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COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION OF KENTUCKY

In the Matter of:

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

EXHIBIT 4

Proposed Procedural Schedule

December 2007

EXHIBIT 4

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION OF KENTUCKY

In the Matter of:

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

PROPOSED PROCEDURAL SCHEDULE

Filing Date ....Dec. 28, 2007

Informal Conference..Jan. 4, 2008

All initial requests for information to Applicants
shall be filed no later than ....Jan. 14, 2008

Applicants shall file responses to initial requests
for information no later than.. ..Jan. 25, 2008

All supplemental requests for information to
applicants shall be filed no later than .... Feb. 4, 2008

Applicants shall file responses to supplemental
requests for information no later than............................ ....Feb. 15, 2008

Intervenors' testimony, if any, shall be filed in
verified, prepared form no later than..................................Feb. 25, 2008

Applicants' rebuttal testimony, if any, shall be filed in
verified, prepared form no later than..................................March 5, 2008

Last day for Applicants to publish notice
of hearing date.. March 5, 2008

Public Hearing shall begin ....March 17, 2008

Simultaneous briefs shall be filed no later than...................... March 21, 2008

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION OF KENTUCKY

In the Matter of:

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

<u>EXHIBIT 5</u>

Direct Testimony of Mark A. Bailey

December 2007

COMMONWEALTH OF KENTUCKY
BEFORE THE
PUBLIC SERVICE COMMISSION OF KENTUCKY

Case No. 2007-00455

DIRECT TESTIMONY OF
MARK A. BAILEY

ON BEHALF OF
APPLICANTS

DECEMBER 2007

DIRECT TESTIMONY OF
MARK A. BAILEY

I. INTRODUCTION

Q. Please state your name, business address, position, and qualifications.

A. My name is Mark A. Bailey. My business address is 201 Third Street, Henderson, Kentucky, 42419. I am employed by Big Rivers Electric Corporation ("Big Rivers") as Executive Vice President and Chief Operating Officer, a position I have held since June 2007. Prior to joining Big Rivers, I served as President and CEO of Kenergy Corp. ("Kenergy") from 2004 until acceptance of my current position with Big Rivers. Before joining Kenergy, I was employed by American Electric Power Company ("AEP") for nearly 30 years, beginning as an Electrical Engineer in 1974. I held the position of Vice President of AEP subsidiary Indiana Michigan Power Company until AEP's reorganization in 1996, when I became Director-Regions with American Electric Power Service Corporation ("AEPSC"), also a subsidiary of AEP. I was Vice President of Transmission Asset Management for AEPSC from June 2000 until my move to Kenergy. A copy of my resume is attached as Exhibit MAB-1 to my testimony.

In addition, I have been elected by the Big Rivers Board of Directors ("Board") to become President and Chief Executive Officer of Big Rivers upon the retirement of the current President and CEO, Michael H. Core, which is expected to occur after closing of the proposed unwind ("Unwind Transaction") of the 1998 transactions between Big Rivers and E.ON U.S. LLC ("E.ON") (formerly LG&E Energy Corp.), and certain E.ON affiliates approved by the Kentucky Public Service Commission ("Commission") in Case Nos. 97-204 and 98-265 ("1998 Transactions").

I received a Bachelor of Science Degree in Electrical Engineering from Ohio Northern University in 1974, and a Master of Science Degree in Management from the Massachusetts Institute of Technology in 1988. I am a Registered Professional Engineer in the State of Ohio.

Q. Have you previously testified before this Commission or other regulatory bodies?

A. Yes, I have testified before this Commission previously. In addition, I have testified before state regulatory commissions in Arkansas, Texas, Louisiana, and Oklahoma in support of AEP's merger with Central and South West Corporation.

Q. Please summarize the purpose of your testimony in these proceedings.

A. The primary purpose of my testimony is to describe how Big Rivers will transition to resuming control over the operations of the Big Rivers generating facilities, and how Big Rivers intends to operate those facilities in the future, provided the Commission grants the necessary approvals and the Unwind Transaction is fully consummated. Initially, I will describe the Big Rivers-owned generating facilities that currently are leased to, and operated by, Western Kentucky Energy Corp. ("WKEC"), and that will once again be operated by Big Rivers upon closing of the Unwind Transaction. I will then describe the organization of Big Rivers following closing of the Unwind Transaction, and will identify the personnel who will manage Big Rivers after closing, with particular attention to their experience and capabilities. In this portion of my testimony, I demonstrate that Big Rivers will have a management team in place that will enable it to transition smoothly and effectively into resuming operational control over its generating facilities.

My testimony also addresses the operational and administrative aspects of the transition from operation of the generating facilities by WKEC to operation by Big Rivers, to demonstrate that Big Rivers will have arrangements in place to ensure a seamless transition when Big Rivers resumes operational control of the facilities. I describe agreements that either are or will be in place to address the period before and after closing of the Unwind Transaction, whereby WKEC will provide certain support services to Big Rivers.

Next, my testimony addresses the manner in which Big Rivers will operate the generating facilities. I provide an overview of the initial production work plan that Big Rivers will follow in operating the facilities. I also briefly describe certain policies that have been adopted by the Big Rivers Board to manage various categories of risk that it already faces and will face in the future, once the Unwind Transaction has closed and Big Rivers resumes control of its generating facilities. I also address the policies and procedures that will govern Big Rivers' fuel procurement activities once it has resumed operational control of the facilities.

Finally, my testimony addresses certain aspects relating to the business relationship between Big Rivers and the two aluminum smelters, Alcan Primary Products Corporation ("Alcan") and Century Aluminum of Kentucky General Partnership ("Century") (collectively, "Smelters"), as it will exist after the closing of the Unwind Transaction. Particularly, I describe certain aspects of the Coordination Agreements that will be entered into by and among Big Rivers and the Smelters.

II. BIG RIVERS' POST-CLOSING ORGANIZATION AND MANAGEMENT

Q. Please describe the generating facilities over which Big Rivers will possess operational control as a result of the Unwind Transaction.

A. As a result of the 1998 Transactions, WKEC currently operates and maintains five generation stations, four of which are owned by Big Rivers and one of which is owned by the City of Henderson Utility Commission (acting through Henderson Municipal Power & Light ("HMP&L")). There are a total of 424 employees at these facilities. Three of these facilities are located in Sebree, Kentucky: (1) Reid Station, consisting of Unit 1 (coal-fired and natural gas-fired, with a net generating capacity of 65 MW) and the Reid Station Combustion Turbine (fired by fuel oil or natural gas, with a net generating capacity of 65 MW); (2) Station Two (owned by HMP&L), consisting of two coal-fired units with a combined net generating capacity of 310 MW; and (3) Green Station, consisting of two coal-fired units with a combined generating capacity of 454 MW.

Big Rivers also owns K. C. Coleman Station, located in Hawesville, Kentucky. This plant consists of three coal-fired electric generating units with a combined net generating capacity of 440 MW. Finally, Big Rivers owns D. B. Wilson Station, which is located in Matanzas, Kentucky. This plant began commercial operation in 1986, and consists of one coal-fired generating unit with a net generating capacity of 417 MW. Both Coleman Station and Wilson Station are equipped to receive fuel by truck or barge.

Q. Will Big Rivers' organization change as a result of the Unwind Transaction?

A. Yes. Although Big Rivers' existing organizational structures will essentially remain in place, it will need to incorporate new functions and substantially increase its workforce to handle the responsibilities that it will once again have when it resumes control over the operation of its generating facilities upon closing of the Unwind Transaction. Big Rivers anticipates that it will increase its number of employees from the 112 that it currently employs to approximately 630. The post-closing organization of Big Rivers is shown on the organizational chart that is attached as Exhibit MAB-2 to my testimony. 485 positions will be direct transfers from WKEC, which will ensure continuity of operations, as there will be no need to bring in a large group of employees with no experience in operating these generating facilities. Indeed, approximately 70 percent of these individuals are former Big Rivers' employees who joined WKEC after it assumed operational control of the facilities in 1998. Thus, an effect of the Unwind Transaction will be the transfer to Big Rivers of the institutional knowledge of an experienced and trained work force.

Q. Please describe the management structure that will be in place for Big Rivers after closing of the Unwind Transaction.

A. As I noted previously, Big Rivers' existing organizational structure will not change significantly, except that Big Rivers will incorporate new functions to address its additional responsibilities as operator of the generating facilities. Bob Berry, who is currently plant manager at Sebree and a 27-year veteran with Big Rivers and WKEC, will become Vice President and Chief Production Officer. In that role, he will have overall operation and maintenance responsibility for Big Rivers' generating fleet. I have become quite familiar with Mr. Berry's abilities, and he is eminently qualified for this position.

Big Rivers will also resume responsibility for procuring fuel for the facilities, and we will have another seasoned individual, Mark McAdams, in charge of fuel procurement. Mark currently performs this function for WKEC for the Big Rivers plants. He will report to C. William Blackburn, currently Big Rivers' Interim Vice President Power Supply, Vice President Financial Services, and Chief Financial Officer, who will become Senior Vice President Energy Services and Chief Energy Officer.

David Spainhoward, who currently serves as Vice President External Relations and Interim Chief Production Officer, will become Senior Vice President External Relations, with the added responsibility of overseeing non-fuel procurement activities. Rob Toerne, who currently serves as WKEC's Contract Manager will report to David as Director of Supply Chain.

Big Rivers also intends to bring on board an industry veteran to serve as either Vice President or Director Enterprise Risk Management & Strategic Planning/Chief Risk Officer. That individual, with support staff, will assist Big Rivers in overseeing compliance with its enterprise risk management policies, which I discuss later in my testimony.

Q. Who will comprise the balance of Big Rivers' management team?

A. Big Rivers has assembled a highly experienced and capable team to manage its business in the new environment that will be created by the Unwind Transaction. In addition to those individuals mentioned earlier, James Haner, who currently serves as Big Rivers' Vice President Administrative Services, will continue in that role. David Crockett, who is presently Vice President System Operations, will continue to oversee transmission operations and maintenance functions. Mark Hite, who is presently Interim Director Enterprise Risk Management, will become Vice President Financial

Services and Chief Financial Officer. Mark held this position with Big Rivers for seven years before leaving to work for another employer, returning to Big Rivers in April 2007. The biographies of Big Rivers' senior vice presidents and vice presidents after the Unwind Transaction are attached as Exhibit MAB-3.

III. TRANSITION

Q. Does Big Rivers have the physical space to accommodate the new employees and functions that it will take on upon closing of the Unwind Transaction?

A. Yes. Big Rivers will continue to utilize its existing headquarters building, which housed all headquarters functions when Big Rivers previously operated its plants. As such, Big Rivers has vacant office space at its headquarters, and while this space will need to be reworked and refurbished, Big Rivers plans to bring some of the WKEC employees into this space immediately upon closing, in order to foster communications, build positive relations between current and new employees, and build a unified team. In addition, Big Rivers will have available for its use, if needed, buildings currently being used by WKEC, including facilities that are currently used for storage.

Q. How does Big Rivers plan to make the transition to resuming operational control over the generating facilities?

A. Big Rivers and WKEC have agreed to enter into agreements by which WKEC will provide certain support services to Big Rivers at cost for a period up to 18 months following the closing of the Unwind Transaction. These agreements will help to ensure a seamless transition as Big Rivers resumes operational control of the facilities, by providing a period during which Big Rivers can pursue longer term solutions while relying upon WKEC's provision of the services in the short term.

Q. What will the support services agreements cover?

A. First, WKEC has agreed to continue to perform generation dispatch on Big Rivers' behalf at cost for 18 months following closing of the Unwind Transaction. Currently, WKEC dispatches the generating facilities from its operational headquarters in Louisville, and it will continue to do so while Big Rivers seeks and prepares for a longer term solution, as I discuss below. The Generation Support Services Agreement, which was recently completed and has been executed, is included as Exhibit 16 to the Application. Second, WKEC has agreed to continue to provide information technology ("IT") services to Big Rivers at cost for up to 18 months following closing. These include services such as payroll, asset management, and financial management software. The Information Technology Support Services Agreement, which was approved by Big Rivers' Board at its December 21, 2007 meeting, is included as Exhibit 17 to the Application. The IT agreement does not require Commission approval, but is being submitted for the Commission's information.

Q. Has Big Rivers engaged a consultant to assist it in making decisions regarding the transition to resuming operational control of the generating facilities?

A. Yes. Big Rivers has been working with Black & Veatch Corporation ("Black & Veatch"), a leading engineering, construction, and consulting firm, to assist Big Rivers' management in identifying transaction process issues that need to be addressed as Big Rivers makes the transition to resuming operational control of the facilities. Black & Veatch is also assisting Big Rivers in determining how these issues will be addressed post closing. They are also helping Big Rivers evaluate longer term generation dispatch and IT solutions that need to be in place after the 18 month E.ON transition period ends.

Q. Has any provision been made for ensuring that the generating facilities are maintained properly prior to closing of the Unwind Transaction?

A. Yes. In late 2006, WKEC provided Big Rivers with its operating plans for each of the generating facilities. Section 12.2 of the Transaction Termination Agreement entered into between Big Rivers, WKEC, and LG&E Energy Marketing Inc. ("Termination Agreement"), which is included as Exhibit 3 to the Application (with a summary included as Exhibit 12 and an analysis of its provisions included as Exhibit 11), provides that WKEC shall use commercially reasonable efforts through the Unwind Transaction closing to operate the generating facilities in accordance with these plans, subject to deviations consistent with prudent utility practice, and subject to consultation with Big Rivers prior to making any material change to the operating plans. In addition, Section 12.1 provides for Big Rivers to station a representative at each of the generating facilities, with the right to access books and records, the right to confer with employees responsible for operation and maintenance of the facilities, and the right to be present when maintenance or capital repairs or replacements are being performed. Thus, Big Rivers will have an opportunity to verify that the generating facilities are being operated and maintained according to the established operating plans and according to prudent utility practice prior to resuming operational control of the facilities.

Other conditions to closing include that (a) each of the generating facilities are, as of the closing, in all material respects in good condition and state of repair, ordinary wear and tear excepted, consistent with prudent utility practice, as determined in the reasonable judgment of Big Rivers, and (b) WKEC will repair or otherwise correct any material damage to the generating facilities that occurs prior to closing and that results in a forced or unscheduled outage of a generating unit having a duration in excess of five consecutive days.

IV. <u>ONGOING OPERATIONAL ISSUES AND RISK MANAGEMENT</u>

Q. Does Big Rivers have a production work plan for operating the generating facilities following closing of the Unwind Transaction?

A. Yes, there currently is a detailed plan that Big Rivers has developed for operating the generating facilities when it has resumed operational control of the facilities. This work plan has been incorporated into the financial model Big Rivers has used in evaluating the Unwind Transaction, as described by Robert S. Mudge in his testimony, Exhibit 9.

Q. Would you describe this work plan?

A. There currently is a detailed plan for each of the generating facilities for a three-year period (2008-2010), and a high-level summary for each facility for the succeeding two-year period (2011-2012). For each of the Big Rivers generating facilities, the detailed work plan for 2008-2010 includes non-fuel fixed operation and maintenance, capital, and labor, and incorporates average planned and forced outage hours, plus annual averages for capacity factor, generation, and fuel burn.

The work plan is based upon the existing WKEC work plan for 2008-2010. Big Rivers effectively will have to follow the WKEC plan for the balance of 2008 after the Unwind Transaction closes, because of the lead time needed for planning and undertaking new projects. However, Big Rivers has made relatively minor changes to incorporate into the plan certain capital projects that it plans to undertake during 2009 and 2010. Big Rivers will develop a new work plan each year, using the same model (detailed for three years, with a summary for the succeeding two years). In essence, Big Rivers will assume control of the plants as they are, and will then evaluate on an ongoing basis what work is needed to maintain the facilities in good operating condition.

Q. What are the capital projects that Big Rivers has incorporated into the work plan?

A. For 2009, Big Rivers has added the following additional projects to the WKEC work plan: Precipitator repairs at Green Unit 2; flue-gas desulfurization ("FGD") refurbishment at Green Units 1 and 2; boiler structural painting at Green Units 1 and 2; and a reliability study for the Reid Station Combustion Turbine. For 2010, Big Rivers has added the following projects: Precipitator repairs at Green Unit 1; continued FGD refurbishment at Green Units 1 and 2; continued boiler structural painting at Green Units 1 and 2; and hot and wet side duct repairs at Wilson Unit 1. These additional projects are also reflected in the financial model used in evaluating the Unwind Transaction, as I discussed earlier.

Q. You previously explained that WKEC will dispatch the generating facilities for 18 months after closing of the Unwind Transaction. Has Big Rivers considered how it will provide for generation dispatch after the arrangement with WKEC expires?

A. Big Rivers is currently exploring various alternatives to address generation dispatch in the future. One possible solution may be to contract with ACES Power Marketing ("APM"), a national energy risk management and transaction execution company of which Big Rivers is a member-owner, along with numerous other cooperatives. APM already provides trading services to Big Rivers, and there may be synergies in having APM also perform generation dispatch. However, Big Rivers is also considering re-establishing an internal generation dispatch function staffed by Big Rivers personnel.

Q. Is Big Rivers similarly considering alternatives for the provision of IT services when the arrangement with WKEC concludes?

A. Yes. Big Rivers is considering outsourcing these functions to an IT services company or hiring staff internally to perform them. Moreover, Big Rivers may choose to assume some IT functions on its own prior to the expiration of the support services arrangement with WKEC. Big Rivers is working with Black & Veatch to evaluate its options, and to provide assistance in reaching a final determination with respect to these functions.

Q. You previously mentioned that the Big Rivers Board has adopted policies to address its business risks. What led the Board to do this?

A. As Big Rivers proceeded through the steps needed to enter into the Unwind Transaction, Senior Management and the Board recognized that it would be desirable to have a set of written policies and procedures in place to address various forms of business risk. To that end, the Board has approved six risk management policies:

(1) Safety Policy;

(2) Financial Policy;

(3) Hedge Policy;

(4) Risk Management Sanctions Policy;

(5) Trading Authority Policy; and

(6) Enterprise Risk Management Policy.

These policies set forth the standards adopted by the Board in each policy area, and further identify which personnel and institutions will be responsible for overseeing compliance with the policies. They also provide procedures for imposing sanctions in the event of violations of the policies.

Q. Would you briefly describe the objectives of these policies?

A. The overall objectives of three of these policies – the Financial Policy, the Hedge Policy and the Trading Authority Policy – are addressed by C. William Blackburn in his testimony, Exhibit 10, and are included as exhibits to his testimony. Therefore I will confine myself to discussing the objectives of the Safety Policy (which is attached as Exhibit MAB-4 to my testimony), the Enterprise Risk Management Policy (Exhibit MAB-5), and the Risk Management Sanctions Policy (Exhibit MAB-6).

Q. Please describe the objectives of the Safety Policy.

A. The objective of the Safety Policy is, very simply, to emphasize that safety is the highest corporate value at Big Rivers, and to provide guidelines to ensure that this core value is adhered to at all levels in Big Rivers' business. The Safety Policy sets forth the responsibilities applicable to all levels of Big Rivers' organization, from senior management through managers, supervisors, and other employees.

Q. Please describe the Enterprise Risk Management Policy.

A. The Enterprise Risk Management Policy sets forth Big Rivers' risk management objectives, and identifies the individuals and institutions that are responsible for overseeing compliance with the policies, and what their specific duties and responsibilities are. Responsibility begins with the Board and continues through the CEO, the internal risk management committee, and the Vice President/Director Enterprise Risk Management & Strategic Planning/Chief Risk Officer, who will chair the internal risk management committee and will be responsible for overseeing the risk management function, with a focus on ensuring that corrective actions are taken in instances where there has been non-compliance.

Q. What are the objectives of the Risk Management Sanctions Policy?

A. The Risk Management Sanctions Policy is intended to make Big Rivers' personnel aware that violations of the risk management policies can result in disciplinary actions against the violator, and to provide procedures for Big Rivers to address any such violations. The Human Resources Department will be responsible for recommending and administering the appropriate level of disciplinary action.

