

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

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

Case No. 2013-00199

ATTORNEY GENERAL'S POST-HEARING BRIEF
PUBLIC REDACTED VERSION

Respectfully submitted,
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Comes now the intervenor, the Attorney General of the Commonwealth of Kentucky, by and through his Office of Rate Intervention, and states as follows for his post-hearing brief in the above-styled matter.

Introduction

Big Rivers Electric Corporation ["Big Rivers" or "BREC"] is a not-for-profit generation and transmission cooperative ["G&T"] serving approximately 113,000 customers in western Kentucky.¹ However, Big Rivers, over the course of several decades, built 70% of its electric generation and transmission capacity to serve just *two customers* ² under special contracts. These industrial customers, aluminum smelters Located in Hawesville and Sebree Kentucky, respectively, carried a combined load of approximately 850 MW, or enough energy to serve as many as 800,000 homes.³ The aluminum smelting industry is subject to extreme price volatility; indeed, world-wide

¹ See Big Rivers' website at <http://www.bigrivers.com/intro.aspx>. BREC states as its mission that it "exists for the principal purpose of providing the wholesale electricity requirements of its three distribution cooperative member-owners" Direct Testimony of David Brevitz, p. 49, line 5.

² See, "Energy Rate Impacts on Kentucky Industry," Executive Summary at p. X, of which the Commission can take administrative notice, at:

http://www.caenergy.com/downloads/Morey_Kirsch_Kentucky_Energy_Rate_Impacts_2012.pdf

³ See, e.g., <http://answers.yahoo.com/question/index?qid=20100503225758AAcZLtb>.

aluminum prices have been depressed for many years.⁴ The historically contentious relationship between Big Rivers and its two-largest customers has been well-established over several decades throughout multiple cases heard before the Kentucky Public Service Commission ["PSC" or "Commission"] and appealed to and through the Kentucky court system. It is fair to say that this contentious, yet symbiotic relationship has drained the attention, energy and resources of Big Rivers' management, the Commission, and Kentucky policymakers. Moreover, this antagonistic interconnection has played a key role in causing several periods of major financial hardship for Big Rivers.⁵ In fact, both smelters have now left BREC's system altogether, which has placed Big Rivers in the current, and most precarious financial crisis in its history.

BREC's controversial solution to this crisis, for which it continues to seek the approval of the Kentucky Public Service Commission, is to ask its remaining 112,998 customers -- who were not responsible for causing the costs of providing service to the two smelters -- to pay for the excess capacity that the smelters leave in their wake after exiting BREC's system. In fact, BREC's system is now more than twice as large as it needs to be to serve its entire remaining captive native load. The two smelter customers together consumed over 70% of BREC's power production and provided at least 66% of

⁴ See, e.g., "Aluminum: Shock and Ore," *Financial Times*, <http://www.ft.com/intl/cms/s/0/5912a91e-0ed0-11e2-9343-00144feabdc0.html>.

⁵ For more on this history of Big Rivers' financial difficulties and troubled relationship with the smelters, see the Attorney General's post-hearing brief filed in Case No. 2012-00535 at: http://www.psc.ky.gov/PSCSCF/2012%20cases/2012-0535/20130726_AG_Post%20Hearing%20Brief.pdf

its revenues.⁶ BREC's proposal is all the more troubling because it comes in an era of sharply depressed off-system sales ["OSS"].⁷ Therefore, OSS cannot serve to mitigate the amount of the rate increases being forced onto the backs of BREC's remaining captive ratepayers.

BREC incurred major costs in order to build the utility infrastructure necessary serve the smelters, and the smelters were paying those costs while they remained on BREC's system. However, the smelters have now left BREC's system by virtue of obtaining market-priced power. Since the smelters' departure, BREC is left with a great deal of *excess capacity* (850 MW of generation in the Wilson and Coleman generating stations), for which BREC is asking its remaining captive ratepayers to pay. In fact, BREC maintains that it is fair, just and reasonable to require the company's remaining captive ratepayers to pay those costs. Those captive ratepayers, as demonstrated in their public comments, are especially troubled by this proposal because they themselves have never needed or used most of this excess capacity, and now are being asked by BREC to shoulder the full fixed cost of that excess capacity.

The Office of the Attorney General, in Case No. 2007-00455 ["the Unwind Case"], was the sole party to oppose BREC's proposal to reacquire the responsibility and risk associated with generation and transmission assets, after another utility had operated those assets for a period of time following BREC's 1994 bankruptcy. In that case, the Attorney General's witness, David Brevitz, could not support the transaction as

⁶ See Standard & Poor's ratings downgrade of Feb. 4, 2013, p. 2, filed in Direct Testimony of Billie Richert, Case No. 2013-00199, Exhibit Richert-4.

⁷ Bailey direct testimony, p. 5 lines 11-13.

proposed due to a lack of due diligence on BREC's part, and forecasts showing extensive rate increases facing BREC's rural class of ratepayers if the Commission approved the transaction, among other reasons.⁸ The concerns raised by the Attorney General in the Unwind Case have now, in fact, come to pass.

The Attorney General, charged with representing the interests of BREC's ratepayers in this matter, believes that BREC's proposed solution, if approved, will lead to unfair, unjust and unreasonable utility rates for the Western Kentucky ratepayers remaining on BREC's system, and could cause other ratepayers to leave BREC's system. The consequences to ratepayers, and to the Commonwealth's economy, of the outcome of this proceeding are potentially the most urgent this Commission has confronted.

FACTUAL BACKGROUND

As part of the transaction approved in the Unwind Case, the two smelters negotiated special contracts for the price of power. These 2009 electric service agreements ["2009 Retail Agreements"] obligated BREC, as the wholesale generation and transmission provider, and its member-owner Kenergy Corporation ["Kenergy"], to provide service for the smelters, and were lauded by the virtually all of parties to the Unwind transaction as a solution for years to come. Shortly after the Unwind was consummated, however, the smelters began discussions with BREC seeking even further concessions on the price of power. By January of 2012, the nature of those discussions took on a significantly different turn when Century and Alcan first began

⁸ See Supplemental Direct Testimony of David Brevitz, Case No. 2007-00455 (in particular pp. 3-8), at http://www.psc.ky.gov/PSCSCF/2007%20cases/2007-00455/20081121_AGs_Brevitz_Testimony.PDF

discussions with BREC regarding the smelters' desire to obtain market-priced power⁹ – which was completely the opposite of the smelters' position in the Unwind Case, in which they wanted to avoid market-priced power.¹⁰ The management of both smelters also began meetings with state officials in the first few months of that year, and a meeting with the Kentucky Legislature occurred in March 2012.¹¹ Big Rivers recognized the possibility of the smelters' departure from its system, and as a result began developing its "Load Concentration Analysis and Mitigation Plan" ["Mitigation Plan"]¹² in the November, 2011 – January, 2012 timeframe, at least six (6) – eight (8) months¹³ before it was completed, in June, 2012.¹⁴ The Big Rivers' Board of Directors was advised of the Mitigation Plan from the very outset of that process.¹⁵

Even while BREC was making plans for the smelters' departure, on March 28, 2012, the company filed an application in Case No. 2012-00119, seeking permission to issue new debt in the sum of \$537 million from CoBank and National Rural Utilities Cooperative Finance Corporation ["CFC"].¹⁶ The purpose of this new financing was to prepay existing Rural Utility Service ["RUS"] debt in the amount of \$442 million; to fund \$60 million in new capital expenditures; and to use \$35 million to replenish the

⁹ Bailey Cross-Examination, January 7, 2014 Video Transcript of Evidence ["VTE"] at approximately 12:16:00 – 12:16:31.

¹⁰ Case No. 2007-00455, Order dated March 6, 2009, pp. 14-16.

¹¹ Bailey Cross-Examination, Jan. 7, 2014 VTE at approximately 12:16:00 – 12:16:31.

¹² Provided as a confidential attachment to BREC's response to Post-Hearing Data Request No. 4. BREC in this report (p. 9) describes the mitigation efforts the company will take upon closure of a smelter.

¹³ Bailey Cross-Examination, Jan. 7, 2014 VTE at 13:51:35 – 13:52:05.

¹⁴ *Id.* at approximately 12:19:00; 13:45:12.

¹⁵ *Id.* at 13:50:30.

¹⁶ See application in that case, numerical paragraph 13.

http://www.psc.ky.gov/PSCSCF/2012%20cases/2012-00119/20120328_Big_Rivers_Application.pdf. The PSC issued its Final Order approving BREC's application in that case on May 25, 2012.

Transition Reserve created in the Unwind Case, which had been used to prepay on the RUS Note on April 1, 2011. This refinancing proposal served to greatly reduce RUS's exposure to Big Rivers' risks associated with concentrated load, and transfer those risks to CoBank and CFC.

As required by the terms of its Series 1983 Ohio County Pollution Control Refunding Bonds,¹⁷ Big Rivers filed a Disclosure Statement dated July 12, 2012,¹⁸ in which BREC disclosed to the public and its lenders: (1) that the two smelters had advised Kentucky State Government officials that they "could not envision a future with Big Rivers;" (2) that BREC's rates were "not sustainable;" (3) that BREC's rates placed the smelters' viability at great risk; and (4) that there could be no assurances that one or both smelters would not give their one-year notice of termination.¹⁹ Two weeks later, on July 27, 2012,²⁰ BREC and its lenders closed on the new financing—in excess of one-half billion dollars.

As predicted in the disclosure statement, however, events did indeed take a sharp turn for the worse barely three weeks later when on August 20, 2012, Century

¹⁷ Those bonds were "being held as bank bonds by the liquidity provider, bearing an interest rate of 3.25%, as the remarketing agent has been unsuccessful at marketing them at the prescribed maximum rate, 120% of the variable rate index." See Big Rivers' July 12, 2012 Disclosure Statement, introduced as OAG Hearing Exhibit 6, p. 22 in the original pagination.

¹⁸ See OAG Hearing Exhibit 6. This document was provided in discovery for the first time on Jan. 3, 2013, in Case No. 2012-00492, in response to KIUC 1-9, pp. 295-459. This document was prepared by BREC's previous Chief Financial Officer, Mark Hite and filed at approximately the same time as his departure from BREC. See Richert cross-examination, Jan. 7, 2014 VTE at 17:44:40 - 17:45:35.

¹⁹ See OAG Hearing Exhibit 6, pp. 39-40.

²⁰ On this same date, perhaps coincidentally, Mark Hite, Big Rivers' then-Vice President of Accounting and Interim CFO, left the company as the refinancing documents were being executed, according to a company press release issued ten days earlier:

<http://www.bigrivers.com/documents/MarkHiteretires.pdf>. See also Case No. 2012-00063, BREC's letter to the Commission filed July 27, 2012, indicating Mark Hite had resigned to accept another position:

http://www.psc.ky.gov/PSCSCF/2012%20cases/2012-00063/20120727_Big%20Rivers%20Witness%20Substitution%20Table.pdf.

Aluminum – BREC's single-largest power consumer – gave notice to BREC and its local distribution cooperative Kenergy that Century would exercise its option to terminate the 2009 Retail Agreements for the supply of electricity that Century consumes at its Hawesville aluminum smelter. Only two days after Century submitted its termination notice, Moody's on Aug. 22, 2012 downgraded BREC's credit rating to Baa2, and a few days later, Fitch and S & P both placed BREC's credit on negative watch.²¹

On November 14, 2012, BREC filed a new financing application in Case No. 2012-00492, in which it sought to refinance its maturing Series 1983 Ohio County pollution control bonds with new, Series 2013A bonds.

On December 4, 2012, BREC, pursuant to its Mitigation Plan, filed its notice of intent in Case No. 2012-00535 that it would seek to raise rates, primarily to replace \$63 million in contribution to margins the company would lose when the Century Hawesville smelter left BREC's system.²² Significantly, a portion of the proposed massive rate increase in that case was designed to impose a \$25.551 million annual increase on the then-remaining smelter,²³ then BREC's second-largest customer, Alcan Primary Products Corporation ["Alcan"], relating to its Sebree aluminum smelting facility.²⁴

²¹ See Case No. 2012-00492, application at p. 7.

²² Bailey Rebuttal Testimony, p. 6, wherein he states Century Hawesville's power purchases contributed \$205 mil. to BREC revenues in 2012, while Century Sebree's facility contributed \$155 mil.

²³ Bailey Direct Testimony, Case No. 2012-00535, pp. 12-13.

²⁴ Subsequent to that time, Alcan sold its Sebree smelter to Century. See, e.g., article, "Century Completes Acquisition of Sebree Smelter," at the following link:

<http://www.courierpress.com/news/2013/jun/03/century-completes-acquisition-of-sebree-aluminum/?print=1>].

On January 24, 2013, the company amended the application in the financing Case No. 2012-00492, stating it:

“. . . has decided that the potential cumulative impact on prospective bond purchasers of the Century Aluminum notice to terminate its retail service agreement, the uncertainty about the outcome of Big Rivers' pending rate case, and the impact of that rate case on Alcan Primary Products Corporation's Sebree facility weigh in favor of postponing the offering of debt until some or all of that uncertainty has been eliminated.”²⁵

One week after the Amended Application was filed in the financing case, and not even eight (8) weeks after BREC filed its rate case in Case No. 2012-00535, Alcan provided its Notice of Termination on January 31, 2013. Just a few days following Alcan's January 31st notice of termination, Standard & Poor's on Feb. 4, 2013 downgraded ²⁶ Big Rivers to BB-, a rating below investment grade. Additional downgrades from Moody's [downgrade to Ba1], and Fitch [downgrade to BB with negative outlook] quickly followed.

