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PUBLIC SERVICE COMMISSION

December 22, 2014

Via Federal Express

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

Re: *In the Matter of: An Examination of the Application of the Fuel Adjustment Clause of Big Rivers Electric Corporation from November 1, 2013 through April 30, 2014*
Case No. 2014-00230

Dear Mr. Derouen:

Enclosed for filing are an original and ten (10) copies of Big Rivers Electric Corporation's post-hearing brief in the above-referenced matter. I certify that on this date, a copy of this letter and a copy of the brief were served on each of the persons listed on the attached service list by regular mail.

Sincerely,

TSK

Tyson Kamuf
Counsel for Big Rivers Electric Corporation

TAK/lm
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COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN EXAMINATION OF THE APPLICATION OF THE FUEL ADJUSTMENT CLAUSE OF BIG RIVERS ELECTRIC CORPORATION FROM NOVEMBER 1, 2013 THROUGH APRIL 30, 2014	)	**Case No. 2014-00230**

POST-HEARING BRIEF OF BIG RIVERS ELECTRIC CORPORATION

December 23, 2014

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN EXAMINATION OF THE APPLICATION OF THE FUEL ADJUSTMENT CLAUSE OF BIG RIVERS ELECTRIC CORPORATION FROM NOVEMBER 1, 2013 THROUGH APRIL 30, 2014	)))))	Case No. 2014-00230

POST-HEARING BRIEF OF BIG RIVERS ELECTRIC CORPORATION

Comes Big Rivers Electric Corporation ("Big Rivers"), by counsel, and for its post-hearing brief before the Kentucky Public Service Commission (the "Commission"), states as follows:

I. Introduction.

The purpose of this proceeding is to review the reasonableness of the application of Big Rivers' fuel adjustment clause ("FAC") from November 1, 2013, through April 30, 2014. During the period under review, Big Rivers properly calculated and applied the charges under its FAC tariff, and its fuel procurement practices were proper.

Questions arose during this proceeding relating to the differences in how the Commission-regulated generating utilities allocate fuel costs between sales to native load customers and off-system sales for purposes of calculating FAC charges.[1] As discussed below, the methodology Big Rivers employs to allocate fuel costs between native load sales and off-system sales is reasonable and proper, but if the Commission finds otherwise, any change in the methodology should only be made in the context of a base rate proceeding and no refund should be ordered.

[1] *See, e.g.*, Item 1 of the Commission Staff's Third Request for Information ("PSC 3-1").

II. Big Rivers' methodology for allocating fuel costs is reasonable and proper.

Big Rivers uses its monthly system average fuel cost per kWh generated to allocate fuel costs between native load sales and off-system sales for purposes of calculating FAC charges. Big Rivers calculates its monthly system average fuel cost per kWh by dividing (a) the total costs (using weighted average inventory costing) of the fuel burned for generation during the current expense month (excluding the cost of fuel burned at Coleman Station during the review period[2]) by (b) the net kWh generated during the current expense month, after accounting for line losses.[3] This system average fuel cost is then multiplied by the volume of off-system sales from generation during the month and subtracted from the total recoverable fuel expense for purposes of calculating FAC charges.[4] As noted in Big Rivers' response to Item 6 of Kentucky Industrial Utility Customers, Inc.'s ("KIUC") Initial Request for Information ("KIUC 1-6"), "[b]ecause the calculation of fuel costs recoverable through the FAC (*i.e.*, assigned to native load) includes adjustments for MISO Make Whole Payments received for startup fuel costs during the month, the cost of fuel which would have been used in plants suffering forced outages, and the cost of fuel related to substitute generation during forced outages, the actual fuel costs assigned to native load generally will not equal the system average fuel costs."[5]

Big Rivers' use of system average fuel costs to allocate fuel costs for purposes of calculating FAC charges is reasonable and proper. Big Rivers has used system average fuel costs to allocate fuel costs since the 1980's,[6] and although current personnel cannot determine

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[2] Coleman Station fuel costs were excluded from the FAC during the period under review because Big Rivers was reimbursed for the costs of running the Coleman units under a System Support Resource agreement. *See* Big Rivers' response to Item 3b of the Commission Staff's Second Request for Information.
[3] *See* Big Rivers' response to Item 1 of KIUC's Initial Request for Information ("KIUC 1-1").
[4] *See id.*
[5] Big Rivers' response to KIUC 1-6.
[6] *See* Big Rivers' response to PSC 3-1.a.

why Big Rivers initially chose to use system average fuel costs,[7] the Commission has explicitly approved the use of system average fuel costs in previous Big Rivers FAC review cases. In Case No. 94-458-A, for example, the Commission explained that "Big Rivers uses system average fuel cost to allocate fuel costs among its native load customers and firm off-system customers. It uses incremental costs, however, to allocate fuel costs to non-firm off-system sales."[8] The Commission found this methodology reasonable.[9] Although Big Rivers generally used incremental costs to allocate fuel costs to non-firm off-system sales at that time, Big Rivers also used system average fuel costs to allocate fuel costs to non-firm off-system sales when Big Rivers' Energy Management System was not functioning properly, and the Commission also found that practice to be reasonable.[10] These Commission findings remain valid at this time, and there is no evidence presented in this case to contravene this point.

