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October 12, 1990
Project No. 8840-00

American Electric Power
Service Corporation

Demolition Cost Estimates

Mr. R. I. Pawliger, Group Manager
Mechanical Engineering
American Electric Power
Service Corporation
One Riverside Plaza
Columbus, OH 43215

Dear Mr. Pawliger:

In accordance with your authorization, Sargent & Lundy conducted a site-specific conceptual cost study to estimate the cost of dismantling Kentucky Power Company's (KP) Big Sandy coal-fired generating station.

The method used to prepare this conceptual cost estimate consisted of standard and accepted techniques. It consisted of reviewing general arrangement drawings of the plant site which showed the location of major structures on site and the arrangement of equipment inside the power block buildings. We were also provided with the weights of certain major pieces of equipment and the amount of asbestos to be removed. In order to confirm certain information and to gather additional data, we visited the Big Sandy plant site. We have also incorporated information from demolition and asbestos removal contractors.

The major assumptions used in preparing the cost estimate are stated in the estimate and include assumptions such as the only activities necessary to decommission an ash pond are to pump it dry and to cover the ash pond with two feet of soil. We also assumed it would not be necessary to remove the thousands of feet of underground piping and wiring and that there would be sufficient room on site to dispose of all the non-hazardous debris. In our opinion, assumptions such as these are conservative and minimize the dismantling cost estimate which results in a cost estimate at the lower range of potential dismantling costs.

SARGENT & LUNDY
ENGINEERS
CHICAGO

We estimated the salvage value for the amounts of recoverable steel in the plant and showed the salvage value as a reduction to the estimated cost for dismantling the plant.

We included a 10% factor for indirect expenses in the cost estimate which is intended to provide for KP's administrative and overhead costs such as obtaining permits, construction services such as water and electricity, security facilities, environmental monitoring and the cost of construction management which includes scheduling, monitoring and supervising the contractors who will be doing the actual dismantling work. It is also intended to cover such additional expenses as engineering assistance for particularly complex dismantling work.

Considering the above and given the magnitude of the project and the uncertainties and unplanned occurrences which can be encountered, we included a 25% contingency on the labor, material and indirect portions of the estimate. We believe that this contingency factor is reasonable.

Our estimate of the cost to dismantle the Big Sandy generating station is $43,157,000 in current (1990) dollars.

If we can be of any further assistance, please do not hesitate to call.

Yours very truly,

A. W. Wendorf
Project Manager

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KENTUCKY POWER COMPANY

Request:

Refer to the response to the Staff's Second Request, Item 36.

a. Of the companies included in the electric proxy group, Ameren, DTE Energy, Exelon Corp., FirstEnergy, Wisconsin Energy, and WPS Resources operate nuclear electric generators. Kentucky Power has no nuclear facilities and, therefore, does not experience any of the risks or expenses associated with such operations. Explain why these companies should be considered appropriate comparisons to Kentucky Power.

b. Of the companies included in the electric proxy group, DTE Energy obtains 26 percent of its operating revenues from non-utility operations, FirstEnergy obtains 37 percent from non-utility sources, Vectren Corp. obtains 25 percent, and WPS Resources obtains 73 percent. Kentucky Power does not obtain such large percentages of its revenues from non-utility sources. Explain why these companies should be considered appropriate comparisons to Kentucky Power.

c. Kentucky Power receives nearly 100 percent of its revenues from electric operations. Explain why Vectren Corp., with 23 percent of its revenue from electric utility operations, and WPS Resources, with 17 percent of its revenue from electric operations, are appropriate proxies for Kentucky Power.

d. Two proxy companies, Vectren Corp. and WPS Resources, obtain 23 and 17 percent, respectively, of their operating income from electric utility operations. NiSource, which was not included in the proxy group, derives around 73 percent of its operating income from regulated electric operations. Explain why NiSource, which appears to obtain a greater portion of its revenues from electric operations than either Vectren Corp. or WPS Resources, should not qualify as a comparison company for Kentucky Power.

