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PUBLIC SERVICE COMMISSION

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

IN THE MATTER OF:

APPLICATION OF KENTUCKY POWER	)	
COMPANY FOR APPROVAL OF A	)	**P.S.C. Case No. 2004-00420**
STIPULATION AND SETTLEMENT AGREEMENT	)	
RESOLVING STATE REGULATORY MATTERS	)	

Kentucky Power Company ("Kentucky Power") respectfully applies to the Public Service Commission of Kentucky ("Commission") for an Order: (1) approving the terms of the Stipulation and Settlement Agreement between Kentucky Power, the Office of Attorney General, Office Rate Intervention ("AG") and Kentucky Utility Customers, Inc. ("KIUC"); (2) approving changes to its System Sales Clause Tariff; (3) permitting the recovery of additional revenues; and (4) establishment of the schedule for Kentucky Power to file its Integrated Resources Plan ("IRP"). In support thereof, Kentucky Power states:

APPLICANT

1. Kentucky Power is an electric utility organized as a corporation under the laws of the Commonwealth of Kentucky in 1919 and is a first-tier, direct subsidiary of American Electric Power Company, Inc ("AEP"). A certified copy of Kentucky Power's Articles of Incorporation and all amendments thereto was filed as Exhibit 1 to the Joint Application in Public Service Commission Case No. 99-149. The post office address of Kentucky Power is 101A Enterprise Drive, P.O. Box 5190, Frankfort, Kentucky 40602-5190. Kentucky Power is engaged in the generation, purchase, transmission, distribution and sale of electric power. Kentucky Power serves approximately 175,000 customers in the following 20 counties of eastern Kentucky:

Boyd, Breathitt, Carter, Clay, Elliott, Floyd, Greenup, Johnson, Knott, Lawrence, Leslie, Letcher, Lewis, Magoffin, Martin, Morgan, Owsley, Perry, Pike and Rowan. Kentucky Power also supplies electric power at wholesale to other utilities and municipalities in Kentucky for resale. Kentucky Power is a utility within the meaning of KRS 278.010(3).

BACKGROUND

The System Sales Clause.

2. As part of the settlement agreement of P.S.C. Case No. 9061, the Commission approved Kentucky Power's use of a System Sales Clause. Under the System Sales Clause, Kentucky Power's ratepayers receive a credit (or a debit) of 50% of the amount by which Kentucky Power's Total System Sales Net Revenues for sales to non-associated utilities vary from the base amount for that same month used in the test year in setting Kentucky Power's base rates.

3. Although revenues associated with sales to non-associated utilities are included in the calculation of Kentucky Power's Total System Sales Net Revenues for purposes of the System Sales Clause, the environmental costs allocated those sales are not. Nor are such costs recovered through the environmental surcharge levied pursuant to KRS 278.183.[1]

4. The effect of failing to include the environmental costs allocated with sales to non-associated utilities in the calculation of the Total System Sales Net Revenues is to increase the System Sales credit to ratepayers in those months in which a credit is due, and to decrease the charge to ratepayers in those months in which a charge is payable.

[1] *See*, Order, *In the Matter of: An Examination By The Public Service Commission Of The Environmental Surcharge Mechanism Of Kentucky Power Company D/B/A American Electric Power For the Six-Months Billing Periods Ending December 31, 1998 And December 31, 1999, And For The Two-Year Billing Period Ending June 30, 1999*, P.S.C. Case No. 2000-107 at 12-14 (February 8, 2001).

The 2002 Kentucky PSC Proceeding.

5. On December 20, 2001 Kentucky Power's parent, AEP, its corporate affiliate, American Electric Power Service Corporation, KIUC and the Commission entered into a settlement agreement with respect to two cases pending before the Federal Energy Regulatory Commission (Case Nos. ER01-2668 and EC01-130) as part of a Combined Offer of Settlement. The FERC proceedings and the December 20, 2001 Settlement Agreement arose in connection with a planned corporate restructuring by AEP.

6. Under the terms of the Settlement Agreement with KIUC and the Kentucky Commission:

(a) The Unit Power Supply Agreement ("UPSA") between AEP Generating Company and Kentucky Power for 195 MW of Rockport Unit No. 1 was to be extended for five years until December 31, 2009;

(b) The UPSA between AEGCO and Kentucky Power for 195 MW of Rockport Unit No. 2 was to be extended approximately 18 years until December 7, 2022;

(c) Kentucky Power agreed to submit an Integrated Resource Plan to the Commission no later than June 30, 2006. The 2006 date was agreed upon because of the December 31, 2009 expiration (under the terms of the 2001 Settlement Agreement) of the extension of the UPSA for Rockport Unit No. 1. The plan would have reflected the resources available to Kentucky Power, as well as the resources available to Kentucky Power as a member of any pool arrangement Kentucky Power expected to exist during the period reflected in the Integrated Resource Plan;

(d) Kentucky Power indicated it would apply to the Kentucky PSC to amend the System Sales Clause Tariff: (i) to recover the additional revenues called for under the Settlement Agreement; and (ii) to recover the environmental costs associated with sales to non-associated utilities. KIUC agreed in the Settlement Agreement not to oppose the application to amend the System Sales Clause Tariff.

7. On December 17, 2002 the Kentucky PSC entered an Order in P.S.C. Case 2002-00039 approving the December 20, 2001 Settlement Agreement. In its December 17, 2002 Order the Kentucky PSC:

(a) found that:

> the proposed terms, including the pricing, for extending the Rockport ... [UPSA] are quite reasonable. The contract extensions will provide Kentucky Power sufficient capacity, at reasonable and fixed prices, to meet its customers needs for most of the time during the next few years, with any shortfall being available from its affiliates under the terms of the AEP Interconnection Agreement;[2] and

(b) approved the proposed modifications of the System Sales Clause Tariff.[3]

<u>THE STIPULATION AND SETTLEMENT AGREEMENT</u>

8. Kentucky Power subsequently advised the Commission staff and parties to Case No. 2002-00039 that the planned restructuring of AEP as contemplated in the December 20, 2001 Settlement Agreement was no longer contemplated. Thereafter, Kentucky Power, KIUC and the AG entered into negotiations to address a number of state regulatory issues, including amending the System Sales Clause Tariff to permit Kentucky Power to recover non-associated

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[2] Order, *The Matter of: Joint Application of Kentucky Power Company, ...* [*et al.*] *for (1) Approval of the Changes to the System Sales Clause Tariff; ...* [etc.], P.S.C. Case No. 2002-00039 at 6 (December 17, 2002).
[3] *Id.* at 6-7.

utilities' monthly environmental costs, the filing of Kentucky Power's next IRP and the extension of the UPSA for Rockport Unit Nos. 1 and 2.

9. In its March 29, 2004 and May 29, 2004 Orders in Administrative Case No. 387, *In the Matter of: A Review of the Capacity of Kentucky's Generation and Transmission System*, the Commission directed Kentucky Power to continue to seek extensions of the UPSA for Rockport Unit No. 1 and Rockport Unit No. 2.

10. On October 20, 2004 Kentucky Power, KIUC and the AG entered into a Stipulation and Settlement Agreement resolving the state regulatory issues that were the subject of their negotiations. A copy of the October 20, 2004 Stipulation and Settlement Agreement is attached to the testimony of Errol K. Wagner, which is **EXHIBIT 1** to this Application, as **EXHIBIT EKW-1**.

11. The Stipulation and Settlement Agreement provides that, subject to the receipt of all necessary regulatory approvals,

(a) the term of the UPSA for 195 MW of Rockport Unit No. 1 and 195 MW of Rockport Unit No. 2 will be extended until December 7, 2022. If not extended, the UPSA for Rockport Unit No. 1 and Rockport Unit No. 2 will expire December 31, 2004;

(b) Kentucky Power's System Sales Clause Tariff will be amended to permit Kentucky Power to recover the environmental costs allocated to sales to non-associated utilities;

(c) Kentucky Power will file an IRP no later than June 30, 2009. In addition, if in the interim the AEP Interconnection Agreement is amended to change the resources available to Kentucky Power under the agreement, Kentucky Power will file an IRP at the request, following a meeting with Kentucky Power, of any other party to the Stipulation and Settlement Agreement or the Commission Staff;

(d) In consideration of the resolution of these state regulatory matters, KIUC and the AG agreed that Kentucky Power should receive an additional $5.1 million a year in 2005 through 2009, an additional $1.1 million a year (for a total of $6.2 million a year) in 2010 through 2021 and an additional $5,792,329 in 2022 (through December 7, 2022.) The Stipulation and Settlement Agreement further provides that the additional revenue should not to be considered by the Commission in establishing Kentucky Power's base retail rates and that Kentucky Power should receive the revenues called for in the Stipulation and Settlement Agreement in addition to base retail rates established by the Commission. Until Kentucky Power's first retail base rate case, the additional revenues will be collected by means of a per kWh charge collected through the System Sales Clause Tariff. The Stipulation and Settlement Agreement also provides for the allocation of the additional revenues among customer classes. Coincident with the Order establishing Kentucky Power's rates in its next retail base rate case, the additional revenues will be collected by means of a separate tariff to be approved by the Commission.

