COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

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

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POST-HEARING BRIEF OF KENTUCKY POWER COMPANY

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Table of Contents

For its brief in support of an annual increase of $63.66 million in Kentucky Power Company's retail rates and the Commission's approval of the other terms and conditions set forth in the May 19, 2010 Unanimous Settlement Agreement, Kentucky Power states:

A. Background[1]

On December 29, 2010, Kentucky Power filed its application to adjust its existing retail electric rates. Through its application, Kentucky Power sought to increase its rates to provide additional annual revenues of $123.63 million.[2] The major components of the requested increase include:

- Increase Kentucky Power's return on equity to 11.75%;[3]
- Net increase in expenses resulting from the Renewable Energy Purchase Agreement;[4]
- Additional expenses incurred in connection with the Company's enhanced reliability initiatives;[5]
- Increased depreciation expenses.[6]

During the proceedings, the Commission granted intervention to Kentucky Industrial Utility Customers, Inc., the Attorney General, Commonwealth of Kentucky, Community Action Kentucky, Inc., Kentucky School Boards Association, Wal-Mart Stores East, LLC, Sam's East, Inc., and Hazard Perry County Community Ministries, Inc. (collectively the "Intervenors").

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[1] For the convenience of the Commission and the parties, the transcript of the May 25, 2010 hearing prepared from the video recording by Julieanna Hennebert, Registered Court Reporter, is attached as **EXHIBIT 1** to this Brief.

[2] As a result of adjustments and the known and measureable effects of post-test year events, the increased revenue requirement subsequently was reduced to $108.156 million.

[3] Pre-filed Testimony of Timothy C. Mosher at 6.

[4] *Id.* at 6-8.

[5] *Id.* at 6, 8; Pre-filed Testimony of Everett G. Phillips; Pre-filed Testimony of Errol K. Wagner at 43; Application, Section V, Workpaper S-4, Page 41.

[6] Pre-filed Testimony of Timothy C. Mosher at 6; Pre-filed Testimony of Errol K. Wagner at 38. *See also*, Pre-filed Testimony of James E. Henderson, Exhibit JEH-1.

The Commission also granted Pike County Senior Citizens Programs, Inc.'s petition for limited intervention. Consistent with its status as a limited intervenor, Pike County Seniors did not sponsor any testimony; nor did it take any discovery.

Kentucky Power and the Intervenors met on May 3, 2010 and May 7, 2010 to discuss settlement. The Intervenors and Pike County Seniors also were invited to participate in the negotiations. Commission Staff attended the negotiating sessions by agreement of all parties, but is not a party to the settlement agreement. On May 7, 2010, Kentucky Power and the Intervenors reached an agreement in principle to settle the issues raised in the Company's application to adjust its rates. The agreement in principle between Kentucky Power and the Intervenors was reduced to a Unanimous Settlement Agreement dated May 19, 2010.

The executed Unanimous Settlement Agreement was filed with the Commission on May 20, 2010, along with the testimony of Errol K. Wagner in support of the settlement. Pike County Seniors, which is a limited intervenor and not a party to this proceeding, objected to the Unanimous Settlement Agreement.

On May 25, 2010 a hearing was held on all issues relating to both the Company's application to adjust its rates and the Unanimous Settlement Agreement.[7] Prior to the hearing the Commission Staff and counsel for Pike County Seniors notified the parties that they wished to cross-examine Company witnesses Mosher, Phillips and Wagner. Cross-examination was waived by all parties, Pike County Seniors, and the Commission Staff for all other witnesses. The identified witnesses were presented at the May 25, 2010 hearing for cross-examination.

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[7] Kentucky Power respectfully renews its argument that the Commission, consistent with *Kentucky American Water Company v. Commonwealth of Kentucky*, 847 S.W.2d 737, 741 (Ky. 1993) and 807 KAR 5:001, Section 3(8)(a), may limit its decision in this proceeding to the reasonableness of the Unanimous Settlement Agreement. The decision by Pike County Seniors, a limited intervenor, not to join in the settlement, does not render the settlement less than unanimous. Likewise, resolving this proceeding upon the reasonableness of the Unanimous Settlement Agreement does not violate any due process rights Pike County Seniors may possess.

B. In The Absence Of The Unanimous Settlement Agreement, Kentucky Power Would Be Entitled To An Annual Increase In Its Retail Rates Of At Least $63.66 Million.

Although Kentucky Power agreed to a $63.66 million annual increase in its retail rates as part of the Unanimous Settlement Agreement, the record supports an increase substantially in excess of that amount.[8]

1. Return on Equity.

Kentucky Power's return on equity for the 12-month test year ended September 30, 2009 was 2.9% before adjustments.[9] No witness testified that a 2.9% return was adequate. Richard Baudino, who testified on behalf of KIUC recommended a 10.1% return on equity,[10] while the Company's witness, William Avera, recommended a return on equity of 11.75%.[11]

Increasing the return on equity from the unadjusted end of test year 2.9% to 11.75%, as proposed by Company witness Avera,[12] would require additional annual revenue of $60.32 million.[13] The restoration of the Company's return on equity to 10.95%, the low point of the reasonable range of returns on equity determined by Mr. Avera, would require additional annual revenues of $54.87 million.[14] Use of a return on equity of 10.5%, the rate currently used for the

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[8] For purposes of clarity and concision this presentation focuses only on five amounts. The net effect of the remaining adjustments, including the Renewable Energy Purchase Agreement, increases the amount of the increase in its retail rates to which Kentucky Power otherwise is entitled. By addressing only these five issues, Kentucky Power is not waiving its right to argue in favor of a larger increase involving the entirety of its application as adjusted in the event the Unanimous Settlement Agreement is not approved.

[9] Pre-Filed Testimony of Timothy C. Mosher at 5.

[10] Pre-filed Testimony of Richard A. Baudino at 29. Mr. Baudino's recommended range was 9.69%-10.55%. *Id.*

[11] Pre-filed Testimony of William E. Avera at 60.

[12] *Id.* Mr. Avera's recommended range was 10.8%-12.4% (or 10.95%-12.55% after incorporating an adjustment for flotation costs.) *Id.* at 58.

[13] Mr. Kollen testified that the effect on Kentucky Power's revenue requirement of each one percent change in its return on equity was $6.816 million. Pre-filed Testimony of Lane Kollen at 49-50. (Kentucky Power calculated the effect as $6.866 for each one percent change in its return on equity. Kentucky Power's use of Mr. Kollen's calculation in this brief is not an admission that his calculation is correct, and shall not preclude Kentucky Power from otherwise using and advocating $6.866 million.) Using Mr. Kollen's calculation of $6.816 for these computations only, Kentucky Power's revenue requirement would need to increase by $60.32 million to raise its return on equity from the unadjusted end of test year level of 2.9% to Mr. Avera's recommended 11.75%. [(11.75%-2.9%) x $6.816 million = 8.85% x $6.816 million = $60.32 million].

[14] [(10.95%-2.9%) x $6.816 million = 8.05% x $6.816 million = $54.87 million].

Company's environmental surcharge and AFUDC, and an amount within the range of reasonable returns on equity testified to by Richard Baudino on behalf of KIUC, would require additional annual revenues of $51.8 million.[15] Indeed, even a 10.1% return on equity, the value recommended by Mr. Baudino, would require a $49.08 million increase in the Company's annual revenues from the unadjusted test year level of 2.9% earned by Kentucky Power.[16]

In sum, additional revenues required to increase Kentucky Power's return on equity from the unadjusted test year level of 2.9% earned by Kentucky Power to a value within the range recommended by the two witnesses addressing the question would require an annual increase of $49.08 million to $60.32 million.

2. Increased Reliability Spending.

As Chairman Armstrong underscored at the May 25, 2010 hearing, the need to improve the reliability of Kentucky Power's distribution system was at the forefront of concerns raised by the Company's customers at the public meetings sponsored by the Commission:

> Q. But I heard them personally in Hazard and in Pikeville. I was keeping track. ... [There were] more issues about reliability than the cost of your rate increase.[17]

Kentucky Power understood this need even before the public hearings. Specifically, the Company requested $16.373 million in additional O&M funding to expand its reliability efforts beyond test year levels.[18] Among the four major initiatives to be funded through the increased

[15] [(10.5%-2.9%) x $6.816 million = 7.6% x $6.816 million = $51.8 million].

[16] [(10.1%-2.9%) x $6.816 million = 7.2% x $6.816 million = $49.08 million].

[17] Hearing Transcript at 79 (Chairman Armstrong).

[18] Pre-filed Testimony of Errol K. Wagner at 43; Application, Section V, Workpaper S-4, Page 41. The reliability initiatives also required additional capital expenditures of $21.4 million, with their accompanying return on, and return of, investment. Pre-filed Testimony of Errol K. Wagner at 43; Application, Section V, Workpaper S-4, Page 41, col. 4, line 18 (increase in annual depreciation expense of $373,142) ; Application, Section V, Schedule 3, col. 5, line 7 (increase in capitalization of $9,422,784).

spending was Kentucky Power's proposed Enhanced Vegetation Initiative.[19] In the first year, the increased distribution vegetation management spending was projected to total $15.77 million, and it would increase to $19.27 million in Year 5.[20] Based upon these funding levels, along with the associated capital investments, Kentucky Power projected that within five years it could convert its current distribution vegetation management efforts from its current performance-based program to a four-year trim cycle.[21] In doing so, the Company projected it would reduce its tree-caused outages by 47% once the four-year cycle was established.[22] As Mr. Phillips testified, this shift in approach is important because it will allow the Company to move from its current "reactive" vegetation management program to one that allows the Company to address the potential vegetation-related issues well in advance of the problems manifesting themselves.[23]

KIUC witness Lane Kollen recommended that the Commission reject <u>any</u> increased funding for reliability.[24] His recommendation in part was premised upon his stated belief that the Company failed to demonstrate a need to improve reliability beyond the level that can be achieved under current spending levels. Mr. Kollen's belief is not credible in light of the reliability issues facing the Company and its customers. The Commission heard the reliability concerns expressed by Kentucky Power's customers at the public hearings. Mr. Kollen presumably did not. The objective measures of reliability provided by Mr. Phillips in his pre-

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[19] Also included within the Company's proposal were an "Enhanced Equipment Inspection and Mitigation Initiative," (first year incremental O&M cost of $0.827 million), "Distribution Workforce Planning Initiative" (first year O&M cost of $0.956 million), and gridSMART[SM] initiative (first year incremental O&M expense of 0.154 million). Pre-filed testimony of Everett G. Philips at 29, 32, 39.

[20] *Id.* at 23. The Year 1 expenditures were composed of $13.93 million in incremental O&M expenses and $1.84 in capital expense. By Year five the amounts were slated to increase to $16.58 million and $2.69 million, respectively. *Id.*

[21] *Id.* at 14-15.

[22] *Id.* at 20.

[23] *Id.* at 13.

[24] Pre-filed Testimony of Lane Kollen at 16-28.

filed and rebuttal testimony likewise establish that Kentucky Power currently is experiencing a declining tree-related reliability trend that must be addressed.[25]

Nor are Kentucky Power's current vegetation management resources adequate. Mr. Kollen's testimony ignores the fact that since the last rate case the Company's vegetation management O&M spending, on average, has exceeded the 2005 test year levels by almost 25%.[26] Yet, as Mr. Phillips explained in his rebuttal testimony:

> The Company is suffering from a declining tree-related reliability trend while the customers' expectations of reliability are increasing. ***The Company's ability to maintain vegetation on its system can not be achieved under either the spending levels included in the last rate case or under the spending levels the Company is currently maintaining.***[27]

Mr. Kollen nowhere offers any evidence to refute these simple facts.

In the face of rising costs, Mr. Kollen's stand-pat approach would make it difficult for the Company to maintain its current level of effort, much less expand it.[28] Far from being the weakness decried by Mr. Kollen,[29] the Company's proposed tripling of its O&M vegetation management expense and doubling of its capital expenditures would give Kentucky Power the financial resources to undertake the broad, systemic actions the Commission heard Kentucky Power's customers demanding.

It is beyond cavil that substantial additional resources must be deployed, and paid for, to enable the Company to carry out its migration from a reactive performance-based vegetation

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[25] Pre-filed Testimony of Everett G. Phillips at 4, 11, 12, 15; Rebuttal Testimony of Everett G. Phillips at 3-4.

[26] Pre-filed Testimony of Everett G. Phillips at 22. In effect, customers received five years of tree-trimming while only paying four years of rates.

[27] Rebuttal Testimony of Everett G. Phillips at 3 (emphasis supplied).

[28] Pre-filed Testimony of Everett G. Phillips at 22 ("Specifically, the costs for material, trucks, equipment, spray and labor have increased by 15% over the past 4 years since KPCo's last rate case.")

[29] Pre-filed Testimony of Lane Kollen at 24.

management program to the cycle based program recommended by Commission Staff.[30] The Company clearly is entitled to a rate adjustment of at least $14.57 million (average of the first three years of incremental vegetation management O&M expenditures), along with the associated capital-related expenses, to fund the Company's Enhanced Vegetation Initiative to carry out that migration.[31]

3. Depreciation Expense.

In its March 14, 2006 Order in the Company's last general rate case, the Commission directed Kentucky Power to file a new depreciation study within five years of the date of the order, or by the filing date of the Company's next general rate case.[32] The new study was filed by Kentucky Power in connection with its application in this case.[33] Based upon the results of the study, Mr. Wagner recommended an increase of $11,934,322 in the Company's annual depreciation expense.[34]

No testimony was filed challenging Kentucky Power's depreciation study, or the $11.934 million increase in annual depreciation expense.

[30] Rebuttal Testimony of Everett G. Phillips at 7.

[31] Pre-filed testimony of Everett G. Phillips at 23. [∑ Year 1 + Year 2 + Year 3 of Enhanced Distribution Vegetation Management Expenditures/3 years = ($13.93 million + $14.56 million + $15.22 million)/3 years = $14.57 million.] In fact, Kentucky Power believes the O&M expenses, along with the associated capital related costs, required by the four distribution reliability improvement initiatives should be approved by the Commission.

[32] Order, *In the Matter of: General Adjustment of Electric Rates of Kentucky Power Company*, P.S.C. Case No. 2005-00341 at 10 (Ky. P.S.C. March 16, 2006).

[33] Pre-filed Testimony of Errol K. Wagner at 38. *See also*, Pre-filed Testimony of James E. Henderson, Exhibit JEH-1.

[34] Pre-filed Testimony of James E. Henderson at 5.

4. Amortization Of Incremental Storm Costs Associated With The December, 8 2009 and December 18, 2009 Storms.

In December, 2009, Kentucky Power's service territory was struck by two major storm events causing widespread disruptions of service.[35] The incremental O&M expenses associated with restoring service following the two storms totaled $14,048,828.[36] Amortized over three years, the Kentucky jurisdictional incremental O&M costs associated with restoring service following the two major storm events increased Kentucky Power's O&M expenses by $4,640,796.[37]

No party has challenged these expenses or their amortization. It is appropriate that Kentucky Power be permitted these costs over a three year period.[38]

5. Traditional Ratemaking Treatment For Certain Kentucky Power Transmission Related Expenses.

As part of its application in this proceeding, Kentucky Power proposed the establishment of a Transmission Adjustment Tariff. Under the proposed tariff ratepayers would receive or pay the difference between the expenses incurred by Kentucky Power under PJM's Federal Energy Regulatory Commission approved Open Access Transmission Tariff and its embedded cost of transmission (which would be included in base rates).[39] Such a tracker mechanism would

[35] Kentucky Power Company's Response to Commission Staff's First Set of Data Requests, *In the Matter of: General Adjustments in Electric Rates of Kentucky Power Company*, P.S.C. Case No. 2009-00459, No. 43, Pages 1-2 of 7 (Ky. P.S.C. Filed January 20, 2010).

[36] *Id* at 4, col. 5, lines 2-3.

[37] *Id.* at line 2, col. 5; line 3, col. 5. [(($820,738 + $13,228,090)/3) x .991 = ($14,048,828/3) x .991 = $4,682,942.67 x .991 = $4,640,796.] The Kentucky jurisdictional factor is .991. *Id* at line 10, col. 5.

[38] *See*, Order, *In the Matter of: The Application of Kentucky Power Company For An Order Approving Accounting Practices to Establish Regulatory Assets and Liabilities Related to the Extraordinary Expenses Incurred by Kentucky Power Company in Connection with Three Major Storm Events in 2009* (Ky. P.S.C. December 22, 2009) (Granting Kentucky Power authority to record a regulatory asset for its actual costs, not to exceed $10,306,227, incurred to restore service in connection with three earlier 2009 major storm events.)

[39] Pre-filed Testimony of David M. Roush at 19-20.

operate in lieu of traditional ratemaking which would use the Company's test year embedded cost of transmission to set rates.[40]

Mr. Baron, testifying on behalf of KIUC, opposed the proposed Transmission Adjustment Tariff on the grounds that it was both illegal and unnecessary.[41] In absence of the tracker, Kentucky Power's rates should be established, as in the past, based upon its embedded cost of service.[42] Using Kentucky Power's embedded cost of transmission service would increase the revenue requirement between $4.568 M to $7.038 M, depending on the final return on equity authorized.[43] Again, recovery of this expense is appropriate.

These five items, standing alone, are sufficient to entitle the Company to a rate adjustment of more than $63.66 million. Kentucky Power, nevertheless, as part of the settlement of this proceeding upon the unmodified terms of the Unanimous Settlement Agreement, is willing to accept retail rates designed to produce an additional $63.66 million in annual revenue.[44]

C. The Unanimous Settlement Agreement's Terms Are Fair, Just And Reasonable And Establish Benefits For Ratepayers Not Available Except By Agreement Of The Company.

1. The Principal Terms Of The Unanimous Settlement Agreement.

The Unanimous Settlement Agreement provides for an annual increase in the Company's retail rates of $63.66 million.[45] The agreement locks in the Company's test year distribution vegetation management expenditures of $7.237 million, and commits an additional

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[40] *Id.*

[41] Pre-filed Testimony of Stephen J. Baron at 24-25.

[42] Kentucky Power reserves the right to argue in future proceedings that the expenses its pays under the PJM Open Access Transmission should be used in establishing its rates.

[43] Pre-filed Testimony of David M. Roush, Exhibit DMR-4; Rebuttal Testimony of David M. Roush at 3-4 (describing calculation of the expense using different returns on equity.)

[44] *See*, Settlement Testimony of Errol K. Wagner at 13; Settlement Exhibit EKW-3; Settlement Exhibit EKW-4.

$10 million a year (to be funded through the increased rates) to distribution vegetation management. Kentucky Power's return on equity under the agreement is fixed at 10.5%, which is substantially less than the 11.75% demonstrated by the Company as being appropriate.

The Unanimous Settlement Agreement also provides for substantial increased funding for Kentucky Power's Home Energy Assistance Program ("HEAP"). HEAP currently is funded solely by Kentucky Power's customers at the rate of $0.10 per month per residential meter. Under the agreement, customer funding will be increased by 50%, and Kentucky Power will contribute $0.125 per residential meter per month. Finally, Kentucky Power agreed to forego many of the increases in non-recurring charges, and to maintain its current depreciation rates.[46]

The Unanimous Settlement Agreement also recommends a procedure to be followed by the Commission with respect to the ratemaking aspects of the Company's Renewable Energy Purchase Agreement that is the subject of the Company's Application in Case No. 2009-00545.[47]

2. <u>The Rates Provided For In The Unanimous Settlement Agreement Are Fair, Just And Reasonable</u>.

Under the Unanimous Settlement Agreement, Kentucky Power will receive a general retail rate increase of $63.66 million,[48] or approximately 59% of the increase sought in Kentucky Power's adjusted application.[49] The settlement amount represents an increase of 12.48% over base rates established more than four years ago.[50] In the interim, many of the Company's expenses increased at a higher rate.[51]

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[45] Unanimous Settlement Agreement at ¶ 1(a); Settlement Testimony of Errol K. Wagner at 2, 4-5.

[46] Unanimous Settlement Agreement at ¶¶ 6(a), 11; Settlement Testimony of Errol K. Wagner at 15.

[47] Unanimous Settlement Agreement at ¶ 2; Settlement Testimony of Errol K. Wagner at 5-6.

[48] Unanimous Settlement Agreement at ¶ 1(a).

[49] $63.66/$108.156 = 58.85%.

[50] Settlement Testimony of Errol K. Wagner at 4-5.

[51] *See, e.g.*, Pre-Filed Testimony of Everett G. Phillips at 22 (15% increase for reliability related expenses). *See, generally*, Pre-Filed Testimony of Timothy C. Mosher at 5.

As discussed below, $10 million of the increase is earmarked for expanding Kentucky Power's existing Distribution Vegetation Management Program.[52] This additional spending is in addition to the test-year O&M Distribution Vegetation Management expenditures of $7,237,965, which are "locked in" under the Unanimous Settlement Agreement.[53] Thus, under the Unanimous Settlement Agreement the Company has committed to spending $17,237,965 each year on Distribution Vegetation Management (2 1/3 times the test year amount),[54] with almost 60% of the committed expenditures funded by the general rate increase.[55]

At the May 25, 2010 hearing, Pike County Seniors sought to portray the increase as having been unfairly allocated to residential customers. Pike County Seniors errs:

- Under the existing rates and allocation of the Company's revenue requirement, Kentucky Power's return on rate base for residential customers is -2.8%.[56]

- Kentucky Power loses money under the current allocation, as measured in terms of return on rate base, on each kWh it delivers to residential customers.[57] For the 12 months ended September 30, 2009 the loss was $15,409,365.[58]

- Pike County Seniors failed to offer an alternative allocation of the increase. To the extent it proposes to continue the current allocation, as it apparently does, Pike County Seniors failed to offer any authority that supports requiring the Company to provide service to residential customers at a loss. To the contrary, the allocation under the current rates stands in direct opposition to one of the key objectives of ratemaking, which is to implement rates that "reflect as nearly as possible the actual costs of serving the customer."[59]

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[52] Unanimous Settlement Agreement at ¶ 5.