Q. Are there other risk management policies that Big Rivers is developing?

A. Yes. Big Rivers is in the process of revising a credit policy, and ultimately it will be approved by the Board and included with the other risk management policies. In addition, at its December 21, 2007 meeting, the Board approved a final Fuel Procurement Policies and Procedures protocol.

Q. Why does Big Rivers need policies and procedures to address its fuel procurement activities?

A. As Mr. Blackburn notes in his testimony, Exhibit 10, there are contracts in place to provide for a considerable portion of the generating facilities' fuel requirements for 2008 and 2009. However, Big Rivers will need to procure fuel for a portion of the facilities' requirements during and after those years. Accordingly, the Board has approved policies and procedures to help assure that this function will be carried out in a prudent manner, and to ensure that Big Rivers will maintain reliable production from the generating facilities at reasonable cost.

Q. Who at Big Rivers was responsible for developing and administering the Fuel Procurement Policies and Procedures?

A. I was responsible for developing these policies and procedures, which ultimately will be included with the risk management policies, and Mr. Blackburn will be responsible for administering them, as well as for administering the existing fuel contracts prior to their expiration or termination. I have included the Fuel Procurement Policies and Procedures as Exhibit MAB-7 to my testimony.

Q. Please summarize the Fuel Procurement Policies and Procedures.

A. Essentially, the Fuel Procurement Policies and Procedures state the principles that are to govern Big Rivers' procurement of fuel, reagent, and associated transportation. Big Rivers' fuel procurement policy is to obtain an adequate supply of fuel of sufficient quality at the most competitive evaluated cost, consistent with Big Rivers' obligations to provide adequate and reliable service to its Members, to meet operational and environmental standards, and to meet any other applicable legal requirements. Implementation of this overarching policy is of the highest priority for Big Rivers. The Fuel Procurement Policies and Procedures provide for a structure to enable Big Rivers to implement that policy, by providing clear lines of authority, from the Director of Fuels, who will head the Fuels Department, through the Senior Vice President Energy Supply, to whom the Director of Fuels will report, and up to the Chief Executive Officer.

The Fuel Procurement Policies and Procedures further provide for clear standards and responsibilities to govern how Big Rivers will project fuel needs and costs, determine the appropriate mix of term contract and spot market purchases, evaluate potential suppliers, evaluate responses to solicitations for supplies, and enter into contracts. The policies also address administration and enforcement of fuel supply agreements, consideration of inventory levels, emergency procurement, and standards for transportation services contracts. The policies also require those involved in fuel procurement activities to adhere to Big Rivers' ethical standards and policies.

Q. In your view, does Big Rivers have the managerial capability to resume operational control of the generating facilities, and does it have appropriate policies and procedures to ensure that it will be able to operate the facilities, both in the short term and the long term?

A. Yes. As I have explained in my testimony, Big Rivers has assembled a management team who is experienced and highly capable, who will oversee existing experienced employees in operating the generating facilities following the closing of the Unwind Transaction. Moreover, Big Rivers has given serious and studied consideration to the many issues that it will face once it resumes operational control over the facilities, and Big Rivers is in the process of finalizing arrangements to ensure that there will be a seamless transition when operational control is transferred back to Big Rivers. Finally, Big Rivers has established policies and procedures to ensure that it will be able to manage the generating facilities in a reliable and efficient manner in the years to come.

V. COORDINATION WITH THE SMELTERS

Q. Please briefly describe the business arrangements between Big Rivers and the Smelters that will exist after Big Rivers resumes operational control of the generating facilities.

A. As described in greater detail in the testimony of C. William Blackburn, Exhibit 10, Big Rivers, Kenergy, and the Smelters will enter into a series of special contracts, pursuant to which Big Rivers will sell electricity to Kenergy, which in turn will sell electricity to Alcan and Century. Among the agreements that will be entered into are a pair of Coordination Agreements, one between Big Rivers and Alcan and the other between Big Rivers and Century. Copies of these agreements are included as Exhibit 20 to the Application. As Mr. Blackburn explains, the Coordination Agreements provide for the creation of direct obligations between Big Rivers and the Smelters, and also provide a mechanism for administrative coordination among the parties.

Q. What mechanism for administrative coordination is provided in the Coordination Agreements?

A. Section 4.1 of each Coordination Agreement provides for the establishment of a committee, consisting of representatives of the Members, the Smelters, and Big Rivers' management, organized for the purpose of reviewing, analyzing and discussing information relating to Big Rivers' operational and financial performance. The committee shall meet at least once every calendar quarter. Pursuant to Section 4.4, the information subject to examination by the committee shall include: (i) analysis criteria and procedures for evaluating plans, procedures, expenditures, and maintenance programs; (ii) budgets; (iii) operations and capital expenditures; (iv) fuel procurement or supply; (v) comparison of actual performance to the budget and explanation of variances between actual performance and the budget; (vi) load forecasts and integrated resource plans; (vii) depreciation studies, proposed changes in depreciation rates and associated proposed changes in electric rates; and (viii) other activities that may impact Big Rivers' operational and financial performance. Section 4.2 provides that Big Rivers will still be obligated to coordinate with the Smelters with respect to the matters identified in Section 4.1 in the event that the committee ceases to exist or ceases to function with respect to those matters.

Q. How will Big Rivers coordinate with the Smelters concerning its budget?

A. Section 3.4 of each Coordination Agreement provides that each year Big Rivers will provide the Smelters with a copy of its then-current proposed annual capital and operating budget for the following fiscal year, along with reasonably requested supporting information. If a Smelter so requests, the budget will be reviewed by an independent expert mutually agreed to by Big Rivers and the Smelters, and the independent expert will evaluate the proposed budgeted operating expenses and capital expenditures. Upon request, the Smelters may present the conclusions of the independent expert to the Big Rivers Board, but Big Rivers will have no obligation to take any action based on that report. In addition, Big Rivers will be obligated to provide notice to the Smelters of certain upward departures from the budgeted amounts. The Smelters may request that the Coordinating Committee discuss the causes of such variances from the budget, and may also request to make one presentation to the Big Rivers Board on the subject. No later than the last day of each fiscal year, Big Rivers will provide the Smelters with a copy of the final budget for the following fiscal year.

Q. Are there other significant provisions of the Coordination Agreements that you would like to address?

A. Yes. Section 3.13 of each Coordination Agreement provides that Big Rivers will operate its system for the benefit of its Members, consistent with prudent utility practice, and will apply the same standards to operating decisions that may affect the monthly charge to the Smelters. Big Rivers will not rely on the obligations of Alcan and Century to pay the TIER Adjustment Charge as the substantive basis for making an operating decision.

Q. Does this conclude your testimony at this time?

A. Yes.

VERIFICATION

I verify, state, and affirm that the foregoing testimony is true and correct to the best of my knowledge and belief.

Mark A. Bailey

Mark A. Bailey

COMMONWEALTH OF KENTUCKY)
COUNTY OF HENDERSON)

Subscribed and sworn to before me by Mark A. Bailey on this the 17th day of December, 2007.

Paula Mitchell

Notary Public, Ky. State at Large
My Commission Expires: 1-12-09

MARK ALAN BAILEY

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Kenergy Corp. Henderson, Kentucky May 2004 – present	**President & CEO** •Responsible to an elected 11 member board for all facets of operations of a distribution electric cooperative serving approximately 54,000 members including 19 large industrial customers in portions of 14 counties in western Kentucky with ~ 160 employees, a peak demand of approximately 1,300 MW, annual kwh sales in excess of 9.4 billion, $300 million in annual revenue, and $210 million in assets
American Electric Power Service Corporation Columbus, Ohio June 2000 – April 2004	**Vice President Transmission Asset Management** •Managed AEP's $2.5B transmission and substation assets located in eleven states, including $100M annual O&M and $250M capital expenditure decisions, as well as engineering and maintenance standards, annual maintenance and capital plans, development of strategic, business and incentive plans, system planning and interconnection agreements, regulatory and legislative policy formation and testimony, and all transmission related contracts
American Electric Power Service Corporation Columbus, Ohio Jan. 1998 – May 2000	**Managing Director, Energy Delivery and Customer Relations** •Responsible for administration of the Energy Delivery and Customer Relations business group consisting of the Transmission, Distribution, Marketing, System Operations, Public Relations, Regulatory functions and the state Presidents' offices including development of strategic, business and incentive plans, operational metrics, performance targets and monitoring systems •Managed Transmission and Distribution Materials Management organization. • Testified before 4 state Commissions in support of AEP's merger w/ CSW
American Electric Power Service Corporation Columbus, Ohio Jan. 1996 – Dec. 1997	**Director – Regions** •Directed the reorganized AEP's six southern distribution regions serving nearly 1,300,000 customers in portions of 5 states with 2,700 company and 2,500 contractor employees •Oversaw the Transmission and Distribution Materials Management organization
Indiana Michigan Power Fort Wayne, Indiana Oct. 1994 - Dec. 1995	**Vice President, Administration** •Oversaw Marketing, Customer Services, Accounting, Rates, and Purchasing and Materials Management Departments as well as the Budgeting Section •Chaired the company's Political Action Disbursements Committee •Coordinated operating company administrative support for the company's three coal fired and one nuclear generating stations (6,200MW)
Indiana Michigan Power Fort Wayne, Indiana 1989 – Sept. 1994	**Vice President, Operations** •Directed four operating divisions serving nearly 520,000 customers in 28 counties in Indiana and Michigan and a total of ~ 1,300 employees •Oversaw Transmission and Distribution, Purchasing and Materials Management, System Operations, General Services and Land Management Departments at corporate headquarters •Coordinated operating company administrative support for the company's three coal fired, one nuclear and five hydro power plants (6,200MW)

Ohio Power Columbus, Ohio 1988 – 1989	**Executive Assistant to the President** •Assisted the AEP Executive Vice President – Operations performing studies and analyses such as ramifications of merging Ohio Power and Columbus Southern Power operating companies and design of a management incentive compensation system •Lobbied on behalf of Ohio Power with the Ohio General Assembly
Ohio Power Cambridge, MA 1987 – 1988	**Division Manager** •Completed course work leading to attainment of a Masters Degree in Management as a Sloan Fellow at the Massachusetts Institute of Technology
Ohio Power Tiffin, Ohio 1985 – 1987	**Division Manager** •Managed all aspects of providing electrical service to 58,000 customers through five operating units consisting of 210 employees
Ohio Power Canton, Ohio 1983 – 1985	**Administrative Assistant to the President** •Coordinated operating company administrative support for the company's five fossil fired power plants (8,120 MW) •Oversaw operation and maintenance of the company's two unit, 48 MW hydro plant •Assisted the President with various studies and assignments
Cardinal Operating Co. Cardinal Plant Brilliant, Ohio 1981 - 1983	**Performance Superintendent** •Directed department of 65 employees responsible for installation and maintenance of the plant's instruments and controls, engineering and thermal performance, and laboratory operations at the three unit, coal fired 1,860 MW plant •Directly supervised start-up & shut-downs of the 600 MW supercritical units
Ohio Power Muskingum River Plant Beverly, Ohio 1979 - 1981	**Production Superintendent** •Directed department responsible for operations of a five unit, coal fired 1,460 MW plant •Directly supervised start-ups & shut-downs of the plant's 600 MW supercritical unit, wrote plant operating procedures and trained operators following major modifications of the 600 MW Unit 5 steam generator & precipitator addition
Ohio Power Gavin Plant Cheshire, Ohio 1975 - 1979	**Performance Engineer** •Various engineering positions of increasing responsibility at the two unit, 2,600 MW coal fired plant. Major areas of involvement included analyzing thermal performance, instrument and control installation and maintenance •Wrote plant operating procedures for all the AEP system's 1,300 MW supercritical units
Ohio Power Portsmouth, Ohio 1974 – 1975	**Electrical Engineer** •Designed, laid out and specified material for construction of distribution facilities to serve retail customers in the Portsmouth division
Education:	•The Massachusetts Institute of Technology, Cambridge, Massachusetts Masters of Science in Management, 1988 •The Ohio Northern University, Ada, Ohio Bachelor of Science in Electrical Engineering with Distinction, 1974

Honors and Activities:

- •Registered Professional Engineer, State of Ohio
- •Member of Tau Beta Pi National Engineering Honorary
- •Member - Order of Kentucky Colonels
- •President of the Board - Henderson Habitat for Humanity
- •Vice Chairman of the Board – Owensboro Foundation for Health
- •Board member - Methodist Hospital, Henderson, Kentucky
- •Board member – Methodist Hospital Foundation
- •Board member - Leadership Kentucky
- •Board member – Henderson Chamber of Commerce
- •Board member – Kentucky Community & Technical College Foundation
- •Member- Henderson Rotary Club

December 2007

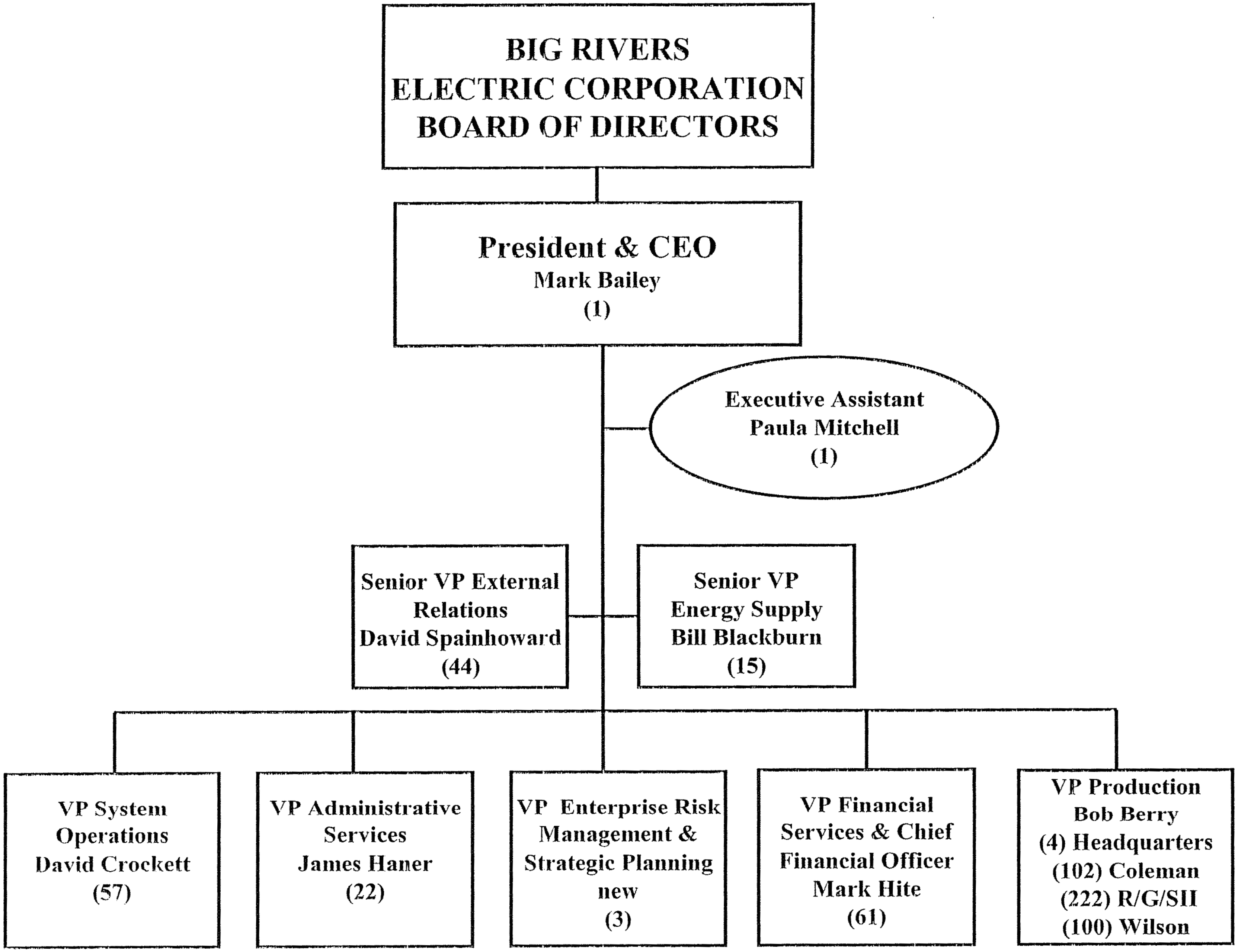

Exhibit MAB-2

Name:	David A. Spainhoward
Current Position:	Vice President External Relations & Interim Chief Producton Officer
Length of Service at Big Rivers:	35 years
Education:	Bachelor of Science in Management - Oakland City University; Master of Science in Management - Oakland City University.
Previous Positions:	Big Rivers Electric Corporation: Property Acquisition; Accounting; Corporate Planning; Vice President Contract Administration and Regulatory Affairs

Name:	C. William Blackburn
Current Position:	CFO & Vice President of Financial Services (Acting Vice President of Power Supply)
Length of Service at Big Rivers:	30 years
Education:	Bachelor of Arts in Business/Math/Accounting - Murray State University.
Previous Positions:	Big Rivers Electric Corporation: General Accounting Supervisor; Manager of Accounting (1984); Vice President of Power Supply (1986); Vice President and Chief Financial Officer (2005).

Name:	David Crockett
Current Position:	Vice President of System Operations
Length of Service at Big Rivers:	34 years
Education:	Bachelor Degree in Electrical Engineering – University of Kentucky,
Previous Positions:	Big Rivers Electric Corporation: Manager of Engineering – Energy Control, Supervisory positions in Engineering Department.

Name:	James Haner
Current Position:	Vice President of Administrative Services
Length of Service at Big Rivers:	35 years
Education:	Bachelor of Science in Accounting - University of Kentucky
Previous Positions:	Big Rivers Electric Corporation: Station II Accountant Manager - Human Resource Department

Name:	Mark Hite
Current Position:	Interim Director Enterprise Risk Management
Length of Service at Big Rivers:	24 years
Education:	Bachelor of Science in Accounting – Masters of Business Administration - University of Evansville, Evansville, IN; (PFS) - Personal financial specialist.
Previous Positions:	Big Rivers Electric Corporation: Financial Services Manager; Vice President and CFO; Returned to Big Rivers in mid-2007; Donaldson Capital Management (2005-2007).

Name:	Robert W. Berry
Current Position:	Plant Manager Western Kentucky Energy, Henderson, KY
Length of Service at Current Employer:	9 years
Education:	Associate in Applied Science/Mechanical Engineering Kentucky Community College System Additional hours toward Bachelor of Science – Business Management degree, Mid-Continent University Training in management, communication and mechanical maintenance.
Previous Positions:	Western Kentucky Energy Maintenance Manager – Reid/Green/HMPL Station Big Rivers Electric Corporation Superintendent of Maintenance – Reid/Green Station Maintenance Supervisor – Reid/Green Station

Big Rivers Electric Corporation

COMPANY POLICY

POLICY NUMBER: 107 | **ORIGINAL EFFECTIVE DATE: 10-19-07**
APPROVED BY: Board | **ORIGINAL APPROVAL DATE: 10-19-07**
DATE LAST REVISED: ______

SAFETY POLICY

I. Objective

This policy is intended to promote the health and well-being of all Big Rivers Electric Corporation (BREC) employees as well as the general public, and minimize damage to equipment and facilities.

II. Policy

BREC considers safety its most important corporate value. Accordingly, "no operating condition or urgency of service can ever justify endangering the health and well-being of anyone," and any employee has the authority to stop any work practices he/she considers unsafe, without fear of repercussion.

BREC is committed to maintaining a proactive safety, health, and loss prevention program designed to protect life and property; providing a work environment where recognized health/safety hazards are controlled; complying with all applicable regulatory issues; and ensuring that employees return home at the end of the workday in as good a condition as when they arrived for work that day, and that no member of the public is harmed by any action or inaction of any BREC employee.

BREC's Safety Principles

1. BREC holds safety as its highest core value.
2. Business productivity, efficiency, and quality are a direct result of a comprehensive safety program, with safety an integral and essential part of work procedures.
3. All injuries/incidents can be prevented.
4. Every hazard can be managed.
5. Employee involvement and accountability are critical to the success of any safety program.
6. Training is an essential element in any ongoing effort to achieve an injury-free work environment.
7. Working safely is a condition of continued employment.
8. It is essential to investigate incidents that result in or had the potential for injury to individuals and/or damage to equipment and facilities.

