COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In The Matter Of:	:	
	:	
The Application Of Kentucky Power Company For: (1) A General Adjustment Of Its Rates for Electric Service; (2) An Order Approving Its 2014 Environmental Compliance Plan; (3) An Order Approving Its Tariffs and Riders; And (4) An Order Granting All Other Required Approvals And Relief.	:	**Case No. 2014-00396**

BRIEF OF KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC.

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Kentucky Industrial Utility Customers, Inc. ("KIUC") submits this Brief in support of its recommendations to the Kentucky Public Service Commission ("Commission" or "KPSC"). The members of KIUC who are participating in this proceeding are: Air Products and Chemicals, Inc., Air Liquide Industrial U.S. LP, AK Steel Corporation, EQT Corporation and Marathon Petroleum Company LP. These companies purchase electricity from Kentucky Power Company ("Kentucky Power" or "Company").

INTRODUCTION

The Commission should approve the Settlement Agreement among Kentucky Power, KIUC, and the Kentucky School Boards Association (which Wal-Mart Stores East, LP and Sam's East, Inc. do not oppose) filed in this proceeding on April 30, 2015 ("Settlement"). While one party to this proceeding - the Attorney General of the Commonwealth of Kentucky ("AG") - opposes the Settlement, Commission acceptance of the Settlement as filed is reasonable since: 1) the Settlement provides a variety of benefits to Kentucky Power's customers, including financial, reliability, and economic development benefits; 2) the Settlement resolves all of issues surrounding Kentucky Power's FAC allocation methodology; 3) the Settlement is better than the probable results of litigation; and 4) the rate increase to residential customers resulting from the Settlement is in large part due to the increased funding for the Company's Distribution Vegetation Management Program, which will benefit residential customers through improved system reliability.

ARGUMENT

I. The Commission Should Approve the Settlement.

A. The Settlement Benefits All of Kentucky Power's Customers.

The Commission should approve the Settlement because it provides a variety of benefits to Kentucky Power's customers. One significant benefit is the reduction in the Company's requested increase from approximately $71.059 million per year (12.68%) to $45.4 million (8.10%).[1] That reduction is in part the result of an agreed-upon decrease in base rates of $23 million, which is lower than the $4.69 million base rate decrease initially proposed by Kentucky Power.[2] The 8.10% rate increase that would result from the Settlement compares favorably with the Company's projected 8.21% increase in the Mitchell Transfer Case.[3] And if the funds related to the Distribution Vegetation Management Program, which were not included in the Mitchell Transfer Case projections, are similarly removed from the Settlement revenue requirement in this case, the resulting increase is approximately 6.8%, which is significantly lower than what the Company previously projected.[4]

The Settlement benefits customers by limiting the rate increase for each tariff class to single digits, rather than the double-digit increases initially proposed by the Company.[5] The Settlement also removes the transmission adjustment initially proposed by the Company, which further reduces the requested increase. For example, the residential increase is reduced from the proposed 16.04% with the transmission adjustment to 9.89%.[6] Company witness Ranie K. Wohnhas discussed this change at the hearing:

> *Q: Kentucky Power filed this case in two different ways, your filed case, with the [PJM Open Access Transmission ("OATT") Tracker] and without the OATT Tracker?*
>
> *A: ...yes.*
>
> *Q: And your preference was to get the PJM OATT Tracker approved?*
>
> *A: That is correct, and the transmission set consistent with FERC, yes.*
>
> *Q: Okay. And that is not part of the Settlement? There is no OATT Tracker?*

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[1] Application at 7 as adjusted in the Company's Corrected Response to KIUC Data Request 1-63 (April 8, 2015) to include the effects of accumulated deferred income tax in the Big Sandy Retirement Rider; Settlement at 4.
[2] Settlement at 4.
[3] Case No. 2012-00578; Testimony of Ranie K. Wohnhas in Support of the Settlement Agreement (April 30, 2015) ("Wohnhas Testimony") at 10-11
[4] Wohnhas Testimony at 11.
[5] Settlement Exhibit 1.
[6] Application (December 23, 2014) at 7; Settlement Exhibit 1.

