

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

RECEIVED

In the Matter of:

MAY 11 2012

PUBLIC SERVICE
COMMISSION

APPLICATION OF KENTUCKY POWER)
COMPANY FOR APPROVAL OF ITS 2011)
ENVIRONMENTAL COMPLIANCE PLAN,)
FOR APPROVAL OF ITS AMENDED)
ENVIRONMENTAL COST RECOVERY)
SURCHARGE TARIFF, AND FOR THE)
GRANT OF A CERTIFICATE OF PUBLIC)
CONVENIENCE AND NECESSITY FOR THE)
CONSTRUCTION AND ACQUISITION OF)
RELATED FACILITIES)

CASE NO. 2011-00401

ATTORNEY GENERAL'S POST-HEARING BRIEF
PUBLIC REDACTED VERSION

Comes now the intervenor, the Attorney General of the Commonwealth of Kentucky, by and through his Office of Rate Intervention, and tenders his post-hearing brief in the above-styled matter. For the reasons set forth in this brief, the Attorney General states that the application does not meet the relevant standards required under KRS Chapter 278 and, therefore, should be denied.

STATEMENT OF THE CASE

On September 30, 2011, Kentucky Power Company ("KPCo") filed its original notice of intent in this matter, and its application was filed on December 5, 2011. The application sets forth KPCo's request for approval of its 2012 Environmental Cost Recovery ("ECR") plan, and for permission to construct environmental containment facilities with a cost estimate in excess of \$1 billion. The following parties sought and were granted full intervention: The Attorney General of the Commonwealth of

Kentucky, Kentucky Industrial Utility Customers (“KIUC”), and the Sierra Club (by and through its Kentucky members Tom Vierheller and Beverly May). Riverside Generating Co., LLC, an independent owner of electric generating facilities located within KPCo’s operating territory, sought but was denied full intervention.

The record in this matter consists in part of sworn pre-filed written direct testimony from the applicant KPCo, and from each intervening party, extensive discovery and responses thereto, together with miscellaneous pleadings. Most of the applicant’s witnesses appeared on behalf of KPCo, but worked for KPCo’s parent AEP, or other affiliated entities such as AEP Service Co. A formal hearing was held from April 30th, 2012 – May 2nd, 2012. Numerous witnesses provided additional sworn testimony at that hearing, and the parties entered into evidence additional numerous exhibits.

The Attorney General recommends that the Commission deny KPCo’s petition for the following reasons.

ARGUMENT

I. Legal Standards for Approval of Kentucky Power’s Application

a. Environmental Compliance Plan Must be Reasonable and Cost-Effective

KRS 278.183 requires the Kentucky Public Service Commission (“PSC” or “the Commission”) to determine whether an environmental compliance plan and rate surcharge are "reasonable and cost-effective" for compliance with certain

environmental requirements. Both the Commission and Kentucky courts have stated that the utility applicant carries the burden of proof to demonstrate reasonableness.¹

KRS 287.183 requires that the Commission conduct a hearing in order to "[c]onsider and approve the plan and rate surcharge if the commission finds the plan and rate surcharge reasonable and cost-effective for compliance with the applicable environmental requirements...." KRS 278.183 provides that a hearing must be conducted, and a decision based thereon within six months after an application is filed.

b. Public Convenience and Necessity

Before a utility can construct new facilities in the Commonwealth, KRS 278.020 (1) requires the utility to first prove that the petitioned-for facility is required for public convenience and necessity. If the PSC should agree, it issues a Certificate of Public Convenience and Necessity ("CPCN") granting approval for such construction.² KRS 278.020 gives the Commission broad authority to approve, modify or disapprove an application; and gives the Commission discretion to conduct a hearing or decide the case as filed. KRS 278.020(1) states:

¹ "The burden of demonstrating the reasonableness of a proposed rule or condition of service is upon the utility." *In the Matter of Hardin County Water District No. 1*, Case No. 2009-00113, 2010 WL 4250014 (Ky.P.S.C.), citing *Energy Regulatory Commission v. Kentucky Power Company*, 605 S.W.2d 46,50 (Ky. App. 1980)(applicants before an administrative agency have the burden of proof). Further, administrative findings must be based on substantial evidence. *Kentucky Board of Nursing v. Ward*, 890 S.W.2d 641, 642 (Ky. App. 1994).

² See, *In Re: The Application of Kentucky-American Water Company for a Certificate of Public Convenience and Necessity Authorizing the Construction of Kentucky River Station II, Associated Facilities and Transmission Main*; Case No. 2007-00134, Final Order dated 25 April 2008, p. 29.

"Upon the filing of an application for a certificate, and after any public hearing which the commission may in its discretion conduct for all interested parties, the commission may issue or refuse to issued the certificate, or issue it in part and refuse it in part..."

If the Commission determines that the evidence presented in KPCo's application and testimony is insufficient to determine the reasonableness and cost-effectiveness of its proposed CPCN and ECR plan, the Commission has authority to either disapprove of the petition, or to dismiss it without prejudice, pursuant to KRS 278.020.

II. The Applicant Has Failed to Satisfy its Burden of Proof

a. As Ratepayers Cannot Absorb the Projected Costs, the Application is Not Economically Feasible

In *Kentucky Utilities Co. v. Pub. Serv. Comm'n*, 252 S.W.2d 885 (Ky. 1952), Kentucky's then-highest Court noted that a utility must be able to prove the need for facilities which are the subject of the proposed CPCN, which requires:

" . . . a showing of a substantial inadequacy of existing service, involving a consumer market sufficiently large to make it **economically feasible** for the new system or facility to be constructed and operated." *Id.* at 890 [emphasis added].³

The PSC in *In Re: The Application of Kentucky-American Water Company for a Certificate of Public Convenience and Necessity Authorizing the Construction of Kentucky River Station II, Associated Facilities and Transmission Main*; Case No. 2007-00134, Final

³ During the formal hearing, KPCo's counsel asserted that it was inappropriate to rely on a ruling from 1952. The Attorney General points out that this ruling remains the law of the Commonwealth.

