COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of: Application of Big Rivers Electric Corporation for Approval to Modify its MRSM Tariff, Cease Deferring Depreciation Expenses, Establish Regulatory Assets, Amortize Regulatory Assets, and Other Appropriate Relief	: : : :	Case No. 2020-00064

BRIEF OF KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC.

This case is a pivotal chapter in the future of the Big Rivers Electric Corporation ("Big Rivers") and its 118,000 member/owners. The management of Big Rivers has developed a plan to: 1) pay off $371.9 million (gross) $252.5 million (net) Smelter Loss Mitigation Regulatory Assets;[1] 2) regain at least two investment grade credit ratings thus curing its current position of being in technical default on its Rural Utilities Service ("RUS") debt[2] and saving millions of dollars per year in interest expense, creditor fees and power purchase and sales agreement collateral requirements;[3] and 3) begin booking approximately $21 million per year in Wilson depreciation expense.[4] Big Rivers will do all of this without the need for a rate increase. But the plan will only work with the continued constructive regulatory support from this Commission. This case must be viewed from a broad perspective.

How We Got Here

In 1998, Big Rivers emerged from Chapter 11 bankruptcy under the terms of a Reorganization Plan involving the unregulated affiliates of Louisville Gas and Electric (Western Kentucky Energy Corp. ("WKEC"), E.ON U.S ("EO.N") and LG&E Energy Marketing ("LEM"), (collectively the "E.ON

[1] Direct Testimony of Mr. Smith at page 13.
[2] Direct Testimony of Mr. Berry at page 26.
[3] Direct Testimony of Mr. Berry at page 27.
[4] Supplemental Direct Testimony of Mr. Berry at page 11.

Entities")).[5] Big Rivers' bankruptcy was largely necessitated in order to discharge several above-market, long-term coal contracts that were the result of a criminal conspiracy to defraud Big Rivers.[6] The Commission had previously disallowed from FAC recovery certain of these coal costs that were deemed to be unreasonable.[7]

Under the Bankruptcy Reorganization Plan, Big Rivers entered into a 25-year lease of its generating facilities (and those owned by Henderson Municipal Power & Light ("HMP&L")) to WKEC. Under the terms of the 1998 lease, WKEC was to lease and operate Big Rivers' (and HMP&L's) generation facilities through 2023, while Big Rivers (and HMP&L) retained ownership of their respective generating facilities both during the term of the 25-year lease and after the lease expiration. Also, under the Reorganization Plan, Big Rivers purchased power from LEM at levels sufficient to meet the needs of its Members. Finally, under the Reorganization Plan, Big Rivers' outstanding debt with the RUS was restructured and the credit providers for Big Rivers' pollution control bonds were replaced.

The 25-year lease was terminated early in the 2009 "Unwind" transaction.[8] In the Unwind, Big Rivers again began operating its generating facilities for power supply to its Members, including the smelters.

The two Western Kentucky aluminum smelters and their role in the creation of $371.9 million (gross) $252.5 million (net) Smelter Loss Mitigation Regulatory Assets is the genesis of the instant proceeding. In its Unwind Order, the Commission explained that the Bankruptcy Reorganization Plan provided the two smelters with fixed pricing for about 70% of their power at $25/MWh, with the balance

[5] The history of Big Rivers' bankruptcy, 25-year lease of its generating facilities to the E.ON Entities and the subsequent "Unwind" of that 25-year lease is described by the Commission in its April 30, 1998 Order in Case No. 97-204 and March 6, 2009 Order in Case No. 2007-00455.
[6] See First Amended Plan Of Reorganization Proposed By Debtor Big Rivers Electric Cooperation dated June 9, 1997, United States Bankruptcy Court for the Western District of Kentucky, Case No. 96-41168.
[7] July 21, 1994 Commission Order in Case No. 90-360-C.
[8] March 6, 2009 Order in Case No. 2007-00455.

supplied by market purchases of $50-$60/MWh.[9] The Commission further explained that in 2010 and 2011 the smelters would be at 100% market pricing, which as noted above, was higher than Big Rivers' cost-based rates. Fearing that market pricing could force the closure of the smelters, with significant attendant negative financial consequences to the economy, the Commission recognized that the Unwind provided the smelters with cost-based, below-market power from Big Rivers generation. "*Although it would not be possible to guarantee the future financial health of the Smelters, providing them with a long-term supply of power priced below market prices should enable them to maintain their current competitive positions and continue in operations over the long-term. It was for this reason that Big Rivers entered into negotiations with the Smelters on new service agreements that will provide them power at competitive prices while providing protections to Big Rivers and its non-Smelter customers against the risks inherent in resuming the role of power supplier to the Smelters.*"[10]