Witness: Paul R. Moul

Response:

a. The Company disagrees with the premise of the question because, although Kentucky Power owns no nuclear facilities, as a member of the AEP Power Pool Kentucky Power incurs costs associated with nuclear generation owned by I&M. In any event, as to the Electric Group companies that have direct investments in nuclear generation, the market does not seem to view the ownership of nuclear generation as a negative risk factor, unless operational problems exist. Indeed, in a more competitive market for electricity, nuclear generation is viewed as an attribute because of its much lower operating costs. Further, nuclear generation has recently received renewed interest since it does not have air emission issues. Indeed, nuclear generation received prominent attention in the new Energy Policy Act of 2005.

b. Generally, these companies are viewed by investors as electric companies as revealed by their classification by Value Line. Each of the companies were included in the Electric Group because they fit each of the six criteria set forth on page 8 of Mr. Moul's direct testimony.

c. Please refer to the response to item (b) above.

d. NiSource was excluded from the Electric Group because it failed to qualify for criteria (v) in the selection processes (i.e., it reduced its dividend in the fourth quarter of 2003).

Witness: Paul R. Moul

KENTUCKY POWER COMPANY

Request:

Refer to the response to the Staff's Second Request, Item 42. Kentucky Power states that it uses companies operating in the Great Lakes region because companies outside this region are geographically remote from Kentucky Power. Kentucky Power goes on to quote the geographic criteria specified in the Bluefield case in support of this selection criteria.

a. Provide a detailed description of why electric utilities operating in Wisconsin and Michigan provide enough geographical similarity to Kentucky Power to be appropriate comparison companies.

b. Provide a detailed list of the electric supply fundamentals of each company in the proxy group and an explanation of what makes them distinctly similar to Kentucky Power.

c. Provide a detailed list of the electric supply fundamentals of the electric utilities in states adjacent to Kentucky and an explanation of what makes them distinctly dissimilar to Kentucky Power.

Response:

a. The states that comprise the Great Lakes region include: Illinois, Indiana, Kentucky, Ohio, Michigan and Wisconsin. The states in the Great Lakes Region have a general geographic similarity to Kentucky, with each lying in the north central United States. Kentucky is located on the southern edge of the region and borders all but two of the other states in the region. In addition, Ameren, which is a company within the region, also has operations in Missouri, another state that borders Kentucky. In reviewing the results of the utilities that operate in the Great Lakes region, there did not appear to be a distinction in the return on equity based upon the location of the utility within that region.

In response to Staff Data Request No. 42, Mr. Moul did not intend to convey the impression that each of the utilities in the Great Lakes region were located in states contiguous to Kentucky. Rather, the point was that Mr. Moul did not include utilities operating in the Northwest, the far Southeast or California.

Witness: Paul R. Moul

b. Electric supply fundamentals were not included as part of the selection criteria. For the companies in the Electric Group, the fuel source for electric generation is:

	Fuels				
	Coal	Fossil & Hydro	Nuclear	Other	Purchases
Ameren Corp.	85%		13%	2%	
DTE Energy Co.	71%		16%	1%	12%
Exelon		26%	48%	1%	25%
FirstEnergy Corp.	N/A	N/A	N/A	N/A	N/A
MGE Energy, Inc.		65%		2%	33%
Vectren Corp.	N/A	N/A	N/A	N/A	N/A
WPS Resources	61%	2%	18%		19%
Wisconsin Energy	61%		24%	2%	13%

Source of Information: Value Line Investment Survey, April 1, and June 3, 2005

c. Mr. Moul has not performed an exhaustive study to compare the electric supply fundaments in the states adjacent to Kentucky. Generally, the fuel sources in those states are coal, natural gas, nuclear, and hydro.

Witness: Paul R. Moul

KENTUCKY POWER COMPANY

Request:

Refer to the response to the Staff's Second Request, Item 43. Kentucky Power is a regulated utility and the subject of this rate case. It does not engage in all of the business ventures and, therefore, is not exposed to all of the business risks of AEP, the parent holding company. Explain how using AEP as a substitute for Kentucky Power is a valid procedure when making risk comparisons between the electric proxy group and Kentucky Power, the subject of this rate case.