A: That is correct. And the rates...when you look at the 12.61%, looking at strictly the residential, versus 16.04% in the numbers we...show that without the Transmission....and so everything in the Settlement, in my Settlement Testimony, and the Settlement document itself are without the transmission adjustment.

Q: But under your preferred case, with the Open Access Transmission Tracker, the residential increase would have been 16.04% versus the 9.89% under the Settlement?

A: Yes.[7]

Another financial benefit of the Settlement for customers is the agreement that customers will be credited 75% of Kentucky Power's off-system sales revenues and the Company will retain 25% of those revenues. This is an improvement from the off-system sales sharing percentages that were effective prior to January 1, 2014, as well as the $836,000 increase in the annual off-system sales base rate credit.[8]

Residential and smaller business customers also benefit from the improvements to Kentucky Power's Distribution Vegetation Management Program contained in the Settlement, including increasing program spending by approximately $10.6 million to improve the reliability of the Company's distribution system, extending the current maintenance cycle from four years to five years (resulting in an estimated $20 million in cumulative savings through 2023 compared to the Company's proposal),[9] and establishing a one-way balancing account whereby any underspent program funds will be returned to customers.[10] The expansion of the Distribution Vegetation Management Program will also add new high-paying jobs to the eastern Kentucky region, as Company witness Everett G. Phillips discussed at the hearing:

Q: About how many employees or jobs will be created from that $10.6 million?

A: We will bring on, this year, roughly 30 crews, or 100 additional FTEs this year and probably will see that increase even more.

Q: That's at least 100 extra additional jobs?

A: That is correct.

Q: What do the contractors pay these individuals who do the tree-trimming on average?

A: Well, starting out, a ground man is $16 something an hour, but a [payroll foreman] is close to $30 an hour.

Q: So those are high-paying jobs, relatively high-paying jobs?

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[7] Tr. at 12:57:51.
[8] Wohnhas Testimony at 13-14; Settlement at 6-7.
[9] Wohnhas Testimony at 45.
[10] Wohnhas Testimony at 20-25; Settlement at 9-12.

A: For the foreman, yes.[11]

The Settlement also requires Kentucky Power to reduce base retail rates for the tariff classes that fund the Distribution Vegetation Management Program by approximately $11.8 million as of July 1, 2019.[12]

In addition to the benefits already listed, the Settlement provides economic development benefits by increasing shareholder funding for economic development initiatives ($300,000 annually) and by establishing a new IGS tariff in order to attract and retain large commercial and industrial customers in the Company's territory.[13] And the Settlement benefits Kentucky schools by establishing a new pilot rate class for K-12 public schools and by increasing funding for the Company's School Energy Manager Program.[14]

Company witness Wohnhas listed additional benefits that could be derived from approving the Settlement, including:

- *The first change in generation, transmission, and general plant depreciation rates since 1991. The adjustment of these rates more closely aligns the expense with the rates paid by the customers receiving the benefit of the depreciable property.*
- *Innovative deferral mechanisms to address possible volatile changes in the Company's PJM and new NERC compliance and cybersecurity expenses.*
- *Modest progress toward the gradual reduction of rate class subsidization. Even with the reduction of the subsidy for residential customers, the ROR of Tariff R.S. is less than two-thirds of total settlement ROR.*
- *A balancing of the continued gradual reduction of the subsidy received by residential customers with an effort to limit the increase to be experienced by those rate payers.*[15]

KIUC would add several additional benefits to this list:

- *Reflecting no short-term debt in Kentucky Power's Weighted Average Cost of Capital;*[16]
- *Lowering Kentucky Power's proposed Gross Revenue Conversion Factor;*[17]
- *Reducing the base net environmental costs identified in Tariff E.S.;*[18]
- *Reducing the amount of annual revenues to be produced by the initial Big Sandy Retirement*

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[11] Tr. at 16:38:55.
[12] Settlement at 12.
[13] Wohnhas Testimony at 27 and 40-41; Settlement at 13-14 and 20.
[14] Wohnhas Testimony at 38-40; Settlement at 18-19.
[15] Wohnhas Testimony at 45-46.
[16] Wohnhas Testimony at 11-12; Settlement at 5.
[17] Wohnhas Testimony at 12; Settlement at 5.
[18] Wohnhas Testimony at 12-13; Settlement at 6.