Big Rivers also used the system average fuel cost methodology in its last three rate cases.[11] For example, the use of this methodology can be seen in the calculation of the off-system sales margins in the financial model used in Big Rivers' last rate case, Case No. 2013-00199,[12] which Lane Kollen, witness for KIUC in that proceeding, acknowledged.[13]

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[7] *See id.*

[8] Order dated June 19, 1996, in *In the Matter of: An Examination by the Public Service Commission of the Application of the Fuel Adjustment Clause of Big Rivers Electric Corporation from November 1, 1994 to April 30, 1995*, Case No. 94-458-A, at p. 2; *see also* Order dated March 5, 1996, in *In the Matter of: An Examination by the Public Service Commission of the Application of the Fuel Adjustment Clause of Big Rivers Electric Corporation from November 1, 1992 to October 31, 1994*, Case No. 94-458. A copy of these orders is attached hereto.

[9] *See* Order dated June 19, 1996, in *In the Matter of: An Examination by the Public Service Commission of the Application of the Fuel Adjustment Clause of Big Rivers Electric Corporation from November 1, 1994 to April 30, 1995*, Case No. 94-458-A, at pp. 2-5.

[10] *See id.* at p. 5.

[11] *See* Big Rivers' response to PSC 3-1.a.

[12] *See* Testimony of Lindsay N. Barron, Nov. 12, 2014 ("Barron Hearing Testimony"), Tr. 47'06"-47'50".

[13] *See* KIUC's response to Item 1 of the Commission Staff's Initial Request for Information in Case No. 2013-00199, a copy of which is attached hereto.

The fact that other utilities in Kentucky use an hourly stacked cost approach to allocate fuel costs to off-system sales[14] does not make Big Rivers' current allocation methodology unreasonable because Big Rivers' Members and their retail customers are not adversely affected by the use of the current methodology instead of a stacked cost methodology. But they could be adversely affected if Big Rivers is forced to adopt a stacked cost methodology. In its response to PSC 3-1, Big Rivers explained how its Members and their retail customers are not adversely affected by the use of the current methodology:

> Further, regardless of the methodology used to allocate fuel costs in Big Rivers' rate case test periods, the costs to Big Rivers' Members are virtually the same. For instance, in Big Rivers' last rate case filing, the Public Service Commission used Big Rivers' base period off-system sales margins in determining the revenue requirement. The base period off-system sales margins were based on Big Rivers' current allocation methodology, which assumed that off-system sales would pay the system average cost for fuel. Thus, base period off-system sales margins were higher than they would have been if highest cost fuel was allocated to off-system sales. Because Big Rivers is a cooperative, margins made from off-system sales are used to offset our total revenue requirement. Thus, if off-system sales had been assumed to pay the highest fuel costs, off-system margins would have been less. Less off-system sales margins would have resulted in higher base rates in the last rate case. While changing the allocation methodology would reduce the costs that flow through the FAC, a corresponding increase in base rates to account for the lower projected off-system sales margin would fully offset any difference.[15]

On the other hand, if Big Rivers is forced to adopt a stack cost allocation methodology, Big Rivers' Members and their retail customers could be adversely affected:

> Finally, as a member-owned cooperative, Big Rivers does not have shareholders that benefit from increased off-system sales. Instead, Big Rivers maximizing its off-system sales ultimately benefits its Members and their ratepayers. Currently, Big Rivers' Members and their ratepayers are benefitting not only by the margins Big Rivers is making on its off-system sales, but also because Big Rivers' off-system sales have enabled it to continue operating Wilson Station, which has reduced the system average fuel costs used to calculate FAC charges significantly (due to lower price spot fuel purchases). If changing the fuel cost allocation methodology reduces the volume of off-system sales – which it could, due to the

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[14] *See* Big Rivers response to PSC 3-1.b.

[15] Big Rivers' response to PSC 3-1.a.

