

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ADJUSTMENT OF RATES OF)
KENTUCKY POWER COMPANY)

CASE NO. 8734

O R D E R

On October 10, 1983, Kentucky Power Company ("Kentucky Power") and the Attorney General's Office ("AG") filed petitions for rehearing of the Commission's Order entered September 20, 1983, adjudicating Kentucky Power's application for an adjustment of rates. Kentucky Power's petition requests reconsideration on the issues of Big Sandy Plant maintenance and the rate-making treatment of Job Development Investment Tax Credits ("JDIC") and American Electric Power Company, Inc., ("AEP") tax loss. The AG's petition for rehearing requests reconsideration on the issues of capital structure, cost of equity and fuel cost synchronization.

On October 14, 1983, Kentucky Power filed a response in opposition to the AG's petition and on October 20, 1983, the AG filed a response in opposition to Kentucky Power's petition.

Kentucky Power Petition for Rehearing

The first issue raised by Kentucky Power is the Commission's denial of the proposed adjustment to production plant maintenance expense. Kentucky Power states that the basis for

its petition lies with the Commission's change of standards for determining production maintenance expense and the Commission's reliance on historical averages in determining the reasonableness of the proposed level of expense. Kentucky Power also claimed that the approach taken by the Commission has not adequately compensated it in the past, and if continued, the Commission's approach will perpetuate this under-compensation.

The Commission allowed for rate-making purposes the actual production plant maintenance expense incurred during the test year. This is consistent with the treatment afforded Kentucky Power in its last rate case, Case No. 8429, General Adjustment in Electric Rates of Kentucky Power Company. Having adhered to the methodology established in Case No. 8429, the Commission is of the opinion that a measure of consistency has been established.

The Commission is also of the opinion that a review of the historical levels of maintenance expense is necessary to accurately evaluate the adjustment proposed by Kentucky Power. Inasmuch as those historical expenses were the basis for the proposed adjustment, such a review was imperative. However, the Commission did not rely on historical averages of maintenance expenses. The record fully supports the Commission's finding that Kentucky Power's actual test year level of maintenance expense is reasonable and proper for rate-making purposes.

In support of its claim that the Commission's approach has not adequately compensated it in the past and will continue to do so in the future, Kentucky Power provided a table which compared its maintenance expense requested, maintenance expense awarded,

and maintenance expense incurred during the past 6 years covering five previous rate cases. According to its table, Kentucky Power has under-recovered \$10.1 million in maintenance expense over the years 1977 through 1982. However, as the schedule shows, \$9.4 million of this under-recovery occurred from 1977 through 1980 during which time Kentucky Power was awarded, in three rate cases, the full amount it had requested for plant maintenance expense. Furthermore, during 1981 and 1982, when Kentucky Power was granted less than the requested levels of maintenance expense in two rate cases, it failed to recover only \$700,000 of a total expense of \$19.1 million. Moreover, had the Commission awarded the amounts requested in the two cases, Kentucky Power would have over-recovered \$1.4 million during this time period.

It is clear that Kentucky Power's long-term under-recovery has not been due to the Commission's rate-making methodology consistently applied in this case and Case No. 8429. The petition for rehearing has failed to show that the Commission's use of the actual test year expense will result in an under-recovery. Furthermore, the petition offers no meaningful response to the Commission's original critique of the proposed adjustment. Therefore, the request for rehearing of this issue should be denied.

The second issue raised by Kentucky Power is the Commission's treatment of JDIC. Since this issue is presently pending before the Court of Appeals in Continental Telephone Company v. Public Service Commission, 82-CA-2657-MR, Kentucky Power has requested that the Commission permit a future adjustment of its rates if the final decision in that case or any other appellate

case pending in Kentucky is adverse to the Commission's position. Considering that a final decision in Continental is imminent and that this request is an attempt to avoid additional judicial review of the same issue, the Commission is of the opinion that Kentucky Power's request is reasonable and should be granted. However, if a final judicial opinion should be adverse to the Commission's position, a rate adjustment will be authorized only after Kentucky Power has filed proposed tariffs which reflect the additional revenues to be generated based on the level of JDIC as of the end of the test year ended December 31, 1982. Furthermore, the Commission will require an earnings test to insure that the additional revenues will not cause Kentucky Power to exceed its authorized rate of return.

The third issue by Kentucky Power was the Commission's treatment of the AEP parent company tax loss. Kentucky Power requested that the Commission review its decision on this issue based on its claim that the record supports the use of its proposed methodology. The Commission has reviewed the record and is of the opinion that it fully supports the rate-making treatment utilized in the Commission's Order entered September 20, 1983.