Order dated 25 April 2008, also discussed the application of *Kentucky Utilities, supra*, and held that:

“To demonstrate that a proposed facility does not result in wasteful duplication, we have held that the applicant must demonstrate that **a thorough review of all alternatives** has been performed. . . .

With regard to the issue of economic feasibility, we are of the opinion that the record **must contain evidence supporting the economic feasibility of the proposed facilities.** The evidence must address the effect on the demand for utility service from the rates necessary to recover the cost of the proposed facilities and provide a reasonable rate of return on them. If the resulting rates would significantly reduce demand for utility services so as to negate or significantly reduce the need for the proposed facilities, then the facilities are not economically feasible and a Certificate should not be granted.⁴ [emphasis added]

During the hearing in this matter, KPCo witness Wohnhas, upon cross-examination by the Attorney General, confirmed that the company had not conducted any studies indicating whether the proposed Dry Flue Gas Desulfurization System (“DFGD”) for KPCO’s Big Sandy Unit-2 (the “Big Sandy Retrofit”) was in fact economically feasible for the company’s certified service territory.⁵ This admission by the company is in and of itself tantamount to a *prima facie* finding by the Commission that the company has failed to carry its burden in demonstrating the economic feasibility of the proposed application.

Notwithstanding this utter failure by the company to meet its burden, certain points should be emphasized to highlight the gravity of the consequences if the

⁴ *In Re: The Application of Kentucky American Water Company, supra* at 30 (citing Case No. 2005-00142, *The Joint Application of Louisville Gas & Electric Co. and Kentucky Utilities Co. for the Construction of Transmission Facilities In Jefferson, Bullitt, Meade, and Hardin Counties, Kentucky* (Final Order dated 8 Sept. 2005)).

⁵ April 30, 2012 Video Transcript of Evidence (“VTE”) beginning at approximately 11:14:18 through 11:30:25..

application were to be approved. Specifically, it is beyond dispute that the instant case has the potential to be one of the most major rate increases which KPCo customers have faced in the past several decades. The potential ramifications are so great, in fact, that they would likely carry a significant impact on the viability of the economy of the counties comprising KPCo's dedicated service territory. Indeed, there is the potential for major industrial customers to leave KPCo's territory if the Big Sandy Retrofit is approved as filed.

It is likewise beyond dispute that the counties comprising KPCo's certified service territory are among the most economically deprived regions of the Commonwealth, and are on average 28% below the federal poverty line.⁶ This fact was graphically illustrated in the map of Kentucky counties entered into evidence as Attorney General Hearing Exhibit 3. Mr. Wohnas acknowledged this fact in his cross-examination.⁷ Nonetheless, AEP's profitability strategy includes the goal of "grow[ing] rate base and earnings through adding environmental controls."⁸ KPCo's customers can thus ill-afford, if at all, the whopping the \$1.65 billion (pre-tax)⁹ bill for the proposed Big Sandy Retrofit promises to bring.

⁶ See Attorney General Hearing Exhibit 3, map of counties depicting poverty level in KPCo's service territory; data source: Kentucky Data Center.

⁷ April 30, 2012 VTE beginning at approximately 11:12:10.

⁸ See KIUC Hearing Exhibit No. 5, p. 6; see also Wohnas cross examination, April 30, 2012 VTE beginning at approximately 11:55:20.

⁹ Based on the 16.55% pre-tax ROR as set forth in Munsey direct exhibit 3 (*see also* Munsey cross-examination, April 30, 2012 VTE at approximately 18:09:00). *See also* Kollen direct testimony.

The Attorney General is very concerned about the accuracy and transparency of the notice of the proposed increase that KPCo provided to its customers, so much so as to call its legal sufficiency into question.¹⁰ That notice stated:

“For a KPCo residential customer *using an average* of 1,000 kWh per month, the initial monthly increase is expected to be . . . [the] maximum monthly increase expected to be \$30.76 in 2016.”¹¹ [emphasis added]

Although the company filed its application on December 6, 2011, it was not until the company provided an amended response to AG 1-11 on February 22, 2012 that KPCO acknowledged that the average residential customer actually consumes 1,300 kWh and would experience an increase of \$38.02 by 2016.¹² The company subsequently revised that estimate upward once again, in its response to PSC 1-20, in which it acknowledged that the increase for the average residential customer would be \$39.39 per month by 2016. Mr. Wohnhas confirmed these figures in cross-examination by the Attorney General.¹³

While the petition which is the subject of this matter calls for an approximate 29% increase in the average residential customer’s monthly bill (\$39.39/month, or \$472.68 annualized),¹⁴ it will also lead to a base rate increase of approximately 5.84%

¹⁰ See application, exhibit 5, p. 6 of 8.

¹¹ *Id.*

¹² See Amended Response to AG 1-11, Filed February 22, 2012.

¹³ These figures were also confirmed by KPCo witnesses Weaver (April 30, 2012 VTE at 16:50) and Muncey (April 30, 2012 VTE at 18:15). However, the Company, only 46 hours prior to the time that post-hearing briefs are due to be filed, submitted a response to a post-hearing data request in which the Company indicated that if the proposed Big Sandy Retrofit is approved, the retirement of the existing scrubber plant will decrease the monthly ECR charge for the average KPCo customer downward to \$36.20 (\$434.40 annualized).

¹⁴ See KPCo’s amended response to AG 1-11, p. 2 of 2 (filed Feb. 22, 2012), and its updated response to PSC 1-20. This was also confirmed at the hearing cross-examination of witness Weaver, May 1, 2012 VTE at 18:12.