Rider ("BSRR");[19]

- *Modifying the cost allocation of the Biomass Energy Rider to align that allocation more closely with the types of costs recovered under the Rider;*[20]
- *Reducing the Residential Customer Charge compared to Kentucky Power's initial proposal.*[21]

Accordingly, approval of the Settlement would be beneficial for customers. Moreover, the total rate increase that customers would pay as a result of the Settlement is reasonable given what customers will receive in exchange for their money, as Mr. Wohnhas explained at the hearing:

Q: So included in the rate increase is retiring Big Sandy Unit 2?

A: That is correct.

Q: Converting Big Sandy Unit 1 to natural gas?

A: That's correct.

Q: Putting all of Mitchell into rates, all 780 MW of Mitchell into rates?

A: That is correct.

Q: An extra $10.6 million to vegetation control to improve reliability...?

A: Yes.

Q: That's 25% of the rate increase, isn't it, almost?

A: Yes.

Q: You're expanding the DSM school energy manager program?

A: Those are other benefits, yes.

Q: And we're settling any myriad of fuel cases to give consumers the certainty that that $54 million fuel order will not be changed on appeal?

A: As part of the Settlement package, yes.

Q: So there is real value that consumers are getting in exchange for the rate increase, would you agree?

A: I would agree, yes.[22]

B. The Settlement Resolves All of Issues Surrounding Kentucky Power's FAC Proceedings.

One major benefit of the Settlement is that it provides certainty that the Commission's decision to prohibit Kentucky Power from retaining approximately $54 million of improperly collected FAC costs will be

[19] Wohnhas Testimony at 14-19; Settlement at 7-8.
[20] Wohnhas Testimony at 33-35; Settlement at 16-17.
[21] Wohnhas Testimony at 41-42; Settlement at 20.
[22] Tr. at 11:33:11.

upheld without challenge.[23] This concession from Kentucky Power, which was secured through the Settlement, could not have been achieved through rate case litigation.

The Settlement ensures that customers will receive the full $54 million benefit of the Commission's decision not to allow Kentucky Power to retain improperly collected Mitchell *"no load"* costs from January 1, 2014 through May 31, 2015. This eliminates the litigation risk associated with the Kentucky Power's appeal of the Commission's recent FAC decision to the Franklin Circuit Court and it resolves Kentucky Power's two-year FAC review case (Case No. 2014-00450) in which the parties continued to debate the Company's FAC methodology. Adoption of the Settlement therefore will provide both base rate and FAC rate certainty for customers, whereas rejecting or modifying the Settlement will result in continued litigation that could ultimately result in a less favorable outcome for customers.

C. The Settlement Results in a Better Outcome Than Is Probable Through Litigation.

While no one can predict with certainty how the Commission would rule on the myriad of revenue requirement issues presented in this proceeding, it is important to evaluate what result is reasonably achievable if the parties litigated the rate case to its conclusion. If a settlement results in a lower rate increase than what a probable *"best case"* litigated outcome, then an intervenor or the Commission should have a higher level of confidence that the settlement is reasonable. To this end, KIUC performed a high-level *"best case"* outcome of a litigated case based on the AG's recommendations. In this analysis, KIUC aggressively assumed that the Commission would adopt the AG's recommendations to:

- *Remove all Company pro forma adjustments resulting in negative short-term debt.*
- *Adjust capitalization to reflect contributions in aid of construction as a reduction in construction work in progress.*
- *Adjust capitalization to reflect an increase in accumulated deferred income tax ("ADIT") due to bonus depreciation extension in 2014.*
- *Continue to reflect transmission costs in base rates.*
- *Remove Long-Term Incentive Plan ("LTIP") stock based incentive compensation expense tied to financial performance. (See adjustment to that amount described below.)*

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[23] Wohnhas Testimony at 28-33; Settlement at 14-16.

