

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

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MAY 28 2013

PUBLIC SERVICE  
COMMISSION

**In The Matter Of:**

**APPLICATION OF KENTUCKY POWER COMPANY FOR (1) A CERTIFICATE OF PUBLIC CONVENIENCE AND NECESSITY AUTHORIZING THE TRANSFER TO THE COMPANY OF AN UNDIVIDED FIFTY PERCENT INTEREST IN THE MITCHELL GENERATING STATION AND ASSOCIATED ASSETS; (2) APPROVAL OF THE ASSUMPTION BY KENTUCKY POWER COMPANY OF CERTAIN LIABILITIES IN CONNECTION WITH THE TRANSFER OF THE MITCHELL GENERATING STATION; (3) DECLARATORY RULINGS; (4) DEFERRAL OF COSTS INCURRED IN CONNECTION WITH THE COMPANY'S EFFORTS TO MEET FEDERAL CLEAN AIR ACT AND RELATED REQUIREMENTS; AND (5) ALL OTHER REQUIRED APPROVALS AND RELIEF**

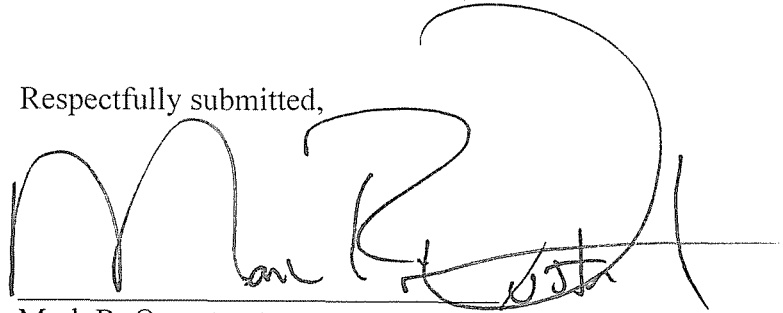
Case No. 2012-00578

**KENTUCKY POWER COMPANY'S NOTICE OF FILING**  
**OF EXECUTED MEMORANDUM OF UNDERSTANDING REGARDING**  
**STIPULATION AND SETTLEMENT AGREEMENT AMONG KENTUCKY POWER,**  
**SIERRA CLUB, AND KIUC**

\* \* \* \* \*

Kentucky Power Company files with the Public Service Commission of Kentucky the original and ten copies of the executed Memorandum of Understanding Regarding Stipulation and Settlement Agreement.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'Mark R. Overstreet', written over a horizontal line.

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COUNSEL FOR KENTUCKY POWER  
COMPANY

**CERTIFICATE OF SERVICE**

I hereby certify that a copy of the foregoing was served by U.S. Mail, postage prepaid, upon the following parties of record, this 28<sup>th</sup> day of May, 2013.

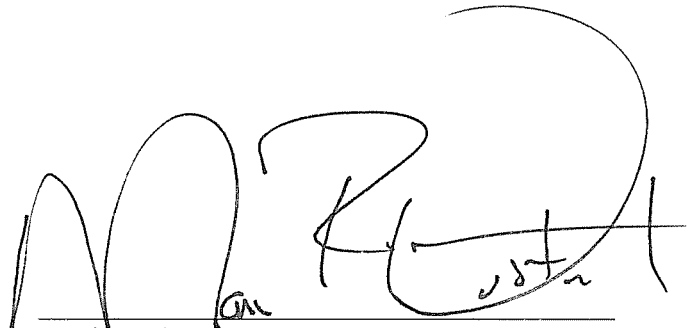
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COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

IN THE MATTER OF:

