



COMMONWEALTH OF KENTUCKY
OFFICE OF THE ATTORNEY GENERAL
April 3, 2008

JACK CONWAY
ATTORNEY GENERAL

RECEIVED

APR 03 2008

PUBLIC SERVICE
COMMISSION

1024 CAPITAL CENTER DRIVE
SUITE 200
FRANKFORT, KENTUCKY 40601

Stephanie Stumbo
Executive Director
Kentucky Public Service Commission
211 Sower Boulevard
Frankfort, Kentucky 40602-0615

Re: Case No. 2007-00455

Dear Mrs. Stumbo:

Please find attached the original and ten copies of the Attorney General's Testimony, Completely Unredacted, in the above matter. Because there are confidentiality agreements which control the exchange of material to varying degrees between the parties, I also provide the following breakdown of the Redacted Testimonies which have been filed with the Commission as well as the particular draft which each party will receive. The items listed below are filed under seal. In addition to the items below, a completely redacted public version has been filed which is the copy that the Member Cooperatives and Henderson will receive.

- Item 1 Completely Unredacted Testimony
- Item 2 E.ON U.S. Parties: Redacted Copy of Testimony
- Item 3 Big Rivers: Redacted Copy of Testimony
- Item 4 Smelters: Redacted Copy of Testimony

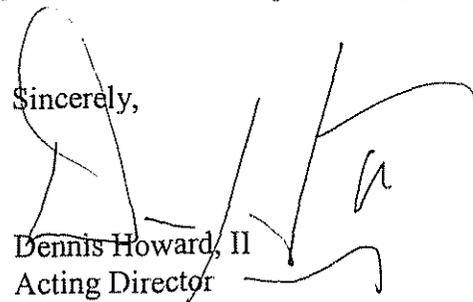
The basis for the "roadmap" employed for ascertaining the degree of disclosure resulted from a series of emails pursuant to my inquiry on the subject during the actual discovery phase of the case. It is the hope and the intent of the Attorney General that no inadvertent disclosure has occurred yet that all information publicly available has been filed and all parties have received their respective testimony.



Stephanie Stumbo, Executive Director
Kentucky Public Service Commission
April 3, 2008
Page 2

Should you have any question, feel free to contact me immediately. I thank you in advance for your attention to this matter.

Sincerely,



Dennis Howard, II
Acting Director
Office of Rate Intervention
Office of the Attorney General
502.696.5453

Attachments

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

RECEIVED

APR 03 2008

PUBLIC SERVICE
COMMISSION

In the Matter of:

THE APPLICATIONS OF BIG RIVERS)
ELECTRIC CORPORATION FOR:)
(I) APPROVAL OF WHOLESALE TARIFF)
ADDITIONS FOR BIG RIVERS ELECTRIC)
CORPORATIONS, (II) APPROVAL OF)
TRANSACTIONS (III) APPROVAL TO ISSUE)
EVIDENCES OF INDEBTEDNESS, AND)
(IV) APPROVAL OF AMENDMENTS TO)
CONTRACTS; AND)

CASE NO.

2007-00455

OF E.ON U.S., LLC, WESTERN KENTUCKY)
ENERGY CORP. AND LG&E ENERGY MARKETING)
INC. FOR APPROVAL OF TRANSACTIONS)

DIRECT TESTIMONY OF DAVID BREVITZ
ON BEHALF OF
THE ATTORNEY GENERAL

Certificate of Service and Filing

Counsel certifies that an original and ten photocopies of the foregoing Direct
Testimony of David Brevitz On Behalf Of The Attorney General were served and filed
by hand delivery to Stephanie L. Stumbo, 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:

C. William Blackburn
Big Rivers Electric Corporation
P. O. Box 24
Henderson, KY 42420

David Brown
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400 West Market St.
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Honorable John N. Hughes
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Honorable Frank N. King, Jr.
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Honorable Michael L. Kurtz
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David Spainhoward
Big Rivers Electric Corporation
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Henderson, KY 42420

Honorable Don Meade
Priddy Cutler Miller & Meade
800 Republic Bldg
429 W. Muhammad Ali Blvd.

this 3rd day of April, 2008


Assistant Attorney General

BEFORE THE PUBLIC SERVICE COMMISSION OF KENTUCKY

CASE NO. 2007-00455

**DIRECT TESTIMONY OF
DAVID BREVITZ ON BEHALF
OF THE KENTUCKY ATTORNEY GENERAL**

April 3, 2008

BEFORE THE PUBLIC SERVICE COMMISSION OF KENTUCKY

CASE NO. 2007-00455

DIRECT TESTIMONY OF

DAVID BREVITZ

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4
5
6 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

7 A. My name is David Brevitz. My business address is 3623 SW Woodvalley Terrace, Topeka,
8 Kansas.

9 **Q. BY WHOM AND IN WHAT CAPACITY ARE YOU EMPLOYED?**

10 A. I am an independent consultant serving state regulatory commissions, Attorney General's
11 Offices, and consumer organizations. I am testifying on behalf of the Attorney General of
12 Kentucky.

13 **Q. DO YOU HAVE SPECIFIC EXPERIENCE, EXPERTISE AND DIRECT**
14 **KNOWLEDGE REGARDING THE SUBJECTS WHICH ARE CONTAINED IN**
15 **YOUR TESTIMONY?**

16 A. Yes. Most recently I have conducted several detailed and extensive analyses of proposed
17 utility financial transactions and related utility regulatory policies, under the relevant laws
18 in those states. Those transactions were, in sequence:

- 19 • The proposed spin-off of its wireline telephone division ("Embarq") by
20 Sprint/Nextel, on a tax-free basis, which included incurrence of substantial new
21 debt by Embarq, and payments and other transactions with Sprint/Nextel. Work
22 and analyses was conducted on two separate cases—first on behalf of the
23 Nevada Attorney General's Bureau of Consumer Protection, and also (later) as a
24 member of the Kansas Corporation Commission's Advisory Staff. Both cases
25 were resolved by stipulations.
- 26 • The proposed spin-off of Alltel's wireline telephone division ("Windstream"),
27 and subsequent merger with Valor Communications in a reverse Morris Trust
28 transaction on a tax-free basis, which included incurrence of substantial new
29 debt by Windstream, and payments and other transactions including special
30 dividends to Alltel. Work and analyses was conducted on behalf of the
31 Attorney General of Kentucky's Office of Rate Intervention.

- The proposed acquisition by FairPoint Communications of Verizon's Northern New England operations (Maine, New Hampshire and Vermont) in a reverse Morris Trust transaction on a tax-free basis, which included incurrence of substantial new debt by FairPoint, and payments, Transition Services Agreement, development of back office systems "from the ground up" and other transactions including special dividends to Verizon. Work and analyses was conducted in two separate cases—on behalf of the Office of Public Advocate in Maine and the Office of Consumer Advocate in New Hampshire. The Hearing Examiner in Maine issued her report, subsequent to which a stipulation among many parties was reached. Similarly, a stipulation was reached in New Hampshire. Subject to conditions, this transaction closed on March 31, 2008.

Q. PLEASE STATE YOUR EXPERIENCE AND PROFESSIONAL QUALIFICATIONS.

A. My career has been in public utility regulation with an emphasis in telecommunications. My interest in public utility regulation began while studying at the Institute of Public Utilities in the Economics Department at Michigan State University. This program covered principles of public utility regulation, and addressed issues for telephone, gas and electric utilities. While at Michigan State, I earned an undergraduate degree in Justice, Morality and Constitutional Democracy from James Madison College (a residential college at MSU) and an MBA in Finance (1980). Since that time, I have worked on numerous matters for state utility commissions, consumer advocates, Attorneys General, and international regulatory bodies. A complete description of my background and experience is provided on Exhibit DB-1.

Q. DO YOU HAVE OTHER RELEVANT QUALIFICATIONS?

A. Yes. In 1984 I was designated as a Chartered Financial Analyst by the Institute of Chartered Financial Analysts ("ICFA"). The ICFA is the organization which has defined and organized a body of knowledge important for all investment professionals. The general areas of knowledge are ethical and professional standards, accounting, statistics and analysis, economics, fixed income securities, equity securities, and portfolio management.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

1 A. The purpose of my testimony is to address whether the Commission should approve the
2 "Unwind Transaction", related planned issuances of evidences of indebtedness, and other
3 requests of the Joint Applicants, based on the financial projections of Big Rivers Electric
4 Corporation ("BREC"). My review was conducted under the applicable legal standard as
5 provided to me by counsel. In accomplishing my review, I consider information contained
6 in the Application and supporting filed materials, and materials provided through discovery
7 in this case. In particular, I have reviewed and considered

- 8 1. The nature and extent of the BREC organization, both current and proposed;
- 9 2. Statements and rationale offered by Joint Applicants as to why the proposed
10 transactions are in the public interest;
- 11 3. E.ON, BREC/cooperatives, and Smelters' internal managerial analyses,
12 presentations and reports;
- 13 4. The completeness of the Application and supporting materials;
- 14 5. The financial projections and related materials offered by BREC in support of
15 the proposed transactions; and,
- 16 6. The proposed agreements among BREC, Kenergy and the aluminum smelters,
17 including termination provision.

18 **Q. WHAT STANDARD DID YOU USE FOR YOUR REVIEW?**

19 A. I am advised by counsel that the standard for use in this case is from KRS
20 278.300(3),¹ which states:

21 The commission shall not approve any issue or assumption unless, after
22 investigation of the purposes and uses of the proposed issue and the proceeds
23 thereof, or of the proposed assumption of obligation or liability, the commission
24 finds that the issue or assumption is for some lawful object within the corporate
25 purposes of the utility, is necessary or appropriate for or consistent with the proper
26 performance by the utility of its service to the public and will not impair its ability
27 to perform that service, and is reasonably necessary and appropriate for such
28 purpose.
29

¹ The Attorney General notes that the Informal Conference Memorandum dated January 16, 2008, referenced the December 18, 2007, order in Case No. 2007-00374 as governing the transfer in the instant matter. That order clearly states that KRS 178.300 applies.

1 This standard appears to require more than a generalized public interest finding regarding
2 the proposed transactions. Other implications of the standard include:

- 3 • It clearly suggests that the “proposed issue” (or assumed obligation or liability) is in
4 fact known to the Commission;
- 5 • The Commission must find the proposed issue to be necessary for the proper
6 performance by the utility of its service to the public;
- 7 • The Commission must find that the proposed issue will not impair the utility’s
8 ability to perform its service to the public; and,
- 9 • The Commission must find that the proposed issue is reasonably necessary for the
10 utility to perform its service to the public.

11 **Q. DOES YOUR TESTIMONY ADDRESS THE LEGALITY OF THE VARIOUS**
12 **SURCHARGES, SURCREDITS, OR OTHER RATE MAKING PRINCIPLES**
13 **WHICH ARE INCLUDED IN THIS FILING?**

14 A. No. The scope of my work for the Attorney General does not include any analysis of the
15 legality of any of the surcharges, surcredits or rate making principles.

16 **Q. DOES YOUR TESTIMONY REFLECT THE FULL POSITION OF THE**
17 **ATTORNEY GENERAL’S OFFICE ON THIS TRANSACTION?**

18 A. No. I have been advised that the Attorney General is considering many factors in this
19 “unwind,” including the economic impact with the loss of jobs associated with the possible
20 closing of the smelters. However, I have not been apprised of any of the details. My
21 engagement is limited to whether BREC will be financially viable on a going forward basis
22 following any approval of the transaction. This includes a scenario if both smelters leave
23 the system.

24 **Q. WHAT INFORMATION DID YOU REVIEW IN ORDER TO PREPARE THIS**
25 **TESTIMONY?**

26 A. I reviewed and considered the information contained in the multiple exhibits and
27 testimonies associated with the Application, information provided in response to data
28 requests, as well as information from newspapers such as the The Wall Street Journal.

29 **Q. AT THE OUTSET, DO YOU BELIEVE THAT A COMPLETE APPLICATION**
30 **INCLUDING NECESSARY SUPPORTING DOCUMENTS HAS BEEN PUT**
`1 **BEFORE THE COMMISSION AND THE PARTIES?**

1 A. No, in my view the Application and supporting documents are substantively incomplete in
2 at least four crucial areas:

- 3 • There are no specific debt issue or specific creditor agreements for the
4 Commission to review and consider. Big Rivers has had to “explore financing
5 alternatives” due to “the unsettled condition in the credit market and the
6 extremely wide credit spreads”.² The “proposed new financing agreement”³
7 suggested by Joint Applicants cannot be provided, and instead an alternative
8 interim approach is being utilized.⁴ “Big Rivers financing plans have changed
9 as a result of the upheaval in the public financial markets that has occurred over
10 the past months.”⁵ Most of the documents associated with the latter interim
11 approach have not been provided and apparently are not complete or available at
12 this time;
- 13 • Credit ratings have not yet been obtained by BREC, although an investment
14 grade credit rating is a required condition for the proposed transactions;
- 15 • Required consents to the proposed transaction have not been obtained by the
16 parties, including existing creditors and approvals/releases from the City of
17 Henderson, and the amounts of the consent fees that will be required to be paid
18 are not known or estimable by the parties; and,
- 19 • BREC has not completed and provided a due diligence report on the generating
20 facilities.

21 This testimony must be considered as preliminary until the record has been supplemented
22 by the Joint Applicants to include and address these crucial areas, which are demonstrably
23 and materially incomplete. In addition, some time will also be necessary for the parties and
24 the Commission to address this new information.

25 **Proposed Transaction, Transaction History and Objectives of the Parties**

² BREC response to OAG Supplemental No. 116.

³ Exhibit 10, Direct Testimony of C. William Blackburn, page 11, line 3.

⁴ BREC First Amendment and Supplement to Application, paragraph 19. BREC does provide two documents associated with \$100 million in lines of credit/revolving credit arrangement, but the larger public debt offering remains indefinite and in the future.

⁵ Id.

1 **Q. PLEASE DEFINE “UNWIND TRANSACTION”.**

2 A. My intent is to ascribe the same meaning to that term as intended by the parties. “Unwind
3 Transaction” is defined by Joint Applicants to be “the combined transactions by which Big
4 Rivers and the E.ON entities propose to terminate and unwind the 1998 Transactions”.⁶
5 The 1998 transactions were part of Big Rivers’ implementation of its bankruptcy
6 reorganization, and included leasing Big Rivers’ generating facilities to E.ON’s
7 predecessor for it to manage, operate and maintain; transferring responsibility to manage,
8 operate and maintain two additional generating units owned by the City of Henderson
9 (through Henderson Municipal Power & Light, or “HMPL”); purchasing by Big Rivers of a
10 set amount of power at substantially fixed prices through a Power Purchase Agreement that
11 it uses to serve the loads of its three member cooperatives; payment by LG&E Energy
12 Marketing (“LEM”) to the US Rural Utilities Service (“RUS”) of monthly margin
13 payments; and, providing a portion of the Smelters’ power needs at substantially fixed rates
14 through power supply contracts between LEM and predecessors of Kenergy. The facilities
15 lease and power purchase agreements terminate in 2023 by the terms of those agreements,
16 and the power supply contracts for the smelters terminate in 2010-2011.