But when market pricing changed to be less than Big Rivers' cost-based rates, so did the position of the smelters. In 2013-2014, the smelters pushed for and were authorized by the Commission to have Kenergy change its wholesale electric provider to pass-through market-based rates to the smelters.[11] The Commission-approved Electric Service Agreements between Kenergy and Century Aluminum Sebree LLC and Century Aluminum Of Kentucky General Partnership both expire on December 31, 2023. Removing Big Rivers as the wholesale generation supplier of Kenergy for service to the smelters necessitated two Big Rivers base rate cases to shift costs from the smelters to the remaining non-smelter customers. [12]

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[9] March 6, 2009 Order at 14, Case No. 2007-00455.
[10] Id at 15-16.
[11] Case No. 2013-00221, Order entered August 14, 2013 and Case No. 2013-00413, Order entered January 30, 2014.
[12] Case No. 2012-00535 and Case No. 2013-00199.

The rate increase to make up for the loss of the first smelter was $54.2 million based on a TIER of 1.20.[13] The rate increase would have been approximately $6 million higher had the Commission not required that a like amount of annual depreciation on Coleman (which represented excess capacity) be deferred. The Coleman depreciation deferral balance was $37.2 million at the end of 2019 and will be recovered in this case. In the first smelter related base rate increase, the Commission rejected the Attorney General's ("AG") proposal to set rates based on the 1.10 MFIR minimum coverage ratio required by Big Rivers' loan covenants because this "*will not provide any 'cushion' in the event of either an unexpected decline in revenues or unavoidable increase in expenses*."[14]

The second smelter related rate increase was $36.1 million based on a TIER of 1.30.[15] The rate increase would have been approximately $21 million higher had the Commission not deferred depreciation on Wilson. At the end of 2019, the Wilson depreciation deferral balance was $120.5 million. That deferral balance, plus ongoing depreciation on Wilson of approximately $21 million per year, will be recovered in this case. The Commission again denied the AG's proposal to use a 1.10 TIER in setting rates. "*The Commission finds the AG's proposal for setting Big Rivers' TIER to be unreasonable. It is inappropriate to base a cooperative's revenue requirement on the minimum TIER it is required to achieve in order to be in compliance with its mortgage or other controlling loan agreement."*[16]

<u>The Current Case</u>

In this case, Big Rivers proposes a plan to pay off the $371.9 million (gross) $252.5 million (net) Smelter Loss Mitigation Regulatory Assets and begin recovering the $21 million annual Wilson depreciation expense. The components of the $371.9 million (gross) smelter-related regulatory assets are

[13] Case No. 2012-00535 October 29, 2013 Order at 43.
[14] Order at 41-42.
[15] Case No. 2013-00199 April 25, 2014 Order at 32.
[16] Case No. 2013-00199 April 25, 2014 Order at 31.

shown on page 13 of Mr. Smith's Direct Testimony. $90.4 million of the remaining net book costs of Big Rivers' Station Two contractual obligation. Station Two is located in Sebree adjacent to the Sebree smelter and has served that smelter for decades. $117.1 for the remaining net book costs of Coleman. Coleman is adjacent to the Hawesville smelter and was built to serve it. $37.2 million of deferred Coleman depreciation. $120.5 million of deferred Wilson depreciation. Because Wilson is still operating, Big Rivers will begin booking approximately $21 million of Wilson depreciation in 2021.[17] $0.7 million for the focused management audit which addressed how to mitigate the loss of the smelter load, which had represented about 70% of Big Rivers' Member sales. This $371.9 million gross regulatory asset balance will be reduced by 80% of the Member Equity in excess of that required in Big Rivers 2015 CFC Syndicated Senior Secured Credit Agreement ($91 million),[18] 2019 Station Two TIER Credit ($27.7 million) and 2019 DSM Liability ($0.7 million). The net regulatory asset balance to be recovered before the end of the Members' (Kenergy, Jackson Purchase and Meade County) all requirements contracts expire in 2043 is $252.5 million.[19]

