

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

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| APPLICATION OF BIG RIVERS ELECTRIC |) | |
| CORPORATION FOR APPROVAL TO TRANSFER |) | CASE NO. |
| FUNCTIONAL CONTROL OF ITS TRANSMISSION |) | 2010-00043 |
| SYSTEM TO MIDWEST INDEPENDENT |) | |
| TRANSMISSION SYSTEM OPERATOR, INC. |) | |

O R D E R

On February 1, 2010, Big Rivers Electric Corporation (“Big Rivers”) tendered an application requesting approval to transfer functional control of its transmission system to the Midwest Independent Transmission System Operator, Inc. (“Midwest ISO”). Intervenors in this matter are the Midwest ISO, Kentucky Industrial Utility Customers, Inc. (“KIUC”), and the Attorney General of the Commonwealth of Kentucky (collectively, “Intervenors”). A procedural schedule was established by Order dated March 15, 2010, which provided for two rounds of discovery on Big Rivers’ application, intervenor testimony, one round of discovery on the intervenor testimony, and a formal public hearing.¹

On September 14, 2010, Big Rivers and the Intervenors submitted a unanimous Stipulation and Agreement (“Stipulation”) pursuant to which the Intervenors agreed that they did not oppose Big Rivers’ membership in the Midwest ISO. The hearing was held

¹ Pursuant to a motion by the Midwest ISO, the procedural schedule was later modified to allow for the scheduling of an informal conference, which was held on July 7, 2010.

on September 15, 2010, and responses to post-hearing information requests have been received, as well as post-hearing briefs. This matter now stands submitted for decision.

BACKGROUND

Big Rivers, a not-for-profit generation and transmission electric cooperative, owns and operates both electric generation and transmission facilities. It supplies the wholesale electricity requirements of its three member distribution cooperatives, Meade County Rural Electric Cooperative Corporation, Jackson Purchase Energy Corporation, and Kenergy Corp. (collectively, "Members"), who provide retail electric service to roughly 110,000 customers in 22 western Kentucky counties. Big Rivers requests approval to join the Midwest ISO in order to enable it to meet the contingency reserve requirement of the North American Electric Reliability Corporation ("NERC") as approved by the Federal Energy Regulatory Commission ("FERC"). Meeting this contingency reserve standard is an operational reliability necessity as well as a legal requirement. Failure to meet the NERC contingency reserve standard could result in Big Rivers being assessed penalties of up to \$1 million per day.

Historically, Big Rivers met NERC's contingency reserve requirement through membership in different reserve-sharing arrangements, most recently the Midwest Contingency Reserve Sharing Group ("MCRSG"), which expired December 31, 2009. During 2009, Big Rivers investigated various alternatives to enable it to continue to meet the NERC contingency reserve standard, including other sharing arrangements, purchasing power, investigating the potential for significant demand interruptions by the largest customers on its system, and operating its generating units at reduced capacity levels. Upon determining that these options were economically or legally infeasible, or

that there was insufficient time in which to implement them, on November 20, 2009, Big Rivers' Board of Directors approved initiating the process to join the Midwest ISO.

The Midwest ISO is a regional transmission organization which operates the interconnected transmission system of its members. It administers energy, ancillary services, and financial transmission markets, and controls facilities in all or parts of 13 states and the Canadian province of Manitoba.

In order to join the Midwest ISO, Big Rivers must obtain approval, or consent, from this Commission as well as two of its creditors: the United States government and CoBank ACB. Big Rivers initially proposed to join the Midwest ISO by September 1, 2010. It later amended its proposal by revising the date to join the Midwest ISO to December 1, 2010.²

STANDARD OF REVIEW

Big Rivers' proposed transfer of control of its transmission system falls within the purview of KRS 278.218, which requires Commission approval prior to the transfer of ownership or control of a utility's assets with a value of \$1,000,000 or greater. The statute provides, in part, that "[t]he commission shall grant its approval if the transaction is for a proper purpose and is consistent with the public interest."³ There is no statutory