17 **Q. IN ADDITION TO SEEKING APPROVAL OF THE UNWIND TRANSACTION,**
18 **ARE THE JOINT APPLICANTS SEEKING APPROVAL OF ANY OTHER**
19 **MATTERS?**

20 A. Yes. The Joint Applicants also seek a number of approvals which are listed in Exhibit 29,
21 and include:

- 22 1. A set of new agreements with the smelters by which Big Rivers and Kenergy
23 propose to serve essentially all of the needs of the smelters for electric power
24 through 2023;
- 25 2. A new set of rate mechanisms to address retail rates between the closing of the
26 unwind transaction and the date at which the Commission approves new rates
27 pursuant to a general rate proceeding to be filed no later than three years after the
28 date of a final order in this proceeding;

⁶ Application, paragraph 10.

- 1 3. Issuance of certain evidences of indebtedness (which have not yet been created or
- 2 provided in this matter);
- 3 4. Amending Big Rivers' Member cooperative Wholesale power contracts; and,
- 4 5. Terminating and rescheduling Big Rivers' pending IRP proceeding.

5 **Q. THE 1998 FACILITIES LEASE AND POWER PURCHASE AGREEMENTS**
6 **BETWEEN BIG RIVERS AND E.ON HAVE A 25 YEAR TERM, EXPIRING IN**
7 **2023. WHICH PARTY INITIALLY BROACHED THE POSITION OF**
8 **TERMINATING THE AGREEMENTS?**

9 A. It is stated E.ON approached Big Rivers in 2003, seeking to unwind the transactions.⁷
10 Discussions occurred over a number of years, resulting in execution of a letter of intent to
11 negotiate a transaction termination ("unwind") agreement in December 2005, execution of
12 the termination agreement by the Joint Applications in March 2007, substantial agreement
13 to the Smelter Agreements in December 2007, and the Application in this matter was filed
14 before the Commission on December 28, 2007.

15 **Q. WHAT ARE E.ON'S INTERESTS DRIVING ITS PURSUIT OF THE UNWIND**
16 **TRANSACTION?**

17 A. Limited general information is available directly from E.ON's on its interest in terminating
18 the transactions, through the initial and supplemental rounds of discovery. Since the
19 original agreements were reached between LG&E and Big Rivers, there had been a
20 succession of ownership changes of LG&E, first being acquired by Powergen, which was
21 subsequently acquired by E.ON. The Application is somewhat cryptic on the point of
22 E.ON's interests, where it notes that the Commission approved the 1998 transactions as
23 being reasonable and proper, "but circumstances have changed".⁸ The Application states
24 "the business plan of E.ON U.S. [is] to focus on its regulated lines of business rather than
25 on wholesale generation."⁹ It is apparent that in recent years, E.ON has lost money on its
26 energy marketing operation—LEM—and that the "transactions with Big Rivers ... had not

⁷ Exhibit 14, Direct Testimony of Michael H. Core, page 4, line 19.

⁸ Application, paragraph 10, line 17.

⁹ Application, paragraph 11.

1 proven advantageous to E.ON U.S.”¹⁰ “The rates charged by E.ON are currently not
2 directly affected by changes in fuel and environmental costs, and, in fact, there have not
3 been any adjustments to the purchased power rates charged by E.ON due to changes in fuel
4 or environmental costs since the lease and purchased power arrangement was established in
5 1998.”¹¹

6
7 E.ON overall corporate strategy goals are not clear. There are differences between
8 company strategy statements in its financial reports versus equity analyst reports. Some
9 equity analyst reports suggest that E.ON’s US operations could be sold. E.ON could be
10 disposing of the BREC obligations to prepare for disposition of the remaining US
11 operations. E.ON’s 2006 Annual Report (page 69) shows no “new markets” in the US, all
12 E.ON’s “new markets” are in Europe. Further, E.ON US is a declining proportion of total
13 E.ON revenues.¹²

14 **Q. WAS E.ON DIRECTLY ASKED FOR INFORMATION, ANALYSES AND**
15 **DOCUMENTS REGARDING ITS INTERESTS IN PURSUING THE UNWIND**
16 **TRANSACTION?**

17 **A.** Yes, this information was sought via interrogatories issued by the Office of Attorney
18 General. However E.ON objected to providing that information, and it was not provided in
19 discovery. In contrast, Big Rivers, the member cooperatives, and the Smelters have
20 generally provided this information,¹³ so those perspectives on the transaction are relatively
21 clear to the parties and the Commission. At a later date, E.ON did however provide some
22 relevant information regarding the economics of the Lease Agreement (but not overall
23 corporate goals) to the parties under confidential claim.

24 **Q. WHAT ARE THE OBJECTIVES OF THE SMELTERS IN THIS MATTER?**

¹⁰ Application, paragraph 21.

¹¹ Exhibit 25, Direct Testimony of William Steven Seelye, pages 4-5, lines 20-2.

¹² E.ON response to OAG No. 97, 2006 Form 20-K, page 36.

¹³ See for example, Member Cooperatives Response to OAG Supplemental 1.

1 A. Century Aluminum Company operates the Hawesville smelter, which is adjacent to
2 Southwire's Rod and Cable Mill.¹⁴ Rio Tinto Alcan operates the Sebree smelter.¹⁵ The
3 Smelters state "aluminum is a global commodity ... [that] is sold at a price that is based on
4 global supply in demand and established by trading activity on the London Metal
5 Exchange, or LME."¹⁶ In other words, aluminum producers are "price takers" of the
6 market price for aluminum. The Smelters further state that "in general, the cost of alumina,
7 labor and electricity accounts for 75-80% of the cost [of production of aluminum], with
8 alumina and electricity each comprising about one-third of the cost of production. ... it is
9 the cost of electricity that most significantly determines the ongoing success or viability of
10 an aluminum smelter."¹⁷ In addition to price, the reliability of the energy supply is critical.
11 "The Smelters require 100% reliable energy supply."¹⁸ The immediate present situation of
12 the Smelters is that their respective power supply contracts through E.ON expire in 2010-
13 2011, and E.ON has indicated the contracts will not be renewed upon expiration.
14 Furthermore, those contracts only provide for a portion of the Smelters' electricity needs,
15 with the remaining needs being met via purchases on the open market at higher prices. In
16 sum, "the Smelters require an affordable and predictable energy supply in order to make
17 the large capital investments necessary to maintain and operate their production facilities
18 efficiently. ... The proposed agreements provide a power supply that can reasonably be
19 expected to be significantly lower-cost and less volatile than market-priced power."¹⁹
20 Alcan states "we believe that cost based rates from coal fired generation that are close to
21 the fuel supply and to the smelter, which have relatively low capital costs and which
22 comply with existing environmental regulations, provide a better option for us than market
23 priced electricity."²⁰

24 **Q. WHAT CONCERNS DO THE SMELTERS EXPRESS?**

¹⁴ Direct Testimony of Wayne Hale on behalf of Century Aluminum Company, page 2, lines 1-4.

¹⁵ Direct Testimony of Guy Authier on behalf of Rio Tinto Alcan, page 2, line 1.

¹⁶ Direct Testimony of Henry W. Fayne, page 3, lines 20-22.

¹⁷ Direct Testimony of Henry W. Fayne, page 4, lines 8-13.

¹⁸ Direct Testimony of Henry W. Fayne, page 10, line 17.

¹⁹ Direct Testimony of Henry W. Fayne, page 14, lines 12-19.

²⁰ Direct Testimony of Guy Authier on behalf of Alcan, page 2, line 14.

1 A. While the Smelters support the transaction as “the best alternative available”, and “have
2 concluded that it is reasonable to expect that costs will be within the range projected in the
3 financial model, if not lower,”²¹ the support is tempered by the following concerns:

4 1. If industry analysts are correct about the long term price of aluminum, “then long-
5 term operation of the Smelters at the rates projected in the financial model will be a
6 close call. Certainly, if costs increase significantly, the Smelters will be unable to
7 survive.”²²

8 2. “The financial model was prepared solely by Big Rivers. ... the Smelters do not
9 have sufficient information to agree or disagree with the forecast.”²³

10 3. “There is still an outstanding issue with the City of Henderson. If the resolution of
11 that issue imposes additional cost to the Smelters, the transaction may no longer be
12 viable.”²⁴

13 4. “The new financing arrangements have not been completed. If the cost of
14 refinancing is higher than reflected in the financial model, the transaction may no
15 longer be viable.”²⁵

16 **Q. DID THE SMELTERS PROVIDE INTERNAL CONFIDENTIAL ANALYSES**
17 **PERTAINING TO THE PROPOSED TRANSACTIONS?**

18 A. Yes, my understanding is that these confidential responses were provided only to the Office
19 of the Attorney General in response to its data requests.

20 **Q. PLEASE OUTLINE CONCLUSIONS FROM ALCAN’S ANALYSES, PROVIDED**
21 **IN RESPONSE TO OAG No. 1-8, AND PROVIDED ONLY TO THE OFFICE OF**
22 **THE ATTORNEY GENERAL.**

23 A. My current understanding of the confidential classification of this response is that only
24 Alcan, Century and the Commission may see the confidential information, in addition to
25 the Office of the Attorney General. The Alcan analysis states as follows [BEGIN

²¹ Direct Testimony of Henry W. Fayne, page 15, line 19.

²² Direct Testimony of Henry W. Fayne, page 14, lines 5-8.

²³ Direct Testimony of Henry W. Fayne, page 15, lines 5-10.

²⁴ Direct Testimony of Henry W. Fayne, page 16, line 2.

²⁵ Direct Testimony of Henry W. Fayne, page 16, line 5.

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[END SMELTER CONFIDENTIAL] The Century analysis states as follows [BEGIN
SMELTER CONFIDENTIAL] [REDACTED]

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[REDACTED]

[END SMELTER CONFIDENTIAL]

Q. DO THE SMELTERS HAVE AN INCENTIVE AND ABILITY TO AFFECT BREC'S OPERATIONS UNDER THE PROPOSED TRANSACTION?

A. Yes, the Smelters have a strong incentive to take any available actions to minimize or otherwise reduce rates charged to the Smelters. The Smelters have the ability to take direct action on this incentive in a variety of ways, including advocacy positions before policymakers including the Commission, and through Sections 3.4 and 4.1 of the Coordination Agreement with BREC. Section 4.1 provides for the establishment of a Coordinating Committee. The Committee consists of "representatives of the Members, the Smelters, and Big Rivers' management, organized for the purpose of reviewing, analyzing and discussing information relating to Big Rivers' operational and financial performance."²⁶ The Committee shall meet at least once every calendar quarter, and is able to examine the following information:

- "analysis criteria and procedures for evaluating plans, procedures, expenditures, and maintenance programs;
- Budgets;
- Operations and capital expenditures;
- Fuel procurement or supply;

²⁶ Exhibit 5, Direct Testimony of Mark Bailey, page 25, lines 2-5.

- 1 • Comparison of actual performance to the budget and explanation of variances between
- 2 actual performance and the budget;
- 3 • Load forecasts and integrated resource plans;
- 4 • Depreciation studies, proposed changes in depreciation rates and associated proposed
- 5 changes in electric rates; and,
- 6 • Other activities that may impact Big Rivers' operational and financial performance."²⁷

7 Section 3.4 provides:

- 8 • Each year, BREC will provide the Smelters a copy of its then current proposed annual
- 9 capital and operating budget for the following fiscal year, along with reasonably
- 10 requested supporting information;
- 11 • The Smelters may request review of the budget by an independent expert mutually
- 12 agreed to with BREC;
- 13 • The Smelters may present a report from the independent expert to the BREC board;
- 14 • BREC is obligated to provide notice to the Smelters of certain upward departures from
- 15 budgeted amounts; and,
- 16 • The Smelters can request the Coordinating Committee discuss the causes of budget
- 17 variances and present to the BREC Board of Directors on the subject.

18 Clearly, the Smelters are entwined with BREC management and have the ability for

19 substantial influence on BREC operating and financial matters in support of Smelter

20 interests in lower power rates.

21 **Q. WHAT ARE THE INTERESTS OF BREC AND THE MEMBER COOPS IN**

22 **PURSUING THIS UNWIND TRANSACTION?**

23 **A.** In their response to OAG No. 1, the member cooperatives state they support the Unwind

24 transaction because:

- 25 1. "It will result in a more financially secure Big Rivers with positive equity and an
- 26 investment grade credit rating. As owners of BREC it is in the Members' interest
- 27 for BREC to have financial stability;

²⁷ Id., lines 7-15.

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- 2. BREC will be better able to provide power for economic development should the need arise; and
- 3. The Unwind will help keep jobs in the local community by providing the smelters a source of electricity that can maintain their profitability.”

BREC amplifies these points in response to OAG No. 1, No. 43, and others. BREC states that it “will receive large and immediate and tangible benefits under the unwind transaction—to the tune of approximately \$623 million from E.ON alone and approximately \$327 million in contributions from the Smelters.”²⁸

Q. DID THE COOPERATIVES PROVIDE INFORMATION AND ANALYSIS REGARDING THEIR VIEWS OF THE PROS AND CONS OF THE UNWIND TRANSACTION?

A. Yes. In response to OAG Supplemental No. 1, the cooperatives provided substantial documentation regarding the evaluation and consideration of the proposed transaction. The member cooperatives “exercise control of Big Rivers through representation on the Big Rivers board of directors”, and determined that “Big Rivers should prepare studies, hire consultants and otherwise produce the necessary documentation for their review and consideration of the proposed transaction.” The cooperatives provided “documents from the calendar year 2007 that relate to analysis of the Unwind Transaction and the existing transaction, under which Big Rivers currently operates.” These documents are claimed confidential and include explanations to the Board of the proposed new smelter agreements and the Unwind transaction, and presentation/review of the Termination Agreement, the smelter agreements, Unwind schedule, Pros/Cons/Recommendation, and iterative updates of proposed transaction financial data.

Q. PLEASE PROVIDE THE INFORMATION FROM THESE DOCUMENTS THAT YOU FIND MOST RELEVANT TO THE COMMISSION’S CONSIDERATION OF THIS MATTER.

A. The first document I will provide excerpts (direct quotes) from is [BEGIN BREC/MEMBER COOPERATIVE CONFIDENTIAL] [REDACTED]

²⁸ BREC response to OAG No. 43.