12. The Stipulation and Settlement Agreement is contingent upon Kentucky Power receiving all necessary approvals for the Stipulation and Settlement, as well as the rates and actions contemplated therein, without modification unacceptable to any party to the Stipulation and Settlement Agreement. The Stipulation and Settlement Agreement further provides that in the event the Commission enters an Order during the period that is the subject of the Stipulation and Settlement Agreement that is inconsistent with the rate treatment specified in the Stipulation and Settlement, Kentucky Power may seek, after meeting with the other Parties and the Staff of the Commission, any approvals necessary to terminate the extensions of the UPSA for Rockport Unit No. 1 and Rockport Unit No. 2.

<u>Request for Adjustment Of The System Sales Clause Tariff</u>

13. By this Application, Kentucky Power requests two amendments to the System Sales Clause Tariff. First, Kentucky Power requests that the System Sales Clause Tariff be amended to permit the recovery in conformity with Exhibit 2 to the Stipulation and Settlement Agreement of environmental costs allocated to sales to non-associated utilities in the calculation of Net System Sales Revenues until its next rate case. Second, Kentucky Power requests that the System Sales Clause be amended as set out in Exhibit 1 to the Stipulation and Settlement Agreement to permit Kentucky Power to collect the revenues called for in the Stipulation and Settlement Agreement.

<u>Recognition of Environmental Expenses Allocated To Sales to Non-Associated Utilities</u>.

14. For the twelve months ended June 30, 2004, Kentucky Power received, exclusive of environmental costs associated with sales to non-associated utilities, Total System Sales Net Revenue of $33.4 million. During the same period, Kentucky Power incurred environmental costs allocated to sales to non-associated utilities (the revenues which comprise the Total System Sales Revenue) of $6.9 million that are not reflected in the Total System Sales Net Revenue of $ 33.4 million. The $6.9 million in environmental costs are not recovered through Kentucky Power's environmental surcharge or otherwise. As a result, Kentucky Power System Sales profits, 50% of which above the base amount are paid to ratepayers in the form of a credit, have been overstated during the twelve months ended June 30, 2004 by $3.45 million.

15. In Case No. 2000-107, the Commission rejected Kentucky Power's application to amend the manner in which its environmental surcharge is calculated to permit recovery through

the environmental surcharge of environmental costs allocated to sales to non-associated utilities, explaining:

> If the off-system sales profits are misstated because the current Sales Clause does not provide for the recognition of fixed environmental costs, then it is the Sales Clause which needs modification, and not the jurisdictional allocation approach used to assign environmental costs.... Kentucky Power's concerns over the interaction of the environmental surcharge mechanism with its Sales Clause indicate that if there is a problem, it lies with the Sales Clause and does not constitute justification for a change in the allocation approach.

Order, P.S.C. Case No. 2000-107 at 12, 14.

16. In conformity with the Commission's February 8, 2001 Order in Case No. 2000-107, Kentucky Power proposes to adjust the manner in which Net System Sales Revenue is calculated by including environmental costs allocated to sales to non-associated utilities as part of Net System Sales Expenses. The adjustment will be made by adding a new line item to the monthly System Sales Clause Schedule filed by Kentucky Power with the Commission. The new line item, labeled "Non-Associated Utilities Monthly Environmental Costs," will be added to other System Sales Expenses currently reported ("Sales for Resale Expenses and "Interchange-Delivered Expenses") to calculate "Total System Sales Expenses." As is done in connection with the existing calculation, "Total System Sales Expenses" will be subtracted from "Total System Sales Revenues" to compute "Total System Sales Net Revenue." The revised monthly System Sales Clause Schedule is Exhibit 2 to the Stipulation and Settlement Agreement. The conforming amended tariff reflecting the changes to the System Sales Clause is filed as **EXHIBIT EKW-2** to the testimony of Errol K. Wagner, which is appended as **EXHIBIT 1** to this Application.

17. Adjustment of the System Sales Clause to include environmental costs allocated to System Sales as part of Net System Sales Expenses assigns the costs of such sales to the revenues produced by the sales, thereby furthering the principle that costs be allocated to the cost-causer.[4]

Adjustment of the System Sales Clause To Permit Collection of Additional Revenues.

18. In consideration of the resolution of the state regulatory issues resolved by the Stipulation and Settlement Agreement, KIUC and the AG agreed that Kentucky Power should collect a fixed amount of additional revenue each year between January 1, 2005 and December 7, 2022:

(a) $5.1 million a year in Years 2005-2009;

(b) an additional $1.1 million a year (for a total of $6.2 million a year) in Years 2010-2021; and

(c) $5,792,329 from January 1, 2022 through December 7, 2022.

19. Kentucky Power proposes to amend the System Sales Clause Tariff to provide for "netting," on a monthly kWh basis as allocated by the Stipulation and Settlement Agreement among customer classes, of the amount of the annual additional revenues[5] against the customer share of the increase or decrease in System Sales Net Revenue. The worksheet for netting the additional revenues against the customer share of the increase or decrease in System Sales Net Revenues is Exhibit 1 to the Stipulation and Settlement Agreement. Because Kentucky Power's kWh sales vary from year to year, the System Sales Clause Tariff also will be amended to include a balancing factor, to be instituted after the first year, and modified annually thereafter,

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[4] *See*, Order, P.S.C. Case No. 2000-107 at 11.

[5] The Stipulation and Settlement Agreement further provides that the same allocation methodology should be used in allocating the collection of the additional revenues in the new tariff to be adopted in Kentucky Power's next retail base rate case.

to prevent the over-collection or under-collection by Kentucky Power of the additional annual revenues called for in the Stipulation and Settlement Agreement. The conforming amended tariff reflecting the changes to the System Sales Clause is filed as **EXHIBIT EKW-2** to the Testimony of Errol K. Wagner, which is appended as **Exhibit 1** to this Application.

20. Under the Stipulation and Settlement Agreement, the additional revenues will be collected by means of a new tariff to be developed by Kentucky Power and approved by the Commission in the next rate case. KIUC and the AG have agreed not to oppose the new tariff. Upon the effective date of the Commission's approval of the new tariff, the amendments to the System Sales Tracker will be deleted, although the balancing factor will remain in effect for a period sufficient to permit the collection or refund of any discrepancy between the amount called for in the Stipulation and Settlement Agreement and the amount actually collected by Kentucky Power.

Integrated Resource Plan

21. Kentucky Power agrees in the Stipulation and Settlement Agreement to file an IRP no later than June 30, 2009. The IRP will reflect the resources available to Kentucky Power as a "stand-alone" utility and the resources available to Kentucky Power as a member of any pool arrangement that Kentucky Power expects to exist during the period reflected in the IRP. The Stipulation and Settlement Agreement further provides that the IRP shall be subject to formal review by the Commission.

22. In the event Kentucky Power seeks authority to change the resources available to Kentucky Power under the AEP Interconnection Agreement, Kentucky Power will file an IRP earlier than June 30, 2009 if requested to do so by the Commission Staff, KIUC or the AG following consultation with Kentucky Power.

Communications

23. The Joint Applicants respectfully request that all communications involving the Joint Application and this proceeding be directed to:

J. Craig Baker
American Electric Power Service Corporation
1 Riverside Plaza
Columbus, Ohio 43215-2373

Errol K. Wagner
Kentucky Power Company
101A Enterprise Drive
P.O. Box 5190
Frankfort, Kentucky 40602-5190

Kevin F. Duffy
American Electric Power Service Corporation
1 Riverside Plaza
Columbus, Ohio 43215-2373

Mark R. Overstreet
STITES & HARBISON, PLLC
421 West Main Street
P.O. Box 634
Frankfort, Kentucky 40602-0634

Testimony

24. Kentucky Power files the following testimony in support of this application: Errol K. Wagner.

Expedited Treatment

25. Kentucky Power respectfully requests expedited treatment of this Application and deviation from the Commission regulations concerning notice.

