Response of the Attorney General to
Initial Data Request of Commission Staff to the Attorney General
Kentucky Power Company
Case No. 2005-00341

Responding Witness: Michael J. Majoros, Jr.

17. KIUC's witness, Mr. Kollen, has recommended using all salvage and removal data in the determination of the appropriate level of net negative salvage to include in Kentucky Power's proposed depreciation rates. What is Mr. Majoros's opinion of Mr. Kollen's recommendation? Explain the response.

Response:

Mr. Majoros does not object to Mr. Kollen's longer period. However, to the extent that Mr. Kollen's results reflect future inflation as a result of the Traditional Inflated Future Cost Approach ("TIFCA"), i.e., relating current cost of removal dollars to historical retirement dollars, Mr. Majoros does not agree with Mr. Kollen.

Kentucky Power Company

Case No. 2005-00341

Five-Year Average Net Salvage Experience
Total Plant, Based on FERC Form 1 Reports

Year	Gross Salvage	COR	Net Salvage
Total Plant			
2000	1,527,191	435,430	1,091,761
2001	2,463,822	3,670,847	(1,207,025)
2002	5,075,181	15,353,719	(10,278,538)
2003	1,737,692	3,992,255	(2,254,563)
2004	6,361,290	5,169,516	1,191,774
5-Year Total	**17,165,176**	**28,621,767**	**(11,456,591)**
5-Year Avg.	**3,433,035**	**5,724,353**	**(2,291,318)**

Source: FERC Form 1 Reports, 2000-2004, page 219.

Kentucky Power Company

Case No. 2005-00341

Five-Year Average Net Salvage Experience
Based on Response to AG 2-34

Year	Gross Salvage	COR	Net Salvage
Production Plant			
2000	1,711	203,653	(201,942)
2001	172,103	(80,513)	252,616
2002	30,879	39,320	(8,441)
2003	(28,698)	7,312,512	(7,341,210)
2004	14,006	4,666,328	(4,652,322)
5-Year Total	**190,001**	**12,141,300**	**(11,951,299)**
5-Year Avg.	**38,000**	**2,428,260**	**(2,390,260)**
Transmission Plant			
2000	23,740	53,562	(29,822)
2001	101,608	823,970	(722,362)
2002	(31,282)	48,654	(79,936)
2003	305,945	912,736	(606,791)
2004	129,249	224,657	(95,408)
5-Year Total	**529,260**	**2,063,579**	**(1,534,319)**
5-Year Avg.	**105,852**	**412,716**	**(306,864)**
Distribution Plant			
2000	1,501,740	213,654	1,288,086
2001	2,190,111	2,918,529	(728,418)
2002	4,835,825	2,969,610	1,866,215
2003	1,560,605	1,682,264	(121,659)
2004	1,040,987	2,120,023	(1,079,036)
5-Year Total	**11,129,268**	**9,904,080**	**1,225,188**
5-Year Avg.	**2,225,854**	**1,980,816**	**245,038**
General Plant			
2000	-	(35,438)	35,438
2001	-	8,861	(8,861)
2002	239,760	35,368	204,392
2003	(100,160)	(844,736)	744,576
2004	1,063,478	(1,474,937)	2,538,415
5-Year Total	**1,203,078**	**(2,310,882)**	**3,513,960**
5-Year Avg.	**240,616**	**(462,176)**	**702,792**
Total Plant			
2000	1,527,191	435,431	1,091,760
2001	2,463,822	3,670,847	(1,207,025)
2002	5,075,182	3,092,952	1,982,230
2003	1,737,692	9,062,776	(7,325,084)
2004	2,247,720	5,536,071	(3,288,351)
5-Year Total	**13,051,607**	**21,798,077**	**(8,746,470)**
5-Year Avg.	**2,610,321**	**4,359,615**	**(1,749,294)**

Source: 2000-2001 from Henderson Workpapers. 2002-2004 from AG 2-34.

Response of the Attorney General to
Initial Data Request of Commission Staff to the Attorney General
Kentucky Power Company
Case No. 2005-00341

Responding Witness: Michael J. Majoros, Jr.

18. While reviewing the historical salvage and removal data for Kentucky Power, did Mr. Majoros have concerns about the reasonableness or accuracy of the data? Explain the response.