1 financial modeling to be a “central” prediction or projection of future financial results.
2 Furthermore, BREC intends the projections to reflect “least cost” financing decisions—
3 BREC states its “least cost” direction means “the structuring of potential financing such
4 that the most expensive debt components are repaid early, and the less expensive
5 components are kept in place as long as possible, within the constraints of maturities
6 imposed by contract or tax regulations and other objectives such as reducing RUS
7 exposure”.³⁰ However, this “least cost” direction has no doubt been affected by current
8 credit market conditions which have prevented Big Rivers’ execution of its original
9 financing plan as incorporated in the model, and required reversion to an alternative
10 financing plan. This alternative plan implies restructuring existing RUS debt to fit the debt
11 service level contemplated in the Model—which is necessarily a deferral of debt service
12 given that a smaller prepayment will be made, and interest expense will be higher. This
13 deferred debt service will either be paid on that deferred schedule, or prepaid via proceeds
14 from later financing. It is unknown at this time what later circumstances will permit. The
15 later sale of public debt is anticipated to raise an additional \$200 million to make a further
16 prepayment of RUS debt. Of course, the timing, cost and proceeds from this future debt
17 offering cannot be known at this time. Presumably BREC will seek to accomplish these
18 financing steps in “least cost” fashion, but whether it is as “least cost” as that presumed in
19 the model remains to be seen—the process could be more expensive in total than that
20 projected in the model. The impact of these considerations will apparently be addressed in
21 an upcoming filing by BREC of a revised financial model which addresses the alternative
22 financing structure.

23 **Q. IS BREC’S FINANCIAL MODEL RUN INHERENTLY OR INNATELY**
24 **CORRECT?**

25 A. No. As with any financial projections, actual results can and will differ. Future deviations
26 from inputs and assumptions (e.g., the Production Work Plan; departure of one or both
27 Smelters; capital expenditures; environmental requirements; fuel costs; financing costs)
28 represent risks that the financial projections will not be achieved. There are a myriad of
29 assumptions in the projections which may or may not hold true. The span and range of

³⁰ BREC Response to OAG No. 1-48.

1 these risks is also illustrated in Appendix A of BREC's Enterprise Risk Management
2 Policy.³¹

3 **Q. DOES THE FINANCIAL MODEL INCLUDE ALL COSTS TO RECTIFY**
4 **MAINTENANCE AND OTHER CONCERNS REGARDING BREC'S**
5 **GENERATING FACILITIES?**

6 A. It appears that such costs would not necessarily be included since BREC has not completed
7 its due diligence review. The Production Work Plan which BREC has incorporated into
8 the financial model "is based upon the existing WKEC work plan for 2008-2010. ... Big
9 Rivers has made relatively minor changes to incorporate into the plan certain capital
10 projects that it plans to undertake during 2009 and 2010."³² Furthermore, as elaborated
11 upon below, the Stone & Webster Technical Assessment for the Smelters [BEGIN
12 SMELTER CONFIDENTIAL] [REDACTED]
13 [REDACTED] [END SMELTER
14 CONFIDENTIAL]

15 **Q. DOES E.ON PROVIDE ANY REPRESENTATION OR WARRANTY TO BREC**
16 **REGARDING THE CONDITION OF THE GENERATING PLANTS AND SITES?**

17 A. [BEGIN BREC/MEMBER COOPERATIVE CONFIDENTIAL] [REDACTED]
18 [REDACTED]
19 [REDACTED]
20 [REDACTED]
21 [REDACTED]
22 [REDACTED] [END BREC/MEMBER COOPERATIVE
23 CONFIDENTIAL]

24 **Q. HAVE YOU OBSERVED EVIDENCE OF CONCERNS REGARDING RECENT**
25 **YEARS' MAINTENANCE AND THE CONDITION OF THE FACILITIES?**

26 A. Yes. A number of documents in this case reference concerns regarding recent years'
27 maintenance and the condition of the facilities. These documents include:

³¹ Exhibit 5, Direct Testimony of Mark Bailey, Exhibit MAB-5, pages 8-11.

³² Exhibit 5, Direct Testimony of Mark Bailey, page 5, lines 11-16, emphasis added.

³³ Cooperative response to OAG Supplemental No. 1, "Executive Summary Relating to the Unwind of E ON US Arrangements", page 6.

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1. BREC's response to OAG No. 1-27, which suggests that the facilities may be operated differently on a regulated basis by BREC than on an unregulated basis by E.ON. "The regulated production assets under Big Rivers' control may be operated differently than if they were unregulated assets. Some of the differences could be fuel mix, operating and maintenance objectives, generation levels, and economic dispatch criteria." (Emphasis added.)

2. Smelters response to OAG No. 1-3, which attaches a Stone & Webster Technical Assessment [BEGIN SMELTER CONFIDENTIAL] [REDACTED]

[REDACTED]

- [REDACTED]
- [REDACTED]

[END SMELTER CONFIDENTIAL]

3. BREC's response to OAG Supplemental No. 103 provides [BEGIN BREC/MEMBER COOPERATIVE CONFIDENTIAL] [REDACTED]

³⁴ BREC response to Supplemental OAG No. 1-103, Confidential Information Memorandum, December 19, 2005, page 5.

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[REDACTED] [END

BREC/MEMBER COOPERATIVE CONFIDENTIAL]

4. The Member Cooperatives response to OAG Supplemental No. 1 contains repeated references to maintenance concerns. For example, **[BEGIN BREC/MEMBER COOPERATIVE CONFIDENTIAL]** [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

• [REDACTED]

[REDACTED] **[END BREC/MEMBER COOPERATIVE CONFIDENTIAL]**

Q. HAVE THE SMELTERS PERFORMED A DUE DILIGENCE REVIEW OF THE GENERATING FACILITIES?

A. Yes, the Smelters seem to be the only party which has performed and completed a due diligence review. The Smelters response to OAG No. 3 contains a confidential attachment which provides a Stone & Webster Technical Assessment dated May 18, 2007. This response was subsequently supplemented and updated to provide a later final report dated March 11, 2008 containing a Technical Assessment of the generating facilities, which is also considered confidential. This report to the Smelters **[BEGIN SMELTER**

CONFIDENTIAL] [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

³⁵ Id., page 38.
³⁶ Member Cooperatives response to OAG Supplemental No. 1, September 20, 2007, Board presentation, page 26.
³⁷ Id., September 20, 2007 Annual Meeting presentation, pages 21, 22, 25.
³⁸ Smelters Supplemental response to OAG No. 3, page 1.

1 [REDACTED]
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19 [REDACTED]
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22 [REDACTED]

[REDACTED] [END SMELTER CONFIDENTIAL]

23
24 **Q. DOES THE FINANCIAL MODEL INCLUDE FINANCIAL CONSIDERATION AS**
25 **EXCHANGED IN ASSOCIATION WITH THE PROPOSED TRANSACTIONS?**

³⁹ Id.

⁴⁰ Id., page 4.

⁴¹ Id., page 4, emphasis added.

1 A. Yes, the model reflects the financial considerations as stated in BREC's testimony.⁴²
 2 BREC receives \$301.5 million in cash proceeds. BREC receives fuel and other inventory
 3 valued at \$55 million, SO₂ allowances valued by BREC at \$10.9 million, forgiveness of the
 4 residual value payment obligation associated with the lease transaction in the amount of
 5 \$150.4 million, the scrubber installed at the Coleman plant valued at \$97.5 million, and
 6 forgiveness of a note to E.ON in the amount of \$16 million. The transaction will also
 7 cause or accelerate recognition of certain items (\$11.4 million in deferred E.ON lease
 8 revenue; \$15.7 in expenses currently being amortized; and, assumption of an E.ON liability
 9 of \$4.3 million to the smelters). This totals to the \$622.7 million consideration to be
 10 recognized by BREC under the proposed transaction. In addition one payment is not
 11 reflected in the model, "WKEC has agreed to pay to the smelter customers, collectively, at
 12 the closing a sum of money in immediately available funds".⁴³ This sum of money is
 13 **[BEGIN E.ON CONFIDENTIAL]** [REDACTED] **[END E.ON CONFIDENTIAL]**.⁴⁴

14 **Q. DOES BREC INTEND TO REDUCE ITS DEBT UNDER THIS TRANSACTION?**

15 A. Yes. The model reflects BREC's original plans to apply part of its cash proceeds to debt
 16 reduction, prepayment of a portion of RUS debt and incurrence of new public markets debt,
 17 and also to the establishment of two restricted cash accounts. The model shows that \$195.8
 18 is applied to debt restructuring, \$75 million is restricted to the Economic Reserve fund, and
 19 \$35 million for the Transition Reserve fund. In the model, the originally planned debt
 20 restructuring is the net of prepayment of RUS debt (cash out of \$449.7 million), new
 21 capital markets debt (cash in of \$263.5 million), and costs of underwriting (\$4.6 million)
 22 and bond insurance (\$5.0 million). Under the alternative financing plan, BREC has
 23 provided information on a revolving line of credit with National Rural Utilities Cooperative
 24 Finance Corporation (CFC), and a Revolving Credit Agreement with CoBank, the principal
 25 balances for each of which is not to exceed \$50 million. In addition under this alternative
 26 plan, BREC intends to
 27 use proceeds from the Unwind Transaction to prepay approximately \$200 million of
 28 its RUS debt, and restructure the debt service schedule on the remaining balance of

⁴² E.g., Exhibit 10, Direct Testimony of William Blackburn, pages 12 – 19.

⁴³ Exhibit 15, Testimony of Paul W. Thompson on behalf of E.ON, page 13.

⁴⁴ E.ON Confidential Response to OAG No. 1-83.

1 the RUS debt to approximate the debt service contemplated in the Unwind Financial
 2 Model. Big Rivers expects the RUS Amended and Restated Loan Contract,
 3 discussed below, to require that Big Rivers sell sufficient public debt within a fixed
 4 period of years to pay an approximate additional \$200 million on Big Rivers' RUS
 5 debt.⁴⁵
 6

7 However, these plans have not been reflected in an updated run of the Financial Model as
 8 provided to the Commission and the parties.

9 **Q. IF THE ALTERNATIVE FINANCING PLAN RESULTS IN INCREASED COSTS
 10 AND REQUIRED CASH FLOW AT ANY POINT IN TIME, SHOULD THE
 11 COMMISSION EXPECT PRESSURE ON BREC FROM THE SMELTERS TO
 12 DEFER SUCH INCREASED COSTS AND REQUIRED CASH FLOW?**

13 A. Yes. The Smelters have stated "If the cost of refinancing is higher than reflected in the
 14 financial model, the transaction may no longer be viable."⁴⁶ The Smelters also state "As
 15 shown in the financial model prepared by Big Rivers and submitted in this proceeding,
 16 interest expense other than interest expense related to the sale-leaseback transaction is
 17 expected to average about \$45.4 million/year during the first three years of the contract,
 18 and decline thereafter. The interest expense reflected in the model is the target level of
 19 performance."⁴⁷ The Smelters have both the incentive and ability through participation on
 20 the Coordinating Committee to pressure BREC to avoid arrangements which might
 21 increase costs in the shorter term, and defer such costs to a later date. Such cost deferral
 22 may or may not be coincident with the public interest, or interests of the general body of
 23 ratepayers.

24 **Q. ARE THE SMELTERS' INTERESTS NECESSARILY THE SAME AS THE
 25 INTERESTS OF BREC AND ITS MEMBERS?**

26 A. No, the Smelters' interests are not necessarily the same as BREC and the member
 27 cooperatives. The Smelters are for-profit entities whose revenues are constrained by
 28 market prices and conditions. The Smelters' preponderant interest in this case is the lowest
 29 achievable cost for power, so long as the Smelters are operating in Western Kentucky.

⁴⁵ BREC First Amendment and Supplement to Application, paragraph 19.

⁴⁶ Direct Testimony of Henry W. Fayne, page 16, line 5.

⁴⁷ Smelters' Response to OAG No. 1-19.

1 Whenever the Smelters cease operations, their interest in the cost and price of power in
2 Western Kentucky no longer exists. The Smelters would tend to favor deferral of cost
3 recognition in near term periods, leaving costs for later recovery at a point in time when the
4 Smelters' may no longer be operating in Western Kentucky. This is clearly the case in this
5 matter on the subject of depreciation. From a December 21, 2007 email (one week before
6 the Application was filed at the Commission):

7 I just received word that the Smelters are on board with the latest model update.
8 Sandy, Steve and Nib may not be aware that BREC agreed to go back to the
9 depreciation rates methodology reflected in the September model for the years 2011
10 – 2016. They are also using the current rates for 2008 – 2010 which result in
11 slightly less depreciation expense in those years. The net effect is lower rates for all
12 but less recovery [of] the plant value from the Smelters within the finite period of
13 the deal.⁴⁸
14

15 This obviously leaves plant capital recovery to a later time when market conditions
16 affecting coal power plants could be much more uncertain and challenging. If the Smelters
17 are not there to share in the capital recovery load at that time, the full burden will fall to
18 remaining ratepayers. Furthermore, it can be expected that there will be an advocacy
19 position from the Smelters, if they are still present, against assigning such capital recovery
20 responsibility to the Smelters with the same basis as before the Commission currently—
21 loss of jobs in an industry facing worldwide competition.

22 Also, the Smelters [BEGIN SMELTER CONFIDENTIAL] [REDACTED]

23 [REDACTED]
24 [REDACTED]
25 [REDACTED]
26 [REDACTED]
27 [REDACTED]
28 [REDACTED]
29 [REDACTED]

⁴⁸ BREC Response to OAG No. 1-119, email from Jack D. Gaines dated December 21, 2007, emphasis added.

1 [REDACTED]
2 [REDACTED]
3 [REDACTED]
4 [REDACTED]
5 [REDACTED]
6 [REDACTED] [END SMELTER

7 **CONFIDENTIAL]**

8 **Q. DOES BREC STATE IT STANDS TO EARN MORE REVENUES IF THE**
9 **SMELTERS DEPART?**

10 A. Yes. BREC's response to Commission staff No. 10 indicates that "revenues lost as a result
11 of both Smelters' departure, with a ten percent reduction in market prices, are more than
12 recovered by alternative sales into the market." BREC provides financial model scenarios
13 in support of this. What is not stated here is that part of the increased revenue comes from
14 higher rates being charged to consumers. Exhibit DB-2 compares the Rural "effective rate"
15 (page 3, line 46 of the Financial model) for the "base case" versus "both Smelters depart"
16 cases, and shows rates increased up to 18%.

17
18 **Impact of Support Provisions**

19
20 **Q. TO WHAT ARE YOU REFERRING WITH THE TERM "SUPPORT**
21 **PROVISIONS"?**

22 A. By this term, I am referring to the various means and mechanisms BREC uses to defer or
23 mitigate rate impacts on consumers. This would include such items as the Member Rate
24 Stabilization Account (MSRM), the Transition Reserve, the Tier Adjustment charge paid
25 by the Smelters, and the surcredit mechanism.

26 **Q. ARE THE ASSERTED BENEFITS OF THE PROPOSED TRANSACTION FROM**
27 **THE SUPPORT PROVISIONS AND OTHER COMMITMENTS EVENLY**

⁴⁹ Smelter response to OAG No. 1-8.