WHEREFORE, Kentucky Power Company respectfully requests:

1. Entry of an Order approving the Stipulation and Settlement Agreement between Kentucky Power, Kentucky Industrial Utility Customers, Inc. and the Office of Attorney General, Office of Rate Intervention, including the grant of all authority and approvals necessary to effectuate the Stipulation and Settlement Agreement;

2. Entry of an Order approving the revision of the System Sales Clause Tariff to include environmental costs allocated to sales to non-associated utilities as part of Net System Sales Expenses as set out in Exhibit 2 to the Stipulation and Settlement Agreement and approving the tariff filed as **EXHIBIT EKW-2** to the testimony of Errol K. Wagner;

3. Entry of an Order approving the amendment of the System Sales Clause Tariff to permit the collection by Kentucky Power of the additional revenues specified in the Stipulation and Settlement Agreement and approving the tariff filed as **EXHIBIT EKW-2** to the testimony of Errol K. Wagner;

4. Expedited approval of this Application; and

5. Such further relief as the Commission may deem appropriate.

Respectfully Submitted,

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American Electric Power Service Corporation
1 Riverside Plaza
Columbus, Ohio 43215-2373

COUNSEL FOR KENTUCKY POWER COMPANY

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing was served in the manner indicated on this 25th day of October 2004 upon:

Elizabeth E. Blackford
Assistant Attorney General
Office of Rate Intervention
1024 Capital Center Drive
Frankfort, Kentucky 40601

(By Hand Delivery)

David F. Boehm
Michael L. Kurtz
Boehm, Kurtz & Lowry
2110 CBLD Center
36 East Seventh Street
Cincinnati, Ohio 45202

(By Overnight Delivery)

Richard G. Raff
Public Service Commission of Kentucky
211 Sower Boulevard
Frankfort, Kentucky 40601

(By Hand Delivery)

Mark R. Overstreet

KE057:KE142:6631:FRANKFORT

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

IN THE MATTER OF:

APPLICATION OF KENTUCKY POWER COMPANY FOR APPROVAL OF A STIPULATION AND SETTLEMENT AGREEMENT RESOLVING STATE REGULATORY MATTERS	))))	**P.S.C. Case No. 2004-___**

DIRECT TESTIMONY OF
ERROL K. WAGNER, ON BEHALF OF
KENTUCKY POWER COMPANY

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 (KPCo or Company). My business address is 101 A Enterprise Drive, Frankfort, Kentucky 40602.

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 KPCo. This would include the preparation 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 of Regulatory Services is the proper application of the Company's rates to all classifications of customers.

Q. To whom do you report?

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

Q. Have you previously testified before this Commission?

A. Yes. I have testified before this Commission in numerous regulatory proceedings involving the application of the general adjustment in electric base rates, the fuel adjustment clause, the operation of the environmental cost recovery mechanism, approval of certificates of public convenience and necessity and other regulatory matters.

Q. What is the purpose of your testimony in this proceeding?

A. The purpose of my testimony is to describe and support the Stipulation and Settlement Agreement ("Settlement Agreement"), dated October 20, 2004 and entered into by the duly authorized representatives of KPCo, Kentucky Industrial Utility Customers ("KIUC") and the Office of the Attorney General, Office of Rate Intervention ("AG"). In addition my testimony supports the changes to the Company's System Sales Clause tariff and explains the changes to the Company's schedules used in the monthly calculations of the System Sales Clause factor.

These changes are consistent with Exhibits 1 and 2 of the Settlement Agreement. (See Exhibit EKW-1).

Q. Are you sponsoring any exhibits in connection with your testimony?

A. Yes. I am sponsoring Exhibits EKW-1 and EKW- 2.

Description of AEP

Q. Please describe American Electric Power Company, Inc. (AEP) and its subsidiaries.

A. AEP is an investor owned electric public utility holding company with subsidiaries serving approximately 5 million retail customers in eleven states (Indiana, Arkansas, Kentucky, Louisiana, Michigan, Ohio, Oklahoma, Tennessee, Texas, Virginia, and West Virginia) and selling bulk power at wholesale both within and beyond its domestic retail service area. AEP has approximately 34,000 megawatts of generation, over 38,000 miles of transmission lines, and 186,000 miles of distribution lines in the United States.

AEP was incorporated under the laws of the State of New York in 1906 and reorganized in 1925. It is a public utility holding company that owns, directly or indirectly, all of the outstanding common stock of its domestic electric utility subsidiaries and varying percentages of other subsidiaries. The provisions of the Public Utility Holding Company Act, administered by the Securities and Exchange Commission (SEC), regulate all aspects of a registered holding company system, such as the AEP System.

Q. How are AEP's generating and transmission facilities operated?

A. The generating and transmission facilities of AEP's subsidiaries are coordinated and operated as a single integrated electric utility system. Transmission networks are interconnected with extensive distribution facilities in the territories served. The electric utility subsidiaries of AEP have traditionally provided electric service, consisting of generation, transmission and distribution, on an integrated basis to their retail customers.

Q. Please identify some of AEP's wholly-owned subsidiaries.

A. AEP owns all of the common stock of KPCo, Appalachian Power Company, AEP Texas Central Company, Columbus Southern Power Company, Indiana Michigan Power Company, Kingsport Power, Ohio Power Company, Public Service Company of Oklahoma, Southwestern Electric Power Company, AEP Texas North Company, and Wheeling Power Company (the AEP Operating Companies). All of the common stock of AEP Generating Company (AEGCo) is also owned by AEP.

Q. What activities of the AEP Operating Companies are regulated by Federal Energy Regulatory Commission (FERC)?

A. The AEP Operating Companies are subject to regulation by FERC under the Federal Power Act with respect to rates for interstate sales at wholesale and transmission of electric power, accounting and construction and operation of hydroelectric projects.

Q. What activities of the AEP Operating Companies are regulated by state regulatory commissions?

A. The AEP Operating Companies' retail rates and services are subject to regulation by the utility commissions of the states in which they operate.

Description of Kentucky Power

Q. Please describe the business of Kentucky Power Company.

A. KPCo (organized and incorporated in Kentucky in 1919) is engaged in the generation, sale, purchase, transmission and distribution, of electric power to approximately 175,000 customers in eastern Kentucky, and in supplying electric power at wholesale to other electric utility companies and municipalities. KPCo is subject to the regulatory jurisdiction of the Kentucky Public Service Commission (KPSC).

The Stipulation and Settlement Agreement

Q. What is contained in Exhibit EKW-1?

A. Exhibit EKW-1 contains the Kentucky Stipulation and Settlement Agreement ("Settlement Agreement"), dated as of the 20th day of October 2004, and entered into by the duly authorized representatives of KPCo, the AG and KIUC, altogether referred to as "the Settling Parties." This Settlement Agreement specifies, among other things, that the Settling Parties agree not to oppose filings at the KPSC to place into effect the elements of the October 2004 Settlement Agreement.

Q. Please describe the process that led to the execution of the Settlement Agreement.

A. The Settling Parties to the Settlement Agreement met face to face on at least five occasions in good faith negotiations to address Kentucky Power's need for additional capacity beyond the December 31, 2004 expiration of the Unit Power

Supply Agreement ("UPSA") between American Electric Generating Company ("AEGCo") and Kentucky Power for 195 MW of Rockport Unit No. 1 and 195 MW of Rockport Unit No. 2. As part of the negotiations the parties also addressed other state regulatory issues. The executed Stipulation and Settlement Agreement confirms that Kentucky Power and the other parties are satisfied that the terms of the Settlement Agreement are fair, just and reasonable and will promote the public interest. The Commission Staff was in attendance during the negotiations; however, it is not a party to the Settlement Agreement. After extensive good faith negotiations, the Settling Parties were able to resolve their differences by compromise, and these compromises are incorporated in the Settlement Agreement provided as Exhibit EKW-1.

Q. Please summarize the provisions of the Stipulation and Settlement Agreement.

A. The Stipulation and Settlement Agreement resolves several outstanding state regulatory matters. In particular,

(a) it provides for the extension of the existing UPSA for Rockport Units No. 1 and 2 in response to the Commission's direction that KPCo should seek to replace the expiring contractual right to Rockport generation with a long-term entitlement to base-load economical capacity;

(b) it resolves the issue concerning KPCo's current inability to recover that portion of its environmental costs allocated to non-associated utilities in the monthly environmental surcharge calculation;

(c) it establishes a schedule for the filing of KPCo's next Integrated Resource Plan and also requires KPCo to provide additional information concerning the AEP System's load and resources; and

(d) it authorizes KPCo to collect additional retail rates in consideration of the resolution of these state regulatory matters.