Response:

Yes, he did. Mr. Majoros had gross salvage and cost of removal amounts from three separate sources to consider in the calculation of his 5-year average amount. The source he used for his testimony was the same data Mr. Henderson used in his net salvage studies, which is the reason Mr. Majoros chose to use that particular data source. The amounts for gross salvage and cost of removal shown in the Company's FERC Form 1 reports did not match the amounts shown in Mr. Henderson's workpapers, with the primary differences being in 2002 and 2004. Additionally, Kentucky Power provided salvage and cost of removal by function for the years 2002 through 2004 only in response to AG 2-34. This data also did not match Mr. Henderson's, nor did it match what was reported in the FERC Form 1 reports. These calculations are included in Mr. Majoros' response to Kentucky Power Data Request No. 27 which he has also attached here. As noted above, Mr. Majoros decided to use Mr. Henderson's data for his analysis.

Response of the Attorney General to
Initial Data Request of Commission Staff to the Attorney General
Kentucky Power Company
Case No. 2005-00341

Responding Witness: Michael J. Majoros, Jr.

19. Refer to the Majoros Testimony, page 27 of 30. Does Mr. Majoros agree that the environmental requirements of the Clean Air Interstate Rule could make the continued operation of Big Sandy Unit 1 uneconomical by 2015? Explain the response.

Response:

Mr. Majoros is not familiar with the Clear Air Interstate Rule. However, Mr. Majoros is in favor of clean air and recommends that the Company endeavor to not only meet, but exceed all clean air rules relating to its plants. Mr. Majoros assumes that by 2015 the Company will find an economical way to comply with the requirements of the Clean Air Interstate Rule.

Response of the Attorney General to
Initial Data Request of Commission Staff to the Attorney General
Kentucky Power Company
Case No. 2005-00341

Respondent: OAG Witness Dr. J. Randall Woolridge

20. Refer to the Woolridge Testimony, page 5. Provide a copy of Jeremy J. Siegel's article, "The Shrinking Equity Risk Premium."

Response

The document was provided on CD in response to KPC-I-41.

Response of the Attorney General to
Initial Data Request of Commission Staff to the Attorney General
Kentucky Power Company
Case No. 2005-00341

Respondent: OAG Witness Dr. J. Randall Woolridge

21. Refer to the Woolridge Testimony, page 8, where Dr. Woolridge discusses his selection criteria for Group A.
    a. Explain why Dr. Woolridge chose 80 percent as the minimum level of electric revenues.
    b. Provide Kentucky Power's percentage of revenue from electric operations.
    c. Provide the percentage of regulated generation capacity represented by nuclear facilities for each company in the group.
    d. Provide the percentage of total revenue represented by regulated electric revenues for each company in the group.

Response

a. Dr. Woolridge is attempting identify a group of utilities that are predominantly in the business of the generation and distribution of electric service. The 80% of revenues figure allows for the selection of a group which is sufficiently large and is predomiantly engaged in the generation and distribution of electric service.

b. 100%

c.

Ameren	10%
Cleco	0%
Empire	0%
Green Mountain	37%
Hawaiian	0%
IDACORP	0%
Westar	9%

d. See Exhibit_(JRW-3).

Response of the Attorney General to
Initial Data Request of Commission Staff to the Attorney General
Kentucky Power Company
Case No. 2005-00341

Respondent: OAG Witness Dr. J. Randall Woolridge

22. Refer to the Woolridge Testimony, pages 19 and 20. In developing his dividend yield for the Discounted Cash Flow ("DCF") model, Dr. Woolridge explains that he uses the average of the dividend yields for the six month period July through December, 2005 and the December 2005 dividend yield.

a. Did Dr. Woolridge average the mean of the six month period and the mean of December 2005 in order to derive the dividend yields used in his DCF analysis presented in Exhibit JRW-7, page 1 of 5?
b. If yes, explain the rationale for averaging the mean of the six months with one of its subparts.
c. Explain the derivation of and the rationale for applying an adjustment factor to the Dividend Yield.

Response

a. Yes.

b. The use of current and six-month average dividend yields to two fold: (1) to measure a dividend yield over the recent time period, and (2) a six-month period approximates the period, in Dr. Woolridge's opinion, over which analysts' growth rate projections are made.

c. See response to KPC-I-50.

Response of the Attorney General to
Initial Data Request of Commission Staff to the Attorney General
Kentucky Power Company
Case No. 2005-00341

Respondent: OAG Witness Dr. J. Randall Woolridge

23. Refer to the Woolridge Testimony, page 23, and Exhibit JRW-7, page 3 and 4 of 5. Dr. Woolridge appears to have averaged the mean and the median values of the Earnings, Dividends, and Book Value columns.
a. .Explain the meaning and validity of averaging the mean and median values for use in the DCF calculations.
b. Explain the meaning and validity of averaging the mean and median values for the average historic growth rate of both the past 10 years and the past 5 years.
c. Explain the rationale for averaging the mean and medians for the past 10 years with a subpart of 5 years.
d. Explain the meaning and validity of using an average of Earnings, Dividends, and Book Values in the DCF calculations.
e. Explain why it is reasonable to use negative and zero values in these calculations.

