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JAN 14 2014

PUBLIC SERVICE
COMMISSION

Via Hand Delivery

January 14, 2014

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

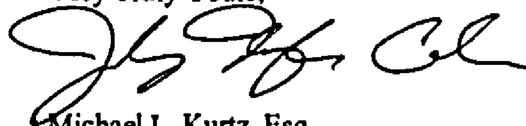
Re: Case No. 2013-00413

Dear Mr. Derouen:

Please find enclosed the original and ten (10) copies of the BRIEF OF KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC. for filing in the above-referenced matter.

By copy of this letter, all parties listed on the Certificate of Service have been served. Please place these documents of file.

Very Truly Yours,



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Attachment
cc: Certificate of Service
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CERTIFICATE OF SERVICE

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COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In The Matter of: The Joint Application of Kenergy Corp. and Big Rivers Electric Corporation for Approval of Contracts and for a Declaratory Order	:	Case No. 2013-00413

BRIEF OF

KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC.

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January 14, 2014

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COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In The Matter of: The Joint Application of Kenergy Corp. and Big Rivers Electric Corporation for Approval of Contracts and for a Declaratory Order	: : :	Case No. 2013-00413

BRIEF OF KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC.

Kentucky Industrial Utility Customers, Inc. ("KIUC") representing the interests of Domtar Paper Co., LLC, Kimberly Clark Corporation and Aleris International, Inc. submits its Main Brief to the Kentucky Public Service Commission ("Commission") as follows:

I. INTRODUCTION

The basic question facing the Commission in this case is whether giving Century Aluminum Sebree LLC (the "Sebree Smelter") an approximately $72 million rate reduction that would only increase its profits from good to great,[1] while non-Smelter customers pick up the $71.2 million tab created by the Sebree Smelter's contract termination, is fair, just and reasonable in accordance with KRS 278.030 and not unduly discriminatory in violation of KRS 278.170. The answer to this question is no. But the Commission can take steps in this case to ensure that the distribution rate charged by Kenergy Corp. ("Kenergy") to the Sebree Smelter will in fact satisfy the requirements of those statutes.

Like the rate agreements recently approved for the Hawesville Smelter in Case No. 2013-00221, the new rate agreements proposed by Big Rivers Electric Corporation ("Big Rivers") and Kenergy ("collectively, "the Companies") would allow the Sebree Smelter to bypass the cost-based generation service presently provided by Big Rivers and instead acquire that service at market-based rates.[2] However, the circumstances surrounding the Sebree Smelter are fundamentally different than those surrounding the Hawesville Smelter. Whereas the

[1] KIUC Ex. 6.
[2] Through MISO market purchases and/or through other bilateral agreements beginning on January 31, 2014.

Hawesville Smelter's financial circumstances indicated that market-based rates were necessary in order to avoid shutdown, the record in this case does not reflect that the Sebree Smelter requires purely market-based rates to avoid such an outcome. To the contrary, rather than savings jobs, granting an approximately $72 million rate reduction to the Sebree Smelter by approving the proposed agreements as filed may only increase the profits of an already profitable company at the expense of Big Rivers' non-Smelter customers. It is therefore necessary for the Commission to fully evaluate the Sebree Smelter's financial circumstances in this case, including its profitability, in order to avoid authorizing an excessive reduction in the Sebree Smelter rate.

The Sebree Smelter's financial circumstances indicate that the proposed agreements should be modified to impose a reasonable market access charge on the Sebree Smelter before those agreements will comply with KRS 278.030 and KRS 278.170. To do so, the Commission can either: 1) alter the agreements immediately to require the Sebree Smelter to pay the market access charge to result in a $43/MWh rate as recommended by KIUC; or 2) approve the agreements on an interim basis and simultaneously open a *"phase two"* investigation into the appropriate level of a market access charge for the Sebree Smelter. But the Commission should not simply approve the proposed agreements on a permanent basis without either imposing or investigating the appropriate level of a market access charge for the Sebree Smelter. Failing to take at least one of these actions may result in Big Rivers' non-Smelter customers being forced to subsidize an already profitable Sebree Smelter's unduly preferential access to the lower-cost market power at unjust and unreasonable levels.

Big Rivers' non-Smelter customers did not cause the stranded costs created as a result of the Smelter contract terminations. Hence, imposing massive rate increases on those customers in order to fund an unnecessarily massive rate reduction to the Sebree Smelter would not be fair, just, and reasonable in accordance with KRS 278.030. Moreover, allowing an already profitable Sebree Smelter to access lower-priced market power that none of the other non-Smelter customers get similar access to while forcing the non-Smelters to pay all the stranded costs caused by Sebree's contract termination would provide an unreasonable preference or advantage to the Sebree Smelter and would result in unreasonable economic prejudice or disadvantage to other non-Smelter customers in violation of KRS 278.170. Accordingly, the Commission must take steps in this case to ensure that these adverse outcomes do not occur.

II. BACKGROUND

Throughout the lengthy history of interactions between Big Rivers and the Smelters, the Smelters have aggressively sought to minimize their cost of power through various transactions and pricing mechanisms, and more specifically, by shifting back and forth between cost-based generation service from Big Rivers and market access and/or bilateral agreements with other parties.

