COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

APPLICATION OF BIG RIVERS ELECTRIC CORPORATION, INC. FOR AN ADJUSTMENT OF RATES	)))	Case No. 2012-00535

ATTORNEY GENERAL'S POST-HEARING BRIEF

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Comes now the intervenor, the Attorney General of the Commonwealth of Kentucky, by and through his Office of Rate Intervention, and states as follows for his post-hearing brief in the above-styled matter.

STATEMENT OF FACTUAL BACKGROUND

On August 20, 2012, Century Aluminum Kentucky ["Century"], the single largest customer of Big Rivers Electric Corporation ["Big Rivers" or "BREC"], filed a written notice with Big Rivers and Big Rivers' local distribution cooperative Kenergy Corporation ["Kenergy"], which supplies power to Century, that on August 20, 2013, Century would terminate its written agreements with BREC and Kenergy for the supply of electricity that Century consumes in the aluminum smelting process. Only two days later, on August 22, Moody's downgraded BREC to Baa2. On December 4, 2012, BREC filed its notice of intent that it would seek to raise rates, primarily to replace

the $63 million in revenues that would be lost from serving Century's load.[1] Significantly, the proposed massive rate increase also sought to impose a $25.6 million annual increase on its second-largest customer, Alcan Primary Products Corporation ["Alcan"], relating to its Sebree aluminum smelting facility.[2]

Scarcely eight [8] weeks later, Alcan, on Jan. 31, 2013, filed its notice that it would terminate its own contracts with both Kenergy and Big Rivers, effective January 31, 2014. In response to Alcan's notice of termination, Big Rivers promptly filed its notice of intent to file yet another base rate case, co-extensive with the instant one, in which it seeks yet another $70.4 million in still new revenues. [3,4] This includes $23.7 million in increased revenues which Big Rivers sought to assess to Alcan in the Century rate case.[5] With the filing of these two notices of termination, Big Rivers was thus placed on notice that it would lose a combined total of approximately 70% of its customer base, at least 66% of its revenues,[6] and that it would have 850 MW of excess capacity in an era of depressed off-system sales ["OSS"].

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[1] Bailey Direct Testimony ["TE"], p. 8. *See also* Case No. 2013-00199, Application, Bailey Direct TE,[] p. 5, in which he states that in 2012, Century provided BREC with $205 million in revenue. In the instant case, BREC seeks a revised total of $68.6 million in new revenues; Bailey TE on Cross-Examination, July 1, 2013 Video Transcript of Evidence ["VTE"] at approximately 16:05.

[2] Since that time, Alcan announced that it has sold its smelter, located at Sebree, to Century [*see, e.g.*, article, "Century Completes Acquisition of Sebree Smelter," at the following link: http://www.courierpress.com/news/2013/jun/03/century-completes-acquisition-of-sebree-aluminum/?print=1]. For that reason, internal references herein to the two smelters will be to either the *Hawesville Smelter* [the original Century smelter], or the *Sebree Smelter* [f/k/a the Alcan Smelter].

[3] Case No. 2013-00199, Bailey Direct TE, p. 5.

[4] In 2012, Alcan provided BREC with approximately $155 million in revenues. *Id.* at p. 5.

[5] Case No. 2013-00199, Bailey Direct TE, p. 5. Note that the proposed Alcan revenue increase figures differ between the cases.

[6] *See* Standard & Poor's ratings downgrade of Feb. 4, 2013, p. 2.

BREC's pre-filed direct testimony in the instant case indicates that the company's OSS, upon which the company relies for almost all of its margins, has been depressed since at least 2010.[7] The company attempted to deal with this depressed OSS market by reducing maintenance, deferring outages, cutting costs and by filing for an increase in base rates[8] in Case No. 2011-00036.[9] Unfortunately, Big Rivers maintains that its financial difficulties have not only continued, but due to the departure of Century's load they have now progressed to "the breaking point."[10]

On March 29, 2012 Big Rivers filed an application in Case No. 2012-00119, seeking permission to issue new debt in the sum of $537 million from CoBank and National Rural Utilities Cooperative Finance Corporation ["CFC"]. The purpose of this new financing was to prepay existing Rural Utility Service ["RUS"] debt in the amount of $442 million; to fund $60 million in new capital expenditures; and to use $35 million to replenish the Transition Reserve created in Case No. 2009-00455 [the "Unwind Case"], which had been used to prepay on the RUS Note on April 1, 2011. In connection with those loans, Big Rivers filed a Disclosure Statement dated July 12, 2012[11] in which BREC appropriately advised the lenders: (1) that the two smelters had advised Kentucky State Government officials that they "could not envision a future with Big Rivers;" (2) that BREC's rates were "not sustainable;" (3) that BREC's rates placed the

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[7] *See, e.g.*, Bailey Direct TE, p. 8.
[8] *Id.*
[9] Notice of intent filed Jan. 31, 2011; Final Order dated Nov. 17, 2011, granting an increase in base rates of $26.744 mil.; Final Order on Rehearing dated Jan. 29, 2013, granting an additional $1.042 mil. in new revenues, for a total of $27.787 mil. in new revenues; Final Order on Rehearing at pp. 24-25.
[10] Bailey Direct TE, p. 8 lines 3-5.
[11] *See* July 12, 2012 Disclosure Statement, BREC Response to KIUC 1-9 in Case No. 2012-00492, pp. 295-405.

smelters' viability at great risk; and (4) that there could be no assurances that one or both smelters would not give their one-year notice of termination.[12] Two weeks later, BREC, CFC and CoBank closed on the new financing.

Century's termination notice came less than one month after the new financing was in place. Just two (2) days later, Moody's downgraded BREC to Baa2. A few days later, Fitch and S & P both placed BREC's credit on negative watch.

On November 14, 2012, BREC filed a new financing application in Case No. 2012-00492, in which it sought to refinance its maturing Series 1983 Ohio County pollution control bonds with new, Series 2013A bonds. The company then amended the application in that case on January 24, 2013, stating it "has decided that the potential cumulative impact on prospective bond purchasers of the Century Aluminum notice to terminate its retail service agreement, the uncertainty about the outcome of Big Rivers' pending rate case, and the impact of that rate case on Alcan Primary Products Corporation's Sebree facility weigh in favor of postponing the offering of debt until some or all of that uncertainty has been eliminated." [13] One week after the Amended Application was filed, Alcan provided its Notice of Termination on January 31st. Just a few days following Alcan's January 31st notice of termination, Standard & Poor's on Feb. 4, 2013 downgraded[14] Big Rivers to BB-, a rating below investment grade. Additional downgrades from Moody's [downgrade to Ba1], and Fitch [downgrade to BB with negative outlook] quickly followed.

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[12] *See* July 12, 2012 Disclosure Statement, pp. 39-40.
[13] Case No. 2012-00492, Amended Application, paragraph 2.
[14] This ratings action applied to both the company itself, and to its Series 2010A Ohio County pollution control bonds.

Then, during the February 28, 2013 evidentiary hearing in Case No. 2012-00492, Big Rivers' Chief Financial Officer ["CFO"] further amended the application from the witness stand to indicate that the company would not seek to re-finance the bonds because Goldman Sachs indicated the company could have faced a difficult time in refinancing the bonds. Instead, the CFO advised that the company planned to: (a) purchase the bonds through a $60 million CoBank loan that had been intended for capital expenditures; and (b) use the $35 million Transition Reserve to partially replace those funds intended for capital expenditures. The Commission approved this twice-amended financing application by Order dated March 26, 2013.

Two days later, BREC filed another financing application,[15] seeking approval to amend and restate its revolving line of credit agreement with the CFC. BREC negotiated the amendments to avoid an event of default that would be triggered upon Century's departure. Such a default could result in CFC no longer making advances to BREC, and accelerating all unpaid principal and interest due from BREC.

Century's departure places BREC's liquidity into jeopardy. In response to the threat posed by the departure, there was an amendment to the CFC revolver allowing BREC to retain access to $50 million in liquidity. However, as illustrated in questioning by Vice-Chairman Gardner,[16] CFC did not allow BREC to retain access to the $50 million revolver without extracting concessions in return. It is clear that CFC is strengthening its position through the amendments, in light of BREC's precarious

[15] Case No. 2013-00125.
[16] Case No. 2012-00535, Richert TE on Cross-Examination, July 2, 2013, VTE 11:22:00 - 11:22:12.

financial condition. The Commission timely approved BREC's financing application in Case No. 2013-00125 by Order dated July 15, 2013.

Within a fairly short period of time following the announcements of the two smelters' terminating from the BREC system, the company was thus stripped of any investment-grade ratings. The company, however, in an attempt to deal with its "precarious" financial condition, has chosen a strategy of requiring all its remaining customers to pay more to make up for the massive loss of revenue and margins, rather than addressing it directly via restructure of its excess scale of operations.[17]

ARGUMENT

The Attorney General opposes Big Rivers' substantive philosophy and strategic attempt to draw the parties, and ultimately the Commission, inch-by-inch into a piecemeal approach to ratemaking, which will ultimately lead to a doubling of rates by 2014. Further, the company's lack of transparency with the parties, Commision staff and this administrative tribunal, as the trier of fact, should not be tolerated.

I. BREC Fails to Address Its Precarious Financial Position With Candor and Transparency before the Commission

While BREC admits it is in a "precarious financial position,"[18] it has nonetheless elected to take the most aggressive litigation stance possible, having retained at least four (4) law firms to handle regulatory affairs, restructuring, and bankruptcy issues.[19] BREC accuses the Attorney General of at least indirectly advocating bankruptcy for

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[17] Bailey Direct TE, p. 7, line 18. Mr. Bailey confirmed that his intent is to pass all fixed costs onto BREC's remaining ratepayers. July 1, 2013 VTE beginning at approximately 12:00:00 through 12:03:50.
[18] Bailey Direct TE, p. 7, line 18.
[19] Speed Rebuttal TE, p. 8 lines 17-23, and p. 9 lines 1-19.

BREC in its pre-filed direct testimony filed on May 24, 2013, and thus forcing BREC's hand to hire restructuring and bankruptcy attorneys Haynes and Boone, LLP ["Haynes and Boone"] to address these issues. In fact, the evidence in the record demonstrates that BREC actually engaged Haynes and Boone on these restructuring/bankruptcy issues as early as April 11, 2013 - - almost six weeks before the Attorney General filed Direct Testimony of experts in this matter.[20] It is clear that BREC was actually contemplating these restructuring/bankruptcy issues substantially in advance of Attorney General's pre-filed direct testimony of his experts. Therefore, BREC's allegations against the Attorney General are inaccurate and misleading.

