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

TELECOPIER (513) 421-2764

RECEIVED
DEC 24 2014
PUBLIC SERVICE
COMMISSION

Via Overnight Mail

December 23, 2014

Mr. Jeff Derouen, Executive Director
Kentucky Public Service Commission
211 Sower Boulevard
Frankfort, Kentucky 40602

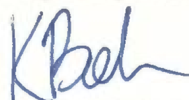
Re: **Case No. 2014-00230**

Dear Mr. Derouen:

Please find enclosed the original and ten (10) copies of the BRIEF OF KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC. for filing in the above-referenced matter.

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

Very Truly Yours,



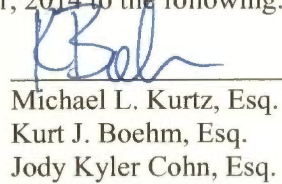
Michael L. Kurtz, Esq.
Kurt J. Boehm, Esq.
Jody Kyler Cohn, Esq.
BOEHM, KURTZ & LOWRY

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

G:\WORK\KIUC\Kenergy - Big Rivers\2014-00230 (FAC)\Derouen Ltr.docx

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing was served by electronic mail (when available) and by regular, U.S. mail, unless other noted, this 23RD day of December, 2014 to the following:



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

Roger Hickman
Regulatory Affairs Manager
Big Rivers Electric Corporation
201 Third Street
P. O. Box 24
Henderson, KY 42420

James M. Miller
Tyson Kamuf
Sullivan, Mountjoy, Stainback & Miller, P.S.C.
100 St. Ann Street
P. 0. Box 727
Owensboro, Kentucky 42302-0727

RECEIVED

DEC 24 2014

PUBLIC SERVICE
COMMISSION

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

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

BRIEF OF
KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC.

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

COUNSEL FOR KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC.

December 23, 2014

TABLE OF CONTENTS

ARGUMENT 2

1. Big Rivers' Allocation Of Above Average Fuel Costs To Native Load And Below Average Fuel Costs To Off-System Sales Is Improper 2

2. Big Rivers' Method Of Allocating System Average Fuel Costs To Both Native Load And Off-System Sales As The FAC Starting Point Is Contrary to FERC Guidance Addressing Fuel Cost Allocation 6

3. Big Rivers Is The Only Kentucky Electric Utility That Allocates System Average Fuel Costs To Both Native Load And Off-System Sales As The FAC Starting Point 7

4. It Is Not A Violation Of The "Matching Principle" For The Commission To Change Big Rivers' Fuel Cost Allocation Methodology Outside Of A General Rate Case 9

5. The Commission Should Require Big Rivers to Refund $2,694,861.00 Million In Improperly Collected Fuel Costs To Kentucky Native Load Customers Plus Interest And To Modify Its Fuel Cost Allocation For FAC Purposes Going Forward 11

CONCLUSION 12

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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

BRIEF OF
KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC.

Kentucky Industrial Utility Customers, Inc. ("KIUC") submits this Brief in support of its recommendations to the Kentucky Public Service Commission ("Commission"). The members of KIUC who are participating in this proceeding are: Aleris International, Inc., Domtar Paper Co., LLC, and Kimberly Clark Corporation. These companies purchase electricity from Big Rivers Electric Corporation ("Big Rivers", "BREC" or "Company") through Kenergy. KIUC's recommendations are set forth below.

I. ARGUMENT

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

Big Rivers begins its monthly Fuel Adjustment Clause ("FAC") process by allocating its system average fuel costs to both native load and off-system sales. This means that the same fuel cost is initially allocated to both native load and off-system sales. Big Rivers explained this methodology in a Data Response to KIUC:

> *"An overall system average fuel cost per kWh is calculated each month by dividing the total cost of fuel used for generation by the net kWh generated (after accounting for line losses) during the current expense month. Fuel costs are allocated to off-system sales by multiplying this overall system average fuel cost per kWh by the off-system sales volumes (kWh)."*[1]

---

[1] BREC Response to KIUC 1-1, page 1.