[53] Settlement Testimony of Errol K. Wagner at 7, 14.

[54] [$17,237,965/$7,237,965 = 238%].

[55] [$10 million/$17,237,965 million = 58%.] Almost 16% of the increase in retail rates is used to fund the $10 million in incremental Distribution Vegetation Management spending [10/63.66 = 15.71%].

[56] Kentucky Power Response to Hearing Data Request No. 1, col. 3. A copy of the Company's Response to Hearing Data Request No. 1 is attached to this Brief as **EXHIBIT 2**.

[57] Hearing Testimony of Errol K. Wagner at 145.

[58] Pre-filed Testimony of David M. Roush, Exhibit DMR-3, Page 2 of 4.

[59] *Id.* at 9

- Under the current rates, each of the remaining classes subsidize the cost of providing service to residential customers.[60] The value of the subsidy paid by the other classes on behalf of the residential ratepayers for the 12 months ended September 30, 2009 was $35,142,378.[61]

- Approximately 50% of the subsidy provided to the residential ratepayers under the current rates is funded by two classes of service: CIP-TOD and QP.[62] For the test year ended September 30, 2009 the subsidy from these two classes totaled $17,877,261.[63]

- Under the proposed rates, Kentucky Power's residential customers will continue to be subsidized by all other rate classes.[64] Indeed, residential ratepayers will continue to receive 75% of the subsidy previously received from the CIP-TOD and QP classes, and relatively unchanged levels of subsidy from the remaining rate classes.[65]

- Although Kentucky Power no longer will provide service to its residential customers at a loss under the proposed rates,[66] the return on rate base for the residential class is less than 1/5 of the average return on investment for all ratepayers.[67]

- Nearly two-thirds of the 436 basis points difference between the 16.84% increase for residential customers, and the 12.48% rate increase that would have been allocated to all rate classes if the increase had been evenly distributed,[68] is attributable to the allocation under the Unanimous Settlement Agreement of the $10 million in increased Distribution Vegetation Management Program expenditures to those customers benefiting from the increased expenditures.[69]

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[60] Hearing Testimony of Errol K. Wagner at 120-121; Settlement Testimony of Errol K. Wagner at 11; Pre-filed Testimony of David M. Roush, Exhibit DMR-3, Page 2 of 4; Pre-filed Testimony of Stephen J. Baron at 4.

[61] Pre-filed Testimony of David M. Roush at 9.

[62] Pre-filed Testimony of Stephen J. Baron at 10;

[63] Pre-filed Testimony of David M. Roush, Exhibit DMR-3, Page 2 of 4.

[64] Settlement Testimony of Errol K. Wagner at 11.

[65] *Id.*

[66] The return on rate base for the residential class under the proposed rates is 0.88%. Kentucky Power Response to Hearing Data Request No. 1, col. 11. The average return on all classes, including residential customers, is 4.92%. *Id.* [0.88%/4.92% = 17.9%].

[67] *Id.*

[68] Kentucky Power Response to Hearing Data Request No. 1, col. 7. 16.84% - 12.485 = 436 basis points. 285/436 = 65.4%.

[69] Unanimous Settlement Agreement at ¶ 1(a)(i).

- Under the Unanimous Settlement Agreement, all customers, except CIP-TOD customers and those QP customers receiving service at transmission or sub-transmission voltages, were allocated the costs associated with the $10 million in increased Distribution Vegetation Management Program expenditures.[70] Customers in the CIP-TOD class, and those QP customers that receive energy at transmission and sub-transmission levels, do not use the Company's distribution facilities, and will not benefit from the $10 million Distribution Vegetation Management Program to be funded by the $63.66 million retail rate increase.[71]

- The Unanimous Settlement Agreement appropriately allocates the cost of the $10 million in enhanced Distribution Vegetation Management expenditures to the rate classes that will benefit from the expenditures. It likewise does not require CIP-TOD and transmission and sub-transmission QP customers to subsidize the benefitted classes even more by bearing a portion of the $10 million in additional distribution reliability expenditures. In doing so, the allocation conforms to one of the key principles of ratemaking: allocating costs to the cost causer.[72]

- Even after the reduction in the subsidy provided residential customers by the CIP-TOD and QP customers, and even after the allocation of the $10 million in increased Distribution Vegetation Management expenditures to those customers receiving service at distribution voltages, the return on rate base for the CIP-TOD and QP classes under the proposed rates is more than ***nine times*** the return on rate base for the residential class.[73] The return on rate base for the other non-residential classes is even higher.[74]

- The interests of Kentucky Power's residential customers were fully and vigorously represented in the negotiations leading to the Unanimous Settlement Agreement and in the allocation of increases under the agreement. The Attorney General, who is statutorily charged with representing consumer interests,[75] fully participated in the pre-hearing proceedings, including serving discovery, and was an active and effective representative of consumer interests in settlement negotiations. Community Action Kentucky, Inc., which was granted full intervention and likewise fully participated in the pre-hearing proceedings and settlement negotiations, is a "Kentucky non-profit 501(c)(3) public interest

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[70] Kentucky Power Response to Hearing Data Request No. 1, col. 7.

[71] Hearing Testimony of Errol K. Wagner at 117-118.

[72] Pre-filed Testimony of David M. Roush at 9. *See also*, Hearing Testimony of Errol K. Wagner at 118-119, 199-122.

[73] Kentucky Power Response to Hearing Data Request No. 1, col. 11.

[74] *Id.*

[75] KRS 367.150(8).

corporation that … operates Low Income Home Energy Assistance Program (LIHEAP) in all 120 Kentucky counties and provides assistance to approximately 250,000 low income households in the state each year."[76] Both the Attorney General and Community Action Kentucky, Inc. regularly intervene in electric utility rate cases and have the experience and ability to represent the interests of residential customers. Hazard Perry County Community Ministries, Inc. sought and was granted full intervention in this proceeding and is a party to the Unanimous Settlement Agreement. Hazard Perry County Community Ministries, Inc. has worked with families and individuals in need since 1976, and "currently operates a homeless shelter, rental housing for homeless families, homelessness prevention assistance and two childcare centers."[77]

- The Attorney General, Community Action Kentucky, Inc., and Hazard Perry County Community Ministries, Inc., whose interests were fully aligned with residential customers, including Pike County Seniors, agreed to the allocation of the increase under the Unanimous Settlement Agreement.[78]

Both the amount of the increase in Kentucky Power's retail rates, and the allocation of the Company's revenue requirement among classes of service, under the Unanimous Settlement Agreement yield fair, just and reasonable rates.[79]

3. <u>The Enhanced Distribution Vegetation Management Program</u>.

Paragraph 5 of the Unanimous Settlement Agreement focuses on a concern shared by Kentucky Power, its customers, the Commission, and Commission Staff: improvement in the reliability of Kentucky Power's distribution system. At current funding levels, Kentucky Power will be unable to maintain, much less improve, distribution system reliability.

[76] Community Action Kentucky, Inc. Motion For Full Intervention, P.S.C. Case No. 2009-00459 at 1 (Ky. P.S.C. Filed February 4, 2010).

[77] Hazard Perry County Community Ministries, Inc.'s Motion for Intervention, P.S.C. Case No 2009-0045900459 at 1 (Ky. P.S.C. Filed February 26, 2010).

[78] Notwithstanding uninformed suggestions to the contrary, all parties to this proceeding were invited to participate in the negotiations leading to the Unanimous Settlement Agreement. In addition, Pike County Seniors was invited to participate in the negotiations and Commission Staff was invited to observe. Settlement Testimony of Errol K. Wagner at 4. Representatives who wished to participate or observe the negotiations, but were unable to travel to Frankfort, were provided a toll-free number to call and participate in, or monitor, the negotiations. There was nothing clandestine or surreptitious about the negotiations, or the Unanimous Settlement Agreement. The written agreement was filed in the Commission's public records the day after it was signed, and hence was accessible to the world on the Commission's website. In addition, a copy provided to the Pike County Seniors through its counsel that same day.

> The Company is suffering from a declining tree-related reliability trend while the customers' expectations of reliability are increasing. ***The Company's ability to maintain vegetation on its system can not be achieved under either the spending levels included in the last rate case or under the spending levels the Company is currently maintaining.***[80]

No person speaking at the May 25, 2010 hearing, including Pike County Seniors, challenged the need to improve the Company's distribution system reliability.

The Unanimous Settlement Agreement contains three provisions that address distribution system reliability. ***First***, it locks in the $7,237,965 in test-year distribution vegetation management expenditures.[81] Without the agreement, the Company would have been free to shift a portion of those expenditures to other needs if circumstances so required.[82] ***Second***, it provides $10 million annually to fund increased distribution vegetation management work.[83] Combined with the test-year amounts, Kentucky Power's distribution vegetation management expenditures will be at two and one-third times the test year level.[84] ***Third***, the Company is obligated to provide the Commission and the Attorney General annually with a circuit-by-circuit work plan prior to beginning each year's work, and a circuit-by-circuit report of the work actually performed after the completion of each year's work.[85] The Plan and subsequent Report will enable the Commission Staff and the Attorney General to monitor the Company's distribution vegetation management efforts, and to measure the results achieved against its plans. The Plan

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[79] *See also*, Settlement Testimony of Errol K. Wagner at 13-15.

[80] Rebuttal Testimony of Everett G. Phillips at 3 (emphasis supplied).

[81] Unanimous Settlement Agreement at ¶ 5(a); Settlement Testimony of Errol K. Wagner at 7.

[82] For example, in 2010 the Company decreased the amount budgeted for distribution vegetation management from the prior year's level. Everett G. Phillips Hearing Testimony at 70-71. Notwithstanding the amount budgeted, the Company overspent its budget by $700,000 for the first four months of 2010. *Id.* at 71. Indeed, for the first six months of 2010, the Company projects distribution vegetation management expenditures of approximately $4 million, which is at a rate of more than 10% above the test year level. Kentucky Power 2010 Distribution Vegetation Management Plan at 1 (Filed May 20, 2010). [(2 x $4 million)/$7,237,965 = 10.5%.]

[83] Unanimous Settlement Agreement at ¶ 5(b); Settlement Testimony of Errol K. Wagner at 7.

[84] [($7,237,965 + $10,000,000)/ $7,237,965 = 238%].

[85] Unanimous Settlement Agreement at ¶ 5(c); Settlement Testimony of Errol K. Wagner at 7.

and Report are in addition to other reliability reports Kentucky Power is currently providing the Commission.[86]

Although the reduced funding amounts under the Unanimous Settlement Agreement mean it will take the Company longer to achieve the four-year trim cycle than it would if the full "as filed" Distribution Vegetation Management Initiative were implemented, Kentucky Power still projects it can reach a four-year trim cycle under the Unanimous Settlement Agreement in seven years instead of the five years under the "as-filed" plan.[87] Once the four-year trim cycle is achieved, Kentucky Power projects, as it did under the "as-filed" plan, a 47 percent decrease in tree-caused sustained outages.[88] This alone should have a significant impact on Kentucky Power's distribution system reliability in light of the fact that tree-related outages are the largest single cause of service interruptions.[89] In addition, it will allow faster restoration of service after storms.[90]

In the initial implementation of the Distribution Vegetation Management Plan, Kentucky Power will perform the work calculated to have the largest immediate effect on improving distribution system reliability.[91] In particular, Kentucky Power will focus on many of the 2009 worst-performing circuits, as well as circuits with large number of customers.[92] As early as the first six months of the increased spending, the Company expects to expand its distribution vegetation management efforts substantially:

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[86] Everett G. Phillips Hearing Testimony at 76.

[87] *Id.* at 100.

[88] *Id.*

[89] Pre-filed Testimony of Everett G. Phillips at 4; Everett G. Phillips Hearing Testimony at 100.

[90] Pre-filed Testimony of Everett G. Phillips at 19.

[91] Everett G. Phillips Hearing Testimony at 100.

[92] *Id.*

- Approximately 1257 miles of distribution line will be re-cleared by manual trimming, mechanical trimming and herbicide treatment during the six months ended December 31, 2010. This is 851 miles more than the 406 miles planned for the second half of 2010 in the absence of the increased reliability funding.[93]

- The Distribution Vegetation Management contract crew complement will be expanded from 71 existing crews to 91 crews (60 Asplundh new hires).[94]

- 12 experienced contract crews will be brought in from other locations for three months of work. (36 FTE's).[95]

- An aerial saw will be utilized to trim 90 miles of distribution line. No aerial saw work was in the original 2010 work plan. The use of an aerial saw allows re-clearing in the most inaccessible areas and helps resolve tree overhang problems.[96]

- Herbicide application will be increased from the 182 miles in the original plan for the second half of the year to 600 miles.[97]

- Three contract foresters will be employed to assist the Company's foresters in planning and monitoring the work performed.[98]

- Planned overtime work of 80 hours per Asplundh crew will be performed (equivalent to 21 additional FTE's for six months).[99]

As a result of this expanded work, Kentucky Power "customers will recognize the power quality and reliability benefits [from the vegetation management work] immediately once the work has been completed on their circuit."[100]

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[93] Kentucky Power 2010 Distribution Vegetation Management Plan at 2 (Filed May 20, 2010).

[94] *Id.*

[95] *Id.*

[96] *Id.*

[97] *Id.*

[98] *Id.*

[99] *Id.* Kentucky Power determined that it was more cost-effective ("biggest bang for the buck") to use existing crews to greatest extent possible because of the time required to train new crews to work in the difficult terrain of its service territory. Everett G. Phillips Hearing Testimony at 69. After the initial six months, the work will be performed by additional crews at regular pay rates. *Id.* at 69-70.

[100] Pre-filed Testimony of Everett G. Phillips at 20.

Although the focus of the Distribution Vegetation Management Plan under the Unanimous Settlement Agreement will be O&M expenditures, reliability work requiring capital expenditures also will continue to be made:

> Q. .... Is it the Company's intention [if the Unanimous Settlement Agreement is approved] not to make any capital expenditures to improve reliability?
>
> A. No. Our intention is still to have capital expenditures. It's just not in the settlement for incremental capital.[101]

In fact, Mr. Phillips noted that he expected reliability-related capital expenditures to continue at historical levels.[102]

Included in the capital expenditures being considered are one to two new substations:

> Q. So you're not planning for this set of rates to build a substation or any substations in the district?
>
> A. Oh, I don't think you can say that. I would defer to Mr. Phillips. We're constantly looking at the need for new substations. In fact I know we are looking for additional funding for substations in the Hazard area and in the Pikeville area.[103]

Other reliability-related capital expenditures include the Sectionalizing Program, which "results in smaller circuit segments and fewer customers being interrupted due to faults that may occur on distribution circuits."[104] Sectionalizing lines is another way the Company is addressing the length of its circuits.[105] Finally, Kentucky Power's existing Major Distribution Reliability and

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[101] Everett G. Phillips Hearing Testimony at 101. *See also*, *Id.* at 89 ("I fully intend to have capital available for the forestry [vegetation management] program.")

[102] *Id.* at 90.

[103] Timothy C. Mosher Hearing Testimony at 39. Mr. Phillips later confirmed Mr. Mosher's testimony concerning the new substation in the Hazard area: "We currently are looking at and adding plans to add a substation in the Hazard area. It's to relieve loading off of the Bonham station in that area... And that will help the Haddix area and so there will be an opportunity to, in your terms, shorten the circuit." Everett G. Phillips Hearing Testimony at 81. In addition, in 2008 Kentucky Power added the Soft Shell Station in Knott County. Pre-filed Testimony of Everett G. Phillips at 7.

[104] Pre-filed Testimony of Everett G. Phillips at 6.

[105] Everett G. Phillips Hearing Testimony at 102; Timothy C. Mosher Hearing Testimony at 35. The manner in which "circuit length" is calculated can lead to some confusion. Circuit length measures the total length of the

Capacity Additions Program involves, among other efforts, capital expenditures to re-conductor lines to address load growth, to create a back-up source for existing circuits, installation of distribution automation systems to enable automatic sectionalizing detection of a fault, and the construction of new distribution feeder ties.[106]

Kentucky Power proposed a robust, effective, four-part program to improve the reliability of the Company's distribution system.[107] In the course of negotiations, concerns arose about the rate impact of fully funding the four-part reliability program. In the context of this settlement, the commitment by Kentucky Power under the Unanimous Settlement Agreement to spend $17.237 million annually on Distribution Vegetation, $10 million of which is to be funded by the increased rates, properly balances the need for significantly increased funding for reliability work against the competing need to limit the impact of increased rates on customers.[108] By focusing the effort on distribution vegetation management, the parties agreed to deploy the increased funding where it could have the greatest immediate effect on reliability.[109]

In sum, the Distribution Vegetation Management provisions of the Unanimous Settlement permit the Company to significantly strengthen its efforts to increase the reliability of the distribution system, albeit at a slower rate, without unduly burdening Kentucky Power's customers.

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conductor in the station-to-station circuit, plus the length all taps running off the station-to-station circuit. In many cases the length of the circuit from station-to-station may constitute only a 10% of the entire circuit length. The remainder of the circuit length is made up of the taps off the station-to-station circuit. These taps are often sectionalized, as described above, to limit the effect of an outage along the tap, although the circuit length remains unchanged. *See*, Timothy C. Mosher Hearing Testimony at 35. This may address the concern regarding circuit length expressed at the hearing by members of the Commission.

[106] Pre-filed Testimony of Everett G. Phillips at 7.

[107] *Id.* at 11.

[108] Settlement Testimony of Errol K. Wagner at 14.

[109] Everett G. Phillips Hearing Testimony at 51, 101.

4. Home Energy Assistance Program.

The Commission has determined it lacks the statutory authority to implement "lifeline rates"[110] to assist low-income ratepayers in meeting their electric bills. In its March 14, 2006 Order approving the settlement agreement in Kentucky Power's last rate case, the Commission approved the funding mechanism for a Home Energy Assistance Program[111] to assist some of these same low-income ratepayers with their electric bills. The program itself was later approved in a separate proceeding.[112]

Kentucky Power's HEAP currently is funded solely through a $0.10 per residential meter per month charge.[113] The most recent information of record concerning the program indicates that as currently funded Kentucky Power's HEAP assists approximately 385 low-income customers with their electric bills.[114]

Under the Unanimous Settlement Agreement, the residential customer funding will be increased to $0.15 per meter per month.[115] In addition, Kentucky Power agreed to contribute to its HEAP an amount equal to $0.125 multiplied by the number of residential customer payments of $0.15.[116] The increased customer payment, along with the new annual contributions by Kentucky Power of approximately $214,900,[117] will provide the HEAP with $300,900 in

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[110] *In the Matter of: The Consideration of Lifeline Rates As Required By Section 114 of the Public Utility Regulatory Policies Act*, Administrative Case No. 248 (Ky. P.S.C. February 28, 1982). A lifeline rate is a rate "'for essential needs of residential electric customers which is lower than the rate under the [PURPA ratemaking] standard....'"

[111] Order, *In the Matter of: General Adjustment of Electric Rates of Kentucky Power Company*, P.S.C. Case No. 2005-00341 at 6-9 (Ky. P.S.C. March 16, 2006).

[112] Order, *In the Matter of: The Joint Application of Kentucky Power Company and Kentucky Association for Community Action, Inc. for the Establishment of a Home Energy Assistance Program*, P.S.C. Case No. 2006-00373 (Ky. P.S.C. December 14, 2006).

[113] Settlement Testimony of Errol K. Wagner at 8.

[114] Unsworn Hearing Statement of Joe F. Childers at 107.

[115] Unanimous Settlement Agreement at ¶ 8; Settlement Testimony of Errol K. Wagner at 8.

[116] Unanimous Settlement Agreement at ¶ 8(c); Settlement Testimony of Errol K. Wagner at 8.

[117] Settlement Testimony of Errol K. Wagner at 8.

incremental funding.[118] This additional funding increases the HEAP funding by more than 175%, and will allow HEAP to nearly triple the number of low-income customers served.[119]

By nearly tripling the number of low-income customers who can receive assistance under Kentucky Power's HEAP, the Unanimous Settlement Agreement significantly expands this program and helps alleviate the effect of the increased rates on low-income customers who qualify. Moreover, the contribution to the HEAP by Kentucky Power's shareholder, which accounts for more than two-thirds of the increased funding, "is a real benefit to Kentucky Power's customers that the Company [in the absence of the Unanimous Settlement Agreement] otherwise would not be obligated to provide."[120]

5. Return On Equity.

As part of the Unanimous Settlement Agreement, Kentucky Power and the Intervenors stipulated to a return on equity of 10.5% for purposes of calculating the settlement amount.[121] They also agreed to use the 10.5% return on equity for purposes of the Company's environmental surcharge, and for the purpose of accounting for the allowance for funds used during construction ("AFUDC").[122]

Although Kentucky Power maintains that it is entitled to a significantly higher return on equity, certainly one within the range calculated by Company witness Avera, it agreed to accept the lower 10.5% return on equity as part of the Unanimous Settlement Agreement. The 10.5% rate is equal to the return on equity currently used by Kentucky Power for AFUDC purposes and

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[118] Settlement Testimony of Errol K. Wagner at 8. [86,000 + $214,900 = $300,900]

[119] Unsworn Hearing Statement of Joe F. Childers at 108.

[120] Settlement Testimony of Errol K. Wagner at 8.

[121] Unanimous Settlement Agreement at ¶ 7; Settlement Testimony of Errol K. Wagner at 9.