Response:

An analysis of AEP is important because it is the source of common stock equity for Kentucky Power. In addition, AEP is primarily involved in electric utility operations. According to its 2004 Form 10-K, domestic utility operations of AEP had assets of $32.281 billion at December 31, 2004. Hence, the domestic utility operations represented 93% ($32.281 billion ÷ $34.663 billion) of total AEP assets.

Witness: Paul R. Moul

KENTUCKY POWER COMPANY

Request:

Refer to page 12 of the Direct Testimony of Paul R. Moul ("Moul Testimony"). Is Mr. Moul stating that Kentucky Power will be spending $1 billion for a 600 MW Integrated Gasification Combined Cycle generating plant in Kentucky? If yes, provide documentation that demonstrates Kentucky Power will be constructing this plant in the state.

Response:

Mr. Moul is not stating that Kentucky Power will be investing $1 billion for a 600 MW Integrated Gasification Combined Cycle generating plant in Kentucky.

Witness: Paul R. Moul

KENTUCKY POWER COMPANY

Request:

Refer to response to the Staff's Second Request, Item 44. The range of forecasted average Earnings Per Share ("EPS") for the electric group between the various ratings agencies extends from 4.51 percent from IBES/First Call to 5.63 percent for Value Line. Explain how Mr. Moul derived 5.5 percent as the growth rate for his DCF calculations.

Response:

As a matter of professional judgment, Mr. Moul believes that 5.5. % is the appropriate growth rate for DCF calculations. Both the simple average and median are above 5%. In addition, Mr. Moul also considered the macroeconomic factors described at pages 18-20 of his testimony in the analytical process that indicated that growth in corporate profile in the long-term will average approximately 6%.

Witness: Paul R. Moul

KENTUCKY POWER COMPANY

Request:

Refer to the response to the Staff's Second Request, Item 44 and the Moul Testimony, Exhibit No. PRM-1 Schedule 7. Provide a table with the projected EPS data used to construct Schedule 7 for each company from IBES/First Call, Zacks, Reuters/Market Guide, and Value Line.

Response:

Please refer to the data provided below:

Electric Group	I/B/E/S First Call	Zacks	Reuters Market Guide	Value Line
Ameren Corp.	3.36%	4.90%	4.36%	0.50%
DTE Energy Co.	4.20%	4.60%	4.50%	7.00%
Exelon	5.29%	6.10%	6.35%	6.50%
FirstEnergy Corp.	4.20%	4.10%	4.43%	10.00%
MGE Energy, Inc.	-	N/A	-	6.00%
Vectren Corp.	4.00%	5.00%	6.67%	4.50%
WPS Resources	4.33%	4.70%	4.33%	6.50%
Wisconsin Energy	6.20%	6.10%	6.25%	4.00%
Average	4.51%	5.07%	5.27%	5.63%

Source of Information: Thomson Financial, June 22, 2005
Zacks, June 22, 2005
Market Guide, June 22, 2005
Value Line Investment Survey, April 1 and June 3, 2005

Witness: Paul R. Moul

KENTUCKY POWER COMPANY

Request:

Refer to the response to the Staff's Second Request, Item 47(a). Given the distribution of the data points in the sample, explain why 13.75 percent should not be considered an outlier and eliminated from consideration.

Response:

The 13.75 percent figure was not eliminated because the model developed by the FERC does not make a provision for its elimination. The model considers all values except for those so close to the cost of debt that they would not represent reasonable compensation to investors for the risk of equity. *See*, Opinion No. 445, Southern California Edison Company, Docket Nos. ER97-2355-000, ER98-1261-000 and ER98-1685-000 at 21 (July 26, 2000) provided in the Company's Response to Data Request No 48, Staff Second Set.

