

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

IN THE MATTER OF:)
)
APPLICATION OF BIG RIVERS ELECTRIC)
CORPORATION FOR A GENERAL)
ADJUSTMENT IN RATES)

CASE NO. 2011-00036

POST-HEARING BRIEF OF JACKSON PURCHASE ENERGY CORPORATION

Comes intervenor, Jackson Purchase Energy Corporation (hereinafter "JPEC"), by and through Counsel, and pursuant to the briefing schedule established by the Public Service Commission of the Commonwealth of Kentucky (the "Commission") at the close of the formal hearing in the above referenced case on July 28, 2011, hereby submits its post hearing brief.

This matter concerns a request for an increase in the wholesale electric rates of Big Rivers Electric Corporation ("Big Rivers"). JPEC, Kenergy, and Meade County Rural Electric Cooperative Corporation are the three member-owners of Big Rivers. The purpose of JPEC's brief is to address the issue of the allocation of this rate increase among the classes of customers served by Big Rivers and its members.

Pursuant to KRS 278.040, the Commission has exclusive jurisdiction over the rates and services of regulated utilities within the Commonwealth of Kentucky. The Commission is charged with ensuring that rates are fair, just and reasonable. KRS 278.170. In this case, a key component in arriving at fair, just and reasonable rates will be the apportionment of the increase among the various classes: the two smelters (Alcan and Century Aluminum), the large industrials, and the rural customers.

As part of the unwind transaction approved by this Commission in Case Number 2007-00455, the smelters, Kenergy, and Big Rivers entered into certain long-term agreements wherein

the smelters agreed to be subject to charges which are in addition to the large industrial rate. These charges contained in that agreement include a TIER adjustment charge prescribed in Section 4.7.1, the surcharge described in Section 4.11, and the \$0.25 per Mwh premium to the large industrial rate as prescribed in Section 1.1.20. (Seelye rebuttal testimony at page 19). Jack Gaines, who participated in these negotiations of these agreements, testified that the purpose of those provisions was to offset costs or enhance the margins of Big Rivers. (Gaines direct testimony at page 4). There is no dispute among the parties that the rates payable by the smelters under the contracts provide for a rate above cost-of-service. Mr. Gaines' testimony makes clear that the purpose of those contract provisions, from Kenergy and Big Rivers' perspectives, was to justify accepting the obligation to serve the smelters' load. (Gaines testimony at page 4). The smelters recognized that they were paying higher rates, which they categorized as subsidies, in their unwind brief. (Seelye rebuttal testimony at page 19). The rate provisions contained in the smelters' current agreements were deemed to be fair, just and reasonable by the Commission in Case Number 2007-00455.

In this case, three cost-of-service proposals have been presented to the Commission. These were from Big Rivers' witness, William Steve Seelye, Kentucky Industrial Utility Customers (hereinafter "KIUC") witness, Stephen J. Barron, and Kenergy witness, Jack Gaines.

Mr. Seelye, the first cost-of-service witness, used a traditional cost-of-service approach where costs are allocated and resulting margins are calculated by subtracting costs from revenue. (Seelye direct testimony at page 11). This allowed him to then calculate a rate of return for each class of customer based on current rates. *Id.* Those are summarized in his testimony as -1.48% for the rurals, 1.65% for the large industrials, and 3.14% for the smelters. (Seelye rebuttal

testimony at page 18). This figure was not adjusted to exclude the factors which the smelters agreed to pay as part of the unwind which are above and beyond the large industrial rate. (Seelye direct testimony at page 17). In fact, Seelye states that the rate of return for the smelters is expected to be higher for this reason. (Seelye rebuttal testimony at page 18).

Seelye's proposal calls for a gradual shift in the rates to eliminate the so-called subsidies to the rural class. (Seelye rebuttal testimony at page 23). He states that it is his belief that Big Rivers should take reasonable steps to equalize the rates of return between classes, but does not believe it is appropriate to eliminate all differentials in one fell swoop. (Seelye rebuttal testimony at page 23).

