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Via Overnight Mail

May 4, 2010

Mr. Jeff Derouen, Executive Director
Kentucky Public Service Commission
211 Sower Boulevard
Frankfort, Kentucky 40602

RECEIVED
MAY 05 2010
PUBLIC SERVICE
COMMISSION

Re: Case No. 2009-00459

Dear Mr. Derouen:

Please find enclosed the original and twelve (12) copies each of the RESPONSES OF KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC. to KENTUCKY POWER COMPANY DATA REQUESTS and FIRST DATA REQUEST OF COMMISSION STAFF filed in the above-referenced matter. By copy of this letter, all parties listed on the Certificate of Service have been served.

Please place this document of file.

Very Truly Yours,

David F. Boehm, Esq.
Michael L. Kurtz, Esq.
BOEHM, KURTZ & LOWRY

MLKkew
Attachment
cc: Certificate of Service

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing was served by e-mailing a true and correct copy via electronic mail (when available) and regular U.S. mail (unless otherwise noted) to all parties on the 4th day of May, 2010.

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COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

RECEIVED

MAY 05 2010

PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF KENTUCKY POWER)
COMPANY FOR A GENERAL ADJUSTMENT) Case No. 2009-00459
OF ELECTRIC RATES)

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1. Refer to page 8 of the Direct Testimony and Exhibits of Lane Kollen ("Kollen Testimony"), lines 8-12. If the Commission were to consider Kentucky Power Company's ("Kentucky Power") proposed adjustments to reduce its off-system sales margins as "[k]nown and measurable," explain specifically how Mr. Kollen would also have the Commission quantify and reflect the increased off-system sales margins from the Big Sandy 1 turbine uprate and the wind power purchase power agreement.

Response:

There are at least several alternative computations. First, the Commission could normalize the Company's historic OSS margins. The proforma adjustment would be computed by subtracting the actual test year OSS margins, adjusted only to correct the MLR error ($15.743 million total Company from Section V Workpaper S-4 page 26), from the average of the prior years and the test year ($37.984 million, computed as the average of $27.645 million in 2005, $49.892 million in 2006, 51.285 million in 2007, $45.353 million in 2008 and $15.743 million in test year; all calendar year total Company amounts provided in response to AG 1-9), and then multiplying the result ($22.241 million) times the jurisdictional allocation factor of 98.7% (from Section V Workpaper S-4 page 26) ($21.951 million).

Second, the Commission could adopt the Company's quantification of the 2010 OSS margins, $26.796 million, which the Company provided in response to AG 1-9, a copy of which was attached to Mr. Kollen's Direct Testimony as Exhibit___(LK-4). The proforma adjustment would be computed by subtracting the actual test year OSS margins, adjusted only to correct the MLR error ($15.743 million total Company from Section V Workpaper S-4 page 26) from the projected test year amount of $26.796 million, and then multiplying the result ($11.053 million) times the jurisdictional allocation factor of 98.7% (from Section V Workpaper S-4 page 26) ($10.909 million).

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Third, the Commission could specifically quantify the incremental effects of the Big Sandy 1 turbine uprate and the wind power PPA. The energy from the Big Sandy 1 turbine uprate is 115,413 mWh per year assuming the 85% capacity factor for the twelve months prior to the outage for the uprate (1,934,942 mWh actual generation at 260 mW capacity) and the average of the 13 mW to 18 mW uprate cited by the Company in response to KIUC 2-23. The energy from the wind power PPA is [trade secret] mWh per year, according to the Company witness Mr. Scott's confidential Exhibit SCW-3. The fuel expense for Big Sandy 1 was $29.85 per mWh and the non-fuel variable expense was $4.67 for the test year, according to the Company's response to KIUC 2-23. The Commission could use the PJM AEP Gen Hub forward prices provided by the Company in response to KIUC 1-24 to determine the off-system revenues from the additional energy from Big Sandy 1 and then subtract the Big Sandy 1 fuel and non-fuel variable expenses. Similarly, the Commission could use the same forward prices to determine the off-system sales revenues from the additional energy from the wind power PPA. Finally, the Commission would multiply these AEP OSS margins times the KPCo MLR and then times the 98.7% jurisdictional allocation factor.

