COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE GENERAL ADJUSTMENTS IN ELECTRIC RATES OF KENTUCKY POWER COMPANY	))	CASE NO. 9061

O R D E R

On December 20, 1984, the Attorney General's Office, Consumer Protection Division, ("AG") filed an application for rehearing of the Commission's Order entered December 4, 1984, granting Kentucky Power Company ("Kentucky Power") an adjustment in electric rates to increase annual revenues by $29.6 million. The AG requested reconsideration on the issues of Allowance for Funds Used During Construction ("AFUDC") annualization adjustment, AFUDC accrual on the Hanging Rock-Jefferson transmission line, return on equity, proposed year-end customers adjustment and level of coal inventory.

On December 21, 1984, Air Products and Chemicals, Inc., Armco Inc., Ashland Oil, Inc., Huntington Alloys, Inc., Kentucky Electric Steel Company, and Pickands Mather & Co., collectively referred to as Kentucky Industrial Utility Customers ("KIUC"), filed an application for rehearing on the issues of AFUDC annualization adjustment, recognition of transmission services revenue and the desirability of a grace period prior to switching industrial billing demand from a 30-minute period to a 15-minute period.

On December 26, 1984, Residential Intervenors filed an application for rehearing on the issues of return on equity and capacity charges paid pursuant to the Interconnection Agreement.

On January 3, 1985, Kentucky Power filed a response addressing each of the issues included in the applications for rehearing.

The AG and the KIUC contend that the Commission improperly calculated the AFUDC annualization adjustment. Both parties claim that the Commission failed to reduce test-year deferred federal income tax expense applicable to the borrowed portion of the test year AFUDC. The AG and KIUC contend that the omission of this $4.4 million adjustment resulted in an $8.7 million overstatement in the amount of additional revenue granted Kentucky Power.

The Commission did not reflect the tax reduction as part of the adjustment to AFUDC; however, the adjustment was made and was included in the Commission's total adjustment to operating expenses in a manner similar to Kentucky Power's Exhibit CRB-5, page 8 of 19. The Commission's adjustment gives the same result as the adjustment proposed by Kentucky Power and shown on Exhibit CRB-5, page 18 of 19. It was merely reflected in a different manner on the adjusted operating statement.

The second issue raised by the AG concerns the accounting and rate-making treatment which allowed Kentucky Power to accrue AFUDC on its investment in the Hanging Rock-Jefferson transmission line after the line was placed in service. The AG's objection, which was raised for the first time in its petition for rehearing, claims that the Commission has provided a guaranteed return on a portion of Kentucky Power's investment and has departed from its usual practice by allowing Kentucky Power to earn a return on an investment level in excess of that experienced during the test year. Furthermore, the AG disputes the finding that such treatment is justified, in part, because of the timing of the completion of the transmission line and Rockport Unit No. 1 ("Rockport").

The Commission's decision did not guarantee a return on investment; it merely provided a mechanism to allow for the recovery of Kentucky Power's capital costs. Furthermore, the Commission's decision did not depart from past practice. This is one of several cases involving the completion of a major construction project after the test year in which the Commission has allowed a return on an investment level greater than the test-year level. Finally, the timing of the two construction projects created the issue in question. Were there but one project, this case obviously would have been filed to coincide with that project and the question of post-in-service AFUDC would be non-existent. The Commission is of the opinion that the AG's petition provides no evidence to support rehearing of this issue.

The AG and the Residential Intervenors both filed petitions for rehearing citing rate of return as an issue. Both parties were of the opinion that a 16.5 percent return on equity was not justified by the record on the basis that the risk associated with Kentucky Power's construction program and high level of AFUDC has been all but eliminated. The AG stated that Kentucky Power's financial difficulties stemmed from imprudent management and should not be rewarded with an excessive rate of return. The AG and the Residential Intervenors were of the opinion that the recommended 15 percent return on equity, proposed by Mr. James Rothschild, the AG's witness, was appropriate.

In Kentucky Power's last rate case, Case No. 8734, Kentucky Power's capital structure contained over 63 percent debt. Currently Kentucky Power's capital structure contains over 61 percent debt. On average, companies in the AEP system (excluding Kentucky Power) have approximately 55 percent debt.[1] Louisville Gas & Electric Company has approximately 49 percent debt and Kentucky Utilities Company has approximately 46 percent debt. On page 45 of its brief in Case No. 8734, the AG stated the following:

> . . . [I]t is the Attorney General's belief that Kentucky Power will continue to experience financial difficulties so long as it maintains so highly leveraged a capital structure.

Kentucky Power's financial integrity has not significantly improved since Case No. 8734 was decided. Kentucky Power's coverage ratios continue to be very low, even when unit power payments are excluded from expenses. Incorporating the AG's recommended rate relief (which also excludes unit power payments) and Mr. Rothschild's 15 percent return on equity would reduce Kentucky Power's interest coverage ratios further.[2]

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1 Giordano Prefiled Testimony, Schedule 9, p. 1.

2 Kentucky Power's Response to Oral Request No. 3.

The AG and the Residential Intervenors did not present any new evidence which the Commission has not already considered. The 16.5 percent return on equity reflects the risk associated with Kentucky Power's highly leveraged capital structure and its generally low level of financial integrity. Therefore, the requests for rehearing on the issue of rate of return are denied.