⁵⁰ Smelters Supplemental response to OAG No. 1-3, page 4.

1 **DISTRIBUTED OVER THE PERIOD OF THE PROJECTIONS IN THE**
2 **FINANCIAL MODEL?**

3 A. No. The support provisions associated with the proposed transaction and other benefits in
4 several cases occur or are consumed in the early years of BREC's financial projections.
5 While the early benefits are enticing in nature, once the benefits are used up, BREC's
6 operations are become exposed to market and economic events and risks. Examples
7 include:

- 8 1. BREC's plan not to increase member rates initially, but rate increases are assumed in
9 the model at 2011 (2%), 2015 (1.02%), and 2017 (9.98%);
- 10 2. BREC's depreciation rates in the financial model may have been artificially depressed
11 to meet Smelter requirements, with overhanging later depreciation rate study and
12 depreciation rate increase which would tend to affect all consumers;
- 13 3. Temporary funds are set up to shield BREC consumers from rate increases in
14 environmental surcharge and fuel adjustment clause costs for a limited period
15 (approximately five years);
- 16 4. Large up-front payments in cash and other consideration from E.ON (approximately
17 \$622 million);

18 **Q. WHAT ARE THE IMPACT AND IMPLICATIONS OF THE TIER ADJUSTMENT**
19 **CHARGE MECHANISM FROM THE SMELTERS?**

20 A. In the first two years under the financial projections, the Smelters receive a rebate from the
21 TIER adjustment mechanism. In later years, the Smelters pay additional costs under the
22 TIER adjustment mechanism. But the actual adjustment will be a complex calculation, and
23 could potentially deviate from what is projected. The TIER Adjustment Charge as paid for
24 the benefit of non-Smelter member rates is subject to potential reduction for an extensive
25 list of items in the Smelter Agreements (Section 4.7.5), including:

- 26 1. Imputed rate increases to non-Smelter member rates in 2010, 2018, and 2021,
27 for which increased charges under FAC and Environmental Surcharge Rider do
28 not count;
- 29 2. Imputed revenues from "New Ratepayers" at the Large Industrial Rate;
- 30 3. Imputed interest expense reductions, including those associated with
31 construction of non-peaking generating facilities under certain circumstances;

1 Furthermore, the TIER adjustment payments from the Smelters are subject to a hard cap.
 2 The Smelters' obligations may not exceed the total of the Large Industrial rate for a
 3 customer with a 98% load factor plus \$0.25 per MWh plus the applicable amount from the
 4 table in section 4.7.1 of the Smelter agreements:

<u>Fiscal Years</u>	<u>Maximum Additional Charge</u>
2008-2011	\$1.95 per MWh
2012-2014	\$2.95 per MWh
2015-2017	\$3.55 per MWh
2018-2020	\$4.15 per MWh
2021-2023	\$4.75 per MWh

Times Interest Earned Ratio (TIER) Considerations

8 **Q. WHY IS THE TIER IMPORTANT FOR THIS PROCEEDING?**

9 A. The "times interest earned ratio" (TIER) is an income statement-based calculation which
 10 compares a company's earnings level to its annual interest expense. It is one ratio used to
 11 measure a company's ability to meet its debt obligations. The higher the ratio, the greater
 12 is the company's indicated ability to cover its interest payments. As such, the ratio also
 13 helps assess the financial risk associated with the company's operations. Implications
 14 from TIER are present in many aspects of the case. First of all, TIER is a notable input
 15 into the credit rating process.⁵¹ As such, it will be one aspect of the credit rating entities
 16 assessment of BREC's creditworthiness and credit ratings (further discussed below). The
 17 TIER calculation is also a crucial element of contracts with the Smelters, in that the
 18 Smelters subject to certain limitations will pay to support BREC's annual achievement of a
 19 minimum TIER level (1.24x, as specified in the Glotfelty testimony). Correspondingly, the
 20 financial model is built to accommodate TIER considerations with the Smelters and to
 21 yield periodic TIER calculations and TIER support payments from the Smelters.
 22 Ultimately, TIER requirements will affect ratepayers who will be required to pay rates that
 23 cover operating costs, depreciation and margins including interest/debt service coverage.

24 **Q. ARE THERE DIFFERENT TIER CALCULATIONS?**

⁵¹ See BREC response to OAG No. 1-60, generally; and, Exhibit 21, Direct Testimony of Mark W. Glotfelty, page 4.

1 A. Yes. As explained by BREC, there may be at least three different TIER calculations. In
2 its financial modeling and contracting with the Smelters, BREC uses a “conventional
3 TIER”. This TIER measures coverage of interest and financing charges on all debt
4 (including sale-leaseback debt, but net of capitalized interest) on a pre-tax basis.⁵² A
5 second measure is for Rural Utilities Service (RUS) purposes, which measures coverage of
6 interest on long term debt only and on an after-tax basis.⁵³ A third measure is one
7 employed by the Commission for ratemaking purposes, which divides the sum of net
8 margins and interest on long term debt by interest on long term debt. BREC states:

9 It is not Big Rivers’ intention to suggest that the Commission adopt Conventional
10 TIER for rate-making purposes. The Conventional TIER is offered solely for
11 reference purposes as to the criteria that may be applied to Big Rivers’ creditors,
12 rating agencies, and others in assessing the Unwind Transaction. It is intended to
13 show the outcome in conventional terms of stipulating a revenue requirement from
14 the members and the Smelters sufficient to achieve a “contract TIER” equal to
15 1.24x.⁵⁴

16 BREC response to OAG No. 46 states that “the creditors and credit rating agencies will
17 likely use the conventional TIER calculation.”

18 **Q. DOES THE OBJECTIVE TIER LEVEL STATED BY THE COMPANY APPEAR**
19 **REASONABLE?**

20 A. The 1.24x TIER level as supported by Mr. Glotfelty appears reasonable for the intended
21 purpose of the financial projections and related agreements including the Smelter
22 agreements. Of course, in later rate proceedings, the Attorney General (and staff and the
23 Commission) may choose to differ from this TIER level based on facts, analysis and
24 circumstances present at that time.

25 **Q. IF BIG RIVERS’ NEW CREDIT AGREEMENTS ARE INCOMPLETE AND NOT**
26 **PRESENTED AT THIS TIME, IS THE INTEREST EXPENSE DETERMINABLE**
27 **FOR PURPOSES OF THE COMMISSION’S DECISION?**

28 A. No. Interest expense is the crucial variable for calculation of TIER, along with the
29 financial modeling of profits. Big Rivers has stated its estimated required TIER, but the
30 actual projected TIER remains unknown to the Commission and other parties until credit

⁵² BREC response to Staff No. 1-13 a.

⁵³ Id.

1 terms including interest rates are finalized with creditors. One clear implication of the
2 uncertainty of TIER is that this renders the Smelters' participation in the transaction
3 uncertain. The Smelters have stated that "if the cost of financing is higher than reflected in
4 the financial model, the transaction may no longer be viable."⁵⁵ The Smelters further state
5 that "the interest expense reflected in the model is the target level of performance."⁵⁶ The
6 Smelter Agreements filed in this case allow the Smelters to terminate the agreements if
7 Smelters conclude Big Rivers cannot achieve the financial model filed with the
8 Commission in December during the first five years.⁵⁷ If interest rates in the final credit
9 agreements and resulting interest expense turn out to be higher than assumed in the
10 financial model for whatever reason, the calculated TIER will fall, other things equal, and
11 Big Rivers will not have met the "target level of performance" which would permit the
12 Smelters to terminate the agreements. Finally, the TIER adjustment payments from the
13 Smelters is capped and limited, such that the remaining "uncapped" costs of achieving a
14 certain TIER level will fall back to remaining customers other than the Smelters. The
15 Commission should note that the financial projections show that the smelter rate subject to
16 TIER adjustment is very close in many years to the cap, with the consequence that if there
17 is a negative deviation from the financial projections, the smelter cap would be reached,
18 and consumers would become responsible for maintenance of the desired TIER level.
19 (Compare: line 36, "Smelter Rate subject to TIER Adjustment" to line 35, "Bandwidth
20 Ceiling", at page 12 of the Financial Model, "Smelter Rate Structure".)

Investment Grade Credit Ratings

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23
24 **Q. DOES BREC STATE INVESTMENT GRADE CREDIT RATINGS FOR ITS DEBT**
25 **ARE IMPORTANT?**

⁵⁴ Id., 13.b.

⁵⁵ Fayne testimony, page 16, lines 6-7.

⁵⁶ Smelters' Response to AG Request No. 1-19.

⁵⁷ Exhibit 20, Smelters' Retail Agreements, Article 7.2.4(a).

1 A. Yes. BREC states this is a requirement of the Unwind transaction, and investment grade
 2 credit ratings are implicit in BREC's financial modeling. I agree that an investment grade
 3 credit rating is a crucial objective for a public utility. Standard and Poor's defines its credit
 4 rating as "a letter grade that reflects Standard & Poor's opinion of the ability and
 5 willingness of an entity to meet its debt and other obligations on time and in full"⁵⁸ and
 6 other rating agency definitions would be identical in direction. A public utility normally
 7 should have a higher, rather than lower, ability and willingness to pay its obligations in full
 8 and on time. S&P, Moody's and Fitch employ different "grades" but the underlying
 9 concept is the same. An investment grade credit rating can be understood as being in
 10 contrast to speculative grade ratings. This can be illustrated by using Standard & Poor's
 11 "rating scale".⁵⁹

Investment Grade

AAA	Extremely strong
AA	Very Strong
A	Strong
BBB	Adequate

Speculative Grade

BB	Vulnerable to nonpayment
B	More Vulnerable, but retains capacity to meet obligations
CCC	Vulnerable
CC	Highly Vulnerable
D	Default

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Q. HAS BREC OBTAINED INVESTMENT GRADE CREDIT RATINGS AT THIS TIME?

A. No. BREC apparently has not sought indicative credit ratings from any of the credit rating entities (Moody's, S&P, or Fitch), or otherwise obtained credit ratings despite internal indications that it intended to do so. **[BEGIN BREC/MEMBER COOPERATIVE CONFIDENTIAL]** [REDACTED]

⁵⁸ BREC response to OAG No. 1-60, S&P's Rating Methodology for U.S. Power Cooperatives: An Overview, November 2, 2006, page 3.

⁵⁹ Id.

⁶⁰ Cooperative response to OAG Supplemental No. 1, page 31.

1 [END BREC/MEMBER COOPERATIVE CONFIDENTIAL] Meetings BREC had
2 scheduled with S&P and Moody's in early March have been postponed.⁶¹ Presumably this
3 stems from the difficulties BREC has experienced in executing its original plan for
4 refinancing/restructuring its debt, along with other scheduling considerations such as
5 current lack of completion of negotiations with creditors. The Application states BREC
6 will "begin the process to obtain investment grade credit ratings on the debt secured by its
7 generating assets from Standard & Poor's and Moody's rating agencies"⁶², after formal
8 application is made for approval of indebtedness upon completion of negotiations with
9 creditors. This places the burden on the Commission and the parties to make multiple
10 assessments of this transaction at various stages. Ultimately, it is possible that the
11 Commission and the parties will have to address this matter again, even after and assuming
12 the Commission approves a not-yet-presented formal application for approval of issuance
13 of indebtedness, since BREC will not have obtained its credit rating at that point. If the
14 rating agencies do not provide an investment grade credit rating at that point, presumably
15 changes impacting the financial projections would be required in order to gain the
16 investment grade rating, which changes would require further review by the Commission
17 and the parties. BREC has observed that [BEGIN BREC/MEMBER COOPERATIVE
18 CONFIDENTIAL] [REDACTED]

19 [REDACTED]
20 [REDACTED] [END
21 BREC/MEMBER COOPERATIVE CONFIDENTIAL]

22 Q. WHAT IMPORTANCE DO INVESTMENT GRADE CREDIT RATINGS HAVE
23 FOR THE FINANCIAL MODEL WHICH THE JOINT APPLICANTS HAVE
24 PRESENTED IN THIS CASE?

25 A. The financial model as presented is an integrated scenario that assumes among other things
26 a pro forma debt restructuring, recasting and reducing the RUS debt, and issuance of new
27 public debt—all at estimated/forecasted interest rates. BREC believes that the modeled
28 results of this integrated scenario will be sufficient to obtain an investment grade credit

⁶¹ BREC response to OAG Supplemental No. 119.

⁶² Application, paragraph 66.

1 rating. A major contingency is that the integrated scenario is changed, and the modeled
2 results are not sufficient to obtain an investment grade credit rating (or approval by the
3 Smelters). In fact, BREC has changed its financing plan to defer the issuance of public
4 debt, and reduce the prepayment of RUS debt by more than 50%. The interest rates for the
5 new public debt are lower than the RUS rates (RUS interest is fixed at 5.82% in the model,
6 while the public debt interest cost is assumed to carry fixed interest rates of 5.82% for the
7 “short term” tranche, and 5.92% for the long term tranche). The estimated interest rates for
8 the public debt are “indicative” rates from Goldman Sachs as of April 23, 2007. However,
9 this modeled financing scenario is not reflective of the recently filed alternative financing
10 plan, which alters BREC’s financial structure. It has not been demonstrated that the
11 financial impacts of this altered financial structure will be acceptable to the Smelters, or
12 earn an investment grade credit rating from the credit rating entities. The Smelter
13 agreements allow the Smelters to terminate the agreements prior to the effective date based
14 on business judgment if the Smelters determine that the financing plan “would materially
15 affect the calculation of the TIER adjustment”, and that “actual interest cost would be more
16 than 15 basis points in excess of [estimated interest costs]”. (Smelter Retail Agreement,
17 section 7.2.4). 15 basis points is a tight criteria. As stated in the Application:

18 The need to obtain financing at reasonable rates drives the condition to closing in
19 the Termination Agreement that Big Rivers obtain an investment grade rating. The
20 TIER Adjustment mechanism in the Smelter Agreements supports a 1.24 TIER,
21 which Big Rivers and its financial advisors believe is important to achieve the
22 appropriate investment grade ratings.⁶³
23

24 If interest expense is higher than in the model, achieved TIER is lowered absent Smelter
25 contributions through the TIER adjustment mechanism. If TIER is lowered, then
26 achievement or maintenance of an investment grade credit rating is impeded or prevented
27 absent rate increases or cost reductions.

28 **Q. DID YOU ATTEMPT TO MODIFY THE MODEL INPUTS TO REFLECT THE**
29 **ALTERNATIVE FINANCING SCENARIO IN ORDER TO ASSESS THE IMPACT**
30 **ON INTEREST EXPENSE, TIER, TIER ADJUSTMENT CHARGES AND RATES?**

⁶³ Application, paragraph 52.

