BOEHM, KURTZ & LOWRY
ATTORNEYS AT LAW
36 EAST SEVENTH STREET
SUITE 1510
CINCINNATI, OHIO 45202
TELEPHONE (513) 421-2255
TELECOPIER (513) 421-2764

VIA HAND DELIVERY

November 15, 2017

Gwen R. Pinson, Executive Director
Kentucky Public Service Commission
211 Sower Boulevard
Frankfort, Kentucky 40602

Re: Case No. 2017-00287

Dear Ms. Pinson:

Kentucky Industrial Utility Customers, Inc. (KIUC) has identified a formatting error in its Brief that was filed November 14, 2017 in the above-referenced case. The last paragraph on page 19 was incorrectly formatted as a quote. In order to correct this formatting error, KIUC submits the original and ten (10) copies of its re-formatted brief. No words or phrases were changed from the originally filed brief.

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

Very Truly Yours,

Michael L. Kurtz, Esq.
Kurt J. Boehm, Esq.
Jody Kyler Cohn, Esq.
BOEHM, KURTZ & LOWRY

MLKkew
Attachment
cc: Certificate of Service
Quang Nyugen, Esq.
Richard Raff, Esq.

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing was served by electronic mail (when available) and by regular, U.S. mail, unless otherwise noted, this 15th day of November, 2017 to the following:

K Boehm

Michael L. Kurtz, Esq.
Kurt J. Boehm, Esq.
Jody Kyler Cohn, Esq.

Big Rivers Electric Corporation
201 Third Street
P. O. Box 24
Henderson, KY 42420

Honorable James M Miller
Honorable Tyson A Kamuf
Sullivan, Mountjoy, Stainback & Miller, PSC
100 St. Ann Street
P.O. Box 727
Owensboro, KENTUCKY 42302-0727

RECEIVED

NOV 15 2017

PUBLIC SERVICE
COMMISSION

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, 2016 THROUGH APRIL 30, 2017.	)))))	**CASE NO. 2017-00287**

BRIEF OF KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC.

Michael L. Kurtz, Esq.
Kurt J. Boehm, Esq.
Jody Kyler Cohn, Esq.
BOEHM, KURTZ & LOWRY
36 East Seventh Street, Suite 1510
Cincinnati, Ohio 45202
Ph: 513.421.2255 fax: 513.421.2764
mkurtz@bkllawfirm.com
kboehm@BKLlawfirm.com
jkylercohn@BKLlawfirm.com

COUNSEL FOR KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC.

November 14, 2017

TABLE OF CONTENTS

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, 2016 THROUGH APRIL 30, 2017.	)))))	**CASE NO. 2017-00287**

BRIEF OF KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC.

Kentucky Industrial Utility Customers, Inc. ("KIUC") submits this Brief in support of its recommendations to the Kentucky Public Service Commission ("Commission") that: 1) Big Rivers Electric Corporation's ("Big Rivers," "BREC," or "Company") allocation of above-average fuel costs to both native load and off-system sales is improper; and 2) the Commission should require Big Rivers to refund excessive fuel expense plus interest and to change its Fuel Adjustment Clause ("FAC") allocation methodology so that its lowest fuel costs generation resources are allocated to native load. The members of KIUC who are participating in this proceeding are: Domtar Paper Co., LLC, and Kimberly Clark Corporation. These companies purchase electricity from BREC through Kenergy. KIUC's recommendations are set forth below.

I. ARGUMENT

1. Big Rivers' Allocation Of Above-Average Fuel Costs To Both Native Load And Off-System Sales Is Improper And Harmful To Big Rivers' Native Load Customers.

Big Rivers incurs fuel expenses to meet its native load obligations and to make off-system sales. The fuel expenses incurred to serve native load customers are recovered through the FAC while the fuel expenses incurred to make off-system sales are recovered through the terms of bilateral contracts and other sales at market clearing prices and are ultimately paid by off-system end users. The method in which Big Rivers allocates fuel expense between native load and off-system sales affects the fuel expense recovered from native load customers through the FAC. If the methodology allocates an unreasonably high fuel expense to native load customers, then the Company's FAC rates are excessive and the margins from off-system sales are artificially inflated.

The method that Big Rivers presently uses to allocate fuel costs between its native load customers and off-system sales is unreasonable because it allocates system average fuel costs to both native load and off-system sales. This approach fails to provide native load customers with the benefit of the lowest cost power even though native load customers pay the capital costs for Big Rivers' generation assets.

Big Rivers explained that it "*uses an overall system weighted average generation fuel cost to allocate fuel costs between native load sales and off-system sales for purposes of calculating FAC charges*."[1] This means that the same fuel cost is initially allocated to both native load and off-system sales customers. But it is inherently unreasonable to charge native load customers and off-system sales customers the same fuel expense per kWh. Big Rivers' native load customers are entitled to and should be allocated the lowest fuel costs since those customers pay 100% of the allowed fixed investment and non-fuel operating costs of all the Company's generating units (including the Coleman units that are shut down), aside from certain amounts that are allocated to off-system sales through the environmental surcharge. Off-system sales customers should be allocated the highest fuel costs. The Company's methodology therefore runs counter to cost causation principles and results in native load customers paying unreasonably high FAC charges in order to enhance the Company's off-system sales margins.

KIUC witness Lane Kollen produced the following table which provides the fuel expense for each of the Company's generating units by month and in total for the review period.[2] The least-cost units over the review period were Green Unit 1, Green Unit 2, and Wilson, respectively, although their relative cost varied each month. The most expensive units during the review period were Henderson Station Two Unit 1 and Unit 2.[3]

---

[1] Rebuttal Testimony of Lindsay Durbin ("Durbin Rebuttal") at 5.
[2] Direct Testimony of Lane Kollen ("Kollen Testimony") at 11.
[3] Company's Response to KIUC 1-11.

