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April 1, 2008

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HAND DELIVERED

Stephanie L. Stumbo
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Public Service Commission of Kentucky
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RE: Administrative Case No 2007-00477 - Rebuttal Testimony of Errol K. Wagner

Dear Ms. Stumbo:

Enclosed please find and accept for filing the original and five copies of the rebuttal testimony of Errol K. Wagner in the above proceeding.

By copy of this letter, the testimony also is being served on all parties of record and Overland Consulting as indicated on the attached service list.

Very truly yours,

Mark R. Overstreet

cc: Parties of Record

16770:1:FRANKFORT

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COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

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COMMISSION

In the Matter of:

AN INVESTIGATION OF THE ENERGY AND REGULATORY ISSUES IN SECTION 50 OF KENTUCKY'S 2007 ENERGY ACT	))))	**ADMINISTRATIVE CASE NO. 2007-00477**

REBUTTAL TESTIMONY OF

ERROL K. WAGNER

ON BEHALF OF

KENTUCKY POWER COMPANY

Filed: April 1, 2008

Rebuttal Testimony of Errol K. Wagner
On behalf of Kentucky Power Company
Before the Public Service Commission of Kentucky

I. Introduction

Q. Please state your name, position and business address.

A. My name is Errol K. Wagner. My position is Director of Regulatory Services, Kentucky Power Company ("Kentucky Power, KPCo or Company"). My business address is 101 A Enterprise Drive, Frankfort, Kentucky 40602.

Q. To whom do you report?

A. I report to the President of Kentucky Power, Mr. Timothy C. Mosher, who is also located in Frankfort, Kentucky.

II. Background

Q. Please summarize your educational background and business experience.

A: I received a Bachelor of Science degree with a major in accounting from Elizabethtown College, Elizabethtown, Pennsylvania in December 1973. I am a Certified Public Accountant. I worked for two certified public accounting firms prior to joining the Pennsylvania Public Utility Commission Staff in 1976. In 1982, I joined the American Electric Power Service Corporation ("AEPSC") as a Rate Case Coordinator. In 1986, I transferred from AEPSC to Kentucky as the Assistant Rates, Tariffs and Special Contracts Director. In July 1987, I assumed my current position.

Q. What are your responsibilities as Director of Regulatory Services?

A. I supervise and direct the Regulatory Services of the Company, which has the responsibility for rate and regulatory matters affecting Kentucky Power. This includes the preparation of and coordination of the Company's exhibits and testimony in rate cases and any other formal filings before state and federal regulatory bodies. Another responsibility is assuring the proper application of the Company's rates in all classifications of business.

III. Purpose of Testimony

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to state and describe the positions of Kentucky Power Company (KPCo) in response to the report prepared by Overland Consulting titled Review of the Incentives for Energy Independence Act of 2007 Section 50. My testimony addresses several important issues but my failure to discuss a topic from the Overland Consulting Report should not be understood to signify agreement with the report's characterization or recommendations. Also, as with any policy initiative, the specifics of the manner in which the policy is implemented oftentimes can affect the efficacy of the initiative and KPCo's ability to support the initiative.

Q. Referring to the recommendations in Chapter 5 on pages 69 and 71 of the Overland Consulting report, what is KPCo's position on voluntary renewable portfolio standard (RPS) targets with financial incentives for performance?

A. KPCo can support voluntary RPS targets with appropriate cost recovery if the targets are reasonable and achievable. KPCo's affiliate, Appalachian Power Company (APCo), recently filed an application with the Virginia State Corporation Commission for participation in a similar program. The Virginia program allows for a Performance

Incentive for achieving reasonable targets added on to the most recent Commission approved rate of return. APCo currently is seeking to recover the energy costs associated with the renewable energy sources through its fuel (adjustment) factor.

If voluntary RPS targets are implemented in Kentucky, energy costs and any incentive payments should be recoverable through an adjustment clause.

Q. Overland Consulting states at Chapter 6, pages 82 and 83, under the heading Statewide Integrated Resource Planning (IRP): "We do not believe that Commission responsibility for statewide planning is either practical or particularly beneficial, given the reality that utilities, regulated or not, do not engage in Kentucky-level system planning that would necessarily result in any joint development or operation of generation resources" Does KPCo agree with this statement?

