXCHANGE

10.26 (local) 3 Apr 2012

LME Aluminium

Welcome to the **LME Aluminium** hub page. In this useful section of the site you will find information relating to the LME's largest traded contract. For convenience, settlement prices, opening stocks and the forward price curve for Aluminium are detailed below. From this page you can also navigate to the LME Aluminium contract specification, details of the Aluminium committee members, consumption and production information, and current listed brands.

LME Official Prices (US$/tonne) for 2 Apr 2012

ALUMINIUM	Prompt Date	Buyer ($)	Seller ($)
Cash	04/04/2012	2,081.00	2,081.50
3 Months	02/07/2012	2,121.00	2,121.50
December 1	18/12/2013	2,265.00	2,270.00
December 2	17/12/2014	2,353.00	2,358.00
December 3	16/12/2015	2,420.00	2,425.00
15 Months	17/07/2013	2,228.00	2,233.00
27 Months	16/07/2014	2,318.00	2,323.00

Register free on for current calendar year historical LME ALUMINIUM Price Data

LME Official Settlement Price

ALUMINIUM	PROMPT	SELLER
Cash	04/04/2012	$2,081.50

LME Asian Benchmark for 22/03/2012

ALUMINIUM	22/06/2012	$2203.6

LME Official Opening Stock (in tonnes)

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

REHEARING CASE

EXHIBIT__(SJB-2)

OF

STEPHEN J. BARON

Energy Information Administration Residential Electric Rates - Average 2011 Rate by State

Year	Month	State	Avg. Residential (c/kWh)
2011		ID Total	7.90
2011		WA Total	8.33
2011		ND Total	8.56
2011		UT Total	8.97
2011		AR Total	9.05
2011		LA Total	9.06
2011		KY Total	9.09
2011		WY Total	9.14
2011		NE Total	9.30
2011		SD Total	9.34
2011		WV Total	9.40
2011		OK Total	9.51
2011		OR Total	9.60
2011		MT Total	9.77
2011		MO Total	9.78
2011		TN Total	9.83
2011		IN Total	10.06
2011		MS Total	10.14
2011		NC Total	10.29
2011		IA Total	10.50
2011		KS Total	10.63
2011		VA Total	10.68
2011		MN Total	10.97
2011		NM Total	11.04
2011		GA Total	11.07
2011		AZ Total	11.07
2011		SC Total	11.13
2011		CO Total	11.26
2011		TX Total	11.27
2011		AL Total	11.30
2011		OH Total	11.44
2011		NV Total	11.61
2011		FL Total	11.67
2011		IL Total	11.81
2011		WI Total	13.06
2011		MI Total	13.12
2011		PA Total	13.38
2011		DC Total	13.40
2011		MD Total	13.44
2011		DE Total	13.74
2011		RI Total	14.45
2011		MA Total	14.82
2011		CA Total	15.24
2011		ME Total	15.41
2011		NJ Total	16.24
2011		VT Total	16.28
2011		NH Total	16.54
2011		AK Total	17.57
2011		CT Total	18.11
2011		NY Total	18.30
2011		HI Total	34.68
2011		US Total	11.80