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PUBLIC SERVICE
COMMISSION

Big Rivers
ELECTRIC CORPORATION

Your Touchstone Energy® Cooperative

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION OF KENTUCKY

In the Matter of:

FILING OF AGREEMENT FOR THE PURCHASE AND SALE OF FIRM CAPACITY AND ENERGY BETWEEN BIG RIVERS ELECTRIC CORPORATION AND THE KENTUCKY MUNICIPAL ENERGY AGENCY	)))))	Case No. 2016-00306

Response to Kentucky Industrial Utility Customers, Inc's,
Initial Request for Information
Dated September 26, 2016

FILED: October 6, 2016

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BIG RIVERS ELECTRIC CORPORATION

FILING OF AGREEMENT FOR THE PURCHASE AND SALE OF FIRM CAPACITY AND ENERGY BETWEEN BIG RIVERS ELECTRIC CORPORATION AND THE KENTUCKY MUNICIPAL ENERGY AGENCY
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Item 1) **Given that Wilson has the lowest fuel costs on the Big Rivers system, please explain how the KyMEA Agreement is expected to affect the fuel adjustment clause (FAC). Please provide an estimate of the incremental change in the FAC expected as a result of the KyMEA Agreement.**

Response) Big Rivers does not anticipate an incremental change in the FAC as a result of the KyMEA Agreement.

Witness) Lindsay N. Barron

BIG RIVERS ELECTRIC CORPORATION

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Item 2) Please explain and identify any expected changes to the environmental surcharge as a result of the KyMEA Agreement.

Response) Big Rivers has not prepared calculations to specifically identify changes that could hypothetically occur in the environmental surcharge as a result of the KyMEA Agreement. The KyMEA contract includes provisions for KyMEA to pay [redacted]. As such, Big Rivers anticipates that the Environmental Surcharge will be adjusted to reflect this cost allocation. Big Rivers will coordinate with the Commission on making that change before the KyMEA power begins to flow in 2019.

Witness) Lindsay N. Barron

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Item 3) **Currently, Big Rivers is recovering the entire fixed cost revenue requirement of Wilson in member rates (except depreciation which is being deferred). Beginning June 2019, Big Rivers will receive a Monthly Reservation Charge at a Firm Capacity Price of [redacted]. Please explain how and when Big Rivers intends to reduce member rates as a result of the KyMEA Agreement.**

Response) Big Rivers objects to this request on the grounds that it seeks information that is neither relevant nor likely to lead to the discovery of admissible evidence. Subject to and without waiving its objections, Big Rivers states as follows. Big Rivers is not recovering the entire fixed cost revenue requirement of Wilson in its base rates. Big Rivers' revenue requirement in its current rates includes fixed departmental expenses and labor expenses that support Wilson only in an idled state, not in an operational state.

Big Rivers has not determined what its revenue requirement and rate structure will be in 2019. As Big Rivers gains more clarity, Big Rivers will take appropriate action with the Commission to address its future revenue requirement and rate structure.

Witness) Lindsay N. Barron

BIG RIVERS ELECTRIC CORPORATION

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Item 4) **The annual depreciation expense on Wilson that is currently being deferred is approximately $20 million.**

a. Please identify the amount currently in the deferral balance.

b. In June 2019, how much is projected to be in the deferral balance.

c. If in June 2019 Big Rivers were to write-off the deferral balance and take a one-time reduction to earnings, please estimate Big Rivers' total Margins and Equities and equity ratio.

d. Under its debt agreements, what is Big Rivers' minimum equity ratio.

Response) Big Rivers objects to this request on the grounds that it seeks information that is neither relevant nor likely to lead to the discovery of admissible evidence. Subject to and without waiving its objections, Big Rivers states as follows.

a. The amount in the deferral balance as of August 31, 2016, is $52,088,144.73.

b. The amount currently projected to be in the deferral balance in June 2019 is approximately $110 million.

c. Big Rivers has not prepared such an estimate for June 2019.

d. Under Big Rivers' current debt agreements, there are no minimum equity ratio requirements. However, Section 6.07(b) of the Senior Secured Credit Agreement dated as of March 5, 2015, among Big Rivers, the Lenders party thereto, Regions Bank, as Syndication Agent, and National Rural Utilities Cooperative Finance Corporation, as Lead Arranger, Issuing Lender, Swingline Lender and Administrative Agent, does include the following covenant related to Big Rivers' Members' Equities' Balance:

6.07(b) Members' Equities' Balance. The Borrower will maintain, in accordance with GAAP, a minimum Members' Equities' Balance at each fiscal quarter-end and as of the last day of each fiscal year, as specified below during the following calendar year periods:

Period Ending *(and the Fiscal Quarters Ending Therein)*	**Amount**
December 31, 2014:	$375,000,000
December 31, 2015:	$375,000,000 plus 50% of the positive net margins for the Borrower's fiscal year ending December 31, 2014
December 31, 2016:	$375,000,000 plus 50% of the cumulative positive net margins between the Borrower's fiscal years ending December 31, 2014 and December 31, 2015
December 31, 2017:	$375,000,000 plus 50% of the cumulative positive net margins between the Borrower's fiscal years ending December 31, 2014, December 31, 2015, and December 31, 2016.

Witness) Lindsay N. Barron

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Item 5) **With respect to Exhibit B to the KyMEA Agreement dealing with the [redacted] please answer the following.**

a. [redacted]

b. [redacted]

Response)

a. [redacted]

b. [redacted]

[redacted]

Witness) Robert W. Berry

BIG RIVERS ELECTRIC CORPORATION

FILING OF AGREEMENT FOR THE PURCHASE AND SALE OF FIRM CAPACITY AND ENERGY BETWEEN BIG RIVERS ELECTRIC CORPORATION AND THE KENTUCKY MUNICIPAL ENERGY AGENCY
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Item 6) **Please provide all correspondence among and between Big Rivers and its outside auditors regarding the Wilson deferral.**

Response) Big Rivers objects to this request on the grounds that it seeks information that is neither relevant nor likely to lead to the discovery of admissible evidence. Notwithstanding this objection, and without waiving it, please see the attachment to this item.

Witness) Lindsay N. Barron

Big Rivers
ELECTRIC CORPORATION

TO: KPMG

FROM: Big Rivers Electric Corporation

DATE: March 11, 2015

RE: Wilson Depreciation

Big Rivers began deferring the depreciation on Wilson Station in February 2014 as a result of the Commission's Order in Case No. 2013-0199. The commission found "it reasonable to require the depreciation on Wilson to be recorded in a regulatory asset account and excluded from rate recovery at this time." The Commission also noted that "treating the depreciation in this manner allows for the depreciation expense to be considered for recovery in rates at a future point in time." Big Rivers has no reason to believe the recovery of the deferred Wilson depreciation is not probable in the future. It is Big Rivers' belief that if the Commission intended to disallow the Wilson depreciation, the Commission would have required such in their order.

The Commission has allowed on numerous occasions the establishment of a regulatory asset at the request of utilities. The Commission's order to Big Rivers to establish this account clearly indicates the Commission's willingness to consider the recovery of these costs in the future.

The Applicable portion of the Commission's Order is attached hereto.

ASC 980 *"Accounting for the Effects of Certain Types of Regulation"* specifies that a regulatory asset is recognized when "It is probable that future revenue in an amount at least equal to the capitalized cost will result from inclusion of that cost in allowable costs for rate-making purposes, and based on available evidence, the future revenue will be provided to permit recovery of the previously incurred cost rather than to provide for expected levels of similar future costs. If the revenue will be provided through an automatic rate-adjustment clause, this criterion requires that the regulator's intent clearly be to permit recovery of the previously incurred cost."

PSC Order CN 2013-00199
April 2014

period, the 12 months ended April 30, 2013, as the appropriate amount to use for ratemaking purposes.[37]

In this proceeding, Big Rivers' base period is the 12 months ending September 30, 2013, a period in which it realized off-system sales margins of $9,559,026. With the improvement in its off-system sales margins for this more recent period, the record does not support Big Rivers' test-year forecasted amount. Accordingly, as in the prior rate case, the Commission finds that Big Rivers' test period should be adjusted to reflect the actual results realized during its base period. This results in an adjustment to increase revenues to $9,559,026, the amount of Big Rivers' base-period off-system sales margins.