Q. Is the Stipulation and Settlement Agreement subject to any contingencies?

A. Yes. Sections VI(2) and VI(5) provide that Stipulation and Settlement Agreement are subject to the acceptance and non-objection of state and federal regulators and that if the necessary regulatory approvals are not received, or that any approvals are conditioned upon modifications to the Stipulation and Settlement Agreement that are unacceptable to any Party, the agreement is void. In such an event, however, the Parties agree to meet and confer, along with the appropriate members of the Staff of the KPSC, to engage in good faith discussions concerning any amendments to the Stipulation and Settlement Agreement that might be acceptable to all parties.

The Extension of the Rockport UPSA.

Q. Why do the Parties contend that the extension of the UPSA is in the public interest?

A. Currently both Rockport Unit No. 1 and Unit No. 2 agreements expire December 31, 2004. This will result in a reduction to the Company's installed capacity of 390 MWs. However, the Commission, in Administrative Case No. 387, expressed concern about Kentucky Power's plans to meet its customer's needs through wholesale power purchases that, to a greater or lesser extent, would reflect market prices:

> The Commission believes that reliance on power purchases that reflect market price volatility is not in the best interests of Kentucky consumers. AEP-KY must plan to meet its load by securing sufficient capacity that is not subject to market price volatility. Only by doing so will AEP-KY be able to maintain reasonable electric rates while mitigating to the extent possible market price and fuel price fluctuations. The Commission has intervened at the FERC in AEP's pending restructuring case. We have asserted that the Rockport Unit power purchases should be extended beyond their 2004 expiration and negotiations on that issue are ongoing. We look forward to continuing to address this matter in the future in a constructive manner that will result in a positive outcome for AEP-KY and its customers.[1]

The Commission reiterated these concerns earlier this year when it directed KPCo in its Orders in Administrative Case No. 387 to continue to seek extensions of the UPSA for Rockport Unit No. 1 and Rockport Unit No. 2.

Acting on the Commission's concerns, KPCo, the AG and KIUC discussed the extension of the UPSA for Rockport Unit No 1 and Rockport Unit No. 2. In the settlement ultimately produced by those negotiations the parties agreed that extension of the Rockport Unit No. 1 and the Rockport Unit No. 2 agreement until December 7, 2022 was in the public interest.

Q. What commitments are made by KPCo in Section I of the Stipulation and Settlement Agreement?

A. Section I provides that the UPSA between AEGCo and KPCo for KPCo's purchase of 195 MW of power and energy from Rockport Unit No. 1 will be extended for approximately 18 years beyond the current expiration date of

[1] Order, *In the Matter of: A Review of the Adequacy of Kentucky's Generation Capacity and Transmission System*, P.S.C. Administrative Case 387 (December 20, 2001).

December 31, 2004 to December 7, 2022. All other terms of the existing UPSA will remain the same.

Q. Please summarize the commitment made by KPCo in Section II of the Settlement Agreement.

A. Section II provides that the UPSA between AEGCo and KPCo for KPCo's purchase of 195 MW of power and energy from Rockport Unit No. 2 will be extended until the expiration of the current lease agreement between Wilmington Trust and AEGCo, which is December 7, 2022. All other terms of the exiting UPSA will remain the same.

Q. Under the terms of the Stipulation and Settlement Agreement can the UPSA be terminated prior to the expiration of its extended term?

A. The Stipulation and Settlement Agreement provides that, except upon termination of the Stipulation and Settlement Agreement pursuant to Section VI(3), neither the Parties to the Stipulation and Settlement Agreement nor any affiliate of Kentucky Power will seek to have the UPSA terminated before its new expiration date of December 7, 2022. However, Section VI(3) provides that in the event the KPSC enters an Order preventing KPCo from charging rates consistent with the terms of the Stipulation and Settlement Agreement, Kentucky Power on 120 days notice may begin proceedings to terminate the extension. In addition, the Stipulation and Settlement Agreement also provides that the KPSC may cure within the 120 days notice period any noncompliance with the Stipulation and Settlement Agreement resulting from its orders.

<u>The Additional Retail Revenues To Be Collected By KPCo</u>.

Q. Please summarize the provisions of Section III of the Settlement Agreement.

A. In consideration of the resolution of the various state regulatory matters addressed by the Stipulation and Settlement Agreement the Parties agreed that KPCo shall be entitled to collect: (i) an additional $5.1 million in annual revenues each year beginning January 1, 2005 through December 31, 2009; and (ii) a further increase in additional annual revenue of $1.1 million (yielding a combined total increase in additional revenue of $6.2 million) each year beginning January 1, 2010 through December 7, 2022. The actual additional revenues to be collected in 2022 will be $5,792,329 (341/365 of $6.2 million) because of the December 7, 2022 termination date of the UPSA extension.

Q. How will these additional annual revenues be collected by the Company until the effective date of the Company's next change resulting from a base rate case?

A. KPCo will revise its monthly System Sales Clause Schedule filed with the KPSC to collect the additional annual revenues (The System Sales Clause Tariff and the proposed modifications to it are described below in more detail at pages 13-18). The Settlement Agreement also contains a "true-up" mechanism, similar to that used in connection with KPCo's Net Merger Savings Credit. It is designed to protect against over-collection or under-collection by KPCo. The "true-up" mechanism is necessary because the additional annual revenues are collected through a kWh charge. Of course, the total kWh sold by KPCo varies each year and thus the charge will never precisely collect the exact amount of additional revenues. Under the "true-up" mechanism the amount of any over-collection or under-collection in a year is refunded or collected by a balancing adjustment to the following year's charge. The Balancing Adjustment Factor will remain in effect for a period of time sufficient to permit a true up, over a ten month period, of any over-or-under collection at the time rates are established in the next base rate case. The conforming amended tariff reflecting the changes to the System Sales Clause is filed as Exhibit EKW-2.

Q. How are the $5.1 million or $6.2 million annual payments to be allocated in future rate cases?

A. The parties have agreed that the methodology used to calculate the per kWh rates on Exhibit 1 of the Stipulation and Settlement Agreement that I just described should be employed in allocating the $5.1 million or $6.2 million payments (as applicable) among customer classes in future rate cases during the term of the extension.

Q. How will the additional annual revenues be collected by the Company after the effective date of the Company's next change in base rates?

A. First, the additional annual revenues to be collected by KPCo from the retail rate adjustments set forth in this Settlement Agreement will not be considered by the KPSC in establishing KPCo's retail base rates.

Second, KPCo is entitled to collect the additional annual revenues ($5.1 million and $6.2 million respectively) under the Settlement Agreement in addition to the base retail rates established by the KPSC. The Company will make a revenue adjustment eliminating the additional annual revenue from the Company's cost of service which is used in calculating the Company's base rates. The costs associated with underlying Rockport UPSA also will continue to be included in base rates.

Third, KPCo will develop a new tariff that will permit it to collect separately from its base rates and other charges the additional annual revenues under the Settlement Agreement.

Q. Will the modification of the System Sales Clause be eliminated upon the effective date of the Company's next change to base rates?

A. Yes. Line 8 in the System Sales Clause Monthly Schedule should be eliminated once a new separate tariff to collect the additional annual revenues is effective. Line 9 should be eliminated once any over-or-under amount is eliminated.

Q. Will there be any additional transmission costs associated with the extension of the Rockport UPSA?

A. No. Kentucky Power's purchase of power from Rockport will continue to be treated as a network resource available to the AEP system, as it is today.

Q. How will the $5.1 million or $6.2 million payments be treated in any Kentucky Power base retail rate case?

A. The Stipulation and Settlement Agreement provides that Kentucky Power may reduce test year revenues by the amount of the payments in any retail base rate case.

<u>KPCo's Integrated Resource Plan</u>.

Q. When will the Company submit its next Integrated Resource Plan to the KPSC?

A. The Stipulation and Settlement Agreement provides that the Company will submit its next Integrated Resource Plan (IRP) to the KPSC no later than June 30, 2009.

The filing will reflect the resources available to KPCo both as a stand-alone utility and as a member of any pool arrangement that KPCo expects to exist during the period reflected in the IRP. In addition, within 120 days of filing with FERC an application to amend the AEP-East Interconnection Agreement to change the generation resources available to KPCo under the AEP-East Interconnection Agreement, the Parties agree to meet with the appropriate members of the Staff of the Kentucky Public Service Commission to confer concerning the need for KPCo to file an IRP prior to June 30, 2009. If after such discussions one or more of the Parties or the Staff of the Kentucky Public Service Commission in good faith requests that KPCo makes an IRP filing, KPCo will do so in conformity with Section IV (2) of the Stipulation and Settlement Agreement within 90 days of receiving such request. Finally, KPCo agrees to provide information concerning KPCo and AEP resources and load in connection with its annual Administrative Case No. 387 filings.