Prior to 1998, the Smelters were all-requirements customers of Big Rivers and subject to regulated cost-based rates. During this time, Big Rivers generating resources were constructed, acquired, and financed to meet the needs of the Smelters, which together comprised between 70% and 80% of the Big Rivers load.[3] The Reid-Green Station Two plant complex was built in close proximity to the Sebree Smelter primarily to serve the Sebree Smelter load and the Coleman plant was built in close proximity to the Hawesville Smelter primarily to serve the Hawesville Smelter load.[4]

In the 1980s, the Wilson plant was built in part to serve a projected increase in the Hawesville Smelter load. The construction of the Wilson plant resulted in significant excess generating capacity and the related costs, including excessive fuel costs due to fraudulent coal contracts. These mostly self-imposed circumstances caused severe financial distress for Big Rivers and subsequently led to a default on its debt. In response, the Commission oversaw a "*workout*" process that resulted in an increase in rates, creditor concessions, and the adoption of variable rates for the Smelters tied in part to the LME price of aluminum. The Big Rivers "*workout plan*" relied heavily on sales of Big Rivers' excess capacity into the market at prices greater than its variable costs to generate.[5]

When market prices subsequently declined in the late 1990s, however, Big Rivers' market sales margins also declined and it was forced to file for bankruptcy so that it could restructure its operations and its debt, resolve certain lawsuits and rescind the fraudulent coal contracts. Under the oversight of the Bankruptcy Court, Big Rivers entered into a series of transactions and agreements with its creditors and other parties that fundamentally transformed the structure and operation of Big Rivers, including its relationships with the Smelters and its

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[3] Kollen Testimony at 23:5-19.
[4] Kollen Testimony at 23:20-23.
[5] Kollen Testimony at 24:6-18.

obligation to serve the Smelter loads, and restructured its debt.[6] Under the Reorganization Plan approved by the Bankruptcy Court,[7] Big Rivers restructured and downsized its operations and its obligations. Big Rivers entered into a 25-year agreement to lease its power plants to Western Kentucky Energy Corp. ("WKEC") and WKEC assumed the operation and maintenance of the Big Rivers' generating plants. Big Rivers used the lease income from WKEC to cover the debt service costs incurred to finance the generating plants.[8] Commission approval of the rates incorporated into the Reorganization Plan was required and was given. Importantly, during the pendency of the bankruptcy, the Commission retained all of its ratemaking jurisdiction.

Pursuant to 1998 bankruptcy reorganization, Big Rivers successfully shed its obligation to serve the Smelters. The agreements specified that LG&E Energy Marketing, Inc. ("LEM") *"will supply directly to Henderson Union and Green River the wholesale power needed to serve Alcan [Sebree Smelter] and Southwire [Hawesville Smelter]* ***with LEM assuming all the risks for the Smelter loads."***[9] The Smelters paid LEM a fixed rate of $25/MWh for approximately 70% of their requirements and an average rate of $50 to $60/MWh for market purchases to meet their remaining requirements. This resulted in a blended cost to the Smelters of $35/MWh.[10] Although the Big Rivers agreement with LEM would not have terminated until 2023, the Hawesville Smelter agreement terminated in 2010 and the Sebree Smelter Agreement terminated in 2011.[11]

In 2009, the Unwind Transaction was consummated primarily to resolve the scheduled termination of the Smelter agreements with LEM and to address LEM's desire to prematurely terminate the power purchase agreement with Big Rivers.[12] At that time, the Smelters faced market prices of $50 to $60/MWh for all of their requirements after their agreements with LEM terminated in 2010 and 2011, which were significantly greater than the LEM contract prices and significantly greater than the rates/contract prices they could achieve if they again were served by Big Rivers at cost-based rates. In light of those market prices, the Smelters claimed that they

[6] Kollen Testimony at 24:19-25:5.
[7] *See* Case Nos. 97-204 and 98-267.
[8] Kollen Testimony at 25:6-14.
[9] Kollen Testimony at 25:15-21 (citing Order, Case No. 97-204 at 9 (emphasis added)).
[10] Kollen Testimony at 27:4-8 (citing Order, Case No. 2007-00455 at 14).
[11] Kollen Testimony at 26:3-5.
[12] Kollen Testimony at 26:19-27:1.

would be forced to shut down if the Unwind Transaction was not approved because they could not economically operate the Smelters at market prices.[13]

The agreements between Big Rivers, WKEC, and LEM were terminated early and Big Rivers reacquired approximately 1,800 MW of generating assets so that it could serve the Smelters, among other reasons. Big Rivers commenced operating and maintaining its power plants and again assumed the risk and obligation to supply the Smelter loads, entering into new agreements with each of the Smelters to supply their loads at cost-based rates/contract prices that could be adjusted as the Company's costs increased or otherwise changed. Both Big Rivers and the Smelters also received cash payments from LEM in conjunction with the Unwind Transaction.[14] But for the Smelters, Big Rivers would not have reacquired its power plants until 2023.

The Smelter contracts approved pursuant to the Unwind Transaction did not provide the Smelters with an option to terminate their contracts if market prices subsequently were less than Big Rivers' cost-based rates or to avoid cost-based rate increases. The only "*out*" pursuant to the agreements was if the Smelter planned to cease smelting operations and to shut down permanently. Pursuant to this provision, each Smelter was required to provide a statement, under oath, from its Chief Executive Officer, that it ***"has made a business judgment in good faith to terminate and cease all aluminum smelting at the...Smelter and has no current intention of re-commencing smelting operations at the...Smelter."***[15] The purpose of the provision was to protect customers from the stranded costs and massive rate increases that a market bypass would cause if the fixed costs incurred to serve the Smelter load instead were allocated to the non-Smelter customers.[16]

The Smelters ultimately concluded that the "*out*" provision in their contracts really did not require them to shut down and cease smelting operations permanently. Instead, the Smelters concluded that the "*out*" provision could be used to bypass the Big Rivers generation resources and obtain lower cost market prices while avoiding paying for any of the fixed costs that were incurred to serve them.[17] Prior to providing their respective Termination Notices, each Smelter engaged in negotiations with Big Rivers to obtain rate reductions. These

[13] Kollen Testimony at 27:8-12.
[14] Kollen Testimony at 27:13-21. The Commission's Order in Case No. 2007-00455 provides a more detailed description of the Unwind Transaction and the circumstances that led to that transaction at pages 1-23.
[15] KIUC Ex. 4 (emphasis added); Kollen Testimony at 28:11-21.
[16] Kollen Testimony 29:1-7.
[17] Kollen Testimony at 29:11-17.

