COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF KENTUCKY POWER COMPANY FOR APPROVAL OF A STIPULATION AND SETTLEMENT AGREEMENT RESOLVING STATE REGULATORY MATTERS	)))))	CASE NO. 2004-00420

<u>O R D E R</u>

On October 25, 2004, Kentucky Power Company ("Kentucky Power") filed an application requesting the Commission to approve the terms and provisions of a Stipulation and Settlement Agreement ("Stipulation") among Kentucky Power, the Office of the Attorney General ("AG"), and Kentucky Industrial Utility Customers, Inc. ("KIUC"). A copy of the Stipulation is attached hereto as Appendix A. The Stipulation provides for: (1) an 18-year extension, through 2022, of a unit power agreement, whereby Kentucky Power purchases 15 percent of two generating units in Rockport, Indiana ("Rockport"); (2) modifications to Kentucky Power's system sales clause tariff to provide for retail rate recovery of supplemental payments incurred to extend the Rockport unit power agreement; (3) modifications to Kentucky Power's system sales clause tariff to reflect as an expense the environmental costs attributable to off-system sales; and (4) establishing a schedule for Kentucky Power to file its next integrated resource plan ("IRP").

The AG and KIUC requested and were granted full intervention. Kentucky Power published notice of the content of its application, as well as the date of the hearing, in newspapers of general circulation in its service territory. A hearing was held at the Commission's offices on December 7, 2004. No member of the public appeared at the hearing, and no comments have been filed with the Commission in response to Kentucky Power's application.

ROCKPORT PURCHASE POWER CONTRACT

In approximately 1984, Kentucky Power entered into a wholesale power contract to purchase 15 percent of the output of Rockport Unit Nos. 1 and 2. These are coal-fired 1,300 MW generating units owned by an affiliate of Kentucky Power. The contract obligates Kentucky Power to pay for 15 percent of all costs associated with the two Rockport units and entitles Kentucky Power to receive 15 percent of the output of those units. The power purchased from Rockport Unit No. 1 is priced at cost of service, while the power purchased from Rockport Unit No. 2 is priced at the levelized cost of service over approximately 35 years to reflect a sale/leaseback transaction. Since each unit is 1,300 MW, Kentucky Power's 15 percent share equates to 195 MW from each unit, for a total of 390 MW.

Under the terms of the Stipulation, the Rockport purchase power contract will be extended through December 7, 2022. The current wholesale pricing for the power purchase will continue through the extended term of the contract, but there will also be an annual supplemental payment by retail ratepayers to Kentucky Power. This supplemental payment, as set forth in the Stipulation, will be $5.1 million annually in 2005 through 2009, and then increases to $6.2 million annually in 2010 through 2021, and then decreases to $5,792,329 in 2022. Kentucky Power will be entitled to receive these annual supplemental payments in addition to the base retail rates established by the Commission as being fair, just, and reasonable, and the supplemental payments will not be considered in establishing Kentucky Power's base retail rates.

MODIFICATIONS TO THE SYSTEM SALES CLAUSE TARIFF

Kentucky Power, along with four affiliated utilities, are members of the AEP-East Power Pool. Collectively, the members of this power pool have relatively low-cost coal-fired generation, and at times they are able to make significant quantities of power sales to non-affiliates. The net revenues from these off-system sales are shared on a proportionate basis among the members of the AEP-East Power Pool. Kentucky Power has historically received a relatively high level of revenue from these off-system sales, although the revenue level has varied annually. To ensure that ratepayers receive the benefits from those off-system sales, while also providing an incentive for Kentucky Power to maximize those sales, a system sales clause has been in effect for approximately 15 years. Under Kentucky Power's system sales clause, for each month that its net revenue from off-system sales exceeds the base amount included in base rates, 50 percent of the excess is credited to ratepayers. Similarly, for each month that its net revenue from off-system sales falls below the base amount, 50 percent of the shortfall is charged to ratepayers. On an annual basis, $11.3 million of net revenue from off-system sales is in Kentucky Power's base rates.

The Stipulation proposes two modifications to the system sales clause. The first modification is to allow Kentucky Power to recover from retail ratepayers the supplemental annual payments tied to the 18-year extension of the Rockport purchase power contract. The supplemental annual payments will be recovered from all customer classes on a monthly kWh basis in accordance with the allocation methodology set forth in the Stipulation. Due to annual variations in kWh sales, the system sales clause will also include a balancing factor which will be instituted after the first year and will be modified annually thereafter to prevent over-collection or under-collection of the supplemental payments. Kentucky Power will continue to collect the supplemental payments under the terms of the system sales clause until it files its next base rate case. At that time, Kentucky Power will propose a new tariff to collect the supplemental payments. This new tariff will maintain the same allocation methodology used in the system sales clause to collect the supplemental payments, and the AG and KIUC have agreed not to oppose the new tariff. Upon implementation of such a new tariff, the revisions to the system sales clause to recover the supplemental payments will be deleted.