The AG's fourth issue for rehearing is the allegation that the Commission erred in rejecting the adjustment for year-end customers sponsored by the AG's accounting witness. The AG contends that the deficiency in its adjustment was due to Kentucky Power's failure to respond adequately to AG data requests. Kentucky Power's responses to some of the data requests were somewhat inadequate; however, the omission of the customers served under the Quantity Power tariff was the only reason for rejecting the adjustment, and the record indicates that the omission of those customers was the result of an arbitrary decision by the AG's accounting witness. The Commission affirms its original decision and reiterates its directive that Kentucky Power maintain adequate data and submit a year-end customer adjustment in its next general rate case.

The final issue raised in the AG's petition for rehearing is its recommendation that a reduction in the coal inventory level be approved by the Commission. Kentucky Power has demonstrated its commitment to fuel inventory control and the Commission believes that the "plaudits" it bestowed upon Kentucky Power were appropriate as evidenced by the record in this case. Certainly, the Commission hopes the AG recognizes that the negotiation of the

UMW-BCOA contract is a major factor to be considered in planning for appropriate fuel inventory levels. Since the AG has failed to present any new evidence or arguments of merit, the Commission is of the opinion that no adjustment to coal inventory is warranted in this case.

The second issue raised by the KIUC concerned the fact that no recognition was given to the projected revenues that Kentucky Power would begin receiving in 1985 via power sales by the American Electric Power Company ("AEP") to the Virginia Electric Power Company ("VEPCO"). The KIUC claims that Kentucky Power's revenue from retail customers should be reduced by an amount equal to its share of these revenues.

No witness sponsored an adjustment such as that now proposed by the KIUC, and, although counsel for KIUC cross-examined Kentucky Power's witnesses on the subject of the VEPCO sale, the question of recognizing those projected revenues for rate-making purposes was not raised until KIUC did so in its post-hearing brief. It would be both selective and arbitrary for the Commission to isolate one segment of AEP's system sales and recognize a change therein which occurred subsequent to the date of the Commission's rate Order without giving similar recognition to the other components of AEP's system sales. Furthermore, the new VEPCO agreement replaces an earlier agreement and is projected to generate less revenue than was reflected in the test year. Finally, the revenues under the new VEPCO sale are greatly dependent on the projected energy sales which do not meet the Commission's known and measurable standard. For these reasons, the Commission continues to be of the opinion that such an adjustment would be improper.

The KIUC's final rehearing request concerned the switch from a 30-minute demand measurement to a 15-minute demand measurement for industrial customers. The KIUC petition states

> . . . [W]e are not contesting the Commission's judgment to go to a 15-minute measured demand; we are seeking rehearing only so that the 15-minute measurement will not have begun as a surprise to those customers using load management equipment geared to 30-minute demands.[3]

In response to KIUC's request for a grace period, Kentucky Power stated that the switch to 15-minute demand measurement should not have come as a surprise in light of the prefiled testimony of Mr. Robert Bibb, Rate and Tariffs Manager for Kentucky Power, and the extended cross-examination by KIUC counsel at the hearing. Further, Kentucky Power argues that the current billing determinants reflect a 15-minute demand cycle and that if a grace period were approved, the company would lose revenue. The Commission finds that the request for a grace period for industrial customers to switch from a 30-minute to a 15-minute demand measurement is unreasonable and should be denied. However, the Commission does note that, by letter under separate cover distributed to all parties, KIUC has identified a particular customer that may have incurred an unusually high demand because of the uncertainty of the precise time of the switch to the 15-minute demand measurement. This situation may have been

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3 KIUC Application for Rehearing, p. 2.

compounded by the ratchet provision of the tariff which provides for a minimum payment which is based upon 60 percent of the highest billing demand recorded during the previous 11 months. At the time of the letter, the extent of any problem, if there is one, could not be quantified. When the magnitude of the problem is determined, and if KIUC believes they have been unduly harmed, this problem can be handled through the Commission's complaint process.

The final issue raised by the Residential Intervenors is whether or not the capacity charge rate of $4.50 was sufficiently known and measurable to be considered for rate-making purposes. The Residential Intervenors contend that this rate is based on the expectation that Indiana and Michigan Electric Company ("I&M") would become a surplus member of the AEP pool with the addition of Rockport. The record shows that, with 85 percent of Rockport, I&M is expected to become a surplus member of the pool in the summer of 1985; however, with 100 percent of Rockport, which was the implicit result of the Commission's ruling on the unit power agreement, I&M would become a surplus member of the pool at the time the plant was commercialized. The Residential Intervenors' petition has not altered the Commission's opinion on this matter.

Based on the petitions for rehearing submitted by the AG, the KIUC and the Residential Intervenors, Kentucky Power's response in opposition thereto, the evidence of record and being advised, the Commission is of the opinion and finds that the petitions for rehearing failed to present any evidence or arguments to merit the granting of a rehearing.

IT IS THEREFORE ORDERED that the petitions for rehearing be and they hereby are denied and the Commission's Order entered December 4, 1984, be and it hereby is affirmed.

Done at Frankfort, Kentucky, this 10th day of January, 1985.

PUBLIC SERVICE COMMISSION

Richard D. Hemanyf

Chairman

Vice Chairman

Commissioner

ATTEST:

Secretary