Steven L. Beshear
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June 12, 2008

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CERTIFICATE OF SERVICE

RE: Case No. 2007-00522
American Electric Power

I, Stephanie Stumbo, Executive Director of the Public Service Commission, hereby certify that the enclosed attested copy of the Commission's Order in the above case was served upon the addressee by U.S. Mail on June 12, 2008.

Stephanie Stumbo

Executive Director

SS/tw
Enclosure

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June 12, 2008

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RE: Case No. 2007-00522
American Electric Power

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COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN EXAMINATION OF THE APPLICATION OF THE FUEL ADJUSTMENT CLAUSE OF KENTUCKY POWER COMPANY FROM MAY 1, 2007 THROUGH OCTOBER 31, 2007	)))))	CASE NO. 2007-00522

ORDER

Pursuant to Administrative Regulation 807 KAR 5:056, the Commission, on January 23, 2008, established this case to review and evaluate the operation of the fuel adjustment clause ("FAC") of Kentucky Power Company ("Kentucky Power") for the 6 months ended October 31, 2007. The Commission directed any party wishing to file testimony in this proceeding to petition for an Order establishing a procedural schedule. On January 30, 2008, Kentucky Power petitioned the Commission for such an Order.

Kentucky Power proposed to file the testimony of Errol K. Wagner ("Wagner Testimony"),[1] stating that the testimony would address the effect of the recent Order of the Federal Energy Regulatory Commission ("FERC") directing PJM[2] to change its methodology for determining and allocating to load-serving entities the costs associated with transmission line losses. The testimony would also address the effect of the change on the calculation of Kentucky Power's fuel costs for purposes of its FAC

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[1] The testimony was filed on February 1, 2008.

[2] Pennsylvania, New Jersey, Maryland Interconnection, LLC, a Regional Transmission Organization which extends from the mid-Atlantic states to the Midwest.

filings.[3] The Commission granted Kentucky Power's motion and established a procedural schedule to be followed in this proceeding.

As part of this review, Kentucky Power, pursuant to Commission Order, submitted certain information concerning its compliance with Administrative Regulation 807 KAR 5:056. The Commission held a public hearing on March 18, 2008, and on March 28, 2008, Kentucky Power filed post-hearing data responses to questions asked at the hearing.

Transmission Line Loss Methodology

Effective June 1, 2007, FERC ordered that a new locational marginal loss methodology for the determination of transmission line losses replace PJM's existing average loss method of accounting for transmission line losses. FERC's stated goal in changing the methodology was to achieve a more efficient dispatch of generation resources across the PJM footprint.

Prior to June 1, 2007, PJM billed transmission users for the generation necessary to serve load including transmission line losses, which effectively added the generation necessary to cover average line losses to the total load. Kentucky Power was therefore responsible for generation costs which included the fuel costs incurred to fulfill the load requirement and the fuel costs associated with the average transmission line losses. These costs would be accounted for in either the FERC 501 Fuel Costs account or the FERC 555 Purchased Power account.

Beginning June 1, 2007, marginal line losses have been included in the PJM

[3] Kentucky Power, as part of the American Electric Power Company, is a member of PJM.

locational marginal price ("LMP") and have been settled financially, resulting in Kentucky Power's load obligation and the fuel costs associated with fulfilling its load obligation being reduced. The power that was formerly associated with transmission line losses prior to June 1, 2007 is still generated, but is now available for sale off-system. The additional off-system sales margins generated are shared among American Electric Power Company East Pool members, including Kentucky Power.

Under the new methodology, marginal transmission line losses are settled financially in the form of charges and credits that appear on the PJM bill. Charges are now recorded in Account 4470207 and credits are recorded in Account 4470208 by Kentucky Power. These charges and credits represent identifiable fuel costs associated with energy purchases which fall under 807 KAR 5:056, Section 1(3), paragraphs (b) and (d). Kentucky Power states that the charges and credits related to marginal transmission line losses recorded in Accounts 4470207 and 4470208 comport with 807 KAR 5:056 and are the same types of costs that were included in its FAC calculations prior to June 1, 2007.

Approvals Sought by Kentucky Power

Kentucky Power requests that the Commission confirm that charges and credits recorded in Accounts 4470207 and 4470208 can be included in its FAC calculations, on a prospective basis, starting with the first monthly filing following the Commission's Order in this proceeding.