Moreover, the company has been adamantly non-transparent – if not hostile – to providing the full picture of the consequences of this financial position to the Commission in a comprehensive fashion. BREC is attempting to draw the Commission, inch-by-inch into piecemeal approval of the company's preferred course of events—a course which has little likelihood of success. The Commission should not condone BREC's lack of transparency, and should instead look at the full picture of BREC's circumstances with the aid of the Attorney General's testimony and analysis. This analysis draws on other matters before the Commission regarding BREC [including the Alcan rate case], which all parties clearly can see, but as to which BREC refuses to acknowledge the clear impact on the request currently before the Commission. Specifically, BREC has:

[20] *See* BREC's June 26, 2013 Second Supplemental response to PSC 1-54.

1. Refused to acknowledge, admit or address the near term impact of the Alcan termination in this case, even though it will occur during the future test period chosen by BREC. BREC filed a "pancaked" rate case for the Alcan/Sebree termination at 4:00 p.m. one business day prior to the start of hearings on the Century termination rate case;

2. Suddenly transformed itself from a "precarious financial position" and "at the breaking point" in the Century rate case to merely being "in the midst of a difficult transition period"[21] in the Alcan rate case;

3. Failed to include or address the impact of the proposed contracts for market-based power between and among BREC, Kenergy, and Century, even though it will occur during the future test period chosen by BREC;

4. Informed the Commission and intervenors only one week prior to the hearings it was changing the generating resource it plans to idle from Wilson Station to Coleman Station—for purposes of the rate case only, as Coleman will likely be "must run" from a MISO status;

5. Refused to admit, address or acknowledge that there will be a significant impact on consumers from "laying up" generating plants—whether Coleman or Wilson [or actually both], in that consumers will still be required to pay depreciation, interest and other charges related to that "layed up" plant;

6. Refused to provide information on significant increases in officer and management salaries following the Unwind transaction in 2009, and did so despite the Commission's Order in the same year chastising BREC for attempting to recover $441,000 in bonuses in an emergency rate relief case;[22]

7. Refused to provide information regarding a significant one-time Retention bonus payment in 2010, which along with other significant pay increases has caused important maintenance costs to be deferred;[23]

8. Issued false and misleading claims that the Attorney General has raised issues of bankruptcy in its testimony, when it was BREC itself that hired restructuring/bankruptcy attorneys in April 2013, *see supra* at p. 6; and

9. Refused to admit or acknowledge there are more than two options on important issues—thus presenting the Commission with only a binary choice of BREC's position, "or else".

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[21] Case No. 2013-00199, Bailey Direct TE at p. 4, line 21.
[22] Ostrander Direct TE, p. 27 lines 1-7 and footnote 12, and p. 28 lines 1-16.
[23] Ostrander Direct TE, p. 24 lines 18-23, p. 25 lines 1-19, p. 26 lines 1-7, and p. 28 lines 15-16.

This list should not be viewed as all inclusive, as a number of other examples of BREC's lack of candor and transparency toward the Commission can be identified in the record.

BREC attempts to cover its lack of candor and transparency by hiding behind purported legal requirements associated with this case. BREC states the Alcan termination notice came after the instant rate case was filed, and therefore BREC is restricted from modifying the rate case filing.[24] This is a feeble argument, at best, since the termination notice came *merely two weeks* after the rate case was filed, and by its own choice BREC proposes a future test period which includes the point in time at which the Alcan termination will take place. It is very likely BREC knew Alcan/Sebree would terminate its contract, particularly when BREC sought to spread the impact of the Century departure to Alcan in this rate case.[25] BREC had to have known proposing that $25 million in additional revenues be paid by Alcan/Sebree due to the Century departure would accelerate any consideration Alcan/Sebree was giving to termination. It cannot be any coincidence that two short weeks after the filing of the Century rate case, Alcan/Sebree gave its notice of termination.

Furthermore, BREC must have been assessing the impacts of Alcan departing on the heels of the Century departure and making plans for that departure—if not, it would be clear mismanagement to ignore such a likely contingency. Although the Alcan load is one with which BREC's management had a great deal of experience, and

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[24] Bailey TE on Cross-Examination, "the Alcan notice came after the filing, and therefore we feel restricted", July 1, 2013 VTE, 10:46:30.

[25] BREC foresaw the probability that the smelters would depart at least as early as 2011, when it began working on its Load Mitigation Plan. July 1, 2013 VTE at approximately 16:26:10.

for which an enormous amount of verifiable, objective data exists, BREC would have the Commission and other parties believe that it has no way to provide that information, as requested in numerous data requests to which the company provided non-responsive or only partially responsive answers.

There is nothing that prohibits BREC from providing updated information on a timely basis, and there is nothing that prohibits BREC from providing historic information that precedes the base period. It is BREC's *choice* to be non-transparent and not provide the Commission, Commission Staff and intervenors with information on the impact of the Alcan/Sebree departure. BREC stated in response to PSC 2-1 that it "sees no reason why the Alcan termination notice should impact this proceeding," when plainly BREC will not receive the $25 million in increased revenue it projects to receive in the future test period, and plainly it will not continue to receive existing revenue levels from Alcan in the future test period. The Alcan termination notice clearly impacted this proceeding since it removes substantial margins and revenues that are included in the future test period selected by BREC. For BREC to contend otherwise that the Alcan termination notice "should not impact this proceeding" is non-transparent and lacks candor.

BREC based its rate case filing and related financial modeling on "laying-up" the Wilson Station to mitigate the effects of the Century departure. Then, essentially at the last minute in Rebuttal Testimony filed one week before the hearing, BREC changed its case from laying up Wilson Station to laying up Coleman Station. Again, BREC had to have known well before filing its Rebuttal Testimony that its plant layup strategy had

changed. BREC demonstrates a lack of candor and transparency by making such a fundamental change to its case, which it must have known well-beforehand, in rebuttal testimony one week prior to the hearing.

It is conceivable that this fundamental change in the rate case filing also is intended to support BREC's strategy of drawing the Commission along inch-by-inch into approving piecemeal requests. KIUC and the Attorney General recommended disallowing some or all of the costs of Wilson Station since it is demonstrably not used or useful in providing service to remaining consumers. Only after a review of this argument did BREC rebut its own application, *as filed,* and argue, improperly, that Wilson Station is "used or useful" in the forecasted test period. Based solely on this stratagem, was BREC able to factually attack KIUC's and the Attorney General's recommended disallowance of Wilson Station costs. BREC's attack is based on litigation artifice and non-transparency for a number of reasons including:

1. BREC proposes to idle Wilson Station anyway in its Alcan/Sebree rate case filing;

2. BREC argues in its Rebuttal Testimony that the costs and savings of idling Coleman vs. Wilson are essentially identical;[26] and

3. Coleman will likely be "must run" as a System Support Resource ["SSR"] for MISO to support the Century load proposed to be served under new contracts. SSR payments from MISO to BREC will not pay for Coleman Station's fixed costs such as depreciation and interest, leaving remaining consumers to pay for plant that is not used or useful.

BREC apparently has suddenly transformed itself from a "precarious financial position" "at the breaking point" in the Century rate case to merely being "in the midst

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[26] Berry Rebuttal TE, Exhibit Berry Rebuttal-2.

of a difficult transition period"[27] in the Alcan rate case. BREC's change of terminology begs the question of what changed or improved—was there something that occurred in between the rate case filings that improved BREC's circumstances to merely being "in the midst of a difficult transition period"? Clearly, nothing has changed except for BREC's financial position perhaps becoming even more precarious. Comparison of the plain meaning of the two phrases suggests an improvement from a "precarious financial position." It is not transparent or candid of BREC now to suggest to the Commission that it is merely in a "difficult transition period" when in fact as originally stated BREC's financial position is precarious due to the excess scale of its operations compared to its significantly reduced load. BREC's word choice may well be strategic, since clearly the intervenors made BREC's "precarious financial position" a central issue in this case.

BREC has surrounded the subject of the impact of the new contracts between and among BREC, Kenergy and Century with a lack of transparency and information regarding financial impacts. Provision of power under these contracts to Century will affect BREC's costs and revenues in the future forecasted test period. Yet, BREC's CFO refused—repeatedly—to answer questions regarding whether the filing includes either the savings from Wilson or Coleman being idled, or the SSR Coleman "must run" payments from MISO.[28] Furthermore, even though it is clear from calculations based

[27] Case No. 2013-00199, Bailey Direct TE at p. 4, line 21.
[28] Richert TE on Cross-Examination, July 2, 2013, VTE beginning at 9:44:30 – 9:49:30 and extending into confidential session beg. at 9:50

upon BREC's own cost allocation that there are substantial offsetting revenues[29] if Century continues to operate and pay its appropriate share of Big Rivers transmission costs, BREC refuses to acknowledge that anything has changed since its initial filing and that its entire increase continues to be substantiated and justified. It is important to know the financial impact of the new contracts so that revenues and costs expected to be realized in the future forecasted test period can be accounted for, and so that BREC is not allowed to double recover its costs.

BREC refused to provide any information on individual officer salary increases following the Unwind transaction. BREC claims officer level salary detail is not available for 2009 and 2010 due to the unavailability of a prior Oracle database.[30] However, even if true, this ignores the obvious alternative source of the information in BREC's W-2 tax records for those periods, which BREC itself admits.[31] BREC's refusal to provide this information is an attempt to deflect scrutiny from its use of scarce resources to increase officer salaries and bonuses, after the Commission had expressed very strong concerns about such uses of funds. This is yet another area where BREC lacks candor and transparency.

BREC attempts to support its "inch-by-inch" strategy by presenting issues as a binary choice, without any additional options available—the Commission must act as the company's auditor and blankly rubber-stamp its request, "or else." For example, BREC states the Commission must give it the rate increase it has requested, or the

[29] $10,760,729 as calculated in Exhibit Holloway-6, based on BREC's filed cost allocation methodology.
[30] Haner Rebuttal TE, p. 5, lines 4-7.
[31] Haner TE on Cross Examination, July 3, 2013, VTE at 10:41:30.

Commission requires BREC to file for bankruptcy. According to BREC, there is only this "stark choice."[32] BREC indicates the only "reasonable" choice for the Commission is to give it the requested rate increase, and thereby exhibit "regulatory patience"[33] and "regulatory support."[34] Questioning by the Vice-Chairman made clear what "regulatory support" means: give the company what it has requested.[35] The Commission surely will not abdicate its responsibilities as advocated by BREC.