(\$7.83/month)¹⁵ within just a few years, at most, which will yield a total increase of \$47.22/month, or \$566.64 annualized. It is important to keep in mind that just two years ago, KPCo's residential customers experienced an average 17% base rate increase.¹⁶

Additionally, KPCo's growth has been nearly non-existent for the past several years, and the company's own records predict its load will remain stagnant for at least the next ten (10) years.¹⁷ With few, if any additional ratepayers coming on-line, those costs will not and cannot be diffused. Thus, the notion of affixing a brand new high-tech DFGD facility onto the 43-year old Big Sandy Unit 2 (together with the assumption that Big Sandy 2 would continue in operation until 2040)¹⁸ hardly seems reasonable, which calls the "necessity" of the petitioned-for plant into question.

KPCo has clearly failed to meet its burden to prove that the increase is economically feasible; accordingly, the application should be denied.

b. KPCo's Proposed Retrofit Would Fail to Bring any New Socio-Economic Benefits, and Rather Merely Maintain the Status Quo, at Best

KPCo witness Wohnhas' pre-filed testimony indicates that the Big Sandy Retrofit option would bring additional socio-economic benefit to the region. However, upon cross-examination it appeared that the best the company can do in this regard is to preserve the status quo: "All I can do is still have the coal plant there."¹⁹ Although

¹⁵ Kollen direct testimony, p. 9.

¹⁶ See, *In Re: General Adjustments in Electric Rates of Kentucky Power Co.*, Case No. 2009-00459 in which the company sought a revenue increment of \$123.6 million, but was granted an increase of \$63.66 million.

¹⁷ See KPCo response to PSC 1-48, attachment 1. See also KIUC Hearing Exhibit 1 which depicts the increases KPCo's ratepayers have incurred from 2003 through 2011; data taken from FERC Form 1.

¹⁸ Weaver cross examination, April 30, 2012 VTE at approximately 14:40.

¹⁹ April 30, 2012 VTE at 10:20:22-26. Wohnhas' direct testimony indicates the current benefits provided by the Big Sandy plant include an overall benefit of approximately \$165 million a year, together with 500 mining jobs, directly and indirectly, and associated taxes of \$8 million and wages of \$25 million.

witness Wohnhas also highlighted the fact that the Big Sandy plant consumed a significant amount of Kentucky coal, he acknowledged two important facts: (a) only thirty percent (30%) of that coal was mined in Kentucky;²⁰ and more importantly, (b) if the Big Sandy Retrofit is approved and constructed, KPCo would likely expand the types of coal that it uses at the plant, thus using less low-sulphur Eastern Kentucky coal, and replacing it with more higher-sulphur varieties such as Illinois Basin coal.²¹ Additionally, KPCo's statement that the Big Sandy Retrofit would bring socio-economic benefit to the region was done only on the basis of gross benefit; in other words, it fails to net-out the cost that its ratepayers pay for coal.²² The Commission can take administrative notice that even if it orders the company to pursue the natural gas option, jobs will still be created for the construction of new plant, and many other workers would be needed maintain the plant once constructed. While it seems clear that the PSC should at least consider socio-economic effects and impacts, they clearly must be weighed against the socio-economic impact which the massive rate hike will have for this impoverished region. As such, it is clear that whatever economic benefits the Big Sandy Retrofit option could or may maintain are insufficient factors in determining

²⁰ *Id.* at approximately 11:15 and 14:53. As was brought out in cross examination of Sierra Club witness Dr. Fisher, Kentucky's coal exports have been steadily increasing over the past few years. May 1, 2012 VTE beginning at approximately 10:37:30. However, only 46 hours prior to the time that final post-hearing briefs are due, the company issued a response to a post-hearing data request that its witnesses were mistaken, and in essence had somehow transposed these figures so that in actuality, 70% of the coal used at its Big Sandy units is mined in Eastern Kentucky, while 30% comes from other sources. None of this updated information changes the fact that if the proposed Big Sandy Retrofit is approved, it would allow the company to use up to 50% of higher-sulphur coal, non-East Kentucky coal, such as from the Illinois Basin.

²¹ April 20, 2012 VTE at approx. 10:23:30 through 10:24:00.

²² *Id.* at approximately 11:32:20.

whether the instant ECR plan and the accompanying CPCN petition meet the clear legal standards set forth in KRS 278.183 and 278.020.

Given these facts of record, it is abundantly clear that KPCo should have conducted some sort of economic feasibility study along the lines of that mandated in *In Re: The Application of Kentucky-American Water, supra*, in order to determine whether the Big Sandy Retrofit option could be afforded by its ratepayers without significantly reducing the demand for KPCo's services.²³ KPCo's ratepayers simply cannot afford the gargantuan increase in rates, especially when other feasible, lower cost options exist and were not fully explored.²⁴

KPCo has therefore failed to meet its burden of proving that the massive proposed Big Sandy Retrofit project is reasonable, cost-effective, and publicly convenient and necessary, within the meanings of KRS 278.183 and 278.020, and as interpreted in *Kentucky Utilities, supra*, and *In Re: The Application of Kentucky-American Water, supra*. As such, its petition must be denied.

III. Other Feasible And Reasonable Options Were Either Not Explored, Or Received Insufficient Analysis

a. Company's Use of Modeling was Skewed and Outcome Determinative

Witness Weaver testified that KPCo assumed it had only four options available.²⁵ Although KPCo's own model indicates option 1 is the least cost option, the company did not model what option would be the least cost if Big Sandy 2 retired in 2030, which

²³ *In Re: The Application of Kentucky-American Water, supra*, p. 30.

²⁴ See Argument, Section III, *infra*.

²⁵ Weaver direct, pp. 7-8.

company witness Wohnhas acknowledged was **likely to occur**.²⁶ The company defended the failure to take this probable, crucial fact into consideration only by saying that it's "not reasonable that a retrofitted Big Sandy Unit 2 would retire in 2030."²⁷ Company witness Becker further conceded that the Strategist model itself retired Big Sandy Unit Two by 2030,²⁸ yet the company has offered no data to support this supposition and conjecture. Also, capital costs were not modeled using Strategist or any modeling software.

