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COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION OCT 01 2012

In the Matter of:

PUBLIC SERVICE
COMMISSION

APPLICATION OF BIG RIVERS)
ELECTRIC CORPORATION, INC.)
FOR AN ADJUSTMENT OF RATES)

Case No. 2011-00036

ATTORNEY GENERAL'S POST-HEARING BRIEF ON REHEARING

On March 2, 2011, Big Rivers Electric Corporation ("BREC" or "company") filed the instant application for a general increase in its base rates. The following parties filed motions for intervention, all of which were granted: The Attorney General of the Commonwealth of Kentucky ("Attorney General"); Kentucky Industrial Utility Customers ("KIUC"), representing Alcan Primary Products Corporation and Century Aluminum of Kentucky General Partnership (hereinafter jointly referred to as "the Smelters"); Jackson Purchase Energy Corporation, and Kenergy Corporation. The original evidentiary hearing was held on this matter from July 26-28, 2011, during which witnesses from all parties having filed testimony were offered for cross-examination. A Final Order was entered on November 17, 2011.

On or about December 1, 2011, KIUC filed a notice of rehearing in the Franklin Circuit Court, while BREC filed its motion for rehearing with the Commission on or about December 6, 2011. On December 14, 2011, KIUC filed a motion to dismiss BREC's rehearing, but on February 14, 2012, the Commission issued an order denying KIUC's

motion and subsequently¹ issued a procedural schedule pertaining to this rehearing. On April 12, 2012, in response to motions filed by the parties, the Commission modified the scope of the rehearing to include issues raised by KIUC and amended the procedural order accordingly.

On September 12, 2012 a formal hearing was held regarding the rehearing, which focused exclusively on the following issues:

1. BREC's request for approval of its rate case expenses totaling approximately \$1.976 mil.;
2. A mathematical miscalculation of BREC's depreciation adjustment related to construction work in progress ("CWIP");
3. Whether BREC should have been allowed to include CWIP for some of its depreciation expenses adjustment;
4. The finding that the financial model relied upon by Big Rivers during the Unwind Transaction did not include any Smelter TIER revenues, and any other findings that the Commission deems appropriate to change if this finding relating to the financial model is eliminated;
5. Whether the Final Order dated November 17, 2011, should have eliminated interclass rate subsidies;
6. Whether the Final Order exempted all non-rural customers from payment of any demand-side management ("DSM")-related expenses; and
7. Whether the Commission should have adopted KIUC's proposed depreciation rates.

Consistent with is April 12th Order, during the course of the rehearing, the Commission sustained BREC's objections to questions concerning matters occurring after November 17, 2011, and advised that it would not entertain evidence relating to matters after that

¹ See Order dated March 7, 2012.

date.² To the extent that the Attorney General references herein any matters occurring after November 17, 2011, it does so merely to permit the Commission to take administrative notice of the same and consider it in only a prospective fashion.

1. Rate Case Expenses

BREC is a G &T owned by its three (3) members,³ and as such is not an investor owned utility. In seeking recovery of its rate case expenses, BREC posits that as a Cooperative, it has no other source from which to recover its rate case expenses other than its members. The Commission's Final Order of November 17, 2011 ("Final Order") did not discuss BREC's rate case expenses. If the expenses are not recovered directly through means of this rehearing, the company will incur a loss, which will have a negative effect on its debt service coverage ("DSC") and Margins for Interest Ratio ("MFIR").⁴ BREC's original rate case expenses as set forth in its Application were \$893,390, which it proposed to defer and amortize over three years. However, the company now seeks to recover an additional \$976,052 in actual rate case expenses, yielding a total through August 18, 2011, of \$1,976,030.

A large portion of BREC's additional costs (83%, or \$809,587) come in the form of additional legal fees. As has been its practice in many matters heard before the Commission, BREC has retained the services of two law firms: (a) the Kentucky-based

² See VTE beginning at approximately 10:24:48 (Objection) and at approximately 11:11:50 (Commission's Ruling).

³ BREC's member cooperatives are Jackson Purchase Energy Corp., Kenegy Corp., and Meade County Rural Electric Cooperative Corp.

⁴ Whether BREC could seek to recover all or any portion of those costs in the company's next base rate case is uncertain.