9. Safety performance is a key indicator of BREC's organizational excellence and is incorporated into the business processes.
10. Safety off the job is an important component of any safety program.

III. Provisions

A. Compliance

BREC is committed to conducting its business safely in a manner that ensures compliance with all applicable health/safety regulatory issues and company policies and requirements.

B. Leadership

BREC will strive to be a leader in safety performance. It will assess its progress toward this goal through internal measurement and external benchmarking, and will incorporate best practices, institute mechanisms to drive continuous improvement, and participate in research and development of new/improved safety practices. BREC will hold each manager/supervisor accountable and responsible for the safety performance of the employees who report to him/her.

C. Performance Management

BREC drives continuous improvement in the safety performance of its organization by establishing goals, programs, and procedures that govern its industry.

D. Prevention and Risk Management

BREC values prevention as the best method to protect the safety and well-being of its employees and the communities in which it operates. BREC commits to identifying and evaluating the health and safety impacts of its operations, and strives to minimize any adverse impacts by implementing best practices to prevent incidents and protect organizational assets. It is a condition of continued employment that all incidents be immediately reported to supervision. In the event of an incident, BREC commits to performing follow-up investigations and analyses to further refine its preventive efforts.

E. Communication

BREC will foster openness and dialogue with its employees and the public by anticipating and responding to concerns about the safety of BREC's operations.

F. Education and Training

BREC values well-informed and trained employees as essential in achieving safety excellence. BREC will provide appropriate education and training programs for its employees to ensure they are prepared to perform their jobs safely.

G. Accreditation

BREC will strive to achieve NRECA safety accreditation. This program requires certification every three years. The goal of accreditation is to instill in all employees an awareness of the importance of safety in all operations; to increase a desire to work safely; to fully educate employees in proper procedures of safe practices; and to certify electric systems with such objectives that are an integral part of everyday operations.

H. Inspections

Employees are responsible for inspection of all personal protective equipment and tools prior to each use. BREC provides and mandates use of safety eye protection, hearing protection, head protection, and fall protection in accordance with OSHA 29 CFR 1910.269 and 1910.132 standards. Any irregularities will be reported to supervision for repair or replacement. All personal protective equipment and tools will meet applicable OSHA and ANSI standards.

I. Safety Manual

BREC will use the APPA Safety Manual as a guide for safety.

J. Safety Committees

The purpose of the safety committees is to identify hazards and collect incident data, including near-miss incidents; and to make recommendations on possible solutions to correct problems, reduce hazards, and create a safety-conscious work environment. All employees will be required to report hazardous conditions to their supervisor.

IV. Responsibilities

A. Senior Management

a. Serve as members of the safety leadership team.
b. Ensure that health, safety, and wellness are given consideration in the strategic plan, including development of an annual corporate safety plan.
c. Lead by example and take responsibility for the safety performance of the employees who work under their supervision.
d. Respect and advocate health and safety concerns.
e. Provide necessary budget and human resources commitment.
f. Provide appropriate emphasis on health, safety, and wellness in the performance measurement system, including safety performance review as part of annual appraisals.
g. Respect health, safety, and wellness in all business decisions.

B. Managers

a. Establish health, safety, and wellness goals, and monitor and communicate progress.
b. Lead by example and take responsibility for the safety performance of the employees who work under their supervision.
c. Ensure OSHA standards and requirements are followed.
d. Actively encourage suggestions through safety committees, internal reviews, and audits.
e. Ensure training guidelines are followed.
f. Promote off-the-job safety and wellness.

C. Supervisors

a. Ensure all employees are properly trained and safety policies and procedures are followed.
b. Lead by example and take responsibility for the safety performance of the employees who work under their supervision.
c. Correct unhealthy/unsafe acts and conditions promptly.
d. Elicit employee participation and encourage suggestions to improve the work environment through various employee activities, e.g., tailgate/job briefings and safety committees.
e. Evaluate and implement suggestions for improvement when appropriate.
f. Investigate all employee injuries, occupational illnesses, property damage, and near-miss incidents.

D. Employees

a. Take responsibility for their personal, co-worker, and the public's safety.
b. Stop any work practices he/she considers unsafe.
c. Become familiar with and perform their work in accordance with established safety rules and procedures.
d. Conduct themselves as positive role models for health, safety, and wellness.
e. Be alert to any hazards to themselves, co-workers, and the public, including calling attention to any violations of or deficiencies in adherence to safety rules and procedures.
f. Be active in education and training programs to enhance their knowledge of healthy and safe work practices.
g. Actively support and participate in BREC health, safety, and wellness programs and initiatives.
h. Promptly report all incidents and near-miss incidents to their supervisor.
i. Immediately correct the problem when an imminent life-threatening situation is encountered, if he/she has the skills and equipment to do so, and/or call for help and barricade the area until help arrives.

V. Penalties for Noncompliance

BREC employees who improperly or carelessly endanger themselves, co-workers, or the public by failing to follow safety rules and procedures will be subject to disciplinary action, up to and including discharge.

Big Rivers Electric Corporation

COMPANY POLICY

POLICY NUMBER: 100	**ORIGINAL EFFECTIVE DATE: ______**
APPROVED BY: Board	**ORIGINAL APPROVAL DATE: 6-15-07**
DATE LAST REVISED: ______	

ENTERPRISE RISK MANAGEMENT ("ERM") POLICY

1. Policy Purpose

The purpose of this document is to formalize the policies of Big Rivers Electric Corporation ("BREC") regarding managing its enterprise-wide risks. Accordingly, this policy will set forth BREC's:

- risk management objectives,
- risk governance structure and responsibilities,
- scope of business activities governed by this policy and the list of associated ERM guidelines and policy documents, and supporting risk management policies.

BREC intends that risk management will support the advancement of its strategic business plan, and will properly manage its business and financial risks through:

- prudent oversight,
- adequate mitigation of risks consistent with BREC's defined risk tolerance, and sufficient internal controls and procedures.

Managing the enterprise-wide risks of BREC's business entails the coordination of resources and activities among all departments within BREC.

2. Risk Management Objectives

BREC exists primarily to safely deliver low-cost, reliable wholesale power, and cost effective shared services desired by its Members. Managing BREC's risk is consistent with that mission, and serves the following objectives:

- to maintain risk within desired tolerances for a defined period in the future,
- to mitigate price volatility to the Members,
- to maintain a proactive safety, health, and loss prevention program designed to protect life and property, provide a hazard-controlled work environment, and comply with all applicable regulations,
- to meet lender debt covenants,
- to maintain financial liquidity within desired tolerances,
- to maintain an investment grade credit rating,
- to enhance the value of BREC's assets/resources,

- to ensure that the risks of economic development and other business opportunities are effectively managed to increase the value of BREC to its Members,
- to participate in commodity markets and derivative instruments for hedging and not for speculative purposes, and
- to develop an ERM culture throughout the organization and provide for an ongoing strategic planning process.

3. Risk Governance Structure and Responsibilities

Risk governance will follow a top-down approach whereby the Board of Directors ("Board") identifies BREC's risk management objectives and provides risk management oversight. Supporting controls, policies and procedures will be implemented and aligned throughout the risk governance structure, with distinct roles and responsibilities that result in a risk control environment. Governance and controls include the organizational structure, policies, reporting process and procedures that support BREC's business models, risk tolerances, power supply objectives, financial objectives, safety objectives, and segregate responsibilities appropriately.

a. Board – ERM Duties

- Has a basic understanding of ERM,
- Approves BREC's ERM objectives, and the president and chief executive officer's ("CEO") authority limits to conduct risk management transactions,
- Approves no less than annually a resolution of the energy supply goals (e.g., fuel cost, production targets), financial goals (e.g., liquidity, TIER, rates, costs, net margin), and risk tolerance guidelines around such goals. These goals and risk tolerance guidelines shall be consistent with the Board's desired risk management objectives, time horizons, and risk tolerance for managing enterprise risk,
- Approves, periodically reviews, and makes recommended changes to the ERM Policy that establishes an overall framework for evaluation, management, and control of risk,
- Approves participation in specific commodity markets and derivative instruments,
- Oversees the risk management activities of BREC,
- Establishes scope and frequency for management reporting to the Board,
- Periodically reviews risk exposures and compliance with policies and procedures,
- Discusses BREC's major financial risk exposures and the steps management has taken or will take to mitigate, control, and monitor such exposures,
- Reviews and approves any new commodity products, locations, or markets,
- Approves management staff to serve as members of an Internal Risk Management Committee ("IRMC"),
- Receives reports by the independent risk management function on BREC's compliance with its risk policies,
- Reviews and approves the energy risk identification and exposure management guidelines (Appendix A).

b. CEO – Risk Management Responsibilities and Duties

- Recommends staff to serve as members of the IRMC,

- Has authority to transact within the limits set by the Board in the Trading Authority Policy,
- Approves proper organization, separation, or consolidation of functional activities,
- Assures prudent administrative procedures are established for execution of commodity and derivative transactions, contract controls, credit controls, trading controls, enterprise-wide risk monitoring and measurement, settlement controls, and other risk management activities,
- Ensures that the identification and quantification of risks and related risk mitigation strategies are integrated into the strategic planning process,
- Establishes and maintains an effective working relationship with ACES Power Marketing ("APM").

c. IRMC – Responsibilities and Duties

Membership shall be comprised of seven executive voting committee members:

1. CEO
2. Sr. VP of Energy Supply
3. VP of Production
4. VP of Finance
5. VP of Administrative Services
6. VP of System Operations
7. Sr. VP of External Relations

The VP/Director of Enterprise Risk Management/Chief Risk Officer shall participate as a non-voting member of the committee and serve as the IRMC chairperson. The chairperson shall be responsible for keeping, or causing to be kept, a true and complete record of the proceedings. Other non-voting participants shall participate in the meetings as determined by the executive voting committee members.

The IRMC establishes a forum for discussion of BREC's significant risks and must develop guidelines required to implement an appropriate risk management control infrastructure, which includes implementation and monitoring of compliance with BREC's ERM-related policies. The IRMC executes its risk management responsibilities through direct oversight and prudent delegation of its responsibilities to the independent risk management function, as well as to other company personnel.

Responsibilities include:

- Reviews and recommends the ERM-related policies and oversees enforcement by the independent risk management function,
- Ensures that risk management objectives, risk tolerance guidelines, and authority limits are employed throughout BREC,
- Receives reports by the independent risk management function concerning BREC's compliance with its risk policies, controls, and procedures, in accordance with established policies, controls, and procedures,

- Recommends to the CEO the proper organizational structure, separation or consolidation of functional risk management activities,
- Reviews and approves proposed risk management strategies for strategic fit, risk exposure consistent with risk tolerance, and reporting and control requirements,
- Ensures approved strategies are consistent with BREC's approved strategic business plan, risk management objectives, approved risk tolerance guidelines, and compliance with risk policies,
- Periodically reviews BREC's risk management program (a detailed review at least once a year) in light of recent changes in business practices, improved procedures, BREC's philosophy and strategy, or market changes; and ensures continued compliance with its established guidelines,
- Formulates risk management strategy, policy or procedures necessary for new product or market implementation,
- Requires and reviews regular risk reports provided by the independent risk management function,
- Reports to the CEO regularly on BREC's risk management activities,
- Periodically engages an independent audit (internal and/or external) of risk control policies and procedures,
- Holds formal IRMC meetings at least quarterly, with standing agenda items including, but not limited to, current commodity market strategies, power cost uncertainty, level of exposure to non-member transactions, production strategies and exposures, financial strategies and exposures, environmental strategies and exposures, control requirements/enhancements, counterparty contract and credit exposure, and policy and procedural violations,
- Performs an annual review of transaction compliance with policies and procedures for market transactions executed within BREC,
- Reviews the infrastructure supporting risk management and ensures that it meets the requirements for risk oversight and compliance,
- Reviews compensation policies to ensure they are structured to avoid incentives for excessive risk taking,
- Reviews and recommends that the Board approve the BREC annual strategic plan.

d. Independent Risk Management Function – Responsibilities and Duties

This function shall be the responsibility of the VP/Director of Enterprise Risk Management/Chief Risk Officer, who is organizationally independent of functions whose activities initiate or directly participate in managing most of the risk of BREC. Various departments will be required to provide this function with reports or information required for risk assessment and analysis on a regular or periodic basis. Responsibilities include:

- Performs responsibilities delegated by the IRMC,
- Organizes and chairs the IRMC meetings,
- Engages the IRMC in discussions regarding events or developments that could expose BREC to potential losses,

- Develops, recommends, and administers risk management processes and procedures; provides input to tools to assist in risk management,
- Provides risk management education/training to Board, staff and management,
- Reviews risk management activities, risk controls, and recommends modifications of controls to meet changing business needs,
- Reviews adequacy and accuracy of reports, and reports any deficiencies to the IRMC,
- Assesses risks to BREC in aggregate, by department, and by material business activity,
- Performs periodic internal audits of risk control policies and procedures to ensure that BREC complies with its risk policies,
- Reports any violation of BREC's risk policies,
- Reviews and approves changes to the risk management policies and procedures, as appropriate,
- Reports regularly to the IRMC, at a minimum, but not limited to:
    - Portfolio model risk measures (1-60 months),
    - Financial forecasting model risk measures (1 month–20 years),
    - Resource planning model risk measures (5-20 years),
    - Power cost projections and confidence intervals,
    - Financial projections and confidence intervals,
    - Loss/near miss incidents and results of any investigations,
    - Production output,
    - Credit and contract risk exposures,
    - Other key performance indicators that support effective ERM,
    - Policy and procedural violations,
    - Status of exemptions and exceptions.
- Reports to the IRMC and Board on BREC's compliance with its risk policies and risk management in accordance with the policies,
- Reviews and evaluates proposed risk management transactions to be executed by BREC, and ensures adequate analysis has been performed with proper assessment and mitigation of any such risk consistent with risk management objectives and risk tolerance guidelines, and compliance with risk management policies, including the financial, legal, credit, and operational impacts.

e. APM – Roles and Responsibilities

BREC is a member of APM and will use this alliance to obtain selected energy risk management and transaction execution services. In accordance with the agreements between BREC and APM, APM is authorized to and shall:

- Periodically provide BREC with a controls audit report from an independent auditor,
- Execute transactions on behalf of BREC in accordance with established delegations of authority and compliance requirements set forth by the CEO,

- Administer counterparty contracts and manage credit in compliance with the Credit Policy according to the types of agreements the BREC CEO or the Sr. VP of Energy Supply, as delegated by the CEO, authorizes APM to administer,
- Provide BREC with daily reports on individual transaction details, commodity positions, and counterparty credit positions for transactions executed by APM,
- Provide BREC with periodic risk profile reports addressing its energy risk and recommend hedging strategies within the time horizon specified by BREC for assessment, but typically within the 1-60 month horizon,
- Capture BREC 's energy supply transactions in APM's risk management systems,
- Monitor compliance of transactions with BREC's Trading Authority Policy,
- Confirm and settle transactions with BREC 's counterparties for commodities and transactions authorized by the CEO or the Sr. VP of Energy Supply, as delegated by the CEO, for APM to administer,
- Mark to market forward energy supply transactions for credit exposure purposes.

4. Scope of Business Activities Governed by this Policy

The scope of this policy is designed to address the management of the enterprise-wide risk associated with BREC including, but not limited to:

- Commodity price risk,
- Volumetric risk,
- Power and fuel delivery risk,
- Operational risk,
- Financial risk,
- Environmental and regulatory risk,
- Counterparty contract and credit risk,
- Organizational risk,
- Board and officer risk,
- Safety risk.

The ERM and strategic planning functions of BREC will facilitate the development and monitor the implementation of a strategic plan that will incorporate enterprise risks that require additional strategic focus. The plan will be consistent with the risk management policies and objectives of BREC.

5. Associated ERM Guidelines and Policies

Supporting guidelines and policies are required as outlined below. Responsibility for their approval, modification, oversight, and compliance shall be consistent with the governance section of this policy and unless otherwise stated does not require the approval of the Board.

Policy 101	Trading Authority Policy
Policy 102	Risk Management Sanctions Policy
Policy 103	Hedge Policy
Policy 104	Financial Policy
Policy 105	Credit Policy

Big Rivers Electric Corporation

APPENDIX A of the ENTERPRISE RISK MANAGEMENT (ERM) POLICY

1. Identification of Enterprise-Wide Risks

The enterprise-wide energy portfolio of BREC is naturally exposed to the following primary risks:

- Commercial operational risk
  - Inadequate controls and procedures
  - Errors and fraud
- Commodity market price risk
  - Power
  - Fuels
  - Emission allowances
  - Bulk materials
- Concentration risk (or lack of diversity)
  - Suppliers
  - Coal
  - Smelter load
  - Steam coal generation unit technology
- Contract risk (counterparty performance)
  - Large industrial contract default
- Credit risk
  - Bad debts expense
  - Supplier bankruptcy (mark to market risk)
  - Large industrial bankruptcy
- Delivery risk
  - Transmission risk (aka congestion)
  - Fuel delivery risk
- Financial risk
  - Financial liquidity (cash flow, meeting debt covenants)
  - Interest rates
- Operations risk
  - Generation unit outages
  - Transmission outages
- Regulatory and environmental risk
  - Federal and state regulatory changes
  - Environmental requirements (New Source Review)
- Safety and hazard control risk

  - Loss of life
  - Injuries/Illness
  - Equipment damage
  - Loss of employee productivity
  - Federal, state and local regulations
- Volumetric risk
  - Load forecast/ weather variability risk
  - Forced outage/ de-rate risk
  - Loss of load
  - Load Growth

Section 2 of this document defines these primary risks and other relevant definitions.

Section 3 identifies the tools and provides guidelines as to how risks shall be managed under most conditions.

Section 4 provides a description of BREC's power supply risk profile and why it differs from others engaged in the energy markets.

2. Definition of Risks

Commercial operational risk is the risk of loss from inadequate or failed internal processes, people, and systems.

Commodity market price risk is the risk of loss due to potential fluctuations in the prices of an underlying energy commodity. In the wholesale power market, BREC has risk that commodity prices rise, spike or are generally high when it is short of meeting its firm supply obligations. BREC has risk that prices fall or are generally low when it is has excess capacity or electric energy compared to its firm supply obligations.

Due to heavy reliance on coal generation units, BREC has a natural short position in the coal that it needs to supply fuel to its generating resources.

Commodity market price risk occurs across all tenors, from the hourly market to the long-term forward market (5 years +). BREC is exposed to commodity price risk for power, coal, natural gas, emission allowance (SO2 and NOX), fuel oil and various bulk materials (e.g. ammonium, limestone) that exhibit price volatility.

Contract risk or counterparty performance risk is the risk of a potential adverse occurrence of a counterparty's ability to operationally perform on an agreement or due to contractual provisions that leave BREC with no recourse under an event of default.

Concentration risk is the risk of having large exposures to significant power supply components. Concentration risk can be found with suppliers (contract and credit risk), generation units (outage risk), unit technology (environmental), native load customers (smelters).

Credit risk is the risk of a potential adverse occurrence of a counterparty's ability to pay its obligations (debts) to BREC or that a supplier declares bankruptcy and abrogates a supply contract that must be replaced during a time of higher commodity market prices.

Delivery risk is the risk that BREC cannot meet a firm supply obligation due to a transmission constraint. Delivery risk is natural to BREC in meeting its firm supply obligations and reliability of service. BREC can also be exposed to delivery risk in the transportation of its fuel supply.

Financial risk is the risk that a company's scarce resources are not best employed, resulting in adverse financial consequences. Quantification of risks in terms of their impact on financial measures including member rates, costs per MWh, margins, cash flow, credit, derivatives, TIER and DCS will be considered in risk analysis and mitigation. Risk quantification and mitigation pursuant to appropriate risk tolerance shall have significant focus.