Kentucky Power also requests that the Commission confirm that it can recover, through its FAC, the charges and credits recorded in Accounts 4470207 and 4470208, beginning June 1, 2007, related to the implementation of PJM's financial settlement methodology for marginal transmission line losses. This request for approval of its proposed FAC treatment of charges and credits incurred under PJM's revised line loss methodology applies to losses incurred in connection with off-system sales as well as losses associated with Kentucky Power's internal load requirements. These amounts were excluded from the calculation of total fuel expenses for FAC purposes during the seven months from June 1, 2007 through December 31, 2007. This exclusion, which was necessary prior to Commission approval of the FAC treatment that Kentucky Power now seeks, had the effect of understating its fuel expense for those months. In addition, the fuel expenses associated with the additional generation allocated to off-system sales were excluded from Kentucky Power's net energy costs in accordance with 807 KAR 5:056, Section 1(3)(d). The increased off-system sales margins realized by the additional generation were approximately $3.9 million which, through Kentucky Power's system sales clause, effectively reduced its customers' bills by nearly $2.5 million during the 7-month period. Kentucky Power proposes to recover the omitted costs in equal amounts over the same period of time they were incurred.

Exhibit EKW-1[4] provides the net monthly amounts that Kentucky Power under-recovered in each month subsequent to PJM's changes in its methodology for determining and allocating the costs associated with transmission line losses. For the 7 months from June 2007 through December 2007, Kentucky Power experienced a total under-recovery of $7,042,498.45. For the months of June 2007 through October 2007,

[4] Direct Testimony of Errol K. Wagner on behalf of Kentucky Power Company, filed February 1, 2008.

months included in the current FAC review period, the amount of the under-recovery was $5,287,740.09, or an average of $1,057,548.02 per month.

SUMMARY

The Commission has previously established Kentucky Power's base fuel cost at 21.24 mills per kWh.[5] A review of Kentucky Power's monthly fuel clause filings shows that the actual fuel cost incurred for the 6-month period under review ranged from a low of 18.95 mills in June 2007 to a high of 24.09 mills in May 2007, with a 6-month average of 20.80 mills.

The approvals sought by Kentucky Power in connection with the change in PJM's determination of marginal transmission line losses reflect a move away from what has been a standard approach to such losses. However, while the after-the-fact recovery of the costs previously excluded gives the appearance of customers being disadvantaged under PJM's new "financial settlement" approach to such losses, customers receive a benefit from the increase in the margins realized on off-system sales. In addition, the principle of federal preemption requires that the Commission accept as fair, just and reasonable any FERC-approved rate or charge, rate formula or methodology. Therefore, we are bound to grant the approval Kentucky Power seeks, for FAC purposes, of the impact on its fuel costs of the FERC-ordered change in PJM's method of determining transmission line losses.

[5] Case No. 2006-00507, An Examination of the Application of the Fuel Adjustment Clause of American Electric Power Company from November 1, 2004 to October 31, 2006 (Ky. PSC Dec. 19, 2007).

FINDINGS AND ORDERS

The Commission, having considered the evidence of record and being otherwise sufficiently advised, finds:

1. There is no evidence of improper calculation or application of Kentucky Power's FAC charges or improper fuel procurement practices for the period of May 1, 2007 through October 31, 2007.

2. The charges and credits related to marginal transmission line losses that Kentucky Power recorded in Accounts 4470207 and 4470208 beginning June 1, 2007 are for the same types of costs that were included in Kentucky Power's FAC calculations prior to June 1, 2007.

3. Kentucky Power should be authorized to prospectively include the charges and credits related to marginal transmission line losses, which it records in Accounts 4470207 and 4470208, in its FAC calculations starting with the first monthly FAC filing following the issuance of this Order.

4. Kentucky Power should be authorized to recover the charges and credits related to marginal transmission line losses that it recorded in Accounts 4470207 and 4470208 during the 5-month period from June 1, 2007 through October 31, 2007, which falls within the current review period. Kentucky Power should recover the previously omitted costs in 5 equal monthly amounts of $1,057,548.02 starting with the first monthly FAC filing following the issuance of this Order.

5. Recovery by Kentucky Power of charges and credits related to marginal transmission line losses recorded in Accounts 4470207 and 4470208 subsequent to

October 31, 2007 are outside the review period in this case and should be addressed in Kentucky Power's next 6-month FAC review.

IT IS THEREFORE ORDERED that:

1. The charges and credits billed by Kentucky Power through its FAC for the period of May 1, 2007 to October 31, 2007 are approved.

2. Kentucky Power is authorized to prospectively include charges and credits related to marginal transmission line losses, which it records in Accounts 4470207 and 4470208, in its FAC calculations starting with its first monthly FAC filing following the issuance of this Order.

3. Kentucky Power is authorized to recover the charges and credits related to marginal transmission line losses recorded in Accounts 4470207 and 4470208 during the 5-month period from June 1, 2007 through October 31, 2007 in 5 equal monthly amounts of $1,057,548.02, commencing with its first monthly FAC filing following the issuance of this Order.

Done at Frankfort, Kentucky, this 12th day of June, 2008.

By the Commission

ATTEST:

Stephanie Stumbo

Executive Director