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

TELECOPIER (513) 421-2764

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Via Overnight Mail

May 6, 2015

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

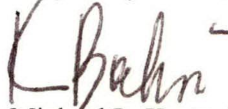
Re: Case No. 2014-00230 and 2014-00455

Dear Mr. Derouen:

Please find enclosed the original and ten (10) copies each of KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC'S RESPONSES to COMMISSION STAFF'S INITIAL REQUEST FOR INFORMATION and to BIG RIVERS ELECTRIC CORPORATION'S FIRST REQUEST FOR INFORMATION 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.

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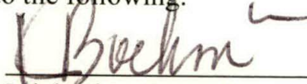
CERTIFICATE OF SERVICE

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 6th day of May, 2015 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, KY 42302-0727

Jennifer Black Hans
Lawrence W Cook
Angela M Goad
Assistant Attorney General
Office of the Attorney General Utility & Rate
1024 Capital Center Drive, Suite 200
Frankfort, KY 40601-8204

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COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN EXAMINATION OF THE APPLICATION OF THE FUEL ADJUSTMENT CLAUSE OF BIG RIVERS ELECTRIC CORPORATION FROM NOVEMBER 1, 2013 THROUGH APRIL 30, 2014	)))))	**CASE NO. 2014-00230**
AN EXAMINATION OF THE APPLICATION OF THE FUEL ADJUSTMENT CLAUSE OF BIG RIVERS ELECTRIC CORPORATION FROM NOVEMBER 1, 2012 THROUGH OCTOBER 31, 2014	)))))	**CASE NO. 2014-00455**

KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC.'S RESPONSE TO COMMISSION STAFF'S INITIAL REQUEST FOR INFORMATION

1. Refer to the Direct Testimony of Lane Kollen ("Kollen Testimony"), page 8. Provide the source for the information reflected in the table on this page.

RESPONSE:

The reserve margin was calculated using the data provided in Big Rivers Response to KIUC 1-8. KIUC assumed that the total reduction in Smelter load was 850 MW prior to 2015.

Please see the attachments to this response for all of the workpapers used to support Mr. Kollen's testimony:

KIUC_AG_response_to_Staff 1-1 (Attachment A).xlsx
KIUC_AG_response_to_Staff 1-1 (Attachment B).xlsx
KIUC_AG_response_to_Staff 1-1 (Attachment C).xlsx

Attachment A includes the reallocation calculation. Attachment B includes Off-System Sales and Native Load comparison calculations. Attachment C includes the requested support regarding Mr. Kollen's reserve margin table from page 8.

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2. Refer to the Kollen Testimony, page 12, lines 2-1 1. Is it KIUC's position that there is no benefit to Big Rivers Electric Corporation's ("Big Rivers") members from Big Rivers' increase in off-system sales and for the Wilson unit to remain in service to make those sales?

RESPONSE:

No. The testimony cited addresses the increase in fuel expense resulting from the shutdown of Coleman, not Wilson. Nevertheless, there are fuel savings that inure to the distribution cooperatives and their members from the continued operation of Wilson. That is because Wilson generally is the lowest fuel cost unit on the system and running Wilson reduces the system average fuel costs allocated to both native load and off-system sales.

There is no direct or immediate benefit to the distribution cooperatives or their members from the increase in off-system sales margins because these margins are retained by Big Rivers between base rate cases. Big Rivers retained approximately $26.5 million in off-system sales margins in excess of the amount reflected in base rates in Case No. 2013-00199.[1]

[1] According to Big Rivers' response to KIUC 1-7, Big Rivers made $51.7 million in margins from off-system sales from January through October of 2014, or approximately $62 million if the ten months were annualized compared to $9.5 million in off-system sales margins included in the Company's base rates set in Case No. 2013-00199. In its filing in that case, the Company assumed that Wilson would be shutdown. This was reflected in the lower projected off-system sales margins. In addition, the Company's filing excluded $26 million in fixed departmental O&M expenses that Big Rivers continues to incur by operating the Wilson unit. Big Rivers is permitted to keep 100% of all profits from off-system sales above the $9.5 million per year base amount. As a result, Big Rivers kept an

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Instead of using these additional off-system sales margins to reduce member rates, the margins were booked as increased member equity. These margins could eventually be used to effectively and temporarily lower rates through the distribution of patronage capital, although Big Rivers has opposed such distributions in prior proceedings. Unlike many other cooperative utilities, Big Rivers has not made a patronage capital allocation to member in decades. It also should be noted that base rates include all interest expense and TIER margins on Wilson. Although depreciation expense associated with Wilson of approximately $20 million per year is being deferred, Big Rivers likely will seek recovery of the deferral balance in a future base rate proceeding.