[122] *Id.*

in the Company's environmental surcharge.[123] It also lies within the range testified to by Mr. Baudino who testified on behalf of KIUC.[124] As such it is reasonable in the context of the settlement and yielded a significantly lower settlement amount than would have been the case if Mr. Avera's 11.75% return on equity had been adopted.[125]

6. The System Sales Clause.

As part of the Unanimous Settlement Agreement, Kentucky Power abandoned in its proposal to credit its customers with one-half of the test year off-system sales margins.[126] Instead, the Company agreed to credit the full jurisdictional test year amount, $15.29 million,[127] against its revenue requirement.[128] The result was to reduce Kentucky Power's revenue requirement by $7.645 million from what it would have been if the Company's proposal had been adopted.[129] In return, the Intervenors agreed to change the manner in which off-system sales margins above and below the test year amount were shared. Under the current allocation off-system sales margins above or below the test-year level are shared on either a 70% (customer)/30% (Company) or 60% customer/40% Company basis, depending on whether the annual margins exceed $30 million. Under the Unanimous Settlement Agreement the margins are to be shared on a fixed 60% customer/40% Company allocation.[130]

[123] Settlement Testimony of Errol K. Wagner at 9.

[124] Pre-filed Testimony of Richard A. Baudino at 29. Mr. Baudino recommended a range of 9.69% to 10.55%.

[125] According to KIUC's witness Mr. Kollen, each one percent increase in Kentucky Power's return on equity increases the Company's revenue requirement by $6.812 million. Pre-filed Testimony of Lane Kollen at 49-50. Increasing Kentucky Power's return on equity to 11.75 would have increased the settlement amount by $8.52 million. [(11.75%-10.5%) x $6.812 million.]

[126] *See*, Pre-filed Testimony of David M. Roush at 16.

[127] Settlement Testimony of Errol K. Wagner at 6; Unanimous Settlement Agreement at ¶ 4.

[128] *Id.*

[129] Application, Section V, Workpaper S-4, Page 26; Unanimous Settlement Agreement at ¶ 4.

[130] Unanimous Settlement Agreement at ¶ 4; Settlement Testimony of Errol K. Wagner at 6.

To the extent Pike County Seniors opposed this portion of the Unanimous Settlement Agreement, its objection apparently was premised upon the misapprehension that Kentucky Power's customers will not benefit from test year margins above the amount built into base rates:

> Q. And if there had been a greater amount of off-system sales, the ratepayers wouldn't see a reduction in their actual rates, would they?
>
> A. Oh, yes, they would. Most definitely.[131]

Pike County Seniors similarly was mistaken in its apparent belief that the increased rates will be used to offset off-system sales "losses." As Mr. Wagner emphatically testified, Kentucky Power will not make an off-system sale if it will lose money on it.[132]

The Unanimous Settlement Agreement's provisions addressing Kentucky Power's System Sales Clause represent a fair and equitable balancing of the interests of the Company and its customers and should be approved.

7. <u>Environmental Surcharge</u>.

Kentucky Power's environmental surcharge is a statutorily prescribed rider that allows the Company to recover certain environmental costs associated with coal combustion wastes and by-products.[133] These include the costs associated with the Big Sandy SCR facilities, the Company's member load ratio of the SCR and scrubber facilities at its sister utilities' plants, environmental fees, and the costs of NO_X and SO_X allowances.[134] Under Paragraph 3 of the Unanimous Settlement Agreement the base net environmental costs under Tariff E.S. are

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[131] Errol K. Wagner Hearing Testimony at 115.

[132] *Id.* at 114. Mr. Wagner further explained that because of the downturn in off-system sales margins otherwise available to offset Kentucky Power's revenue requirements were reduced. *Id.* This is a fact of rate-making and the use of a historical test year. To the extent off-system sales return to higher levels, the customers' share of the increased margins will help offset their rates going forward. *Id.* at 114-116.

[133] KRS 278.183; *Kentucky Industrial Utility Customers, Inc. v. Kentucky Utilities Company*, 983 S.W.2d 493, 496-497 (Ky. 1998).

[134] Errol K. Wagner Hearing Testimony at 125-126.

increased from $28,106,683 to $44,185,079.[135] The change has "zero impact" on the total rate paid by Kentucky Power's customers because the effect is to transfer the recovery of the environmental costs from the environmental surcharge to base rates, while reducing the recovery of environmental costs through the environmental surcharge by a commensurate amount.[136]

The modification of Kentucky Power's environmental surcharge under the Unanimous Settlement Agreement conforms to long-standing Commission practice, is designed to have no effect on the total rate paid by Kentucky Power's customers, and should be approved.

In sum, the Unanimous Settlement Agreement represents a fair and equitable balancing of the interests of Kentucky Power and its customers and results in fair, just and equitable rates.[137]

D. Conclusion.

Upon the evidence of record, including the May 25, 2010 evidentiary hearing, Kentucky Power Company is entitled to an annual increase in its retail rates far in excess of the settlement amount. As part of the settlement of this proceeding, however, Kentucky Power is willing to accept, but only in conjunction with the Commission's approval of the Unanimous Settlement Agreement without modification, retail rates designed to produce an additional $63.66 million in annual revenue.

Accordingly, Kentucky Power respectfully requests that the Commission approve the Unanimous Settlement Agreement without modification, and that the rates and tariffs specified therein, as set forth in more detail in the Settlement Testimony of Errol K. Wagner, Settlement

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[135] Unanimous Settlement Agreement at ¶ 3; Settlement Testimony of Errol K. Wagner at 6.

[136] Errol K. Wagner Hearing Testimony at 125.

[137] Settlement Testimony of Errol K. Wagner at 13-15.

Exhibit EKW-3, be approved and implemented without modification, effective for service rendered on or after June 29, 2010.

Respectfully submitted,

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CERTIFICATE OF SERVICE

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<u>EXHIBIT 1</u>

COMMONWEALTH OF KENTUCKY

BEFORE THE

PUBLIC SERVICE COMMISSION OF KENTUCKY

\- - -

In the Matter of The Application for General Adjustment of Electric Rates of Kentucky Power Company.	: Case No. 2009-00459

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PROCEEDINGS

before Chairman David L. Armstrong, Vice-Chairman James W. Gardner, and Commissioner Charles R. Borders, at the offices of the Kentucky Public Service Commission, 211 Sower Boulevard, Frankfort, Kentucky, called at 10:00 a.m. on Tuesday, May 25, 2010.

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On behalf of Wal-Mart East LP and Sam's East.

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INDEX

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Tuesday Morning Session,

May 25 2010,

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CHAIRMAN ARMSTRONG: It's just myself and I'm Dave Armstrong, I'm Chairman of the Public Service Commission. And with me is the Vice-Chairman, Jim Gardner, and our Commissioner is Charles Borders.

The appearance of counsel, those of you who I recognize and those who I don't. The Kentucky Power Company, Mark Overstreet.

MR. OVERSTREET: Good morning, Mr. Chairman, members of the Commission, I'm Mark R. Overstreet of the law firm Stites & Harbison, 421 West Main Street, Frankfort, Kentucky on behalf of Kentucky Power, and appearing with me today is Matthew J. Satterwhite who has been admitted pro hac vice.

CHAIRMAN ARMSTRONG: You are?

MR. SANDERS: Steve A. Sanders, I'm an attorney with the Appalachian Citizen's Law Center, 317 Main Street, Whitesburg, Kentucky 41858. I'm here on behalf of the Pike County Senior Citizens Program.

CHAIRMAN ARMSTRONG: Thank you very much.

MR. MALONE: Good morning. My name is Matt Malone, I'm here on behalf of the Kentucky School Boards Association, with the law firm of Hurt, Crosbie & May, 127 West Main, Lexington, Kentucky.

CHAIRMAN ARMSTRONG: Representing the Attorney General?

MR. COOK: Mr. Chairman, Vice-Chairman, Commissioner, my name is Lawrence Cook. Seated behind me is my co-counsel Dennis Howard. Our office is on 1024 Capital Center Drive, Suite 200, Frankfort 40601.

MR. BOEHM: Good morning, Mr. Commissioner. My name is Dave Boehm on behalf of KIUC, and with me is Michael Kurtz, also with Boehm, Kurtz & Lowry, 2110 CBLD Center, 36 East Seventh Street, Cincinnati, Ohio. And with us today as well is Kimberly McCann, co-counsel for A.K. Steel with the law firm of VanAntwerp, Monge, Jones, Edwards & McCann, LLP, 1544 Winchester Street, Ashland, Kentucky.

MR. CHUPPE: Mr. Chairman, Frank Chuppe of the law firm of Wyatt, Tarrant & Combs, 2800 PNC Plaza, 250 West Main Street, Lexington, Kentucky.

I'm here with co-counsel Holly Rachel Smith of Marshall, Virginia, who has been admitted pro hac vice on behalf of intervenor Wal-Mart East LP and Sam's East, Inc.

CHAIRMAN ARMSTRONG: Thank you, Mr. Chuppe.

Yes, proceed.

MR. COLLINS: Sam Collins from the law office of Deborah Lewis, 470 East Main Street, Hazard, Kentucky, and I'm counsel for Hazard (inaudible).

MR. CHILDERS: Joe Childers, your Honor, the firm of Getty & Childers, 1900 Lexington Financial Center, 250 West Main Street, Lexington Kentucky, representing Community Action Kentucky.

CHAIRMAN ARMSTRONG: Thank you, Mr. Childers.

Public notice has been given --

MR. RAFF: I would like to make my appearance. Richard Raff, Quang Nguyen, and Anita Mitchell, for the Commission and the staff, your Honor.

CHAIRMAN ARMSTRONG: Thank you very much.

Is the public notice filed in the file?

MR. OVERSTREET: Yes, it is filed.

CHAIRMAN ARMSTRONG: Are there any outstanding motions?

MR. OVERSTREET: Your Honor, the only thing I'm aware of is a joint motion on behalf of Kentucky Power Company and the Attorney General. It involved a dispute between the two over the confidentiality of certain responses to data requests, specifically numbers 47 and 51 to the AG's first set.

And the AG had moved to have a hearing on that matter and the Attorney General and Kentucky Power reached an agreement and we simply ask that the question of confidentiality be submitted for decision by the Commission on the record. So that's the only thing.

CHAIRMAN ARMSTRONG: Mr. Cook?

MR. COOK: Thank you, your Honor. We're in agreement on that.

CHAIRMAN ARMSTRONG: Comments, Mr. Raff?

MR. RAFF: Motion's under advisement and we should rule on it in writing.

CHAIRMAN ARMSTRONG: The Commission may choose to hear that at the end of our docket here.

So thank you.

We have a number of people here today and I don't know all of them would like to speak but this is the time for public response to this hearing. This is a post-settlement hearing and we're going to take testimony with regard to the post settlement.

I know there are a number of people here. Have they all signed up to speak, Mr. Raff, do you know?

MR. RAFF: May I just make the record very clear, the hearing today is for all issues on the rate application as well as any discussion or issues relating to the settlement.

CHAIRMAN ARMSTRONG: Correct.

Are there people who would like to be heard at this time? I'm going to allow about two minutes.

If you'll state your name, we should have a microphone right up here, if we can adjust that.

UNIDENTIFIED SPEAKER: Your Honor, my name --

CHAIRMAN ARMSTRONG: Kind of tap and see if it's working.

Try it again.

You've got a loud voice so I think --

UNIDENTIFIED SPEAKER: I think we got it now.

My name is (inaudible) and I'm from Pike County and we represent around 68,000 people in Pike County. We have approximately 24,400 that draw Social Security benefits and disability. And these people hadn't had a raise since 2008, according to the Social Security office.

And I'm here today to try to represent the people that can't be here. We have a lot of citizens that are on SSI benefits in Pike County and they only draw about $600 a month. And if this increase goes in, then they won't be able to make a decision on their medicine or food or whatever.

You know the power bill has to be paid first. We understand that. And then they have to adjust their living according to that. And we testified on behalf of the people and hopefully that we will say something here today that will have a little bearing to the Commission.

These people are in a situation to where they have to turn their thermostats down real low in order to get money to pay their power bills and try to keep it at a bare minimum. And people that live up in some pretty tough terrain in Pike County, I don't know if you all are familiar with it or not.

But we would hope that this Commission would take in consideration that the people that we represent and maybe try to set some kind of a rate to where the low-income and the people that can't afford to pay these bills could be adjusted to a percentage.

In Pike County we have a solid waste program and we charge them 10 percent of their check. And maybe that you guys could look at something like that to where these people could afford to pay their bills, and we just beg you to take all this in consideration and make a good judgment on it.

Thank you.

CHAIRMAN ARMSTRONG: Thank, Mr. Dotson.

Others who wish to be heard?

Seeing no other interested parties who wish to be heard at this time, we'll move on to the matter at hand.

Mr. Overstreet?

MR. OVERSTREET: Thank you, Mr. Chairman. The company's first witness is Mr. Timothy C. Mosher.

(Witness sworn.)

CHAIRMAN ARMSTRONG: Have a seat and speak up loud and give your name and address, and what you do.

THE WITNESS: My name is Tim Mosher, I'm president and chief operating officer of Kentucky Power Company, Frankfort, Kentucky, 40601.

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TIMOTHY C. MOSHER

being first duly sworn, as prescribed by law, was examined and testified as follows:

DIRECT EXAMINATION

By Mr. Overstreet:

Q. Mr. Mosher, did you cause to be filed in this proceeding testimony and rebuttal testimony?

A. Yes, I did.

Q. Do you have any corrections, modifications, or additions to that filed testimony?

A. No, sir, I do not.

Q. If you were asked those same questions here today, would your answers be the same?

A. Yes, sir, they would.

MR. OVERSTREET: Your Honor, I would tender the witness for cross-examination.

CHAIRMAN ARMSTRONG: Any questions?

MR. SANDERS: I have some questions.

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CROSS-EXAMINATION

By Mr. Sanders:

Q. Mr. Mosher, is Kentucky Power engaged in the sale of excess electric power to other utilities?

A. Yes, sir, we are, through an off-system sales program that we have, yes.

Q. And is that sometimes referred to by its initials OSS?

A. Yes, sir.

Q. When does Kentucky Power sell excess electric power; is it a continuous process? Continually during your business?

A. We operate as part of a pool within the American Electric Power system and when our generation is more than our customers demand at that point, the additional megawatts that we generate are available for sale in this off-system sales pool program.

Q. Is it unusual to generate more than your customers want or is it usual?

A. It's probably more usual than unusual. On a day like today we might, because of the heat, have the better chance of exactly meeting our customers' demands than having excess to put into the pool for sale.

Q. As the economic recession, that's sort of a general condition across the nation, has that affected Kentucky Power's off-system sales of electric use?

A. Yes, sir, it has.

Q. How has it affected the off-system sales?

A. I don't have a specific percentage reduction number but it has been reduced. Perhaps Witness Wagner would have a better opportunity to answer specific percentage numbers for you.

Q. I might ask him.

According to the American Electric Power's 2010 corporate accountability report, it's stated, quote, lower demand than the retail and wholesale market also resulted in excessive coal inventories and a 50 percent reduction in off-system sales volumes of the electricity we sell in the wholesale power market, unquote.

Would that seem to be accurate for Kentucky Power Company?

A. I don't know that those numbers would be specific to Kentucky Power Company, but as you stated, that is in the sustainability report so I would agree that reflects the position of American Electric Power.

Q. Did Kentucky Power lose significant income in declining off-system sales in the last two years?

A. In my opinion, yes, sir, we did. Again, Witness Wagner would be much better able to answer your specific questions on those numbers.

Q. The rate increase that Kentucky Power seeks in this proceeding for residential and small commercial would be used for revenues to offset the loss of revenues caused by the loss of off-system sales, correct?

A. That is one of the factors in determining the amount of rates to be set in base rates, yes, sir.

Q. Do the Kentucky Power shareholders bear the loss of the off-system sales decline?

A. The shareholders share in the formula for the sharing of profits of off-system sales. Again, specifics on those numbers would be better answered by Witness Wagner.

Q. If a rate increase is needed to offset losses suffered by off-system sales decline, shouldn't all of Kentucky Power's customers share that cost equally?

A. That is a factor that goes into the development of the rates that we have filed and the rates that we charge. So I hope I'm answering your question that that is part of the ratemaking process to include the off-system sales formula in it.

Q. If the proposed unanimous settlement agreement is approved, doesn't it call for a 16.84 percent rate increase for residential customers?

A. Yes, sir, it does.

Q. Doesn't it also call for a much lower rate increase for large commercial and retail -- and industrial consumers?

A. It does have a lower increase for those classes of customers, that's correct.

Q. In what's classified or characterized as Exhibit 1 to the unanimous settlement agreement, there is a listing by initials.

A. I do not have that in front of me. Can I borrow yours?

MR. SANDERS: I'll be glad to show it to him.

Q. I just wanted to ask you to go through that with me if you could.

A. I have in front of me Exhibit 1 from the settlement. It's EKW-1 which I would preface my comments by saying specifics about these numbers Mr. Wagner would be a much better witness to answer than I, but I certainly will try.

Q. If you look on the very left column it shows class RS. Do you know what "RS" stands for?

A. Residential service.

Q. "SGS"?

A. Small general service.

Q. And if you go over towards the right under the line "Total Increase," is that the percentage increase in the electricity rates under the unanimous settlement agreement for those two classes?

A. Yes, sir, it is.

Q. And what is that percentage?

A. 16.84.

Q. If we go down to on the left column "MGS", what do those initials stand for?

A. Medium general service.

Q. And "LGS"?

A. Large general service.

Q. And again looking at the total increase, is the percentage increase for those two classes of consumers greater than 16 percent?

A. It is greater than 16 percent.

Q. The next on the left is "QP." What does the "QP" stand for?

A. I am not recalling exactly what "QP" stands for. The "P" is power, the "Q" is quantity I'm going to -- quantity power.

Q. Is that large commercial consumers?

A. Yes. Large commercial and -- or, yes.

Q. What is the percentage total increase for that class?

A. 6.58.

Q. And the next category is "CIP-TOD." What do those initials stand for?

A. I believe it is consumer industrial power -- or, excuse me, commercial industrial power time of day.

Q. Are those your industrial consumers?

A. Those are the large industrial consumers usually fall into that class of customer.

Q. Would that include coal mines in Pike County?

A. I believe it would.

Q. And if you look at their increase, what is the percentage increase for that group of consumers?

A. 3.62.

Q. Your last three categories, do you know what those initials stand for "MW," "OL," and "SL"?

A. Municipal water, outdoor lights, and street lights.

Q. What is the rate increase for those three classes?

A. 16.84.

Q. So it appears that the large commercial and the industrial users are getting a rate increase that is significantly lower than that of the residential and the small retail commercial. Is that correct?

A. That is correct.

Q. Do you know what the maximum LIHEAP benefit is? Do you know what the LIHEAP program is?

A. I do know what the LIHEAP program is.

Q. What is it?

A. Low-Income Housing Energy Assistance Program -- Heating Energy Assistance Program, excuse me.

Q. Essentially it's a method of --

A. Helping low-income people pay for engineering bills, correct.

Q. Do you know what the maximum annual benefit is under the LIHEAP program for a residential customer?

A. No, sir, I do not. I do not.

Q. If the 16.84 percent rate increase is approved, won't that have the effect of reducing the LIHEAP benefit to customers who can't -- who need the LIHEAP to pay for their electricity?

A. I'm not sure I understand the question. Could you restate it for me?

Q. Well, if the LIHEAP benefit is a fixed amount and the cost of electricity goes up 16.84 percent, won't it have the effect of making the LIHEAP benefit less valuable?

A. That would follow I believe, yes.

Q. Do you know how many Kentucky Power customers received LIHEAP subsidies last year?

A. I do not have that in front of me. I do not know.

Q. Do you know how many Pike County residential users had their electricity terminated by Kentucky Power in 2007 for nonpayment?

A. I could get you that number. I do not have it in front of me at the moment.

Q. Well, it's in the answers to the -- or, the responses to the Community Action Kentucky's first set of data requests.

A. Okay.

Q. The question No. 1. I don't know if you have that with you or if you want me to show it to you.

A. I have some of mine. I'm not sure I have that one, sir.

Mr. Sanders, now that I have this in front of me would you please restate your question?

Q. Are these the Kentucky data power questions and you signed those, these are your answers.

A. Yes, I did.

Q. I'm looking at Exhibit 1 or answer to data request No. 1 I should say. It shows Kentucky

Power residential account information for the year 2007.

A. Yes.

Q. And Pike County is the next-to-last numbers above the line. Do you see that?

A. Yes, sir, I do.

Q. So how many residential users in Pike County had their electricity terminated in 2007 due to nonpayment?

A. 2,627.

Q. And what is the rate of disconnect of all Pike County residential users?

A. Appears to me to be 0.08.

Q. Would that be 8 percent?

A. 0.08. Which would be 8 percent.

Q. What about 2008, how many Pike County residential consumers had their electric terminated by Kentucky Power for nonpayment?

A. 3,400.

Q. What is the percentage of residential users that had their power terminated for nonpayment?

A. 11 percent.

Q. What about in 2009, how many consumers had their power terminated in Pike County for nonpayment?

A. 2,899.

Q. What was the percentage of users that had their power disconnected?

A. 9 percent.

Q. If the 16.84 percent rate increase is approved, what's your prediction for the percentage of residents of Pike County whose power will be disconnected?

MR. OVERSTREET: I'm going to object to that question, your Honor. I don't think Mr. Mosher has a basis to make predictions like that.

CHAIRMAN ARMSTRONG: If he knows, he is free to answer that.

A. I do not know the answer to that.

Q. Did you consider that when you were applying for the rate increase what would be the effect on residential users?

A. We did consider what the implications/impacts would be on residential consumers on the eventual rate that we applied for, that's correct.

Q. Did you consider it in terms of the numbers or percentages of people who would be disconnected for inability to pay for their electric power?