Witness: Paul R. Moul

KENTUCKY POWER COMPANY

Request:

Refer to the response to the Staff's Second Request, Item 47(b). Mr. Moul states that he has adopted the FERC model as his own. Mr. Moul utilized two methods for calculating Discounted Cash Flow ("DCF") input values to obtain individual company Return on Equity ("ROE") estimates. He then selected extreme company ROE estimates between the methods, after truncating the sample, in order to arrive at a reduced sample. The ROE recommended by Mr. Moul is an average of the extreme high and extreme low data points in the reduced sample. From the reduced sample, his recommended ROE is not close to either the average or the median values.

a. Mr. Moul's procedure does not blend results of using different procedures to obtain DCF inputs until the final step. The various DCF results from the two methods are then used to search for the most extreme values, which are then placed in a reduced sample. Explain why it is not better to blend the ROE estimates from the two methods of estimating ROE in recognition that different methods for obtaining the DCF inputs will produce slightly different results.

b. It appears that using Mr. Moul's DCF procedure for calculating ROE ignores all but two companies in the proxy group. Mr. Moul's ultimate proxy group appears to only consist of two companies, those that produce the most extreme ROE estimates. Explain why it is valid to use a proxy group that effectively consists of only two companies.

Response:

a. It is Mr. Moul's opinion that the better approach would be to analyze the final results of the FERC's form of the model. The advantage of the approach is to provide discrete values for each form of the model. Mr. Moul chose the FERC model because it is employed by FERC in setting rates and contains elements that are generally recognized by regulatory authorities. The FERC model does not provide for blending in the fashion suggested and Mr. Moul is unaware of any regulatory body employing the suggested blending with the FERC model. It further is Mr. Moul's opinion that it is preferable to utilize this established FERC model than to create a new one.

b. Mr. Moul disagrees with the contention that the proxy group consists of only two companies. The entire proxy group is used in establishing the range. The mid-point is then calculated for that range. The use of the midpoint is specified by the FERC form of the DCF model.

Witness: Paul R. Moul

KENTUCKY POWER COMPANY

Request:

Refer to the response to the Staff's Second Request, Item 50(a) and the Moul Testimony, Exhibit No. PRM-1 Schedule 9, page 3 of 4. In the "b times r" Growth Rate table, explain the derivation of the Growth column under Common Equity.

Response:

Growth in Common Equity is the compound growth rate in the common equity amounts from 2006 to the midpoint of the period 2008-10. As an example, the growth rate for Ameren is $7,059 ÷ $6,320 = 1.169

$1.1169^{1/3} - 1 = 0.0375$

0.0375 = 3.75%.

Witness: Paul R. Moul

KENTUCKY POWER COMPANY

Request:

Refer to the response to the Staff's Second Request, Item 46. Mr. Moul states that a flotation cost provision must be made in the cost-of-equity calculation, unless otherwise provided in the cost-of-service-study. Explain how flotation cost would be presented in a cost-of-service-study.

Response:

Please refer to the explanation provided below that was taken from The Cost of Capital – A Practitioners Guide that explains that approach.

> Cost of Service Approach
>
> Cost of service approaches treat flotation costs like most other operating costs and allow for their recovery, on a dollar-for-dollar basis, in the cost of service (accounting) phase of a rate case. In this type of approach, past flotation costs (usually from a public offering during the test period) are identified and allowed to be recovered through rates.
>
> The use of a cost of service approach to recovering flotation costs is often rationalized in one of two ways. First, a cost of service approach specifically recognizes the actual dollar value of flotation costs and provides a mechanism for recovering the exact amount of costs.
>
> Second, a cost of service approach has been advocated as an alternative mechanism for overcoming the perceived shortcomings of formula approaches. Such a rationale has been suggested by How (1984), citing three reasons why formula approaches may not be accepted by regulators: 1) the likelihood that flotation cost measurement is controversial; 2) if the estimate of the bare bones cost of equity is misestimated upward, the adjustment formula only serves to magnify the error; 3) implicit in the Gordon model are pre-specified relationships concerning the utility's investment and financing programs, which may not be accurate representations for a particular utility.

Several alternatives are available to recover expenses through a cost of service approach. Normally, these approaches are directed only toward the issuance cost component of flotation costs.

1. Immediate Recovery

Expensing issuance costs in the year incurred has the advantage of simplicity. There is no need to set up an amortization schedule and the utility is compensated immediately. This method either recognizes the amount of flotation costs in rates to be recovered in a single year or in a relatively short period of time (e.g. two or three years).

