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August 12, 2013

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HAND DELIVERED

Jeff R. Derouen
Executive Director
Public Service Commission
211 Sower Boulevard
P.O. Box 615
Frankfort, KY 40602-0615

RE: Case No. 2012-00578

Dear Mr. Derouen:

Enclosed please find and accept for filing the following:

(a) Post-Hearing Brief Of Kentucky Power Company;

(b) Notice Of The Filing Of The Stenographic Transcript Of The July 10-12, 2013 Hearing and accompanying transcripts;

(c) Motion For Confidential Treatment and accompanying confidential information.

By copy of this letter, the above is being served on counsel of record, except that the transcripts are not being served.

Very truly yours,

Mark R. Overstreet

MRO
cc: Counsel of Record

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In The Matter Of:

The Application Of Kentucky Power Company For: (1) A Certificate Of Public Convenience And Necessity Authorizing The Transfer To The Company Of An Undivided Fifty Percent Interest In The Mitchell Generating Station And Associated Assets; (2) Approval Of The Assumption By Kentucky Power Company Of Certain Liabilities In Connection With The Transfer Of The Mitchell Generating Station; (3) Declaratory Rulings; (4) Deferral Of Costs Incurred In Connection With The Company's Efforts To Meet Federal Clean Air Act And Related Requirements; And (5) For All Other Required Approvals And Relief	)	Case No. 2012-00578

POST-HEARING BRIEF OF KENTUCKY POWER COMPANY

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INTRODUCTION

The December 19, 2012 application of Kentucky Power Company ("Kentucky Power" or "Company") seeks all required approvals to consummate the transfer to Kentucky Power of a fifty percent undivided interest in Unit 1 and Unit 2 of Mitchell generating station and all associated assets at their December 31, 2013 net book value ("Mitchell Transfer.") The approval of the Company's application, as modified by the July 2, 2013 Stipulation and Settlement Agreement among Kentucky Power, Kentucky Industrial Customers, Inc. and Sierra Club ("Settlement Agreement"), will secure low-cost, reliable power for the Company's customers through at least 2040.[1] The Mitchell Transfer is part of the least-cost means for Kentucky Power to address the requirement that the Company retire or retrofit the Big Sandy generating station as a coal-fired plant by mid-2015.

The Settlement Agreement brings to an end for this Commission, the Company's customers, and the Company, the years-long effort to address the environmental issues facing the Company's Big Sandy generating station. The Settlement Agreement is a carefully crafted balance of the interests of all of the Company's customers and the Company, is in the public interest, and provides significant benefits to the Company's customers, some of which would not otherwise be available. In particular, the Mitchell Transfer and the Settlement Agreement provide:

- The least-cost means of addressing the June 2015 deadline to retire or retrofit Big Sandy Unit 2. The Mitchell Transfer is hundreds of millions of dollars less expensive on a cumulative present worth ("CPW") basis than any of the alternatives;

[1] LaFleur Hearing Testimony at 560-561, 562.

- Significant rate benefits. The $44 million annual Asset Transfer Rider will collect, over the seventeen months it is expected to be effective, ***$131 million less*** than the full Mitchell Transfer cost of service;

- An estimated $16.75 million in annual fuel savings (based on 2012 jurisdictional sales) as a result of the Mitchell units' lower fuel cost;

- A base rate case "stay-out" provision coupled with the requirement that the Company file a rate application at the end of 2014 that will permit the Company's customers to capture the rate benefits associated with the retirement of Big Sandy Unit 2. In addition, Kentucky Power will withdraw its pending rate case application.

- Modest rate increases to recover the Mitchell Transfer cost of service – 5.33% on January 1, 2014 and 8.21% in June 2015 (13.98% overall);

- A means for the Company and its customers to avoid the volatility and uncertainty associated with the capacity and energy markets;

- Shareholder investment in Kentucky Power's service territory through a five-year commitment of shareholder-funds for economic development and job training;

- A 20% increase in shareholder-funded contributions to home energy assistance programs serving the Company's customers;

- Provisions mitigating the risk of increased costs resulting from greenhouse gas regulation;

- Increased generation fuel diversity as the result of the requirement that Kentucky Power file an application for authority to convert Big Sandy Unit 1 to natural gas; and

- A doubling by 2016 of the amount invested in Company's demand-side management and energy efficiency programs. The Company also agreed to investigate wind resources.

The Mitchell Transfer and the Settlement Agreement are in the public interest, satisfy the applicable statutes and regulations, and should be approved.

BACKGROUND

Mitchell Units 1 and 2 are "two of the jewels of AEP,"[2] and provide the least-cost solution[3] for meeting Kentucky Power's need to replace the 800 MW Big Sandy Unit 2 no later than mid-2015.[4] Without the Mitchell Transfer, the Company will be energy-deficit beginning as early as January 2014[5], and will have a ***-66.26% reserve margin*** (-937 MW)[6] beginning the 2015/2016 PJM planning year. The Mitchell Transfer allows the Company to meet both of these needs in the least-cost fashion through the transfer to Kentucky Power of a fifty percent undivided interest in the efficient,[7] economical,[8] and environmentally-controlled[9] Mitchell generating station.

A. The Mitchell Transfer Represents The Culmination Of A Continuing, Eight-Year Investigation And Evaluation By The Company Of Its Big Sandy Environmental Compliance Options.

Continually changing circumstances beyond Kentucky Power's control forced it into a decision about the future of the Big Sandy Plant.[10] The past decade has seen dramatic tightening of environmental regulations governing coal-fired power plants, particularly those under the

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[2] LaFleur Hearing Testimony at 560.

[3] Exhibit SCW-1R.

[4] McManus Direct Testimony at 5.

[5] Weaver Rebuttal Testimony at 13 (Table 2R).

[6] Exhibit SCW-1 at 9.

[7] Karrasch Supplemental Testimony at 6.

[8] Pauley Hearing Testimony at 156-157.

[9] LaFleur Direct Testimony at 3-4.

[10] *See e.g.* Ronnie Ellis, *Lawmakers Send Letter To Obama Over "Unfair Attack On Coal,"* Ashland Independent, August 7, 2013 (detailing August 2, 2013 letter from a bipartisan group of 50 members of the Kentucky House of Representatives, including House Majority Floor Leader Adkins, Speaker of the House Stumbo, Representative Hall, and others, to President Obama expressing "deep concern" over the effect environmental regulation has had on the Commonwealth's coal industry, Kentucky's "cheap electrical rates," and the Commonwealth's ability to attract and retain industry.)

Clean Air Act. This changed regulatory framework prohibits Kentucky Power from operating the Big Sandy Plant as currently configured beyond May 2015.[11] In light of these changes, Kentucky Power has prudently evaluated all possible options to meet its customers' long term needs. The Company's exhaustive analysis demonstrates that the least-cost option is the transfer of a fifty percent undivided interest in the Mitchell generating station from Ohio Power to Kentucky.[12]

1. Emerging Environmental Requirements Will Prohibit The Operation Of the Big Sandy Plant as Currently Configured Thereby Resulting In The Need For Nearly 1,100 MW Of Replacement Generation No Later Than Mid-2015.

Beginning in May 2015, the Big Sandy Plant can no longer operate as currently configured. Emerging environmental requirements in the form of the 2012 Mercury and Air Toxics Standard ("MATS") and the terms of the 2007 New Source Review ("NSR") Consent Decree will make the current environmental controls at the Big Sandy Plant insufficient to maintain compliance. It is these changes to regulatory requirements, which indisputably are beyond the control of both the Commission and the Company,[13] that create the need for the Mitchell Transfer.

(a) *The Mercury and Air Toxics Standard ("MATS").*

On February 16, 2012, the United States Environmental Protection Agency published the final MATS Rule in the federal register.[14] The purpose of the MATS Rule is to reduce the

[11] McManus Direct Testimony at 5.

[12] Exhibit SCW-1R.

[13] Wohnhas Supplemental Testimony at 18.

[14] McManus Direct Testimony at 3.

emission of hazardous air pollutants from coal- and oil-fired electric generating units.[15] The final rule sets stringent, unit-specific emission limits for mercury, particulate matter (as a surrogate for non-mercury metals), and hydrochloric acid or sulfur dioxide (as surrogates for acid gases).[16] The initial compliance date for the MATS Rule is April 16, 2015; however, it is anticipated that the AEP-East operating units scheduled for retirement, of which Big Sandy Unit 2 is one, will be allowed to continue operation, without penalty, until May 31, 2015 to coincide with the end of the PJM 2014/2015 planning year.[17]

With its current environmental control equipment, the Big Sandy Units will be unable to comply with the emissions limits established in the MATS Rule.[18] As a result, Kentucky Power would have to install additional, expensive environmental control equipment (in the form of a flue gas desulfurization ("FGD") system), switch fuels, or retire.[19] Operation of the Big Sandy Units without these changes, in violation of the MATS Rule, would subject the Company to extensive civil penalties, injunctive relief, and likely criminal prosecution.[20] The environmental controls on the Mitchell Units, however, are expected to achieve the MATS Rule emission limits without any additional upgrades or installations.[21] The inability of the Big Sandy Units to comply with the MATS Rule without $900 million in changes to the facility[22] drives the decision to retire Big Sandy Unit 2.

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[15] McManus Direct Testimony at 3.

[16] McManus Direct Testimony, at 3-4.

[17] Weaver Direct Testimony at 9.

[18] McManus Direct Testimony at 5.

[19] McManus Direct Testimony at 5.

[20] *See*, Kentucky Power's Response to Commission Staff Hearing Data Request PH-8.

[21] McManus Direct Testimony at 5; McManus Hearing Testimony at 484-85.

[22] Weaver Direct Testimony at 22.

(b) *2007 NSR Consent Decree.*

In addition to the stringent emission limits established in the MATS Rule, the 2007 NSR Consent Decree contains provisions requiring Kentucky Power to explore alternatives to current Big Sandy Unit 2 operations. In December 2007, AEP and its eastern Operating Companies entered into a consent decree settling litigation with the United States Department of Justice, EPA, various states and other parties relating to the interpretation of NSR regulations associated with coal unit maintenance practices.[23] As relevant to this case, the 2007 NSR Consent Decree required Kentucky Power to install a FGD system at Big Sandy Unit 2 by December 31, 2015.[24]

On May 14, 2013, the United States District Court for the Southern District of Ohio, entered the third modification to the Consent Decree. The modification expanded the compliance options available to Kentucky Power for Big Sandy Unit 2 from solely installing a FGD to retrofitting the unit with an FGD,[25] repowering the unit, refueling the unit,[26] or retiring the unit.[27] The compliance date did not change. While the NSR Consent Decree's compliance date is after the date the Company is required to comply with the MATS Rule, the NSR Consent

[23] McManus Direct Testimony at 4.

[24] McManus Direct Testimony at 4.

[25] Retrofitting Big Sandy Unit 2 with an FGD unit is, on a CPW basis, $819 million more expensive than the Mitchell Transfer. Exhibit SCW-1R.

[26] It is not practicable to repower or refuel Big Sandy Unit 2. Weaver Direct Testimony at 20-21; Weaver Hearing Testimony at 726-727 ("So what you're left with – and I'm not sure one exists – is about a 2,000 MW facility.")

[27] McManus Hearing Testimony at 423. The third modification to the Consent Decree also authorized the installation of a dry sorbent injection ("DSI") system at the Indiana & Michigan Company's Rockport Plant in Indiana and extended the deadline to install FGD system on those units. Kentucky Power could not install a DSI system on Big Sandy Unit 2 without incurring expenses of the same magnitude of those likely to be incurred in installing an FGD system, principally because the Company would have to install a new, larger electrostatic precipitator as part of the DSI system installation. McManus Hearing Testimony at 479-481.

Decree – like the MATS Rule – mandates that Kentucky Power dramatically alter the current configuration at the Big Sandy Plant or retire it.[28]

2. Kentucky Power's Prudent Evaluation of Compliance Alternatives Led to the Least-Cost Mitchell Transfer Option.

In response to evolving environmental requirements and fundamental changes to the energy marketplace, Kentucky Power prudently evaluated all options available to it to meet its customers' long-term needs.[29] The specific regulatory driver of the investigation may have changed over the past eight years, but the focus remained the same – providing low cost, reliable capacity and energy to Kentucky Power's customers. The end result is the least-cost Mitchell Transfer presented in this case.

(a) *Evaluation Of Compliance Alternatives Under The Clean Air Interstate Rule ("CAIR").*

Kentucky Power and its parent company, AEP, evaluated upgrades to Big Sandy Unit 2 to meet emerging environmental requirements, especially those under the Clean Air Act. The work began in 2004 and focused, at that time, on whether the installation of a FGD system at Big Sandy Unit 2 would be part of a cost-effective compliance plan under the CAIR.[30] The CAIR includes a flexible compliance approach that allowed the AEP-Eastern fleet, of which Kentucky Power's Big Sandy Unit 2 is a part, to evaluate and determine where to install additional controls to meet the fleet-wide SO_2 and NOx emissions requirements.[31] During this portion of the

[28] *Id.*

[29] Walton Rebuttal Testimony at 5.

[30] *Id.* In July 2011, the US EPA issued the Cross State Air Pollution Rule ("CSAPR") to replace CAIR; however, in August 2012, the United States Circuit Court for the District of Columbia has vacated CSAPR and ordered EPA to continue to administer CAIR until a replacement for CSAPR is promulgated. McManus Direct Testimony at 6. EPA has appealed the DC Circuit's decision and the United States Supreme Court will hear the appeal in the coming term. McManus Hearing Testimony at 473-74.

[31] McManus Hearing Testimony at 431.

investigation it became clear to Kentucky Power and AEP that installing a FGD system at Big Sandy Unit 2 was not the most cost-effective alternative for fleet-wide compliance with CAIR and the investigation was suspended in 2006.[32]

The fleet-wide evaluation also showed that the installation of scrubbers at the Mitchell Plant was more cost-effective.[33] This decision was driven in large part by the Mitchell Plant's location and its ready access to higher-sulfur, lower-cost coal from the Northern Appalachian coalfields.[34] As a result, the Mitchell Plant resulted in lower cost CAIR SO_2 allowances available for use by the entire fleet for CAIR compliance, a benefit that Kentucky Power and its customers enjoyed for years under the Pool Agreement.[35] Kentucky Power's customers benefitted from the decision to scrub Mitchell through the AEP-East Pool Agreement, and by deferral of the costs, including a return on and of the Company's investment in, relating to a Big Sandy FGD unit.[36]

(b) *Evaluation Of An FGD System For MATS And NSR Consent Decree Compliance.*

Subsequent to the decision to suspend the FGD investigation, the Company entered into the NSR Consent Decree which required Kentucky Power to install a FGD system at Big Sandy Unit 2 no later than December 31, 2015. Kentucky Power knew, based on the experience of other AEP-East operating companies, that the FGD retrofit would require 54-60 months to complete.[37] Accordingly, to meet the 2015 in-service date, Kentucky Power reinitiated its prior

[32] Walton Rebuttal Testimony at 5.

[33] LaFleur Hearing Testimony at 596-98.

[34] *Id.* at 597-98.

[35] *Id.* at 598.

[36] Munczinski Hearing Testimony at 770.

[37] Walton Rebuttal Testimony at 5.

investigation into a FGD system for Big Sandy Unit 2 in the first quarter of 2010.[38] During the period when the investigation was suspended, FGD technology advanced so that for Big Sandy Unit 2, a "dry" FGD system was determined to be the most cost-effective system for installation.[39] While the technology changed, considerable work carried forward from the prior portion of the investigation provided real benefits to Kentucky Power and its customers.[40]

(c) *Filing And Withdrawal Of The "Scrubber Case."*

Having determined that the installation of a dry FGD system would be the best path forward to continue operating Big Sandy Unit 2 as a coal-fired generating unit, Kentucky Power in 2011 evaluated the relative economics of retrofitting Big Sandy Unit 2 against a complete suite of reasonable options. Significantly, at the time the Company undertook the analysis that led to the December 2011 filing of Case No. 2011-00401 (the "Scrubber Case"), the fifty percent Mitchell option was not available to it.[41]

Following the completion of this analysis, Kentucky Power sought a certificate of public convenience and necessity for the installation of a dry FGD system at Big Sandy Unit 2 in the Scrubber Case. The analysis filed in support of the Scrubber Case showed that, at the time it was performed, scrubbing Big Sandy Unit 2 represented the least-cost, lowest-risk option for Kentucky Power to meet its capacity and energy obligations to its customers in the face of the emerging environmental requirements. That said, the cost of scrubbing Big Sandy Unit 2 was

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[38] *Id.* The February 2012 publication of the Final MATS Rule also provided a need to reinitiate the FGD investigation as installation of an FGD would be required for Big Sandy Unit 2 to meet the emissions

[39] *Id.* at 4.

[40] *Id.* at 6.

[41] Pauley Direct Testimony at 11-12.

high – an estimated 31% increase for all customers.[42] In the time between the filing of the Scrubber Case in December 2011 and May 2012, conditions in the market changed, notably the order of the Ohio Public Utilities Commission mandating the divestiture of Ohio Power's generating assets, that counseled Kentucky Power to step back and reevaluate its options.[43] On May 30, 2012, Kentucky Power filed its motion with the Commission to withdraw its application on the Scrubber Case. The Commission granted the motion on May 31, 2012.

Following the withdrawal of the Scrubber Case, Kentucky Power again evaluated its options for operating after the 2015 environmental deadlines. As a result of the developments in Ohio,[44] the Company evaluated the addition of a 50% undivided interest in the already-retrofitted Mitchell generating station as an option.[45] As demonstrated by the evidence in this case, Kentucky Power's decade-long evaluation of environmental compliance options resulted in a solution that allows the Company to provide reliable, least-cost electricity to its customers for at least the next 25 years.

B. Kentucky Power's Robust Analyses Demonstrate That The Mitchell Transfer Is The Least-Cost Option.

To demonstrate that the Mitchell Transfer option was the least-cost option for Kentucky Power to meets its customers' long-term needs, Kentucky Power performed a robust economic modeling evaluation. This evaluation analyzed the Mitchell Transfer against a full suite of reasonable alternatives using Strategist® – an economic modeling software tool used throughout

[42] Pauley Hearing Testimony at 42-43.

[43] *Id.* at 43-44.

[44] *See* Munczinski Hearing Testimony at 771-772.

[45] Pauley Direct Testimony at 11-12.

the electric utility industry for resource planning decisions.[46] In performing the analysis, which took approximately a month, the Company made 55 modeling runs.[47] In light of the termination of the AEP-East Pool Agreement, Kentucky Power's modeling analysis was performed on a stand-alone basis – meaning that the Company could not rely on other pool members to make up any capacity or energy short fall.[48] The Strategist® model calculated the total revenue requirement for each alternative over the 30 year modeling period.[49] This amount was then discounted to 2011 dollars and reflected on a CPW basis.[50] Kentucky Power's Strategist® analysis focused not on the absolute CPW of each option, but rather on a comparative view of the alternatives.[51]

Kentucky Power's Strategist® analysis demonstrates that even on a CPW basis the Mitchell Transfer was the least-cost alternative by a margin of hundreds of millions of dollars.[52]

1. Kentucky Power Evaluated The Mitchell Transfer Against A Suite Of All Reasonable Alternatives.

As part of its Strategist® modeling analysis, Kentucky Power evaluated eleven[53] unique resource variations to address the unit disposition decisions for Big Sandy Units 1 and 2:[54]

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[46] Becker Direct Testimony at 2-3.

[47] Becker Hearing Testimony at 265.

[48] Weaver Direct Testimony at 15.

[49] *Id.*

[50] *Id.*

[51] *Id.*

[52] Exhibit SCW-1R.

[53] A twelfth option, Option 2C, subsequently was modeled at the request of Vice-Chair Gardner. Option 2C included a natural gas combined cycle plant constructed in 2017 plus the Big Sandy Unit 1 natural gas conversion *See* Kentucky Power's Response to Commission Staff Hearing Data Request PH-14.

[54] Weaver Direct Testimony at 5.

Option	Big Sandy Unit 2 Replacement	Big Sandy Unit 1 Replacement
1A	Retrofit with DFGD	20% Mitchell
1B	Retrofit with DFGD	PJM Market (10 yrs.)[55]
2A	Replace with NGCC	20% Mitchell
2B	Replace with NGCC	PJM Market (10 yrs.)
3A	BS1 Repower	20% Mitchell
3B	BS1 Repower	PJM Market (10 yrs.)
4A	PJM Market (5 yrs.)	PJM Market (5 yrs.)
4B	PJM Market (10 yrs.)	PJM Market (10 yrs.)
5A	50% Mitchell	Nat. Gas Conversion
5B	PJM Market (5 yrs.) And Then New Build Combined Cycle or Combustion Turbine	Nat. Gas Conversion
6	50% Mitchell	PJM Market (10 yrs.)

These eleven alternative scenarios represent all available, real-world, practical solutions for Kentucky Power to meet its long-term capacity and energy obligations to its customers in light of the emerging environmental requirements.[56] Against this suite of reasonable options, the Strategist® modeling confirmed that the Mitchell Transfer Option was the least-cost alternative.

[55] For alternatives with market purchases for periods less than the full study period the Strategist® model selected either a new-build combined cycle or simple-cycle combustion turbine to provide capacity and energy for the remainder of the period. *See* Becker Direct at 5-6.

[56] Weaver Direct Testimony at 47.

2. Kentucky Power's Economic Modeling Used Appropriate Inputs to Demonstrate that the Mitchell Transfer is the Least-Cost Option.

The Strategist® modeling that Kentucky Power used to evaluate its long-term resource planning options relies on several key inputs. Foremost among these are the long-term forecasts of Kentucky Power's energy sales and peak demand and the long-term forecast of generation related commodity prices, such as energy, capacity, coal, natural gas, emissions allowances and carbon/CO_2.[57] The long-term energy sales and demand forecast was prepared by AEP's Economic Forecasting group, and AEP's Fundamentals Analysis group prepared the long-term commodity price forecast.[58] In addition to the "base" commodity price forecast, the Company also used four additional pricing scenarios to represent the effects of higher fuel costs, lower fuel costs, an earlier CO_2 pricing date, and no CO_2 pricing.[59] These additional commodity pricing scenarios allowed the Company to evaluate each option over a range of plausible pricing scenarios, resulting in a more robust evaluation.[60]

Additional key inputs to the Strategist® model include the capital costs associated with each alternative. These costs were provided by AEP's Generation group and included costs developed as part of the FGD investigation described above and through collaboration with third-party architectural and engineering firms with extensive utility experience for the new-build options.[61] The analysis also included additional non-recurring environmental costs to address known capital improvements for emerging regulations.[62] These non-recurring costs were

[57] *Id.* at 16.

[58] *Id.*

[59] *Id.* at 17-18; Bletzacker Direct Testimony at 12-13.

[60] Bletzacker Direct Testimony at 13.

[61] Weaver Direct Testimony at 16-18, 22; Weaver Hearing Testimony at 719-720.