Cash margin risk is the risk associated with inadequate cash flow resulting from margin requirements of a contractual agreement. For example, the EEI Master Agreement provides that counterparties may margin each other when they are overexposed above credit thresholds that were negotiated between the parties when the agreement was executed. Credit exposures include replacement cost exposure on a mark-to-market basis when a counterparty's position is out-of-the money.

Operations risk is the risk associated with physical assets. This would include failures or outages associated with generation units, fuel delivery systems (weather or mechanical), generation step-up transformers, the transmission system, control systems, or other critical components associated with the production or delivery of electricity.

Safety and hazard control risk is the risk of loss from an accident or incident that results in bodily injury or property damage disrupting or impairing operations, and exposing the company to liability, repair, and other costs in the process of mitigating the loss.

Volumetric risk is the risk that energy commodity volumes will vary from expected and result in a potential loss due to changing commodity market prices. The primary volumetric risks that BREC is exposed to are *load forecast/ weather variability risk, forced outage/ de-rate risk, loss of load (smelter load concentration),* and *transmission delivery risk, and transmission congestion risk.*

Load forecast/weather variability risk is the risk that actual loads differ from forecasted loads due to the error in weather forecasts and load forecasts. This risk is natural to BREC's portfolio since it serves load serving entities. Since this risk will result in BREC being unintentionally long or short in the spot market, it naturally results in hourly market price risk.

Forced outage and de-rate risk is the risk that a generating unit does not perform when it is expected to be available, or when it performs below expected capability. This risk is natural to BREC's portfolio since it owns and operates generation units to meet its load requirements. Since this risk will result in BREC being unintentionally short in the market, it also naturally results in market price risk.

Loss of load risk is the risk that BREC loses a significant portion of one of its members' load, for example, an aluminum smelter, and that the market price for electricity coincidentally falls below the sales price of the lost load and thereby creates a financial strain on the company. However, if market prices for electricity remain above the sales price of a potential lost load it would create a financial benefit to the company.

Congestion risk is the risk of negative price differentials between the location of power supplies and the demand location. If BREC needs to buy electricity and the transmission system is congested, it would pay a premium to secure the needed electricity, if it is available at all. If BREC has excess electricity to sell and the transmission system is congested, then it may not be able to sell the excess or may have to sell at a discounted price to a non-congested area. Congestion risk typically manifests itself in power commodity market price risk.

3. Guidelines and Tools to Manage Risk

ERM Framework Assessment and Risk Dictionary

These tools are used to identify and prioritize risks and the gaps at BREC for effectively managing enterprise-wide risk. On an annual basis, the ERM function of the company will assess the ERM framework including gaps in: data, tools, processes, and education/skills gaps necessary for effectively managing risk. Additionally, the ERM function will identify and prioritize all of the enterprise risks of the organization and assure that each risk is being effectively managed within the policies and risk tolerance of the organization. Outcomes of these tools will be a key input to the strategic planning function of BREC.

Strategic Planning Process

BREC will develop a strategic planning process that identifies and addresses strategic issues, high priority risks, and gaps in the ERM framework. Several sources will have input into the strategic plan including employees, the Board, CEO, Members, ERM function, senior staff, and departmental functions. The objective of the process will be to identify and anticipate strategic issues and risks, understand the assumptions, quantify these risks, and enable BREC to move swiftly to develop and implement effective strategies to address them.

Short/Intermediate-Term Planning - Portfolio Model

Market price risks and volumetric risks will be managed in the near term planning cycle (1-60 months forward) utilizing a portfolio model. The portfolio model is a risk assessment of BREC's energy portfolio based on monte-carlo simulation that provides a cumulative probability curve of BREC's variable costs in forward months, rolled up to years. The Board's risk tolerance will be set at least annually using this model as one tool, which will include a stress test outside of reasonable expectations of plant operations, commodity market prices and their volatilities, and load forecast.

Long-Term Planning – Integrated Resource Planning Model

Market risks and volumetric risks will also be managed by long-term resource planning for a period of 6-20 years. BREC's Energy Supply Department will forecast its long-term firm supply obligations based on its expectations for load growth. This tool, along with the short/ intermediate-term portfolio model and the financial forecasting modeling tool, will assist BREC in making appropriate capital investments to meet the needs of its membership. BREC will seek to meet a planning capacity reserve margin in accordance with applicable reliability region standards. The actual targeted reserve margin will be documented, and managed through long-term generation additions and intermediate term purchased power contracts based upon the cost and risk tradeoffs of the company as identified in the Hedge Policy.

Financial Forecasting Model

BREC will manage its financial risks and capital planning and budgeting process through the use of a probabilistic monte-carlo simulation tool. The financial forecasting modeling tool will be linked to the short/intermediate and long-term planning tools to enable BREC to assess cost and risk tradeoffs and impacts on key financial metrics (e.g., targets for TIER, rates, DSC, cash flow, margins) of risk mitigation strategies. The financial forecast will generally be on a monthly basis for approximately 24 months and annually for calendar years beyond that period. The financial forecasting function of the company will work closely with departments that manage key risks and the ERM function.

Delivery Risk

Delivery risks for electricity and fuels will be managed by thoroughly evaluating the risk and procuring firm transmission and transportation in a proactive manner. Delivery procurement strategies will be developed in the Energy Supply Department in coordination with electricity and fuel procurement activities. In the event that adequate firm transportation or transmission is not available to adequately mitigate risk, the IRMC will be formally notified as to recommended methods by which it will be managed.

Credit Policy

Credit risk and counterparty performance risk will be managed according to the credit controls, per the Credit Policy.

Contract Controls

Counterparty performance risks will be managed according to the Trading Authority Policy and supporting APM trading control procedures as requested by BREC.

Diversity Management

BREC will manage its concentration risks on a rolling 12-month basis by diversifying its capacity, fuel, and purchased power requirements as defined in the Hedge Policy.

Commercial Controls

BREC will manage its commercial operational risks according to trading authority limits to conduct market transactions. The trading authority limits to conduct commodity market transactions are approved by BREC board, and are included in the Trading Authority Policy BREC will also manage its commercial operational risks to new products, instruments, or locations according to a control process for such as found in the Trading Authority Policy. Numerous other internal controls and procedures shall be in place at BREC to manage other purchasing activities and vendor relationships.

Financial Policy - Liquidity Management

Financial risks will be managed according to the Financial Policy and supporting internal control procedures.

Hedging Policy

Commodity price risk and volumetric risk will be managed according to the Hedging Policy and supporting internal execution strategies and control procedures.

Risk Management Transactions

Numerous transactions may be entered into to mitigate risk consistent with the board-approved power supply cost goal and risk tolerance. Several hedging instruments and commodities are used to manage BREC enterprise risks, which include purchases or sales of physical commodities, financial instruments, fuel transportation, power transmission, power generation capacity, and fuel storage. The following hedging instruments and commodities are permitted to be transacted when used consistent with this policy and its supporting controls, policies and procedures:

- Physical Transactions
    - Forward power, natural gas, and coal
    - Options on power, natural gas, and coal
    - Spot market power, natural gas, and coal
    - Power transmission and ancillary services
    - Coal and natural gas transportation and ancillary services
- Financial Transactions
    - Futures contracts for power, natural gas, and coal
    - Swap contracts for power, natural gas, coal, and interest rates
    - Options on power, natural gas, and coal
    - Weather protection transactions

- Unit outage protection transactions

Safety Policy

Safety and hazard control risk will be managed according to the Safety Policy and supporting internal safety and training policies and procedures.

4. BREC Energy Supply Risk Profile

BREC operates its power supply function under a different business model than merchant energy companies, and, therefore, has a different risk profile, requiring a different approach to risk management.

- BREC's mission is to safely deliver low-cost, reliable wholesale power, and cost effective shared services desired by its Members,
- BREC is not in the energy business to trade speculatively (buy low – sell high), or to initiate energy risk positions,
- BREC is not in the energy business to take at-risk positions in merchant generation,
- BREC by nature has significant volumetric risk that results from: 1) long-term load serving obligations, 2) the supply hedges used to meet those obligations (generation, forwards, options, demand side management, etc), and 3) the volumetric differences that occur between numbers 1 and 2 ('unmatched positions'),
- BREC participates in the forward term electric market *defensively* to hedge the risk of its forward load serving obligations (short positions) based on monthly or seasonal forecasted peak loads, plus a capacity planning reserve. There are about 730 hours in each calendar month, and due to the unpredictability of the weather, it is impossible to know when the peak load hour will be. Consequently, BREC's forward short and long positions are measured in both MW and MWh.
- Sometimes BREC also has forward positions that are net long after meeting its firm load obligations, and it will participate in the forward term electric market to hedge that risk by selling,
- BREC participates in the weekly/daily/hourly electric market to balance its unmatched positions at the market price in real time, and in the near term timeframe of predictable weather trends,
- BREC also participates in both the short-term and long-term energy markets to hedge its anticipated fuel consumption, financially or physically, and to supply fuel to its generation units,

- BREC is not in the practice of mark-to-market revenue recognition.[1] Revenues from rates to its member systems are cost based, without variability for mark-to-market fluctuations,
- Unlike managing a portfolio of only standard traded electric products (e.g., 5X16 Firm LD at a pricing hub) that protect the parties financially from volumetric risk, BREC's energy portfolio typically has significant volumetric risk, because:
    - Its load obligations are obviously not flat in volume, they fluctuate hour-by-hour, minute-by-minute,
    - Its loads can be difficult to predict (weather forecasts, weather correlation),
    - It owns generation, which is subject to forced outages and derates,
    - Some of its supply resources are not financially firm (hydro allocations, unit contingent purchases, non-firm purchases, etc.),
    - It has physical transmission delivery risks,
- Unlike managing a portfolio of only standard traded electric products (e.g., 5X16 Firm LD at a pricing hub) which are generally liquid, it would be very time consuming to liquidate the entire forward risk in a typical BREC energy portfolio. It is not unusual for BREC to have unmatched positions of load obligations (short) and supply resources (long) that extend out in forward time for 20 to 30 years. In order to 'flatten' BREC's book of unmatched risk positions to a risk neutral position, it would usually require a lengthy time period for a request for proposal ("RFP") and negotiation process to obtain a tailored physical 'wrap-around' alliance deal. Even then, because of the uncertainty of forward electric prices beyond about four years, these types of deals are usually limited to the next 5 or 10 years forward, not 20 to 30,
- Typical derivative risk metrics, such as Value at Risk (VaR), do not factor in volumetric risk, and are, therefore, inadequate to reflect the full risk that is inherent to BREC's business,
- Native load does not behave according to any derivative that can be loaded into a risk system,
- The proper risk measurement and decision support tool for most of BREC's risks are a risk model that incorporates both market price risk and volumetric risk together, and provides for a correlation of native load demand to market prices.

[1] Under the GAAP principle of matching revenues and expenses, even the required FAS 133 marks on options are usually deferred from affecting BREC's statement of revenue and expense since the revenue recovery for option premiums will occur in the period(s) that the option can deliver energy.

Big Rivers Electric Corporation

COMPANY POLICY

POLICY NUMBER: 102 **ORIGINAL EFFECTIVE DATE: _________**
APPROVED BY: Board **ORIGINAL APPROVAL DATE: 7-20-07**
DATE LAST REVISED: ______

RISK MANAGEMENT SANCTIONS POLICY

1. Policy Purpose

The purpose of the Risk Management Sanctions Policy is to assist in ensuring adherence to the BREC Risk Management Policies (Enterprise Risk Management, Trading Authority, Hedge, Financial, Credit, Economic Development, and Safety) and in facilitating the appropriate risk management culture.

The Risk Management Sanctions Policy articulates the consequences of violating the BREC Risk Management Policies, and the methodology used to evaluate violations and develop sanctions. The policy provides the CEO, department management, and the Human Resources Department with the guidelines for determining appropriate disciplinary action, thereby ensuring disciplined and consistent enforcement procedures as they pertain to the BREC Risk Management Policies.

2. Objectives

The objectives of the Risk Management Sanctions Policy are: 1) Ensure that appropriate staff members are aware and educated about the Risk Management Policies; 2) Publicize that disciplinary measures can be taken for policy violations; and 3) Define the procedures by which violations of the Risk Management Policies will be addressed by BREC or its agents.

3. Roles and Responsibilities

It is the responsibility of all employees to report any suspected incidents of risk management policy non-compliance to their immediate supervisor and, in turn, to the VP/Director of Enterprise Risk Management/Chief Risk Officer in a timely, accurate, and complete manner.

The APM Directors of Trading Control, Contract Administration and Credit, and BREC management are responsible for monitoring compliance with the Trading Authority, Hedge, and Credit Policies and reporting all non-compliance incidents of commercial trading activities to the VP/Director of Enterprise Risk Management/Chief Risk Officer for review.

The Enterprise Risk Management Department of BREC is responsible for overseeing enforcement of the Risk Management Policies and notifying the Human Resources Department of any policy violations. Department management and the Human Resources Department are responsible for evaluating non-compliance with policies and recommending appropriate sanctions to the CEO. In situations where time is of the essence, the CEO initiates actions based on his or her findings. At the discretion of the CEO, sanctions may be subject to review and/or approval of the IRMC.

Violations of risk management policies by APM staff are handled internally by APM in a manner that is similar to this policy. APM trading control personnel will report APM staff violations involving BREC activity to BREC's VP /Director of Enterprise Risk Management/Chief Risk Officer.

PROGRAM EDUCATION AND DISTRIBUTION

All policies, programs, procedures, controls, and sanctions governing trading and risk management will be presented to and reviewed with all employees having risk management authority and responsibility. Such employees will be required to sign a written declaration (Exhibit A) stating they have read the policies (Enterprise Risk Management, Trading Authority, Risk Management Sanctions, Hedge, Financial, Credit, Economic Development, and Safety) applicable to their position and acknowledge their understanding of those policies.

EVALUATION PROCESS

The CEO, department management, and Human Resources Department will review the non-compliance incidents as necessary. These parties will decide on the appropriate disciplinary action to be taken. Key factors considered will include:

- Risk management policy awareness
- Record of previous occurrences
- Nature of infraction
- Magnitude of exposure
- Employee's intent
- Collective bargaining agreements
- Other mitigating circumstances

All violations will be reported to the IRMC at their periodic meetings, and significant violations will be reported to the Board.

If the violation involved an IRMC member, that person shall not attend the IRMC meeting when the matter is discussed.

PROGRESSIVE DISCIPLINE LEVELS

The Human Resources Department will be responsible for administering the level of disciplinary action to be applied in any given situation. Within defined parameters, the process allows for the selection of various resolutions and may include a combination of disciplinary actions depending upon the specific circumstances under review. Using the criteria above (see Evaluation Process section), the Human Resources Department will recommend one or more of the following four levels of disciplinary actions:

LEVEL ONE:	**Warning and Education/Counseling**
LEVEL TWO:	**Suspension of Authority/Letter to Human Resources File**
LEVEL THREE:	**Suspension of Employment /Monetary Sanctions**
LEVEL FOUR:	**Discharge**

Note: Although the intent is to be progressive, a deciding factor in the level of disciplinary action to be applied is the nature of the violation, with serious violations resulting in an immediate move to a higher level.

4. **Acknowledgements**

It shall be the responsibility of the Board, through the CEO, IRMC, and the VP/Director of Enterprise Risk Management/Chief Risk Officer to ensure compliance with this policy.

Nothing in this policy shall be deemed to create an express or implied contract of employment or to otherwise alter the fact that employment at BREC is at will employment for no specified period.

Further, this policy does not take precedence over the terms of any applicable collective bargaining agreement.

EXHIBIT A

ACKNOWLEDGEMENT

I, ______________________________, have read the (insert relevant policies for appropriate positions). Further, I understand these policies and have had any questions I have about them answered to my satisfaction.

Date:___________________

____
Signature

Printed Name:_____________________________

Title:____________________________________

Big Rivers Electric Corporation

COMPANY POLICY

POLICY NUMBER:	**ORIGINAL EFFECTIVE DATE: 12-21-07**
APPROVED BY: Board	**ORIGINAL APPROVAL DATE: 12-21-07**
DATE LAST REVISED: _________	

The purpose of the Fuel Procurement Policies and Procedures guidelines is to present the principles that govern the procurement of fuel, reagent, and associated transportation. This document is not intended to provide a step-by-step procedural flow, but place an emphasis on procurement policies and a concise overview of appropriate procurement practices. The awarding of Contracts and Purchase Orders will comply with business controls including corporate governance, authority limit matrices, auditing recommendations, and other established practices and limitations.

FUEL PROCUREMENT POLICIES AND PROCEDURES

A. <u>Definitions</u>:

1. "Agreement" means a legally binding document, in which one party agrees to sell and the other agrees to buy fuel, reagent, or transportation services for such, which is executed by both Buyer and Seller.

2. "Award Recommendation" means the Company's approval process for the review and approval by Senior Management of a recommended fuel, reagent, or transportation purchase that fall outside the limits established in the Company's granted authority limits.

3. "Company" means Big Rivers Electric Corporation.

4. "Contract" is an Agreement, Letter Agreement, Purchase Order, or Spot Contract for fuel supply, reagent, or such transportation with certain terms and conditions that describe the business transaction under which the Company procures fuel, reagent, and related transportation.

5. "Contract purchase" means any purchase of fuel, reagent, or transportation on behalf of the Company under a contract, typically more than one year's duration.

6. "Department" means the Company's Fuels Department.

7. "Director" means the Company's Director of Fuels.

8. "Emergency" means extraordinary conditions affecting Fuel production, transportation, or usage, including but not limited to strikes, lockouts or other labor problems, embargoes, mining impediments and other problems affecting the production or transportation of Fuel, existing and/or forecasted extreme weather conditions, or any other conditions or circumstances that could be reasonably foreseen as impairing the continued supply of Fuel to Company facilities.

9. "Environmental standards" mean the legal requirements for compliance with emission levels or other environmental requirements applicable to one or more of the Company's generating units.

10. "Fuel" means combustibles purchased by the Company for one or more of its generating stations.

11. "Senior Vice President Energy Services and Chief Energy Officer" means the Company's principal senior officer responsible for fuel procurement, among other duties.

12. "Vice President Power Production and Chief Production Officer" means the Company's principal senior officer responsible for power generation, among other duties.

13. "Solicitation" means the process of soliciting bids (written or oral) for the supply of fuel, reagent, and/or related transportation services.

14. "Spot Contract" is a type of agreement that may be issued by the Company for the supply of fuel, reagent, or related transportation of such with a term of typically one year or less.

15. "Spot Purchase" means any purchase of fuel, reagent, or related transportation on behalf of the Company where the terms and conditions are incorporated in the Letter Agreement, Purchase Order or Spot Contract and the term is typically of one year or less.

16. "Station" means one of the Company's generating facilities.

17. "Supplier" means the seller or counterparty to an agreement who is obligated to comply with and fulfill the agreement's terms and conditions.

18. "Unit" means a generating unit at a station.

B. Fuel Procurement Policies:

The Company's fuel procurement policy is to obtain an adequate supply of fuel and reagent of sufficient quality at the most competitive overall evaluated cost on a unit bus bar basis consistent with the Company's obligations to provide adequate and reliable service to its customers, to meet operational and Environmental Standards, and to meet any other applicable legal requirements. The Company will use its best efforts to secure its fuel and reagent supply at competitive prices through solicitation for such.

Implementation of this policy is of highest priority to the Company. The Fuels Department shall be organized and staffed, and fuel procurement procedures and administration shall be conducted, in an efficient and practical manner consistent with this policy. Fuel, reagent, and related transportation shall be purchased at competitive prices considering all material factors. The factors include but are not limited to: quantity needed to maintain an adequate supply, quality necessary to ensure generating unit operating and maintenance characteristics and environmental standards, reliability of the supplier, creditworthiness, and forward planning to meet projected system requirements, and meeting emergency or other unusual circumstances that might affect operating conditions. From time to time, the Director of Fuels will review the Company's Fuel Procurement Policies and Procedures and update the policies as appropriate.

C. Organization:

1. Department Structure. The Department shall be organized and staffed to effectively administer the Company's fuel procurement function.