This $252.5 net regulatory asset balance will be recovered in two ways. First, by Big Rivers incurring an annual amortization expense of $12 million.[20] Second, by using one-half of margins above a TIER of 1.30 to amortize the Regulatory Asset. The other half of margins above a 1.30 TIER will go to Members as an MRSM Bill Credit.[21]

This is a solid, flexible plan. It is only possible because of the constructive regulation by this Commission and the success that Big Rivers' management team has had in mitigating the loss of the smelter load. The Commission approved execution of wholesale full-requirements purchase power

[17] Supplemental Direct Testimony of Mr. Smith at page 11.
[18] Exhibit Berry-6.
[19] Direct Testimony of Mr. Smith at page 13.
[20] Supplemental Direct Testimony of Mr. Smith at page 12.
[21] Direct Testimony of Mr. Smith at page 18.

contracts with the Nebraska entities through 2026.[22] Big Rivers now satisfies the full capacity and energy requirements of OMU through 2026. Big Rivers provides dispatchable power to nine municipal utilities in the KYMEA through 2029.[23] These are all outstanding accomplishments. Big Rivers is now on the cusp of regaining its investment grade credit rating from at least two of the three rating agencies.

However, if Big Rivers TIER is reduced below 1.30, then regaining investment grade status from two of the three rating agencies is almost certainly out of the question. Or as stated at the hearing, at least not during the lifetime of Mr. Daniel Walker. Big Rivers' 2019 interest expense on long term debt was $37.144 million.[24] A TIER (interest on long term debt plus margins divided by interest on long term debt) of 1.30 results in margins of $11 million. That $11 million is booked as an increase to Member Equity for the future benefit of ratepayers (who are the owners). A TIER of 1.10 would result in margins of only $3.7 million. That provides no cushion and would be viewed as negative by the rating agencies.[25] But unlike a reduction in the ROE for an investor-owned electric utility which lowers consumer rates, a TIER below 1.30 will actually raise rates.

A TIER below 1.30 will raise rates because Big Rivers will not achieve at least two investment grade credit ratings. This would be bad for multiple reasons. First, Big Rivers would remain in technical default on its RUS loan agreements.[26] Second, interest expense will increase just as Big Rivers seeks to refinance $245.5 million of the outstanding RUS B note that comes due in 2023 and $83.3 million in Series 2010A Pollution Control Bonds that are callable in July 2020.[27] Finally, fees on credit facilities will

[22] Case No. 2017-00134.
[23] Case No. 2016-00306.
[24] Supplemental Direct Testimony of Mr. Smith at page 7.
[25] Direct testimony of Mr. Walker at page 15.
[26] Direst Testimony of Mr. Berry at page 26.
[27] Id. at 26-27.

be higher as will collateral requirements on power purchase and sales agreements which are a vital part of the smelter Load Mitigation Plan. [28]

A TIER below 1.30 would be counterproductive. It would hurt consumers. Furthermore, a 1.10 TIER for setting rates was soundly rejected by the Commission in the last two rate cases.

It would also be counterproductive to treat this accounting case like a base rate case and scrutinize every element of revenue and expense. The Commission's position of protecting ratepayers from paying excessive pension costs is well established and much appreciated. Big Rivers has 31 participants in a defined benefit plan who are also eligible for the 401k matching component of a defined contribution plan. For 2019, that "*double-dip*" amounted to only \$106,614.[29] This is not the proper proceeding to address that relatively minor cost.

If this were a base rate case, then approximately \$500,000 of costs for promotional advertising, economic development, lobbying, donations and Touchstone Energy dues would be excluded.[30] Also, if this were a base rate case, then Big Rivers would seek a TIER of 1.45 (which was authorized in the Station Two depreciation reduction case) or 1.50 (the TIER currently authorized for EKPC). A TIER of 1.45-1.50 would off-set the \$500,000 many times over. The Settlement at Paragraph 4 allows Big Rivers to calculate its TIER including economic development expenses, promotional advertising and Touchstone dues of up to \$400,000 per year. Costs for lobbying and donations are excluded. Including legitimate expenses that benefit consumers of up to \$400,000 per year helps ensure that the 1.30 TIER in the Settlement will actually be achieved. KIUC supports economic development and we look forward to the new Nucor plant

[28] Id.
[29] Response to Staff Third Request For Information, Item 6.
[30] See Attachment to Response to Staff Second Request For information, Item 7b.

that will be a huge boost to Kentucky's economy. Economic development expenses are reasonable in the context of this accounting case. Paragraph 4 of the Settlement is reasonable.

