KENTUCKY PUBLIC SERVICE COMMISSION MEMORANDUM

TO: Main Case File 2011-00036

FROM: Jeff Derouen, Executive Director

DATE: October 19, 2012

SUBJECT: Application of Big Rivers Electric Corporation for a general adjustment in rates

An October 15, 2012 letter from Serge Gosselin, General Manager of Alcan Primary Products Corporation ("Alcan"), was sent to Senator Dorsey Ridley with copies to 24 persons including PSC Chairman David Armstrong, PSC Vice Chairman Jim Gardner, and PSC Commissioner Linda Breathitt, Deputy Executive Director Stephanie Bell, and myself

Jim Miller called me on October 17 indicating Big Rivers was going to object to the letter being read by the Commissioners on the ground that it was an ex parte communication. Out of caution, I instructed PSC staff that the Alcan letter not be distributed to the PSC Commissioners. A letter dated October 17 was received by the Commission from Big Rivers in which it stated that it considers the Alcan letter "an inappropriate *ex parte* communication between a party and the decision makers in this case." An October 18, 2012, letter from Michael L. Kurtz Esq., on behalf of Kentucky Industrial Utility customers ("KIUC"), followed, responding to Big Rivers stating that the letter sent by Alcan was not an ex parte communication.

The Alcan letter set out its concerns with the report requested by Kentucky Legislative Research Commission and conducted by Christensen Associates Energy Consulting LLC. The report, *Energy Rate Impacts on Kentucky Industry* dated September 30, 2012, was presented to the Interim Joint Committee on Natural Resources and Environment on October 4, 2012.

The letters have remained unopened and in my office. However, a copy of the Alcan letter was attached to the letter Big Rivers sent alleging an ex parte communication. The Big Rivers' letter, its attachment, and the KIUC response are attached to this memo.

According to Black's Law Dictionary, ex parte means "a judicial proceeding, order, injunction, etc." that is "taken or granted at the instance and for the benefit of one party only, and without notice to, or contestation by, any person adversely interested."

Big Rivers' letter to the Commission included the Alcan letter and was sent to all the parties to this case. There appears to no longer be an ex parte issue.

In any event, the Commission ruled at the September 12, 2012 **rehearing** in Case No. 2011-00036 that it would not consider any evidence that came into existence after the initial rate order which was issued November, 17, 2011. Because the Alcan letter addresses issues which did not exist prior to November 17, 2011, the Commission will not consider the Alcan letter under its prior ruling in this case.

Note that legal opinions provided in this memo are those of the Executive Director and not binding upon the Commission if the issue presented is heard by them.

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October 17, 2012

Via Federal Express

Jeff DeRouen
Executive Director
Public Service Commission
211 Sower Boulevard, P.O. Box 615
Frankfort, Kentucky 40602-0615

Re: *In the Matter of: Notice and Application of Big Rivers Electric Corporation for a General Adjustment in Rates*, PSC Case No. 2011-00036

Dear Mr. DeRouen:

Big Rivers Electric Corporation ("*Big Rivers*") received today a copy of a letter dated October 15, 2012, from Serge Gosselin of Alcan Primary Products Corporation ("*Alcan*") to the Hon. Dorsey Ridley. The four-page letter critiques the September 30, 2012, *Energy Rate Impacts on Kentucky Industry* report, and makes statements that are directly related to issues pending in the rehearing in this matter, which is submitted to the Public Service Commission ("*Commission*") for decision. A copy of that letter is attached. The letter shows that it has been copied to twenty-four persons, including Chair Armstrong, Vice-Chair Gardner and Commission Breathitt.

This letter constitutes an inappropriate *ex parte* communication between a party and the decision makers in this case under any definition of that term. Big Rivers asks that the Commission disregard the letter, and take appropriate steps to assure that the contents of the letter are not considered in any respect in the Commission's deliberations in this case. We know that the Commission and all parties to this matter are as concerned as Big Rivers that the integrity of this proceeding is protected, and that the final decision of the Commission is untainted by this inappropriate communication.