A. I do not recall that we ever went to that part of a discussion, no, sir.

Q. This is more of a hypothetical and if you don't know, you can tell me, but could Kentucky Power operate a system of rates which provided a price support to persons with certain impairments or disabilities such that they could not afford to pay for electricity?

Such as people who were on a low fixed income and also dependent on oxygen or other life support in their homes? Could you adopt such a rate system?

A. Make sure I understand your question. Do you mean develop something like lifeline rates that perhaps are used?

Q. Question could you do something like that?

A. We've not discussed that.

MR. SANDERS: That's all the questions I have, sir.

CHAIRMAN ARMSTRONG: Thank you, Mr. Sanders.

Mr. Cook?

MR. COOK: Your Honor, on behalf of the Attorney General, we're going to waive cross-examination of this witness. Reason we're doing so, your Honor, is because we believe that the stipulation that was submitted into the record on behalf of the other parties constitutes the best possible resolution of the rate case here. I don't know if Mr. Overstreet, if you wanted to address that further.

MR. OVERSTREET: I would just point out that it was a unanimous settlement agreement signed off -- and we would agree that it is in fact best in this case, it provides benefits that would not otherwise be available such as the company's not insignificant contributions to the Home Energy Assistance Program.

CHAIRMAN ARMSTRONG: One second.

And, Mr Cook, in this matter you represent whom?

MR. COOK: We represent the ratepayers, your Honor.

CHAIRMAN ARMSTRONG: Thank you.

MR. BOEHM: Your Honor, KIUC has no cross for this witness.

MR. MALONE: The School Boards don't have any cross of this witness.

UNIDENTIFIED SPEAKER: Your Honor, CAK has no cross-examination.

UNIDENTIFIED SPEAKER: Your Honor, we have no cross either.

(Inaudible.)

CHAIRMAN ARMSTRONG: Thank you.

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CROSS-EXAMINATION

By Mr. Raff:

Q. Morning, Mr. Mosher.

A. Morning, Mr. Raff.

Q. Let me just follow-up the last question that Mr. Sanders posed to you.

Are you aware of whether this Commission some years ago considered implementing lifeline rates and determined that under Kentucky statute that that was -- income was not a permissible basis to grade a class of customers?

A. Mr. Raff, I do recall those discussions. Although the specifics of it I would not be able to bring back. I do recall that that was discussed.

Q. All right, thank you.

Can you tell me a little about the budgeting process at Kentucky Power and how a -- how the numbers kind of come together and who reviews them and how they get finalized?

A. Yes, I can. Our budgeting process is really led from the Frankfort office for Kentucky Power Company. We have a business operation support group led by Rainy Wanhaus (phonetic) who is a witness in this case. He works in tandem with Everett Phillips who is our director of customer operations who's office is in Ashland.

He along with the three district managers, we have a manager in Ashland, a manager in Pikeville, a manager in Hazard. So that group really determines the budget process for Kentucky Power is myself, Mr. Wanhaus, Mr. Phillips, Mike Lazo, the manager in Hazard, DeLinda Bordon, the manager in Ashland, the manager in Pikeville, and then Joe Pemberton, a support person in Ashland is intimately involved in putting the numbers together for Kentucky Power Company.

Q. And once you put those numbers together then what happens?

A. We put those numbers together specifically for Kentucky Power and we then submit them to Columbus, Ohio, the corporate headquarters of American Electric Power, and at that level the operating budgets of all seven companies, all seven operating companies of American Electric Power are brought together and it's studied on the available dollars and how the budgets match those available dollars.

Q. And what input do you have into that process?

A. We have direct input into that process. I do at my level, Mr. Wanhaus does at his level, and Mr. Phillips does at his level.

Q. I'm not sure I understand what you're saying.

A. Well, we have meetings in Columbus where the company presidents get together and we discuss the overall budgeting process and how Kentucky Power's proposed budget fits that. That's also done at the business operations support level with the business operations support directors or vice presidents of regulatory and finance for the companies.

It's also studied by the distribution leadership team that Mr. Phillips participates in in terms of addressing where operating budgets come together across the seven companies.

Q. Okay, I think at one point you stated in Columbus they look at the available dollars; is that correct?

A. Yes.

Q. Well, can you maybe elaborate on that? I would assume you here in Frankfort, if you're doing budgets you would be projecting both your revenues and expenses? Are you not?

A. Yes, we are. And then we develop a budget to try and match the available dollars from revenues to the programs within that budget that we've put together.

Q. Okay. So what kind of a change would the folks in Columbus make to a budget that you have proposed and sent to them?

A. They would look at our overall budget and, you know, based on dollars we have set aside for specific programs and then they would make recommendations on best practices in other operating companies: Did you look at this kind of programming?

Did you consider this in developing your overall budget?

Q. Okay, and if they were to cut money in one area, would there be an equal increase in a different area?

A. That would seem to logically follow, yes.

Q. Does that in fact -- is that in fact what happens?

A. They had made recommendations to us in the past to take a closer look at specific programs within our overall budget. And we have done that.

Q. You're aware of recent problems with vegetation management on Kentucky Power's system, are you not?

A. If your reference is do we have some specific problem areas of keeping the trees out of the lines, yes, sir, I'm very aware of that.

Q. Okay, and that has been causing some severe problems when you have snow and ice storms; is that correct?

A. It has caused problems for sure.

Q. For the 12 months of the test year which was ending September 30, appears that the O&M expenses for vegetation management was 7.24 million.

But for the year of 2010 your budget is 6.5 million.
Can you explain why that budget would have decreased in 2010?
A. Actually if we go back to our last rate case and the base rates there we had some 5., and I could get you the specific number, I can't recall it off the top of my head, million in that category. We have overspent that intentionally to try and address some of the problems that you referred to with respect to trees in the lines.
For the budget cycle we recognize in the dollars that we needed to spend across the total operation of Kentucky Power Company we would only be able to budget at the 6., and I don't have that number in front of me either, the 6.-some million dollar level, one of the reasons why we included in the base rate case the need for additional reliability dollars.
Q. Do you know whether you originally included more than 6.5 million in your budget and whether that number was reduced by people in Columbus?
A. That, sir, I don't know that, the answer to that question directly. I do know that in looking

at our overall budget, we make decisions on shifting dollars from one category to another if there's a pressing need in another category as well.

Q. So even though for 2010 your budget was 6.5 million, are you saying that you could or you have the leeway to shift more dollars into vegetation management if you believe that it was necessary?

A. We in fact did that. We had budgeted previously this $5 million and we spent 7. We spent at a rate higher than that knowing that we had to begin to address more aggressively the vegetation management plan.

Q. I guess what I'm trying to figure out, as of the 12 months ended September of 2009, you'd spent on an annual basis 7.24 million. And then in December of '09 there was a significant couple of snow storms with a large number of extended customers being without service, and assuming that that was in large part because of trees growing into power lines.

And then when I see that for 2010 your actual budgeted amounts for vegetation management is decreased from what was 7.24 million down to 6.5 million, I'm trying to find a reason why knowing that you have that reliability problem and tree trimming problem you would budget less money, not more.

A. Well, we budgeted the dollars that we thought we needed for that program for the year 2010 based on the total dollars available for us to budget with, I guess is my best answer to that.

Q. Do you get to spend all of the revenue that Kentucky Power collects?

A. I would probably rather defer that question to Witness Wagner. I would try to answer it, Richard, but I might misspeak in terms of when you say the total revenue that we received from our customers, some of that goes to pay for our budgeting program, some of it goes to pay for dividends to the corporate headquarters, some of it goes to the salaries of employees.

Q. Okay.

MR. RAFF: Thank you, Mr. Mosher, I have no further questions -- wait a minute, one second.

No further questions.

CHAIRMAN ARMSTRONG: Mr. Overstreet?

MR. OVERSTREET: No redirect, Mr. Chairman.

CHAIRMAN ARMSTRONG: I have a question.

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EXAMINATION

By Chairman Armstrong:

Q. You're not an engineer, or are you?

A. Mr. Chairman, I am an engineer. The University of Detroit, 1969, December.

Q. You practice that skill in your daily routine?

A. Sir, I did. I've been with the AEP system just over 40 years. The first 15 I was directly involved in some form of direct engineering. Although I stay close to what's going on, I do not practice engineering on a day-to-day basis.

Q. You're not an expert?

A. Well, I'd like to think I'm a expert in some of the distribution programs that we provide in trying to serve our customers. I wouldn't consider myself an expert in network synthesis.

Q. Would you be an expert in circuit design?

A. Sir, probably not. I mean, I could take you through three phase versus single phase, delta V, open Y, and all those terminologies, but I would certainly defer to Mr. Phillips and our engineering support staff as opposed to try and make a stab at that myself.

Q. You're familiar that your circuits in this district are fairly long between circuit to circuit?

A. Yes, sir, they are.

Q. One is 260 some odd miles.

A. Yes, sir, we are very aware of that.

Q. At a 34,500-volt level.

A. Yes, sir.

Q. And is it the company's intention to keep that circuit at that length?

A. I would defer to Witness Phillips to answer your question directly, Mr. Chairman. But I know for a fact that we are continually looking at ways to sectionalize, and that's an engineering term, sectionalize those circuits into much more manageable distances. That's part of our overall distribution.

Q. Would that decision be made here in Kentucky at Kentucky Power or would it be made in Columbus?

A. That decision is made here in Kentucky with Mr. Phillips and Mr. Pemberton that I referred to, with input from our district managers who know in their districts the circuits that need the most attention.

Q. In your four-year cycle for vegetation management there's no mention of the circuits being bifurcated or sectionalized as you mentioned. Is there a reason for that?

A. Again, I would defer a more specific answer to Mr. Phillips, but I believe the reasoning that's not mentioned there is we were focusing more on control of the vegetation, what to do about trimming the trees, how long it would take us to get to that four-year cycle on trimming trees. We have other programs that address the sectionalizing, the automatic control of substations.

Q. What are those programs, if you know?

A. Boy, I'm going to miss the acronym, SCADA, and to ask Mr. Phillips, S-C-A-D-A. No, I'll miss it if I say it.

But when Mr. Phillips comes up, Everett will define SCADA. But that's one of the things we're looking at in terms of better control of a substation that's in a rural area where we have those long 34.5 kV circuits.

Q. As I already mentioned here, during the ice storm we had particularly lengthy periods of repair, and were those caused by the length of the circuits would you estimate?

A. That certainly was a factor, but more importantly, what happened specifically in that December snow storm was the enormous amount of the snow and the water content of the snow, how heavy it was coupled with and right on top of three, four, in some instances six days of rain that loosened the soil to the point that the trees could not support the weight of that snow and came down the hill or slid down the hill and took our circuits out.

One of the things I'm most proud of is our reaction to that snow storm. Granted there were people out for a long period of time, but I truly believe that was the best approach to complete restoration in that storm.

We were able to sectionalize some circuits and get people back on I believe in a very orderly fashion. But we couldn't get it all back at some times.

When a tree would come, and most of them were from outside the right-of-way, when it would hit one of the wires, if we were lucky it snapped the wire. Because we could just find that and fix it.

If we were unlucky it either broke a cross arm, snapped that piece of wood in two, or worse yet, snapped the pole.

And in most of those instances, as was brought up by the gentleman that spoke from Pike County, it is a mountainous ratio where a lot of those cases we actually had to hand carry the poles, cross arms, and wire in. It's not accessible by truck, especially with 20 inches of snow on the ground.

Q. One final question. Are substations considered a capital investment?

A. Yes, sir, they are.

Q. Could those decisions be made in Columbus?

A. Well, the decisions about substations in Kentucky are made in Kentucky. Now, granted, we work very closely with the transmission function. But the decision for the need and placement of a new substation is in fact made in Kentucky.

Q. That's a major expense, isn't it?

A. Yes, sir.

Q. About how much money?

A. Oh, I'd again defer to Mr. Phillips on that. I'd be guessing if I tried to give you a number.

Q. If you were planning to do a substation, you would start at your next rate hearing, wouldn't you?

A. Well, to recover the costs of a substation let's say between rate case, that doesn't happen. We don't recover the cost of that new substation until there's a subsequent rate case where it can be folded into the test year total amount of dollars necessary.

Q. So you're not planning for this set of rates to build a substation or any substations in the district.

A. Oh, I don't think I can say that. I would defer to Mr. Phillips. We're constantly looking at the need for new substations.

In fact I know that we're looking for additional funding for substation in the Hazard area and in the Pikeville area. We're continually looking at where to increase the overall reliability of service to our customers where we need new or expanded substations. And they are very expensive.

Q. I can't find it right now, but in your capital planning for the next four years, is there ample money to build a substation?

A. I'd defer the specifics of that either to Witness Wagner or Phillips. But I know that we have plans for some additional substations. Which means we are at least trying to budget those substations in our current capital budgets.

CHAIRMAN ARMSTRONG: Commission, questions?

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EXAMINATION

By Vice-Chairman Gardner:

Q. Yes, sir, Mr. Mosher. I know that you're increasing the amount of the environmental surcharge that's going to be -- the environmental surcharge that's going to be put into base rates from 28 million to 44 million.

Why is -- what additional environmental costs are there at this point that are in the environmental surcharge projects where you all are doing right now or they have already been completed?

A. Vice-Chairman Gardner, what I believe we're doing is because it's a base rate filing shifting the dollars that were in environmental surcharge into base rates and then resetting the base for the environmental surcharge. Witness Wagner would be very more detailed on the specifics of that.

Q. I guess I wasn't clear.

What environmental projects are there right now that Kentucky Power is doing?

A. It's not just environmental projects at the Big Sandy plant, although those are included. Because we're a deficit member in the AEP pool which means we buy from the AEP pool, any plant that's in the pool that is deficit is surplus we can take a pro rata share of their environmental expense and put it in our environmental surcharge because we're buying from the AEP pool.

Q. What projects are there right now going on at Big Sandy?

A. Right now at Big Sandy I know, and I don't know the specific answer to your question, but I know that we're doing work on unit 1, and I know that there's some work coming up for unit 2. But I don't know the specific answer to your question on an environmental project that's going on right now.

Q. One of the other witnesses better able to answer that question?

A. I would suspect perhaps Witness Wagner could address that.

Q. Okay. One of the things that you all are requesting in this or one of the things that has been agreed upon in the proposed settlement is a 10.5 percent ROE and it's going to apply to the environmental surcharge and it's also on allowance for funds used during construction.

Are there any projects -- now, on the allowance for funds used during construction, is that also a function like the environmental projects where you get to take credit from other parts within the AEP system or is that limited just to Kentucky Power projects?

A. Vice-Chairman Gardner, that specific question I would defer to Witness Wagner.

Q. Mr. Sanders asked you a question about off-system sales and I guess help me understand, if Kentucky Power is a deficit member with respect to capacity in the AEP system, why AEP receives off-system sales credited to them if they're a deficit member with respect to capacity.

A. I think this is the right answer, and if not, then I know Witness Wagner will correct it. But here's how I understand your question and what I think my answer to it should be:

We generate a thousand-60 megawatts at Big Sandy plant, we own 15 percent of the Rockport plant, that total is 1450 megawatts. Might be 1453 megawatts.

On a day let's say not today because today's supposed to be in the mid-80s, but let's say it's only 65 degrees today and we have both unit 1 and unit 2 running and Rockport is running to a point that our customers are only using 800 megawatts of power and we have 1453 megawatts running.

The difference between those two is then available if the AEP pool for off-system sales which benefit our customers and our shareholders in sharing of those profits. Now, on a day when it's very, very hot and perhaps one of our units is down and we have to buy from the pool, then it works the other way.

Q. So why are you considered deficit? Is that because of the Rockport, because you're counting Rockport in with the thousand-60 or are you a deficit because on an average day you need more than the 100? Or is this a question for Mr. Wagner?

A. Well, it is a question for Mr. Wagner, but because I know the answer I'm going go ahead and give it to you.

The reason we're referred to as deficit is there are days in January and February -- we are a winter peaking company, some of the AEP companies are summer peaking but we are winter peaking.

We could have a peak in the winter and I think our peak is 1662 or 1652 megawatts, which means when you add Big Sandy, Rockport together at 1453, we're deficit. That's what they based -- that's what they base the definition on.

Q. I am going to like to have Mr. Sanders' question answered about LIHEAP and then I have a question or two also about LIHEAP.

Is that -- would Mr. Wagner know that or is that something we need to ask for a post-hearing data request on?

A. I will gladly try and answer a question about LIHEAP, but if there's additional information that's needed because either I or Errol can't answer.

Q. It's just trying to understand what the settlement means.

A. Okay.

Q. In other words, previously there was a point -- there was a 10 cent per customer, it's gone up to .15 and then the company shareholders are contributing .125.

I'm trying to understand how many customers benefited from that before now, what is the maximum, what's the estimated number of customers that will benefit from that going forward? I just have no frame of reference as to what that means.

A. In my opinion that's an excellent question. Let me try and frame it and then perhaps we're going to need to follow up with some additional information.

In the last rate case there were factored in we charge the customers 10 cents per residential meter. The company agreed to match that for a 24-month period, two years. Those rates became effective in April of 2006 we did just that, we matched 10 cents per 10 cents that was collected by the customers.

Those dollars were then available for Mr. Childers' clients to take advantage of, although the money stayed within Kentucky Power Company and we worked with them on which customers would receive benefit.

So from a total number of customers that benefited, I would defer to those gentlemen or we could work with them and get you that answer.

Q. Well, maybe at the conclusion of the hearing I could ask Mr. Childers those questions so that I can get a feel for what this means.

A. In this settlement agreement then the 10 cents that's charged to customers went to 15 cents.

Q. Right. And then your all's contribution is .125, I understand that. But I'm trying to understand what -- I mean, not what the settlement actually is but what the impact of that is so that I can see the difference, how meaningful that is. So ask Mr. Childers that at the end of it.

And then I also have a question about Wal-Mart, so they would probably be able to better answer that. But do you know what class they are in, whether it's CIP or QP?

A. I believe Wal-Mart is in QP.

MS. SMITH: It is my understanding that Wal-Mart is in more than one class.

A. And Witness Wagner is agreeing to that as well.

Q. Do you know how many customers

participate in the realtime pricing tariff?

A. I do not, but Witness Wagner would.

Q. We previously approved a regulatory asset for three of the storms that occurred in 2009 and do you know -- and so my understanding is that December is actually, you all characterize it as two additional storms; is that correct or --

A. I believe that's the case but --

Q. Let me ask Mr. Wagner on this?

A. Yeah, I'd ask Mr. Wagner. I know there were a total of three, now whether . . .

Q. And then I have one final question and that has to do with the amortization of the Carbon Management Research Group and the Kentucky Consortium Carbon Storage fees. Is that better asked to Mr. Wagner?

A. Yes. Yeah, we are participating with them in that study.

Q. Sure, okay. So I'll ask those other questions of him.

VICE-CHAIRMAN GARDNER: That's all I have. Thank you.

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EXAMINATION

By Commissioner Borders:

Q. Mr. Mosher, hard to call you "Mr. Mosher" because I've known Tim through the legislature so many years and of course back in our Ashland area, but I'll show all due respect.

Mr. Mosher, from the standpoint that the original proposal from Kentucky Power was 123 plus million, and you would consider that to at that time to have been fair, just, and reasonable, your request?

A. Yes.

Q. And now what we have before us today is a settlement to where the various parties have agreed that 60 million plus is where we find ourselves and we would consider that fair, just, and reasonable and would take it.

A. Yes.

Q. My question would be while we all have had the opportunity, I know you all went out because I'd see you and stuff at various commissions and I certainly know the commissions travel at certain power districts and obviously everyone would like to get the rates down as low as possible, but some of the issues that you address in the 123 million-dollar proposal before reaching a settlement, such as vegetation management, such as you have employees now in their late 50s being retiring in five years and you all going to start putting a mentor program where these people could come on either be engineers or whatever and get the advantage of working with those folks for five years, such as replacing various pieces of equipment or getting the capability of equipment that would enable you to replace things maybe sooner before they cause a problem, things of that nature.

So I guess my real question in a nutshell is this: If 123 million is fair, just, and reasonable, and now we're here talking about $60 million plus being fair, just, and reasonable, what sacrifices have we made to want to single out to get us to that point then? Is that something we should be concerned about?

A. The 123.6 million was a number that was put together based on needs that we defined, we, Kentucky Power defined as necessary, and that's what it turned out to be using the test year numbers plus adding some other things, including the purchase of wind. Which I know is going to be handled in a later proceeding.

It also included $16 million in reliability funding because we really identified in order to get to a four-year trimming cycle as quickly as we could, $16 million in additional reliability funds would get us there.

It had an anticipated return of equity of 11.75 percent. It had depreciation rates that were different than what ended up.

The 123.6 million was made up of a lot of individual components that in my opinion we justifiably could point to and say that's what was needed. That's why we asked for those dollars.

In the negotiation process leading to the unanimous settlement agreement with the intervenors, it is give and take, we did give, I'm not sure we had any take, but we did give specifically the $16 million in reliability went down to 10, the ROE was 10 and a half. The depreciation rates were not changing.

Other factors were in there that we're going to have to make adjustments internally. We had dollars in the 16 million that we asked for originally to address the aging workforce issue. Well, we're going to have to change that a bit because of the fact that we're now down to a $10 million level.

So the 63.66 sounds like we walked away from half of what we needed, which we did need the 123.6, but based on what's in the unanimous settlement agreement in my opinion the 63.66 is a level of revenues that we can in fact make an impact on improving the reliability to serve our customers as well as address the other issues that are part of the case.

Q. Will you still be able to address this personnel situation where you have these folks coming in to training for those that are getting close to retirement, would you still be able to address that to a lesser degree?

A. Yes, sir, to a lesser extent we can still address that.

Q. So would it be fair to say that you'll get as much bang for the buck on the $63 million as you would on the 123, it's just to get more bang per dollar you're going to accomplish a comparable amount of things, just going to have to be able to do less?