Sierra Club witness Dr. Fisher testified that capital costs for natural gas models were inflated above the costs he would have expected, and moreover, that the capital costs utilized for the DFGD option appeared to be much lower than expected.²⁹ Also, despite the fact that Strategist is designed to choose the best option available based upon all relevant data (when applied impartially), in the instant case, the company has apparently **pre-determined** and **pre-selected** the five (5) options and inputted data relevant only to those options. As Dr. Fisher noted, "the Strategist model, in its ideal use, is able to choose from a range of futures . . . to produce an optimum scenario but in this case, I believe the way the company has used the model is to broadly lock [] down most of [Strategist's] abilities to make independent decisions."³⁰ When Vice-

²⁶ April 30, 2012 VTE beginning at approximately 15:34:30.

²⁷ Weaver cross-examination, May 1, 2012 VTE beginning at approximately 19:18:30 and 19:28:20.

²⁸ May 2, 2012 VTE at approximately 10:01:00.

²⁹ May 1, 2012 VTE beginning at approximately 10:45:30 through 10:47:00.

³⁰ May 1, 2012 VTE beginning at approx. 10:57:10 through 10:59:17.

Chairman Gardner asked company witness Weaver whether he agreed with Dr. Fisher's assertion, Mr. Weaver did not dispute it.³¹

The method in which KPCo selected an manipulated the Strategist model to provide the options which the company wanted to see, should be contrasted with the method in which another utility, KU/LG&E, handled Strategist modeling in a recently-decided CPCN case³² when it came to evaluating the options for replacement power. In that case, KU/LG&E issued an RFP for replacement power, and received 116 offers from other electric generation entities. The offers went through a 2-stage analysis, so that the best 24 offers were considered in the mix of options. Those top 24 offers -- representing 24 additional options -- were entered into Strategist ³³ [together with other options]. It is important to note that this is the same computer model utilized by KPCo. However, KPCo did not issue an RFP in connection with the instant filing, and when it came to considering alternative replacement sources of generation, chose instead to focus solely on resources internal to AEP.³⁴

b. KPCo Failed to Adequately Consider and Give Proper Weight to a Purchased Power Option

As acknowledged by company Witness Wohnhas, the option of replacing power generated by both of Big Sandy's units with purchased power from other PJM-footprint

³¹ Weaver cross-examination, May 1, 2012 VTE beginning at approximately 18:20:00.

³² *In Re: The Joint Application of Louisville Gas and Electric Company and Kentucky Utilities Company of Public Convenience and Necessity and Site Compatibility Certificate for the Construction of a Combined Cycle Combustion Turbine at the Cane Run Generating Station and the Purchase of Existing Simple Cycle Combustion Turbine Facilities From Bluegrass Generation Company, LLC in Lagrange, Kentucky*, Case No. 2011-00375, Final Order dated May 3, 2012.

³³ *Id.* at p. 7.

³⁴ Wohnhas cross examination, April 30, 2012 VTE at approx. 14:53:40.

utilities (including other AEP affiliates) would result in only a 10%-12% increase on residential ratepayers by 2016, as opposed to the 35% increase envisioned in the company's plan.³⁵ One factor which may have caused the company to decide against a purchased power option is the fact that it would not be able to earn any return if it chooses that option.³⁶

Another method of obtaining replacement power would be to purchase at least a portion of the generation from KPCo affiliate Ohio Power Company's ("OPCo") Mitchell plant. AEP's Executive Vice-President and COO Robert Powers testified before the Ohio Public Utilities Commission that it was AEP's intent to transfer 312 MW from Mitchell to KPCo.³⁷ Despite that fact, Strategist models that KPCo submitted in this case did not include the potential transfer of 312 MW of power from OPCo's Mitchell Unit to KPCo.³⁸ As a result of market deregulation in Ohio, OPCo will likely have to sell some generating assets, and is in fact considering selling them to KPCo and/or another affiliate, Appalachian Power Co.³⁹

³⁵ April 30, 2012 VTE beginning at approximately 11:24:10. *See also* Kollen direct testimony, pp. 10-20 in which he indicates the Company's Option 4B, in which it would retire BS-2 at the end of 2015, replace the capacity and energy with purchases from PJM for 10 years, and then construct new natural gas combined cycle plant would be less expensive than the Big Sandy Retrofit Option.

³⁶ April 30, 2012 VTE beginning at approximately 11:52:00.

³⁷ *See* p. 21 of that testimony (filed March 30, 2012), introduced into evidence as Sierra Club Hearing Exhibit 17; *see also* May 1, 2012 VTE beginning at approximately 17:44:40.

³⁸ May 1, 2012 VTE beginning at approximately 17:44:40; *see also* Wohnhas cross examination, April 30, 2012 VTE beginning at approx. 12:02:45. Subsequent to this filing, KPCo performed a study on the possibility of KPCo obtaining a greater share of Mitchell, and also included a natural gas-fired unit to replace Big Sandy-1; however, the results of that study purportedly did not change the conclusion of the filing that the Big Sandy Retrofit was still the best option (*see* response to Sierra Club 1-52).

³⁹ *See* KPCo response to Sierra Club 1-52., and Wohnhas cross examination, April 30, 2012 VTE beginning at approx. 12:02:45.