[62] Weaver Direct Testimony at 23-24; Exhibit SCW-4.

developed in a collaborative process among the Environmental Services and Projects groups within AEPSC.[63]

3. The Record Unambiguously Demonstrates That The Mitchell Transfer Is The Least-Cost Alternative.

(a) *The Company's Strategist® Analysis Demonstrates That the Mitchell Transfer Is The Least-Cost Alternative.*

The Strategist® modeling demonstrates that the transfer of a 50% undivided interest in the Mitchell generating station, combined with the conversion of Big Sandy Unit 1 to a natural gas fired steam boiler (Option 5A), is clearly the least-cost option for Kentucky Power to meet its long-term capacity and energy requirements in light of emerging environmental requirements. The relative CPW of all other options compared to Option 5A is summarized below:[64]

Option	Big Sandy Unit 2 Replacement	Big Sandy Unit 1 Replacement	CPW v. Option 5A (In Millions Of Dollars)
1A	Retrofit with DFGD	20% Mitchell	625
1B	Retrofit with DFGD	PJM Market (10 yrs.)	819
2A	Replace with NGCC	20% Mitchell	483
2B	Replace with NGCC	PJM Market (10 yrs.)	682
3A	BS1 Repower	20% Mitchell	558
3B	BS1 Repower	PJM Market (10 yrs.)	754
4A	PJM Market (5 yrs.)	PJM Market (5 yrs.)	532
4B	PJM Market (10 yrs.)	PJM Market (10 yrs.)	557

[63] McManus Hearing Testimony at 461-463.

[64] *See* Exhibit SCW-1R.

Option	Big Sandy Unit 2 Replacement	Big Sandy Unit 1 Replacement	CPW v. Option 5A (In Millions Of Dollars)
5A	50% Mitchell	Nat. Gas Conversion	-
5B	PJM Market (5 yrs.)	Nat. Gas Conversion	379
6	50% Mitchell	PJM Market (10 yrs.)	156

The two options that include the transfer of a fifty percent undivided interest in the Mitchell generating station as a replacement for Big Sandy Unit 2 are by far – hundreds of millions of dollars on a CPW basis – the least-cost alternative over the study period.[65] Indeed, even the transfer of a 20% interest in Mitchell,[66] whether coupled with the construction of a 762 MW combined cycle natural gas unit (Option 2A),[67] or the repowering of Big Sandy Unit 1 as a 745 MW natural gas fired combined cycle unit (Option 3A),[68] is at least $400 Million more expensive on a CPW basis.[69] The least-cost advantage of the Mitchell Transfer holds true over all five commodity pricing scenarios utilized by the Company in its modeling.[70] Stated otherwise, the rejection of the Settlement Agreement means the Company's customers will be forced to pay hundreds of millions of dollars more for their electricity between now and 2040.

To further test whether the Mitchell Transfer was the least-cost option, the Company also performed a "break-even" analysis in which it calculated how much the price used by the

[65] *Id.*

[66] This option also would leave the Company significantly capacity deficient. Weaver Rebuttal Testimony at 7-9.

[67] Weaver Direct Testimony at 6.

[68] *Id.*

[69] Exhibit SCW-1R.

[70] *Id.*

Company in its modeling of a new natural gas combined cycle unit[71] would have to decline so that the total cost of the unit over the study period equaled the study period cost of the Mitchell Transfer combined with the conversion of Big Sandy Unit 1 to natural gas. The analysis indicated that the "purchase" cost of a new combined cycle unit would have to decline *62%* to $448/kW before its CPW over the study period equaled that of the Mitchell Transfer and Big Sandy Unit 1 conversion.[72] In the case of an existing unit, the price would have to decline even further to $310/ kW because of the lower efficiencies of such units.[73] As Mr. Weaver observed, such a unit is not likely to be found or built.[74]

(b) *The Sensitivity Analyses Performed By Kentucky Power Further Support That The Mitchell Transfer Is The Least-Cost Alternative.*

Kentucky Power also ran a series of sensitivity analyses to confirm that Option 5A (Mitchell Transfer and Big Sandy Unit 1 gas conversion) was the least-cost alternative for the Company's customers. First, in response to a data request from Commission Staff, Kentucky Power evaluated the CPW of the Mitchell Transfer in the event a baghouse were required.[75] Even with the additional cost associated with installing a baghouse, Option 5A remains the least-

[71] The price of a new combined cycle unit that was tested by the break-even analysis was developed using data provided by third-party architectural (Sargent & Lundy) and construction engineering firms (Kiewit) with extensive utility experience with new-build options. Weaver Hearing Testimony at 719-720.

[72] Weaver Rebuttal Testimony at 20-21.

[73] *Id.*

[74] *Id.* This same analysis further underscores the absence of any need to perform an RFP to determine the least-cost alternative. *Id.*

[75] There is no reason to believe that a baghouse will be required. Weaver Hearing Testimony at 701; McManus Hearing Testimony at 476.

cost alternative; its CPW was $274 Million less than the closest non-fifty percent of Mitchell, option.[76]

In addition to the predominant gas-based options modeled in connection with its application,[77] Kentucky Power also evaluated the relative economics of a new option, "Option 2C" (natural gas combined cycle plant constructed in 2017 plus the Big Sandy Unit 1 natural gas conversion), that was almost entirely natural gas-based.[78] Using the Company's most recent natural gas forecasts, Option 2C was $560 million more costly, on a CPW basis, than Option 5A.[79] Significantly, and to stress the modeling further, the Company ran the Option 2C using the less plausible LOWER Band pricing for natural gas. Not only was the Mitchell Transfer combined with the conversion of Big Sandy Unit 1 to natural gas still the least-cost alternative of all of the options under this lower commodity price scenario, it was $377 Million less expensive on a CPW basis than Option 2C.[80] "This again suggests that the proposed Option 5A would continue to offer significant relative benefits to Kentucky Power's customers even under lower-than-anticipated natural gas pricing projections."[81]

Finally, Kentucky Power evaluated Option 5A under a scenario where the Mitchell Units were retired early, in 2035. While, as the testimony in this case clearly demonstrates, there is no reason to believe that the Mitchell Units will not continue in operation to 2040 and beyond,[82] this

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[76] Weaver Hearing Testimony at 700-702; Kentucky Power's Response to Commission Staff Data Request 2-17.

[77] Options 2 (replace Big Sandy Unit 2 with a new natural gas combined cycle facility), 3 (replace Big Sandy Unit 2 with a 745 MW combined cycle repowered Big Sandy Unit 1), and 4 market purchases followed by 700MW-800 MW gas-fired combined cycle or combustion turbine).

[78] Kentucky Power's Response to Commission Staff Post-Hearing Data Request, PH-14.

[79] *Id.*

[80] *Id.*, Attachment 1 at 1.

[81] Kentucky Power's Response to Commission Staff Post-Hearing Data Request, PH-14.

[82] LaFleur Hearing Testimony at 564-65.

early-retirement sensitivity analysis performed by Kentucky Power shows that even if the Mitchell Units were to retire early the Mitchell Transfer remains the least-cost alternative – by at least one quarter of a billion dollars – to meet the long-term needs of Kentucky Power's customers.[83]

By performing these sensitivity analyses the Company was able to "stress" its modeling by introducing unanticipated events (the requirement of an unanticipated major capital investment at the Mitchell generating station, lower than anticipated commodity prices, including natural gas, combined with an almost entirely gas-dependent alternative, and the early retirement of the Mitchell units). In each instance, the Mitchell Transfer was the least-cost alternative by a substantial amount. This indicates not only the robustness of the results, but the significant margin by which the Mitchell Transfer remains the least-cost option even when modeling for improbable scenarios that favor other alternatives.

(c) *The Results Of The Indicative 250 MW RFP*[84] *Confirm The Mitchell Transfer Is The Least-Cost Solution.*

Kentucky Power conducted a 250 MW RFP to evaluate alternatives for replacing Big Sandy Unit 1.[85] While a 250 MW RFP is not directly translatable to what would be expected in an RFP to replace the larger Big Sandy Unit 2, it is, as Mr. Kollen testified, useful in providing key market information:

> I would say that it's not directly translatable, if you - - if you will, but I do think it is indicative. In other words, that there is capacity out there, and, generally you can get a sense for what is available and - - and the pricing of it. So I think from that perspective, but it is not a direct analog of, you know - - ... - - 250 for 800.

[83] Kentucky Power's Response to Commission Staff Post-Hearing Data Request, PH-14.

[84] *See* Exhibit JAK-1S.

[85] Weaver Direct Testimony at 39.

> It's - - ... It's just not the same...But it's - - but it's a very good indicative, I think, for pricing purposes and availability.[86]

Mr. Karrasch, who conducted the RFP on behalf of Kentucky Power,[87] indicated in response to questioning from Vice Chairman Gardner [redacted]

[redacted][88]

The results of this indicative 250 MW RFP confirm that the Mitchell Transfer is the least-cost alternative. First, an analysis of conforming bids demonstrated that the Mitchell Transfer Option was indeed lowest cost. Second, the non-conforming bids were incapable of being evaluated or replacing Big Sandy Unit 2.

[86] Kollen Hearing Testimony at 229 – 231.

[87] Karrasch Supplemental Testimony at 3.

[88] [redacted]

(i) The Company's Stacking Analysis Of The Conforming Bids Confirms that the Mitchell Transfer Option is the Least-Cost Solution.

In response to the Commission's May 28, 2013 Order, Kentucky Power provided supplemental testimony outlining an analysis of the bids received in response to the 250 MW RFP. This analysis confirmed that the gas conversion of Big Sandy Unit 1 was the lowest cost alternative to replace Big Sandy Unit 1 coal-fired generation.[89] In addition, Kentucky Power performed a "stacking analysis" of the bids for comparison with the larger Mitchell Transfer Option. Kentucky Power performed this analysis in response to language in the Commission's May 28, 2013 Order stating that "the details of the bids submitted in response to this [250 MW] solicitation should provide useful information regarding the current availability and pricing of long-term generation...."[90]

Kentucky Power received a total of [redacted] bids in response to the 250 MW RFP. Of these, [redacted] were conforming.[91] Kentucky Power combined the most competitive conforming bids received in the 250 MW RFP into a "stack" of resources that closely approximated the size of the 50% Mitchell Transfer Option.[92] The Company then modeled this "stack" using the Strategist® tool and compared the CPW against Option 5A. Even before accounting for the impracticability of working with a patchwork of resources contained in the stack,[93] as well as the Company's

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[89] Weaver Supplemental Testimony at 9.

[90] *Id.* at 11; Order, *In the Matter of: The Application of Kentucky Power Company For: (1) A Certificate of Public Convenience And Necessity Authorizing The Transfer To the Company Of A Fifty Percent Undivided Interest In The Mitchell Generating Station And Associated Assets; (2) Approval Of The Assumption By Kentucky Power Company Of Certain Liabilities In Connection With The Transfer Of The Mitchell Generating Station; (3) Declaratory Rulings; (4) Deferral of Costs Incurred In Connection With The Company's Efforts To Meet Federal Clean Air Act And Related Requirements; And (5) For All Other Required Approvals And Relief* at 3. (Ky. P.S.C. May 28, 2013).

[91] Karrasch Supplemental Testimony at 5.

[92] Weaver Supplemental Testimony at 10.

[93] These include the risks associated with the Company neither owning or having a controlling interest in the resources, thus lacking the ability to control the maintenance and operation of the units. *Id.*

[redacted],[94] the modeling showed that Option 5A was $110 million less costly than the "stack" of RFP responses.[95]

(ii) The Non-Conforming Bids Were Not Capable Of Being Evaluated Or Replacing Big Sandy Unit 2.

The remaining [redacted] bids failed to meet one or more of the fundamental product requirements set forth in the RFP.[96] Of the non-conforming assets that theoretically could have provided the capacity and baseload energy to replace Big Sandy Unit 2, the flaws in the proposals were insurmountable. [redacted][97] As Mr. Karrasch testified, the RFP requirement limiting the responses to PJM resources[98] was in recognition of the fact that:

> [t]he process of securing all of the necessary firm transmission service [required for non-PJM resources] would add significant time, cost and uncertainty to a bid proposal from a resource in [redacted]. There is no need for KPCo or its customers to assume such large risks when alternatives, without those risks, are available within PJM.[99]

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[94] *Id.* at 11-12.

[95] *Id.* at 13-14.

[96] Karrasch Supplemental Testimony at 6.

[97] *Id.* at 6.

[98] This limitation is not unique to Kentucky Power; it also is found in RFPs issued by other PJM utilities in the Commonwealth such as Duke Energy Kentucky and East Kentucky Power Cooperative Corporation, Inc. Karrasch Hearing Testimony at 47.

[99] *Id.* at 7.

[redacted], much less rely upon the resources as a substitute for the Mitchell Transfer.[102]

[redacted] or evaluated fully, the information that was provided suggested that [redacted].[103] The entire 780 MW Mitchell Transfer, by contrast, is $536 Million or $648/kW.[104] [redacted] higher than the Mitchell Transfer price. Moreover, there is nothing in the record to suggest that the operating characteristics of [redacted] than the Mitchell heat rate of

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[100] [redacted].

[101] [redacted]

[102] Karrasch Supplemental Testimony at 6-7; [redacted].

[103] [redacted].

[104] Weaver Direct Testimony at 22.

[105] [redacted].

9,600.[106] [redacted] are unlikely to be a lesser cost alternative to the Mitchell Transfer.

[redacted][112]

4. The Mitchell Transfer Is Also Low Risk.

In addition to being the least-cost option for Kentucky Power's customers, the Mitchell Transfer is also a low risk alternative.[113] As part of its evaluation of the various alternatives, Kentucky Power performed a stochastic, Monte Carlo-type, modeling analysis of the resource alternatives using the Aurora$^{XMP®}$ tool.[114] This risk assessment modeling develops the revenue requirements of each alternative using multiple commodity pricing scenarios and provides a

[106] Weaver Hearing Testimony at 710.

[redacted]

[113] Weaver Direct Testimony at 42-44.

[114] *Id.* at 42.

measure of how susceptible (revenue requirement at risk or "RRaR") each alternative is to variations in commodity pricing.[115]

The Company's stochastic modeling demonstrated that the Mitchell Transfer, combined with the conversion of Big Sandy Unit 1 to natural gas, was the second least risky alternative.[116] Although Option 3A (repowering Big Sandy Unit 1 combined with the transfer of 20% of Mitchell) was determined to be slightly less risky (the difference in the RAaRs of the two options was only $4 Million or 0.8%)[117] it carried with it a $402 MW CPW premium.[118] Thus, other than Option 3A and its much higher price tag, the Mitchell Transfer was the least susceptible to changes in revenue requirement arising from variations in the Company's forecasted commodity prices.[119] What this means is that not only does the Mitchell Transfer provide Kentucky Power's customers with the least-cost solution to the Company's impending environmental requirements, but it does so with low risk.[120]

[115] *Id.*

[116] Exhibit SCW-6 at 1.

[117] *Id.*

[118] Exhibit SCW-1R.

[119] Weaver Direct Testimony at 42-44.

[120] *Id.*; Exhibit SCW-6.

5. Criticisms Of The Company's Modeling Are Meritless.

(a) *The Company's Long-Term Commodity And Other Price Forecasts Are Reasonable And Appropriate.*

(i) The Company's Forecasts Are Regularly Reviewed And Tested, And Also Updated When Reasonable

Witnesses for KIUC and the Sierra Club criticized Kentucky Power's use of the same long-term fundamental commodity price forecast values that were used in the Scrubber Case.[121] Their criticism is without merit. The AEP Fundamentals Group, responsible for developing the long-term forecast, regularly monitors the markets for changes.[122] In addition, Mr. Bletzacker's group has "access to some of the best consultancies in the United States, PIRA, CIRA, and Wood Mackensie, that are providing us insight daily, if not – if not hourly."[123] Not surprisingly, the Company's long-term natural gas forecast, for example, lies within the range of these external forecasts.[124]

While regularly being reviewed and tested, the Company's *long-term fundamental forecasts*, which are used in all aspects of the Company's business and not just Mr. Weaver's modeling, are only modified when changes in *the long-term drivers* of the fundamentals forecast make it reasonable to do so.[125] Indeed, the criticisms of Messrs. Kollen and Hayet seem founded more in their failure to appreciate the distinction between the terms "reviewing and testing" and "updating," than in any failing of the forecasts themselves. Under Messrs. Hayet and Kollen's logic, it is not enough to have your car regularly serviced and inspected by a mechanic to ensure

[121] Kollen Direct Testimony at 23-30; Hayet Direct Testimony at 12-28.

[122] Bletzacker Hearing Testimony at 499. ("we review those, our fundamentals, constantly.")

[123] *Id.*

[124] Bletzacker Direct Testimony at 5.

[125] Bletzacker Hearing Testimony at 499-500.

it can provide safe and reliable transportation. Instead, according to KIUC's witnesses, such peace of mind can only be obtained by buying a new – updated – car each year.

Mr. Bletzacker's review and revision of the long-term forecasts for natural gas prices, a commodity of some interest in the hearing, illustrates the process employed by the Company. In reviewing these forecasts, the Company considers the long-term drivers that affect natural gas prices, including upside pricing pressure from LNG exports, increased use of natural gas as a transportation fuel, and enhanced environmental regulation of natural gas extraction technologies.[126] Based upon its review of these and other drivers, the forecast "for each successive forecast since 2005, natural gas prices have been lowered."[127] Now, "we've reached a point where the threats to the upside [of natural gas prices] have really started to exceed those continued threats to the downside, this is a point where there's really a pause. There's no change in long-term drivers, so we will come up with long – new long-term forecast, and [*sic*] when those drivers justify the change."[128] Or, as Mr. Bletzacker assured the Commission during the hearing: "[n]one of those [changes in long-term drivers] are to the point to where it justifies a change today, but when they do, ***we will make that change***."[129]

(ii) The Intervenors' Use Of The Energy Information Agency ("EIA") Forecasts, As Well As NYMEX Futures Prices And Impairment" Testing Values Is Erroneous.

Messrs. Kollen and Hayet also urged the Commission to reject the Company's forecasts and instead employ a hodgepodge of selectively chosen values for certain commodity or other

[126] *Id.* at 500-01.

[127] *Id.*

[128] *Id.* at 500.

[129] *Id.* at 501 (emphasis supplied).

forecast prices.[130] None of the values advocated are appropriate for long-term modeling, much less superior to the forecasts employed by the Company. As an initial matter, however, the Intervenors erred in employing an *a la carte* approach in their modeling.[131] Some commodity prices[132] are correlated so that an increase in the price of one may increase the price of the other. Natural Gas and CO_2 are an obvious example; an increase in CO_2 prices (in the form of a tax or otherwise) is expected to lead to increased natural gas usage and a corresponding increase in natural gas prices.[133] The Company's fundamentals forecast recognizes and adjusts for these correlations through use of the Aurora$^{xmp®}$ model.[134] The Intervenors' modeling, on the other hand, modified some inputs without considering the effect of such changes on other inputs; it thus is flawed and unreliable.[135]

a. EIA Forecasts.

Calls by Intervenors to modify the Company's long-term commodity price forecast based on the Energy Information Agency ("EIA") forecast of natural gas prices ignore the inherent shortcomings of the EIA forecast.[136] The EIA forecast does not account for the effects of reasonably known and emerging regulations, making it particularly inappropriate for long-term

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[130] *See e.g.* Kollen Direct Testimony at 23-30 (impairment analysis capacity values); Hayet Direct Testimony at 13-17 (EIA natural gas prices).

[131] Bletzacker Rebuttal Testimony at 8, 10; Weaver Hearing Testimony at 696-697; Weaver Rebuttal Testimony at 36.

[132] With other commodity prices, natural gas and coal prices for example, the correlation is less clear, Weaver Hearing Testimony at 698-699 (remarking on understanding of low positive correlation between coal and natural gas, or there may be other reasons for not reflecting any correlation. Bletzacker Hearing Testimony at 496 (coal prices not modified to provide transparency in sensitivity modeling.)

[133] *Id.* 495.

[134] Bletzacker Direct Testimony at 4-5.

[135] Weaver Rebuttal Testimony at 36.

[136] Bletzacker Rebuttal Testimony at 2-3.

resource planning activities.[137] Additionally, analysis of the EIA forecasts show an inelastic supply, demand, and price relationship making its use for long-term resource planning purposes even riskier.[138] Despite these shortcomings, Kentucky Power performed a sensitivity analysis of the Mitchell Transfer Option using natural gas and energy values based on a corrected EIA forecast.[139] After correcting the EIA values for the effect of reasonably known and emerging regulations, as well as developing a more realistic price elasticity,[140] the Company used the EIA-based commodity forecast to compare Option 5A with an alternative proposed by KIUC.[141] The sensitivity analysis modeling showed that, ***even with EIA-based commodity pricing that favored natural gas, Option 5A remained the lowest cost alternative.***[142]

b. NYMEX Natural Gas Futures Are Not Forecasts And Are Inappropriate For Judging The Company's Natural Gas Forecasts In This Case.

Mr. Hayet also challenged the Company's forecasted natural gas prices based on changes in NYMEX natural gas futures.[143] Mr. Hayet's mistaken characterization of the NYMEX futures prices as "forecasts" is perhaps unique to him,[144] and reflects a fundamental misunderstanding[145] of the nature of the NYMEX prices:

> NYMEX futures represent the price point that willing buyers and sellers can agree to. That price, however, is unique to the individual buyer and seller and are [*sic*]

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[137] *Id.* at 3

[138] *Id.* at 3.

[139] *Id.* at 9.

[140] *Id.*

[141] Weaver Rebuttal Testimony at 39.

[142] *Id.* at 39, Table 5R.

[143] Hayet Amended Direct Testimony at 16.

[144] Bletzacker Rebuttal Testimony at 5-6.

[145] *Id.*

> not necessarily representative of the fundamentals of supply, demand and resulting spot market prices over a long-term (i.e. 25 year) period for the entire market.[146]

In addition, NYMEX futures prices are not weather-normalized,[147] unlike the Company's natural gas forecasts,[148] and are only available for approximately one-third of the Strategist® study period.[149] In short, contrary to Mr. Hayet's approach, "year to year changes in NYMEX future natural gas prices do not require an update to the fundamentals driven Long-Term North American Energy Market Forecast used in this proceeding."[150]

c. The AEP-Ohio Impairment Test Analysis Capacity Values Are Both Inappropriate For Use In The Company's Strategist® Modeling And Would Not Have Changed The Outcomes Of The Company's Modeling If They Had Been Used.

Mr. Kollen also criticized the Company's use of its forecasted capacity values in lieu of the lower PJM RPM-based capacity values employed in AEP-Ohio's impairment analysis.[151] But the impairment analysis values were developed for a different purpose than the Company's forecasted capacity prices, and thus, to employ Mr. Weaver's apt turn of a phrase, the use of the impairment analysis capacity values is akin to using a catcher's mitt to play first base.[152]

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[146] *Id.* at 4.

[147] Bletzacker Direct Testimony at 9.

[148] *Id.*

[149] *Id.* NYMEX futures, unlike the Company's 25-year weather normalized forecast for natural gas, are only available for ten years in the future. *Id.*

[150] Bletzacker Rebuttal Testimony at 4.

[151] Kollen Direct Testimony at 23-30.

[152] Weaver Rebuttal Testimony at 25.

Although both are proper baseball gloves (and forecasts), differences in the requirements of the position (analysis) in which they are employed make each unsuitable for use in the other.[153]

Even more telling is when the impairment analysis capacity values are substituted for the more appropriate (for the purposes of this proceeding) ones employed by Mr. Weaver, the Mitchell Transfer, coupled with the conversion of Big Sandy Unit 1 to natural gas, remained the least-cost alternative by a quarter of a Billion dollars.[154] In short, Mr. Kollen's criticism of the Company's modeling for failing to use the impairment analysis capacity values is a make-weight argument that is flawed in both theory and implementation.