> effect of such a change on the calculation of margins used in the off-system sales decision-making process – then such a change could actually be detrimental to the Members and their ratepayers. In other words, changing the fuel cost allocation methodology has implications on Big Rivers' Load Mitigation Plan and the related operational decisions, like determining whether or not to dispatch Wilson. If the lowest fuel cost (which is Wilson) is allocated to native load, then the decision to dispatch Wilson for an off-system sale with the higher "allocated" fuel costs may not be economically justified. If Wilson is not dispatched, the lower cost unit is not run, and the Members do not get the benefit through the FAC.[16]

In other words, as Lindsay Barron, Big Rivers' Chief Financial Officer, explained during the hearing in this matter, Wilson Station was assumed to be idled in Big Rivers' last rate case.[17] As a result, Big Rivers incurs approximately $26 million in costs to operate Wilson not recovered through Big Rivers' base rates.[18] Big Rivers must instead recover these costs through off-system sales from Wilson to justify running Wilson.[19] If Big Rivers' is required to allocate additional fuel costs to the Wilson off-system sales, then sales from Wilson would also have to cover the additional costs to make running Wilson economically justified. If the additional costs tip the balance and running Wilson is no longer economically justified, Big Rivers' Members and their retail customers will suffer.

KIUC appears to argue that no harm would result from changing the allocation methodology since Big Rivers' total margins for year to date September 2014 are approximately $25 million,[20] which is greater than the $13 million in margins projected for the test period in Big Rivers' last rate case.[21] This difference in actual and projected margins is not relevant to the current proceeding. Even though annualizing four or even nine months of margins (which on its face is inappropriate given the seasonal variations in off-system sales margins) may result in a

[16] *Id.*
[17] Barron Hearing Testimony, Tr. 12'35"-13'55".
[18] *See* Case No. 2012-00535, Rebuttal Testimony of Robert W. Berry, Exhibit Berry-Rebuttal-2.
[19] *See* Barron Hearing Testimony, Tr. 11'22"-13'55".
[20] *See id.*, Tr. 17'45"-18'44".
[21] *See id.*

greater figure than the annual margins figure projected in the last base rate case, that is entirely unrelated to whether Big Rivers' FAC charges during the period under review were reasonable, just as Big Rivers would not have been able to increase its FAC charges if its margins had been less than had been projected in its rate case.[22] In both cases, changing FAC charges because of off-system sales results would be fundamentally inconsistent with traditional ratemaking.

In fact, the entire KIUC discussion of unmeaningful and irrelevant "annualized margins" in this FAC review appears to be designed to advance a general claim that Big Rivers is over-earning. The FAC review is not the proper venue to advance such a complaint. KIUC offers no evidence that Big Rivers' FAC charges during the period under review were unreasonable.

Moreover, despite the difference in actual and projected margins thus far this year, Big Rivers' Members will be harmed if a change in the allocation methodology tips the balance and makes Wilson uneconomic. The characterization by KIUC that Big Rivers is "keeping the profits from the Wilson sale" is misplaced because "keeping profits" implies "keeping profits for the shareholders." Big Rivers is a not-for profit entity that does not have shareholders, Big Rivers does not pay the additional margins to shareholders like an investor-owned utility might do, and Big Rivers retaining the additional margins benefits its Members because the additional margins have a positive impact on the Members' equity and Big Rivers' credit rating evaluations and borrowing costs.[23] If Wilson does not run, Big Rivers' Members will lose these benefits. Additionally, if Wilson does not run, the Members would also lose the $13 million reduction in the FAC charges that running Wilson provides from February 1, 2014, through December 31, 2015.[24]

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[22] *See id.*, Tr. 27'40"-28'00".
[23] *See* Big Rivers' response to PSC 3-1.b.
[24] *See* Barron Hearing Testimony, Tr. 14'37"-15'20".

Further, the fact that Big Rivers' methodology differs from the methodology of other utilities should not render Big Rivers' methodology unreasonable since even the stacked cost approaches of other utilities do not appear to be uniform.[25] Lack of uniformity, then, should not be used as a basis for determining whether or not the Big Rivers' methodology is reasonable, because none of the utilities (with the exception of post-merger Kentucky Utilities Company and Louisville Gas & Electric Company) appear to utilize identical methodologies.

Finally, it is not clear that switching to the stacked cost approach used by other utilities in Kentucky would result in a benefit to Big Rivers' Members even if the change were not offset by a corresponding change in base rates. Several of the utilities (including Kentucky Utilities Company, Louisville Gas & Electric Company, and Kentucky Power Company) that use a stacked cost approach only allocate incremental fuel costs to off-system sales.[26] The incremental cost approach used by some utilities would only allocate to off-system sales the fuel costs required to produce the additional MWhs of energy needed for the off-system sales and would therefore not include the fuel portion of start-up and no load costs required to bring a unit to minimum generating levels when any portion of that unit is used to serve native load.[27] Big Rivers' system average cost approach, on the other hand, allocates a portion of all fuel costs to off-system sales, including the fuel portion of start-up and no load costs.[28]

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[25] *Compare, e.g.,* Duke Energy Kentucky's response to Item 1.b.2-3 of the Commission's Staff's Second Request for Information in Case No. 2014-00229 *with* the Rebuttal Testimony of Kelly D. Pearce in Case No. 2014-00225 at pp. 17-18..