APPLICATION OF KENTUCKY POWER COMPANY FOR (1) A CERTIFICATE OF PUBLIC CONVENIENCE AND NECESSITY AUTHORIZING THE TRANSFER TO THE COMPANY OF AN UNDIVIDED FIFTY PERCENT INTEREST IN THE MITCHELL GENERATING STATION AND ASSOCIATED ASSETS; (2) APPROVAL OF THE ASSUMPTION BY KENTUCKY POWER COMPANY OF CERTAIN LIABILITIES IN CONNECTION WITH THE TRANSFER OF THE MITCHELL GENERATING STATION; (3) DECLARATORY RULINGS; (4) DEFERRAL OF COSTS INCURRED IN CONNECTION WITH THE COMPANY'S EFFORTS TO MEET FEDERAL CLEAN AIR ACT AND RELATED REQUIREMENTS; AND (5) ALL OTHER REQUIRED APPROVALS AND RELIEF

Case No. 2012-00578

**MEMORANDUM OF UNDERSTANDING REGARDING  
STIPULATION AND SETTLEMENT AGREEMENT**

This Memorandum of Understanding Regarding Stipulation and Settlement Agreement, made and entered into this 28<sup>th</sup> day of May, 2013, by and among Kentucky Power Company ("Kentucky Power" or "Company"); Kentucky Industrial Utility Customers, Inc. ("KIUC"); and Sierra Club, Alexander Desha, Tom Vierheller, and Beverly May ("Sierra Club");

WITNESSETH:

**WHEREAS**, on December 19, 2012 Kentucky Power filed a verified application pursuant to KRS 278.020, 807 KAR 5:001, Section 9 (now 807 KAR 5:001, Section 15), KRS 278.300, and 807 KAR 5:001, Section 11 (now 807 KAR 5:001, Section 17). In its application, styled *In the Matter of: Application of Kentucky Power Company for: (1) A Certificate Of Public Convenience and Necessity Authorizing The Transfer To The Company Of An Undivided Fifty Percent Interest In The Mitchell Generating Station And Associated Assets; (2) Approval Of The Assumption By Kentucky Power Company Of Certain Liabilities In Connection With The Transfer Of Mitchell Generating Station; (3) Declaratory Rulings;*<sup>1</sup> *(4) Deferral Of Costs Incurred In Connection With The Company's Efforts To Meet Federal Clean Air Act And Related Requirements; And (5) For All Other Required Approvals And Relief*, Case No. 2012-00578 ("Transfer Application.") In the Transfer Application, the Company sought approval for all approvals necessary to effectuate the transfer of a fifty percent undivided interest in Ohio Power Company's Mitchell Generating Station, including the assumption of certain liabilities. In addition, the Company sought the authority, in accordance with Financial Accounting Standards Board Standards Codification 980-340-25-1, to accumulate and defer for review and recovery in its next base rate proceeding the approximately \$28 million dollars of costs incurred from 2004 through 2012 in connection with the Company's ongoing efforts to meet Federal Clean Air Act and other environmental requirements with respect to Big Sandy Unit 2; and

**WHEREAS**, KIUC, Sierra Club, and the Attorney General of the Commonwealth of Kentucky, by and through his Office of Rate Intervention ("Attorney General") (collectively the

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<sup>1</sup> On February 15, 2013 the Commission issued a declaratory order stating that prior approval pursuant to KRS 278.020(5) and KRS 278.020(6) is not required for the merger of Kentucky Power and NEWCO Kentucky.

“Intervenors”) filed motions for full intervention in P.S.C. Case No. 2012-00578. The Public Service Commission of Kentucky (“Commission”) granted each of the intervention motions; and

**WHEREAS**, Sierra Club and KIUC filed written testimony raising issues regarding Kentucky Power’s Transfer Application; and

**WHEREAS**, Kentucky Power and the Intervenors have had a full opportunity for discovery, including the filing of written data requests and responses; and

**WHEREAS**, Kentucky Power offered the Intervenors, along with Commission Staff, the opportunity to meet and review the issues presented by Kentucky Power’s application in this proceeding and for purposes of settlement; and

