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DIRECT TESTIMONY OF
C. WILLIAM BLACKBURN

I. INTRODUCTION

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

A. My name is C. William Blackburn. I am employed by Big Rivers Electric Corporation ("Big Rivers") as its Vice President Financial Services, Chief Financial Officer ("CFO"), and Interim Vice President Power Supply. I have held this position since November 2005. Prior to serving as CFO, I held the position of Vice President Power Supply for 9 years, and I remain in this position on an interim basis. Upon closing of the transaction described in this Application, my title will be Senior Vice President Energy Services and Chief Energy Officer. I have testified on behalf of Big Rivers many times before the Kentucky Public Service Commission ("KPSC" or the "Commission"), including for fuel hearings, environmental cases, rate cases, and transmission cases. Altogether I have been employed by Big Rivers for a total of 29 years.

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

A. Over the past two years in my role as CFO I have served as one of the principal negotiators of the unwind transaction with E.ON U.S. LLC and its various affiliates ("E.ON U.S. Parties") presented here to the KPSC for its approval ("Unwind Transaction").

My testimony in Section II begins by addressing the financial effects of the Unwind Transaction on Big Rivers. I first present an overview of the financial benefits demonstrating why Big Rivers has decided to terminate its 1998 lease with the E.ON U.S. Parties (the "Lease Transaction") in favor of the Unwind Transaction. I discuss the financial effects of the Unwind Transaction on Big Rivers' projected cash flows and operations. I present the results of the Big Rivers financial model in terms of Big Rivers' Times Interest Earned Ratio ("TIER"), debt service coverage ("DSC"), and days of cash on hand for the period 2008 through 2023. I also discuss the projected rate path for Big Rivers' non-Smelter members.

I then describe the financial model used by Big Rivers to assess and predict the financial effects of the proposed Unwind Transaction. As part of this discussion, I describe Big Rivers' development of the financial model in conjunction with its outside consultants. I also discuss various inputs into the financial model.

Q. Does your testimony also address issues relating to the new terms of service with the Smelters?

A. Yes. A central element of the Unwind Transaction is Big Rivers' agreement to resume wholesale service to Kenergy Corp. ("Kenergy") for resale to Alcan Primary Products Corporation ("Alcan") and Century Aluminum of Kentucky General Partnership ("Century") (collectively, the "Smelters"). In Section III I summarize and describe the new special contracts with Kenergy used to serve the Smelters. These new special contracts provide the terms and conditions of the power sales from Big Rivers to Kenergy for the benefit of the Smelters on and after the closing date of the Unwind Transaction. These contractual arrangements are an essential component of the Unwind Transaction. The long-term well-being of the Smelters and their economic impact in Western Kentucky was a very significant consideration in entering the Unwind Transaction. Big Rivers entered into the Unwind Transaction based on the terms of service provided to the Smelters, which include a number of measures designed to protect Big Rivers' member distribution cooperatives ("Members") from additional risk of unwinding the Lease Transaction. Big Rivers' three Members are Kenergy Corp., Jackson Purchase Energy Corporation, and Meade County Rural Electric Cooperative Corporation. In summarizing the special contracts with the Smelters, I describe some of these protections.

Q. What else does your testimony cover?

A. In Section IV, I address certain accounting issues that arise in the Termination Agreement with the E.ON U.S. Parties. I present the accounting for certain of the consideration to be received by Big Rivers at closing of the Unwind Transaction. I also describe the methods by which Big Rivers and the E.ON U.S. Parties will value inventory and personal property as part of the Termination Agreement.

In addition, the agreements between Kenergy, Big Rivers and the Smelters anticipate the creation of both an Economic Reserve Account and a Transition Reserve Account, each of which will require certain accounting treatments that I describe. These two reserve accounts are designed to provide Big Rivers' Members' non-Smelter customers with additional protection against increased costs as a result of Big Rivers' decision to resume indirect service to the Smelter loads, and I explain the operation of each in this section of my testimony. Big Rivers also seeks approval to create two Purchased Power Accounts in which it will accrue costs associated with Big Rivers' purchases of power for service to its non-Smelter Members, and I also explain how these accounts will operate.

Q. Does your testimony also discuss how these various deal components are incorporated into rates?

A. Yes. The Unwind Transaction will require a number of changes to the Big Rivers Rates, Rules and Administrative Regulations for Furnishing Electric Service (the "Tariff"). I describe these changes in Section V of my testimony. I first discuss the new Fuel Adjustment Clause ("FAC") that will be used in the Tariff to track changes in Big Rivers' fuel costs. I also discuss the new Environmental Surcharge to be used to track certain changes in Big Rivers' environmental costs. I discuss the Member Rate Stability Mechanism ("MRSM") that will be used to expend funds from the Economic Reserve Account to offset costs to the Members resulting from either the FAC or the Environmental Surcharge. I further discuss the operation of the Unwind Surcredit that will be used to credit certain fixed monthly payments made by the Smelters to Big Rivers for the benefit of the Members. Finally, I discuss the rider Big Rivers will use to rebate certain amounts to the non-Smelter customers (the "Rebate") in situations where Big Rivers exceeds a TIER of 1.24, as defined in the Smelters' agreements, and Big Rivers elects to rebate such amounts.

In Section V, I also explain the structural changes necessary to accommodate the termination of the Smelters' current arrangements with Big Rivers, including the means by which any so-called Tier 3 power purchase agreements with third-parties will be handled on and after the closing date of the Unwind Transaction.

Q. Please continue with your summary.

A. In Section V, I further discuss the future rate structure Big Rivers is anticipating in connection with approval of the Unwind Transaction. Big Rivers' costs of operating its generating units can only be estimated at this time, and accordingly Big Rivers is not submitting a general rate case as a part of its Application. Instead, Big Rivers proposes to leave existing non-Smelter rates largely unchanged (apart from any application of the FAC and the Environmental Surcharge) at least through December 2009. The application of the FAC and the Environmental Surcharge will be offset by the operation of three riders: the Unwind Surcredit, the Rebate, and the MRSM. Operating experience of the units as regulated assets can be developed during the initial period, permitting a 2009 Test Year for a new general rate case to be effective no earlier than January 1, 2010 (a date Big Rivers and the Smelters have agreed to).

The one exception to this proposal concerns transmission and ancillary services rates, changes to which have been submitted in the Application. Big Rivers has extensive operating experience with respect to these rates. Moreover, the current Big Rivers ancillary services rates reflect a pass through of the costs of one of the E.ON U.S. Parties (*i.e.*, Western Kentucky Energy Corp. ("WKEC")). WKEC's ancillary services rates were developed based on WKEC's costs, not Big Rivers' costs, and no longer will be appropriate once Big Rivers operates the generating assets. Because these ancillary rates must be changed to reflect Big Rivers' rates, Big Rivers also has performed cost of service analyses for transmission and ancillary services which are presented for Commission approval as a part of this filing and explained in part in my testimony and in part in the testimony of Ralph L. Luciani (Exhibit 35).

This section of my testimony concludes with a discussion of the relationship of the present proceeding to Big Rivers' separate Phase 2 Transmission Project for which Big Rivers previously submitted a request for, and subsequently received, a Certificate of Public Convenience and Necessity. In particular, I address the Commission's concern with the issue of who appropriately should bear the costs of this transmission project consistent with the Commission's October 30, 2007 order in Case No. 2007-00177. I also testify regarding certain regulation requirements relating to the impact of the proposed tariff changes.

Q. Does your testimony also address Big Rivers' restructured financing arrangements?

A. Yes, I discuss issues regarding Big Rivers' restructured financing arrangements in Section VI of my testimony. A major aspect of the Unwind Transaction is a proposed new financing arrangement that will permit Big Rivers greater flexibility to borrow funds to meet its capital requirements once Big Rivers has regained control over the leased assets. Unlike Big Rivers' current operations under the Lease Transaction, which, due to its structure, would require relatively modest future capital requirements and permit only limited Member growth, the Unwind Transaction contemplates system expansion and permits Big Rivers to borrow funds for future needs.

The existing Big Rivers financial arrangements are complicated and unaccommodating to a prospective lender. To correct this structural inflexibility, the Unwind Transaction would implement a new financing arrangement to replace the complex existing Big Rivers Restated Mortgage and Existing Intercreditor Agreement with a new, simpler Indenture and New Intercreditor Agreement. My testimony describes the existing financial arrangements under the Lease Transaction and then explains the need to replace these financial arrangements with the proposed financial arrangements, which are described in detail. I also discuss certain procedural requirements that must be met to obtain approval of a financing under Kentucky law.

II. BIG RIVERS' FINANCIAL STATUS AFTER CLOSING

A. Overview of Financial Effects of Unwind Transaction

Q. Mr. Blackburn could you summarize the total financial benefit of the Unwind Transaction for Big Rivers and its non-Smelter Members?

A. I estimate the total financial benefit of the Unwind Transaction to Big Rivers to be approximately $950 million. This financial benefit comes from both payments made at closing by the E.ON U.S. Parties and from ongoing power purchase payments at rates in excess of non-Smelter Member rates made by the Smelters under their restructured contracts with Kenergy. The total compensation in cash, assets, and payment forgiveness received from the E.ON U.S. Parties will be approximately $623 million. The total compensation in cash and increased power purchase payments from the Smelters amounts to approximately $327 million.

Q. Based on Big Rivers' financial analysis, will the Unwind Transaction leave Big Rivers in an improved financial state after the closing?

A. In my opinion, most definitely yes. Subject to certain potential adjustments, Big Rivers will receive $301,500,000 in cash at closing from the E.ON U.S.

Parties. This cash consideration and non-cash consideration, as discussed below, will greatly improve Big Rivers' equity. As of October 2007, Big Rivers' equity is a negative 13.6%. Immediately upon closing of the Unwind Transaction Big Rivers' equity will improve to a positive 24.1%. As I note later in my testimony in Section VI, this improvement in Big Rivers' equity will enable Big Rivers to significantly restructure its financial arrangements. These improved financial arrangements will in turn make Big Rivers much more able to respond to changing market circumstances and provide greater access to capital.

Q. Apart from the cash consideration, will Big Rivers receive any non-cash consideration at closing from the E.ON U.S. Parties?

A. Yes. The non-cash consideration is set forth in the Termination Agreement, attached as Exhibit 3 to the Application. First, there is the transfer of inventories, including fuel, in an amount estimated to be $55 million. As described later in my testimony in Section IV, the cash consideration will be adjusted up or down to account for the inventories (fuels, reagents, personal property, and material and supplies) transferred by the E.ON U.S. Parties to Big Rivers, with each such inventory valued pursuant to the Termination Agreement. Second, Big Rivers will receive 14,000 SO_2 allowances with an approximate market value of $10.9 million. Third, additional value comes in the form of the E.ON U.S. Parties forgiving the residual value payment obligation recorded on Big Rivers' books under the Lease Transaction of approximately $150.4 million. Fourth, the E.ON U.S. Parties also will forgive the Settlement Promissory Note of approximately $16.0 million. And fifth, Big Rivers will receive the scrubber installed by the E.ON U.S. Parties on the Coleman plant. Big Rivers plans to record the Coleman Scrubber on its books at $97.5 million, which Big Rivers believes represents its fair market value.

Q. Mr. Blackburn, E.ON and Big Rivers appear to value the Unwind Transaction differently. In his testimony, Paul W. Thompson puts a value on the transaction of $700 million, but Mr. Core values the transaction at $623 million in his testimony. Can you reconcile those figures?

A. Yes. In addition to relatively minor accounting and timing variations, which explain some of the differences in the numbers, each company looks at the transaction from its own perspective and necessarily evaluates its costs and benefits differently.

The difference between E.ON's valuation of $700 million and Big Rivers' valuation of $623 million is roughly $77 million. That difference is due to the fact that E.ON includes approximately $64.5 million in costs not included in Big Rivers' calculation and that Big Rivers includes roughly $7.0 million in costs not included in E.ON's calculation, shown on Exhibit CWB-1 (E.ON) and Exhibit CWB-2 (Big Rivers), as follows:

a. **Net Book Value.** E.ON's costs, shown on Exhibit CWB-1, include net book value on line 10, line 11, line 12, line 14, and line 15 or approximately $182.8 million. Big Rivers' Exhibit CWB-2 includes net book value on line 6, or approximately $150.4 million – a difference of roughly $32.4 million. This difference is due to the fact that E.ON has not included several months of depreciation in its calculation and to E.ON's higher projected construction work in progress.

b. **Coleman Scrubber.** E.ON's costs in Exhibit CWB-1 include approximately $1.5 million less in value for the Coleman Scrubber in line 13 than Big Rivers' Exhibit CWB-2 includes on line 14. This difference is due to different accounting techniques.

c. **Transaction Costs.** E.ON's costs shown in Exhibit CWB-1 include $22 million in transaction costs on line 16. Although this is undoubtedly a cost to E.ON, it is not considered a benefit in Big Rivers' calculation.

d. **SO_2 Allowances.** E.ON's costs in Exhibit CWB-1 values the 14,000 SO_2 allowances on line 17 at their cost of roughly \$21.1 million. Big Rivers' Exhibit CWB-2 values the SO_2 allowances on line 16 at their estimated market value at closing of approximately \$10.9 million – a difference of roughly \$10.2 million. Big Rivers can only record the allowances at their market value, not their cost to E.ON.

e. **IT Support.** E.ON's costs in Exhibit CWB-1 value the anticipated cost of continuing IT support on line 18 at approximately \$5.5 million. Big Rivers' Exhibit CWB-2 does not include this item as a benefit because Big Rivers will reimburse E.ON for continuing IT support at cost pursuant to the terms of the Information Technology Support Services Agreement.

f. **Lease Income.** Big Rivers' Exhibit CWB-2 includes on line 8 approximately \$11.4 million for deferred E.ON lease revenue it will recognize at the Unwind Transaction closing. Although this is undoubtedly a benefit to Big Rivers, it is not considered a cost in E.ON's calculation.

g. **Marketing Payment/Settlement**. Big Rivers' Exhibit CWB-2 includes approximately $15.7 million in expenses on line 18. This unamortized monthly payment/settlement promissory note reflected on Big Rivers' balance sheet was being amortized over the life of the lease and now will be expensed at the Unwind Transaction closing.

h. **Smelter Payment**. Big Rivers' Exhibit CWB-2 includes approximately $4.3 million for an E.ON liability to the Smelters that has now been assumed by Big Rivers.

Below I summarize the differences in the E.ON and Big Rivers calculations.

(in millions)	E.ON	Big Rivers
a	$32.4	
b		<$1.5>
c	$22.0	
d	$10.2	
e	$5.5	

f		<$11.5>
g		$15.7
h		$4.3
Total	$70.1	$7.0

Q. Mr. Blackburn, you mention that E.ON includes $22 million in costs attributable to transaction costs payable by it to Big Rivers. Could you please describe this aspect of the Unwind Transaction?