AG Petition for Rehearing

The first issue in the AG's petition for rehearing is an allegation that the capital structure authorized in the Commission's Order (54.48 percent long-term debt, 9.29 percent short-term debt and 36.23 percent common equity) was too highly leveraged. The AG recommended a hypothetical capital structure of 50 percent long-term debt, 5 percent short-term debt and 45 percent

common equity. The AG argued that unless Kentucky Power's capital structure was significantly improved, no allowed return on equity would successfully maintain Kentucky Power's financial integrity. The Commission recognizes the highly leveraged nature of Kentucky Power's actual end of test year capital structure. However, the Commission believes it is unreasonable to expect dramatic changes in the capital structure within a brief time period. Further, the use of a hypothetical capital structure does not alter the actual amount of debt Kentucky Power has outstanding or increase its common equity. Investors look at actual capital ratios when assessing the financial risk of a company. Finally, the AG did not present any new arguments or evidence to convince the Commission to grant a rehearing.

The AG's second issue is a request for the Commission to reconsider the 16.5 percent return on equity authorized in the Order. The AG stated that the 16.5 percent return was unwarranted and again recommended that the Commission grant a return no greater than 14.25 percent using the hypothetical capital structure proposed by Mr. James A. Rothschild, the AG's witness, or 14.5 percent using Kentucky Power's actual end of test year capital structure. The Commission has determined that the 16.5 percent return on equity, applied to Kentucky Power's actual end of test year capital structure, is not more costly to ratepayers than Mr. Rothschild's recommended return on equity applied to his recommended capital structure. The Commission is of the opinion that the 16.5 percent return on equity reflects the risk associated with Kentucky Power's actual capital structure, its current

construction program and the absence of CWIP in the rate base. The 16.5 percent authorized return reflects Kentucky Power's current situation and is not an indication of a trend toward necessarily higher returns for utilities. The AG presented no new arguments or evidence to convince the Commission to grant a rehearing.

The final issue raised by the AG was that Kentucky Power should be required to match fuel revenues with fuel expenses by adopting a "fuel cost synchronization" adjustment. The AG alleged that the Commission has not taken a consistent stand concerning the treatment of the fuel adjustment clause, and that the Commission's failure to adopt the AG's proposed fuel cost synchronization adjustment has resulted in a "windfall" to Kentucky Power.

The AG's argument that the Commission has not taken a consistent stand concerning its treatment of the fuel adjustment clause is unfounded. The AG made specific reference to a surcharge granted to Kentucky Power in Case No. 8058, An Examination by the Energy Regulatory Commission of the Application of the Fuel Adjustment Clause of Kentucky Power Company from May 1, 1980 to October 31, 1980, but the issue in that case was whether Kentucky Power had ever been afforded the opportunity to collect the fuel costs in question and not an issue of over- or under-collection of fuel costs.

Since Kentucky Power's test year fuel revenues exceeded fuel expenses by approximately \$1,352,598, an adjustment to match fuel revenues with fuel expenses would require a \$1,352,598

reduction in test year normalized revenues. Such a reduction in normalized revenues would cause a revenue deficiency necessitating a \$1,352,598 increase in rates. The absence of such an adjustment does not result in a "windfall" to Kentucky Power. The AG did not present any evidence or arguments of merit to support the granting of a rehearing on this issue.

Based on the petitions for rehearing, the responses thereto, the evidence of record and being advised, the Commission is of the opinion and hereby finds that:

1. Kentucky Power has failed to present a meritorious argument or allege the existence of new evidence to justify granting its petition for rehearing on the issues of Big Sandy Plant maintenance and AEP tax loss.

2. If a final opinion of an appellate court of Kentucky is adverse to the Commission's rate-making policy on JDIC, Kentucky Power should be authorized to file proposed tariffs designed to recover the additional revenue to be generated based on the level of JDIC as of December 31, 1982.

3. The AG has failed to present a meritorious argument or allege the existence of new evidence to justify granting its petition for rehearing.


IT IS THEREFORE ORDERED that Kentucky Power's petition for rehearing on the issues of Big Sandy Plant maintenance and AEP tax loss be and it hereby is denied.

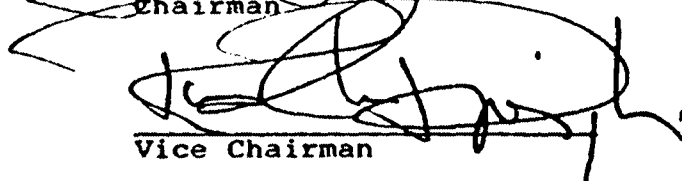
IT IS FURTHER ORDERED that Kentucky Power's petition for rehearing on the issue of rate-making treatment of JDIC be and it hereby is granted in accordance with Finding No. 2.


IT IS FURTHER ORDERED that the AG's petition for rehearing
be and it hereby is denied.

Done at Frankfort, Kentucky, this 31st day of October,
1983.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:

Secretary