BIG RIVERS GENERATING UNITS AVERAGE FUEL COST PER NET MWH OF GENERATION (AFTER LOSSES)($/MWH)	Nov-16	Dec-16	Jan-17	Feb-17	Mar-17	Apr-17	Total
Station Two - Unit 1	$ 26.797	$ 28.526	$ 28.871	$ 28.407	$ 29.782	$ 26.888	$ 28.213
Station Two - Unit 2	$ 28.075	$ 28.623	$ 28.775	$ 32.436	$ 28.272	$ 27.873	$ 28.564
Reid CT	N/A	$ 99.488	$ 268.225	$ 91.816	$ 379.038	N/A	$ 132.928
Wilson	$ 22.707	$ 23.538	$ 23.546	$ 26.025	$ 24.759	$ 24.907	$ 24.040
Green - Unit 1	$ 23.315	$ 24.332	$ 23.895	$ 27.244	$ 23.743	$ 22.606	$ 23.808
Green - Unit 2	$ 22.156	$ 24.175	$ 23.952	$ 25.040	$ 24.886	$ 25.043	$ 23.955
Average Fuel Cost	$ 23.574	$ 24.824	$ 24.499	$ 26.635	$ 25.457	$ 24.672	$ 24.764

Big Rivers' FAC allocation method includes the highest cost generation in the system average fuel expense per kWh, which increases the fuel expense allocated to the native load customers. For example, in November 2016, the least-cost generation required to meet the native load requirements of 164,361 MWh was Green Unit 2 at $22.16 per MWh (133,834 MWh) and then Wilson at $22.71 per MWh (50,527 MWh). Native load customers should have been allocated the fuel costs of these low-cost units through the FAC, but instead the Company calculated and used an average of $23.57 per MWh that included the costs of Henderson Station Two Unit 1 at $26.80 per MWh and Unit 2 at $28.08 per MWh.[4] The fact that Big Rivers allocated the system average fuel costs to native load customers rather than the fuel costs associated with Big Rivers' lowest cost units, which those native load customers actually paid for, is inherently unreasonable. Native load customers should have gotten the benefit of the lowest cost units on the Big Rivers' system. Native load customers paid for, and continue to pay for, the debt service and TIER of all of Big Rivers' generating units. In that sense, those units belong to Big Rivers' native load customers.

2. Big Rivers' Significant Excess Generating Capacity Compounds The Harm To Native Load Customers Caused By Big Rivers' Unreasonable Fuel Cost Allocation Method.

Big Rivers has significantly more generating capacity than it needs to serve its native load customers due to the loss of approximately 850 MW of Smelter load in 2013 and 2014.[5] During the evidentiary hearing, Big Rivers witness Durbin confirmed that the Company's current reserve margin is approximately 102% percent, meaning that Big Rivers has a little more than twice the amount of generating capacity than it needs to serve native load.[6] As a result, the Company now sells most of its generation off-system. In fact, the Company

[4] Company's Response to KIUC 1-11. *See* Ex. LK-4.
[5] Kollen Testimony at 10.
[6] Tr. (October 16, 2017) at 11:47:16 through 11:49:02.

sold nearly two-thirds of its generation off-system during the six-month review period. To make these off-system sales, the Company operated and dispatched its less efficient and more expensive generating units more frequently, which increased its system average fuel expense per kWh. In turn, this increased the fuel expense allocated to native load customers using the Company's allocation methodology.[7]

This highlights the importance of the fuel cost allocation issue. Under the Company's allocation methodology, the greater the amount of off-system sales, the greater the increase in the fuel expense allocated to native load customers through the FAC and the greater the subsidization of the Company's off-system sales margins. Given Big Rivers' high level of off-system sales relative to its native load sales, native load customers are severely disadvantaged by Big Rivers' current fuel cost allocation methodology.[8]

At the hearing, Big Rivers witness Durbin argued that the Company is "*indifferent*" to the allocation methodology as long as the methodology is changed during a base rate case,[9] and that the method of allocating fuel costs does not "*change* [Big Rivers'] *members' effective rates*."[10] Ms. Durbin is correct that when rates are reset during a rate case, Big Rivers' off-system sales margins are reflected in the new rates and the method that Big Rivers uses to allocate fuel costs between native load and off-system sales does not change Big Rivers' members' effective rates. But that alignment exists only at that exact point in time and is extremely temporary.

FAC rates are reconciled to actual fuel expenses and adjusted every six months. Conversely, base rates are not reconciled and are not adjusted to reflect actual off-system sales margins made by the Company. Hence, regardless of the actual off-system sales margins, base rates still reflect only the historic amount included in the revenue requirement in the last base rate case. If Big Rivers' off-system sales margins increase after base rates are set, then the Company retains the additional margins and makes native load customers subsidize the additional off-system sales by forcing native load customers to pay the average fuel costs of a more expensive portfolio of units necessary to supply power to the additional off-system sales. This problem is presently occurring. As Big Rivers notes, the Company earned approximately $20.5 million in off-system sales gross margins in 2016. Yet

[7] Kollen Testimony at 10.
[8] Kollen Testimony at 11.
[9] Tr. (October 16, 2017) at 12:22:25 through 12:22:35 and 12:25:00 through 12:25:20.
[10] Id. at 12:25:00 through 12:25:20.

only $9.6 million of this amount was offset by forecasted off-system sales margins in base rates.[11] This represents a windfall of approximately $10.9 million to Big Rivers that was partially subsidized by the Company's harmful fuel cost allocation methodology. Big Rivers kept all of the $10.9 million in margins that exceeded the rate case forecast with no obligation to refund these margins to its customers.

3. Big Rivers Is The Only Kentucky Electric Utility That Allocates System Average Fuel Costs To Both Native Load And Off-System Sales.

Big Rivers is the only Kentucky electric utility that relies on system average fuel expense per kWh to allocate fuel expense to native load and off-system sales. Every other electric utility regulated by this Commission uses some form of an after-the-fact economic dispatch so that the highest cost resources are allocated to off-system sales customers.