² Since December 31, 2009, Big Rivers has contracted with the Midwest ISO to receive "backstop" service under Midwest ISO Tariff RR, which provides contingency reserve service during a prospective member's phased integration into the Regional Transmission Organization. Such service is available for a period of time during which the prospective member is actively working toward full integration into the Midwest ISO. In its post-hearing brief, Big Rivers stated that, in order to fully integrate into the Midwest ISO by December 1, 2010, the last integration cycle before the January 1, 2011 expiration of its arrangement under Tariff RR, it required a Commission decision no later than November 1, 2010.

³ KRS 278.218(2).

definition of “public interest.” However, the Commission has interpreted the “public interest” as follows:

[A]ny party seeking approval of a transfer of control must show that the proposed transfer will not adversely affect the existing level of utility service or rates or that any potentially adverse effects can be avoided through the Commission’s imposition of reasonable conditions on the acquiring party. The acquiring party should also demonstrate that the proposed transfer is likely to benefit the public through improved service quality, enhanced service reliability, the availability of additional services, lower rates or a reduction in utility expenses to provide present services. Such benefits, however, need not be immediate or readily quantifiable.⁴

While the application in this case involves the transfer of functional control of utility assets, rather than a transfer of ownership of the assets, the same criteria apply in determining whether the proposed transfer satisfies the “public interest” standard.⁵

OVERVIEW OF THE PROPOSED TRANSFER

Big Rivers seeks to join the Midwest ISO in order to satisfy the requirements of NERC standard BAL-002 regarding contingency reserves. Pursuant to this standard, Big Rivers must be able to balance its supply resources and its system demand within 15 minutes of an event characterized as a “Reportable Disturbance” occurring due to the loss of supply. For Big Rivers, compliance with the standard requires that it maintain contingency reserves sufficient to meet the largest single contingency on its

⁴ Case No. 2002-00018, Application for Approval of the Transfer of Control of Kentucky-American Water Company to RWE Aktiengesellschaft and Thames Water Aqua Holdings GmbH (Ky. PSC May 30, 2002) at 7.

⁵ Case No. 2002-00475, Application of Kentucky Power Company d/b/a American Electric Power, for Approval, to the Extent Necessary, to Transfer Functional Control of Transmission Facilities Located in Kentucky to PJM Interconnection, L.L.C. Pursuant to KRS 278.218 (Ky. PSC Aug. 25, 2003).

system, which would be the loss of its D. B. Wilson Generating Station, which has a maximum capacity of 417 MW.⁶

After extensive research of the potential options for meeting its contingency reserve requirements, Big Rivers determined that joining the Midwest ISO was the only reasonable means currently available that will enable it to satisfy its contingency reserve obligations and avoid potential NERC penalties for non-compliance.⁷ Big Rivers avers that joining the Midwest ISO will not only provide it with the reliability benefits inuring from having contingency reserves available in the event of a loss of generation, but will provide additional reliability benefits by providing access to: (1) additional generation resources; (2) Midwest ISO's Security Constrained Economic Dispatch as a means of resolving congestion problems; and (3) Midwest ISO's ability to analyze potential reliability problems across a much larger area than Big Rivers can do as a stand-alone system.

Big Rivers compared the benefits and costs of membership in the Midwest ISO with those of meeting its contingency reserve requirements on a stand-alone, or self-supply, basis. Depending on the assumptions as to the availability of 200 MW of interruptible load from two aluminum smelters served at retail by Kenergy Corp., Big Rivers estimated that joining the Midwest ISO would produce net present value benefits between \$32.3 million and \$132.8 million over the 2011-2015 period. Big Rivers utilized

⁶ Under the terms of the MCRSG arrangement, Big Rivers was able to comply with the NERC contingency reserve standard with only 32 MW of contingency reserves.

