COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

BIG RIVERS ELECTRIC CORPORATION'S NOTICE OF CHANGES IN RATES AND TARIFFS FOR WHOLESALE ELECTRIC SERVICE	)))	CASE NO. 10265

O R D E R

INTRODUCTION

On June 30, 1988, Big Rivers Electric Corporation ("Big Rivers") filed its application with the Commission requesting authority to increase its rates for service rendered on and after August 1, 1988. The proposed rates would increase Big Rivers' annual revenues by $11,372,391, an increase of 4.37 percent over normalized revenues.

On July 26, 1988, the Commission issued a Procedural Order suspending the proposed increase in rates for a period of 5 months, until January 1, 1989, in order to conduct public hearings and investigations into the reasonableness of the proposed rates. A hearing was scheduled for October 24, 1988 for the purpose of cross-examination of the witnesses of Big Rivers and the intervenors. Big Rivers was directed to give statutory notice to its consumers of the proposed rate increase and of the scheduled hearing pursuant to 807 KAR 5:011, Section 8.

The Commission granted Motions to Intervene filed by the Utility and Rate Intervention Division of the Office of the Attorney General ("AG"); National-Southwire Aluminum Company ("NSA");

Henderson-Union Rural Electric Cooperative Corporation ("Henderson-Union"); Green River Electric Corporation ("Green River"); Alcan Aluminum Corporation ("Alcan"); and Willamette Industries Incorporated ("Willamette"). Testimony by Maurice J. Brubaker for Alcan and the comments of NSA were filed on September 19, 1988. No other intervenors filed testimony in this proceeding and on October 24, 1988, Big Rivers filed the Rebuttal Testimony of Paul A. Schmitz.

The hearing was conducted in the Commission's offices in Frankfort, Kentucky on October 24 and 25, 1988. Big Rivers, NSA, and Alcan filed initial briefs on November 18, 1988 and reply briefs on December 2, 1988. Information requested during the hearing has been submitted.

Big Rivers is a non-profit cooperative corporation engaged in the generation, transmission, and sale of electricity, through 4 distribution cooperatives to approximately 78,000 customers in 22 western Kentucky counties. Big Rivers derives 68 percent of its member revenues from 2 industrial customers, NSA and Alcan, each operating an aluminum smelter.

BACKGROUND

On August 10, 1987, the Commission issued its Order in Case No. 9885, An Investigation of Big Rivers Electric Corporation's Rates for Wholesale Electric Service. In that Order, the Commission, among other things, approved a debt restructuring plan between Big Rivers and its major creditors; instituted a Variable Aluminum Smelter Rate ("Variable Rate") for NSA and Alcan;

approved the first step of Big Rivers' suggested three step rate increase; and required Big Rivers to file subsequent rate proposals on or before July 1, 1988 and July 1, 1990. Big Rivers subsequently filed an application seeking approval of a Debt Restructuring Agreement ("Restructuring Agreement"), and authorization and approval to execute necessary evidences of indebtedness. The application was docketed as Case No. 10217, Big Rivers Electric Corporation's Application for Approval of Restructuring Agreement and for Authority to Issue Notes or Other Evidences of Indebtedness Pursuant Thereto. The Restructuring Agreement was executed to implement the debt restructuring plan approved in Case No. 9885. The Commission reviewed the Restructuring Agreement, determined that it was in substantial conformity to the debt restructuring plan, and approved it and authorized the evidences of indebtedness on July 1, 1988.

DISCUSSION

The rates that Big Rivers has requested in this proceeding are the second step of the three step increase it suggested in Case No. 9885. These rates are also identical to those set forth in the Restructuring Agreement. Big Rivers has requested to increase its monthly demand charge from $7.50 per kilowatt ("kw") to $8.80 per kw. The aluminum smelter delivery points, at which power is supplied to NSA and Alcan, are billed separately under the Variable Rate. Big Rivers has also requested to increase to $8.80 per kw the demand charge incorporated into the Variable Rate. As established by the Commission in Case No. 9885, the

Variable Rate has a 10-year term and is subject to no adjustments, other than for the demand charge, prior to Big Rivers' rate filing on July 1, 1990.

The proposed increase in demand charge in the Variable Rate, if approved by the Commission, will result in increased billings to Alcan, but not NSA. As explained by Alcan's witness, Mr. Brubaker, the Variable Rate "includes the entire demand charge if Alcan is operating at an annual load equal to contract demand and at a 99 percent load factor."[1] Since Alcan's actual load is 50 megawatts less than its contract demand, and its load factor is only 97 percent, a portion of any increase in the demand charge will be borne by Alcan. NSA's high level of operations, however, will insulate it from the financial effects of any such increase.[2]

Alcan opposes Big Rivers' rate increase on the basis that the existing rates now produce revenues substantially greater than necessary to meet the Minimum Government Debt Service Schedule incorporated into the Restructuring Agreement.[3] Alcan argues that it and NSA have provided revenues far in excess of those anticipated in Case No. 9885, and they have prepaid, for all of the ratepayers, enough revenue to obviate the need for the requested second step rate increase.