Under East Kentucky Power Cooperative's ("EKPC") fuel cost allocation approach, "[f]*uel is allocated between native-load sales and off-system sales on a stacked cost basis. EKPC considers each hour of operation, determines if a sale was made from its system during that hour and then allocates the highest cost resource(s) to that sale for FAC purposes.*"[12]

Duke Energy Kentucky, Inc. ("Duke") described its fuel cost allocation process as follows: *"After the generating unit is dispatched, the actual energy costs consumed in a generating unit is allocated as either native or non-native based on a stacking process, allocating the lowest cost resources to native load first."*[13]

Both Kentucky Utilities Company and Louisville Gas & Electric Company *"use the After-the-Fact Billing ('AFB') model to determine the joint dispatch savings between LG&E and KU and to allocate the highest cost energy to off-system sales."*[14]

---

[11] Big Rivers' Response to Commission Staff's Request for Information from the Hearing of October 16, 2017, Item 1. In that Response Big Rivers attempts to rationalize the $10.9 million difference between its 2016 off-system sales margins and the forecasted test year margins subtracting by $19 million in Wilson facility costs that were disallowed in Case No. 2013-00199. This is an unrelated item that is not relevant to the comparison between test-year forecasted margins and actual margins and is therefore not responsive to Staff's Request.
[12] Case No. 2014-00226, EKPC Response to Commission Staff's Information Request Dated 08/13/014, Request 29.
[13] Case No. 2014-00229, Duke Kentucky Response to Staff First Set of Data Requests, Staff-DR-01-029.
[14] Case No. 2014-00228, LG&E Response to Information Request in Appendix of Commission's Order Dated August 13, 2014, Question No. 25; Case No. 2014-00227, KU Response to Information Request in Appendix of Commission's Order Dated August 13, 2014, Question No. 25.

Big Rivers' average cost allocation methodology is the outlier among Kentucky electric utilities. It is unreasonable for the customers of all other Kentucky electric utilities to enjoy the benefit of the lowest cost generation resources that customers pay for in rates, while Big Rivers' customers are forced to pay higher fuel rates than those allocated to off-system sales. As explained above, this inequity is magnified by the fact that Big Rivers also has, by far, the highest reserve margin in the Commonwealth (102 percent)[15] and makes more off-system sales relative to native load than any other Kentucky electric utility. The Commission should require consistent treatment of fuel cost allocation among all of the Kentucky electric utilities to the greatest extent possible. Unlike other regulations, 807 KAR 5:056 does not allow for deviation upon a showing of good cause. This should result in the consistent application of the FAC regulation to all utilities.

The FAC allocation methodology used by EKPC and Duke should be adopted here. That methodology ensures that native load customers receive the benefit of the utility's least-cost resources and that off-system sales are allocated incremental costs. Big Rivers has attempted to rationalize allocating system average fuel costs to both native load and off-system sales by repeatedly reminding the Commission that Big Rives is a not-for-profit, member-owned cooperative.[16] But the same can be said of EKPC. There is no valid reason why the member/owners of one cooperative (Big Rivers) should receive less favorable treatment than the member/owners of a different cooperative (EKPC) under the FAC regulation, which is required to be applied uniformly. Big Rivers' status as a member-owned cooperative does not exempt it from Kentucky's FAC regulations and does not give the Company free pass to charge customers unreasonable rates.

4. Big Rivers' Method Of Allocating System Average Fuel Costs To Both Native Load And Off-System Sales Is Contrary to FERC Guidance Addressing Fuel Cost Allocation.

Kentucky's FAC regulation, 807 K.A.R. 5:056, is modeled upon the FERC's fuel regulation, 18 C.F.R. §35.14. 807 K.A.R. 5:056(3), provides that fuel costs recovered through the Kentucky fuel adjustment clause include a number of costs "*less...the cost of fossil fuel recovered through intersystem sales including the fuel costs related to economy energy sales and other energy sold on an economic dispatch basis.*" FERC's fuel regulation, 18 C.F.R. §35.14(a)(2), provides that fuel costs recovered through the FERC fuel adjustment clause include a

[15] Tr.(October 16, 2017) at 11:47:16 through 11:49:02.
[16] Durbin Rebuttal at 9.

number of costs *"less the cost of fossil and nuclear fuel recovered through all inter-system sales."* It therefore makes sense to examine how FERC interprets its fuel regulation and use that as guidance in interpreting Kentucky's fuel regulation.

In a 2006 FERC Opinion (Opinion No. 501), the FERC rejected a fuel cost allocation approach that is substantively identical to Big Rivers' allocation methodology. In that case, Southwestern Public Service Company had assigned system average fuel costs to both native load and off-system sales. The FERC concluded that this practice forced native load customers to subsidize off-system sales by paying higher incremental fuel costs associated with those sales. This case is directly on point. According to the FERC, an approach that allocates fuel costs *equally* to native load and off-system sales customers is improper.

In another case involving Appalachian Power Company ("APCO"), the FERC stated that it *"believe*[d] *that it is both appropriate, and a common industry practice to assign the highest fuel cost to off-system sales, while lower fuel cost resources are reserved for the benefit of the APCO native load customers who, through their rates, provide for the construction and operation of the generating facilities."* The FERC interpreted its FAC regulation to mean that it would be appropriate if costs from the highest fuel cost units formed the basis for pricing of off-system sales and the lowest cost units were dedicated to native load. This is exactly what KIUC recommends in this case. Big Rivers' highest incremental fuel costs should be allocated to off-system sales.

5. It Is Not A Violation Of The "*Matching Principle*" For The Commission To Change Big Rivers' Fuel Cost Allocation Methodology Outside Of A General Rate Case.