⁷ Big Rivers also determined that it was possible to meet its contingency reserve requirements on a stand-alone basis by operating its generating units at reduced capacity levels and relying on its largest industrial customers, two aluminum smelters, for 200 MW of interruptible load, but that this option would be prohibitively expensive and carry a level of reliability risks that was unacceptable.

a five-year period for analyzing costs and benefits since, under the Midwest ISO Transmission Owner's Agreement, a new member is not permitted to withdraw for five years after signing the membership agreement.⁸

STIPULATION AND AGREEMENT

The September 14, 2010 Stipulation reflects the agreement of the parties that Big Rivers' proposal to transfer functional control of its transmission system to the Midwest ISO is for a proper purpose, is consistent with the public interest, and should be approved by the Commission. In addition, the Stipulation contains a commitment by Big Rivers that it will not seek to recover through the Non-FAC Purchase Power Adjustment mechanisms contained in its wholesale power supply contracts either Midwest ISO administrative costs or FERC fees for which it may be obligated. The Stipulation also addresses the means available for Big Rivers to seek recovery of costs related to its membership in the Midwest ISO. Finally, the Stipulation reflects agreement between Big Rivers and KIUC on how they will work together to explore and implement plans for the aluminum smelters to sell demand response service to the Midwest ISO. As clarified at the public hearing, the parties are requesting that the Commission approve only Paragraph Nos. 1 and 2 of the Stipulation, claiming that the other substantive provisions of the Stipulation do not need Commission approval and have been filed

⁸ In response to a hearing data request, Item 4, Big Rivers and the Midwest ISO clarified that, since Big Rivers signed its membership agreement in December 2009, it could withdraw as early as December 31, 2014 if proper notice is given.

solely for the purpose of disclosing Big Rivers' commitments to KIUC.⁹ Paragraph No. 1 of the Stipulation specifies that the transaction proposed in this case satisfies the requirements of KRS 278.218(2) and should be approved by the Commission, while Paragraph No. 2 specifies that no approval is requested in this case to recover any costs or fees related to Midwest ISO membership through the Non-FAC Purchase Power Adjustment in Big Rivers' wholesale power supply contracts.

DISCUSSION OF ISSUES

Big Rivers presented an analysis of the 2011-2015 costs and benefits of membership in the Midwest ISO. The analysis is uncontroverted, and it shows that at this time membership in the Midwest ISO is Big Rivers' only economically feasible means for complying with NERC's contingency reserve standard. As evidenced by the Stipulation, the Intervenors agree that Big Rivers' proposal to transfer functional control of its transmission system to the Midwest ISO is for a proper purpose, is consistent with the public interest, and should receive Commission approval.

The Commission concurs with the conclusion of the parties that joining the Midwest ISO is the only feasible alternative at this time for Big Rivers to comply with NERC's contingency reserve requirement. While almost any cost-benefit analysis of future events can be subject to debate, Big Rivers' analysis of the period 2011-2015 generally indicates that membership in the Midwest ISO is preferable to meeting its

⁹ September 15, 2010 Video Transcript, at 10:18:35. The Commission notes that other provisions of the Stipulation commit Big Rivers to take, or not take, certain actions in connection with future filings at the Commission. Since those provisions have been filed solely for the purpose of disclosure, the Commission will withhold its review of those commitments until future filings are made.

contingency reserve requirements on a stand-alone basis and, for that five-year period, the costs of such membership will not significantly affect its financial condition.