Response

a. The procedure is an attempt to discover the central tendency for the outcomes so as to determine what investors might expect when reviewing this data. This approach, in Dr. Woolridge's opinion, represents a reasonable effort to measure the central tendency of outcomes in the presence of outliers.

b. See response to a.

c. See response to a.

d. See response to a.

e. Negative and zero outcomes are obviously a possible outcome for the future, as they have been in the past. Omitting these figures provides a biased and distorted indication of the potential outcomes investors might expect to occur.

Response of the Attorney General to
Initial Data Request of Commission Staff to the Attorney General
Kentucky Power Company
Case No. 2005-00341

Respondent: OAG Witness Dr. J. Randall Woolridge

24. Refer to the Woolridge Testimony, page 24, and Exhibit JRW-7, pages 4 and 5 of 5. Explain why the Value Line Earnings per Share ("EPS") projected growth rates were not included with the other analysts.

Response

The Value Line projections come from one analyst whereas the IBES, First Call, and Zacks EPS projections are the consensus estimates from a number of analysts who cover the stock.

Response of the Attorney General to
Initial Data Request of Commission Staff to the Attorney General
Kentucky Power Company
Case No. 2005-00341

Respondent: OAG Witness Dr. J. Randall Woolridge

25. Refer to the Woolridge Testimony, Exhibit JRW-7, pages 3 through 5 of 5. Provide the missing values for Green Mountain Power Company, Exelon Corporation, Vectren Corporation, and MGE Energy Inc. and resubmit all tables including the missing data points.

Response

Value Line does not a report a data point for the missing data in the table.

Response of the Attorney General to
Initial Data Request of Commission Staff to the Attorney General
Kentucky Power Company
Case No. 2005-00341

Respondent: OAG Witness Dr. J. Randall Woolridge

26. Refer to the Woolridge Testimony, page 25.

a. Provide the source for the Historic Value Line Growth of .6 percent in EPS, Dividends per Share, and Book Value per Share for Group A.

b. Dr. Woolridge proposes using 4 percent, the top of the range, as the growth rate for Group A instead of an average of the projected growth rates. For Group B, he proposes an average of the projected growth rates. Explain why it is appropriate to develop one growth rate without averaging and one with averaging.

Response

a. The figure should be 0.5%, which comes from page 3 of Exhibit_(JRW-7).

b. Dr. Woolridge does not recommend simply averaging the historic and projected growth rate figures for either group in arriving at a DCF growth rate. He does not use a simple average for either group. As discussed in the testimony, the 4.0% would appear to be at the high end of investors' expectations for Group B. Therefore, the recommended equity cost rate of 8.75% for KPC is very fair from a DCF equity cost rate framework. Group B's growth is clearly higher. But, as noted, his 5.0% figure is not a simple average of the historic and projected growth rates.

Response of the Attorney General to
Initial Data Request of Commission Staff to the Attorney General
Kentucky Power Company
Case No. 2005-00341

Respondent: OAG Witness Dr. J. Randall Woolridge

27. Refer to the Woolridge Testimony, page 28. Dr. Woolridge states that the benchmark for long-term Treasury bonds is the 10-year Treasury bond. Provide any reports, studies, or other documentation upon which Dr. Woolridge relied in making this statement.

Response

The Street.Com: Treasury Bonds
(www.thestreet.com/tsc/basics/ tscglossary/Treasury_Securities.html)

> The 10-year note is the U.S. benchmark, meaning that people look to its yield as a proxy for all U.S. interest rates. Formerly, that honor went to the 30-year bond. But reduced issuance of 30-year bonds has given them scarcity value, making them less reliable as an indicator of how high people think interest rates should be. (30-year bond sometimes trades like commodities.)

Recession Telltale
(www.forbes.com/forbes/2000/1113/6613388a_print.html)

> That bellowing you hear from the bulls would have you believe that this time it's different, that the inversion is really a chimera produced by the shortage of long Treasury bonds. Indeed, the 30-year yield has fallen 20 basis points since the Fed started its rate-raising campaign. Moody's, Merrill Lynch and other major Wall Street powers assume the long bond is going the way of the passenger pigeon and have switched to the 10-year Treasury as their benchmark.

Goldman Sachs Sees 10 year note as its government debt benchmark
(www.bradynet.com/bbs/us/100004-0.html)

> 2000 Feb, NEW YORK, Feb 9 (Reuters) - With the U.S. Treasury Department buying back benchmark 30-year bonds and cutting back on new issuance of long bonds, investment bank Goldman Sachs said on Wednesday it would now use the Treasury 10-year note as its government debt benchmark to gauge appropriate prices and yields on other types of securities.