A. Yeah, clearly we could do a lot more in the reliability area especially with 16 million as opposed to 10. But we believe the 10 is still going to get us to the four-year cycle and address the aging workforce issue, just going to take us a little longer to get there.

Q. So the key components of vegetation management, the personnel cycle, things such as the various pieces of equipment that you all are going to have that would enable you to identify some problems that might be created down the road you could deal with earlier, you'll still be addressing all those components in your opinion in this settlement would just take longer, would be fair?

A. Yes, sir, it would.

Q. And LIHEAP I know we've heard a lot of discussion about and so forth, and one thing that always concerned me I guess in my legislative years was while it was so grateful in our district, which my entire district I think was in the Kentucky Power district, to see people get a check to enable them to pay their power bill for a month.

Have you all ever addressed with the legislature or with some of these groups that are here today maybe while some people would have to get churches or whoever to help pay their bill but rather than paying a bill having the same problem next year taking the same comparable amount or maybe even more and really addressing the problem for 10 percent of those people and it's fixed, now their bills are going to go down for the rest of their days, have you all looked at that at all?

Do you hear where I'm coming from? Do I make myself clear?

I guess my concern is that every year as I understand it LIHEAP, when the programs comes before us we talk about putting plastic on windows and we talk about roofs and those type things, but do you know, does a considerable amount of LIHEAP just go to making the payment to the bill itself?

A. I believe it does but I would defer to Mr. Childers on that. We do have weatherization programs within our demand side management program, we're constantly working with customers to help them better understand that they can in fact affect their usage of kilowatt hours and in fact reduce their consumption, reduce their bill.

Q. And I guess my point is, and maybe this is not fair to even bring it up here today, but I think it is because of the players that we have here to get this accomplished.

But it's like the old adage you're talking about giving someone a fish or teaching them to fish. If we give them money to pay their electric bill and the doors are still cracks three inches and the windows are missing, and the roof is escaping, then what have we accomplished?

I just wonder if you all had the opportunity to work with the legislature and these folks to say we need to spend these dollars wiser won't be able to impact as many people perhaps but the 10 percent we attack this year with their bills have gone down more than just maintenance next year. They're going to get that savings for the rest of their life and more next year and more the next year. I just wonder if there's any dialogue.

A. There has been in the past and I know we've been involved in some of those dialogues. There was none in this past session of the general assembly.

VICE-CHAIRMAN GARDNER: Thank you very much, appreciate it.

CHAIRMAN ARMSTRONG: Redirect?

MR. OVERSTREET: No, Mr. Chairman.

UNIDENTIFIED SPEAKER: No questions.

UNIDENTIFIED SPEAKER: No questions.

MR. RAFF: Nothing further, your Honor.

CHAIRMAN ARMSTRONG: You're excused, Mr. Mosher.

Next witness?

MR. OVERSTREET: Mr. Chairman, we would call Everett Phillips to the stand.

(Witness sworn.)

CHAIRMAN ARMSTRONG: Have a seat. Speak up loud and clear your name and your address, what you do.

THE WITNESS: My name is Everett G. Phillips. I'm director of customer distribution operations for Kentucky Power. Address is 12333 Gavin Avenue, Ashland, Kentucky 41102.

MR. OVERSTREET: Thank you, Mr. Chairman.

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EVERETT G. PHILLIPS

being first duly sworn, as prescribed by law, was examined and testified as follows:

DIRECT EXAMINATION

By Mr. Overstreet:

Q. Good morning, Mr. Phillips.
A. Good morning.
Q. Did you cause to be filed in this proceeding prefiled direct testimony and prefiled rebuttal testimony?
A. Yes, I did.
Q. Do you have any corrections, modifications, or additions to that prefiled testimony?
A. No, I do not.
Q. If you were asked those same questions here today would your answers be the same?
A. Yes, they would.

MR. OVERSTREET: Mr. Chairman, the witness is available for cross-examination.

CHAIRMAN ARMSTRONG: Mr. Sanders?

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CROSS-EXAMINATION

By Mr. Sanders:

Q. Are you involved in the transmission and distribution lines and systems that provide power to the Kentucky Power Company consumers?

A. My primary focus is on distribution. That's what I'm in charge of. But I do work in collaborative efforts with the transmission group.

Q. Are there large industrial users that are in remote areas in Pike County who receive power from Kentucky Power?

A. Yes, there is. The coal mines, some of the coal mines.

Q. Are they classified as CIP-TOD in the classification of rate users?

A. Some are. I don't know if all of them are. I don't have that in front of me. I don't have . . .

Q. And do those consumers receive their power from transmission lines that also serve residential users?

A. Yes, through a step-down transformer. In other words, transmission comes in to a step-down transformer, then we feed it as a distribution into our -- into the customers' homes. So could be the same transmission line, yes, that serves.

Q. Could those transmission lines exist without the residential customers?

A. Yes, they could. And in some cases they do.

Q. Some cases there are special transmission lines to serve the industrial users, the remote -- the mines and the remote locations?

A. That's correct.

Q. In other cases the transmission lines serve residential users and they also serve these mines and these locations?

A. That's correct.

Q. So the cost of maintaining those transmission lines in the distribution system is not a cost for one class but it's a cost shared by other classes, correct?

A. Mr. Wagner would be better answer to that question. I'm in charge of the distribution so . . .

Q. Also I asked you about industrial users in particularly talking about coal mines in remote locations but are there large commercial users that are also on these transmission lines in various areas of Pike County?

A. Again, I don't recall their classification, their customer classification. But the primary transmission users are coal companies and gas companies.

Q. Are they gas --

A. In Pike County.

Q. I'm sorry.

A. In Pike County.

Q. I didn't mean to interrupt you.

Are they gas companies also located in remote locations?

A. Yes.

Q. Throughout Pike County?

A. Yes.

MR. SANDERS: That's all the questions I have.

CHAIRMAN ARMSTRONG: School Board.

MR. MALONE: No questions, your Honor.

UNIDENTIFIED SPEAKER: We have no questions, your Honor.

UNIDENTIFIED SPEAKER: No questions, your Honor.

CHAIRMAN ARMSTRONG: Mr. Raff?

MR. RAFF: Yes, your Honor.

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CROSS-EXAMINATION

By Mr. Raff:

Q. Morning, Mr. Phillips.

A. Good morning.

Q. In your prepared direct testimony you have some discussion with regards to vegetation management, something you call performance based clearing.

A. Yes.

Q. Could you explain exactly what that is?

A. Performance based is more of a type of vegetation management or control of just in time trimming. It's more of just in time, just before the trees hit the line, or you can even call it a reactive based trimming.

In other words, once issues have presented itself, then you're looking at your performance level and then you tend to take care of your vegetation in that manner.

Q. You're saying you trim trees before they touch into the lines?

A. Yes. But they may get close at times

versus trying to keep a set width.

Q. And that's true for your whole system; all trees are trimmed before they touch into the lines?

A. That is our goal, yes.

Q. You said your "goal." Is that what you do?

A. In some cases, just like I said, we have reactive based so in some cases the trees are touching before we get there.

Q. You say "reactive based." How do you know when the tree is about to touch the line in order to get out there and cut it? You have some schedule that you follow? Someone go out into the field to survey the trees?

A. Yes. We have planners that go out and look at -- as issues arise, we send planners out and look at those areas of concern.

Q. And is this the type of tree trimming that is performed by the other four utilities that comprise the AEP system?

A. You're referring to the other op co's within AEP?

Q. Yes.

A. There's a varying method among the op co's, Public Service of Oklahoma has just instituted their four-year cycle so they're on a cycle based. Other op co's within AEP are on a performance based approach as well.

Q. Indiana, Michigan, Ohio Power, Columbus Southern, Appalachian Power, all performance based?

A. Appalachian is performance based. Ohio has been performance based but my understanding is they are migrating to a cycle based.

Q. Okay, and how does a cycle based differ from performance based?

A. Cycle based you are -- you have a set schedule. In other words, as you get out there and as our plan is we're going to go out, take a true inventory of the trees as we cut them, and then you will know the type of trees, approximately how fast they grow.

So before they can get close to the lines again, you'll cut it on a cycle. In other words, anywhere from three to six years, which will be on average about every four years.

Q. And do you then just cut certain trees in a certain area? Or do you cut all of the trees when you're in an area?

A. Once you're in an area or a cycle based you will clear-cut the area. You will clear-cut the right-of-way.

Q. Is that what you would do now under the performance based?

A. Under the performance based you more -- you try to cover as much territory as you can so you cut what has to be cut. In some cases if you feel a tree is not going to be into the line for another four years, you may let it go.

Q. In this case there was a proposal to increase vegetation management O&M by a little over $16 million; is that correct?

A. That's correct.

Q. And under the proposal that's going to be reduced to $10 million; is that correct?

A. That's correct.

Q. Could you basically tell us what the company would have been doing if it had gotten the 16 plus million that it won't be doing with the $10 million?

A. Primarily we're going to be doing the same thing, it's just going to take us longer to do that. In the original plan it was 16 million over a five-year period, this would be 10 million over a seven-year period. So that that's primarily the difference.

The other difference would be we were going to take a complete inventory of our system upfront. Now we will take that inventory as we trim the trees. Trim the circuits one by one we'll do the inventory versus doing it all at one time.

Q. And when you say "inventory," can you tell me exactly what you mean?

A. The type of trees, the distance that's currently added, whether they're cycle busters within that zone, that circuit protection zone if you will. And whether we need to go back sooner.

So we can figure out what time frame we need to come back next time without having to always send a planner out looking ahead of time or waiting for a customer to make a complaint or bring up an issue.

Q. Does that consist of mapping? I mean do you just write down on a piece of paper there's an Elm tree or?

A. No, into our software system that we keep track of the type of trees, amount of trees that we cut and trim, remove, we're able to put that into our software program.

Q. Does that software program also have like a GPS that shows the physical location?

A. No, it's not quite that detailed, no. We list it by, if you will, by circuit zone, either it's in the station zone of circuit A or second protection zone or the third. That type of information.

Q. So it's more general in nature and you couldn't look at your inventory and determine the exact physical location of a tree? Is that true?

A. That's true.

Q. Okay. I believe the additional monies were to or are to include the hiring of three foresters to be retained on a full-time basis; is that correct?

A. It's three contract foresters, yes, sir.

Q. Contract, okay.

Can you tell me what their duties will be?

A. Their duties will be to assist our current company foresters, there's currently four of those, in planning and monitoring work. They'll go out and ensure that contract crews that we bring on are performing to our standards, are working efficiently and safely.

Q. And will these three additional foresters be employed for just the first six months or for how long?

A. The plan is for them to be on as long as we need them. And that will be as long as we have this level of funding, this many contract crews we feel we'll need the additional help.

Q. Okay. Does Kentucky Power have any full time employees whose duties are vegetation management?

A. Yes, we currently have four.

Q. Four employees?

A. Yes.

Q. And all other tree trimming is done by contractors?

A. That's correct.

Q. And is that work done on a bid basis?

A. No, we have an alliance contract with Asplundh currently. We work through Asplundh or with Asplundh on that.

Q. Have you ever done it on a bid basis?

A. Yes, we have, and -- yes, we have in the past.

Q. How long have you had a contract with Asplundh?

A. I don't recall for sure, but I believe it was around the year 2000. But I don't recall for sure exact.

Q. And is that something that is specific to Kentucky Power or is this some kind of a contract negotiated by the AEP system for many of the operating companies?

A. We have a separate contract for Kentucky Power with Asplundh. But several of the AEP affiliates contract Asplundh as well.

Q. And under that contract do you pay just an hourly rate or is it based upon the crews' performance?

A. It's both. We do pay an hourly rate but they also have what we call KPI, key performance indicators that we do measure productivity in their performance in order to get additional pay.

Q. Do you know whether there's been any studies done to determine whether paying just on an hourly basis is the best way to hire tree trimmers?

A. I don't know if there's been any studies. I do know that our sister affiliate Ohio, AEP Ohio has recently put some out to bid.

We have tried a few different things here in Kentucky, a lump sum bid, if you will, with Asplundh and we have been evaluating that. But as far as any actual studies, I'm not aware of any.

Q. Asplundh the only company that does tree trimming?

A. No. There are others.

Q. Do you know whether they've ever taken any bids with others within the last ten years?

A. Kentucky Power has not. AEP has.

Q. Do you know why Kentucky Power has not?

A. Let me back up. Let me back up. Not in the last ten years. I don't know when the contract -- we probably took bids in the early 2000 time frame. I can't recall when. But as far as since this contract's been running with Asplundh we haven't taken any bids with other tree trimmers.

Q. Think it might be reasonable to do so?

A. Yes. Yes. That is our plan to evaluate, and whether we can get that done in this first six months or not, that may be something we have to focus on for 2011 to get the contracts in place.

Q. I believe there is as part of the proposal for the vegetation management going to be an increase from 71 to 91 crews?

A. Yes.

Q. And there's also going to be a budgeted 80 hours of overtime?

A. Yes.

Q. Is that per crew?

A. That's per crew, yes.

Q. And could you explain the reasons why there would need to be budgeted overtime?

A. In order to -- because those -- the current crews that we have on staff are experienced crews. In order to get the biggest bang for the buck, if you will, for these first -- for the second half of the year, the first six months of the additional funding, I just feel it's prudent to use our existing workforce as effectively as we can. Because it just takes quite a bit of experience to work in the tough terrain of Pike County and Perry County, Letcher County, that area.

Q. Is the expectation that beyond the first six months that that level of overtime will be reduced or eliminated?

A. It will be replaced with additional crews that we would bring on at that time.

Q. Okay. And is it safe to assume that it's more cost-effective to have crews that are being paid at straight time rather than existing crews at overtime?

A. Yes.

Q. What you filed here was a fairly detailed plan covering the first six months. Do you have a similar plan for the second six months?

A. That's not developed yet but for the second six months for 2000 year we planned on developing a very similar plan.

Q. Do you have that plan with you? I think it was --

A. Yes, I do.

Q. -- filed on May 20th.

Let me ask you, I think you heard me ask a couple of questions to Mr. Mosher about the budgeting process and the fact that for the test year the 12 months ended September 30th of '09 that the vegetation management O&M expenses were 7,240,000, whereas at page 1 of 3 of this document shows that for 2010 that amount was going to be decreased 6,500,000?

Was that the amount that you had originally budgeted for 2010, do you know?

A. I don't recall if that was the original amount or not. The budgeting cycle starts -- for the original plan year starts almost practically a year in advance. I don't recall for sure what that number was or would have been.

Q. Well, after the December snow storms and the significant service outages, was there any efforts to increase the amount of O&M expenditures for 2010?

A. Yes. Currently I'm overspending this budget.

Q. What level are you now spending?

A. Through April's numbers what I recall, I don't have those numbers in front of me, but we're right at I think about 700,000 over our current budget of the 6 and a half.

Q. So over a four-month period you're 700,000 over? Is that what you're saying?

A. Yes.

Q. If you could refer to Exhibit 2 to that document please. It's titled "2010 Second Half Kentucky Forestry Plan Summary."

A. Yes.

Q. Did you put that plan together?

A. Yes, with the help of the foresters and Joe Pemberton, as Mr. Mosher has brought up before, our support manager.

Q. Many of the comments listed on the right side refer to feeder breaker zone. Could you explain what that means?

A. Again, our feeder breaker zone is your first zone outside of the station circuit breaker. And so that is where your most customers reside on any circuit.

In other words, if that first zone goes out, the whole circuit goes out. So if we can get the first zone cleared, then in a sense we will be affecting the most customers in a positive way.

Q. And for the line miles that are listed on the lines where you have the comments feeder breaker zone, those are the lines -- those are the line miles from the station to the first breaker; is that what you're saying?

A. No. The line mile column which is the one, two, three, four, the fifth column over, that's the one you're referencing?

Q. Yes.

A. That is your miles of that circuit.

Q. Okay. If we look at one, two, three, four, five, six, eight lines down, Pikeville, Henry, Clay Station.

A. Okay, thank you, yes.

Q. There's line miles 80, miles planned 5.62, feeder breaker zone.

A. Correct.

Q. So the whole circuit is 80 miles, and what does the 5.62 represent?

A. That's the feeder breaker zone. That's your first zone. That's how long the first zone is.

Q. Okay. So then the other 74 plus miles will not be cleared under this proposal; is that correct?

A. If you look under the next line, it's the same circuit, the second zone 4.8 miles of the second zone will also be cleared in this first six months of the program.

Q. Okay.

A. Which impacts a large number of

customers. So again, we're trying to hit as many customers as we can as quickly as we can with the additional funding.

Q. Is clearing through the feeder breaker zone what Kentucky Power has typically done in the past and what you refer to as the performance based?

A. It has been a primary focus, yes.

Q. Do you know when the rest of these circuits will get cleared?

A. We will be putting a plan together for next year and be filing it with the Commission in September, and at that time we will take several things into consideration until we get it to a four-year cycle we'll continue to look at the historical trends, number of outages, the number of customers that are affected on those circuits, and evaluate which circuits we need to or portions of circuits that we need to focus on for next year.

Q. And under the comment column those that show full circuit clear, can you tell me what that means?

A. That means we will completely go through that circuit single phase and three phase as we clear. Like, for example, the very first one, we had started on that one previously and we've been working on it currently actually this year. And so we're going to finish that out in the second half and do that entire circuit.

Q. And the proposal here is that in over the course of seven years you will then be able to be on a four-year cycle; is that correct?

A. That's correct.

Q. Now, when we say four-year cycle, does that mean that every circuit will be fully cleared within the four-year period?

A. That's correct.

MR. RAFF: If I could have a minute, your Honor, I may be done.

Q. Mr. Phillips, in part of the agreement that's been submitted in this case includes provisions for reporting under paragraph 5, which is titled "Reliability." Are you aware of those reporting requirements?

A. Yes. Are you referring to the settlement agreement?

Q. Yes, sir.

A. Okay. Yes, I'm aware of those.

Q. Are you also aware of an order issued a few years ago by the Commission in Administrative Case 2006-00494 which had to do with reliability maintenance practices?

A. Yes, I'm aware of that.

Q. And are you aware of the reports that Kentucky Power has been filing annually pursuant to the Commission's order in that administrative case?

A. Yes.

Q. And those reports include many items in much more detail such as ten worst performing circuits; is that true?

A. That's correct.

Q. Is it your intent that you will continue to file the information annually under that administrative case as well as the information that you're proposing here under the provision of the settlement agreement? Or is one to replace the other?

A. No, it's my intent to file both of them.

Q. Okay, thank you.

I'd asked you some questions about some long circuits but I have a feeling the chairman would like to ask those. So I think my throat needs a break anyway, so thank you, Mr. Phillips.

A. Thank you, Mr. Raff.

CHAIRMAN ARMSTRONG: Thank you, Mr. Raff. I do have a few questions in that regard.

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EXAMINATION

By Chairman Armstrong:

Q. You do agree with the Ike and Ice Report that the Commission has issued --

A. Yes.

Q. -- and the findings of that?

Where else in Kentucky do you find such long circuits as we have in Eastern Kentucky?

A. I don't know outside of Kentucky Power service territory. I'm not sure of the configuration of other utilities.

Q. Haven't made an exhaustive search but I don't think there are any as far as yours.

I learned early on when I came here that after storm damage the shorter the line, the quicker the restoration. Is that an apt conclusion?

A. It's more based on your sectionalizing devices. In other words, if a tree falls through the line, be it a tenth of a mile or be it a hundred miles, if you don't have it sectionalized, broken up into sections, then, yes, the entire circuit's got to be locked out.

But we do have ours sectionalized into smaller portions. So we take advantage of the 34.5 is brought on because of the numerous coal companies in our area and the continuous miner that the coal mines use causes a lot of flicker on the system.

So on a traditional 12 kV system that most of the utilities do use then and we have a lot of 12 kVs as well, but in the coal mining area, 34.5 kV is a more engineering economical voltage to serve our customers in those areas.

Q. So after these three storms or two storms, how many storms exactly did you go through in this historical period?

A. In 2009 I believe we had a total of five storms that were classified as major storms.

Q. On these large circuits like the Haddox quicksand circuit, how long is that again? Would Mr. Wagner know it?

A. You don't have that data? I don't think he has that data in front of him. But a rough estimate is about 200 miles for that circuit.

Q. 160 something?

So when there is a tree that cuts that circuit, is everyone on that circuit up to the, as you said, sectionalization out?

A. That's correct.

Q. Do you know, Vice-Chairman and myself, we had three hearings in the service district and outside of the rate increase the predominant issues were outage and the lack of service and the lack of reliability. Were you at those meetings?

A. Yes, I was at all three, yes.

Q. Did you agree with the public saying that?

A. I understand that the public's -- some of our customers have seen several outages. In particular for 2009.

Q. But I heard them personally in Hazard and in Pikeville. I was keeping track. Are there more issues about reliability than the cost of your rate increase? Does that mean you're not able to design a system that people can rely upon?

A. No. Our customers can rely and we provide a reliable service. We do have some tough terrain that has been brought up before and that makes for some unique challenges in that area in particular.

And that's why we've asked for and in this unanimous settlement agreement with the $2 million we think we can really make a significant impact on reducing those numbers of tree-related outages which have been the primary cause of outages for our customers.

Q. So this four-year plan or cycle is going to take five years to transition; is that correct?

A. It would take seven.

Q. Seven years.

A. Under the settlement agreement.

Q. As I look at the not of money you're putting into the incremental capital, according to Mr. Mosher's estimation if it's a half a million dollars per substation, do you have planned in incremental capital to do some substations over seven years? Some new substations?

A. In this unanimous settlement agreement there's not any incremental capital dollars. The 10 million is all O&M dollars.