The following table shows the fuel cost allocated to native load versus off-system sales by Big Rivers in its FAC between November 2013 and April 2014:[2]

Big Rivers Electric Corporation Average Generation Fuel Costs for Native Load and Off-System Sales in FAC Calculation ($/MWH) November 2013 through April 2014		
Month During Review Period	**Average Fuel Costs for Native Load in FAC**	**Average Fuel Costs for Off-System Sales in FAC**
November 2013	**$ 24.59**	**$ 23.87**
December 2013	**$ 25.89**	**$ 24.22**
January 2014	**$ 27.44**	**$ 25.45**
February 2014	**$ 25.57**	**$ 24.48**
March 2014	**$ 25.82**	**$ 24.42**
April 2014	**$ 24.44**	**$ 24.44**

As shown above, the final fuel cost allocated to native load is actually higher than the system average fuel cost allocated to off-system sales. This is because native load is allocated the same average fuel costs as off-system sales as the starting point and is also allocated 100% of the fuel costs assigned during forced outages.[3] The allocation of average fuel costs to both native load and off-system sales as the FAC starting point is improper and results in unreasonable fuel charges to native load customers.

Native load customers should get the benefit of the lowest cost units on the Big Rivers' system. Native load customers paid for, and continue to pay for, the debt service and TIER of all of Big Rivers' generating units, including debt service and TIER for the Wilson generating station. In that sense, these units belong to Big Rivers' member/customers.

---

[2] See KIUC Ex. 1. BREC Response to KIUC 1-1.
[3] See BREC Response to KIUC 1-9, "Note 2."

Big Rivers' practice of beginning the FAC process by allocating average fuel costs to all sales is particularly problematic given Big Rivers' excess capacity after the loss of the smelter load. The Table below shows that since both smelters left the system Big Rivers is making significantly more off-system sales than it is making native load sales:

Calculation Of Average Fuel Cost Per MWh For Native Load and Off-System Sales In Monthly Form A Filing February 2014 through April 2014[4]

	Feb-2014	Mar-2014	Apr-2014
Native Load Sales (MWh)	**220,532,495**	**186,387,640**	**161,217,954**
Native Load – Fuel Cost Per MWh Of Generation	25.57	25.82	24.44
Off-System Sales (MWh)	**496,508,754**	**600,162,486**	**586,076,982**
Off-System Sales – Fuel Cost Per MWh Of Generation	24.48	24.42	24.44

The Table above shows that in April of 2014, for example, Big Rivers sold approximately three-and-a-half times more off-system than it sold on-system. If Big Rivers ran only the units needed to serve its relatively small native load, it would only run its lowest cost unit(s) and native load customers would only pay the fuel costs associated with these low cost units.[5] However, since Big Rivers is selling, in some months, three-and-a-half times more off-system than they sell on-system they are also running less efficient units solely for the purpose of making off-system sales. But Big Rivers isn't allocating the incremental fuel costs of the units used to make off-system sales to the off-system sales that caused the cost. It is allocating system average fuel costs to all sales as the FAC starting point. This inflates the cost of fuel for native load customers and deflates the cost of fuel assigned to off-system sales. As a result native load is subsidizing off-system sales.

[4] KIUC Ex. 1 page 3.
[5] Video Transcript (11-12-14; 13:10:00-13:10:30).

If Big Rivers' margins from off-system sales were entirely credited to native load customers on a real-time basis through the FAC or some other rider, then the allocation of average fuel costs to all sales as the FAC starting point would not be harmful to native load customers. In that scenario, native load customers would pay inflated fuel costs in the FAC, but they would also receive the benefit of the higher off-system sales profits that result from allocating average, rather than incremental, fuel costs to off-system sales. Customers would be held harmless. However, Big Rivers is keeping the vast majority of off-system sales profits and is not using these profits to reduce the rates of their native load customers. Big Rivers' base rates, as set in Case No. 2013-00199, only reflect about $9.5 million per year in off-system sales margins because the future test year filed by Big Rivers assumed that Big Rivers would not run the 443 MW Wilson generating station.[6] Since the Wilson station continues to run, Big Rivers has a large amount of excess capacity to sell off-system and the utility keeps 100% of all profits from off-system sales above $9.5 million per year. Given Big Rivers' net margins of $40.1 million as of April of 2014,[7] Big Rivers' profits from off-system sales are far in excess of this $9.5 million threshold.

As the Commission is well aware, the depreciation of Wilson is currently being deferred. This means that the utility may seek recovery of the deferral in the future. But the debt service and associated TIER on Wilson is being recovered in rates. And that recovery is not subject to refund. There is a ratemaking inconsistency with charging consumers for the debt service and TIER on Wilson, while allowing the utility to retain all profits from selling Wilson into the wholesale power market. That inconsistency should not be made worse by subsidizing off-system sales by charging such sales less for fuel than is charged to native load.

