COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF BIG RIVERS ELECTRIC CORPORATION FOR A DECLARATORY ORDER	)))	CASE NO. 2016-00278

ORDER

On July 29, 2016, Big Rivers Electric Corporation ("Big Rivers") filed an application seeking an order declaring that the rate and service standards under Big Rivers' existing Power Sales Contract with the City of Henderson, Kentucky, and City of Henderson Utility Commission (jointly "Henderson"), as amended, require Henderson to be responsible for the variable production costs of any Excess Henderson Energy generated by Henderson's Station Two Generating Station ("Station Two"), as that term is defined in the Power Sales Contract, that Big Rivers declines to take and utilize.[1] In the alternative, Big Rivers requests an order pursuant to KRS 278.030 and KRS 278.200 finding that the Power Sales Contract is unfair, unjust, and unreasonable unless Henderson is deemed to be responsible for the variable costs of Excess Henderson Energy that Big Rivers declines to take and utilize, and declaring that Henderson is responsible for such variable costs.[2]

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[1] Big Rivers Application at 1.

[2] *Id.*

On August 5, 2016, the Commission issued an Order, pursuant to 807 KAR 5:001, Section 19(8), establishing a procedural schedule in this matter. The procedural schedule provided for a deadline to request intervention, two rounds of discovery upon Big Rivers, an opportunity for any intervenor to file testimony, discovery upon intervenor testimony, and an opportunity for Big Rivers to file rebuttal testimony. Pursuant to an Order issued on August 24, 2016, Henderson was granted intervention in this matter. An evidentiary hearing was held on February 7, 2017. Big Rivers filed responses to post-hearing data requests on February 16, 2017. Big Rivers filed its post-hearing brief on February 28, 2017. Henderson filed its post-hearing response brief on March 14, 2017. Big Rivers filed a post-hearing reply brief on March 21, 2017. At the parties' requests, the matter was held in abeyance so that the parties could engage in settlement discussions to resolve the issues involved herein. While the parties were able to reach an informal settlement, they were unable to produce a document formalizing their agreement. The matter now stands submitted to the Commission for a decision.

BACKGROUND

Big Rivers is a member-owned rural electric generation and transmission cooperative organized pursuant to KRS Chapter 279. As a rural electric cooperative, Big Rivers "shall be subject to all the provisions of KRS 278.010 to KRS 278.450 inclusive, and KRS 278.990."[3] Big Rivers owns and operates generating assets, and purchases, transmits, and sells electricity at wholesale. Its three distribution cooperative member-owners, Jackson Purchase Energy Corporation, Kenergy Corp., and Meade County

[3] KRS 279.210(1).

Rural Electric Cooperative Corporation, sell electricity to approximately 114,000 retail customers in 22 western Kentucky counties.

Henderson owns Station Two, which is a two-unit coal-fired electric generating station with a total capacity of 312 megawatts ("MW").[4] Big Rivers operates and maintains Station Two under a series of contracts that originally were executed on August 1, 1970, and that have since been amended.[5] One of those contracts is the Power Sales Contract, which sets forth the methodology for allocating the Station Two capacity between Henderson and Big Rivers. Specifically, under the Power Sales Contract, Henderson each year elects a portion of Station Two's 312 MW to be reserved to it for serving the City of Henderson and its inhabitants by way of a rolling five-year reservation methodology.[6] After electing its reserved capacity, Henderson then allots the balance of the capacity of Station Two to Big Rivers.[7] Big Rivers is then entitled to, and obligated to pay the capacity charges for, the allotted Station Two capacity.[8]

Henderson's reserved capacity for the 2016–2017 contract year is 115 MW and Big Rivers' allotted capacity share is 197 MW.[9] Big Rivers and Henderson are separately responsible for the variable costs associated with the energy each of them uses in a given hour, including the obligation that each party must replace at its cost all

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[4] Application at 5.

[5] *Id.*

[6] *Id.* at 7.