1 A. Yes, but I found that the model version we were provided would not accept changed debt
2 inputs and yield a revised pro forma financial projection. Changing the debt inputs
3 generated a plethora of Excel spreadsheet “#NUM!” errors.

4 **Q. IS BREC EXPOSED TO INTEREST RATE RISK?**

5 A. Yes. This risk pertains to the use of variable rate borrowing instruments, short term
6 borrowing or uncommitted planned borrowing. The risk in this context is that interest rates
7 will continue to rise, thus causing BREC to bear increased fixed interest charges associated
8 with higher interest for any debt which is carried at the variable rate (e.g., revolving credit
9 or lines of credit), or bear higher interest costs at the time short term financing must be
10 refinanced, or long term financing consummated. These higher interest expenses must be
11 paid—thus the term “fixed” in this context, and would preempt cash use that had been
12 planned or is necessary for other purposes (e.g., capital investment or operating expenses).
13 These higher interest expenses would also impact calculated TIER and TIER Adjustment
14 charges to the Smelters, including going outside the “bandwidth” which the Smelters must
15 pay, thus causing additional costs for consumers.

16 **Q. DOES BREC RECOGNIZE CONDITIONS IN THE CREDIT MARKETS, UPON
17 WHICH ITS RE-FINANCING DEPENDS, AS BEING STABLE OR UNSETTLED?**

18 A. BREC has stated that current credit market conditions are unsettled, and I agree with this
19 assessment. This of course affects BREC’s ability to achieve its refinancing objectives,
20 and compels BREC to search for alternatives. Alternative financing considerations are the
21 subject of BREC’s recently filed Amendment to the Application. BREC states that “the
22 sole reason driving Big Rivers to explore financing alternatives is the unsettled condition in
23 the credit market and the extremely wide credit spreads.”⁶⁴

24 **Q. PLEASE ADDRESS THE SUBJECT OF CREDIT SPREADS.**

25 A. This term is a reference to the margin or premium charged as a component of the total
26 interest rate, over and above a “risk free” rate of interest such as that which is associated
27 with United States Treasury bonds, which are presumed to be backed by the full faith and
28 credit of the United States government and bear no risk of default. The credit spread or
29 premium or margin reflects the unique business and financial risks of the borrower, but is

⁶⁴ BREC response to OAG Supplemental No. 116, emphasis added.

1 also dependent on market conditions. As noted by BREC, credit market conditions are
2 currently “unsettled” as a result of events dating back to Summer 2007, and the substantial
3 ripples from the sub-prime mortgage problems. It is not clear when the credit markets will
4 “settle”, and more importantly, it is not clear what credit spreads will be at the point in time
5 when the credit markets do in fact “settle”. Market conditions may be such at that point in
6 time that margins settle at levels well above what has been prevalent in recent years as
7 investors demand higher compensation for perceived risks.

8 **Q. DO YOU HAVE A CURRENT EXAMPLE FOR THE COMMISSION OF OTHER**
9 **COMMISSIONS FACING THE CONSEQUENCES OF UNEXPECTEDLY WIDE**
10 **CREDIT SPREADS?**

11 A. Yes. In January 2007, FairPoint Communications struck an agreement with Verizon
12 Communications to acquire Verizon’s Northern New England (Maine, New Hampshire and
13 Vermont) telecommunications operations. The proposed transaction was supported before
14 the three state commissions by the Joint Applicants by financial projections that extend to
15 2015, and proposed bank loan and bond financing. The state commissions (among other
16 things) approved a stipulated level of borrowing at interest rates averred to by FairPoint.
17 The transaction and related financing is to close March 31, 2008. Early in the week of
18 March 24th, FairPoint informed certain Commissions that the interest rate on the bonds
19 would be much higher (approximately 11% per annum) than anticipated in the company’s
20 financial model as presented in support of stipulations among the parties, which were also
21 the core of state commissions’ approvals of the transaction. Then late in the day on
22 Wednesday March 26th, it became known that the interest rate on the bonds would actually
23 be much higher than that—13.5% per annum. According to S&P, “Terms for the B+/B3
24 rated deal, ... were forced 200 bps wide of initial guidance, to 13.5%, amid the highly
25 challenging market conditions ...” State commissions were already concerned about the
26 financial projections and financial viability of FairPoint following the transaction as
27 evidenced by the Commission orders. The consequence of this unexpectedly very large
28 margin on the bond issue over what was projected and anticipated results in increased
29 interest expense of over \$27 million annually. Also, as a consequence, the state
30 commissions were faced with a Hobson’s choice regarding a transaction that had been
31 approved. Hearings on this issue were held on Friday, March 28th in Maine, and on Sunday

1 March 30th in New Hampshire. At this late date (two business days before the planned
 2 closing date of the transaction), there were not any viable alternative remedies available to
 3 the commissions. I am familiar with the details of this matter as a result of my participation
 4 in both the Maine and New Hampshire cases, including pre-filed testimony supported
 5 under cross examination, on behalf of the Office of Public Advocate and Office of
 6 Consumer Advocate (respectively). In my view this clearly illustrates a risk to ratepayers
 7 and to the Public Service Commission of Kentucky of approving the proposed transaction
 8 here with financing arrangements left to the future. It is not at all clear that interest rate
 9 margins will revert to previous low levels, or remain high relative to those levels for the
 10 foreseeable future. This uncertainty or risk clearly affects BREC's future under the
 11 proposed transaction.

12 **Q. HAVE INTEREST RATE MARGINS BEEN AT RELATIVELY LOW LEVELS,**
 13 **COMPARED TO HISTORICAL AVERAGES?**

14 A. Yes. This is illustrated by the following for "high yield" bonds:

- 15 • "The flood of new debt in the high-yield bond market hasn't
 16 widened risk premiums. Within the past week, the Lehman
 17 Brothers U.S. High yield index showed risk premiums hit a
 18 record low of 232 basis points over Treasuries." "The premium
 19 investors charge companies to compensate them for default risk
 20 has shrunk to reach near or record lows in May, even though the
 21 new debt raised is being used to finance activities that typically
 22 bode poorly for bondholders: stock buybacks and leveraged
 23 buyouts."⁶⁵
- 24 • "In recent months, lower credit bonds—conventionally defined
 25 as BB+ and below—have traded at a smaller risk premium (as
 26 compared to U.S. Treasuries) than ever before in history. Over
 27 the past 20 years, this margin averaged 5.42 percentage points.
 28 Shortly before the Asian crisis in 1998, the spread was hovering
 29 just above 3 percentage points. Earlier this month, it touched
 30 down at a record 2.63 percentage points. That's less than 8%
 31 money for high-risk borrowers."⁶⁶
- 32 • "Several factors underlie the new pushback against buyout
 33 financings. One is the growing awareness that investors have
 34
 35

⁶⁵ "Demand Continues for Debt; Investors Rush in to Take on Risk", The Wall Street Journal, June 1, 2007.

⁶⁶ "The Coming Credit Meltdown", The Wall Street Journal, June 18, 2007.

1 **Q. WHAT PROPORTION OF BREC'S PROJECTED TOTAL REVENUE IS**
2 **DERIVED FROM THE SMELTER AGREEMENTS?**

3 A. The percentage varies by year and is 53.5% of projected total revenues in 2009, 60% in
4 2011, and 57.4% in 2018, for example. By another measure, BREC notes that "56% of its
5 Members' demand [is] associated with" the Smelters.⁷⁰

6 **Q. WHAT PROPORTION OF THE "TOTAL FINANCIAL BENEFIT OF THE**
7 **UNWIND TRANSACTION" TO BREC IS ESTIMATED TO STEM FROM THE**
8 **SMELTER AGREEMENTS?**

9 A. According to the Blackburn testimony at page 12, the total financial benefit of the unwind
10 transaction to BREC is \$950 million, of which \$327 million is due to "increased power
11 purchase payments from the Smelters". The \$327 million amount is the present value of
12 annual sums in excess of the large industrial rate-for additional margin, TIER surcharge
13 payments, and other surcharge payments.

14 **Q. IS THIS ADDITIONAL \$327 MILLION IN REVENUE (PRESENT VALUE) FROM**
15 **THE SMELTERS CERTAIN TO BE EARNED BY BREC?**

16 A. No. BREC states the \$327 million present value figure "is arrived at by calculating the
17 amount of payments from the Smelters that exceed what would be collected from Big
18 Rivers' large industrial tariff at a 98% load factor. ... the Smelters pay at least 25 cents
19 over the large industrial tariff, the cost of the 1.24 TIER and surcharges that flow back to
20 the Members to offset some of their fuel costs."⁷¹ The \$327 million present value figure
21 depends on its assumed inputs: the discount rate, and per period cash flows. It appears
22 BREC uses a discount rate of approximately 5.4% for this calculation. The Commission
23 should note that per period cash flows assumed for the TIER and Surcharges in the model
24 are smaller in the early years (2008-2012), and larger in later years. The present value of
25 later year payments are less than early year payments due to time value of money. The
26 Smelters are able to terminate the contracts under stated circumstances, so the actual receipt
27 by BREC of the later years' cash flow is uncertain. If Smelter payments are assumed to
28 cease after 2012, the present value of payments to that point is substantially less--\$86

⁷⁰ Application, paragraph 53.

⁷¹ BREC response to OAG No. 1-67.

1 million, or 26% of the \$327 million. Please see attached Exhibit DB-3 for a comparison of
2 these present values. This is one instance which illustrates the fact that the benefits of the
3 proposed transaction tend to be “front end loaded” into the early years, while risks and
4 uncertainties are prevalent in the later years. While the Smelters do make additional
5 payments in the early years, continued and larger payments in subsequent years must be
6 viewed as more uncertain for at least two reasons—first, there is some possibility that the
7 Smelters close operations in Kentucky due to business and cost conditions; and, second
8 over time the Smelters can use advocacy positions before policy makers including the
9 Commission to reduce the amounts paid below what is projected in the financial model.

10 **Q. WHAT IS THE BASIS FOR THE RATES TO BE CHARGED TO SMELTERS**
11 **OVER THE TERM OF THE PROPOSED RETAIL AGREEMENT?**

12 A. The basis for the rates is a cost basis, rather than a market rate basis. A consequence of this
13 is that to the extent that BREC’s operating, capital and financial costs cause increased rates,
14 this is flowed through to the smelters, and to the extent those increases make the smelter
15 operations uneconomic in the commodity markets, the operations could be shut down and
16 the loads lost to BREC. Smelter payment obligations as defined by the Smelter
17 Agreements are driven by a very complex set of calculations.

18 **Q. HAVE YOU REVIEWED THE SMELTER AGREEMENTS IN EXHIBIT 20?**

19 A. Yes, I have reviewed them from a non-legal perspective.

20 **Q. WHAT IS THE EFFECTIVE DATE OF THE SMELTER RETAIL**
21 **AGREEMENTS?**

22 A. The Agreements have not been executed, and are not effective at this time. The Retail
23 Agreements, Article 6, sets out the conditions for occurrence of the effective date. I
24 summarize the conditions as follows:

- 25 1. The Unwind Transaction will have been consummated (6.2.2);
- 26 2. The Wholesale Agreement shall be acceptable to each individual Smelter
27 (6.2.4);
- 28 3. Each Smelter’s Wholesale and Retail agreements will have been executed and
29 delivered to the parties (6.2.8);
- 30 4. RUS shall have consented to the transactions and all arrangements and
31 agreements necessary to implement the transactions (6.2.10);

- 1 5. Guarantee by the Smelter Parent shall have been delivered (6.2.5);
- 2 6. Representations and warranties of the parties will continue to be correct as of
- 3 the effective date, and certificates to such effect shall have been received
- 4 (6.2.1);
- 5 7. Other documents shall have been delivered as required (6.2.3 and 6.2.6); and,
- 6 8. No further authorizations or approvals are required (6.2.7 and 6.2.9).

7 **Q. UNDER WHAT CONDITIONS CAN THE RETAIL AGREEMENT BE**
8 **TERMINATED PRIOR TO THIS EFFECTIVE DATE?**

9 A. The Retail Agreement can be terminated prior to its effectiveness for the following reasons,
10 as stated in Article 7:

- 11 1. Failure to satisfy the conditions to Effective Date (above) (7.2.1);
- 12 2. If the Unwind Transaction will not be consummated (7.2.2);
- 13 3. If KPSC orders modify pricing or material terms of these agreements, BREC's
- 14 ability to recover costs from Smelters, or non-Smelter ratepayers (7.2.3);
- 15 4. Business judgment (7.2.4), such that
 - 16 a. "Big Rivers' operations cannot produce during the first five years the
 - 17 charges projected in Big Rivers' financial model ...";
 - 18 b. Smelters can terminate if "material adverse change in the production
 - 19 facilities", or if "material change in [external] economic or business
 - 20 factors ... that would have a material adverse financial effect on" the
 - 21 Smelter; and,
 - 22 c. Smelters determine that the financing plan "would materially affect the
 - 23 calculation of the TIER adjustment", and that "actual interest cost would
 - 24 be more than 15 basis points in excess of [estimated interest costs] or
 - 25 other terms or conditions are materially different than those estimated".

26 BREC response to OAG No. 1-79 provides a complete discussion of applicable terms,
27 conditions and circumstances for Smelter termination of the agreements.

28 **Q. UNDER WHAT CONDITIONS CAN THE RETAIL AGREEMENT BE**
29 **TERMINATED AFTER THE EFFECTIVE DATE?**

1 A. Per 7.3.1 (a), the Agreement can be terminated “in connection with the termination and
2 cessation of all aluminum smelting operations at the” Smelter operation in Kentucky, but
3 such termination may not be effective prior to December 31, 2010.
4

5 **Risk Management**
6

7 **Q. DOES BREC PLAN TO FORM A NEW ENTERPRISE RISK MANAGEMENT**
8 **FUNCTION?**

9 A. Yes. This function is the subject of a new company policy adopted in June 2007, and will
10 focus on risk identification, evaluation and mitigation of risks. The company policy
11 document is included as Exhibit MAB-5 to the Bailey testimony. Risk management and
12 strategic planning are intertwined. “The ERM and strategic planning functions of BREC
13 will facilitate the development and monitor[ing of] the implementation of a strategic plan
14 that will incorporate enterprise risks that require additional strategic focus.”⁷² While the
15 Board of Directors is ultimately responsible for risk management, senior management of
16 BREC constitutes the Internal Risk Management Committee (IRMC), and is responsible for
17 risk management activities at the working level. The IRMC is chaired by the VP (or
18 Director) of Enterprise Risk Management/Chief Risk Officer, but as a non-voting member.
19 This person has not yet been hired—“Big Rivers intends to bring on board an industry
20 veteran to serve as either Vice President or Director Enterprise Risk Management &
21 Strategic Planning/Chief Risk Officer.”⁷³ This position, and the risk management
22 function and responsibility are critically important for BREC’s future. There are
23 substantial inherent risk exposures for BREC going forward, which will need to be
24 understood, addressed and mitigated to the extent possible. BREC may also be able to
25 obtain risk management support in certain areas from ACES Power Marketing (APM).
26
27 BREC has noted it is “unique to other generation and transmission cooperatives in that it
28 has one Member with two large aluminum smelters in its customer base that operate at a

⁷² Exhibit 5, Direct Testimony of Mark Bailey, Exhibit MAB-5, page 6.