The option of obtaining power from the Mitchell plant is very important and highly relevant for several reasons, none of which is more important than the fact it is already fully compliant with all of the new EPA standards.⁴⁰ Additionally, Mitchell's power cost is only \$640 kw (on a net book value basis) as contrasted with the projected \$1175/kw cost of power from Big Sandy 2 following the proposed retrofit.⁴¹ Despite the fact that purchasing power generated at the Mitchell plant is an attractive and highly viable option, {BEGIN CONFIDENTIAL} [REDACTED] {END CONFIDENTIAL} removed it from KPCo's mix of possible options.⁴²

c. Natural Gas-Fired Generation Received Inadequate Consideration

An existing single-cycle combustion turbine natural gas-fired electric generation facility owned by Riverside Generating Co., LLC is located less than three miles from the Big Sandy generation site. However, neither KPCo nor AEP conducted a {BEGIN CONFIDENTIAL} [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]⁴³

{END CONFIDENTIAL}

During the hearing, KIUC introduced its Hearing Exhibit 10, which depicts natural gas price futures on Henry Hub for 2016. Those prices average approximately

⁴⁰ April 30, 2012 VTE at approximately 12:04:17.

⁴¹ See KIUC Hearing Exhibit 5; and April 30, 2012 VTE at approximately 11:51.

⁴² Thomas confidential cross-examination at approximately 4:30 p.m., April 30, 2012.

⁴³ Confidential cross-examination of KPCo witness Thomas, April 30, 2012 at approximately 5:30 p.m.

\$4.27/mmbtu⁴⁴ which is approximately 40% lower than prices in AEP's base case set forth in its Strategist modeling. Although the company's modeling relied on other gas price forecasting, it appears at a minimum that its modeling would have been more complete had it included these futures in its modeling scenarios.⁴⁵

d. **Company Failed to Conduct Any Studies Associated With This Filing Regarding Potential Energy Efficiency Savings**

Throughout the past several years, the Kentucky Public Service Commission has repeatedly emphasized in its orders the importance of Demand Side Management ("DSM"), and has urged all electric generation and gas LDCs to increase DSM programs in order to decrease demand. Despite the fact that the instant filing carries a potential rate impact of approximately \$1 billion, and could require the building of new generation facilities, the company as a part of this filing failed to conduct any studies to indicate how much energy efficiency potential it could obtain.⁴⁶ Although company witness Wohnhas testified that the company is constantly seeking more DSM savings, the Attorney General believes that given a case of this magnitude, together with the prevailing widespread poverty rate in KPCo's service territory, the Company should have at least considered contracting with an external company to provide a comprehensive study in this regard.

e. **No External Consultants Utilized**

⁴⁴ May 1, 2012 VTE at approximately 20:41:50.

⁴⁵ See KIUC Hearing Exhibit No. 10; see also Weaver Cross Examination, May 1, 2012 VTE beginning at approx. 18:00:00.

⁴⁶ Wohnhas cross examination, April 30, 2012 VTE at approx. 15:17:50 and Weaver cross examination, May 1, 2012 VTE at 14:34:35.

KPCo is a subsidiary of AEP, one of the largest utilities in the nation. As such, it enjoys access to many services, including engineering, through AEP Service Company, which it shares with other AEP affiliates. Nonetheless, projects such as those contemplated in the instant filing in which rate base would be virtually doubled should have multiple, independent technical reviews in order to obtain different perspectives. The Attorney General is troubled by the fact that KPCo chose to not engage the services of any external consultants⁴⁷ for the selection of compliance methodology and design aspects of this case. While KPCo's parent, AEP chose to utilize Sargent & Lundy for cost estimates, that review was limited to the final decision AEP had already made on KPCo's behalf. This is especially true given the fact that AEP has not installed any DFGD's to date, yet still chose to rely solely upon its own in-house expertise.

The Attorney General is concerned that this failure not only calls the decision-making process into question, but it also calls the independence of the jurisdictional entity, KPCo, into question, especially given its almost exclusive reliance upon expertise from AEP and other affiliates. This fact is underscored by the observation that the vast majority of witnesses called were from AEP or other affiliates, and no officer from KPCo offered any form of testimony in this proceeding. Further, although AEP has not installed any DFGDs to date,⁴⁸ it nonetheless insists upon relying on its own in-house expertise for holding true to the timetable.

⁴⁷ See KPCo response to PSC 3-9; see also May 1, 2012 VTE at approximately 11:26:00.

⁴⁸ May 1, 2012 VTE beginning at approximately 11:29:30.

As the Commission has previously ruled, an application for a CPCN must demonstrate that a thorough review of all alternatives has been conducted.⁴⁹ Clearly, that has not occurred in this case; as such, the subject petition must be denied.

IV. Abrupt Move from Natural Gas Option to Retrofit Was Clearly Not the Least-Cost Option

As late as October, 2011, KPCo was advising the investment community that in order to achieve compliance with the new EPA regulations, the company intended to build a new natural gas combined-cycle generation unit, and shut down both Big Sandy units. At that time, the company projected the cost of that new plant to be \$525 million.⁵⁰ That cost would roughly approximate the estimated cost of a new gas-fired intermediate-load unit of approximately 640 MW which KU/LG & E plan to construct at their Cane Run generation station.⁵¹

However, a little over one month later, KPCo, in another presentation to the investment community, indicated it had decided to proceed with a DFGD unit for Big Sandy Unit 2. The high estimate of the Big Sandy Retrofit at that time was \$525 million.⁵²

Despite extensive questioning from all intervenors, PSC Staff and the Commissioners themselves, no company witness was able to precisely identify who in KPCo and/or its corporate parent, AEP, made the decision to not proceed with the originally-selected option of a natural gas combined cycle plant, and instead proceed

⁴⁹ *In Re: The Application of Kentucky American Water Company, supra* at 30.

⁵⁰ See attachment to Sierra Club 1-1, Bates-stamped p. 7059 of 9556, contained in a presentation named "ISI Analyst Meeting Handout," dated October 6, 2011.

⁵¹ See generally Case No. 2011-00375, *supra*.