<u>The System Sales Clause Tariff</u>.

Q. What are "system sales profits" and what is the System Sales Clause Tariff?

A. When KPCo's rates were last established in 1991 (in KPSC Case No. 91-066) 100% of the costs associated with the 1450 MWs of generating capacity (1060 MWs at Big Sandy Generating Plant and 390 MWs at Rockport Generating Plant) were included in the cost of service. When the generating capacity available to the AEP operating companies, including Kentucky Power, is greater than the capacity needed to meet the their customers' demand, the excess energy is sold "off-system" at a price greater than the variable costs. One-half of net revenue from these "off-system" sales (labeled Total System Sales Net Revenues in the System Sales Clause Tariff) above the level of system sale profits used in calculating base rates is used to reduce the Kentucky jurisdictional customer's cost of service. Pursuant to the KPSC's October 28, 1988 Order in Case No. 9061 the Company retains the other half of the net revenues from "off-system" sales that is above the base used in calculating base rates as an incentive to make "off-system" sales and thereby further reduce Kentucky jurisdictional customers' cost of service.

Q. What is the level of net revenues or system sales profit built into the Company's current base rates?

A. The Company's System Sales Clause Tariff Sheet No. 19-1 demonstrates that the current level of net revenues built into base rates is $11,315,336 (see Exhibit EKW-2).

Q. The System Sales Clause Tariff contains a different level of system sales profit for each calendar month, is that correct?

A. Yes. One reason for the different levels of system sales profit each calendar month is that the system's load (and consequently the amount of energy available to be sold) varies from month to month.

Q. If the current month's level of net revenue is greater than that month's level of net revenue built into base rates, how is the difference handled in the System Sales Clause calculations?

A. The difference between the current month net revenue level and the base month net revenue level is multiplied by .5 and that result is divided by the current month sales level of kWhs. The resulting factor is credited to the customer's current monthly bill on a per kilowatt-hour basis.

Q. If the current month's level of net revenue is smaller than that month's level of net revenue built into base rates, how is the difference handled in the System Sales Clause calculations?

A. The difference between the current month net revenue level and the base month net revenue level is multiplied by .5 and that result is divided by the current month sales level of kWhs. The resulting factor is debited to the customer's current monthly bill on a per kilowatt-hour basis. Because of the volatile nature of "off-system" sales, Kentucky Power and the ratepayers share in both the risk and reward of these transactions.

Q. Please explain the changes to the Company's System Sales Clause Tariff the Company is requesting in this proceeding?

A. The Company is requesting two changes to the current System Sales Clause Tariff. The first change is to reduce net revenues by the amount of environmental costs allocated to non-associated utilities in the monthly environmental surcharge calculation. The conforming amended tariff reflecting this change to the System Sales Clause is filed as Exhibit EKW-2.

Q. Why is it appropriate to deduct these environmental costs in calculating the net revenues available to be split between ratepayers and KPCo under the System Sales Clause Tariff?

A. These environmental costs are reasonable and prudently incurred costs. The Commission allocated a portion of these environmental costs to the non-associated utilities in connection with calculation of the Company's environmental surcharge. As a result, these costs are not recovered through the environmental surcharge. At the same time, these costs also are excluded from the calculation of Total System Net Sales Revenues. The effect of doing so is to increase the System Sales Net Revenue due customers in those months in which a credit is payable, and to decrease the charge in those months in which a charge is due.

Q. Is this approach consistent with previous Commission orders?

A. Yes, the Commission indicated that the proposed amendment of the System Sales Clause is the appropriate mechanism to recover these costs. Specifically, in Case No. 2000-107, the Commission rejected Kentucky Power's application to amend the manner in which its environmental surcharge is calculated to permit recovery through the environmental surcharge of environmental costs arising in connection with sales to non-associated utilities, explaining:

> If the "off-system" sales profits are misstated because the current Sales Clause does not provide for the recognition of fixed environmental costs, then it is the Sales Clause which needs modification, and not the jurisdictional allocation approach used to assign environmental cost. . . . Kentucky Power's concerns over the interaction of the environmental surcharge mechanism with its Sales Clause indicate that if there is a problem, it lies with the Sales Clause and does not constitute justification for a change in the allocation approach.

Order, P.S.C. Case No. 2000-107 at 12, 14.

Q. What is the second change to the System Sales Clause Tariff the Company is requesting in this proceeding?

A. The second change is to modify the System Sales Clause Tariff to permit the collection of the additional revenues as described in the Stipulation and

Settlement Agreement. The first five years the additional revenues are $5.1 million per year and $6.2 million each year thereafter until the end of the Rockport lease agreement or December 7, 2022. This increased additional annual revenue will remain in the System Sales Clause calculation until KPCo's base rates are next changed by order of the Kentucky Commission following a retail case under K.R.S. 278.190 or K.R.S. 278.260. At that time the $5.1 million or $6.2 million, whichever is in effect, will be removed from the System Sales Clause calculations and be included in a new tariff developed by the Company (See Exhibit EKW-1, paragraph III(1)(d)(iii)).

Q. Is the Company proposing any changes to the monthly System Sales Clause schedules that the Company files monthly with the Commission?

A. Yes, Exhibits 1 and 2 of the Stipulation and Settlement Agreement demonstrates how the Company proposes: (1) to change the monthly System Sales Clause schedule to incorporate the inclusion of the environmental costs assigned to non-associated utilities and (2) to change the monthly System Sales Clause schedule to incorporate the inclusion of the additional annual revenues associated with the Settlement Agreement.

Q. How were the per kWh rates calculated on Exhibit 1 of the Stipulation and Settlement Agreement?

A. The Company first determined both the revenues collected and the kWh sold for the twelve months ending June 30, 2004 for each class of retail customer. Then the Company took the total revenue from the CIP-TOD customer class and divided it by the total revenue for the twelve months ending June 30, 2004 to arrive at a percent of revenue from the CIP-TOD customer class. That percent was multiplied by the $5.1 million of additional revenue and that result was divided by the total kWh sold to the CIP-TOD customer class for the twelve months ending June 30, 2004. These calculations resulted in a $0.000500 kWh rate. The same calculations were made for the all other customer classes which resulted in a $0.000847 kWh rate.

Q. Would the per kWh rates shown on Exhibit 1 of the Stipulation and Settlement Agreement need to be changed when the additional revenue changes from the $5.1 million to the $6.2 million of additional revenue?

A. Yes. Sometime prior to the January 1, 2010 effective date, the same calculations will be performed using an updated twelve month customer class revenues and kWh sales information.

<u>Other Matters</u>.

Q. Is the Stipulation and Settlement Agreement KPCo is seeking approval of in this proceeding, including the provision for an additional payment by retail ratepayers, fair, just and reasonable and in the public interest?

A. Yes, it is. The Stipulation and Settlement Agreement resolves several state regulatory matters. As demonstrated above, and as the KPSC previously has determined, Kentucky ratepayers will benefit by the assurance of a reliable source of generation at a price not subject to market uncertainties. In addition, the Stipulation and Settlement Agreement resolves the long-standing issue of the Company's failure to recover that portion of its environmental costs allocated to sales to non-associated companies. Finally, a schedule is established for the filing of KPCo's next IRP as well as providing for the annual filing of additional information on AEP system load and resources.

Q. Is Kentucky Power requesting expedited consideration of this Application by the KPSC?

A. Yes. It is in the interest of all parties that the Settlement Agreement be approved as quickly as possible.

Q. Does this conclude your testimony?

A. Yes it does.

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION OF KENTUCKY

COMMONWEALTH OF KENTUCKY

CASE NO. 2004-

COUNTY OF FRANKLIN

AFFIDAVIT

Errol K. Wagner, upon first being duly sworn, hereby makes oath that if the foregoing questions were propounded to him at a hearing before the Public Service Commission of Kentucky, he would give the answers recorded following each of said questions and that said answers are true.

Errol K Wagner

Errol K. Wagner

Subscribed and sworn to before me by Errol K. Wagner this 25th day of October, 2004.