⁷³ Exhibit 5, Direct Testimony of Mark Bailey, page 9, lines 7-9.

1 continuous 98% load factor.”⁷⁴ Also, BREC notes [BEGIN BREC/MEMBER
2 COOPERATIVE CONFIDENTIAL] [REDACTED]
3 [REDACTED]
4 [REDACTED] [END BREC/MEMBER
5 COOPERATIVE CONFIDENTIAL] Some important risk areas are identified as
6 standing agenda items for the IRMC, as follows:

- 7 • “Current commodity market strategies;
- 8 • Power cost uncertainty;
- 9 • Level of exposure to non-member transactions;
- 10 • Production strategies and exposures;
- 11 • Financial strategies and exposures;
- 12 • Environmental strategies and exposures;
- 13 • Counterparty contract and credit exposure.”⁷⁶

14 Also, the Enterprise Risk Management policy identifies the scope of business activities to
15 be addressed by risk management as:

- 16 • “Commodity price risk;
- 17 • Volumetric risk;
- 18 • Power and fuel delivery risk;
- 19 • Operational risk;
- 20 • Financial risk;
- 21 • Environmental and regulatory risk;
- 22 • Counterparty contract and credit risk;
- 23 • Organizational risk;
- 24 • Board and officer risk;
- 25 • Safety risk.”⁷⁷

26 These risks are further detailed in Appendix A to the ERM policy document.

⁷⁴ BREC response to OAG No. 1-20.

⁷⁵ BREC response to Supplemental OAG No. 103, page 40.

⁷⁶ Direct Testimony of Mark Bailey, Exhibit MAB-5, page 4.

⁷⁷ Id., page 6.

1 **Q. DOES THE PROPOSED UNWIND TRANSACTION EXTEND RISKS IN TIME?**

2 A. Yes. Big Rivers seeks approval to amend its wholesale power contracts with the member
3 cooperatives, extending the term of such contracts to 2043. "This term extension will
4 accommodate the maturities of new debt or debt refinancing that Big Rivers anticipates in
5 connection with the Unwind Transaction, and may allow for the maturity of any other debt
6 that Big Rivers might incur in the near term without another round of Member wholesale
7 power contract amendments."⁷⁸ Risks are extended in time by this proposed contract
8 amendment at a time when uncertainties are increasing regarding coal-fired generation of
9 electricity due to environmental issues. The Commission may find it inadvisable to extend
10 such risks in time.

11 **Summary of Conclusions**

12
13 **Q. PLEASE STATE CONCLUSIONS YOU HAVE DRAWN FROM REVIEW OF THE**
14 **APPLICATION, TESTIMONY, RESPONSES TO DISCOVERY QUESTIONS, AND**
15 **RELEVANT STATUTES.**

16 A. I draw the following conclusions:

- 17
18 1. The Joint Applicants have placed the parties and the Commission in the position of having
19 to address an Application which is incomplete in material respects. The Application is
20 contingent on its own terms on matters which are presently unfulfilled and unknown to the
21 parties or the Commission. The transaction requires accomplishment of due diligence on
22 the generating facilities by BREC which has not been completed; earning of an Investment-
23 grade credit rating which has not yet been accomplished; filing of many financing
24 documents which have not yet been negotiated/executed or provided; reaching contractual
25 agreement with a large industrial customer (Southwire); and, obtaining the consents of
26 various parties (including approvals and releases from the City of Henderson) to the
27 financing and transaction, the cost of the consents are presently unknown to the parties and
28 the Commission (and do not appear to be accounted for in the financial model). The
29 Commission could reasonably hold this proceeding in abeyance until these matters have

⁷⁸ Application, paragraph 50.

1 been accomplished and addressed through additional discovery and analysis presented
2 before the Commission. Since the "proposed issue" is not known to the Commission at this
3 time, the Commission cannot find it to be necessary for performance of the utility of its
4 service to the public. Further, since the "proposed issue" is unknown, and its financial
5 impact is unknown, the Commission cannot find that the proposed issue will not impair the
6 utility's ability to perform its service to the public.

7 2. The claimed benefits of the proposed transactions occur in the very early years, while the
8 substantial risk exposures occur later. BREC's view that a rate increase is needed is
9 deferred by the \$75 million Economic Reserve account. Further, depreciation rates are
10 known by BREC to not be current and in fact have been depressed to obtain smelter
11 agreement. It is known that depreciation rates will need to be addressed in a planned
12 general rate application. The unique components of Smelter contribution are through
13 surcharges and TIER adjustments. In the early years, the Smelters are projected to realize
14 TIER rebates, with TIER payments projected to begin in 2011. The Smelters can seek
15 through the policy process and the general rate case which is planned for 2010 to alter and
16 reduce the surcharges and adjustments, thus reducing dollars paid by the Smelters and
17 increasing payments from other consumers (all things equal). Other risk exposures are
18 outlined below.

19 3. BREC states that revenues lost if the Smelters leave "are more than recovered by
20 alternative sales into the market".⁷⁹ While this is true given the assumptions utilized, it is
21 also true that rates for consumers are substantially increased at the same time by
22 elimination of offsets to rates paid by the Smelters under the Smelter agreements, and by
23 modeled general rate increases.

24 4. The Commission may reasonably have concerns about BREC's financial viability going
25 forward, given its exposure to risks from future events such as credit market uncertainties,
26 the large smelter load disappearing, current lack of due diligence completion coupled with
27 concerns about the condition of the facilities, and environmental regulations including
28 carbon legislation. BREC notes that **[BEGIN BREC/MEMBER COOPERATIVE**
29 **CONFIDENTIAL]** [REDACTED]

⁷⁹ BREC response to Commission staff No. 1-10.

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[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED] **[END BREC/MEMBER COOPERATIVE CONFIDENTIAL]**

5. Big Rivers' ability to effectively and explicitly manage risks facing the enterprise is crucial in order to ensure and protect its financial viability. BREC's enterprise risk management direction is laudable, but it must be comprehensive in scope, and well-implemented.

6. Achievement of BREC's projected financial results materially depends on direction taken on environmental concerns, which are largely outside of BREC's control. The financial model includes impacts only for present environmental requirements, but no impacts are included for potential future carbon/greenhouse gas regulations or regulations pertaining to mercury. Further, environmental cost increases would significantly impact Smelter rates such that continued operation could become uneconomical.

7. The interests of the Smelters do not align in all respects with the interests of the general body of ratepayers. Yet the Smelters have a direct and continuing ability to affect BREC's operational and financial decisions through the Coordinating Committee and other means. One example of where Smelter interests may be contrary to BREC interests in that Smelters prefer to defer/depress current costs in favor of recovery "later" (e.g, depreciation). Also, the smelters have **[BEGIN SMELTER CONFIDENTIAL]** [REDACTED]

[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED] **[END SMELTER CONFIDENTIAL]**

8. This case may be considered as requiring consideration of two alternatives, each of which has substantial uncertainties. Neither alternative (continuing the present mode of operation however it may later unfold, versus accepting the Joint Applicant's application) is free of difficulties or concerns. However, I conclude the balance should fall in favor of the efforts of the Joint Applicants, subject to the certain concerns and considerations expressed here.

1 The Commission and the Office of Attorney General will need to be watchful and fully
2 informed on particular issue areas, especially in the area of risk management.

3
4 **Recommendations**

5 **Q. DO YOU RECOMMEND THAT THE COMMISSION APPROVE THE**
6 **TRANSACTIONS AS PROPOSED BY THE JOINT APPLICANTS?**

7 A. My recommendation at this time is provisional, since final information on consent
8 agreements and fees, the nature of any agreement with the City of Henderson (and related
9 financial impacts associated with releases and approvals), credit ratings and credit
10 restructuring agreements and financial implications is not known at this time. In my view,
11 these matters should have been settled first so they could be provided to the Commission as
12 part of a comprehensive filing. Instead the parties have been required to address a partial
13 filing, which leaves many crucial matters unknown and subject to later serial and piecemeal
14 additions to the Application. I therefore make a provisional recommendation that the
15 Commission approve the transactions, but with limited enthusiasm, and with certain
16 conditions and understandings. This recommendation also gives weight to the
17 straightforward analysis of BREC and its member cooperatives of the “pros and cons” of
18 the proposed transaction, as provided by the member cooperatives in response to OAG
19 Supplemental No. 1.

20 **Q. WHAT CONDITIONS DO YOU RECOMMEND THAT THE COMMISSION**
21 **INCLUDE WITH APPROVING THE TRANSACTION?**

22 A. I recommend the following conditions:

- 23 1. BREC has presented its financial model results as the “base case” upon which its
24 decisions were based. Yet the application is incomplete and there are pending matters
25 which may affect this “base case”. The Commission should require that the “base case”
26 rates and results be maintained past resolution of the pending matters such that if
27 resolution of a matter (e.g, due diligence finalization, credit restructuring, City of
28 Henderson matters, or consent fees and agreements) would unfavorably impact the
29 “base case” rates and results, E.ON and/or the smelters must step forward to fund and
30 eliminate those unfavorable impacts in order to restore the “base case” projections.
31 2. BREC shall not waive any conditions to closing without Commission approval.

- 1 3. BREC shall use the March 11, 2008 Stone & Webster Final Report in addition to its
2 own resources to finalize its due diligence on the generating facilities and sites.
- 3 a. BREC shall reconcile [BEGIN SMELTER CONFIDENTIAL] [REDACTED]
4 [REDACTED]
5 [REDACTED]
6 [REDACTED] [END SMELTER
7 CONFIDENTIAL]
- 8 b. BREC shall provide its final due diligence report to the Commission and the
9 parties, and include the reconciling information and estimated costs, along with
10 its recommendation as to when and how each item should be addressed.
- 11 c. BREC shall provide to the Commission and the parties a revised run of the
12 Financial Model which incorporates these items in a revised Production Work
13 Plan, BREC's recommended method of addressing each item, and BREC's
14 estimated cost of doing so, for Commission approval prior to closing the
15 transaction.
- 6 4. BREC shall fund, initiate and maintain a comprehensive risk management plan and
17 program, which includes the ability to address impact of contingencies including, but
18 not limited to, fuel prices, cost exposure for environmental remediation programs (both
19 existing and contemplated), and any other material risks pertaining to BREC.
- 20 5. Prior to any filing by BREC to increase its rates, BREC shall file with the Commission
21 a comprehensive report on identified risks and steps taken under its Risk Management
22 program to address or mitigate those risks.
- 23 6. BREC shall provide the Commission with minutes and documents from each meeting
24 of the Coordinating Committee at least through 2011. Upon request of either the
25 Commission, BREC's required provision of minutes and documents shall be extended.
- 26 7. In the event of future changes in environmental regulations compliance which BREC
27 determines will have a material financial effect on it, BREC shall report on a timely
28 basis to the Commission of the nature and expected cost of compliance with changed
29 environmental regulations, including financial projections modified to include
30 compliance costs and impacts on rates and revenues.

- 1 8. BREC shall file with the Commission projected budgets on the same schedule as
2 management adopts annual budgets each year through 2013 and shall pay, if so
3 requested by the Commission, for a third party to review same. BREC shall provide
4 and include in the filing explanation of differences between that year's budget and the
5 projected amounts for that same year in the final version of the Financial Model
6 considered by the Commission in this case.
- 7 9. BREC will continue to employ at least the same level of workforce, with comparable if
8 not better skill and expertise, as it currently does, or notify the Commission if BREC
9 has concluded it would be imprudent to do so, stating the reasons why BREC believes it
10 to be imprudent.
- 11 10. BREC will negotiate in good faith with IBEW during any collective bargaining
12 agreements.
- 13 11. BREC shall advise the Commission and the Attorney General of any material changes
14 to its financing arrangements, on a timely basis.
- 15 12. BREC shall advise the Commission of any changes to RUS' criteria for the financing of
16 both new coal-fired plants, and regarding any financing relating to existing coal-fired
17 plants, on a timely basis. In the event of any such changes, BREC shall supply a plan
18 for assessing the impact and ramifications (if any), and how BREC will address those
19 changes.
- 20 13. BREC shall advise the Commission of any material changes to smelter contracts, on a
21 timely basis.
- 22 14. BREC shall advise the Commission and the Attorney General in event of any material
23 changes in its agreements with HMPL, on a timely basis.
- 24 15. BREC shall advise the Commission in the event of any material changes in its
25 agreements with labor unions, on a timely basis.
- 26 16. BREC shall advise the Commission and the Attorney General on a timely basis of any
27 material events that in any way could impact BREC's ability to wheel excess power to
28 other markets.
- 29 17. BREC shall advise Commission on a timely basis of any material changes in its
30 generating units or their operation not included in BREC's Production Work Plan as
31 submitted in this case and finalized by BREC's due diligence.

1 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

2 A. Yes, it does at this time. I reserve the right to provide supplemental testimony at a later
3 date to address items, information and issues that are presented by BREC at a later date to
4 fill in incomplete aspects of the filing as it is enumerated in this testimony.

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATIONS OF BIG RIVERS)	
ELECTRIC CORPORATION FOR:)	
(I) APPROVAL OF WHOLESALE TARIFF)	
ADDITIONS FOR BIG RIVERS ELECTRIC)	
CORPORATIONS, (II) APPROVAL OF)	CASE NO.
TRANSACTIONS. (III) APPROVAL TO ISSUE)	
EVIDENCES OF INDEBTEDNESS, AND)	2007-00455
(IV) APPROVAL OF AMENDMENTS TO)	
CONTRACTS; AND)	
OF E.ON U.S., LLC, WESTERN KENTUCKY)	
ENERGY CORP. AND LG&E ENERGY MARKETING)	
INC. FOR APPROVAL OF TRANSACTIONS)	

DIRECT TESTIMONY OF DAVID BREVITZ
ON BEHALF OF
THE ATTORNEY GENERAL

Certificate of Service and Filing

Counsel certifies that an original and ten photocopies of the foregoing Direct Testimony of David Brevitz On Behalf Of The Attorney General were served and filed by hand delivery to Stephanie L. Stumbo, 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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this 3rd day of April, 2008


Assistant Attorney General

EXHIBIT DB-1

BEFORE THE PUBLIC SERVICE COMMISSION OF KENTUCKY

CASE NO. 2007-00455

DIRECT TESTIMONY OF

DAVID BREVITZ

David Brevitz, C.F.A.
3623 SW Woodvalley Terrace
Topeka, Kansas 66614
785-266-8769, dbrevitz@cox.net

General

Mr. Brevitz is an independent telecommunications consultant, a Chartered Financial Analyst and has more than twenty-seven years of experience in government affairs and telecommunications regulation/de-regulation. He previously served in management positions with industry regulatory organizations. He is a former Chief of Telecommunications for the Kansas Corporation Commission ("KCC"). He is familiar with the details of the FCC's implementation of the Telecommunications Act of 1996, and has provided expert testimony on numerous issues including telco local division spin-offs, competition, industry and market structure, service bundles, substitutability of VoIP and wireless for local exchange service, resale, unbundled elements, TELRIC/cost studies, network modernization, access charges, rate design, cost allocations, universal service and other matters.