[7] *Id.*

[8] *Id.*

[9] *Id.*

fuels, reagents, and sludge disposal consumed in producing the energy used by that party.[10]

Under the 1998 amendments to the Power Sales Contract, a provision was added to address the situation in which Henderson takes less energy than is actually available to Henderson under its reserved capacity in any given hour. The term Excess Henderson Energy is defined in Section 3.8(a) of the 1998 amendments and provides, in full, as follows:

> Big Rivers and City hereby agree that the following provisions shall apply to energy from capacity not utilized by City or from capacity in excess of the capacity calculated in accordance with Section 3.6 of this Agreement.
>
> (a) In the event that at any time and from time to time City does not take the full amount of energy associated with its reserved capacity from Station Two (determined in accordance with this Agreement), Big Rivers may, at its discretion, take and utilize all such energy (or any portion thereof designated by Big Rivers) not scheduled or taken by City (the "Excess Henderson Energy"), in accordance with Section 3.8(c).

Big Rivers asserts that the central issue in the dispute over the Excess Henderson Energy is whether Big Rivers is responsible for the variable costs associated with Henderson's Excess Henderson Energy that Big Rivers does not take and utilize.[11] From July 15, 1998, the effective date of the 1998 amendments to the Power Sales Contract, until June 1, 2016, Big Rivers elected to take the Excess Henderson Energy even when it was uneconomic to do so.[12] However, by letter dated May 25, 2016, Big

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[10] *Id.*

[11] Direct Testimony of Robert W. Berry ("Berry Testimony") at 6.

[12] *Id.*

Rivers notified Henderson that after June 1, 2016, Big Rivers may, at its discretion, decline to take Excess Henderson Energy, particularly during those times when the cost to generate the energy is higher than the cost of energy in the Midcontinent Independent System Operator ("MISO") wholesale power market.[13] The Big Rivers' letter also notified Henderson that if Big Rivers did not take any Excess Henderson Energy, Big Rivers also would not be responsible for the variable costs associated with the production of that energy.[14] Big Rivers notes that there has been a significant increase in the number of hours in which Station Two is not competitive in the MISO energy market, due to recent competition from natural gas generating units and other market forces.[15] For the period from June 1, 2016, through October, 31, 2016, Big Rivers states that the variable production costs associated with the unwanted Excess Henderson Energy total $3,888,843, compared to revenues produced by such energy of only $2,818,628.[16] Big Rivers contends that Section 3.8 of the 1998 amendments gives Big Rivers the option, but not the obligation, to take and utilize all or any portion of the Excess Henderson Energy that Henderson chooses not to take.[17] Big Rivers further contends that, under the 1998 amendments, it is not required to replace the fuel and reagents or pay the sludge disposal costs for the Excess Henderson Energy that Big Rivers does not take.[18]

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[13] *Id.*

[14] *Id.*

[15] Berry Testimony at 10.

[16] Rebuttal Testimony of Robert W. Berry ("Berry Rebuttal") at 5–6.

[17] Berry Testimony at 8–9.

[18] *Id.*

Henderson interprets Excess Henderson Energy, as provided in Section 3.8 of the 1998 amendments, as energy which is within Henderson's reserved capacity and which is not scheduled or taken by Henderson.[19] Thus, it is Henderson's contention that Excess Henderson Energy is that energy which Henderson, for whatever reason, has neither scheduled or taken for the use of the City of Henderson and its inhabitants, nor scheduled or taken by Henderson for sale to third parties.[20] Henderson contends that Excess Henderson Energy is a defined contractual term and should not be confused with mere "excess" or "surplus" energy, which is that energy which exceeds the amount Henderson needs to serve its native load in a given period of time, but is equal to or less than the amount of energy associated with Henderson's reserved capacity for that given time period.[21] According to Henderson, in the event that Henderson's reserved capacity is used to generate energy above Henderson's native load, the energy above native load does not become Excess Henderson Energy until and unless Henderson elects to either not schedule or not take the energy for its own use, or offer the energy for sale to third parties.[22]

Henderson asserts that Big Rivers is required to generate only that energy which Henderson schedules or takes, up to Henderson's reserved capacity.[23] Henderson points out that Big Rivers has operated Station Two in the past to generate only the minimum amount of capacity, i.e., 115 MW for Unit 1 and 120 MW for Unit 2, required to

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[19] Direct Testimony of Gary Quick ("Quick Testimony") at 6.