However, there are other options beyond the "stark choice" presented by BREC. Clearly BREC should be engaged with its creditors to develop a restructuring plan. BREC's "fears" of talking to its own creditors[36] appears to be driving the company's position that there is only the "stark choice" of the Commission granting the full rate increase requested, or the Commission requires BREC to file for bankruptcy. This is directly contradicted by the testimony of BREC's own expert, Mr. Snyder, who when questioned whether discussions with lenders are customary, stated "oh yes absolutely, you never want to surprise them".[37] Mr. Snyder also testified that a company in a precarious financial position would "first restructure operations, and then restructure debt to fit."[38] Mr. Snyder's testimony also offers insight into reasons why BREC management sees only the "stark choice" and "fears" talking to its lenders. Mr. Snyder

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[32] Bailey Rebuttal TE, p. 5
[33] *See, e.g.*, Bailey Rebuttal TE, p. 5.
[34] *Id.* at 16.
[35] Snyder TE on Cross-Examination, July 2, 2013, VTE at approx. 12:45.
[36] *See, e.g.*, Bailey TE on Cross-Examination, July 1, 2013, VTE beg. after 1:08.
[37] Snyder TE on Cross-Examination, July 2, 2013, VTE at 11:38.
[38] Snyder TE on Cross-Examination, July 2, 2013 VTE, 11:35.

states in his experience it is uncommon for a company which reorganizes its operations and debt to have the same management after the reorganization as before.[39]

BREC's presentation of a "stark choice" is non-transparent, lacks candor, and is designed to manipulate the Commission into supporting BREC's "inch-by-inch" strategy. The Commission should see through BREC's "stark choice" to the additional steps and options—as made clear by BREC's own expert—which should be explored instead of putting unjust and unreasonable rates into effect as the "only" solution.[40] Rather, as Mr. Snyder's testimony specifically addressed **"appropriate rate relief" in this matter is "whatever the Commision decides."**[41]

Similarly, BREC presents the issue of regulatory treatment of generating plants which are not used or useful in terms of a binary choice: either ratepayers must pay for those plants through substantially increased rates, or the plants are immediately written off at a very substantial loss.[42] Of course, these are not the only two options that exist for addressing generating plants that are not used or useful for purposes of setting BREC's wholesale rates. As the Commission well knows, there are regulatory accounting treatments that are possible in the context of restructuring utility operations and debt, such as amortizations of extraordinary retirements. The Commission should see through BREC's non-transparent contention that there are only two choices to

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[39] Snyder TE on Cross-Examination, July 2, 2013, VTE beginning at 11:45.

[40] *See also* TE on Re-direct Examination of KIUC witness, Lane Kollen, who testified he sees a final solution falling between the stark choices that Bailey paints for the Commission; for example, a solution could occur by engaging in negotiations with lenders and devising a restructuring or workout plan, similar to the one developed in the late 1980s; "There are any number of opportunities and options available in a restructuring." July 3rd VTE, 15:13:52; 15:38:44. With nearly 30 years of familiarity with BREC's history, the Attorney General urges the Commission to consider Mr. Kollen's recommendations.

[41] Snyder TE on Re-Direct, July 2, 2013, VTE 12:55:00 – 12:55:10.

[42] Bailey TE on Cross-Examination, July 1, 2013, VTE at 16:45:30.

address generating plants that are no longer used or useful for wholesale rate setting. There are other options available in the context of BREC restructuring to reduce BREC's excess operational scale.

II. BREC's Ratepayers Should Not Endure Onerous and Economically Unfeasible Rate Increases or Suffer "Budgetary Patience" Unless and Until BREC Identifies Replacement Load

Big Rivers believes that although it will have nearly three times the capacity it needs to serve its customers' load following the departure of both smelters, that excess should not be seen as "excess," but rather as "an appropriate risk mitigation strategy," and "a real asset for customers." [43] But as Standard & Poor's noted in its downgrade of the company and its Series 2010A bonds:

> "We believe it might be **too onerous** for remaining customers to assume the fixed costs that the smelters have historically borne, particularly because many of the counties that BREC serves have income levels that are 20%-30% below the national median household effective buying income."[44]

The Attorney General believes the company's management needs to step back from its decision, leave behind the well-insulated walls of the Boardroom where this decision was made, and instead walk in the shoes of its ratepayers. As reflected in the public comments, the ratepayers clearly understand that they simply cannot afford the series of gargantuan rate increases its utility seeks to shift onto their shoulders, which the company acknowledges will be permanent unless or until replacement load can be

[43] July 1, 2013 VTE beginning at 15:20:30 – 15:22:33.
[44] *Id.* AG Hearing Exh. 3 at p. 2; also introduced as BREC Attachment to Response to AG 1-57.

found.[45] The company's statement that "patience is a virtue in this case,"[46] rings hollow in the ears of those who cannot afford to render it.[47]

As indicated in the Hancock County Public Schools' public comments made at the evidentiary hearing on July 1, 2013, BREC's proposed rate increases, if approved, will jeopardize businesses such as Southwire, Aleris, and Domtar, cause some of them to leave BREC's territory, and will in turn cause a devastating loss of revenue for the school board.[48] The County Judge-Executive of Hancock County, Mr. Jack McCaslin, speaking on behalf of his county and two others in BREC's territory, stressed that the increase will be detrimental to industries in Hancock County; "I'm not sure any will be able to sustain this increase; this is quite a huge increase."[49] These industries include the intervening large industrials, but also smaller industrial companies, like Crestline Plastic Pipe Company, which estimates its rates will increase by almost $100,000 per year. Finally, a Ms. Taylor, who wished to speak on behalf of families, commented that "I do not see how we can do this to young families, to impoverished families, and to families with people living on fixed incomes."[50] The stories of these families are adequately addressed in the written public comments, which detail their own stark

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[45] *See* BREC's response to AG 1-133, pp. 3, 7 of 28.
[46] *Id.* at 15:07:28.
[47] The Company's officers have admittedly given themselves pay raises up to 48% on average, and ranging upwards to 70%, around the time of the 2009 Unwind case. *See* Ostrander Direct TE, p. 35, l. 6-15, p. 26, l. 1-5, and BREC Response to AG 1-253(b). Even if merely symbolic, the officers of BREC are not making any noticeable concessions on their own behalf while seeking to bestow virtually unprecedented rate increases on their customers.
[48] July 1, 2013 VTE beginning at approximately 10:37:00. through 10:39:40.
[49] VTE at 14:39:44 - 14:39:57.
[50] VTE beg. .at approximately 10:41:50.

choices, such as choosing between paying for prescription medications and paying the estimated monthly increase in electricity.

III. BREC is Inherently Unstable Financially Due to the Departure of the Smelter Load

Big Rivers acknowledges it is in a "precarious financial position," and the extent of this position became clearer during the evidentiary hearing in this matter, held on July 1st – 3rd. BREC has lost 70% of its customer base, and is attempting to recover the costs of the full current scale of its operations on the backs of the remaining 30% of its customer base. A revenue loss of this scale renders BREC inherently financially unstable, which was immediately confirmed with the loss of investment grade credit ratings. It is not possible or reasonable to regain financial stability by increasing rates on the remaining 30% of the customers to recover the costs of serving those customers plus the now-departed smelter load. BREC's strategy of continued rate increases to attempt to keep lenders whole and regain financial stability is the wrong course, and has little chance of succeeding. *BREC is already in the hands of its lenders.*

The Commission should not take even the first step down the road suggested by BREC. The company's inherent financial instability can only be dealt with by addressing the mismatch between the scale of the company's operations, and the size of its customer base. The Commission should require BREC to deal with its lenders prior to and without the imposition of unfair, unjust and unreasonable rates. "Lenders were made aware of the issues with the smelters"[51] at the time additional financing was extended to conclude the Unwind transaction. The smelter risk "was covered with

[51] Bailey TE on Cross-Examination, July 1, 2013 VTE at 11:37:45.

appropriate interest rates."[52] It is appropriate that BREC go to its lenders to pursue a restructuring plan rather than come to the Commission to seek unjust and unreasonable rates for the 30% of the customers that remain. This is not "a little hitch in the road" that can or should be addressed via rates.[53] BREC states that "work on the Mitigation Plan began in late 2011".[54] It is truly mind boggling that at no time during that period from then to now did it strike BREC that it should be engaged with its lenders to pursue restructuring options.

BREC recounted the current status of matters with its lenders[55] in the hearing, as follows:

1. BREC has provided the required "Corrective Plan" to RUS, and there was "no push back" for that plan to seek massive rate increases while seeking new load to replace the departed smelters. RUS has provided nothing in writing in response, and there have been no communications from RUS regarding any concerns about idling generating plants.[56] BREC also has an application pending with RUS for additional loan funds for MATS requirements.

2. BREC has pending at the Commission its financing application in Case No. 2013-00125 to amend the terms of its credit line with CFC.

3. BREC intends to apply for "bridge financing" from CFC to fund MATS expenditures while the RUS loan application is pending. This would occur in mid-July, conditioned on favorable outcome of this case.[57]

4. BREC has terminated its credit line with CoBank, and intends to resume discussions with CoBank "later".[58] BREC notified CoBank of the

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[52] Bailey TE on Cross-Examination, July 1, 2013 VTE at 11:39.
[53] Bailey TE on Cross-Examination, July 1, 2013 VTE beginning at 13:20:21.
[54] Bailey TE on Cross-Examination, July 1, 2013, VTE beginning at 16:26:30.
[55] Bailey TE on Cross-Examination, July 1, 2013 VTE beginning at 11:30:20.
[56] Richert TE Cross-Examination, July 2, 2013 VTE at beg. at 11:14
[57] Richert TE Cross-Examination, July 2, 2013 VTE at 10:40.
[58] Bailey TE Cross-Examination, July 1, 2013 VTE beginning at 11:32:14, BREC plans to "resume conversation at a later time" with CoBank..

> termination of the credit line due to inability to complete negotiations by August 20, 2013.[59]

"BREC is already in a position where it cannot access capital."[60] BREC has mandatory environmental pollution control projects that are required in the near term, which require capital expenditures. This is the tip of the iceberg, as BREC has ongoing capital requirements for maintenance and other matters that will cause continued requests for rate increases if the Commission goes down the road BREC suggests. BREC has maintenance that it cannot safely defer any longer.