⁵² See *Id.*, Bates-stamped p. 678 of 9556, presentation given to Morgan Stanley, November 17, 2011.

with the vastly more capital-intensive DFGD option. However, witness Walton testified that he thought the original decision to proceed with the natural gas-fired option was only a “tabletop” decision, one which is made informally without any analysis.⁵³ The Attorney General finds this statement highly questionable, at best. Moreover, if true, this convoluted approach to last-minute decision making on a project to be borne on the backs of impoverished Kentuckians for the enrichment of shareholder profit is nothing short of breath taking. In addition, the notion of a Fortune 500 stock company giving presentations to the investment community regarding “tabletop” decisions for capital projects worth one-half billion dollars hardly seems credible.

Moreover, KPCo witness Wohnhas testified under cross-examination that the application took approximately three (3) months to prepare.⁵⁴ Since the actual application was filed on December 6, 2011, that would mean that the company began work on the application in early October, during the time frame that AEP was still representing to the investment community that both coal units would be retired and replaced with natural gas-fired facility. Prudent corporate governance, forthrightness and transparency should dictate that at least those staff members who worked on the application should have at least some knowledge of who in the corporate structure made this critical change.

Incredibly, while the Applicant’s witnesses seemed unable to identify exactly who was responsible for making the decision to not proceed, the company’s own press

⁵³ Walton cross-examination, May 1, 2012 VTE at approximately 14:03 and 14:20:10.

⁵⁴ April 30, 2012 VTE beginning at approximately 10:25:00. Furthermore, the application was completed prior to the start of the DFGD Retrofit Phase 1. Wohnhas cross examination, April 30, 2012 VTE beginning at 12:13:30.

releases indicate that it went through a change of leadership close to the time that the decision was made. Then-Chairman and CEO Michael Morris announced in a June 9, 2011 press release that both Big Sandy units would be retired, and that a natural gas generation facility would be constructed on the site.⁵⁵ The reigns of company control changed hands on or about October 25, 2011 when its Board elected Akins President and CEO, to take effect on November 12, 2011.⁵⁶ Just a few days later, the company gave a presentation to Morgan Stanley indicating that Big Sandy Unit 2 would instead receive a DFGD retrofit.⁵⁷ While the precise identity of those responsible for making the decision to not pursue the originally-selected natural gas option remains unknown, one thing is certain: KPCo failed to produce **even one single company officer** to provide testimony in this matter, either in pre-filed direct testimony or at the hearing, despite the fact that KPCo's President and COO was present in the audience for the hearing.⁵⁸

What may be even more telling is the fact that, as pointed out in Chairman Armstrong's questioning of witness Wohnhas, the company waited six (6) years from the time it entered the consent decree with EPA until the time of this filing.⁵⁹

V. In the Event the Commission Should Approve the Application, it Should Significantly Modify the Company's Request

a. Company's Requested Rate of Return Represents Gross Departure from Current Economic Conditions

⁵⁵ <http://www.aep.com/newsroom/newsreleases/?id=1697>

⁵⁶ <http://www.aep.com/newsroom/newsreleases/?id=1726>

⁵⁷ See n. 15, *supra*.

⁵⁸ See the attached list of persons who attended the three-day hearing, attached hereto as AG Brief Exhibit 1.

⁵⁹ April 30, 2012 VTE at approximately 14:51:20.

Pursuant to the pre-filed testimony of Attorney General expert Dr. Randall Woolridge, the company should receive no greater than a 9.0 % return on equity. KIUC also submitted return on equity testimony from Mr. Steve Hill, who opined that the company should receive no greater than a 9.2% return. The company's direct pre-filed testimony had no expert witness to provide testimony regarding rate of return, and instead relied solely upon superficial evidence tendered by witnesses Mr. Wohnhas and Munsey, who by happenstance and without any supporting data briefly mentioned that a 10.5% ROE should be used because it was the amount agreed upon in the company's last general rate case.⁶⁰

The company utilized the services of Dr. William Avera, who provided written rebuttal testimony and live cross-examination. Dr. Avera's written testimony was limited to criticizing the testimony of Dr. Woolridge and Mr. Hill by simply re-manufacturing and manipulating the intervenors' data. At the hearing, Dr. Avera criticized Dr. Woolridge's CAP-M approach,⁶¹ yet ignored the fact that Dr. Woolridge opined that he as well as most experts rely more heavily upon the DCF approach.

At the hearing, Dr. Avera testified that in his exhibit WEA-4, he uses the same data Dr. Woolridge used for his DCF analysis of historic growth rates. Dr. Avera revised those figures by eliminating all figures below 7%, but kept all of the high-end figures, including those that could be as high as 17%.⁶² In fact, Dr. Avera eliminated a

⁶⁰ Wohnhas direct at pp. 17-18; Munsey direct at pp. 12-13.

⁶¹ May 1, 2012 VTE at approximately 19:40:30.

⁶² *Id.* at approximately 19:42:50.

total of 39 low rates, but eliminated only two (2) of the high-end rates.⁶³ Dr. Avera defended his choice by simply stating that this is what he had done in FERC with his application of a high band number. Obviously, such an extreme editing of the study results will radically alter measures of central tendency, such as means, mediums and midpoints, and produce wildly distorted results unless there are obviously strong outliers. Dr. Avera essentially agreed with this statement by even retorting that to do otherwise would result in a “Bill Gates” scenario where Mr. Gates could have been in the sample group and then “all bets are off.”⁶⁴

Dr. Avera indicated that he does not use historic growth rates, but instead relies exclusively on the forecasted EPS growth rates of Wall Street financial analysts, in developing a DCF equity cost rate. In his rebuttal testimony, Dr. Avera manipulated the Projected EPS Growth Rates in a similar fashion with the data set forth in Exhibit WEA-5 (Projected EPS Growth Rates), where he eliminated 20 low equity cost rates and eliminated 0 high rates.⁶⁵ Of particular importance is the fact that Dr. Avera himself employed a Bill Gates scenario with the use of a 17% upper band, **after** tax, which would obviously drive up the central tendencies. It is noteworthy that Dr. Avera’s average DCF equity cost rate, even after his asymmetric editing of the results, is still only 9.6%. To further clarify just how high this high water mark is, Dr. Woolridge has testified that projected earnings growth rates as forecasted by Wall Street are overly

⁶³ Throughout his testimony, Dr. Woolridge uses the median as a measure of central tendency so as to minimize the impact of very high or low outliers.