2. Organizational Responsibility. The Senior Vice President Energy Services and Chief Energy Officer to whom the Director reports, has the responsibility for fuel procurement. The Director is responsible for the Department. Other departments may be called upon by the Department to the extent the Director or Senior Vice President Energy Services and Chief Energy Officer considers advisable in the execution of the functions of the Department.

3. Approval Authority (Award Recommendation). An Award Recommendation will be prepared for all fuel purchases that exceed the term, tenor, or notional amount of authority of the Director of Fuels which is specified in the single transaction authority limits by the Company. The Award Recommendation will be drafted by the Director, reviewed by Fuels legal counsel, and executed by the Senior Vice President Energy Services and Chief Energy Officer within the authority granted by the Trading Authority Policy. Greater expenditures shall require the signature of the Company's President and Chief Executive Officer and within his trading authority as

established by the Board of Directors. These levels of authority may be amended, supplemented, or superseded as dictated by the Company.

4. Reports. The Director will instruct the Department to prepare, maintain and distribute reports to management and others as deemed necessary for business operations and regulatory requirements.

5. Records. The Department shall maintain the following records:

   a. Open Files. The Department shall maintain the following on open status for at least one-year or longer as the contract term or other conditions warrant:

      (1) For each current contract supplier, the files will contain:

         (a) Contract documents, amendments, purchase orders and escalation documentation;

         (b) General correspondence;

         (c) Invoices and invoice verification data;

         (d) Delivery records and quality analyses data;

         (e) Inspection reports and other data.

      (2) A record of transportation equipment owned or leased by the Company (as applicable).

      (3) A list containing current suppliers and known potential Suppliers of fuel.

   b. Closed Files. The Department shall maintain its files according to the Company's record retention plan.

6. General Administrative Duties.

   The Department shall subscribe to and have membership in appropriate trade and industry publications and/or associations, to include reports of governmental or consulting agencies concerning fuel, reagent, and related transportation market information, to include fuel prices and/or projections. Department personnel shall use their best efforts to keep current with fuel market conditions, prices and availability, and other developments relating to fuel procurement.

D. Fuel Supply Procedures:

1. Projections. In conjunction with other departments of the Company, the Department shall prepare annually a projection of fuel usage and cost at each

Station for the number of years required for use in the Company's planning process.

2. Contract/Spot Mix. Subject to the approval of the Senior Vice President Energy Services and Chief Energy Officer, the Director shall determine whether a contract purchase is advisable, considering the following factors: (a) the availability of adequate supplies from qualified suppliers, (b) the advisability or need to have an adequate supply committed for an existing or planned unit (subject to inventory limits specified by the Company), (c) the desire to maintain practical flexibility as to market conditions and other factors affecting price and availability, (d) existing and anticipated Environmental Standards, (e) such other factors as may reasonably affect the implementation of the Company's Fuel procurement policy and (f) fuel impact on generation facilities' operation and maintenance.

3. Current Requirements. The Department shall review and analyze the data available to the Department for purposes of conducting fuel and reagent purchases in a timely manner to meet the requirements of the Company.

4. Supplier Qualifications. The Company shall select potential suppliers on the basis of evaluation, market intelligence, performance information (as available), industry research, and creditworthiness, as determined by the Director and his staff. No potential qualified supplier shall be preferred or discriminated against because of race, religion, color, sex, age or marital status of the supplier or any of its representatives.

   A supplier evaluation (to include site visit and mine engineering and/or performance report) may be performed to determine if a supplier has the ability to deliver in the time frame requested the quantity and quality of coal or reagent bid at the offered price.

5. Solicitations. The Department shall maintain a current list of Suppliers and shall review that list from time to time to ensure that it remains current. Normally, the Company shall purchase its Fuel and reagent through sealed bid solicitations; however, the Company reserves the right to utilize its market intelligence to seize opportunity purchases of Fuels and reagent, request oral, written, or electronic offers, potentially followed by negotiations, when in its judgment market conditions provide an opportunity to obtain Fuel or reagent more advantageously than through mailed bid solicitations and usual procedures. When the Company foregoes the solicitation process, documentation shall be appended to the resulting purchase order file describing the conditions.

   A notice of a request for quotation ("RFQ") shall be provided to normal industry newsletters and information postings. The normal solicitation process shall require that potential suppliers be notified in writing as to the general quantities, terms and quality specifications required. An RFQ number will be assigned to for the quotation package. An RFQ will include: instructions to bidders (date and time due); scope of supply (quantity and quality); potential term; standard terms and conditions of typical agreements.

Offers from potential suppliers shall be returned by the requested date and time or they will be rejected. A bid log shall be kept for logging in receipt of bid offers. Attendees viewing the opening of the bid shall initial the bid document as opened and the log as at the completion of the opening. Offers shall be opened and logged in the presence of the Senior Vice President Energy Services and Chief Energy Officer and Director of Fuel or their representative in their absence, and another selected representative outside of the Fuels Department.

All appropriate bid data shall be documented and electronically categorized for the process of evaluation of the various offerings of Fuel and reagent. The documents shall be maintained in a secured area and shall be kept pursuant to normal record keeping practices.

6. <u>Contract Awards.</u> The Department shall review and analyze each Contract offer. The Director, or his/her representative, may engage in preliminary negotiations to determine which offers warrant further consideration. The Director and/or representative shall investigate the potential supplier and proposed source of supply; and, as to any offer for fuel, the Department shall verify the adequacy of the proposed source of supply as to quantity, quality, and timely deliverability.

   The evaluation shall include, but not necessarily be limited to, the response to the RFQ (items required by the RFQ for satisfactory operational, environmental, and economic criteria); diversity of supply; supplier credit assessment; transportation mode and cost; and diversity of suppliers to provide the lowest evaluated cost of electrical energy to the Unit bus bar over the long term.

   From this initial evaluation, a select group of potential suppliers (a "short-list") of suppliers shall be developed for more in-depth evaluation. The Department may then engage in preliminary discussions to ensure that the offer warrants further evaluation and consideration. The objective of the negotiating discussions is to ensure that the Company achieves balanced terms and conditions and the lowest evaluated electrical energy delivered to the Unit bus bar and reliable supply consistent with other qualifiers related to supplier reliability, environmental restraints, transportation options, etc.

   The recommended Supplier(s) shall be selected by the negotiating team based upon the evaluation criteria and the results of the negotiating discussions. The Department shall prepare a detailed Award Recommendation for approval. The Award Recommendation shall document the selection criteria and pertinent factors, and in circumstances where more than one company is selected, the recommendation shall describe the tonnage requirements and other responsibilities of each of the other recommended Suppliers.

All contracts for which the term, tenor or notional amount exceed the limits specified for the Director of Fuels must be approved and signed by applicable Senior Officer(s).

7. Spot Purchases. Spot purchases may be made by the Company whenever considered advisable by the Director in furtherance of the Company's Fuel and reagent needs, subject to the limit of authority as outlined by the Company.

8. Documentation. Contracts shall be signed by a duly appointed officer of the Supplier and the Company. A purchase order may be issued for a spot purchase. A purchase order shall contain all terms of that purchase. Further, the Department shall maintain documentation of the final list (log) of bidders, a copy of the entire bid package; bidder's responses; and the bid evaluation summary used for decision support.

9. Fuel Oil. Fuel Supply Procedures principally address procurement of solid fuel. Fuel oil is procured on an "as-needed" basis due to the infrequency of use of this fuel and the nature of the oil markets. When the need for oil arises, the Fuels Department shall act to solicit vendors for offers. Orders are assigned on the basis of lowest delivered cost per mmBTU and ability to fill the order. Solicitation results shall be documented and purchase orders issued in the Fuels Department for those purchases initiated and completed by the Department.

E. Fuel Supply and Reagent Agreement Administration:

1. Compliance. The Department shall review and analyze daily business and operational reports to properly administer all fuel and transportation agreements.

2. Coal weights. Coal weights shall be obtained by either the Company or by Supplier, upon agreement by Company. Coal weight is obtained by scale or draft method, depending upon Company site or methodology employed by Supplier to ascertain weights. In either event, coal weights are obtained by industry-accepted standards, and in cases where scales are utilized, are duly tested and maintained in proper order for such purpose. In cases where draft weights are utilized, the Company employs processes to verify actions to obtain draft weights and that such measures are by industry-accepted standards. Coal quantity is obtained by Station personnel and reported through the fuels information system or is provided by the Supplier pursuant to the contract agreement.

3. Coal sampling. Coal sampling and analysis shall be performed by either the Company or the Supplier, upon agreement by Company. Coal sampling and analysis shall be performed according to procedures adopted by the Company's laboratory in accordance with A.S.T.M. standards for coal sampling, coal sample preparation, coal sample identification, handling of sample, and coal analysis. Coal quality is assessed and reported through the fuels information system by

the Company's laboratory personnel or is provided by the Supplier pursuant to the contract agreement.

4. Amendments. A contract shall not be materially amended except after analysis by the Department and recommendation of the Director of Fuels or the Senior Vice President Energy Services and Chief Energy Officer. No material contract or purchase order addendum shall be made except upon recommendation of the Director and subject to the approval limits of the Company.

5. Contract Administration. The Director and the Department shall remain informed as to the terms and conditions of each current contract, and maintain the necessary data to administer the contracts. Every supplier request for a change in terms, conditions, or prices must be written and supported by adequate data in conformity with the contract. Each such request shall be analyzed by the Department against the contract provisions, and reported with recommendations to the Director. After review by the Director, the supplier request and Department's recommendations shall be approved as required by the Company. If any request is not approved in whole or in part, the Director shall advise the supplier, specifying the Company's objections with an adequate explanation. If the supplier's request is not approved, negotiation between the supplier and Company as dictated by contract terms shall be the primary method of resolving the issue.

6. Force Majeure. A supplier's claim for relief from compliance with fuel supply agreement terms due to force majeure conditions must be in writing with an adequate description of conditions warranting nonperformance. Each force majeure claim shall be reviewed by the Director and the company's legal counsel.

7. Inspections. The Director shall request inspections of mining and other facilities of a contract fuel and/or reagent supplier or other facilities as required or deemed necessary to manage the performance and contractual relationship (Contract Administration).

F. Fuel and Reagent Supply Agreement Enforcement:

1. General Enforcement Policy. Supplier obligations under Fuel or Reagent Supply Agreements shall be enforced by the Company in a reasonable, fair, and practical manner to achieve supplier compliance with the Company's overall procurement policy and the continuing supply of fuel to meet current and anticipated system requirements.

2. Director Responsibility. Whenever it is determined that a shipment does not meet Fuel Supply or Reagent Agreement terms, the Director, or his/her designee, shall inform the supplier and direct that subsequent shipments be in compliance. When necessary the Senior Vice President Energy Services and

Chief Energy Officer and the Director may determine, or receive advice, as to further action needed to assure fuel or reagent supply agreement compliance.

3. Legal Assistance. The Department shall have access to, and shall receive advice from, legal counsel as provided by the Company on any matter relating to Fuel, reagent, and related transportation procurement, contracts and amendments thereto, administration, and enforcement. Should a dispute as to a supplier's performance fail to be satisfactorily resolved by the Director, the matter shall be referred to legal counsel. Legal counsel may consider further negotiation, arbitration (if provided by the contract), or litigation. No arbitration or litigation shall commence except on the advice of said counsel with approval by senior management.

G. Inventory Levels:

The Company has an obligation to ensure continuous low cost, reliable service to its members. Decisions affecting fuel inventory shall consider these obligations.

The Company shall maintain an adequate inventory while allowing for enough flexibility to permit inventory levels to be responsive to known and anticipated changes in conditions in an attempt to avoid risks and stoppages due to unforeseen conditions. Inventory shall be recommended based upon, but not limited to, supplier performance, environmental conditions, labor matters, logistical issues and concerns, and generation requirements and dispatch. The general level of inventory shall be monitored for such matters and recommendations to adjust inventory to meet anticipated conditions shall be made from time to time. Such inventory recommendations shall be made by the Director for approval by the Senior Management of the Company.

Coal inventories and reagent shall be monitored and reported regularly via the Company's fuel information system(s).

H. Emergency Procurement:

Any one or more of the procedures described herein may be waived by the Senior Vice President Energy Services and Chief Energy Officer, when, in the informed judgment of the Director, and on his recommendation, fuel must be purchased without complying with one or more of such provisions due to extraordinary conditions including strikes, lockouts or other labor problems affecting fuel production, embargoes, mining or other problems affecting production or transportation, existing and/or forecasted extreme weather conditions, or any other conditions or circumstances that can be reasonably foreseen as impairing the continued supply of Fuel and reagent to the Company from its existing suppliers. When such a purchase is made, documentation of circumstances will be appended to the purchase order and/or contract file.

I. Transportation Services Contracts:

Transportation services bids shall be requested and Contracts negotiated whenever appropriate. Consideration shall be given to plant requirements, supplier loading capabilities, relative location of supplier to Stations, transportation mix, unloading capabilities and capacities at Stations, logistic constraints, transportation provider economics, Station material handling economics, and any other factor which might affect the delivery of Fuel and reagent to the Company's Stations.

Unless otherwise dictated by Emergency situations, the Solicitation process will be utilized for transportation services. The selection of transportation provider will generally be based upon, but not necessarily limited to cost, reliability, insurance, past / current performance, container availability and suitability for purpose, material handling capacities and constraints, transportation mix, and any other mitigating factors in terms of logistics.

All transportation service agreements shall be in written contractual form duly executed by an authorized supplier of service and the Company.

J. Ethics and Conduct:

The Company recognizes the importance of following appropriate Business Conduct to guide the conduct of the Fuels Department in the performance of its duties and responsibilities and as such has added a guide as addendum to this document.

Fuels staff shall endeavor to serve the best interests of the Company, its members, and stakeholders in the performance of their duties and responsibilities.

Fuels staff shall adhere to the ethical standards and policies of the Company. Each contractual document shall denote that the contract was prepared and executed in ethical dealing.

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION OF KENTUCKY

In the Matter of:

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

<u>EXHIBIT 6</u>

Final orders dated April 30, 1998, in *The Application of Big Rivers Electric Corporation, Louisville Gas and Electric Company, Western Kentucky Energy Corp., Western Kentucky Leasing Corp., and LG&E Station Two Inc. for Approval of Wholesale Rate Adjustment for Big Rivers Electric Corporation and for Approval of Transaction,* PSC Case No. 97-204 (Final Order dated April 30, 1998), and July 14, 1998, in *The Application of Big Rivers Electric Corporation for Approval of the 1998 Amendments to Station Two Contracts Between Big Rivers Electric Corporation and the City of Henderson, Kentucky and the Utility Commission of the City of Henderson,* PSC Case No. 98-267 (Final Order dated July 14, 1998)

December 2007

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF BIG RIVERS ELECTRIC CORPORATION, LOUISVILLE GAS AND ELECTRIC COMPANY, WESTERN KENTUCKY ENERGY CORP., WESTERN KENTUCKY LEASING CORP., AND LG&E STATION TWO INC. FOR APPROVAL OF WHOLESALE RATE ADJUSTMENT FOR BIG RIVERS ELECTRIC CORPORATION AND FOR APPROVAL OF TRANSACTION	)	CASE NO. 97-204

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COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF BIG RIVERS ELECTRIC CORPORATION, LOUISVILLE GAS AND ELECTRIC COMPANY, WESTERN KENTUCKY ENERGY CORP., WESTERN KENTUCKY LEASING CORP., AND LG&E STATION TWO INC. FOR APPROVAL OF WHOLESALE RATE ADJUSTMENT FOR BIG RIVERS ELECTRIC CORPORATION AND FOR APPROVAL OF TRANSACTION	) CASE NO. 97-204

ORDER

BACKGROUND

On June 30, 1997, Big Rivers Electric Corporation ("Big Rivers") and the LG&E Parties[1] (collectively referred to as "Applicants") filed an application requesting the Commission to approve or declare nonjurisdictional numerous rate, financing and operating agreements that are an integral part of Big Rivers' efforts to implement the First Amended Plan of Reorganization ("Reorganization Plan") approved by the U.S. Bankruptcy Court in Big Rivers' Chapter 11 proceeding. These agreements provide for a long-term lease of Big Rivers' generating units to WKEC, reduced wholesale rates for Big Rivers'

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1 The LG&E Parties are wholly-owned subsidiaries of LG&E Energy Corp. ("LEC"). The subsidiaries which are co-applicants with Big Rivers are Louisville Gas and Electric Company ("LG&E"); Western Kentucky Energy Corp. ("WKEC"); Western Kentucky Leasing Corp. ("Leaseco"); and WKE Station Two Inc. ("Station Two Subsidiary"), formerly known as LG&E Station Two Inc. In addition, LG&E Energy Marketing Inc. ("LEM"), formerly known as LG&E Power Marketing Inc., is a party to numerous agreements making up the proposed transaction.

four member distribution cooperatives, and the financings necessary to effectuate a restructuring of Big Rivers' debts.

The Applicants requested a declaration from the Commission that implementation of the Reorganization Plan does not constitute a transfer of ownership or control over Big Rivers within the meaning of KRS 278.020(4) or 278.020(5). In the alternative, they requested that if the Commission determines that there is a transfer of control within the meaning of the statute, that the Commission approve the transfer of control, as implemented through a series of Reorganization Plan documents.[2] Approval was also requested of a Transmission Service and Interconnection Agreement, including to the extent required, Big Rivers' Open Access Transmission Tariff, which is to be filed at the Federal Energy Regulatory Commission ("FERC"). The Applicants have filed in this case numerous versions of the Reorganization Plan documents, as well as the corresponding tariffs which reflect the provisions of those documents.

In summary, the proposed transaction is structured into two phases. Under Phase I, WKEC will operate and maintain the Big Rivers' generating units, Big Rivers will sell all power generated to LEM, and LEM will resell to Big Rivers power sufficient to meet its wholesale obligations. All power not resold by LEM to Big Rivers can be sold by LEM for

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2 The Reorganization Plan documents include the Participation Agreement; the Facilities Operating Agreement; the Cost Sharing Agreement; the Power Purchase Agreement; the Lease and Operating Agreement; the Mortgage and Security Agreement; the Guarantee Agreement; the Nondisturbance Agreement; and the Tax Indemnification Agreement. See Application, at 14-15.

its own account. Leaseco will purchase from Big Rivers the generation-related inventory[3] at its fair market value, all personal property at its net book value, and will be assigned certain intangible assets.[4] After necessary federal regulatory approvals are received, and prior to or contemporaneously with the commencement of Phase II, Leaseco will be merged with and into WKEC.

In Phase II, WKEC will lease Big Rivers' generating facilities for a 25-year term, perform all necessary operations and maintenance services, and sell the output of the generating facilities to LEM. WKEC will be an Exempt Wholesale Generator ("EWG") in accordance with Section 32 of the Public Utilities Holding Company Act of 1935 ("PUHCA") and its wholesale sales of power will be under the exclusive jurisdiction of FERC.

Station Two Subsidiary will subcontract with Big Rivers to perform operations and maintenance services for the Henderson Municipal Power & Light ("HMP&L") Station Two facility, and Big Rivers will assign to Station Two Subsidiary certain of its rights and obligations under contracts with HMP&L for operation of HMP&L's Station Two facility. Big Rivers' wholesale power supply contracts with its four member cooperatives will be revised, as well as the member cooperatives' retail contracts with the aluminum Smelters.[5]

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3 Included in this inventory is all of Big Rivers' fuel and scrubber reagent, spare parts, SO_2 emission allowances, and all materials and supplies held for use in conjunction with the operation of the generating facilities.

4 Intangible assets include real property leases, equipment leases, permits, and contracts used in connection with the operation of the generating facilities.

5 The aluminum smelters are the Southwire Company and NSA, Inc. ("Southwire") and Alcan Aluminum Corporation ("Alcan").

The Reorganization Plan further provides that Big Rivers will contract with LEM to purchase power from LEM, at levels sufficient to cover all of the anticipated needs of Big Rivers' members. Big Rivers' outstanding debt with the Rural Utilities Service ("RUS"), formerly the Rural Electrification Administration, has been restructured and the current credit providers for Big Rivers' pollution control bonds have been replaced by new credit providers. Once the necessary approvals for the Reorganization Plan have been secured, Big Rivers will be out of the generating business while retaining its wholesale supply, transmission, and planning functions.