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2. Refer to pages 13-14 of the Kollen Testimony and Kentucky Power's response to Item 29 of Commission Staff's Third Data Request in this proceeding.

a. If the Commission were to approve the proposed wind power purchase power agreement, explain whether Mr. Kollen believes it would be appropriate for the costs and risks associated with the agreement to be shared in some fashion by shareholders and ratepayers.

b. If, above some threshold level, the costs of the agreement were to be deferred and recorded as a regulatory asset and amortized and borne by ratepayers only after the enactment of either a federal or state renewable portfolio standard, explain how Mr. Kollen would view such regulatory treatment.

Response:

a. The Company's proposal will result in the assignment of all risks and costs to ratepayers and none to shareholders. That is an inappropriate sharing. The Company is not obligated to proceed with the contract if the Commission does not approve the contract as proposed, according to the terms of the contract itself. Nevertheless, if the Commission were to approve the contract, it could condition its approval. Such conditions might include a hold harmless on the costs associated with additional common equity, although as a practical matter that would be difficult to implement.

b. Mr. Kollen would oppose such a proposal in concept even without further detail, primarily because it presumes that there will be a renewable portfolio standard mandate and presumes that there will be recovery regardless of whether there is such a mandate either now or in the future. This proposal is also problematic because it does not meet the requirements set forth in ASC 980-340-25-1 (formerly SFAS 71). The proposal does not provide "reasonable assurance" of recovery because it would be contingent on an

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unknown future occurrence (enactment of renewable legislation). In that event, the Company could not defer the cost as a regulatory asset in accordance with the requirements of GAAP. Alternatively, if for some reason, the Company and its auditors determine that there is "reasonable assurance" of recovery, then, similar to the Company's proposal, it will result in the assignment of all risks and costs to ratepayers and none to shareholders; the only difference is in the timing of recovery.

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3. Refer to pages 14-16 of the Kollen Testimony, specifically regarding the adjustment to reflect the termination of the capacity sale by Indiana & Michigan Power ("I&M") to Carolina Power and Light ("CP&L") as of January 1, 2010.

a. At lines 10-11 on page 15, Mr. Kollen states, "This adjustment is a selective post-test year adjustment and is not known and measurable." It appears that Mr. Kollen's last paragraph on this subject, on page 16, addresses why he considers this a "selective post-test year adjustment." Explain in detail why he believes it is "not known and measurable."

b. Hypothetically, had the l&M-to-CP&L capacity sale terminated September 1, 2009, with one month left in the test year, and Kentucky Power proposed an adjustment similar to the one it proposed based on the January 1, 2010 termination date, explain how Mr. Kollen's recommendation would differ, if at all.

Response:

a. The Company itself claims that only one part of the termination of the sale is known and measurable. The Commission cannot accept only a portion of the effects of the termination of the sale as known and measurable. The termination is either known and measurable in its entirety or not at all. The sale terminated on January 1, 2010 and it is now the beginning of May. Yet, the Company claims that it doesn't know how the capacity was or will be allocated or to whom, according to its response to KIUC 1-43. In other words, even though the Company provided its responses to KIUC Initial Data Requests on February 26, 2010, it would have the Commission believe that it doesn't know what AEP has done or will do with this capacity or energy. In its response to KIUC 1-43, the Company states that "it cannot be predicted with certainty where the energy from the 250 MW of capacity will be allocated. It is possible that the energy from this 250 MW may be allocated internally to it's owner Indiana Michigan Power Company. It is also possible that the 250 MW could be used for primary deliveries to other deficit

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sister companies. The likelihood of allocation to system sales cannot be known at this time." If the capacity were sold pursuant to another unaffiliated entity similar to CPL, then no adjustment would be appropriate. If the capacity were retained by I&M, then the AEP system would have more energy to sell into the wholesale market and OSS margins allocated to KPCo would be increased. In any event, there are other effects related to the termination of the sale. If one effect is included as "known and measurable," then all effects should be included.

b. Mr. Kollen would not necessarily argue that the proposed adjustment was a selective post test year adjustment, but would recommend that all related adjustments be incorporated.