In response to Alcan's notice of termination, Big Rivers filed a second base rate (the instant case, 2013-00199), even before the hearing in Case No. 2012-00535 had been held. In this current case, BREC seeks an additional \$71.2 mil.²⁷ in new revenues from its remaining captive ratepayers, virtually all of which would go to replace revenues and contribution to margins lost from serving the Sebree smelter load. As such, BREC continues to seek a rate case solution to its revenue problems by asking its captive

²⁵ Case No. 2012-00492, Amended Application, paragraph 2.

²⁶ This ratings action applied to both the company itself, and to its Series 2010A Ohio County pollution control bonds.

²⁷ This revised figure is increased from the original amount of \$70.4 mil. set forth in BREC's application. See Wolfram Rebuttal Testimony, p. 36, lines 7-8.

ratepayers to pay stranded costs which the two smelters avoided by leaving Big Rivers' system, the majority of which system was built to serve those two customers.^{28, 29} This includes \$25.551 million in increased revenues which Big Rivers sought to assess to the Century Sebree smelter in the 2012-00535 case, but which Century Sebree has avoided paying by leaving BREC's system and instead obtaining market-priced power.³⁰

BREC's pre-filed direct testimony in both Case Nos. 2012-00535 and 2013-00199 indicate that the company's OSS, upon which the company relies for almost all of its margins, have been depressed,³¹ and in fact have been depressed since at least 2010.³² The company attempted to deal with this depressed OSS market by reducing maintenance, deferring outages, cutting costs and by filing for an increase in base rates³³ in Case No. 2011-00036.³⁴ None of those measures, however, were enough to stem the massive loss of revenues the company has experienced from losing nearly 66% of its stream of revenue.

²⁸ See, e.g., Bailey Direct Testimony, p. 5 lines 14-23; p. 6 lines 1-7.

²⁹ In Case No. 2012-00221, the Commission in its final order dated Aug. 14, 2013 approved new contracts filed by BREC and Kenergy which allowed Century Hawesville to leave BREC's system, and to instead obtain market-priced power from MISO. In Case No. 2013-00413, the Commission in its final order dated Jan. 30, 2014 approved of similar contracts allowing the Century Sebree smelter to leave BREC's system and instead obtain market-priced power.

³⁰ Case No. 2013-00199, Bailey Direct Testimony, p. 5. Note that the proposed Alcan revenue increase figures differ between the cases.

³¹ Bailey Direct Testimony, p. 5 lines 11-13.

³² See, e.g., Case No. 2012-00535, Bailey Direct Testimony, p. 8.

³³ *Id.*

³⁴ Notice of intent filed Jan. 31, 2011; Final Order dated Nov. 17, 2011, granting an increase in base rates of \$26.744 mil.; the Final Order on Rehearing dated Jan. 29, 2013, granted an additional \$1.042 mil. in new revenues, for a total of \$27.787 mil. in new revenues; see Final Order on Rehearing at pp. 24-25.

On October 29, 2013, the PSC issued its Final Order in Case No. 2012-00535, awarding BREC \$54.227 million in new revenues,³⁵ amounting to 73% of the amount BREC initially requested. Despite this significant increase, Big Rivers unfortunately maintains that its financial difficulties have continued, due primarily to the loss of the Sebree smelter's load. If the Commission should award the full amount of revenues BREC seeks in the instant case, then the effect of the rate increase from Case No. 2012-00535, when combined with new revenues from the instant case, would be to raise "all-in rates"³⁶ for Rural class ratepayers 108.9% at wholesale, and 69% at retail, while the increase for Large Industrial ratepayers would be 107%.³⁷

ARGUMENT

1. BREC's Proposed Rates are Unfair, Unjust and Unreasonable, as Public Comments and Evidence in the Record Unequivocally Reveal

- *"We can't keep raising the rates, it's got to stop someplace . . . They got us by the neck, we're stuck and can't buy our power from anyplace else, and they control it. They are killing us"³⁸. . . I feel like that Century got off scot free and we are left, like I said, left holding the bag."³⁹*

Unlike Big Rivers, which has the ability to sell its power to multiple parties, BREC's members are captive customers who sell only to their own captive ratepayers,

³⁵ Case No. 2012-00535, Final Order dated Oct. 29, 2013. The increase amounted to a 15.5% increase in wholesale rates. The Commission also did not allow BREC to recover depreciation expense for the to-be-idled Coleman plant during the period of its lay-up, instead deferring recovery of those expenses to a later date. *Id.* at pp. 32-33. This adjustment reduced BREC's test-year revenue request by \$6,192,660. *Id.* at 33.

³⁶ The term "all-in rates" includes environmental surcharge rates and fuel adjustment charge rates, together with base rates.

³⁷ See Direct Testimony of Lane Kollen, pp. 12-15. This percentage would equate to an additional \$838 per year for the average residential customer on an all-in basis.

³⁸ Larry Heistand, Dec. 17, 2013 Public Comment Hearing, video transcript at 9:12; 10:38.

³⁹ Peggy Nance, *Id.* at 13:40.

by virtue of the Commonwealth's territorial service law,⁴⁰ and as such, they lack the Commission-approved ability of Century's Hawesville and Sebree smelters to obtain market-priced power.⁴¹ As a result, Big Rivers' ratepayers are in a struggle for survival.

- *"More of our income comes from industry than about any other county in the country. . . it truly impacts us as far as attracting new industry to the area. . . we have gone from one of the lowest rates in the state of Kentucky to one of the highest."*⁴²

Big Rivers has employed a strategy of filing continual rate cases in order, illogically and contrary to the regulatory compact, to maintain and possess generating capacity that exceeds its remaining, captive load by approximately 1,169 Megawatts, or 180%.⁴³ In fact, BREC's CEO testified that should the next-largest industrial load (40 MW) leave BREC's system, it would create revenue concerns that might lead to another rate increase.⁴⁴ This strategy will devastate the many industrial customers located within the service territories of its members Kenergy and Jackson Purchase.⁴⁵ As demonstrated in the testimony of several KIUC members, many of BREC's customers

⁴⁰ KRS 278.016.

⁴¹ As the Commission noted in Case No. 9613: ". . . BREC's ratepayers, unlike shareholders in investor-owned utility, do not vote their stock in proportion to their economic interest, nor could they sell their stock if they disagreed with management decisions." Order dated March 17, 1987, p. 30.

⁴² Richard Basham, President of Hancock County Industrial Foundation, Dec. 17, 2013 Public Comment Hearing, video transcript at 17:55, 18:21, and 18:58. See also comments of Hancock County Judge Executive Jack McCasland, "This will be devastating to industry." Jan. 7, 2014 VTE at approximately 10:22:00.

⁴³ Holloway Direct Testimony, p.7, L6-11.

⁴⁴ Baily Cross-Examination, Jan. 7, 2014 VTE at approximately 11:13:30.

⁴⁵ In the 1980s, BREC was going through other financial difficulties that led to the development of a workout plan with its creditors [which ultimately failed]. The Commission, as set forth in Case No. 9613 (Order dated March 17, 1987, pp. 16-17), noted that the workout plan:

" . . . was thus achieved by merely deferring present financial obligations to future periods and thereby committing Big Rivers' ratepayers to two projected rate increases, in 1989 and 1991, and an indeterminable number thereafter. Rather than provide a workable solution, the plan would intensify the climate of uncertainty. The result would very likely be a severe erosion in the economic base – including the aluminum industry that supports the Big Rivers system. This would be a disastrous result not only for Big Rivers and its customers, but also for its creditors." [Emphasis added].

will lose their competitive edge and are already becoming desperate to find solutions.⁴⁶ Adversely-affected businesses may have no other choice but to leave, and will take many good-paying jobs with them.⁴⁷ In concert with other responses businesses and consumers will make to reduce their demand through energy efficiency and other measures, this is certain to create a death spiral for BREC, a tide that even a Commission-approved rate case solution will not be able to stem, and in fact will only exacerbate. The existence of any plan to mitigate rate increases to BREC's remaining industrial customers is conspicuously absent in this case.

- *"People that live on the opposite side of the street can pay as much as 40-50% more just because of who has the monopoly rights essential to their jurisdiction. . . They have always known, or at least they should have known, they were always vulnerable to the aluminum industry and the peaks and valleys that are included in it. . . Big Rivers should return to what its original goal was – to be a low cost producer of electricity."*⁴⁸
- *"I am concerned about the impact it is going to have on the overall competitiveness of this area. . . I don't want to have to wind up in another rust belt arrangement here, and that is what you are headed to."*⁴⁹
- *"Being a board member of the JPEC [BREC member coop Jackson Purchase Energy Cooperative] Board of Directors for the past 15 years, and a member of the coop for the past 55 years, I have seen the ups and downs of Big Rivers... The cooperative program was started for the people and small businesses of America. These people...have been pushed to the bottom of the food chain....These people will pay their fair share, but let us*

⁴⁶ See, e.g., direct testimony of Steve Henry on Behalf of Domtar Paper, p. 4, line 3, wherein he states the 111% all-in increase the company would experience from the combined increases in both Case No. 2012-00535 and 2013-00199 will leave Domtar's Hawesville mill with the highest power rates of any of the company's five (5) U.S.-based mills; and direct testimony of Bill Cummings on behalf of Kimberly-Clark, wherein he states the 112% combined all-in rate increase from both cases for his company (pp. 5-6) will leave the Owensboro mill with the highest per unit rates of any Kimberly-Clark tissue mill in the U.S. (p. 4, lines 8-10), which in turn may force the company to expand its co-gen facility and leave the BREC system, which would reduce BREC's native load by an additional 9.4% (p. 7, lines 22-23 – p. 8 line 1).

⁴⁷ See KIUC Hearing Exhibit 8, *"The Vulnerability of Kentucky's Manufacturing Economy to Increasing Electricity Prices,"* published by the Commonwealth of Kentucky Energy and Environment Cabinet.

⁴⁸ Chuck Stagg, Dec. 17, 2013 Public Comment Hearing, video transcript at 20:07, 22:54, and 25:30.

⁴⁹ Michael Hunter, *Id.* at 29:34, and 29:53.

make them pay ONLY their fair share and make those higher on the chain step up and bear their part of the higher costs that are going to occur.”⁵⁰

BREC’s continual rate case solution will fundamentally alter the core economy within Big Rivers’ territory, and will make it vastly uncompetitive with its neighboring utilities. BREC’s failure to recognize or admit to any elasticity of demand for its large industrial class⁵¹ will only further exacerbate the situation, and will likely lead to a death spiral as previously noted. Both Big Rivers – *and its lenders* – were well aware of the *extraordinary risk* this utility faced in serving the concentrated load of two aluminum smelters, a risk which had already been an aggravating factor in BREC’s bankruptcy in the 1990s.⁵² History conclusively proves that unbalanced and unjust utility rates yield high unemployment and poverty, and leave governments lacking the revenue necessary to meet their constituents’ needs.⁵³

⁵⁰ Mr. Jack Marshall, Jackson Purchase RECC Board of Directors Member. Public Comment Hearing, Jan. 8, 2014, VTE at 10:44:30 – 10:46:00. Mr. Marshall testified on behalf of Jackson Purchase, not as an individual. Bailey cross-examination, Jan. 9, 2014 VTE at approximately 11:58.

⁵¹ See generally cross-examination of Lindsay Barron, Jan. 9, 2014 VTE at 11:06:20 – 11:06:31.

⁵² See the Commission’s ruling in Case No. 9613, Order dated March 17, 1987, pp. 13-13, wherein it stated:

“This overwhelming dependence on two huge customers creates a tremendous risk for the utility. If the aluminum industry goes sour, the result for Big Rivers and its 75,000 customers will be catastrophic. When the aluminum industry entered a deep recession beginning in 1983, Big Rivers found itself in a nightmarish position. To add to its misery, the utility’s remaining load growth had leveled off, the prospect of a synthetic fuels industry had evaporated, and the \$900 million Wilson Unit No. 1 was nearly completed. Big Rivers was paying the price for being basically a one-industry utility.” [Emphasis added.]

⁵³ See, e.g., public comments of Rita Stevens, Mayor of City of Hawesville, who stated “We have had all we can take. City services are dependent on electricity. We have infrastructure way past due for replacement.” In the aftermath of Big Rivers’ rate increase authorized in Case No. 2012-00535, the city’s electric bill has increased from \$6800.00 / mo. to \$9400.00 / mo., and has forced the city to raise its water rates. As a result, some city residents cannot afford to pay their water bills. Jan. 7, 2014 VTE at 10:24:30 – 10:27:18. See also public comments of Mr. Kyle Estes, Superintendent, Hancock County Public Schools, who stated that if Domtar Paper should close its mill, the school system would suffer a \$900,000 net revenue loss (8.5% of the district’s total budget). *Id.* at 10:19:50 – 10:20:20.