IMPACTS OF IDLING COLEMAN AND WILSON

Depreciation Expense

In its application, Big Rivers included full depreciation on both Coleman and Wilson in its forecasted test year. In response to our 535 Rate Order, Big Rivers made a number of adjustments to its application, one of which recognized the deferral of the Coleman depreciation beginning in September 2013 to recognize the effective idling of that generating station concurrent with the start of the period in which Coleman would be operated as a System Support Resource ("SSR") under MISO's functional control and not be part of Big Rivers' generation portfolio.

In their direct testimonies, KIUC and the Sierra Club stated that, with Big Rivers' plan to idle Wilson concurrent with the effective date of the Sebree termination, no

[37] *Id.* at 39.

depreciation on Wilson should be recognized for ratemaking purposes.[38] KIUC stated that the Rural Utilities Services' Uniform System of Accounts required that Big Rivers cease depreciation on a plant after it is shutdown.[39] In their joint post-hearing brief, KIUC/Sierra Club acknowledged Big Rivers' having temporarily delayed its idling of Wilson in order to make off-system sales through March 2014, but stated that this did not change the fact that Wilson represents excess capacity with regard to Big Rivers' remaining non-smelter customers.[40] KIUC/Sierra Club asserted that depreciation on Wilson should be removed for ratemaking purposes and that Big Rivers should be required to defer that expense for possible recovery at a future date.[41] KIUC/Sierra Club argued that Big Rivers' current and projected cash reserves would negate any cash-flow reductions resulting from eliminating the Wilson depreciation as a ratemaking expense.[42] Hence, they proposed deferring the Wilson depreciation expense in the amount of $20.177 million.

In its rebuttal testimony, Big Rivers acknowledged the Commission's decision that deferral of depreciation on Coleman, as was required in the 535 Rate Order, would not jeopardize its ability to meet its debt-service requirements, but argued that deferring the Wilson depreciation of approximately $21 million annually would have a much

[38] Kollen Testimony at 45-46 and Direct Testimony of Frank Ackerman at 25-26. The AG did not propose a specific depreciation adjustment, but included depreciation as one of several fixed costs of Coleman and Wilson that he believed should be eliminated for ratemaking purposes.

[39] Kollen Testimony at 45.

[40] KIUC/Sierra Club Post-Hearing Brief at 56.

[41] *Id.* at 55.

[42] *Id.* at 58.

greater impact on its cash flow.[43] Big Rivers also claimed that not having all of the Wilson depreciation expense in base rates would place it at a "distinct disadvantage in collecting the cash flows necessary to meet its debt obligations and in internally financing its capital expenditures."[44] Big Rivers claimed that this could jeopardize its ability to regain investment-grade ratings and to access credit markets, and could undermine its ongoing financial viability.[45] Big Rivers also stated that, even in its idled status, Wilson would continue to provide benefits to its member cooperatives and their ratepayers.[46]

The Commission recognizes that since post-hearing briefs were filed in this matter, Big Rivers has announced additional power sales, through February 2015, which have postponed the actual physical idling of the Wilson station. However, we agree with KIUC/Sierra Club that this does not change Wilson's status as it relates to the customers on the Big Rivers system. From a practical standpoint, Wilson is not needed to serve those customers and, therefore, represents excess capacity. As such, based on the amount of excess capacity on Big Rivers' system due to the loss of the smelter loads, and the impact on customers of a rate increase of the magnitude sought by Big Rivers not only in this case but in Case No. 2012-00535, the Commission finds it

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[43] Rebuttal Testimony of Billie J. Richert ("Richert Rebuttal") at 12-13.

[44] *Id.* at 18.