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4. Refer to the Kollen Testimony from page 23 at line 12 to page 24, line 2. Explain, from this discussion, whether Mr. Kollen believes that all planned expenditures for the stated purpose of improving reliability are inappropriate unless they will ultimately result in a net cost savings for customers.

Response:

Yes, unless there is a need to improve reliability beyond that which can legitimately be achieved with present expense levels, there are specified goals to improve reliability, and the Company actually has a plan in place to achieve the specified goals at a specified cost, none of which has been demonstrated by the Company or proposed by the Company in conjunction with its "planned expenditures."

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5. Refer to the Kollen Testimony from page 24, line 16 to page 25, line 1. If it were to determine that "[additional spending on vegetation management is appropriate," provide the amount of such spending Mr. Kollen would recommend the Commission include in determining Kentucky Power's revenue requirement.

Response:

Mr. Kollen does not have a specific proposal. Mr. Kollen simply noted that the Commission has options other than simply rejecting or accepting the Company's proposal. For example, the Commission may adopt all or part of one of the plans comprising the Company's proposed Reliability and Service Enhancement plan, but reject all of the other plans. As another example, the Commission may determine that it is appropriate to increase the test year vegetation management expense amount by 20% to achieve specified reliability goals. The amount is a matter of judgment based on the identified needs to improve reliability, if any, the specified goals to be achieved, the expense necessary to achieve those goals, and the certainty that the additional recoveries can be traced to specific activities and the expenses of those activities to achieve those goals without a reduction in other spending.

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6. Refer to pages 43-44 of the Kollen Testimony. Mr. Kollen has contested a number of Kentucky Power's adjustments, while advocating a strict test-year concept and arguing that the proposed adjustments are "selective post-test year" adjustments. With that background, explain why his proposal to update the test-year short-term interest rates to reflect current short-term interest rates should not also be considered a "selective post-test year" adjustment.

Response:

The Commission historically has used the most recent updated cost of short term debt and long term debt capital in the rate of return, even though there is not usually a significant deviation from the test year end cost of these forms of debt capital. Mr. Kollen would not disagree with using the test year end cost of these forms of capital because this represents the normalized or going forward cost of capital at the end of the test year and is consistent with a strict or at least a consistent application of the test year concept. However, Mr. Kollen strongly disagrees with using a 13 month average of the cost of short term debt because: 1) it is inconsistent with Commission practice, 2) it does not represent the normalized cost of short term debt given the global financial crisis during the test year, and 3) it does not represent the going forward cost of debt.

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7. Refer to page 57 of the Kollen Testimony where Mr. Kollen recommends that off-system sales margins be set at $15.29 million and that the present 70-percent sharing factor be maintained for margins above this level. Explain whether Mr. Kollen is also recommending that the present 60-percent sharing factor for margins in excess of $30 million be maintained.

Response:
Mr. Kollen does not oppose a reduction in the margin sharing to 60% for OSS margins in excess of $30 million.

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8. Refer to page 26 of the Direct Testimony and Exhibits of Stephen J. Baron ("Baron Testimony"). Mr. Baron states that the proposed Transmission Adjustment mechanism "would lead to an incorrect accrual of over/under recoveries." Explain in greater detail why Mr. Baron believes this would occur and provide an example, with calculations, showing how this would occur.

Response:

Mr. Baron's concern refers to Ms. Gregory's testimony on page 8 at lines 5 through 7. As Mr. Baron understands the testimony, the Company's proposal is to accrue the difference between 1) actual PJM costs allocated to KPCo and 2) the sum of the T.A. revenues plus the "base transmission revenues." While over time, actual PJM costs and the T.A. revenues would tend to vary with the level of KPCo sales (either up or down) the "base transmission revenues" are fixed. The purpose of the T.A. mechanism is to recover actual allocated KPCo PJM costs. The table below illustrates this point.