(b) *There Was No Need To Perform An RFP To Demonstrate That The Mitchell TransferWas The Least-Cost Alternative.*

The evidence in this case shows that the Mitchell Transfer, especially when combined with the potential natural gas conversion of Big Sandy Unit 1, is the least-cost alternative to allow Kentucky Power to continue to meet its capacity and energy requirements in the face of emerging environmental regulations. Kentucky Power did not issue a request for proposals ("RFP") as part of its evaluation process because doing so was unnecessary.

(i) Kentucky Power's Analysis Utilized Benchmarks that Make an RFP Unnecessary.

Instead of conducting an RFP for up to 1,100 MW of capacity and energy, Kentucky Power evaluated the Mitchell Transfer against resource alternatives that served as proxies for what would be expected in response to an RFP. First, because a potential bidder with an existing resource in PJM would not bid that resource in response to an RFP for a price less than what it could receive by selling the output in the market, the Company's market alternative (Options 4A

[153] *Id.* at 25-26.

[154] Weaver Rebuttal Testimony at 23-24; Exhibit SCW-3R.

and 4B) provide an RFP proxy.[155] As discussed above, the Mitchell Transfer is far less costly, and less risky, to Kentucky Power's customers than the market proxy.[156]

Second, because Kentucky Power needs a long-term solution to replace the majority of its current capacity and energy, it is reasonable to assume that the bids received in response to an RFP would be equal to the cost of a new build natural gas, combined-cycle power plant.[157] Kentucky Power evaluated the Mitchell Transfer against such a new-build combined cycle facility via the analysis of Options 2A, 2B and 2C.[158] *Again*, the Mitchell Transfer was by far the lower cost alternative in each case.[159]

During the hearing, in response to questions from Vice Chairman Gardner, Dr. McDermott summarized why an RFP would be unnecessary to demonstrate that the Mitchell Transfer was the least-cost alternative, explaining, as discussed below, that the Company's Strategist® modeling would provide the same information as likely would be gleaned from an RFP:

> Q: And it's your belief that - - that an RFP is unnecessary?
>
> A: Right, because I think the participants in any RFP process would make the same types of calculations that Mr. Weaver did to get to their - - their ana - - their bids. So they would look at the market data.
>
> And, you know, when you think about it, if I own a power plant, and I have the opportunity to bid into a particular process, what are my alternatives? Well, I could sell power to the market.

[155] McDermott Direct Testimony at 11.

[156] *See* Exhibit SCW-1R.

[157] Weaver Direct Testimony at 37.

[158] *Id.* at 37; Kentucky Power's Response to Commission Staff's Hearing Data Request, PH-14; McDermott Direct Testimony at 11.

[159] *See* Exhibit SCW-1R.

Well, Mr. Weaver's analysis employed market proxies to develop an alternative price to compare to the original cost depreciated value.

Q: What were the market proxies that he used?

A: PJM prices.

Q: Did - - so if one - - was there anything else that was a proxy for the market other than PJM prices?

A: Well, the cost of entry was also modeled.

Q: What - - what does that mean?

A: That means that one of the alternatives a supply has is that they could build a new unit in order to supply the power that they would want to bid in.

And in this case, it was a combined cycle unit that they were using as the proxy, and those costs are pretty well-known in the marketplace, and so those can be accurately assessed and used another benchmark for what costs you would offer.[160]

An RFP was not required to determine the least-cost alternative because the Company's robust modeling provided benchmarks that adequately represented the response to any RFP process, while, as discussed, establishing the Mitchell Transfer as the least-cost alternative

(ii) There Is Only Speculation that an RFP Would Have Identified Unknown But Suitable Distressed Assets.

There also was speculation that an RFP might identify a suitable distressed asset – a "diamond in the rough" – that meets the Company's requirements for long-term capacity and energy at a below-market price.[161] This scenario, however, would be highly unlikely in this case. First, Kentucky Power's plans for significant changes to its current generation portfolio have been known for several years. Kentucky Power filed the Scrubber Case in December 2011 and

[160] McDermott Hearing Testimony at 630-31.

[161] Kollen Direct Testimony at 12.

then subsequently withdrew the application to reevaluate all possible alternatives.[162] At no time after it became clear that Kentucky Power was evaluating possible replacements for capacity and energy from the Big Sandy Plant did anyone come to the Company with a resource to meet its needs.[163] As part of AEP, Kentucky Power is well aware through Mr. Fransen and others of the market for generating assets, and the fact that there simply is not an existing, below-market asset that would meet its long-term capacity and energy needs.[164]

Moreover, the analysis performed by Company Witness Weaver further demonstrates how unlikely a suitable "diamond in the rough" is. As part of his evaluation, Mr. Weaver calculated a "break-even" point where the long-term CPW of a combined cycle plant would equal the CPW of the Mitchell Transfer Option.[165] For a new-build combined cycle plant, the cost would have to be reduced to $448/kW, a reduction of nearly 62%, to reach a point of economic indifference with Option 5A.[166] Because it would likely have poorer thermal efficiency and cost more to operate, the cost of an existing combined cycle plant would have to be reduced even further, to as low as $310/kW, to reach the same point of economic indifference.[167] In short, it is highly unlikely that an existing asset exists that would be discounted sufficiently to beat the Mitchell Transfer Option.

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[162] Pauley Hearing Testimony at 43-44.

[163] *Id.* Testimony at 105.

[164] *See* Fransen Rebuttal Testimony at 12.

[165] Weaver Rebuttal Testimony at 20.

[166] Weaver Rebuttal Testimony at 21.

[167] Weaver Rebuttal Testimony at 21.

(c) *The Company Appropriately Priced Carbon In Its Modeling.*

As part of its rigorous modeling, Kentucky Power ran the unit disposition alternatives using three different groups of "scenarios" that used (or in one case did not use) a $15 per ton "carbon tax" as a proxy greenhouse gas regulation.[168] The BASE, HIGHER Band, and LOWER Band scenarios each modeled the imposition of a $15 per ton carbon tax beginning 2022.[169] The Early Carbon scenario used the same $15 per ton carbon tax, but imposed it beginning in 2017.[170] Finally, the No Carbon scenario removed the carbon tax from the modeling.[171] The use of these scenarios allowed the Company to stress its modeling to account for any greenhouse gas regulation.

The $15 per ton value used for the carbon tax in the Company's modeling fairly accounted for any risk arising from greenhouse gas regulation. It is not a *de minimis* amount, but instead imposes real costs on Mitchell and other coal-fired generation:

> I think I mentioned that it [the $15 per ton carbon tax] had about a 10 to 12 percent reductive impact on Mitchell output in that 2022 time frame.
>
> ...
>
> that's a pretty significant impact inasmuch as if you're talking 12 percent of a unit that already has an excellent heat rate ... So if the agency is going to be true to the President's request that any performance-based reduction would be fair from the standpoint it is achievable, then I think ***we were very, very adequate in terms of the proxying of a $15 per ton carbon tax.***[172]

[168] Weaver Direct Testimony at 17-18; Weaver Hearing Testimony at 709-710.

[169] Weaver Direct Testimony at 17-18.

[170] *Id.* at 18.

[171] *Id.*

[172] Weaver Hearing Testimony at 710 (emphasis supplied).

This "very, very adequate" carbon price becomes even more so when that value was further stressed by the Early Carbon scenario that imposes the $15 per ton carbon tax five years prior to the likely advent of any such greenhouse gas regulation, even if done so in accordance with the President's June 25, 2013 initiative.[173] Yet, even under this Early Carbon scenario the Mitchell Transfer remains the least-cost alternative.[174] Finally, as discussed below, Paragraph 21 of the Settlement Agreement provides the Company's customers with further protections in the unlikely event the Company's carbon modeling proves anything but "very, very adequate."[175]

At the hearing, Mr. McManus was asked about an article reporting on the Department of Energy's recent regulatory impact statement assigning a $38 per ton cost to carbon as part of its efforts to justify higher efficiency standards for microwave ovens.[176] Neither the article, nor the regulatory impact statement serve to undermine the credibility of the Company's use of a $15 per ton carbon tax in its modeling. First, the speculation in the popular press concerning the effects of a federal agency's regulatory impact statement must be taken with more than a few grains of salt.[177] Second, the regulatory impact statement is not a proposal by the Department of Energy, much less the Environmental Protection Agency, to impose a $38 per ton carbon tax, or even to promulgate regulations that would have the effect of imposing such costs. Third, any such efforts would still be limited by the requirement of the Clean Air Act "that there has to be technology available that EPA can base whatever guidelines it establishes on."[178] Finally, and

[173] Munczinski Supplemental Testimony at 16.

[174] Exhibit SCW-1R.

[175] Weaver Hearing Testimony at 710.

[176] McManus Hearing Testimony at 444-450.

[177] *Id.* at 447 ("I'm not sure that it accurately describes exactly what's going on here. I don't' know that the reporter understands this, so I am not taking this at face value.")

[178] *Id.* at 449-450.

perhaps most importantly, any attempt to extrapolate from the decision to assign a $38 per ton societal cost to carbon to the appropriate value of carbon to model is an exercise in conflating apples and oranges:

> this is an attempt to put a dollar value on potential, as I indicated, either public health or environmental impacts from a changed climate going forward. ***That's very different than what it might cost to reduce CO2 emissions or to mitigate carbon emissions***
>
> ...
>
> It's not a value you would use to compare to, well, what it would cost you to reduce carbon emissions by – by improving the efficiency of a power plant. That's a mitigation cost. ***That is a very different cost, and they're not comparable.***[179]

In sum, the Company's modeling fairly and appropriately accounts for the risk and impact of future greenhouse gas regulation.

ARGUMENT

A. The Stipulation And Settlement Agreement Is In The Public Interest And Enables Kentucky Power's Customers To Receive "Two Of The Jewels Of AEP"[180] At A Discount, To Enjoy A Base Rate Case Freeze, To Avoid The Volatility Of The Market, And To Receive Other Benefits Not Available To Them Absent The Agreement.

The July 2, 2013 Settlement Agreement provides for:

- The transfer of an undivided fifty percent interest in the Mitchell generating station to Kentucky Power on December 31, 2013;
- Regulatory and other advantages such as decreased rate volatility attendant to a "steel in the ground" solution;
- Rates until at least May 31, 2015 that are significantly below those that otherwise would be required if the Mitchell Transfer were placed in base rates effective January 1, 2014;

[179] *Id.* at 448-49 (emphasis supplied).

[180] LaFleur Hearing Testimony at 560.

- A base rate freeze until at least May 31, 2015;
- Agreement by the settling parties concerning certain issues related to the Company's next base rate case;
- A concrete plan to increase Kentucky Power's fuel diversity;
- Risk mitigation for possible greenhouse gas regulation;
- Retention of the jobs and tax base associated with the conversion of Big Sandy Unit 1 to natural gas;
- Increased shareholder contributions to the Company's home energy assistance program, along with new shareholder contributions to Kentucky Power's economic development and job training efforts; and
- Increased spending on new Commission-approved demand-side management and energy efficiency programs.

The Settlement Agreement represents the product of more than six weeks of detailed and difficult negotiations among Kentucky Power, KIUC, and the Sierra Club. As in any negotiations, there was much give and take so that the final agreement represents a delicate balance among its three signatories. Moreover, although the Attorney General is not a party to the agreement, the Settlement Agreement fairly balances the interests of the Company ***and all of its customers***, not just those party to the agreement. The parties to the Settlement Agreement represent a diverse range of customer interests, have significant expertise in all aspects of Commission regulation, and provided the entirety of the testimony and data request responses in this case.

The Commission need not simply defer to the recommendations and expertise of the settling parties.[181] The record evinces that the Mitchell Transfer not only satisfies the requirements of KRS 278.020, KRS 278.2207, and KRS 278.300, but that there is insufficient

[181] *In the Matter of: Application of Louisville Gas And Electric Company For An Adjustment Of Its Electric And Gas Rates, A Certificate Of Pubic Convenience And Necessity, Approval Of Ownership Of Gas Service Lines, And A Gas Line Surcharge*, Case No. 2012-00222 at 7-8 (Ky. P.S.C. December 2012) ("LG&E Order").

credible evidence of record to support a contrary decision.[182] The Settlement Agreement itself accomplishes the Mitchell Transfer in a fashion that is in the public interest, and also provides benefits to all of Kentucky Power's customers beyond those that could be ordered by the Commission.

1. Under The Settlement Agreement Kentucky Power's Customers Receive The Benefits Of Owning Environmentally-Controlled, Efficient, Baseload Generation That Consists Of "Two Of The Jewels Of AEP" And That Is The Least-Cost Alternative.

(a) *The Mitchell Generating Station – "Two Of The Jewels Of AEP."*[183]

Paragraph 1 of the Settlement Agreement provides for the December 31, 2013 transfer to Kentucky Power of an undivided fifty percent interest in the Mitchell generating station.[184] The Mitchell generating station consists of twin, pulverized supercritical coal-fired base load 770 MW and 790 MW units.[185] Unlike Big Sandy Unit 2, the Mitchell generating station already is environmentally controlled with FGD and SCR units.[186] This fact alone represents a significant savings for the Company's customers. Indeed, the cost of just retrofitting Big Sandy Unit 2 with an FGD unit is ***86% greater*** than the projected transfer price of the ***entire*** 50% undivided interest in the Mitchell generating station – including the FGD and SCR units.[187] In addition, the Company's customers also will benefit from receiving installed, well-functioning, and optimized environmental controls,[188] thereby avoiding the financial and operating risks associated with new

[182] *Id.* at 8.

[183] LaFleur Hearing Testimony at 560.

[184] Settlement Agreement at ¶ 1.

[185] LaFleur Direct Testimony at 3.

[186] *Id.* at 3-4.

[187] $998 million/$536 million = 1.86. Weaver Testimony at 22 (Table 2).

[188] LaFleur Direct Testimony at 5.

construction.[189] With the FGD units and other existing environmental controls the Mitchell generating station – unlike Big Sandy Unit 2 – is expected to comply with both MATS and the 2007 NSR Consent Decree.[190]

There also is substantial benefit to the Company's customers in receiving a "known" asset – the Company understands what it is receiving.[191] The Mitchell generating station was built, operated, and maintained by Ohio Power Company[192] and will continue to be operated after the transfer by the same personnel currently operating the unit.[193] By contrast, the Company cannot have the same knowledge of, or expertise with, third-party units that might be considered in lieu of Mitchell, or that might underlie a power purchase agreement.[194] Along with the lack of knowledge inherent in third-party transactions comes the increased risk of higher capital and operating and maintenance costs associated with repairing and maintaining purchased third-party units that prove less reliable than Mitchell.[195]

The Mitchell Transfer also enables the Company to mitigate the consequences of a unit outage. Currently, when Big Sandy Unit 2 suffers a planned or forced outage, the Company sustains a loss of 800 MW of capacity. Kentucky Power will receive its 780 MW undivided interest in Mitchell capacity in lieu of Big Sandy Unit 2 in two "pieces:" 385 MW of the 780 MW Unit 1 and 395 MW of the 790 MW Unit2.[196] Because the Company will receive an

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[189] Munczinski Supplemental Testimony at 15.

[190] LaFleur Direct Testimony at 4.

[191] LaFleur Rebuttal Testimony at 5; Munczinski Hearing Testimony at 778.

[192] *Id.*

[193] *Id.* at 9 ("the Company will benefit from the continuity of staff expertise given AEP's ownership and operation of 800 MW units at not only the Mitchell Plant, but at Amos Units 1 and 2 and Big Sandy Unit 2 as well.")

[194] *Id.*; Karrasch Supplemental Testimony at 9.

[195] *Id.*

[196] Pauley Direct Testimony at 13.

undivided fifty percent interest in each of the two Mitchell units, the loss of a single unit will leave the remaining unit's capacity available to the Company, thereby mitigating the risk that now exists with the loss of the single 800 MW Big Sandy Unit 2.[197] This is a substantial benefit, particularly in light of the termination of the AEP-East Pool Agreement.

The Mitchell Transfer also provides a hedge against the premature retirement of Big Sandy Units 1 and 2:

> With the planned retirement of Big Sandy Units 1 and 2 in June 2015, Kentucky Power has reduced its Plant investments so that expenditures necessary to support plant safety and environmental compliance are incurred, primarily. Should either Big Sandy Unit 1 or Big Sandy Unit 2 encounter a major issue that would take the unit out of service before its planned retirement date, additional investment would be more difficult to justify given the need to retire the unit by June 1, 2015.[198]

With the December 31, 2013 termination of the Pool Agreement, and absent Mitchell, Kentucky Power's customers could be required to pay the possibly higher spot capacity and energy prices in the event either of the Big Sandy Units are forced to retire early.[199] Even with both Big Sandy Unit 1 and Unit 2 functioning, but absent Mitchell, Kentucky Power may be required to buy 1,069 GWh of energy in the seventeen months prior to the retirement of the Big Sandy units.[200]

The two Mitchell units are among the most economical units in the AEP Eastern Fleet,[201] and every bit the equal of Big Sandy Unit 2.[202] They are capable of burning a lower-

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[197] *Id.* at 16; Wohnhas Supplemental Testimony at 11.

[198] LaFleur Rebuttal Testimony at 2-3.

[199] *See* Karrasch Supplemental Testimony at 8-9.

[200] Weaver Rebuttal Testimony at 12-13. The 1,069 GWh shortfall is calculated assuming the units are fully dispatched "during all hours – excluding planned and forced outages – regardless of the relative dispatch economics." *Id* at 13. If the Big Sandy units were to be dispatched on an economic basis, the shortfall may reach 5,415 GWh. *Id.*

[201] Karrasch Supplemental Testimony at 6.

[202] Pauley Hearing Testimony at 156-157. *See also, id.* at 157 ("their ability to perform moving forward is – is – is solid.")

cost blend of high-sulfur and low-sulfur coal.[203] Like all of AEP's generation fleet, the Mitchell units have been well-maintained; in fact they "receive a high-priority for operational reliability and maintenance-related expenditures."[204] Ohio Power has made, and Kentucky Power expects to continue to make, the level of investment in the Mitchell Plant that permit it to provide reliable and economical baseload generation.[205]

No one who was in the hearing room on July 11, 2013 can doubt Mr. LaFleur's pride in "two of the jewels of AEP,"[206] or the sincerity of his belief, founded on more than 30 years of generating station experience,[207] including the Mitchell generating station,[208] that the Mitchell Units 1 and 2 will continue to operate past the 2040 end of the study period:

> I have no problem testifying that ***the unit physically capable of doing it [running unit at least 2040], and – and I believe it will do it.***[209]
>
> The – the capital plan we have in the model for the Mitchell units is to continue to run ***these units for at least through the analysis whether the transfer occurs or not. These are valuable units and they are going to run.***[210]
>
> ...
>
> We – we – ***we constantly are doing studies on different options***, equipment, adding equipment, not adding equipment. I, as well as our engineering department has input into those studies. Mr. Weaver would – I think, can explain his process ***but I did weigh in on whether or not those units could run till 2040*****.....** And like I said, we look at our assessments as well as the third-party

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[203] LaFleur Direct Testimony at 4.

[204] *Id.* at 3; LaFleur Hearing Testimony at 558-559.

[205] LaFleur Testimony at 3, 6-7; LaFleur Hearing Testimony at 558-561, 588-589. Notwithstanding the more than $600 million of additional capital investment included in the Company's Strategist® modeling for Mitchell generating station during the study period, LaFleur Hearing Testimony at 563; Exhibit SCW-4, the Mitchell Transfer remains the least-cost alternative relative to the other options by hundreds of millions of dollars. Exhibit SCW-1R.

[206] LaFleur Hearing Testimony at 560. Mr. Munczinski, Senior Vice President – Regulatory Services, American Electric Power Service Corporation, similarly characterized the Mitchell units: "We did the best – made the best decisions – gave them the best assets." Munczinski Hearing Testimony at 763.

[207] LaFleur Direct Testimony at 1-2.

[208] *Id.* at 6.

[209] LaFleur Hearing Testimony at 562 (emphasis supplied).

[210] *Id.* at 565 (emphasis supplied).

assessments on individual pieces of equipment, and collaboratively we look – we decide whether or not there are any indications that would keep us from making during that evaluation period – and that's what we did.

We know of no indication, any life threatening indication, such as creep or any other indication, that would end the life of those units.[211]

The Settlement Agreement paves the way for the transfer of these superior units to Kentucky Power, and will permit Kentucky Power's customers to continue to enjoy the advantages of efficient and economical coal-fired base load generation through at least 2040.

Mr. Munczinski testified at length under close questioning from each member of the Commission concerning Kentucky Power's long-term commitment to its customers, and why the Mitchell units and the Settlement Agreement are the best-solutions – both in the short-term and the long-term – for the issues facing the Company and its customers.[212] And as Mr. Munczinski explained, "it was a good story, it was an honest story."[213] But as compelling as Mr. Munczinski's testimony was, there is an independent barometer of both the value the Company places in the Mitchell units, [redacted] so as to remain, as discussed below, an asset-based utility subject to full Commission cost-based regulation. [redacted]

[211] *Id.* at 583-584. *See also* Munczinski Hearing Testimony at 754.

[212] Munczinski Hearing Testimony at 752-782.

[213] *Id.* at 772.

[214] [redacted]

Company.[215] The Mitchell Transfer represents the Company's effort to do the right thing, to offer up the best solution for its customers, [redacted].

(b) *The Mitchell Transfer Is The Least-Cost Alternative.*

The Mitchell Transfer, which the Settlement Agreement facilitates, also represents the least-cost alternative to the disposition of Big Sandy Unit 2.[216] Indeed, coupled with the conversion of Big Sandy Unit 1 to natural gas, the Mitchell Transfer, even on a CPW basis, is hundreds of millions of dollars less expensive than any of the alternatives:

Option	**Description**	**Cumulative Present Worth Of The Premium To Be Paid By Kentucky Power Customers To Acquire Alternative**
1	Retrofit Big Sandy Unit 2 with a scrubber	$625-$819 Million
2	Replace Big Sandy Unit 1 and Big Sandy Unit 2 with a New Build Natural Gas Combined Cycle Unit	$483-$682 Million
3	Repower Big Sandy Unit 1	$558-$754 Million
4	Replace Big Sandy Units 1 and 2 With Market Purchases And Then Build A Combined Cycle or Combustion Turbine	$532-$557 Million
5[217]	Replace Big Sandy Unit 2 Only With Market Purchases And Then Build A Combined Cycle or Combustion Turbine	$379 Million
2C[218]	Replace Big Sandy Unit 2 With A Combined Cycle Unit	$560 Million

Source: Exhibit SCW-1R; Company's Response to Hearing Data Request 14.

[215] [redacted]

[216] Exhibit SCW-1R; Munczinski Hearing Testimony at 778; Weaver Hearing Testimony at 685; Pauley Hearing Testimony at 15, 113; Wohnhas Supplemental Testimony at 38.

[217] Assumes Big Sandy Unit 1 is converted to natural gas.

[218] Assumes Big Sandy Unit 1 is converted to natural gas.

In fact, for all but three of the ten alternatives modeled, the CPW of the premium that will be imposed on the backs of Kentucky Power's customers if the settlement is rejected ***exceeds*** the transfer price of the Mitchell units.[219]

Significantly, the alternatives carry this premium under all scenarios[220] – whether there is an early (2017) carbon tax,[221] no carbon tax,[222] high commodity prices,[223] or low (including natural gas) commodity prices.[224] That is, even if natural gas prices are materially lower[225] than modeled by Kentucky Power in its BASE Case, the Mitchell Transfer remains the least-cost alternative when compared to natural gas alternatives. For example, the Mitchell Transfer and the conversion of Big Sandy Unit 1 are $682 million less expensive than a new build natural gas combined cycle unit, and $379 million – more than a third of a billion dollars – less expensive than an option that combines market purchases, a new build combined cycle or combustion turbine unit and the conversion of Big Sandy Unit 1 to natural gas.[226] Most importantly, this cost advantage to the Company's customers only increases when the rate benefits of the Settlement Agreement, discussed below, are considered because the Strategist® modeling is premised upon

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[219] Exhibit SCW-1R. *See also* Munczinski Hearing Testimony at 770.

