

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF BIG RIVERS ELECTRIC CORPORATION FOR APPROVAL OF ENVIRONMENTAL COMPLIANCE PLAN AND ENVIRONMENTAL SURCHARGE TARIFF)	CASE NO.
)	2007-00460
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O R D E R

On December 28, 2007, Big Rivers Electric Corporation (“Big Rivers”) filed an application, pursuant to KRS 278.183, seeking Commission approval of an environmental compliance plan consisting of emission compliance programs and to establish its Environmental Surcharge tariff (“ES tariff”). On the same date, Big Rivers filed a separate application seeking to terminate its lease transaction with affiliates of E.ON U.S., LLC, and resume the control and operation and maintenance of its generating facilities.¹ Once Big Rivers regains control of its generating facilities, it will be responsible for the costs incurred in conjunction with the compliance programs, which Big Rivers contends are necessary in order to comply with the requirements of various federal, state, and local environmental regulations applicable to coal combustion wastes and by-products from its coal-fired generating units. The proposed

¹ Case No. 2007-00455, The Applications of Big Rivers Electric Corporation for: (I) Approval of Wholesale Tariff Additions for Big Rivers Electric Corporation, (II) Approval of Transactions, (III) Approval to Issue Evidences of Indebtedness, and (IV) Approval of Amendments to Contracts; and of E.ON U. S., LLC, Western Kentucky Energy Corp., and LG&E Energy Marketing, Inc. for Approval of Transactions. The termination of the existing lease transaction is commonly referred to as the “Unwind Transaction.”

ES tariff is an integral part of the Unwind Transaction, and Big Rivers proposes that the ES tariff become effective with the closing of the Unwind Transaction.

The three distribution cooperatives² of Big Rivers have filed applications seeking Commission approval of both a pass through mechanism that would allow each distribution cooperative to bill its respective retail customers for the portion of the environmental surcharge that Big Rivers bills each distribution cooperative and other tariffs needed to pass through the effects of the Big Rivers' Unwind Transaction.³

The following parties requested and were granted full intervention: the Attorney General of the Commonwealth of Kentucky, by and through his Office of Rate Intervention ("AG"), Meade County, Kenergy, Jackson Purchase, the Kentucky Industrial Utility Customers, Inc., Alcan Primary Products Corporation ("Alcan"), and Century Aluminum of Kentucky General Partnership ("Century").⁴ A public hearing was held on June 10, 2008.

² The three Big Rivers distribution cooperatives are Meade County Rural Electric Cooperative Corporation ("Meade County"), Kenergy Corp. ("Kenergy"), and Jackson Purchase Energy Corporation ("Jackson Purchase").

³ See Case No. 2007-00470, Application of Meade County Rural Electric Cooperative Corporation for Approval of Retail Tariff Riders, Revised Tariffs and New Tariff, and for Approval of Amendment of Wholesale Agreement; Case No. 2008-00009, Application of Kenergy Corp. for Approval of Retail Tariff Riders and Revised Tariffs, Approval of Smelter Agreements, and Approval of Amendment to Wholesale Agreement; and Case No. 2008-00010, Application of Jackson Purchase Energy Corporation for Approval of Retail Tariff Riders, Revised Tariffs and New Tariff, and for Approval of Amendment of Wholesale Agreement.

⁴ Alcan and Century are identified as the Smelters.

BACKGROUND

Big Rivers is a rural electric cooperative organized pursuant to KRS Chapter 279 and is a utility subject to Commission jurisdiction. Big Rivers owns facilities used to generate electricity, and it owns and operates facilities used to transmit electricity to its three member distribution cooperatives for compensation for lights, heat, power, and other uses. All of the three distribution cooperatives are also rural electric cooperatives organized pursuant to KRS Chapter 279, and each is a utility subject to Commission jurisdiction. The distribution cooperatives are engaged in the distribution of electricity to the public for compensation for lights, heat, power, and other uses. They collectively serve approximately 110,000 member-consumers in all or parts of 22 counties in western Kentucky.

KRS 278.183(1) provides that a utility shall be entitled to the current recovery of its costs of complying with the Clean Air Act as amended and those federal, state, or local environmental requirements that apply to coal combustion wastes and by-products from facilities utilized for the production of energy from coal. Pursuant to KRS 278.183(2), a utility seeking to recover its environmental compliance costs through an *environmental surcharge* must first submit to the Commission a plan that addresses compliance with the applicable environmental requirements. The plan must also include the utility's testimony concerning a reasonable return on compliance-related capital expenditures and a tariff addition containing the terms and conditions of the proposed surcharge applied to individual rate classes. Within 6 months of submission, the Commission must conduct a hearing to:

- (a) Consider and approve the compliance plan and rate surcharge if the plan and rate surcharge are found reasonable and cost-effective for compliance with the applicable environmental requirements;
- (b) Establish a reasonable return on compliance-related capital expenditures; and
- (c) Approve the application of the surcharge.