2. Generation Facilities Idled for Significant Periods Are by Definition Not “Used or Useful,” and Should Be Excluded from Big Rivers’ Rate Base

As a result of the departure of 70% of its load, Big Rivers obviously will be left with far more capacity than it needs. Moreover, BREC’s plans for idling both Wilson and all three of its Coleman units indicate the company intends to use the longer-term “mothballed” status to accomplish the idling.⁵⁴ This status is designed to insure that idled plants do not appreciably age or degrade while idled.⁵⁵ Additionally, the company acknowledged that it would take approximately 43 days to restore a unit from mothballed status, a procedure which would cost at least \$1.470 million.⁵⁶ BREC obviously intends for one or more of these generating units to be idled for years, and will not be able to return to active status without extensive work. Finally, the fact that the company has now publicly disclosed that one or even both plants are for sale is certainly strong evidence that the to-be-idled plant[s] are not “used or useful.”

Moreover, since the conclusion of the regular, non-rehearing issues in Case No. 2012-00535,⁵⁷ the Commission has now allowed both Century’s Hawesville smelter,⁵⁸

⁵⁴ See Case No. 2012-00535, BREC Response to PSC 2-21(e). Big Rivers indicated that in IEEE Std. 762-2006, there are three identified deactivated shutdown states. Of those, BREC states that it intends to utilize what this standard terms the “mothballed” status, meaning a “state where unit is unavailable for service, but can be brought back into service with the appropriate amount of notification, typically weeks or months.”

⁵⁵ Case No. 2012-00535, Holloway Direct Testimony, p. 33.

⁵⁶ Case No. 2012-00535, BREC Response to AG 1-111.

⁵⁷ Although the Commission in Case No. 2012-00535 stated that the Coleman plant is “excess capacity” (Final Order dated Oct. 29, 2013, p. 20) and excluded depreciation costs for the Coleman plant while it is in mothball status (*id.* at p. 19), nonetheless all fixed costs related to Coleman must be excluded for at least the time that Coleman is in mothball status, and its full value must be removed from Big Rivers’ rate base during that period.

⁵⁸ Case No. 2013-00221.

and its Sebree smelter,⁵⁹ to leave the BREC system. Therefore, the departure of both smelters from the BREC system will leave the company's ratepayers with the bill for major stranded costs which they will be paying for many years to come – absent Commission action.

These stranded costs offer perhaps the most solid evidence that Wilson and Coleman are not "used or useful," and therefore the value of both plants should be removed from the company's rate base.

Finally, ratepayers should only pay for the energy they use. It is axiomatic that the used or useful doctrine should apply to all plant which is not necessary to meet a utility's native load. In this case, even if the Wilson plant operates for two or potentially more months, it is still useful only for Big Rivers' merchant operation, i.e., solely for OSS. The fact that Wilson's extended operation is useful only for OSS graphically illustrates the immediate need to right-size BREC, perhaps by creating a merchant generation affiliate or taking some other action to separate the costs of BREC's merchant-generating function away from burdening BREC's remaining ratepayers.

A. The Commission and Kentucky Courts Have a Long History of Excluding Plant that Is Not "Used or Useful" from Utility Rate Base

Well-settled decisions of the Commission and Kentucky courts leave no doubt that the used or useful test has been, and continues to be a vital part of the statutory "fair, just, and reasonable" ratemaking standard.⁶⁰ The strong public policy behind the used and useful doctrine is needed today just as critically as it was in the past, because it provides a stern message to utilities: both companies and lenders are responsible for

⁵⁹ Case No. 2013-00413.

⁶⁰ See KRS 278.030(1).

insuring that facilities are deployed only when true need is clearly expected. Absent the used or useful doctrine, utilities and lenders are encouraged to pursue and continue bad decision-making.

" . . . [A] customer or consumer should not be required to pay for investments made by the utility which are of no benefit to the consumer. The "used and useful" concept protects against rates based upon such "useless" investments."⁶¹

In Fern Lake Co. v. Public Service Comm'n, 357 S.W.2d 701, 704-705 (Ky. 1962), the Court of Appeals held "excess facilities were not used or useful so as to be a proper factor in establishing a rate base" and that "over-adequate facilities" should be excluded for ratemaking purposes, "as a matter of law." In Blue Grass State Telephone Co. v. Public Service Comm'n, 382 S.W.2d 81, 82-83 (Ky. 1964), the Court adjusted that utility's rate base to exclude facilities "not entirely usable."

The rulings of the Commission reflect a similar adoption and implementation of the doctrine of used or useful. In its decision in In Re Kentucky-American Water Co., Case No. 8571 (Order dated February 17, 1983), the Commission held that ". . . [a] utility's rate base should include only those items of plant that are used and useful, i.e., reasonably necessary to provide adequate and efficient service."⁶² In In Re Kentucky Utilities Co., 52 PUR 4th 406, 436 (1983), the Commission excluded investment in a proposed electric generating plant because it "seems doubtful that the investment in

⁶¹ National-Southwire Aluminum Co. v. Big Rivers Elec. Corp., 785 S.W.2d 503, 518 (Ky. App. 1990), Wilhoit, J., concurring in part and dissenting in part.

⁶² Order dated Feb. 17, 1983, p. 7 (citing San Diego Land and Town Company V. Jasper, et. al., 189 U.S. 439 (1902)). In Case No. 8571, the Commission found that Kentucky-American had an excess capacity of 6 MGD, that shareholders should share \$903,037 of the cost of this excess capacity with the ratepayers, and thus removed that sum from rate base. *Id.* at 8.

Hancock will ever be used and useful for providing service." In In Re Kentucky Power Co., Case No. 8904,⁶³ the Commission excluded the cost of transmission ". . . facilities greatly in excess of jurisdictional needs constructed to meet the needs of non-jurisdictional customers." In In Re Kentucky Power Co., Case No. 8734 (56 PUR 4th 151, 156, Order dated September 20, 1983), the Commission excluded property not needed for nine years, in which the system had a 43% reserve capacity.

The Commission has also considered matters of fairness in its analysis of the used or useful doctrine. In In Re South Central Bell Telephone Co., Case No. 9160 (Order dated May 2, 1985, p. 16), the Commission held it "unfair to require Bell's ratepayers to pay a current cash return on a plant not used and useful because that would not match cost and benefit." Additionally, the Commission applied Fern Lake, supra, to disallow rate recovery of Louisville Gas and Electric Co.'s 25% interest in the Trimble County generating station. See In re: A Formal Review of the Current Status of Trimble County Unit No. 1, Case No. 9934, Order dated July 1, 1988, at 33.

Finally, the PSC again embraced the used or useful doctrine in Case No. 2012-00535, when it refused to allow the depreciation costs for BREC's Coleman plant into the ratebase while the plant is in mothball status.⁶⁴

⁶³ *An Investigation of The Necessity and Usefulness of the Cost Responsibility For the Hanging Rock-Jefferson 765 Kv Transmission Line Under Construction by Kentucky Power Company*, Order Denying Rehearing, dated Sept. 11, 1984, pp. 6-7; *aff'd*, *In Re Kentucky Power*, Case No. 9061, 64 P.U.R. 4th 56, 66 (1984), Order dated Dec. 4, 1984.

⁶⁴ See Case No. 2012-00535, Final Order dated Oct. 29, 2013, pp. 20, 33.

Therefore, the history of the application of the used or useful doctrine in Kentucky jurisprudence and the regulatory precedent of the Commission clearly require exclusion of plant that is not used or useful.

*B. The Commission's Historical Application of "Used or Useful"
Doctrine Regarding Big Rivers*

The Commission correctly found in Case No. 9613⁶⁵ that, in balancing the interests to determine fair, just and reasonable rates, the used or useful doctrine can and should be applied in full measure to Big Rivers, as a generation co-op.⁶⁶ The PSC also noted that it could not impose a "mechanical application" of the used or useful doctrine, and that the analysis of determining the need for facilities [and hence whether to include them in rate base] should include several factors, including: (a) whether they are used or useful; (b) the need for improved reliability; (c) the system's load characteristics; (d) the potential for growth of both system load and load factor; and (e) other relevant economic and engineering factors.⁶⁷ Finally, the analysis includes an allocation of risk.⁶⁸

Just as in Case No. 2012-00535, the record in the instant case establishes that any plant(s) BREC chooses to idle: (a) will not be used or useful, by definition and as demonstrated by BREC's own actions; (b) the plants to be idled are not needed for

⁶⁵ *In re: Big Rivers Electric Corp.'s Notice of Changes in Rates for Wholesale Electric Service and of a Financial Workout Plan*, Order Dated March 17, 1987.

⁶⁶ *Id.* at 39 [explaining distinction between co-op and industry-owned utility ["IOU"], but applying used or useful doctrine in parallel fashion, even though a co-op lacks shareholders].

⁶⁷ *Id.* at 38.

⁶⁸ *Id.* at 39.

system reliability;⁶⁹ (c) there is nothing inherent in the BREC system's load characteristics that indicates the mothballed plant(s) are necessary for the foreseeable future; and (d) no other economic or engineering factors indicate the mothballed plant(s) should be included in rate base. Simply stated, the record is devoid of any indication, other than the self-serving opinions of management based solely on its own Load Mitigation and Replacement Plan, that there is any committed potential for load replacement at any time in the next several years.

In its March 17, 1987 order in Case No. 9613, the Commission extended to Big Rivers, its creditors and the parties time to develop a new Workout plan based on variable smelter rates tied to world aluminum prices.⁷⁰ In addition, the Commission offered guidelines for a revised workout, most of which remain relevant even now, to wit:

1. . . . [A] good starting point for negotiation is the Sunflower Electric cooperative ⁷¹ Debt Restructure Plan. Recognizing the disturbing lack of load diversity and Big Rivers' dependence upon a sluggish aluminum industry, provisions similar to the Sunflower Plan which are not contingent upon an immediate rate increase and guaranteed full repayment of debt are desirable;

2. The immediate and primary source for debt service is off-system sales. Therefore, an agreement on off-system sales should be used in calculating any schedule of debt repayment. Big Rivers' ratepayers should not have unlimited responsibility for the payment of Big Rivers' debt. Furthermore, they should

⁶⁹ Although MISO has determined that the Coleman plant is necessary on an SSR basis, this SSR status will be removed as soon as Century's Hawesville smelter installs the necessary protective relay equipment; hence its SSR status is only temporary.

⁷⁰ Case No. 9613, Order dated March 17, 1987, at 42.

⁷¹ *In the Matter of the Application of Sunflower Electric Cooperative, Inc., for approval of the State Corporation Commission to Make Certain Changes in its Charges for Sale of Electricity to its Member Cooperatives*; Docket No. 143,069-U, Order dated April 2, 1985; a copy of the complete final order in that case is attached to the testimony of David Brevitz in Case No. 2012-00535, as Exhibit DB-3.

not be required to provide all the revenues required to offset shortfalls arising from insufficient off-system sales;

3. The interests of all affected parties must be considered: rural consumers, industrial customers and creditors. Big Rivers should meet with the creditors to negotiate a revised workout plan. Big Rivers and the aluminum companies should negotiate a flexible rate-plan that recognizes the cyclical nature of the industry and the revenue requirements of the utility. Big Rivers, the Attorney General, and other interested parties should meet to discuss the negotiation and determine how the interests of customers other than NSA and Alcan can best be protected;

4. While the Commission expects and the public interest requires that all participants negotiate expeditiously and in good faith, the Commission will make the ultimate decision as to a reasonable long-term solution and no participant will have a veto. The Commission wishes to see the results of negotiations within the time frame established herein;

5. The payment of Big Rivers' obligations to its creditors should take into consideration longer terms, reduced interest rates, deferral of principal and interest payments, preferred stock options, payments tied to off-system sales, and reduction of principal;

6. Consideration should be given to sale or disposal of Wilson to another entity or through establishment of a generating subsidiary as a possible long-term solution;

7. The plan should include well documented projections of system and off-system sales and cash flow over both the short and long term. Documentation should include a thorough explanation of all assumptions, reasonable specificity of targets, and detailed work papers supporting the long and short run cash flow projections;

9. Priority of disbursements with regard to principal and interest should be clearly established. . . . [Emphasis added.]⁷²

⁷² *Id.* at 43-45.

Quite remarkably, these eight (8) points taken together should, in the Attorney General's opinion, comprise a basic groundwork for developing a similar plan to deal with the issues facing BREC and its ratepayers in the immediate rate case, as follows:

1. BREC must meet with its creditors to establish a Workout Plan;
2. BREC's creditors should not be allowed to escape the significant risk they bear in agreeing to continually make major loans to the utility, despite knowing that the smelters' departure was inevitable and was approaching very rapidly; accordingly, the creditors should agree to negotiate with BREC;
3. BREC's sluggish OSS should be dealt with by removing plant which is not used or useful from the company's rate base;
4. The payment of Big Rivers' obligations to its creditors should take into consideration longer terms, reduced interest rates, deferral of principal and interest payments, payments tied to off-system sales, and reduction of principal;
5. The company should continue to consider sale or disposal of Wilson and Coleman and/or such additional plant as may be necessary, or alternatively, consider establishing a generating subsidiary as a possible long-term solution; and
6. Unlike the projections set forth in the current financial and production cost models, the new Workout Plan should be based on well-documented projections of system and off-system sales, and cash flow over both the short and long term. Documentation should include a thorough explanation of all assumptions, reasonable specificity of targets, and detailed work papers supporting the long and short run cash flow projections together with manuals completely illustrating how the models were constructed, and their inputs and outputs.