---

1 Brubaker Prefiled Direct Testimony, page 3.

2 NSA Comments, page 1.

3 Alcan Brief, page 2.

The Commission finds Alcan's argument lacking in merit. In establishing the Variable Rate in Case No. 9885, the Commission expressly recognized that in times of high aluminum prices, the Variable Rate could generate enough revenue to allow Big Rivers to satisfy the minimum debt service schedule and pay additional interest and principal. Conversely, in times of low aluminum prices, it is likely that Big Rivers will not be able to satisfy the minimum debt service schedule. It was for these very reasons that the Commission stated in Case No. 9885, that it would subsequently review the extent to which the revenues from Alcan and NSA have enabled Big Rivers to meet its debt service obligations. The Commission further stated that if this review demonstrates that the revenues collected from the smelters are higher than Big Rivers needs, the Variable Rate will be reviewed, in conjunction with Big Rivers rate filing on July 1, 1990, with a view to making an appropriate adjustment.

Arguments by NSA and Alcan to encourage the Commission to review the parameters of the Variable Rate in this proceeding are premature. The Variable Rate and debt restructuring plan have been in effect for only 15 months. When established in Case No. 9885, the rate formula was based on the projection that the average price of aluminum would be 62 cents per pound over the next 10 years. Generalizations drawn from the high aluminum prices during the past 15 months cannot be regarded as indicative of a trend. It is the accumulation of early payments in excess of the minimum required debt service that will enable Big Rivers to avoid a default during later periods of low aluminum prices and diminished revenues from NSA and Alcan. Further, although aluminum prices have been higher than projected, the Variable Rate is capped when aluminum prices exceed 80 cents per pound. Consequently, all of the current benefits resulting from aluminum prices being above 80 cents are retained by NSA and Alcan. None of these benefits are shared with Big Rivers.

The Variable Rate is to be in effect through 1997. It was designed to produce sufficient revenues, over time, to insure the continued financial stability of Big Rivers while simultaneously protecting the viability of NSA and Alcan during periods of low aluminum prices. The Commission is encouraged by the current high level of aluminum prices, which has contributed to the smelters' profitability and enabled Big Rivers to make additional interest and principal payments above the minimum required. However, the Commission recognizes that aluminum prices are projected to fluctuate over time. Alcan's witness in this case declined to make a projection of future aluminum prices.[4] In Case No. 9885, other expert witnesses on the aluminum industry all warned of the volatility of aluminum prices. That volatility, alone, is a factor which makes the Restructuring Agreement fragile and subject to short-term swings in Big Rivers' cash flow.

The Commission finds that, based on Big Rivers' projections of its annual cash flows, the need for the requested rate increase is clearly demonstrated. A 5-year projection of cash flow for the period 1988-1992 indicates that, without the second step rate

---

4 Hearing Transcript Vol. I, October 24, 1988, page 146.

increase, total cash flow is reduced by $16.4 million.[5] Even with the requested rate increase, the projected cash flows indicate that Big Rivers must rely upon its $10 million cash working capital reserve to avoid a default under the Restructuring Agreement.[6] Consequently, it will not be possible for Big Rivers to pay its debts as restructured without the additional cash flow that will be generated by the requested rate increase.

Absent the requested rate increase, Big Rivers could be subject to creditor claims of default and, ultimately, foreclosure proceedings. Big Rivers would then be faced with the same financial disaster and potential for disruption of electric service that it averted just last year by negotiating a debt restructuring plan. The second step rate increase is required to insure Big Rivers' financial integrity and avoid a default under the Restructuring Agreement.

While the Commission finds that Big Rivers' need for the rate increase is fully justified based on its projected 5-year cash flows, a detailed review of the proposed rate case adjustments has also been conducted. These adjustments have been fully considered in arriving at the decision to grant the rate increase. The Commission notes that several of Big Rivers' adjustments to revenues and expenses have been calculated by utilizing methodologies that differ from those traditionally adopted by the

---

5 Schmitz Rebuttal Testimony, pages 6-8.

6 Id.

Commission. None of the adjustments has been modified, however, due to Big Rivers' need for the full rate increase.