Carolyn S. Payne

Notary Public

My Commission Expires Jan. 8, 2005

COMMONWEALTH OF KENTUCKY
BEFORE THE
PUBLIC SERVICE COMMISSION OF KENTUCKY

IN THE MATTER OF:

APPLICATION OF KENTUCKY POWER COMPANY FOR APPROVAL OF A STIPULATION AND SETTLEMENT AGREEMENT RESOLVING STATE REGULATORY MATTERS	**))) P.S.C. CASE No. 04-____)**

STIPULATION AND SETTLEMENT AGREEMENT AMONG KENTUCKY POWER COMPANY, KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC. AND OFFICE OF ATTORNEY GENERAL, OFFICE OF RATE INTERVENTION

This Stipulation and Settlement Agreement is made as of October 20th, 2004, by and among the Kentucky Office of Attorney General, Office of Rate Intervention ("KOAG"); Kentucky Industrial Utility Customers, Inc. ("KIUC")[1] (the KOAG and KIUC are collectively referred to herein as the "Kentucky Parties"); and Kentucky Power Company ("Kentucky Power.") These entities are sometimes individually referred to herein as a "Party" or collectively as "Parties".

WITNESSETH:

WHEREAS, on December 20, 2001 the Parties and the Public Service Commission of Kentucky ("Kentucky PSC") entered into a Settlement Agreement to resolve two proceedings then pending before the Federal Energy Regulatory Commission ("FERC"): Docket No. EC01-130-000 and Docket No. ER01-2668-000;

WHEREAS, among the issues before FERC in Docket No. EC01-130-000 was a Section 203 Application by American Electric Power Service Corporation to transfer certain jurisdictional assets among American Electric Power Company, Inc. ("AEP") subsidiaries in connection with AEP's proposed restructuring plan;

WHEREAS, in the negotiations leading to the December 20, 2001 Settlement Agreement the Parties addressed state regulatory issues including:

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[1] KIUC consists of AK Steel Corporation; Air Products & Chemicals, Inc.; Marathon Ashland Petroleum LLC; Calgon Carbon; and Specialty Metals Corporation.

(a) Kentucky Power's need for additional capacity beyond the December 31, 2004 expiration of the Unit Power Supply Agreement ("UPSA") between American Electric Generating Company ("AEGCo") and Kentucky Power for 195 MW of Rockport Unit No. 1 and 195 MW of Rockport Unit No. 2;

(b) Resolution of Kentucky Power's claim against AK Steel Corporation for late payment charges claimed due then pending in P.S.C. Case No. 2000-428, *Kentucky Power Company d/b/a American Electric Power v. AK Steel Corporation*;

(c) The date for filing by Kentucky Power of its next Integrated Resource Plan pursuant to 807 KAR 5:058;

(d) The amendment of Kentucky Power's System Sales Clause to permit the offset against system sales revenues of the environmental costs currently allocated to Non-Associated Utilities in calculating Kentucky Power's environmental surcharge pursuant to KRS 278.183;

(e) The setting of Kentucky retail rates in connection with the extension of the UPSA for 195 MW of Rockport Unit No. 1 and 195 MW of Rockport Unit No. 2.

WHEREAS, as part of the December 20, 2001 Settlement Agreement the Parties agreed to a settlement of the state regulatory issues, subject to approval by the Kentucky PSC;

WHEREAS, as part of the December 20, 2001 Settlement Agreement the Parties and the Kentucky PSC agreed that extending the UPSA between AEGCo and Kentucky Power for 195 MW of Rockport Unit No. 1 for five years beyond its December 31, 2004 expiration date was in the best interest of Kentucky Power and its ratepayers;

WHEREAS, as a further part of the December 20, 2001 Settlement Agreement the Parties and the Kentucky PSC agreed that extending the UPSA between AEGCo and Kentucky Power for 195 MW of Rockport Unit No. 2 until the December 7, 2022 end of the lease agreement dated as of December 1, 1989 between Wilmington Trust Company as Lessor and AEGCo was in the best interest of Kentucky Power and its ratepayers;

WHEREAS, on December 17, 2002 the Kentucky PSC approved the December 20, 2001 Settlement Agreement, finding that the extension of the UPSA for Rockport Unit No. 1 and Rockport Unit No. 2 was in the best interest of Kentucky Power and its ratepayers;

WHEREAS, the corporate restructuring and transfer of assets was never consummated;

WHEREAS, the Commission in its March 29, 2004 and May 29, 2004 Orders in Administrative Case No. 387, *In the Matter of: A Review of the Capacity of Kentucky's*

Generation and Transmission System, directed Kentucky Power to continue to seek extensions of the UPSA for Rockport Unit No. 1 and Rockport Unit No. 2;

WHEREAS, the Parties believe that extension of the UPSA for 195 MW of Rockport Unit No. 1 and for 195 MW of Rockport Unit No. 2 is in the best interest of Kentucky Power's ratepayers and will enable Kentucky Power to secure long-term low-cost, coal-fired base load generation;

WHEREAS, the Parties agree that the additional revenues set out in Section III(a)(1) and Section III(a)(2) of this Stipulation and Settlement Agreement are fair, just and reasonable consideration for the extension of the UPSA for Rockport Unit No. 1 and Rockport Unit No. 2 and the resolution of the other matters considered herein, and that the rates imposed to recover the additional revenues are fair, just and reasonable rates;

WHEREAS, the Parties agree that the state regulatory issues that were the subject of the December 20, 2001 Settlement Agreement should be resolved;

WHEREAS, the Parties have engaged in good faith negotiations to resolve the matters set forth below;

NOW THEREFORE, the Parties have reached a settlement and agree as follows:

I. ROCKPORT UNIT NO. 1 CAPACITY

1. The UPSA between Kentucky Power and AEGCo for 195 MW of Rockport Unit No. 1 will be extended beyond the current expiration date, which is December 31, 2004. The UPSA for 195 MW of Rockport Unit No. 1 will be extended until the expiration of the lease agreement for Rockport Unit No. 2 between Wilmington Trust Company as Lessor and AEGCo, which expires December 7, 2022. All other terms and provisions of the existing UPSA will continue through December 7, 2022. Except as provided in Section VI(3) of this Stipulation and Settlement Agreement neither Kentucky Power nor any of its affiliates, nor any party to this Stipulation and Settlement Agreement will seek to have the UPSA terminated before its new expiration date of December 7, 2022.

II. ROCKPORT UNIT NO. 2 CAPACITY

1. The UPSA between Kentucky Power and AEGCo for 195 MW of Rockport Unit No. 2 will be extended until the expiration of the lease agreement for Rockport Unit No. 2 between Wilmington Trust Company as Lessor and AEGCo, which expires December 7, 2022. All other terms and provisions of the existing UPSA will continue through December 7, 2022. Except as provided in Section VI(3) of this Stipulation and Settlement Agreement neither Kentucky Power nor any of its affiliates, nor any party to this Stipulation and Settlement Agreement will seek to have the UPSA terminated before its new expiration date of December 7, 2022.

III. ADDITIONAL REVENUES

1. In consideration of the benefits conferred by the extension of the UPSA and other matters resolved herein, all Parties further agree not to oppose an application by Kentucky Power to the Kentucky PSC to amend its retail tariffs to permit Kentucky Power to collect additional retail revenues as follows:

(a) Kentucky Power shall collect $5.1 million in additional revenue each year of this Stipulation and Settlement Agreement for the five years beginning January 1 of 2005 through 2009;

(b) Kentucky Power shall collect a further increase in additional annual revenues of $1.1 million (yielding a combined total increase in annual revenue of $6.2 million) each year for the approximately thirteen years beginning January 1 of 2010 through December 7, 2022, except that the additional revenues for the year beginning January 1, 2022 shall be $5,792,329 (341/365 of $6.2 million.)

(c) Following approval of the retail rate adjustments set forth in Section III(1)(a) and Section III(1)(b) of this Stipulation and Settlement Agreement Kentucky Power will:

(i) implement those rate adjustments by revising its monthly System Sales Clause Schedule filed with the Kentucky PSC in the fashion illustrated on Exhibit 1 to this Stipulation and Settlement Agreement. The increased annual revenues will be generated by two different kWh rates. The first rate will be for all customers except the CIP-TOD tariff customers and the second kWh rate will be for the CIP-TOD tariff customers. The kWh rate to be applied to each of these two customer class groups shall be sufficient to generate that portion of the total increase in annual revenues required under this Stipulation and Settlement Agreement equal to the percentage of total annual revenues produced by each of the two customer class groups (CIP-TOD and all other tariffs) for the twelve months ending June 30, 2004 and for each twelve month period thereafter during which the revenues are collected through the system sales tracker.

(ii) calculate each calendar year during the period between January 1, 2005 and the effective date of the Company's next change in retail base rates a Balancing Adjustment Factor (BAF) in the same manner as the Company does for the current Net Merger Savings Credit tariff and include the factor in the combined System Sales Clause factor as shown on Exhibit 1 to this Stipulation and Settlement Agreement.