In its final analysis in Case No. 9613, the PSC in its March 17, 1987 Order in Case No. 9613 put-off for a later date any decision on whether to include the Wilson plant's costs into rate base, and simultaneously initiated, *sua sponte*, an investigation into BREC's rates, Case No. 9885. In that case, the PSC noted that REA:

". . . had already made significant concessions in the current workout proposal. It has agreed to a variable power rate, clarified uncertainties about future rate requests, provided longer terms for repayment, a lower interest rate, and a deferral of certain principal and interest payments." *Id.* at 29.

In Case No. 9885, the PSC noted that in Case No. 9613, it rejected:

"a mechanical application of the used and useful standard as the sole determinant of whether the Wilson station would be included in rates. . . . [T]he Commission is under no statutory obligation to apply a used and useful standard exclusively, or any other single, rigid standard."⁷³

The PSC found further support for its ruling in *Federal Power Comm'n v. Hope Nat. Gas Co.*, 320 U.S. 575 (1944), which stated in pertinent part:

"The Constitution does not bind rate-making bodies to the service of any single formula or combination of formulas. Agencies to whom this legislative power has been delegated are free, within the ambit of their statutory authority, to make pragmatic adjustments which may be called for by particular circumstances."⁷⁴

The PSC concluded, in Case No. 9885, that the Revised Workout Plan it developed, which included variable smelter rates based on world aluminum prices, represented a fair and just resolution and provided fair rates to its customers.⁷⁵

However, BREC's problems were far from over, and the new Workout Plan the PSC developed in Case No. 9885 would be contested. The smelters appeal of the PSC's final order in that case, claimed, *inter alia*, that the PSC should have applied the used of useful doctrine to exclude the Wilson plant's costs from rate base. That appeal

⁷³ Case No. 9885, Order dated Aug. 10, 1987, p. 8.

⁷⁴ *Id.*, 320 U.S. at 586.

⁷⁵ Case No. 9885, Order dated Aug. 10, 1987, p. 10. In so ruling, the PSC also noted that BREC's rates had not been raised since 1981. *Id.* at 10-11.

eventually came before the Court of Appeals in *National-Southwire Aluminum Co. v. Big Rivers Elec. Corp.*, 785 S.W.2d 503 (Ky. App. 1990). In *National-Southwire*, *supra*, the Court of Appeals upheld, *inter alia*, the PSC's ruling in Case No. 9885 which refused to apply the used or useful doctrine in a "mechanical application." However, the Court also made the following key observations:

(a) "[T]he PSC did not totally ignore the used and useful concept in this case. It simply refused to apply it in as strict a manner as requested by the aluminum companies."⁷⁶

(b) *Wilson at that time* was certainly not a "useless" plant.⁷⁷

(c) "[I]t would be more appropriate for the PSC to first determine a value for a utility before setting a rate for recovery of the investment plus operating costs, and the value should not include any unreasonable, useless excesses to be borne by the consumers."⁷⁸

(d) Although the Court was satisfied with the result the PSC reached and affirmed it, nonetheless "it would be good to see more clear concern for the consumer, a clearer burden of proof on the producer to show that the excess capacity was a prudent investment, and a clear finding of just how much excess exists."⁷⁹ [Emphasis added].

(e) Finally, the Court found that "it appears to be part of our public policy to insure that utility consumers do not pay unreasonable rates and that utilities do not make unreasonable expansions."⁸⁰ [Emphasis Added].

Therefore, it is abundantly clear that the *used or useful doctrine is still viable under Kentucky law*. Moreover, its application in the instant case is even more

⁷⁶ *National-Southwire* at 513.

⁷⁷ *Id.* The Court specifically found that *Wilson* enabled *Big Rivers* "to provide continuous uninterrupted service and to be ready to make available on demand enormous amounts of energy" to the smelters. *Id.* at 515.

⁷⁸ *Id.*

⁷⁹ *Id.* at 513-514.

⁸⁰ *Id.* at 510.

warranted than in Case Nos. 9613 and 9885, because BREC now proposes to “lay-up” two generating plants [as set forth in Case Nos. 2012-00535 and 2013-00199] for as long as five (5) years. Unlike the situation in the prior cases, Wilson and Coleman will indeed become not used or useful in the context of serving BREC’s current customer base, and the costs of those plants should clearly not be borne by ratepayers. The Attorney General advocates that the Commission again demonstrate its clear concern for consumers by exercising its statutory authority to remove plant that is neither used nor useful from Big Rivers’ rate base.

Finally, the Commission in Case No. 9885 was incorrect in finding support from *Hope, supra*, for its decision to not remove Wilson from BREC’s ratebase at that particular time. In a subsequent ruling, the U.S. Supreme Court in *Duquesne Light Co. v. Barasch*, 109 S.Ct. 609, 615–620 (1989), held that nothing in *Hope* or the Constitution itself precludes a state from applying the used and useful principle to prevent a utility from recovering its investment in unneeded plant. This was later held to be the case even where application of this principle ultimately resulted in the utility’s bankruptcy. *In Re Public Service Co.*, 539 A.2d 263 (N.H. 1988) (*appeal dismissed, no federal question*, 488 U.S. 1035 (1989)). Therefore, nothing in *Hope, supra* or its progeny require the PSC to restore BREC’s financial integrity by including the costs of two generating plants that are not “used or useful” in rates to be paid by consumers.⁸¹

⁸¹ See also, *Market St. Ry. Co. v. Railroad Comm’n of State of Cal.*, 324 U.S. 548, 566, 65 S.Ct. at 770, 779 (1945) (“it was noted in the *Hope* Natural Gas case that regulation does not assure that the regulated business make a profit”; *id.* at 65 S.Ct. 779, citing *Hope*, 320 U.S. at 603, 64 S.Ct. at 288, 88 L.Ed. 333).

C. The Commission Has the Statutory Authority to Determine Value of Utility Plant in Connection with Rates

The Commission has the statutory authority, pursuant to KRS 278.290, to determine the amount of excess plant and capacity that exists. As noted by the Court of Appeals in *National-Southwire*, KRS 278.290 is applicable in determining what constitutes a fair, just and reasonable rate.⁸² Indeed, it is through this statute that the Commission determines the value of a utility's used or useful plant to be included in rate base.

The Commission's own precedent recognizes this authority. The Commission in Case No. 9613 noted that in order to establish rates that are fair, just and reasonable, the Commission must: (a) determine the appropriate level of operating expenses; (b) fix a value on the utility's property; and (c) in the case of a co-op such as BREC, establish a time interest earned ration ["TIER"] to allow payment of interest and principle.⁸³ The Kentucky Public Service Commission has all the authority it needs to exclude utility plant that is not used or useful from a utility's rate base. KRS 278.290 provides, in pertinent part:

"(1) Subject to the provisions of subsection (2) of this section, the commission may ascertain and fix the value of the whole or any part of the property of any utility in so far as the value is material to the exercise of the jurisdiction of the commission In fixing the value of any property under this subsection, the commission shall give due consideration to the history and development of the utility and its property. . . and other elements of value recognized by the law of the land for rate-making purposes.

⁸² *National-Southwire*, *supra* at 512-513.

⁸³ Case No. 9613, Order (March 17, 1987) at 38.

(2) The commission shall not value or revalue the property of any utility unless the valuation or revaluation is necessary or advisable in order to determine the legality or reasonableness of any rate or service" [Emphasis added.]

While normally this might not be a difficult task, the information BREC provided in this case relevant to the value of Wilson and Coleman has been scant, and tends to be skewed toward showing only what BREC believes is the net book value, rather than the market value. Significantly, it failed to perform a net-present value analysis which could have provided more information in this regard. The Attorney General urges the Commission in this particular case to exclude the value of all plant in BREC's system that is no longer used or useful, unless or until such time as it returns to being used or useful.

3. The Mitigation Plan, Load Replacement Estimates, and BREC's "Singularly Unreliable" Long Term Projections

After presenting and emphasizing its Load Concentration Analysis and Mitigation Plan ["Mitigation Plan"] to the Commission, Commission staff and intervenors in both Case No. 2012-00535⁸⁴ and the current case,⁸⁵ Big Rivers has reversed itself in its rebuttal and hearing testimony in an effort to shield the Mitigation Plan from analysis and scrutiny:

- "It is our perspective" that intervenor arguments about problems with the Mitigation Plan are "not relevant";⁸⁶

⁸⁴ See, e.g., Berry Direct Testimony at pp. 19-25 in Case No. 2012-00535; the "Load Concentration Analysis and Mitigation Plan" itself was provided in response to AG 1-89 in that case.

⁸⁵ See, e.g., Bailey Direct Testimony at pp. 8-12, and Berry Direct Testimony at pp. 9-18. Big Rivers provided the Mitigation Plan itself in response to Commission Staff's Post-Hearing Data Request, Item No. 4.

⁸⁶ Bailey Cross-Examination by Vice Chairman Gardner, Jan. 7, 2014 VTE at 16:21.

- "This case is not about the Mitigation Plan;"⁸⁷
- ". . . [W]hile consideration of Big Rivers' Load Concentration Analysis and Mitigation Plan provides some context for justifying Big Rivers' proposed rates, that fact should not divert attention from the primary focus on evaluating the base period and forecasted test period revenues and expenses for ratemaking purposes."⁸⁸
- "The Mitigation Plan is not the basis for this proceeding."⁸⁹

BREC's new position in this hearing contradicts the Commission's findings on rehearing, as the Order on Rehearing explicitly allows "the parties to explore this issue" [the Mitigation Plan], and that "evidence on the load-mitigation plan shall be taken in Case No. 2013-00199."⁹⁰ BREC's latest position in this hearing also contradicts its extensive discussion and reliance upon the Mitigation Plan in its Post-Hearing Brief in the 2012-00535 case, wherein it spent fully sixteen (16) pages explaining the tight fit between its rate increase requests and the Mitigation Plan, including the following:

"In light of Big Rivers' unique circumstances, as discussed in Section IV.A., Mr. Bailey has similarly requested 'the Commission to evaluate [Big Rivers'] rate request not just on the basis of the current factual circumstances, but also on the basis of the long-running historical context and reasonable future opportunities for Big Rivers and its members."⁹¹

"In designing its rates and planning for its operations after Century's termination, Big Rivers planned for long-term success and developed an operational strategy likely to produce long-term benefits to its Members, and their member-owners."⁹²

⁸⁷ Bailey cross-examination, Jan. 7, 2014 VTE at 11.11.05 - 11:24:00.

⁸⁸ Wolfram Rebuttal Testimony, p. 3, l. 23.

⁸⁹ Barron cross-examination, Jan. 9, 2014 VTE at approximately 10:31:00.

⁹⁰ Case No. 2012-00535, Order on Rehearing, dated Dec. 10, 2013, p. 8.

⁹¹ Post-Hearing Brief of Big Rivers, Case No. 2012-00535, July 26, 2013, at p. 38, l. 12. Vice-Chairman Gardner, during Mr. Bailey's cross-examination, also inquired concerning this statement. Jan. 7, 2014 VTE, at approximately 16:23:00.

⁹² *Id.* at p. 37, l. 20.

Every element of these statements are critically relevant to BREC's future. The Mitigation Plan is inextricably related to Big Rivers' rate increase requests, and Big Rivers cannot now claim it is irrelevant. The Commission should not condone or accept BREC's strategic attempt to put the Mitigation Plan "off limits" for inquiry now that both the Commission and the intervenors have devoted substantial analysis to both its viability and the reasonableness of its assumptions and forecasts.

As BREC describes, the Mitigation Plan essentially consists of three elements: "Petition the Commission for a rate increase. . . .market all excess power idle or reduce generation [and] execute forward bilateral sales with counterparties, enter into wholesale power agreements, and/or participate in capacity markets."⁹³ The intervenors in the instant case have conducted the first thorough and comprehensive review of BREC's Mitigation Plan.

BREC's "Financial Forecast (2014 - 2027) 5-16-2013,"⁹⁴ a spreadsheet workbook based on BREC's Financial Model tool derives its inputs from BREC's plans and assumptions regarding execution of the Mitigation Plan. The data and results for the first four years of this Long Term Financial Forecast are the same as the four year financial modeling that BREC presents for and includes to support its forecasted test period.⁹⁵ This Long Term Financial Forecast has been presented to BREC's Board of Directors.⁹⁶

⁹³ Berry Direct Testimony, pp. 10-11.

⁹⁴ This spreadsheet model was provided in response to PSC 2-14.

⁹⁵ Warren Cross-Examination, Jan. 9, 2014 VTE at 12:08:50.

⁹⁶ *Id.* at 12:40:20.

No financial entity – not the RUS,⁹⁷ nor any of BREC's other lenders,⁹⁸ nor the credit rating agencies -- have reviewed critically the assumptions regarding the Mitigation Plan that are embedded in BREC's Long Term Financial Forecast, or the test period financial modeling. While this may be viewed as a little surprising at one level, the lack of perceived need to conduct a thorough and critical review of the Mitigation Plan and Long Term Financial Forecast is understandable especially as long as the Commission facilitates rate increases for BREC—which, by way of analogy, turns the purported three elements of the Mitigation Plan⁹⁹ into what is essentially a one-legged stool.

Had the credit rating agencies, the RUS and BREC's other lenders critically reviewed BREC's Mitigation Plan, they would have discovered the following issues that would warrant their direct involvement.

A. BREC's Mitigation Plan Fails to Analyze the Plan from a Member/Consumer Perspective, Using Basic Financial Net Present Value ["NPV"] Techniques which Consider Risk and the Time Value of Money.

