

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF BIG RIVERS)
ELECTRIC CORPORATION,)
LOUISVILLE GAS AND ELECTRIC)
COMPANY, WESTERN KENTUCKY)
ENERGY CORP., WESTERN)
KENTUCKY LEASING CORP.,) CASE NO. 97-204
AND LG&E STATION TWO INC. FOR)
APPROVAL OF WHOLESALE RATE)
ADJUSTMENT FOR BIG RIVERS)
ELECTRIC CORPORATION AND FOR)
APPROVAL OF TRANSACTION)

O R D E R

On April 30, 1998, the Commission issued an Order approving the immediate and permanent implementation of reduced rates for Big Rivers Electric Corporation ("Big Rivers") and approving, in principle, the lease of Big Rivers' generating units to a subsidiary of LG&E Energy Corp. ("LEC"). Six petitions requesting the Commission to rehear limited portions of that Order have been filed by the following parties: (1) Big Rivers; (2) Alcan Aluminum Corporation, Southwire Company, and NSA, Inc. ("The Smelters"); (3) Chase Manhattan Bank; (4) The Bank of New York; (5) the Attorney General's Office of Rate Intervention ("AG"); and (6) Green River Electric Corporation and Henderson Union Electric Cooperative Corporation ("The Co-ops").

Effective Date of Rates

In its original application, Big Rivers proposed reduced rates which were requested to become effective during the pendency of this case. In response to the request, the

Commission entered an Order on August 28, 1997 allowing the reduced rates to become effective on September 2, 1997. Those rates, hereinafter referred to as the "September 2 rates," were designated by the Commission to remain in effect only until it issued a final Order in this case, which occurred on April 30, 1998.

The rates subsequently approved by the Commission in its April 30, 1998 Order were designed to reflect the implementation of Big Rivers' proposed lease transaction with LEC and were designated to become effective immediately and permanently. Those rates, hereinafter referred to as the "transaction rates," differed in certain significant respects from the September 2 rates.

In their respective petitions, Big Rivers and the Smelters challenge the Commission's April 30, 1998 decision to make the transaction rates effective immediately and permanently. They contend that by making the transaction rates effective on April 30, 1998, the Commission inadvertently created legal and regulatory problems that will continue up until the closing of the Big Rivers lease transaction. These problems arise because under Big Rivers' reorganization plan as filed with the Bankruptcy Court, the September 2 rates were to remain in effect until closing of the Big Rivers lease transaction,¹ and only then were the transaction rates to become effective.

¹ The Smelters raise the same issue in their petitions filed in: (1) Case No. 97-219, The Application of Green River Electric Corporation to Adjust Electric Rates; and (2) Case No. 97-200, The Application of Henderson Union Electric Cooperative Corporation to Adjust Electric Rates.

More specifically, the Smelters emphasize that the 0.5 mill per KWH included in the Tier 1 and Tier 2 transaction rates was designed to compensate LEC for assuming the additional risk associated with future unforeseen environmental, legislative, and regulatory costs and was to become effective only upon the closing of the Big Rivers lease transaction. In addition, Big Rivers points out that the transaction rates provide that the Smelters' load will be served by LEC, but that service cannot legally commence until the lease transaction closes. Thus, between April 30, 1998 and the closing of the lease transaction, there is a regulatory gap because Big Rivers must continue to serve the Smelters but it has no rates in effect to provide that service. Big Rivers also requests a delay in filing its Transaction Tariff until the time that such filing has been authorized by the Bankruptcy Court.

Chase Manhattan Bank and The Bank of New York ("the Banks") similarly request rehearing to change the effective date of the transaction rates to the date of the closing of the lease transaction. They also request the Commission to modify its April 30, 1998 Order to provide that the September 2 rates will remain in effect until closing of the lease transaction or August 31, 1998, whichever occurs first.

Based on the petitions for rehearing and being otherwise sufficiently advised, the Commission finds that its April 30, 1998 Order has inadvertently created a regulatory gap in the provision of electric service to customers of Big Rivers. Due to the provisions of the lease transaction and Big Rivers' reorganization plan, the transaction rates cannot become effective until the closing of the lease. Therefore, the Commission will grant rehearing and, since the record already supports these changes, will modify the April 30, 1998 Order to

provide that: 1) the rates that went into effect on September 2, 1997 should remain in effect until closing of the Big Rivers lease transaction or further Order by the Commission; and 2) the transaction rates approved by the April 30, 1998 Order should become effective the day after Big Rivers closes its lease transaction. In addition, the Commission finds good cause to allow Big Rivers to delay filing its Transaction Tariff until its lease transaction is closed.