Professional Designation and Community Service

Mr. Brevitz has achieved designation as Chartered Financial Analyst from the Institute of Chartered Financial Analysts ("ICFA") in 1984. The ICFA is the organization which has defined and organized a body of knowledge important for all investment professionals. The general areas of knowledge are ethical and professional standards, accounting, statistics and analysis, economics, fixed income securities, equity securities, and portfolio management.

Mr. Brevitz is Past President of the Topeka Kiwanis Club (1988 – 1999). He has served numerous terms on the Board of Directors of the Club, has been recognized by Kiwanis International as a George F. Hixson Fellow, and has his name inscribed on the Kiwanis International Foundation Tablet of Honor.

Mr. Brevitz is currently serving as Treasurer of Topeka Ice, a non-profit organization organized to build an ice rink for community use in Topeka, Kansas. He also currently serves as Treasurer of the Kansas City Junior Outlaws High School Hockey team (Tier II). In addition, he has served two terms as President of the Topeka Junior Scarecrows Hockey Association and two terms as Treasurer.

Recent Relevant Experience

- 1999-Current, Kansas Corporation Commission Advisory Staff: Mr. Brevitz is serving as advisor to the Commissioners on telecommunications technical and policy matters, including determinations on state universal service fund issues; spin-off of Sprint/United's Local Telecommunications Division (now Embarq); application of price cap regulation to Southwestern Bell-Kansas and Sprint/United Telephone (now Embarq); designation of wireless carriers and other entities as Eligible Telecommunications Carriers; arbitrations between carriers pursuant to the Federal Telecommunications Act; Southwestern Bell-Kansas' Section 271 application; pricing and costing of unbundled network elements for Southwestern Bell and Qwest; modification of the Kansas Universal Service Fund to be cost based consistent with state and federal law; adaptation of

the FCC cost proxy model for intrastate use; rate rebalancing and DSL deployment; Digital Subscriber Line (DSL) matters; legislative issues; advanced services; access charge restructure; collocation; and, toll dialing parity and carrier of last resort as examples. Mr. Brevitz also serves as advisor on electric industry matters, including cases involving structure/restructure of Westar Energy and Aquila.

➤ **2007 to current, FairPoint/Verizon Merger/Acquisition of New England State Operations:** Mr. Brevitz is working on behalf of the Maine Office of Public Advocate to assess the proposed spin off of Verizon operations in Maine, New Hampshire and Vermont and subsequent merger with and into FairPoint Communications, in a reverse Morris trust transaction. The assessment includes evaluating financial projections of the company in support of financial viability of the proposed transaction; financial analyses associated with the proposed transaction performed by the company and investment advisors; and implications of resulting debt leverage and structure of the company as "high debt/high dividend". The Hearing Examiner's Report adopted Mr. Brevitz's financial recommendations including substantial debt (\$600 million) and dividend reduction.

➤ **2007 to current, FairPoint/Verizon Merger/Acquisition of New England State Operations:** Mr. Brevitz is working on behalf of the New Hampshire Office of Consumer Advocate to assess the proposed spin off of Verizon operations in Maine, New Hampshire and Vermont and subsequent merger with and into FairPoint Communications, in a reverse Morris trust transaction. The assessment includes evaluating financial projections of the company in support of financial viability of the proposed transaction; financial analyses associated with the proposed transaction performed by the company and investment advisors; and implications of resulting debt leverage and structure of the company as "high debt/high dividend". The Commission has made preliminary determination in favor of Mr. Brevitz's financial recommendations.

April 2007, PURC Advanced Training Course on Regulatory Economics and Process: Interconnection, Pricing and Competition: Mr. Brevitz developed and presented three courses to members of the National Telecommunications Commission from Thailand. The courses covered accounting separation, case study on a rate proposal, and principles and practices for rate rebalancing.

➤ **January, 2007, 21st International Training Program on Utility Regulation:** Mr. Brevitz developed and presented training sessions on accounting separation, rate rebalancing (case study), and universal service obligations to the semi-annual training program for regulatory agency staff and commissioners worldwide. The training program is provided by the Public Utilities Research Center at the University of Florida in Gainesville.

➤ **2006-Current, Telecommunications Training for Regulatory Agency for Telecommunications (RATEL) in Serbia:** Mr. Brevitz is working to assist RATEL in implementation of new polices designed to open telecommunications markets in Serbia to competition. Issues being addressed include cost orientation of prices (rate rebalancing), universal service funds, interconnection, administrative procedures, internet telephony, and spectrum management.

➤ **2006-2007, Embarq UNE Loop Pricing Application:** Mr. Brevitz assisted the Bureau of Consumer Protection in the Nevada Attorney General's office in its assessment of Embarq's proposal to increase rates for the unbundled loop. This work included assessment of Embarq's proposed UNE loop cost model and its inputs, FCC orders which speak to TELRIC costing and UNE pricing, and use of the mapping program to support Embarq's proposed cost model.

- **“Assessing Pricing Behavior Under Deregulation”**: Presentation at the NASUCA Mid-Year Meeting, June 14, 2006, Memphis Tennessee.

- 2006 Spin-off of Windstream from Alltel**: On behalf of the Kentucky Attorney General (Office of Rate Intervention), Mr. Brevitz formulated discovery, and analyzed and addressed information relevant to the proposed spin-off of the local telecommunications operations from Alltel Corporation and subsequent merger with Valor Communications. Prefiled testimony was provided before the Kentucky PSC addressing the excessive debt burden placed on “SpinCo” by Alltel; conflicting company claims regarding merger synergies; lack of basis for claimed increased buying power; and non-arms-length nature of decisions and transactions in the proposed spin-off.

- **2005 Rate and Revenue Requirement Review of Saco River and Pine Tree Telephone Companies**: On behalf of the Maine Public Advocate’s Office, Mr. Brevitz addressed revenue requirement levels for both companies, including detailed review of expense levels and trends, expanded calling plan criteria and data, and detailed review of holding company organization and charges between affiliates.

- **2005 Price Deregulation of Basic Local Exchange Service**: On behalf of AARP, Mr. Brevitz provided comments before the Public Utilities Commission of Ohio regarding final rules to implement procedures for addressing price deregulation applications. The comments addressed the need for effective competition to be demonstrated before approving price deregulation of BLES; market segmentation between stand-alone BLES and service bundles; barriers to entry; current competitive market conditions and whether “many sellers” exist; functionally equivalent and substitute services; and other related matters.

- 2005 Spin off of “LTD Holding Company” from Sprint Nextel**: On behalf of the Nevada Bureau of Consumer Protection, Mr. Brevitz led a team to analyze the proposed spin-off from a technical and public interest perspective under Nevada statutes. Issues addressed included: asset transfers to LTD Holding Co.; levels of debt to be placed on LTD Holding Co.; “normal” levels of debt for Sprint’s Local Telecommunications Division; financial and cost of capital implications of the spin off; impact on LTD’s ability to compete and other competitive trends; and accounting issues such as division of pension assets and pension liabilities.

- **“Telecommunications Convergence: On Duopoly?”**: Presentation at the NASUCA Mid-Year Meeting, June 15, 2005, New Orleans, Louisiana.

- **2005 Intrastate Deregulation Proposal of SBC Oklahoma**: On behalf of AARP, Mr. Brevitz filed testimony addressing SBC Oklahoma’s proposal to deregulate pricing of almost all intrastate services (E911 and access services were excepted). The testimony responded to SBC Oklahoma assertions regarding significant retail competition on a widespread basis, openness of markets, barriers to entry and exit, reasonable interchangeability of use of cellular and VoIP services for basic residential services, market share analysis, and competitive trends including CLEC responses to the elimination of UNE-P, access line losses. The testimony further analyzed the actions, opportunities, and competitive responses of SBC Oklahoma and its corporate affiliates, observed public safety deficiencies of cellular and VoIP services, and market trends converging on duopoly.

- **2004 to 2005: Alternative Regulation Plan Filing by Verizon Vermont**: Mr. Brevitz assisted the Vermont Department of Public Service in assessing matters included in the Vermont Public Service Board’s assessment of proposed changes to the Alternative Regulation Plan applicable to Verizon Vermont. Prefiled testimony addresses matters including assessment of competition and modes of competition, VoIP/wireless substitution, continuation of direct assignment practices

under the FCC's separations freeze, jurisdictional cost allocations, rate flexibility, and UNE availability and commercial agreements with CLECs.

2005 UNE Loop Cost Proceeding: On behalf of the Arkansas Public Service Commission General Staff, Mr. Brevitz filed testimony which analyzed SBC Arkansas' proposed increased UNE loop rates, and UNE loop model and shared and common cost model inputs and outputs, including fill factors, defective pairs, IDLC, DSL expenses, and retail related costs.

- **2004 Mass Market Switching Reviews under the FCC Triennial Review Order:** Separately for the Arkansas Public Service Commission staff, and the New Mexico Attorney General's office, Mr. Brevitz provided analysis and two-step evaluation under the FCC's Triennial Review Order ("TRO") of impairment in access to local circuit switching for mass market customers. The evaluations were done on a granular, market-specific basis. The evaluations determined whether unbundled local circuit switching (and by extension, the UNE-Platform) must continue to be provided as an Unbundled Network Element by incumbent local exchange companies.
- **2004 OSIPTEL/Peru:** Worked with OSIPTEL (telecom regulator in Peru) to analyze barriers to competition in Peru. Presented workshop and training materials regarding the Economic Aspects of Competition Regulation for Public Utilities, which addressed concepts of market power, dominance, cross subsidies, essential facilities, ex ante versus ex post regulation, asymmetric regulation.
- **2003 to 2005: Cable & Wireless Rate Adjustment/Barbados Fair Trading Commission:** Mr. Brevitz advised the FTC and its staff regarding the application of C&W Barbados to increase domestic revenues and institute local measured service, and providing related analyses. The Company's filing was in part designed to enable Price Cap regulation, and opening the market to competitors. As such, Price Cap and competitive issues were necessarily considered along with revenue requirements and tariff/pricing issues.
- **2003 CenturyTel Rate Case/Arkansas PSC:** Mr. Brevitz led a team providing analysis and testimony on behalf of PSC staff in the CenturyTel of Northwest Arkansas rate case, in which the Company sought to treble local rates. Mr. Brevitz provided an analysis of CenturyTel of Northwest Arkansas' ("CNA") modernization programs and provision of DSL services from the perspective of basic local service ratepayers, and also addressed the local competition claims of the Company.
- **2002 Maryland Office of People's Counsel:** Maryland PSC's Case No. 8918 is to review Verizon's Price Cap regulatory plan, after Verizon had operated five or more years under it. Topics addressed included the proper productivity factor to use in the price Cap formula, and any necessary amendments to the structure of the price cap plan. Mr. Brevitz provided expert testimony on the proper formulation and terms for the price cap formula, competition, and other matters related to the extension of price cap regulation.
- **2001 Maine Office of Public Advocate-Verizon Maine 271 Review:** Review of Verizon's Section 271 filing before the Maine Public Service Commission, and Declaration filed on behalf of the Public Advocate which addresses Checklist Item #13 (Reciprocal Compensation), and Verizon's proposed performance measurement metrics and proposed Performance Assurance Plan.

2001 Vermont Department of Public Service-Verizon Vermont 271 Review: Review of Verizon's Section 271 filing assertions of compliance with the "14 Point" competitive checklist and non-discrimination obligations of the Telecommunications Act of 1996, before the Vermont Public Service Board. Mr. Brevitz filed a Declaration on behalf of the DPS which addresses

Checklist Item #13 (Reciprocal Compensation), and Verizon's proposed performance measurement metrics and proposed Performance Assurance Plan.

2001 Public Utility Research Center (PURC)/University of Florida: Presentation of two seminar modules and an interconnection case study as staff training for the Panamanian telecommunications regulatory body, ERSP. Mr. Brevitz developed course content and presentation materials for the seminar, under the auspices of PURC, on the topics of the "US Experience in Telecom Competition" and "Consumer Issues in Telecom Competition". These topics were presented by Mr. Brevitz in the seminar at Panama City, Panama on March 29-30, 2001.

- **2001-2002 Michigan Attorney General's Office–Federal District Court Litigation Support:** Mr. Brevitz supported the Attorney General's office in its defense of lawsuits by Ameritech and Verizon against the PSC and the Governor regarding recently passed state legislation. The state legislation eliminated the intrastate EUCL being charged by both companies, expanded local calling areas, and froze the application of the Price Cap Index for a period of time.
- **1999-2000 Delaware Public Service Commission Staff–Evaluation of Bell Atlantic-Delaware's Collocation Tariff Filing:** On behalf of the Staff, Mr. Brevitz reviewed BA-Delaware's Collocation tariff filing, and prefiled testimony on behalf of Delaware PSC staff. Issues addressed include non-discriminatory provisioning of collocation; collocation intervals; utilization of "best practices" for terms, conditions and pricing; and costing.
- **1999-2000 Vermont Department of Public Service–Evaluation of Carrier to Carrier Wholesale Quality of Service:** On behalf of the Vermont DPS, Mr. Brevitz was engaged in the review of quality of service standards related to Verizon's wholesale activities of provisioning Unbundled Network Elements and resold services. The work effort was conducted within a workshop of the parties, and was drawn on the similar activity for BA-NY and a number of other states including Massachusetts and Virginia. Measures, standards and benchmarks were to be determined, along with an appropriate remedy plan in the event those items are not met by the incumbent carrier. This matter was resolved in the context of Verizon's Section 271 case.
- **1999-2000 Vermont Department of Public Service–Investigation of Geographically Deaveraged Unbundled Network Prices:** On behalf of the Vermont DPS, Mr. Brevitz testified before the Vermont Public Service Board regarding the appropriateness and extent of geographic deaveraging of rates for Unbundled Network Elements (UNEs) in Vermont. In formulating these positions, it was necessary to consider FCC Orders, competitive policy implications, and related issues such as distribution of federal high cost support. The FCC had spotlighted the linkages between high cost support and geographic deaveraging determinations. Consequently the testimony also considered federal high cost support distribution implications and local rate impacts stemming from geographic deaveraging determinations to be made by the Board.
- **1999 Vermont Department of Public Service–Evaluation of Bell Atlantic Proposed Alternative Regulation Plan, Wholesale Quality of Service Standards, and Cost of Service:** Mr. Brevitz served as project manager and lead consultant in the DPS review of Bell Atlantic's proposed Price Point Plan and proposed appropriate modifications. Those modifications included moving rate reductions forward to the inception of the plan, and aligning the plan more closely to the status of competition in Vermont by allowing streamlined regulation only for truly new services, not bundles of existing services. Mr. Brevitz also supported the immediate implementation of detailed wholesale quality of service standards along with a remedies structure. Mr. Brevitz addressed the cost of service issues of reciprocal compensation and local number portability, and proposed rate design changes to effect the return of \$16 million in excess revenues.