A. As described in the testimony of Paul W. Thompson, Exhibit 15, WKEC has agreed to reimburse Big Rivers for 75% of certain transaction costs incurred during the period November 2004 through the date of closing in connection with the Unwind Transaction (up to specified caps), whether or not a closing of the Unwind Transaction occurs, and for 100% of these costs (up to a specified cap) if the Unwind Transaction is successfully closed. These transaction cost reimbursement provisions are set out in the agreements attached as Exhibit CWB-3 to my testimony. These reimbursement commitments are subject to a cap of $16.5 million if no closing of the Unwind Transaction occurs and a cap of $22 million if a closing does occur. In addition, E.ON reimbursed 75% of Big Rivers' costs incurred in connection with the Unwind Transaction prior to November 2004, which reimbursement amounted to approximately $1.096 million.

Also included in Exhibit CWB-3 are certain cost-sharing agreements between the E.ON U.S. Parties, Big Rivers and the Smelters establishing their respective equal one-third shares of any consent fees that may be required to be paid to certain designated creditors of Big Rivers in exchange for those creditors' consent to the Unwind Transaction. The amount of those consent fees, if any, is not yet known, as the discussions with those creditors remain ongoing. Exhibit CWB-3 also includes agreements among the E.ON Parties, Big Rivers and the Smelters establishing their respective equal one-third shares of any transaction costs to be reimbursed to certain designated creditors of Big Rivers (including the United States Rural Utilities Service ("RUS")) as a condition to their consideration and support of the termination transactions. These reimbursable transaction costs cannot be reasonably estimated at this time. Neither the potential consent fees nor reimbursable transaction costs represent a difference between the E.ON and Big Rivers valuations of the Unwind Transaction.

Q. Apart from the immediate financial improvements under the Unwind Transaction, will Big Rivers remain financially stable and healthy in future years?

A. The Unwind Transaction will give Big Rivers an excellent foundation for future financial stability. Of course, no one can predict the vagaries of future circumstances. However, Big Rivers believes that the various contractual undertakings and tariff arrangements being proposed will serve to protect Big Rivers and its customers from future risks, permitting Big Rivers to remain financially stable and healthy. These results are fully supported by the outputs of Big Rivers' financial model (details of which I describe below). In all years studied (except one, early on), Big Rivers is projected to maintain a TIER of at least 1.24 and an ample DSC.

Q. What comfort does Big Rivers have that it will be able to achieve an acceptable TIER over the course of the proposed transaction?

A. As described below in Section III of my testimony, the Smelters have agreed as part of the new Wholesale Smelter Contracts to a TIER Adjustment Charge that will assist Big Rivers in achieving a 1.24 TIER, as defined in the Smelter Agreement, each fiscal year. Big Rivers and its financial advisors determined that Big Rivers should be able to demonstrate an ability to earn a 1.24 TIER in order to have a reasonable opportunity to obtain and maintain an investment grade financial rating. Accordingly, Big Rivers in its negotiations with the Smelters insisted that the Smelters assist Big Rivers in achieving this goal. Under the TIER Adjustment mechanism included in the Wholesale Smelter Agreements, the Smelters support Big Rivers' earnings by becoming solely responsible for certain of Big Rivers' cost increases that would cause Big Rivers in a given year to fail to meet a 1.24 TIER. While there are certain limitations, adjustments and assumptions applicable to this payment obligation, the net result in most circumstances will be to assure that Big Rivers receives a TIER of 1.24. The operation of this provision is discussed in greater depth in Section III below describing the Smelter agreements.

Q. **Has Big Rivers modeled its TIER in future years under the Unwind Transaction?**

A. Yes. As part of its financial model Big Rivers has determined the rate levels that would be necessary to maintain a TIER of 1.24 over the period from closing on April 30, 2008 through December 31, 2023. With the exception of only one year (2010, the year before an expected general rate adjustment, when the modeled TIER is 1.22), the model demonstrates that a contractual TIER of 1.24 will be achieved under the projected rates in all years.

Q. **Has Big Rivers modeled its DSC over the period 2008 through 2023?**

A. Yes. Over the period 2008 through 2023, Big Rivers' financial model projects that Big Rivers will maintain a DSC at levels between 2.04 and 1.48. The highest DSC of 2.04 occurs in the initial year of the Unwind Transaction and the lowest DSC of 1.48 occurs in 2013. Thereafter, from 2014 through 2023, the DSC stays within a band ranging from 1.58 to 1.75 in every year modeled.

Q. Does Big Rivers' financial model estimate the effect of the Unwind Transaction on Big Rivers' days of operating cash on hand?

A. Yes. The financial model shows days of operating cash on hand two separate ways: including Big Rivers' line of credit and excluding that line of credit. I believe that including Big Rivers' line of credit is an appropriate basis for measuring cash on hand, as Big Rivers will be able to draw on those funds as needed. However, excluding the line of credit provides a more conservative estimation, so it is provided as well. When Big Rivers' funds available under its line of credit are included, Big Rivers during 2008 will have approximately 290 days of operating cash on hand. This amount declines to 211 days in 2009 and to 181 days in 2010. Thereafter, the days of cash on hand declines to a low of 136 days in 2013 before climbing to approximately 164 days of cash on hand in 2023. When Big Rivers' line of credit is excluded from the calculation of days of cash on hand, Big Rivers will have approximately 207 days of cash on hand in 2008, declining to 128 days in 2009. The days of cash on hand reaches a low of approximately 62 days in 2013, and thereafter rises to approximately 105 days in 2023.

Q. Is it your opinion, Mr. Blackburn, that Big Rivers will be financially healthy on and after the Unwind Transaction?

A. Yes, it is. The financial model demonstrates that Big Rivers will achieve a 1.24 TIER in every year modeled (except for 2010, as mentioned previously). Big Rivers will have sufficient revenues to more than cover its debt service in each year as shown by the modeled DSC amounts. And Big Rivers will maintain a reasonable amount of cash on hand, as measured by days of operating cash on hand (whether including or excluding Big Rivers' line of credit), to permit it to continue operating in a financially strong manner.

Q. Could you please describe the projected rate effects of the Unwind Transaction on Big Rivers' non-Smelter Member rates?

A. Big Rivers initially will be maintaining existing demand and energy rates for rural and large industrial customers at current levels commencing on and after the closing of the Unwind Transaction, plus any adjustments from the application of the FAC and the Environmental Surcharge. Big Rivers' financial model demonstrates the need for modest base rate increases in the future. On the whole, however, Big Rivers believes its base rates will remain remarkably stable. The existing rural energy rate of $20.40/MWh in 2008, for example, is projected in the financial model to increase to $23.12 in the period 2017 through 2023, and the existing rural demand rate of \$7.37/KW-month is projected to increase to \$8.35 over the same period. Similarly, the existing non-Smelter large industrial energy rate of \$13.72/MWh in 2008 is projected to increase to \$15.54/MWh for the period 2017 through 2023, and the existing large industrial customer demand rate of \$10.15/KW-month in 2008 is projected to increase to \$11.50/KW-month in that same period.

Q. Would you please walk through the *pro forma* rate changes for rural members in the financial model?

A. Sure. Lines 30 and 31 of page 2 of the *pro forma* financial model (Exhibit 8) show that base rates to non-Smelter rural members are unchanged for the first three years of the Unwind Transaction. (Line 46 shows that the overall effective rate is level except for changes in load factor and the operation of the tariff riders which cause slight rate variations, both positive and negative.) The financial model then assumes a base rate increase of approximately 2.0% in 2011. The FAC and Environmental Surcharge continue to be offset by the Economic Reserve. The Economic Reserve has been projected to be depleted in 2013. The base rate increase, combined with the fact that the 5-year cumulative effect of inflation for fuel and environmental costs is partially offset by the Economic Reserve in 2013, is projected on line 46 to result in an increase in the effective rate of 19.8%. In

2015, the financial model assumes that base rates will increase 0.92%. The only other projected base rate change through 2023 is the 9.98% increase in 2017 shown on line 17.

Q. How do these non-Smelter base rates compare to the Smelter base rates?

A. The Smelter base rates will be higher but similarly will face the same projected base rate increases. Smelter base rates (incorporating both energy and demand) in 2008, for example, begin at $27.32/MWh as shown on line 88 and rise to $31.26/MWh in 2023 in the financial model. These base rates will be subject to adjustment in accordance with the provisions of the Smelter Agreements, as discussed elsewhere in my testimony.

B. Description of Big Rivers' Financial Model

Q. Please describe the financial model Big Rivers used to benchmark the reasonableness of the terms of the Unwind Transaction proposal.

A. Big Rivers has engaged in extensive financial modeling to attempt accurately to project Big Rivers' future rate path based on the terms of the Unwind Transaction and expected future conditions. Big Rivers is convinced that the financial model provides the best available financial information that can be assembled to predict future operating results at Big Rivers. Early on in the process of negotiating the Unwind Transaction, Big Rivers engaged the consulting services of Robert Mudge of CRA International, Inc. Mr. Mudge has worked closely with all of Big Rivers' financial personnel as the Unwind Transaction has unfolded to develop a dynamic financial model able to accurately measure the likely financial effects of the Unwind Transaction. Mr. Mudge separately in his testimony, Exhibit 9, describes the process he used to develop the financial model and the factors he weighed as part of that process. Mr. Mudge also presents the outcomes of the model for a variety of circumstances.

Q. What role did Big Rivers and Big Rivers personnel play in the development of the financial model?

A. The creation and development of the financial model has been an organic process with a free flow of ideas between Big Rivers' management, Big Rivers' financial personnel, Goldman Sachs, and CRA International. Mr. Mudge's modeling and decisions were subjected to this internal peer-review process throughout the course of this transaction to help ensure that the outputs of the model remain as accurate as possible.

Q. Please describe the inputs provided by Big Rivers to the financial model presented in Exhibit 8.

A. Big Rivers provided multiple inputs to Mr. Mudge for use in performing the financial modeling for the Unwind Transaction. First, Big Rivers provided a production cost model for the generating facilities. This model draws upon the expertise of Big Rivers personnel formerly involved in production from the facilities, with this internal expertise supplemented by inputs by WKEC based upon their recent experience in operating the facilities. Big Rivers also provided information regarding its own operations, and further provided information concerning its finances, both current and projected. Finally, Big Rivers provided inputs developed by Goldman Sachs, which generated certain financial data for use in modeling the Unwind Transaction.

Q. How was the production cost model for the generating facilities developed?

A. The production cost modeling for the generating facilities was performed by ACES Power Marketing ("APM"), incorporating inputs provided by Big Rivers and the E.ON U.S. Parties. The inputs to the production cost model include: (1) variable operation and maintenance expense; (2) the current fuel and reagent contracts in place, taking into consideration the remaining life of the contracts and the value of the contracts; (3) rolling seven or eight-year turbine outage plans (depending on the particular plant concerned) for the life of the model; (4) rolling two or three-year boiler outage plans (depending on the particular plant concerned) for the life of the model; (5) plant outage history; (6) a coal price forecast provided by a leading economic consulting firm, Global Insight, Inc.; (7) a natural gas price forecast provided by APM; (8) SO_2 and NOx allowance price forecasts provided by Global Insight, Inc.; and (9) a regional variable cost dispatch forecast from APM that projects likely dispatches of regional units.

Q. Did Big Rivers provide any of its own inputs to the financial model?

A. Yes, Big Rivers developed numerous inputs for use in the financial modeling. First, Big Rivers provided information regarding its own operations, including an organizational chart that reflects current Big Rivers' personnel, labor and overheads, as well as a projected organizational chart reflecting anticipated personnel, labor and overhead following closing of the Unwind Transaction. Big Rivers also provided its current balance sheet, as well as its current budget and budget projections going forward from April 30, 2008, for inclusion in the financial model. As I noted above, Big Rivers has significant internal expertise based on its prior experience in operating the generating facilities, and this expertise was used in developing the model. Big Rivers also took the existing E.ON U.S. Parties' work plan for the generating facilities and reconciled it to Big Rivers' operations, including the need to replace the existing petroleum coke contracts for Green Plant Units 1 and 2 and for Wilson Unit 1. The Wilson Unit 1 petroleum coke contract expires in 2008, while the Green Plant Units 1 and 2 petroleum coke contract expires in 2011. Big Rivers currently plans to transfer the petroleum coke deliveries under the Green Plant contract to Wilson on and after 2008 until that contract's expiration in 2011.

Big Rivers also provided data regarding projected electricity sales, purchases, and production, including fuel consumption, startup costs, and emissions, as well as information regarding current rates for electricity sales for each customer class. Big Rivers provided information concerning anticipated receipts, including, among other things, the proceeds of the Unwind Transaction, and projected capital expenditures and other disbursements.

Q. Are there any other inputs that Big Rivers provided?

A. Yes. Big Rivers obtained a projection of interest rate spreads from Goldman Sachs for the period covered by the model (2008 through 2023), for use in developing alternative financial assumptions for the model. In addition, Goldman Sachs provided information regarding the credit structure that Big

Rivers would need to maintain, including the appropriate TIER and other requirements relating to the Unwind Transaction, in order to achieve investment grade credit ratings from Standard & Poor's and Moody's. The Goldman Sachs inputs are further described in the testimony of Mark W. Glotfelty, Exhibit 21.

C. Risk Management Policies

Q. Has Big Rivers adopted any policies to manage risks that it may confront after the closing of the Unwind Transaction?

A. Yes. As Mark A. Bailey explains in his testimony, Exhibit 5, Big Rivers' Board of Directors ("Board") has adopted a set of policies to manage various categories of risk that Big Rivers either faces now or might face in the future, once the Unwind Transaction has closed and Big Rivers resumes control of its generating facilities. Copies of certain of these policies are attached as exhibits to Mr. Bailey's testimony and the remaining policies are attached to my testimony. Mr. Bailey describes the overall purposes of these policies in his testimony, but I would like to summarize briefly the objectives of three particular policies: the Financial Policy (Exhibit CWB-4), the Hedge Policy (Exhibit CWB-5), and the Trading Authority Policy (Exhibit CWB-6).

Q. Why has Big Rivers adopted the Financial Policy?

A. The Financial Policy is designed to provide a framework to enable Big Rivers to timely meet its financial obligations and maintain its financial viability. It sets forth responsibilities and guidelines to ensure that Big Rivers will be able to maintain the key financial metrics that are required to meet its investment grade credit rating target and that it will be able to access both short-term and long-term capital on a timely basis. The policy provides for an annual fiscal review by the Board to evaluate Big Rivers' performance under the policy.