[45] *Id.*

[46] *Id.* at 15.

reasonable to require the depreciation on Wilson to be recorded in a regulatory asset account and excluded from rate recovery at this time.[47]

The Commission recognizes that this treatment will reduce Big Rivers' cash flow. However, we also recognize that Big Rivers has maintained cash balances in excess of $100 million,[48] which it may use to supplement its annual cash flow. The Commission has further considered, in making this decision, that Big Rivers has no borrowing needs in the test year[49] and no plans for capital expenditures related to the federal Mercury Air Toxic Standard ("MATS") for Coleman or Wilson during the test year.[50] Therefore, the use of its cash flow should be largely, or entirely, to make its debt-service payments. While the amount of such payments in the test year was identified as $20.1 million, Big Rivers test-year depreciation expense, without the Coleman and Wilson depreciation and based on its new depreciation rates, is more than $22.5 million.[51] [52]

Based on the above discussion, Big Rivers will be required to record its test-year depreciation on the Wilson Station of $20,175,771 as a deferred asset rather than as an expense. It should offset its debits to the deferred asset with a credit to its reserve for accumulated depreciation, as it would if the depreciation were being charged to

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[47] Treating the depreciation in this manner allows for the depreciation expense to be considered for recovery in rates at a future point in time.

[48] Cross-examination of Billie J. Richert, January 7, 2014 Evidentiary Hearing at 18:13:11 – 18:13:27, and Big Rivers' January 2014 Monthly Budget Variance Report, p. 30, filed March 28, 2014.

[49] Vice-Chairman Gardner's questioning of Billie J. Richert, January 8, 2014 Evidentiary Hearing at 12:59:10 – 12:59:28.

[50] *Id.* at 13:00:43 – 13:00:55, and Richert Rebuttal at 14.

[51] Total test year depreciation = $49,189,590 per Big Rivers' Response to Staff's Fourth Request for Information, Item 1. Test year depreciation on Coleman and Wilson = $26,660,949 per Big Rivers' Response to Staff's Second Request for Information, Item 37. $49,189,590 - $26,660,949 = $22,528,641.

[52] In addition to being able to draw on its cash balances, Big Rivers will be afforded a modest increase in its cash flow with the higher Times Interest Earned Ratio ("TIER") being awarded herein.

expense. This treatment results in a reduction in Big Rivers' test-year depreciation expense. To match the test year, Big Rivers should recognize this accounting treatment beginning in February of 2014.

Excess Capacity Adjustment

Based on the amount it identified as excess generating capacity on the Big Rivers system after the loss of the smelters, KIUC proposed that the costs of that capacity be shared by customers on the Big Rivers system and by Big Rivers' creditors.[53] KIUC calculated 31.3 percent as the portion of excess capacity-related costs that should be borne by customers and recommended that the remaining 68.7 percent of those costs be borne by Big Rivers' creditors. Based on these percentages, KIUC claimed that Big Rivers' revenue requirement should be reduced by $18.786 million to reflect KIUC's recommended treatment of the costs of Big Rivers' excess capacity.[54] In their post-hearing brief, KIUC/Sierra Club modified the original KIUC proposal by calculating the excess capacity adjustment at $23.121 million rather than $18.786 million.

In its rebuttal, Big Rivers averred that KIUC's proposal was not realistic and would have serious negative consequences.[55] It claimed that KIUC's proposal would have the Commission direct Big Rivers to require that its creditors write off a portion of its debt, which would seriously impact Big Rivers' ability to attract capital in the future.[56] Big Rivers asserted that it was not aware of a single cooperative financial institution that

[53] Kollen Testimony at 71.

[54] *Id.* at 72.

[55] Rebuttal Testimony of Daniel M. Walker ("Walker Rebuttal") at 10.

[56] *Id.*

Big Rivers
ELECTRIC CORPORATION

Your Touchstone Energy® Cooperative

TO: KPMG

FROM: Big Rivers Electric Corporation

DATE: March 2, 2016

RE: Coleman and Wilson Depreciation

On January 15, 2013, Big Rivers Electric Corporation ("Big Rivers") filed an Application with the Kentucky Public Service Commission ("Commission") for an adjustment of rates (Case No. 2012-00535). The Commission issued its rate order on October 29, 2013. In its rate order, ordering paragraph 4, the Commission stated, "Beginning with the month of September 2013, Big Rivers shall discontinue recording depreciation of the Coleman Station as an expense and shall defer this depreciation and record it in a regulatory asset account. All other aspects of Big Rivers' accounting for depreciation shall remain unchanged." The Commission further stated on page 33 of its order, "It is the Commission's intent that the amount recorded as a deferred asset will be considered for amortization at some future point in time if and when the facility is needed to serve customers, is sold, or is permanently closed." Big Rivers began deferring depreciation on Coleman as ordered by the Commission.