[20] *Id.*

[21] *Id.*

[22] Quick Testimony at 6–7.

[23] Quick Testimony at 7.

maintain safe and reliable operation.[24] In the event Big Rivers elects to operate Station Two at minimum operating levels that require the generation of energy which exceeds Henderson's native load, plus energy scheduled or taken by Henderson, Henderson contends that such energy should be considered attributable to the capacity that is allocated to Big Rivers.

Henderson argues that Big Rivers' position is contrary to the arbitration award issued in May 31, 2012 ("2012 Arbitration") involving a dispute between parties concerning whether Henderson had a contractual right to sell Excess Henderson Energy directly to a third party without first offering the energy to Big Rivers at a certain price.[25] Henderson also argues that Big Rivers' interpretation of Excess Henderson Energy represents a unilateral change in practice by Big Rivers regarding the generation of Station Two energy and the assignment of responsibility for variable production costs, and is inconsistent with Exhibit A of the Indemnification Agreement that Big Rivers and Western Kentucky Energy Corp. ("WKE") executed in 2009 with respect to the operation of Station Two.[26]

Lastly, Henderson contends that the Commission does not have jurisdiction to resolve any issues related to the Power Sales Contract because that contract does not implicate Big Rivers' rates or service and because the only issue presented in Big Rivers' application relates to an interpretation of a contract, an issue that lies solely within the jurisdiction of a court and not within that of the Commission.[27].

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[24] *Id.*

[25] Quick Testimony at 5.

[26] *Id.* at 5–6.

[27] Henderson Post-Hearing Brief at 4–6.

On rebuttal, Big Rivers argues that its interpretation of Excess Henderson Energy is supported by the Power Sales Contract and consistent with the 2012 Arbitration decision.[28] Big Rivers notes that the 2012 Arbitration decision, on page 4, refers to Excess Henderson Energy as energy that is within Henderson's reserved capacity but is not needed to serve its native load, and which Henderson may sell to a third party.[29] Big Rivers contends that the phrase "not scheduled or taken by the City" as provided in Section 3.8(c) is taken out of context by Henderson.[30] Big Rivers asserts that this phrase applies to energy that Henderson uses to meet its native load.[31] Big Rivers maintains that this phrase, contrary to Henderson's interpretation, does not apply to energy that Henderson may want to sell to a third party[32] Big Rivers also references a March 14, 2008 letter from Henderson to WKE in which Henderson admits that Excess Henderson Energy includes energy within Henderson's reserved capacity that Henderson may sell to a third party. Big Rivers asserts that this admission is contrary to Henderson's position in the instant proceeding.[33]

Big Rivers contends that Henderson's reliance on the Indemnification Agreement is misplaced because Henderson was not a party to that agreement and because none of the Station Two contracts, including the Power Sales Contract, require Big Rivers to

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[28] Berry Rebuttal at 5.

[29] Berry Rebuttal at 7.

[30] Berry Rebuttal at 7–8.

[31] Berry Rebuttal at 8.

[32] *Id.*

[33] Berry Rebuttal at 8–9.

utilize the calculation methodology set forth in the Indemnification Agreement.[34] Big Rivers points out that, in Henderson's response to Big Rivers' discovery request, Henderson agrees that the amount of Excess Henderson Energy should not be calculated in accordance with the Indemnification Agreement.[35] Big Rivers notes, however, that even if the calculation of Excess Henderson Energy were done pursuant to the Indemnification Agreement, there would continue to be Excess Henderson Energy that Big Rivers would not want to generate or that Henderson would insist that Big Rivers must generate and pay the variable costs of producing.[36]