Q. What is the purpose of the Hedge Policy?

A. The Hedge Policy outlines the criteria that Big Rivers will follow as it engages in the hedging of resources (including natural gas, coal, and electricity). The Hedge Policy is intended to reduce the volatility of the Members' wholesale rates by identifying criteria to be applied by Big Rivers in procuring resources to meet its projected energy needs and to avoid potential adverse impacts that could result from significant increases or decreases in energy prices. The policy does provide for some flexibility to depart from strict application of the criteria in specific circumstances, provided that the Board concurs. The Board will review performance under this policy on a monthly basis.

Q. Please explain the objective of the Trading Authority Policy.

A. The Trading Authority Policy is designed to clearly delineate who has authority to execute energy-related transactions on Big Rivers' behalf, as well as to identify the types of commodities and financial products that may be traded and the delivery locations where trading may occur. The Trading Authority Policy also sets forth the requirements and trading limits applicable to such transactions, as determined by the Board in adopting the policy, and sets out processes for approving new commodities and products to be traded and for approving new trading locations. The policy also identifies certain transactions that are subject to approval by the Board prior to execution.

Q. Will the Trading Authority Policy govern Big Rivers' fuel procurement activities?

A. Yes, in part. The Trading Authority Policy covers trading in fuel commodities and products, and thus provides broad guidelines similar to those applicable to Big Rivers' trading in other energy-related commodities and products. However, Big Rivers also has developed, and the Board has approved, a set of policies and procedures that are specifically applicable to fuel procurement.

Q. **Do you discuss the Big Rivers Fuel Procurement Policies and Procedures in your testimony?**

A. No. These policies and procedures are described in Mr. Bailey's testimony, Exhibit 5, and therefore I do not describe them separately here, other than to note that under the policies, I will have the ongoing responsibility for fuel procurement in my future capacity as Senior Vice President Energy Services and Chief Energy Officer. Big Rivers will have a Director of Fuels who will oversee a Fuels Department and who will report to me, and I in turn will report to Mr. Bailey concerning fuel procurement. In addition, I will administer existing contracts for fuel supply to the generating facilities which will be assigned by WKEC to Big Rivers upon closing of the Unwind Transaction.

Q. **What arrangements currently exist for obtaining fuel for the generating facilities?**

A. At present, there are contracts in place providing for significant amounts of the required fuel for the generating facilities in the near term. These contracts include existing petroleum coke contracts for Green Plant Units 1 and 2 and Wilson Unit 1, which expire at the end of 2008 and 2011, respectively. I understand that 87 percent of the anticipated fuel needs for 2008 are currently contracted for. These fuel contracts will be assigned to Big Rivers by WKEC when the Unwind Transaction closes. Big Rivers currently plans to carry on with the existing fuel contracts, including the petroleum coke contracts, until they expire. Copies of these contracts are included as Exhibit 42 to the Application, and are submitted subject to the confidentiality provisions of 807 KAR 5:001 § 7.

Q. Has Big Rivers evaluated the existing fuel contracts for prudence?

A. Yes. Big Rivers and its attorneys have reviewed the fuel contracts. Moreover, in 2006, Big Rivers engaged the consulting firm of Hill & Associates to review the fuel contracts and to evaluate whether the payments under the contracts are prudent and whether the prices reflect the current market, and to recommend whether Big Rivers should accept or reject the contracts. Hill & Associates has reported to Big Rivers that the payments are prudent and the contracts are priced to market, and has recommended that Big Rivers accept them. More recently, Big Rivers has asked Hill & Associates to perform an update of its review for any subsequent fuel contracts, amendments or fuel escalation clauses – all of which will be filed with the Commission.

III. DESCRIPTIONS OF SMELTER CONTRACTS

Q. What is the purpose of this portion of your testimony?

A. In this portion of my testimony, I will explain the manner in which Big Rivers will provide electric service to Kenergy for resale to Alcan and Century under the Unwind Transaction, and I will describe the agreements entered into by and among Big Rivers, Kenergy, and the Smelters to effectuate the new electric service arrangements.

Q. Please describe how Big Rivers will provide electric service to Kenergy for resale to Alcan and Century.

A. Big Rivers will sell electric service to Kenergy under special contracts. Kenergy in turn will resell electric service to Alcan and Century under special contracts.

Q. What agreements will govern the relationships between Big Rivers, Kenergy, and the Smelters?

A. There are eight agreements ("Smelter Agreements") that embody substantially all of the terms and conditions relating to Big Rivers' sale of electric service to Kenergy for resale to the Smelters. There are four relating to each Smelter, and the structure of the agreements is the same. The agreements are:

<u>For service to Alcan</u>:

1. Wholesale Electric Service Agreement (Alcan) between Big Rivers and Kenergy (Exhibit 20);
2. Retail Electric Service Agreement between Kenergy and Alcan (Exhibit 20);
3. Coordination Agreement between Big Rivers and Alcan (Exhibit 20); and
4. Security and Lockbox Agreement between Big Rivers, Kenergy, Alcan and a depository bank (Exhibit 20).

<u>For service to Century</u>:

1. Wholesale Electric Service Agreement (Century) between Big Rivers and Kenergy (Exhibit 20);
2. Retail Electric Service Agreement between Kenergy and Century (Exhibit 20);
3. Coordination Agreement between Big Rivers and Century (Exhibit 20); and

4. Security and Lockbox Agreement between Big Rivers, Kenergy, Century and a depository bank (Exhibit 20).

A summary of these contracts is provided in Exhibit 19.

Q. What are the functions of these agreements?

A. The wholesale service agreements ("Smelter Wholesale Agreements") call for Big Rivers to provide electric service to Kenergy, for resale to Alcan and Century, respectively. The retail service agreements ("Smelter Retail Agreements") call for Kenergy to provide retail electric service to the respective Smelters. The coordination agreements ("Coordination Agreements") set forth certain direct obligations between Big Rivers and each Smelter. The security and lockbox agreements ("Lockbox Agreements") provide for the Smelters to make payments due under the Retail Agreements to a depository bank selected by the parties.

Q. How are the parties' respective obligations under the Smelter Agreements related?

A. The Smelter Agreements are structured so that each obligation of Kenergy to Big Rivers under a Smelter Wholesale Agreement is conditioned on the performance by that Smelter of its related obligation to Kenergy, and each obligation of Kenergy to a Smelter under a Smelter Retail Agreement is conditioned on the performance by Big Rivers of its related obligation to Kenergy. Under the structure of the Smelter Agreements, either Big Rivers or a Smelter will be able to enforce directly any obligation arising out of the Smelter Agreements, thereby decreasing the possibility that Kenergy will be involved in disputes between Big Rivers and the Smelters. In essence, the Smelter Agreements create a pass-through arrangement for the obligations between Big Rivers and the Smelters.

Q. Given that the respective structures of the contractual arrangements for service to Alcan and Century are the same, are there substantive differences between the individual agreements applicable to service to each Smelter?

A. With two exceptions, no. The Smelters have agreed to identical terms and conditions of electric service. The only differences are with respect to the amount of electric energy to be delivered to each Smelter and the monthly surcharge that I describe below in addressing payment obligations under the Smelter Agreements, which surcharge is calculated based on each Smelter's pro rata share of the total electric energy to be delivered to the Smelters. For that reason, I do not distinguish in my testimony between agreements applicable to electric service to Alcan and agreements applicable to electric service to Century.

Q. Do you discuss all of the Smelter Agreements in your testimony?

A. No. In my testimony, I describe the Smelter Wholesale Agreements, the Coordination Agreements, and the Lockbox Agreements, although I am advised that the Coordination Agreements and the Lockbox Agreements may not require approval by the Commission. Below, I explain why the Smelter Wholesale Agreements are reasonable, and should be approved by the Commission. Although my testimony occasionally (and necessarily) refers to the Smelter Retail Agreements, I do not separately describe those agreements because the Smelter Wholesale Agreements and Smelter Retail Agreements are substantially identical, reflecting the pass-through nature of the obligations between Big Rivers and the Smelters. Therefore, my description of the Smelter Wholesale Agreements substantially describes the Smelter Retail Agreements as well. In addition, I am advised that although the Smelter Retail Agreements are included as part of Exhibit 20 to this Application, Kenergy will file those agreements separately for approval by the Commission.

Q. Do the Smelter Wholesale Agreements cover service to the Southwire Company Rod & Cable Mill?

A. No. At present, Southwire Company is a co-party to the existing retail agreements between Kenergy and Century. After the implementation of the Unwind Transaction, our understanding is that Kenergy will serve Southwire Company's Rod & Cable Mill separately as a dedicated delivery point large industrial customer. Big Rivers is in the process of drafting a proposed contract with Kenergy for wholesale service for this load.

Q. What is the purpose of the Smelter Wholesale Agreements between Big Rivers and Kenergy?

A. The Smelter Wholesale Agreements specify the rates, terms and conditions pursuant to which Big Rivers will sell electric energy and related services to Kenergy for resale to the Smelters beginning on the day following the effective date as determined pursuant to Article 6 of the Smelter Wholesale Agreements, and continuing through December 31, 2023, unless the Smelter Wholesale Agreements are terminated at an earlier date pursuant to their terms. As I stated previously, there is a separate Smelter Wholesale Agreement relating to service to each Smelter. The Smelter Wholesale

Agreements will replace the current arrangements by which Kenergy obtains power at wholesale to meet the Smelters' power requirements.

Q. How does Kenergy currently meet the Smelters' power requirements?

A. Under existing arrangements, Kenergy obtains the majority of the wholesale power required to meet the needs of the Smelters from LG&E Energy Marketing, Inc., one of the E.ON U.S. Parties, pursuant to contracts that expire concurrently with the existing Smelter retail contracts in 2010 (for Century) and 2011 (for Alcan). Kenergy currently meets the balance of the Smelters' power requirements through Tier 3 purchases on the open market from the best available sources.

Q. How will Kenergy meet the Smelters' power requirements under the Smelter Wholesale Agreements?

A. Section 2.3.1 of the Smelter Wholesale Agreements obligates Big Rivers to supply, subject only to the occurrence of an event of force majeure, an aggregate of up to 850 MW of electric energy and related services ("Base Monthly Energy") to Kenergy for resale to the Smelters. Base Monthly Energy is calculated based upon the "Base Demand," as set forth in Section 1.1.15. For Alcan, the Base Demand is 368 MW, and for Century, the Base

Demand is 482 MW; however, Section 3.1 provides that the Base Demand for a given fiscal year may be changed, if Big Rivers and Kenergy consent to the change.

Q. Do the Smelter Wholesale Agreements provide for any other sales to Kenergy for resale to the Smelters?

A. Yes. Pursuant to Section 2.3.2, Big Rivers may, but is not obligated to, sell additional electric energy and related services to Kenergy for resale to either Smelter. Specifically, Big Rivers may agree to supply a specified amount of energy, interruptible subject to terms, limitations and conditions set forth in Section 2.3.2 ("Interruptible Energy"). In the event that Interruptible Energy is interrupted, Big Rivers may in its sole discretion offer to supply energy purchased from third-party suppliers ("Buy-Through Energy") on a firm basis, but only in situations where a Smelter agrees to purchase such energy after being notified of the estimated price or prices to be charged during the hour or hours during which Big Rivers would supply such energy. Big Rivers also may agree to supply Kenergy with additional quantities of electric energy and related services requested by a Smelter ("Market Energy"). Big Rivers is not obligated to sell Market Energy to Kenergy for resale to a Smelter, and Kenergy may purchase electric energy and related services from sellers other than Big Rivers for resale to the Smelters. Finally, Section 2.3.3 states that

Big Rivers will use reasonable commercial efforts to provide, or cause to be provided, additional hourly energy required by the Smelter and requested by Kenergy in excess of the amounts supplied pursuant to Sections 2.3.1 and 2.3.2 ("Back-Up Energy").

Q. **Is Kenergy obligated to arrange for scheduling of deliveries of energy made pursuant to the Smelter Wholesale Agreements?**

A. Yes, with respect to certain types of energy. Pursuant to Section 3.2, Kenergy is *not* obligated to schedule Base Monthly Energy, Buy-Through Energy or Back-Up Energy, but must use reasonable commercial efforts to apprise Big Rivers of any material change in a Smelter's intended usage of such energy. However, Kenergy *is* obligated to direct the Smelters to schedule deliveries of Interruptible Energy and Market Energy in accordance with the Big Rivers Open Access Transmission Tariff ("OATT"), and this scheduling obligation of the Smelters is reflected in the Smelter Retail Agreements.

Q. **Are there any provisions for resale of energy by Big Rivers that otherwise would be deliverable to the Smelters?**

A. Yes. Big Rivers has agreed that it will attempt to sell energy that otherwise would be deliverable to the Smelters in three instances. First, a Smelter may request that Kenergy sell energy through Big Rivers that is surplus to that Smelter's needs ("Surplus Sales"). Second, a Smelter may request that Big Rivers sell energy that is effectively undeliverable due to damage to, or destruction of, equipment that prevents or limits normal aluminum smelting operations ("Undeliverable Energy Sales"). Third, a Smelter may request that Big Rivers sell energy in the event that a Smelter has or will cease aluminum smelting operations on one of its potlines ("Potline Reduction Sales"). Big Rivers also may make "Economic Sales," as defined and described below, of energy. Each of these types of sales is subject to certain conditions and restrictions.

Q. Would you summarize the conditions applicable to Surplus Sales?

A. Pursuant to Section 10.1, a Smelter must request Big Rivers to make Surplus Sales by prior written notice, and must specify the amount of the Smelter's hourly Base Demand to be sold, as well as the times and durations of the requested sales. In addition, the Smelter must curtail its hourly demand so that the combination of the Smelter's demand and the energy sold as surplus does not exceed the Smelter's hourly Base Demand. There will be no obligation to make Surplus Sales if the portion of hourly Base Demand the

Smelter requests to be sold exceeds the Smelter's hourly Base Demand, or is less than ten MW, or is not in multiples of one MW. Big Rivers will use reasonable commercial efforts to make the Surplus Sales, subject to an economic test, subject to its right to sell its own surplus energy, and subject to transmission or other constraints.

Q. What conditions and limitations apply to Undeliverable Energy Sales?

A. Section 10.2.1 provides that a Smelter may request that Big Rivers make Undeliverable Energy Sales if the damage or destruction of plant initially reduces the Smelter's demand by at least 50 MW per hour, the limitation is expected to continue for at least 48 hours, and the proximate cause of the damage is not due to intentional or willful misconduct of the Smelter or its affiliates. Big Rivers will use reasonable commercial efforts to sell an amount of energy up to the reduction in the Smelter's demand, subject generally to the same conditions as are applicable to Surplus Sales. At the Smelter's request, Undeliverable Energy Sales will continue for up to six months, subject to an extension of three months if the Smelter certifies that the condition cannot be remedied with reasonable diligence in six months.