[220] Because of time constraints, Option 2C was only modeled using the BASE Case assumptions.

[221] *Id.* Under the Early Carbon scenario the rejection of the Settlement Agreement would saddle customers with a $293 million to $770 million in additional revenue requirements on a CPW basis.

[222] *Id.* The No Carbon scenario yields a $475 million to $860 million premium on CPW basis in the event Kentucky Power does not acquire Mitchell.

[223] *Id.* The HIGHER Band commodity price scenario results in a $591 million to $1.131 billion premium on a CPW basis.

[224] *Id.* Rejection of the Mitchell Transfer under the LOWER Band commodity scenario would result in a $181 million to $737 million premium on a CPW basis.

[225] For example, under the LOWER Band scenario natural gas prices are projected to be approximately 12% less than the BASE Case price for natural gas. Exhibit SCW-3.

[226] Exhibit SCW-1R.

the customers paying all of the costs associated with the Mitchell units. By contrast, under the Settlement Agreement the customers pay only a fraction of those costs for the first 17 months.[227]

2. The Settlement Agreement Provides The Commission, The Company's Customers, And Kentucky Power With The Benefits Of The Regulated Owned Asset Model While Avoiding The Volatility and Increased Risk Attendant To A Market-Based Solution.

The regulated owned asset model, which has been extant in Kentucky during most, if not all, of the more than 100 years of the Company's existence,[228] is premised upon the ownership and operation by the utility of the facilities used to provide service to customers.[229] The model produces stable and predictable rates for customers, while providing the Company with a stable source of revenue.[230] The stable revenue stream in turn permits the Company to "finance long-term investments like the Mitchell units at a low cost."[231] The model has provided "low electricity costs for customers in Kentucky."[232] In fact, "the end use rates for electricity that customers paid in Kentucky are the third lowest in the country and 27% below the national average ...."[233] Most fundamentally, the regulated owned asset model provides the Company's customers with the best of the market-based and the cost-based worlds:

> At times when the market price of energy is below the cost of producing the same power from an owned asset, the Company procures power from the market and provides the savings to customers. At times when the market price of energy is above the cost of producing the same power from an owned asset, the Company procures power from the owned asset and provides the savings. ***When energy***

[227] *See* Wohnhas Supplemental Testimony at 12.

[228] Munczinski Hearing Testimony at 756.

[229] Munczinski Supplemental Testimony at 3-4.

[230] *Id.* at 3.

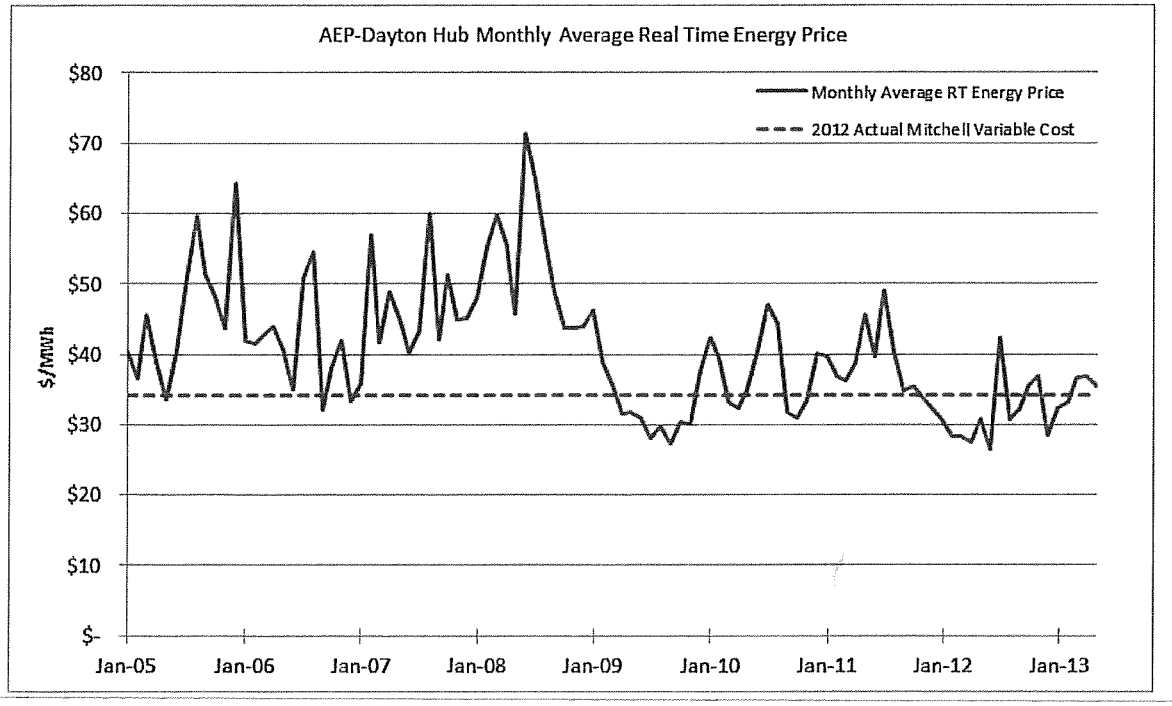
[231] *Id.*

[232] *Id.* at 4-5.

[233] *Id.*

markets are high, the customer is protected. When energy markets are low, the customer can benefit – without facing the risks the risks of market.[234]

The regulated owned asset model also protects the Company's customers and the Company against the extreme volatility[235] of the PJM capacity and energy markets.[236] For example, on average the PJM Reliability Pricing Model market for capacity has changed by 96% annually, with annual swings exceeding 350%, during its existence.[237] Market energy prices have proven equally volatile. Average monthly prices in the PJM energy market have increased as much as 60% as recently as the summer of 2012. Moreover, since 2005 this volatility in monthly average energy prices has mostly been at levels ***above*** the 2012 actual Mitchell variable cost:[238]



[234] *Id.* at 4 (emphasis supplied). *See also* Munczinski Hearing Testimony at 766-767 ("You get a free option on energy. Energy is going to be – whatever it is out there – it is the cheapest.")

[235] Munczinski Supplemental Testimony at 5.

[236] *Id.* at 6.

[237] *Id.*

[238] *Id.* at 7

In addition, certain aspects of the PJM markets have been subject to manipulation,[239] further undermining the willingness of regulated entities to rely upon the markets.

This volatility brings with it not only the risk of high prices, but also other real world consequences. Certainly, it adversely affects the ability of communities in the Company's service territory to retain and attract good-paying industrial jobs,[240] a not insignificant concern in one of the poorest areas in the Commonwealth:[241]

> One of the problems is that our economic development people are telling us that when an industrial comes to Ohio, the first question they ask is, "What are your electric prices?" And nobody knows. Because if you look at that curve, it could be anywhere between $30 and $70. And I can't tell you what next week's, next year's, two years, three years from now is going to be.
>
> So what they'll do is they'll say, "Well, I'll go to Indiana, I'll go to Kentucky," because we know the coal-based states ... The coal base states are not going to see that kind of volatility and the regulatory states are not going to see that kind of volatility.[242]

Likewise, this volatility can also impair the financial strength of the utility and affect its ability to maintain the steady revenue stream necessary to raise capital at lower costs and make the investments required to provide reliable, low-cost service.[243] In addition, because the current low PJM RPM capacity rates associated with this volatility do not reflect the long-term cost of

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[239] *Id.* at 8-9.

[240] Munczinski Supplemental Testimony at 4, 6, 7.

[241] Wohnhas Supplemental Testimony at 10. *See also* Statement by Chairman Armstrong , Hearing Transcript at 777-778.

[242] Munczinski Hearing Testimony at 762-763. Conversely, a coal-based unit like Mitchell, coupled with the stable and predictable rates resulting from the regulated owned asset model, helps bring jobs to the area. *Id.* at 779.

[243] *Id.* at 779-780 ("the street likes that better, likes the stability, likes the predictability, and that's what – that's really what our company is about.") *See also* Munczinski Supplemental Testimony at 3, 7. Even in the absence of volatility, market-based solutions such as purchase power agreements can stress Kentucky Power's financial metrics and yield higher costs. *Id.* at 14.

capacity[244] a utility foregoing owned assets and relying upon the market is likely to face either the inability to acquire needed generation or much higher energy rates.[245]

Rejection of the Settlement Agreement, and the regulated owned asset model the agreement facilitates, also will undermine the ability of this Commission to do its job. The Commission's long-standing preference for a "steel in the ground" solution – which has well served the citizens of the Commonwealth[246] – allows the Commission to continue its full regulatory control over the Company and its business.[247] Rejection of the Settlement Agreement will force the Company to the market, thereby ceding a not insignificant amount of the Commission's regulatory wherewithal to FERC.[248] Moreover, the traditional regulatory model provides the Company and the Commission greater flexibility to work with all stakeholders to reach a solution – such as the Mitchell Transfer – that is in everyone's best interest:

> what we want to do is to be committed to Kentucky, and the way to be committed is through a regulatory model so that we all work together and we all try to solve some of these problems.
>
> If we go to market, if we go to an RFP, if we buy a plant in Pennsylvania or Illinois that we don't even understand, that's not helping our customers.[249]

Finally, rejection of the Settlement Agreement, or efforts to modify the delicate balance it strikes, will not only increase risk and volatility, but also lead to greater uncertainty and continued litigation. With the termination of the Pool Agreement, and without Mitchell,

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[244] Munczinski Supplemental Testimony at 8.

[245] *Id.* at 9-10. *See also* Herbert W. Stein, *Herb Stein's Unfamiliar Quotations*, Slate Magazine http://www.slate.com/articles/business/it_seems_to_me/1997/05/herb_steins_unfamiliar_quotations.single.html#pagebreak_anchor_2 (May 16 1997) ("If something cannot go on forever, it will stop.")

[246] Wohnhas Supplemental Testimony at 10.

[247] Munczinski Supplemental Testimony at 14; Wohnhas Supplemental Testimony at 10-11; Karrasch Supplemental Testimony at 9-10.

[248] *Id.*

[249] Munczinski Hearing Testimony at 778. *See also* Munczinski Supplemental Testimony at 14-15.

Kentucky Power is projected to be energy short beginning January 2014.[250] Similarly, without Mitchell, Kentucky Power is projected to fall from a 22.74% reserve margin in the current 2013/2014 planning year to a ***-66.26%*** reserve deficiency in the 2015-2016 planning year.[251] In light of the Company's clear need for capacity and energy, the status quo is not an option; indeed, the rejection of the Settlement Agreement:

> only kicks the ball down the road. The Commission and all of the parties to this proceeding will not only be faced with addressing again Kentucky Power's long-term capacity needs in the very immediate future, there is no guarantee that the available solutions will carry the price and other advantages of the Mitchell transfer.[252]

Starting anew by issuing an RFP or going with another alternative not only means further proceedings before this Commission, but also the uncertainty, disruption, and costs that come with such proceedings. As with many things,[253] the failure to act out of concern of unknowns, or in hopes of finding the "magic bullet," carries with it more – not less – uncertainty and risk, along with higher costs.[254]

3. The Settlement Agreement Provides Substantial Rate Benefits To The Company's Customers.

Under Paragraph 4 of the Settlement Agreement, Kentucky Power agreed to limit its recovery of the Company's Mitchell related non-fuel costs, including the Company's return on and of its investment in the Mitchell units, to $44 million annually.[255] In return, the Company's

[250] Weaver Rebuttal Testimony at 13-14.

[251] Exhibit SCW-1at 9. Even with Mitchell, the Company's reserve margin, after the retirement of Big Sandy Unit 2, is projected not to exceed 20.8% -- that is, less than it currently is. *Id.* at 10.

[252] Wohnhas Supplemental Testimony at 9.

[253] *See* Voltaire, *Dictioinnaire Philosophique*, Dramatic Art (1764) ("The best is the enemy of the good.")

[254] Wohnhas Supplemental Testimony at 9.

[255] Settlement Agreement at ¶ 4

base rates will not be adjusted January 1, 2014 to reflect the Mitchell Transfer.[256] Instead, beginning January 1, 2014 the $44 million will be recovered through the Asset Transfer Rider, which will remain in effect until the Company's next base rate case.[257] By contrast, without the Settlement Agreement the increase in the Company's stand-alone Mitchell-related annual revenue requirement would be approximately $138 million,[258] or more than three times the amount provided for in the Settlement Agreement. Over the 17 months the Asset Transfer Rider will be in effect Kentucky Power's customers will save $7.83 million a month, or more than $133 million between the date of the Mitchell Transfer and the expected retirement of Big Sandy Unit 2.[259]

By facilitating the transfer of the Mitchell units, which unlike Big Sandy Unit 2 can burn a blend that includes high sulfur coal,[260] the Settlement Agreement provides the Company's customers further rate relief through lower fuel costs[261] which will reduce the amounts recovered through Kentucky Power's fuel adjustment clause. Kentucky Power estimates that the difference between Mitchell fuel costs and Big Sandy fuel costs is approximately $2.50/MWh.[262] By including the Mitchell units in the economic dispatch of Kentucky Power's generation

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[256] Under paragraph 3 of the Settlement Agreement, the Company agrees to withdraw its pending base rate case, Case No. 2013-00197, and to maintain its current base rates through at least May 31, 2015. The base rate freeze is further subject to the force majeure provision of paragraph 16.

[257] Settlement Agreement at ¶ 4.

[258] Kollen Hearing Testimony at 218, 220; Kentucky Power's Response to KIUC Hearing Data Request 1. The difference between the $44 million and $138 ***is not deferred*** for later recovery. Kollen Hearing Testimony at 220.

[259] (138 Million - $44 Million)/12 months = $7.83 Million/month. $7.83 Million/month x 17 months = $131.17 Million. *See also* Kollen Hearing Testimony at 220 ("So, in other words, the – the haircut, if you will, to use a slang term, is almost a $100 million per year.")

[260] LaFleur Hearing Testimony at 566.

[261] Wohnhas Supplemental Testimony at 13; Settlement Agreement at ¶ 2.

[262] Wohnhas Supplemental Testimony at 13.

resources,[263] and "[b]ased on 2012 jurisdiction kWh sales of 6.7 GWh, these fuel savings benefits could total $16.75 million annually."[264] These estimated fuel savings will further reduce the annual cost of the Mitchell Transfer during the 17-month period between the transfer and the retirement of Big Sandy Unit 2 from $44 million to $27.25 million,[265] or a 5.33% increase in the Company's' revenue requirements.[266] In return, the Company's customers receive the benefits of reliable, baseload generation for at least the next 30 years.[267]

Finally, the Settlement Agreement provides Kentucky Power's customers with a third rate benefit. Paragraph 3 requires the Company to withdraw its pending application[268] for an adjustment of its rates. In that application, which includes the full recovery by the Company of its costs in connection with the Mitchell Transfer among other adjustments, the Company is seeking to increase its revenue by 23.39%,[269] or approximately three times the increase provided for in the Settlement Agreement without the fuel savings during the period prior to the retirement of Big Sandy Unit 2.[270] The rate benefit is even more dramatic in the case of the Company's residential customers. If the pending rate application were granted in full, the revenue to be collected from the Company's residential customers through base rates would increase by $62.553 million or 31.12%.[271] Although this 31.12% increase would be partially offset by the

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[263] Settlement Agreement at ¶ 2.

[264] Wohnhas Supplemental Testimony at 13

[265] Kentucky Power's Response to Staff Data Request 5-10, col. 2, row 11.

[266] *Id.* at row 13.

[267] Munczinski Hearing Testimony at 775.

[268] Application, *In the Matter of: The Application For General Adjustment Of Electric Rates Of Kentucky Power Company*, 2013-00197 at 6 (Ky. P.S.C. Filed June 28, 2013) ("2013 Rate Application").

[269] *Id.* at 6.

[270] $44 million/$511.321 million = 8.61%. Kentucky Power's Response to Staff Data Request 5-10, col. 2, rows 1, 12.

[271] 2013 Rate Application at 7.

residential customers' share of Mitchell-related fuel savings, and there is no guarantee that the Company's rate application would be granted in full, the withdrawal under the Settlement Agreement of the Company's pending rate application will provide a real financial benefit to some of the poorest residential customers in the Commonwealth.[272]

Nor will the rate benefits associated with the Mitchell Transfer end with the retirement of Big Sandy Unit 2 in June 2015 and the expiration of the $44 million cap on the Company's recovery of its Mitchell non-fuel costs. Although the Strategist® modeling is not a cost of service study, the hundreds of millions of dollars of relative savings on a CPW basis provided by the Mitchell Transfer should translate into lower rates for all of the Company's customers.[273] In fact, there is compelling evidence in the record to support just this sort of common-sense reasoning.

In response to Staff Data Request 5-10 the Company provided an apples to apples comparison between the estimated stand-alone rate impact of the Mitchell Transfer and the stand-alone rate impact of the most-passionately advocated alternative to the transfer[274] – the retrofit of Big Sandy Unit 2 with a dry scrubber as proposed by the Company in Case No. 2011-00401. As set out in that response, the annual unadjusted cost of service impact of the retrofit of Big Sandy Unit 2 is $177.7 Million,[275] or nearly 2.2 times[276] the estimated annual unadjusted cost service impact of the Mitchell Transfer beginning July 2015.

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[272] Wohnhas Supplemental Testimony at 10.

[273] As Mr. Weaver notes, however, every $100 Million change in CPW is equivalent to a $2.00 MWh (0.200 cents/kWh) on Kentucky Power's annual revenue requirement on a levelized basis. Exhibit SCW-1R.

[274] *See* Statement of Representative Adkins at 16-28.

[275] Kentucky Power's Response to Staff Data Request 5-10, col. 1, row 1.

[276] *Id.* at col. 3, row 1. $177,699 million/$81,244 million = 218%.

Even when the Big Sandy retrofit cost of service is reduced to account for, on an annual basis, Big Sandy fuel savings ($18.211 Million), the elimination of AEP-East pool charge ($21.304 Million), and certain environmental costs that currently flow through the AEP-East pool ($7.32 Million), the annual ***additional costs to be borne by the customers if Big Sandy Unit 2 is retrofitted*** – relative to the Mitchell Transfer – are still an estimated $130.864 million.[277] By contrast, when the Mitchell Transfer annual cost of service is similarly reduced, but then ***increased*** to account for, in accordance with the Settlement Agreement,[278] Big Sandy Unit 2 decommissioning costs ($7.95 Million), the amortization of Big Sandy Unit 2's undepreciated balance ($21.056 Million), and the amortization of the Big Sandy Unit 2 2004-2012 Feasibility Study Costs ($6.598 Million),[279] the Mitchell Transfer adjusted cost of service is still only $71.472 Million,[280] or only 55%[281] of the Big Sandy Unit 2 retrofit $130.9[282] Million adjusted cost of service impact. Not surprisingly then, the ***total***[283] (not incremental) estimated Mitchell Transfer and retirement of Big Sandy Unit 2 revenue requirement increase is 13.98% compared to the 25.59% revenue requirement increase that the retrofit of Big Sandy Unit 2 would require.[284]

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[277] *Id.* at col. 1, rows 2, 4, 5.

[278] *See* Settlement Agreement ¶¶ 8, 14.

[279] Kentucky Power's Response to Staff Data Request 5-10, col. 3, rows 7-9.

[280] *Id.* at col. 3, row 11.

[281] $130.864 million/$71,472 million = 54.8%.

[282] Kentucky Power's Response to Staff Data Request 5-10, col. 1, row 11.

[283] The January 2014 to June 2015 increase of 5.33% is not additive to the 13.98% revenue requirement increase. Kentucky Power's Response to Staff Data Request 5-10.

[284] Kentucky Power's Response to Staff Data Request 5-10, col. 1, row 13; *Id* at col. 3, row 13.

In short, the Mitchell Transfer will continue to provide rate benefits to the Company's customers long after the retirement of Big Sandy Unit 2 as a result of the Settlement Agreement and because the Mitchell Transfer is the least-cost alternative.

4. The Settlement Agreement Will Facilitate Rate Stability.

In addition to providing the long-term rate stability and predictability inherent in the regulated owned asset model,[285] the Settlement Agreement facilitates short-term rate stability through a "stay-out" provision. Subject to a narrow and carefully drawn "force-majeure" provision, Kentucky Power committed to retain its current base rates through at least May 31, 2015.[286]

The Force Majeure provision of Paragraph 16 of the Settlement Agreement limits the Company's ability to file a base rate case during the stay-out period in three respects. First, the Company may invoke the Force Majeure Provision only in connection with "[t]he retirement of Big Sandy Unit 2 prior to May 31, 2015."[287] Otherwise, the Company is barred from seeking a general adjustment of its rates no matter how low its earnings. Second, the adjustment may only be sought only when required "to prevent its credit or operations from being materially impaired or damaged."[288] In addition, any such application must be sought in accordance with the emergency rate relief provisions of KRS 278.190(2), including "the Commission's orders and precedent governing such relief."[289] Finally, the amount of any such relief is limited to $24

[285] *See* Munczinski Supplemental Testimony at 3.

[286] Settlement Agreement at ¶ 3; Wohnhas Supplemental Testimony at 20.

[287] Settlement Agreement at ¶ 16. In addition, Big Sandy Unit 2 may only be "retired" upon review as required under the PJM tariff. Wohnhas Supplemental Testimony at 22.

[288] *Id.*

[289] *Id*

million annually; an order granting emergency relief effective February 1, 2015 would provide an additional $8 million in revenue, while one effective April 1, 2015 would provide at most $4 million of emergency rate relief.[290]

5. The Settlement Agreement Provides Significant Economic Benefits To Lawrence And Surrounding Kentucky Counties.

Big Sandy Unit 2 is located in Lawrence County, Kentucky.[291] During the public comment period during the hearing, commenters voiced concerns over the effect that the June 2015 retirement would have on Lawrence County and surrounding areas.[292] The decision to retire Big Sandy Unit 2 was forced on the Commission, the Company's customers, and the Company,[293] and it is one reached only after eight years of investigation,[294] including six months of proceedings in Case No. 2011-00401 in which the Company sought, over the strenuous objections of all parties to this proceeding, authority to retrofit Big Sandy Unit 2.[295] No one disputes that Big Sandy Unit 2 may remain open only if it is retrofitted with a scrubber. The ***billion dollar price tag*** of such a retrofit would produce a ***$819 million CPW premium*** over the costs of the Mitchell Transfer.[296] This price tag will be paid by the Company's Lawrence County customers, as well as the customers in the other 19 counties of its service territory, many

[290] Wohnhas Supplemental Testimony at 22.

[291] *Id.* at 15-16.

[292] *See* Statement of Representative Adkins at 16-28; Statement of Lawrence County Attorney Michael Hogan at 8-16; Statement of Representative Keith Hall at 28-33.

[293] Wohnhas Supplemental Testimony at 18.

[294] Wohnhas Testimony at 9-10; Wohnhas Rebuttal Testimony at 2.

[295] Wohnhas Supplemental Testimony at 17.