It is also worth mentioning that in addition to the improper assignment of system average fuel cost to both native load and off-system sales as the FAC starting point, Big Rivers may also be improperly allocating 100% of total system forced outage costs to native load customers. The Attachment to Big Rivers' Response to PSC 3-2 shows that over the six month review period, fuel costs assigned during forced outages and recovered through the FAC averaged $765,207 per month.[8] Yet there is no proof that such costs were incurred entirely for native load. Given that most of the Big Rivers system is now acting in a merchant function to make off-system

---

[6] Case No. 2013-00199, Order p. 13 (April 25, 2014).
[7] KIUC Ex. 2 p. 4, line 38.
[8] Attachment to Big Rivers' Response to PSC 3-2, page 1 of 8.

sales it seems likely that not all of those costs are properly attributable to native load. This practice, along with the use of average fuel costs as the FAC starting point, contributes to the anomalous result, shown in the Table above, in which Big Rivers' native load customers pay more for fuel than off-system sales.[9]

The Commission has sufficient information to find that the assignment of system average fuel costs to both native load and off-system sales as the FAC starting point results in a subsidization of off-system sales to the detriment of native load customers. The Commission should order that Big Rivers adjust its fuel cost allocation methodology, both going forward and looking back over the review period, so that the least cost resources are dedicated to native load.

2. Big Rivers' Method Of Allocating System Average Fuel Costs To Both Native Load And Off-System Sales As The FAC Starting Point Is Contrary to FERC Guidance Addressing Fuel Cost Allocation.

Kentucky's FAC regulation, 807 K.A.R. 5:056, is modeled upon the FERC's fuel regulation, 18 C.F.R. §35.14.[10] 807 K.A.R. 5:056(3), provides that fuel costs recovered through the Kentucky fuel adjustment clause include a number of costs "*less...the cost of fossil fuel recovered through intersystem sales including the fuel costs related to economy energy sales and other energy sold on an economic dispatch basis.*" FERC's fuel regulation, 18 C.F.R. §35.14(a)(2), provides that fuel costs recovered through the FERC fuel adjustment clause include a number of costs "*less the cost of fossil and nuclear fuel recovered through all inter-system sales.*" It therefore makes sense to examine how FERC interprets its fuel regulation and use that as guidance in interpreting Kentucky's fuel regulation.

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

[9] There also appears to be a disconnect between the fuel costs that are added and the fuel costs that are subtracted in re-pricing the fuel costs for forced outages. The Commission requires that the actual costs incurred to replace generation lost during a forced outage be re-priced at the cost of the generation that was lost if the purchases were more expensive. Yet it appears that the Company is using this requirement to increase the fuel costs to native load.
[10] Order, Case No. 96-524 (February 9, 1999) at 7; Order, Case Nos. 94-461-A (July 15, 1999) at 11 ("*Reviewing the purpose of Order 517 – the Order which established FERC's FAC Regulation and upon which Administrative Regulation 807 KAR 5:056 is modeled.*").

costs associated with those sales.[11] This case is directly on point. According to the FERC, an approach that allocates fuel costs *equally* to native load and off-system sales customers is not proper.

In another case involving Appalachian Power Company ("APCO"), the FERC stated that it *"believe[d] that it is both appropriate, and a common industry practice to assign the highest fuel cost to off-system sales, while lower fuel cost resources are reserved for the benefit of the APCO native load customers who, through their rates, provide for the construction and operation of the generating facilities."*[12] The FERC interpreted its FAC regulation to mean that it would be appropriate if costs from the highest fuel cost units formed the basis for pricing of off-system sales and the lowest cost units were dedicated to native load.[13] This is exactly what KIUC recommends in this case. Big Rivers' highest incremental fuel costs should be allocated to off-system sales.

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

Big Rivers is the only Kentucky electric utility that begins the FAC process by allocating its system average fuel costs to both native load and off-system sales. Except for Kentucky Power, all other utilities regulated by this Commission use some form of economic dispatch so that the highest cost resources are allocated to off-system sales customers.