Q. Under what circumstances and conditions will Big Rivers make Potline Reduction Sales?

A. As I explained above, Potline Reduction Sales may occur when a Smelter has or will cease aluminum smelting operations on one of its potlines. Section 10.3 specifies several conditions that must be met before Big Rivers will engage in Potline Reduction Sales. The Smelter must submit the request to Kenergy and Big Rivers at least 30 days in advance, the cessation of aluminum smelting operations may apply to only one potline, and the Smelter must estimate that the cessation will last for 12 months or longer. In addition, a Smelter may not request Potline Reduction Sales if previous Potline Reduction Sales were made during the 12 months preceding the giving of notice. Big Rivers shall have no obligation to make Potline Reduction Sales until it has sold its own surplus energy available for sale, or to the extent that transmission or other constraints prevent Big Rivers from making Potline Reduction Sales.

Q. How are Kenergy's (and, by extension, the Smelters') payment obligations structured under the Smelter Wholesale Agreements?

A. The payment obligations involve several components and are quite complex. As an initial matter, it is important to keep in mind that the charges have been developed in order to ensure that the Smelters, in the aggregate, assist Big Rivers in achieving an annual TIER of 1.24, subject to certain limitations and adjustments discussed in greater detail below. The Smelters will be billed on a monthly basis. They will pay a Base Energy Charge for Base Monthly Energy, including adjustable charges for fuel, the environmental surcharge, and Non-FAC Purchased Power Costs, and will pay separate charges for Supplemental Energy, Back-Up Energy, transmission and ancillary services, and excess reactive demand, as applicable. In addition, the Smelters will pay a monthly charge ("TIER Adjustment Charge") to ensure that Big Rivers achieves in each fiscal year a TIER of 1.24, calculated as provided in the contracts. The Smelters also will pay an additional amount ("Surcharge") that will increase periodically over the lives of the Smelter Wholesale Agreements, as discussed below, and will pay an amount to compensate Kenergy ("Retail Fee"). These total amounts will be offset by certain rebates and credits described below, and the resulting charges will be paid to Kenergy, which will in turn pay the collected amounts (less the Retail Fee) to Big Rivers under the applicable Smelter Wholesale Agreement.

Because the ultimate payment obligations run from the Smelters to Big Rivers (with the exception of the Retail Fee, which is paid to Kenergy and not passed through to Big Rivers), I will focus on the Smelter payment obligations, even though under the Smelter Wholesale Agreements, Big Rivers receives its payments from Kenergy.

Q. Please describe the Base Energy Charge and how it is calculated.

A. The Base Energy Charge is a monthly charge to the Smelters. For each Smelter, Base Monthly Energy is broken down into two components: "Base Fixed Energy," which is the product of Base Demand, the number of hours in the billing month, and 0.98 (reflecting an assumed 98 percent load factor); and "Base Variable Energy," which is the result of subtracting Base Fixed Energy from Base Monthly Energy for that billing month, and which may be either a negative or a positive amount. As set forth in Section 4.2, the Base Energy Charge is determined by adding the products of two calculations. First, Base Fixed Energy is multiplied by the "Base Rate," which is the sum of (1) $0.25 per MWh, and (2) the "Large Industrial Rate," which is defined in Section 1.1.63 as Big Rivers' tariff rate for sales to its Members for resale to large direct-served industrial customers for a customer with a 98 percent load factor, but excluding certain adjustments applicable to that tariff rate, including the Rebate, the FAC Factor, and the Environmental Surcharge, each of which is discussed more fully elsewhere in my testimony as well as in the testimony of William Steven Seelye, Exhibit 25. The result is added to the product of multiplying Base Variable Energy by the sum of the "FAC Base" under Big Rivers' Tariff and the "Purchased Power Base" (as defined in Appendix A to the Smelter Retail Agreement) to derive the Base Energy Charge. If Base Variable Energy is a negative amount in a given month, the result will be an offset to the charge for Base Fixed Energy.

Q. How are charges for Supplemental Energy determined?

A. As I explained previously, under certain circumstances the Smelters may purchase Interruptible Energy, Buy-Through Energy, or Market Energy from Big Rivers. Section 4.3 of the Smelter Wholesale Agreements provides that rates for these products shall be as agreed to from time to time by Big Rivers and the applicable Smelter. Charges to the Smelters will include all separate charges for third-party transmission and related services, as applicable. For Buy-Through Energy and Market Energy, charges to the Smelters will also include additional amounts that Kenergy may be required to pay upon termination by reason of default of the supply arrangements between Big Rivers or Kenergy and third-party suppliers, net of recoveries from those suppliers with respect to the supply of energy for resale to the Smelters.

Q. Please explain how charges for Back-Up Energy are calculated.

A. The charges for Back-Up Energy are assessed on an hourly basis, and are designed to encourage the Smelters not to use this type of energy except as imbalance energy. A threshold amount is established pursuant to Section 4.4.1(c), consisting of the sum of 10 MW, plus the amount of Back-Up Energy resulting from interruptions of Interruptible Energy that had been scheduled by the Smelter, plus the amount of Back-Up Energy resulting from nondelivery of Market Energy purchased by Kenergy from a third party. Assuming that a Smelter uses less than that threshold amount of Back-Up Energy in a given hour, the rate depends upon whether Big Rivers has to purchase the energy in the market. If so, the rate is (1) the product of the amount of Back-Up Energy taken multiplied by 110 percent of the highest price for any energy purchased by and delivered to Big Rivers in that hour, plus any separate charges for third-party transmission and related services, divided by (2) 1.00 minus the loss factor under Big Rivers' OATT. If Big Rivers supplies the Back-Up Energy from generating facilities that it owns or controls and that are located in Big Rivers' control area, the rate is (1) the product of the amount of Back-Up Energy taken multiplied by either the locational marginal price at Big Rivers' interconnection with the Midwest Independent System Operator or Big Rivers' system lambda, whichever is greater, divided by (2) 1.00 minus the loss factor under the OATT.

Q. What if a Smelter's use of Back-Up Energy does exceed the threshold amount in a given hour?

A. The charge for using Back-Up Energy in excess of the threshold amount is the product of the amount of Back-Up Energy taken in excess of the threshold multiplied by the greater of (1) $250 per MWh, or (2) 110 percent of the highest price for any energy purchased by and delivered to Big Rivers in that hour, plus any separate charges for third-party transmission and related services, divided by 1.00 minus the loss factor under Big Rivers' OATT.

Q. What charges do the Smelters pay for transmission and ancillary services and for excess reactive demand?

A. Pursuant to Section 4.5, the Smelters will pay for transmission and ancillary services associated with Base Monthly Energy that are unbundled from the Large Industrial Rate in accordance with the terms of the Smelter Wholesale Agreement. The Smelters also will pay for transmission and ancillary services associated with Supplemental Energy. The charges will be calculated pursuant to the OATT. An "Excess Reactive Demand Charge" is applied pursuant to Section 4.6 if the maximum metered reactive demand of a Smelter for a given billing month exceeds a specified level of kilovars agreed to in the Smelter Retail Agreement. The charge for excess reactive demand is $0.1433 per kilovar.

Q. What is the TIER Adjustment Charge?

A. As I stated previously, in addition to their payments for power and related services, the Smelters have agreed to pay a separate monthly charge that will assist Big Rivers in achieving a 1.24 TIER each fiscal year as calculated in accordance with the contracts. The "TIER Adjustment" is the positive amount, if any, that is necessary in addition to all of Big Rivers' other revenues for the year to cause Big Rivers to achieve a TIER of 1.24 (as so calculated) for the year. Prior to each fiscal year, Big Rivers shall project whether a positive TIER Adjustment is required for the coming fiscal year. If so, Big Rivers will estimate the TIER Adjustment Charge based on the budget for that fiscal year, and will assess one-twelfth of the TIER Adjustment Charge to Kenergy during each billing month of the year; in turn, Kenergy will pass that assessment to the Smelters during each billing month of the fiscal year. If the TIER Adjustment is negative, there will be no TIER Adjustment Charge.

Q. Are there limits on the possible TIER Adjustment Charge applicable to the Smelters?

A. Yes. Big Rivers has agreed that the Smelter's obligations for any given year may not exceed the product of the Based Fixed Energy and a maximum additional charge per MWh that is specified in Section 4.7.1. Over the life of the Smelter Agreements, the applicable maximum additional charges are as follows:

Fiscal Years	Maximum Additional Charge
2008-2011	\$1.95 per MWh
2012-2014	\$2.95 per MWh
2015-2017	\$3.55 per MWh

2018-2020	$4.15 per MWh
2021-2023	$4.75 per MWh

Thus, there is a ceiling on the TIER Adjustment Charges that the Smelters will be required to pay during any given year.

Q. Will the TIER Adjustment Charge be subject to possible adjustment after it is initially determined for a given fiscal year?

A. Yes. Section 4.7.4 provides for Big Rivers to perform a new estimate of the TIER Adjustment and corresponding TIER Adjustment Charge within 45 days of the end of the first, second, and third fiscal quarters of each fiscal year, based on a comparison of the budget and year-to-date operational results. Based on the new estimate, Big Rivers shall calculate a modified amount to be collected from, or refunded as a credit against, the monthly charge to each Smelter for the balance of the fiscal year, including any amounts necessary to address estimated over- or undercollections from the Smelters as compared to the budget during the remainder of the fiscal year. The amount to be collected from, or credited to, the Smelters by Kenergy shall be spread over equal installments for each month remaining in the fiscal year.

Furthermore, at the end of each fiscal year there will be a final true-up process with respect to that fiscal year. No later than 120 days after the end of each fiscal year, Big Rivers shall calculate the TIER Adjustment and TIER Adjustment Charge for that fiscal year, and shall compare the TIER Adjustment Charge to the amounts actually paid by the Smelters under the estimated TIER Adjustment Charge over the fiscal year. Any difference between the TIER Adjustment Charge and the amounts actually paid by the Smelters will be included as a charge or credit, as applicable, in the bill for the fourth billing month of the new fiscal year.

Q. Are there any assumptions that underlie the TIER Adjustment mechanism?

A. There are numerous assumptions that underlie the TIER Adjustment mechanism, and which are enumerated in Section 4.7.5. Two of these assumptions are intended to moderate the TIER Adjustment Charge payable by the Smelters, and thus merit special attention. First, it is assumed in the Smelter Agreements, for purposes of the TIER Adjustment calculation, that Big Rivers shall have raised revenues from service to the Members for their non-Smelter customers as if Big Rivers had raised its base rates for such service by a weighted average of 2.00 percent in 2010, 2.50 percent in 2018, and 4.00 percent in 2021, to the extent that Big Rivers in fact had not raised the non-Smelter Member rates by at least those amounts prior to or during the year of the calculation. For purposes of this assumption, revenues from any roll-in of costs recovered under the FAC Factor and the Environmental Surcharge into the non-Smelter Member base rates will not count as an increase to the non-Smelter Member rates.

Second, it is assumed that for any entity that becomes a direct-serve customer of a Member after the Unwind Transaction and that has a firm demand in excess of 15 MW, the Member shall have paid Big Rivers an amount equal to the greater of (1) the amount the entity actually paid for service, or (2) the charge to the Smelters for Base Fixed Energy, adjusted for actual load factor, plus appropriate charges for fuel, environmental costs, and purchased power costs, plus a proportionate share of the TIER Adjustment Charge (if any) and the Surcharge. For any entity that becomes a direct-serve customer of a Member after the Unwind Transaction and has a firm demand of 15 MW or less, it is assumed that the Member shall have paid Big Rivers an amount equal to the Large Industrial Rate, plus appropriate charges for fuel, environmental costs, and purchased power costs. However, this assumption shall not apply in the last three years of the term of a Smelter Retail Agreement or following notice of termination of either Smelter Retail Agreement.

Q. Can you describe the other assumptions that underlie the TIER Adjustment mechanism?

A. As I noted above, they are numerous, and are recited in Section 4.7.5 of the Smelter Wholesale Agreements. The general purpose of these assumptions is to net out the potential effects on the TIER Adjustment Charge of such items as (i) patronage capital retirements; (ii) interest imputed on debt related to new non-peaking facilities that are not included in Big Rivers' revenue requirements for ratemaking purposes; (iii) interest related to construction work-in-progress to the extent not included in Big Rivers' revenue requirements for ratemaking purposes; (iv) indemnification payments; (v) certain penalties; (vi) proceeds from agreed curtailments; and (vii) expenses disallowed by governmental authorities. This is not intended to be an exhaustive list, but merely indicative.

Q. Are there special provisions governing the operation of the TIER Adjustment mechanism immediately following the closing of the Unwind Transaction?

A. Yes. Pursuant to Section 4.7.7, any proceeds that Big Rivers receives as part of the consummation of the Unwind Transaction shall be disregarded for purposes of calculating the TIER Adjustment Charge for the fiscal year in which the Unwind Transaction occurs. This provision will ensure that the calculation for that fiscal year is not distorted by the inclusion of certain one-time payments and transfers to Big Rivers occurring as part of the Unwind Transaction.

Q. You mentioned that the Smelters will pay certain adjustable charges for fuel, environmental costs, and purchased power costs. Can you explain how these charges will be assessed?

A. Section 4.8 provides for these charges to be assessed to each Smelter as follows: (1) The FAC Charge will be the product of the FAC Factor (calculated pursuant to the Fuel Adjustment Clause Rider in Big Rivers' Tariff) and the Smelter's Base Monthly Energy; (2) the Non-FAC Purchased Power Adjustment Charge will be the product of the Purchased Power Adjustment Factor (calculated in accordance with Appendix A to the Smelter Retail Agreement) and the Smelter's Base Monthly Energy; and (3) the Environmental Surcharge will be the product of the Environmental Surcharge Factor (calculated pursuant to the Environmental Surcharge rider in Big Rivers' Tariff), the Smelter's Base Monthly Energy and Big Rivers' revenues attributable to amounts paid for electric services provided to each Smelter (excluding revenues from the Rebate and Environmental Surcharge with respect to prior billing months).

Q. Please explain the Surcharge that is to be paid by the Smelters.

A. In addition to the payment obligations I have already described, the Smelters each have agreed to pay a Surcharge that includes three factors. First, the Smelters have agreed to an aggregate annual payment of $5,110,000, payable in equal monthly installments from the effective date of the agreements through and including December 2011. From January 2012 through and including December 2016, the aggregate annual payment will be $7,300,000, and from January 2017 through the expiration of the agreements, the aggregate annual payment by the Smelters will be $10,182,813. These amounts are allocated between the Smelters on a pro rata basis; thus, Alcan's obligation will rise from $184,361 per billing month to $263,373, and then finally to $367,380, while for Century, the applicable figures are $241,472 per month for the first period, $344,960 for the second, and $481,188 for the third.