Although the evidence shows that Big Rivers' transfer of functional control of its transmission system to, and its membership in, the Midwest ISO should be approved through 2015, the Commission also recognizes that the longer-term financial implications of membership in the Midwest ISO are uncertain. The evidence presented by KIUC regarding the costs and benefits of such membership through 2025 raise significant concerns with the Commission. KIUC's evidence indicates that, if the transmission projects planned by the Midwest ISO are built, and if the cost allocation methodology proposed by the Midwest ISO is approved by FERC, the net present-value cost to Big Rivers over this longer time period could exceed benefits by \$162 million.¹⁰

We do not know at this time whether FERC will accept the Midwest ISO's recent cost allocation proposal as filed, nor do we know how many of the transmission projects planned by the Midwest ISO will be built. However, the potential for Big Rivers to incur future costs far in excess of benefits raises the question of whether long-term membership in the Midwest ISO is in the best interests of Big Rivers, its three Members, and their retail customers. In recognition of this potential cost, Big Rivers has committed to reviewing the costs and benefits of Midwest ISO membership on a regular basis and communicating the results of its reviews to the Commission.¹¹ Big Rivers

¹⁰ The proposed cost allocation methodology will be applied to new transmission projects that the Midwest ISO refers to as Multi-Value Projects.

¹¹ September 15, 2010 Video Transcript, 10:18:35.

also committed to continue to evaluate its options for complying with NERC's contingency reserve requirement.¹²

ANALYSIS AND CONCLUSION

The Commission finds that Big Rivers' request to transfer functional control of its transmission system to the Midwest ISO is for a proper purpose and consistent with the public interest. We find that Big Rivers' membership in the Midwest ISO for the period 2011-2015 is also for a proper purpose and consistent with the public interest. However, while subject to many uncertainties, the evidence presented in this proceeding indicates that longer-term membership in the Midwest ISO could carry substantial financial risks for Big Rivers, its three Members, and their retail customers.

In recognition of these risks, the Commission will impose two conditions on the approval of Big Rivers' request to transfer functional control of its transmission system to the Midwest ISO. The first condition is that Big Rivers file annually with the Commission a report that: (1) evaluates the available options for complying with NERC's contingency reserve requirement; and (2) reviews and analyzes future short-term and long-term costs and benefits of continued membership in the Midwest ISO.¹³

The Commission concurs with the parties that no approval is needed for the provisions of the Stipulation that state how Big Rivers and KIUC will work together to explore the potential for the two aluminum smelters, Alcan Primary Products Corporation and Century Aluminum of Kentucky General Partnership, and other

¹² Id., 10:25:58.

¹³ These reports are to be filed concurrent with Big Rivers' filing of its FERC Form 1 with the Commission, with the first such report to be filed when Big Rivers files its 2011 FERC Form 1. All reports should include a cover letter which specifically refers to this docket number.

industrial customers to sell demand response service to the Midwest ISO. However, before any retail customer can participate in a demand response program sponsored by the Midwest ISO, the customer's participation must be subject to review by the Commission to ensure that the sale is permissible under KRS Chapter 278 and that there is no adverse financial or operational effect on either Big Rivers or its Members. Consequently, the second condition that we impose on this transfer is that any sale of demand response be set forth in a special contract that is filed with the Commission for its review and approval.¹⁴

FINDINGS AND SUMMARY OF DECISION

Based on the evidence of record and being otherwise advised, the Commission finds that:

1. Big Rivers' request to transfer functional control of its transmission system to the Midwest ISO is for a proper purpose and in the public interest, and should be approved subject to Big Rivers' acceptance of the two conditions specified below and Midwest ISO's acceptance of the one condition specified below relating to participating in demand response programs.

2. Big Rivers should file a report by September 30 of each year describing its current evaluation of available options for complying with NERC's contingency reserve requirement and its review of the short-term and long-term costs and benefits of continued membership in the Midwest ISO.

¹⁴ This was one of the conditions upon which the Commission accepted a rate case settlement among Kentucky Power Company and the intervenors in Case No. 2005-00341 which provided for customer participation through the utility in the PJM demand response program. See Case No. 2005-00341, General Adjustments of Electric Rates of Kentucky Power Company (Ky. PSC Mar. 13, 2006).

3. No retail customer will be allowed to participate in any Midwest ISO demand response program until that customer has entered into a special contract with its retail electric supplier and Big Rivers, and the special contract has been filed with the Commission for review and approval.