- *Remove amortization expense for deferred Big Sandy 2 Flue-Gas Desulfurization ("FGD") costs.*
- *Remove amortization expense for deferred IGCC costs.*
- *Remove amortization expense for deferred CCS/FEED costs.*
- *Remove amortization expense for deferred Carr Site costs.*
- *Remove test year Engage to Gain program costs.*
- *Remove certain miscellaneous expenses for items such as the lobbying, portions of Messrs. Pauley and Hall's salaries, tickets to sporting events, employee gifts and awards, membership dues, charitable contributions and public relations.*
- *Correct interest synchronization deduction error in income tax expense calculation.*
- *Include Parent Company Loss Allocation ("PCLA") in income tax expense.*

KIUC then conservatively assumed the following:

- *The return on equity ("ROE") would be raised from the 8.65% recommended by the AG to 10.0% for Base Rates, the BSRR, and the Mitchell FGD Costs. This would increase the AG's overall revenue requirement by approximately $13.863 million.*
- *The calculation of the BSRR would be performed using the Company's revised model and not using the AG's calculation, which assumes incorrectly that all estimated future costs had been added by Company in its original filing in the first year. The revised model correctly reflects the effects of ADIT in the BSRR revenue requirement. Company witness Jason M. Yoder discusses in Rebuttal Testimony his calculation, utilizing the revised BSRR model, of the AG's revenue requirement assuming the AG's recommended ROE of 8.65%, the AG's other cost of capital changes, and the AG's recommended removal of all estimated future costs. The BSRR revenue requirement would be $15.578 million compared to the AG's calculation of $11.114 million, an increase of approximately $4.464 million.*[24] *$1.082 million of this difference relates to the correct reflection of ADIT in the revised model, while $3.382 million relates to the AG's incorrect calculation assumptions. Utilizing the Company's revised model, we have calculated the BSRR revenue requirement to be approximately $16.650 million assuming a 10.0% ROE, an additional increase of $1.072 million.*
- *The AG's cost disallowance for the Incentive Compensation Plan (AIP) would be corrected to remove the double count of costs already removed in the Company's adjustments to remove Big Sandy costs and to annualize the Mitchell generation expense. The Company had not provided those calculations in discovery but Company witness Yoder provided them in Rebuttal Testimony. This would increase the AG's overall revenue requirement by approximately $1.668 million based on Yoder's calculations grossed up for the effects of bad debt expense and PSC assessments.*[25]
- *The remainder of the AG's cost disallowance for the Incentive Compensation Plan (AIP) would be removed except for the portion directly tied to a financial performance measure. The AG recommended a 75% disallowance of these costs because the overall funding measure or amount was based on operating earnings per share. Company witness Andrew R. Carlin pointed out in Rebuttal Testimony that a distinction needed to be made between the funding measures and the performance measures in the plan. The funding measures help determine the total amount of incentive compensation that can be paid out. Incentive*

[24] Rebuttal Testimony of Jason M. Yoder (April 29, 2015) ("Yoder Testimony") at 9:16-18.
[25] Yoder Testimony at 3:22-6:9.

compensation is actually paid out to all employees based on their individual performance measures.[26] *Mr. Carlin provided each of the applicable performance measures in a table on page 7 of his Rebuttal. The only financial performance measure indicated in that table is 15% based upon "KPCo Net Income." The entire additional disallowance computed by Yoder in his rebuttal testimony was $2.948 million.*[27] *Removal of this disallowance, except for this 15%, would increase the AG's overall revenue requirement by approximately $2.511 million after grossing up the effects of bad debt expense and PSC assessments.*