- **1998-99 Delaware Public Service Commission Geographic Deaveraging of Bell Atlantic UNE Loop Rates:** Mr. Brevitz worked for PSC staff to analyze cost and policy issues associated with geographic deaveraging of UNE loop rates. Methodology and policy to determine geographic zones was reviewed for BA-Del, and compared to all other Bell Atlantic states. BA-Del cost data was reviewed to assess closeness of fit between BA-Del's proposed population of zones with existing exchanges to the loop costs of those exchanges. After review of comments of interested parties, Mr. Brevitz prepared and submitted a report and recommendation to the PSC regarding modification of BA-Del's proposal to implement geographically deaveraged UNE loop rates. The PSC adopted the report and recommendation in its Order in the matter.
- **1998 Vermont Department of Public Service- Evaluation of Proposed Special Contracts for Toll and Centrex Services for Compliance with Imputation Requirements:** Mr. Brevitz worked for the DPS in this matter, which was an evaluation of four individual customer toll contracts, and two individual customer Centrex contracts, under the Vermont Public Service Board's price floor and imputation requirements. This evaluation included analysis of whether Bell Atlantic had appropriately followed the Board's imputation requirements; whether the imputed costs had been appropriately calculated and included all relevant costs; and, whether undue price discrimination would result from approval of Bell Atlantic's proposed prices. Mr. Brevitz analyzed the Company's filed testimony and costing information provided in support of the contract pricing; drafted staff discovery and analyzed responses of other parties in the matter; and, supported pre-filed rebuttal and surrebuttal testimony before the Board under cross examination. Hearings in this matter were held in November and December of 1998 and January 1999.
- **1998 Delaware Public Service Commission- Re-classification of Residential ISDN as "Competitive":** Mr. Brevitz worked for Delaware Public Service Commission staff in this case (Docket 98-005T), which was a filing by Bell Atlantic to move Residential ISDN ("R-ISDN") from the basic service classification to the competitive service classification, pursuant to the Telecommunications Technology Investment Act and related Commission rules to implement the Act. Bell Atlantic filed an application before the PSC stating that R-ISDN met the statutory and rule conditions for moving the service to the competitive class of services, along with market information in support of that statement. Mr. Brevitz analyzed the company's filing and the comments of other parties in the matter from an economic and public policy perspective, analyzed the Company's compliance with applicable provisions of the TTIA and Commission rules, drafted staff discovery and analyzed discovery responses of other parties, and presented testimony under cross examination before the Commission. The hearing in this matter was held July 9, 1998.
- **1997 Delaware Public Service Commission - Costing and Pricing of Residential ISDN Service:** Mr. Brevitz assisted the Delaware PSC staff in this case (Docket 96-009T) by reviewing the prefiled testimony of all parties; reviewing the cost studies supporting Bell Atlantic's proposed R-ISDN pricing; comparing those costs to Bell Atlantic's UNE rates and costs; reviewing Bell Atlantic's contribution analyses and demand forecasts for the R-ISDN service; reviewing and comparing two Bell Atlantic local usage studies (the second of which more than tripled the costs of the earlier study); providing an analytic report on the usage cost studies to PSC staff and rate counsel; assisting in the preparation and conduct of cross-examination; and assisting staff rate counsel in preparation of the brief in this matter. The hearing in this matter concluded in January 1998.
- **1997 Georgia Public Service Commission - Unbundled Network Elements Cost Study Review:** Mr. Brevitz was a lead consultant in this engagement. The GPSC opened a cost study docket to determine the cost basis for BellSouth UNE rates, following arbitration hearings

involving BellSouth and several competitors. Introduced for the first time by BellSouth, and considered in the hearing was BellSouth's "TELRIC Calculator". Also considered in the hearing, as sponsored by AT&T/MCI was Hatfield Model Versions 3 and 4. Mr. Brevitz prepared and provided to GPSC staff an "Issues Matrix" which listed the issues, party positions on the issues, and a suggested staff position. Also on behalf of GPSC staff, Mr. Brevitz analyzed cost inputs and outputs pertaining to both models. No testimony was provided in this matter as GPSC staff did not testify in the hearing. Hearings on the matter concluded in September 1997.

- **1995, 1996 and 1997 Wyoming Public Service Commission - Competition Rules:** Mr. Brevitz was the Project Manager and a lead consultant for this engagement. Mr. Brevitz is actively involved in writing and implementing comprehensive competition rules in Wyoming which consider the new 1995 Telecommunications Act in Wyoming and the 1996 Federal Telecommunications Act. These rules address interconnection/unbundling, universal service, service quality, price caps/alternative regulation, privacy, resale, intraLATA dialing parity, TSLRIC/cost study methods; access charge rate design; number portability, reciprocal compensation, rights-of-way and other matters.
- **1995 and 1996 Wyoming Public Service Commission - U S WEST Pricing Plan:** Mr. Brevitz was the Project Manager and a lead consultant for this engagement. Mr. Brevitz has evaluated and filed testimony regarding U S WEST's pricing plan, competition issues, universal service and U S WEST cost study issues.
- **1996 Oklahoma Corporation Commission - Seminar on 1996 Federal Telecom Act:** Mr. Brevitz presented a seminar on the 1996 Federal Telecom Act to the Oklahoma Corporation Commission Staff.

1995 and 1996 Georgia Public Service Commission - Local Number Portability and Competition Policy: Mr. Brevitz was the Project Manager and a lead consultant for this engagement. Mr. Brevitz assisted the GPSC in implementing rules related to the new 1995 Telecommunications Act in Georgia and the 1996 Federal Telecom Act. Mr. Brevitz was primarily involved in initiating and coordinating the Number Portability Task Force and guiding the industry workshop on permanent number portability. The PSC has accepted the industry workshop recommendation. As a result, Georgia will be one of the first states to implement full number portability. Assistance was also provided on other competition issues.

- **1996 California Public Service Commission - Pricing of Unbundled Elements and Resale services:** Mr. Brevitz assisted Sprint in the pricing (second) phase of the California Commission's OANAD proceeding. Testimony was presented regarding proper pricing of unbundled network elements, given previous a PUC decision on UNE costs. The cost (first) phase involved the development of cost study principles, performance of TSLRIC cost studies of unbundled network elements by Pacific Bell and GTEC, and performance of avoided cost studies for retail services for resale.
- **1995 to 1996 Kansas Telecommunications Strategic Planning Committee - Kansas Corporation Commission:** Mr. Brevitz served as the Kansas Corporation Commission representative on this legislative committee, which was organized in mid-1994 to research and recommend any needed changes to the telecommunications statutes and state policies. The TSPC issued its final report to the Governor and the legislature in January 1996.
- **1995 Chairperson of Kansas Corporation Commission Working Groups:** Mr. Brevitz was appointed to the Cost Studies and Universal Service Working Groups for the KCC's general

competition investigation, subsequent to the KCC's May 1995 Phase I competition order. He was also active in other Task Forces including Unbundling, Number Portability and Local Resale.

- **Kansas Corporation Commission - Infrastructure/Competition Report:** Produced a special report on Kansas telecommunications infrastructure/competition issues which was provided to the 1995 Kansas legislature.
- **1994 Kansas Corporation Commission - Alternative Regulation Legislation:** In 1994 the Kansas Legislature passed House Bill 3039, which extended SWBT's "TeleKansas" alternative regulation plan for two years. Mr. Brevitz provided substantial assistance in negotiating the detailed provisions for the KCC's implementation of the bill.
- **Kansas Corporation Commission - Southwestern Bell Telephone Infrastructure Analysis:** Investigated SWBT's infrastructure/modernization budget and addressed construction requirements, tariffs, rates, terms and conditions for SWBT's provision of interactive television ("ITV") to all Kansas schools at deep discount prices for the benefit of the Kansas infrastructure and schools.

Work History

Independent Telecommunications Consultant

Following a significant engagement with the Kansas Corporation Commission, extensive professional services have been provided to state public utility commissions, as indicated above under "Recent Relevant Experience".

A variety of duties and tasks have been performed for the Kansas Corporation Commission, including providing staff support for Statewide Strategic Telecommunications Planning Committee, composed of 17 members (legislators, state agency heads, private enterprise); assisting in KCC implementation of House Bill 3039 ("TeleKansas II", extension of alternative regulatory plan for Southwestern Bell Telephone); and providing analysis and testimony for communications general investigations into competition in the local exchange and other markets. Those general investigations included General Competition, Competitive Access Providers, Network Modernization, Universal Service, Quality of Service, and Access Charges.

Kansas Consolidated Professional Resources - Director of Regulatory Affairs

Duties included monitoring of and participating in state regulatory affairs on behalf of twenty independent local exchange companies in Kansas that compose the partnership of KCPR. Active participation in statewide industry committees in the areas of access charges, optional calling plans/EAS, educational interactive video, dual party relay systems and private line/special access merger.

Kansas Corporation Commission - Chief of Telecommunications

Duties included supervising the formulation of staff testimony and policy recommendations on matters such as long distance competition, access charges, telephone company rate cases, and deregulation of CPE and Inside Wiring; analyzing Federal Communications Commission and Divestiture court decisions; supervising and performing tariff analysis; and testifying before the Commission as necessary. SWBT's \$120 million "Divestiture rate case" was completed in this time period, as were several other large rate cases. Active member of the National Association of Regulatory Utility Commissioners (NARUC) Staff Committee on Communications.

Arizona Corporation Commission - Chief Rate Analyst - Telecommunications

Duties included supervision of staff and formulation of policy recommendations on telecommunications cases, along with production of analyses and testimony as required.

Kansas Corporation Commission - Economist - Research and Energy Analysis Division

Duties included research, analysis and production of casework and testimony regarding gas/electric and telecommunications matters. Matters addressed included revision of jurisdictional separations, deregulation of CPE and inside wire, Wolf Creek Nuclear Generating Plant Task Force, and divestiture of the Bell Operating Companies from AT&T.

Education

Michigan State University - Graduate School of Business

East Lansing, Michigan

Master's Degree in Business Administration-Finance.

Michigan State University/James Madison College

East Lansing, Michigan

Bachelor of Arts Degree in Justice, Morality and Constitutional Democracy.

EXHIBIT DB-2

Testimony of David Brevitz
Case Number 2007-00455
Exhibit DB-2

Calendar Year		2008 H2	2009	2010	2011	2012	2013	2014	2015
<u>Scenario</u>									
Smelters Leave	Effective Rate (\$/MWH)	35.82	35.71	35.69	37.01	43.62	47.83	48.50	49.69
Base Case	Effective Rate (\$/MWH)	35.82	35.71	35.69	37.75	36.85	42.90	44.96	46.57
Increase/(Decrease)		-	-	-	(0.74)	6.76	4.93	3.55	3.12
% Increase/(Decrease)		0%	0%	0%	-2%	18%	11%	8%	7%
Calendar Year		2016	2017	2018	2019	2020	2021	2022	2023
<u>Scenario</u>									
Smelters Leave	Effective Rate (\$/MWH)	50.08	59.71	59.87	60.39	60.71	60.97	61.42	61.96
Base Case	Effective Rate (\$/MWH)	47.43	50.63	51.18	51.53	52.26	52.71	53.34	53.61
Increase/(Decrease)		2.65	9.08	8.69	8.86	8.46	8.25	8.08	8.34
% Increase/(Decrease)		6%	18%	17%	17%	16%	16%	15%	16%

Source: Page 3, line 46 of the Financial Model, for each referenced scenario

EXHIBIT DB-3

Testimony of David Brevitz
Case Number 2007-00455
Exhibit DB-3

Scenario:

"Base Case"

"Smelters Leave"

Year	Margin	TIER	Surcharges	Total	Margin	TIER	Surcharges	Total
Present Value (\$mil)	\$18.39	\$144.46	\$164.29	\$327.15	\$7.14	\$25.53	\$53.61	\$86.28
Discount Rate	5.40%	5.40%	5.40%		5.40%	5.40%	5.40%	26.37%
2008	1.2	0	9.3		1.2	0	9.3	
2009	1.8	0	10.3		1.8	0	10.3	
2010	1.8	0	13.9		1.8	0	13.9	
2011	1.8	13.2	13.9		1.8	13.2	13.9	
2012	1.8	19.3	16.1		1.8	19.3	16.1	
2013	1.8	17.5	16.1		0	0	0	
2014	1.8	16.5	16.1		0	0	0	
2015	1.8	23.1	16.1		0	0	0	
2016	1.8	21.1	16.1		0	0	0	
2017	1.8	22.9	18.9		0	0	0	
2018	1.8	1.1	18.9		0	0	0	
2019	1.8	23.1	18.9		0	0	0	
2020	1.8	15.8	19		0	0	0	
2021	1.8	25.2	18.9		0	0	0	
2022	1.8	18.3	18.9		0	0	0	
2023	1.8	27	18.9		0	0	0	

Source: BREC Response to OAG No. 67

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATIONS OF BIG RIVERS)
ELECTRIC CORPORATION FOR:)
(I) APPROVAL OF WHOLESALE TARIFF)
ADDITIONS FOR BIG RIVERS ELECTRIC)
CORPORATIONS, (II) APPROVAL OF) CASE NO. 2007-00455
TRANSACTIONS, (III) APPROVAL TO ISSUE)
EVIDENCES OF INDEBTEDNESS, AND)
(IV) APPROVAL OF AMENDMENTS TO)
CONTRACTS; AND OF E.ON U.S., LLC,)
WESTERN KENTUCKY ENERGY CORP. AND)
LG&E ENERGY MARKETING, INC.)
FOR APPROVAL OF TRANSACTIONS)

AFFIDAVIT OF DAVID BREVITZ

State of Kansas)
)
)

David Brevitz, being first duly sworn, states the following: The prepared Pre-Filed Direct Testimony, and the exhibits attached thereto constitute the direct testimony of Affiant in the above-styled case. Affiant states that he would give the answers set forth in the Pre-Filed Direct Testimony if asked the questions propounded therein. Affiant further states that, to the best of his knowledge, his statements made are true and correct. Further affiant saith not.

David Brevitz (handwritten signature)
David Brevitz

SUBSCRIBED AND SWORN to before me this 2 day of April, 2007.

Brandy Atkins (handwritten signature)
NOTARY PUBLIC

My Commission Expires: 11-15-11