Big Rivers claims that the Commission should not change its methodology for allocating fuel costs between rate cases because assumptions concerning off-system sales were built into its base rate requests. Company witness Durbin states:

> *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, but in a way that is consistent with the matching principle. 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 impacting the determination of base rates. Thus, disallowing*

unreasonable fuel costs would create a mismatch between the revenues and costs used in the determination of base rates, thereby not violating the matching principle.[17]

This argument is without merit. The "*matching principle*" is inapplicable in this case because the off-system sales margins are not reconciled to the amount included in base rates and the Company consistently earns greater off-system sales margins than are reflected in its base rates, which it retains and does not refund to customers. Further, Big Rivers provides no citation to Commission precedent or Kentucky law demonstrating that the "*matching principle*" has ever been used to reject changes to the FAC outside of a rate case. If the "*matching principle*" exists in Kentucky ratemaking, then that principle certainly does not bar the Commission from changing how fuel costs are allocated outside of a rate case. The Commission's FAC regulations plainly state that the Commission can make adjustments to the FAC outside of a rate case and there is plenty of precedent for the Commission doing just that. 807 KAR 5:056 provides:

> *This administrative regulation prescribes the requirements with respect to the implementation of automatic fuel adjustment clauses by which electric utilities may immediately recover increases in fuel costs subject to later scrutiny by the Public Service Commission.*
>
> ***
>
> *At six (6) month intervals, the commission will conduct public hearings on a utility's past fuel adjustments. The commission will order a utility to charge off and amortize, by means of a temporary decrease of rates, any adjustments it finds unjustified due to improper calculation or application of the charge or improper fuel procurement practices.*

The language of the regulation requires the Commission to order refunds in proceedings such as this one if it finds that a utility has improperly calculated or applied its fuel adjustment charge. And the Commission has previously disallowed improperly collected fuel costs in the context of non-base rate proceedings. It did so with respect to KU/LG&E in the late-1990s,[18] with respect to Big Rivers in the mid-1990s[19] and most recently with respect to Kentucky Power's "*no-load*" fuel expenses in 2015.[20]

---

[17] Durbin Rebuttal at 18.

[18] *An Examination by the Public Service Commission of the Application of the Fuel Adjustment Clause of Louisville Gas & Electric Company From November 1, 1998 to October 31, 1996*, Case No. 96-524, Order (February 9, 1999); *An Examination by the Public Service Commission of the Application of the Fuel Adjustment Clause of Kentucky Utilities Company From November 1, 1997 to April 30, 1998*, Case No. 96-523-C; Order (July 21, 1999).

[19] *An Examination by the Public Service Commission of the Application of the Fuel Adjustment Clause of Big Rivers Electric Corporation from November 1, 1991 to April 30, 1992*, Order (July 21, 1994).

[20] *The Application Of The Fuel Adjustment Clause Of Kentucky Power Company From November 1, 2013 Through April 30, 2014*, Case No. 2014-00225, Order (January 22, 2015).

Further, in 2010, the Supreme Court of Kentucky held that rates could be changed outside of a base rate case so long as the resulting rates are fair, just, and reasonable, stating:

> *We hold that so long as the rates established by the utility were fair, just and reasonable, the PSC has broad ratemaking power to allow recovery of such costs outside the parameters of a general rate case and even in the absence of a statute specifically authorizing recovery of such costs.*

Hence, the Commission can make rate changes outside of the context of a base rate proceeding.

6. Per The Stipulation Signed By Big Rivers In Two Previous FAC Cases, Big Rivers Should Already Be Allocating Its Lowest Fuel Costs Resources To Native Load Customers.

KIUC disputed the methodology used by the Company to allocate fuel expense between native load customers and off-system sales in two prior FAC cases, Case Nos. 2014-00230 and 2014-00455 (referenced collectively herein as "the 2014 FAC Cases"). During those review periods, Big Rivers allocated its fuel expense between native load customers and off-system sales using the same system average fuel expense per kWh with only minor reductions in the FAC calculations for specific ratemaking adjustments required by the Commission. In the prior proceedings, KIUC asserted that native load customers should be allocated the system's lowest fuel expense in every hour and that off-system sales should be allocated the highest fuel expense in every hour. In those proceedings, Big Rivers, the Attorney General, and KIUC entered into a July 27, 2015 Stipulation and Recommendation ("Stipulation"), in which Big Rivers agreed to provide a monthly credit of $311,111 through the FAC to all customers (residential, commercial, and industrial) over 15 months (totaling $4.67 million).[21]

Big Rivers credited these 15 payments to customers from October 2015 through December 2016 (expense months). The credit compensated customers for the monthly difference between the two allocation methods and ensured that Big Rivers' native load customers received the benefit of the lowest fuel expense on the system, not the higher average fuel expense. As explained above, this result was consistent with the allocation methodology used by other Kentucky electric utilities.[22] In addition, Big Rivers agreed to propose a permanent change in its FAC allocation methodology in its next base rate case, which it stated that it expected to file in the first quarter of 2016:

---

[21] Kollen Testimony at 3-4.
[22] Kollen Testimony at 4.

In Big Rivers next base rate case, which it expects to file in the first quarter of 2016, Big Rivers shall propose, among other things, to change its FAC calculation methodology to 'stack' its generating units for purposes of allocating fuel costs between native load and off-system sales, allocating the highest fuel costs to off-system sales.[23]

Big Rivers still has not filed a base rate case, even though some nineteen or more months have passed since the first quarter of 2016 date cited in the Stipulation. In the absence of a base rate case, Big Rivers should have made this change so that it was effective in January 2017 after the expiration of the monthly credits pursuant to the Stipulation. Yet it appears that Big Rivers did not propose the change in a FAC proceeding because it would have reduced the recovery of fuel expense through the FAC and reduced the retained margins on its off-system sales.[24] Consequently, after the expiration of the $311,111 monthly credit in December 2016, native load customers were once again put in the same position that they were in prior to the Stipulation, forcing KIUC to litigate this issue for the second time.

The possibility that Big Rivers would not file a base rate case nor propose to change to its fuel cost allocation methodology was contemplated in the Stipulation. In Paragraph 3 of the Stipulation, the parties agreed that KIUC and the AG could "*contest, seek a change in, or oppose the manner in which Big Rivers allocates FAC costs between native load and off-system sales*" after the last of the 15 credits has been paid to customers "*if Big Rivers has not changed its FAC calculation methodology to an hourly stacked-cost methodology.*"[25] KIUC and the AG never agreed that Big Rivers could wait to change its FAC allocation methodology until it files its next base rate case if such a case was not resolved prior to the payment of the last of the $311,111.11 credits. Instead, KIUC and the AG preserved their rights to challenge the FAC methodology if Big Rivers failed to timely change the method on its own as contemplated in the Stipulation. In accordance with the Stipulation, KIUC is challenging that methodology in this case because this is the first FAC review case that contains a review period in which the $311,111.11 credits to customers have been exhausted.

---

[23] Stipulation at ¶ 2.