⁶⁴ *Id.* beginning at 19:45:32.

⁶⁵ *Id.* beginning at approximately 19:47:00.

optimistic.⁶⁶ Consequently, a 9.6% ROE should be considered as an absolute upper band by the Commission in establishing an ROE as even the company's witness tacitly admits.

The more appropriate ROE number which should be adopted by the Commission is 9.0% as offered by the Attorney General who avoids the mistakes made by Dr. Avera. In particular, Dr. Woolridge correctly applies the median in his analysis, without the whimsical elimination of outliers, which relies more heavily on the DCF model. He concludes that an ROE of 9.0% would be more than adequate for the applicant to attract capital in today's volatile market.⁶⁷

b. Other Modifications

As discussed by KIUC witness Lane Kollen,⁶⁸ in the event the Commission grants the company's petition, it should require the company to finance as much of the proposed debt as possible using short-term debt as opposed to the company's as-filed position of using solely long-term debt.

Mr. Kollen makes several other recommendations, including but not limited to adjust the depreciation period from the as-filed 15-year period to 30 years. The Attorney General endorses all of Mr. Kollen's remaining recommendations, with the exception of rate of return, which the Attorney General believes should be set at no greater than 9.0%.

⁶⁶ See prefiled Woolridge testimony at pp. 31-32 and Exhibit B attached thereto.

⁶⁷ See Woolridge prefiled testimony in general.

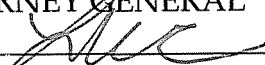
⁶⁸ See Kollen direct testimony, pp. 28-47.

VI. CONCLUSION and RECOMMENDATIONS

At a time when Kentucky continues to recover from arguably the worst economic downturn since the Great Depression, the Applicant seeks to employ a strategy of profiting from the onerous regulatory requirements which the new EPA Clean Air standards impose on the Commonwealth. The Commission should deny the petition because it was not based on the least cost alternative, was based on manipulated modeling results, was done without the assistance of external consultants, and without any estimation of savings which could be achieved through DSM. Alternatively, if the Company is permitted to proceed with the as-filed Big Sandy Retrofit, the Commission should adopt as conditions the other recommendations as noted herein.

Moreover, the Attorney General is very concerned about the state of KPCo's corporate governance and the degree to which it is able, and capable of exercising judgment independent of its corporate parent AEP. For this reason, the Attorney General recommends that the Commission order a comprehensive management audit of KPCo.

Respectfully submitted,
JACK CONWAY
ATTORNEY GENERAL



JENNIFER BLACK HANS
DENNIS G. HOWARD, II
LAWRENCE W. COOK
ASSISTANT ATTORNEYS GENERAL
1024 CAPITAL CENTER DRIVE, STE. 200
FRANKFORT KY 40601-8204
(502) 696-5453
FAX: (502) 573-8315

EXHIBIT 1



Steven L. Beshear
Governor

Leonard K. Peters
Secretary
Energy and Environment Cabinet

Commonwealth of Kentucky
Public Service Commission
211 Sower Blvd.
P.O. Box 615
Frankfort, Kentucky 40602-0615
Telephone: (502) 564-3940
Fax: (502) 564-3460
psc.ky.gov

David L. Armstrong
Chairman

James W. Gardner
Vice Chairman

May 8, 2012

TRANSMITTED VIA E-MAIL

Office of the Attorney General
Attention: Jennifer Black Hans
1024 Capital Center Drive, Suite 200
Frankfort, Kentucky 40601

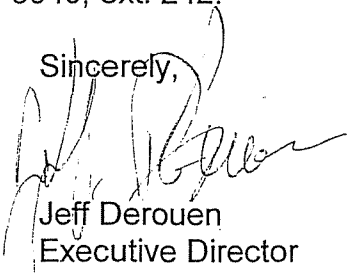
Re: Open Records Request dated May 3, 2012 regarding last sign in sheets for hearings held April 30, 2012, May 1, 2012 and May 2, 2012 in PSC Case No. 2011-00401

Dear Ms. Hans:

Please excuse the tardiness of the Commission's response to your records request. It appears that you had e-mailed the request to the PSC's General Counsel, who had been out of the office and therefore unable to attend to having your request fulfilled until today's date. I have attached pdf copies of the sign-in sheets for the dates listed above in Case No. 2011-00401. I have also attached for your convenience, an Open Records Request Form, which can be found on the PSC website at <http://psc.ky.gov/>. Please use this form following the directions provided on the form for any future requests in order to avoid delaying our response.

I hope this information will be of assistance to you. If you have further inquiries, please do not hesitate to contact Kathy Gillum at (502) 564-3940, ext. 242.

Sincerely,


Jeff Derouen
Executive Director

kg/

Attachment: pdf



COMMONWEALTH OF KENTUCKY
OFFICE OF THE ATTORNEY GENERAL

JACK CONWAY
ATTORNEY GENERAL

1024 CAPITAL CENTER DRIVE
SUITE 200
FRANKFORT, KENTUCKY 40601

May 3, 2012

Via Electronic Mail

ATTN: Open Records Custodian
Kentucky Public Service Commission
Office of General Counsel
211 Sower Boulevard
Frankfort, Kentucky 40601-0615

RE: Case No. 2011-00401

Dear Counsel:

Pursuant to KRS 61.870 et. al., Kentucky's Open Records Act, the Office of the Attorney General requests a copy of the sign-in sheet attendance lists for the public hearings in the above-referenced case, which occurred on April 30, 2012, May 1, 2012 and May 2, 2012.