[296] Exhibit SCW-1R.

of whom are every bit as economically disadvantaged as the Company's customers living in Lawrence County.[297]

The Settlement Agreement contains several provisions that will help mitigate the effect of the retirement of Big Sandy Unit 2. The provisions are not the complete solution. But they provide meaningful help that is not otherwise available in the absence of the Settlement Agreement.

Most important among these provisions is the Company's commitment in Paragraph 13 of the Settlement Agreement to file an application for a certificate of public convenience and necessity to convert Big Sandy Unit 1 to natural gas. Absent the conversion, Unit 1 will be forced to retire in 2015.[298] As both Mr. Wohnhas[299] and Mr. Weaver[300] testified, the estimated $60 million investment[301] required for the conversion will in part mitigate the job loss and loss of tax base resulting from the retirement of Big Sandy Units 1 and 2, along with providing other benefits to the Company and its customers:

> Factors such as Company ownership and asset control (versus potential performance risk associated with receiving power and energy via a purchase power agreement), the continuity of jobs and other socio-economic benefits associated with the continued presence of an operating generating unit in the Lawrence County area, as well as the associated leveraging [of] the Company's Big Sandy Plant employees' skills and knowledge at that particular facility, all represent qualitative benefits....[302]

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[297] Wohnhas Supplemental Testimony at 17.

[298] Pauley Testimony at 10-12; Wohnhas Supplemental Testimony at 16; Weaver Supplemental Testimony at 1, 10.

[299] Wohnhas Supplemental Testimony at 16.

[300] Weaver Supplemental Testimony at 10.

[301] Wohnhas Supplemental Testimony at 16

[302] Weaver Supplemental Testimony at 9. *See also* Weaver Hearing Testimony at 688-689.

In addition, although the merits of the Big Sandy Unit 1 conversion will be adjudicated by the Commission in a future certificate proceeding, the conversion also is a least-cost alternative for the disposition of Big Sandy Unit 1.[303]

The Company also agreed to make a $100,000 a year contribution for five years to aid economic development efforts and job training efforts in Lawrence County and adjoining Kentucky counties.[304] The contributions will be paid entirely from shareholder funds,[305] and provide, along with the Mitchell Transfer itself, evidence of the Company's intent, as Mr. Munczinski testified, to remain an important part of the twenty counties of its service territory:

> We're going to be here a long time. We've been here for a hundred years. We are not selling you a used car that is not going to work. We're selling you, as Mr. LaFleur said, the crown jewel of the AEP system.[306]

Third, Kentucky Power also agreed to increase its contribution to its home energy assistance program by 20% from 12.5 cents per residential meter per month to 15 cents per residential meter per month.[307] Although not limited to Lawrence and surrounding Kentucky counties like the economic development and job training contributions, the shareholder contributions to home energy assistance program will aid customers throughout the Company's service territory, including Lawrence and adjoining counties.[308] Again, the contribution will paid solely from shareholder funds.[309] And again the contributions are further evidence of the

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[303] Weaver Supplemental Testimony at 9-10; Exhibit SCW-1S.

[304] Settlement Agreement at ¶ 10.

[305] *Id.*; Wohnhas Supplemental Testimony at 14.

[306] Munczinski Hearing Testimony at 756.

[307] Wohnhas Supplemental Testimony at 14-15.

[308] *Id.* at 15.

[309] Settlement Agreement at ¶ 11.

Company's commitment to its customers, and the additional benefit available through the Settlement Agreement.

Finally, in agreeing to the 17-month Base Rate Freeze Kentucky Power is investing shareholder funds – in the form of $131.17 million in foregone revenues[310] [redacted] [311] – in its service territory. This type of investment is certainly unprecedented for Kentucky Power, and perhaps any utility in the Commonwealth, and one that is available only through approval of the Settlement Agreement.

6. The Settlement Agreement Promotes Appropriate And Reasonable Fuel Diversity.

Kentucky Power's 1,470 MW of currently owned and contracted for generation is entirely coal-fired.[312] Even though the Settlement Agreement provides for the substitution of a fifty percent undivided interest (780 MW) in the coal-fired Mitchell generating station for Big Sandy Unit 2 (800 MW),[313] it also provides for the conversion, through Paragraph 13 which requires the filing of the necessary application for a certificate of public convenience and necessity, of Big Sandy Unit 1 from coal (278 MW)[314] to gas (268 MW).[315] With the approval of the Settlement Agreement, and all necessary approvals for the Big Sandy Unit 1 conversion, Kentucky Power will move from being 100% coal-fired to being 18% natural gas and 82% coal-fired. This represents an almost 20% reduction in the Company's reliance upon owned or

[310] Kentucky Power's Response to KIUC Hearing Data Request 1; (138 Million - $44 Million)/12 months = $7.83 Million/month. $7.83 Million/month x 17 months = $131.17 Million. *See also* Kollen Hearing Testimony at 220.

[311] Kentucky Power's Response to Staff 5-1.

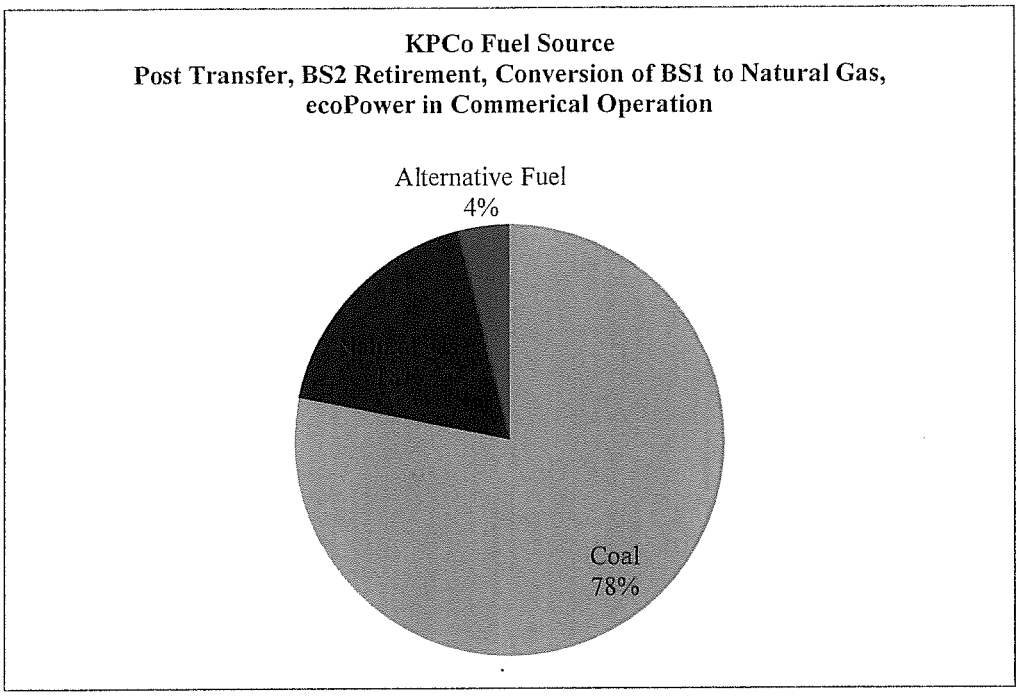
[312] Exhibit SCW-1 at 5

[313] Pauley Testimony at 8-9.

[314] SCW-1 at 5

[315] Weaver Supplemental Testimony at 1.

contracted for coal-fired generation. In addition, if the Company's application in Case No. 2013-0144[316] is approved, Kentucky Power's would become even less coal dependent at 79% coal, , 17% natural gas, and 4% renewables:[317]



This approximate 80%-20% coal/non-coal mix is both reasonable and appropriate for Kentucky Power, particularly given the location of its service territory in the coal-fields of eastern Kentucky, and the General Assembly's statutorily-declared policy "to foster and encourage the use of Kentucky Coal by electric utilities serving the Commonwealth."[318]

[316] *In The Matter Of: The Application Of Kentucky Power Company For: (1) The Approval Of The Terms And Conditions Of The Renewable Energy Purchase Agreement For Biomass Energy Resources Between The Company And ecoPower Generation-Hazard LLC; (2) Authorization To Enter Into The Agreement; (3) The Grant Of Certain Declaratory Relief; And (4) The Grant Of All Other Required Approvals and Relief*, Case No. 2013-00144 (Ky. P.S.C. Filed April 10, 2013).

[317] Pauley Rebuttal Testimony at 22. The Company also agreed as part of the settlement to issue a non-binding RFP for 100 MW of wind power and to include the results of the RFP in its December 2013 Integrated Resource Plan. Settlement Agreement at ¶ 19.

[318] KRS 278.020(1).

Moreover, as Mr. Munczinski testified,[319] substantial reliance on gas-fired generation – whether through the market or through direct ownership – will subject Kentucky Power's customers to unacceptable levels of volatility and the risk of high prices:

> And we've had this experience, Public Service of Oklahoma, one of our subsidiaries is mainly gas. And when gas prices are very low, people are very, very happy, and when gas prices are very – are higher, people are very unhappy.[320]

Mr. Weaver's testimony provides empirical support for Mr. Munczinski's observations. As part of the modeling performed on behalf of the Company, Mr. Weaver's group used Aurora$^{xmp®}$ to perform stochastic modeling to determine the revenue requirements at risk for each of the modeled alternatives.[321] Revenue requirement at risk is a measure of the risk that Kentucky Power's customers could be subjected to higher generation-related cost of service.[322] As shown on Exhibit SCW-6, the heavily market-dependent alternative (where gas is on the margin[323]) present the greatest measure of revenue requirement uncertainty.[324]

The Settlement Agreement reasonably balances fuel diversity while promoting rate stability.

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[319] Munczinski Supplemental Testimony at 6-7; Munczinski Hearing Testimony at 761-762.

[320] Munczinski Hearing Testimony at 762.

[321] Weaver Direct Testimony at 42-45.

[322] Exhibit SCW-1 at 12.

[323] Munczinski Hearing Testimony at 761.

[324] Weaver Direct Testimony at 44.

7. The Risk Mitigation Provisions Of The Settlement Agreement Provide Reasonable And Important Protections For The Company And Its Customers.

(a) *Customer Protection Against Unreasonably Higher Costs As A Result Of Unanticipated Greenhouse Gas Regulation.*

The Company's Strategist® modeling incorporates increased costs as a result of greenhouse gas regulation through a 2022 "carbon tax." Although the modeling was done in late 2012, a 2022 carbon tax is consistent with the implementation schedule for President Obama's June 25, 2013 Climate Action Plan.[325] Notwithstanding this "tax," which, of course, does not exist today, the Mitchell Transfer coupled with the conversion of Big Sandy Unit 1 to natural gas, is the least-cost option by hundreds of millions of dollars on a CPW basis.[326] Indeed, the transfer remains the least-cost alternative even when the "carbon tax" is imposed five years earlier in 2017.[327]

Although the "economics" of the Mitchell Transfer provide ample mitigation of the risks of increased costs as a result of greenhouse gas regulation, Paragraph 21 of the Settlement Agreement provides further, explicit risk mitigation for Kentucky Power's customers against such higher costs as a result of unanticipated greenhouse gas regulation. Specifically, Paragraph 21 provides:

- That Kentucky Power agrees to file in connection with each of its future Integrated Resource Plans an economic analysis of all generating unit costs, including the costs

[325] Munczinski Supplemental Testimony at 16; Wohnhas Supplemental Testimony at 36. Mr. Kollen also testified that the President's initiative was not a "big surprise." Kollen Hearing Testimony at 201. According to Mr. Kollen, the open question is when the costs might first be imposed. *Id.* The Company fully addressed this "open question" through its use of the no carbon, early carbon and 2022 carbon tax scenarios in its Strategist® modeling. Munczinski Supplemental Testimony at 22; Weaver Testimony at 17-18; Weaver Hearing Testimony at 709-711.

[326] Exhibit SCW-1R. Even without the conversion of Big Sandy Unit 1, the Mitchell Transfer (Option 6) was the least-cost option. *Id.* The Big Sandy Unit 1 conversion only makes it more so. *Id.*

[327] *Id.*

of complying with greenhouse gas emission regulation.[328] "This will give the Commission and any intervenors the information necessary to assess the impact, if any, of future greenhouse regulation on all Kentucky Power generating unit costs."[329] In addition, Kentucky Power agreed to work collaboratively with KIUC and Sierra Club to address with state regulatory authorities "the potential regulation of carbon and its impact on Kentucky Power customers."[330]

- For the recovery by Kentucky Power of greenhouse gas environmental costs through the environmental surcharge or similarly-structured surcharge.[331]

- For the explicit recognition by the Company of the right of the Commission or any parties to challenge the Company's rates on the ground that they are unreasonable or unjustly discriminatory "because Mitchell Units 1 and 2 are no longer the least-cost generation resource for the ratepayers of the Company due to federal, state or local environmental laws or regulations imposing on Mitchell Units 1 or 2 costs or operational requirements associated or related to greenhouse gas emissions."[332]

- For the explicit recognition by Kentucky Power of the Commission's authority to retire for ratemaking purposes the Company's interest in Mitchell Units 1 and 2 upon the Commission's determination, following a full due process hearing, that the Mitchell units are no longer the least-cost generation resource for the Company's customers "due to federal, state or local environmental laws or regulations imposing on Mitchell Units 1 or 2 costs

[328] Settlement Agreement at ¶ 21(c).

[329] Wohnhas Supplemental Testimony at 37.

[330] Settlement Agreement at ¶ 21(a).

[331] *Id.* at ¶ 21(b).

[332] Settlement Agreement at ¶ 21(a).

or operational requirements associated or related to greenhouse gas emissions."[333] Once retired, the customers "would not be subjected to any further co – environmental costs – that would be incurred such as CO_2 costs."[334] This ability to "retire" the Mitchell units for ratemaking purposes was recognized by Mr. Kollen as a "safety valve" that benefitted the Company's customers.[335]

In the event the Mitchell units are retired by the Commission for Kentucky ratemaking purposes pursuant to Paragraph 21(a) of the Settlement Agreement, the Company further agreed to collect the Mitchell retirement costs with a debt-only carrying charge.[336] This represents a significant concession by the Company, and a substantial benefit to its customers:

> Q. – just assume that the co – this commission determined that – that Mitchell should be retired for rate-making purposes even though West Virginia wants to keep it going.
>
> A. Sure.
>
> Q. The – the – the benefit of having a debt-only return, over a period of time that the Commission determines is reasonable, is significant very significant versus the overall costs of capital?
>
> A. It is very significant. Let's say, for example, that there is $200 million worth of costs here, and let's say that the grossed-up rate of return is 12 percent. That would be $24 million, 12 percent times $200 million, and a debt-only cost, let's say at four percent, would be $8 million. ***There's a $16 million savings just by virtue of using a debt-only rate of return on the same investment.***
>
> Q. ***So having this safety valve in paragraph 21 is valuable, and having it at a debt-return is very valuable?***

[333] *Id.*

[334] Kollen Hearing Testimony at 202.

[335] *Id.* at 245.

[336] Settlement Agreement at ¶ 21(c).

A. ***It is extremely valuable to customers.***[337]

(b) *Other Customer Risk Mitigation Provisions.*

Further customer risk mitigation is provided the Company's customers through the "zeroing out" (until the rates to be established in the Company's next base rate case become effective in approximately June 2015) the Company's system sales clause under Paragraph 7 of the Settlement Agreement. Doing so guarantees that the Company's customers will receive the full benefit of the $15.3 million of off-system sales built into base rates, while eliminating the risk of increased customer payments under the clause.[338] In addition, the Company receives the right to earn back some of its foregone revenue during the Base Rate Freeze period in return for assuming the full risk that off-system sales fall below or exceed the amount built in to base rates.[339]

(c) *The Settlement Agreement's Company Risk Mitigation Provisions Are Both Reasonable And Intended To Protect The Company Against The Loss Of Generation Following The Termination Of The AEP-East Pool Agreement.*

The Settlement Agreement provides Kentucky Power with two risk mitigation provisions. The first is the Force Majeure provision that permits the Company to seek emergency rate relief Big Sandy Unit 2 retires early.[340] Mr. Wohnhas explained both the need for and reasonableness of the provision:

> The economics of the Stipulation and Settlement Agreement, and specifically the "stay-out provision," work only if both Big Sandy Unit 2 and Mitchell generation is available for potential market sales during the 17-month stay-out period following the transfer of the Company's interest in the Mitchell generating

[337] Kollen Hearing Testimony at 245 (emphasis supplied).

[338] Wohnhas Supplemental Testimony at 26-27.

[339] *Id.* at 27.

[340] Settlement Agreement at ¶ 16.

station. Without the ability to utilize both Mitchell and Big Sandy Unit 2 generation during the stay-out period the Company's operations and credit may be severely impaired.[341]

The Settlement Agreement also provides for the concurrent recovery by the Company of costs related to unit outages. With respect to Big Sandy Unit 2, paragraph 15 authorizes the Company to recover concurrently, through the fuel adjustment clause, incremental power purchase costs in the event of a Big Sandy Unit 2 outage, including its retirement.[342] In addition, following the retirement of Big Sandy Unit 2, the new Purchase Power Adjustment allows the Company to recover the net costs of any power purchases as a result of the forced outage of any other Kentucky Power generation facility, including Rockport.[343]

Both provisions provide for the concurrent recovery of otherwise unforeseeable costs and benefit "the Company's customers by exerting downward pressure on the Company's capital costs, and by helping the Company stay out longer between base rate cases."[344]

These modest Company risk mitigation provisions are both necessary and reasonable, and represent a fair balancing of the interests of the Company and its customers.

8. The Settlement Agreement Provisions Regarding The Company's 2015 Base Rate Case Are Fair And Reasonable And Benefit The Company's Customers.

Recognizing that the expected June 2015 retirement of Big Sandy Unit 2 will affect the Company's post-retirement cost of service, thereby making an adjustment of the Company's rates appropriate, the parties to the Settlement agreed on several aspects of the proceeding to

[341] Wohnhas Supplemental Testimony at 21.

[342] *Id.* at 33.

[343] *Id.* at 32; Settlement Agreement at ¶ 15.

[344] Wohnhas Supplemental Testimony at 33.

review and establish the Company's post-Big Sandy Unit 2 rates. Specifically, the Settlement Agreement provides that:

- Kentucky Power will file a base rate case no later than December 29, 2014 using a September 30, 2014 test year.[345] This will permit the Company's customers to capture the rate benefits associated with the planned mid-2015 retirement of Big Sandy Unit 2 (as well as the coal-related retirement costs of Big Sandy Unit 1)[346] at the earliest possible time, while providing the Company with the opportunity for timely recovery of Big Sandy retirement costs.[347]

- The Company will be permitted to "recover the coal-related retirement costs of Big Sandy Unit 1, the retirement costs of Big Sandy Unit 2, and other site-related retirement costs that will not continue in use."[348] During cross-examination of Mr. Wohnhas, the Attorney General suggested that this provision somehow inappropriately tied the Commission's hands.[349] Significantly, in cross-examining Mr. Wohnhas the Attorney General failed to provide him with any statute, regulation, or decisional authority from this Commission suggesting that the recovery of the retirement costs associated with plants that have each provided more than forty years of service to the Company's customers, and that are being retired because of changes in federal environmental regulations, is inappropriate, or would not otherwise be allowed by the Commission. Moreover, the Attorney General overlooks the fact that under Kentucky law it is

[345] Settlement Agreement at ¶ 3.

[346] *Id.* at ¶ 14.

[347] Wohnhas Supplemental Testimony at 23-24.

[348] Settlement Agreement at ¶ 14.

[349] *See* Wohnhas Hearing Testimony at 319-320.

the result in ratemaking and the not the method employed that determines the legality of the rates.[350]

- Concomitantly with the Company's filing to recover the Big Sandy retirement costs, Kentucky Power will remove from its December 2014 base rate case filing: (a) all coal-related operating expenses, plant, and other coal-related capitalized costs related to Big Sandy Units 1 and 2; and (b) all Big Sandy Unit 2 operating expenses, as well as Big Sandy Unit 2 plant and other Big Sandy Unit 2 capitalized costs.[351] The removal of such costs is not only appropriate in light of the retirement of Big Sandy Unit 2 and the coal-related aspects of Big Sandy Unit 1, but will also reduce the rates otherwise required.[352]

- The retirement costs, along with a weighted average cost of capital carrying charge, will be recovered on a levelized basis over a 25-year period through Asset Transfer Rider-2.[353] As explained by Mr. Kollen, the use of a rider to recover these expenses on a levelized basis provides significant benefits to customers:

> the value of that ... is that we capture in real time the decline, and, in essence, through the fact that it's a levelized recovery.
>
> And so that's something that we couldn't hope to capture in a base rate case. You would normally capture it on the higher level of the cost slope, and then you would just pay at the higher level even though the costs continue to decline until base rates next to [*sic*] reset. So we view this as a really significant ratepayer benefit of the partial stipulation.[354]

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[350] *Kentucky Public Service Commission v. Commonwealth ex rel. Conway*, 324 S.W.3d 373, 383 (Ky. 2010).

[351] Settlement Agreement at ¶ 3; Wohnhas Supplemental Testimony at 24; Kollen Hearing Testimony at 217-218.

[352] Wohnhas Supplemental Testimony at 24.

[353] Settlement Agreement at ¶ 14.

[354] Kollen Hearing Testimony at 243. *See also* Wohnhas Supplemental Testimony at 25.

- The Company will discontinue the $44 million recovery through the Asset Transfer Rider and instead begin recovering all Mitchell costs (except for those costs associated with the Mitchell FGD units)[355] in base rates.[356] The elimination of the $44 million Asset Transfer Rider at the time the Company's undivided fifty percent interest in Mitchell goes into base rates mitigates, along with the removal of Big Sandy capital and operating costs, the rate impact of placing Mitchell in base rates.[357]

- All costs associated with the Mitchell FGD units are to be recovered through the Company's environmental surcharge instead of base rates.[358] Doing so is not inconsistent with KRS 278.183 and permits customers to receive on a "real-time basis" the benefit of declining depreciation costs, as well as any decline in environmental consumables.[359] This is a significant benefit to the Company's customers because the FGD units represent the largest environmental cost at Mitchell.[360]

9. The Settlement Agreement's Revenue Allocation Provisions Are Reasonable And Do Not Prejudice Residential Customers.

Paragraphs 4 (Asset Transfer Rider [Base Rate Freeze Period Mitchell non-fuel costs]), 6 (Mitchell FGD costs), and 14 (Asset Transfer Rider-2 [Big Sandy Unit retirement costs]) of the Settlement Agreement each employ the same methodology for allocating the revenue among rate classes. Under each, the revenue requirement is first allocated between residential customers and

[355] Settlement Agreement at ¶ 6; Wohnhas Supplemental Testimony at 25-26. Paragraph 1 of the Settlement Agreement recognizes that upon approval of the agreement the Mitchell Transfer will "be deemed a prudent component of rate base in future proceedings."

[356] Settlement Agreement at ¶ 4.

[357] Kollen Hearing Testimony at 242.

[358] Settlement Agreement at ¶ 6.

[359] Wohnhas Hearing Testimony at 366-367.