[24] Kollen Testimony at 17.

[25] The original Stipulation at ¶ 3 stated that the AG and KIUC each agree to not contest the manner in which Big Rivers allocates FAC costs for a review period prior to November 1, 2016, which was the original expected termination date of the fifteen $311,111.11 credits. The Stipulation was later amended in Case No. 2016-00286 in order to account for the fact that the Rural Utilities Service (RUS) had to approve the payment of the credit, and this delayed the payment of the credits by three months. The Amendment to the Stipulation extended the final payment, and the date in which the AG and KIUC could challenge the FAC allocation methodology if unchanged, by three months to February 1, 2016. However, as shown in KIUC Cross Ex. 1, Big Rivers' final $311,111.11 credit payment occurred for the expense month December 2015, not January 2016 as contemplated in the Amendment to the Stipulation.

7. Big Rivers' Characterization Of The $4.67 Million In Credits As "*A Return Of Margins*" To Customers Is Erroneous.

At the hearing, Big Rivers witness Durbin attempted to characterize the Company's payment of $4.67 million in credits to customers contained in the Stipulation as a "*return of margins*" to customers. On cross-examination, Ms. Durbin stated:

> *At the time that we were going through the FAC proceeding we had been through the polar vortex. In the polar vortex we had the opportunity to make a lot more money in off-system sales than we had anticipated would be the case. As you're all aware the Polar Vortex resulted in market prices skyrocketing. So Big Rivers made a significant amount of off-system sales margins during that time period and we took, we saw the opportunity through the fuel adjustment clause as a chance for us to flow some of those excess margins that we didn't actually need back to the members.*[26]

Ms. Durbin's characterization of the $4.67 million in credits paid to customers is simply incorrect. The Company did not refund a single cent of the off-system sales margins earned from the polar vortex or any other off-system sales. Ms. Durbin's claim is an attempt to disguise the fact that Big Rivers agreed to change its allocation method in the previous rate case and that the Stipulation agreed to by Big Rivers contemplated that this change of methodology should have already happened in 2016.

Ms. Durbin's contention that the $4.67 million in credits paid to customers was not related to the fuel cost allocation issue that is the subject of this proceeding, but was instead a generous gesture on the part of Big Rivers to return excess margins earned during the polar vortex is contrived from a single "*Whereas*" clause proceeding the Stipulation in which the Company states: "*Big Rivers believes its current FAC methodology and practices are reasonable, but desires to allocate certain margins to its three distribution cooperative members.*"[27] Outside of this one vague assertion, there is no other basis for Ms. Durbin's contention. The rest of the record of the 2014 FAC Cases plainly shows that Big Rivers paid the $4.67 million in credits in order to compensate native load customers for the monthly difference between the two allocation methods and to ensure that native load customers received the benefit of the lowest fuel expense on the system, not the higher average fuel expense.

The only issue raised by KIUC in the 2014 FAC Cases was whether native load customers should be allocated the system's lowest fuel expense and that off-system sales should be allocated the highest fuel

---

[26] Tr. (October 16, 2017) at 11:28:10 through 11:28:45.
[27] Stipulation at 2.

expense.[28] Neither KIUC, Big Rivers, nor the Attorney General ever discussed the concept of returning excess margins from the polar vortex to customers in the 2014 FAC Cases. During cross-examination, Ms. Durbin conceded this point, agreeing that Big Rivers did not propose to return margins from the polar vortex to customers in that case.[29] In fact, the very idea of returning margins to customers through the FAC is unprecedented. When Big Rivers return margins to its customers, it does not do it through the FAC. Ms. Durbin conceded this point at the hearing as well stating that Big Rivers' has never returned margins to customers through the FAC.[30] The concept of returning excess margins earned during the polar vortex was simply not an issue in the 2014 FAC Cases.

The fact that Big Rivers referred to the payment of credits to customers as "*margins*" in a "*Whereas*" clause does not change the clear intention of the parties that is evident in the Stipulation. Paragraphs 1 through 3 of the Stipulation plainly show that the parties' intent was to compensate customers for Big Rivers' continued use of its harmful fuel cost allocation method through the payment of credits to customers of $311,111.11 each month for 15 months. For example, Big Rivers insisted on language in the Stipulation that would allow Big Rivers to immediately terminate the payment of the $311,111.11 credits if Big Rivers' FAC fuel cost methodology changed before the payment of all 15 credits. Paragraph 1 of the Stipulation provides in part:

> *The FAC Credits shall cease upon the first to occur of the following*:
>
> *(a) The date of the fifteenth FAC Credit;*
>
> *(b) The effective date of new rates to be set in Big Rivers' next base rate case;*
>
> *(c) The date methodology Big Rivers uses to allocate fuel costs to off-system sales for purposes of calculating FAC charges is changed from a system average cost methodology to a stacked-cost methodology; and*
>
> *(d) The date, if any, the Commission orders a refund of amounts collected through Big Rivers' FAC on the basis of the methodology Big Rivers uses to allocate fuel costs to off-system sales.*

This provision of the Stipulation undermines Ms. Durbin's characterization of the credits as a "*return of margins to customers.*" If the credits were a "*return of margins,*" they would not prematurely cease if Big Rivers'

[28] *See* Case No. 2014-00230, Brief of Kentucky Industrial Utility Customers, Inc. (December 23, 2014).
[29] *See* Tr. (October 16, 2017) at 11:35:40 through 11:36:00.(*"Q. Did Big Rivers' testimony, in either of the 2014 cases state that their position was that they would like to return margins to members through the FAC?... Did Big Rivers propose to return margins through the FAC?" "A. No..."*).
[30] *See* Tr. (October 16, 2017) at 11:35:00 through 11:35:40. (*"Q. When Big Rivers returns margins to its customers do they usually do it through the FAC?" "A. No, No. We've never done that before..."*).

fuel costs allocation method was changed prior to the payment of the 15th credit. A return of margins would not be contingent upon the FAC fuel cost allocation method.