If a utility has a rate case in the year of a stock issue, the full amount of issuance expenses is included in rates. If rates are not reset the following year, the recovery mechanism remains in place even though the expenses have been recovered.

Conversely, if stock is issued and a rate case is not held, the expenses would be booked and never recognized in rates. This problem could be solved by deferring the expenses until the time of the next rate case. Again, however, the expenses would be included in rates until the time of the next rate change.

The immediate recovery method is the most straightforward and common method to recover issuance costs via an accounting treatment. The remaining three methods represent accounting "fine-tuning" mechanisms designed to more accurately recover issuance costs.

2. Recovery on a Present Value Basis

When issuance expenses are incurred, common equity is reduced by the amount of expenses. If an accounting recovery mechanism is put in place, common equity is restored over time as the expenses are amortized. Under this alternative, on the other hand, a return is allowed only on the book value of equity during the recovery period. If the passage of time is not recognized in determining the amount of expenses to be recovered, an earnings shortfall occurs. To solve this potential problem, recovery of the present value of out-of-pocket expenses can be allowed.

3. Capitalization of Expenses With Amortization

Instead of calculating the flotation allowance on a present value basis, the alternative recovery can be accomplished via straight-line amortization. The difference between these alternatives lies in the equity balance to which the allowed return is applied. In the latter alternative, unamortized flotation costs are capitalized, i.e., included in the capital structure and rate base. The allowed return is then applied to the gross proceeds of the stock issue.

This method permits the utility to record the gross proceeds from any equity sales in the common equity account. This essentially requires flotation costs to be recorded as an intangible asset and be considered part of rate base (Bierman and Hass, 1984).

4. Permanent Capitalization

Permanent capitalization of out-of-pocket expenses refers to the practice of including the full amount of expenses in the capital structure and rate base indefinitely.

Witness: Paul R. Moul

KENTUCKY POWER COMPANY

Request:

Refer to the response to the Staff's Second Request, Item 54 and the Moul Testimony, Exhibit No. PRM-1 Schedule 11.

a. Mr. Moul obtained his measure of risk premium by subtracting the geometric means, the arithmetic means, and the median values for the Public Utility B Series Bonds from the S&P Public Utility Index series. The "risk premiums" for the geometric mean and the median values were averaged together and then that average was averaged with the arithmetic mean "risk premium" to obtain his risk premium for investing in utility stocks over utility bonds. Explain how this process provides an accurate picture of the risk premium required to invest in utility stocks over utility bonds over time.

b. Explain how the median values of the series provide a meaningful measure of risk premium.

Response:

a. There are a variety of procedures that can be used to measure the risk premium. As noted by the question, the primary measures of central tendency are the arithmetic mean, the geometric mean, and the median. It is Mr. Moul's opinion that the structuring of these measures using each provides a comprehensive analysis of the data through the development of various ranges that encompass each of these measures. From the range, a representative risk premium is developed that considers each of the measures of central tendency.

b. The median value is a standard statistical measure of central tendency. The definition provided by Microsoft Excel of the median is: The median is the number in the middle of a set of numbers; that is, half the numbers have values that are greater than the median, and half have values that are less.

Witness: Paul R. Moul

Kentucky Power Company

REQUEST

Refer to the response to the Staff's Second Request, Item 58. The response states that Draft No. 3 of the North America Electric Reliability Council's ("NERC") proposed standards on the Transmission Vegetation Management Program was posted for ballot through November 16, 2005. Provide the result of that ballot.

RESPONSE

For the NERC standard posted for ballot through November 16, 2005, an insufficient number of ballots were cast from the ballot pool. Consequently, the proposed standard was reposted for a 30-day review through December 19, when balloting will again commence.

WITNESS: Everett G Phillips

Kentucky Power Company

REQUEST

Refer to the response to the Staff's Second Request, Item 59. Explain in detail why Kentucky Power has not conducted an inventory of trees, tree growth, and tree mortality rates.

RESPONSE

Please refer to Witness Phillips direct testimony, page 8, which describes requirements for a vegetation inventory:

"To adopt the Audit's recommendation would require additional financial resources to obtain the technology required to inventory vegetation on KPCo's system, to conduct the tree inventory, to increase the number of tree trimming crews, and additional administrative oversight to implement an effective cycle-based program."