COMPLIANCE PLAN

The compliance plan proposed by Big Rivers consists of programs and the associated costs dealing with the control of sulfur dioxide (“SO₂”), nitrogen oxide (“NO_x”), and sulfur trioxide (“SO₃”). Big Rivers has detailed in its proposed environmental compliance plan all applicable environmental laws and regulations the three programs address. At this time, Big Rivers is only seeking to recover certain variable operating expenses associated with the compliance programs. Big Rivers’ compliance plan does not include any capital projects or investments in utility plant to comply with the requirements of federal, state, or local environmental statutes or regulations; consequently, it is not seeking a return on such projects or utility plant.⁵

The costs proposed to be recovered for each of the programs are:

- (1) SO₂ program – Costs of reagents (lime, limestone, and di-basic acid), costs for the disposal of coal combustion by-products (fly ash, bottom ash, and scrubber sludge), and cost of purchasing SO₂ emission allowances. Costs would be offset by revenues received from the sale of SO₂ emission allowances and gypsum, a coal combustion by-product produced at the Coleman station.
- (2) NO_x program – Costs of reagents (sulfur and ammonia) and cost of purchasing additional NO_x emission allowances as needed. Costs would be offset by revenues received from the sale of NO_x emission allowances.

⁵ As the proposed compliance plan does not include capital projects or investment in utility plant, Big Rivers has also not proposed a rate of return.

(3) SO₃ program -- Costs of a reagent, lime hydrate.

In support of the proposed compliance plan, Big Rivers presented testimony describing each program in detail.⁶

No intervenors filed testimony concerning the proposed compliance plan. Based upon a review of the record, the Commission finds the proposed compliance plan is reasonable and cost-effective and should be approved.

SURCHARGE MECHANISM AND CALCULATION

Big Rivers proposes that its environmental surcharge mechanism use a “base/current” approach as expressed by the formula:

$$\text{MESF} = \text{CESF} - \text{BESF}$$

Where:

MESF = Monthly Environmental Surcharge Factor;

CESF = Current Environmental Surcharge Factor; and

BESF = Base Environmental Surcharge Factor.

The base/current approach calculates a current period revenue requirement, which reflects recoverable compliance costs for the current expense month, and a base period revenue requirement, which reflects corresponding environmental costs already included in base rates. As the program costs Big Rivers proposes to recover through its surcharge mechanism are not currently recovered in base rates, the BESF will initially

⁶ Spainhoward Direct Testimony at 31-48 of 48 and Exhibit DAS-1.

be set at \$0.00000 per kWh.⁷ Under Big Rivers' proposal, the current period and base period revenue requirements are each divided by the appropriate level of kWh sales to determine the CESF and BESF. The net difference between the two factors is the MESF, which is billed to the three member distribution cooperatives.

As proposed by Big Rivers, the current period revenue requirement is comprised of the specific environmental compliance operating expenses, less proceeds from by-product and emission allowance sales, plus or minus a 2-month true-up adjustment and plus or minus a 6-month surcharge over- or under-recovery adjustment.⁸ The environmental compliance operating expenses include the cost of reagents, the cost for the disposal of coal combustion by-products that cannot be sold, and the purchase of emission allowances. Any proceeds Big Rivers receives from the sale of marketable by-products or emission allowances would be used as an offset in the determination of the current period revenue requirement. Big Rivers' surcharge mechanism includes a 2-month true-up adjustment to address surcharge over- or under-recovery related to timing differences. Finally, Big Rivers proposes to amortize any over- or under-recovery of the surcharge revenue requirement from the previous 6-month period.

The current period revenue requirement would then be adjusted to reflect Big Rivers' jurisdictional operations. A "Jurisdictional System Allocation Ratio" would be applied to the total current period revenue requirement to determine the jurisdictional

⁷ The calculation of the BESF usually is where the impact of retirements and replacements resulting from the projects approved in the compliance plan are recognized. However, in this proceeding, there are no retirements or replacements to consider, since the compliance plan includes no new capital projects or investments in utility plant.

⁸ Seelye Direct Testimony, Exhibit WSS-6.

portion. The Jurisdictional System Allocation Ratio is the ratio of the kWh sales to the three member distribution cooperatives to which the surcharge will be applied, ending with the current expense month, divided by the kWh sales related to jurisdictional sales, off-system sales, and supplemental or back-up sales to the Smelters supplied from Big Rivers' generation resources during the month.