Sullivan, Mountjoy, Stainback & Miller, PSC (“Miller law firm”); and (b) the Washington, D.C.-based firm of Hogan Lovells US, LLP (“Hogan Lovells”). Originally, BREC had estimated owing Hogan Lovells \$173,930,⁵ but in just a few months’ time, that amount had skyrocketed to \$723,270. While local counsel’s fees increased by approximately 30%, the Attorney General is troubled that the far-more expensive out-of-state firm’s fees increased by approximately 500%.⁶ Moreover, it appears that no effort was taken to determine whether any other local counsel could have assisted the Miller law firm rather than Hogan Lovells.⁷

While parties have a recognized right to the counsel of their own choice, it is just as well-recognized that BREC is under an affirmative fiduciary duty to its ratepayers to limit its expenses to the least cost possible. The retention of a firm located in Washington, D.C. (one of the most expensive areas in the nation) to perform what company witness Mr. Ashworth described as essentially “back-up work” to the Kentucky Miller law firm⁸ hardly seems to be an exercise in prudence. This is further supported by the semi-unredacted bills produced by BREC on September 18, 2012, in response to a post-hearing data request, which reveal a possible duplication of efforts.⁹ While BREC asserts that Hogan Lovells possesses a great deal of knowledge of BREC’s

⁵ See BREC’s response to KIUC Rehearing DR 7 (a), and Video Transcript of Evidence [“VTE”] at approximately 10:19:20.

⁶ See VTE at approximately 11:16:30.

⁷ VTE at approximately 11:17:40.

⁸ VTE at approximately 11:26:20.

⁹ This possible duplication of efforts is likely the result of BREC’s inadequate management, review and control of its outside counsel. The Attorney General appreciates BREC’s submission of the largely unredacted billing statements into the record. In requesting these documents, the Attorney General did not wish to imply or infer any potential wrongdoing on the part of BREC’s attorneys.

inner workings and its complex history,¹⁰ the difference in billing rates (a maximum of \$740 / hour for Hogan Lovells contrasted with a maximum of \$220 for the Miller law firm) is far from commensurate with costs the Commission typically approves. Therefore, the Attorney General is forced to conclude that the sums billed are not fair and reasonable for ratepayers to bear.

The Attorney General recommends that the Commission: (a) award the original sum BREC initially sought to recover for its rate case expenses (\$893,390); and (b) adjust that portion of the revised expenses constituting Hogan Lovells' fees¹¹ in a manner such that the maximum hourly rate is reduced to levels more in keeping with local and regional law firms' rates. The Attorney General believes it is necessary and appropriate for the Commission to exercise its authority in this manner so that BREC and indeed all jurisdictional utilities will understand that the Commission will not allow recovery of imprudently-incurred expenses.

The Company's responses to KIUC Rehearing date request 7(a), together with the rehearing cross-examination of Company witness, Mr. Ashworth, provide the unmistakable impression that throughout the conduct of this matter, BREC lacked adequate controls and safeguards to manage its rate case expenses, especially the fees its attorneys charged. Upon staff's cross-examination, Mr. Ashworth¹² at first indicated

¹⁰ VTE at approximately 10:21:00.

¹¹ It appears that BREC has been expensing rate case expenses as items of expense have been incurred.

¹² See generally VTE at approximately 11:12:50 through 11:20:00. The Attorney General notes that both Mr. Blackburn and Mr. Hite retired within approximately one year of each other, with Mr. Hite's retirement coming mere weeks prior to the Sept. 12th rehearing. See, e.g., VTE at approximately 11:20:00.

that these statements were reviewed by upper management.¹³ However, when he was asked whether there was any one person who was charged with this responsibility, he responded only that legal invoices are subject to a review and approval process as are all invoices. Later in his testimony, however, he stated that BREC CFOs Bill Blackburn and Mark Hite exercised this function.¹⁴

The testimony presented on rehearing strongly suggests a problem that BREC should address; specifically, that BREC should fundamentally revise its policies and procedures regarding review of fees incurred for attorneys and other external experts. Furthermore, if BREC believes it requires additional legal support to back-up its lead Kentucky counsel, then the company should keep an open mind as to whether it may reasonably consider engaging additional counsel at the local or regional level to perform this regulatory work. In this regard, the Attorney General recommends that the Commission order a limited and focused management audit or require a regulatory condition regarding BREC's cost management of fees incurred by its experts and attorneys.

¹³VTE beginning at approximately 11:18:15.

¹⁴ VTE at approximately 11:19:50.