The second was Kenergy's witness, Jack Gaines. Mr. Gaines' testimony indicates that the charges which the smelters agreed to in addition to the large industrial rate should be excluded in determining in class cost-of-service for determining the allocation of the revenue requirement between classes. (Gaines rebuttal testimony at page 5). The basis for his position is that including those amounts results in a reallocation of revenues among the classes which effectively alters the amounts which the smelters agreed to pay in their contracts. (*Id.*). Mr. Seelye and Mr. Gaines agree that the additional negotiated amounts payable by the smelters increase the rate of return for the smelters. (Seelye rebuttal testimony at page 18; Gaines rebuttal testimony at page 6). Gaines testified that only if those contractual payments made by the smelters are removed can the Commission get a true rate to rate comparison of class subsidies and excesses. (Gaines rebuttal testimony at page 8). Gaines calculates the rates of return as identified on Exhibit JDG-1. They are -0.43% for the rurals, 5.32% for the large industrials, and 0.87% for the smelters with an overall total system rate or return of 0.80%. *Id.* According to

Gaines, after removing the smelters' contractual payments, the subsidy to the rural class is actually \$4.8 million rather than the \$13.2 million claimed by KIUC. (Gaines rebuttal testimony at page 9 and Gaines' Exhibit JDG-1). While Gaines calculation removes the payments made by the smelters from the overall cost-of-service calculation, he does recognize that they should be included in determining appropriate base rates as they are revenues actually received by Big Rivers. (Gaines rebuttal testimony at page 4). Accordingly, they are not disregarded as suggested by KIUC witness, Stephen J. Baron in his surrebuttal testimony. (Baron surrebuttal testimony at page 3). Gaines' calculations return in a much more modest rate or return for the smelters than either Seelye or Baron. (Gaines Exhibit JDG-1). Ultimately, Mr. Gaines concludes that taking into account the rate increase proposed by Big Rivers that the real difference in rate of return from base rates is between the large industrial customers and the rural customers. (3.48 for rurals and 8.48 for large industrials) (Gaines Exhibit JDG-1). Because the difference between these two classes is not as large as is portrayed by KIUC, it could easily be gradually eliminated without any shock to the rural customers.

Finally, the Commission heard from KIUC witness, Stephen J. Baron. Mr. Baron includes all smelter payments or subsidies, even those paid pursuant to the contractual provisions referenced previously, in determining the cost-of-service allocation. (Baron surrebuttal testimony at page 3). According to Mr. Baron's calculation, the rural class is receiving \$18.3 million in subsidies from the smelter customers. (Baron direct at page 9). He even went further concluding that all of those "subsidy" payments should be eliminated immediately with the first \$18.3 million of the rate increase being allocated to the rural class. KIUC's proposal then seeks to mitigate the effect of that rate increase by utilizing funds from the Rural Economic Reserve, a

fund established by the Commission for the purpose of ensuring that the rural customers were not jarred by rate increases which were expected to occur after exhaustion of the economic reserve. (Baron direct testimony at page 9). According to Mr. Baron, the fact that those agreed upon contractual payments were included in long-term contracts is irrelevant and should be disregarded by this Commission. (Baron surrebuttal testimony at page 7). This is interesting in light of the fact that Mr. Baron testified that he had no involvement in the negotiations of those contracts; and therefore, can't testify as to the intent of the parties. (Baron testimony on 7/27/11 at 16:56). Mr. Baron further testified that KIUC was not seeking to avoid the smelter agreements in this case. (Baron surrebuttal testimony at page 9). However, it simply makes no sense for KIUC to say on one hand that the subsidies to the rurals, which are contained in the smelter power agreements, should be discontinued immediately and on the other hand maintain that the smelters wish to continue under their present agreement. Quite simply, there is no logical way to reconcile those two positions. It is submitted by JPEC that KIUC's and the smelters' true intent was shown in Big Rivers Exhibit #7, a document stating, "Sebree will seek to have a true cost-of-service rate. The case will be held beginning in March 2011 and calls for an 11.75% increase."