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Copies of this letter and attachment have been served today on each person shown on the attached service list. Please contact us if you have any questions.

Sincerely yours,

James M. Miller

James M. Miller

JMM/ej
Enclosure

cc: Mark A. Bailey
Albert Yockey

SERVICE LIST
BIG RIVERS ELECTRIC CORPORATION
PSC CASE NO. 2011-00036

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October 15, 2012

The Honorable Dorsey Ridley
Senate of the Commonwealth of Kentucky
702 Capitol Ave
Annex Room 255
Frankfort, Kentucky 40601

Dear Senator Ridley:

We address this letter to you as the member of the Kentucky Senate representing the 4th District and as a member of the Interim Joint Committee on Natural Resources and Environment. The 4th District is the home of the Sebree Smelter and encompasses the area in which so many of our employees reside.

As you know, on October 4th Christenson Associates Energy Consulting LLC (the "Consultant") issued and presented to the Interim Joint Committee its report, dated September 30, 2012, on *Energy Rate Impacts on Kentucky Industry* (the "Report"). In the intervening days we have reviewed carefully the contents of the Report. It is an understatement to say that we are very disturbed and disappointed with the Report. We are especially disturbed by a number of the underlying premises, both expressed and implied, in the Report and the implications and conclusions that the Report draws from them. These include, among others, that:

- the aluminum industry in the United States in general, and the Commonwealth of Kentucky in particular, is doomed to failure and that nothing can or should be done to save it;
- the future of the aluminum industry in the United States is foretold by the substantial decline in the number of aluminum smelters in the United States that has occurred over the past 30 years and not the success of those that have continued to survive and which afford substantial benefits to the local and broader communities;
- in order to survive, the aluminum industry in the United States requires electricity prices that compete with the world average for aluminum smelters of $26 per megawatt hour;
- the cost of any solution resulting in the survival of the aluminum industry will be borne solely by the other customers and ratepayers of Big Rivers and by the taxpayers of the Commonwealth of Kentucky; and
- the data provided by the Sebree Smelter regarding employee compensation and the direct and indirect contribution to larger economy is inflated and have no value.

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We believe the Report either ignores completely, or merely glosses over, a number of points that deserve attention. These include the following:

- While the number of aluminum smelters in the United States has declined substantially over the past 3 decades, there are smelters currently thriving in other parts of the country. They survive and thrive because of a combination of factors, including continuous efforts to improve efficiencies and in some instances the support of state and local government. It is noteworthy that of the nine remaining aluminum smelters in operation in the United States, five are receiving some form of relief from the utility (and by extension their other ratepayers). It is even more telling that of the four smelters that are receiving no relief, two are located in Kentucky. The Sebree Smelter, solely through internal initiatives and actions, has placed itself near the first quartile of all aluminum smelters worldwide in business operating costs. Moreover, the geographic location of the Sebree Smelter and that of its primary end-customers, the applicability of the Midwest Premium, and short lead times from order to delivery, further help to offset partially higher than average electricity costs. In reality, the fact that the Sebree Smelter does not receive any relief places it at an economic disadvantage when compared to those other smelters which do receive relief in one way, shape, or form.

- In order to survive, it is not necessary that the Sebree Smelter obtain electricity at a price that competes with the world average for aluminum smelters of $26 per megawatt hour. To suggest that the Sebree Smelter is seeking this degree of relief is incorrect and artificially increases the amount of relief that is necessary. As a consequence, it makes any suggestion that relief is appropriate immediately both unattractive and untenable to other ratepayers. The proposal of $26 per megawatt hour was presented more than a year ago and then only in the context of creating up to 500 additional direct jobs in a downstream cluster adjacent to the plant. We understand that this is not currently an objective of the Commonwealth of Kentucky. The Sebree Smelter has made it clear that it does not require electricity at $26 per megawatt hour for sustainability <u>in the short to medium term</u>. Indeed, it has never asserted that it requires electricity at even market price (which is substantially higher than $26 per megawatt hour). We believe that the size of relief necessary can be both managed and mitigated.