2. Depreciation ¹⁵

In the rehearing, BREC is claiming an additional approximate sum of \$1.7 million in depreciation expenses. The Attorney General concurs in the Commission's original refusal of BREC's request to adjust its depreciation expense to reflect the accrual of depreciation on Big Rivers' test-year-end CWIP balance. To do otherwise would allow BREC to recover additional depreciation expense by essentially utilizing a post-test year adjustment, which is contrary to well-established Commission precedent.¹⁶ BREC's proposal would have resulted in an additional \$6,252,651 in depreciation expenses, whereas the Commission's Final Order resulted in \$3,489,340 in expenses.

KIUC presented extensive, highly credible evidence that longer remaining service lives would be more appropriate than those selected by BREC. In fact, KIUC witness, Kollen, testified that in the long run, using the longer lives he proposed would benefit the company by reducing downward pressure on the company's operating margins.¹⁷ However, the Commission recognized that depreciation is ". . . not an exact science and it cannot be done with absolute precision."¹⁸ The Commission concluded in its Final Order that it was reasonable to utilize the shorter remaining service lives proposed by BREC, but also did not accept BREC's requested level of depreciation

¹⁵ In this section, the Attorney General addresses both BREC's issue of whether it should have been allowed to include construction work in progress ("CWIP") for some of its depreciation expenses adjustment, as well as KIUC's issue of whether the Commission should have adopted KIUC's proposed depreciation rates. The Attorney General does not contest or otherwise dispute BREC's identification of an apparent mathematical error regarding BREC's depreciation expense adjustment related to CWIP.

¹⁶ Final Order, p. 20.

¹⁷ VTE at approximately 14:39:00.

¹⁸ Final Order, p. 19.

expense that would have reflected the accrual of depreciation on Big Rivers' test-year-end CWIP balance.¹⁹

Although the Commission's approach as expressed in its Final Order appears to be well-reasoned, the Attorney General is nonetheless concerned that the company's position as to why shorter service lives are appropriate appears to be premised upon retirement of plant associated with coal-fired generation. The Attorney General suggests that at least some early retirements may have been premature, given that the U.S. Court of Appeals for the D.C. Circuit ²⁰ has stricken the Environmental Protection Agency's Cross State Air Pollution Rule ("CSAPR").²¹ For that reason, the Attorney General believes that BREC should be required to perform another depreciation study in its next base rate case with particular attention paid to whether the shorter lives can be justified. In its next depreciation study, the Attorney General believes the Commission should give careful consideration to adopting the longer service lives KIUC recommended.

3. Commission's Finding Regarding Financial Model in Unwind Transaction

The Attorney General agrees with BREC that the Commission's statement on page 6 of the Final Order that "[t]he financial model Big Rivers relied upon in

¹⁹ *Id.*, p. 20.

²⁰ *EME Homer City Generation, L.P. v. Environmental Protection Agency et al.*, No. 11-1302 (D.C. Cir. Aug. 21, 2012).

²¹ BREC witness, Kelly, testified upon re-direct that the remaining service lives he selected were historic. However, there appears to be little direct evidence as to the origin of those lives, who may have selected those lives and when, and based upon what data. See VTE at approximately 14:26:30. Further, it appears that BREC's own service lives, as reported to RUS, were longer than those which Burns & McDonnell and Mr. Kelly utilized. See Kollen supplemental direct testimony, pp. 2, 4-15.

conjunction with the Unwind Transaction did not include any Smelter TIER Adjustment revenues,” is erroneous and therefore should be stricken from the Final Order or otherwise amended on rehearing.

4. Interclass Rate Subsidies

In establishing the rate design in this matter, the Commission in its Final Order noted that the Large Industrial class is currently subsidizing the Rural class. In fact, this subsidy started with rates that began in the Unwind Case.²² In addressing that subsidy, the Commission stated unambiguously that it fully intended to follow its well-established pattern of gradualism, finding:

The Commission will not accept KIUC’s proposal to eliminate 100 percent of the Rural subsidy in a single step as part of this proceeding. Such an action would be **inconsistent with our long-standing practice of employing the principle of gradualism in moving toward cost-of-service-based rates.** Considering the amount of the Rural subsidy, **moving to cost-of-service-based rates for all classes is a goal to be achieved gradually, in incremental steps.** However, based on the COSS results, and considering the unique characteristics of the loads on Big Rivers’ system, we find that the Rural subsidy should be reduced by an amount greater than proposed by Big Rivers, \$2.4 million, with the rate-of-return gap between the Rural and Large Industrial classes being reduced accordingly. (Final Order, pp. 29-30, emphasis added)