(d) In any retail rate case pursuant to KRS 278.190 or KRS 278.260 following approval by the Kentucky PSC of the retail rate adjustments set forth in

Section III(1)(a) and Section III(1)(b) of this Stipulation and Settlement Agreement the Parties agree that:

(i) the additional revenues collected by Kentucky Power from the retail rate adjustments set forth in Section III(1)(a) and Section III(1)(b) of this Stipulation and Settlement Agreement will not be considered by the Kentucky Public Service Commission in establishing Kentucky Power's retail base rates. In any such retail rate case Kentucky Power shall be permitted to exclude from the test year period the revenues collected pursuant to Section III(1)(a) and III(1)(b) of this Stipulation and Settlement Agreement;

(ii) Kentucky Power shall collect the additional revenues as set forth Section III(1)(a) and Section III(1)(b) of this Stipulation and Settlement Agreement in addition to such base retail rates established by the Kentucky PSC. The costs associated with the underlying Rockport Unit 1 and 2 UPSA will continue to be included in base rates;

(iii) Kentucky Power will develop, and the other Parties will not oppose, a new tariff that provides for the receipt by Kentucky Power of the additional revenues as described in Section III(1)(a) and III(1)(b) of this Stipulation and Settlement Agreement that will allow the Company to receive the additional revenue amount in addition to its base rates and other charges. Such new tariff will be consistent with the revenue allocation and rate design principles set forth in this Agreement. Such new tariff will include two different rates, one for CIP-TOD tariff customers and one for all other tariff customers. The allocation of the additional revenues to be collected from the CIP-TOD tariff customers and all other tariff customers will be based upon the total annual revenue of each of the two customer classes. Once the additional revenues have been allocated between the two customer classes based upon total annual Kentucky retail revenue, the additional revenue will be collected within the two customer classes (CIP-TOD and all other tariffs) on a kwh basis.

(e) In the first retail base rate case pursuant to KRS 278.190 or KRS 278.260 following approval by the Kentucky PSC of the retail rate adjustments set forth in Section III(1)(a) and Section III(1)(b) of this Stipulation and Settlement Agreement the Parties agree that the modification of the System Sales Clause under Section III(1)(c) of this Stipulation and Settlement Agreement to permit the receipt by Kentucky Power of the additional revenues shall be eliminated upon the implementation by the Kentucky PSC of the provisions of Section III(d) of this Stipulation and Settlement Agreement.

(f) This Stipulation and Settlement Agreement is made upon the express agreement by the Parties that the receipt by Kentucky Power of the additional revenues called for by Section III(1)(a) and III(1)(b) shall be accorded the ratemaking treatment set out in this Section III. In any proceeding affecting the rates of Kentucky Power during the extension of the UPSA under this Stipulation and Settlement Agreement, the provisions of this Section III are an express exception to Section VI(4) of this Stipulation and Settlement Agreement.

IV. INTEGRATED RESOURCE PLAN

1. The Parties agree that Kentucky Power will submit an Integrated Resource Plan ("IRP") to the Kentucky PSC no later than June 30, 2009. The filing shall reflect the resources available to Kentucky Power. The filing shall also reflect the resources available to Kentucky Power as a member of any pool arrangement that Kentucky Power expects to exist during the period reflected in the IRP. The Kentucky Public Service Commission will initiate a formal review of that IRP and issue an order setting forth its findings and conclusions.

2. Notwithstanding the provisions of Section IV(1) of this Stipulation and Settlement Agreement, within 120 days of filing with FERC an application to amend the AEP-East Interconnection Agreement to change the generation resources available to Kentucky Power under the AEP-East Interconnection Agreement the Parties and the appropriate members of the Staff of the Kentucky PSC shall meet and confer concerning the need for Kentucky Power to file an IRP prior to June 30, 2009. If after such discussions one or more of the Parties or the Staff of the Kentucky PSC in good faith requests that Kentucky Power make an IRP filing in conformity with Section IV(1) of this Stipulation and Settlement Agreement Kentucky Power shall do so within 90 days of receiving such request.

3. During the period of the extension of the Rockport UPSA required under this Stipulation and Settlement Agreement, Kentucky Power shall provide in connection with its annual filing pursuant to the Kentucky PSC's December 20, 2001 Order in Administrative Case No. 387 that information provided in Kentucky Power's Integrated Resource Plan concerning the combined load and resources of the parties to the AEP Interconnection Agreement and Kentucky Power.

V. ENVIRONMENTAL COSTS

1. All Parties agree not to oppose an application by Kentucky Power seeking approval by the Kentucky PSC for the environmental costs currently allocated to Non-Associated Utilities as required by the Kentucky Public Service Commission in Kentucky Power's environmental surcharge pursuant to KRS 278.183 to be reflected in Kentucky Power's monthly filing of the System Sales Clause Schedule as shown on Exhibit 2 to this Stipulation and Settlement Agreement. This change in the recovery of such environmental costs will occur on the effective date of the Kentucky PSC's order approving the terms of this Stipulation and Settlement Agreement. When Kentucky Power's base rates are next changed by order of the Kentucky PSC, the appropriate ratemaking treatment for the environmental costs allocated to Non-Associated Utilities may be addressed by the Kentucky Public Service Commission.

VI. PROCEDURAL TERMS

1. The parties will not oppose in proceedings before the Kentucky PSC or FERC or on appeal the issuance of an Order by the Kentucky PSC or FERC approving the terms of this Stipulation and Settlement Agreement.

2. The terms of this Stipulation and Settlement Agreement are expressly conditioned upon:

(a) the approval by the Kentucky PSC and by any court reviewing such action of the Stipulation and Settlement Agreement and all supporting or related tariff filings without any change or condition that is unacceptable to the Parties;

(b) the approval by FERC and by any court reviewing such action of the extension of the UPSA without any change or condition that is unacceptable to the Parties;

(c) the receipt without any change or condition that is unacceptable to the Parties of all approvals from or non-objections by FERC and any state regulatory bodies exercising jurisdiction over other AEP operating companies, and any court reviewing such action, required to implement the terms of this Stipulation and Settlement Agreement.

3. If at any time prior to the expiration of the extension of the UPSA under this Stipulation and Settlement Agreement the Kentucky PSC or its successor enters an Order that prevents Kentucky Power from charging rates consistent with the provisions of Sections III(1)(a), Section III(1)(b), III(1)(d)(i) and III(1)(d)(ii) of this Stipulation and Settlement Agreement Kentucky Power may, upon 120 days notice to the Commission and the parties to this Stipulation and Settlement Agreement, begin legal or regulatory proceedings necessary to terminate the extension of the UPSA and withdraw from all other obligations under this Agreement. During any such proceedings no Party to this Stipulation and Settlement Agreement shall make any arguments nor take any position inconsistent with the provisions of this Stipulation and Settlement Agreement. During the 120 day notice period the Kentucky PSC shall be authorized to cure any noncompliance with this Agreement.

4. This Stipulation and Settlement Agreement further is made upon the express understanding that it constitutes a negotiated settlement, and except as otherwise expressly provided for herein to effectuate this Stipulation and Settlement Agreement, no Party shall be deemed to have agreed to any ratemaking principle, precedent or policy, nor shall any party be deemed to have agreed or consented to any matter not expressly stated in this Stipulation and Settlement Agreement. Nothing in this Paragraph is intended to prevent the admission of this Stipulation and Settlement Agreement as evidence in any proceeding in which it is relevant.

5. In the event the conditions set forth in Section VI(2) of this Stipulation and Settlement Agreement are not satisfied the Parties, upon notice by any Party, shall meet with appropriate members of the Kentucky PSC Staff and in good faith discuss amendments of this Stipulation and Settlement Agreement, if any, that are satisfactory to the Parties. If, despite such good faith discussions, the Parties are unable to agree upon amendments within 30 days of the commencement of such discussions or such longer period as mutually agreed, then this Stipulation and Settlement Agreement shall become void and of no effect.

IN WITNESS WHEREOF, the Parties have caused this Stipulation and Settlement Agreement to be signed by their duly authorized officers and representatives as of the date first written above.

Agreed to and Accepted:

Kentucky Power Company

By: Errol K Wagner

Name: Errol K Wagner

Title: Assistant Secretary

Agreed to and Accepted:

Kentucky Industrial Utility Customers, Inc.