negotiations were unsuccessful, even though Alcan offered to continue purchasing from Big Rivers at a lower rate of $43/MWh that still would have paid Big Rivers a portion of the fixed costs incurred to serve the Sebree Smelter.[18]

Subsequently, the CEOs of the parent companies of each Smelter certified that they intended to terminate and that they had no current intention to continue operations at the Smelters once they terminated service with Big Rivers. Century provided Big Rivers the first Notice of Termination on August 20, 2012. Despite the representations made in its Notice, Century shortly thereafter commenced negotiations with Big Rivers on or about October 1, 2012 in an attempt to continue operating the Hawesville Smelter, bypass the Big Rivers supply resources and costs, and acquire lower cost market-priced power. After Century provided its Notice, Big Rivers filed the Century rate case on January 15, 2013, primarily to recover the stranded fixed costs from the remaining customers that no longer would be paid by Century. Big Rivers requested a $68.6 million rate increase, which would have substantially increased the Sebree Smelter's rate. The Commission ultimately authorized a rate increase of $54.2 million in that case.[19]

Two weeks after Big Rivers filed the Century rate case, on January 31, 2013, Alcan provided Big Rivers its Notice of Termination, certifying that it had made a business judgment in good faith to terminate and cease all aluminum smelting at the Sebree Smelter.[20] On June 28, 2013, Big Rivers filed the "Alcan" rate case specifically and solely to recover the stranded fixed costs from the non-Smelter customers that no longer would be paid by the Sebree Smelter. That request for an increase of $71.2 million on the non-Smelter customers is still pending.[21]

As this history demonstrates, in the previous decades, the Smelters have jumped back and forth from cost-based rates to market-based rates/bilateral contract rates depending upon which was most favorable to them at the time. Now, even though the Smelters caused the now-stranded costs associated with the excess capacity on the Big Rivers system and reaped the benefits of cost-based rate treatment from Big Rivers' generating units when it was favorable to them, they seek to avoid paying any of the stranded costs associated with those generating units and instead wish to pay only market-based rates.

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[18] Kollen Testimony at 29:18-22.
[19] Kollen Testimony at 30:9-16; *See also* Order, Case No. 2012-00535 (October 29, 2013).
[20] KIUC Ex. 5.
[21] Kollen Testimony at 30:17:-31:3.

III. ARGUMENT

A. The Fundamentally Different Circumstances Surrounding the Profitable Sebree Smelter Warrant Different Treatment Than the Commission Authorized for the Hawesville Smelter in Case No. 2013-00221.

Rather than simply adopting essentially the same agreements that it adopted for the Hawesville Smelter in Case No. 2013-00221, the Commission should consider the fundamentally different circumstances of the Sebree Smelter to determine the appropriate rate in this proceeding.[22]

The Hawesville Smelter was not profitable paying $48.68/MWh for power. In fact, the record in Case No. 2013-00221 reflects that it was losing $5 million per month.[23] Consequently, the Commission's decision to provide the Hawesville Smelter a 30% (or $60 million per year) rate reduction through market-based pricing was necessary to avoid an immediate shutdown. Even with the huge rate reduction approved by the Commission, the evidence in that case suggested that the Hawesville Smelter would barely breakeven.[24]

The same is not true for the much more efficient and profitable Sebree Smelter. The record in this case reflects that the Sebree Smelter made $29 million in profit in 2012 at an average cost-based rate of $48.68/MWh and average London Metal Exchange ("LME") price of $2,019 per tonne.[25] And for the twelve months ending April 2013, the record reflects that the Sebree Smelter made $30 million in profit based on an average LME price of $1,959 per tonne and an average cost-based rate of approximately $49/MWh.[26]

These financial results were *"sweet,"* according to the headline in the May 2013 newsletter. The results led to employee bonuses well in excess of the 100% targets for each department, ranging from $590 to $1,410 for the first four months of 2013. These bonuses were possible because the Sebree Smelter was profitable. This is far different than the situation at Hawesville where that Smelter was struggling to survive.[27]

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[22] The Commission should also note the 15 *"principle substantive differences"* between the Sebree compared to the Hawesville agreements that distinguish the two transactions. Companies Response to AG 1-5. These 15 differences include changes in the Kenergy tariff, Direct Agreement, and Arrangement Agreement to explicitly recognize that Big Rivers has no obligation to supply the Smelter from its resources; the equipment necessary to access market power; the reimbursement of Big Rivers' costs; the obligation to purchase zonal resource credits; and the amounts that may be recovered or returned to the Smelter due to the operation of an SSR; among others.

[23] Kollen Testimony at 15:3-7(citing the testimony of Sean Byrne, Case No. 2013-00221 (July 19, 2013)).

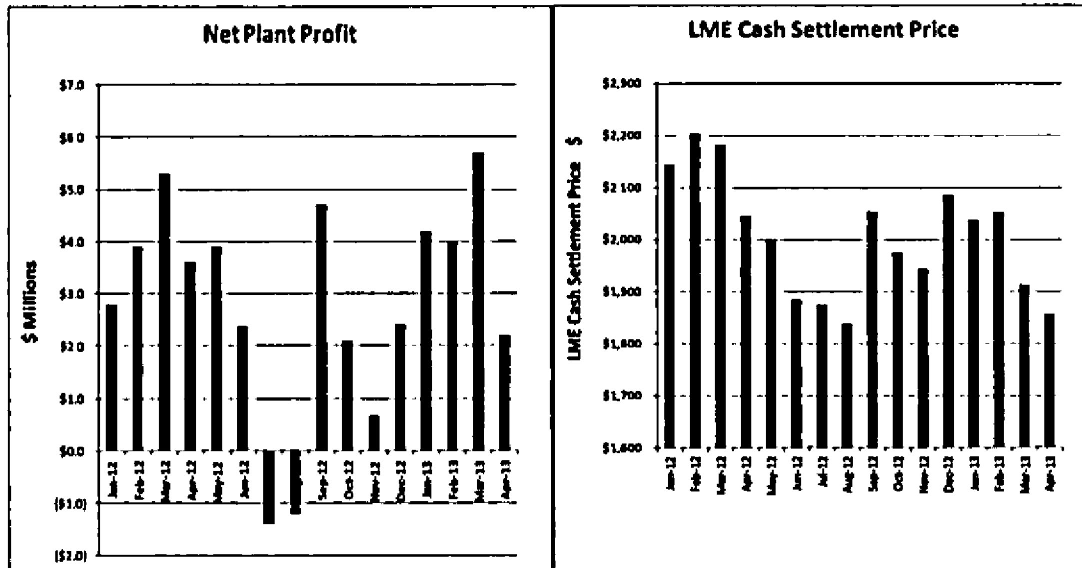
[24] Kollen Testimony at 15:7-13 (citing Century's Post-Hearing Brief).