Under East Kentucky Power Cooperative's ("EKPC") fuel cost allocation approach, *"[f]uel is allocated between native-load sales and off-system sales on a stacked cost basis. EKPC considers each hour of operation, determines if a sale was made from its system during that hour and then allocates the highest cost resource(s) to that sale for FAC purposes."*[14]

---

[11] Initial Decision, *Golden Spread Electric Cooperative, Inc. et al v. Southwestern Public Service Company*, 115 FERC ¶63,043 (May 24, 2006) at ¶132 ("Initial Decision"); Opinion No. 501, 123 FERC ¶61,047 (April 21, 2008) at ¶42-47.

[12] Order Accepting Rates for Filing, Granting Intervention and Terminating Docket, Docket No. ER83-63-000 (December 17, 1982) at 2.

[13] Order Accepting Rates for Filing, Granting Intervention and Terminating Docket, Docket No. ER83-63-000 (December 17, 1982) at 5.

[14] EKPC Response to Commission Staff's Information Request Dated 08/13/014, Case No. 2014-00226, Request 29.

Duke Energy Kentucky, Inc. ("Duke") described its fuel cost allocation process as follows: *"After the generating unit is dispatched, the actual energy costs consumed in a generating unit is allocated as either native or non-native based on a stacking process, allocating the lowest cost resources to native load first."*[15]

Both Kentucky Utilities Company ("KU") and Louisville Gas & Electric Company ("LG&E") *"use the After-the-Fact Billing ('AFB') model to determine the joint dispatch savings between LG&E and KU and to allocate the highest cost energy to off-system sales."*[16]

Big Rivers' average cost allocation methodology is not used by any other Kentucky electric utility. It is unreasonable for the customers of all other Kentucky electric utilities to enjoy the benefit of the lowest cost generation resources that customers pay for in rates, while Big Rivers' customers are forced to pay higher fuel rates than those allocated to off-system sales. As explained above, this inequity is magnified by the fact that Big Rivers also has by far the highest reserve margin in the Commonwealth and makes more off-system sales relative to native load than any other Kentucky electric utility. To the greatest extent possible, the Commission should require consistent treatment of fuel cost allocation among all of the Kentucky electric utilities.

Unlike other regulations, 807 KAR 5:056 does not allow for deviation upon a showing of good cause. This should result in the consistent application of the FAC regulation to all utilities. However, that is clearly not the case with Big Rivers.

The FAC allocation methodology used by the EKPC and Duke should be adopted here. That methodology ensures that native load customers receive the benefit of the utility's least cost resources, and that off-system sales are allocated incremental costs. There is no valid reason why the member/owners of one cooperative (Big Rivers) should receive less favorable treatment than the member/owners of a different cooperative (EKPC) under the FAC regulation which is required to be applied uniformly.

---

[15] Duke Kentucky Response to Staff First Set of Data Requests, Case No. 2014-00229, Staff-DR-01-029.
[16] LG&E Response to Information Request in Appendix of Commission's Order Dated August 13, 2014, Case No. 2014-00228, Question No. 25; KU Response to Information Request in Appendix of Commission's Order Dated August 13, 2014, Case No. 2014-00227, Question No. 25.

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

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

> *Big Rivers' current fuel cost allocation methodology is built into the determination of its base rates. Big Rivers' fuel cost allocation methodology was used in the test periods filed in Big Rivers' last three rate cases and to establish Big Rivers' current rates, which were approved by the Commission as being fair, just and reasonable. It would be unreasonable and a violation of the matching principle to change how Big Rivers allocates fuel costs between native load and off-system sales for purposes of calculating FAC charges outside of a general rate case where the reasonableness of an alternate allocation methodology can be considered in the context of Big Rivers' overall financial circumstances, including whether Big Rivers' rates are still fair, just and reasonable with such a change.*[17]

This argument is without merit. First, the Commission's FAC regulation establishes that improper fuel costs are subject to refund in six month review proceedings. 807 KAR 5:056 states:

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

The language of the regulation requires the Commission to order refunds in proceedings such as this one if it finds that a utility has improperly calculated or applied its fuel adjustment charge.

---

[17] BREC Response to PSC 3-1, p. 2 of 6.