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estimated $26.5 million of profits from off-system sales that were not reflected in base rates (Kollen Testimony pp. 13-14)

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3. Refer to the Kollen Testimony, page 12, lines 7-9. Does KlUC agree that if Big Rivers was not able to make off-system sales, the Wilson unit would be idled? If so, state whether KlUC believes that operation of the Wilson unit reduces Big Rivers' system-average fuel costs.

RESPONSE:

KIUC agrees that Big Rivers planned to idle Wilson after it lost the Sebree smelter load based on its projections of prices in the market at the time it filed its Application in Case No. 2013-00199. KIUC does not know whether Big Rivers would reach the same conclusion today if actual or projected market prices decline or at what level of off-system sales margins it no longer would be economic to operate the unit. Wilson is generally Big Rivers' lowest fuel cost unit in most hours; therefore, operating the Wilson unit lowers Big Rivers' system-average fuel costs.

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KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC.'S RESPONSE TO COMMISSION STAFF'S INITIAL REQUEST FOR INFORMATION

4. Refer to the Kollen Testimony, pages 15-1 6.

a. State whether KIUC believes that the March 5, 1996 Order in Case No. 94-458[2] required the use of the incremental-cost methodology when allocating fuel costs to off-system sales or that the Commission found it to be a reasonable, but not required, methodology.

b. KIUC's position in Case No. 94-458 was that the system-average methodology should be used for allocating fuel costs to off-system sales. In the instant proceeding, KIUC's position is that a different methodology (based on that used by East Kentucky Power Cooperative, Inc. and Duke Energy Kentucky, Inc.) should be used. State whether KIUC believes: 1) that the Commission should require a specific methodology be employed by all electric utilities regardless of the results; 2) that the Commission should require the use of whichever methodology produces the lowest fuel costs for native-load customers, regardless of how often this requirement causes a change in methodology; or 3) that the Commission should allow different methodologies to be used by different utilities, so long as they are considered reasonable by the Commission.

[2] Case No. 94-458, *In the Matter of an Examination by the Public Service Commission of the Application of the Fuel Adjustment Clause of Big Rivers Electric Corporation from November 1, 1992 to October 31, 1994* (Ky. PSC Mar. 5, 1996).

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RESPONSE:

a. The March 5, 1996 Order in Case No. 94-458 states that Big Rivers' "*incremental fuel costs*" allocation method "*is reasonable*." (Order p. 1). The Commission rejected the KIUC proposal to assign Big Rivers' average fuel costs to all sales. Given those two determinations, KIUC believes that the use of incremental fuel costs allocation method is required and that the use of the average allocation method is not allowed.

b. KIUC believes that the Commission should require that all Kentucky utilities employ a fuel cost allocation method that allocates the benefit of the lowest cost fuel resources on the system to native load because native load customers pay the fixed costs to own and operate these resources. The EKPC/Duke methodology will always achieve this objective regardless of whether the utility has excess capacity. The Big Rivers average cost methodology will never achieve this objective even if the utility does not have excess capacity. Nevertheless, other methodologies may achieve this objective if the utility does not have excess capacity.

Big Rivers successfully argued in its last two rate cases (2012-00535 and 2013-00199) that native load customers should be required to pay the stranded costs of its generating units (Coleman and Wilson) even though these units are not needed to serve native load customers after the termination of the smelter load. Currently, Big Rivers is running Wilson, Green, SEPA, HMPL and Reid in order to serve both native load and off-system sales. Native load customers continue to pay all of the debt service and TIER

on all of these units, including the costs of the idled Coleman plant.[3] Depreciation on Wilson ($20 million annually) and Coleman ($6 million annually) is being deferred and the utility may seek recovery of the deferral from consumers at some point in the future. Yet, under Big Rivers' allocation methodology, native load is not given first call on the lowest fuel costs units. This benefit is being proportionately allocated to native load and off-system sales.

Big Rivers' methodology is also counter to the allocation methodologies used by every other electric utility in the Commonwealth, each of which stack their generation resources from lowest cost to highest cost and allocate the lowest cost units to native load. As explained in KIUC's testimony, the native load customers of every other utility in Kentucky enjoy the benefit of first call on the units that native load customers pay for, while the incremental portion of the generation stack is allocated to off-system sales. Big Rivers' customers are being treated less favorably than the customers of every other utility in Kentucky. Unlike other provisions of the Commission's Regulations, the FAC Regulation (807 K.A.R. 5:056) does not contain a deviation clause. The Commission cannot deviate from the FAC regulation for good cause shown.

The Kentucky FAC was modeled on the FERC FAC. Big Rivers' methodology also breaks from FERC's guidance which held in Golden Spread Electric Cooperative (2006) that assigning system average fuel costs to both native load and off-system sales unreasonably forces native load customers to subsidize off-system sales by paying higher

[3] Native load customers continue to pay the debt service and TIER on the Wilson and Coleman units, as well as a portion of fixed O&M and property taxes. Depreciation expenses on Wilson and Coleman are being deferred for possible future recovery from customers.