[25] Kollen Testimony at 8:9-11.

[26] Kollen Testimony at 8:11-13.

[27] Kollen Testimony at 9:7-13.

The following graphs show the Sebree Smelter net plant profit compared to the LME cash settlement price for the months January 2012 through April 2013 at the average cost-based rate of $48.68/MWh and without the effects of the most recent rate increase on August 20, 2013.[28]



The Sebree Smelter's greater profitability at a lower LME and approximately the same cost-based rate demonstrates that it has continued to reduce its financial breakeven point.[29] That is to be expected since Alcan continually invested in the Sebree Smelter, thus improving efficiencies and increasing its output.[30] For example, in May 2011, Alcan indicated that it planned to spend *"$16 million on equipment upgrades that would generate more production with same fixed cost which increases plant's viability"* and that this was *"in addition to further working to reduce [Alcan's] operating cost."*[31] Prior to the Century acquisition of the Smelter, Alcan invested over $100 million in the Smelter over the preceding five years and planned to invest another $70 million in the next five years. The Sebree Smelter is now one of the most efficient smelters in the world on operating (non-energy) cost.[32]

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[28] Kollen Testimony at 8:17-9:6 (citing Exhibit LK-2, Companies' Response to KIUC 1-12(b)).
[29] Kollen Testimony at 8:13-16.
[30] *See* Direct Testimony of Stephane LeBlanc, Case No. 2011-00036 (May 24, 2011)("LeBlanc Testimony").
[31] Kollen Testimony at 22:2-6 (citing LeBlanc Testimony at 7:13-16).
[32] Kollen Testimony at 20:1-6 (citing Companies' Response to KIUC 1-12(a)).

It is also notable that Century acquired the Sebree Smelter in June 2013 at a bargain price (below the net book value) and recognized a pre-tax gain on the transaction of more than $5 million.[33] Kenergy reported to its Board of Directors that the purchase was at a *"ridiculously low price"* and *"well below the $211M offer that Alcan had received previously."* Thus, the Sebree Smelter was profitable before Century acquired it and with a reduction in fixed costs due to the change in ownership, it will be even more profitable in the future.[34]

Though the record indicates that the Sebree Smelter was profitable and could remain profitable paying a power rate of $48.68/MWh, the Sebree Smelter provided its Notice of Termination to Big Rivers on January 31, 2013. The reason for the Notice was that the Sebree Smelter faced a significant rate increase as a result of Big Rivers' pending request in Case No. 2012-00535, wherein Big Rivers sought to recover the stranded fixed costs caused by the Hawesville Smelter's contract termination.[35] That rate increase would raise the Sebree Smelter's power charge at the time from $48.68/MWh to approximately $60/MWh and eliminate the Sebree Smelter's profit, all else equal.[36] Importantly, although the Sebree Smelter's Notice indicates that a rate of $60/MWh for power is too high to sustain its operations, the Notice does not mean that granting the Sebree Smelter market-based rates is the only option that will avoid shutdown.

In fact, the approximately $72 million rate reduction proposed in this case would significantly bolster the Sebree Smelter's profitability. The Sebree Smelter presently pays $59.4/MWh after the increase granted in Case No. 2012-00535. A reduction to a market rate of $36.58/MWh, based on Big Rivers' most recent projection of market prices provided to Alcan earlier this year,[37] will increase the Sebree Smelter's profits by over $70 million annually, all else equal.[38] In addition, Century's decision to increase the load that it will acquire at market to 385 MW (an increase of 23 MW or 6% from the historic 362 MW that it previously took from Big Rivers) due to increased production at the Sebree Smelter will also increase its profits.

The huge boost to the Sebree Smelter's profitability proposed in this case comes at the expense of Big Rivers' remaining non-Smelter customers. Big Rivers' pending request to increase its base rates in Case No.

[33] Kollen Testimony at 22:7-10 (citing LK-6, Century 10-Q for the quarter ending June 30, 2013).
[34] Kollen Testimony at 22:12-15.
[35] KIUC Exs. 2 and 5.
[36] Kollen Testimony at 11:7-13 (citing Direct Testimony of Lane Kollen, Case No. 2012-00535, Exhibit LK-2).
[37] Exhibit LK-5, Companies' Response to KIUC 1-16(c).
[38] Kollen Testimony at 10:5-14; *See also* KIUC Ex. 6.

2013-00199 is necessitated entirely because of the stranded costs resulting from Sebree Smelter's contract termination. If Big Rivers' request is approved in that case, non-Smelter customers would pay an additional $71.2 million in order to allow the Sebree Smelter to acquire its power at market-based pricing through Kenergy.[39]

The Commission should not force the non-Smelter customers to subsidize the Sebree Smelter any more than is absolutely necessary. The evidence indicates that the Sebree Smelter already is more profitable, operates more efficiently, and has a lower financial breakeven point than the Hawesville Smelter. Additionally, the record does not reflect that the Sebree Smelter is in imminent danger of shutdown for economic reasons at a power rate less than $60/MWh. This is in stark contrast to the Hawesville Smelter, which needed a 30% rate reduction just to break even and avoid an immediate shutdown. Accordingly, the Hawesville Smelter's case should not form a basis for the Commission to authorize an unnecessary transfer of cost responsibility from the Sebree Smelter to the remaining non-Smelter customers. Instead, the Commission should either use the financial information currently available in this case or should gather additional financial information from the Sebree Smelter to ensure that it achieves a reasonable balance of interests between the Sebree Smelter and the remaining non-Smelter customers.