Big Rivers requested authority to implement on an interim basis rate reductions for wholesale electric service commencing on September 1, 1997 and continuing through the earlier of the closing date of the proposed transaction or August 31, 1998. The rate reductions proposed in Big Rivers' interim rates mirrored those of its proposed permanent rates. The Commission, by Order dated August 29, 1997, suspended the interim rates for one day and allowed them to become effective subject to change for service rendered on and after September 2, 1997. The Commission also determined that the approved interim rates should remain in effect only until issuance of a final rate Order determining the reasonableness of the proposed permanent rates.[6]

The Commission received requests for and granted intervention to the Office of the Attorney General ("AG"), Southwire, Alcan, Green River Electric Corporation ("Green River"), Henderson Union Electric Cooperative Corporation ("Henderson Union"), Jackson Purchase Electric Cooperative Corporation ("Jackson Purchase"), Meade County Rural

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[6] Case No. 97-204, Order dated August 29, 1997, at 4.

Electric Cooperative Corporation ("Meade County"), Chase Manhattan Bank ("Chase"), Bank of New York, Commonwealth Industries Inc., Willamette Industries Inc. ("Willamette"), PacifiCorp Power Marketing Inc., and the Kentucky Association of Plumbing, Heating and Cooling Contractors, Inc.

Informal conferences were held at the Commission's offices on July 16, 1997, October 8, 1997, and February 4, 1998. Public hearings were held on November 18 - 24, 1997 and March 18, 1998. Initial briefs were filed on January 30, 1998 with reply briefs filed on February 13, 1998. Supplemental briefs which were limited to the "unforeseen cost" issue were filed on March 30, 1998, with supplemental reply briefs filed on April 6, 1998.

HISTORY

Big Rivers is a rural electric cooperative utility, organized pursuant to KRS Chapter 279, which provides generating and transmission services to its four owner members. Each of its members is a rural electric cooperative utility engaged in the distribution of electricity and collectively they serve 91,500 customer members in 22 western Kentucky counties.

Big Rivers began experiencing financial problems in the mid-1980's shortly after completing construction of its newest generating station, the Wilson Generating Station ("Wilson"). Those problems were precipitated by a number of factors, including the relatively high cost of Wilson, a significant reduction in load growth, and claims by the Smelters that any rate increase would render their operations noncompetitive in world markets and drive them out of business. Big Rivers was eventually able to negotiate a debt restructuring agreement with its creditors which the Commission approved in 1987 along with higher rates for all customers, including new rates for the Smelters which varied with the price of aluminum.

The revenue levels necessary to satisfy Big Rivers' debts as restructured in 1987 could not be achieved solely from power sales to its four member cooperatives. Rather, additional revenues needed to be generated each year through the sale of increasing levels of power to non-member wholesale customers. Unfortunately, the wholesale market for power was soft during this time and Big Rivers' sales efforts were unsuccessful in producing the revenue levels necessary. By the early 1990's Big Rivers recognized that it would soon be in a default position and it began discussions with RUS on the need for further debt restructuring.

Big Rivers' fortunes also changed from bad to worse during this period with the criminal and civil investigations and trials involving bribes and kickbacks in connection with its coal contracts and a former general manager. In an effort to find a long-term solution to its mounting financial problems, Big Rivers hired a "turn-around" specialist to advise and assist management in pursuing available business options. This action led to Big Rivers' solicitation of business offers and the eventual decision in early 1996 to pursue a business arrangement with PacifiCorp Holdings, Inc. ("PacifiCorp"). Under the terms of that transaction, a subsidiary of PacifiCorp would lease Big Rivers' generating units for 25 years and sell back to Big Rivers certain quantities of power at pre-established prices. While negotiating the terms of this transaction, Big Rivers was also negotiating with its major creditors to achieve a consensual restructuring of its debts and with its system's two largest retail customers, two aluminum smelters, to achieve long-term rate reductions and rate stability. When its efforts to achieve a consensual debt restructuring were unsuccessful, Big Rivers filed on September 25, 1996 a petition for reorganization under Chapter 11 of the Bankruptcy Code.

Big Rivers' Plan of Reorganization, as originally filed with the Bankruptcy Court on January 22, 1997, included the lease transaction with PacifiCorp and lower electric rates that had been negotiated with the two smelters, one large non-smelter industrial customer and the four member cooperatives. The following month the Bankruptcy Court initiated an auction process to determine whether the PacifiCorp lease was providing maximum value to the Big Rivers' estate. The only entity to submit a bid in this process was LEC, and on March 19, 1997 the Bankruptcy Court accepted LEC's lease proposal on the basis that it would provide greater value to the Big Rivers' estate.

Big Rivers' Plan of Reorganization, as amended, which now included a lease transaction with subsidiaries of LEC and the lower rates previously negotiated with certain customers, was approved by the Bankruptcy Court on June 9, 1997. While the Bankruptcy Court has exclusive jurisdiction over a debtor's plan of reorganization, that jurisdiction does not include the right to approve a change in rates for a debtor utility whose rates are subject to regulation. Rather, the Bankruptcy Code, 11 U.S.C. §1129(a)(6), requires a debtor utility to obtain all necessary rate approvals from the appropriate regulatory agencies as a condition for final approval of a reorganization plan that includes a change in rates.

DISCUSSION OF ISSUES

Unforeseen Cost Issue

The Big Rivers' tariffs for service to Alcan and Southwire, which are to remain in effect for 12-13 years, specified that the Smelter rates contained therein would not be adjusted to reflect any cost or payment incurred by Big Rivers or the member distribution cooperatives for any expenditures due to legislation, regulatory action, legal action, or due to any other reason, whether foreseeable or unforeseeable (commonly known as the unforeseen cost issue).[7] This tariff provision was premised on the assumption that there would be no major changes in environmental law or regulation during the remaining term of the Smelter contracts, which extend to 2010 for Southwire and 2011 for Alcan.[8]

Contrary to this assumption, on October 10, 1997, the U. S. Environmental Protection Agency ("EPA") issued a notice of proposed rulemaking which would significantly reduce the existing emission levels for nitrogen oxide (NOx). The emission reductions, if implemented, have the potential to significantly increase Big Rivers' capital and operating costs such that wholesale rate increases would be necessary. This tariff provision became the focus of extensive cross-examination during the November 1997 hearing. Numerous questions were raised concerning the financial ability of Big Rivers to absorb this or any other unforeseen costs without increasing rates and whether exempting

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7 First Revised Exhibit 3(b), filed September 25, 1997, Item 9, at 48, 76, and 77 of 115. The tariffs referenced the following examples of such action: carbon tax, BTU tax, CO, emissions reduction, or any other environmental or energy tax, charge, or liability.

8 Transcript of Evidence ("T.E."), Volume I, November 18, 1997, at 100.

the Smelters from paying an appropriate share of unforeseen costs would obligate all other customers to pay the Smelters' share. At the conclusion of the November 1997 hearing, the Commission stated that the absence of a resolution of the unforeseen cost issue was a serious deficiency and suggested that the affected parties attempt to negotiate a mechanism to allocate future unforeseen costs in an equitable manner to each class of ratepayers.[9]

Big Rivers and the LG&E Parties notified the Commission on January 27, 1998 that a resolution of the unforeseen cost issue had been agreed to by some of the parties[10] and a term sheet for the resolution was submitted on February 3, 1998. In summary, the unforeseen cost resolution includes the following provisions:

1) LEM will supply directly to Henderson Union and Green River the wholesale power needed to serve Alcan and Southwire, with LEM assuming all the risks for the Smelter loads.

2) Big Rivers will continue to supply wholesale power to Henderson Union and Green River for their non-smelter loads, as well as the total loads of Jackson Purchase and Meade County.

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9 T.E., Volume V, November 24, 1997, at 235-236.

10 The parties agreeing to the Resolution were Big Rivers, the LG&E Parties, Alcan, Southwire, Green River, Henderson Union, and Meade County.

3) LEM will pay directly to RUS, on the behalf of Big Rivers, the level of Smelter net margins originally included in Big Rivers' financial models.[11]

4) Big Rivers and LEM agreed to a number of changes concerning the financing of all future capital improvements envisioned for the Big Rivers' generating facilities.

5) Revisions were made to the RUS mortgage which provide Big Rivers a financing source for its share of future capital improvements.[12]

6) The use of arbitrage sale proceeds was revised, which would allow Big Rivers to make additional payments on its RUS mortgage as well as the RUS asset residual value note ("ARVP").

7) Big Rivers will pay to LEM $1.85 million per year over the 25-year lease. The Smelters will pay to LEM an additional .5 mills per KWH on Tier 1 and Tier 2 power purchased.

8) Big Rivers was required by RUS to make additional up-front payments on its mortgage, and Big Rivers and LEM agreed to

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11 The original Big Rivers' financial model was provided in the Application as Appendix L. While revisions to the financial model have been prepared and submitted, all versions are based on the version contained in Appendix L. These subsequent revisions have been identified as "MH-5A," "MH-5B," "SUP-11," and "SUP-16."

12 Referred to in the record as the "clawback" provision.

a financing arrangement which would allow Big Rivers to make the additional payments.

Big Rivers, the LG&E Parties, Alcan, Southwire, and Chase all expressed support for the unforeseen cost resolution.[13] Big Rivers stated that the resolution addressed the Commission's concerns regarding how Big Rivers would meet future unforeseen costs, including the possible impact of the EPA's NOx proposal, without the subsidization of the Smelters by non-Smelter customers.[14] The LG&E Parties noted that the resolution changes Big Rivers' initial funding responsibilities for capital expenses and allows it additional funds and increases its financial flexibility in the early years of the transaction.[15] Alcan and Southwire argue that the resolution should be given a chance to close since it has the potential to finally resolve the difficult Big Rivers' situation in a manner that is fair to all customer classes and creditors.[16] Chase contends that the resolution provides significant benefits to Big Rivers and its non-Smelter customers, in that Big Rivers is protected from credit risks associated with the Smelters, Big Rivers and its other customers are shielded from unforeseen costs attributable to the Smelters' load, and all customers will enjoy the same rates they were to receive under the Reorganization Plan.[17]

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13 The Bank of New York filed a statement on March 30, 1998 concurring with the statements filed by Chase, but did not file a separate brief.

14 Big Rivers Supplemental Initial Brief at 4.

15 LG&E Parties Initial Brief Addressing Future Unforeseen Cost Issue at 14-15.

16 Alcan and Southwire Supplemental Brief on Unforeseen Cost Resolution at 15.

17 Chase Brief Concerning "Unforeseen Costs" Issue at 3.

Willamette did not oppose the unforeseen cost resolution, noting that it was more fair and reasonable than Big Rivers' original proposal.[18] However, Willamette expressed its concern that the customers remaining with Big Rivers would have to bear the annual $1.85 million payment to LEM, either directly through the cost of electric power or indirectly by other revenue that would otherwise be dedicated to offsetting costs borne by Big Rivers' customers.[19]

The AG opposed the unforeseen cost resolution, contending that the filing was incomplete and the record lacked sufficient evidence upon which to base a decision.[20] The AG further argued against the resolution because it would cause Big Rivers to incur additional expenses to maintain the Smelters' fixed rates and negate the Smelters' contribution to the debt payments, all to the detriment of the other customers.[21] The AG also claims that the resolution will cause Big Rivers, Green River, and Henderson Union to be in violation of KRS 279.095 because they will no longer be operated for the mutual benefit of their members.[22]

In support of the unforeseen cost resolution, Big Rivers prepared an economic analysis which compared the cash flows generated in its financial model under two scenarios. The first financial model, identified as MH-5A, included no expenditures for

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18 Willamette Initial Brief on the Unforeseen Cost Issue at 1.

19 Id. at 6.

20 AG Initial Brief on the Unforeseen Cost Resolution at 2.

21 Id. at 7.

22 Id. at 8-10.

unforeseen costs; while the second, identified as SUP-11, reflected the $1.85 million annual payments.[23] The comparison revealed that, over the 25-year term, SUP-11 showed a cumulative decrease in cash flow of $130.3 million on a nominal basis and a negative $18.5 million cumulative net present value when compared to MH-5A.[24] In each year of the analysis, the ending cash balance was positive, but at lower levels in SUP-11 than in MH-5A. However, arbitrage sales were not modeled in either MH-5A or SUP-11.

In evaluating the reasonableness of the unforeseen cost resolution, the Commission has considered all of the arguments put forth by the parties and the economic analysis prepared by Big Rivers. In addition, the Commission has considered the potential impact that arbitrage sales would have on the economic analysis which compared the financial models MH-5A and SUP-11. Arbitrage sales are defined in the Reorganization Plan as all net revenues received in any particular calendar year resulting from one of three types of transactions. The first reflects the net benefit of purchasing power from third parties instead of purchasing such power from LEM during off-peak periods. The second reflects the net benefit of selling equivalent amounts of power using purchases from LEM during peak periods. The third reflects the net revenues of any new off-system power sales in

23 MH-5A is a version of the Appendix L financial model updated before the November 1997 hearing, prior to the parties addressing the unforeseen cost issue. SUP-11 is based on MH-5A, but reflects the impact of the Resolution, and was filed on February 23, 1998, as part of the Robison, Schaefer, and Hite Supplemental Testimony.

24 Response to the Commission's March 10, 1998 Order, Item 1, page 4 of 16.

excess of net revenues currently projected for such sales.[25] Originally, the net revenues from arbitrage sales were to be allocated 50 percent to Big Rivers and 50 percent as a payment on the RUS ARVP. As part of the unforeseen cost resolution, the allocation was changed to one third to Big Rivers, one third as payment on the RUS mortgage, and one third as payment on the ARVP. The Commission believes that arbitrage sales were an important benefit originally to Big Rivers' Reorganization Plan and that the unforeseen cost resolution's changes to arbitrage sales have increased that benefit.

The Commission finds that the unforeseen cost resolution is reasonable and addresses the concerns expressed at the November 24, 1997 hearing. The change in the way capital expenditures are financed, the adjustment in the allocation of operation and maintenance costs, the availability of financing resources for Big Rivers in the event additional unforeseen capital expenditures arise, the guarantee of the Smelter margins, and the revisions to arbitrage sale proceeds are all improvements to the overall transaction. The benefits of these improvements outweigh any detriments of the additional expenses for Big Rivers. While the ending cash flow is lower with the unforeseen cost resolution than without it, such a comparison is inappropriate. The financial model without the resolution included no expenditures for unforeseen costs, although Big Rivers was at risk for all such costs. The financial model with the resolution transfers that previously unquantifiable risk to the LG&E Parties for a known cost. The unforeseen cost issue has thus been resolved in a manner which produces significant additional benefits for non-

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25 Application Appendix C, page 35 of 121, First Amended Plan of Reorganization. The current projections for off-system sales are incorporated into the financial model, beginning in 2011.

Smelter customers without changing non-Smelter rates and is consistent with the cooperatives' obligations under KRS 279.095. Therefore, based on the representations and concepts expressed in the documents filed on or before February 27, 1998, the Commission approves in principle the unforeseen cost resolution.

Market Power Purchases

A central feature of Big Rivers' application is the proposal to allow Alcan, Southwire, and certain Large Industrial Customers the option of acquiring a portion of their power needs from third-party suppliers of their choice, no earlier than January 1, 2001.[26] This option is incorporated into the proposed Smelter tariffs as "Tier 3" and in the proposed Large Industrial Customer tariffs as "Market Power Purchases."

Smelters' Tier 3 Purchases. The interim tariffs permitted to go into effect on September 2, 1997 created three rate levels for Alcan and Southwire: Tier 1, Tier 2, and Tier 3. Under the interim tariffs, the maximum demand available under Tier 1 and Tier 2 energy is 233,000 KW for Alcan and 339,000 KW for Southwire, at a 98 percent load factor for each Smelter. Any demand in excess of these levels qualifies for purchase under Tier 3. The Smelter tariffs are structured as energy only rates which include the fixed costs typically recovered through a demand charge. The Tier 1 energy volumes

[26] This option was part of the original application, as well as a component of the Resolution.

constitute the Smelters' minimum purchase obligation[27] and the payment of the Tier 1 energy charges constitute their respective take-or-pay obligations to Big Rivers. The energy rates for Tier 1, Tier 2, and Tier 3 are fixed under the interim tariffs, and a separate transmission rate is included for Tier 3 energy only.[28]

Under the proposed tariffs,[29] the three tier rate structure is retained, with LEM supplying power directly to Henderson Union and Green River for consumption by the Smelters. The demand and energy levels are essentially the same as those in the interim tariffs. The rates for Tier 1 and Tier 2 energy are the same as in the interim tariff, with the exception of the additional .5 mill per KWH payment to LEM to resolve the unforeseen cost issue. Two changes occur on January 1, 2001. First, the Tier 2 energy rate, which had been fixed, will be subject to change annually in accordance with a schedule incorporated into the tariff. Second, the Tier 3 energy rate, which had also been fixed at the same rate as in the interim tariff, is terminated and LEM has no further obligation to supply the

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27 Alcan's minimum purchase obligation, Tier 1, is calculated by multiplying 2,304,960 KWH by the number of days in the billing month; the Tier 2 purchase allowance is the difference between the minimum purchase obligation and the amount calculated by multiplying 5,480,160 KWH by the number of days in the billing month. For Southwire, the minimum purchase obligation is based on 3,045,840 KWH and the Tier 2 purchase allowance is based on 7,973,280 KWH. See Second Revised Exhibit 3(a), filed August 22, 1997, pages 26, 27, and 36 of 52.

28 The Tier 1 energy rate is $.0307 per KWH; Tier 2 is $.02098 per KWH; and the total Tier 3 rate, excluding transmission, is $.01958 per KWH. The Tier 3 transmission rate is $.98 per KW per month of Tier 3 demand. See Second Revised Exhibit 3(a), filed August 22, 1997, pages 25, 26, 34, and 35 of 52.

29 The reference "proposed tariffs" reflects the terms and conditions contained in the documents filed on February 27, 1998. Also, these proposed tariffs reflect the impact of the resolution, which the Commission has accepted in principle.

obligation to supply the Smelters power in excess of the Tier 1 and Tier 2 volumes. All power consumed in excess of the Smelters' Tier 1 and Tier 2 maximum demands can be acquired from any power supplier at market-based rates. For these purchases the Smelters are to assume the responsibilities of identifying the third-party supplier, setting the terms of the transaction, calculating the amount of losses involved, and securing the transmission path.[30] The Smelters' respective distribution cooperatives, Green River or Henderson Union, would sign the actual contracts with the third-party supplier and purchase the power to supply the Smelters.

The AG opposed the Tier 3 market purchase provision, contending that wholesale market access for retail customers by contract is retail wheeling which is not authorized by the Territorial Boundary Act for electric service, KRS 278.016-278.018. The AG argues that the parties that negotiated Tier 3 have achieved electric deregulation and dictated its terms, without the benefit of legislative direction or oversight, for all incremental power used by the two largest retail electric customers in Kentucky. If Tier 3 is approved, the AG contends, it will establish a precedent which will encourage large power users served by other utilities to ask for similar or better treatment, and as a policy matter, such a precedent should not be established.[31]

Big Rivers, the LG&E Parties, Alcan, Southwire, and Chase disagreed with the bases for the AG's opposition and cited numerous arguments to support the market purchase option. They contend that the option is not retail wheeling, is not contrary to

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30 Response to the Commission's October 21, 1997 Order, Items 4 and 26.

31 AG Initial Brief at 7-10.

Kentucky law or public policy, need not await any legislative analysis of electric industry restructuring, and is not dissimilar to the right afforded to Gallatin Steel Company in 1995 to choose its wholesale power supplier. The market purchase option, they claim, is designed to reduce costs to the Smelters without raising costs for other customers,[32] while the Reorganization Plan as a whole brings the benefits of competitively priced power to all customers.[33]

Other Industrials' Market Power Purchases. Big Rivers proposed that three years after closing its Reorganization Plan certain Large Industrial Customers could acquire a portion of their power requirements under market-based conditions. To be eligible, a customer would have to have a peak demand of one MW or greater, sign a contract for a minimum term of five years, have a base contract demand of not less than 75 percent of its maximum contract demand, and have a minimum contractual monthly load factor of 70 percent.[34] Big Rivers estimated that six customers could be eligible for this market-based proposal.[35]

The AG opposed this proposal, claiming it was an attempt to offer other industrial customers rates similar to the market purchase Tier 3 proposal for the Smelters. While

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32 Big Rivers Reply Brief at 8-9.