In the column labeled "Future Period," base transmission revenues are held constant, per Mr. Baron's understanding of the Company's proposal. An under-recovery of $2.9 million is shown. In the column labeled "Future Period*," base transmission revenues are grown at the average assumed 5.9% growth rate. In this case, there is no under-recovery.

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Illustration

	Base Period	Future Period	Future Period*	% Change
KPCo PJM Jurisdictional Costs	42,475,930	45,000,000.0	45,000,000.0	5.9%
KPCo Sales Revenues	623,195,180	660,227,642	660,227,642	5.9%
T.A. Factor	-1.12942%	-1.12942%	(0.0)	
T.A. Revenues	(7,038,463)	(7,456,713)	(7,456,713.4)	
Base Transmission Revenues	49,514,393	49,514,393	52,456,713	5.9%
Net Revenue Recovery	42,475,930	42,057,680	45,000,000	
over/under recovery	-	2,942,320	-	

* with adjustment to base transmission revenues to reflect sales growth.

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9. Refer to the Baron Testimony, Exhibits SJB-2, SJB-3, and SJB-4. Provide these exhibits in electronic format with the formulas intact.

Response:
See attached file.

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10. Refer to page 4 of the Direct Testimony and Exhibits of Richard A. Baudino ("Baudino Testimony"). Provide a copy of the article referenced in footnote 1.

Response:
Please refer to the attached page from the SBBI Yearbook.

Chapter 1 Highlights of the 2008 Markets and the Past Decade

Events of 2008

In one of the worst years since the Great Depression,the stock market declined significantly in 2008. Both large company stocks and small company stocks declined approximately 37% and experienced remarkable volatility

The bond market was characterized by a flight to safety, as investors pulled money out of corporate bonds and purchased U.S. Treasuries. On a month-end basis, long-term government bond yields fell to levels not seen since June 1956, and intermediate-term government bond yields fell to levels not seen since December 1949. The Consumer Price Index (a measure of inflation) increased 4 18 percent in the first half of 2008, but declined 3.92 percent in the second half, the largest June to December decrease since 1930.

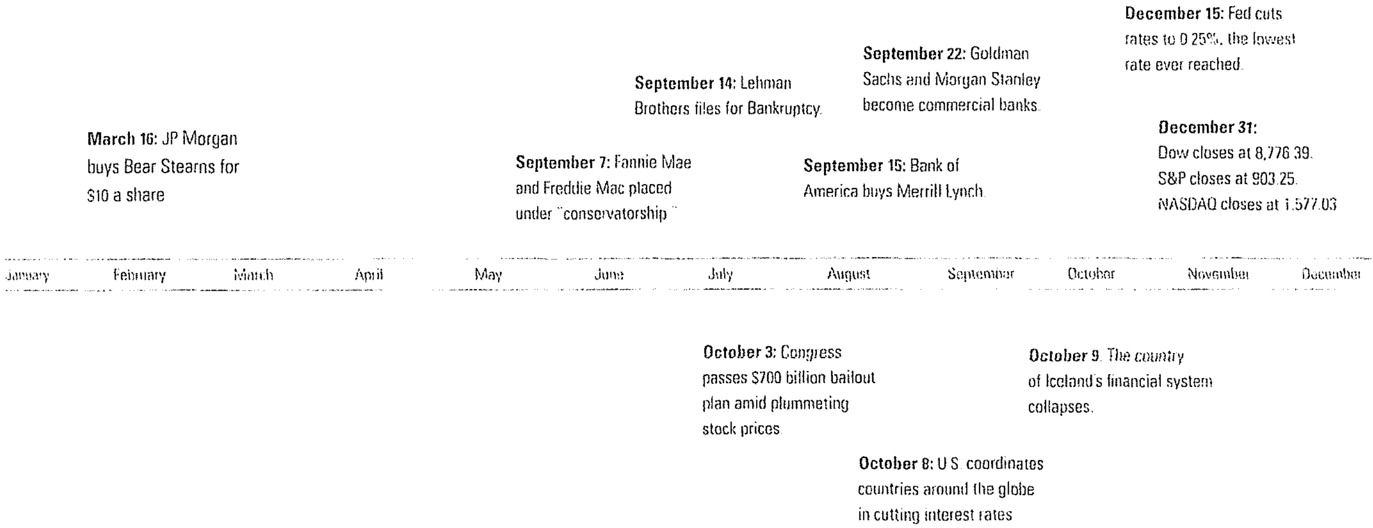
2008 was a very volatile year in securities markets and a very tumultuous year for business in general. Figure 1 1 displays a timeline of the major events of the year. The purchase of Bear Stearns by JP Morgan made many aware of the tremendous pressure the investment banking industry was facing; however, it wasn't until Lehman Brothers collapsed later in the year that the true weakness of the sector became evident to all. Perhaps even more emblematic was the passage of the $700 billion Emergency Economic Stimulus plan by Congress in the midst of a plummetting stock market. Throughout the year, the government of the United States, as well as others around the globe, took unprecedented action to avoid a total breakdown of financial markets.