As stated by the Attorney General's expert: "Basic management and managerial finance practices would require [member benefit] statements to be supported by NPV analysis, especially since this is an exceptional watershed moment for Big Rivers and its assets/operations, over a long time horizon. NPV analysis is employed by corporate management for decisions regarding assets, capital investment and strategic

⁹⁷ Richert Cross-Examination, Jan. 8, 2014 VTE at 13:19:10.

⁹⁸ *Id.*

⁹⁹ See Berry Direct Testimony, pp. 10-11.

decisions.”¹⁰⁰ Big Rivers has not only failed to contradict this testimony, it has even confirmed it by: (a) recognizing that “market values are based on cash flow,”¹⁰¹ yet failing to perform an NPV financial analysis of cash flows associated with its proposed Mitigation Plan to more adequately inform the Commission, lenders and financial entities regarding perhaps the most important strategic decision of its existence; and (b) stating that “asset decisions must be made with a long term view,”¹⁰² yet failing to perform NPV financial analysis of cash flows set forth in its Long Term Financial Forecast—which in turn embodies the Mitigation Plan’s assumptions—to more adequately inform the Commission, lenders and financial entities of what, once again, is arguably the most important strategic decision of its existence.

There is a startling contrast between the aggressiveness with which BREC asserts its actions are for the benefit of its members and with what arguably appears to be an intentional blind view BREC management takes regarding basic financial management NPV analysis for a watershed moment in its corporate existence. The Attorney General, utilizing BREC’s own Long Term Financial Forecast as presented to its Board of Directors, which embodies the Mitigation Plan’s analyses and assumptions, did what BREC failed to do by performing an NPV analysis. This Member Benefit Analysis¹⁰³ clearly shows that “continued ownership of [the Coleman and Wilson plants] costs Big

¹⁰⁰ Attorney General’s Direct Testimony of David Brevitz, p. 36, l. 14 – p. 37, l. 2.

¹⁰¹ Bailey Cross-Examination, Jan. 7, 2014 VTE at 12:27:10.

¹⁰² BREC Post-Hearing Brief, Case No. 2012-00535, p. 38, fn. 174 (citing Bailey Rebuttal Testimony at p. 10, lines 17-22).

¹⁰³ Brevitz Direct Testimony at pp. 37 – 39; Holloway Direct Testimony, Exhibit Holloway-3, “Member Benefit Analysis for Rate Treatment of Coleman and Wilson Costs.”

Rivers' members far more than any future benefits"¹⁰⁴ estimated under the Long Term Financial Forecast.

BREC criticizes the use in the Member Benefit Analysis of a 10% discount rate for distant revenues from off-system sales and replacement load.¹⁰⁵ However, it is entirely appropriate in this instance to use differential discount rates, since the revenue sources are entirely different in nature. Discount factors are used to reflect risk. The two estimated revenue streams are of entirely different natures. The revenues from member consumers are public utility in nature, and associated with demand for an essential service in a certificated territory with no direct competition. A lower cost-of-service level discount rate is appropriate here,¹⁰⁶ and the Member Benefit Analysis uses a 5% discount rate representing BREC's cost of debt for this less risky, currently existing revenue stream. On the other hand, the estimated revenue streams from replacement load and off-system sales are competitive in nature, and are characteristic of a merchant generator operation, with all the high risks that pertain to such an operation. Use of a significantly higher discount rate is clearly warranted in this case, and in fact the 10% discount rate used in the Member Benefit Analysis is conservative, and could have been higher to reflect the cost of capital associated with a merchant generator.

Further proof of the appropriateness of the 10% discount rate can be derived from the Commission's own experience in electric utility rate cases. The overall rate of return requested by electric companies in state public utility rate cases commonly is

¹⁰⁴ Holloway Direct Testimony, Exhibit Holloway-3, p. 2.

¹⁰⁵ Wolfram Rebuttal Testimony, p. 17, line 11.

¹⁰⁶ Brevitz Direct Testimony at p. 44, line 2.

10% or higher (although the Attorney General and other intervenors frequently challenge ROR requests which they believe are inappropriate and unjustified). Seen in this light, use of the 10% discount factor in the Member Benefit Analysis for estimated merchant generation revenues from load replacement and off-system sales is conservative.

B. BREC Fails to Assess and Consider the Market Value of Coleman and Wilson in Setting a Sale Price for those Plants, as Opposed to Their Book Value.

It is evident in this case that BREC has tunnel vision and intends to retain the two idled power plants through higher rates charged to remaining consumers unless a buyer materializes that is willing to pay a premium for the plants. BREC states it has been actively engaged in trying to sell the plants, and "has offered them to many who have had requests for power."¹⁰⁷ When asked by staff counsel about pricing relative to market value of the plants, BREC stated it "hadn't done any analysis" of the market value of the plants.¹⁰⁸ When asked if the attempted sales are at or above book value, BREC stated it had "priced them at a modest increase above book value level."¹⁰⁹ BREC further states that its lenders have not been approached regarding any proposal or sale of plants, whether at NBV or below.¹¹⁰

BREC has maintained through both Case No. 2012-00535 and the current case that it has performed no studies or analyses regarding market value, and thus has no information on the market value of the Coleman and Wilson plants. However, in the

¹⁰⁷ Bailey Cross-Examination by Staff Counsel, Jan. 7, 2014 VTE at 15:39.

¹⁰⁸ *Id.*, 15:38.

¹⁰⁹ *Id.*, 15:40:39.

¹¹⁰ Richert Cross-Examination by Staff Counsel, Jan. 8, 2014 VTE at 12:41 - 12:43.

requests for this information in spite of its statement in response to PSC 2-18 in Case No. 2012-00535 that such information is provided and attached. The confidential response to PSC 2-18 states: [BEGIN CONFIDENTIAL] [REDACTED]

[REDACTED] [END CONFIDENTIAL]¹¹⁵ Yet BREC failed to provide the attachment which it clearly indicated was to be provided. Later, when BREC filed its petition for confidential treatment regarding that response, BREC stated that it would provide this information only to the PSC, and not to the intervenors, despite the fact that all intervenors had signed binding confidentiality agreements with the company. This is one clear confirmation of Commissioner Breathitt's observation that "we are only getting bits and pieces of the financial picture."¹¹⁶

The Commission should require BREC to provide this attachment forthwith to it and the parties, along with a clear explanation of why it did not provide the attachment in a timely fashion. If it is not clear from the attachment who the intended "direct recipients" of the information were, the Commission should require BREC to state who were the direct recipients of the information, and equally important, why the CEO of the organization would not be a "direct recipient." Finally, the Commission

¹¹⁵ BREC Confidential Response to PSC 2-18, at p. 4, l. 13.

¹¹⁶ Richert Cross-Examination by Commissioner Breathitt, Jan. 8, 2014 VTE at 12:44:45.

should permit supplemental briefing limited to this issue, to be filed promptly upon provision of the attachment to the intervenors.

C. BREC Shifts Financial Costs and Risks Associated with the Mitigation Plan to Existing Members and Consumers for an Indefinite Time Period.

Under the Mitigation Plan, BREC's members and their retail ratepayers are expected to pay the substantial fixed costs associated with two extra power plants that are not used or useful in producing the power those members consume—in addition to paying for the two power plants that do produce power necessary to serve their needs. The Mitigation Plan therefore requires consumers to underwrite the risks associated with sales efforts seeking load—or, merchant generation. The time period for which member/consumers are obliged to bear this heavy financial burden under BREC's plan is unknown, but estimated in BREC's Long Term Financial Forecast to be the better part of five years, at minimum. The Attorney General has quantified this heavy burden through the Member Benefit Analysis¹¹⁷—and was obliged to do so by BREC's failure to back up its claims of "member benefit" using the net present value technique associated with standard "best practice" financial management.

The heavy burden of this cost and risk is epitomized by the fact that BREC knows of no prior circumstance or example where a utility has idled a generation plant and then brought it back into service five years later¹¹⁸—let alone idling two generation plants and bringing them back into service five years later. The actual return to service

¹¹⁷ Holloway Direct Testimony, Exhibit Holloway-3, "Member Benefit Analysis for Rate Treatment of Coleman and Wilson Costs."

¹¹⁸ Wolfram Cross-Examination, Jan. 9, 2014 VTE at 14:03:30.

of the two generating plants to be idled under BREC's Mitigation Plan is truly uncertain and dependent on many unknown circumstances associated with future developments in the energy sector. This leaves the heavy burden of cost and risk on consumers served by BREC for an indeterminate time, which is unacceptable to BREC's ratepayers.

D. BREC's Mitigation Plan's Assumptions Regarding the Value of Wilson and Coleman have Significantly Changed; Assumptions Regarding Development of Replacement Load are Unrealistic and Unfounded

In Case No. 2012-00535, the Mitigation Plan's assumptions as to the future value of both the Wilson and Coleman plants was based upon inconsistent assumptions regarding wholesale prices of electricity. Those assumptions, which have never been based upon solid forecasting, showed a huge jump in price in 2019 which in the hearing of Case No. 2012-00535 was referred to as a "hockey stick" curve. BREC claimed it would be economical to bring Wilson and Coleman back on-line at the inflection point of the "hockey stick" because of this optimistic, inconsistent forecast. However, in the instant case, BREC now states that the value inherent in Wilson and Coleman lies in projections of replacement load which BREC believes it could find and serve.

Regardless of the apparently changing nature of the Mitigation Plan's assumptions, they remain highly unrealistic because: (a) BREC is *merely hoping*¹¹⁹ that it can obtain 800 MW in replacement load by 2021, which it further believes can be priced at 25% above market prices;¹²⁰ and (b) BREC's assumptions fail to take into

¹¹⁹ See BREC's response to KIUC 2-7.

¹²⁰ See Hayett Direct Testimony, pp. 11-12.

consideration critical environmental requirements.¹²¹ Moreover, assuming BREC can find 800 MW of replacement load by 2021, which it believes it can, that replacement power alone would be significantly greater than BREC's current entire native load.¹²² Whereas BREC believes its system will grow by a compound average growth rate of 17.5% beginning in 2015,¹²³ the U.S. Energy Information Administration forecasts that national load growth will only be 0.9% over this period.¹²⁴ This means that essentially all of BREC's estimated replacement load must be taken from other entities currently serving that load—with all which that scenario entails, including the great lengths to which the entities currently serving the respective loads will go to in order to maintain the customer relationship.

BREC's replacement load estimate is the product of an insular process which did not include testing of the assumptions for reality in the outside world, or otherwise subjecting them to external review. Economic development entities in the BREC area were "not invited" to review BREC's projection of replacement load.¹²⁵ BREC did not seek the expertise of economic development professionals in the creation of the load replacement estimates¹²⁶—even though the load replacement clearly relies on economic development activities. The apparent lack of any economic development expert input in BREC's development of its Economic Development rate, which is part of BREC's plan

¹²¹ *Id.* at p. 39, l. 18 - p. 40 l. 2, discussing additional costs that should be included in the Wilson and Coleman restart analysis for CO₂, MATS, CCR and the Cooling Water Intake Rule.

¹²² *Id.* at p. 14.

¹²³ *Id.* at p. 22, lines 1-6.

¹²⁴ [http://www.eia.gov/forecasts/aeo/pdf/0383\(2013\).pdf](http://www.eia.gov/forecasts/aeo/pdf/0383(2013).pdf) at p. 71.

¹²⁵ Bailey Cross-Examination, Jan. 7, 2014 VTE at 12:10:50.

¹²⁶ Barron Cross-Examination, Jan. 9, 2014 VTE beginning at approximately 9:37:00 - 9:38:00.

to attract replacement load, is as extraordinary as it is lacking. No external parties were involved in the development of the load replacement estimates¹²⁷ – they were created solely within the four walls of BREC offices. Load replacement projections were “sketched out on the white board” at BREC, and “more closely resemble ‘plug’ numbers necessary to make the [financial] projections ‘work’.”¹²⁸ This insular approach to development of load replacement assumptions for the Long Term Financial Forecast is the main support for BREC’s claim of “member benefit,” and the Commission should find it wanting of any robust analysis and derivation, or external input or review.

*E. BREC Again Relies Upon Higher Market Prices to Resolve
Financial Problems Arising from Excess Capacity*

In the Unwind case, BREC advised the Commission it should have no concerns if the smelters terminated their special contract agreements since BREC would simply sell the excess power on the market at projected high market rates, and make even higher margins.¹²⁹ This reliance on projected high market prices proved highly inaccurate and damaging. Now, in the two smelter contract termination cases before the Commission, BREC again relies upon projections of higher market prices to justify its rate requests, and endorse its Mitigation Plan. The Commission should not rely upon projections of higher market prices within BREC’s Long Term Financial Forecast to address BREC’s significant financial issues caused by excess capacity in the form of two generating plants which are not used or useful in the provision of public utility service. The Commission need look no further than BREC’s prior reliance on market price forecasts,

¹²⁷ *Id.* at 9:37:50.

¹²⁸ Brevitz Direct Testimony, p. 42, line 1.

¹²⁹ *See, e.g.,* Blackburn Rebuttal Testimony, Case No. 2007-00455, pp. 14-15.

especially in light of the testimony of BREC's own witness, Mr. Mabey, for why it should not rely upon projections of future market prices:

Q: "Would it concern you that under the long-term financial plan, the company reaches a 1.24 TIER only twice out through 2027?"