Q. You mentioned that the Surcharge includes three factors. What are the other two?

A. The other two factors are not fixed dollar amounts. The first is the product of the Base Fixed Energy for any billing month multiplied by $0.60 per MWh. The second is the product of the Base Fixed Energy for any billing month and the number of cents (between zero and 60) per MW per hour that Big Rivers' fuel costs for coal-fired generation per MWh for a given fiscal year exceed the amounts set forth in Schedule 4.11(c) for that fiscal year.

Q. What is the Retail Fee that will be paid by the Smelters to Kenergy?

A. As I stated previously, the Smelter Retail Agreements provide for the Smelters to pay a Retail Fee to Kenergy that is not passed through to Big Rivers pursuant to the Smelter Wholesale Agreements. Accordingly, I do not address it in my testimony, although, as I have explained, I have been advised that Kenergy will file those agreements separately for approval by the Commission.

Q. You stated that the Smelters' payment obligations will be offset by certain credits. Will you describe these?

A. Generally, the credits to the Smelters fall into two categories: Credits related to the TIER Adjustment, and credits related to resales and curtailment of energy otherwise deliverable to the Smelters. All of these credits will be offset against the Smelter's payment obligations to determine the final monthly bills.

Q. What are the credits related to the TIER Adjustment, and how are they calculated?

A. As I explained previously, if the TIER Adjustment calculated by Big Rivers for any fiscal year is a positive number, a TIER Adjustment Charge will be assessed to the Smelters. Section 4.9 provides that in the event that the final TIER Adjustment calculation for a given fiscal year yields a negative number (*i.e.*, if Big Rivers' TIER exceeds 1.24, as calculated in accordance with the contract for that fiscal year), Big Rivers may choose to implement a rebate to its Members. If it should do so, then no later than the first day of the fifth month of the following fiscal year, Big Rivers will credit to the Smelters a "Rebate" which will be a portion of the excess TIER amount, calculated based on sales to all Members. If there is a Rebate, it will not cause the Smelters to pay less than the Large Industrial Rate (assuming a 98 percent load factor) plus $0.25 per MWh, plus the FAC, Environmental Surcharge and Non-FAC Purchase Power Adjustment, unless the entire amount of any excess is rebated to all of Big Rivers' Members on a kWh basis.

Section 4.10 further provides that if there is an excess TIER amount and Big Rivers chooses not to implement a rebate to its Members, Big Rivers nevertheless will provide a credit to the Smelters. This "Equity Development Credit" shall be calculated in the same manner as the Rebate is calculated, and similarly is structured so that the Smelters will not pay less than the sum of the Large Industrial Rate (assuming a 98 percent load factor), plus the FAC, Environmental Surcharge and Non-FAC Purchase Power Adjustment.

Q. What other amounts may be credited to the Smelters?

A. Section 4.14.1 provides for each Smelter to be credited with the net proceeds of Surplus Sales, Undeliverable Energy Sales, and Potline Reduction Sales made on its behalf. For Surplus Sales, the net proceeds to be credited will be limited to the fixed amount that Kenergy otherwise would be obligated to pay Big Rivers for the power sold. For Undeliverable Energy Sales and Potline Reduction Sales, the net proceeds to be credited. For each of these three types of sales, the credit will be reduced by $0.25 per MWh as an administrative fee and Big Rivers will estimate its income tax liability for the sales, and any difference between Big Rivers' actual tax liability and the estimated tax liability will be charged to, or credited to, the Smelters as appropriate.

In addition, pursuant to Section 4.14.2, a Smelter may voluntarily curtail the delivery of hourly Base Demand by agreement with Big Rivers and Kenergy, and be credited at a market rate for the energy curtailed thereby. Section 4.14.3 provides that a Smelter may agree with Big Rivers and Kenergy to voluntarily curtail the delivery of up to 100 MW per hour for a period of no more than four hours, so that Big Rivers may sell the energy thus curtailed in the wholesale market ("Economic Sales"). The Smelter will be credited with 75 percent of the net proceeds received by Big Rivers. A Smelter may invoke the Economic Sales provision no more than twelve times per year. Finally, if Kenergy purchases Market Energy from third parties, and resells it to third parties, all revenues derived therefrom will be credited to the Smelters.

Q. Do the Smelter rates that you have described include taxes?

A. No. Section 4.16 provides that the charges and credits for service to the Smelters do not include state or local sales, excise, gross receipts or other taxes. In addition to the rates that I have described, the Smelters also will be required to pay any such taxes that are now or subsequently become applicable to the sale of electric services under the Smelter Agreements.

Q. Are there any limitations on the ability of Big Rivers or the Smelters to seek rate changes?

A. Yes. Pursuant to Section 13.1.1, the parties agree that Big Rivers may seek Commission approval for changes to the rates for the non-Smelter Members, but Big Rivers has agreed that it will not seek to have any proposed increase to its Members' rates, including the Large Industrial Rate, take effect prior to

January 1, 2010. In addition, the parties have agreed not to support or seek challenges or changes to the rate formula agreed to by the parties before any governmental body, including the Commission.

Q. Are there other provisions of the Smelter Wholesale Agreements that you wish to address?

A. Yes. Section 13.3 requires Kenergy in certain circumstances to direct each Smelter to maintain credit support in specified forms in an amount no greater than the amounts due from the Smelter for a period of two months plus estimated taxes from sales to third parties made by Big Rivers on the Smelter's behalf, and for the Smelter's designated parent company to guarantee the Smelter's payment and performance under the Smelter Retail Agreements. These obligations are recognized in the Smelter Retail Agreements as well.

In addition, Big Rivers has agreed in Section 16.5 to protect the economics of the Smelter Retail Agreements of a "Restructuring," meaning either that (1) Big Rivers is acquired, or (2) Big Rivers or one of its Members enters into a restructuring, merger, or acquisition of another utility system, or (3) Big Rivers adds a new Member, and the result of the transaction is an increase in Big Rivers' sales to its Members of greater than five percent on a *pro forma* basis. Big Rivers, Kenergy, and the Smelters shall determine a good faith estimate of the cumulative increase or decrease in the TIER Adjustment that would result in each fiscal year over the 24-month period following the effectiveness of the Restructuring (excluding any associated change to the Large Industrial Rate). This cumulative increase or decrease will be billed to the Smelters over the 48-month period following the effectiveness of the Restructuring, provided that this will not result in a Smelter paying less than the product of (i) the Large Industrial Rate plus the FAC Factor and the Non-FAC Purchase Power Adjustment Factor and (ii) the Environmental Surcharge Factor, all on a per MWh basis for a customer with a 98 percent load factor with respect to Base Monthly Energy in any fiscal year.

Q. When do the Smelter Wholesale Agreements terminate?

A. As I mentioned previously, the Smelter Wholesale Agreements are scheduled to terminate on December 31, 2023. There are provisions for early termination in certain limited instances, whether before or after the effective date under the contracts. If the Smelter Wholesale Agreements and Smelter Retail Agreements have not been terminated as of January 1, 2023, Section 13.6 provides for Big Rivers, Kenergy, and the Smelters to negotiate in good faith concerning rates, terms, and conditions for new power supply arrangements to take effect following the expiration of the existing agreements.

Q. How may the Smelter Wholesale Agreements be terminated prior to becoming effective?

A. Section 7.2 conditions the effectiveness of the Smelter Wholesale Agreements on consummation of the Unwind Transaction, as well as on satisfaction of standard conditions precedent to effectiveness that are set forth in Section 6.2. In addition, either party will have the right to terminate a Smelter Wholesale Agreement if the Commission makes a material modification to the agreement. Furthermore, if a Smelter determines that costs projected under the financial model delivered at closing cannot be achieved by Big Rivers during the first five years that the Smelter Agreements are effective, or if there is a material change to a Smelter's production facilities or to its industry that would have a material adverse financial effect on that Smelter, the Smelter may terminate the Smelter Agreements prior to the consummation of the transactions thereunder. The Smelters' rights to terminate prior to the effective date end after they have reviewed and approved Big Rivers' financing plan, including approval of a maximum interest rate on that financing. If the Smelter Agreements are terminated pursuant to Section 7.2, there will be no cost or penalty for termination.

Q. What are the provisions governing termination after the effective date of the Smelter Wholesale Agreements?

A. Once a Smelter Wholesale Agreement has become effective, Section 7.3.1 provides that it may be terminated by a Smelter on one year's written notice that the Smelter will cease all aluminum smelting activities at its individual smelting plant. Termination on this basis may not occur prior to December 31, 2010, and only one Smelter may terminate its respective Smelter Wholesale Agreement prior to December 31, 2011 unless Big Rivers has not yet completed the transmission upgrade authorized by the Commission by order dated October 30, 2007 in Case No. 2007-00177. In addition, Section 7.3.2 provides for termination in the event of a default pursuant to Article 14.

Q. If a Smelter Agreement is terminated, will either Kenergy or Big Rivers have any remaining obligation to sell power to that Smelter?

A. Big Rivers and Kenergy will not have any contractual obligation to serve the Smelter. Kenergy will still have a non-contractual obligation to serve the Smelter. There is a dispute between Big Rivers and the Smelters as to whether Big Rivers would have a non-contractual obligation to provide the Smelters with power after termination of the contracts. The parties have agreed to resolve this issue themselves on a long-term basis so the matter is not a part of the Application.

Q. Do you have any further comments regarding the Smelter Wholesale Agreements?

A. Yes. I believe that the terms and conditions of those agreements are reasonable, and will provide substantial benefits to Big Rivers, the Smelters, and Big Rivers' Members. As Michael H. Core explains in his testimony, Exhibit 14, the Smelters are important to the economy of Western Kentucky, and the Smelter Wholesale Agreements, in conjunction with the other Smelter Agreements, are crafted to enable the Smelters to continue their current operations while paying rates that contribute to the financial health and stability of Big Rivers and its Members.

Q. Turning now to the Coordination Agreements, why has Big Rivers entered into these agreements with the Smelters?

A. Big Rivers has entered into the Coordination Agreements with Alcan and Century in order to coordinate the complex relationships that are created by the Smelter Wholesale Agreements and the Smelter Retail Agreements, and also to resolve other issues between and among the parties. Generally speaking, the Coordination Agreements provide for the creation of direct obligations between Big Rivers and the Smelters. They also provide a mechanism for administrative coordination among the parties, as Mark A. Bailey discusses in his testimony, Exhibit 5.

Q. How do the Coordination Agreements create direct obligations between Big Rivers and the Smelters?

A. Sections 3.1 and 3.2 of the Coordination Agreements are essentially reciprocal provisions under which each Smelter and Big Rivers agree with one another to fully perform and discharge their respective obligations under the applicable Smelter Retail Agreements and Smelter Wholesale Agreements. Among other matters, there are limitations on each party's ability to modify the Smelter Retail Agreements and Smelter Wholesale Agreements, or to waive Kenergy's performance of its obligations under those agreements, or to rely upon waivers granted by Kenergy under those agreements. The effect of these provisions of the Coordination Agreements is to ensure that the Smelters are obligated to Big Rivers to perform their respective obligations under the Smelter Retail Agreements, and Big Rivers is obligated to the Smelters to perform its obligations under the Smelter Wholesale Agreements.

Furthermore, Sections 5.1 and 5.2 provide for reciprocal cure rights for Big Rivers and the Smelters. These sections are intended to provide additional protection against termination of the Smelter Retail Agreements and Smelter Wholesale Agreements resulting from breach or default. Section 5.1 provides an opportunity for Big Rivers to cure a breach or default by Kenergy under a Smelter Retail Agreement, and also permits Big Rivers to attempt to cure a breach or default by a Smelter under a Smelter Retail Agreement, provided that Big Rivers does not materially interfere with the Smelter's own efforts to cure its breach or default. Likewise, Section 5.2 provides an opportunity for a Smelter to cure a breach or default by Kenergy under the Smelter Wholesale Agreement for service to that Smelter, and also permits a Smelter to attempt to cure a breach or default by Big Rivers under the applicable Smelter Wholesale Agreement, provided that the Smelter does not materially interfere with Big Rivers' efforts to cure its breach or default.

Q. When will the Coordination Agreements terminate?

A. Section 2 of each Coordination Agreement provides for the agreement to remain in effect until the expiration or termination of the related Smelter Retail Agreement. However, certain provisions will survive the expiration or termination of the Coordination Agreement, to the extent necessary for enforcement of its terms and the protection of the party in whose favor such provisions exist. These provisions include those providing for payment for electric energy or related services, assignment of the right to collect and enforce collection of amounts due, and those related to remedies for default, damage claims, or payment of other amounts.

Q. Please describe the Lockbox Agreements.

A. As I explained previously, the Lockbox Agreements are agreements between Big Rivers, Kenergy, the Smelters, and a depository bank. These agreements provide for each Smelter to pay amounts due under the applicable Smelter Retail Agreement to an account of Kenergy at the depository bank, and upon that payment the depository bank will automatically pay to Big Rivers the corresponding amount due from Kenergy. The Lockbox Agreements reflect the pass-through nature of the payment obligations from the Smelters to Big Rivers, and also reflect Kenergy's assignment to Big Rivers of its rights to receive payments from the Smelters, except with respect to Kenergy's right to receive the Retail Fee charged under the Smelter Retail Agreements.

IV. ACCOUNTING ISSUES

Q. Are there any special accounting issues that arise in connection with the Termination Agreement between Big Rivers and the E.ON LLC Parties?

A. Yes. The transition from the Lease Transaction to the Unwind Transaction and the implementation of the new Wholesale Smelter Agreements involve a number of separate accounting issues. To begin, the terms of the Termination Agreement between Big Rivers and E.ON provide for a number of transfers and other issues that require separate accounting considerations. Exhibit CWB-7 to the Application provides a summary of these various Termination Agreement provisions requiring accounting treatment as well as Big Rivers' proposed journal entries with respect to each.

A. Valuation Issues

Q. Why is it necessary to do an accounting valuation of the inventory and personal property as part of the Unwind Transaction?

A. The effect of the Unwind Transaction is to transfer the leased assets from the E.ON U.S. Parties to Big Rivers' control. Among the assets being transferred will be the existing inventories of certain disposable items (coal, generating unit components, etc.) and certain personal property associated with the operation of the leased assets. Because the inventories and the personal property have an economic value that will fluctuate over time depending upon the date the Unwind Transaction closing takes place, it is necessary to adjust the payments flowing from the E.ON U.S. Parties to Big Rivers under the Termination Agreement to reflect the actual value of the inventory and personal property at the time of closing. As a consequence, Big Rivers and the E.ON U.S. Parties have negotiated adjustments to the payments flowing under the Termination Agreement to take into account these changes in value.