Kentucky Power has prudently committed its vegetation management resources to maintaining its rights-of-way. To conduct a vegetation inventory with current level funding will divert resources away from physically maintaining its rights-of-way.

WITNESS: Everett G Phillips

Kentucky Power Company

REQUEST

Refer to the response to the Staff's Second Request, Item 61. Explain why Kentucky Power will not commit to establishing a cycle-based approach to transmission vegetation management, even if that approach needs to be revised as a result of standards adopted by NERC.

RESPONSE

The existing NERC Vegetation Management Standards, as well as the proposed revision of the NERC Vegetation Management Standards posted for review and balloting, do not require a cycle based approach. If in fact a future NERC Standard required a cycle based approach to vegetation management, then Kentucky Power would adjust its approach accordingly. It is also noted that NERC Standards generally apply to transmission facilities above 100 kV.

WITNESS: Everett G Phillips

Kentucky Power Company

REQUEST

Refer to the response to the Staff's Second Request, Item 62.

a. Concerning the responses to Items 62(a) and 62(b), provide a more detailed explanation and list the exact items (e.g., additional chain saws and other tree trimming equipment, new trucks, radios, etc.) that would be capitalized that Kentucky Power envisions as being necessary.

b. Explain in detail why Kentucky Power believes the removal of trees previously trimmed should be a capitalized cost.

c. Concerning the response to Item 62(c), provide a more detailed explanation and list the operation and maintenance expenses that are envisioned under the new trimming cycle regime.

RESPONSE

a. Kentucky Power's vegetation management capital expenditures will consist of the purchase of additional right of way and the clearing of right of way. Kentucky Power will not purchase specific equipment. The associated equipment required to clear the right of way will be acquired by a contract vegetation management provider, i.e. Asplundh Tree Experts.

b. Removal of a tree, even if previously trimmed, improves the right of way and obviates the need for, and cost of, future trimming of that tree. In addition, removal of the tree increases the value of the right of way. As such, the cost should be capitalized.

c. As stated in the response to Item 62(c) the funding necessary to implement a cycle-based approach is based on performing end-to-end work on all of KPCo's Distribution and Transmission circuits and is further explained in Witness Phillips Direct Testimony, page 10:

"The estimates (of both O&M and Capital) were based on actual line mile tree-trimming clearing expenses, which include base tree trimming work, herbicide application, and incremental tree trimming crews to perform end-to-end clearance, administrative oversight, and follow-up trimming for fast growing vegetation between cycles."

The level of expenditures forecast is included in Witness Phillips Direct Testimony, page 10, Table 2:

KPCo's Estimated	**Total Vegetation Management O&M and Capital Summary**	**(Millions)**		Year	Distribution	Transmission
Total			**O&M**	**Capital**	**O&M**	**Capital**
O&M	**Capital**		First	**$11.05**	**$4.97**	**$1.25**
$0.42	**$12.30**	**$5.40**		Second	**$11.38**	**$5.12**
$1.29	**$0.44**	**$12.67**	**$5.56**		Third	**$11.72**
$5.27	**$1.33**	**$0.45**	**$13.05**	**$5.72**		

Table 1 found on page 9 of Witness Phillips Direct Testimony represents an estimated summary of the incremental vegetation management work, which could be performed if the proposed cycle-based approach were adopted.

Actual Right of Way Summary Report			
Test Year	**Trees Trimmed**	**Trees Removed**	**Acres of Brush Cleared**
12 month ending June 2005	47,916	176,649	154,559
Projected Right of Way Summary Report			
Year	**Trees Trimmed**	**Trees Removed**	**Acres of Brush Cleared**
Year 1	166,457	439,189	403,195
Year 2	166,457	439,189	403,195
Year 3	166,457	439,189	403,195

WITNESS: Everett G Phillips

Kentucky Power Company

REQUEST

Refer to the response to the Staff's Second Request, Item 64. In its response, Kentucky Power states it "intends to initiate the programs upon receipt of a favorable Commission Order."

a. Based upon this response, is Kentucky Power stating it will not implement any of the proposed cycle-based vegetation management programs unless it specifically is granted the rate-making treatment it has proposed in this case? Explain the response.

b. The response also references the matching principle. Describe Mr. Everett G. Phillips' experience in applying the matching principle to utility rate-making operations.

c. What is Mr. Phillips' definition of the rate-making concept of "known and measurable?" Explain the response.