A. Yes, KPCo is part of the AEP System East Pool Agreement and participates in the IRP process throughout AEP's combined regional jurisdiction. KPCo's obligation to serve does not extend beyond its jurisdictional footprint and any effort to engage in a state-level IRP process would be cumbersome and potentially conflict with AEP's current regional planning process involving KPCo. However, if the RTO and other operational details are resolved, KPCo is open to, and believes the Commission should evaluate, joint development of generation resources, particularly for construction of higher cost emerging technologies such as advanced coal and carbon capture and storage.

Q. In Chapter 7, pages 102 to 104, under the subtitles *Possible Alternatives to Current Tariff Rate Structures* and *Interruptible and Load Control Tariff Options* and the title Time-of-Use Rates and Smart Metering, Overland Consulting describes a

number of potential tariffs that could encourage energy efficiency and/or demand reduction. Has KPCo considered providing additional tariff offerings to its ratepayers?

A. Yes. KPCo and its affiliates have launched an initiative, known as gridSMART^{sm}, to implement its vision of the electric distribution system of the future. As part of the gridSMART initiative, the Company is reviewing a variety of different tariff offerings, either currently deployable or enabled by smart metering. As advanced technology is implemented to allow two-way communication between the utility, its meters, and its customers; there will be a number of different tariff designs, including various time-of-use options that may be available for utilities to offer customers. Additionally, with this advanced technology in place it will become more cost-effective to modify rate structures in a manner that will provide better price signals to customers on a varying and more real-time basis. Multiple tariff offerings could be provided to each customer class, enabling customers to choose the appropriate rate for their individual circumstances.

Q. Does KPCo agree with the recommendation by Overland Consulting in Chapter 7, page 106 suggesting that modifications to the DSM Surcharge to treat DSM expenditures similarly to supply-side expenditures?

A. It is difficult for KPCo to agree or disagree with Overland's statement due to the fact that the Company lacks details or specificity of any proposed modifications to the current DSM surcharge. KPCo believes that in order to encourage utilities to embrace DSM initiatives fully, utilities need to be indifferent to investing in either the supply side or demand side. A level playing field between new supply and DSM programs is achieved through full cost recovery for DSM, including: 1) program costs, 2) net lost revenues, and

3) shared savings or alternate form of a return on DSM investment similar to investment in new generation. We further believe that utility investment in DSM programs should be contemporaneously recovered. Kentucky's DSM cost recovery rules already provide for all three elements and surcharge recovery. KPCo believes Kentucky's existing DSM rules provide a foundation for a leveling of the playing field and, in fact, AEP has proposed Kentucky's current cost recovery approach (with additional incentives and/or return) as a model for other jurisdictions. Further, KPCo believes the existing rules already grant the Commission the authority to capitalize expenditures, including deployment of smart meters, and provide for recovery through the DSM surcharge.

With respect to the substance of the recommended changes, in as much as Overland Consulting's recommendation treats DSM expenditures in a similar manner to supply-side options (i.e. capitalization of operating costs, amortized over the life of the program, plus a reasonable rate of return), the recommendation appears to be a viable alternative option for recovery. However, additional clarification is necessary before KPCo can embrace this approach.

Q. Does KPCo have a position with respect to Overland Consulting's statement on page 106 that "should modifications to the surcharge mechanism be made, the continuing need for a lost revenue provision must be evaluated?

A. KPCo does not support modification of the current DSM Surcharge mechanism Also, KPCo opposes Overland Consulting's recommendation that recovery of net lost revenues be reevaluated. Lost revenues are a key element of the current DSM recovery rules. KPCo does not view net lost revenues as part of a DSM incentive, but rather as compensation for the under recovery of our fixed cost revenue requirement due to lower energy consumption attributable to DSM programs.

Q. Does KPCo have other concerns about Overland Consulting's recommendation on page 106?

A. Yes. First, it is not clear under the Overland Consulting recommendation if recovery would still be through a DSM surcharge or placed in rate base as a regulatory asset. Although KPCo would not oppose placing capitalized DSM expenditures in rate base there must also be an opportunity for contemporaneous recovery of DSM expenditures. Contemporaneous recovery is an important aspect of the existing DSM recovery rules, eliminating regulatory lag and allowing timely recovery of program expenditures.