The Termination Agreement assumes a fixed value of $55 million for the value of the inventory and the personal property being transferred as of the date of closing. To the extent the actual value of the transferred inventory and personal property is higher, the payment to Big Rivers by the E.ON U.S. Parties will be lower to compensate them for the increased value of the assets being transferred. To the extent the actual value of the transferred inventory and personal property is lower, the payment to Big Rivers by the E.ON U.S. Parties will be higher in compensation. As a result, it is necessary to establish procedures for valuing these assets so that these adjustments can be performed.

Q. Can you describe the procedures by which inventory and personal property will be valued for purposes of these calculations?

A. To start, Big Rivers and the E.ON U.S. Parties in Section 4.1 of the Termination Agreement have agreed upon the definitions of what shall be classified as inventories for purpose of these valuations. Section 4.1 defines four categories of inventories: (i) coal, synthetic fuel and petroleum coke ("Solid Fuels"); (ii) fuel oil; (iii) lime and limestone; and (iv) spare parts, material and supplies. Prior to closing of the Unwind Transaction, the quantities of each inventory shall be set forth in Schedule 4.1 of the Termination Agreement, which shall be adjusted for any changes at closing. Section 4.1(a) further provides that an inventory of Solid Fuels will be conducted at least 45 days prior to closing using procedures set forth in Exhibit P to the Termination Agreement.

Big Rivers and the E.ON U.S. Parties have agreed in Schedule 4.3 of the Termination Agreement upon a list of tangible personal property to be conveyed to Big Rivers at closing. A final list of tangible personal property will be agreed upon 14 days prior to the closing of the Unwind Transaction. The most current form of this list of personal property is attached to this Application as part of the Termination Agreement filed in Exhibit 3.

Q. How will the actual inventory and personal property valuations be determined?

A. Big Rivers, in collaboration with the applicable E.ON U.S. Parties, has worked to establish procedures that will be used in making the valuations, particularly with respect to the personal property. With respect to non-coal inventories, Big Rivers has engaged Neal and Co. to value the parts and other inventories at the plants. For the existing coal purchase agreements, Big Rivers has retained Hill & Associates to review the prices, quality, and duration of the existing agreements for general prudence. This is discussed further in the testimony of Mark A. Bailey, Exhibit 5. For the existing coal inventory, Big Rivers has retained L. Robert Kimball & Associates, Inc. to calculate the coal quality and quantity already in the coal stockpiles at the various Big Rivers generating units. With regard to personal property, Big Rivers and the E.ON U.S. Parties agreed to property valuation methods as part of the Termination Agreement. By utilizing the expertise of these parties, Big Rivers is confident that a fair and accurate valuation of these transferred inventories and personal property will be made and reflected in the adjustment to the payments under the Termination Agreement.

Q. How does Big Rivers intend to account for and capitalize the assets received from the E.ON U.S. Parties on and after the Closing?

A. Big Rivers will account for these assets as specified in Schedule 3.15 to the Coordination Agreements with the Smelters.

Q. Will Big Rivers be performing a new depreciation study in connection with the Unwind Transaction?

A. It would be premature to do so at the present time. Big Rivers has determined that the most prudent and reasonable course of action would be to wait to perform a new depreciation study until Big Rivers' next general rate case. A new global depreciation study conducted after Big Rivers has had a chance to operate the assets will provide the relevant information for Big Rivers to determine how to depreciate these assets. Because Big Rivers expects to file a new general rate case within the next three years, to be effective no earlier than January 1, 2010, Big Rivers believes that maintenance of the current depreciation policies through 2010 will not pose any difficulties.

B. Economic Reserve Account

Q. Do the terms of the Unwind Transaction call for the use of any other special accounting procedures?

A. Yes, aspects of the Unwind Transaction together with certain terms of the special contracts that will be used to serve Kenergy with respect to the electric service supplied to Alcan and Century present unique accounting issues in relation to two reserve accounts. As an outgrowth of the economics of the Unwind Transaction and discussions between Big Rivers, its Members, and the two Smelters, two separate reserve accounts will be created to place Big Rivers in a better position to deal with the potential risks posed by the Unwind Transaction and Big Rivers' agreement to resume service to Kenergy to meet the specified portion of the two Smelters' load requirements. At the closing of the Unwind Transaction, Big Rivers will create two reserve accounts, an Economic Reserve Account and a Transition Reserve Account, each funded by money Big Rivers receives at closing. In addition, Big Rivers seeks approval to create a Purchased Power Account to address regulatory treatment of purchased power costs that will not immediately be passed through to its Members.

Q. Please describe the Economic Reserve Account.

A. One consequence of the Unwind Transaction is that Big Rivers' costs will become more subject to future variation as Big Rivers' costs of operating the returned generation assets replace the costs of power purchases from the E.ON U.S. Parties under the partly fixed terms of the existing power purchase agreement, which required Big Rivers to share in the costs of fuel increases only once a specified bandwidth of increase had been exceeded. As described in the Testimony of Michael H. Core, Exhibit 14, Big Rivers and its Members agree that this potential risk is a worthwhile one to assume in return for retaining the Smelters' presence in Western Kentucky and gaining the additional financial flexibility that the Unwind Transaction offers to Big Rivers. But, as discussed elsewhere in my testimony, one consequence of Big Rivers resuming control over its formerly leased generation assets is that future power supply costs may increase now that a significant portion of Big Rivers' costs are no longer largely fixed under the Lease Agreement.

The Economic Reserve Account represents an attempt on the part of the parties to the Unwind Transaction to establish a regulatory account that, in part, will help to cushion the effect of any potential future rate increases in Big Rivers' rates to its member distribution cooperatives for service to their non-Smelter members. At closing, Big Rivers will create a separate reserve account to hold $75 million of the funds it receives from the E.ON U.S. Parties. In addition, as a one-time option, Big Rivers has the right under its agreements with the Smelters to increase the amount it will place into this separate reserve account. Certain criteria limit the amount of Big Rivers' cash on hand that it may include in this separate reserve account (Section 1.1.33 of the Wholesale Smelter Agreements), but otherwise Big Rivers on this one occasion can increase the money it will place in this account for the stabilization of its Members' rates. Interest accrued on the funds in the Economic Reserve will not be recorded to interest income, but will be credited to the Economic Reserve, and the proceeds later will be applied by Big Rivers pursuant to the MRSM in Big Rivers' Tariff to mitigate fuel adjustment charges and economic surcharge payments for non-Smelter members.

Q. Could you please describe the accounting for the Economic Reserve Account?

A. In terms of the accounting to be used, Big Rivers will establish the Economic Reserve Account as a regulatory liability. Big Rivers requests Commission approval to exclude from income in 2008 the funds Big Rivers will place into the Economic Reserve at closing. In future situations where Big Rivers determines that withdrawals from the Economic Reserve Account are necessary, Big Rivers would then debit the regulatory liability with the amount of the withdrawal and credit that amount directly to Member revenue.

Q. Please describe the MRSM and how it operates to rebate amounts in the Economic Reserve Account to Big Rivers' non-Smelter Members.

A. The MRSM is a rider applied to all of Big Rivers' wholesale sales to its Members under Big Rivers' rural and large industrial customer rate schedules which excludes the wholesale sales by Big Rivers to Kenergy pursuant to special contracts to serve Alcan and Century. The MRSM is funded solely by the Economic Reserve Account. The MRSM will terminate and have no further force or effect once all amounts in the Economic Reserve Account have been used.

In each month, Big Rivers will calculate the MRSM factor for that month. The MRSM shall be calculated by first determining the FAC and the Environmental Surcharge for the month in question in accordance with Big Rivers' filed FAC and Environmental Surcharge included as part of its Tariff. If the sum of the FAC and the Environmental Surcharge results in a positive number, Big Rivers next will reduce this sum by the amount determined as the Unwind Surcredit for that month. As part of the negotiated terms of the Wholesale Smelter Agreements, the Smelters at sections 4.11.1, 4.11.2, and 4.11.3 agree to pay a monthly Surcharge to Big Rivers as part of their wholesale rates, and this monthly Surcharge is flowed back to the Members through the Unwind Surcredit. As described earlier in my testimony in Section III, these monthly Surcharges owed by the Smelters are established by the terms of the Wholesale Smelter Agreements.

In each month, Big Rivers will sum the FAC amount and the Environmental Surcharge amount and subtract from this combined amount the Unwind Surcredit and one-twelfth of any applicable Rebate. If the result is positive, the MRSM provides that amounts from the Economic Reserve Account will be applied as a credit against such net amount. Amounts withdrawn from the Economic Reserve Account will be applied on a dollar for dollar basis each month under the MSRM until the entire amount has been expended. Thus, the combination of Smelter Surcharge payments (*i.e.*, the Unwind Surcredit), the Rebate, and Economic Reserve Account payments (*i.e.*, the MRSM) will be applied to reduce Member rates for service to non-Smelter customers. In essence, this $75 million (or more, as applicable) is a pre-funding of a portion of the potential FAC and Environmental Surcharge rate increases that the non-Smelter members otherwise would be required to pay, and serves to hold Member rates at their current levels for as long as possible.

C. Purchased Power Account

Q. Please describe the Purchased Power Account.

A. In providing indirect service to the Smelters and the non-Smelter members, Big Rivers will incur costs associated with purchasing power from third parties. As I explained in the preceding section of my testimony, under the

Smelter Agreements, the Smelters will be charged for the portion of Big Rivers' purchased power costs attributable to service to the Smelters via the Non-FAC Purchased Power Adjustment ("PPA") mechanism. However, Big Rivers does not have authority to charge the non-Smelter members for the portion of its purchased power costs attributable to service to the non-Smelter members, and Big Rivers is not seeking such authority at this time.

Q. How will Big Rivers account for the non-Smelter customers' shares of Purchase Power Costs?

A. Instead of applying the Non-FAC PPA to non-Smelter sales and billing any charges or credits to Members, we have agreed to ask the Commission to allow Big Rivers to establish two regulatory accounts – a deferred asset and a deferred liability – which would fully account for any charges or credits that would have otherwise been billed to the Members through the application of the Non-FAC PPA to non-Smelter sales. Specifically, Big Rivers is proposing to establish a regulatory asset (deferred debit) which would be used to accrue any Non-FAC PPA amounts that are applicable to non-Smelter sales. In a general rate case, the regulatory asset balance would then be amortized over a period of time, most likely for three years, and included as an expense for purposes of determining test-year requirements. Once rates are implemented from the rate case, the amortization authorized by the Commission would be charged to expense with a corresponding credit to the regulatory asset to draw down the amount accrued to the regulatory asset up to the end of the test year in the rate case, but with any Non-FAC PPA charges otherwise applicable to non-Smelter sales after the end of the test-year continuing to being added to the regulatory asset. In other words, the regulatory asset will continue to account for all Non-FAC PPA charges that would have otherwise been charged to non-Smelter sales, after considering the amortization of the value of the deferred asset as of the end of the test year used to determine revenue requirements in a general rate case.

Similarly, we would establish a regulatory liability (deferred credit) which would be used to accrue any Non-FAC PPA amounts that would have otherwise been *credited* to non-Smelter sales. In a general rate case, the regulatory liability balance would then be amortized, presumably over a period of time, most likely for three years, and included as a reduction to expenses for purposes of determining revenue requirements for the rate case. Once rates are implemented from the rate case, the amortization authorized by the Commission would be *charged* to the regulatory liability to draw down the amount accrued to the regulatory liability up to the end of the test year in the rate case, but with any Non-FAC PPA credits otherwise applicable to non-Smelter sales after the end of the test-year continuing to being credited to the regulatory liability. Thus, the regulatory liability will continue to account for all Non-FAC PPA credits that would have otherwise been credited to Members for non-Smelter sales, after considering the amortization of the value of the deferred liability at the end of the test year used to set rates.

Q. Would the Smelter rates need to be adjusted to prevent double counting of billings under the Non-FAC PPA provision of the Smelter Agreements and through the amortization of the regulatory account reflected in base rates in a general rate case proceeding?

A. Yes. The Smelters should not pay or receive any of the revenue requirement amounts (either positive or negative) associated with the amortization of the two regulatory accounts. Because the rates paid by the Smelters are tied to Big Rivers' standard large industrial rates, and because in a general rate case the standard large industrial rates will be affected by the amortization of the two deferred accounts, it is necessary to *adjust out* any amounts recovered as credits or charges reflected in the large industrial rate *from* the effective rates paid by the Smelters. The amount that would be adjusted out of the rates paid by the Smelters would be determined by dividing (i) the annual amortization of the deferred accounts authorized by the Commission, by (ii) test-year non-Smelter kWh sales.

Q. Instead of establishing a regulatory asset and a regulatory liability to reflect the charges and credits that would have otherwise been paid or received by Members through the application of the Non-FAC PPA to non-Smelter sales, wouldn't an alternative approach be to apply the Non-FAC PPA to non-Smelter sales?

A. Yes. Big Rivers clearly has the authority to enter into special contracts with the Smelters – developed through arms-length negotiations between the parties – which contain a provision to make Big Rivers whole with respect to changes in its purchased power costs. Big Rivers can also ask the Commission for authority to establish a regulatory account to reflect reasonably incurred changes in a particular component of cost. Our proposal is thus consistent with regulatory practice in Kentucky and other jurisdictions. Certainly, applying the Non-FAC PPA to non-Smelter sales would be significantly less complicated than establishing deferred asset and liability accounts to track amounts that would have otherwise been charged or credited through the Non-FAC PPA, and we would not object to applying the Non-FAC PPA to non-Smelter sales if the Commission determines that this is the most appropriate approach.

D. Transition Reserve Account

Q. Please describe the Transition Reserve Account.

A. Together, the Smelters' loads will account for approximately 56% of Big Rivers' Member demand. Electricity costs are a significant component of the Smelters' production costs, and the future costs of generation inputs such as fuel, reagent and other variable costs are expected to increase. Because aluminum is a commodity, in the future one or both of the Smelters may opt to terminate their operations if these costs increase too much relative to the Smelters' worldwide competition. The Transition Reserve Account is a financial reserve account that is to be established by Big Rivers from funds received at closing that will help protect Big Rivers against the eventuality of a Smelter closure. Immediately after the closing of the Unwind Transaction, Big Rivers will contribute $35 million of the proceeds received from the E.ON U.S. Parties to establish the Transition Reserve Account. By keeping these funds on-hand and separate, the Transition Reserve Account provides a ready source of cash to cushion the short-term negative financial effects of one of the Smelters shutting down. This benefits Big Rivers and its Members and provides additional comfort to Big Rivers' creditors as they can rely in advance on Big Rivers having this additional protection.

Q. Why did Big Rivers pick $35 million as the appropriate amount to place into the Transition Reserve Account?

A. One of the prerequisites for Big Rivers' proposed new financing arrangements is that Big Rivers obtain an investment grade rating from a credit rating agency. Big Rivers was aware that creditors might be concerned regarding the extreme "lumpiness" of Big Rivers' Member load with approximately 56% tied up in these two Smelters' demand. Although Big Rivers is confident that it could resell any power freed up by one of the Smelters should it determine to suspend operations, Big Rivers desired to provide the credit rating agency with demonstrable evidence that Big Rivers could financially survive a loss of one of the Smelters' loads even if market prices at the time of the shutdown were lower than the rates to the Smelters.