RESPONSE

a. Subject to the response to the Company's Response to Staff's Third Request, Item 28, Kentucky Power will not implement the enhanced vegetation management programs described in Mr. Phillips testimony absent the rate making treatment proposed in this case.

The cost of implementing a comprehensive, cycle-based vegetation management program is significantly above the levels in Kentucky Power's historical rates and current test year. Vegetation inventories and accelerated maintenance programs are two of the major cost factors in implementing this program, therefore if the result of the requested rate-making treatment is diminished, implementation of a full cycle-based program and the resulting enhancement of reliability will be impacted accordingly.

b. Mr. Phillips' background and experience is more focused on electrical engineering and distribution operations, not accounting. However, it is his understanding that the matching principle concept matches revenues with expenses incurred during the same period.

c. "Known and measurable" are expenses that are reasonably certain to occur subsequent to the selected test year and the amount of the changes is reasonably determinable. Known, estimated or reasonably expected to occur within a period of time given based on the history and experience of the operations.

WITNESS: Everett G Phillips

Kentucky Power Company

REQUEST

Refer to the response to the Staff's Second Request, Item 65 and Attachment C to the Appendix to the Commission's June 14, 1999 Order in Case No. 1999-00149, (Case No. 1999-00149, Joint Application of Kentucky Power Company, American Electric Power Company, Inc., and Central and South West Corporation Regarding a Proposed Merger, final Order dated June 14, 1999.) pages 1 through 6 of 6. Attachment C includes the commitment of Kentucky Power to maintain the overall quality and reliability of its electric service at levels no less than it had achieved in calendar years 1995-1998. The measures of this performance are the Customer Average Interruption Duration Index ("CAIDI") and System Average Interruption Frequency Index ("SAIFI") including all storms.

a. Compare the responses to Item 65(c), the CAIDI and SAIFI overall indices including major events, with the baseline included in Attachment C, page 6 of 6. Based upon this comparison, has Kentucky Power met its merger commitment? Explain the response in detail.

b. Part 4, page 1 of 6, of Attachment C describes how Kentucky Power will gather information on reliability and outages and "develop a comprehensive work plan each year which focuses efforts to improve service reliability. The Company will undertake all reasonable expenditures to achieve the goal of limiting customer outages." Has Kentucky Power been developing these annual work plans and has it undertaken all reasonable expenditures to achieve the goal of limiting customer outages? Explain the response in detail.

c. Part 9, page 3 of 6, of Attachment C states:

9. All prudent costs incurred to comply with the items contained in this Agreement, once incurred, will constitute known and measurable expenses that Kentucky Power shall have an opportunity to recover in accordance with traditional ratemaking principles, through recognition of these costs in its revenue requirement in future rate review. (emphasis added)

In this application, Kentucky Power is requesting rate recovery of estimated expenditures for vegetation management prior to incurring the actual expenditures. Explain in detail how Kentucky Power's proposal in this case is consistent with the provisions of Part 9 of Attachment C.

RESPONSE

a. KPCO has determined it is meeting its merger commitment. The reported reliability indices are heavily influenced by the extent of major events and by an upgrade of Kentucky Power's outage management system (OMS). The OMS upgrade impacts has been communicated in a White Paper submitted in conjunction with KPCO's annual merger compliance filings beginning in 2002 and discussed in Staff's 2003 "Management Audit Findings." Combining these influences with the fact that customer satisfaction regarding reliability has remained steady over the years reassures KPCO its commitment to maintain the overall quality and reliability of its electric service to its customers has been upheld.

b. Yes. Kentucky Power continues to compile outage data detailing each circuit's reliability performance. The worst performing circuits are identified considering CAIDI, SAIDI and repeat outages, as well as those with outage causes that can be addressed through existing asset improvement programs targeting animal, lightning, small conductor failure, and tree caused outages. This allows for the identification of areas needing reliability improvements and for the development of work plans to optimize system performance where within utility control.