Future Rate Increases

The intervenors have argued that the Commission should consider, in this proceeding, the changed circumstances that have affected Big Rivers' financial condition. The Commission is of the opinion that the nature of the current economic changes may be relatively short-term and they do not negate the need for the second step rate increase. However, should any factors materially change for the long run, the third step rate increase specified in the Restructuring Agreement may not be the optimal rate level for Big Rivers to request in 1990. It will be incumbent upon Big Rivers to look closely at financial data, including updated forecasts of revenues and expenses, and consider whether the third step increase is necessary, insufficient, or excessive. Dependent upon the results of that review, Big Rivers may need to propose rates that differ from the third step contained in the Restructuring Agreement.

Financial Forecast

Big Rivers' projected cash flows were derived from its financial forecast that was provided in response to the Commission's Second Information Request in Case No. 10217, Item No. 9(b). Although this forecast was based on projected operations for calendar year 1987, Big Rivers stated in this case that this was its most recent forecast. Based on a comparison of its 1987 projected operations with its actual experience, Big Rivers indicated that this forecast was still valid for determining the availability of cash flow to satisfy the requirements of the Restructuring Agreement.[7] The Commission recognizes that this type of financial forecast is an essential element to be reviewed when monitoring Big Rivers' financial progress. Therefore, Big Rivers should update its forecast annually to reflect the results of its 1988, and then 1989, operations. These 2 annual forecasts should be filed with the Commission within 90 days after the end of the year. The forecast should be based on current operations and reflect any changes in price or changes in the assumptions or other factors supporting the forecast. All assumptions, including those concerning off-system sales, should be clearly explained and be based on the most current information available to Big Rivers. These forecasts will be utilized only for financial monitoring purposes. In addition to these two forecasts, a third forecast should be filed with Big Rivers' next rate application based on the adjusted test-year financial statements.

Cost Savings Measures

Big Rivers provided details of a number of the measures implemented to control costs. While the Commission is encouraged by Big Rivers' actions, we recognize that continued efforts to control costs are necessary if Big Rivers is to satisfy the requirements of the Restructuring Agreement without rate increases in excess of those contained in the Restructuring Agreement.

---

7 Big Rivers' Response to Commission Data Request dated August 4, 1988, Item 23.

Therefore, the Commission puts Big Rivers on notice that in its next rate case it will be required to fully document all cost savings measures implemented since the date of this Order and project the dollar impact of each measure.

SUMMARY

In this proceeding, Big Rivers has demonstrated its need for the requested rate increase. Although the proposed rates are below Big Rivers' full cost of service, they are projected to produce sufficient revenues to allow Big Rivers to satisfy its financial obligations under the Restructuring Agreement and thereby avoid a default. The Commission intends to keep the Restructuring Agreement on course to preserve Big Rivers' financial integrity. As stated in Case No. 9885, the Commission will continue to monitor Big Rivers' financial condition and review the equity of the Variable Rate following the July 1, 1990 rate filing. Therefore, the Commission finds that the rate increase requested by Big Rivers is necessary and should be approved. The rates in Appendix A are the rates proposed by Big Rivers and they are fair, just, and reasonable rates to be charged by Big Rivers for service rendered.

IT IS THEREFORE ORDERED that:

1. The rates in Appendix A, which are those proposed by Big Rivers, be, and they hereby are, approved for service rendered by Big Rivers on and after January 1, 1989.

2. Big Rivers shall file a current, updated financial forecast within 90 days following the end of calendar years 1988 and 1989, and an additional forecast with its next rate application.

3. Big Rivers shall fully document its cost saving efforts and project the dollar effect of such efforts in its next rate case.

4. Within 30 days from the date of this Order, Big Rivers shall file with this Commission its revised tariff sheets setting out the rates approved herein.

Done at Frankfort, Kentucky, this 21st day of December, 1988.

PUBLIC SERVICE COMMISSION

Chairman

Robert M. Davis

Vice Chairman

Commissioner

ATTEST:

Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 10265 DATED 12/21/88

The following rates and charges are prescribed for the customers in the area served by Big Rivers Electric Corporation. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of this Commission prior to the date of this Order.

Rate Schedule:

Monthly Delivery Point Rate:

(1) Demand Charge of:

All KW of billing demand at $8.80 per kilowatt.

(2) Plus an Energy Charge of:

All KWH per month at $.017755

6. VARIABLE ALUMINUM SMELTER RATE:

c. Rate:

(1) Initial Rate Charges Subject to Adjustments:

The following rates shall apply to sales for resale to primary aluminum smelter customers that purchase power under the variable aluminum smelter power rate schedule.

(a) Base Variable Aluminum Smelter Rate:

1. Demand Charge: $8.80 per kilowatt of contract demand