- The Report emphasizes that the entire cost of relief will be borne by the ratepayers and perhaps the taxpayers of the Commonwealth of Kentucky. The Report glosses over the fact that if one or both of the aluminum smelters in Kentucky closes, the ratepayers will still face a substantial rate increase to offset the loss of revenues faced by Big Rivers. To add further injury, closure of one or both of the aluminum smelters will have a devastating impact on the economy of the Commonwealth of Kentucky. The reality is that the ratepayers will face an increase in any event but with the aluminum smelters still in operation there are means of mitigating the amount and the impact of those rate increases.

- With regard to the Report's contention that the employment compensation data and the direct and indirect contributions to the economy are overstated by the Sebree Smelter, the model used is accepted and used statewide and even internationally. In addition, we note that the testimony of Professor Paul Coomes, filed with the Kentucky Public Service Commission in May 2011, identified a loss of 4,733 jobs resulting from the closure of both smelters. Regardless, what is important, and what is undeniable, is that the closure of one or both of the aluminum smelters will have a damaging effect on direct, indirect, and induced employment, the tax base, and numerous other aspects of life in the Commonwealth of Kentucky.

We are especially distressed and disturbed by the overall tenor of the Report and its failure to offer, explore, or discuss creative approaches that have been and are being used in other jurisdictions, or that might be considered in the Commonwealth, to maintain and preserve the industrial base, including especially the aluminum industry. The Report is little more than a thinly veiled endorsement of the direction selected by Big Rivers and is more concerned with its survival than the survival of its two largest customers.

Even though Rio Tinto plc, the ultimate corporate parent of the Sebree Smelter, has indicated its intention to sell the Sebree Smelter, there remains a strong and continued commitment to, and interest in, the long term sustainability and success of the Sebree Smelter. In this regard, I note that in the past 5 years more than $100 million has been invested in improvements to the Sebree Smelter, including a $32 million bake furnace modernization project in 2011 and a $20 million anode process project to increase production this year. Indeed, at this very moment work continues on a project that will allow the Sebree Smelter to increase its production capacity in the future.

Rio Tinto, and even more importantly, the employees of the Sebree Smelter believe in the future of the Sebree Smelter and its importance to the local community, the Commonwealth of Kentucky, and the industrial base of the United States. The Sebree Smelter is alone responsible for nearly 1,800 direct, indirect, and induced jobs in the region. Annual payroll and benefits to the employees of the Sebree Smelter exceeds $50 million. The Sebree Smelter purchases annually goods and services from suppliers in Kentucky in excess of $16 million and more than an additional $100 million in electricity from Kenergy Corp. and its supplier, Big Rivers Electric Corporation. Annual contributions by the Sebree Smelter to local not-for-profit organizations exceed $150,000. The economic impact on, and the importance of the Sebree Smelter to, the larger community is substantial.

The Report pays lip service to these economic impacts and then dismisses them with a wave of the hand. The Report concludes that it is better to spend money retraining employees for as yet undetermined and non-existent jobs rather than to offer or find any creative and innovative solution to preserve existing jobs, the existing tax base, and create an atmosphere and environment for enhancing and expanding the economic and industrial base in the Commonwealth of Kentucky. The Report fails to even intimate what that other work might be, especially at a time when there already exists double digit unemployment. The Report does not address how other businesses that have compensation comparable to those of the aluminum smelters can be attracted to the Commonwealth of Kentucky --- especially after the failure of the Commonwealth to support the aluminum industry.

Despite the tone and conclusions of the Report, we remain convinced there is a solution that exists that will result in the long term survival and sustainability of the Sebree Smelter and the larger aluminum industry in Kentucky. That solution, which might involve a "market supply," "cost of service," or some other approach, can be structured in such a manner as to allow the aluminum smelters to survive and be

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sustainable for the long term and at the same time reduce the impact on the other ratepayers. Finding the right solution and the right balance of interests requires creativity and the will and cooperation of everyone, including the Sebree Smelter, Big Rivers, and the Commonwealth of Kentucky (including the Governor, the Legislature, and the Public Service Commission).