Accordingly, Big Rivers prepared a sensitivity run based on 450 MW being returned to Big Rivers by a Smelter shutdown with a concurrent three year downturn in wholesale market prices for energy. Big Rivers assumed that the 450 MW of energy would be sold at prevailing market prices and calculated the difference between the revenues achieved by this wholesale sale and the revenues that would have been generated by a sale to the Smelters under the contract prices for that year. These calculations demonstrated that $35 million would be an adequate Transition Reserve Account amount to withstand a three year period after the loss of one of the Smelters even if it coincided with a downturn in the market.

Q. Do you believe that the $35 million calculated for the Transition Reserve Account is based on conservative assumptions?

A. Yes. The calculations are based on a situation in which regional wholesale power prices are depressed at the same time that one of the Smelters opts to shut down operations. It is my belief that future energy prices in all probability will be higher and that Big Rivers' prices to the Smelters will remain lower than general wholesale market prices since both will be based on similar inputs (fuel, reagent, etc.). Accordingly, I believe that in most situations involving a Smelter shutdown the spread between the wholesale market prices and Big Rivers' then-effective rates to the Smelter shutting down will be smaller than the amounts calculated in this estimate. This makes Big Rivers well-positioned to avoid any short-term adverse effect of one of the Smelters shutting down. Moreover, Big Rivers has been extremely successful in marketing power off-system during the past ten years. I am very confident that Big Rivers would continue to be successful in marketing any capacity returned to it as a result of a Smelter shutting down. In short, I believe Big Rivers would be able under most circumstances to remarket any returned capacity produced by a Smelter shut-down such that recourse to the Transition Reserve Account would not be necessary.

Q. How will the Transition Reserve Account be administered?

A. The Transition Reserve Account will be a completely separate account, and it will not be comingled with other Big Rivers funds. Once Big Rivers deposits the $35 million at the closing of the Unwind Transaction, those funds will remain in that account and will earn interest. Big Rivers' management will not be able to access these funds without express approval from the Board.

V. TARIFF AND OTHER REGULATORY ISSUES

A. Overview of Tariff changes

Q. Does the Unwind Transaction require Big Rivers to make any changes to its Tariff on file with the Commission?

A. Yes. Part C of Big Rivers' Tariff, PSC No. 22, reflects the rates, terms and conditions under which Big Rivers will offer service to Big Rivers' member rural electric service. As currently structured, the Tariff reflects the details of the Lease Transaction with the E.ON U.S. Parties. Due to the significant changes that result from the elimination of the E.ON U.S. Parties and the resumption of control by Big Rivers over the formerly leased assets, large parts of the Big Rivers Tariff need to be changed.

Q. Section C(3) of the Big Rivers Tariff currently provides the terms under which Big Rivers will provide services to its Members for use by the Smelters. Does Big Rivers plan to change this section?

A. Yes. This section will be revised to provide that it is terminated effective with the date of the closing of the Unwind Transaction. On and after the date of closing of the Unwind Transaction, Big Rivers will commence serving Kenergy with the wholesale power used to serve Alcan and Century pursuant to a special contract rather than as part of the Tariff.

Q. Are there any other changes to the Tariff required to implement the new wholesale arrangement with the Smelters?

A. Yes. Five new tariff schedules or clauses are added to the Big Rivers Tariff to implement components of the Smelter deal as they apply to non-Smelter Member rates. Most important, Big Rivers will implement an FAC as part of its Tariff. The FAC will be applicable to all Member rates (being incorporated into wholesale Smelter rates through the special contract with the Smelters under terms mirroring the FAC to the member distribution cooperatives). I provide additional detail regarding operation of the FAC below.

Second, Big Rivers will implement an Environmental Surcharge as part of its tariff. The Environmental Surcharge will be applicable to all Member rates (being incorporated into wholesale Smelter rates, as is the FAC). I provide additional detail regarding operation of the Environmental Surcharge below.

In addition to the FAC and Environmental Surcharge, Big Rivers will implement three new tariff schedules to flow through certain of the rate benefits and protections of the new Smelter deals to the non-Smelter Members. Two of these tariff schedules, the MRSM and the Unwind Surcredit, already have been addressed above in my testimony in relation to the Economic Reserve Account, but are summarized below as well. In addition to the MRSM and the Unwind Surcharge, Big Rivers also will implement a Rebate that will flow through to non-Smelter Members rebates that Big Rivers makes in certain situations where Big Rivers' TIER exceeds 1.24.

B. Fuel Adjustment Charge

Q. Why is Big Rivers proposing to implement a FAC?

A. As with many utilities in Kentucky and nationwide, a significant component of Big Rivers' costs is its fuel costs. Because of the variability in these fuel costs and the belief that it would be impracticable to conduct a new general rate case each time these costs changed, Big Rivers chooses to use an FAC. Under the Lease Transaction with the LG&E Parties, Big Rivers' purchased power costs for its non-Smelter Members' power requirements were largely fixed at the amounts specified in the Power Purchase Agreement ("Purchase Agreement") with the E.ON U.S. Parties, although there were certain provisions providing for a sharing of the costs of certain large fuel increases. These largely fixed rates in the Purchase Agreement with the E.ON U.S. Parties were the foundation for the Commission-approved Member rates. With these costs largely fixed, there was no need to maintain a FAC while the Purchase Agreement remained in effect.

Now that Big Rivers is resuming its control and operation of the leased assets, changes in fuel costs will be an important economic consideration for Big Rivers. Big Rivers' goal is to maintain existing rate levels while meeting its legitimate costs of operation. Although Big Rivers is not at this time proposing to change the underlying Member rates, Big Rivers nevertheless cannot accept all of the risk of fuel cost increases as part of these rates. Accordingly Big Rivers proposes to implement an FAC.

Q. Could you describe the basis for the FAC?

A. The basis for the FAC and general support for the FAC is contained in the testimony of William Steven Seelye, Exhibit 25.

Q. Please describe the operation of the FAC.

A. The FAC is consistent with the Kentucky regulations on fuel adjustment charges. In operation, Big Rivers is proposing a separate FAC schedule as part of its Tariff. Every month each Member's bill will include a separate charge for the FAC. Changes in Big Rivers' fuel costs will be reflected in the FAC consistent with Kentucky regulations. Additional detail regarding the FAC is presented in the testimony of William Steven Seelye, Exhibit 25.

Q. Will the KPSC retain oversight over the amounts billed as part of the FAC by Big Rivers?

A. Absolutely. Consistent with regulations, Big Rivers expects that the KPSC will conduct public hearings on the calculation and application of prior months' FAC charges. At that time, the KPSC could order Big Rivers to charge off any amounts it finds unjustified due to improper calculation or application of the FAC. And every two years following the initial effective date of the FAC, Big Rivers expects that the KPSC will hold a public hearing to review and evaluate past operations of the FAC.

C. **Environmental Surcharge**

Q. Why is Big Rivers proposing to implement an environmental surcharge?

A. As explained earlier, Big Rivers does not consider this to be an appropriate time to conduct a new general rate case and has proposed that its underlying base rates to its Members remain in effect until Big Rivers files its next general rate case, which will be filed to take effect no earlier than January 1, 2010. Big Rivers intends to file that rate case using a 2009 test year. Big Rivers recognizes that certain environmental costs are not accounted for in existing rates, which costs necessarily must be accounted for to maintain the economics of the Unwind Transaction during the period prior to the next rate case, and so it is proposing the Environmental Surcharge.

Q. Please describe the basis for the Environmental Surcharge.

A. The Environmental Surcharge is based on recovering the costs of three separate environmental programs (SO_2, NOx, and SO_3) which are presented in the Big Rivers Electric Corporation Environmental Compliance Plan ("Environmental Compliance Plan"). The Environmental Compliance Plan is attached as Exhibit DAS-1 to the testimony of David A. Spainhoward,

Exhibit 18. Mr. Spainhoward describes the cost composition and relation of these costs to applicable regulatory requirements for each of these three programs as a part of his testimony.

Q. Please describe the operation of the Environmental Surcharge.

A. The Environmental Surcharge is consistent with the Kentucky statute and established regulatory practices with regard to environmental surcharges. In operation, Big Rivers is proposing a separate Environmental Surcharge schedule as part of its Tariff. Every month each Member's bill will include a separate charge for the Environmental Surcharge. Additional detail regarding the Environmental Surcharge is presented in the testimony of David A. Spainhoward, Exhibit 18, and in the testimony of William Steven Seelye, Exhibit 25, where Mr. Seelye presents the Environmental Surcharge and other new rate schedules.

D. Member Rate Stability Mechanism and Unwind Surcredit

Q. Please describe the relation between the Unwind Surcredit and the MRSM Big Rivers is proposing to implement as part of its Tariff.

A. The MRSM serves as a mechanism to use the Economic Reserve Account to cushion Member rates against a potential increase produced by operation of the FAC and the Environmental Surcharge. The MRSM is a temporary schedule funded exclusively by the amounts placed into the Economic Reserve Account at the closing of the Unwind Transaction. These payments into the Economic Reserve Account are set forth in Sections 4.11.4 and 4.11.5 of the Wholesale Smelter Agreements. When these funds are exhausted, the applicability of the MRSM will terminate.

The Unwind Surcredit, by contrast, flows through certain fixed monthly payments that the Smelters agree to make pursuant to Sections 4.11.1, 4.11.2, and 4.11.3 of the Wholesale Smelter Agreements. The beginning amount of the Unwind Surcredit to be paid by the Smelters and credited to non-Smelter Member rates through the Unwind Surcredit is $425,833 per month. That amount increases to $608,833 per month in 2012, and to $848,568 per month in 2017 through the end of the terms of the Smelter Agreements in 2023.

Q. How is the Unwind Surcredit allocated to non-Smelter Members?

A. The allocation will be made on a kWh basis. Each month the surcharge value will be determined based on the aggregate amount received by Big Rivers from the Smelters pursuant to Sections 4.11.1, 4.11.2, and 4.11.3 of the

Wholesale Smelter Agreements. This Unwind Surcredit amount will then be allocated across all kilowatt-hours sold at wholesale by Big Rivers to its Members under all electric rate schedules, including the Large Industrial Rate, for resale to Kentucky ratepayers, specifically excluding all sales for resale to the Smelters. The resulting amount per kWh is the Unwind Surcredit Factor for the month and it will be used to reduce all applicable non-Smelter bills accordingly.

Q. How will the Member Rate Stability Mechanism be allocated?

A. Each month Big Rivers first will determine the sum of the FAC Factor and the Environmental Surcharge. If the sum of the FAC Factor and Environmental Surcharge for that month is a positive number, Big Rivers then will subtract from it any amounts to be provided to non-Smelter Member rates through the Unwind Surcredit and one-twelfth of any applicable Rebate. If the resulting amount is still positive it becomes the MRSM factor for that month, and corresponding amounts will be withdrawn from the Economic Reserve Account (as discussed earlier in my testimony). By this means FAC and Environmental Surcharge increases will be eliminated for non-Smelter Member rates until the Economic Reserve Account is exhausted. The operation and interaction of these various rate schedules and riders is presented more fully in the testimony of William Steven Seelye, Exhibit 25.

Q. Will the KPSC have oversight over Big Rivers' calculation and billing of the Unwind Surcredit factor and the MRSM factor?

A. Yes. Big Rivers envisions that the KPSC will treat these two rate schedules similarly to the FAC. Big Rivers proposes that at six month intervals the KPSC should conduct public hearings on the calculation and application of prior Unwind Surcredit and MRSM factors as part of (or parallel to) the FAC hearings provided for under Kentucky law. At such time, the KPSC can order Big Rivers to charge off any amounts it finds unjustified due to improper calculation or application of these factors. And as with the FAC, Big Rivers envisions that every two years following the effective date that the Commission would hold a public hearing to review and evaluate past operations of the Unwind Surcredit and MRSM in conjunction with its review of the FAC.

E. Member Rebate

Q. You mentioned a Rebate as being included as part of the offset against the MRSM. What is the Rebate to which you are referring?

A. As I discussed previously the Smelters agreed to assist Big Rivers in maintaining a minimum TIER of 1.24. As part of the negotiated deal to maintain an annual TIER of 1.24, Big Rivers agreed to return to the Smelters earnings in excess of that amount in a payment denominated as the TIER Adjustment Charge. Under the negotiated terms of the deal with the Smelters, when Big Rivers earns more than a 1.24 TIER, the Smelters first receive the benefits of the returned amounts pursuant to the terms of their special contract subject to certain limitations. Big Rivers will perform a final accounting not later than 120 days after the end of each Fiscal Year as part of which Big Rivers will calculate its TIER for the prior Fiscal Year. The difference between the amount of Net Margins required for Big Rivers to achieve a 1.24 TIER and the amount already paid by the Smelters constitutes the TIER Adjustment payment from or credit owed to the Smelters. This TIER Adjustment can result in either a payment from the Smelters, if the TIER is below 1.24, or a credit to the Smelters, if the TIER is above 1.24.

Q. How does the Rebate relate to the TIER Adjustment Charge to which you are referring?

A. The Rebate operates in the specialized situation in which Big Rivers owes the Smelters a credit due to a TIER in excess of 1.24. One of the negotiated limitations on Big Rivers' obligation to make a TIER Adjustment credit to the

Smelters is that under no circumstances can the Smelters' rates go below the Big Rivers' large industrial rate at a 98% load factor plus an adder of $0.25 per MWH unless the credit is extended as a rebate to all of Big Rivers' other customers as well. Accordingly, the Rebate is the tariff mechanism to pass through any future Rebates that may result when Big Rivers earns a TIER in excess of 1.24 and the amounts to be credited to the Smelters would push the Smelters' rates below the Big Rivers' large industrial rate at a 98% load factor plus the $0.25 per MWh adder.

Q. How does the Rebate work?

A. Big Rivers proposes to implement a new Rebate Adjustment to serve as the mechanism for flowing back on a base revenue basis the amount of any rebate determined in a separate KPSC proceeding. Importantly, Big Rivers is not committing automatically to flow through a rebate to its Members for their non-Smelter customers in all situations in which a TIER Adjustment Charge results in a credit to the Smelters bringing their rates down to the equivalent of the Big Rivers Large Industrial Customer rate at a 98% load factor plus the adder of $0.25 per MWh. Instead, Big Rivers merely wishes to establish the mechanism for flowing a rebate to customers in situations where Big Rivers chooses to make this kind of rebate based on Big Rivers' exercise of its best judgment at that time. Big Rivers envisions that in those circumstances where Big Rivers believes it would be financially reasonable to make this sort of rebate that Big Rivers at that time would make application to the KPSC to approve the rebated amount. Once the KPSC has determined the amount Big Rivers is permitted to rebate, Big Rivers would then use the Rebate Adjustment to allocate the Rebate as a credit to all customers in the billing months concerned.