- *The AG's cost disallowance for the LTIP Incentive Compensation would be corrected to remove the double count of costs already removed in the Company's adjustments to remove Big Sandy costs and to annualize the Mitchell generation expense. The Company had not provided those calculations in discovery but Company witness Yoder provided them in Rebuttal Testimony. This would increase the AG's overall revenue requirement by approximately $0.893 million based on Yoder's calculations grossed up for the effects of bad debt expense and PSC assessments.*[28]

- *The AG's cost disallowance related to the 5-Year Normalization of Mitchell Plant Maintenance costs would be removed. The Company included a normalization based on the last three years (2012-2014) of actual costs, adjusted for inflation. Company witness Jeffery D. LaFleur pointed out in his Rebuttal Testimony that the costs recorded in 2010 and 2011, also used in the AG's calculations, were low in the years immediately following the installation of SCR and FGD systems at the Mitchell Plant since there were fewer planned outages.*[29] *Since the AG's disallowance was based solely upon the belief that a longer smoothing period would be better, providing no support, we believe the Company would likely win this issue. This would increase the AG's overall revenue requirement by approximately $1.004 assuming a gross-up for the effects of bad debt expense and PSC assessments.*

- *The AG's post-test year adjustment to increase commercial and industrial customer revenue would be removed. We believe the Commission would remove this as a selective post-test year adjustment. This would increase the AG's overall revenue requirement by approximately $1.057 assuming a gross-up for the effects of bad debt expense and PSC assessments.*

- *The AG removed the PJM Administrative Fees from the Company proposed BS1OR, which had been annualized based on an entire year of operation, and included the test year amounts, only nine months of activity from January 2014 through September 2014, in base rates. We believe the Commission would determine that it would be appropriate to annualize these costs and recover them through the new rider. This would increase the AG's overall revenue requirement by approximately $1.446 assuming a gross-up for the effects of bad debt expense and PSC assessments.*

- *The AG removed the $0.308 million revenue requirement requested by the Company associated with the Kentucky Economic Development Surcharge. This amount represented the ratepayer portion of economic development expenditures that the Company estimates. It proposed to match these costs with shareholder funds. We believe the Commission will allow this new surcharge.*

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[26] Rebuttal Testimony of Andrew R. Carlin (April 29, 2015) at 4:10-16.
[27] Yoder Testimony at 6:5-9.
[28] Yoder Testimony at 7:11-16.
[29] Rebuttal Testimony of Jeffery D. LaFleur (April 29, 2015) at 4:8-17.

The result is a realistic *"best case"* litigated revenue requirement outcome of $47.668 million, detailed on the attached comparison, which is higher that the settlement revenue requirement of $45.4 million. KIUC believes that this analysis should give the Commission a higher degree of confidence that the Settlement results in fair, just, and reasonable rates.

D. Much of the Rate Increase for Residential Customers That Would Result From Approving the Settlement Relates to the Improvements to the Company's Distribution Vegetation Management Program, Which Benefits Those Customers.

A large portion of the rate increase for residential customers that would result from the Settlement is due to Kentucky Power's commitment to increase funding for its Distribution Vegetation Management Program by $10.6 million annually, which benefits residential customers by increasing the reliability of the Company's distribution system. Without that additional $10.6 million funding, the increases to the various rate classes would be as follows:

Tariff	Current Revenue	Settlement Increase	Less: Distribution Reliability *	Net Settlement $ Increase	Net Settlement % Increase
Residential	230,140,567	22,769,279	7,388,759	15,380,520	6.68%
SGS	19,611,846	1,734,292	340,657	1,393,635	7.11%
MGS	59,677,592	5,284,965	1,111,917	4,173,048	6.99%
Schools **	13,648,403	699,681	248,247	451,434	3.31%
LGS **	56,921,244	5,039,149	1,076,892	3,962,257	6.96%
IGS	171,550,109	9,147,740	448,856	8,698,884	5.07%
OL	7,256,320	570,432	28,159	542,273	7.47%
SL	1,422,709	113,875	6,031	107,844	7.58%
MW	364,284	29,327	6,380	22,947	6.30%
Total	560,593,074	45,388,740	10,655,900	34,732,840	6.20%