Second, the Commission has previously disallowed improperly collected fuel costs in the context of a non-base rate proceeding. It did so with respect to KU/LG&E in the late-1990s and with respect to Big Rivers in the mid-1990s.[18]

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

> *We hold that so long as the rates established by the utility were fair, just and reasonable, the PSC has broad ratemaking power to allow recovery of such costs outside the parameters of a general rate case and even in the absence of a statute specifically authorizing recovery of such costs.*[19]

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

If Big Rivers believes that the enforcement of the FAC regulation will make its base rates unreasonable, then its recourse is to file a new base rate case. However, Big Rivers had already earned net margins of over $40.1 million as of April of 2014,[20] which is $27 million more than the $13.1 million it needs to make its allowed 1.30 TIER for all of 2014.[21] According to Big Rivers' most recent monthly financial report on file at the Commission, its net margins for the first eleven months of 2014 were $25.6 million, or almost double its authorized return for the entire year.[22] Therefore, it seems unlikely that Big Rivers would voluntarily submit to a rate case at this time.

Big Rivers will not be unreasonably harmed financially if it is required to dedicate its lowest cost resources to native load. All that would happen is that its profits from off-system sales would be reduced by about $0.49/MWh and consumers would experience an FAC rate reduction of about $1.46/MWh.[23] Since the exit of the

---

[18] *An Examination by the Public Service Commission of the Application of the Fuel Adjustment Clause of Louisville Gas & Electric Company From November 1, 1998 to October 31, 1996*, Case No. 96-524, Order (February 9, 1999); *An Examination by the Public Service Commission of the Application of the Fuel Adjustment Clause of Kentucky Utilities Company From November 1, 1997 to April 30, 1998,* Case No. 96-523-C; Order (July 21, 1999); *An Examination by the Public Service Commission of the Application of the Fuel Adjustment Clause of Big Rivers Electric Corporation from November 1, 1991 to April 30, 1992*, Order (July 21, 1994).
[19] *Kentucky Pub. Service Com'n v. Com. ex. rel. Conway*, 324 S.W. 3d 373, 374 (Ky. 2010).
[20] KIUC Ex. 2 p. 4, line 38.
[21] Case No. 2013-00199, Order (April 25, 2014) at 32.
[22] Big Rivers' Financial and Operating Report, Electric Power Supply, Part A- Financial (Period Ended November 2014), line 38(b). Pursuant to 807 KAR 5:001 Section 11(5), KIUC moves that the Commission take judicial notice of this document "by reference only." See also Polley v. Allen, 132 S.W.3d 223, 226 (Ky. Ct. App. 2004) "*A court may properly take judicial notice of public records and government documents...*"
[23] KIUC Ex. 3.

smelters from the system, this would translate into a rate reduction of only about $277,000 per month.[24] Given the utility's excess profits, and given the 40% rate increase that all business customers will experience when the Reserve Accounts run out in July/August 2015, this is a reasonable trade off.

5. The Commission Should Require Big Rivers to Refund $2,694,861.00 Million In Improperly Collected Fuel Costs To Kentucky Native Load Customers Plus Interest And To Modify Its Fuel Cost Allocation For FAC Purposes Going Forward.

In light of the issues discussed above, the Commission should order Big Rivers to refund $2,694,861.00 million in excessive fuel costs that were improperly allocated to native load customers and recovered through the FAC from November 2013 through April 2014, with interest. This refund amount is based upon Big Rivers own calculations of what the FAC would have been if Big Rivers had assigned its lowest cost generation to native load customers as per Big Rivers' response to PSC 3-1.[25] The Commission should also order that Big Rivers adjust its fuel cost allocation methodology going forward so that the lowest cost resources, including both generating unit fuel costs and purchase power costs, are allocated to native load.

---

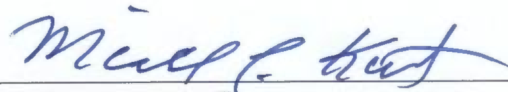
[24] Id.

[25] See Attachment to BREC Response to PSC 3-1, page 1 of 1. Note that this calculation was based on monthly average costs for each specific unit and applying the cost differential per MWh to FAC generation volumes to serve native load. This method is sufficient for calculating the refund amount, but going forward Big Rivers should use hourly costs, rather than monthly costs, for each unit when assigning costs to native load and off-system sales.

CONCLUSION

WHEREFORE, for the reasons discussed above, the Commission should order Big Rivers to refund $2,694,861.00 million in fuel costs improperly allocated to native load customers, plus interest. The Commission should also order that Big Rivers adjust its fuel cost allocation methodology going forward so that the lowest fuel costs resources are dedicated to native load customers. This will result in both of Kentucky's generation and transmission cooperatives utilizing the same allocation methodology under the uniform FAC regulation.

Respectfully submitted,



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

COUNSEL FOR KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC.

December 23, 2014