B. Neither the Companies Nor the Sebree Smelter Provided Sufficient Evidence Demonstrating that the Massive Rate Reduction Proposed for the Sebree Smelter is Lawful or Necessary.

The Commission should not simply view the electric service arrangements as a "*take it or leave it*" proposition that cannot be reasonably modified. Those arrangements constitute the proposed "*rate*" for the Sebree Smelter.[40] And the Commission is statutorily charged with setting rates at fair, just, and reasonable levels and on a non-discriminatory basis. No party to this case has adequately proven that the proposed rate is fair, just and reasonable pursuant to the requirements of KRS 278.030. Similarly, no party provided sufficient evidence to demonstrate that the proposed rate does not provide an *"unreasonable preference or advantage"* to the Sebree

[39] Kollen Testimony at 10:16-11:5.
[40] KRS 278.010(12)(defining "*rate*" as "*any individual or joint fare, toll, charge, rental, or other compensation for service rendered or to be rendered by any utility, and any rule, regulation, practice, act, requirement, or privilege in any way relating to such fare, toll, charge, rental, or other compensation, and any schedule or tariff or part of a schedule or tariff thereof.*").

Smelter or an *"unreasonable prejudice or disadvantage"* to the non-Smelter customers, neither of which is permitted pursuant to KRS 278.170.

The Companies provided no quantitative support whatsoever for the severe reduction in the Sebree Smelter rate they propose in this proceeding. Mr. Berry conceded this point at hearing:

> Q: "*...neither Big Rivers nor Kenergy conducted an economic analysis to support this application pending before the Commission, is that correct?*
> *A: That's correct."*[41]

Further, as the record reflects, "[n]*either Big Rivers nor Kenergy performed any financial analysis of whether a market-based power supply was necessary to keep the Sebree smelter in operation ...The only financial information Big Rivers has regarding the profitability of the Alcan smelter comes from monthly plant newsletters."*[42] At the hearing, witnesses for both Big Rivers and Kenergy confirmed that the proposed arrangements were entered into with little knowledge of the Sebree Smelter's profitability or financial needs, though Kenergy's witness Mr. Starheim noted that he understood the Sebree Smelter to be "*marginally profitable*" at the time of the negotiations:

> Q: "*...you've conducted no analysis to know how profitable or unprofitable the Sebree smelter is, correct?*
>
> Mr. Berry: "*That's correct.*"[43]
>
> Q: "*The only information we had on the profitability of Sebree was the information you provided in the discovery. You had those plant employee reports or something?*
>
> Mr. Berry: "*That's all we have, yes.*"[44]
>
> Q: "*How can you say the only alternative is for [the Sebree Smelter] to shut down if you really don't really have any information on how profitable it is?*
>
> Mr. Berry: "*Well, I'm basing that off of the negotiations that we held with Century....And, you know, we're basing that on the negotiations and what Century's feedback from the negotiations are saying.*"[45]
>
> Q: "*...you had in your possession the copies of the Sebree newsletters to its employees in which it referenced its profitability, did you not?*
>
> Mr. Berry: "*Yes, sir.*"
>
> Q: "*At any time during those negotiations did you point that out to Century Sebree and ask them to explain why they would claim that they would be going out of business when they would be*

[41] Tr. at 30:23-31:1.
[42] Kollen Testimony at 13:14-20 (citing Big Rivers' Response to KIUC 1-12(b)).
[43] Tr. at 35:22-25.
[44] Tr. at 48:14-18.
[45] Tr. at 50:3-13.

telling their own employees for purposes of bonuses that they're profitable?

Mr. Berry: *"No sir."*[46]

Q: "*So were you aware that Sebree was profitable at the time that it gave its notice of termination in January 31 of 2013?*

Mr. Starheim: "*What we were told by Alcan staff was that they were marginally profitable with the prior electric rates, and that the increases that they were expected to receive as a result of the Century Hawesville rate increase would make them unprofitable."*[47]

Q: "*So would it be fair then to say that at no time in the last year did you think that it was unusual that a business operation like the Alcan Sebree would be saying that it had no intent to continue operation, even though it was at least marginally profitable?*

Mr. Starheim: "*Well, there was also many statements being made publicly, as well as by their staff, of their corporate parent's intent to sell the plant as well, so I, again, took them at their word that they were sincere about terminating operations if that kind of rate increase was to occur."*[48]

By failing to investigate the profitability of the Sebree Smelter during negotiations, the Companies imprudently ignored a critical opportunity to eliminate or at least reduce the stranded costs imposed on the non-Smelter customers and to ensure that the proposed rate for the Sebree Smelter would be consistent with KRS 278.030 and KRS 278.170. It is insufficient for Big Rivers to merely claim that underlying foundation for its negotiations with Century was to ensure that no additional costs were experienced by its customers as a result of this transaction. Worse, the Companies actually increased the stranded costs to be imposed upon Big Rivers' remaining non-Smelter customers by failing to accept the Sebree Smelter's $43/MWh offer to stay on Big Rivers' system.[49] Because the Companies imprudently failed to strike the right balance between the Sebree Smelter's continued viability and the rates of the remaining non-Smelter customers,[50] this task now falls to the Commission.