To add to the injury and compound the problem of unfair, unjust and unreasonable rates, these expenditures will be required for generating plant that is no longer used or useful. BREC's essential proposal to its remaining ratepayers is *to pay more for less than half the current amount of energy*. Under BREC's chosen direction, it will be required to maintain and upgrade system facilities built to serve the smelters on the backs of the remaining 30% of ratepayers for an indeterminate number of years. BREC cannot regain financial stability going down this road. The Commission should require BREC to deal with this mismatch directly and immediately, and without the imposition of unfair, unjust and unreasonable rates.

Restoration of an investment grade credit rating is not likely to happen soon, even if BREC's rate request were to be granted. BREC states that even with the second rate increase it is proposing, it will not have an investment grade credit rating at that

[59] Richert TE Cross-Examination, July 2, 2013 VTE beginning at 11:19.
[60] Bailey TE Cross-Examination, VTE beginning at 16:45:50.

point.[61] BREC states the credit raters "will want to see that BREC is not a merchant generator, and will want to see Mitigation Plan results."[62] BREC is inherently unstable financially due to the departure of the smelter load. An investment grade credit rating is not likely unless and until BREC has worked through its excess scale issues. Credit rating agents will want to see demonstrated revenues and margins sustained over time. Investment grade credit ratings are not restored simply with a rate increase in this case. BREC states "ratings agencies apply stress to financial results to test ability to deal with uncertainties."[63] It will be some time before BREC's financial results, even if superficially at investment grade levels, will be able to withstand the application of a financial stress test. In fact, BREC's financial results will not be able to withstand financial stress testing unless and until its excess scale of operations is handled directly. Rate increases of the magnitude sought by BREC will cause customer response, which renders revenues unstable. BREC admits that, even with the unreasonable rate increases it seeks, the best result it foresees is that it "will be in a position of rebuilding its credit profile and returning to investment grade."[64]

IV. Generation Facilities Idled for Any Significant Periods Are Not "Used or Useful," and Should Be Excluded from Big Rivers' Rate Base

As a result of the departure of 70% of its load, Big Rivers obviously will be left with far more capacity than it needs.[65] Consequently, the company has proffered

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[61] Richert TE on Cross-Examination, July 2, 2013, VTE at 9:12:45.
[62] *Id.*, VTE at 9:12:50 – 9:13:00.
[63] Case No. 2013-00199, Walker Direct p. 9.
[64] Case No. 2013-00199, Bailey Direct TE, p. 6.
[65] Based on the data supplied by Berry TE on Cross-Examination, July 2, 2013, VTE at 16:00 [confidential session]; provided as reference only, BREC's generating capacity to meet native load could be adequately addressed.

several iterations of plans to idle one or more generation units. In his direct testimony, company witness Berry stated that the company's 2013 budget called for the Wilson plant to be idled.[66] However, the company's most recent statement is that instead, it intends to run Wilson and idle the three (3) Coleman generation units.[67]

Moreover, BREC's plans for idling of generation units calls for the longer-term "mothballed" status.[68] This status is designed to insure that idled plants do not appreciably age or degrade while idled.[69] Additionally, the company acknowledged that it would take approximately 43 days to restore a unit from mothballed status, a procedure which would cost at least $1.470 million.[70] Thus, BREC obviously intends that one or more generating units will be idled for very extensive periods, and will not be able to return to active status without extensive work. These facts are reflected in the current financial model, which assumes that the units to be mothballed will remain so until 2019.[71] Finally, the fact that the company has now disclosed that one or both plants are for sale is certainly a strong indication that the to-be-idled plant[s] are not "used or useful."

Unfortunately, though, the situation has become even more complex because it turns out Coleman *may* actually run under a MISO-imposed System Support Resource ["SSR"] constraint in order for BREC/Kenergy to provide 482 MW of market-priced

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[66] Berry Direct TE, p. 22.
[67] Richert Rebuttal TE, p. 15.
[68] See BREC Response to PSC 2-21(e). Big Rivers indicated that in IEEE Std. 762-2006, there are three identified deactivated shutdown states. Of those, BREC states that it intends to utilize what this standard terms the "mothballed" status, meaning a "state where unit is unavailable for service, but can be brought back into service with the appropriate amount of notification, typically weeks or months."
[69] Holloway Direct TE, p. 33.
[70] BREC Response to AG 1-111.
[71] BREC Response to PSC 2-21(c).

power to Century's Hawesville smelter.[72] Although Big Rivers has attempted to assure the Commission that if Coleman is required to operate in order to satisfy any MISO reliability mandate, that Century will pay all costs of running the Coleman plant, one thing is certain: *Century's departure from the BREC system will leave the company's ratepayers with the bill for major* ***stranded costs*** *which they will be paying for many years to come.* Additionally, the agreements by which Century would be allowed to access market-priced power, as contemplated in Case No. 2013-00221, in fact will not cover all the Coleman-related costs, and BREC's ratepayers will be left holding the bag for the heavy cost burden of depreciation and related interest expenses associated with the Coleman Station.

A. The Commission and Kentucky Courts Have a Long History of Excluding Plant that Is Not "Used or Useful" from Utility Rate Base

Well-settled decisions of the Commission and Kentucky courts leave no doubt that the used or useful test has been, and continues to be a vital part of the statutory "fair, just, and reasonable" ratemaking standard.[73] The strong public policy behind the used and useful doctrine is needed today just as critically as it was in the past, because it provides a stern message to utilities: make certain that the planning processes you employ are sound and transparent, because if you decide to build plant the need for which is uncertain or unproven, the Commission might not allow you to seek recovery from your ratepayers. Absent the used or useful doctrine, utilities are encouraged in bad decision-making.

[72] *See generally, In re: Joint Application of Kenergy Corp. and Big Rivers Electric Corporation for Approval of Contracts and for a Declaratory Order,* Case No. 2013-00221.
[73] *See* KRS 278.030(1).

" . . . [A] customer or consumer should not be required to pay for investments made by the utility which are of no benefit to the consumer. The "used and useful" concept protects against rates based upon such "useless" investments."[74]

In Fern Lake Co. v. Public Service Comm'n, Ky., 357 S.W.2d 701, 704-705 [1962], the Court of Appeals held "excess facilities were not used or useful so as to be a proper factor in establishing a rate base" and that "over-adequate facilities" should be excluded for ratemaking purposes **"as a matter of law**." In *Blue Grass State Telephone Co. v. Public Service Comm'n*, Ky., 382 S.W.2d 81, 82-83 [1964], the Court adjusted the rate base to exclude facilities "not entirely usable."

The rulings of the Commission reflect a similar adoption and implementation of the doctrine of used or useful. In its decision in *In Re Kentucky-American Water Co.*, Case No. 8571 Order (February 17, 1983), the Commission held that ". . . [a] utility's rate base should include only those items of plant that are used and useful, i.e., reasonably necessary to provide adequate and efficient service."[75] In *In Re Kentucky Utilities Co.*, 52 PUR 4th 406, 436 (1983), the Commission excluded investment in a proposed electric generating plant because it "seems doubtful that the investment in Hancock will ever be used and useful for providing service." In *In Re Kentucky Power Co.*, Case No. 8904,[76] the

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[74] *National-Southwire Aluminum Co. v. Big Rivers Elec. Corp.*, Ky. Ct. App., 785 S.W. 503, 518, Wilhoit, J., concurring in part and dissenting in part.

[75] Order dated Feb. 17, 1983, p. 7 *[citing San Diego Land and Town Company V. Jasper, et. al.*, 189 U.S. 439 [1902]]. In Case No. 8571, the Commission found that Kentucky-American had an excess capacity of 6 MGD, that shareholders should share $903,037 of the cost of this excess capacity with the ratepayers, and thus removed that sum from rate base. Id. at 8.

[76] *An Investigation of The Necessity and Usefulness of the Cost Responsibility For the Hanging Rock-Jefferson 765 Kv Transmission Line Under Construction by Kentucky Power Company*, Order Denying Rehearing, dated Sept. 11, 1984, pp. 6-7; *aff'd*, *In Re Kentucky Power*, Case No. 9061, 64 P.U.R. 4th 56, 66 (1984), Order dated Dec. 4, 1984.

Commission excluded the cost of transmission ". . . facilities greatly in excess of jurisdictional needs constructed to meet the needs of non-jurisdictional customers." In In Re Kentucky Power Co., Case No. 8734 [56 PUR 4th 151, 156, Order dated September 20, 1983], the Commission excluded property not needed for nine years, in which the system had a 43% reserve capacity.

The Commission has also considered matters of fairness in its analysis of the used or useful doctrine. In In Re South Central Bell Telephone Co., Case No. 9160, Order (May 2, 1985) at 16, the Commission held "it unfair to require Bell's ratepayers to pay a current cash return on a plant not used and useful "because that would not match cost and benefit." Finally, the Commission applied Fern Lake, supra, to disallow Louisville Gas and Electric ["LG&E"] rate recovery of 25% of its interest in the Trimble County generating station. *See* In re: A Formal Review of the Current Status of Trimble County Unit No. 1, Case No. 9934, Order (July 1, 1988) at 33]. Therefore, the history of the application of the used or useful doctrine in Kentucky jurisprudence and the regulatory precedent of the Commission clearly favor exclusion of plant that is not used or useful.

B. The Kentucky PSC's Historical Application of "Used or Useful" Regarding BREC Offers Clear Precedent, Which Should Be Afforded Deference.