A.: "It doesn't concern me because in my modest experience, in predicting electrical power costs and demand over the years it has been *singularly unreliable*. And I don't think you can project reliably very far in the future. Certainly we were burned by Southern Montana G & T Coop, [which] is in bankruptcy right now because it bet wrong with respect to costs of power. I'm just a little skeptical about long term projections."¹³⁰ [*Emphasis supplied by the Witness*].

BREC's recent history demonstrates the severe consequences to consumers from relying upon market price projections, which in the words of BREC's own witness are "singularly unreliable."

F. BREC's Mitigation Plan Contains Inherent Inconsistencies and Problematic Assumptions, and Fails to Reflect Price Elasticity of Demand.

There are numerous inconsistencies and problematic assumptions associated with BREC's Mitigation Plan. As described above, BREC's continued rate increase requests will not provide it with financial stability. This will make it "difficult at best to attract new large industrial customers who will see the prospect of continued rate increases to support excess capacity in a coal-based generation fleet subject in addition to uncertainty over expected more stringent pollution control regulations."¹³¹ Furthermore, there will be stiff competition among competitors for this load, including but not limited to the Tennessee Valley Authority (TVA). "TVA has suffered a

¹³⁰ Mabey Cross-Examination, Jan. 8, 2014 VTE at 15:43:35 - 15:44:46.

¹³¹ Brevitz Direct Testimony, p. 25, l. 9. Note that BREC recognizes this increased cost in its proposals attached to PSC 2-18 in Case No. 2012-00535, but refuses to acknowledge this cost in its financial modeling for the forecasted test period or in its Long Term Financial Forecast.

'staggering loss' in power sales ..., down \$1.5 billion in the past five years.' This will spark an effort by TVA to set rates at competitive levels in order to attract and retain large industrial customers."¹³²

One large customer TVA has lost due to closure is USEC's Gaseous Diffusion Plant in Paducah, which is directly adjacent to BREC member Jackson Purchase's service territory. This plant has a large, highly-paid workforce ¹³³ so with its closure, "... Jackson Purchase sales to consumers and small businesses will be reduced as the impact of reduced employment ripples through the economy in the area. There is both a direct and indirect effect of reduced employment from plant closure that will affect Jackson Purchase sales."¹³⁴ Despite its own member Jackson Purchase's concern about this impact on sales, BREC decided not to recognize this in its load forecast associated with this case and the financial modeling presented in it.¹³⁵ This means that BREC's Long Term Financial Forecast as it incorporates the Mitigation Plan assumptions overestimates revenues and margins going forward, to the extent of the impact of the USEC plant closure on sales. While Kentucky policymakers, including the Attorney General have taken extraordinary steps to ensure the retention of jobs and the continuing efficacy of USEC site for Western Kentucky, BREC's management and experts turned a blind eye to this issue, despite being warned by its own member.

¹³² *Id.*, p. 26, l. 9 (quoting "TVA Chief Works to Slim Down Agency," *Chattanooga Times Free Press*, October 11, 2013).

¹³³ *Id.* at p. 26, l. 14 (citing "The Effects of Losing USEC"; *The Paducah Sun*, September 15, 2013).

¹³⁴ *Id.* at p. 26, line 16 - p. 27, l. 3.

¹³⁵ *Id.*, p. 27.

This is not the only example of this selective sight with the Mitigation Plan. BREC's treatment of the large industrial class under the Mitigation Plan is internally inconsistent and entirely problematic. BREC proposes substantial rate increases for Large Industrial customers at the same time it is attempting to attract new load by offering discounted economic development rates. The large gap between the higher proposed rate for existing large industrial customers and the \$7.50 proposed economic development rate¹³⁶ will create substantial discord regarding discriminatory and preferential rates. The proposed economic development demand rate of \$7.50 is substantially lower than the proposed Large Industrial demand rate in this case of \$17.979. The questions which BREC expressed in its presentation to the Kentucky Economic Development Cabinet make clear the discriminatory and preferential nature of the proposed economic development rate – BREC questioned how the rate can be “fenced in” and kept away from existing large industrial customers: “Should the [economic development rate] only apply to new businesses to avoid existing industries from gaming the system by renaming a business to capture the EDR pricing? i.e. Avoid having XYZ company change its name to ABC company to access the rate?”¹³⁷ BREC also notes other inherent problems with economic development rates there, such as how to handle terminations prior to contract expirations.

¹³⁶ See BREC Response to Post-Hearing Data Request No. 18, Big Rivers' Presentation on “Economic Development in Western Kentucky,” as presented to the Kentucky Economic Development Cabinet, May 2013, at p. 14. Although BREC's Response to KIUC 2-36 on October 1, 2013 claimed this rate as confidential, and was treated as such in testimony and at hearing, it had obviously been publicly disclosed several months prior to that date. BREC's reason for the confidentiality claim well past public disclosure of the rate has not been explained.

¹³⁷ *Id.* at p. 15 [Emphasis in original].

BREC claims that "discounted rates are not an issue in this proceeding,"¹³⁸ but this is entirely inconsistent with the Mitigation Plan's emphasis on attracting replacement load, and the reliance on replacement load contained in BREC's modeling of the Mitigation Plan's execution in its Long Term Financial Forecast. In yet a further material inconsistency, BREC's Long Term Financial Forecast does not use and include the proposed economic development rate applied to load replacement estimates. Load replacement "revenues are calculated using a different and higher rate."¹³⁹ This will lead to lower revenues than estimated in the Long Term Financial Forecast with all the implications that would be associated with lower revenues, including deferred rate reductions, deferred restart of plants, etc.

Another problem with the Mitigation Plan is that BREC intentionally uses no, or low, price elasticity of demand in its load forecasting, which in turn is incorporated into the Long Term Financial Forecast that assumes execution of the Mitigation Plan. BREC assumes no price elasticity of demand for large industrial customers¹⁴⁰ and assumes low (short-term) price elasticity of demand for rural consumers, which is based on historical prices that did not include any large or significant price increases.¹⁴¹ Even this low, short-term estimate of price elasticity of demand produces an estimated 15.12% reduction in usage by the average customer.¹⁴² BREC's choice to assume no price elasticity of demand for large industrial customers, and a low, short-term estimate

¹³⁸ Bailey Cross-Examination, Jan. 7, 2014 VTE at 11:16:30.

¹³⁹ Brevitz Direct Testimony, p. 31, l. 17.

¹⁴⁰ BREC Response to PSC 2-20.

¹⁴¹ Brevitz Direct Testimony, p. 31, l. 2.

¹⁴² *Id.* at p. 30, l. 15.

for rural consumers appears to be intentional in order to understate the rate increases necessarily associated with BREC's Mitigation Plan.¹⁴³

It is an axiomatic rule of economics that the change in price of a good or service will cause a demand response among consumers.¹⁴⁴ With its choice to assume zero demand elasticity for large industrial customers, and low, short-run price elasticity for rural consumers, BREC is again giving the Commission "bits and pieces"¹⁴⁵ of its financial picture by employing these clearly understated assumptions in the financial modeling it presents to the Commission and the intervenors. Under basic principles of economics, there will surely be significant demand response to the significantly increased prices proposed by BREC. Big Rivers demonstrates a cavalier attitude to the large industrial customer class, by assuming those customers will just "pay up" and not make any response or adaptation to significantly increased prices. This is clearly contradicted by the testimony of the KIUC intervenors, and by analysis of current trends by reputable sources such as *The Wall Street Journal*.¹⁴⁶ Rural price elasticity of demand is underestimated by use of price history in the statistical analysis that is relatively smooth and contains no significant price increases, and moreover by use of the short term measure rather than long term. As a "simple rule of thumb, long run elasticities are about twice the level of short run elasticities."¹⁴⁷ Significant demand response intentionally understated by BREC in its load forecasting will create a revenue

¹⁴³ Barron Cross-Examination, Jan. 9, 2014 VTE at 10:29:30.

¹⁴⁴ Brevitz Cross-Examination by Vice Chairman Gardner, Jan. 9, 2014 VTE at 18:47:30 - 18:48:45.

¹⁴⁵ Richert Cross-Examination by Commissioner Breathitt, Jan. 8, 2014 VTE at 12:44:45.

¹⁴⁶ Brevitz Direct Testimony, at page 24, line 5, citing "Power Play: Companies Unplug from Grid, Delivering Jolt to Utilities"; *The Wall Street Journal*, p. 1, September 18, 2013.

¹⁴⁷ Cross-Examination of Dr. Ackerman, Jan. 9, 2014 VTE at 17:25:40 - 17:26:11.

shortfall which BREC has intentionally not recognized in its financial forecasting, which—all other things equal—will in turn place BREC before the Commission, sooner rather than later, with another significant rate increase request—quickly on the heels of the immediate two cases.

One of BREC's own members --Jackson Purchase--recognizes the impact of price elasticity, and expressed the view that large rate increases and USEC plant closure will "surely also have an effect on consumption."¹⁴⁸ This guidance apparently went unavailing at BREC, which continued in the direction of underestimating price elasticity of demand impacts on its financial picture in order to make its rate request appear less shocking. The environment has changed, and today's consumers are much more frequently thinking about energy efficiency. Increased rates will cause demand response, and this is typified by the public comment of one consumer, stating that in anticipation of the impact of the first rate increase "I unplugged everything I possibly could, [but] my utility bill went up \$50 the next month. How do you explain that?"¹⁴⁹

The directionality of all the above inconsistencies or problematic assumptions regarding the Mitigation Plan, as it is estimated by BREC to be executed in its Long Term Financial Forecast, is to *overestimate* the amount and pace of revenue generation, and consequently paint for the Commission and the intervenors a "rosy scenario" where everything works out if the Commission will just give BREC its rate increases. The Commission should be very concerned at BREC's measured feeding of "bits and

¹⁴⁸ Brevitz Direct Testimony, p. 27, l. 20 (*quoting* email from Chuck Williamson of Jackson Purchase to John Hutts of GDS Associates, copying Michael Mattox and Lindsay Barron, from BREC's Response to KIUC 1-92, Attachment, p. 133).

¹⁴⁹ Comments of Pam Hazelwood, Dec. 16, 2013 Public Comment Session, Video Transcript at 27:45.

pieces"¹⁵⁰ of crucial financial information, and should take no further steps down the path of rate increases sought by BREC.

Both The Attorney General and BREC point out the importance and appropriateness of the Commission considering the history of this public utility in making its determinations in this case. As demonstrated above, there has been a long history of concern regarding excess generating capacity, dating back to the 1980's.

Consistent with its history, and especially as established in the Unwind Case, BREC again relies on projected higher market prices to bail it out of the financial problems caused by the severe mismatch between system capacity needed to serve its members, and its total owned generating capacity. In its rendition of history, BREC leaves out these important facts and asks the Commission to accept a "one-legged stool" approach, effectively relying on proposed rate increases which will break consumer budgets, and significantly worsen business conditions in the regional economy – while nonetheless expecting (contrary to all logic) that it will be able to attract new load to the area. Additionally, BREC leaves out its long-standing excess capacity problems, and again relies on projected higher market prices for salvation— which projections BREC's own witness states are "singularly unreliable." BREC's lenders have knowingly continued to advance funds to it despite at least two opportunities in connection with new financing (the Unwind transaction, and the July 27, 2012 refinancing transaction) to work with BREC to develop a robust approach to dealing with its load concentration and excess capacity.

¹⁵⁰ Richert Cross-Examination by Commissioner Breathitt, Jan. 8, 2014 VTE at 12:44:45.

BREC's excess scale is a much larger problem than consumers can support. BREC's current significant efforts to sell its excess power and capacity should be lauded and should continue, but it must be recognized that is not a permanent solution to addressing the excess scale of BREC's system. Sales efforts are necessary now, but the ultimate focus of BREC and its lenders needs to be on reducing scale during these sales efforts.

4. BREC's Lenders Should Bear Their Portion of the Risk

As is the case with every commercial lender, BREC's lenders have various levels of control over significant management decisions. For several decades, BREC's sophisticated lenders were aware of the unique risk that the utility faced in providing service to two aluminum smelters. At the time of the Unwind Case, however, BREC's lenders apparently failed to insist that the smelters be held to long-term contracts with BREC, which would have provided a more reliable revenue stream for BREC in order to repay its loans.

This lack of comprehensive financial oversight in fact continued into BREC's latest major re-finance case, Case No. 2012-00119, in which the RUS approved BREC's request for over \$500 million in new financing despite being made aware of the fact the smelters were seriously considering leaving BREC's system¹⁵¹ – and that is exactly what happened mere weeks following the closing of that financing.

¹⁵¹ See BREC Disclosure Statement dated July 12, 2012, OAG Hearing Exhibit 8.

This Commission should do just as the Kentucky Commission did in Case No. 9613, when – quite significantly – it refused to agree with BREC and its creditors in their pursuit of a continuous base rate case solution:

We emphatically reject the claim of REA, the banks, and Big Rivers that the members of the cooperative ultimately bear the total risk and responsibility for the utility's debts. The distribution cooperatives and their members do not stand in the same position as shareholders of an investor-owned company. The REA, with its oversight and monitoring responsibility, bears a substantial amount of the risk associated with Big Rivers' actions. The creditor banks are compensated for the risks they take. Cooperative members must shoulder a portion of the risk, too, since they have a say in the affairs of the utility. Nor are the aluminum companies exempt from responsibility.¹⁵² [Emphasis added.]