By: ______________________

Name: Michael L. Kurtz

Title: Attorney

Agreed to and Accepted:

Office of Attorney General, Office of Rate Intervention

By: ___________________________

Name: ELIZABETH BLACKFORD

Title: Assistant Attorney General

Exhibit 1

Exhibit 1 illustrates Page 1 of 2 of the revised monthly System Sales Clause Schedule that Kentucky Power will file with the Public Service Commission of Kentucky to collect $5.1 million in the first five years and $6.2 million in years six through eighteen in additional revenues in consideration of the agreements reached in this Stipulation and Settlement Agreement. Collecting $5.1 million in years 1-5 and $6.2 million in years 6-18 will result in Kentucky Power collecting approximately $106.1 over the 18-year period. The revised System Sales Clause Schedule includes three new lines.

Line 8, entitled "State Issues Settlement Factor," will be a fixed amount equal to $0.000847 for all customers except the CIP-TOD customers and $0.000500 for CIP-TOD customers. Line 9, entitled "State Issues Settlement BAF," will be calculated once a year until the Company's effective date of a change in base rates. The purpose of the BAF factor is to collect or refund any difference between the actual amount collected and $5.1 million or $6.2 million whichever is in effect. Line 10, entitled "Net System Sales Clause Factor - $ kWh," will be the combined result of line 7 "System Sales Clause Factor", line 8 "State Issues Settlement Factor" and line 9 "State Issues Settlement BAF".

Page 1 of 2 of the revised monthly System Sales Clause Schedule will be in the following format:

Kentucky Power Company

System Sales Clause Schedule
Case No. 9061 and
Stipulation and Settlement Agreement

Line No.				
1	Current Month (Tm) Net Revenue	(+)		
2	Base Month (Tb) Tariff Sheet No. 19-1 Net Revenue Level	(-)		
3	Increase (Decrease) of System Sales Net Revenue			
4	Customer 50% Sharing	(x)	50%	
5	Customer Share of Increase (Decrease) in System Sales Net Revenue			
6	Current Month (Sm) Sales Level	(/)		
7	System Sales Clause Factor - $/kWh*			
			All Other Customers	CIP-TOD Customers
8	State Issues Settlement Factor	(+)	$0.000847	$0.000500
9	States Issues Settlement BAF	(+)	$0.000000	$0.000000
10	Net System Sales Clause Factor - $ kWh	(=)	________	________

*This factor is a credit to the customer when current month net revenue levels exceed the base month; and a charge when current month net revenue levels are below the base month.

Effective Date for Billing:

Submitted by:

Signature

Title:

Date Submitted:

Exhibit 2

Exhibit 2 illustrates Page 2 of 2 of the revised monthly System Sales Clause Schedule that Kentucky Power will file with the Public Service Commission to reflect Kentucky Power's environmental surcharge pursuant to KRS 278.183 in accordance with Section V(1) of this Stipulation and Settlement Agreement. Specifically, on page 2 of 2 of the Schedule, Kentucky Power will add a new line (Line 6) entitled "Non-Associated Utilities Monthly Environmental Costs". Line 4 ("Sales for Resale Expense") and Line 5 ("Interchange-Delivered Expense") will be added to Line 6 ("Non-Associated Utilities Monthly Environmental Costs") to arrive at Line 7 ("Total System Sales Expenses"). "Total System Sales Revenues" (Line 3) less "Total System Sales Expenses" (Line 7) will determine "Total System Sales Net Revenue" (Line 8) for the current month. Line 8 will be carried over to Page 1 of 2 of the Schedule, Line 1("Current Month (Tm) Net Revenue Level"), to be used in calculating the monthly "System Sales Clause Factor - $ kWh" (Line 9) on that page. Page 2 of 2 of the revised monthly System Sales Clause Schedule will be in the following format:

Kentucky Power Company

System Sales Clause Net Revenue

Month Ended____________________

Line No.		CURRENT MONTH	PRIOR MO. TRUE-UP ADJUSTMENT	TOTAL
1	Sales for Resale Revenues			
2	Interchange-Delivered Revenues			
3	Total System Sales Revenues			
4	Sales for Resale Expenses			
5	Interchange-Delivered Expenses			
6	***Non-Associated Utilities Monthly Environmental Costs****			
7	Total System Sales Expenses			
8	Total System Sales Net Revenue			

*Source: ES Form 1.0, Line 3
ES Form 3.3, Line 4
Non-Associated Environmental Costs

TARIFF S. S. C.
(System Sales Clause)

APPLICABLE.

To Tariffs R.S., R.S.-L.M.-T.O.D., Experimental R.S.-T.O.D., S.G.S., M.G.S., Experimental M.G.S.-T.O.D., L.G.S., Q.P., C.I.P.-T.O.D., C.S.-I.R.P., M.W., O.L., and S.L. (T)

RATE.

1. When the monthly net revenues from system sales are above or below the monthly base net revenues from system sales, as provided in paragraph 3 below, an additional credit or charge equal to the product of the Kwhrs and a system sales adjustment factor (A) shall be made, where "A", calculated to the nearest 0.0001 mill perkilowatt-hour, is defined as set forth below.

System Sales Adjustment Factor (A) = (.5[Tm - Tb]/Sm) +RF+ B A F

In the above formula "T" is Kentucky Power Company's (KPCo) monthly net revenues from system sales in the current (m) and base (b) periods, "R" is the additional annual revenues associated with the Settlement Agreement in the current (m) period and "S" is the Kwh sales in the current (m) period, all defined below.

2. The net revenue from American Electric Power (AEP) System deliveries to non-associated companies that are shared by AEP Member Companies, including KPCo, in proportion to their Member Load Ratio and as reported in the Federal Energy Regulatory Commission's Uniform System of Accounts under Account 447, Sales for Resale, shall consist of and be derived as follows:

a. KPCo's Member Load Ratio share of total revenues from System sales as recorded in Account 447, less b. and c. below.

b. KPCo's Member Load Ratio share of total out-of-pocket costs incurred in supplying the power and energy for the deliveries in a. above.

The out-of-pocket costs include all operating, maintenance, tax, transmission losses and other expenses that would not have been incurred if the power and energy had not been supplied for such deliveries, including demand and energy charges for power and energy supplied by Third Parties.

c. KPCo's environmental costs allocated to non-associated utilities in the Company's Environmental Surcharge Report. (N)

3. The base monthly net revenues from system sales are as follows:

Billing Month	Base Net Revenues from System Sales (Total Company Basis)
January	$ 895,960
February	767,802
March	893,126
April	1,036,738
May	1,085,852
June	1,324,166
July	1,027,403
August	1,154,184
September	912,736
October	731,014
November	624,320
December	862,035

4. The Revenue Factor (RF) will be determined in accordance with the Stipulation and Settlement Agreement dated October 20, 2004 in Case No. 2004-____. The Revenue Factor will be based upon KPCo's additional annual revenues of $5.1 million per year (for the first five years) and $6.2 million per year starting January 1, 2010, until the effective date of the Company's next base rate change, where these amounts will be removed from the system sales clause schedule and included in a new KPCo tariff separate from base rate calculations. (N)

DATE OF ISSUE October 25, 2004 DATE EFFECTIVE November 29. 2004

E.K. Wagner

ISSUED BY E.K. WAGNER DIRECTOR OF REGULATORY AFFAIRS FRANKFORT., KENTUCKY
NAME TITLE ADDRESS

Issued by authority of an Order of the Public Service Commission in Case No. dated

TARIFF S. S. C. (Cont'd.)
(System Sales Clause)

5. A Balancing Adjustment Factor (B A F) will be calculated on a per KWH basis for the second through the twelfth months of the current recovery year, which reconciles any over-or under-collection of additional revenues from prior periods. The B A F will be determined by dividing the difference between amounts which were expected to be collected and the amounts actually collected from the application of paragraph 4 of this tariff from the previous year by the expected Kentucky retail jurisdictional KWH. The final B A F will be applied to customer billings in the second month following the effective date of a Commission's order establishing new base rates. (N)

6. Sales (S) shall be equated to the sum of (a) generation (including energy produced by generating plant during the construction period), (b) purchase, and (c) interchange-in less (d) energy associated with pumped storage operations, less (e) inter-system sales and less (f) total system losses. (T)

7. The system sales adjustment factor shall be based upon estimated monthly revenues and costs for system sales, subject to subsequent adjustment upon final determination of actual revenues and costs. (T)

8. The monthly System Sales Clause shall be filed with the Commission ten (10) days before it is scheduled to go into effect, along with all the necessary supporting data to justify the amount of the adjustments which shall include data and information as may be required by the Commission. (T)

9. Copies of all documents required to be filed with the Commission under this regulation shall be open and made available for public inspection at the office of the Public Service Commission pursuant to the provisions of KRS 61.870 to 61.884. (T)