Big Rivers' system is likely unique in that most of its system was built to serve the two smelters.[77] In 1977, a company-sponsored study predicted capacity shortages of 274 MW in 1986, increasing to 597 MW by 1991.[78] In 1980, Big Rivers obtained a certificate of public convenience and necessity ["CPCN"] from the Commission to build

[77] *See, e.g.*, Bailey Rebuttal TE, p. 6, lines 11-12.
[78] Case No. 9613, Order (March 17, 1987) p. 5.

two coal-fired units named Wilson units I and II.[79] However, a new load study in 1980 showed that system growth would only be one-third of the earlier projection, so the company suspended and ultimately cancelled construction of Wilson II.[80] However, BREC decided to continue construction of Wilson I based primarily on information that the Sebree smelter would add another pot line, although the company was still facing reduced demand.[81] In 1982-83, world aluminum prices fell significantly, which led both smelters to shut-down one pot line. Although prices rebounded in late 1983, they fell again in 1984. In an attempt to mitigate the rate-shock that would result from bringing Wilson's approximate $900 million cost into rate base, BREC in 1984 sought to enter into a sale-leaseback of Wilson, but that plan failed.[82] As a result, BREC in April, 1984 filed a rate case [the first rate case in which BREC attempted to include the costs of the now-operating Wilson plant into rate base],[83] only to voluntarily withdraw it a short time later, after the smelters asserted that any rate increase would jeopardize their continued operations.[84] However, within that same year BREC had filed yet another rate case,[85] but elected not to include any of the Wilson costs.[86]

By November of 1984, the Rural Electrification Administration ["REA" now reorganized into RUS] refused to advance any additional funds that had been

[79] Case No. 7557.
[80] Case No. 9613, Order (March 17, 1987) p. 7. At that time, evidence indicated Big Rivers was experiencing rapid erosion of its rural demand, so the company focused primarily on industrial demand. *Id.* at pp. 34-35.
[81] *Id.* The forecast upon which BREC relied also apparently indicated there was potential for new industrial load, but no firm commitments were made. *Id.* at pp. 33, 35.
[82] Id.
[83] Case No. 9006.
[84] Case No. 9613, Order (March 17, 1987) at 8.
[85] Case No. 9163.
[86] Case No. 9613, Order (March 17, 1987) at 8.

committed toward constructing Wilson. As a result, BREC filed suit against REA, but continued work on Wilson using internally-generated funds. In January 1985, REA notified BREC that it was in default, demanded full payment of BREC's $1.1 billion debt, and instituted a foreclosure action against BREC.[87] Later that year, National Southwire filed a complaint case[88] in which it sought decreased rates, while BREC filed yet another case for a rate increase. These latter two cases were combined into Case No. 9613.

The hearing in Case No. 9613 lasted three (3) weeks. The PSC again refused to allow the costs of Wilson I into rate base. Instead, the Commission made recommendations which included the possible sale of Wilson or write-down of related debt. Prior to the hearing in Case No. 9613, BREC had negotiated a debt restructuring that became known as "the Workout," which included reducing amounts of debt service, providing rates that would allow the smelters to stay in operation, and settling litigation in U.S. District Court between the REA and BREC.

At some time later during the course of the same matter, the creditors rejected the Workout.[89] Based on that development, the Commission on March 17, 1987 denied the rate relief BREC sought in 9613, finding BREC had not met its burden, and simultaneously instituted Case No. 9885 to investigate BREC's rates. The PSC's order in

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[87] *Id.* at 9.

[88] Case No. 9437.

[89] Testimony filed by at least some of the intervenors in Case No. 9613 indicated that BREC's forecasts for off-system sales, as found in BREC's response to National-Southwire 2-281, were overly optimistic when compared with historical results. Quite significantly, however, witnesses for the REA [*n/k/a* "Rural Utility Service," or "RUS"] testified that BREC's projections were not only prudent, but even greater off-system sales levels could be achieved. Case No. 9613, Order (March 17, 1987) at pp. 24-26.

that case, dated Aug. 10, 1987 set rates to pay Wilson-related debt service but didn't address over-capacity or "used or useful." The PSC then ordered BREC to negotiate a variable aluminum rate with the smelters, and to revise the debt restructuring plan with its creditors. Those negotiations broke down. Moreover, the smelters also did not agree to the Workout settlement BREC had reached with its creditors. The Smelters filed an appeal, which eventually led to the *National-Southwire* Court of Appeals ruling.[90]

As the PSC noted in its March 17, 1987 Order in Case No. 9613:

> "This overwhelming dependence on two huge customers creates a tremendous risk for the utility. If the aluminum industry goes sour, the result for Big Rivers and its 75,000 customers will be catastrophic. **When the aluminum industry entered a deep recession** beginning in 1983, Big Rivers found itself in a nightmarish position. To add to its misery, the utility's remaining load growth had leveled off, the prospect of a synthetic fuels industry had evaporated, and the $900 million Wilson Unit No. 1 was nearly completed. **Big Rivers was paying the price for being basically a one-industry utility**."[91] [Emphasis added.]

Clearly, the on-again/ off-again attempts at including the Wilson unit's costs into BREC's rate base were problematic from the very outset, primarily because it led to over-capacity.[92] Sadly, it appears that history is repeating itself in the instant case: the

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[90] *National-Southwire Aluminum Co. v. Big Rivers Elec. Corp.*, Ky Ct. App., 785 S.W.2d 503 [1990], and supra at note 75.

[91] Case No. 9613, Order (March 17, 1987) at pp. 13-14.

[92] As complex as the situation was, it became even more complex with the news that Big Rivers' ex-general manager William Thorpe had throughout this time frame been taking illegal kickbacks from certain coal suppliers. The criminal fraud perpetrated by Mr. Thorpe played a major role in BREC's troubled history. As set forth in the Franklin Circuit Court judgment [87-CI-0422, Franklin Circuit Court Div. II, dated Aug. 19, 1988] which led to the Court of Appeals ruling in *National-Southwire, supra* , **Thorpe provided the "primary rebuttal testimony"** upon which the PSC relied to counter the argument the smelters made that bringing Wilson's costs into BREC's rate base was imprudent and unnecessary [87-CI-0422 Judgment, p. 13]. Clearly, Thorpe was also advising BREC's then-Board of Directors regarding vital decisions such as whether to build Wilson, and whether and when to seek inclusion of its costs in rate base. In hindsight, Thorpe's self-serving advice and testimony, upon which Big Rivers

aluminum industry has been in prolonged recession, so bad in fact that Big Rivers is now paying the full price for being an industry-dependent utility, to wit, the complete termination of the relationship between BREC and the smelters.

The tentative "Workout" plan developed between BREC and its creditors also came under the Commission's sharp scrutiny in Case No. 9613. The Commission noted that the plan:

> " . . . was thus achieved by merely **deferring present financial obligations to future periods** and thereby committing Big Rivers' ratepayers to two projected rate increases, in 1989 and 1991, and **an indeterminable number thereafter**. Rather than provide a workable solution, the plan would **intensify the climate of uncertainty**. The result would very likely be a severe erosion in the economic base -- including the aluminum industry that supports the Big Rivers system. This would be a disastrous result not only for Big Rivers and its customers, but also for its creditors." [93] [Emphasis added.]

By employing a strategy in the instant case of simultaneous pancaked rate cases, with the probability of an indeterminable number of more rate cases thereafter in an attempt to deal with a reserve margin that has grown unacceptably large, it appears BREC is headed down a similar path. This trajectory, if permitted to continue, would not only extend BREC's current woes, but could indeed set off a death-spiral in the event one or more of its remaining large industrial customers should leave the system. Moreover, the fact that the company "...did not give consideration to customer consumption changes that may result from the specific rate increase proposed in this

Board, the PSC, and Kentucky's Courts all relied without knowledge, was not in the best interests of and was ultimately detrimental to the company and all parties. While this past history did not involve any of Big Rivers' current leadership, it cannot not be ignored in consideration of an overall assessment of the used or useful doctrine in the context of this matter.

[93] *Id.* at pp. 16-17.

case," [or price elasticity of demand] [94] also makes decreased demand much more certain, all at a time when BREC can least afford it.

The Commission in Case No. 9613 also had very favorable comments on the Kansas Corporation Commission's ruling regarding the debt restructuring plan of Sunflower Electric Cooperative,[95] another financially troubled generation and transmission co-op that attempted to remedy its problems through rate increases. The Kentucky PSC noted that although Sunflower and BREC have unique characteristics, nonetheless there were "striking similarities between the two."[96] Accordingly, the PSC did not endorse the Sunflower plan in its entirety, but still noted:

> ". . . [T]he Sunflower plan, **by not requiring immediate rate increases and not guaranteeing full recovery of debt,** presents a more equitable balancing of interests. Further, the severe economic condition of the aluminum industry and Big Rivers' unique load configuration place Big Rivers in a financial position similar to that which nearly led to Sunflower's collapse."[97] [Emphasis added.]

As a result of its concerns over the proposed "Workout," the PSC ordered BREC to: (a) negotiate a revised workout plan with its creditors similar to the one approved by the REA in the Sunflower Electric Cooperative case; (b) to negotiate a variable rate for the smelters based on world aluminum prices; and (c) to meet with the Attorney General and other interested parties to explain the negotiations and discuss how the

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[94] BREC response to KIUC 1-35; *see also* Brevitz Direct TE, pp. 39-40.
[95] *In the Matter of the Application of Sunflower Electric Cooperative, Inc., for approval of the State Corporation Commission to Make Certain Changes in its Charges for Sale of Electricity to its Member Cooperatives*; Docket No. 143,069-U, Order [April 2, 1985]; a copy of the complete final order in this case is attached to the testimony of David Brevitz, as Exhibit DB-3.
[96] Case No. 9613, Order (March 17, 1987) at 31-32.
[97] *Id.* at 32.

interests of the non-smelter customers are being protected.[98] In the instant case, BREC has expressed what can only be described as some sort of lender-phobia, stating that it has absolutely no intentions of meeting with them, and indeed "fears" meeting them.[99] Additionally, although extensive negotiations were held between BREC and the smelters last year, those parties never invited the Attorney General, nor any other interested parties, to discuss how the interests of the non-smelter customers would be protected.

Quite significantly, ***the PSC in Case No. 9613 refused to agree with BREC and its creditors in their pursuit of a continuous base rate case solution*** [in other words, making the ratepayers bear all of the risk of company's problems]:

> **We emphatically reject** the claim of REA, the banks, and Big Rivers that the **members of the cooperative ultimately bear the total risk and responsibility for the utility's debts.** The distribution cooperatives and their members do not stand in the same position as shareholders of an investor-owned company. **The REA**, with its oversight and monitoring responsibility, **bears a substantial amount of the risk associated with Big Rivers' actions.** The creditor banks are compensated for the risks they take. Cooperative members must shoulder a portion of the risk, too, since they have a say in the affairs of the utility. Nor are the aluminum companies exempt from responsibility. [100] [Emphasis added.]