Second, placing DSM recovery in rate base also raises accounting concerns regarding lost revenue recovery. In order to record a regulatory asset for lost revenues, the requirements of Emerging Issues Task Force (EITF) Issue No. 92-7, Accounting by Rate-Regulated Utilities for the Effects of Certain Alternative Revenue Programs must be met. EITF Issue No. 92-7 addresses the recognition of revenues from alternative revenue programs including programs that adjust billings to compensate the utility for demand-side management initiatives. In accordance with EITF Issue No. 92-7, KPCo can recognize the additional revenues to be billed in the future if all of the following conditions are met: 1) The DSM program is established by an order from the utility's regulatory commission that allows for automatic adjustment of future rates to recover lost revenues. Verification (an audit) of the computation of lost revenues and the adjustment to future rates by the regulator or its staff would not preclude the adjustment from being considered automatic. 2) The amount of recoverable lost revenues for the period is objectively determinable and is probable of recovery. 3) The additional revenues will be collected within 24 months following the end of the annual period in which they are recognized. Because of the 24-month restriction on revenue collection, rate base treatment is not an appropriate mechanism for recovery of lost revenues. KPCo therefore recommends that, should the Commission consider placing capitalized DSM expenditures in rate base, the Commission maintain surcharge recovery of net lost revenues.

Q. Does KPCo currently review the operating efficiency of its generating facilities (Chapter 7, page 108)?

A. Yes. KPCo is constantly reviewing our generation capabilities to improve operational efficiencies. To improve the efficiency of our plants KPCo's affiliate American Electric Power Service Corp. formed a Generation Performance Team to develop a program for heat rate improvement and to provide guidance for a coordinated, disciplined approach to performance improvement.

Q. Are generation facilities the only existing assets where efficiency improvements are continuously implemented?

A. No. KPCo and AEP regularly evaluate our transmission and distribution systems as well. AEP, with its 765 kV transmission backbone is a leader in transmission efficiency and reducing line losses. We are also continuously replacing older transformers with newer, higher efficiency models within our distribution system. As part of our gridSMART initiative, AEP is actively reviewing advanced technology options to achieve efficient, reliable energy delivery. Commission consideration of incentive rate of return on investment for generation efficiency improvements should also contemplate transmission and distribution efficiency investments as well.

Q. At page 113 Overland Consulting recommends that "[a]ny potential increase in rates due to programs effective on or after January 1, 2009, which are recoverable by operation of the proposed surcharges contained in this report, should be considered in light of other cost increases in base rates, FAC, and other charges. If the Commission finds it appropriate to do so, it may impose a rate cap on those costs for a particular period or periods. Approved costs, if any, that exceed the rate cap, should be deferred for future recovery, including appropriate carrying costs." Does KPCo agree with this recommendation?

A. No. The sorts of programs that are the subject of this proceeding should be evaluated and paid for based on their own merits. If a program is deemed worthwhile it should be implemented and the utility allowed to recover its costs (and to the extent applicable, lost revenues) contemporaneously with their occurrence. This is the particularly the case with DSM or any other programs that are required to be cost-effective. *See* KRS 278.285(1)(b). In addition, the ratepayers are better served, and are better able to take appropriate actions, where the sort of "rate shock" that could result from Overland Consulting's recommendation can be avoided.

Q. Does this conclude your testimony?

A. Yes.

VERIFICATION

COMMONWEALTH OF KENTUCKY)
) CASE NO. 2007-00477
COUNTY OF FRANKLIN)

The undersigned, **Errol Wagner**, being duly sworn, deposes and says he is the Director of Regulatory Services for Kentucky Power Company, that he has personal knowledge of the matters set forth in the foregoing testimony, and the answers contained therein are true and correct to the best of his information, knowledge and belief.

Errol K. Wagner
ERROL K. WAGNER

Subscribed and sworn to before me, a Notary Public in and before said County and State, this 1st day of April 2008.

Judy K. (Jackett) Rosquist (SEAL)
Notary Public

My Commission Expires:
January 14, 2009