**WHEREAS**, during May 2013 representatives of Kentucky Power and the Intervenors, along with Commission Staff, met to review the issues and discuss settlement of the Transfer Application; and

**WHEREAS**, Kentucky Power, Sierra Club, and KIUC have reviewed the issues raised in P.S.C. Case No. 2012-0578, and Kentucky Power, along with Sierra Club, and KIUC (“Settling Intervenors”), on May 24, 2013 reached an agreement in principle regarding settlement of the case, including the issues raised therein, which counsel for KIUC and Sierra Club will recommend to their respective clients for their approval and such approval cannot be guaranteed; and

**WHEREAS**, the Attorney General declined to enter into a settlement of the issues and thus there is not a unanimous settlement of the proceedings in Case No. 2012-00578; and

**WHEREAS**, the hearing on the Transfer Application is scheduled to commence on May 29, 2013 and there is insufficient time for Kentucky Power and the Settling Intervenors to

prepare and obtain client execution of a final and binding Stipulation and Settlement Agreement prior to the commencement of the scheduled hearing; and

**WHEREAS**, Kentucky Power and the Settling Intervenor execute this Memorandum of Understanding Regarding Stipulation and Settlement Agreement (“Memorandum of Understanding”) for purposes of memorializing their agreement in principle for which client approval is sought.

**NOW, THEREFORE**, for and in consideration of the mutual premises set forth above, and the agreements and covenants set forth herein, Kentucky Power and the Settling Intervenor hereby agree:

1. On December 31, 2013, fifty percent of Mitchell Units 1 and 2 (including associated assets and liabilities) are to be transferred to Kentucky Power Company in the manner described in the Transfer Application. The transfer will be at actual net book value, including all Accumulated Deferred Income Tax benefits with no off-set to negate the transfer of those tax benefits to Kentucky ratepayers, as of December 31, 2013 in a manner consistent with methodology shown in RKW-Exhibit 3 (The net book value is currently estimated to be approximately \$536 million). Such transfer shall be deemed a prudent component of rate base in future proceedings. The Company will use current depreciation rates for Mitchell Units 1 and 2 until such rates are changed in a base rate proceeding.

2. Mitchell-related fuel costs shall be included in the calculation of charges or credits under Kentucky Power Company’s Fuel Adjustment Clause. The Mitchell units will be included in the economic dispatch of Kentucky Power Company’s generation resources. Because of the anticipated lower fuel costs of Mitchell Units 1 and 2 vis-à-vis the anticipated fuel costs of the Big Sandy units, the transfer of the Mitchell units to Kentucky Power is

expected to provide Kentucky Power customers with the benefit of reduced fuel costs of approximately \$2.50/MWh. Based on 2012 jurisdictional kWh sales of 6.7 GWh, the benefits are estimated to total \$16.75 million annually.

3. Upon approval by the Commission of the Stipulation and Settlement Agreement to be submitted to the Commission by Kentucky Power Company and the Settling Intervenors pursuant to Paragraph 21 of this Memorandum of Understanding, the Company shall withdraw any pending base rate case.<sup>2</sup> The Company agrees to maintain current base rates at least through May 31, 2015, subject to paragraph 16 of this Memorandum of Understanding. In addition, the Company agrees to file a base rate proceeding (“Base Rate Case”) no later than December 29, 2014 utilizing a September 30, 2014 test year. Prior to filing the Base Rate Case, the Company agrees to work with KIUC to develop a stand alone cost-based rate or tariff offering for facilities of 100 MW or more at a single site. The Company agrees to remove test year Operations and Maintenance expenses related to Big Sandy Unit 2 from the cost of service study in the Base Rate Case. The Company further agrees that all capital costs associated with Big Sandy Unit 2 will be removed from the cost of service study in the Base Rate Case and instead these capital costs will be recovered pursuant to Paragraph 14 of this Memorandum of Understanding.