Paragraph 3 of the Stipulation also shows that the intention of the parties was to compensate customers for Big Rivers' continued use of the system average fuel cost allocation method while Big Rivers transitioned to a "*stacking*" method in 2016. That Paragraph states that KIUC and the AG agree not to contest the FAC fuel cost allocation method for any month in which a $311,111.11 credit is paid.[31] Big Rivers wanted to ensure that there was no double-counting of the difference between the two allocation methods by insisting on language that would not allow KIUC or the AG to challenge the FAC allocation methodology in any month in which customers were also receiving a credit that compensated them for the difference in the allocation methodology. This provision also makes no sense if the purpose of the credits was to return excess margins to customers.

Finally, if Ms. Durbin's recollection of the 2014 FAC Cases that the $4.67 million was intended as a return of excess margins from the polar vortex was accurate, this concept would surely be discussed in the Commission's Order approving the Stipulation in the 2014 FAC Cases. But the Commission's Order approving the Stipulation shows that the Commission also understood that the Stipulation was a commitment by Big Rivers to credit customers with the difference between the two methodologies in the short-term and to change to a "*stacking methodology*" in its next rate case to be filed in the first quarter of 2016. Beginning on page 4 of that Order, the Commission summarizes the fuel cost allocation issue, explaining:

> *One of the issues under review is the methodology being utilized by Big Rivers for allocating fuel costs between native load customers and off-system sales. Big Rivers uses a monthly system average in allocating fuel costs between native load and off-system sales. KIUC and the AG filed testimony objecting to Big Rivers' methodology arguing that it was 'improper and unreasonable' and that Big Rivers should use a stacking methodology. The Stipulation, filed on May 29, 2015, resolves the issues related to the fuel-cost allocation methodology among all of the parties to this proceeding.*[32]

***

[31] Stipulation and Recommendation at ¶ 3: "*The AG and KIUC each agree not to contest, seek a change in, or oppose the manner in which Big Rivers allocates FAC costs between native load and off-system sales in any Commission proceeding initiated prior to November 1, 2016, or for any FAC review period prior to November 1, 2016, but shall not be prohibited in any respect from: (a) raising issues related to the manner in which Big Rivers allocates FAC costs between native load and off-system sales in FAC proceedings initiated by Commission order after November 1, 2016, for review periods after November 1, 2016, if Big Rivers has not changed its FAC calculation methodology to an hourly stacked-cost methodology; or (b) contesting the appropriateness of the changes proposed by Big Rivers to its FAC calculation methodology in the 2016 Rate Case or in any other proceeding initiated after November 1, 2016.*"

[32] Consolidated Case Nos. 2014-00230 and 2014-00455.

Big Rivers reiterates its belief that its system-average fuel cost methodology is reasonable and that changing the methodology outside of a general rate case is unreasonable. However, Big Rivers agrees to provide up to 15 monthly credits to customers through the FAG and to propose switching to a stacking methodology in its next general base rate proceeding.

***

In its next base rate proceeding, Big Rivers agrees to propose a change in its FAC calculation methodology to one in which it stacks its generating units for purposes of allocating fuel costs, allocating the highest fuel costs to off-system sales.

The Order concludes:

The Commission appreciates the parties efforts in entering into the Stipulation and supports Big Rivers' commitment to credit customers $4.67 million through the FAC and to change its fuel-cost allocation methodology to a stacking methodology in its next general base rate proceeding.

Ms. Durbin's assertion that the $4.67 million in credits were intended to return excess margins to customers from the polar vortex is not consistent with the Commission's description of the Stipulation. In fact, the words "*margins,*" "*polar,*" and "*vortex*" do not appear anywhere in the Commission's Order. In sum, the characterization of the $4.67 million in credits as anything other than compensation to customers for Big Rivers' ongoing use of an improper FAC cost allocation method is specious and should not be given credence by the Commission.

8. The Commission Should Require Big Rivers To Refund Excessive Fuel Expense Plus Interest And To Change Its FAC Fuel Cost Allocation Methodology So That Its Lowest Fuel Costs Generation Resources Are Allocated To Native Load.

KIUC recommends that the Big Rivers' fuel expense be allocated between native load customers and off-system sales using a methodology similar to the EKPC/Duke methodology. Under the EKPC/Duke methodology, all generation is economically stacked from the lowest to the highest in each hour. The lowest cost resources, and thus, the lowest fuel expenses first are allocated to native load customers and then the remaining and highest fuel expense then are allocated to off-system sales each hour. This methodology ensures that the highest cost resources and fuel expenses are allocated to off-system sales.[33]

KIUC witness Kollen used the Company's fuel expense per kWh for each generating unit to recalculate the fuel expense allocated to native load customers using the available output from each generating unit, starting

[33] Kollen Testimony at 13.

with the lowest cost generating unit and then following with the next lowest cost generating until all native load requirements were supplied for the months of January 2017 through April 2017. Mr. Kollen's Testimony shows that the fuel expense would have been $14,148,991, or $770,174 less than the fuel expense using the Company's methodology for those four months.[34] The fuel expense would have been $22,758,965, or $1,235,976 less than the fuel expense using the Company's methodology for the entire review period,[35] although this difference was addressed for the first two months of the review period through the monthly $311,111 credits pursuant to the Stipulation in the prior FAC proceedings.

Mr. Kollen's calculation is different than the calculation provided by Big Rivers in its discovery responses.[36] The Company's calculation managed to *increase* the fuel expense allocated to native load customers by $299,564 for January 2017 through April 2017. This is obviously incorrect on its face because it is logically inconsistent for a method that allocates the lowest system fuel costs to native load customers to produce higher fuel costs than a method that allocates system average fuel cost to native load customers. Despite KIUC's specific request to calculate fuel expense for the FAC as "*if Big Rivers had assigned its lowest fuel cost generation to native load customers each hour*," the Company did not allocate the lowest cost resources to native load customers. Instead, the Company first allocated the most expensive generation from Henderson Station Two Unit 1 and Unit 2 to native load customers, and only after all generation available from those two units was allocated to native load did it then allocate generation on an economic or least-cost basis to meet the remaining native load requirements.[37]

Big Rivers' calculation was not responsive to the request and improperly allocated the highest cost generation first to native load customers. It also should be noted that the discovery request in this proceeding was nearly identical to discovery requests in the prior proceedings (Case Nos. 2014-00230 and 2014-00455).[38] In its responses in the prior proceedings, the Company performed an after-the-fact dispatch for each hour during the