The Commission further finds that the Banks' request to automatically terminate the September 2 rates on August 31, 1998 raises an issue that warrants additional review. For example, Big Rivers has already indicated a willingness to continue charging the September 2 rates until September 1, 1999 (Big Rivers Petition For Rehearing, p. 3, fn. 1) and the Banks have not suggested what rates should be charged after August 31, 1998 if the lease transaction has not closed. Thus, all parties should have an opportunity to address this issue on rehearing.

Reasonableness Of Rates

The AG challenges on three grounds the reasonableness of the transaction rates approved by the April 30, 1998 Order. The first is the absence of a specific finding in that Order that the rates approved therein are "fair, just, and reasonable," and the lack of any findings therein to support such a conclusion. The second is whether it is unduly discriminatory to afford the Smelters rates that are fixed for a term of years while other customers are afforded rates that might change over time. The third is whether it is unduly discriminatory to afford the Smelters firm power without an added demand charge for power classified as Tier 2 and, until January 1, 2001, Tier 3.

The omission of a finding that the transaction rates are fair, just, and reasonable was an inadvertent oversight. Contrary to the AG's assertions, the transaction rates are not unduly discriminatory when considered in conjunction with those factors that are critical to the success of Big Rivers' proposed lease transaction. The purpose of that transaction is to allow Big Rivers to emerge from bankruptcy, no longer be financially burdened by unsold generating capacity, and provide all its customers an immediate rate reduction.

The complexity of both Big Rivers' reorganization plan as proposed to the Bankruptcy Court, and the elimination of the Smelters' proposed exemption from future unforeseen costs, influences the entire analysis of Big Rivers' proposed rates and their reasonableness. Given all the many factors that must be considered in reviewing the rates proposed by Big Rivers in this proceeding, there is no question that the transaction rates approved on April 30, 1998 are fair, just, and reasonable. First, there are obvious and distinct differences between the Smelters and all other customers of Big Rivers. The size of the Smelters' total load and Big Rivers' reliance on the Smelters for system revenues are distinguishing factors. The Smelters' total load accounts for three-fourths of Big Rivers' system load and historically the Smelters have contributed two-thirds of the system's revenues.² By operating 24 hours per day, 365 days per year, at almost 100 percent load factors, the Smelters' loads are unique in their operating characteristics and the margins on those sales are of critical importance to the financial restructuring of Big Rivers. The

² Although LEC rather than Big Rivers will provide the wholesale power for the Smelters' after closing the lease transaction, there will be a concomitant reduction in Big Rivers' power supply with an LEC guarantee of the Smelters' margins.

energy-intensive, cost-sensitive nature of the aluminum smelting industry, which has frequently pitted the Smelters' financial viability against that of Big Rivers, also makes the Smelters unique among Big Rivers' customers.

All of these factors have led the Smelters to seize every available opportunity to reduce their loads as permitted under their contracts with Big Rivers in an effort to reduce their costs of operation. Absent fixed rates for a term of years, there is a very high probability that the Smelters would continue to exercise their contractual rights to further reduce their loads, resulting in further negative impacts on Big Rivers and all non-smelter customers, as well as the economy of Western Kentucky in general. In return for the fixed Tier 1 and Tier 2 rates during the term of their contracts, the Smelters relinquished their rights to continually reduce their loads. By eliminating future Smelter load reductions, Big Rivers was able to demonstrate to its creditors an assured future stream of margins, which was critical to a consensual debt restructuring.

Taking all these factors into consideration, in light of the overall benefits of the lease transaction and the elimination of the Smelters' exemption from future unforeseen costs, the Commission determined the transaction rates to be fair, just, and reasonable. The transaction rates, in combination with the projected revenues from non-member sales, will allow Big Rivers to pay its reasonable expenses, service its debt and allow it to regain its financial integrity.

Similarly, the Smelters' rates for power under Tier 2 and, until January 1, 2001, Tier 3 must be viewed as part of an overall resolution of Big Rivers' significant financial problems and the many factors enumerated above. The fact that the proposed rates were

based largely on negotiations by certain parties to the bankruptcy proceeding, with the actual cost support prepared after the fact, is of no consequence. The cost support does show that, overall, under the lease transaction, the total revenue stream generated from all rates will be adequate to cover Big Rivers' costs. While each individual component of each rate may not precisely match to an individual component of Big Rivers' costs, all costs will be adequately covered.