Interclass subsidies are not impermissible under the Kentucky PSC’s precedents, and have been accepted in the rate structures of many jurisdictional utilities. Regarding the matter of how an existing subsidy should be mitigated, phased out or eliminated is

²² Cross exam of KIUC witness, Baron; VTE beginning at approximately 15:22:00. See also, *In the Matter of The Application of BREC and of E.ON U.S., LLC. et al for Approval of Transactions*, Case No. 2007-00455, “Unwind Order” (March 6, 2009) at pp. 18, 23-26.

a matter that needs to be approached with caution and addressed on a case-by-case basis. Most certainly, the fundamental ratemaking principle of gradualism, as reflected in the Commission's Final Order, should be applied.

In addition, the rule against retroactive ratemaking must be observed. As the Commission opined when considering BREC's application to recover Midwest ISO-related expenses,²³ absent evidence of actual savings, the rule prevents the Commission from rolling back rates to benefit any party. The rule against retroactive ratemaking clearly prevents an immediate and complete elimination of the subsidy:

The rule against retroactive ratemaking is a 'generally accepted principle of public utility law which recognizes the prospective nature of utility ratemaking and prohibits regulatory commissions from rolling back rates which have already been approved and become final.' . . . It further prohibits regulatory commissions when setting utility rates, from adjusting for past losses or gains to either the utility consumers, or particular classes of consumers.²⁴

In the case pending on rehearing, BREC witness, John Wolfram, expressed the dilemma that the Commission confronts most succinctly when he testified:

. . . . [A]s a result of the unwind transaction, the smelters agreed to pay contractual adders above cost of service. The smelters now want the Commission to forget that the rates the smelters agreed to were in consideration for higher rates and increased risks to Big Rivers and its members, and instead want the Commission to place an even greater burden on the non-smelter customers.²⁵

The Attorney General fully agrees with and supports the Commission's position set forth in the Final Order. The Attorney General believes the principle of gradualism

²³ Final Order at pp. 15-16.

²⁴ *In the Matter of: OAG v. Atmos Energy Corporation*, 2005-00057, Order dated February 7, 2009, p. 3 (citing *Kentucky Industrial Utility Customers, Inc. v. Big Rivers Electric Corp.*, Case No. 1995-00011, Order dated April 1, 1997).

²⁵ Wolfram Rehearing Rebuttal, p. 11.

is consistent with the mandate of KRS 278.030 (1) that rates must be fair, just and reasonable. Gradual movement toward cost of service based rates is fully consistent with this mandate, whereas KIUC's proposal for an immediate and complete elimination of the subsidy would fail to meet that mandate. Under the current circumstances, as BREC's ratepayers will confront unprecedented rate increases due to stringent environmental regulations and the yet-to-be-determined impact of at least one smelter leaving BREC's territory, gradualism must be pursued. Abrupt changes to rates would only exacerbate the current financial difficulties for both BREC and its ratepayers. .

Therefore, the Attorney General encourages the Commission to maintain its position in the Rehearing Order.

5. Whether the Final Order Exempted Non-Rural Customers from Payment of DSM-Related Expenses

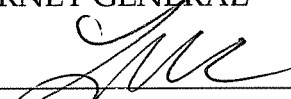
KIUC asserts that the Commission's Final Order has the effect of assigning a portion of DSM costs – which rightfully should be allocated solely to the Rural class – to the smelters. The Attorney General disagrees with this position, as the Final Order clearly assigns all such costs to the Rural class,²⁶ thus he believes there is no need for the Commission to change its findings on this point.

²⁶ Final Order, pp. 22, 29.

WHEREFORE, the Attorney General tenders his brief in the above-styled matter.

Respectfully submitted,

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Certificate of Service and Filing

Counsel certifies that an original and ten photocopies of the foregoing were served and filed by hand delivery to Jeff Derouen, Executive Director, Public Service Commission, 211 Sower Boulevard, Frankfort, Kentucky 40601; counsel further states that true and accurate copies of the foregoing were mailed via First Class U.S. Mail, postage pre-paid, to:

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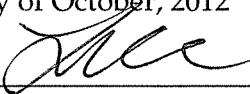
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