Q. I'm looking at your graph here, figure 9.

A. In my testimony?

Q. Yes.

A. Under the original plan this incremental capital in figure 9 was to address trees outside the right-of-way, hazardous trees.

Q. Well, in the right-of-way.

A. That's growing in the right-of-way.

Q. Do you ever anticipate having to shorten these circuits?

A. We constantly evaluate it. We currently are looking at and making plans to add a substation in the Hazard area. It's to relieve loading off of the Bonham station in that area. And we're working up a plan working with transmission group and so we do have plans. And that will help the Haddox area and so there will be an opportunity to, in your terms, shorten the circuit. But we, in other words, have another circuit tie and you can change the open points if you need to.

CHAIRMAN ARMSTRONG: That's all I have.

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EXAMINATION

By Vice-Chairman Gardner:

Q. Mr. Phillips, I'm going to follow up on a couple of these areas.

Are you aware of how much other operating companies pay or spend with respect to vegetation management compared to Kentucky?

A. No, I'm not aware. I can't recall what the other sister companies spend on forestry alone.

Q. So you don't know, for example, whether Appalachian Power spends the same or more or less than Kentucky Power does?

A. No, I don't know for sure. I'm sure they spend more, I mean they're a larger company. But I don't know their amount.

Q. Is there a percentage, is this like a figure as to what is standard within the AEP system as to how much is spent on clearing on vegetation management per mile or per circuit? Is there any figure that you all use as a rule of thumb?

A. Not that I'm aware of, no.

Q. Okay. On page 10 of your direct testimony, at the very bottom of the page, I guess line 22, you talk about that the plan that was being developed here that you talk about in your testimony is to address what we said with respect to Ike and Ice. And then you also said a deteriorating distribution system.

Tell me what you meant by that. What is

"deteriorating" with respect to the distribution system?

A. It's anticipated that if we didn't get additional funding, that over time within inflationary costs and increases in wage rates and et cetera, that we would not be able to keep up with the system and you therefore would see a deteriorating system.

Q. You were not meaning to say that it was already deteriorating?

A. That's correct.

Q. Well, and this kind of goes to what Commissioner Borders was asking of Mr. Mosher before. As I understood it, what your testimony did was divide it into four different areas that you were going to allocate significant funds to improve to keep the system from deteriorating, one of which was vegetation management, right?

A. Correct.

Q. Okay. And then No. 2, well, No. 2 was enhanced equipment inspection and mitigation. And under the -- and you have -- you had a chart talking about how much money was going to be spent with respect to that.

And tell me, is that -- are the dollars that were being allocated for that, and I think the charge is on page 29, tell me what is with respect to the settlement, are all those dollars going to be the same or not? With respect to that --

A. With respect to the settlement, there will not be any fund allocated to this chart of figure 11.

Q. All right, so no funds will be allocated to that. And that was one of the four areas that you thought were important, correct?

A. Correct.

Q. And again just so I understand, back to what Mr. Sanders was asking to make clear that I understand it, in your testimony you are only talking about distribution and not transmission.

A. That's correct.

Q. Your third point was the distribution workforce planning initiative, and tell me what changes in the settlement will be made, and I believe that chart is on -- for this section is on page 32 of your testimony.

What changes are there in the settlement from what you are proposing here?

A. Again, in the settlement there will not be any funds allocated for this initiative.

Q. And then the fourth one is Grid Smart initiative, which includes SCADA and other things like that.

A. That's correct.

Q. Tell me what are there -- is any monies for that in this plan, in the proposed settlement?

A. No, not in the settlement there's not any funds been allocated for this.

Q. But there had been, just again to make sure we're talking apples to apples, in items 2 through 4 that I've just gone through your testimony, those were monies that were specifically allocated if the Commission had approved the 123 figure.

A. If they had approved the 16.4 million for the reliability plan, full plan. Which was a part of the 123, yes.

Q. Now I'm confused. So the four items 2 through 4 which I've just gone through, that you're saying there's no money in those under the settlement. There was money before. Are those monies all -- were those monies all part of the 16.4?

A. Yes.

Q. So they were included within the 16.4.

A. Correct.

Q. And now nobody, none of those are going to be included because we're only including 10 million in incremental costs.

A. Correct.

Q. Now, additionally, in answer to questions from Mr. Raff, it seemed as if there won't be an inventory taken at the beginning, and in fact the inventory will just happen as you're going through the cycling of the whole system.

A. That's correct.

Q. And you're extending from seven years to -- or, excuse me, from five years to seven years the initial going through.

A. That's correct.

Q. And you're saying removing all those items 2 through 4 plus those additional, and I haven't done the arithmetic, comes up with that 6 million a year difference? It's not more than 6 million, it is that 6 million?

A. 6.4 million what I recall. Now, some of these items had incremental capital as well besides the 16.4.

Q. 16.4 that you were proposing of additional monies was only O&M.

A. That's correct.

Q. So then there was an additional capital that was being proposed in each of these different four that were not part of the 16.4 million.

A. That's correct.

Q. I didn't understand that. And that's helpful.

A. Okay.

Q. So the capital in items 2 through 4, is that going to be done or not under the settlement?

A. Not under the settlement.

Q. So 2 through 4, no O&M, no capital.

A. Right.

Q. Item 1, let's talk about that for a second, the enhanced vegetation management. You were originally proposing 6.4 million, under the settlement it's 10 million.

A. 16.4, and it's -- are we just speaking of vegetation only?

Q. Yes, I'm only looking at the No. 1, the vegetation management.

A. The vegetation portion under the original request plan was for roughly 14 million.

Q. Okay.

A. Or 14 and a half.

Q. So in the other 2 million were some of these other things.

A. Right. Was 2 through 4.

Q. So in the vegetation management alone we've reduced that from 4 million to 10 million.

A. 14.

Q. So the 14 million to 10 million.

A. Correct.

Q. Now, and I think back to Mr. Raff's question, on page 18 of your testimony, the proposal includes -- excuse, me line 21 to 22, an incremental capital component of 2.04 million for removal of large hazard trees and widening of ROWs. That is now not in the proposal settlement agreement; is that correct?

A. That's correct, it's not in the settlement agreement.

Q. Because that includes capital costs which are not in there.

A. Correct.

Q. Now, in the charts that you had, and

particularly on the vegetation management, you had the -- it was in the chart but the chart referred to it in vegetation management there were incremental costs.

A. Correct.

Q. And the -- try to find what page.

A. Page 23.

Q. Thank you.

And we're using a base amount that those incremental costs are of 9.28 million, 2 million of which is capital and 7.24 O&M. My question is how much of that is going to be still available in the going forward?

A. That full amount the O&M portion, the 7.24 will be in addition to the 10 million.

Q. So that means that -- does that mean that because the 2.04 capital is not included and there's no capital included in the settlement part of it, does that mean that the capital allocated to vegetation management is actually going to be reduced in the settlement?

A. It's not been -- it's not part of the settlement. I fully intend to have capital available for the forestry program.

Q. At approximately what dollar amount would you expect?

A. I would expect it to be similar to what we've historically done.

Q. And if Mr. Raff asked this question, I apologize. When he was talking about the 6.5 million in the budget for this year, was there any capital in addition to the 6.5 million?

A. Yes.

Q. What was that capital amount? In the budget.

A. I don't have that in front of me. I don't recall.

Q. Would it be fair to say it was in the range of 2 million plus or minus?

A. Yes.

Q. So it's the intention of AEP then to continue this 9. roughly allocated for O&M plus capital in addition to the 14 million for vegetation management.

A. No, the 10 million.

Q. Excuse me, correct, I apologize, that's right.

Let me just check my notes.

VICE-CHAIRMAN GARDNER: That's all I have, thank you.

CHAIRMAN ARMSTRONG: Mr. Borders?

COMMISSIONER BORDERS: Yes, thank you, Mr. Chairman.

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EXAMINATION

By Commissioner Borders:

Q. I couldn't resist at least making that comment on this 2 million trying to get a reference. I live in Carter County, it's about 120 miles from this building to my home and if I go home today it takes me two hours on the interstate, turn around and come back, that's 240 miles, that's less than that 270 miles, that's a long stretch.

On page 20 of your testimony, Mr. Phillips, you reference and you show a nice chart there, 47 percent estimated reduction in outages based upon field observations. And you show the impact of that from 2010 would be 3,694 down to 1,958 tree caused outages, 47 percent reduction.

Now, is that also based upon the $123 million settlement as opposed to the -- 123 million as opposed to the settlement?

A. That's based on doing it over a five-year period.

Q. And I guess my question along this would be when we think about return on equity and we all wage and invest on a product we think it's too late to buy stock yesterday that something good happened, would it make sense, and maybe this is not fair to ask you this question, but I just asked that because your chart is in this and your testimony, would it seem reasonable to ask the shareholders to bear a portion of that because if they're going to get that kind of result, a 47 percent reduction in outages, in the end would the company, they've invested, not to sell more electricity on the one hand with revenues and not have less cost with all these outages, would it seem reasonable to maybe ask those folks to bear a portion of that?

A. You're correct in that I think Mr. Wagner would be much better suited to answer that question. But all customers will benefit from a 47 percent reduction in outages.

Q. And you also mentioned and you'll have to just around page 13 and I'll quote, we would be able to move reactive vegetation management to a more proactive vegetation management program. Does that enable you to make that same statement?

A. Yes.

Q. Right-of-ways are extremely important. I can't tell you the amount of times we see orders come in or reports of outages where it's been a downed tree outside the right-of-way that's fallen and slid down the bank of whatever and fallen on those wires and poles and so forth.

And you all have made a reference to a more aggressive effort from a right-of-way perspective to be able to cut those trees outside of right-of-way. The folks in this very rough terrain we're talking about this 270 miles, well up into Eastern Kentucky.

Do you get much grief in going and asking to cut those trees out of right-of-ways that are -- I can see when you're in downtown Lexington you want to take a tree out, maybe someone gives you grief, but could you not move all those trees just maybe upon the asking if you explain to the customer that could hopefully decrease the outages?

A. Unfortunately there's some property owners that don't want their trees trimmed. So we still face those challenges even in Eastern Kentucky as well. They like their wooded areas.

Q. And your more progressive position toward this, where is that coming from? You're progressive in out of right-of-way trees.

A. In the past we have taken our customers' point of view on it that we'll just trim enough to get by for now and move on to the next tree. But going forward because the line affects so many customers more than just that property owner, we're going to try and take a more aggressive approach with those property owners to try to maintain a more established right-of-way.

Q. And Mr. Raff touched upon this. Your right-of-way crews, you have some subcontracting or contracting you do out for some folks but do you have your own crews as well, do you?

A. No, not to actually trim the trees. We use all contractors to do the actual trimming.

Q. And when you make reference to increasing the number of employees and so forth, we're talking about contract employees as opposed to Kentucky Power employees?

A. That's correct.

Q. And I've often wondered and I'm very appreciative when we have these storms and it seems like hundreds of trucks are lined up from out of state because they're going to help get our people's power back on.

But I often wondered would your cost not be reduced if you employed these contract or employees of Kentucky Power on a year-round basis to keep the cycle as short as possible compared to when we have these storms and you've got to bring these people from out of state and house them and all those kind of things?

I'm sure you all have looked at those kind of figures?

A. Yes, that's been evaluated and it's the industry standard to use contractors. That's been evaluated.

COMMISSIONER BORDERS: Thank you very much.

Thank you, Mr. Chairman.

CHAIRMAN ARMSTRONG: No further question?

VICE-CHAIRMAN GARDNER: Yes. I forgot to ask one more question that's along the lines of what Mr. Sanders was asking.

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FURTHER EXAMINATION

By Vice-Chairman Gardner:

Q. Just so I understand, on the commercial industrial power TOD there's no reliability increase, none of the increase goes to those customers? Or do all of those customers, are they all transmission, do they get their power all from transmission or do they get some from distribution?

A. My understanding they get it all from transmission.

Q. And the QP, is that a few of them get it from distribution and a few get it from transmission; is that right?

A. There could be a mix there, yes.

VICE-CHAIRMAN GARDNER: Thank you.

CHAIRMAN ARMSTRONG: Redirect?

MR. OVERSTREET: Yes, Mr. Chairman. The witness has been on the stand for an hour, 15 minutes. Do we want to break for lunch?

CHAIRMAN ARMSTRONG: How much time do you need for your redirect?

MR. OVERSTREET: Shouldn't be too long.

CHAIRMAN ARMSTRONG: How you doing?

MR. OVERSTREET: It's his first time.

THE WITNESS: Considering it's my first time.

CHAIRMAN ARMSTRONG: Would you like a break?

THE WITNESS: Sure. Really I would like a break.

CHAIRMAN ARMSTRONG: Well, it's now the noon hour, if you'd like to break for lunch, we can do that and we can come back.

MR. OVERSTREET: It's whatever is the Commission's pleasure.

CHAIRMAN ARMSTRONG: Mr. Raff?

MR. RAFF: I'm fine.

CHAIRMAN ARMSTRONG: Anybody else?

Yes, sir.

UNIDENTIFIED SPEAKER: We've got a lot of people that traveled a long distance and if we have time it's going to be real late to get back. Respectfully I'd like to ask that there might be a couple that would want to comment on what they've already heard and we'll have to leave when you break for lunch. (Inaudible).

CHAIRMAN ARMSTRONG: We really don't have comment. Your counsel may have some comments. But that's the purpose of having the opportunities to speak before we began.

UNIDENTIFIED SPEAKER: Well, speaking for myself there's just a minute and a half worth (inaudible).

CHAIRMAN ARMSTRONG: Wait, wait, this is not the time to do that. So just hang on.

We want to go ahead and finish this witness if we can.

MR. OVERSTREET: Surely.

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REDIRECT EXAMINATION

By Mr. Overstreet:

Q. Mr. Phillips, Commissioner Borders was asking you about contract crews. Are those -- do those contract crews that you intend to hire for your regular vegetation management program, I'm not talking about special crews brought in for storms, where do they live?

A. Those contract crews live within the areas that we serve. I mean they're local employees.

Q. So the difference is only in who their employer is, whether it's Kentucky Power or Asplundh?

A. Yes.

Q. And with respect to figure 7 on page 20, this is a projection of the number of avoided tree cost outages once the four-year cycle was implemented; is that correct?

A. Yes.

Q. And would your projections in the re -- 47 percent reduction in the number of related outages being the same once you get your reduction in the number of tree-related outages be the same? Once you get your four-year cycle at the end of seven years under the settlement?

A. Yes.

Q. It's just going to take a little longer?

A. Will take a little longer.

Q. Okay. Mr. Raff was asking you some questions about I believe it was the distribution vegetation management plan. It was Exhibit 2 I believe. Yes.

Could you just briefly explain to the Commission what is represented there on Exhibit 2?

A. This is the circuits and their district that they're located in. It just lists circuit by circuit the clearing, the tree trimming plan for that circuit for the remainder of 2010 for the second half of 2010.

Q. And why were those circuits chosen to be addressed in the first six months of the -- under the settlement plan?

A. Some of them are what's performing circuits that are identified in the 2009 plan that we submitted to the Commission as well as areas that had -- we've had some issues with and it's areas that we can affect large customer blocks very quickly to make some improvement to our reliability.

Q. Would it be accurate to say that you felt like you could have the largest immediate impact by addressing these circuits?

A. Yes.

Q. And is it your intention to spend a full $8.62 million to do that?

A. For the second half of the year, yes.

Q. And Vice-Chairman Gardner was asking you some questions about the relationship between the settlement plan and the plan that was proposed as part of your testimony. Do you remember those questions?

A. Yes.

Q. And in particular he was asking you about capital expenditures. Is it the company's intention not to make any capital expenditures to improve reliability?

A. No. Our intention is still have capital expenditures. It's just not in the settlement for incremental capital.

Q. And it's -- would it also be accurate to say that the settlement plan details how the -- in accordance with that settlement how the incremental $10 million is to be spent?

A. Yes.

Q. And that agreement was to spend it on vegetation management?

A. Yes.

Q. And why was vegetation management chosen?

A. That's our number one cause of outages.

Q. So again, you're trying to have the biggest impact.

A. Correct.

Q. Now, on page 6 of your prefiled testimony -- well, excuse me, if you start on page 5, the question is Describe Kentucky Power contribution asset management program.

Then if you turn over to page 6 there's No. 9, something called the sectionalizing program. Could you explain to the Commission what's involved there?

A. There's where we either add or modify circuits to sectionalize them into smaller segments, if you will.

Q. And what's the purpose of doing that?

A. To reduce or to improve the customer's performance or the circuit performance. In other words, to affect the smaller number of customers that could be impacted by an outage by a fault on the circuit.

Q. And that's one way of addressing the length of the circuit?

A. Correct.

Q. And is that in an existing program?

A. Yes.

Q. Is that a program the company intends to continue?

A. Yes.

MR. OVERSTREET: That's all I have, your Honor.

CHAIRMAN ARMSTRONG: Mr. Sanders?

MR. SANDERS: No questions, your Honor.

UNIDENTIFIED SPEAKER: No questions.

MR. RAFF: Nothing further.

CHAIRMAN ARMSTRONG: Thank you, Mr. Phillips.

THE WITNESS: Thank you.

CHAIRMAN ARMSTRONG: Any more witnesses?

MR. OVERSTREET: We have one more witness, your Honor.

CHAIRMAN ARMSTRONG: Is this going to take some time?

MR. OVERSTREET: I think Mr. Wagner will take some time, and I'm certainly not even thinking about telling the Commission how to conduct it's hearing, but to the extent the Commission is interested, Kentucky Power has no objection if the Commission wanted to.

CHAIRMAN ARMSTRONG: We didn't want to get into that situation. His counsel, their counsel is here, they've brought them up so he can consult with them but we're not going to -- we set aside ample time for that. So thank you for your recommendation, but that's not going to happen.

MR. OVERSTREET: We could start with

Mr. Wagner, if you like, and take a break or do what you want.

CHAIRMAN ARMSTRONG: I think probably better break now and then come back. So we're going to break for about an hour. Is that enough time for everybody?

MR. OVERSTREET: That would be fine.

CHAIRMAN ARMSTRONG: And return here around 1:30?

MR. OVERSTREET: Thank you.

(Lunch recess taken.)

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Tuesday Afternoon Session,
May 25, 2010.

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CHAIRMAN ARMSTRONG: We're back on the record.

And, Mr. Overstreet, would you call your next witness?

MR. OVERSTREET: Yes, Mr. Chairman. And I don't know how the Commission wants to proceed, but Mr. Childers said that he had that information that you requested about the HEAP program, he can provide it now or we can call Mr. Wagner now, whatever the Commission's preference.

CHAIRMAN ARMSTRONG: Why don't you ask Mr. Childers to come forward and we'll take that.

MR. CHILDERS: Thank you, your Honor. Want me to just use this microphone?

CHAIRMAN ARMSTRONG: Sure.

MR. CHILDERS: I guess it's working.

Your Honor, I was able to check on the figures that Commissioner Gardner had -- Vice-Chairman Gardner had asked about. I wanted to preface it by distinguishing between the three programs that are involved.

The program that's involved in this proceeding is the Home Energy Assistance Program, the state mandated, or I guess it's actually a discretionary program at the state level, state statute called the Home Energy Assistance Program. There's also the LIHEAP program which is the Low-Income Home Energy Assistance Program, which is the federal Home Energy Assistance Program, this is federal dollars. There is also dollars that are derived from the ratepayers and from the company.

Then there is the federal, I think there's question about the weatherization of homes, there's a federal weatherization program as well. Some of the utilities also have sponsored their own weatherization programs.

The state weatherization program -- excuse me, the federal weatherization program has been vastly increased in the last two years to the point where Kentucky is now the recipient of approximately $70 million in federal weatherization dollars.

So that will be major once that's all spent and able to be attributed to the low-income homes where it's needed, that should reduce the need of a lot of low-income people to -- with the higher power bills.

The Low-Income Home Energy Assistance Program, the LIHEAP, the federal program also provides for money that goes directly to low-income customers' bills. Hundreds of thousands of Kentuckians benefit from that program every year.

By contrast and by comparison, this particular program with Kentucky Power last year with the 10 cent per meter charge on residential meters generated about $170,000 which served about approximately 385 customers. There was 275 all electric customers, 110 base load customers. My understanding is the all electric --

CHAIRMAN ARMSTRONG: So that was through Kentucky Power.

MR. CHILDERS: Through Kentucky Power.

The way it works is the customer goes to the local community action office, becomes eligible, based on poverty guidelines, on LIHEAP eligibility. They then certified to the company, the company then applies the money from the program directly to that customer's bill after being certified by our agency.

So 385 will be served. There were seven

months on the year when they were able to get assistance; four winter months, three summer months.

The all electric customers were able to get approximately $65 per month on their bills. The base load customers $33 per month on their bills. With this settlement the total amount of the program will increase from 170,000 to approximately 470,000.

That will enable the program to serve approximately 760 all electric customers, 304 business load customers, for a total of 1,064. So it's nearly a tripling of the program.

If there are any questions, I'd be glad to answer.

CHAIRMAN ARMSTRONG: Questions of the witness?

Thank you.

Your next witness, Mr. Overstreet

MR. OVERSTREET: Thank you, Mr. Chairman. We call Errol K. Wagner.

(Witness sworn.)

CHAIRMAN ARMSTRONG: Have a seat. Speak up loud and clear and state your name and address and what you do.

THE WITNESS: My name is Errol Wagner,

I'm director of regulatory services for Kentucky Power Company. And my address is 101A Enterprise Drive, Frankfort, Kentucky.

MR. OVERSTREET: Mr. Chairman, Mr. Wagner is a bit under the weather and he may have to stop occasionally and drink some water or whatnot. But he'll speak as loudly as he can.