[360] *Id.* at 367.

all other customers based on their respective percentage of total revenues.[361] This is consistent with typical class allocations and as a result will not affect residential customers.[362] Following the initial allocation, the non-residential customer revenue requirement is allocated among non-residential customers based on their respective non-fuel revenues.[363] This is reasonable because each of these costs is non-fuel related; thus it is logical to allocate the revenue requirement among classes on the non-fuel revenues of each customer class.[364] Indeed, this type of allocation is consistent with the allocation methodology previously approved by the Commission in connection with the Louisville Gas and Electric Company and Kentucky Utilities Company environmental surcharges.[365]

10. The Settlement Agreement Provides Customers With Benefits Not Available Absent An Agreement.

Because the Commission's authority is purely statutory,[366] it is constrained by the provisions of Chapter 278 of the Kentucky Revised Statutes as to what it may order a utility to do. For example, it seems unlikely [redacted]. By contrast, so long as an agreement is not contrary to statute, a utility may accept limitations or undertake obligations beyond the Commission's statutory powers to order. The Settlement Agreement contains at least six undertakings by Kentucky Power that would be at the outer limits of, or even exceed, the Commission's statutory authority to mandate:

[361] Settlement Agreement at ¶¶ 4, 6, 14. *See also* Wohnhas Supplemental Testimony at 29-30, 31-32.

[362] Wohnhas Hearing Testimony at 288.

[363] Wohnhas Supplemental Testimony at 29-30, 31-32.

[364] Wohnhas Hearing Testimony at 288.

[365] *Id.*

[366] *South Central Bell Telephone Co. v. Utility Regulatory Commission*, 637 S.W.2d 649, 653 (Ky. 1982).

- The previously discussed provisions whereby the Company has committed shareholder money to aid its lower income customers and to mitigate the economic effects the closure of Big Sandy Unit 2 may have on Lawrence County, Kentucky and other areas in Kentucky Power's service territory.[367] These include the five-year, $100,000 a year contribution for economic development and job training in Lawrence and contiguous Kentucky counties,[368] as well as the 20% increase in shareholder contributions to home energy assistance programs.[369]

- The commitment to convert Big Sandy Unit 1 to natural gas,[370] thereby retaining a portion of the jobs and tax base that would be lost through closure of the Big Sandy Plant.[371]

- To continue to use, when practicable, local labor sources in connection with the conversion of Big Sandy Unit 1 to natural gas.[372]

- To continue to acquire coal for the Mitchell generating station without bias toward coal produced in Kentucky;[373]

- To increase the Company's cost-effective demand-side management and energy efficiency expenditures from the current $3 million annual amount[374] to $6 million in 2016, and to maintain the expenditure level at $6 million through at least 2018.[375] As part of this commitment, Kentucky Power also agreed to fund energy management programs for schools affected by KRS 160.325.[376] This expanded demand-side management and energy efficiency effort is in accord with the Commission's recognition of the importance of demand-side management and energy efficiency

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[367] Wohnhas Supplemental Testimony at 14.

[368] Settlement Agreement at ¶ 10.

[369] *Id.* at ¶ 11.

[370] *Id.* at ¶ 13.

[371] Wohnhas Supplemental Testimony at 15, 43.

[372] *Id.* at ¶ 18.

[373] *Id.* at ¶ 17.

[374] Wohnhas Supplemental Testimony at 20.

[375] Settlement Agreement at ¶ 12.

[376] *Id.*

in capacity planning and acquisition.[377] Significantly, Mr. Woolf, who testified on behalf of the Sierra Club, likewise recognized that this doubling of the Company's existing demand-side management and energy efficiency programs was in the public interest and provided "ratepayer benefit."[378]

- The commitment to issue a non-binding RFP for 100 MW of wind power for the purposes of incorporating the results in the Company's December 2013 Integrated Resources Plan.[379]

These commitments, both individually and collectively, by Kentucky Power provide real value to the Company's customers that likely would be unavailable absent the Company's agreement, and further ensure the Settlement Agreement is in the public interest.

11. The Establishment Of A Regulatory Asset In The Amount Of The Company's Big Sandy Unit 2 Investigation Costs, And Subsequent Five Year Amortization Of The Asset At The Company's Long-Term Debt Rate Of 6.48%, Is Consistent With Commission Authority, Is Reasonable, And Reflects The Benefits Flowing To Customers As A Result Of The Investigation.

Between 2004 and 2012 Kentucky Power investigated the disposition of Big Sandy Unit 2 in light of emerging and ever-changing environmental requirements,[380] developing SO_2 control technologies,[381] rapidly escalating costs, and changing fuel economics.[382] The record is uncontroverted the investigation was prudently undertaken and performed;[383] no one has challenged the amount of the investigation costs. Because the purpose of the investigation was

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[377] Order, *In the Matter of: Consideration Of the New Federal Standards Of The Energy Independence And Security Act of 2007*, Case No. 2008-00408 at 18 (Ky. P.S.C. July 24, 2014).

[378] Woolf Hearing Testimony at 179.

[379] Settlement Agreement at ¶ 19.

[380] Walton Rebuttal Testimony at 4-5; McManus Testimony at 3-5. Although suspended from 2006-2010, the charges were incurred in connection with a single investigation. Walton Rebuttal Testimony at 4-6.

[381] Walton Rebuttal Testimony at 5-6.

[382] Wohnhas Testimony at 9.

[383] Walton Rebuttal Testimony at 4, 7.

to determine the least-cost pollution control alternative for Big Sandy Unit 2,[384] the Company never recorded the costs as expenses.[385] Instead, the costs were accumulated in a capital account to be included in the cost of the to-be-constructed Big Sandy Unit 2 pollution control facility.[386]

The Settlement Agreement includes the agreement of Kentucky Power, Sierra Club, and KIUC that the Company be authorized in accordance with Financial Accounting Standard Board Standards Codification 980-340-25-1 to accumulate and defer for review the $28,113,304 in Big Sandy Unit 2 investigation costs.[387] It also provides for amortization and recovery in base rates of the regulatory asset over five years beginning in 2015 using a long-term debt rate of 6.48%.[388]

Prior to his client entering into the Settlement Agreement, Mr. Kollen filed testimony recommending that the Company's request to create the regulatory asset be denied.[389] His recommendation is premised upon two factual errors, as well as a misapplication of two decisions of this Commission. First, he argues that the costs were incurred in the course of two separate investigations.[390] But Mr. Walton, who was involved in the investigation, offers compelling testimony there was only a single investigation.[391]

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[384] Wohnhas Testimony at 10; Wohnhas Supplemental Testimony at 35.

[385] Wohnhas Rebuttal Testimony at 2-3

[386] *Id.* at 3. The costs originally were recorded in Account 107 (Construction Work In Progress – Electric) and then moved to Account 183 (Preliminary Surveys and Investigation Charges) in 2012 when the determination was made not to pursue the retrofit of Big Sandy Unit 2. *Id.*

[387] Settlement Agreement at ¶ 8.

[388] *Id.*

[389] Kollen Testimony at 40-44.

[390] *Id.* at 41-42.

[391] Walton Rebuttal Testimony at 4-6.

Second, Mr. Kollen suggests that the Company should have expensed the costs as they were incurred.[392] But his testimony is devoid of any accounting, legal, or regulatory authority suggesting the Company erred in accounting for ongoing investigatory costs in connection with a long-lived capital project as construction work in project in progress. Indeed, Mr. Kollen's recommendation would have the effect of erasing Accounts 107 and 183, both of which are capital accounts, from the FERC Uniform System of Accounts. Moreover, under Mr. Kollen's logic, the Company would be required to expense each year the labor, material, and other construction costs associated with a multi-year construction project.

Nor is the Commission authority Mr. Kollen cites in support of his argument that the Company's request is tantamount to retroactive ratemaking apposite.[393] Both Case No. 2010-00523[394] (voluntary severance plan and Midwest office consolidation costs) and Case No. 2011-00036[395] (MISO regulatory proceeding costs) involve costs that appear to have been incurred over a relatively short period of time during which they were expensed.[396] The effect of the subsequent creation of a regulatory asset after the costs had been expensed would, in the Commission's felicitous turn of a phrase, have resulted in "retroactive accounting."[397] Here, by contrast, Kentucky Power never expensed these costs.[398] More fundamentally, unlike the costs at issue in the Duke Energy Kentucky and Big Rivers cases, which by their very nature were more

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[392] Kollen Testimony at 41.

[393] *Id.* at 44.

[394] *In the Matter of: Application Of Duke Energy Kentucky, Inc. For An Order Approving The Establishment Of A Regulatory Asset Related To Voluntary Opportunity And Other Post Retirement Expenses*, Case No. 2010-523 (Ky. P.S.C. July 14, 2011) ("Duke Energy Kentucky Order").

[395] *In the Matter of: Application Of Big Rivers Electric Corporation For A General Adjustment In Rates*, Case No. 2011-00036 (Ky. P.S.C. November 17, 2011) ("Big Rivers Order").

[396] Big Rivers Order at 15; Duke Energy Kentucky Order at 6.

[397] Big Rivers Order at 15.

[398] Wohnhas Rebuttal at 2-3.

like operating expenses, Kentucky Power's Big Sandy Unit 2 investigation costs were a necessary part of a major multi-year capital asset project, and would have been included in the capital cost of the project if the retrofit of Big Sandy Unit 2 had proven the least-cost alternative.[399]

Finally, Mr. Kollen complains of the time period, which he erroneously calculates as ten years, over which the costs were incurred.[400] But he nowhere suggests, nor could he, that the Company imprudently elongated the study period; nor does he suggest that the final years of the study did not benefit to the Company's customers. More importantly, Mr. Kollen misses the point: the full span of the study was necessary, and in fact permitted the Company, to reach the least-cost option for the environmental issues facing Big Sandy Unit 2. Mr. Kollen's insistence on some never specified, but arbitrarily shorter, study period would provide a perverse incentive for regulated companies to prematurely end investigations out of concern over whether the costs will be eligible for deferral.

At bottom, the eight-year investigation enabled Kentucky Power to obtain the least-cost option for the disposition of Big Sandy Unit 2's 800 MW of generation. Indeed, it was only in the eighth and final year in which the Company was able to reduce the capital cost by $412 million.[401] Moreover, the continued investigation saved the Company's customers from paying a return on the investment that would have been made if the investigation had been prematurely ended and the Company had acted earlier to build the Big Sandy Unit 2 scrubber.

[399] *Id.* at 4.

[400] Kollen Testimony at 43-44.

[401] Weaver Testimony at 22, Table 3, col. (f).

> But I would ask you to look at it this way: The scrubber costs $900 million. Mitchell 1 and 2 cost $500 million. So did we save the customer of Kentucky a 500 million – a return on $500 million for one, two, three, four, as many years as you think we should have went back and did that? I would say we did.[402]

12. The Settlement Agreement Is In The Public Interest.

The Settlement Agreement provides each of above benefits to the Company's customers. In doing so, it fairly balances the interests of the Company's customers and the Company. Unless the Settlement Agreement is approved, the Company's customers will lose (absent the Commission's approval of the Mitchell Transaction without the Settlement Agreement) the least-cost solution for the environmental issues facing the Big Sandy generating station. In addition, the customers will also be required to forego the rate relief, base rate freeze, and many of the other benefits that are part of the Settlement Agreement. In addition, the failure to approve the Settlement Agreement will subject the Company's customers to volatility and unpredictability of the PJM capacity and energy markets.

The Settlement Agreement furthers the public interest and should be approved by the Commission.

B. The Record Unambiguously Supports The Conclusion That The Company's Application And The Settlement Agreement Meet The Requirements Of KRS 278.2207, KRS 278.020, KRS 278.300, And The Commission's Regulations, And That The Mitchell Transfer Should Be Approved.

1. The Record Unambiguously Establishes That The Fair Market Value Of The Fifty Percent Undivided Interest In The Mitchell Generating Station To Be Transferred To Kentucky Power Exceeds The Net Book Value Of That Fifty Percent Interest And Thus The Transfer Comports With KRS 278.2207.

KRS 278.2207(1)(b) provides that "products provided to the utility by an affiliate shall be priced at the affiliate's fully distributed cost but in no event greater than market ...." Because

[402] Munczinski Hearing Testimony at 770.

Ohio Power Company qualifies as an affiliate of Kentucky Power as that term is defined at KRS 278.010(18), the Mitchell transfer price must be the lesser of market or net book value, or the Company must demonstrate that deviation from the requirement is in the public interest.[403] The fifty percent undivided interest in the Mitchell generating station will be transferred to Kentucky Power at its net book value on the transfer date.[404] The transfer thus complies with KRS 278.2207(1)(b) because the record unequivocally establishes that the net book value of the fifty percent undivided interest is less than its fair market value. Alternatively, the Company has demonstrated that the Mitchell Transfer at net book value is in the public interest, and thus a deviation from the statutory requirement is appropriate.

(a) *The Fair Market Value of Mitchell Generating Station Exceeds Its Net Book Value.*

Kentucky Power established that the fair market value of the fifty percent undivided interest in the Mitchell generating station ***exceeds*** the December 31, 2013 net book value at which the interest will be transferred. Specifically, Mr. Weaver provided extensive testimony and evidence that the fair market value of the Mitchell generating station exceeds its net book value.[405] Dr. McDermott validated the Company's use of the Strategist® modeling to establish that the fair market value of the Mitchell generating station and reached the same conclusion as Mr. Weaver.[406] In addition, [redacted]

[403] KRS 278.2207(2).

[404] Application at ¶ 11.

[405] *See* Weaver Rebuttal at 15-21; SCW-1R.

[406] McDermott Rebuttal at 2.

[407] [redacted].

[redacted].[408] Finally, Mr. Fransen likewise testified that based upon his experience in electric generating plant acquisitions and valuations, the fair market value of the Mitchell generating station was greater than its net book value.[409]

(i) *The Company's Modeling And Other Testimony Demonstrated That The Fair Market Value Of The Mitchell Generating Station Far Exceeded Its Net Book Value.*

Because of the amount of generation to be acquired (up to 1100 MW),[410] and the need for base load energy,[411] as well as the absence of recent comparable coal plant transactions,[412] Kentucky Power elected to use Strategist® modeling tool to determine whether the fair market value of the Mitchell generating station exceeded its net book value transfer price.[413] Indeed, the use of an RFP to establish a fair market value for the Mitchell generating station "would been artificial and less than genuine for the bidding community," and viewed as little more than as a thinly-veiled "attempt to gain market intelligence...,"[414] thereby undermining the reliability of any responses as an indicator of fair market value. Indeed, Dr. McDermott testified that "there are good reasons to conclude that an RFP process would neither provide a viable market value to which the Commission to attribute any validity ...."[415]

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[408] Weaver Supplemental Testimony at 8-9, 12-15.

[409] Fransen Hearing Testimony at 511-512, 513.

[410] Weaver Direct Testimony at 37.

[411] *Id.*

[412] Fransen Rebuttal Testimony at 12; Fransen Hearing Testimony at 514-515.

[413] Weaver Direct Testimony at 37.

[414] Weaver Rebuttal Testimony at 16-17.

[415] McDermott Rebuttal Testimony at 4. *See also* McDermott Rebuttal Testimony at 5 ("[U]tilities and regulators have utilized this approach [the Planning Model used by Kentucky Power] for decades and it is a well-known and relatively sophisticated method.")

By contrast, Strategist® is a widely-used and sophisticated modeling tool relied upon by utilities and regulatory bodies in connection with resource planning and unit disposition analyses, and provides a transparent means of establishing the market value of assets such as the Mitchell generating station.[416] In fact, Strategist® has been used by the utility industry for over 30 years.[417] In addition to its use in this case, as well as the earlier Scrubber case,[418] Kentucky Power and its sister companies rely upon Strategist® as part of their resource planning analyses, including the Company's Integrated Resource Plans submitted to this Commission.[419] According to Mr. Fransen, the type of analysis performed by Mr. Weaver provides both the best[420] and only appropriate[421] basis for determining the fair market value of a base load plant such as the Mitchell generating station.

Kentucky Power established that the fair market value of the Mitchell Transfer Interest exceeded its net book value through its modeling of Option 2 of Mr. Weaver's analysis. Option 2 modeled the cost on a CPW basis over the thirty year study period of a new-build combined cycle unit.[422] As explained by Mr. Weaver, and confirmed by AEP commercial experts, this option provided a reasonable means of determining the relationship between the net book value of the Mitchell Transfer Interest and its fair market value.[423]

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[416] *Id.* at 5.

[417] Becker Testimony at 2-3.

[418] *Id.* at 2.

[419] *Id.* at 2, 6.

[420] Fransen Hearing Testimony at 512.

[421] *Id.* at 513.

[422] Weaver Testimony at 6.

[423] *Id.* at 37; Weaver Rebuttal Testimony at 16.

Based upon the results of this modeling, Mr. Weaver unequivocally testified that the fair market value of the Mitchell generating station exceeded its net book value: "I conclude that the Company's analysis, and its costs of various resource options, ***fully supports that a market valuation would exceed the NBV of the Mitchell units.***"[424] Upon cross-examination, Mr. Weaver was even more emphatic:

> A. The fair market value is equal to the net book value? Is that your question?
>
> Q. Yes.
>
> A. No, I disagree with that.
>
> Q. Okay. And why do you disagree with that?
>
> A. I think we've got significant study information that would suggest that, in fact, ***the market value is – for the Mitchell station is well above the net book value.***[425]

Putting the conclusions drawn by Mr. Weaver in some context is the magnitude of the difference between the CPW of the Mitchell Transfer, coupled with the conversion of Big Sandy Unit 1 to natural gas, and the other market proxies:

Market Option	**Amount By Which CPW Of Mitchell Transfer Coupled With Big Sandy Unit 1 Conversion Is *Less Than* The Market Option**[426]
2A	$483 Million
2B	$682 Million
2C	$560 Million

[424] Weaver Rebuttal at 19 (emphasis supplied).

[425] Weaver Hearing Testimony at 683-684 (emphasis supplied). *See also, id.* at 686 ("Basically, I just I just indicated that fair market value was significantly above net book value....") *See also* Pauley Hearing Testimony at 101-102.

[426] SCW-1R; Kentucky Power Response to Commission Staff Post-Hearing Data Request, PH-14.

Although differences in CPW can be driven by factors other than the fact that the net book value of the Mitchell Transfer is less than the fair market value, differences of nearly one-half billion dollars, to more than two-thirds of a billion dollars, are highly indicative of the fact that the starting point of the Strategist® analysis, the net book value of the Mitchell Transfer, is less than market.

Mr. Weaver's conclusions were confirmed by Mr. Fransen and Dr. McDermott. Thus, based upon this same modeling, as well as his "ten years of doing valuation work,"[427] Mr. Fransen testified that the market value of the Mitchell units exceeded their net book value even in the current market for existing coal plants:

> Q. Would you agree, given the current market of existing coal plants, that it is possible that the market value of the Mitchell units could be less than the net book value?
>
> A. In – in my opinion and based upon the body of evidence I have seen before me, I believe that in the instance of the Mitchell units, that they [the fair market value of the Mitchell units] are not below their current net book value.[428]

Indeed, Mr. Fransen continued by testifying that he was aware of several instances where coal-fired generation had been purchased in the past two years for amounts in excess of its net book value.[429]

Anecdotal evidence that the fair market value of the Mitchell Units exceeds their net book value is provided by the appeal by Industrial Energy Users – Ohio to the Ohio Supreme Court from a decision of the Public Utilities Commission of Ohio regarding Ohio Power Company's Corporate Separation Plan. As explained by Mr. Munczinski, an Ohio industrial

[427] Fransen Hearing Testimony at 510-511.

[428] *Id.* at 512.

[429] *Id.* at 550-551.

group is challenging the Public Utilities Commission of Ohio's decision authorizing the transfer of the Mitchell generating station at net book value despite the fact that the station's fair market value exceeded the transfer price.[430] The Ohio industrials argue that the Ohio Commission should have required Ohio Power to "dividend" back to Ohio customers the amount by which the fair market value of Mitchell units exceeds their net book value.[431]

Finally, Dr. McDermott, who served as a Commissioner on the Illinois Commerce Commission from 1992 until 1998, likewise concluded that that the fair market value of the Mitchell units to be transferred to Kentucky Power exceeded the net book value transfer price: "The Company's benchmarking process [Strategist® modeling] was appropriate and demonstrated that the expected market price for similar products is expected to be greater than the transfer price over the planning horizon for the Proposal."[432] In addition to Option 2, which was used by Mr. Weaver, Dr. McDermott also relied upon Option 4 of Mr. Weaver's Strategist® modeling as a proxy for the Mitchell units' fair market value.[433] Under Option 4, Big Sandy Unit 2 was replaced with market purchases from the PJM market for either five or ten years, followed by the construction of a new combined cycle unit, to estimate.[434] As was the case with Option 2, the CPW of Option 4 was substantially greater ($532 million to $557 million)[435] than the Mitchell transfer, thereby indicating that the fair market value of the Mitchell units exceeded

[430] Munczinski Hearing Testimony at 758.

[431] *Id.* Mr. Munczinski further explained that in his opinion the Ohio decision comported with Ohio law and that in any event an adverse decision by the Ohio Supreme Court regarding a possible "dividend" to Ohio customers would not affect the transfer of Mitchell or the transfer price. *Id.* at 758-759.

[432] McDermott Rebuttal Testimony at 2.

[433] McDermott Hearing Testimony at 630-631.

[434] Weaver Direct Testimony at 6.

[435] Exhibit SCW-1R.

their net book value.[436] This result was consistent with Dr. McDermott's understanding of the relationship between the net book cost of the Mitchell units and their market price:

> And so all you need to do is look at that as whether or not that alternative is available to you, and then when you assess what would be my market value if I could sell my power in that place and compare that to the original depreciated cost, as he found, all of those alternatives were above the cost of the – of the Mitchell transfer at the historic depreciated cost
>
> Which doesn't surprise me, because it is an older unit, and – and ***you are getting*** sort of ***this depreciated, you know, historical cost number, which I would expect it to – to be less than a lot of the market proxies***. So I wasn't surprised by what he found.[437]

(ii) *The Company's "Stacking Analysis" Using The Conforming Responses To The Big Sandy Unit 1 RFP Also Demonstrates That The Net Book Value Of The Mitchell Units Is Less Than Their Fair Market Value.*

On March 28, 2013 Kentucky Power issued an RFP for up to 250 MW of capacity and energy for use in connection with the Company's investigation of the conversion of Big Sandy Unit 1 to natural gas.[438] In response to that RFP, Kentucky Power received [redacted] conforming offers.[439] Although these offers are not directly "translatable" to the results that might be obtained in the case of an RFP for 800 MW, [redacted] Mr. Kollen on behalf of KIUC, [redacted] that the responses were "indicative" of the availability of generation resources and their ***pricing***.[440]

The indicative nature of the Big Sandy Unit 1 RFP results provides further evidence that the fair market value of Mitchell units exceeds their net book value. Because the generation bid into the Big Sandy Unit 1 RFP could, subject to the operational and other impediments identified

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[436] McDermott Hearing Testimony at 631-633.

[437] *Id.* at 633 (emphasis supplied).

[438] Karrasch Supplemental Testimony at 3.

[439] Weaver Supplemental Testimony at 2.

[440] Kollen Hearing Testimony at 230-231; [redacted]

by Mr. Weaver in his Supplemental Testimony,[441] be substituted for the Mitchell Transfer, an analysis of the CPW of their costs to the CPW of the Mitchell Transfer costs would provide evidence of the relationship between the net book value and the fair market of the Mitchell units. That is, just as Mr. Weaver and Dr. McDermott testified concerning two other market substitutes for Mitchell – Options 2 and 4 – a higher CPW for this market option would further indicate that the fair market value of Mitchell exceeds its net book value.[442]

Kentucky Power used the "stacking" analysis filed in connection with Mr. Weaver's Supplemental Testimony to perform just this analysis. The Company first created a substitute for the fifty percent undivided interest in the Mitchell generating station by combining or "stacking" the least-cost conforming third-party bids.[443] It then compared, using Strategist®, the CPW of the substitute generation stack's costs against the CPW of costs for the Mitchell Transfer.[444] Both "runs" assumed that Big Sandy Unit 1 would be converted to natural gas.[445] The results, which are presented in SCW-2S and supporting papers, indicate that the CPW of the costs of the substitute stack generation significantly exceeded the CPW of the costs of the Mitchell Transfer:

> the substitution of the 50% Mitchell transfer with the remaining non-selected offers from the 250 MW RFP solicitation would result in a $110 million cost premium over the study period versus the Company's recommended plan which would include the asset transfer.[446]

[441] Weaver Supplemental Testimony at 8-9, 12-15.