The PSC correctly, and courageously, moved down a path of placing at least some of the risk where it belonged: on BREC's lenders, who were well-aware of the great degree of risk BREC took upon itself when it became a utility primarily geared toward serving two individual loads, which together comprised approximately 70% of

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[98] Case No. 9613, Order (March 17, 1987) at 17-18.
[99] Bailey TE on Cross-Examination, July 1, 2013 VTE beginning at 12:02:30; and at 13:15:40, 13:15:50 ["Fear going to creditors"], and 13:18:50.
[100] *Id.* at 19.

its total load. BREC's ratepayers are truly captive to management decisions, and have no alternatives. As the PSC noted in Case No. 9613, ". . . BREC's ratepayers, unlike shareholders in investor-owned utility, do not vote their stock in proportion to their economic interest, nor could they sell their stock if they disagreed with management decisions."[101]

Despite the fact that BREC, during the last thirty (30)years has not been able to diversify its load, the lenders continued to provide access to capital. As noted above, the lenders in fact continued to provide BREC with access to capital despite BREC's disclosure statement which made it abundantly clear that the smelters' departure from the BREC system was imminent.[102] Clearly, BREC's creditors by continuing to provide capital served to only deepen the co-dependent relationship between BREC and the smelters, one which they knew was headed toward a day of reckoning.

In reviewing the law and precedents applicable to the used or useful doctrine, the Commission in Case No. 9613 made particular note of the Kentucky Court of Appeals ruling in *Fern Lake, supra*. In affirming the Commission's decision, the Court of Appeals noted:

> "[T]here was also evidence that since this water system was designed to serve an expected population far greater than the number of customers it has ever had, its facilities are far in excess of those needed; and hence the excess facilities are not used or useful so as to be a proper factor in establishing a rate base. . . . Furthermore, as a matter of law, we believe the Commission properly refused to include the cost of over-adequate facilities in the rate base." *Fern Lake, supra* at 704-705.

[101] *Id.* at 30.

[102] *See* BREC Disclosure Statement, dated July 12, 2012, provided in response to KIUC 1-9 in Case No. 2012-00492, pp. 295-405[pp. 39-40 of the actual Disclosure Statement]. *See also* July 2, 2013 VTE beginning at approximately 10:43:28.

The Commission correctly found in Case No. 9613 that in balancing the interests to determine fair, just and reasonable rates, the used or useful doctrine can be applied in full measure to Big Rivers, as a generation co-op.[103] The PSC also noted that it could not impose a "mechanical application" of the used or useful doctrine, and that the analysis of determining the need for facilities [and hence whether to include them in rate base] should include several factors, including: (a) whether they are used or useful; (b) the need for improved reliability; (c) the system's load characteristics; [d] the potential for growth of both system load and load factor; (e) and other relevant economic and engineering factors.[104] Finally, the analysis includes an allocation of risk.[105]

In the instant case, the record establishes that any plant(s) BREC chooses to idle: (a) will not be used or useful, by definition and as demonstrated by BREC's own actions; (b) the plants to be idled are not needed for system reliability; (c) there is nothing inherent in the BREC system's load characteristics that indicates the mothballed plant(s) are necessary for the foreseeable future; and (d) no other economic or engineering factors indicate the mothballed plant(s) should be included in rate base. Simply stated, the record is devoid of any indication, other than the opinions of management based solely on their own Load Mitigation and Replacement Plan, that there is any committed potential for load replacement at any time in the next several years.

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[103] *Id.* at 39 [Explaining distinction between co-op and industry-owned utility ["IOU"], but applying used or useful doctrine in parallel fashion, even though a co-op lacks shareholders].
[104] *Id.* at 38.
[105] *Id.* at 39.

At the time of the May 17, 1987 order in Case No. 9613, the Commission first wanted to give the parties time to develop a new Workout plan based on variable smelter rates tied to world aluminum prices.[106] In addition, the Commission offered guidelines for a revised workout, most of which remain relevant even to this date, to wit:

> 1. . . . . [A] good starting point for negotiation is the Sunflower Electric cooperative Debt Restructure Plan. **Recognizing the disturbing lack of load diversity and Big Rivers' dependence upon a sluggish aluminum industry, provisions similar to the Sunflower Plan which are not contingent upon an immediate rate increase and guaranteed full repayment of debt are desirable**;
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> 2. The immediate and primary source for debt service is off-system sales. Therefore, an agreement on off-system sales should be used in calculating any schedule of debt repayment. **Big Rivers' ratepayers should not have unlimited responsibility for the payment of Big Rivers' debt. Furthermore, they should not be required to provide all the revenues required to offset shortfalls arising from insufficient off-system sales**;
>
> 3. **The interests of all affected parties must be considered: rural consumers, industrial customers and creditors**. **Big Rivers should meet with the creditors to negotiate a revised workout plan**. Big Rivers and the aluminum companies should negotiate a flexible rate-plan that recognizes the cyclical nature of the industry and the revenue requirements of the utility. Big Rivers, the Attorney General, and other interested parties should meet to discuss the negotiation and determine how the interests of customers other than NSA and Alcan can best be protected;
>
> 4. While the Commission expects and the public interest requires that all participants negotiate expeditiously and in good faith, the Commission will make the ultimate decision as to a reasonable long-term solution and no participant will have a veto. The Commission wishes to see the results of negotiations within the time frame established herein;
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> 5. **The payment of Big Rivers' obligations to its creditors should take into consideration longer terms, reduced interest rates, deferral of**

[106] Case No. 9613, Order (March 17, 1987) at 42.

principal and interest payments, preferred stock options, payments tied to off-system sales, and reduction of principal;

> 6. **Consideration should be given to sale or disposal of Wilson to another entity or through establishment of a generating subsidiary as a possible long-term solution**;
>
> 7. The plan should include well documented projections of system and off-system sales and cash flow over both the short and long term. **Documentation should include a thorough explanation of all assumptions, reasonable specificity of targets, and detailed work papers supporting the long and short run cash flow projections**; . . . .
>
> 9. Priority of disbursements with regard to principal and interest should be clearly established. . . . [Emphasis added.][107]

Quite remarkably, these eight (8) points taken together should, in the Attorney General's opinion, comprise a basic groundwork for developing a similar plan to deal with the issues facing BREC and its ratepayers in the immediate rate case, as follows:

1. BREC must meet with its creditors to establish a Workout Plan;
2. BREC's creditors should not be allowed to escape the significant risk they bear in agreeing to continually make major loans to the utility, despite knowing that the smelters' departure was inevitable and was approaching very rapidly; accordingly, the creditors should agree to negotiate with BREC;
3. BREC's sluggish OSS should be dealt with by removing plant which is not used or useful from the company's rate base;
4. The payment of Big Rivers' obligations to its creditors should take into consideration longer terms, reduced interest rates, deferral of principal and interest payments, payments tied to off-system sales, and reduction of principal;
5. The company should continue to consider sale or disposal of Wilson and/or such additional plant as may be necessary, or alternatively, consider establishing a generating subsidiary as a possible long-term solution; and

[107] *Id.* at 43-45.

6. Unlike the projections set forth in the current financial and production cost models, the new Workout Plan should be based on well-documented projections of system and off-system sales, and cash flow over both the short and long term. Documentation should include a thorough explanation of all assumptions, reasonable specificity of targets, and detailed work papers supporting the long and short run cash flow projections together with manuals completely illustrating how the models were constructed, and their inputs and outputs.

In the final analysis, the PSC in its March 17, 1987 Order in Case No. 9613 put-off for a later date any decision on whether to include the Wilson plant's costs into rate base, and simultaneously initiated [on its own motion] an investigation into BREC's rates. *See* Case No. 9885. In that case, the PSC noted that REA, ". . . had already made significant concessions in the current workout proposal. It has agreed to a variable power rate, clarified uncertainties about future rate requests, provided longer terms for repayment, a lower interest rate, and a deferral of certain principal and interest payments."*Id.* at 29.

In Case No. 9885, the PSC noted that in Case No. 9613, it rejected:

> "a mechanical application of the used and useful standard as the sole determinant of whether the Wilson station would be included in rates. . . . [T]he Commission is under no statutory obligation to apply a used and useful standard exclusively, or any other single, rigid standard." [108]

The PSC found further support for its ruling in *Federal Power Comm'n v. Hope Nat. Gas Co.*, 320 U.S. 575 (1944), which stated in pertinent part:

> "The Constitution does not bind rate-making bodies to the service of any single formula or combination of formulas. Agencies to whom this legislative power has been delegated are free, within the ambit of their statutory

[108] Case No. 9885, Order dated Aug. 10, 1987, p. 8.

authority, to make pragmatic adjustments which may be called for by particular circumstances."[109]

The PSC concluded, in Case No. 9885, that the Revised Workout Plan it developed, which included variable smelter rates based on world aluminum prices, represented a fair and just resolution and provided fair rates to its customers.[110]

However, BREC's problems were far from over, and the new Workout Plan the PSC developed in Case No. 9885 would be contested. The smelters appeal of the PSC's final order in that case, claimed, *inter alia,* that the PSC should have applied the used or useful doctrine to exclude the Wilson plant's costs from rate base. That appeal eventually came before the Court of Appeals in *National-Southwire Aluminum Co. v. Big Rivers Elec. Corp.,* 785 S.W.2d 503 (Ky. App. 1990). In *National-Southwire, supra,* the Court of Appeals upheld, *inter alia,* the PSC's ruling in Case No. 9885 which refused to apply the used or useful doctrine in a "mechanical application." However, the Court also made the following key observations:

(a) "[T]he PSC did not totally ignore the used and useful concept in this case. It simply refused to apply it in as strict a manner as requested by the aluminum companies."[111]

(b) Wilson ***at that time*** was certainly not a "useless" plant. [112]

(c) "[I]t would be more appropriate for the PSC to first determine a value for a utility before setting a rate for recovery of the investment plus operating costs,

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[109] *Id.,* 320 U.S. at 586.
[110] Case No. 9885, Order dated Aug. 10, 1987, p. 10. In so ruling, the PSC also noted that BREC's rates had not been raised since 1981. *Id.* at 10-11.
[111] *National-Southwire* at 513.
[112] *Id.* The Court specifically found that Wilson enabled Big Rivers "to provide continuous uninterrupted service and to be ready to make available on demand enormous amounts of energy" to the smelters. Id. at 515.

and the value should not include any unreasonable, useless excesses to be borne by the consumers."[113]

(d) Although the Court was satisfied with the result the PSC reached and affirmed it, nonetheless "it would be good to see more clear concern for the consumer, a clearer burden of proof on the producer to show that the excess capacity was a prudent investment, and a clear finding of just how much excess exists."[114]

(e) Finally, the Court found that "it appears to be part of our public policy to insure that utility consumers do not pay unreasonable rates and that utilities do not make unreasonable expansions."[115]

Therefore, it is abundantly clear that the used or useful doctrine is still viable under Kentucky law. Moreover, its application in the instant case is even more warranted than in Case Nos. 9613 and 9885, because BREC now proposes to "lay-up" two generating plants [in the Century and Alcan rate filings, viewed transparently] **for as long as five (5) years**. Unlike the situation in the prior cases, Wilson and Coleman will indeed become "useless" and the costs of those plants should clearly not be borne by ratepayers. The Attorney General advocates that the Commission again demonstrate its clear concern for consumers by exercising its statutory authority to disallow plant that is neither used nor useful.