Although Century submitted last-minute evidence disputing KIUC's claims regarding its profitability,[51] that evidence is flawed and unreliable. The evidence fails to provide a complete and accurate view of the Sebree Smelter's profits, is not supported by sufficient or detailed documentation, fails to remove non-recurring expenses, and, ultimately, fails to demonstrate that market-based rates are necessary to economically sustain its operations. Further, neither Staff nor the intervenors have had any opportunity to review Century's recent claims

[46] Tr. at 51:10-20.
[47] Tr. at 108:11-18.
[48] Tr. at 109:10-21.
[49] Tr. at 45:4-13.
[50] Kollen Testimony at 13:7-12.
[51] *See* Century Response to On-The-Record Data Request (January 9, 2014).

in detail. Thus, Century's claims fail to provide adequate assurance that the proposed arrangements will not result in non-Smelter customers excessively subsidizing the Sebree Smelter's preferential access to market-based rates.

Century's claims are based on adjusted GAAP earnings rather than operating profits (earnings before interest, taxes, depreciation and amortization, or "EBITDA") and reflect reductions from operating profits for interest, taxes, and depreciation. However, GAAP earnings are not the proper basis for economic evaluation. The proper basis is operating profits. Century's claims also fail to normalize revenues and profits to remove the effects of a reduction in "*non-essential*" activities at the Smelter in early July due to "*safety*" issues. Nor do they reflect increases in revenues and profits due to significant planned increases in Smelter production. But even if Century's claims that the Sebree Smelter was not profitable on a GAAP basis are accepted at face value, which they should not be, the proposed rate reduction to market-based rates would increase its profits by approximately $70 million, an amount much greater than is necessary to maintain the Sebree Smelter's profitability going forward.

Revealingly, while Century is telling the Commission that it must accept the proposed agreements without modification or the Sebree Smelter will shut down, Century is telling Wall Street that the proposed rate will increase its annual profits by approximately $66.4 million.[52] The Sebree Smelter's adoption of this position with Wall Street is inconsistent with a company that is a few weeks away from shutting down. Even if it was the Applicant with the burden of proof, which it is not, Century's inadequately supported claims are therefore insufficient to demonstrate that the proposed rate would be consistent with either KRS 278.030 or KRS 278.170.

C. The Commission Should Either Immediately Adopt KIUC's Recommended Market Access Charge To Result In a $43/MWh Rate Or Approve the Proposed Agreements on an Interim Basis and Simultaneously Open an Investigation to Determine the Level of a Reasonable Market Access Charge for the Sebree Smelter.

Given the circumstances discussed above, the Commission should either impose or investigate the imposition of a reasonable market access charge on the Sebree Smelter in order to avoid violations of KRS 278.030 and KRS 278.170. Such a market access charge would be collected from the Sebree Smelter by Kenergy as a component of the distribution rate, and then remitted to Big Rivers. The revenues from such a charge could

[52] KIUC Ex. 7.

either be credited to the remaining non-Smelter customers through the Economic Reserve or used to reduce the revenue requirement in Case No. 2013-00199. The two different approaches should yield approximately the same results; however, because of the variable nature of the market access charge (monthly difference between $43/MWh and market) crediting the revenue through the Economic Reserve would be more appropriate and accurate. The market access charge would be implemented *prospectively* through the new rates at issue in this proceeding, and would not rewrite the prior Smelter contract with Big Rivers that will terminate on January 31, 2014.[53]

The establishment of a reasonable market access charge to mitigate the imposition of stranded costs on non-Smelter customers is necessary for several reasons. First, as discussed in the Background section above, Big Rivers reacquired its generating plants through the Unwind in 2009 to serve the Smelter loads. Without the Unwind, Big Rivers would not have reacquired its power plants until 2023. In other words, the Sebree Smelter (and the Hawesville Smelter) caused Big Rivers to incur the stranded fixed costs that now cannot be avoided unless Big Rivers successfully divests the generating plants.[54]

Second, the Sebree Smelter contract termination exacerbated Big Rivers' excess capacity issues and caused the fixed costs related to that excess capacity to be stranded. The required planning reserve margin in MISO is 16.7%. After the Sebree Smelter's contract termination, Big Rivers will have a reserve margin of 128.4%, or more than 900 MW of capacity in excess of what it requires to serve the remaining non-Smelter load. 900 MW is enough power to serve approximately 400,000 homeowners. The following graph portrays the Big Rivers reserve margin when it served both the Hawesville Smelter and the Sebree Smelter, after the termination of the Hawesville Smelter, and then after the termination of the Sebree Smelter.[55]

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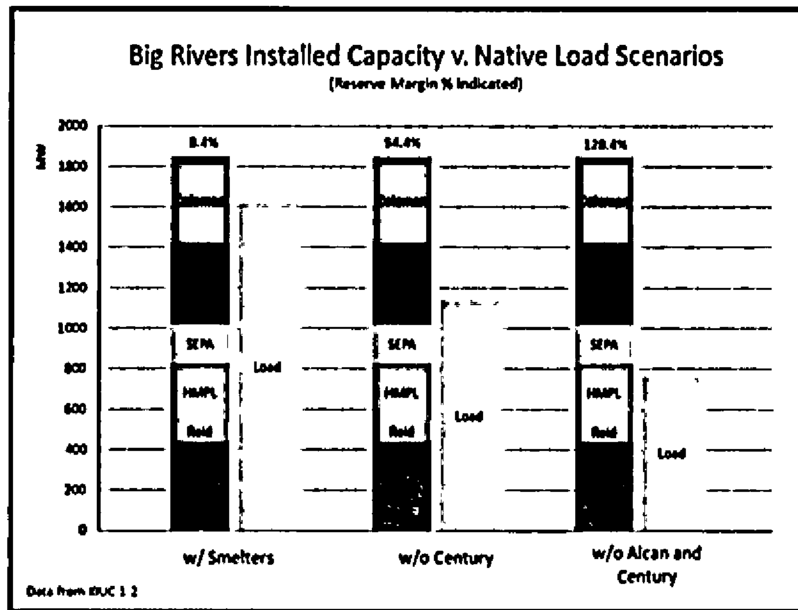
[53] Kollen Testimony at 17:11-16.
[54] Kollen Testimony at 31:15-20.
[55] Kollen Testimony at 31:21-32:12.