Big Rivers avers that its calculation of the Excess Henderson Energy is reasonable and appropriate under the Purchase Sales Contract.[37] Big Rivers explains that, under the Power Sales Contract, Henderson requires that its reserved capacity and the associated energy be available continuously for the needs of itself, its inhabitants, and its third-party sales.[38] Based upon Henderson's response to Big Rivers' discovery request, Big Rivers states that this capacity and energy is the first to come from the Station Two generation.[39] Using this as the starting point, Big Rivers

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[34] Berry Rebuttal at 12–13. Under the Indemnification Agreement, Excess Henderson Energy came after both Henderson's native load and Big Rivers' capacity allocation when both units were operating. When only one unit was operating, Excess Henderson Energy came before any energy associated with Big Rivers' capacity allocation. *See* Big Rivers response to Commission Staff's First Request for Information, Item 8.

[35] Berry Rebuttal at 13.

[36] *Id.*

[37] Berry Rebuttal at 9.

[38] Berry Rebuttal at 11.

[39] *Id.*

asserts that first 115 MW in an hour from Station Two belongs to Henderson.[40] According to Big Rivers, the difference between the 115 MW and the actual requirements of Henderson and its inhabitants in any given hour is Excess Henderson Energy, as defined by the Section 3.8 of the Power Sales Contract and the 2012 Arbitration decision.[41] Big Rivers further contends that Henderson's calculation of the amount of Excess Henderson Energy is unreasonable because it is inconsistent with the Power Sales Contract, past practices, and the 2012 Arbitration decision.[42]

Henderson states that Excess Henderson Energy should be calculated according to the following stacking methodology: 1) generated energy within Henderson's reserved capacity for Henderson's native load; 2) generated energy within Henderson's reserved capacity scheduled or taken by Henderson; 3) energy associated with Station Two capacity allocated to Big Rivers; and 4) energy generated and taken by Big Rivers from Henderson's reserved capacity.[43] Big Rivers contends that Henderson's stacking methodology, which also seeks to divide Excess Henderson Energy into two parts – the part used for third-party sales and the part not used for third-party sales, is not contemplated under the Power Sales Contract.[44] Big Rivers asserts that Henderson's methodology would ensure that the Excess Henderson Energy it wants always will be available for Henderson, and that when the cost of producing energy from Station Two is less than the market price of energy, Henderson will get its full 115 MW allocation,

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[40] *Id.*

[41] *Id.*

[42] Berry Rebuttal at 9.

[43] Henderson response to Big Rivers First Request for Information, Item 4.

[44] Berry Rebuttal at 10.

including Excess Henderson Energy that Henderson sells to third parties, before Big Rivers gets any energy from Station Two.[45] Big Rivers further asserts that, under Henderson's methodology, when the energy is uneconomic, Henderson avoids the variable costs associated with generating that energy and imposes that obligation upon Big Rivers.[46]

Lastly, Big Rivers contends that the Power Sales Contract falls under the exclusive jurisdiction of the Commission pursuant to KRS 278.200, which governs the rate and service terms of a contract between a jurisdictional utility and a city.

DISCUSSION

Having reviewed the record and being otherwise sufficiently advised, the Commission finds that it has jurisdiction over this matter pursuant to KRS 278.200. That statute provides, in full, as follows:

> The commission may, under the provisions of this chapter, originate, establish, change, promulgate and enforce any rate or service standard of any utility that has been or may be fixed by any contract, franchise or agreement between the utility and any city, and all rights, privileges and obligations arising out of any such contract, franchise or agreement, regulating any such rate or service standard, shall be subject to the jurisdiction and supervision of the commission, but no such rate or service standard shall be changed, nor any contract, franchise or agreement affecting it abrogated or changed, until a hearing has been had before the commission in the manner prescribed in this chapter.

The issues in this matter involve a Power Sales Contract, as amended, entered into between Big Rivers, a utility within the Commission's regulatory jurisdiction, and the City of Henderson. The inherent nature of the Power Sales Contract necessarily involves

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[45] Big Rivers Post-Hearing Brief at 16.