F. Member Discount Adjustment

Q. Big Rivers' current tariff also provides for a Member Discount Adjustment. Does Big Rivers' proposed tariff make any provisions with respect to this discount?

A. Yes. In 2000, Big Rivers first implemented for a period of two years a Member Discount Adjustment ("MDA"). Big Rivers implemented the MDA to return to its Members the sum of $3.68 million that Big Rivers realized in debt service interest savings from prepayment on its RUS debt of amounts it received from a leverage lease of three of its generating units in 2000. Big Rivers subsequently has extended that revenue discount from year-to-year without making the revenue discount permanent. Part of Big Rivers' decision not to make this revenue discount permanent has been the financial uncertainty associated with Big Rivers' future capital requirements and the inability of Big Rivers to borrow money on a long-term secured basis. Because Big Rivers is not proposing a general rate adjustment, Big Rivers has determined to continue the existing MDA until its next general rate review, which Big Rivers will file to become effective no earlier than January 1, 2010. At that time, the effects of the interest debt service savings can be permanently reflected in Big Rivers' rates. Accordingly, Big Rivers proposes to amend Sixth Revised Sheet No. 74, Item 12.d, to provide that the MDA tariff rider shall be extended through the effective date established in Big Rivers' next application for adjustment of rates.

Q. Does Big Rivers' selection of an MDA limit the KPSC's ability to terminate this tariff rider at an earlier date?

A. No. The fact that the termination date is reset does not prevent the KPSC from disposing of the tariff at an earlier date at the request of Big Rivers.

Q. What authority did the Commission have to approve the MDA?

A. The Public Service Commission has broad discretion to adopt different means to achieve the result of "fair, just and reasonable rates," as prescribed by KRS 278.030(1). For example, the Commission has approved fuel adjustment clauses, purchased gas adjustment clauses, and nonrecurring charge mechanisms for utilities outside of general rate proceedings. As the Kentucky Court of Appeals stated in the National-Southwire Aluminum Co. case, there is "no litmus test" and "no single prescribed method" for establishing fair, just and reasonable rates. Moreover, because the MDA is a credit to customers (rather than a charge) and is allocated among and within customer classes on a proportional basis, resulting in no change in rate design, the MDA is explicitly authorized by KRS 278.455. The important point is that the MDA, as proposed in 2000, reduced the operating revenues of Big Rivers by *crediting* back the $3.68 million savings in RUS debt service interest to Big Rivers' members. The Commission approved the MDA rider as a credit, and Big Rivers requests that the MDA be extended on the same basis in this filing.

Q. What about the three riders discussed in the testimony of William Steven Seelye, Exhibit 25 – the Unwind Surcredit, the Rebate Adjustment and the MRSM? Are these riders also authorized by KRS 278.455?

It is my understanding that they are. The Unwind Surcredit, the Rebate Adjustment, and the MRSM will apply to the non-Smelter members. Big Rivers' decrease in operating revenues from those riders will be allocated among and within customer classes (e.g., rural, large industrial) on a proportional basis, resulting in no change in rate design. Because those riders will result in a *credit* to customers, not a charge, they are also authorized by KRS 278.455.

Q. Does it matter that these riders will not apply to the Smelters?

A. No. The Smelters are served by special third-party contracts, and sales to the Smelters are not treated as sales to Kenergy under its all-requirements contract. The Smelters' rates will be governed by separate and distinct tariff provisions approved by the Commission pursuant to 807 KAR 5:011(13).

G. Future General Rate Case

Q. Is Big Rivers proposing to change its currently effective Tariff rates for electric service other than with respect to the various riders proposed herein?

A. No. As I mentioned earlier in my testimony, Big Rivers is not proposing a general review of its underlying rates at this time. Many of the costs of operating a reintegrated system can only be estimated until Big Rivers resumes full control of the system. Further, while Big Rivers has estimates of the operating costs for the units as received from the E.ON U.S. Parties, Big Rivers believes that it still will take some time before it can separate out an ordinary year of operations as opposed to the transitory period when Big Rivers retakes control and incurs non-routine and/or non-recurring expenses.

Q. What does Big Rivers propose with respect to a general review of rates?

A. Rather than conduct the general review of rates now, Big Rivers proposes to leave existing non-Smelter rates largely unchanged (apart from any application of the FAC, Environmental Surcharge, and other riders discussed above) for a period of approximately three years after the closing of the Unwind Transaction. Operating experience can be developed during the initial two years, permitting a 2009 Test Year for a new general rate case, which would not be filed to become effective earlier than January 1, 2010. The existing rates already have been found to be fair, just and reasonable by the Commission, and this decision would essentially leave these rates in place for three years after the closing of the Unwind Transaction.

H. New Transmission and Ancillary Services Rates

Q. Are there any exceptions to this policy of essentially leaving existing rates in place?

A. Yes. The one exception to this practice concerns transmission and ancillary services rates, changes to which have been submitted herein. Big Rivers has greater operating experience with respect to these rates as the underlying assets never left Big Rivers' control. Moreover, changes to these rates are an absolute requirement. The current Big Rivers ancillary services rates reflect a pass-through of WKEC ancillary services rates that were developed based on WKEC costs, not Big Rivers' costs. Because these ancillary rates must be changed to reflect Big Rivers' rates and financials, Big Rivers has performed a cost of service study for transmission and ancillary services which is presented for Commission approval as a part of this filing and explained in depth in the testimony of Ralph L. Luciani, Exhibit 35. As can be seen from his testimony, the actual effect on these rates is not extreme. And in any case, Big Rivers' Member rates are already bundled with transmission and ancillary services rates and will not change as a result of these revised rates applicable to third-party users of Big Rivers' transmission system. In the testimony of David A. Spainhoward, Exhibit 18, Big Rivers presents additional detail regarding tariff changes to the Big Rivers OATT that were required both by the Unwind Transaction and as a consequence of changes to the FERC OATT requirements in FERC's 2007 Order No. 890.

I. **Termination of Tier 3 Service**

Q. Apart from changes to the Big Rivers Electric Tariff, how is Big Rivers' Tier 3 service to the Smelters through Kenergy affected by the Unwind Transaction?

A. Under the existing Lease Transaction, Big Rivers provides certain transmission and power sales services to the Smelters pursuant to the so-called Tier 3 provisions of the Smelters' existing contracts with Kenergy. Under those sections, the Smelters were permitted their choice of supplier for their power requirements falling in Tier 3 in return for their agreement to pay Big Rivers for the transmission and ancillary services necessary to transmit the third-party energy to the Smelter load. Big Rivers has entered into certain contracts with Kenergy for service to the Smelters in connection with Tier 3 service, both for transmission and ancillary services and for energy. Kenergy's current Tier 3 contracts with Big Rivers automatically terminate by their own terms effective upon the date of closing of the Unwind Transaction.

J. Phase 2 Transmission Project Cost Recovery

Q. Turning to another matter, can you please explain how this transaction is related to Big Rivers' previously filed request for a certificate of public and convenience and necessity for the Phase 2 Transmission Project?

A. Certainly. A condition to the closing of the Unwind Transaction is Big Rivers obtaining an investment grade rating from Moody's and Standard and Poor's. Big Rivers' financial advisors have told Big Rivers that one of the critical factors in obtaining this rating is mitigation of the risk of the Smelters terminating their agreements, most likely by ceasing production activities. In that situation, Big Rivers would be left with additional capacity, and it would be necessary for Big Rivers to resell it either for load growth or on the regional wholesale power market. It is for this reason that Big Rivers negotiated the Transition Reserve Account discussed previously, and it is for this reason that Big Rivers requires the Phase 2 Transmission Project upgrades. The Transition Reserve Account funds will provide Big Rivers with a financial cushion as it remarkets off-system the capacity and energy formerly used to serve the departing Smelters' load if the Smelters both should suspend their operations.

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Big Rivers, Big Rivers has no need for the insurance provided by the Phase 2 Transmission Project. Big Rivers does not intend to construct this upgrade absent approval of the Unwind Transaction.

Q. Is it appropriate to include the costs of the Phase 2 Transmission Project as a part of Big Rivers' rates to its Members?

A. Yes. In its October 30, 2007 order in Case No. 2007-00777, the Commission left open the rate treatment of the costs of constructing, operating and maintaining the Phase 2 Transmission Project on the ground that it is being built solely to accommodate off-system sales of power that otherwise could not be transmitted off-system in the event the Smelters cease operating. Big Rivers believes that it is entirely appropriate that its Members and third-party users of its transmission system share in these costs. As set forth at length in this testimony and throughout this Application, the Unwind Transaction represents a negotiated transaction with an agreed-upon allocation of risks between Big Rivers, Big Rivers' Members, the Smelters and the E.ON U.S. Parties. One such risk is the chance, however remote, that energy prices or other economic considerations may result in the Smelters ceasing their Kentucky operations. In order for Big Rivers to obtain the investment grade financial rating it requires to undertake this transaction, Big Rivers must be able to demonstrate that it can continue operating in the event it loses the Smelter loads. The Phase 2 Transmission Upgrades are thus a requirement to obtaining an investment grade financial rating, the benefits of which the Members will enjoy, as described in the testimony of Burns E. Mercer, Exhibit 26. Moreover, if the Smelter loads leave and Big Rivers is unable to move the power to third-parties, all system costs would fall on the remaining Members. Sharing the costs of the Phase 2 Transmission Project will help the Members avoid this eventuality. Accordingly, Big Rivers believes that it is entirely appropriate that its Members share in the costs of the Phase 2 Transmission Project if it is built.

K. Compliance with Filing Requirements

Q. Could you please estimate the effect of the proposed Tariff on revenues?

A. Yes. I estimate that the initial effect of the proposed Big Rivers Electric Tariff on revenues will be zero. This effect is shown on Exhibit CWB-8.

VI. <u>FINANCING ARRANGEMENTS</u>

Q. Could you please provide an overview of the structure of Big Rivers' current financing arrangements?

A. Big Rivers' current financing arrangements are a creation of, and intimately connected with, the 1998 Lease Transaction which Big Rivers entered into when it structurally reorganized. Under the Lease Transaction, Big Rivers and its creditors anticipated that, for a twenty-five year period through 2023, Big Rivers would have only modest capital requirements. The Lease Transaction was premised on the assumption that these modest capital requirements could be satisfied largely out of earnings. The lease of Big Rivers' generating assets and the resale back to Big Rivers of a portion of the output of those units left Big Rivers with little ability to raise capital for growth or development. The structure of the financing arrangements adopted in 1998 and continuing to this day were based on these assumptions, and were designed to protect the existing lenders without providing any significant flexibility for accommodating new lenders.

Q. What specific documents evidence Big Rivers' current financial arrangements?

A. Big Rivers' security document for its senior secured creditors which emerged from the reorganization was a Restated Mortgage and Security Agreement ("Restated Mortgage") made by and among Big Rivers, the United States of America (the "Government"), Ambac Assurance Corporation ("Ambac") and the National Rural Utilities Cooperative Finance Corporation ("CFC"). The

Restated Mortgage has been amended and restated since 1998, most recently to accommodate a defeased lease of certain of Big Rivers' generating assets made in 2000. The currently effective mortgage is the Third Restated Mortgage and Security Agreement, dated as of August 1, 2001, among Big Rivers, the Government, Ambac, Credit Suisse First Boston, U.S. Bank Trust National Association, as trustee, CFC, five Delaware statutory trusts as investment vehicles in Big Rivers' 2000 economically defeased lease transactions, and Ambac Credit Products, LLC (the "Third Restated Mortgage"). However, despite the addition of these mortgagees, the Third Restated Mortgage has not changed in any fundamental way from the original Restated Mortgage executed in 1998.

In addition to the Third Restated Mortgage, Big Rivers also has subordinated mortgages with two separate groups of entities. First, as part of the Lease Transaction, Big Rivers has subordinated mortgages in favor of several of the subsidiaries of E.ON U.S. Second, Big Rivers has a subordinated mortgage in favor of all parties to the economically defeased lease transaction which Big Rivers entered into in 2000. Relations between these three separate groups of creditors (those under the Third Restated Mortgage, the E.ON U.S. subsidiaries, and the defeased lease transaction creditors) are governed by an August 1, 2001, Third Amended and Restated Subordination, Nondisturbance, Attornment and Intercreditor Agreement (the "Existing Intercreditor

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loan agreement. Moreover, because the RUS lien priority under this mortgage is subordinate to that of other creditors, Big Rivers has no expectation that RUS would be willing to advance more funds under the mortgage.

Q. Apart from limitations on first liens and security interests, does the Third Restated Mortgage otherwise limit Big Rivers' ability to issue additional debt?

A. Yes. The Third Restated Mortgage precludes the securing of additional debt by Big Rivers without the approval of each of the mortgagees. Two of Big Rivers' noteholders, Philip Morris Capital Corporation and Bank of America, permit Big Rivers to issue certain modest amounts of debt without their consent. These two entities will permit Big Rivers to issue $25 million of debt through April 2009, $50 million of debt through April 2016, and up to $100 million of debt through January, 2027. These two entities also permit Big Rivers to issue debt without their consent where the purpose of such debt is to finance capital improvements to either Plants Green or Wilson as required to comply with applicable law. However, even in situations where these two entities' consents are not required, Big Rivers still would need to obtain the consent of the other senior creditor mortgagees. These required consents thus serve as an additional obstacle to the issuance of new debt by Big Rivers.

The Third Restated Mortgage also establishes three separate priorities of payment for the various obligations secured thereunder. Any new lender would need to subordinate its payment rights to these obligations.

Q. Does the Existing Intercreditor Agreement complicate Big Rivers' ability to enter into new debt obligations as well?

A. Yes. The Existing Intercreditor Agreement establishes four additional payment priorities that would apply in the event of a bankruptcy foreclosure of Big Rivers' assets. The Existing Intercreditor Agreement's four additional payment priorities resolve priorities should the three sets of creditors under the Third Restated Mortgage, the E.ON U.S. subsidiaries, and the defeased lease transaction creditors all foreclose simultaneously. In addition, the Existing Intercreditor Agreement establishes certain nondisturbance and attornment provisions, cure rights, notice provisions, and various other agreements among the three sets of Big Rivers creditors. The Existing Intercreditor Agreement makes no provision for accommodation of a prospective future lender or lenders in these negotiated priorities, thus requiring that they be introduced into the existing financial arrangements on a purely *ad hoc* basis. And each of the three sets of existing mortgagees might require that any future indebtedness secured under these mortgages be subordinated to their own debt. Together, these requirements act as a