[26] *See* Barron Hearing Testimony, Tr. 21'17"-21'42"; *see also* Testimony of Robert Conroy on behalf of Kentucky Utilities Company and Louisville Gas and Electric Company, Case Nos. 2014-00227 and 2014-00228, Nov. 12, 2014, Tr. 26'00"-32'29"; Kentucky Power Company's response to Item 29 of the Commission Staff's Initial Request for Information in Case No. 2014-00225.

[27] *See* Kentucky Power Company's response to Item 29.b of the Commission Staff's Initial Request for Information in Case No. 2014-00225.

[28] *See* Big Rivers' responses to KIUC 1-1, Item 29 of the Commission Staff's Initial Request for Information, and Item 3 of Commission Staff's Second Request for Information.

In the attachment to its response to PSC 3-1.c, Big Rivers calculated an estimated impact of switching to a stacked cost allocation methodology assuming that all fuel costs were allocated. If Big Rivers only allocated incremental fuel costs, the difference between Big Rivers' system average cost methodology and a stacked cost allocation methodology shown in the attachment to the response to PSC 3-1.c would be much less, if not in the other direction.[29] Thus, even if no offset was made to Big Rivers' base rates, changing Big Rivers' fuel cost allocation methodology could be detrimental to Big Rivers' Members and their retail customers.

For the foregoing reasons, Big Rivers' use of system average fuel costs to allocate fuel costs between native load and off-system sales for purposes of calculating FAC charges is reasonable and proper.

III. The Commission should not change Big Rivers' allocation methodology outside of a base rate case.

If the Commission determines that Big Rivers must adopt a different fuel cost allocation methodology, the Commission should not require such a change outside of a base rate proceeding. As noted above, Big Rivers' base rates are based on the current allocation methodology. Requiring a change in the fuel cost methodology without also making a corresponding change in Big Rivers' base rates would be unreasonable and a violation of the matching principle.[30]

The Commission's FAC regulation can operate as a stand-alone rate making procedure, allowing the Commission to make certain changes in a utility's FAC charges without impacting base rates.[31] For example, because some of the fuel costs themselves are excluded from the calculation of base rates, the Commission can disallow unreasonable fuel costs without

[29] *See* Barron Hearing Testimony, Tr. 21'17"-21'42".
[30] *See* Big Rivers' response to PSC 3-1.a.
[31] *See* Hearing Transcript, Nov. 12, 2014-, Tr. 9'57"-10'40".

impacting the determination of base rates.[32] Thus, disallowing unreasonable fuel costs would not create a mismatch between the revenues and costs used in the determination of base rates, thereby not violating the matching principle.

On the other hand, changing the methodology used in allocating costs for purposes of calculating FAC charges does not just impact FAC charges; it also impacts the base rate calculation. Changing the allocation methodology affects the amount of costs allocated to off-system sales and would change the off-system sales margins used in the determination of base rates.[33] As such, changing the allocation methodology only for purposes of the FAC without making a corresponding change in base rates would violate the matching principle by creating a mismatch between the fuel costs used in determining the FAC and the fuel costs (and corresponding revenues) used in determining base rates.[34]

IV. If the Commission requires a change in allocation methodology, it should not order a refund.

As noted above, the Commission has approved Big Rivers' use of the system average fuel costs allocation methodology in past FAC review proceedings. If the Commission requires a change in Big Rivers' fuel cost allocation methodology, it should do so only prospectively because ordering a refund would be unreasonable and arbitrary.

V. Conclusion.

For the foregoing reasons, the Commission should find that Big Rivers' fuel cost allocation methodology is reasonable and should be approved. If the Commission finds that Big Rivers' methodology is unreasonable, it should only require a methodology change in Big Rivers' next base rate proceeding where corresponding changes in the base rate calculation can

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[32] *See id.*
[33] *See* Big Rivers' response to PSC 3-1a.
[34] *See id.*

be made, consistent with the matching principle. Finally, if the Commission finds Big Rivers' methodology is unreasonable, it should not order a refund because Big Rivers was using a Commission-approved methodology.

On this the 22nd day of December, 2014.

Respectfully submitted,

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Certificate of Service

I certify that a true and accurate copy of the foregoing was served by regular mail upon the persons listed on the accompanying service list, on or before the date the foregoing is filed with the Kentucky Public Service Commission.

On this the 22nd day of December, 2014,

Counsel for Big Rivers Electric Corporation