

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF KENTUCKY POWER)
COMPANY FOR A CERTIFICATE OF) CASE NO. 8271
PUBLIC CONVENIENCE AND NECESSITY)

O R D E R

Introduction

After careful deliberation and thorough review of what appears to be an ever-growing host of considerations which impinge upon the financial wellbeing of Kentucky Power Company ("KPC"), the Commission has determined to receive further evidence and testimony concerning KPC's ownership of a 15 percent undivided interest in the electric generating station being constructed near Rockport, Indiana ("Rockport"), by the Indiana and Michigan Electric Company ("I and M Co."); to conduct further hearings into this matter; and to allow persons not currently parties to the proceeding to become parties.

The Commission has decided upon this course because it believes the responsibilities which it has under KRS Chapter 278 mandate such action. The Commission believes KPC's investment in Rockport warrants further review because the Commission is convinced that the financial soundness of KPC is not good, and demands the Commission's careful and immediate attention; because

of recent testimony by KPC witnesses in KPC's general rate adjustment proceeding, Case No. 8734, that, even if the Commission should grant the entire request made by KPC in that proceeding, financial wellbeing would not be restored; because of further testimony by KPC witnesses in Case No. 8734 having to do with the magnitude of KPC's construction program and the impact of that construction program on the financial wellbeing of KPC; because of the recent revelation concerning the extent of KPC's financial obligation for the 765-KV line currently under construction -- an obligation which is a fundamental change from the obligation on the basis of which KPC was granted permission to construct the line; because of the importance of the 765-KV line in KPC's very ambitious construction program; and because of the dramatic increases in customers' rates which are an inescapable consequence of the current construction program and KPC's financial obligation for the 765-KV transmission line.

Discussion

On March 15, 1983, the Commission issued an Order on Remand granting KPC a certificate of public convenience and necessity to purchase a 15 percent undivided interest in two electric generating units being constructed near Rockport, Indiana, by the I and M Co. The certificate restricted KPC to a maximum amount of \$312 million to be included in rate base for ratemaking treatment. On May 12, 1983, the Commission granted KPC a rehearing to present additional evidence in support of its motion to modify

the Commission's Order on Remand by allowing KPC to exceed \$312 million "for good cause shown."

On June 14, 1983, KPC filed testimony in verified prepared form and a hearing was held in the Commission's offices at Frankfort, Kentucky, on June 28, 1983. The Attorney General's office filed a memorandum on July 18, 1983, and KPC filed one on July 21, 1983. The case was then submitted to the Commission.

On August 2, 1983, a hearing commenced on KPC's general rate adjustment, Case No. 8734, General Adjustment in Electric Rates of Kentucky Power Company. During that hearing, KPC witness Mr. Gregory S. Vassell, Senior Vice President-System Planning of American Electric Power ("AEP") Service Corporation, presented extensive testimony regarding KPC's ownership and construction of a 765-KV transmission line connecting the Hanging Rock Station of Ohio Power Company with the Jefferson Station of I and M Co. Construction of the transmission line was authorized by the Commission on May 17, 1974. At that time KPC had stated that the transmission line:

...is intended to provide, by the fall of 1978, needed reinforcement to the AEP System's overall 765-KV transmission network by completing a 765-KV transmission loop across the entire AEP System. Such a 765-KV loop will become indispensable by 1978 in order to retain overall reliability of bulk power supply on both the Company's system and the AEP System of which it is a part. (Application at p. 4, Case No. 6019, Application of Kentucky Power Company For A Certificate Of Public Convenience And Necessity Authorizing It To Construct Additional 765-KV Transmission Facilities.)

In seeking Commission approval to construct the 765-KV line, KPC witness Waldo LaFon, the sole witness presented by KPC,

testified that KPC would be reimbursed by other operating companies within the AEP System for 95 percent of the construction and operating costs of the 765-KV line, yet in the current general rate proceeding KPC witnesses have informed the Commission that KPC will receive no reimbursement for either the construction or operating costs of the transmission line -- a change which would have a very dramatic effect on the revenues of KPC, and, as a consequence, its need to charge its customers higher rates.