Gross Domestic Product (GDP)

The United States Real Gross Domestic Product (GDP), a measure of the market value of all goods and services produced within the U.S., grew at an estimated 1 3 percent in 2008, compared with 2 0 percent in 2007. The first half of 2008 was positive, the second half of 2008 was negative, with quarters one, two, three and four coming in at 0.9 percent, 2 8 percent, -0 5 percent, and an estimated -3 8 percent, respectively.

Since 1970, there have been seven occurrences of lower annual GDP since than what was experienced in 2008: 2001 (0.8 percent), 1991 (-0 2 percent), 1982 (-1 9 percent), 1980 (-0.2 percent), 1975 (-0.2 percent), 1974 (-0.5 percent), and 1970 (0.2 percent). On a quarterly basis since 1970, there have been five occurrences of lower GDP than what was experienced in the fourth quarter of 2008, the most recent being the first quarter of 1982 (-6.4 percent). Overall, there have been 21 occurrences of negative GDP on a quarterly basis since 1970

Figure 1-1: 2008 Financial Crisis Timeline



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11. Refer to page 5 of the Baudino Testimony. Provide the text of footnote 2, which does not appear at the bottom of the page.

Response:
The text should be "Ibid", as the information comes from the page cited in footnote 1.

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12. Refer to page 7 of the Baudino Testimony. Provide a copy of the Standard and Poor's article referenced in lines 5-7.

Response:
Mr. Baudino is unable to provide a copy of this document because it is protected by copyright. This article is available for purchase directly from Standard & Poor's.

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13. Refer to page 15 of the Baudino Testimony. For the electric companies not selected for the proxy group, provide the reason each did not pass the screening process.

Response:
Please see KIUC's response to Kentucky Power's data request No. 10.

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14. Refer to page 26 of the Baudino Testimony and page 2 of Exhibit RAB-5. Were the Earnings, Book Value, and Dividends growth rates calculated by Value Line? If not, provide the calculations and explain whether the methodology is similar to that used in the calculation of DCF growth rates provided on page 1 of Exhibit RAB-4.

Response:

The growth rates were taken from the Summary Statistics report from Value Line. Mr. Baudino did not calculate the growth rates himself, but instead took the average projected growth rates from the report. Value Line did not provide its methodology for calculating these growth rates.

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15. Refer to page 28 of the Baudino Testimony.

a. Explain why it is appropriate to use five-year Treasury note yields in the CAPM analysis.

b. Explain why 30-year Treasury bond yields should not be considered in the CAPM analysis.

<u>Response:</u>

a. In Mr. Baudino's opinion, a 5-year Treasury note may be a more reasonable proxy for the risk-free rate because of its shorter maturity relative to a 30-year or 20-year Treasury bond.

b. 30-year Treasury yields may also be used to estimate the risk-free rate, although they carry similar interest rate risk to the 20-year bonds. Also, the difference in yield between the 30-year and 20-year Treasury bond is rather small and unlikely to make a significant difference in the CAPM results.