Applying the MRSM Bill Credits to the Rural Class (residential, farm, commercial and small industrial) on a per meter basis instead of a KWh basis is a sound policy at the current time. This will benefit the many residential customers who have been economically harmed by the COVID emergency, and it will also help many small businesses that have been forced to close during the emergency. It will disadvantage the large Rural customers, but many of those (like big box retailers) have thrived during the emergency as their small business competitors were forced to shut. This policy does not need to last indefinitely. The Commission can take a second look at this policy through an interim review proceeding.

KIUC obviously supports the cost-based Large Industrial Class ("LIC") rate design contained in Paragraph 5 of the Settlement. KIUC witness Mr. Baron filed Settlement Testimony in support of this provision of the Settlement. The new LIC rate design contained in Paragraph 5 would lower the LIC energy charge and increase the LIC demand charge. In our Direct Testimony, KIUC proposed a revenue neutral, cost-based design for the LIC rate based upon 2019 data. However, during the Informal Conference process we were made aware of the Commission's policy of developing cost-based, revenue neutral rate designs using the financial information and billing determinants from the last rate case. This is what we did in the Settlement Testimony of Mr. Baron. The Settlement would remove the subsidy currently being paid by the high load factor LIC customers to the low load factor LIC customers. The new rate design would not apply to the economic development load that receives a demand charge discount of 90%, as the new rate design would provide an unintended windfall to that load. In order to protect the at-risk Fossil Fuel Customers (almost entirely coal mines that are operating at very low load factors, many of which are in bankruptcy) the Settlement maintains the existing rate design and existing subsidy for them. Protecting the coal mines and using the 2013 billing determinants caused a revenue erosion to Big

Rivers of $265,582, which it agreed to accept.[31] Had the existing coal mine subsidy not been maintained, then this revenue erosion would be less. Also, as the economic development load transitions to the new rate design once the demand discounts end, then Big Rivers will have a revenue increase. It is important to set the LIC rate design at cost of service now since Big Rivers does not forecast the need for a base rate case for many years. Paragraph 5 of the Settlement is reasonable.

The plan proposed by Big Rivers is flexible. If the 50/50 allocation of margins above a 1.30 TIER to Bill Credits and Regulatory Asset amortization needs to be changed, then that can easily be done in the future. For example, if the Regulatory Asset balance is not being reduced fast enough, then in the future more than 50% of margins above the 1.30 TIER can be allocated to that. Nothing in the Settlement prevents Big Rivers from filing for a base rate increase in the future, if needed. Under Paragraph 14, Big Rivers will evaluate opportunities to mitigate the Regulatory Asset amortization expense in the retail rates of its Members, including the use of Excess Member Equity. We fully expect that will be done and that is what the financial model shows. In Paragraph 15, the Parties reserve the right to advocate for a different allocation and manner of recovery of the Smelter Loss Mitigation Regulatory Assets in the future.

At the hearing there was discussion about Big Rivers currently being in default on its RUS loan agreements by not having at least two investment grade credit ratings, thus subjecting it to the possibility of the RUS imposing its Lock-Box rights to effectively take over the utility.[32] While it is true that a rational lender whose primary concern is debt repayment would be unlikely to do that, the federal government is not always rational. For example, a new administration might be just as concerned about lending to a utility to upgrade its coal assets as it is with repayment. Also, being in default on its existing loan

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[31] Exhibit Smith Supplemental-6.
[32] See Direct Testimony of Mr. Berry at page 26.

agreements makes future financing from new lenders problematic. What lending institution wants to advance credit to a utility that is currently in default, and if so at what interest rate and covenants?

The management team of Big Rivers believes that the plan presented here is a good deal for it and for its member/owners. So does the Attorney General and KIUC. Approval of the Settlement does not mean that Big Rivers is out of the woods. A CO2 tax, cap and trade system, increased environmental regulations on coal generation could all disrupt the plan. If that happens, then Big Rivers will be back into problem solving mode. But based upon what we know today, approval of the Settlement Agreement will provide positive benefits and stability.

CONCLUSION

Approval of the Settlement Agreement without material modification will be an important next step in progress of Big Rivers and its member/owners. We urge the Commission to do so.

Respectfully submitted,

/s/ Michael L. Kurtz

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