We urge you and your colleagues to not be guided or influenced by the Report and its pessimism toward the future of the aluminum industry in Kentucky. Other states, including Ohio, Washington, and West Virginia, are struggling with the same issues and are working on creative solutions to maintain the presence of the aluminum industry and ensure its continued sustainability. While there can be no guarantee of success, the failure to even try carries with it the certainty of failure.

We stand ready and willing to work with you and your colleagues on this very important matter.

Very truly yours,

Serge Gosselin
General Manager

Copy:

The Honorable Steve Beshear, Governor of the Commonwealth of Kentucky
Mr. Larry Bond, Chief of Staff
Mr. Larry Hayes, Secretary, Cabinet for Economic Development
Dr. Len Peters, Secretary, Energy and Environment Cabinet
Senator David Williams, Kentucky Senate President
Senator Robert Stivers, Kentucky Senate Majority Leader
Representative Greg Stumbo, Kentucky House Speaker
Representative Rocky Adkins, Kentucky House Majority Leader
Senator Brandon Smith, Co-Chair of Interim Joint Committee on Natural Resources and Environment
Representative Jim Gooch, Jr., Co-Chair of Interim Joint Committee on Natural Resources and Environment
Ms. Tanya Monsanto, Staff Administrator of Interim Joint Committee on Natural Resources and Environment
Representative John A. Arnold
Representative David Watkins
Congressman Ed Whitfield, United States Congress
Mr. David L. Armstrong, Chairman, Kentucky Public Service Commission
Mr. James W. Gardner, Vice Chairman, Kentucky Public Service Commission
Ms. Linda Breathitt, Commissioner, Kentucky Public Service Commission
Mr. Jeff DeRouen, Kentucky Public Service Commission
Ms. Stephanie Bell, Kentucky Public Service Commission
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Via Overnight Mail

October 18, 2012

Mr. Jeff Derouen, Executive Director
Kentucky Public Service Commission
211 Sower Boulevard
Frankfort, Kentucky 40602

Re: ***In the Matter of: Notice and Application of Big Rivers Electric Corporation for a General Adjustment in Rates,*** **Case No. 2011-00036**

Dear Mr. Derouen:

Kentucky Industrial Utility Customers, Inc. ("KIUC") submits this letter in response to the letter filed by Big Rivers Electric Corporation ("Big Rivers") on October 17, 2012 in the above-captioned docket. Big Rivers' letter responds to a letter sent to Kentucky Senator Dorsey Ridley by Alcan Primary Products Corporation ("Alcan") on October 15, 2012. Alcan's letter summarized its reaction to a recent report by Christenson Associates Energy Consulting LLC entitled *Energy Rate Impacts on Kentucky Industry* ("Report"). Noting that Commissioners of the Kentucky Public Service Commission ("Commission") were copied on Alcan's letter, Big Rivers alleges that the letter "constitutes an inappropriate *ex parte* communication between a party and the decision makers" in the above-captioned case.

Big Rivers' reaction to Alcan's letter is unwarranted. The Commission itself was an integral part of the legislative process that procured the Report. Hence, it is perfectly appropriate for the Commission to read the Report itself and any stakeholder's response to or critique of the Report. Moreover, the Report presents larger global issues that are far different from the discreet issues involved in this case. The Commission is perfectly capable of separating those global issues from the specific issues involved in this case. Further, Alcan's letter was in no way intended to influence the Commission in this case, to become part of the record in this case, or to serve as a basis for the Commission's ultimate decision in this case. The Commission itself has already clarified that events occurring after November 2011 are irrelevant to this case. For these reasons, Alcan's letter is by definition not an *ex parte* communication, and KIUC respectfully takes exception to Mr. Miller's characterization.

Very Truly Yours,

Michael L. Kurtz, Esq.
Kurt J. Boehm, Esq.
BOEHM, KURTZ & LOWRY

MLKkew
cc: Certificate of Service
David C. Brown, Esq.

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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing was served by electronic mail (when available) or by mailing a true and correct copy by overnight mail, unless other noted, this 18th day of October, 2012 to the following

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Kurt J. Boehm, Esq.

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