[442] McDermott Hearing Testimony at 630-631; McDermott Rebuttal Testimony at 3; Weaver Rebuttal Testimony at 15-21.

[443] Weaver Supplemental Testimony at 9.

[444] *Id.*

[445] *Id.*

[446] *Id.* at 13-14.

This relationship, as was the case with the comparison of the Mitchell Transfer and the other two market-based options modeled, unambiguously further confirms that the net book value of Mitchell is, as required by KRS 278.2207(1)(b), less than its fair market value.[447]

(iii) *The Fact That The Fair Market Value Of The Mitchell Units Exceeded Their Net Book Value Was Independently Confirmed At The Hearing* [redacted].

[redacted][448] [redacted]

[447] McDermott Hearing Testimony at 630-631; McDermott Rebuttal Testimony at 3; Weaver Rebuttal Testimony at 15-18.

[448] [redacted].

[449] [redacted].

[450] [redacted].

[451] [redacted].

[redacted][453]

(iv) The Company's STRATEGIST® Modeling Is Both Legally Sufficient And Provided Better And More Reliable Evidence Of The Fair Market Value Of The Mitchell Units Than Would Have Been Obtained Through An RFP.

a. There Is No Legal Requirement That The Company Use An RFP To Establish Under KRS 278.2207(1)(b) That The Fair Market Value Of The Mitchell Transfer Exceeds Its Net Book Value.

Although an RFP can provide data that may be used to determine the fair market value of a generation asset,[454] there is no legal requirement under KRS 278.2207(1)(b) that an applicant use an RFP to prove compliance with the statute's asymmetrical transfer standards. Certainly, neither the Attorney General, nor any of the other intervenors, were able to point to any language in Chapter 278 of the Kentucky Revised Statutes mandating such proof. Likewise, the Commission has not issued any regulations limiting the evidence that may be offered to

[452] [redacted].

[453] [redacted].

[454] McDermott Rebuttal Testimony at 4.

demonstrate compliance with the statute. Finally, the Company is unaware of any Commission precedent holding that only an RFP may be used to prove the market value of a generation asset. To the contrary, in Case No. 2003-00252, the Commission rejected the Attorney General's argument, made both in that case and here, that absent an RFP the Commission is left to speculate on whether the transfer meets KRS 278.2207's pricing requirements.[455]

At issue in Case No. 2003-00252 was an application by Union Light, Heat and Power Company to acquire 1,105 MW of generating capacity from its corporate parent.[456] The Attorney General opposed the transfer, arguing that because Union Light failed to conduct an RFP, and instead relied upon a study to establish statutory compliance, the company failed to meet its burden of proving that the transfer met the pricing requirements of KRS 278.2207.[457] The Attorney General also argued, as he does here, that an RFP is "especially warranted" in an affiliate transaction.[458]

The Commission nonetheless concluded that "[t]he AG's arguments regarding the affiliate nature of the transaction and whether ULH&P has met its burden under KRS 278.2207(2)[459] are not compelling."[460] Indeed, the Commission went on to explain that:

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[455] Order, *In the Matter of: The Application Of The Union, Light, Heat And Power Company For A Certificate Of Public Convenience To Acquire Certain Generation Resources And Related Property; For Approval Of Certain Purchase Power Agreements; For Approval Of Certain Accounting Treatment; And For Approval For Deviation From The Requirements of KRS 278.2207 and KRS 278.2213(6)*, 2003 Ky. P.U.C. LEXIS 1030 at * 14 (Ky. P.S.C. December 5, 2003) ("*ULH&P* Order").

[456] *Id.* at * 1.

[457] *Id.* at * 10.

[458] *Id.*

[459] KRS 278.2207(2) is the statute permitting a deviation from the asymmetrical pricing requirements of KRS 278.2207(1)(b). Nevertheless, the Commission's ULH&P Order clearly indicates that an RFP is not the sole evidence of market value and that instead a study may be used to prove the fair market value of a generation asset.

[460] ULH&P Order at * 14.

> The record evidence is also very clear that the cost of units is no greater than market. While the AG claims that the absence of an RFP leaves the Commission no alternative but to speculate as to the market price of alternatives to the proposed transaction, he ignores other measures of "market" prices. ICF's market analysis [the study offered by ULH&P in lieu of an RFP] of the facilities being transferred, ***which the AG neither refuted nor contested, is one such measure.***[461]

Although it appears that the ICF analysis may have used a different methodology to establish that the transfer was at less than market price, nothing in the order suggests that such an analysis is the only alternative to an RFP. Indeed, the Commission noted in the *ULH&P* Order that there were other measures of market price and that the ICF analysis was but one.[462] Moreover, Options 2 and 4 of the Company's disposition analysis,[463] like the ICF analysis,[464] tested the underlying analysis using multiple sensitivities. In each case, the results of the sensitivity analysis indicated that the net book value of the Mitchell Transfer was less than its fair market value.[465] Significantly, as was the case in Case No. 2003-00252, the Company's STRATEGIST® modeling was "neither refuted nor contested" by the Attorney General.[466]

In sum, the Company's STRATEGIST® modeling evidence is both fully consistent with Commission precedent and supplies credible evidence demonstrating that the transfer comports with KRS 278.2207

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[461] *Id.* at ** 14-15. *See also* McDermott Hearing Testimony at 623-624 (recognizing that the RFP was but "one of the approaches the Commission has adopted."

[462] ULH&P Order at ** 14-15.

[463] SCW-1R; The sensitivities included HIGHER Band, LOWER Band, No Carbon, and Early Carbon. In addition, the HIGHER Band, LOWER Band, and Base Case assume carbon pricing beginning in 2022. Weaver Testimony at 17-18.

[464] ULH&P Order at ** 14-15.

[465] SCW-1R. Under each of the sensitivities the market alternatives were $420 million to $728 million more expensive than the Mitchell Transfer, SCW-1R, indicating, as explained by Mr. Weaver and Dr. McDermott, that the net book value of the Mitchell Transfer was less than its fair market value. *See*, McDermott Hearing Testimony at 630-631; Weaver Rebuttal Testimony at 15-18.

[466] *ULH&P* Order at * 15.

b. The Evidence Concerning Market Value Provided By The Company's Strategist® Modeling Is At Least Equal To The Results That Could Have Been Obtained Through An RFP.

– ***"As I have noted there are serious drawbacks to the RFP process in this case that could lead a reasonable person to doubt its value as a benchmark."***[467]

Notwithstanding the Attorney General's position, the Company's Strategist® modeling is at least the equal of the evidence, if any, that might have been gained through an RFP. As the Commission recognized in the *ULH&P* Order, "in this instance, given the uniqueness of the proposed transaction, we are not persuaded that undertaking an RFP process would benefit ..." the Company or its customers.[468] Among the unique characteristics of the ULH&P transaction identified by the Commission was the amount of the generation – its entire generation fleet[469] – being acquired by ULH&P. Mr. Weaver made the same point in this case in explaining why an RFP to replace Big Sandy Unit 1 was practicable, while an RFP seeking a much larger quantity of generation to replace Big Sandy Unit 2 (800 MW), or the entire Big Sandy generating station (1078 MW), was not.[470] Indeed, the large amount of capacity required to replace Big Sandy Unit 2 would limit the number of bidders into such an RFP.[471]

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[467] McDermott Rebuttal Testimony at 11.

[468] *ULH&P* Order at * 16.

[469] Although Kentucky Power will retain its 393 MW Rockport Unit Power Agreement until its expiration in 2022, that generation is not owned by the Company. But even including the Rockport generation, Kentucky Power is faced with replacing the more than 70% of its generation represented by the Big Sandy generating station. Exhibit SCW-1 at 5 (1,078 MW/1,470 MW = 74.86%). As such, any differences between this case and that before the Commission in Case No. 2003-00252 are differences in degree not kind. Indeed, the total Big Sandy generation to be replaced, 1078 MW, equals 97.6% of 1,104 MW was seeking to acquire in Case No. 2003-00252.

[470] Weaver Direct Testimony at 38-39.

[471] Kentucky Power Company Response to KIUC First Set of Data Requests, Item 37.

There were other unique characteristics of the proposed Mitchell Transaction. Most important among these is that the Mitchell Transfer price was made public in February 2012[472] and thus was well known before any Big Sandy Unit 2 RFP would have been conducted.[473] This information "creates a ceiling price that potential bidders would have to beat in order to win the RFP," thereby limiting the bidders into such an RFP.[474] As a result, the RFP may not accurately establish the market price.[475] In addition, the "product" being priced – base load generation – is itself unique. As Dr. McDermott testified, RFPs work best with standardized products, but are more problematic with idiosyncratic "products" such as baseload generation:

> The comparison isn't really sort of like buying houses. It's more like buying the Empire State Building, or, you know, the Hancock Building in Chicago, and those are rather specialized items.
>
> ...
>
> what my testimony says is that, indeed, you know, the – ***the – approach that Mr. Weaver has employed actually captures all of the same information, and I think in a better way because of the idiosyncratic nature of the product that we are looking at in this case.***[476]

In addition to these unique characteristics that render an RFP less useful in the case of the Mitchell Transfer, the Company's Strategist® modeling carries with it several benefits not found with the use of RFPs, while avoiding pitfalls attendant to the Attorney General's preferred method.

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[472] McDermott Rebuttal Testimony at 8.

[473] The Company's application in Case No. 2011-00401 to retrofit Big Sandy Unit 2 with a DFGD unit was withdrawn on May 31, 2012. Order, *In The Matter Of: Application Of Kentucky Power Company For Approval Of Its 2011 Environmental Compliance Plan, For Approval Of Its Amended Environmental Cost Recover Surcharge Tariff, And For The Granting Of A Certificate Of Public Convenience And Necessity For The Construction And Acquisition Of Related Facilities*, Case No. 2011-00401 (Ky. P.S.C. May 31, 2012).

[474] McDermott Rebuttal at 8.

[475] *Id.* at 7 ("[I]n many cases the number of truly comparable sales and RFP responses will not be sufficient to provide enough information such that a reasonable and reliable comparable benchmark can be constructed.")

[476] McDermott Hearing Testimony at 637 (emphasis supplied).

- The modeling process employed by Kentucky Power is completely transparent.[477] The Commission and intervenors have the ability to examine and understand all of the moving parts and "kick the tires on the model."[478]

- It is a process that is well-established and understood by utilities, regulators, and intervenors alike.[479]

- It avoids the need, and the resulting uncertainty, to determine whether historic RFP results are truly comparable to, and can be fairly used to establish the fair market value of, a different asset.[480] Moreover, unlike the fully transparent modeling employed by Kentucky Power, RFPs typically involve non-price terms that are not public, making comparisons even more difficult.[481]

- The use of historic RFP results to benchmark an asset's fair market value may result in "apples to oranges" comparisons where market conditions have changed over time,[482] or where, as was the case with the UHL&P transaction, market conditions are abnormal.[483] One possible such abnormality in current markets is the planned retirement of a significant number of coal plants in the United States prior to the implementation of MATS[484] because, unlike the Mitchell generating station,[485] the plants to be retired lack environmental controls capable of meeting MATS.

- The use of historic RFP results may, at best, only produce a range of fair market value benchmarks. If the net book value of the asset to be transferred falls within that range the lack of precision may make it

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[477] McDermott Rebuttal Testimony at 5; Weaver Rebuttal at 18.

[478] McDermott Hearing Testimony at 626.

[479] *Id.* at 5.

[480] *Id.* at 6-7.

[481] *Id.* at 7.

[482] *Id.* at 6, 7.

[483] *ULH&P* Order at * 16 ("Given the level of uncertainty that exists in the electric industry today, there are several arguments in favor of relying on factors other than the market or financial strength of the firms that make up that market."

[484] *See* Fransen Hearing Testimony at 521-522 ("The point of that article was that there's a lot of retirements in the US of coal plants, and that's going to make the supply side of the demand/supply equation tighter, thus driving up prices.... we've come to the bottom of valuations, and right now, acquiring baseload coal assets provides a lot of upside option value.... I believe that those values would be increasing."); LaFleur Hearing Testimony at 556.

[485]

impossible to determine if the fair market value exceeds the net book value.[486]

- Regulatory and other constraints may limit the ability of otherwise willing and able bidders to respond, and thereby artificially skew the market price.[487]

- Where potential bidders believe that an RFP may only be used to establish the fair market value of another asset, the information receives through the RFP may not be accurate either because some bidders choose not to bid, while others fail to spend the time necessary to develop a bona fide bid.[488]

- Given the expected long operating life of the Mitchell units, compared to the short term nature of most purchase power agreements, bidders may require a premium to enter into a long term purchase power agreement, and thereby skew the "market price" artificially higher.[489]

- The initial response to an RFP is seldom, if ever, the contract price. Use of the initial responses to determine the market price accords the initial bids more accuracy than they merit because absent a contract there is no way to determine whether the bids were the "true final cost bid."[490] Conversely, a final "true" price may reached only after several rounds of protracted negotiations in which bidders are excluded or drop out, thereby diminishing the competitive nature – and resulting accuracy – of the final bid as a proxy for the market price.[491]

At bottom, and as Dr. McDermott concluded, an RFP was unnecessary because "the participants in any RFP process would make the same types of calculations that Mr. Weaver did to get to their – ana – their bids."[492] Indeed, "it may well be, in this case, that an RFP process would provide no additional relevant information,[493] or worse, provide faulty information ...."[494]

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[486] McDermott Rebuttal Testimony at 7.

[487] *Id.* at 11.

[488] *Id.* at 9.

[489] *Id.* at 10.

[490] *Id.*

[491] *Id.*

[492] McDermott Hearing Testimony at 630.

[493] For the same reason, an appraisal was neither required nor superior to the Company's modeling:

(v) The Intervenors' So-Called Comparable Sales Were Anything But Comparable.

Messrs. Kollen[495] and Woolf[496] point to sales of certain generating assets to attack the Company's reliance on the Strategist® modeling to establish that the fair market value of the Mitchell units exceeds their net book value. In effect, both argue that these sales demonstrate that the fair market value of the Mitchell Transfer is substantially less than indicated by the Company's Strategist® modeling.[497] Yet, as Mr. Fransen explained, the information upon which they premised their testimony is at best incomplete: "[a]sset transactions are often too complex and too few of the deal terms are publicly known" to enable the Commission to have the necessary confidence in the press releases and newspaper articles employed by Messrs. Kollen and Woolf.[498] Moreover, such transactions may turn on factors other than price so that "the winning bidder may not have provided the highest price, but may have been successful due to other deal terms."[499]

> Q. Would it be reasonable in this case for Kentucky Power to have conducted an independent appraisal to offer, in addition to their internal market proxy modeling, as an objective corroboration for their internal results.
>
> A. Again, I think the process the Company has used when evaluating the options captures essentially – just as an RFP process would, potentially capture that information.
>
> It captures the same information that would occur in an independent appraisal, and I don't think you're going to get any additional information as a result of that.

Id. at 625.

[494] McDermott Rebuttal Testimony at 3. (emphasis in original).

[495] Kollen Direct Testimony at 13-14.

[496] Woolf Direct Testimony at 45-46.

[497] *Id.*; Kollen Direct Testimony at 13-14.

[498] Fransen Rebuttal Testimony at 4; LaFleur Rebuttal Testimony at 6

[499] Fransen Rebuttal Testimony at 4.

The sales themselves also were sufficiently atypical to make reliance on them by Messrs. Kollen and Woolf problematic. First, because the transactions were bundled sales of ten to 15 units, the pool of potential purchasers was significantly limited.[500] In addition, the limited time available to perform due diligence of the units being offered, as well as the inclusion of lesser quality assets in the pool to being offered also probably served to reduce the purchase price.[501] Third, in one of the portfolio sales, the seller was required by FERC order to divest itself of some of the assets in the pool so that not only was the seller not a willing seller, but the bidders were aware of the fact and could be expected to take advantage of it.[502] Under Kentucky law, the sale could not be used to establish market value, which, "after all, is usually understood as the price a willing buyer would pay ***a willing seller***, both adequately informed ***and neither under an obligation to act.***"[503] By contrast, AEP Generation Resources Inc. is not required to dispose of the Mitchell units. If the transfer is not approved, the units will remain with AEP Generation Resources Inc. to be retained or disposed of in accordance with its interests.[504] Finally, the number of purchasers of the assets was further limited by FERC because of market power considerations.[505]

In the other two sales, both sellers had announced their intention to exit the merchant generator business.[506] Each of these factors further reduced the price likely to be obtained by the

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[500] *Id.* at 6.

[501] *Id.* at 6-7.

[502] *Id.* at 7-8.

[503] *Shawnee Telecom Resources, Inc. v. Brown*, 354 S.W.3d 542, 560 (Ky. 2011).

[504] *See* Wohnhas Hearing Testimony at 415-416; Pauley Rebuttal Testimony at 3-4.

[505] *Id.* at 8.

[506] *Id.* at 9, 10.

sellers in light of the potential bidders' knowledge that the sellers were motivated.[507] Finally, one of the sales required the assumption of above-market interest rate debt, a condition that, not unexpectedly, probably also acted to lower the purchase prices.[508]

Most fundamentally, many of the assets themselves simply are not comparable to the Mitchell units, which are "two of the jewels of AEP."[509] The Mitchell units are well-maintained supercritical units,[510] that have been updated and improved throughout their operating lives,[511] and that have one of the lowest heat rates in the country.[512] As such, they not only are physically capable of running through 2040,[513] but likewise are dispatched daily[514] and "will have the [physical] ability to have capacity factors in the 80s."[515] Equally important, the Mitchell units are environmentally controlled with both SCR and FGD units,[516] and are expected to meet the 2015 MATS standards.[517]

By contrast, many of the assets that were a part of the "comparables" offered by Messrs. Kollen and Woolf were anything but the jewels of anyone's fleet. As shown below in Table 1

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[507] *Id.*

[508] *Id.* at 11-12.

[509] LaFleur Hearing Testimony at 560.

[510] *Id.*; *Id.* at 559.

[511] *Id.* at 558-559 ("The age of the unit – I think that one thing that maybe is not completely understood is a power plant is a system of parts. For instance, in 2007 we put about a billion dollars of equipment in there. That – that equipment, those fans, those scrubbers, they're six years old. They're not forty years old. They're six years old.")

[512] *Id.* at 560.

[513] *Id.* at 560-561, 562 ("I have no problem testifying the unit is physically capable of doing it [operate until at least 2040], and – and I believe it will do it.")

[514] *Id.* at 558.

[515] *Id.*

[516] McManus Direct Testimony at 4-5; LaFleur Hearing Testimony at 571.

[517] McManus Direct Testimony at 5.

from Mr. Fransen's rebuttal testimony, "the coal-fueled units[518] are not equipped with the same level of environmental control equipment as the Mitchell Plant, are generally older, and run at lower capacity factors."[519]

Table 1. Comparison of Cited Asset Transactions[520]

	Mitchell Units 1&2*	Exelon Sale	Dominion Sale	Ameren Sale
Coal-fueled Baseload Generation				
Owned/Transacted Capacity (MW)	780	2,098	2,258	4,080
Number of Units	2	6	5	14
Average Age (years)	42	42	49	49
Capacity *with* Scrubber and SCR Installed (MW (% of total))	780 (100%)	1,273 (61%)	855 (38%)	1,344 (33%)
Capacity *without* Scrubber and SCR installed (MW)	-	825	1,403	2,736
5-year Avg. Unit Capacity Factor (%)	68.6%	43.3%	57.9%	76.3%
Gas/Oil-fueled Peaking Generation				
Capacity (MW)	-	550	561	-
Number of Units	-	4	10	-
Average Age (years)	-	48	16	-
5-year Avg. Capacity Factor (%)	-	1.1%	2.5%	-

*Data reflects 50% undivided ownership of Mitchell Units 1&2

For example, only 38% of the capacity transferred in the Dominion Resources sale cited by Messrs. Kollen and Woolf have FGD and SCR systems installed.[521] The Ameren (33%)[522] and Exelon (68%)[523] sales likewise were not fully environmentally controlled. Perhaps even more importantly for purposes of comparability (or lack thereof), the five-year average capacity factors associated with the Exelon and Dominion units also were 37% and 16% less than the

[518] The Exelon and Dominion transactions also included 550 MW (26%) and 561 MW (24.8%) of oil or gas-fired peaking capacity. Fransen Rebuttal Testimony at 5. Not only is this one-quarter of the Exelon and Dominion portfolios not comparable to the baseload Mitchell capacity to be acquired by Kentucky Power, but the Exelon peaking generation was older than the Mitchell units. *Id.*

[519] *Id.*

[520] *Id.*

[521] LaFleur Rebuttal Testimony at 7.

[522] *Id.* at 8

[523] Fransen Rebuttal Testimony at 5.

Mitchell capacity factor.[524] Capacity factor can be an important measure of a unit's value,[525] and the significant differences between the Mitchell generating station's capacity factors, and the capacity factors of the Exelon and Dominion Units, particularly when coupled with their other differences, only underscores the lack of comparability of the portfolio sales and Mitchell.

The Company incontrovertibly has demonstrated that the net book value of the Mitchell Transfer is less than its fair market value, and thus has satisfied the requirements of KRS 278.2207.

(b) *Even If The Commission Were To Determine That The Net Book Value Of The Mitchell Transfer Exceeds Its Fair Market Value The Transfer Pricing Is Reasonable, And The Grant Of The Requested Deviation Pursuant To KRS 278.2207(2) Is In The Public Interest.*

The Kentucky General Assembly recognized that the asymmetrical pricing rules may be contrary to the best interests of a utility and its customers, and thus authorized the Commission to deviate from the rules where the transfer pricing is reasonable and the deviation is in the public interest.[526] The record evidence is compelling that Kentucky Power is receiving a bargain, and that the Mitchell Transfer's net book value is less than its market value. But even if the Commission were to conclude to the contrary, the evidence is also compelling that the use of net book value for the Mitchell Transfer is both reasonable and in the public interest.

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[524] *Id.*

[525] LaFleur Rebuttal Testimony at 8. Mr. LaFleur explained that a unit's capacity factor was a means of measuring a unit's performance and hence value:

> Capacity factors are often overlooked when comparing the pros and cons of various energy sources. Capacity factor is a measure of performance of a generating station over time as a percentage of production costs, availability of the power plant, and the condition/stability of the power grid.

Id.

[526] KRS 278.2207(2).