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ERROL K. WAGNER

being first duly sworn, as prescribed by law, was examined and testified as follows:

DIRECT EXAMINATION

By Mr. Overstreet:

Q. Mr. Wagner, did you cause to be filed in this proceeding direct testimony and prefiled rebuttal testimony?

A. Yes, I did, sir.

Q. And do you have any corrections, modifications, or additions to that testimony?

A. Not at this time.

Q. And if you were asked those same questions here today, would your answers be the same?

A. Yes, they would be.

MR. OVERSTREET: The witness is available for cross-examination.

CHAIRMAN ARMSTRONG: Mr. Sanders?

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CROSS-EXAMINATION

By Mr. Sanders:

Q. Mr. Wagner, I think you were present earlier when Mr. Mosher testified. I asked him a question about the statement in the AEP 2010 corporate accountability report. There was a quote in there, said lower demand in the retail and wholesale markets also resulted in excessive coal inventories and a 50 percent reduction in off-system sales volumes.

Is that statement also true for Kentucky Power Company?

A. The magnitude I don't know that it's exactly 50 percent, but the magnitude is there. Our coal inventory was clearly double what we were targeted. We were targeting roughly 30 days of coal inventory. And at the time at the end of the test year we had 60 days.

So clearly the downturn in the economy for retail sales and the downturn in mixing system sales to affect our coal inventory, yes.

Q. What about the reduction in off-system sales volumes?

A. I'm sorry, go ahead, sir. I didn't mean to interrupt you. Go ahead.

Q. I was going to say did Kentucky Power Company experience a 50 percent reduction in off-system sales volumes?

A. The reason I'm hesitating is when you say the Kentucky Power experience off-system sales, let me try and explain something and try and answer that question.

Kentucky Power Company receives it's called the member load ratio share. It's our share of the AEP system's sales. So theoretically my Big Sandy unit No. 2 which is 800 megawatts, Rockport unit No. 1 and 2 which is 393 megawatts, they could be down, not operating, and if AEP made a system sales, Kentucky Power would get its member load ratio share of that property from those sales.

So when you're talking about system sales, you almost have to talk about from the system perspective but we get our member load ratio share of that system's number.

So basically because the AEP system's

load was down, and Kentucky Power's load was also down to the retail customers, and because of our sales were also -- our off-system sales were down, our margins, yes, were lower during the test year.

And again, the reasons for the system sales profit being down are many-fold, but the economic conditions are one major factor, and also the low cost of natural gas was another driver that drove the Kentucky Power or the AEP system's off-systems sales were lower than otherwise were the year prior.

Q. Would you give an approximate dollar amount in expected revenue that was lost due to the declining off-system sales?

A. Well, again, the system sales we really don't plan for. I mean, system sales, let me put it this way, our facilities are designed, built, and operated to meet the needs of our retail customers.

If in fact our retail customers aren't using the kilowatt hours that are generated, if they don't place that demand on my system at that point in time, then we attempt to make off-system sales at that point in time.

The level of system sales in a test year was approximately $15 million. The level that was in the system sales when rates were designed in the 2006 case were about $24.8 million. The level of system sales that were built into the 1990 rate case was about $11.3 million, and back in the 1984 case we used 13 million.

So clearly the 24.8 million that was in the test year of the 2006 was one of the higher levels of system sales that were used in designing rates for the Kentucky retail customers.

Q. And the 24.8 million that was built into the 2006.

A. Correct.

Q. Was that -- did that in fact turn out to be the amount of revenue that you, that Kentucky Power received for off-system sales?

A. In the test year of 2006, June 30, 2006, Kentucky Power actually received -- when you say "revenues," as an accountant I get nervous. Those are margins. These are -- it's revenues less expenses and these are margins.

24.8 million was the profit that we made from the system sales. That was our share of the AEP system profit, that's correct.

Q. What about if you know the year of the test year then, what was the next year? What was the margin?

A. I would have to -- I have the number but I don't have it with me. I'd have to go back and pull out those numbers.

Q. Was it greater than 24 do you think?

A. I believe that the year after this it was greater, yes. After that I'm just not positive because I know the test year -- in the test year when we had 15 million, of course it was below the 24.8 million. Yeah, the test year, so.

Q. The rate increase in the revenue that would be received by Kentucky Power if a rate increase is approved, would some of that revenue be used to offset the loss in off-system sales?

A. Well, okay, number one, what I'm struggling with when you say "loss," again, we don't -- we won't make a system sales if we're going to lose money on it. Now if you're talking about the reduced level of system sales, yes, I mean system sales are used to reduce the cost of service that the Kentucky ratepayers have to bear.

And if I have 15 million in base rates of system sales profits, they get a credit in their bill or in their cost of service for 15 million. If I had 25 million, they would get a credit for 25 million.

So again, the last test year 2006 and this test year, yes, there's approximately $10 million of reduced sales profits that were reflected in the cost of service for the Kentucky retail customers.

Q. And if there had been a greater amount of off-system sales, the ratepayers wouldn't see a reduction in their actual rates, would they?

A. Oh, yes, they would. Most definitely.

Q. How would that occur?

A. Well, again, if we had 25 million in the test year, the 12 months ending September 2009, there would have been a $25 million credit in their cost of service versus a 15 million that was included in the test year.

Q. You're talking about in a new rate case but I'm saying if during the period of time after the 2006 rate was approved and you received a greater off-system sales revenues than in the test year for that rate, you wouldn't reduce the consumer's rates during that time.

A. Yes, we would. Most definitely. We have what we call system sales tracker which is an issue that's in this case. And basically what we do each month is we compare the actual level of system sales profit for that particular month, let's say January of the test year, and we compare that level of system sales profit with January of whatever calendar year we're looking at. And if it's above or below that base, that difference is shared with the ratepayers.

So if we had a greater amount of system sales, the ratepayers would have received a credit on their bill for and again, during the test year. It would have been either 70 percent of that increase or 60 percent of that increase depending on the level of system sales.

Q. When you say share to the stockholder, also share in the increased revenue?

A. Yes. The stockholders share in the increased revenues, just like the stockholders share when we're below the base. So it goes both ways.

Q. I'd asked Mr. Mosher about the symbol QP on opinion 1 to the settlement agreement. And seemed to me he wasn't really certain what that stood for. Do you know --

A. It's quantity power. It's customers that use and I believe it is a thousand KW or more a month up to 7500 KW qualify for the QP tariff.

Q. And that would be a commercial entity or an industrial entity?

A. Yes, it would be either commercial -- we have both commercial and industrial entities on the QP tariff.

Q. Now, does the rate structure in Exhibit 1 propose reducing the distribution cost for the large customers and industrial users?

Maybe I didn't phrase that the way you'd understand it. I'm sorry if I confused you.

They pay less under this for distribution costs than the residential users and small commercial pay more for the distribution costs?

A. The answer is no, the CIP-TOD customers all take service from a subtransmission or transmission level. So they don't use any distribution facilities.

The QP customers, we have some customers on QP that take from secondary and primary service which is distribution, and we have transmission and subtransmission on the QP.

So any customer who is on a subtransmission or greater service or takes service from us subtransmission and transmission to not pay any costs associated with distribution because those distribution facilities are not used to serve that customer.

And again, it's a ratemaking, kind of a ratemaking principle that we use to cost. What that means is if we have to do some investment or some costs to provide service to a customer, then that customer is responsible for their share of it.

Let me give you an example. Generation. We bill a generating plant, transmission customers are going to have to pay for those facilities because they use it, subtransmission customers have to pay for it, they use it, primary and secondary customers use it, so they have to pay for it.

You then have transmission facilities that get the power from the generating plant to the substations or to the customer directly. And again, subtransmission and transmission customers will pay for the transmission facilities, and distribution and primary customers will pay for their share of those facilities.

Now you have the distribution facilities which generally is the lower voltage level, customers that are taking service at subtransmission and transmission services to not use those facilities and therefore the cost associated with those facilities are not allocated to the subtransmission and transmission customers.

Q. So they don't pay any of those costs.

A. No. No, they're not using those facilities and they don't pay any of those.

Q. Do you have Exhibit 1 to the proposed settlement agreement in front of you?

A. Yes.

Q. I understand that the total increased percentages that are shown on this Exhibit 1 were equally attributed, it would be 12.48 percent increase.

A. The revenue increase was 12.48 and if they were equally attributed, all classes would get the 12.48 percent, correct.

Q. What we have instead is that most classes get in excess of 16 percent increase and two classes get 6.58 and CIP-TOD gets 16.2 percent increase.

A. That's correct.

Q. If you all classes received a 12.48 rate increase, Kentucky Power would get the revenue that it agreed to accept in the settlement, correct?

A. We would get the 63.66 million, that's correct.

Q. And there wouldn't be a significant change in the proportion paid by the various classes for electricity, would there?

A. There would not be a change, that is correct. But again, I think what we have to keep in mind is you're talking about from the proposed increase of $63.66 million but what you also need to look at I think and factor in is what is the impact once the new rates are in effect and how are the subsidies among those classes reflected after the new rates go into affect. And let me try and give you an example.

Trying to find it here.

I believe in the testimony, and I know it's in Mr. Roush's testimony and I forget which exhibit, I think it's Exhibit 2, page 1, but basically during the test year the company earned on a return on investment basis 1.11 percent in total. But from the residential class it was a negative 2.88

percent.

Let's just look at one class, the CIP-TOD customer was at 6.17 percent. So clearly the residential customers were a negative and the CIP customers were a positive.

Now, after the 12.48 percent increase, average increase, and the way we split it according to the settlement agreement, the residential customers are now earning for the residential customers their percentage, they're earnings on a return on investment is .88 percent. And the CIP customers are 8.27 percent.

So clearly, yes, by allocating these costs to reduce the subsidy by 20 percent -- 25 percent, excuse me, the CIP customers are still subsidizing the residential customers after the new rates go into effect.

It's not like the subsidy goes away. I think you need to look at both how the revenue increase was spread among the different classes but also the end result of what happened once you spread those revenues, what are the different classes earning to the customer to see who is subsidizing, who is being subsidized by whom, I guess is my point.

Q. When you talk about spreading the costs, you're talking about spreading significant 16.84 percent rate increase on poor and elderly people on fixed income.

A. No question about that, yes. It's an increase of 16.84 percent, that's correct.

Q. And the test is whether that's fair, just, and reasonable, correct?

A. I think this is a test that the Commission and I think all parties in the settlement agreement had to negotiate and get a give and take. That wasn't just the industrial customers or just wasn't the commercial customers.

You had the low-income people participating, you had the Attorney General participating, so I think it was a balance among everybody's interest when they were sitting there and discussing how those costs were going to be allocated among the different classes of customers.

MR. SANDERS: That's all the questions I have.

CHAIRMAN ARMSTRONG: Thank you, Mr. Sanders.

Mr. Malone?

MR. MALONE: No questions, your Honor.

UNIDENTIFIED SPEAKER: We have no questions, your Honor.

UNIDENTIFIED SPEAKER: No questions, your Honor.

UNIDENTIFIED SPEAKER: No questions, your Honor.

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CROSS-EXAMINATION

By Mr. Raff:

Q. Good afternoon, Mr. Wagner.

A. Good afternoon, Mr. Raff.

Q. Let me follow up with a couple of questions Mr. Sanders was asking you just so I can understand.

Your testimony was during the test year the Kentucky Power's return on equity was 1.1 percent?

A. I'm sorry if I said "equity." I meant to say the "return on investment." Return on rate base.

What I was looking at was the investment for the rate base that was used was allocated to the residential customers and then we compared that what that rate base earned and then we looked at like I used the CIP-TOD customers and what that -- but that was on rate base, not on equity.

In the test year I believe the company's equity was, well, at the end of the test year it was 2.92 percent is what we earned.

Q. So you earned 2.92 percent on equity. That's total company, correct?

A. That's correct.

Q. And do you know what that figure was for residential customers' rates?

A. Return on equity? No, I do not. Because what we did was in our cost of service we do it among the investment or rate base. We don't really look at it on the equity.

Q. If you did would you expect it to be below that 2.92?

A. Well, the 2.2 return on equity equates to a 1.11 return on investment, okay? I'm having trouble trying to bridge from -- I could tell you the number but I'm having trouble to split that 2.1 percent among residential, commercial, and industrial customers. We just don't do that calculation.

Q. Okay, that's fine.

In your prepared testimony supporting the settlement agreement page 6, line 7, you reference to tariff environmental surcharge.

A. Environmental, yes, sir.

Q. What impact does increasing the annual baseline level for environmental costs recovery from 28 million to 44 million have on customers' bills?

A. I would say it has zero impact. The difference is before I was recovering more money through the environmental surcharge and less money in the base rates.

Now when you roll that into base rates, theory and principle should be that you're going to be recovering most of the costs through base rates and the environmental surcharge will have dropped dramatically. It won't be exactly zero but it could be negative or it could be positive but it's going to drop dramatically from what they saw during the test year.

Q. And do you know the specifics of the environmental programs that are currently being recovered through the environmental surcharge?

A. I do know the specifics. I mean, number one, we are recovering the Big Sandy SER facilities and burners at the Big Sandy plant.

We're also recovering SER and scrubber facilities at our sister -- our share member load ratio share of the costs associated with the SER and scrubbers at like Gavin and Mitchell of the surplus company members in the pool.

You're also recovering allowance costs such as Knox and Socks allowance costs. You're recovering environmental fees there also reflected in the environmental surcharge.

Q. And to the extent that the settlement agreement includes a figure of 10.5 percent to be utilized for the accrual of AFUDC, funds used during construction, can you tell me whether projects Kentucky Power either has under construction or expects to have under construction within the next 12 to 18 months that would be subject to AFUDC accrual?

A. Well, again, it would be any project that was within the company power service territory. Generally what I'll say is longer than a month. I mean if there are capital projects one month, probably not going to see a whole lot of AFUDC. But if you had projects six or eight months, say a station, substation project, they're going to see some AFUDC allowance calculated on that.

If you're going to have any transmission line that's going to span several months to a year or something like that, you're going to see AFUDC calculated on those what I'll call larger capital projects.

Now again, we're -- I'm just sitting here trying to think. I don't know of any multi-year projects where those AFUDC will become an issue. Trying to think of a capital forecast right now and I just don't see any what I'll see three or four year very long projects. Most of them are what I'll call normal extension projects that we do normal course of business.

Q. You've agreed to or you proposed in the rate case to revise your depreciation rates; is that correct?

A. Yeah, that's correct.

Q. You've agreed to maintain the current depreciation rates?

A. Yes, we have.

Q. Can you tell us what the impact on customer bills of keeping the current rates in place versus had you changed the depreciation as you were proposing?

A. Yes, sir. I don't remember the adjustment but there was an adjustment in the filing for the depreciation and it was approximately $12 million increase in depreciation expense. That had two factors to that calculation.

One was the annualization of existing rates on facilities that were missed in service during the test year. That amounted to approximately 1.3, $1.5 million of the 12.

And the remaining about 10 and a half million dollars was a result of new rates. The new rates that were designed. So if we were going to implement those new rates, then in an effort you'd need approximately 10 and a half million dollars of additional revenue to cover that higher expense level.

Q. Just a couple of questions about the AEP policy and system sales. When you say that Kentucky Power is a deficit member of the AEP pool, the use of the term "deficit member," that is a very specific definition under the terms of the pool agreement, is that true?

A. That's correct.

Q. And under the terms of that agreement, any company or any member that is deficit is required to make payments to those companies that are surplus, correct?

A. That's correct.

Q. Once those payments are made, surplus companies are treated identically, are they not, to deficit companies? When it comes to the allocation of off-system sales?

A. That's correct.

Q. By "identical" I mean there's differences based upon each company's load but as far as the ability to share in those profits, everyone shares equally. Correct?

A. In proportion to their load or what we call member load ratio that's correct.

Q. So once a deficit company pays its deficiency, it's then on a par with all other companies.

A. That's correct. And what I -- when we say "deficit company," we're talking about we are a deficit company when you look at capacity. If you're looking at energy, Kentucky Power is -- if all the plants are running during the year, and what I'll say is under a normal year like historically, if we were generally energy long but we were capacity short or capacity deficit.

That's why it's a little confusing when people say how can you make system sales? Well, the system sales are a percent of the AEP system sales. This system sales could have been made by Ohio Power, Indiana, or another company, but because we're a member of the pool and because we made our payment to the capacity to the pool to my sister companies, why, then, we get the share and our member load ratio share of all of the system sales profit made from any generating company.

Q. And to the extent that you're normally energy long, you're fairly energy long, are you not? Substantially energy long?

A. Yes. Yes, we are. And again, the reason we're energy long is because the plants are dispatched on an economic basis and generally Big Sandy units and the Rockport units are relatively low cost generators and they're generally dispatched -- excuse me, they're dispatched whenever they're available generally.

Q. And to the extent that you're capacity short, that is on very few days of the year during peak periods; is that not correct?

A. That's correct. I'm a winter peaker so generally I set my peak could be in December but generally it's January and February is when I set my peak. Kentucky Power sets it's peak, excuse me.

Q. Thank you.

Anything else?

Thank very much, Mr. Wagner, no further questions.

A. Thank you, sir.

CHAIRMAN ARMSTRONG: Questions from the Commission?

VICE-CHAIRMAN GARDNER: Thank you, Mr. Chairman.

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EXAMINATION

By Vice-Chairman Gardner:

Q. Mr. Wagner, I heard you answer Mr. Raff's question about capital projects that you know of where AFUDC would be applied. So you're not aware of any larger project, multi-year projects out there for Rockport -- excuse me, for Big Sandy itself?

A. No. I mean, no, I'm not. Probably the next thing on the Big Sandy horizon is the scrubber which we are going to have to put in place. But that's clearly down around the two-thousand maybe thirteen, '15 time frame.

So I mean we haven't started this. We have evaluated but we haven't really started the construction.

Q. And that would be the only larger project, if you will, that where the environmental surcharge might apply? New projects.

A. This is the only Kentucky Power, that's right.

Q. Sure. The 15 million baseline for off-system sales, was that -- did I understand you to say that is actual number for the test year or was that a negotiated number?

A. No. Well, both.

Q. Both?

A. We started with the actual number and everyone negotiated to use that actual or agreed to use the actual number of the test year as the base.

Q. Okay. It wasn't as if it started -- it wasn't as if it started at '18 and ended up at '15, it was '15 was the historic test year.

A. That's correct. That's correct.

Q. Was some part of the rate increase due to the downturn in the economy and the lack of -- in the downturn in actual power, in the downturn in the actual sales made to customers?

A. The answer is yes. What the company has done is it looked at the actual sales in the test year and if there was a customer that went out of business, we removed those revenues because they're not there, it's known immeasurable.

Just like we've had a couple customers increase their demands or their usage. So we annualized those affects but clearly the downturn did have some impact on the rate increase

Q. And so this is that old notion that you all benefit from upturn in sales because of how the rate design is. More power you sell, the more money you all make.

A. Yes. I mean again, if we make -- if we sell more power, and if the rates were set at one level and if we sell more, yes, there's a possibility for us to earn more.

Q. So the actual incentive to the company is to sell more power, theoretically is to sell more power as opposed to promoting energy efficiency.

A. Well, I'm not sure -- I mean, yes, I want to sell more power. But I also want to make energy efficiency -- energy efficiency programs through my DSM because in the DSM program there is a lost revenue in shared -- there's an incentive to do those programs.

So to say that I want to sell more and not improve the efficiency, I don't think is really a fair comparison. I want to sell more but I want to use my facilities as efficient as I can. Because I don't want to have to build facilities if I can get more sales out of the existing facilities, I guess is what I'm trying to say.

And so we want customers to use our facilities as efficiently as possible. And in fact, even in the rate design you do design rates so there are more efficient customers, well, less efficient customers get penalized. So you want all customers to use their facilities as efficiently as possible.

Q. How are your less efficient customers -- or how are your more efficient customers, how do they benefit?

A. I'm sorry, how do the more efficient

customers what?

Q. I mean I thought -- did I just hear you say that your rates are designed so that your more efficient customers --

A. Yes. Yeah, if a customer has a very important power factor, they're going to be paying for more kilowatt hours because there's a power factor penalty in there. If a customer has a unity power factor, they're going to be paying for exactly the kilowatt hours that they use. So we want customers to use our facilities in the most efficient fashion.

Q. Do I understand that Kentucky Power owns 15 percent of the Rockport facility or do you just have a contractual relationship?

A. People use that term loosely, sir. We have a contract agreement with the American Electric Power generating that we are responsible for 15 percent of the generation -- 15 percent of the costs that the Rockport unit 1 and 2 facilities and we are entitled by making that payment of 15 percent of the output of those facilities. So it's really a contract and that contract expires 2022, and I think it's December 7, 2022.

Q. In your -- let me make sure I get the right . . .

In your prefiled testimony in support of the settlement agreement on page 14 you talked about the very -- actually the very last sentence of 13 where it says since that time the company has earned a substandard return on equity and it has earned substantially less than its peers. Who are your all's peers?

A. When I made that reference I was referring to the -- when I say the peers within the Commonwealth and what I was looking at was Kentucky utilities LG&E and Duke Kentucky.

Q. How many customers do you know are you able to, say, have the realtime pricing tariff?

A. We do not have any customers on the realtime pricing tariff today.

Q. Have you ever?

A. We have never had -- we've talked to several customers and we worked with them to try and show them what their risks and rewards were and of at least the two that I'm thinking of right now they elected to remain on the firm base rate versus going to the realtime.

Q. Okay. And on your CIP-TOD, so there are different rates during the day, it's just not realtime pricing?

A. That's correct. The CIP-TOD tariff has an on-peak and off-peak billing period.

Q. Just those two.

A. It just has those two, that's correct.

Q. Does that change during the course of the year? Not the --

A. The hours that -- they remain the same.

Q. The rates change during the course of the year?

A. No, the rates are the same throughout the year.

Q. So it's on-peak/off-peak whether it's in September or January --

A. That's correct.

Q. -- or July.

Now, you all are requesting that the storms in 2009 be amortized and it's 4.656 over for each of five years. We've already proved regulatory assets for three of those storms and you all consider what happened in the winter in December of '09 to be two storms?