4. That portion of the Stipulation submitted by the parties for Commission approval, specifically, Paragraph Nos. 1 and 2, is reasonable and should be approved.

5. The Chief Executive Officer of Big Rivers should file, within seven days of the date of this Order, a letter accepting and agreeing to be bound by the conditions set forth in Finding Nos. 2 and 3 above.

6. The Chief Executive Officer of the Midwest ISO should file, within seven days of the date of this Order, a letter accepting and agreeing to be bound by the condition set forth in Finding No. 3 above.

7. The approval of Big Rivers' request to join the Midwest ISO will not diminish the Commission's authority to review and set Big Rivers' electric rates based on the value of its property used to provide electric service.

8. The approval of Big Rivers' request to join the Midwest ISO will not diminish Big Rivers' existing obligation to:

a. Regularly file for Commission review an integrated resource plan detailing Big Rivers' load, determining appropriate reserve requirements, and identifying sources of energy, demand-side resources, and projected need for new generation and transmission facilities.

b. Provide regulated service to its Members through the provision of bundled generation and transmission electric service.

c. File for a certificate of public convenience and necessity prior to commencing construction of an electric generation facility or transmission facility.

IT IS THEREFORE ORDERED that:

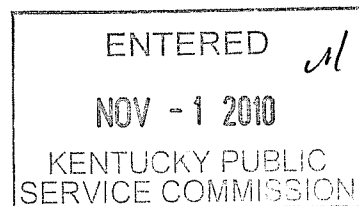
1. Big Rivers' request to transfer functional control of its transmission system to the Midwest ISO is approved subject to the filing within seven days of the date of this Order of the written acknowledgements described in Finding Nos. 5 and 6 above.

2. The provisions of Paragraph Nos. 1 and 2 of the Stipulation submitted by the parties are approved.

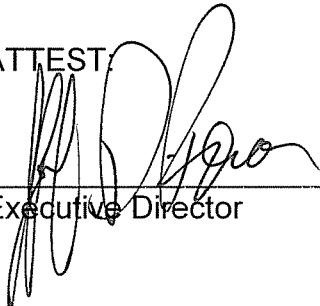
3. Any retail customer electing to participate in a Midwest ISO demand response program shall comply with the procedures set forth in Finding No. 3 above.

4. Any documents filed in the future pursuant to Finding No. 2 herein shall reference this case number and shall be retained in the utility's general correspondence file.

By the Commission



ATTEST:



Executive Director

Keith L Beall
Esquire
P.O. Box 4202
Carmel, IN 46082-4202

Honorable James M Miller
Attorney at Law
Sullivan, Mountjoy, Stainback & Miller, PSC
100 St. Ann Street
P.O. Box 727
Owensboro, KY 42302-0727

Douglas L Beresford
Hogan & Hartson, L.L.P.
555 Thirteenth Street, N.W.
Washington, DC 20004-1109

Gregory A Troxell
Esquire
P.O. Box 4202
Carmel, IN 46082-4202

David Brown
Stites & Harbison, PLLC
1800 Providian Center
400 West Market Street
Louisville, KY 40202

Albert Yockey
Vice President Government Relations
Big Rivers Electric Corporation
201 Third Street
Henderson, KY 42419-0024

David G Crockett
Vice President - System Operations
Big Rivers Electric Corporation
201 Third Street
Henderson, KY 42419-0024

Mark David Goss
Frost, Brown, Todd, LLC
250 West Main Street
Suite 2700
Lexington, KY 40507

Honorable Dennis G Howard II
Assistant Attorney General
Office of the Attorney General Utility & Rate
1024 Capital Center Drive
Suite 200
Frankfort, KY 40601-8204

Honorable Michael L Kurtz
Attorney at Law
Boehm, Kurtz & Lowry
36 East Seventh Street
Suite 1510
Cincinnati, OH 45202