4. Effective January 1, 2014, the Company will implement an Asset Transfer Rider. The Asset Transfer Rider will be set to collect \$44 million annually, with a true-up mechanism to ensure no over or under recovery. The Asset Transfer Rider will be determined by first allocating the \$44 million revenue between residential and non-residential customers based upon their respective total revenues. The Asset Transfer Rider will be implemented as a percentage of

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<sup>2</sup> Kentucky Power Company on May 17, 2013 filed its Notice of Intent to file an Application For General Adjustment of its Rates (Case No. 2013-00197).



total revenues for the residential class, and as a percentage of non-fuel revenues for all other customers. The actual percentage will be based upon actual annual sales for the 12-months ended September 2013. The Asset Transfer Rider will remain in place until the Commission sets new base rates for the Company that include the Mitchell units.

5. Effective January 1, 2014, the monthly Environmental Surcharge factor (Tariff E.S.) will be fixed and maintained at 0.00% until new base rates are set by the Commission.

6. When base rates are set in the Base Rate Case, all costs associated with the Mitchell Units 1 and 2 Flue Gas Desulfurization (FGD) equipment will be recovered through the environmental surcharge (Tariff E.S.) and excluded from base rates in the Base Rate Case. This collection mechanism shall continue at least until the Commission sets new base rates for a period commencing after June 30, 2020 that include these costs. The Environmental Surcharge will be determined by first allocating the revenue requirement between full requirements wholesale customers and retail customers based upon typical allocation factors. The retail allocation of costs will then be allocated between residential and non-residential retail customers based upon their respective total revenues. The Environmental Surcharge will be implemented as a percentage of total revenues for the residential class and as a percentage of non-fuel revenues for all other customers.

7. Effective January 1, 2014, the Company will set and maintain the System Sales Adjustment Factor (Tariff S.S.C.) to 0.0000 mills/kWh until new base rates are set by the Commission. Calendar year off-system sales margins above \$15,290,363 million, the level in current base rates, will be retained by the Company.

8. The Company shall be authorized in accordance with Financial Accounting Standards Board Standards Codification 980-340-25-1 to accumulate and defer for review and recovery the \$28,113,304 of costs incurred from 2004 through 2012 in connection with the Company's ongoing efforts to meet Federal Clean Air Act and other environmental requirements with respect to Big Sandy Unit 2. Collection of the amortization of the regulatory asset will be over a five-year period commencing with the implementation of new base rates from the Base Rate Case. The Company will be authorized to apply carrying costs to the regulatory asset at a long-term debt rate of 6.48%.

9. Effective June 1, 2015, the Company will increase the availability of Tariff C.S.-I.R.P. to 75,000 kW. Further, effective June 1, 2015, the Company will offer credits under Tariff C.S.-I.R.P. of \$3.68 /kW/month for interruptible load which qualifies under PJM's rules as capacity for the purposes of the Company's FRR obligation. This interruptible service will be consistent with PJM's Limited Demand Response, Emergency – Capacity Only Program, subject to any limitations on the availability of that Program by PJM. If insufficient MWs are available for PJM enrollment by Kentucky Power, the Company shall offer to substitute one of the other PJM Emergency Demand Response Programs that is available. To be eligible for the credit, customers must have load over one MW at a single site and commit to a minimum 5-year contract term. Any such credits will be collected through the newly-established Purchased Power Clause to be implemented pursuant to Paragraph 15 of this Memorandum of Understanding.

10. The Company agrees to provide economic development support for Lawrence County, Kentucky and the Kentucky counties contiguous thereto in the total amount of \$100,000 per year for five years. Of this annual amount, \$33,000 will be set aside for job training, with a

preference for training for weatherization and energy efficiency-related jobs. The \$100,000 annual contribution shall not be recoverable from Kentucky Power customers.

11. The Company agrees to increase its contribution to the Home Energy Assistance Program to 15 cents per residential meter per month. Such amounts shall not be recoverable from customers.