Work plans are developed by combining reliability performance with input from field personnel to identify areas that do not satisfy ranking criteria alone. Work plans include ground line treatment of poles; improved fault isolation by installing additional sectionalizing devices; recloser maintenance; and system improvements required due to facility loading, voltage control and reliability performance.

c. Attachment C includes the Company's commitment to <u>maintain</u> the overall quality and reliability of its electric service. In this application, the Company is proposing to enhance, not maintain, the overall level of service quality and reliability through additional expenses and enhanced reliability programs.

WITNESS: Everett G Phillips

Kentucky Power Company

REQUEST

Refer to the response to the Staff's Second Request, Item 67, concerning Kentucky Power's proposed residential rate design, which maintains the current two-step declining block rate structure. Given the discussion regarding the relationship between the customer charge level and the two-step rate structure, to what extent did Kentucky Power consider proposing to increase the residential customer charge to the full cost of $8.69? Explain the response.

RESPONSE

The Company's preference would be to increase the residential customer charge to as close to the full cost of $8.69 as possible. However, in the interest of gradualism and to mitigate the potential impacts on low usage residential customers, the Company proposed to increase the customer charge from the current $4.25 to $5.50 per month, a 29.4% increase.

WITNESS: David M Roush

Kentucky Power Company

REQUEST

Refer to the response to the Staff's Second Request, Item 68(b). Provide a generic outline of the type of filing Kentucky Power envisions making on an annual basis to establish the Net Congestion Recovery Factor for the following calendar year.

RESPONSE

Each year, the Company would file a report showing its actual net congestion costs and its retail kWh sales for the twelve months ending September. Those values would be used to calculate the Net Congestion Recovery Factor for the subsequent calendar year.

The Company would make a second filing early in each year showing the actual costs and collections under the Net Congestion Recovery Factor during the preceeding calendar year. Any over- or under-recovery so determined and projected retail kWh sales would be used to calculate the Balancing Adjustment Factor on a kWh much like the Net Merger Savings Credit to apply in the months of February through December.

WITNESS: David M Roush

Kentucky Power Company

REQUEST

Refer to the response to the Staff's Second Request, Item 70(a). Provide copies of the portions of previous Commission's Orders that found the 3-year average of the percentage of "Accounts – Net Charged Off" was reasonable.

RESPONSE

At page 34 of its May 27, 1997 order in Case No. 96-489 the Commission adopted the 3-year average of the percentage of "Accounts-Net Charged Off proposed by the Company. Please see the attachment.

WITNESS: Errol K. Wagner

5/27/97 ORDER

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF KENTUCKY POWER COMPANY d/b/a AMERICAN ELECTRIC POWER TO ASSESS A SURCHARGE UNDER KRS 278.183 TO RECOVER COSTS OF COMPLIANCE WITH THE CLEAN AIR ACT AND THOSE ENVIRONMENTAL REQUIREMENTS WHICH APPLY TO COAL COMBUSTION WASTE AND BY-PRODUCTS	) CASE NO. 96-489

<u>O R D E R</u>

On November 27, 1996, Kentucky Power Company, d/b/a American Electric Power ("Kentucky Power") filed an application, pursuant to KRS 278.183, for approval of its environmental compliance plan and rate surcharge to recover its costs of environmental compliance. Kentucky Power proposed to make the surcharge effective on December 31, 1996, and estimated that it would recover approximately \$3,000,000 to \$5,000,000 over the two year period beginning December 31, 1996. Pursuant to KRS 278.183(2), the Commission must: (1) consider and approve a compliance plan and rate surcharge if the Commission finds the plan and rate surcharge reasonable and cost-effective for compliance with the applicable environmental requirements; (2) establish a reasonable return on compliance-related capital expenditures; and (3) approve the application of the surcharge. The Commission has six months from the date the application is filed to conduct the necessary proceedings. Consequently, by Order dated December 19, 1996, the Commission suspended Kentucky Power's proposed tariff through May 26, 1997.

May 27, 1997
Order