All three witnesses offered a different approach for the Commission on how to allocate rates among Big Rivers' rate classes. The key distinction between these witnesses was how much cost, if any, should be shifted to the rurals, which includes customers such as Wal-Mart and Burger King as well as private residences.

KIUC's approach seeks to have this Commission do what a court of law would be unwilling to do which is asking the Commission to void its contract and eliminate the payments they had previously agreed to. "It is the settled rule in Kentucky that one who signs a contract is

presumed to know its contents, and that if he has an opportunity to read the contract he is bound by its provisions, unless he is misled as to the nature of the writing which he signs, or his signature has been obtained by fraud." *Carlson v. Ky. Ridge Coal Co.*, 125 F. Supp. 257, 259 (E.D.Ky 1954). "Written documents, admittedly signed by the parties entered into in solemn form and with apparent deliberation, must stand unless by strong evidence of a convincing nature the judicial mind is convinced that it was obtained by fraud, or fails because of the mutual mistake of the parties to state the true agreement" *Restatement of Contracts*, Section 70. None of the factors of fraud or mutual mistake are present in this case so no legal grounds exist for the avoidance of this contract. The evidence clearly showed this was a drawn out, arms-length negotiation between sophisticated parties. The parties knew and acknowledged that the rates agreed to did not represent cost-of-service rates and were actually much higher than a cost-of service rate. As such, this Commission should not indulge in reformation or avoidance of the smelter agreements because KIUC and the smelters have decided they want a better deal.

The cost-of-service study proposed by Jack Gaines should be adopted in order to establish rates which are fair, just, and reasonable. Mr. Gaines cost-of-service study analysis provides the Commission with an appointment method for assigning cost responsibility to each customer classification. To varying degrees, Mr. Seelye's and Mr. Baron's methodologies propose to shift costs which were agreed to by the smelters during the unwind transaction to the large industrial and rural classes. Much of the hearing on this matter was spent considering what effect a rate increase might have on one customer, the smelters. It is evident from the testimony of Mr. Strong and Dr. Coomes, and no party disputes, that the smelters are extremely important to the entire economy of the Commonwealth. Regardless, the evidence indicates that no consideration

was given to the effect that such the cost-of-service study proposed by Mr. Baron would have on the rural rate class, only that it would eliminate what KIUC referred to as “subsidies” to the rural class. Mr. Strong indicated under cross-examination that prior to the morning he testified he had never discussed nor considered what effect such a shift might have on the rural customers.

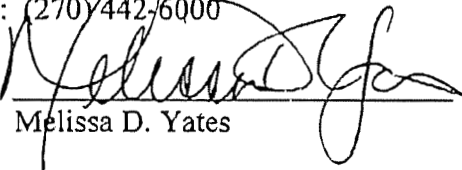
(Strong testimony 7/28/11). As such, JPEC urges this Commission to consider the impact of its decision on the approximately 100,000 rural customers. JPEC asserts that the smelter agreements, which were agreed upon contractual rates which should not be disturbed.

Nevertheless, JPEC submits that in the event that the Commission adopts the cost-of-service study as sponsored by Jack Gaines, and elects to reduce the differential in rate of return between the large industrial and the rurals, that it should be done in a way which promotes a gradual transition rather than imposing an abrupt \$18 million shift as requested by KIUC as consistent with previous Commission orders. See *In the Matter of The Application of Kenergy Corporation for Review and Approval of Existing Rates*, PSC Case No. 2003-00165 and *In the Matter of: The Application of Louisville Gas & Electric Company to adjust its Gas Rates and to Increase Its Charges for Disconnecting Service, Reconnecting Service and Returned Checks*, PSC Case No. 2000-00080.

WHEREFORE, Jackson Purchase Energy Corporation respectfully requests that this Commission enter an order approving and incorporating the cost-of-service study of Jack D. Gaines into the rates approved for Big Rivers Electric Corporation as fair, just, and reasonable.

Respectfully Submitted,

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