33 LG&E Parties Initial Brief at 16.

34 Revised Big Rivers Transaction Tariff, filed February 23, 1998, Item 29 at Original Sheet No. 37.

35 Response to the Commission's August 12, 1997 Order, Item 29. The customers are Commonwealth Aluminum, Kimberly-Clark (Scott Paper), Willamette, World Source, A-CMI, and Wal-Mart Store No. 701.

agreeing that the proposal did not create the same contractual market access as the Smelters would have, the AG argued that the proposal should be rejected because Big Rivers was giving up the right to serve a portion of its load, as well as the ability to earn a full contribution to fixed costs, for no apparent reason. The AG contends that there is no reason for a bankrupt utility to offer such a pricing option.[36]

The LG&E Parties supported the proposal, noting that if market power is priced below Big Rivers' system power, industrial customers who accepted the market-priced option could achieve lower average prices by blending system-priced power with market-priced power.[37] Chase stated that, like the market purchase Tier 3 proposal, this proposal for large industrial customers did not violate the certified service territory statute.[38]

Commission Analysis. Big Rivers has served its member distribution cooperatives for many years through a succession of full requirements contracts that have been required by the RUS to secure prior loan funds. As part of the negotiating process that led to the rates embodied in the Reorganization Plan, the RUS and other affected parties agreed to modify these full requirements contracts to accommodate the market power purchases for the Smelters and qualifying industrial customers. No similar accommodations have been forthcoming for any other customer.

The market purchase rate proposals constitute, at a minimum, the functional equivalent of retail wheeling for 8 out of 91,500 customers. If the electric industry in

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36 AG Initial Brief at 11.

37 LG&E Parties Initial Brief at 14.

38 Chase Initial Post-Hearing Brief at 4.

Kentucky is to be restructured to include retail wheeling, the Commission believes that such a restructuring should be undertaken voluntarily, in a reasoned and comprehensive manner which is designed to meet the overall needs of the Commonwealth and all its citizens, not just the specific needs of a single utility and a few large customers. Further, the Commission does not believe that electric restructuring can permanently be implemented on a case-by-case approach until a rigorous investigation of all aspects of the issue results in a determination that restructuring is in the public's best interest. Until that determination is made, proposals to offer 8 out of 91,500 customers the right to seek lower cost power through retail wheeling constitute unreasonable preferences in violation of KRS 278.170(1).

The existing regulatory scheme in Kentucky requires electric utilities to serve all customers within their certified territorial boundaries. For the Big Rivers' distribution cooperatives, this statutory obligation includes not only the distribution of electric energy to their customers, but also the selection and acquisition of an adequate source of supply to meet the foreseeable needs of their customers. The Commission does not believe that it has the authority to revise this statutory scheme to transfer, from the utility to a limited group of customers, the function of selecting a source of supply to meet those customers' needs. The market purchase options proposed here are dissimilar to the transaction approved in 1995 when East Kentucky Power Cooperative Corporation ("East Kentucky") lacked sufficient capacity to fulfill its contractual obligation to supply Owen Electric

Cooperative for service to Gallatin Steel Company.[39] The contracts and tariffs in that case indicate that East Kentucky fulfilled its contractual obligation by selecting the source of additional generating capacity, not by granting the retail customer the right to select the source of generation.

Therefore, the proposals to terminate the Tier 3 fixed rate after 2000 and to implement market purchase Tier 3 and the Market Power Purchase option for other industrial customers in three years are rejected. Green River and Henderson Union will be responsible for securing additional quantities of power for the Smelters after 2000. The cost for this power is unknown at this time and may result in future changes to the Tier 3 rate for the Smelters.

Revenue Decrease Allocation and Rate Design

For purposes of calculating the revenue impact of its proposed rates, Big Rivers utilized a test year ended December 31, 1996. Based on the rates in effect at the end of the test year, and various normalization adjustments to the actual demand and energy units billed during the test year, Big Rivers calculated its normalized test-year revenues to be $266,261,661.[40] Big Rivers calculated pro forma revenues of $231,482,524, based on its proposed rates and several billing adjustments which reduce its billing demand from

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[39] Case No. 94-456, East Kentucky Power Cooperative, Inc.'s Filing of a Proposed Contract with Gallatin Steel Company.

[40] Application Exhibit 17, at 1, 5 and 6.

a normalized level of 14.4 million KW to a pro forma level of 13.4 million KW. The result is a decrease in revenues of $34.8 million, or 13.06 percent.[41]

Based on Big Rivers' pro forma revenue analysis, the proposed rates produce the following decreases and average rates for Big Rivers' three customer groups:[42]

Customer Group	Existing Average Rates	Proposed Average Rate	Total Decrease	Percentage Decrease
1. Smelters:	28.85 mills/KWH	24.7 mills/KWH	13.7 percent	$20.2 million
2. Non-Smelter industrials:	34.60 mills/KWH	31.1 mills/KWH	12.8 percent	$6 million
3. Rurals:	42.18 mills/KWH	37.2 mills/KWH	11.8 percent	$8.6 million

The Commission finds that Big Rivers' comparison of its proposed rates to its existing rates is flawed. In determining customers' adjusted billing units, Big Rivers relied on its most recent Power Requirements Study to change the demand and energy billing units for several customers. For instance, Willamette's demand billing units were increased by 99,000 KW and its energy billing units were increased by 75 million KWH.[43] Big Rivers also included the impact of the market purchase option in calculating pro forma revenue. In determining the percentage rate decrease, Big Rivers compared pro forma revenue based on pro forma billing units to normalized revenue based on normalized billing units, thereby masking the true effect of the proposed rate change. The Commission believes that a more valid analysis would be one that compares customers'

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41 Id. at 1 and 8.

42 "Existing Average Rate" and "Proposed Average Rate" derived from Application Exhibit 17 at 5-8; "Total Decrease" and "Percentage Decrease" from Application Exhibit 17 at 7-8.

43 Application Exhibit 17 at 3 and 5.

annual bills based on pro forma billing units at both Big Rivers' old base rates and its proposed base rates.[44] Under such a comparison the average decrease for each customer group would be: Smelters - 18.0 percent; non-Smelter industrials - 12.3 percent; and Rurals - 9.2 percent.

Big Rivers presented a cost-of-service analysis which reflected both its pre-restructuring cost structure and its post-restructuring cost structure. The results of this analysis were consistent with the allocation of the proposed decrease amongst the customer classes.

AG Rate Issues. The AG objected to the proposed rates, focusing primarily on the rates offered to the Smelters. The AG urges rejection of the proposed Smelter rates and associated contracts because the Smelters are allowed to leave the Big Rivers system after 2011, their rates are fixed for the term of their current contracts, and their take-or-pay obligations are dramatically reduced.[45] Based on the AG's cost-of-service study, he also argues that the Tier 2 rates make no meaningful contribution to fixed costs, the Smelters make a smaller contribution to fixed costs than other classes, and the Smelters' rates are priced below their cost of service. The AG also argues that the proposed treatment of stranded costs and exit fees for the Smelters is unfair, unjust, and discriminatory.[46] Based

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44 For this analysis, Big Rivers' proposed base rates for the Smelters include the agree upon .5 mills per KWH to resolve the unforeseen cost issue.

45 Brown Kinloch Direct Testimony at 16-28.

46 AG Initial Brief on the Unforeseen Cost Resolution at 10. In this brief, the AG notes that his original objections to the proposed Smelter rates now focus on Henderson Union and Green River, rather than Big Rivers, due to the impacts of the resolution of the unforeseen cost issue.

on the results of his own cost-of-service study, the AG recommended rejection of the proposed rates for all customer classes and adoption of a $5.36 per KW per month demand charge and a 19.58 mills per KWH energy charge for all customer classes and all sales.[47]

Big Rivers noted that the proposed rates are an integral part of the Reorganization Plan and are supported by its cost-of-service study.[48] Big Rivers criticized the AG's cost-of-service study as flawed in its treatment of the purchased power costs from LEM and for proposing rates which resulted in disproportionate rate reductions favoring the rural customers at the expense of the Smelters.[49]

Alcan and Southwire contend that the AG's cost-of-service study is flawed in assuming that purchased power costs were composed only of energy costs, omitting the lease and transmission payments as factors to be included, not considering the lower Smelter line losses, and allocating to the Smelters transmission costs below 161 KV.[50]

The Commission finds the AG's arguments to be less than persuasive. Since the Smelters new contracts will expire at the same time as their old contracts, they are not being allowed to leave the Big Rivers' system. Resolution of the unforeseen cost issue, coupled with the fixed cost of wholesale power from LEM, justifies the prohibition of future rate adjustments, except as noted herein, attributable to wholesale but not retail cost

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47 Brown Kinloch Direct Testimony at 42.

48 Big Rivers Reply Brief at 11-12.

49 Id.

50 Alcan and Southwire Main Brief at 15 and 20.

changes. While the Smelters take-or-pay obligations have been reduced, Big Rivers suffers no harm because LEM has agreed to guarantee the margins from Smelter sales at levels above the take-of-pay obligations.

In addition, the record demonstrates that the AG's cost-of-service study is flawed in assuming that purchase power costs are composed only of energy costs, by allocating costs of transmission facilities below 161 KV to the Smelters, and by omitting consideration of the lease and transmission payments and the lower Smelter line losses. These flaws undermine his proposed alternative rates. The AG has also failed to justify why his proposed class rate reductions are more reasonable than Big Rivers. The Commission also finds unacceptable the underlying premise in the AG's proposal which is the need for a rate increase in 2012 of 29 percent in the demand charge and 4 percent in the energy charge.[51] Thus, the AG's rate proposals are not reasonable and will not be accepted.

Willamette Rate Issues. Willamette argues that the rates proposed for it are discriminatory, not based on cost of service, and are the result of negotiations that included neither itself nor a majority of the industrial customers. It contends that its decrease of 7.29 percent is not as large as that of some other customers in the large industrial class, its additional load has been ignored by Big Rivers, and it should be granted lower rates more in line with those of the Smelters given its status as the system's third largest customer with the third highest load factor. Willamette also argues that the impact of load factor on cost of service should be reflected in rates. In fact, Willamette

51 T.E., Volume V, November 24, 1997, at 227-228.

at market risk, it will receive a 1 5 percent rate increase.[52] As an alternative to revised lower rates, Willamette proposed that all its load in excess of its current 55.5 MW level be eligible for the Market Power Purchase option.[53]

Big Rivers disagreed with Willamette's arguments and rate proposals, noting that Willamette has different load and operating characteristics from the Smelters which justify a different classification of service. Big Rivers argues that Willamette will receive the overall rate reductions available to all non-Smelter industrial customers and will be eligible for the Market Power Purchase option.[54] Big Rivers' revenue comparison shows individual non-Smelter industrial customers experiencing annual bill reductions ranging from 1.51 percent to 26.83 percent, with a class average reduction of 12.82 percent.[55]

The Commission finds Willamette's arguments to be unpersuasive. Willamette's analysis ignores the changes made by Big Rivers in developing its pro forma revenues and presents its arguments regarding the proposed increase based on the same flawed comparison used by Big Rivers. When customers' annual bills based on pro forma billing units at both Big Rivers' old base rates and its proposed base rates are compared, Willamette's proposed decrease will be 12.8 percent while the non-Smelter industrial class has an average decrease of 12.3 percent. Thus, Big Rivers' proposed decrease for Willamette compares favorably with that of the non-Smelter industrial class as a

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52 Willamette Initial Brief at 2 and 6.

53 Biscopick Direct Testimony at 16-17.

54 Big Rivers Reply Brief at 13-19.

55 Application Exhibit 17, page 7.

Willamette compares favorably with that of the non-Smelter industrial class as a whole and, therefore Willamette suffers no undue discrimination by Big Rivers' rate proposal. In addition, Willamette has not demonstrated and the Commission finds no basis to believe that Willamette's proposal will generate the revenue levels needed by Big Rivers under the Reorganization Plan. The Commission further finds that Big Rivers' proposal does not unfairly single out Willamette for a lesser rate decrease than other customers within its class. Therefore, Willamette's rate proposals are denied.

Large Industrial Customer Rates Having rejected the Market Power Purchase option, the Commission finds it necessary to develop a schedule of rates for the large industrial class that will generate over the next 25 years the same approximate revenue stream as the rates proposed by Big Rivers. The Commission also finds merit in the argument raised by Willamette that differences in customers' load factors affect a utility's cost of service and such differences should be reflected in rates.

A simple approach to developing a new rate schedule for the non-smelter industrials would be to retain the $7.37 demand charge proposed by Big Rivers and then calculate the energy charge necessary to generate the additional required revenues. However, a demand charge that is substantially lower than the previous charge of $10.15 per KW necessitates an energy charge that would be significantly higher than the previous energy charge. Such a high energy charge, coupled with the impact of eliminating the Market Power Purchase option, would have a detrimental impact on high load factor customers because they would pay revenues markedly in excess of those produced by Big Rivers' proposed rates.

A rate design with a higher demand charge and corresponding lower energy charge will minimize such impact for the higher load factor customers that would have been eligible for the Market Purchase option. Therefore, the rates for the non-smelter industrial class will retain the $10.15 demand charge that had been in effect prior to the interim rates and the entire decrease will be achieved through a reduction in the energy charge. The result is an energy charge of 13.715 mills per KWH for all energy sold. This energy charge is appropriate because, as Big Rivers pointed out, its post-restructuring variable costs of 18.44 mills per KWH as per its cost-of-service analysis are somewhat artificial because of the energy-only pricing structure contained in the power purchase agreement with LEM.[56] Had that pricing structure included separate demand and energy components, Big Rivers' cost of service would reflect much lower variable costs.[57] A comparison of the results of the Commission-developed rates to the results of Big Rivers' old rates using the pro forma billing units reflects an average decrease of 11.64 percent for the non-smelter industrial class with a 12.58 percent decrease for Willamette. Willamette will continue to have among the lowest rates on the Big Rivers system. Based on these factors, the Commission is satisfied that its rate design is fair, just, and reasonable for all customers in the non-smelter industrial class and should be adopted.

Smelter Tariff Provisions. The AG objected to two provisions in the Henderson Union and Green River Smelter tariffs. One provision would prohibit any adjustment to rates to reflect cost or payment incurred by Big Rivers or the cooperatives for any

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56 Application Exhibit 11 at 48.

57 Id. at 49.

expenditures incurred due to legislation, regulatory, or legal action. The AG argues such a provision attempts to divest the Commission of its authority to change rates.[58] The other provision would allow the Smelters to avoid the payment of stranded costs or exit fees. The AG argues that the issue of stranded costs and exit fees will be a subject for electric industry deregulation, and that such a prohibition infringes upon the legislative prerogative, and unduly favors the Smelters.[59]

Big Rivers countered that under the terms of the Reorganization Plan, there should be no stranded costs or exit fees for anyone on the Big Rivers system to pay.[60] The LG&E Parties contend that the proposed resolution of the unforeseen cost issue eliminates any concerns that non-smelter customers would be at risk for future unforeseen costs related to the Smelter load.[61] Alcan and Southwire stated their belief that all stranded cost issues have been dealt with in the Reorganization Plan.[62]

For Big Rivers, the Commission finds that the lease transaction, coupled with the unforeseen cost resolution, will minimize any risk that non-Smelter customers would be allocated the Smelters' share of costs resulting from legislative, regulatory, or legal changes. Similarly, this transaction will minimize the risk of stranded costs or exit fees

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58 AG Initial Brief at 3.

59 Id. at 12.

60 Big Rivers Initial Brief at 23.

61 LG&E Parties Initial Brief Addressing Future Unforeseen Cost Issue at 17.

62 Alcan and Southwire Supplemental Brief on Unforeseen Cost Resolution at 9.

allocable to the Smelters at the wholesale level. Thus, these provisions do not appear to be unreasonable for application to Big Rivers' wholesale costs.

However, the Commission finds that the same situation does not exist at the retail level. It is impossible to predict the cost changes that could occur over the next 13 years for Henderson Union and Green River and there is no agreement, analogous to the unforeseen cost resolution, to provide indemnification for changes in retail costs allocable to the Smelters. Neither the prohibition for cost adjustments due to legislative, regulatory, or legal action nor the prohibition of stranded costs or exit fees are reasonable at the distribution level and it is unreasonable to include these provisions in the distribution cooperative tariffs and contracts with the Smelters.

<u>Other Transaction Issues</u>

<u>Lease of Generating Units.</u> Big Rivers has proposed to lease, for a term of 25 years, all its generating units to WKEC while having a 25 year right to purchase power, within established minimum and maximum quantities, from LEM. The lease transaction is the centerpiece of the Reorganization Plan and it enables Big Rivers to divest itself of its generating capacity while purchasing only the quantities of power projected to be needed over the 25 year term. The Commission finds that the proposed lease transaction does constitute a change in control within the parameters of KRS 278.020(4) and 278.020(5) and is subject to our jurisdiction. Based on a review of the record and the lease transaction as evidenced by the documents on file as of February 27, 1998, the Commission finds that WKEC has the financial, managerial, and technical expertise to operate Big Rivers' generating units and the transfer is in accordance with law, for a

proper purpose and is consistent with the public interest. Therefore, the Commission will approve the lease transaction in principle, subject to verification that the final transaction documents do not materially change the transaction as reviewed in this case.

In addition, the Commission finds that the proposed accounting treatment for the lease transaction is in accordance with generally accepted accounting principles and the Commission concurs with that treatment. Big Rivers should provide the Commission with the accounting entries made to record the lease transaction within 10 days of their entry on the books of Big Rivers.

Transmission Service and Interconnection Agreement. The Applicants requested approval of the Transmission Service and Interconnection Agreement, as well as Big Rivers' Open Access Transmission Tariff, which will be filed at FERC. The Commission finds that, to the extent these documents are subject to our jurisdiction, they are reasonable and should be approved in principle subject to review of the final draft agreements to verify that there have been no material changes.

Evidences of Indebtedness. Big Rivers and the LG&E Parties have requested the Commission's approval for Big Rivers to issue evidences of indebtedness as contained in several of the transaction documents.[63] These financings are an integral part of the Reorganization Plan and are necessary to implement the debt restructuring and lease

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[63] The documents in question are the Cost Sharing Agreement; the Lease and Operating Agreement; the Mortgage and Security Agreement; the agreement with new credit providers AMBAC and Credit Suisse First Boston, relating to the Pollution Control Bonds, to the extent required; and the security instruments evidencing liens given to LEM under the terms of the revised Participation Agreement.

transaction. The Commission finds that the proposed financing is for a lawful object within Big Rivers' corporate purpose, is necessary and appropriate for the proper performance of its wholesale electric service to the public and will not impair its ability to perform that service, and is reasonably necessary and appropriate for such purpose.

Station Two Subsidiary. Big Rivers and the LG&E Parties requested that the Commission approve Big Rivers' transfer to the Station Two Subsidiary of certain obligations with respect to HMP&L's Station Two facility. In addition, the LG&E Parties requested that the Commission declare the Station Two Subsidiary to be a jurisdictional utility because KRS 96.520 limits a municipal utility to selling excess power either out of state or to a Commission-regulated utility.

The Commission finds that the transfer of HMP&L Station Two facility obligations to the Station Two Subsidiary is reasonable and will be approved. At the March 18, 1998 hearing, the LG&E Parties stated that legislation was pending in the 1998 Regular Session of the Kentucky General Assembly which would eliminate the need to declare the Station Two Subsidiary to be a jurisdictional utility. This legislation has since been approved by the General Assembly and signed by the Governor.[64] Therefore, the request to declare the Station Two Subsidiary a jurisdictional utility is denied as moot.