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[113] *Id.*
[114] *Id.* at 513-514.
[115] *Id.* at 510.

C. The Commission Has the Statutory Authority to Determine Value of Utility Plant in Connection with Rates

The Commission has the statutory authority, pursuant to KRS 278.290, to determine the amount of excess plant and capacity that exists. As noted by the Court of Appeals in *National-Southwire,* KRS 278.290 is applicable in determining what constitutes a fair, just and reasonable rate. [116] Indeed, it is through this statute that the Commission determines the value of a utility's used or useful plant to be included in rate base.

The Commission's own precedent recognizes this authority. The Commission in Case No. 9613 noted that in order to establish rates that are fair, just and reasonable, the Commission must: (a) determine the appropriate level of operating expenses; (b) fix a value on the utility's property; and (c) in the case of a co-op such as BREC, establish a time interest earned ration ["TIER"] to allow payment of interest and principle.[117] The Kentucky Public Service Commission has all the authority it needs to exclude utility plant that is not used or useful from a utility's rate base. KRS 278.290 provides, in pertinent part:

> "(1) Subject to the provisions of subsection (2) of this section, the commission may ascertain and fix the value of the whole or any part of the property of any utility in so far as the value is material to the exercise of the jurisdiction of the commission . . . . In fixing the value of any property under this subsection, the commission shall give due consideration to the history and development of the utility and its property. . . and other elements of value recognized by the law of the land for rate-making purposes.

[116] *National-Southwire, supra* at 512-513.
[117] Case No. 9613, Order (March 17, 1987) at 38.

(2) The commission shall not value or revalue the property of any utility unless the valuation or revaluation is necessary or advisable in order to determine the legality or reasonableness of any rate or service . . . ." [Emphasis added.]

The value of the Wilson and/or Coleman plants that are to be idled can be readily determined from Big Rivers' application and its responses to data requests. The Attorney General urges the Commission in this particular case to exclude the value of all plant in BREC's system that is no longer used or useful, unless or until such time as it returns to being used or useful.

D. Federal Case Law Provides that RUS Cannot Preempt the Commission's Ratemaking Authority

One month following the Commission's March 17, 1987 Order in Case No. 9613, the REA stated that it was placing an embargo on all loans to Kentucky-based electric and telephone cooperatives. In pleadings filed with the PSC, both BREC's then-CEO and an REA representative testified that the Commission was required to increase rates to permit payment of Wilson costs without regard to whether Wilson was needed to serve Big Rivers' ratepayers. In short, they argued that under *Arkansas Electric Coop. Corp. v. Arkansas Public Service Comm'n*, 461 U.S. 375 (1983), when considered together with *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591 (1944), the REA was allowed to preempt the PSC's ratemaking authority.

Virtually simultaneously with the proceedings that led up to an included Case No. 9613, rulings in other cases pending before Federal District Courts in Indiana,

which also involved the "used or useful" doctrine, would conclusively establish that REA's argument was patently incorrect.

In Wabash Valley Power Ass'n, Inc. v. Rural Electrification Admin., 713 F. Supp. 1260 (S.D. Ind. 1989) (*aff'd*, 903 F.2d 445) (7th Cir. 1990), ruled that the REA lacked statutory authority to preempt the ratemaking authority of the then-Indiana Public Service Commission.[118] The Wabash Valley Power Association ["Wabash"] was an Indiana not-for-profit electricity G & T cooperative which provided wholesale electric service to 24 members. From 1978 through 1984, Wabash borrowed approximately $480 million to finance Wabash's 17% interest in the now-infamous nuclear generator at Marble Hill, to be constructed by Public Service Company of Indiana. REA guaranteed these loans, securing them with mortgages on virtually all of Wabash's assets, including power supply contracts with Wabash's members.[119]

In January 1984, Public Service Company abandoned the nuclear project at Marble Hill. In April 1984, at the behest of REA, Wabash sought approval of a 51% rate increase from the Indiana Public Service Commission [now the Utility Regulatory Commission], primarily to pay for its Marble Hill debts. On instructions from the REA, Wabash argued in its rate proceeding that in the case of a co-op such as Wabash, the members are risk-bearers in the same sense as the investors in a for-profit firm.[120] The Indiana Public Service Commission disagreed, and applied the used-and-useful rule

[118] *Id.* at 1266.
[119] *Id.* at 1262.
[120] 903 F.2d at 450.

across the board.[121] The REA appealed that ruling, which was affirmed by both the Indiana Court of Appeals[122] and the Indiana Supreme Court.[123] The majority opinion of that state's Supreme Court reasoned that because co-ops were established to "provide low cost electricity to rural areas," rates should not be allowed to rise even when the owner-members are responsible for the costly blunder.[124] Because "[a] utility may impose a charge on its ratepayers only for service," and Marble Hill provides none, "any charge purportedly imposed for service would have been inappropriate here."[125]

In February, 1989 Wabash filed its declaratory judgment action with the Southern District of Indiana seeking a ruling that REA lacked authority to peremptorily regulate its rates.[126] The district court in Wabash, *supra*, reviewed the Supreme Court's holding in *Arkansas*, *supra*, which held that that a state could regulate the wholesale rates of a rural nonprofit electric cooperative and that a state utility commission's assertion of jurisdiction over such rates was not preempted by federal law.[127] In particular, the Supreme Court declared: "Nothing in the Rural Electrification Act expressly pre-empts state rate regulation of power cooperatives financed by the REA[,]" and noted, "[T]he REA is a lending agency rather than a classic public utility regulatory body...." [128] The district court further noted:

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[121] *Id., citing In re Wabash Valley Power Association, Inc.*, Case No. 37472 (Jan. 14, 1987).
[122] *CFC v. Public Service Commission of Indiana*, 528 N.E.2d 95 (Ind. App. 3d Dist. 1988).
[123] 552 N.E.2d 23 (Ind. 1990).
[124] *Id.* at 27.
[125] *Id.* at 28. Further, the Indiana Supreme Court's decision upholding the PSC was made in the factual context of a voluntary Chapter 11 bankruptcy proceeding. *See In re Wabash Valley Power Ass'n*, 77 B.R. 991 (S.D.Ind.1987). .
[126] 713 F. Supp. at 1263, *supra.*
[127] *Arkansas*, 461 U.S. at 396, 103 S.Ct. at 1918, 76 L.Ed.2d at 18.
[128] *Id.* at 385–86, 103 S.Ct. at 1913, 76 L.Ed.2d at 11.

"[S]tating, as the Court did in Arkansas, that a particular state rate decision may be preempted is a far cry from saying a federal agency dissatisfied with a state decision may, by letter, usurp state regulation and create for itself authority it does not otherwise have. REA has pointed to nothing in the Rural Electrification Act that gives it this authority. Moreover, as the Supreme Court noted, Congress designed REA to be a lending agency, not a federal regulatory body." Arkansas, 461 U.S. at 386, 103 S.Ct. at 1913, 76 L.Ed.2d at 11.

In a separate but related case between the same parties, the Seventh Circuit Court of Appeals invalidated two REA regulations by which the agency attempted to assert jurisdiction over utility ratemaking in the event of a utility bankruptcy. *Wabash Valley Power Ass'n v. Rural Elec. Admin.*, 988 F.2d 1480 (7th Cir. 1993). In that ruling, the court noted:

"As with any other lender, **the REA assumes the business risk of advancing money** to a specific organization, the risk that the organization will not be able to repay. Given the history and function of the RE Act, **the scope of this risk incorporates the possibility that state regulation may occasionally impede the ability of power supply cooperatives to repay their loans**. One could reasonably argue that the structure and operation of the subsidies provided through the REA reflect a congressional preference **for the government's bearing this risk, rather than cooperative members**. **In any event, it is clear that the REA may not dictate who shall bear the risk because that would amount to the agency conferring power on itself**." Id. at 1491. [Emphasis added.]

At the exact time that the Marble Hill debacle was being litigated and played out in multiple courts, yet another issue regarding "used and useful" utility plant was also being litigated, pertaining to Northern Indiana Public Service Company's [NIPSCO] application for a rate increase to cover the expense of its abandoned Bailly N–1 nuclear plant. Although the Indiana PSC initially granted that request,

the Indiana Court of Appeals reversed it,[129] concluding that unless an investment is "used and useful" the utility is not entitled to a return on its investment.

In a similar case, Duquesne Light Co. v. Barasch, 109 S.Ct. 609, 615–620 (1989), the Court held that nothing in *Hope* or the Constitution itself precludes a state from applying the used and useful principle to prevent a utility from recovering its investment in unneeded plant. This was later held to be the case even where application of this principle ultimately resulted in the utility's bankruptcy. In Re Public Service Co., 539 A.2d 263 (N.H. 1988) (appeal dismissed, no federal question, 488 U.S. 1035 (1989)).[130]

Therefore, nothing in *Hope* or its progeny allow the RUS to preempt the Kentucky PSC's ratemaking authority. Moreover, nothing in those rulings require the PSC to restore BREC's financial integrity by including the costs of two generating plants that are not "used or useful" in rates to be paid by consumers.[131]

V. Sudden Elimination of Rural Class Subsidy Does Not Comport with Gradualism

As set forth in the Commission's November 17, 2011 Order in Case No. 2011-00036, the company-sponsored twelve (12) coincident peak cost of service study

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[129] *Citizens Action Coalition v. NIPSCO*, N.E.2d 938 [Ind. App. 1984]; *opinion vacated but aff'd* in 485 N.E.2d 610 [Ind.1985][*cert. den.* 476 U.S. 1137 [1986]].

[130] In the bankruptcy of Cajun Electric Power Cooperative, Inc., the Louisiana Public Service Comm'n and the RUS disputed each other's authority to regulate the utility's rates. Ultimately, the PSC won that issue. *See generally "Chapter 11 Reorganization of Utility Companies,"* Energy Law Journal, Vol. 22 at 277, 286 [KIUC Hearing Exhibit presented July 2, 2013, VTE beg. approx. 12:25, but cited herein as legal authority upon which the Commission may take administrative notice..