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incremental fuel costs associated with those sales.[4] The FERC also stated in a case involving Appalachian Power Company 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."*[5]

It would be reasonable to allocate 100% of the low fuel costs of the Wilson unit to off-system if off-system sale assumed the responsibility to pay for the debt service, TIER and deferred depreciation on Wilson. But native load customers continue to pay the costs of Wilson. Native load customers also continue to pay the costs of the idled Coleman unit and receive no fuel benefit from Coleman. As long as Wilson is running, native load customers should receive 100% of the benefit of the unit.

[4] 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.

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

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5. Refer to the Kollen Testimony, pages 19-20.

a. Provide all spreadsheets developed by Mr. Kollen in his calculation of a fuel refund of $11.77 million and an interest refund of $1.57 million. The spreadsheets should be provided in Excel format with the formulas intact and unprotected and with all columns and rows accessible.

b. Explain why Mr. Kollen believes it is fair to require a change in a utility's fuel methodology outside of a base-rate proceeding.

RESPONSE:

a. Please see response to Staff Request 1, including Attachment A.

b. Fundamentally, in this case, there has been a significant change in circumstances compared to the assumptions in the Company's forecast test year in Case No. 2013-00199. Namely, the continued operation of Wilson. Any assumptions as to off-system sales revenues, fuel expenses, and margins that were reflected in that case are no longer relevant and should not restrict the Commission from setting FAC rates that are just and reasonable. This is particularly true because the Company retains the entirety of the off-

system sales margins over the amounts reflected in base rates until base rates are reset in a future proceeding.

In addition, the Commission has an independent obligation to set FAC rates at just and reasonable levels. Utilities are on notice that their FAC methodologies are always subject to revision during a six month or two year review proceeding. The Commission's FAC regulation establishes that improper fuel costs are subject to refund in six month and two year 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.*"
>
> ***
>
> "*(11) 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.*"
>
> (12) *Every two (2) years following the initial effective date of each utility's fuel clause the commission in a public hearing will review and evaluate past operations of the clause, disallow improper expenses and to the extent*

> *appropriate reestablish the fuel clause charge in accordance with subsection (2) of this section.*"

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.

The Commission has disallowed improperly collected fuel costs in the context of a non-base rate proceeding on numerous occasions. It did so with respect to KU/LG&E in the late-1990s and with respect to Big Rivers in the mid-1990s,[6] and it disallowed FAC costs outside of a base rate case as recently as January of 2015 in Case No. 20-14-00225 involving Kentucky Power Company.

In that case, Kentucky Power argued "*that any change to its fuel allocation methodology can be made only prospectively and only at a time when base rates are modified.*"[7] The Commission rejected that argument and ordered a retrospective change of Kentucky Power's FAC methodology because Kentucky Power's excess capacity after

[6] *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).

[7] Case No. 2014-00225 Order of January 22, 2015) p. 6.

its acquisition of the Mitchell generating station had caused native load customers to be allocated Mitchell "no load" costs that were incurred in order to serve off-system sales.[8]

The Commission's ability to change charges outside of a rate case was affirmed by the Supreme Court of Kentucky in 2010 when that Court 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.*[9]

Hence, rate changes can occur outside of the context of a base rate proceeding. This arrangement is fair because Big Rivers always has the ability to file a base rate case if it believes that the enforcement of the FAC regulation will make its base rates unreasonable. 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.[10] Since the exit of the smelters from the system, this would translate into a rate reduction of only about $277,000 per

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[8] Case No. 2014-00225 Order of January 22, 2015) pp. 10-12.
[9] *Kentucky Pub. Service Com'n v. Com. ex. rel. Conway*, 324 S.W. 3d 373, 374 (Ky. 2010).
[10] KIUC Ex. 3.

month.[11] Given the utility's excess profits, including earning an approximately $26.5 margin on off-system sales in 2014 that was over and above Big Rivers' $9.5 million baseline, and given the 30%-40% rate increase that all business customers will automatically experience when the Reserve Accounts run out in July/August 2015, this is a reasonable trade off.

The Commission historically has not attempted to reconcile the off-system sales margins or the fuel costs allocated to off-system sales during the six month or two year review periods with the margins or fuel costs allocated to off-system sales in the utility's last base rate proceeding, except for Kentucky Power, which has a System Sales Clause tariff. The Commission historically does not attempt to reconcile other revenues or expenses or capitalization between rate cases, except for costs recovered through the environmental surcharge. It would be a change now to determine that such a reconciliation is necessary for Big Rivers, particularly when maintaining the status quo does not result in just and reasonable rates.

Finally, the Commission has retained Concentric Energy Advisors to perform a Focused Management Audit of Big Rivers to determine if it is making all reasonable efforts to mitigate the excess capacity cost to remaining ratepayers of allowing the smelters to receive market pricing through Kenergy. Assigning native load consumers the lowest fuel costs on the system would be a good first step.

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[11] Id.