EWG Status. Big Rivers and the LG&E Parties requested that the Commission declare each of Big Rivers' generating facilities to be an "eligible facility" within the meaning of Section 32(a)(2) of PUHCA. This finding is a prerequisite for WKEC to be

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[64] Senate Bill 269 was passed by the Senate on February 27, 1998, the House of Representatives on March 23, 1998, and was signed by the Governor on April 1, 1998.

declared an exempt wholesale generator by FERC and thereby exempt from all provisions of PUHCA.

After examining the evidence, the Commission finds that the generating facilities of Big Rivers have been used for the generation of electric energy exclusively for sale at wholesale. The Commission further finds that allowing the Big Rivers generating facilities to be eligible facilities will benefit consumers by allowing Big Rivers to consummate its Reorganization Plan which includes the lease transaction, is in the public interest, and does not violate Kentucky law. At the request of the LG&E Parties, the Commission will condition this grant of eligible facility status upon the closure of the transaction between Big Rivers and the LG&E Parties.

Wholesale Power Contracts. Big Rivers and the LG&E Parties requested that the Commission approve the amendments to the wholesale power contracts with the member distribution cooperatives. As with other transaction documents, the Commission finds that these contracts as filed by February 27, 1998, should be approved in principle, subject to deletion of the Smelters' exemptions from distribution level cost changes due to legislative, regulatory, or legal action or distribution level stranded costs and exit fees. The final drafts of these contracts will be reviewed as part of the new proceeding to ensure that appropriate changes have been made to reflect the decisions herein and that no other material changes have been made.

Consolidation of Pending Fuel-Related Cases

In its Application, Big Rivers requested that this case be consolidated with two fuel-related cases currently pending at the Commission. This request was subsequently expanded when Big Rivers filed its initial brief on February 13, 1998 to include additional fuel adjustment clause ("FAC") proceedings covering November 1, 1990 through April 30, 1994 which were remanded to the Commission in January 1998. Big Rivers argues that consolidation of these proceedings with the case at bar and the Commission's approval of the rates set forth in Big Rivers' Plan of Reorganization will render those cases moot.

As a result of an extensive investigation into Big Rivers' fuel procurement practices, the Commission on July 21, 1994, in Case No. 90-360-C,[65] found that Big Rivers had incurred unreasonable fuel costs as a result of its decisions to enter certain coal supply contracts and required Big Rivers to amortize and credit those costs to its customers. Based upon the record developed in Case No. 90-360-C, the Commission in subsequent FAC review proceedings[66] ordered Big Rivers to make additional credits to its customers.

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65 Case No. 90-360-C, An Examination by the Public Service Commission of the Application of the Fuel Adjustment Clause of Big Rivers Electric Corporation from November 1, 1990 to April 30, 1993.

66 Case No. 92-490-B, An Examination by the Public Service Commission of the Application of the Fuel Adjustment Clause of Big Rivers Electric Corporation from May 1, 1993 to October 31, 1993 (August 9, 1994); Case No. 92-490-C, An Examination by the Public Service Commission of the Application of the Fuel Adjustment Clause of Big Rivers Electric Corporation from November 1, 1993 to April 30, 1994 (November 1, 1994); Case No. 94-458, An Examination by the Public Service Commission of the Application of the Fuel Adjustment Clause of Big Rivers Electric Corporation from November 1, 1992 to October 31, 1994 (March 5, 1996); Case No. 94-458-A, An Examination by the Public Service Commission of the Application of the Fuel Adjustment Clause of Big Rivers Electric Corporation from November 1, 1994 to April 30, 1995 (June 19, 1996); Case No. 94-458-B, An Examination by the Public Service Commission of the Application of the Fuel Adjustment Clause of Big Rivers Electric Corporation from May 1, 1995 to October 31, 1995 (July 9, 1996); Case No. 94-458-C, An Examination by the Public Service Commission of the Application of the Fuel Adjustment Clause of Big Rivers Electric Corporation from November 1, 1995 to April 30, 1996 (October 16, 1996).

As a result of judicial reviews filed by Big Rivers and the Smelters, the Franklin Circuit Court affirmed the Commission's July 21, 1994 Order to disallow the unreasonable fuel costs, but remanded the matter to the Commission to determine whether two fuel contracts complied with the FAC regulation and whether the fuel costs associated with those contracts were prudent or the result of improper fuel procurement practices.[67] The Court further directed the Commission to determine, if appropriate, the amount of any additional refunds.

The Commission and Big Rivers appealed the Franklin Circuit Court ruling. Finding that the Franklin Circuit Court's judgment was not final, the Kentucky Court of Appeals on July 3, 1997 dismissed these appeals.[68] On January 14, 1998, the Kentucky Supreme Court denied the Commission's Motion for Discretionary Review.[69] As a result, these cases are again before the Commission.[70]

Having considered Big Rivers' request for consolidation, the Commission denies it. As the request relates to the remanded proceedings, it was not properly raised. The proceedings involving Big Rivers' FACs were not remanded to the Commission until

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67 Big Rivers Electric Corp. v. Pub. Serv. Com'n, No. 94-CI-01184, slip op. at 14 (Franklin Cir. Ct. Oct. 20, 1995).

68 Pub. Serv. Com'n v. Big Rivers Electric Corp., No. 95-CA-3079-MR, slip op. at 2-3 (Ky. Ct. App. July 3, 1997).

69 Pub. Serv. Com'n v. Big Rivers Electric Corp., No. 97-SC-610-D (Ky. Jan. 14, 1998).

70 Not all of the Orders have been remanded to the Commission. Actions for review of Commission Orders in Cases No. 94-458, 94-458-A, 94-458-B, and 94-458-C are still pending before Franklin Circuit Court and have not been remanded to the Commission.

January 14, 1998. The issue was not before the Commission when the principal hearing in this matter was held and was raised for the first time in Big Rivers' initial brief.[71] The parties have not had an adequate opportunity to address the issue.[72]

Moreover, consolidation of the fuel cases into this proceeding is inconsistent with the express directives of the Franklin Circuit Court judgment. The Court directed the Commission to make certain determinations regarding two fuel contracts and the fuel costs incurred under those contracts. Consolidation will not advance this objective but impede it. Under Big Rivers' proposed approach, the Commission would consolidate the cases into this proceeding and then take no further action.

The Commission is not the appropriate forum to address Big Rivers' argument that the Bankruptcy Court's approval of the Plan of Reorganization extinguishes any right of ratepayers to pursue refunds and renders the Franklin Circuit Court judgment moot. That forum is the Franklin Circuit Court. As the matter currently stands, Franklin Circuit Court has directed the Commission to take certain actions. Its judgment has not been modified, suspended or revoked. No court of superior jurisdiction has relieved the Commission of its obligations under the judgment. Absent such court action, the Commission must comply with the judgment and make the required determinations. Given the voluminous record and complex issues in the remanded cases, those determinations should be made in a separate proceeding and not be consolidated with this proceeding.

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[71] Big Rivers Initial Brief at 25-33.

[72] For that matter, Big Rivers failed to provide notice of its request to all parties in Case No. 90-360-C. The record fails to reflect that any notice of the consolidation proposal was given to Prestige Coal Company.

Depreciation Study

Big Rivers disclosed during the proceeding that the required accounting for the lease transaction might result in the book value of Wilson being overstated, and that there might have to be an asset book value write down. However, before Big Rivers could finalize its determination of the need for a write down, it had initiated a new depreciation study, which has not yet been completed.

The Commission finds that within 30 days of Big Rivers' completion and acceptance of a new depreciation study, a copy should be filed with the Commission. No changes in depreciation rates should be implemented under that study until the Commission has reviewed the new study. Big Rivers should also promptly inform the Commission of its determination regarding the need for an asset book value write down and, if one is determined to be necessary, initiate the appropriate proceeding.

Debt Service Plan

The AG objected to the debt service schedule contained in Big Rivers' financial model, contending that it was back loaded. The AG argued that only 36 percent of the principal on the RUS debt will be paid by the time the Smelters are expected to leave the Big Rivers system.[73] The AG notes that under the unforeseen cost issue resolution, more of the debt service is shifted to the later years of the transaction, when only the non-Smelter ratepayers are still on the system.[74]

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[73] AG Initial Brief at 18.

[74] AG Initial Brief on the Unforeseen Cost Resolution at 2.

The Smelters argued that the AG's statement about the 36 percent figure is true, but completely misleading because debt service is not measured only by the repayment of principal, but by the sum of principal and interest. The Smelters stated that the projected debt service schedule, agreed to by the lenders, represents a largely levelized combination of interest and debt principal payments.[75]

The Commission has reviewed the arguments and concludes that the AG's analysis has not taken into consideration the entire scope of the impact of the transaction, as modified by the unforeseen cost resolution. The AG's argument fails to consider the fact that the repayments to RUS must equal a pre-determined present value, regardless of the timing of principal and interest payments. This arrangement allows Big Rivers a degree of flexibility during the early years of the transaction. In addition, the AG does not appear to have considered the impact of LEM's lease payments or the potential impact of arbitrage sales on the outstanding debt. Concerning the impact of the unforeseen cost resolution, Big Rivers apparently had no loan sources to fund the up-front capital expenditures as envisioned in the original plan. While the resolution did result in a shift of the debt service schedule, it also provided Big Rivers with a needed source of financing for its reduced capital expenditures responsibilities. Therefore, while the situation identified by the AG is an important consideration, taken in light of the overall benefits and provisions of the transaction as modified, the Commission finds that the arguments of the AG do not justify the rejection of the proposed debt service schedule.

Monitoring and Reporting

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75 Alcan and Southwire Main Brief at 31.

The proposed transaction, as modified by the resolution of the unforeseen cost issue, contains what the Commission believes to be a valuable incentive to Big Rivers: the ability to make arbitrage sales and Other Sales.[76] Big Rivers has placed a significant amount of reliance on its ability to make Other Sales and the revenues to be generated by those sales will be critical to its long-term financial restructuring.[77] To encourage Big Rivers to utilize this option to its greatest potential, and to ensure that the Commission is timely informed of Big Rivers' progress in making both arbitrage sales and Other Sales, the Commission will require Big Rivers to:

- Develop and file with the Commission within 60 days of the Transaction Closing Date, a strategic plan concerning arbitrage sales;
- Develop and file with the Commission within 30 days of the date of this Order, an interim sales plan, to be in effect until the strategic sales plan is implemented;
- File with the Commission within six months after the date of this Order, and every six months thereafter, a report on arbitrage sales and Other Sales; and
- File with the Commission a report, appended to its annual report, comparing its actual cash flows for the calendar year with the amounts included in the SUP-11 financial model filed in this proceeding.[78]

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76 Other Sales are off-system sales envisioned in Big Rivers' financial models to begin after the termination of the current Smelter contracts in 2011.

77 From 2011 to 2022, Big Rivers forecasts annual gross sales revenues ranging from \$36.1 million to \$45.9 million, which represents 15 to 20 percent of all gross sales revenues during the period. <u>See</u> Robison, Schaefer, and Hite Supplemental Testimony, Exhibit SUP-11, lines 304 through 309. Percentage impact is determined by dividing line 307 by line 309 in any year after 2010.

78 The report will be based on lines 363 through 411 of SUP-11, and include explanations for any deviations from the SUP-11 figures in excess of 10 percent.

SUMMARY AND CONCLUSION

Throughout this proceeding the Applicants, the Smelters, and three distribution cooperatives have repeatedly stated that the proposed rates are an integral part of the Reorganization Plan, were the result of intense and extensive negotiations, and that any modifications could disrupt the carefully balanced interests of those who participated in the negotiations. Simultaneously, the AG and one distribution cooperative, Jackson Purchase, have vigorously opposed the proposed rates on the basis that the benefits of the reorganization have not been fairly distributed among all customer classes, resulting in unduly preferential rates for some customers. The Commission has taken all these statements into consideration and has made the findings and decisions set forth herein based on the evidence and the critical need for Big Rivers to emerge from bankruptcy as quickly as possible.

It has not been an easy task to balance all aspects of the transaction and the proposed rates with our statutory obligations under KRS Chapter 278. Our task was not made any easier by the inclusion of certain rate provisions which appeared to be the product of less than equal bargaining leverage among the parties to the Reorganization Plan. We recognize that there will need to be some changes to the transaction to accommodate our findings. However, we do not believe that those changes will significantly alter either the purpose or the intent of the transaction.

From the perspectives of Big Rivers and its major creditors, our decisions should not reduce the cash flow reflected in Big Rivers' financial models, thus preserving Big Rivers' ability to meet its operating expenses and debt service payments. In addition, as a result of the resolution of the unforeseen cost issue, the margins that were projected to be earned on sales to the Smelters will now be guaranteed by LEM. Although we have denied the market power purchase option for large industrial customers, we have developed rates for this class which provide a reasonable rate reduction, generally between 7 to 12 percent based upon anticipated loads, without requiring the commitment to a five year contract. For the rural consumers, the rate reductions implemented in September 1997 will remain in effect. In addition, the resolution of the unforeseen cost issue should provide significant financial protections to the rural and large industrial customers from the risks of new regulatory, legal or environmental costs not associated with their load.

From the perspective of the Smelters, our decisions retain the fixed prices for Tier 1 and Tier 2 power which is critical to their ability to compete in the world-wide aluminum market. Although we have denied the Tier 3 market purchases for the Smelters' incremental power needs, our decision to allow LEM to supply the Smelters' Tier 1 and Tier 2 power provides an extra margin of reliability and allows Green River and Henderson Union to reduce their full-requirements relationship with Big Rivers. While we have rejected the Smelters' exemption from unforeseen costs and exit fees at the distribution level, we have allowed such exemptions for any wholesale costs or fees attributable to Big Rivers. We truly believe that Big Rivers and the Smelters are vital to the economy of western Kentucky and their fortunes have been intertwined for many years. Even though our decisions today sever most of their existing ties, the Smelters' ability to purchase reasonably priced power at fixed costs from LEM is the result of the availability of valuable generating assets on the Big Rivers system.

Transaction Documentation Approval

The application, as filed on June 30, 1997, contained the supporting transaction documents which were incomplete or otherwise noted as being subject to further revision. Over the next five months, the Applicants filed revisions to the transaction documents and many were not finalized as of the November 1997 hearing. To accommodate the Applicants, the Commission established December 19, 1997 as the due date for final drafts of the documents and January 15, 1998 as the date to resolve the unforeseen cost issue.

Documents were not in final draft form by late December 1997. The Applicants subsequently requested, and the Commission granted, an extension to January 30, 1998 to resolve the unforeseen cost issue. On January 27, 1998, the Applicants and the Smelters filed a joint notice that the unforeseen cost issue had been resolved in principle, but not yet reduced to writing, and subsequently requested to indefinitely suspend the briefing schedule. The Commission, by Order dated January 29, 1998, denied the request, citing KRS 278.190(3) as limiting our rate jurisdiction to 10 months, which would expire on April 30, 1998.

A supplemental procedural schedule dated February 13, 1998 was adopted to investigate the unforeseen cost resolution and it established February 23, 1998 as the final date for all documents. The Applicants filed some documents by that date, but indicated that others were incomplete and would be filed later that week. The AG objected to this delay and, by Order dated February 26, 1998, the Commission extended the due date to

February 27, 1998, but admonished the Applicants that any documents not filed by that date would not be considered in this case.

In contravention of the February 26, 1998 Order, the Applicants continued to file documents after the due date. Chase then objected, claiming a denial of due process, when the Applicants filed additional documents on March 19, 1998, after the supplemental public hearing.

The Commission well recognizes the importance of the pending transaction to Big Rivers' financial rehabilitation and the need to act as expeditiously as possible. However, the parties' due process rights must be respected and accommodated. In addition, the continual revisions to the transaction documents have frustrated the Commission's investigative efforts to the extent that we are no longer confident that the transaction contemplated by the Applicants is not materially different from the transaction reviewed at the March 18, 1998 hearing. Therefore, we will approve the transaction documents in principle as filed with the Commission on the due date of February 27, 1998.

To afford the parties and the Commission an opportunity to verify that no material changes have been made to the structure of the transaction, we will require the Applicants to file as quickly as possible, but no later than May 29, 1998, final drafts of all transaction documents that have undergone any changes since February 27, 1998. The documents should be filed in a new docket with copies to all parties to this case. The scope of review will be limited to determining whether the final transaction documents have materially changed since those filed by February 27, 1998 and to review the changes necessitated by this Order. Each document filed should contain a clear identification of each change and be supported by a detailed explanation of the reason for the change. The review should take no more than 30 days and will include one round of discovery and an informal conference or hearing if necessary.

IT IS THEREFORE ORDERED that:

1. Based on the documents on file with the Commission as of February 27, 1998, the proposed transaction, as modified by the resolution of the unforeseen cost issue, is approved in principle, subject to the modifications contained in this Order.

2. The market power provision in the Smelters' Tier 3 rate and the Market Power Purchase option for certain Large Industrial Customers are hereby denied and the termination date on the Tier 3 fixed rate is rejected.

3. The rates for non-Smelter industrial customers are modified as discussed in this Order. The remaining rates proposed by Big Rivers and contained in the tariff draft bearing an issued date of February 23, 1998 are approved. All rates approved herein are effective for service rendered on and after the date of this Order.

4. The alternative rates proposed by the AG are hereby denied.

5. The alternative rate proposed by Willamette is hereby denied.

6. Provisions in the Smelters' tariffs and their contracts with the distribution cooperatives prohibiting rate adjustments to reflect costs or payments incurred by the distribution cooperatives for expenditures due to legislation, regulatory, or legal action are rejected.

7. Provisions in the Smelters' distribution cooperative contracts and tariffs exempting the Smelters from paying any stranded costs or exit fees relating to the distribution cooperatives are rejected.

8. The Applicants shall file, in a new case, the final drafts of the transaction documents supported by a clear identification of each change made and a detailed explanation of each change to the versions on file with the Commission as of February 27, 1998. The Applicants shall serve copies of all documents on the parties to this case, who shall be deemed parties to the new case.

9. The Transmission Service and Interconnection Agreement, and Big Rivers Open Access Transmission Tariff are approved in principle subject to review of the final drafts of the documents.

10. Evidences of indebtedness required of Big Rivers in conjunction with the transaction documents are approved in principle, subject to review of the final transaction documents.

11. The transfer of control of Big Rivers' generating units to WKEC and the transfer of the HMP&L Station Two facility obligations are hereby approved in principle, subject to review of the final version of the transaction documents.

12. Big Rivers' generating facilities are "eligible facilities" within the meaning of Section 32(a)(2) of PUHCA, subject to the closure of the transaction as contemplated by Big Rivers and the LG&E Parties.

13. Big Rivers shall file the accounting entries made to record the lease transaction within 10 days of entry into the books of Big Rivers.

14. The Wholesale Power Contracts between Big Rivers and the distribution cooperatives are approved in principle, subject to the revisions discussed in this Order and subject to the review of the final version of the contracts.

15. Big Rivers shall file a copy of the new depreciation study within 30 days of its completion and acceptance, and shall not implement any changes in depreciation rates recommended in that study until the Commission has reviewed the study.

16. Big Rivers shall not write down the book value of any generating station without prior Commission approval.

17. Within 30 days of the date of this Order, Big Rivers shall file its tariffs, reflecting all revisions and modifications as described in this Order.

18. Within 60 days of the transaction closing date, Big Rivers shall file a strategic plan for maximizing arbitrage sales.

19. Within 30 days of the date of this Order, Big Rivers shall file an interim sales plan, to be in effect until the strategic sales plan is implemented.

20. Within six months of the date of this Order, and every six months thereafter, Big Rivers shall file a report of arbitrage sales and Other Sales.

21. Big Rivers shall file a report, appended to its annual report, comparing its actual cash flows for the calendar year with the amounts included in the SUP-11 financial model filed in this proceeding. The report shall be based on lines 363 through 411 of

SUP-11, and include explanations for any deviations from the SUP-11 amounts in excess of 10 percent.

22. The reports required herein shall initially be submitted by Big Rivers subject to further modifications as deemed necessary by the Commission, to allow for the monitoring of Big Rivers' compliance with the transaction and the findings of this Order.

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

Done at Frankfort, Kentucky, this 30th day of April, 1998

By the Commission

ATTEST:

Executive Director