[131] *See, e.g., Market St. Ry. Co. v. Railroad Comm'n of State of Cal.*, 324 U.S. 548, 566, 65 S.Ct. at 770, 779 [1945]["it was noted in the Hope Natural Gas case that regulation does not assure that the regulated business make a profit"; *Id.* at 65 S.Ct. 779, *citing Hope*, 320 U.S. at 603, 64 S.Ct. at 288, 88 L.Ed. 333].

["COSS"] indicated that the rural class was receiving a subsidy of $11.1 million.[132] In that case, BREC advocated a reduction in that subsidy of $1.9 million, as opposed to the KIUC position of totally eliminating the subsidy.[133] The Commission ruled that eliminating the complete subsidy:

> ". . . would be inconsistent with our **long-standing practice of employing the principle of gradualism** in moving toward cost-of-service-based rates. Considering the amount of the Rural subsidy, moving to cost-of-service-based rates for all classes **is a goal to be achieved gradually**, in incremental steps."[134] [Emphasis added]

In that case, the Commission concluded that the subsidy should be reduced by $2.4 million, [135] and upheld that position on rehearing.[136]

In the instant case, BREC is proposing a complete elimination of the rural class subsidy, which is a complete reversal of its position in Case No, 2011-00036. In fact, BREC's CEO testified that the offer to eliminate the rural subsidy was made during negotiations with Alcan, in an attempt to appease Alcan to convince it to remain on the BREC system.[137] Given the unprecedented rate increase which BREC proposes to pass on in both this case and Case No. 2013-00199, the Attorney General strongly opposes BREC's proposal, and instead proposes a reduction in the subsidy by an amount equivalent to the Commission-approved reduction in Case No. 2011-00036.

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[132] Case No. 2011-00036, Order dated Nov. 17, 2011 at p. 24.
[133] KIUC's own six-coincident peak COSS indicated the amount of the rural class subsidy was $18.3 mil., which KIUC advocated removing in its entirety. *Id.* at 25.
[134] *Id.* at 30.
[135] *Id.*
[136] Case No. 2011-00036, Order on Rehearing dated Jan. 29, 2013, p. 21.
[137] July 1, 2013 VTE, 16:15:20 – 16:17:10.

VI. The Commission Should Allow Use of Reserve Funds, But Only to Support BREC's Immediate Reduction of Excess Scale

The Commission's creation of the reserve funds, including the Economic Reserve and the Rural Economic Reserve, were specific commitments required of Big Rivers to protect non-smelter ratepayers against risks recognized in the Unwind transaction. The Attorney General has advocated that these funds should be maintained and used in the spirit that they were created. In this proceeding, the Attorney General's expert witness provided the following recommendation: "BREC should not dissipate reserve funds during pursuit of rate increases and replacement load when such an approach cannot generate materially beneficial results for at least 3-4 years. Reserve funds would be best and most appropriately used at this juncture to support a transition while BREC is taking concrete steps to reduce its scale of operation."[138]

The Commission should not adopt BREC's proffered approach of very large rate increases for the remaining 30% of the customer base for an extended period of multiple years while BREC pursues uncertain prospects to utilize or sell two to-be-idled generating plants. In fact, under BREC's approach consumers would be burdened with massive rate increases for an unknown number of years, with very uncertain prospects for later rate reductions. As elicited by Staff Counsel, BREC "would want to make sure revenues are sustainable over a multi-year period"[139] before considering rate reductions. This approach piles uncertainty upon uncertainty such that consumers can have no idea when more normal rate levels may pertain. Finally, generational

[138] Brevitz Direct, page 44, line 13.
[139] Bailey TE on Cross-Examination, July 1, 2013, VTE beginning at 15:58

inequities will compound over time as present consumers pay massive rate increases for the very uncertain benefits to be realized by future ratepayers. During this lengthy period, Big Rivers consumer base will obviously change [e.g. consumers will pass away, change or sell residences, or move out of the BREC service area]. Therefore, not all ratepayers will remain present to realize the deferred and uncertain benefits of BREC's approach of massive rate increases.

BREC's proffered approach will rapidly dissipate the reserve funds without it directly working with its lenders to develop a workout plan to reduce its excess operating scale. In fact, in the Alcan rate case, BREC proposes to *accelerate* use of the reserve funds to temporarily offset rate increases. Under the BREC approach, the Economic Reserve would be depleted one year from now, and the Rural Economic Reserve would be depleted by April 2015.[140] Under BREC's approach, where it "fears" discussions with its lenders, the reserve funds will be dissipated in less than a year and one-half, with no concrete outcome other than the passage of time. The preferable approach is for the Commission to require BREC to engage with its lenders to determine a workout plan which restructures and reduces the scale of its operation. Under that circumstance only it would be reasonable for the Commission to permit accelerated use of reserve funds while there is a focused and serious effort to develop a workout plan to restructure BREC's operations. The reserve funds were intended to be used in the event of departure of the smelters from BREC's system. The thin cushion provided by these reserve funds should not be wasted by BREC's proposed approach.

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[140] Case No. 2013-00199, Bailey Direct TE p. 6, lines 13-18.

BREC indicates it is highly confident in its Mitigation Strategy. BREC's "gut" says it will only take a couple years for the Mitigation Strategy to work.[141] BREC states its "generating assets are very valuable."[142] BREC states that requests for proposals or quotations [RFPs/RFQs) for 1500 MW are outstanding from Kentucky utilities.[143] If this is correct, it should be very apparent to BREC's lenders, and BREC's lenders should therefore be very accommodating of BREC's restructuring efforts. The lenders should take the risk of the work-out associated with restructuring, not the 30% of ratepayers who remain captive to the BREC system.

VII. The Commission Should Reject BREC's Other Dubious Claims to Justify Rate Increases

Certain red herrings asserted by Big Rivers to otherwise justify an unfair, unjust and unreasonable rate increase should be rejected or otherwise disregarded by the Commission. As discussed below, the Attorney General addresses some key flaws in these arguments.

A. Rates should not be Increased for Purposes of Generating Cash to Fund "Economic Development Rates"

BREC appeared to raise a new argument in favor of its proposed rate increases during the hearing. BREC appears to be suggesting that rates should be increased as it proposes so that BREC can generate cash to fund economic development rates.[144] The Commission should reject this argument out of hand, giving it no weight whatsoever.

[141] Bailey TE on Cross-Examination, July 1, 2013, VTE at 16:00:40.
[142] *See, e.g.*, Bailey TE on Cross-Examination, July 1, 2013, VTE, 13:20; and Berry TE on Cross-Examination, July 2, 2013, VTE at 14:43.
[143] Berry TE on Cross-Examination, July 2, 2013, VTE 14:37.
[144] Brevitz TE on Cross-Examination, July 3, 2013, VTE 17:59:30.

It verges on the preposterous that BREC should suggest the door should be opened to increasing rates on the remaining 30% customer base. BREC states it has requested the "bare minimum" rate increase, and that it is in "precarious financial position". It makes no sense whatsoever to saddle remaining consumers with massive rate increases that are designed in part to fund economic development rates, especially given BREC's financial position, and as vague a concept as "economic development rates" are as suggested by BREC literally at the last moment.

B. The Attorney General is in No Way Obliged to Perform "Independent Studies."

BREC attempted to find fault with the intervenors for not having performed their own independent studies of such things as future power prices.[145] Big Rivers carries the statutory burden of proof to demonstrate that the rates it seeks are fair, just and reasonable. *See* KRS 278.190(3). The burden is not upon the intervenors to perform independent studies to stand as an alternate to the Applicant's proposed case. The intervenors analyzed the Application, analyzed the supporting documentation provided by BREC, and found the Application wanting in many respects as amply documented in intervenor testimonies. The Commission should reject any argument out of hand faulting intervenors for not having performed their own independent studies of things which should have been properly addressed by BREC in its Application.

[145] Brevitz TE on Cross-Examination, July 3, 2013, VTE 17:59; Ackerman TE on Cross-Examination, July 3, 2013, VTE 16:35:50.

C. On a Risk/Reward Basis, Benefits from the Unwind Transaction have Been Minimal for Consumers.

BREC maintains the dubious position that the Unwind Transaction resulted in substantial benefits for consumers. If any proof was required that such is not the case, BREC's precarious financial position which has resulted in the filing of the Century and Alcan rate cases demonstrates the falsity of this assertion. The Attorney General will not belabor the point, except to address the obvious fact, which is plain from the record in Case No. 2007-00455 -- that the benefits from the Unwind transaction primarily went to the smelters and the creditors. In particular RUS received large payments to reduce its loan position with BREC. The proffered agreement of the smelters was uncertain from the beginning. BREC "wasn't even sure the smelters would sign after commission approval of the Unwind"[146] at the closing of the Unwind Transaction in New York City. Any benefits consumers may have received from the Unwind Transaction pale in comparison to the risks of that transaction that have become very real before the Commission in this hearing.

CONCLUSION

The Attorney General, on behalf of Big Rivers' ratepayers, opposes the $115.4 million increase sought in this and the successive rate case. While many questions remain unanswered, and the Attorney General's experts continue their analysis of the second pending application, the Attorney General's position, as reflected in this pleading is evident. Big Rivers' management and its lenders should not be permitted to

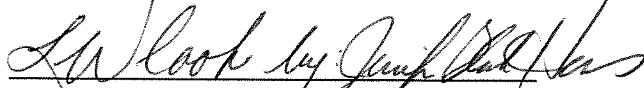
[146] *See* Bailey TE on Cross-Examination, July 1, 2013, VTE 11:36.

escape the significant risks they knew and assumed as a result of the Unwind transaction, which the Attorney General opposed, and subsequent financial decisions. The ratepayers, who are captive to these decisions, should not bear the burden of unfair, unjust and unreasonable rates.

WHEREFORE, the Attorney General asks that the Commision deny Big Rivers' application for a rate increase, as filed in this matter, adopt the balanced and prudent recommendations made by the Attorney General and other intervenors, and enforce its regulatory jurisdiction to ensure fair, just and reasonable rates.

Respectfully submitted,

JACK CONWAY
ATTORNEY GENERAL



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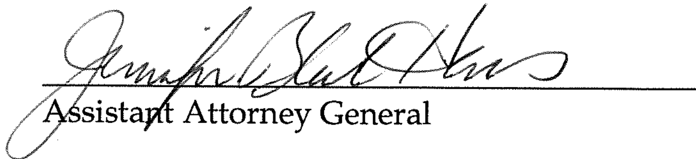

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