But if the Commission is concerned about the fundamental change in KPC's financial obligation for the 765-KV transmission line, that change is not the sole cause for concern. The Commission's March 15, 1983, Order on Remand was based on a finding that KPC could not meet its own need for additional generating capacity by purchases under the AEP pool agreement without jeopardizing its membership in the pool. This finding was made when the Commission was not informed that KPC's 765-KV transmission line was indispensable to the AEP System and that KPC's ratepayers would be responsible for 100 percent of its cost. Consequently, the Commission is of the opinion that additional evidence should be presented on the issue of whether KPC's ownership of 765-KV transmission lines would allow it to purchase needed generating capacity under the AEP pool without jeopardizing its membership therein.

The Commission also is concerned about the total construction program which KPC has underway, and noted with particular

interest the testimony in Case No. 8734 from KPC's cost of capital witness, Charles A. Benore, that KPC:

...has a momentous financial challenge in achieving a satisfactory level of financial integrity because of a near doubling of its plant and capitalization between 1982 and 1984. P. 2 Direct Testimony.

The Commission believes the magnitude of KPC's construction program and the impact of that program on KPC's financial condition -- and the implications of that program for customers' rates -- were not adequately presented for consideration when KPC sought Commission approval to purchase 15 percent of Rockport. The Commission believes those issues simply must be explored thoroughly at this time.

Conclusion

This Commission has an obligation to KPC, and through it to its shareholder and bondholders. The Commission also has an obligation to the customers of KPC. The Commission has an obligation to review thoroughly proposed major capital construction programs of the utilities which it regulates, and to review the proposed financing programs for those construction programs. The Commission has an obligation to act responsibly once it has approved a major capital construction program -- to approve rates which enable the utility to discharge the obligations which it has incurred in order to undertake the construction program for which it sought -- and was granted -- Commission approval.

All of these obligations impose upon the Commission the need to strive for a balance which is as elusive as it is important.

If customer rate increases are unavoidable, an essential part of that balancing process is to see that they are neither greater nor more rapid than they need be, and to assure that the rate increases defray cost increases which truly are inescapable or which provide, for the customers, improved service of equal or greater value. In the case of KPC's investment in Rockport, because of the rate implications of KPC's very ambitious construction program and the irreversibility of major capital projects once they have proceeded beyond a certain point, the Commission has a particular obligation to see that the balance is achieved in this case. Consequently, the Commission is of the opinion that additional evidence should be presented on the issue of future rate increases necessitated by both KPC's purchase of Rockport and its other construction expenditures and their impact on KPC's financial condition.

Based upon the evidence of record and being advised, the Commission is of the opinion and finds that:

1. KPC should be required to present evidence on the benefits, if any, conferred upon the AEP pool and the AEP system by KPC's ownership of 765-KV transmission lines in service and under construction in Kentucky.

2. KPC should be required to present additional evidence on the magnitude of future rate adjustments necessitated by the purchase of a 15 percent undivided interest in Rockport combined with its other construction expenditures and the resulting impact on KPC's financial condition.

3. Within 20 days of the date of this Order, any person not already a party may file a motion to intervene pursuant to 807 KAR 5:001 Section 3(8) for the limited purpose of participating in the issues addressed in this Order.

IT IS THEREFORE ORDERED that KPC shall file by October 7, 1983, testimony in verified prepared form on the issues set forth in Finding Nos. 1 and 2, with copies to parties of record and 12 copies submitted to the Commission.

IT IS FURTHER ORDERED that a hearing be and it hereby is scheduled to commence on October 20, 1983, at 9:30 A.M., Eastern Daylight Time, at the Commission's offices in Frankfort, Kentucky, for the purpose of cross-examination of KPC witnesses, presentation of direct testimony, if any, by intervenors and cross-examination of intervenor witnesses.

Done at Frankfort, Kentucky, this 20th day of September, 1983.

PUBLIC SERVICE COMMISSION


Chairman

Vice Chairman Randall Not
Participating


Commissioner

ATTEST:

Secretary