A. Yes. These are what we call major event storms and there's an EEI definition of what a major event storm is. But these are major event storms, qualify for major event.

There was one in the beginning of December and unfortunately there was one at the end of the December. So we had two different ones.

Q. And the one at the end of December was the biggie.

A. That was much larger than the one at the beginning but the one at the beginning was pretty large. I mean was pretty large.

Q. Do you know off the top of your head what the dollar amount was that you all spent and are seeking to recover in this for those two storms?

A. The answer is yes. I'm trying to think of where it is.

The December storms, and this is above what I'll call incremental costs, and let me kind of define what that is. I mean these are incremental costs. We may have employees on the payroll that are normally on the payroll and they're going to be working eight hours a day. Now they're working on storms because the storm came through.

They're what I call base revenues. We're going to incur those costs anyway so what I'm saying is incrementally in the two storms for December it was approximately $13.9 million for those two storms together. That was the December storms.

Q. And through the regulatory asset you're only seeking to recover those incremental costs.

A. Yes. Yeah, because our theory and principle there is my rates are designed with employees, their normal costs, their normal day-to-day costs are already built into rate. So what we're trying to get together is the incremental or the amount we spent above the normal costs.

Q. Does AEP have a meteorologist on staff?

A. Yes, sir, I believe they do.

Q. Does AEP believe that we can expect more major event storms going forward? Is there any position on that?

A. Yeah. They appear to be, I mean recently they appear to come more frequently and rather large. Is that a growing trend or is that a unique circumstance? I guess I'm not sure AEP has a position on that.

Q. I have my final couple questions relate to the Carbon Management Research Group and the Kentucky Consortium of Carbon Storage, and you all are seeking to the 20,833 is basically 250,000 a year for that amortizing that.

And my question is do we -- does the -- and I'm sorry, I can't find this quickly.

Does the settlement say how many years you can amortize that? Is it until the next rate case?

A. Well, I mean clearly it will be till next rate case. What we -- the payments I believe are 200,000 a year for ten years. That's the total payments. We've made I think about two years worth of payments. So that that annual amount that you came up with was basically to amortize --

Q. What you've already paid and what you expect to pay?

A. And what we're trying to say is at the end of the ten years, we will have fully amortized the full amount or the full $2 million.

Q. That answers my question, because the order that the Commission entered didn't have you all participating at all in the Kentucky Consortium of Carbon Storage so I didn't understand how you got your 250 if what we authorized was the 200,000.

A. Right, it's the 200,000 and it's spread over the remaining, basically the remaining life of that agreement.

VICE-CHAIRMAN GARDNER: That's all, thank you.

CHAIRMAN ARMSTRONG: Mr. Borders.

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EXAMINATION

By Commissioner Borders:

Q. Yes, just one line of questioning and I want to go back to these questions that Mr. Sanders was asking and make sure I do adequately understand.

When we look at a rate of residential household increase of 16.84 but some would be as low as 3.62, and we're talking about fair, just, and reasonable, it is -- my question I want to I guess get to is the fact that even if the 3.62 rate that company or whoever's buying its 3.62 is still subsidizing the residential user?

A. Yes, sir.

Q. And so I guess because taking on face value so we're going to increase on the residential and only going to increase it this much on the business, that sounds bad but I just want to make sure I understand that, I do understand again that the reason we have to do that in a sense is because or at least that you're asking for after looking at it is for that residential user would be more than 16.8 without that subsidy.

A. Most definitely. If they were full cost service, it would be greater than the 16.8 percent, that is correct.

Q. And so when you try to arrive at a calculation of what to place on the one payment 3.62 and what to place on the residence, do you take into consideration such things as kind of like the straw that broke the camel's back?

In other words, keeping that business functioning is important to residents because it will be subsidy towards the residents. If you put too much burden it might endanger the business that would actually be the residence rate; is that a fair assessment?

A. Yes. When you get down into the exact rate design and the establishing of the rates, I mean first off, we kind of reached this settlement agreement of a give-and-take process in coming in allocating these costs through the settlement process.

But kind of a smell test, I guess for what Errol does is once you have all the rates done, then you go back and look and say okay, all these pieces have been the smartest thing in the world but when you put the pieces together, does the end result look smart? Does the end result come out being reasonable?

And I think this does because when I look at what some of the rates of the other utilities that surround Kentucky Power service territory and what they are charging their customers, Kentucky Power is still below many of those customers. Now -- I mean utilities.

Are there some utilities below us? Most definitely there are. But a lot of them that surround Kentucky Power, we are either -- we are less than what they are charging their residential customers. So I think it's a fair, reasonable approach.

Go ahead, sir.

Q. And so would it ever be your goal to reach a point where the customers will be paying no subsidy? For example, now you're reducing that subsidy. Would it be a goal of Kentucky Power to eventually get down to where there's no subsidy?

A. To say no subsidy, again, you're getting into which customer class is a more risky and less risky. I clearly think, you know, if you look at residential customers, I think we in Kentucky, residential customers use more kilowatt hours on any given month than a lot of other states.

Q. And I guess my real question is are you trying to subsidize residential users as much as you can without endangering the very people that help to pay lower rate?

A. That's a fair statement but the primary reason is I want to get the proper price signal to the residential customer, to the industrial customer, to all my customers so that when they spend their energy dollar, they're making an official decision.

Are they going to spend $500 more for an energy efficient heat pump than buy a less efficient heat pump because they know their energy costs are so cheap because they're being subsidized by another customer?

We're trying to get -- in my mind I'd

like to get the proper price signal to the customers so that I'm not making that decision, you people aren't making the policy decision, the customer is making the policy decision when they buy or spend their energy dollar.

Q. And while it sounds maybe bad to some, the fact that those rates are different, did I understand you to correctly to say that you actually lost money on residential business in the last reporting period?

A. In the test year, in the test year we did --

Q. At least 1.1 percent was it?

A. 1.1 was what the company average return -- earned return on investment and it was 2.88 negative to the residence.

Q. And to the commercial it was?

A. Commercial it was --

Q. It was a positive.

A. Yes, yes, it was positive. Some of them were another 8 percent, some of them were at 7 percent. But they were all above.

And again, stop and think if I earn 1.1 percent and if this customer is losing, if I earn on average 1.1, somebody has to be subsidizing that residential customer and it's really all of the other classes of customers that we're subsidizing.

Q. And I just think it's important for the person reading a newspaper, whatever, to understand that when one rate is one thing, one's another, it's no really what it looks like on paper, you have to take everything -- there's a lot of components.

A. And that's why I think it's important not only to look at how the revenue increase was spread but what's the end result.

What's the rates look like, what's the return on investment look like, and I think that is important for people to focus on it. It's not just one -- you can't just focus on one number, you need to focus on many different elements.

Q. And one last question, this may be going the wrong direction on this, but when you're saying looking at those rates and you're concluding it takes 10 percent plus whatever for us to stay in business and direct the capital and those things, that's what we need and they're the various components that sell energy too, you actually have some form there about some way of approaching that.

Do you think it's fair, just, and reasonable in I guess how you apply that and how you determine that when it should be 3.62 and the other one's 16.84?

A. Again, it's one of those things it's you sit down and you design a rate and you look at the result and then you try and factor in your judgment in saying does the end result appear reasonable? And that's what you're trying to do. It's a balancing act.

And you're just trying to balance the interest of the customers, the shareholders, and the employees. You have to balance all three. It's a three-legged stool; all of them have to be at equal length, you have to be able to balance all three of them so that all interests are being fairly represented.

Q. And maybe there's not a way to answer this or maybe you already answered it, but it's on your test year do you know what percentage the residential consumer was being subsidized?

I know we talk about reducing the subsidy of 25 percent, but if a person is out paying $130, do you know what amount they were being subsidized by the commercial?

A. No, I do not. We did not -- I did not calculate the rates if they were at full cost to service.

Q. You just know that overall it was a loss for your test period but as far as calculating to seeing what that --

A. Oh, yes, because what I did here's my revenue, here's my expenses, here's what's left over and I compare that to what my investment level was when that class of customers --

Q. I guess my point being to break even since you lost money on residential, to break even there was X amount of dollars to break even if you divided that among whatever are shown to residential.

A. Yeah. I will have to the calculate that. But I mean that's correct.

Q. You've answered me, thank you very much.

A. Okay.

CHAIRMAN ARMSTRONG: Thank you, Mr. Wagner.

MR. RAFF: Your Honor. I'm sorry. I have a couple more.

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RECROSS-EXAMINATION

By Mr. Raff:

Q. Mr. Wagner, can we refer to your page 25 of 26 attached to your, I guess it's to the settlement agreement? Titled Exhibit 1, "Settlement Revenue Allocation."

A. I'm there, sir.

Q. Was this prepared by you or under your direction?

A. Yes, it was.

Q. Would you be able to refile this and add a couple of columns? Between column No. 2 and 3? Could you add the class rate of return based upon current revenue? And then to the right of column 9 add class rate of return based on the total settlement revenue?

A. So you want the rate of return on the current revenues which is in column 2.

Q. For each class.

A. Yeah, for each class.

Q. I think that's already in the record, is it not?

A. Yeah, that's correct.

Q. Under the class of service study?

A. That's correct.

And then you'd want the same thing I guess --

Q. As a column 10.

A. Okay, that's column 10, okay, total. Yes okay. The answer is yes, we can do that, sir.

Q. Would that not illustrate the subsidies that have been questioned here this afternoon from one class to another?

A. The answer is yes. And hopefully those numbers are the same results that I just spoke about today. That's correct.

Q. I assume it would show some movement from what was the subsidies for the current revenue versus the subsidies for the total settlement revenue? Would that be a fair statement? There would be some reduction in that -- in those subsidies?

A. Subsidies -- the subsidies would go down but the percent could go up. And for example, we're looking at a 12.48 percent increase in revenues. If it was spread evenly then the percent of returns would go up in relationship to that 12.8.

And what you're going to see is the relationship of that return it could still go up a little bit but it's not going to go up in relationship to 12.48. The relative relationship of the increase will be less. That's what you're going to see.

Q. Okay. Let me ask you, let's assume for a moment that the Commission does not accept the settlement agreement. Whatever amount of increase they would decide upon would have to be allocated to each class, would it not?

It's not a trick question.

A. No, I'm sitting here -- whatever the Commission decides --

Q. Whatever the revenue increase, it's going to have to be allocated to each of the rate classes, correct?

A. It's going to have to be allocated in some fashion, yes.

I guess what I'm struggling with is they might say don't allocate anything to residential. Then it would have to go to all the other classes, that's what I'm saying.

If they're going to hit every class, it's going to have to be allocated to each of the classes in the fashion they decide, that's correct.

Q. Or zero.

A. Yeah, that's correct.

Q. Or even negative.

A. Theoretically, yes.

Q. Okay.

A. We hate to see that.

Q. I guess my question to you is do you have a recommendation and a reason for that recommendation as to what would be a reasonable allocation percentage for each class? Assuming the Commission did not accept the settlement agreement?

A. Number one, I do not have an allocation -- I mean I don't have a methodology or recommendation other than what we found in the case and that was to reduce the subsidies by 10 percent.

But again, I think what has to be taken into consideration is the company was requesting $123 million and then there were some adjustments that brought that down to 108 million and what we were saying was to reduce the subsidies by 10 percent.

Now that we're reducing the increase down to about let's say 60 percent of what we were asking, I could see a rationale and a logical approach to going to the 25 percent reduction of subsidy that has been recommended in this settlement.

So I believe in my mind anything between the 10 percent of what the company asked for -- was proposing and the 25 is reasonable, and I think because of the increase is much less than what we originally asked for the impact in residential customers are dramatic, almost cut in half. I believe this approach is very reasonable.

Q. Do you believe that the approach set forth here on page 25 and 26 of Exhibit 1 is more favorable to residential customers than the proposal that you had set forth in your original application?

A. Oh, yes. Yes, sir.

Q. And so your -- it's your recommendation that irrespective of what level of revenues the Commission approves, that this rate allocation on your Exhibit 1 is reasonable.

A. Yes. And again, it gets back to the once you're all said and done and I look at the rates, I try and say okay, what does the end result look like?

And I think that's a reasonable approach to say our rates are still going to be among the lowest within the Commonwealth and throughout the nation, really.

MR. RAFF: Thank you, Mr. Wagner. That's all the questions I have.

CHAIRMAN ARMSTRONG: Yes.

MR. OVERSTREET: Couple very brief questions, Mr. Chairman?

CHAIRMAN ARMSTRONG: Mr. Overstreet?

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REDIRECT EXAMINATION

By Mr. Overstreet:

Q. Mr. Wagner, under the current rates I think you indicated that the return on investment the company earns with respect to its investment in the facilities used to serve residential ratepayers is a negative 2.81 percent; is that correct?

A. Yes, sir.

Q. Let's take and now we're at that negative 2.88 percent, who pays the dollars that allows the company to earn 1.1 percent overall in its investment?

A. All of the other customer classes, the SGS, the MGS, the LGS, the QP, and the CIP, OL, RS, SL, MW, all of the other tariffs.

Q. They're contributing to these dollars that raise up the negative residential return to the overall average return of 1.1 percent.

A. That's correct.

Q. Now, under the new rates what will be the return on investment for the residential class?

A. Approximately .88. One percent let's say.

Q. And what will be the return on investment with respect to CIP-TOD?

A. CIP-TOD will be about 8.27 percent.

Q. So .88 versus 8.2?

A. Yes.

Q. So the return on investment for CIP-TOD is approximately nine times the return on investment for residential customers?

A. Yes.

MR. OVERSTREET: That's all I have.

CHAIRMAN ARMSTRONG: Thank you, Mr. Overstreet.

Yes. Going on the same topic just so I understand this following up on Mr. Raff's question, as originally proposed the residential class was to go up without transmission adjustment 35 percent and with it 33 percent and now we're looking at

16.84 percent.

THE WITNESS: That's correct.

CHAIRMAN ARMSTRONG: Any further witnesses?

MR. OVERSTREET: No further witnesses, your Honor. I just want to make sure that all of the testimony and exhibits and data requests are officially in the record from all the parties. I believe that's Commission practice.

CHAIRMAN ARMSTRONG: Yes, it is. It is all in the record. Thank you --

MR. RAFF: Could I clarify? Mr. Wagoner, when I asked you to revise this exhibit showing the rates of return for class, I assume you'll also include the total at the bottom for both current rates and proposed rates? Revenue, I'm sorry.

THE WITNESS: Yes, the 1.11 and the 4.-something, yes, sir.

MR. RAFF: Okay.

CHAIRMAN ARMSTRONG: Mr. Wagner, you're excused, thank you.

THE WITNESS: Thank you.

CHAIRMAN ARMSTRONG: Mr. Sanders, one of your clients had a question before we broke for lunch. Did you retrieve that question?

MR. SANDERS: I spoke to him. He actually had a statement he wanted to make and I was advised that he could submit that in writing in the next few days.

CHAIRMAN ARMSTRONG: He can, yes.

MR. SANDERS: So that's what I told him.

CHAIRMAN ARMSTRONG: He can either e-mail it, he can call here on our hotline and talk to whomever and they can aid him through that statement. So, happy to receive that.

We have a form actually that might be helpful and if you would wait until the completion of this, I will see that you get a form of that.

MR. OVERSTREET: Mr. Chairman, I think the only outstanding questions is when would the Commission like for us to file the updated exhibit?

MR. RAFF: Seven days would be sufficient.

MR. OVERSTREET: Seven calendar days? I just want to know.

MR. RAFF: Seven working days?

MR. OVERSTREET: All right, thank you.

CHAIRMAN ARMSTRONG: I'm going to bring

this hearing to a conclusion but I first have to ask everyone who is a party to the settlement would be sworn as to the conduct of the settlement and then I will bring it back to close it and then we'll get some time tables if you want to do briefs or not. And data requests time tables as well.

So I'm going to ask everyone and just to remind you, Kentucky Power Company and its representatives to this settlement of the Attorney General's Office, KIUC, Mr. Kurtz or whomever, the Wal-Mart Stores East, Hazard, Perry County Community Ministries, the Community Action of Kentucky, Kentucky School Boards Association, and the -- I don't think you were a party to this, I don't know, were you, Mr. Sanders?

MR. SANDERS: We are not part of the settlement.

CHAIRMAN ARMSTRONG: So if all of you will stand at this time. Raise your right hand and be sworn.

Were you aware of and did you have any opportunity to participate in all of the negotiations that resulted in this settlement agreement? If so say "I do."

ALL: I do.

CHAIRMAN ARMSTRONG: Did you voluntarily sign the settlement agreement and you fully support each and every provision contained there?

ALL: I do.

CHAIRMAN ARMSTRONG: Are there any provisions in the settlement that you do not understand, object to, or take issue with at this time?

ALL: No.

CHAIRMAN ARMSTRONG: Was there any consideration of any kind offered or were there any promises made other than what was expressly set out in the settlement agreement to induce you to negotiate and to sign a settlement agreement?

ALL: No.

CHAIRMAN ARMSTRONG: Finally, are you aware of any reason why the Commission should not adopt and approve the settlement agreement in its entirety?

ALL: No.

CHAIRMAN ARMSTRONG: Have a seat. Thank you all very much.

MR. RAFF: Your Honor, can I just add for the record that while the Pike County Senior Citizens did not sign the settlement agreement, that they were fully aware of the negotiations and participated at least on the telephone in the early part of those discussions.

CHAIRMAN ARMSTRONG: Thank you very much.

Do you want to -- it's going to take some time for the Commission to review the record here, but also other information that we have gleaned from this hearing. I should ask my colleagues how much time we're going to need on this?

Mr. Raff?

MR. RAFF: I believe the parties have requested an order by June 29th is it?

UNIDENTIFIED SPEAKER: That's accurate, Mr. Raff.

CHAIRMAN ARMSTRONG: Is that plenty of time?

MR. OVERSTREET: We would like to put the rates in effect for service on or after June 29, that's correct.

CHAIRMAN ARMSTRONG: Okay with you?

MR. RAFF: It's okay with me.

CHAIRMAN ARMSTRONG: All right.

UNIDENTIFIED SPEAKER: If I may, your Honor, I know between the Attorney General and KIUC that neither party here believes it's necessary to file a brief. I don't know if any of the other intervenors wanted to do so.

UNIDENTIFIED SPEAKER: Your Honor, if it's permissible I would like to submit something, I don't think it will be lengthy, but I do feel like we've objected to the settlement agreement. I've asked questions of some witnesses.

CHAIRMAN ARMSTRONG: Mr. Raff?

MR. RAFF: As long as it's within we say ten days?

CHAIRMAN ARMSTRONG: Is that enough time?

UNIDENTIFIED SPEAKER: Ten days.

MR. OVERSTREET: Your Honor, I think if Pike County's going to file something we'd like to file something brief also within the ten-day period.

CHAIRMAN ARMSTRONG: Ten days for filing of briefs.

UNIDENTIFIED SPEAKER: I have something due on June 7th. Do you think we could put it back a few days after June the 7th? Would that be a problem?

CHAIRMAN ARMSTRONG: I don't have my calendar down here.

MR. RAFF: That's going to be difficult to analyze whatever issues may be raised in the brief if they're not filed until after June 7th and still get an order out by the 29th of June.

UNIDENTIFIED SPEAKER: All right, I'll file a brief before that, that's fine.

CHAIRMAN ARMSTRONG: Thank you, Mr. Sanders.

No further matters, we are adjourned.

MR. OVERSTREET: Thank you, your Honor.

(Hearing adjourned at 2:37 p.m.)

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CERTIFICATE

I do hereby certify that the foregoing is a transcript of the proceedings recorded by the Kentucky Public Service Commission, and transcribed by me to the best of my ability, in this matter on Tuesday, May 25, 2010.

Julieanna Hennebert, Registered Professional Reporter and RMR and Notary Public in and for the State of Ohio.

My commission expires February 19, 2013.

(JUL-1570)

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EXHIBIT 2

Kentucky Power Company
Settlement Revenue Allocation
Twelve Months Ended September 30, 2009

Class	Current Revenue	Current Return on Rate Base	Basic Increase		Reliability Increase		Total Increase		Total Settlement Revenue	Settlement Return on Rate Base
			$	%	$	%	$	%		
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)=(4)+(6)	(9)	(10)=(2)+(8)	(11)
RS	196,964,517	-2.88%	27,564,832	13.99	5,606,426	2.85	33,171,258	16.84	230,135,775	0.88%
SGS	14,551,918	6.37%	2,036,515	13.99	414,208	2.85	2,450,723	16.84	17,002,641	11.55%
MGS	51,640,578	5.64%	7,227,007	13.99	1,452,488	2.81	8,679,495	16.81	60,320,073	11.18%
LGS	58,995,442	4.05%	8,256,307	13.99	1,528,483	2.59	9,784,790	16.59	68,780,232	9.58%
QP	54,976,107	5.23%	2,857,375	5.20	762,128	1.39	3,619,503	6.58	58,595,610	7.99%
CIP-TOD	124,336,206	6.37%	4,496,324	3.62	0	0.00	4,496,324	3.62	128,832,530	8.27%
MW	582,698	6.55%	81,548	13.99	16,586	2.85	98,134	16.84	680,832	12.93%
OL	6,588,349	6.86%	922,028	13.99	187,532	2.85	1,109,560	16.84	7,697,909	10.26%
SL	1,129,448	14.45%	158,064	13.99	32,149	2.85	190,213	16.84	1,319,661	19.38%
Total	509,765,263	1.11%	53,600,000	10.51	10,000,000	1.96	63,600,000	12.48	573,365,263	4.92%