The clearest evidence of the reasonableness of the Mitchell Transfer pricing is that even at net book value the Mitchell Transfer is not only the least-cost alternative, but that it is hundreds of millions of dollars less expensive, even on a CPW basis, than any of the other alternatives.[527] The Mitchell Transfer, coupled with the conversion of Big Sandy Unit 1, is $483 Million to $682 Million[528] and $532 to $537 Million[529] less expensive than the two market options. It is $404 Million less expensive than the "pure" natural gas play of Option 2C,[530] while the retrofit of Big Sandy Unit 2 will impose $625 Million to $819 Million[531] in added costs on the Company's customers. A second measure of the reasonableness of the Mitchell Transfer price is that net book value is the transfer price ordered by the Public Utilities Commission of Ohio, and that such pricing is traditional for intra-company transfers.[532] In addition, while the Ohio Commission's decision is not binding on this Commission, the unwavering application of the asymmetrical pricing rules of KRS 278.2207 in such circumstances would prohibit all intra-company transfers, even where, as here, the consummation of the transaction at net book value is in the interests of customers of Kentucky utilities.

The grant of the requested deviation also is in the public interest. If the Commission determines that the market price is less than the net book value, and also declines to grant the deviation, Kentucky Power's customers, who both the Chairman and Mr. Wohnhas recognized as some of the most economically-disadvantaged in the Commonwealth,[533] will be faced with

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[527] Exhibit SCW-1R.

[528] *Id.* (Options 2A and 2B) (BASE Pricing).

[529] *Id.* (Options 4A and 4B) (BASE Pricing).

[530] Kentucky Power's Response to Commission Staff Hearing Data Request PH-14.

[531] Exhibit SCW-1R (Options 1A and 1B) (BASE Pricing).

[532] Munczinski Hearing Testimony at 758.

[533] *See* Statement by Chairman Armstrong, Hearing Transcript at 777-778; Wohnhas Supplemental Testimony at 10.

paying significantly higher electric costs.[534] There is no less expensive alternative available to the Company.[535] In addition, such a decision likely with force the Company to the market, with its greater volatility and loss of rate predictability.[536] Volatile rates in turn will undermine efforts to attract new businesses to the Company's service territory, while also putting pressure on the existing industrial customers.[537]

2. The Mitchell Transfer Is Required By The Public Convenience And Necessity And Should Be Approved Under KRS 278.020(1).

(a) *The Statutory Standard.*

Kentucky Power seeks a Certificate of Public Convenience and Necessity pursuant to KRS 278.020(1) in connection with the proposed transfer to it of a fifty percent undivided interest in the Mitchell generation station. That statute provides:

> No person, partnership, public or private corporation, or combination thereof shall commence providing utility service to or for the public or begin the construction of any plant, equipment, property, or facility for furnishing to the public any of the services enumerated in KRS 278.010 . . . until that person has obtained from the Public Service Commission a certificate that public convenience and necessity require the service or construction.

"Public convenience and necessity" requires a showing that there is a need for the proposed facility, and that the facility will not create a wasteful duplication.[538]

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[534] For example, the retrofit of Big Sandy Unit 2 will require at a minimum a 25% rate increase. Kentucky Power's Response to Staff 5-1.

[535] Exhibit SCW-1R; Munczinski Hearing Testimony at 778; Weaver Hearing Testimony at 685; Pauley Hearing Testimony at 15, 113; Wohnhas Supplemental Testimony at 38.

[536] Munczinski Supplemental Testimony at 5-7.

[537] Munczinski Hearing Testimony at 762.

[538] *Kentucky Utilities Co. v. Public Service Commission*, 252 S.W.2d 885, 890 (Ky. 1952).

(b) *The Mitchell Transfer Meets The Requirements Of KRS 278.020(1).*

(i) *There Is A Need For The Mitchell Transfer.*

The "need" for the additional facilities is established by demonstrating a "substantial inadequacy of existing service."[539] The inadequacy may be a current deficiency or a deficiency expected well into the future "in view of the long range planning necessary in the public utility field."[540] Kentucky Power has demonstrated the need for the Mitchell Transfer. Current and pending environmental requirements make it impossible for Kentucky Power to continue operating Big Sandy Units 1 and 2 beyond May 31, 2015 without installing additional, expensive environmental control equipment.[541] Specifically, the record establishes:

- The Mitchell Transfer is necessary to meet the energy and capacity needs of Kentucky Power's customers. If the Mitchell Transfer is not approved, the Company is facing a ***-66.26% reserve margin*** (-937 MW)[542] beginning the 2015/2016 PJM planning year. Further, without the Mitchell Transfer, Kentucky Power will become energy deficient beginning January 1, 2014.[543] Even a transfer of 20% of Mitchell would leave the Company significantly capacity deficient.[544]

- The record is uncontroverted that Kentucky Power is required to acquire both capacity (up to nearly 1,100 MW) and energy following the retirement of the Big Sandy generating station.[545]

- None of parties to this proceeding have argued, much less introduced evidence, that the retirement of the Big Sandy generating station should be avoided by saddling Kentucky Power's customers with the nearly $1 Billion,[546] on a CPW basis, in costs – above and

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[539] *Id.*

[540] *Kentucky Utilities Co. v. Public Service Commission*, 390 S.W.2d 168, 171 (Ky. 1965).

[541] McManus Direct Testimony, at 3-5.

[542] Exhibit SCW-1 at 9.

[543] Weaver Rebuttal Testimony at 13-14.

[544] *Id.* at 7-9.

[545] *See e.g.* Weaver Direct Testimony at 37.

[546] Exhibit SCW-1R.

beyond the costs of the Mitchell Transfer and conversion of Big Sandy Unit 1 – that the retrofit of Big Sandy Unit 2 would require.

- The January 1, 2014 Mitchell Transfer meets the Company's need for a generation hedge against the forced premature retirement of Big Sandy Units 1 and 2.[547]

- The "steel in the ground" solution provided by the Mitchell Transfer meets the need for rate stability[548] and protection against the volatility of the both the capacity and energy markets.[549]

(ii) *The Mitchell Transfer Does Not Result In Wasteful Duplication.*

"Wasteful duplication" involves both "an excess of capacity over need" and "an excessive investment in relation to productivity or efficiency, and an unnecessary multiplicity of physical properties."[550] The Commission historically has required an applicant to demonstrate that a thorough review of all reasonable alternatives has been performed.[551] The concept of "least-cost" is embedded in the Commission's analysis of whether a project proposed by a utility is more favorable than other alternatives.[552] However, cost is not the only factor to be considered and a proposal that ultimately costs more than an alternative does not necessarily result in "wasteful duplication."[553] Rather, all relevant factors should be balanced by the Commission.[554]

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[547] LaFleur Rebuttal Testimony at 2-3

[548] Munczinski Supplemental Testimony at 3-4.

[549] *Id.* at 5.

[550] *Kentucky Utilities Co.*, 252 S.W.2d at 890.

[551] *Joint Application of Louisville Gas and Electric Company and Kentucky Utilities Company for a Certificate of Public Convenience and Necessity for the Construction of Transmission Facilities in Jefferson, Bullitt, Meade, and Hardin Counties*, Case No. 2005-00142 (September 8, 2005).

[552] *Application of Kentucky Power Company for Approval of Renewable Energy Purchase Agreement for Wind Energy Resources Between Kentucky Power Company and FPL Illinois Wind, LLC*, Case No. 2009-00545 (June 28, 2010).

[553] *Kentucky Utilities*, 390 S.W.2d at 175.

[554] *Application of East Kentucky Power Cooperative, Inc. for a Certificate of Public Convenience and Necessity for the Construction of a 138 kV Electric Transmission Line in Rowan County, Kentucky*, Case No. 2005-00089 (August 19, 2005).

The record unambiguously demonstrates the absence of wasteful duplication as a result of the Mitchell Transfer:

- The Mitchell Transfer is the least-cost alternative.[555] The rejection of the Mitchell Transfer will require the Company's customers to pay, between January 1, 2014 and December 31, 2040, $379 Million to $819 Million (on a CPW basis) in additional costs.

- The Mitchell Transfer is necessary to meet the energy and capacity needs of Kentucky Power's customers and thus is not duplicative, much less wastefully so. If the Mitchell Transfer is not approved, the Company is facing a ***-66.26% reserve margin*** (-937 MW)[556] beginning the 2015/2016 PJM planning year. Further, without the Mitchell Transfer, Kentucky Power will become energy deficient beginning January 1, 2014.[557]

- A lesser amount of Mitchell, even if it were available, is inadequate to meet the Company's requirements. Even a transfer of only 312 MW (20% of Mitchell) would leave the Company significantly capacity deficient.[558]

- If the requested fifty percent undivided interest in the Mitchell generating station is transferred on January 1, 2014, Kentucky Power's reserve margin following the retirement of Big Sandy generating station will be less each year in the PJM 2015/2016 to 2030/2031 planning years than in the planning year (2013/2014) preceding the transfer.[559]

- In the 17-month period between the Mitchell Transfer and the retirement of Big Sandy Unit 2 any duplication of generation resources resulting from the Company's ownership of Big Sandy Unit 2 and the Mitchell Transfer is not wasteful. The Mitchell Transfer provides a generation hedge against the forced premature retirement of Big Sandy Units 1 and 2.[560] In addition, the efficiencies resulting from the acquisition of larger blocks of capacity and energy oftentimes result in some additional capacity in the early years of the acquisition.[561] The Mitchell generating station is projected to continue to operate through at least 2040,[562] and some "lumpiness" in the initial 17 months (5%) of this period is not wasteful duplication.[563] Indeed, a determination to the contrary would not only be at odds with what the Company understands to

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[555] Exhibit SCW-1R; Munczinski Hearing Testimony at 778; Weaver Hearing Testimony at 685; Pauley Hearing Testimony at 15, 113; Wohnhas Supplemental Testimony at 38.

[556] Exhibit SCW-1 at 9.

[557] Weaver Rebuttal Testimony at 13-14.

[558] *Id.* at 7-9.

[559] Exhibit SCW-1 at 10.

[560] LaFleur Rebuttal Testimony at 2-3

[561] Wohnhas Supplemental Testimony at 9.

[562] LaFleur Hearing Testimony at 560-561, 562.

[563] Wohnhas Supplemental Testimony at 9.

be Commission's long-term view of this issue,[564] but would mean that in almost all cases capacity could only be acquired in small increments. Finally, because the Mitchell Transfer might not be available at the time Big Sandy Unit 2 retires,[565] or may only be available at a higher price,[566] and upon less favorable terms in mid-2015,[567] any duplication during the 17 months between January 1, 2014 and June 2015 is not wasteful.

The Mitchell Transfer is both necessary and furthers the public convenience. The record in this case makes clear the Mitchell Transfer satisfies the requirements of KRS 278.020(1), and that the Settlement Agreement is in the public interest. The Company's application for approval of the Mitchell Transfer should be granted and the Settlement Agreement approved.

3. The Assumption Of Liabilities By Kentucky Power As Part Of The Mitchell Transfer Comports With KRS 278.300.

As part of the Mitchell Transfer, Kentucky Power will assume a fifty percent undivided interest in the December 31, 2013 liabilities associated with the Mitchell generating station.[568] These liabilities will be netted against the December 31, 2013 value of the Mitchell generating station and associated assets to calculate the transfer price – net book value – of the transaction. Any increase in the assumed liabilities thus will decrease the net book value and hence the transfer price. Moreover, the July 31, 2013 denial by the Virginia Commerce Commission of Appalachian Power Company's companion request for approval of the transfer to it of the fifty percent undivided interest in the Mitchell generating station not being transferred to the Company will not affect Kentucky Power's assumption of the Mitchell associated liabilities;[569] whether the other fifty percent interest in Mitchell is owned by Appalachian Power or another

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[564] *Id.*

[565] Pauley Direct Testimony at 18-19; Pauley Rebuttal Testimony at 4-6.

[566] Wohnhas Hearing Testimony at 415-416.

[567] *Id.*

[568] Pauley Direct Testimony at 19.

[569] Kentucky Power's August 5, 2013 Supplemental Response to Commission Staff Hearing Data Request PH-1.

entity such as AEP Generation Resources Inc., Kentucky Power will remain responsible for only fifty percent of the Mitchell liabilities.[570]

KRS 278.300(1) requires Commission approval before the Company may assume its proportionate share of the Mitchell liabilities. Approval may be granted upon the demonstration that the assumption is for a lawful object within the corporate purposes of Kentucky Power.[571] In addition, Kentucky Power must demonstrate that the assumption is necessary for, or consistent with, the proper performance by the Company of its service to the public.[572] Finally, approval requires the demonstration that the assumption will not impair Kentucky Power's ability to provide public utility service and is necessary for the provision of utility service.[573]

The Company's assumption of the Mitchell-related liabilities as part of the purchase price for the Mitchell Transfer satisfies each of these requirement:

- Kentucky Power corporate purposes include the provision of retail electric service to approximately 173,000 customers in 20 counties in the Commonwealth. The Company is assuming the liabilities as part of its efforts to obtain the necessary capacity and energy to continue to provide such service, particularly following the retirement of the Big Sandy generating station.[574] As such, Kentucky Power's assumption of the liabilities is for a lawful object within the corporate purposes of the Company.

- The assumption is both necessary for and consistent with Kentucky Power' provision of public utility service to the public. Without the Mitchell Transfer Kentucky

[570] *Id.*

[571] KRS 278.300(3).

[572] *Id.*

[573] *Id.*

[574] Wohnhas Hearing Testimony at 404.

Power lacks the capacity and energy to meet its customers' needs.[575] The Company's assumption of Mitchell-related liabilities is part of the purchase price of the Mitchell Transfer.[576]

- Absent the assumption of the Mitchell-related liabilities, the Company will be unable to acquire the least-cost option for addressing the environmental requirements facing the Big Sandy generating station.[577] As such, the assumption of liabilities is also appropriate for the proper performance by Kentucky Power of its service to the public.

- The assumption of the liabilities will not impair Kentucky Power's ability to provide public utility service. Any liabilities assumed will reduce the transfer price of the Mitchell Transfer. In addition, there is no evidence in the record suggesting, and no party has argued that the assumption of the liabilities will impair Kentucky Power's ability to provide public utility service.

The assumption by Kentucky Power of the Mitchell-related liabilities satisfies the requirements of KRS 278.300(3), and the Company's application for approval of the assumption of the liabilities should be granted.

4. Appropriate Notice Of The Settlement Rates And Tariffs Has Been Provided.

Mr. Wohnhas was asked at the hearing whether the Company had advertised the tariffs and rates that would become effective January 1, 2014 under the Settlement Agreement.[578] Although the Company did not have time between the execution of the Settlement Agreement on morning of July 2, 2013 and its filing later that day (to provide the Commission and parties with a full opportunity to review the agreement prior to the July 10, 2013 hearing), it has published in conformity with all Commission requirements the rates associated with its June 28, 2013 application for a general adjustment of its rates.[579] The Settlement Agreement requires that the Company withdraw its application in Case No. 2013-00197 upon approval of the agreement, and

[575] Weaver Rebuttal Testimony at 13-14; Exhibit SCW-1 at 10.

[576] Pauley Direct Testimony at 19.

[577] Exhibit SCW-1R; Munczinski Hearing Testimony at 778; Weaver Hearing Testimony at 685; Pauley Hearing Testimony at 15, 113; Wohnhas Supplemental Testimony at 38.

[578] Wohnhas Hearing Testimony at 348-349.

[579] *Id.* at 400-401. *See also* 2013 Rate Application at § 10.

the Settlement Agreement rates and tariffs are to be substituted in their stead.[580] Thus, as with any settlement of a general rate case that results in rates different from those requested in the application, the agreed upon rates – in this case the rates in the Settlement Agreement – will not have been published at the time the Commission approves the settlement.[581] Second, the publication requirements are imposed by Commission regulations, 807 KAR 5:001, Section 16(3)(b) and 807 KAR 5:011, Section 8(2), and thus are subject to deviation upon order by the Commission.[582] To the extent required, the Company requests deviation from the publication requirements of the Commission's regulations. Finally, Kentucky Power commits to publish the Settlement Agreement rates and tariffs upon approval of the Settlement Agreement in whatever fashion the Commission deems appropriate.

C. The Virginia Corporation Commission Decision Denying Appalachian Power Company's Request To Acquire The Remaining Fifty Percent Of Mitchell Does Not Affect The Kentucky Power's Need for The Mitchell Transfer Or The Appropriateness Of This Commission Approving The Transfer.

On July 31, 2013 the Virginia Corporation Commission entered its Order in Case No. PUE-2012-00141 denying the transfer of a fifty percent undivided interest in the Mitchell generating station to Appalachian Power Company.[583] Kentucky Power Company's application to this Commission seeking authorization for the transfer of the remaining fifty percent undivided interest in the Mitchell generating station is independent of any action by either the

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[580] Settlement Agreement at ¶ 3; Wohnhas Hearing Testimony at 400-401.

[581] *See*, Order, *In The Matter Of: In the Matter of: Application Of Kentucky Power Company For A General Adjustment Of Electric Rates*, Case No. 2009-00459 (Ky. P.S.C. June 28, 2010).

[582] 807 KAR 5:001, Section 21; 807 KAR 5:011, Section 15.

[583] Order, *Application of Appalachian Power Company For Approval Of Transactions To Acquire Interests In The Amos And Mitchell Generation Plants And To Merge With Wheeling Power Company*, Case No. PUE-2012-00141 (Va. Corp. Comm. July 31, 2013).

Virginia or West Virginia commissions.[584] Kentucky Power continues to require both the capacity and energy available to it through the Mitchell Transfer, and the Mitchell Transfer, particularly under the terms of the Settlement Agreement, continues to represent the least-cost alternative to address the Company's needs.[585]

In addition, the issues presented by Appalachian Power to the Virginia Corporation Commission's decision are distinguishable from the issues Kentucky Power brings before this Commission. First, Kentucky Power's needs for capacity and energy in the long-term are more pressing than Appalachian Power's, primarily because Kentucky Power does not own numerous generating units. Appalachian Power, in contrast, already owns considerable generating resources to serve its much greater (approximately three times larger) customer base. Other than the 393 MW available under the Rockport Unit Power Agreement, the Kentucky Power's generation portfolio is limited to the Big Sandy generating station, which will retire in 2015. Because, unlike Appalachian Power, it does not own other substantial generating assets, Kentucky Power and its customers would be almost entirely subject to the high volatility and unpredictability of power markets without the Mitchell Transfer.

Second, and perhaps most importantly, the Virginia proceedings did not benefit from the significant advantages of the Settlement Agreement. In this proceeding, KIUC, Sierra Club and the Company have presented a settlement that addresses fairly and constructively the significant challenges posed by the impending retirement of Big Sandy Units 1 and 2 as coal-fired facilities. This agreed-upon path forward includes the conversion of Big Sandy Unit 1 to a gas

[584] Kentucky Power's August 3 5, 2013 Supplemental Response to Commission Staff Hearing Data Request PH-1.

[585] *Id.*

fired generating unit, and the consequent benefits to the Lawrence County tax base and employment,[586] an additional component absent in the Virginia proceedings.

CONCLUSION

The Settlement Agreement presents this Commission with a once in a generation opportunity to ensure that the residents of the 20 counties in Kentucky Power's service territory continue to enjoy the benefits of owned, baseload generation, including affordable and predictable rates. The Mitchell Transfer, which the Settlement Agreement facilitates, will diversify Kentucky Power's fuel mix, while reserving a place for Kentucky coal in Kentucky Power-owned generation. The Mitchell Units are environmentally-controlled, MATS-compliant, efficient, and represent by far the least-cost option for the Company and its customers.

The Settlement Agreement fairly and carefully balances the interests of the Company, its customers, and the Commission, while providing Kentucky Power's customers with significant benefits not otherwise available. The agreement represents the best judgment of the Company, KIUC, and the Sierra Club, subject to Commission review and approval, of the path forward for the Company and its customers, and the means of bringing to an end eight years of investigation by the Company. By approving the Settlement Agreement the Commission will enable the Company's customers to receive the benefit of owning, at a significant discount for the first seventeen months, and on fair and reasonable terms thereafter, "two of the jewels of AEP."[587]

[586] Wohnhas Supplemental Testimony at 16.

[587] LaFleur Hearing Testimony at 560.

Wherefore, Kentucky Power Company respectfully requests that the Commission enter an Order:

(a) Approving the Settlement Agreement without modification;

(b) Granting Kentucky Power Company a Certificate of Pubic Convenience and Necessity pursuant to KRS 278.020(1) and 807 KAR 5:001, Section 15 approving the transfer to the Company a fifty percent undivided interest in the Mitchell generating station, including all associated assets, at its December 31, 2013 net book value;

(c) Granting Kentucky Power Company approval pursuant to KRS 278.300 and 807 KAR 5:001, Section 17 to assume a fifty percent undivided interest in the liabilities associated with the Mitchell generating station;

(d) Establishing and approving the rates and tariffs provided for in the Settlement Agreement;

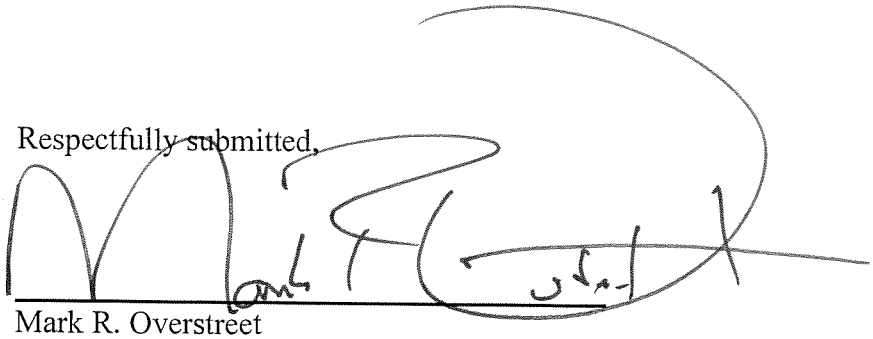
(e) Granting Kentucky Power Company, to the extent required, a deviation pursuant to KRS 278.2207(2) from the requirements of KRS 278.2207(1);

(f) Granting Kentucky Power Company, to the extent required, a deviation pursuant 807 KAR 5:001, Section 21 and 807 KAR 5:011, Section 15 from the notice requirements of the Commission's regulations;

(g) Authorizing the Company in accordance with Financial Accounting Standards Board Standards Codification 980-340-25-1 to accumulate and defer for review and later recovery in base rates beginning in 2015 the $28,113,304 of costs incurred from 2004 through 2012 in connection with the Company's ongoing efforts to meet Federal Clean Air Act and other environmental requirements with respect to Big Sandy Unit 2; and

(h) Granting Kentucky Power Company all other approvals and authority required to consummate the Mitchell Transfer.

Respectfully submitted,



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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing was served by first class mail, postage prepaid, upon the following parties of record, this 12th day of August, 2013.

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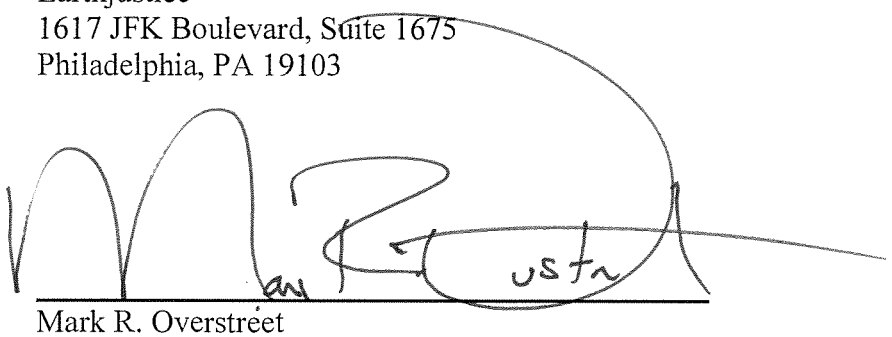

Mark R. Overstreet