The PSC in that case correctly, and courageously, moved down a path of placing at least some of the risk where it belonged: on BREC's lenders, who were well-aware of the great degree of risk BREC took upon itself when it became a utility primarily geared toward serving two individual loads, which together comprised approximately 70% of its total load. BREC's ratepayers are truly captive to management decisions, and have no alternatives. As the PSC noted in Case No. 9613, ". . . BREC's ratepayers, unlike shareholders in investor-owned utility, do not vote their stock in proportion to their economic interest, nor could they sell their stock if they disagreed with management decisions."¹⁵³

Despite the fact that BREC, during the last thirty (30) years has not been able to diversify its load, the lenders continued to provide access to capital. As noted above, the lenders in fact continued to provide BREC with access to capital despite BREC's

¹⁵² Case No. 9613, Order dated March 17, 1987, at p. 19.

¹⁵³ *Id.* at 30.

disclosure statement which made it abundantly clear that the smelters' departure from the BREC system was imminent.¹⁵⁴ Clearly, BREC's creditors served to extend the co-dependent relationship between BREC and the smelters by continuing to provide capital – a co-dependent relationship which they knew was headed toward a day of reckoning.

In a separate case arising out of the construction costs associated with the abandoned Marble Hill, Indiana nuclear power plant, the Seventh Circuit Court of Appeals, in invalidating two REA regulations by which the agency attempted to assert jurisdiction over utility ratemaking in the event of a utility bankruptcy, also found that lenders should share in the risk. In that ruling, the court noted:

"As with any other lender, the REA assumes the business risk of advancing money to a specific organization, the risk that the organization will not be able to repay. Given the history and function of the RE Act, the scope of this risk incorporates the possibility that state regulation may occasionally impede the ability of power supply cooperatives to repay their loans. One could reasonably argue that the structure and operation of the subsidies provided through the REA reflect a congressional preference for the government's bearing this risk, rather than cooperative members. In any event, it is clear that the REA may not dictate who shall bear the risk because that would amount to the agency conferring power on itself."¹⁵⁵
[Emphasis added.]

The need for BREC and the Commission to involve its lenders is obvious, and one wonders why BREC is "scared" to talk to them under present circumstances. BREC's lenders should be involved now while an effective workout plan *can* be reached, rather than wait until it is too late, the economic environment has been

¹⁵⁴ See OAG Hearing Exhibit 8 (BREC Disclosure Statement, dated July 12, 2012).

¹⁵⁵ *Wabash Valley Power Ass'n v. Rural Elec. Admin.*, 988 F.2d 1480, 1491 (7th Cir. 1993).

severely damaged by excessive rate increases, and the "death spiral" is accelerating. BREC cannot gain financial stability from rate increases of the size sought in these cases. Under that path the Commission should expect to see more and more BREC cases filed, under increasingly urgent circumstances, and with fewer available options.

5. Revenue Requirement

A. Summary of Revenue Requirements

The Attorney General ("OAG") urges that the Commission not award any new revenues to Big Rivers in the instant case, and that its TIER be set at 1.10, based upon the Direct Testimony of Bion Ostrander.¹⁵⁶

The OAG's recommendation is all the more relevant now that the results for BREC's calendar year 2013 reveal that the company is apparently earning a "normalized" TIER of 1.5 for the twelve months ending December 2013,¹⁵⁷ reflecting margins of \$21.7 million. This would mean that BREC's margins have been doubled from what the PSC authorized in Case No. 2012-00535. This additional level of margins will be enhanced because BREC, in an apparent effort to recoup revenues which the PSC did not authorize in Case No. 2012-00535,¹⁵⁸ reduced its forecasted revenues by \$8.937 mil.

¹⁵⁶ Ostrander Direct Testimony, p. 12, 21-52 and related exhibits. See also Brevitz Direct Testimony, and Holloway Direct Testimony.

¹⁵⁷ See BREC's Attachment to its 7th Updated Response to PSC 1-43. This figure is based on removing the unusual A&G expense reported for Dec. 2013. In both 2012 and 2013, Big Rivers' average A&G per month from Jan. - Nov. was \$2.2 million. In Dec. 2012, the A&G was \$2.6 million. If the Dec. 2012 amount of \$2.6 million is used as the "normalized" amount for Dec. 2013 in lieu of the actual Dec. 2013 amount of \$15.2 million, then the 2013 margin will increase from \$8.7 million actual to \$21.7 million, resulting in a 1.5 TIER.

¹⁵⁸ See Wolfram Rebuttal Testimony, p. 32.

Mr. Ostrander provided two adjusted revenue requirement options (both using a 1.10 TIER) for the Commission to consider, both of which show that rate increases are not necessary. Option 1, the primary recommendation, removes BREC's \$71.2 million¹⁵⁹ estimated revenue requirement impact related to the loss of the Sebree smelter through Adjustment OAG-1-DB. Option 2, the alternative recommendation,¹⁶⁰ follows a traditional rate case approach and removes certain expenses related to idling both Wilson and Coleman plants along with other rate case adjustments. Two revised adjustments pertaining to Option 2 are described below.

In OAG-4-BCO Mr. Ostrander proposed to decrease forecasted payroll expense by an amount of \$3,594,280 because BREC's forecasted payroll costs were excessive and unreasonable.¹⁶¹ However, in response to Staff Data Request Question No. 7, Mr. Ostrander provided a revised adjustment is more accurate and more consistent with the actual increased reduction in BREC headcount.¹⁶²

The OAG also proposes a change to accommodate the Commission's Final Order in Case No. 2012-00535, which was issued after the OAG's testimony was filed. OAG-6-BCO proposed a two-part adjustment to decrease forecasted rate case expense for both Case No. 2012-00535 and the current rate case, because BREC's filing included

¹⁵⁹ This increase from the original adjustment of \$70.4 mil., as set forth in Ostrander Direct Testimony, pp. 2, 6, and 11, to the current \$71.2 mil. was required based upon BREC's revised revenue requirement. See Bailey Rebuttal, p. 6, 19-21; and Wolfram Rebuttal, page 37, Table 2. The OAG's recommendations in both Options 1 and 2 are sufficient to offset the revised revenue requirement of \$71.2 million such that no rate increases are necessary.

¹⁶⁰ Ostrander Direct Testimony, pp. 1-22.

¹⁶¹ Ostrander Direct Testimony, Confidential Exhibit BCO-2, Schedule A-5, Adj. OAG-4-BCO.

¹⁶² This is because BREC's actual reduction in employee levels is greater than its forecasted reduction in employee levels (as shown at the Attachment to Staff Question No. 7). Thus BREC's actual payroll expense is less than its forecasted payroll expense included in the rate case, and Mr. Ostrander's revised payroll expense adjustment is appropriate.

amortized rate case expense for both cases. Because the Commission's Order allowed BREC to recover its rate case expense from the prior rate case,¹⁶³ the OAG is withdrawing that portion of Mr. Ostrander's rate case expense adjustment of \$342,651¹⁶⁴ to be consistent with the Commission's Order. However, the remaining portion of Mr. Ostrander's rate case expense adjustment is not changed because the OAG is contesting BREC's forecasted rate case expense in the current case based on different rationale.

BREC's actual financial results for the twelve-month calendar year ending December 31, 2013 only serve to strengthen the OAG's concerns regarding BREC's proposed TIER, inaccurate forecasts, and understated earnings.¹⁶⁵ For the twelve months ending December 31, 2013, BREC earned a "normalized" TIER of 1.50, which conclusively establishes that BREC can indeed earn an actual TIER substantially in excess of its current authorized TIER of 1.20.¹⁶⁶

Furthermore, these year-end actual results reveal BREC is earning a "normalized"¹⁶⁷ margin of \$21.7 million (*more than double (149%) the margins of \$8.7 million which the Commission authorized in Case No. 2012-00535*).¹⁶⁸ In fact, this normalized margin of \$21.7 million is *conservative and understated* because it does not

¹⁶³ Commission Order issued October 29, 2013, Case No. 2012-00535, pages 27-30.

¹⁶⁴ Ostrander Direct Testimony, Confidential Exhibit BCO-2, Schedule A-7, Adj. OAG-6-BCO.

¹⁶⁵ Provided in BREC's 7th Updated Response to PSC 1-43 and filed Jan. 31, 2014. This data was not available at the time the Attorney General filed his direct testimony on Oct. 28, 2013.

¹⁶⁶ Order dated Oct. 29, 2013, Case No. 2012-00535, p. 43. The recommended authorized TIER of 1.10 does not limit the actual TIER which the Company can earn.

¹⁶⁷ The normalization removes unusual, excessive and unsupported increases in A&G expenses for the month of December 2013. Normalization is appropriate because of the highly unusual increase in this expense—A&G jumped from \$2.0 mil. in Nov. 2013 to \$15.2 mil. in Dec. 2013. Average monthly A&G expense through Nov. 2013, was only \$2.16 mil., which is the same average monthly A&G expense through Nov. 2012.

¹⁶⁸ Order dated Oct. 29, Case No. 2012-00535, p. 43.

include the normalized impact of the Commission's authorized rate increase of \$54.2 million.¹⁶⁹

This new data also highlights significant inaccuracies in BREC's forecasting process and the related forecasted test period, and suggest that BREC's forecasts may have been manipulated to *substantially understate its earnings and TIER*. BREC's twelve months ending forecasted December 31, 2013 margin of \$4.95 million and related forecasted TIER of 1.11¹⁷⁰ is substantially exceeded by the actual December 31, 2013 normalized margin of \$21.3 million and related TIER of 1.50 - indicating an understatement of actual earnings by \$16.75 million (\$21.3 m - 4.95 m), or 338%. It can be reasonably concluded that this same significant inaccuracy in BREC's forecasts will carry over to its forecasted test period, based on the inaccuracy of its forecasted base period which in fact is the case.

B. Problems with BREC's Proposed TIER of 1.24

The OAG's recommendation for a 1.10 TIER is appropriate because it is the only TIER required of BREC at this time, per existing loan agreements.¹⁷¹ BREC's reliance on 2011 and 2012 data from the G&T Directory to support its 1.24 TIER is misplaced and improper because: (a) the G&T Directories reflect "actual earned" TIERs which are excessive and inapplicable, or the same as "Commission-authorized" TIERs, and BREC cannot establish a direct correlation between "actual earned" TIERs and

¹⁶⁹ *Id.* at p. 2.

¹⁷⁰ BREC's forecasted margin and related TIER for the twelve month ending December 31, 2013 were provided in BREC's Attachment to its response to AG 1-73, p. 276. The related margin of \$4.95 mil. is shown on p. 276, and the related conventional TIER of 1.11 (Case No. 2013-00199) is shown on p. 280.

¹⁷¹ Ostrander Direct Testimony, pp. 1-10.

"Commission-authorized" TIERs; (b) the TIER data is only a snapshot in time for some G&Ts, and actual TIERs can fluctuate from year-to-year, whereas "authorized" TIERs remain the same unless changed by regulatory agencies; (c) BREC has not shown that it is financially and operationally comparable to all of the G&T's to which it compares itself; and (d) a higher TIER does not solve BREC's greater financial problems.¹⁷²

6. The Attorney General Supports the KIUC Recommended Rate Plan Regarding Use of Reserve Funds

The Attorney General urges that the Commission not award any new revenues to Big Rivers in the instant case, and that the Company's TIER be set to 1.10.¹⁷³ However, regardless of whether the Commission awards new revenues, the Attorney General believes that any use of the Economic Reserve and the Rural Economic Reserve ["RER"] must be conducted in a just manner. For that reason, he supports the plan which KIUC presented to the Commission during the hearing of this matter, as set forth below.¹⁷⁴

In the event the Commission awards a rate increase and establishes a specific TIER but BREC is unable to reach that TIER, then BREC would draw on the revenues from the reserve funds¹⁷⁵ in order to achieve the Commission-approved TIER. This

¹⁷² Ostrander Direct Testimony, pp. 1-17.

¹⁷³ See Direct Testimony of Bion Ostrander on behalf of the Office of the Attorney General, pp. 8-9, 22-23.

¹⁷⁴ The Attorney General, however, does not support that portion of the KIUC plan which calls for a rate increase to be awarded in the instant case.

¹⁷⁵ Based on BREC's response to PSC 3-3, the balance of the Economic Reserve as of Aug. 31, 2013 was \$66.130 mil., while the balance of the RER as of that same time was \$65.350 mil.

could be accomplished by means of a monthly true-up based on actual achieved TIER, contrasted with BREC's projected revenues and expenses. This approach would benefit Big Rivers because it provides financial stability, while providing more time to reach a broader long-term solution to right-size the company. This plan would also benefit ratepayers because: (a) the residential portion of BREC's Rural Class of ratepayers would continue to receive the full amount of the RER in accordance with the Commission's prior allocation; (b) it prevents or at least mitigates rate shock; and (c) it prevents BREC from either overearning or any *potential* underearning by removing unknown variables from the fully forecasted test year.