Production of these documents may be made by electronic mail or via messenger mail to the Office of the Attorney General. Please do not hesitate to contact me if you have any questions concerning this request.

Sincerely,

A handwritten signature in cursive script, appearing to read "Jennifer Black Hans".

Jennifer Black Hans
Executive Director
Office of Rate Intervention



HEARING SIGN IN SHEET

<u>Hearing:</u>	AEP
<u>Case number:</u>	2011-00401
<u>Location:</u>	Hearing Rm 1
<u>Date:</u>	4-30-12

NAME	COMPANY
Kama Rogut	McGordon-Rogut Reporting
Mike Kritz	KIUC
Chuck Buechler	Vantage
Walt DeGuzman	" "
Shannon Fisk	Sierra Club
Jody Fisk	KIUC
MARK R. OSTERBERG	STARS / HARBISON RALPH
Ken Coish	Sierra Club / KPCO
Rich Clowett	Sierra Club
Bob Walsh	AEPSC / KPCO
Scott Wynn	AEPSC / KPCO
MARK BECKER	AEPSC / KPCO
KARL BUTZNER	AEPSC / KPCO
LILA MUNSEY	AEPSC / KPCO
Toby Thomas	AEPSC / KPCO
Joe Childers	Sierra Club et al.
Randy Wohlschlag	FPCO
Larry Wade	OAG
Jennifer Hays	OAG
Dennis G. Howard, II	OAG
JOHN McMANUS	AEPSC
Shannon Listebarger	KPCO
Hector Garcia	KPCO
Twana Smith	AEPSC
Nachy Kante	Sierra Club et al
Eric Lopez	NII
Barbara Hatcher	STARS / KPCO

HEARING SIGN IN SHEET

<u>Hearing:</u>	AEP
<u>Case number:</u>	2011-00401
<u>Location:</u>	Hearing Rm 1
<u>Date:</u>	5-1-12

NAME	COMPANY
Walter Dragovich	Vantage
Chuck Buechel	Vantage
Mike Kurts	KWR
Lane Koller	KWC
Hector Garcia	KPCO
Ken Gish	States + Robinson for KPCO
Robert Walton	AEP
Gary Pantony	KY P Co
MARK R OVERSTREET	States + Robinson for KPCO
Becky Boyd	Kptr
William Averca	KPCO
Scott Weaver	AEP/KPCO
Karen Bluetz	AEP SC / KPCO
Ranie Wohles	KPCO
Lila Munsey	"
Jennifer Block Hans	CAG
Kristin Henry	Sierra Club
Larry Cook	CAG
TWANA SMITH	AEP SC
JOHN MCMANUS	AEP SC
JERRY KEE	KYPC
JEREMY FOSTER	Sierra Club
Dennis Howard	MAG
Ed Caffrey	Ky Power / States
Tom Down	LPC
Ron Robinson	Ky Power
Laura Kogut	M ² London-Kogut Reporting

HEARING SIGN IN SHEET

<u>Hearing:</u>	AEP
<u>Case number:</u>	2011-00401
<u>Location:</u>	Hearing Rm 1
<u>Date:</u>	5-2-12

NAME	COMPANY
MARK R. Derskeet	STATS 21 ARBISON TR KPCO
Walt Deabinski	Vantage Energy Consultation
Chuck Buechel	Vantage
Jody Klor	KIUC
Stephen Hill	KIUC
Lone Kallen	KIUC
Stephen Baron	KIUC
Mike Kurtz	KIUC
MARK BECKER	AEPSC/KPCO
Kristin Henry	Sierra Club
Shannon Fiske	Sierra Club
Mike Kurtz	KIUC
Rick Buechel	Syngas / Sierra Club
Jennifer Brock HNS	OAG
Hector Garcia	Kentucky Power Company
Ken Co. Sh	Statco at La. business (KPCO)
Winnis Harzard	OAG
Larry Cook	OAG
Paul W. M.	OAG
Shannon Listebarger	KPCO
Amy Elliott	KPCO
Ramie Wohnka's	KPCO
Greg Pauley	"
Lita Munsey	"
Ben Cottacker	STATS 21 ARBISON Ky Power
Bunn Robinson	Ky Power
Tom Walden	LRC

EXHIBIT 1

Certificate of Service and Filing

Counsel certifies that an original and ten photocopies of the foregoing were served and filed by hand delivery to Jeff Derouen, Executive Director, Public Service Commission, 211 Sower Boulevard, Frankfort, Kentucky 40601; counsel further states that true and accurate copies of the foregoing were mailed via First Class U.S. Mail, postage pre-paid, to:

Lila P. Munsey
Manager, Regulatory Services
Kentucky Power
101A Enterprise Dr.
Frankfort, KY 40601

Mark R. Overstreet
Stites & Harbison, PLLC
P.O. Box 634
Frankfort, KY 40602-0634

Hon. Joe F. Childers
201 W. Short St.
Ste. 300
Lexington, KY 40507

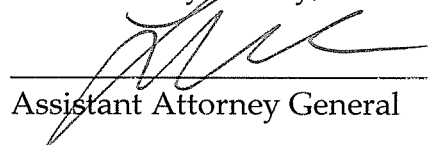
Shannon Fisk
Senior Attorney
Natural Resources Defense Council
2 N. Riverside Plaza, Suite 2250
Chicago, ILLINOIS 60660

Kristin Henry
Staff Attorney
Sierra Club
85 Second Street
San Francisco, CA 94105

Hon. Michael L. Kurtz
Attorney at Law
Boehm, Kurtz & Lowry
36 E. 7th St.
Ste. 1510
Cincinnati, OH 45202

Hon. Hector Garcia
American Electric Power Service
Corporation
1 Riverside Plaza, 29th Floor
Columbus, OH 43215-2373

This 11th day of May, 2012


Assistant Attorney General