[46] *Id.*

rates and service in that the contract sets forth terms relating to Big Rivers's obligations to purchase Station Two capacity and energy from Henderson and Henderson's obligations to provide that capacity and energy to Big Rivers. Likewise, the specific issue that is raised in Big Rivers' application pertains to the quantity and costs of Excess Henderson Energy that is not elected to be taken by Big Rivers. This issue implicates the service and rates under the Power Sales Contract, and such issue is clearly within the ambit of the Commission's jurisdiction under KRS 278.200. We note that under KRS 278.030(1), Big Rivers' rates must be fair, just and reasonable. Consequently, the costs associated with Excess Henderson Energy purchased by Big Rivers would be passed on to Big Rivers' three distribution cooperative owner-members and those costs would ultimately be recovered through the rates charged to the retail consumers of those distribution cooperatives.

Despite their attempts to do so, the parties have been unable to reach an agreement on the issue of whether the Power Sales Contract requires Big Rivers to pay the variable costs of Excess Henderson Energy that is not taken by Big Rivers. Given the parties' inability to settle their differences, the Commission must now address Big Rivers' application for a declaratory order. It is well settled law that in the absence of ambiguity, the terms of a contract should be interpreted by assigning language its ordinary meaning and without resort to extrinsic evidence.[47] Having reviewed the record and, in particular, the 1998 amendments to the Power Sales Contract, the Commission finds that the clear and unambiguous terms as set forth in Section 3.8 of the 1998 amendments allow Big Rivers the option, at its discretion, to either take or decline to

[47] *Board of Trustees of Kentucky School Boards Insurance Trust v. Pope,* 528 S.W.3d 901, 906 (Ky. 2017).

take any Excess Henderson Energy. Section 3.8(a) of the 1998 amendments provides that "[i]n the event that...[Henderson] does not take the full amount of energy associated with its reserved capacity from Station Two . . .Big Rivers may, at its discretion, take and utilize all such energy...not scheduled or taken by [Henderson] (the "Excess Henderson Energy")" A plain reading of this section reveals that Excess Henderson Energy constitutes energy that is not taken or scheduled by Henderson within its reserved capacity. In other words, Excess Henderson Energy is the difference between Henderson's reserved capacity under the Power Sales Contract, or 115 MW as of 2016, and the amount of capacity needed by Henderson to serve its native load and for sale by Henderson to third-parties.

The Commission further finds that Big Rivers is not required to pay for any variable costs associated with Excess Henderson Energy that Big Rivers elects not to take. Section 3.8(d) of the 1998 amendments provides, in relevant part, as follows:

> [Henderson] further agrees that it shall not at any time be permitted to sell or commit to any person other than Big Rivers any Excess Henderson Energy without having first offered Big Rivers the opportunity to purchase such Excess Henderson Energy. Big Rivers shall have a reasonable period of time after submission of the City's scheduled energy requirements to decide whether to purchase any Excess Henderson Energy not scheduled by [Henderson]. Big Rivers agrees to notify [Henderson] thereafter if it does not intend to purchase such energy, and agrees to give [Henderson] a response within a reasonable time so that [Henderson] may take efforts to resell this power to third-parties.

This section clearly and unambiguously provides Big Rivers the discretion to purchase or not to purchase any Excess Henderson Energy. Because the Power Sales Contract requires each party to pay for the variable costs associated with the power

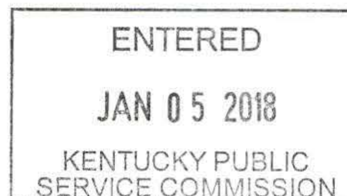
taken or used by that party during any month, the Commission finds that Big Rivers is not obligated, under the express terms of the Power Sales Contract, as amended, to pay for any Excess Henderson Energy that is declined to be taken by Big Rivers at its discretion.

IT IS THEREFORE ORDERED that:

1. Big Rivers request for a declaration that, under the terms of the Power Sales Contract, as amended, it is not required to pay for any variable costs associated with Excess Henderson Energy that it declines to take is granted.

2. Big Rivers alternative request that, in the event that the Commission finds that Big Rivers is required to pay for the variable costs associated with Excess Henderson Energy, the Commission declare the provision not fair, just, and reasonable, is denied as moot.

By the Commission



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