On June 28, 2013, Big Rivers Electric Corporation ("Big Rivers") filed a second Application with the Commission for an adjustment of rates (Case No. 2013-00199). The Commission issued its rate order on April 25, 2014. In its rate order, ordering paragraph 4, the Commission stated, "Big Rivers shall continue to defer recording depreciation on the Coleman Station as an expense and record it in a regulatory asset account. All other aspects of Big Rivers' accounting for depreciation on the Coleman Station shall remain unchanged." The Commission stated in ordering paragraph 5, "Effective as of February 1, 2014, Big Rivers shall discontinue recording depreciation of the Wilson Station as an expense and shall defer this depreciation and record it in a regulatory asset account. All other aspects of Big Rivers' accounting for depreciation on the Wilson Station shall remain unchanged." The Commission noted on page 16 of its order, "Treating the depreciation in this manner allows for the depreciation expense to be considered for recovery in rates at a future point in time." Big Rivers began deferring depreciation on Wilson and continued deferring depreciation on Coleman as ordered by the Commission.

Big Rivers has no reason to believe the recovery of the deferred Wilson and Coleman depreciation is not probable in the future. It is Big Rivers' belief that if the Commission intended to disallow the depreciation, the Commission would have required such in their order.

The Commission has allowed on numerous occasions the establishment of a regulatory asset at the request of utilities.[1] It is important to note that Big Rivers requested that the Commission allow Big Rivers to continue to depreciate the units even though idling was planned—it was the Commission's sole decision to defer the depreciation. The Commission's order to Big Rivers to establish this account clearly indicates the Commission's willingness to consider the recovery of these costs in the future. Big Rivers has had no communications with or from the Commission that would cause Big Rivers to question the future recoverability of these amounts.

Big Rivers continues to record depreciation as ordered in the most recent rate order. A change would require an order or other action from the Commission authorizing Big Rivers to stop recording depreciation in this manner.

ASC 980 "Accounting for the Effects of Certain Types of Regulation" specifies that a regulatory asset is recognized when "It is probable that future revenue in an amount at least equal to the capitalized cost will result from inclusion of that cost in allowable costs for rate-making purposes, and based on available evidence, the future revenue will be provided to permit recovery of the previously incurred cost rather than to provide for expected levels of similar future costs. If the revenue will be provided through an automatic rate-adjustment clause, this criterion requires that the regulator's intent clearly be to permit recovery of the previously incurred cost."

[1] Order dated December 23, 2008, in In the Matter of: The Application of East Kentucky Power Cooperative, Inc. for an Order Approving Accounting Practices to Establish a Regulatory Asset related to Certain Replacement Power Costs Resulting from Generation Forced Outages, Case No. 2008-00436; order dated December 22, 2008, in In the Matter of: Application of Louisville Gas and Electric Company for an Order Approving the Establishment of a Regulatory Asset, Case No. 2008-00456; order dated December 22, 2008, in In the Matter of: Application of Kentucky Utilities Company for an Order Approving the Establishment of a Regulatory Asset, Case No. 2008-00457; order dated October 30, 2008, in In the Matter of: Joint Application of Duke Energy Kentucky, Inc., Kentucky Power Company, Kentucky Utilities Company and Louisville Gas and Electric Company for an Order Approving Accounting Practices to Establish Regulatory Assets and Liabilities Related to Certain Payments Made to the Carbon Management Research Group and the Kentucky Consortium for Carbon Storage, Case No. 2008-00308. Order dated March 6, 2015, in In the Matter of the Application of East Kentucky Power Cooperative, Inc. for an Order Approving the Establishment of Regulatory Assets for the Depreciation and Accretion Expenses Associated with Asset Retirement Obligations, Case No. 2014-00432.

greater impact on its cash flow.[43] Big Rivers also claimed that not having all of the Wilson depreciation expense in base rates would place it at a "distinct disadvantage in collecting the cash flows necessary to meet its debt obligations and in internally financing its capital expenditures."[44] Big Rivers claimed that this could jeopardize its ability to regain investment-grade ratings and to access credit markets, and could undermine its ongoing financial viability.[45] Big Rivers also stated that, even in its idled status, Wilson would continue to provide benefits to its member cooperatives and their ratepayers.[46]

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