The Smelters used the termination provisions of their present contracts to bypass and avoid their responsibility to contribute to the fixed costs that were incurred by Big Rivers to serve them. The Smelters did so by claiming that they had made business judgments in good faith to terminate and cease all aluminum smelting and that they had no current intention of recommencing smelting operations. Their actions have been inconsistent with these representations.[56]

Third, there is strong precedent for the imposition of stranded cost or market access charges on customers in other states that have allowed market access, generally through deregulation of generation in the late 1990s and early 2000s. In those states, the transition to market access resulted in stranded generation costs caused by the customers who accessed the market and no longer took generation service from the incumbent utility.[57] Those stranded costs were charged to those customers who "*shopped*" in the form of a non-bypassable stranded cost distribution charge by the incumbent utility.[58] Hence, the customers who accessed the market were not allowed to escape their obligation to pay the utility for the costs that the utility incurred to serve them and that now could not

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[56] Kollen Testimony at 32:13-33:5.

[57] The stranded costs generally were defined as the excess of the net present value of the cost of service, assuming recovery of the net book value of the utility's generating assets, over the net present value of the projected market revenues.

[58] Kollen Testimony at 39:15-40:6 (citing Connecticut General Statutes Annotated §16-245g; 220 Illinois Compiled Statutes Annotated §5/16-108; 35 Maine Revised Statutes §3208; Maryland Code, Public Utilities §7-513; Massachusetts General Laws 164 §1G; New Hampshire Revised Statutes §374-F:3; New Jersey Statutes 48:3-61; Ohio Revised Code R.C. §4928.37; 66 Pennsylvania Consolidated Statutes §2808; Rhode Island General Laws §39-1-27.4; Texas Code §39.252); *See also* National Council for Science and the Environment, CRS Report for Congress, *available at* http://cnie.org/NLE/CRSreports/energy/eng-57.cfm ("*While all states allow for some recovery of stranded costs, the method for recovering these costs varies by state.*").

be avoided. Nor were the customers who accessed the market able to force the utility's non-shopping customers to pay the utility on their behalf.[59]

In this case, approval of the proposed Sebree Smelter agreements would effectively deregulate electric generation pricing only for the Sebree smelter, allowing it to purchase electric generation service from the market even though it will do so pursuant to the agreements and will remain a distribution customer of Kenergy. Accordingly, it would be not only reasonable, but also consistent with the precedent in other states if the Commission required the Sebree Smelter to pay at least a portion of the stranded costs that it caused by its decision to purchase electric service from the market and bypass the Big Rivers generation resources.[60]

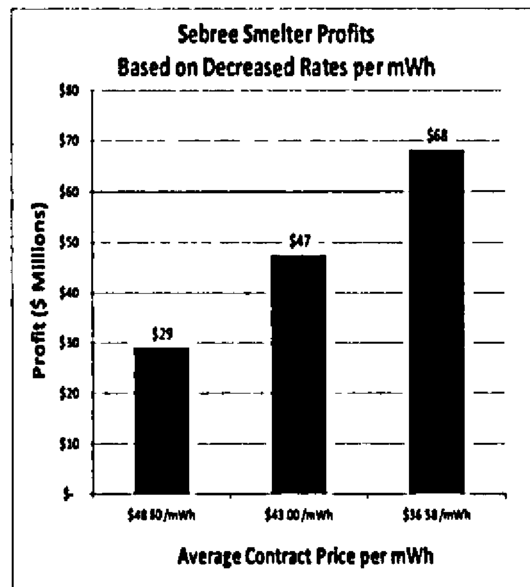
Finally, a contribution toward the Big Rivers' stranded fixed costs by the Sebree Smelter in the form of a market access fee will enhance the financial stability of Big Rivers. This will lessen the chances that the utility will have to reorganize under the bankruptcy laws. Avoiding such a crisis is balanced and reasonable.[61]

KIUC recommends that the market access charge for Sebree be calculated as the monthly difference between the market-based rate and \$43/MWh. Because the market access charge would change monthly, the charge would be computed each month in a manner similar to the fuel adjustment clause whereby the actual market cost for the month is subtracted from the \$43/MWh benchmark and then actually collected as a distribution charge by Kenergy in the second month following. Kenergy then would remit the revenues to Big Rivers. Big Rivers would recognize the revenues each month on an accrual basis in accordance with GAAP. In that manner, there will be no lag in recognizing the revenues for accounting purposes. The \$43/MWh benchmark would be adjusted annually for inflation so that the relative position of the parties remains constant over time.[62] The difference between market pricing and \$43/MWh would save non-Smelter customers nearly \$21 million annually.[63]

KIUC's proposed market access charge would effectively set the Sebree rate at a minimum of \$43/MWh. This is the rate presented by Alcan as the "Sebree Solution" to ensure Sebree's long term viability.[64] Alcan

[59] Kollen Testimony at 33:6-14.
[60] Kollen Testimony at 40:7-14.
[61] Kollen Testimony at 33:17-20.
[62] Kollen Testimony at 34:12-21.
[63] Kollen Testimony at 6:6-7.
[64] Tr. at 45:4-8.

developed the $43/MWh rate based on its assessment of the cost for Big Rivers to serve the Sebree Smelter, excluding any share of the excess capacity and related stranded costs caused by the Hawesville Smelter termination, and offered it to Big Rivers as a viable long-term "*solution*" prior to providing its Notice of Termination.[65] As the following chart graphically portrays, the Sebree Smelter can remain profitable at various power rates, including the $43/MWh offered by Alcan as well as the nearly $49/MWh it was paying prior to August 2013 and the estimated $36.58/MWh market price for the next several years.[66]