The KIUC rate plan calls for: (a) allowing BREC to first utilize the funds from the Economic Reserve as an off-set to any potential rate increases; and (b) split the RER into two separate funds - a Rural Residential amount, and a Rural Business/Large Industrial amount. Residential members of the Rural class would still receive the full amount of funds they would even if the Commission does not accept the KIUC plan (65.4%), whereas the Rural Business/Large Industrial would receive the remaining 34.6% of those funds.¹⁷⁶

The KIUC plan will also resolve an inequity within the Rural class, which contains many businesses (primarily commercial and smaller industrials), some of which due to the nature of their respective operations consume more power than some

¹⁷⁶ See also KIUC's response to post-hearing data request no. 1. Rural Residential members thus would receive 65.4% of the total RER fund balance, while the Rural Business/Large Industrial customers would receive the remaining 34.6% of the RER fund balance. The Rural Residential share would be equal to the share of the RER fund that all Residential customers would receive under BREC's proposal.

members of the Large Industrial class.¹⁷⁷ The end effect of the KIUC plan would be to treat all business customers equally (both Rural and Large Industrial), while the residential portion of the Rural class would continue to receive all of the funds they would have received if the Commission elects to not alter usage of the existing funds.¹⁷⁸

7. BREC's Filed-For Revenue Requirement Must be Reduced to Recognize Smelter Transmission and Ancillary Service Revenue

Big Rivers' initial application failed to recognize that the company will receive quite significant amounts of transmission revenue from the smelters during the forecasted test period.¹⁷⁹ After the Attorney General's direct testimony pointed out this fact,¹⁸⁰ BREC's rebuttal testimony conceded such,¹⁸¹ yet asserted that its revenue requirements should not be reduced in an amount commensurate with the amount of transmission revenues it will receive from the two smelters.¹⁸² Nonetheless, BREC now proposes, in what is at least somewhat of a concession, that the smelter transmission

¹⁷⁷ Thus, load size by itself is not the sole criterion for determining whether a business falls within the Rural class, or Large Industrial class.

¹⁷⁸ The Attorney General believes that since the Commission created both the Economic Reserve and the Rural Economic Reserve, it can certainly alter the terms of their usage, just as the Commission did with regard to the Transition Reserve in Case No. 2012-00492, Order dated March 26, 2013. Another example of how the Commission could alter terms of usage of the two funds comes in BREC's proposal (discussed in more detail, *infra*) to use the Economic Reserve as a tool to receive any transmission revenues the smelters pay to BREC.

¹⁷⁹ See Berry Direct Testimony, p. 17, 14-7: "... At this time, the contracts among Big Rivers, Kenergy, and Century have been filed with the Commission, but they have not been approved or executed. Until the contracts are approved and executed, it would be speculative and inappropriate to include revenues that could arise under the contracts in the forecast."

¹⁸⁰ Holloway Direct Testimony, p.19, lines 11-20.

¹⁸¹ See Berry Rebuttal Exhibit 5.

¹⁸² See, e.g., Berry rebuttal at p. 22.

and ancillary service revenues should be used to replenish the Economic Reserve and offset a portion of any potential rate increase.¹⁸³

During the hearing in this matter, Mr. Berry testified that the Sebree smelter has increased its load from 368 MW to 385 MW, which means that BREC will receive even more transmission revenue than it anticipated (\$6,000,917, contrasted with the original estimate of \$5.736 million).¹⁸⁴ Mr. Berry also testified that he did not revise the total figures for transmission revenues.¹⁸⁵ When this revised, increased figure is placed into the chart set forth in Berry Rebuttal Exhibit 5 (which also recognizes the revenue from ancillary service provided to the smelters), the new total figure becomes \$15.792 million, as follows in Fig. 1:

ESTIMATED SMELTER TRANSMISSION AND ANCILLARY SERVICE REVENUE

	Century Hawesville	Century Sebree	TOTAL
Sch. 1 Revenue to BREC	1,027,651	783,943	1,811,594
Sch. 2 Revenue to BREC	261,192	199,950	460,442
Sch. 9 Revenue to BREC	7,519,098	6,000,917	13,520,015
Total Realized Transmission & Ancillary Service Revenue	8,807,941	6,984,110	15,792,051

Fig. 1

During cross-examination of BREC witness Wolfram at the hearing, the Attorney General introduced OAG Hearing Exhibit 8 ("Allocation of Smelter Transmission

¹⁸³ Berry Rebuttal p. 23, lines 12-14.

¹⁸⁴ Berry hearing testimony, January 8, 2014 VTE at 17:01:25 - 17:02:45.

¹⁸⁵ *Id.*

Revenue to Customers"). While the Attorney General would prefer to have the smelter transmission revenue directly reduce the revenue requirement in the manner set forth in his Hearing Exhibit 8, nonetheless Big Rivers' proposal to place revenues from transmission and ancillary service to the smelters into the Economic Reserve is also reasonable. BREC's proposal would thus allow increases in smelter transmission and ancillary service revenues to immediately benefit ratepayers.

However, while Big Rivers' overall approach may be reasonable (provided the revenue is automatically passed through to the members), the Commission should adjust the allocation methodology. Currently the economic reserve is allocated to Rural and Industrial customers based on energy.¹⁸⁶ However, transmission costs included in Big Rivers' forecasted test period are allocated between the Industrial and the Rural customers based on coincident peak.¹⁸⁷ The difference is significant. Allocation of smelter transmission revenues to the economic reserve based on energy, instead of the proper transmission cost allocation of coincident peak, would cause the Rural customers to subsidize the Large Industrial class by over \$1,200,000 a year.¹⁸⁸

If the Commission adopts Big Rivers' proposal to direct the smelter transmission revenue to the economic reserve, the Attorney General urges the Commission to also direct Big Rivers to allocate these revenues between the Rural and Industrial customers based on coincident peak, not energy. Additionally, the Commission should assure that regardless of the mechanism it orders to be used, the smelter transmission revenue

¹⁸⁶ See, e.g., Wolfram cross-examination, January 9, 2014 VTE, 14:27:25 - 14:27:35 ("[The] economic reserve is based on energy").

¹⁸⁷ *Id.* at 14:10:17.

¹⁸⁸ See OAG Hearing Exhibit 8.

should immediately flow through to benefit ratepayers, as it would in an offset to revenue requirements as originally proposed by the Attorney General.

8. The Commission Should Order a Comprehensive Management Audit of Big Rivers

As has been thoroughly demonstrated in the course of the last three years, and over the course of many cases,¹⁸⁹ Big Rivers has brought itself to a precarious financial situation and is at a cross-roads. Big Rivers is a utility that has lost 70% of its load, and that now seeks, on the one hand, to transform itself into a merchant operation, while on the other hand holding onto its status as a *regulated* utility whereby it can continue to rely on rate increases. While clinging to its internal plans for the future, which lack any independent evaluation, the true nature of this proceeding and anticipated future rate applications by Big Rivers is to seek the Commission's approval to allow BREC to require ratepayers to fund its *merchant* operation. While the Attorney General wishes to fully avoid casting aspersions on the personal character of Big Rivers' management, nonetheless the evidence presented to the Commission establishes that this company's actions during the past several years have not been consistent with the best interests of its members and its ultimate, retail customers.¹⁹⁰

Therefore, the need for a comprehensive management audit is abundantly clear. The key goal in any such audit should be to find the most effective means to "right-

¹⁸⁹ E.g., Case Nos. 2011-00036; 2012-00063; 2012-00119; 2012-00492; 2012-005353; 2013-00221; 2013-00413; and 2013-00199.

¹⁹⁰ See OAG Hearing Exhibit 3, public comment letter ("whistleblower letter") filed with the Commission Dec. 26, 2013. While the Attorney General did not introduce this letter, nor cite it in this Brief for the truth of the assertions set forth therein, nonetheless the letter should be considered in the appropriate context of the entire record.

size" Big Rivers. In Case No. 2008-00436, the Commission ordered a management audit of East Kentucky Power Cooperative which proved very beneficial to both the company, its member-owners and its retail ratepayers. There is every reason to believe that a similar result could be reached in the case of BREC. The Attorney General recommends that in addition to the items of concern to which KIUC witness Lane Kollen testified,¹⁹¹ the following items should be examined and addressed within the scope of any such audit:

- The clear contradiction between BREC's claim that it is acting in its members' interests, and BREC's failure to conduct any basic financial net present value analysis from a member point of view at this critical juncture for the organization;
- The conflict between BREC's current direction of operating as a merchant generator versus its stated mission of providing cost effective power for its members, together with its long-term history of excess capacity;
- BREC's use of "blinders" in setting possible sales prices for generating plants which are not used and useful, and evident failure to have meaningful conversations with lenders on implications and requirements associated with sale of generating plants;¹⁹²
- The very close proximity in time between BREC's closing on refinancing (July 27, 2012), and the first smelter termination notice (August 20, 2012);
- The "extraordinary level of retirements and departures this year" ¹⁹³ experienced by BREC;
- BREC's "fear"¹⁹⁴ of talking to its lenders when a workout plan is clearly needed due to the departure of 70% of BREC's load, and consequent failure to have a robust understanding of alternative strategies;

¹⁹¹ See Direct Testimony of Lane Kollen, generally, and his cross-examination by Vice Chairman Gardner at Jan. 9, 2014 VTE at 19:32:00 - 19:40:10.

¹⁹² Richert Cross-Examination by Vice Chair Gardner, Jan. 7, 2014 Confidential VTE, 17:56:10 - 17:57:07.

¹⁹³ Bailey Cross-Examination, Jan. 7, 2014 VTE at 15:34.

¹⁹⁴ Bailey Cross-Examination, Case No. 2012-00535, July 1, 2013 VTE beginning after 1:08.

- BREC's presentation to the Commission of only "bits and pieces"¹⁹⁵ of its financial picture, with continued additional revelations only upon examination;
- Consequent failure to develop alternative runs of the Financial Forecast for management and Board of Directors review and discussion, based on robust understanding of alternative strategies;¹⁹⁶
- BREC's insular approach to development of replacement load estimates—a crucial input to the Long Term Financial Forecast—without the involvement or counsel of economic development authorities, economic development professionals, especially when Big Rivers "does not personally solicit new economic development prospects"¹⁹⁷ and thus does not have the requisite economic development experience;
- The fact that BREC's Mitigation Plan fails to directly align the scale of its operations to its remaining customer base and member load;
- Significant public comment questioning BREC management decisions, including but not limited to the "whistleblower letter" introduced as OAG Hearing Exhibit 3; and,
- Consequent questions of whether the BREC Board of Directors has maintained reasonable independence from BREC officers and executive management, and is executing its fiduciary responsibilities, based on the above.

The Commission possesses the authority to order an audit under KRS 278.250 and 278.255. No specific acts or allegations regarding company management are required in order for the Commission to require a management audit. However, the items set forth above, together with BREC's self-acknowledged "precarious financial position" are clearly indicative of the need for a comprehensive management audit at this stage of its corporate existence, and especially given the history of the organization with which the Commission is all too familiar.

¹⁹⁵ Richert Cross-Examination by Commissioner Breathitt, Jan. 8, 2014 VTE at 12:44:45.

¹⁹⁶ Warren Cross-Examination, Jan. 9, 2014, VTE about noon.

¹⁹⁷ BREC Response to PSC 2-18, Case No. 2012-00535, at page 2, line 20.

The management audit should be conducted under the Commission's supervision. The Commission should ensure that the Request for Proposals for the management audit specify and include the above-referenced issues and areas among those to be examined, and should require that the contract with the successful bidder incorporate those specific issues and areas as well. The Commission should have a role in the evaluation of the proposals, and approve of the bidder that is selected. Moreover, any reporting requirements the Commission may impose as part of the audit should, as appropriate, include regular updates to the intervenors in the instant proceeding, including the Attorney General.

CONCLUSION

WHEREFORE, the Attorney General requests that the Commission:

- (1) Deny the rate increase proposed by Big Rivers as unfair, unjust and unreasonable;
- (2) Find that the generation assets proposed to be idled by Big Rivers are not used or useful and, therefore, should be excluded from rate base;
- (3) Find that the evidence presented by Big Rivers, including but not limited to the Mitigation Plan, Load Replacement Estimates and Long-Term Forecasting and Projections are inherently unreliable and, therefore, Big Rivers has failed to sustain its burden of proof under KRS 278.190(3) to demonstrate that the proposed rates are fair, just and reasonable;
- (4) Find (a) that Big Rivers failed to produce key documents necessary for the Commission and the intervenors to determine the true value of plants.

proposed to be idled, (b) that this information is necessary for the Commission to determine the value of this plant, and (c) that Big Rivers shall produce this information to the Commission and intervenors forthwith and that intervenors shall be permitted supplemental briefing limited to this issue, to be filed promptly upon provision of the attachment to the intervenors;

- (5) Find that the rate increase proposed by Big Rivers does not result in a balance of interests, and that Big Rivers' lenders must share the risks they undertook in lending to Big Rivers;
- (6) Find that the revenue requirement and the application of a TIER of 1.24 proposed by Big Rivers will not result in rates that are fair, just and reasonable;
- (7) Find that the KIUC rate plan as described herein is reasonable and that the use of the Reserve Funds as proposed is consistent with the Commission's findings in the Unwind Order;
- (8) Find that any and all transmission and ancillary revenues collected by Big Rivers should be used to reduce Big Rivers as-filed revenue requirement;
- (9) Order a management audit of Big Rivers consistent with KRS 278.250 and 278.255 to investigate management effectiveness and operating efficiency consistent with the Attorney General's recommendations herein.

Respectfully submitted,
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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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