Big Rivers proposes that it be allowed to use \$0.00049 per kWh as the CESF for the first 2 or 3 months after the implementation of the surcharge. This level of environmental surcharge has been used in the financial modeling prepared in conjunction with the Unwind Transaction. Big Rivers would use its own actual cost data once it has a full month of costs information to determine the CESF.

None of the intervenors filed testimony concerning the surcharge mechanism and calculation.

The Commission has reviewed Big Rivers' proposed surcharge mechanism and the associated calculations, and finds the approach is generally consistent with other environmental surcharge mechanisms approved by the Commission. The Commission notes that Big Rivers has requested to use kWh sales instead of revenues to determine the CESF and BESF. As noted by Big Rivers, the costs to be recovered at this time through the proposed surcharge mechanism are variable expenses. The Commission agrees with Big Rivers that an energy charge is more appropriate, given the current situation, than the use of a percentage of revenues approach, as authorized for other utilities having an environmental surcharge.

However, the Commission does not agree with the use of a fixed \$0.00049 per kWh as the CESF for the first few months the environmental surcharge is in operation.

The environmental surcharge statute, KRS 278.183, clearly provides for the recovery of actual costs of compliance, not estimated costs. During this proceeding, Big Rivers has indicated that it will be able to secure the actual cost data from Western Kentucky Energy Corp. (“WKEC”) during the transition period after the completion of the Unwind Transaction. The Commission believes it is more appropriate for Big Rivers to obtain the actual cost information from WKEC and use that data in the determination of the CESF.

Therefore, the Commission finds Big Rivers’ surcharge mechanism and calculations are reasonable and should be approved, subject to the use of actual cost data for the CESF rather than the estimate as originally proposed.

OTHER ISSUES

Monthly Reporting Formats

Big Rivers proposed a set of monthly reporting formats for its environmental surcharge, based on the surcharge formats approved by the Commission for other utilities authorized an environmental surcharge. None of the intervenors commented on the proposed reporting formats. The Commission has reviewed the proposed formats, and finds the formats are reasonable and should be approved.

Effective Date of the Surcharge

As noted previously, Big Rivers’ environmental surcharge is an integral part of the overall Unwind Transaction. Big Rivers will not be incurring the additional environmental compliance costs until it resumes control and operation and maintenance over its generating facilities. The Commission agrees with Big Rivers and finds that the

environmental surcharge will not become effective until the Unwind Transaction is completed.

SO₂ Emission Allowance Sales

As noted previously, Big Rivers proposes to offset the current period revenue requirement with the proceeds from the sale of emission allowances. In Case No. 2007-00455, Big Rivers has proposed to sell all excess SO₂ emission allowances. While the Commission is approving Big Rivers' proposal in this case to use emission allowance sale proceeds as an offset in determining the current period revenue requirement, we are not making a decision in this Order concerning when or how many emission allowances should be sold by Big Rivers. Those issues will be addressed by the Commission in the final Order in Case No. 2007-00455.

Pass Through Mechanism

The three member distribution cooperatives of Big Rivers have filed separate applications proposing a pass through of the environmental surcharge, as well as other tariffs needed to pass through the effects of the Big Rivers Unwind Transaction. The Commission will issue Orders concerning those pass through mechanisms in conjunction with the final Order on the Unwind Transaction.

IT IS THEREFORE ORDERED that:

1. Big Rivers' environmental compliance plan is approved.
2. Big Rivers' surcharge mechanism is approved as modified and discussed in this Order.
3. Big Rivers' ES tariff is approved, subject to the modification of the surcharge mechanism discussed in this Order.

4. Big Rivers' ES tariff will become effective in the first month after the completion of the proposed Unwind Transaction if the Commission approves the Unwind Transaction in Case No. 2007-00455.

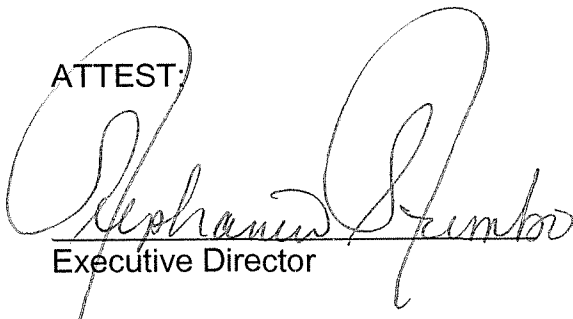
5. Big River' BESF initially shall be 0.00000 per kWh.

6. Big Rivers shall file monthly environmental surcharge reporting formats as proposed in its application.

Done at Frankfort, Kentucky, this 25th day of June, 2008.

By the Commission

ATTEST:


Stephanie Gumbo
Executive Director