Response of the Attorney General to
Initial Data Request of Commission Staff to the Attorney General
Kentucky Power Company
Case No. 2005-00341

Respondent: OAG Witness Dr. J. Randall Woolridge

28. Refer to the Woolridge Testimony, page 51. Dr. Woolridge states that Mr. Moul uses an inappropriate proxy group; however, Dr. Woolridge uses Mr. Moul's proxy group as his Group B. Explain why Dr. Woolridge includes Group B in his analysis if it is an inappropriate set of companies.

Response

As discussed in his testimony, Dr. Woolridge believes that Group A is more appropriate for estimating an equity cost rate for KPC. Nonetheless, Dr. Woolridge believes that Group B can provide insight into KPC's equity cost rate. Furthermore, by including Group B, Dr. Woolridge provides a comparison of the two groups.

Response of the Attorney General to
Initial Data Request of Commission Staff to the Attorney General
Kentucky Power Company
Case No. 2005-00341

Respondent: OAG Witness Dr. J. Randall Woolridge

29. Refer to the Woolridge Testimony, pages 54 and 55. Dr. Woolridge criticizes Mr. Moul's DCF results, in part because Mr. Moul uses data that contains outliers. Dr. Woolridge addressed outliers in his own analysis by averaging the mean and the median values. Would this approach correct some of the problems Dr. Woolridge sees with Mr. Moul's DCF analysis?

Response

Yes, although it is a larger issue when evaluating historic data which have more outliers.

Response of the Attorney General to
Initial Data Request of Commission Staff to the Attorney General
Kentucky Power Company
Case No. 2005-00341

Witness Responsible: David H. Brown Kinloch

30. Refer to the Testimony of David H. Brown Kinloch ("Kinloch Testimony"), pages 3 through 10, and the Direct Testimony of Stephen J. Baron, pages 10 through 13, filed on behalf of KIUC.

a. Mr. Kinloch contends that, because of the "black box" nature of the TACOS Gold software used by Kentucky Power to produce its cost of service study ("COSS"), he was unable to verify, produce, or replicate the calculations performed in Kentucky Power's COSS. Mr. Baron states that Kentucky Power filed a 12 Coincidence Peak ("12 CP") COSS in this case. Was Mr. Kinloch unable to determine that Kentucky Power used the 12 CP method in preparing its COSS? Explain the response.

ANSWER:

I was able to verify that the coincident peak figures contained Kentucky Power's Response to AG-1-181, were used as inputs in the TACOS Gold software. I was unable to determine the calculations done by the TACOS Gold software beyond this input point.

b. Mr. Baron also states that he independently developed a 12 CP COSS, using inputs provided by Kentucky Power, which produced results identical to Kentucky Power's COSS. Explain why Mr. Kinloch was unable to perform a verification of Kentucky Power's COSS as did Mr. Baron.

ANSWER:

Mr. Baron states that he produced the same results as Kentucky Power, but he did not state that he verified the calculations done within the TACOS Gold software. It is not possible at this time to determine exactly how Mr. Baron produced these results, since like Kentucky Power, he only provided the results of his testimony, and none of the intermediate calculations. The Attorney General has requested that Mr. Baron provide his complete studies in an electronic format, with all formulas left intact. Until I have had an opportunity to review Mr. Baron's studies, it is not possible to comment on how he was able to produce his results, and whether they verify the calculations done within the TACOS Gold software.

c. On page 9 of his testimony, Mr. Kinloch cites the requirement for a COSS contained in 807 KAR 5:001, Section 10(6)(u), which requires "a cost of service study based on a methodology generally accepted within the industry." In Mr. Kinloch's opinion, is the 12 CP method a method that is generally accepted within the electric industry? Explain the response.

ANSWER:

The 12 CP method is simply a method to allocate production and transmission demand costs. Production and transmission demand costs are only two of hundreds of input costs contained in a Cost of Service Study. There are many other costs within a Cost of Service Study that also requires a specific allocation methodology, such as the "Zero Intercept" or "Minimum System" methodologies to allocate distribution lines cost between demand and customer costs. Just because a utility uses a methodology to allocate one or two costs within the study, using a recognized methodology, does not mean that the methodology used for the entire study is acceptable. Thus 807 KAR 5:001, Section 10(6)(u) is referring to the methodology of the whole Cost of Service Study, not the allocation of any particular individual costs within the study.

With respect to whether the 12 CP is an acceptable methodology to allocate production and transmission demand costs, please see the Attorney General's Response to Kentucky Power's Data Request, Item 90.