There is no merit to the AG's claim of rate discrimination by omitting a separately stated demand charge from the Smelters' rates for Tier 2 and pre-2001 Tier 3 power. This claim arises under the AG's proposed cost-of-service study, which the Commission rejected as flawed in the April 30, 1998 Order. The record clearly demonstrates that while this power is priced at energy only rates, those rates exceed variable cost and provide a contribution to fixed costs. It is significant to note that the Smelters' Tier 1 power is also priced at an energy only rate but the AG raises no objection to that rate. Overall, the transaction rates are based on Big Rivers' cost of service and the AG's attempt to single out for individual analysis the Tier 2 and pre-2001 Tier 3 rates is inappropriate.

The rates proposed in this case by Big Rivers cannot be viewed in a vacuum. It must be remembered that Big Rivers has been experiencing serious financial problems since completion of its Wilson Generating Plant in 1984. Big Rivers' rates have not been based on traditional cost-of-service principles since that time due to cost deferrals and the need to produce revenues from off-system sales. For all these reasons we find no undue discrimination in the structure of the Tier 2 and pre-2001 Tier 3 rates. Rehearing is denied on the issues raised by the AG.

Fixed Rate For Post-2000 Tier 3 Power

The Co-ops object to our elimination of a January 1, 2001 termination date for the Smelters' Tier 3 fixed rates. Under Big Rivers' application as modified, Tier 3 power after the year 2000 would be available at market rates which could vary frequently. Our decision to reject the termination date does not mean that the Co-ops must continue to supply Tier 3 power at the tariffed rate if it is uneconomical to do so at that rate. The Commission's intent was for the Tier 3 rate to remain fixed only until it is changed by a tariff filing or rate application.

After the year 2000, either Co-op can file on an as needed basis to change the Tier 3 rate to track its wholesale power costs. The Commission did not view this as an unjust or unreasonable burden for either affected Co-op. It has always been their responsibility to secure an adequate supply of power to satisfy the load requirements of their member-customers. In the past, the Co-ops have fulfilled this responsibility primarily through a full-requirements contract with a single wholesale power supplier. However, the structure of the electric industry is undergoing significant change and there are now many competitors in the wholesale power markets. The Co-ops have agreed to modify their full requirements contracts with Big Rivers to allow LEC to supply the wholesale power for the Smelters' under Tier 1, Tier 2, and, until January 1, 2001, Tier 3. To the extent additional power sources are needed for the Smelters under Tier 3 after the year 2000, the Co-ops should be responsible for securing those sources. However, the Commission recognizes that our April 30, 1998 Order may have created some confusion regarding the pricing for Tier 3 power after the year 2000. Therefore, we will grant the Co-ops' request for rehearing.

IT IS THEREFORE ORDERED that:

1. Rehearing is granted on the petitions of Big Rivers, the Smelters and the Banks to the extent that the April 30, 1998 Order is modified to allow Big Rivers to continue charging the September 2 rates until the closing of the lease transaction or further Order by the Commission, and Big Rivers is granted a delay in the filing of its Transaction Tariff until the date of closing.

2. The transaction rates approved by the April 30, 1998 Order are fair, just, and reasonable rates to become effective one day after the closing of the lease transaction.

3. Rehearing is granted to the Banks on the issue of whether the September 2 rates should automatically terminate after August 31, 1998 if the lease transaction has not closed by that date.

4. The AG's petition for rehearing is granted to the extent that the April 30, 1998 Order is modified to include the discussion herein on the basis for finding that the transaction rates are fair, just and reasonable. All other rehearing issues raised by the AG are denied.

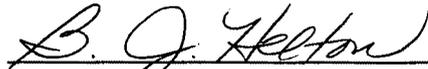
5. Rehearing is granted to the Co-ops on the issue of pricing power for the Smelters under Tier 3 after the year 2000.

6. All provisions of the April 30, 1998 Order not modified herein shall remain in full force and effect.

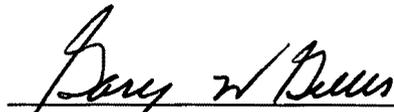
7. Within 20 days of the date of this Order, the parties shall file proposed procedural schedules for the rehearing phase of this case.

Done at Frankfort, Kentucky, this 11th day of June, 1998.

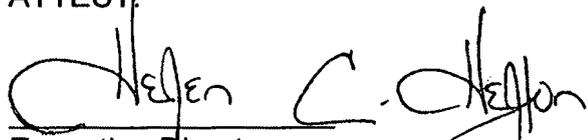
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