12. The Company agrees to institute a new two-year Demand-Side Management (“DSM”) program to help fund energy management programs for schools affected by KRS 160.325. The annual funding level will be \$75,000 in 2014 and \$50,000 in 2015. Further, Kentucky Power agrees to increase its aggregate annual spending on cost-effective DSM and energy efficiency measures through Commission-approved DSM programs to \$4 million in 2014; \$5 million in 2015; and \$6 million in 2016, 2017, and 2018. The Company also will seek to maintain a minimum spending level of \$6 million for Commission-approved cost-effective DSM and energy efficiency measures in years after 2018. The Sierra Club may participate in the Company’s DSM collaborative and receive the Company’s periodic reports and evaluations of its DSM programs.

13. The Company shall file with the Commission an application for Certificate of Public Convenience of Necessity to convert the 268 mw Big Sandy Unit 1 to natural gas, and will exercise its option to terminate its March 28, 2013 Request for Proposals. All parties to this Memorandum of Understanding agree they will not oppose the grant by the Commission of the required Certificate of Public Convenience and Necessity to convert Big Sandy Unit 1 to natural gas, provided the cost to convert is approximately \$60 million.

14. The Company shall be authorized to recover the coal-related retirement costs of Big Sandy Unit 1, the retirement costs of Big Sandy Unit 2, and any site-related retirement costs. The costs shall be recovered on a levelized basis, including a weighted average cost of capital (WACC) carrying cost, over a 25 year period beginning when base rates are set in the Base Rate Case. Retirement costs shall include the net book value, materials and supplies, removal costs and salvage credits. The Company will use best efforts to minimize the cost of dismantling. The Company will use best efforts to maximize salvage credits. Kentucky Power and the Settling Intervenor further will work to incorporate in the Stipulation and Settlement Agreement described in Paragraph 21 of the Memorandum of Understanding the specifics of the mechanism by which the tax benefits associated with the retirement of Big Sandy Unit 2 will be passed through to the Company's customers.

15. Beginning January 1, 2014, no outage associated with Big Sandy Unit 2, including that due to its retirement, shall be treated as a forced outage for purposes of the Fuel Adjustment Clause. After Big Sandy Unit 2 is retired or can no longer be economically operated, the Company shall be authorized to recover any incremental purchased power costs associated with forced outages of other Kentucky Power plants, not otherwise recoverable through the Fuel Adjustment Clause, in a newly-established Purchased Power Clause. Customers shall at all times be entitled to the least cost energy produced by generation owned, leased or purchased by the Company consistent with economic dispatch principles. The Purchase Power Clause will appropriately allocate to rate schedules energy related costs on a kWh basis and demand related costs on peak demand basis. It is recognized that some incremental purchased power costs associated with the forced outages of other Kentucky Power plants may include demand-related costs even if such costs are not specifically identified.

16. The retirement of Big Sandy Unit 2 prior to May 31, 2015, shall be considered a Force Majeure Event and the Company shall have the right to seek emergency rate relief from the Commission to prevent its credit or operations from being materially impaired or damaged under KRS 278.190 (2) consistent with the Commission's orders and precedent governing such relief. Such emergency rate relief shall be limited to \$24 million annually (\$2 million per month for each remaining month through May 2015). For purposes of this provision, the unit shall be deemed retired upon review of the retirement as required under the PJM tariff.

17. The Company agrees to continue to procure coal for the Mitchell units with no bias against coal produced in Kentucky.

18. The Company agrees to continue to work during the conversion of Big Sandy Unit 1 to use local labor sources, in connection with the conversion, when technically practical.

19. The Company agrees to issue a non-binding Request For Proposals for 100 MW of wind power for the purpose of incorporating the results of the RFP in its Integrated Resource Plan that will be filed in December 2013.