* Increase in Reliability Expenditures from Cost of Service Study
** Schools/LGS Reliability Costs spread on Settlement Base Revenues

As the foregoing table reflects, when the increased $10.6 million funding for the Distribution Vegetation Management Program is removed from the revenue requirement, the increase for residential customers is comparable to, if not lower than, the increase for the other rate classes. But that additional program funding serves an important purpose – increasing the reliability of distribution system for residential customers. Thus, residential customers are getting value for their money. The additional rate increase for the residential class is justified by the reliability benefits made possible by improving the Distribution Vegetation Management Program.

CONCLUSION

Approval of the Settlement should complete Kentucky Power's successful transition to a standalone utility after the termination of the AEP Interconnection Agreement. The Settlement puts all of Mitchell into rates, pays for the retirement of Big Sandy Unit 2, starts cost recovery for converting Big Sandy Unit 1 to natural gas, enhances distribution system reliability, and favorably resolves contentious and complex fuel litigation. The resulting rates are fair, just, and reasonable for all customer classes.

WHEREFORE, for the reasons discussed above, the Commission should approve the Settlement as filed.

Respectfully submitted,

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June 5, 2015

ATTACHMENT

Kentucky Power Company Revenue Requirement
Summary of Settlement Proposal and AG Recommendations
Case No. 2014-00396
For the Test Year Ended September 30, 2014
($ Millions)

	KPCo Request and Settlement Amount	AG Amount
Total As-Filed Increase Requested by Company	69.977	
Correction of Company Error to Include Effects of ADIT in Requested BSRR	1.082	
Total Increase Requested By Company - As Adjusted	**71.059**	
Total Increase Recommended by AG		20.454
Correction of Company Error to Include Effects of ADIT in Requested BSRR		1.082
Total Increase Recommended by AG - Adjusted for Company Error in Requested BSRR		**21.536**
Increase AG Revenue Requirement to Increase ROE from 8.65% to 10.0% - Base Rates		10.927
Increase AG Revenue Requirement to Increase ROE from 8.65% to 10.0% - BSRR		1.072
Increase AG Revenue Requirement to Increase ROE from 8.65% to 10.0% - Mitchell FGD		1.864
Increase AG Revenue Requirement to Correct AG Assumption-All Future Costs Added in First Year - BSRR		3.382
Correct Calculation Error in AG Incentive Compensation Plan (AIP) 75% Disallowance - (See Note 1)		1.668
Remove Remaining Amount of AG Incentive Compensation Plan (AIP) 75% Disallowance Except for 15% Portion Tied to Financial Performance - KPCo Net Income		2.511
Correct Calculation Error in AG LTIP Disallowance - (See Note 1)		0.893
Remove Adjustment to Normalize Mitchell Plant Maintenance Expense Based on 5 Yr vs 3 Yr Actuals		1.004
Remove Post-Test Year Adjustment to Increase Commercial and Industrial Customer Revenue		1.057
Add Additional PJM Administrative Fees to Test Year Amounts to Reflect in BS1OR vs Base Rates		1.446
Add Kentucky Economic Development Surcharge ("KEDS")		0.308
Total Increase Recommended by AG Adjusted for Reasonable Positions		**47.668**
Settlement Amount	**45.400**	

Note 1 - Calculation Error on AG ICP and LTIP Disallowance Relates to Double Count for Big Sandy Costs Already Removed and Adjustment to Annualize Mitchell Operating Costs - See Yoder Rebuttal - Information Needed to Remove Costs was not Provided by Company in Response to Discovery.