---

[34] These calculations are reflected in Ex. LK-5 and in Mr. Kollen's electronic workpapers, which were filed concurrently Mr. Kollen's Testimony.
[35] *Id.*
[36] Company's Response to KIUC 1-11. *See* Ex. LK-4.
[37] Kollen Testimony at 14-15.
[38] Company's Response to KIUC 1-1 in Case No. 2014-00455. The narrative response and an excerpt of the Excel file that includes a monthly summary for the two-year review period and the first page of the summary and hourly stacking used to calculate the redispatch and allocation of the lowest fuel expense by generating unit to native load customers for October 2014 are included in Ex. LK-6. *See also* Company's Response to Staff 3-1(c) in Case No. 2014-00230.

review period and correctly allocated the least-cost generation to native load customers. That calculation formed the quantitative basis for the monthly credits adopted in the Stipulation in the prior proceedings. Despite its correct allocation in response to the same data request in the previous proceedings, the Company incorrectly allocated the highest cost generation to native load customers in response to KIUC 1-11 in this proceeding.

The calculation that KIUC witness Kollen performed in this proceeding is consistent with the methodology and calculation performed by the Company in the prior proceedings, although Mr. Kollen used the monthly fuel expense per kWh for each generating unit instead of the hourly expense per kWh. The results of the monthly calculation in the prior proceedings would not have been materially different than the hourly calculation. KIUC recommends that the Commission adopt Mr. Kollen's calculation of and refund $770,174 in excessive fuel costs that were improperly allocated and collected through the FAC from January 1, 2017 through April 30, 2017, plus interest through the date the refunds are completed. The Commission should also order Big Rivers to adjust its fuel cost allocation methodology going forward so that the lowest cost resources and the related fuel expense are allocated to native load.

9. Big Rivers' Argument That The Administrative Burden Of Changing To An Hourly Stacking Methodology Is So Significant As To Outweigh The Benefits To Customers Is Not Credible.

At the hearing, Big Rivers argued that it does not have systems in place to calculate an hourly stacking methodology and that changing to an FAC fuel cost allocation methodology that would allocate its lowest fuel costs to its native load customers and its highest fuel cost to off-system sales on an hourly basis would be a costly administrative burden.[39] However, as explained above, Big Rivers has already agreed to change its fuel cost allocation method to an hourly stacking method and that it planned to implement this change in a 2016 rate case. For Big Rivers to now claim, over a year after the Company projected it would propose to change to an hourly stacking methodology, that it is not administratively prepared to change to an hourly stacking methodology is odd and unconvincing.

[39] Tr. (October 16, 2017) at 12:41:00 through 12:41:17 and 12:26:00 through 12:29:00.

Big Rivers' argument is undermined by its response to data requests in Case No. 2014-00455. In its response to KIUC's Request for Information, Item 1 in that case, Big Rivers provided a calculation of the FAC using an hourly stacking method.[40] Big Rivers cannot plausibly claim that it cannot perform this calculation when it performed the same calculation in a response to discovery back in 2015.

Big Rivers' argument is further undermined by the fact that every other utility in the Commonwealth uses some form of an after-the-fact economic dispatch so that the highest cost resources are allocated to off-system sales customers. This includes Big Rivers' fellow member-owned, not-for-profit cooperative, EKPC. Big Rivers would have the Commission believe that implementing a methodology in which its native load customers receive the benefit of its lowest fuel costs generation resources is overly burdensome even though it is the lone Kentucky utility that does not already implement such a methodology.

Finally as explained above, over the challenged portion of the review period, Big Rivers' native load customers subsidized the Company's off-system sales by about $192,000 per month as a result of Big Rivers' continued use of a methodology that allocates Big Rivers' system average fuel costs to both native load and off-system sales versus a methodology that gives Big Rivers' native load customers the benefit of the lowest fuel cost generation resources.[41] And the dollar difference between the two methods is likely higher in the summer months. Big Rivers stated at the hearing that it does not intend to file a rate case until 2020, for rates effective 2021.[42] Assuming that Big Rivers files a rate case in 2020 for rates effective in 2021, a conservative estimate of the impact on native load customers is that it will cost customers more than $10 million before Big Rivers' methodology is eventually changed in the next rate case. This is not a small dollar issue. It is imperative that the Commission order Big Rivers to change its FAC fuel cost allocation methodology immediately and to order a refund of $770,174 in excessive fuel costs that were improperly allocated and collected through the FAC from January 1, 2017 through April 30, 2017.

[40] Big Rivers' Response to KIUC 1-1 in Case No. 2014-00455 is attached to Mr. Kollen's Testimony (LK-6) in this case.
[41] Mr. Kollen calculated that Big Rivers' system average fuel cost allocation resulted in $770,174 in excessive fuel costs collected in the four months January 1, 2017 through April 30, 2017. $770,174 divided by 4 months = $192,500 per month.
[42] Tr. (October 16, 2017) at 12:28:20 through 12:28:30.

10. The Commission Should Expressly Prohibit Big Rivers From Directly Assigning The Fuel Costs Related To Its Take Or Pay Contracts To Native Load Customers.

As discussed above, in response to KIUC 1-11 in this case, which asked Big Rivers to perform a calculation of the dollar amount of fuel costs that would have been included in the calculation of the fuel adjustment clause if Big Rivers had assigned its lowest fuel cost generation to native load customers each hour and compare that amount to the dollar amount that was included in the calculation, Big Rivers instead performed a calculation that first allocated the most expensive generation from Henderson Station Two Unit 1 and Unit 2 to native load customers.[43] Big Rivers' decision to allocate its most expensive generation resources to native load customers resulted in a calculation that would *increase* the fuel expense allocated to native load customers by $299,564 for January 2017 through April 2017.