The ability of the Sebree Smelter to continue to operate for the long-term even if the Commission modifies the proposed rate to include such a reasonable market access charge is also confirmed by the following chart, which provides estimates of profitability for the Sebree Smelter based on various combinations of rates and LME prices.[67]

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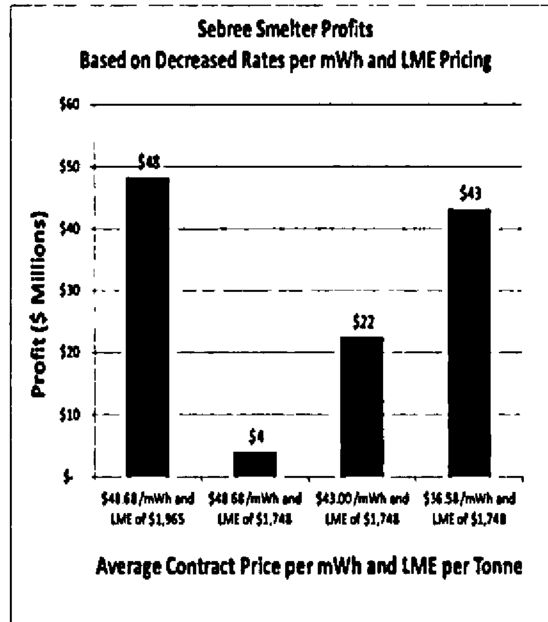
[65] Kollen Testimony at 19:5-11 (citing Exhibit LK-4, Companies' Response to KIUC 1-12(a)).
[66] Kollen Testimony at 19:12-24. In offering its "Sebree Solution" and the $43/MWh rate, Alcan cited certain competitive advantages it had that were not available to other smelters and that enabled it to pay more than the global smelter average electric rate, including: 1) location in the U.S. Midwest and access to the Midwest premium; 2) first-quartile operating cost, excluding electricity; 3) lower capital costs compared to new facilities; 4) skilled and committed employees; and 5) value added aluminum.
[67] Kollen Testimony at 11:15-12:9. The first bar represents the Smelter's annual profit using the actual rate in effect and the average LME price for the first four months of 2013. The second bar represents the Smelter's annual profit at the actual rate in effect for the first four months of 2013 and the lowest daily LME price that has occurred so far in 2013. The third bar represents the Smelter's annual profit at the $43/MWh offered by Alcan as the "Sebree Solution" rate and the lowest daily LME price during 2013. The fourth bar represents the Smelter's annual profit at the estimated market price and the lowest daily LME price during 2013.



Thus, even at lower LME prices, this chart reflects that the Smelter will remain profitable and will become even more profitable as the rate is reduced, first to the "Sebree Solution" offer rate, and then to the estimated market rate.[68]

As discussed above, KIUC recognizes that there is some dispute as to the profitability of the Sebree Smelter at various power rates. If the Commission ultimately determines that there is insufficient evidence regarding the Sebree Smelter's profitability in the record, and therefore insufficient evidence to immediately establish a reasonable market access charge in this case, then the Commission should approve the proposed agreements on an interim basis and open a *"phase-two"* investigation in order to investigate the proper level of a market access charge to the Sebree Smelter. This would resolve the majority of the issues raised in this case on an expedited basis and avoid shutdown of the Sebree Smelter, while also granting the Commission additional time to ensure that the proposed arrangements do not violate KRS 278.030 and KRS 278.170 as discussed above.

If the Commission imposes a market access charge on the Sebree Smelter either immediately or after a *"phase two"* investigation, it should not allow the market access charge to be negative. The purpose of the market access charge is to require the Sebree Smelter to pay a portion of the stranded fixed costs that it incurred.

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[68] Kollen Testimony at 12:11-13:1.

The purpose is not to provide the Sebree Smelter a hedge against market price increases. A negative charge would be an additional subsidy to the Sebree Smelter by the non-Smelter customers and is inappropriate.[69]

Establishing a reasonable market access charge would still provide the Sebree Smelter with a rate reduction, just not as large a reduction as the Companies request in this proceeding.[70] And the amount ultimately collected from the Sebree Smelter through the market access charge would be an important component of a comprehensive and balanced solution to address the stranded costs associated with Big Rivers' excess capacity, while also addressing the effects on the non-Smelter customers who did not cause the excess capacity or the stranded costs.[71]

D. The Commission Should Retain Jurisdiction Over the Proposed Agreements and Should Adopt the Same Reporting Requirements It Adopted in Case No. 2013-00221.

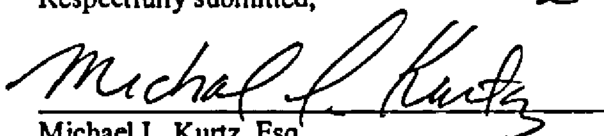
The Commission should explicitly retain authority over the electric service arrangements and, more specifically, the rate, as it did for the Hawesville Smelter electric service arrangements in Case No. 2013-00221. The Commission should also adopt the same reporting requirements for the Sebree Smelter that it adopted for the Hawesville Smelter in Case No. 2013-00221, except that all parties to this case should be served with copies and the Sebree Smelter should be required to provide its energy usage in MWh or kWh so that parties and the Commission can calculate the actual rate that the Sebree Smelter is paying. KIUC takes no specific position with respect to the Commission's jurisdiction over the Load Curtailment Agreement.

[69] Kollen Testimony at 35:1-10.
[70] Kollen Testimony at 6:7-11.
[71] Kollen Testimony at 38:19-39:13.

IV. CONCLUSION

WHEREFORE, for the reasons discussed above, KIUC respectfully requests that the Commission either impose or investigate the imposition of a reasonable market access charge on the Sebree Smelter. Such a market access charge would be one component of a comprehensive solution to the Smelter terminations and the allocation of the stranded costs among the various stakeholders.

Respectfully submitted,



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