20. The Company's application in Case No. 2013-00144 (*In The Matter Of: The Application Of Kentucky Power Company For: (1) The Approval Of The Terms And Conditions Of The Renewable Energy Purchase Agreement For Biomass Energy Resources Between The Company And ecoPower Generation-Hazard LLC; (2) Authorization To Enter Into The Agreement; (3) The Grant Of Certain Declaratory Relief; And (4) The Grant Of All Other Required Approvals and Relief*) is to be decided separately by the Commission.

21. Following the execution of this Memorandum of Understanding and final client approval, Kentucky Power and the Settling Intervenors will cooperate and act promptly to

prepare and execute a Stipulation and Settlement Agreement incorporating all of the terms of this Memorandum of Understanding.

22. Following the execution of the Stipulation and Settlement Agreement, Kentucky Power and the Intervenors shall file the Stipulation and Settlement Agreement with the Commission along with a joint request to the Commission for consideration and approval of the Stipulation and Settlement Agreement.

23. Kentucky Power and the Settling Intervenors acknowledge that the Stipulation and Settlement Agreement to be prepared and executed in accordance with Paragraph 21 of this Memorandum of Understanding is subject to approval by the Commission. Accordingly,

(a) Kentucky Power and the Settling Intervenors shall act in good faith and use their best efforts to recommend to the Commission that the Stipulation and Settlement Agreement be approved in its entirety and without modification, and that its provisions be implemented.

(b) Kentucky Power shall promptly prepare and file with the Commission testimony supporting the Stipulation and Settlement Agreement.

(c) Kentucky Power and the Settling Intervenors filed testimony in Case No. 2012-00578; Kentucky Power also filed rebuttal testimony. In addition, Kentucky Power will file testimony in support of the Stipulation and Settlement Agreement. For purposes of any hearing on the Transfer Application or the Stipulation and Settlement Agreement, including any continuation thereof, the Settling Intervenors and Kentucky Power waive all cross-examination of the other parties' witnesses except for supporting this Memorandum of Understanding and the Stipulation and Settlement Agreement.

(d) Kentucky Power and the Settling Intervenors further agree to support the reasonableness of the Stipulation and Settlement Agreement, including in connection with any appeal from the Commission's adoption or enforcement of the Stipulation and Settlement Agreement.

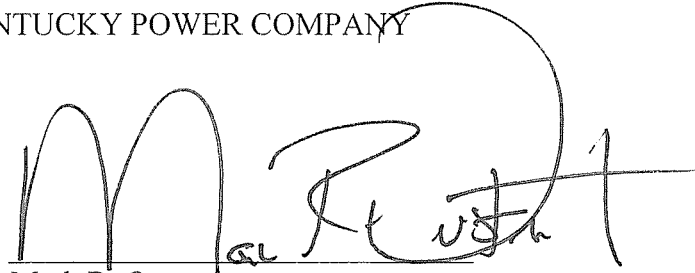
(e) No party to the Stipulation and Settlement Agreement shall challenge any Order of the Commission approving the Stipulation and Settlement Agreement in its entirety and without modification.

24. This Memorandum of Understanding may be executed in multiple counterparts.

IN WITNESS WHEREOF, this Memorandum of Understanding has been agreed to as of this \_\_\_ day of May 2013.

KENTUCKY POWER COMPANY

By:

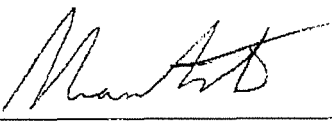
A handwritten signature in black ink, appearing to read "Mark R. Overstreet", written over a horizontal line. The signature is stylized with large, rounded letters and a long horizontal stroke at the end.

Mark R. Overstreet

Its: Attorney



SIERRA CLUB, ALEXANDER DESHA,  
TOM VIERHELLER, AND BEVERLY  
MAY

By:   
Shannon W. Fisk

Their: Attorney

KENTUCKY INDUSTRIAL UTILITY  
CUSTOMERS, INC.

By: Michael L. Kurtz  
Michael L. Kurtz

Its: Attorney