In her Rebuttal Testimony, Ms. Durbin explained the rationale for Big Rivers' judgment that under a hypothetical hourly stacking methodology its native load customers should be directly assigned the costs of its highest cost units. Ms. Durbin states that "*Big Rivers has a contract with the City of Henderson for Big Rivers to operate the Station 2 units*" and "*Big Rivers has a contractual obligation to operate these units.*"[44] Therefore, "[t]*he power Big Rivers has taken pursuant to those contracts should be allocated to the Members first.*"[45]

First, this appears to be a new argument intended to skew the effects of changing the FAC fuel costs allocation methodology. In each of the 2014 FAC Cases, Big Rivers was asked to perform the exact same calculation, once by Commission Staff in Case No. 2014-00230 and once by KIUC in Case No. 2014-00455. When Big Rivers responded to the data requests in the 2014 FAC Cases, the Company did not assign the Henderson units directly to native load. Big Rivers treated those units the same as any of the other generating units despite the fact that Big Rivers' take or pay contract with Henderson dates to the 1970s so it was also in effect at the time that Big Rivers responded to the data requests in the 2014 FAC Cases. Big Rivers changed its position with regard to the allocation of the Henderson units in this case in order to allow Big Rivers to claim that changing the methodology does not necessarily benefit native load customers.

---

[43] Big Rivers Response to KIUC 1-11. *See* Ex. LK-4.
[44] Durbin Rebuttal at 21-22.
[45] Id.

Second, Big Rivers' argument that the fuel costs from power received as a part of a take or pay contract should be directly assigned to native load customers is inconsistent with the practice of the other Kentucky utilities. For example, Kentucky Power has a contract with its AEP affiliates in which Kentucky Power is obligated to take a certain amount of power from the Rockport and Mitchell generating units. Kentucky Power does not directly assign the Rockport and Mitchell fuel costs to their native load customers through the FAC.

If the Commission orders Big Rivers to modify its FAC allocation methodology so that Big Rivers is required to allocate its lowest fuel costs to its native load customers and its highest fuel cost to off-system sales per KIUC's proposal, then the Commission should prohibit Big Rivers from directly assigning the fuel costs related to its take or pay contracts to native load customers.

11. The Commission Should Expressly Prohibit Big Rivers From Allocating "*Start Up*" and "*No Load Costs*" To Native Load Customers.

If the Commission orders Big Rivers to modify its FAC allocation methodology so that Big Rivers is required to allocate its lowest fuel costs to its native load customers and its highest fuel cost to off-system sales per KIUC's proposal, the Commission should prohibit Big Rivers from allocating the fuel portion of "*start up*" and "*no load costs*" to native load.[46] This possibility was raised by Ms. Durbin in her Rebuttal Testimony. Ms. Durbin stated on pages 14 and 15:

> *Several of the other jurisdictional utilities (including LG&E, KU, and Kentucky Power Company) that use a stacked cost approach only allocate incremental fuel costs to off-system sales. The incremental cost approach used by these 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.*

The issue of whether it is appropriate for a utility with significant excess capacity to allocate "*no load*" costs to native load customers through the FAC was recently decided in Case No. 2014-00225. In that case the Commission determined that it was unreasonable for Kentucky Power to allocate "*no load costs*" to native load customers during a period of time in which they had relatively large reserve margins.

[46] "*No load*" costs have been defined as the fixed fuel and consumable costs incurred when a unit is in operation that are not dependent on the output level of the unit. *See* Case No. 2014-00225, Order (January 22, 2015) at 4.

During the 17-month Overlap Period, Kentucky Power will be operating with an unusually large reserve margin, estimated at 57 percent for 2014. Given that most utilities operate with much smaller reserve margins, Kentucky Power's operations during the temporary Overlap Period cannot be considered 'usual' or 'normal.'[47]

***

[T]*he Commission finds that during the Overlap Period, when its reserve margin is unusually large and operating conditions are not 'normal,' Kentucky Power's fuel allocation methodology is unreasonable because it produces an unreasonable result and that certain fuel costs related to the Mitchell Station should be disallowed as discussed below."*[48]

In the 2014 Kentucky Power case, the Commission found that when a utility has relatively high reserve margins the allocation of "*no load*" costs to native load customers through the FAC leads to an unreasonable result. The Commission ultimately disallowed 100% of Kentucky Power's share of Mitchell "*no load costs*" incurred during the period of time in which they had a 57% reserve margin.[49]

The Commission's Order in this Kentucky Power FAC review case is particularly relevant to Big Rivers' contention that it may allocate "*no load*" costs to native load customers if it changes to a methodology in which native load customers are allocated the lowest fuel cost because Big Rivers' reserve margin of 102% is much higher the Kentucky Power's reserve margin of 57%, which Commission characterized as "*an unusually large reserve margin.*"[50] If Kentucky Power's reserve margin of 57% leads to an "*unreasonable result,*" than Big Rivers much higher 102% reserve margin would also lead to an unreasonable result if it were allowed to allocate "*no load*" costs to native load customers. If the Commission orders Big Rivers to modify its FAC allocation methodology per KIUC's recommendation, then it should expressly prohibit Big Rivers from allocating "*no load*" costs to native load customers in accordance with recent Commission precedent.

[47] Case No. 2014-00225, Order (January 22, 2015) at 7-8.
[48] Id. at 8.
[49] Id. at 11.
[50] Tr. (October 16, 2017) at 11:47:16 through 11:49:02.

II. CONCLUSION

WHEREFORE, the Commission should: 1) find that Big Rivers' current FAC allocation method, which harms native load customers, is improper; 2) require Big Rivers to refund the $770,174 in excessive fuel costs collected from native load customers plus interest and to change its FAC allocation methodology so that its lowest fuel costs generation resources are allocated to native load on a going-forward basis; and 3) adopt KIUC's other recommendations in this proceeding.

Respectfully submitted,

K. Boehm

Michael L. Kurtz, Esq.
Kurt J. Boehm, Esq.
Jody Kyler Cohn, Esq.
BOEHM, KURTZ & LOWRY
36 East Seventh Street, Suite 1510
Cincinnati, Ohio 45202
Ph: 513.421.2255 fax: 513.421.2764
mkurtz@bkllawfirm.com
kboehm@BKLlawfirm.com
jkylercohn@BKLlawfirm.com

COUNSEL FOR KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC.

November 14, 2017