The second modification to the system sales clause is to allow Kentucky Power to deduct as an expense the environmental costs allocated to off-system sales under its environmental surcharge. Kentucky Power previously requested the Commission to amend its environmental surcharge to allow recovery of the environmental costs associated with off-system sales. The Commission denied that amendment upon finding that the environmental surcharge was properly allowing for the recovery of only those environmental costs associated with retail sales.[1] The Commission further found in that case that, if Kentucky Power's net revenues from off-system sales were being

[1] Case No. 2000-00107, An Examination by the Public Service Commission of the Environmental Surcharge Mechanism of Kentucky Power Company d/b/a American Electric Power for the Six-Month Billing Periods Ending December 31, 1998 and December 31, 1999, and for the Two-Year Billing Period Ending June 30, 1999 (Order dated February 8, 2001 at 12, 14).

overstated due to its inability to deduct environmental costs as an expense, the remedy was for Kentucky Power to modify its system sales clause.[2]

The Stipulation allows Kentucky Power to modify its system sales clause by deducting the environmental costs allocated to off-system sales under the environmental surcharge.

INTEGRATED RESOURCE PLAN

The Stipulation also provides that Kentucky Power will file a new IRP no later than June 30, 2009. This IRP will reflect the resources available to Kentucky Power as a “stand-alone” utility, as well as the resources available to it as a member of any power-pooling arrangement that is anticipated to exist during the period reflected in the IRP. The Stipulation further provides that this IRP will be subject to formal review by the Commission. In the event that authority is requested to change the resources that are currently available to Kentucky Power under the AEP-East Power Pool, Kentucky Power will file a new IRP earlier than June 30, 2009, if requested to do so by the AG, KIUC, or the Commission.

DISCUSSION

Kentucky Power owns two coal-fired generating units at its Big Sandy Generating Station in Louisa, Kentucky. Big Sandy Unit No. 1 has a capacity of 260 MW, while Big Sandy Unit No. 2 has a capacity of 800 MW, for a station total of 1,060 MW. When this capacity is combined with the 390 MW purchased from Rockport Unit Nos. 1 and 2, Kentucky Power has sufficient generation to satisfy its internal load during most of the hours of the year. During those limited hours when Kentucky Power is short on

[2] Id. at 12.

capacity, it is able to purchase needed generation through the AEP-East Power Pool. The Commission has been concerned for some time about the 2004 expiration of the existing Rockport unit power contract due to the relatively low cost of that power compared to today's cost to either construct new generation or purchase that quantity of power in the wholesale market at competitive prices. Although the existing Rockport unit power contract has been priced at cost of service, the 18-year contract extension will include a supplemental payment to be retained by Kentucky Power.

The Commission previously expressed serious concern about what had been for some time Kentucky Power's intent to meet its native load requirements by purchasing power at market-based prices rather than extending the Rockport unit power contract. In Administrative Case No. 387,[3] the Commission found that:

> [R]eliance on power purchases that reflect market price volatility is not in the best interests of Kentucky consumers. AEP-KY must plan to meet its load by securing sufficient capacity that is not subject to market price volatility. Only by doing so will AEP-KY be able to maintain reasonable electric rates while mitigating to the extent possible market price and fuel price fluctuations.[4]

Consistent with these Commission findings, Kentucky Power is now proposing a long-term extension of the Rockport unit power contract at a price that is not subject to market volatility. Although the price to be paid by retail customers for this power does reflect market forces since it is priced above cost of service, the price now being fixed will insulate retail ratepayers from the risk of future market price volatility.

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[3] Administrative Case No. 387, A Review of the Adequacy of Kentucky's Generation Capacity and Transmission System (Order dated December 20, 2001).

[4] Id. at 34-35.

Based on the evidence of record and being otherwise sufficient advised, the Commission finds that the 18-year extension of the Rockport unit power contract under the terms and conditions set forth in the Stipulation is reasonable and should be approved. Extending the purchase of 390 MW of power from Rockport, when combined with the 1,060 MW from Big Sandy, will provide Kentucky Power sufficient capacity, at reasonable and fixed prices, to meet its native load during most of the hours throughout this decade, with any shortfalls in capacity being met by purchases from affiliates through the AEP-East Power Pool.

The Commission further finds that the proposed modifications to Kentucky Power's system sales clause are reasonable. Kentucky Power had previously indicated that it was unwilling to extend the Rockport unit power contract and, as a wholesale power sale, the Commission has no jurisdiction to require the extension of that contract. Thus, the supplemental payment to Kentucky Power was a requisite for the 18-year contract extension. Even with this supplemental payment, the purchase price for the Rockport power is favorable compared to today's cost to construct new coal-fired generation. In recognition that all parties to this case have agreed that this supplemental payment should be recovered through Kentucky Power's system sales clause, the Commission will approve this modification.

All parties have also agreed that the system sales clause should be modified to recover the environmental costs that are now excluded from recovery under Kentucky Power's environmental surcharge because they are allocated to off-system sales. The Commission previously found, in Case No. 2000-00107, that these environmental costs were more appropriate for recovery under Kentucky Power's system sales clause. The

Commission reaffirms that prior finding and will now approve the recovery of these costs under Kentucky Power's system sales clause.

Finally, the Commission finds the proposal for Kentucky Power to file its next IRP no later than June 30, 2009 to be reasonable. Pursuant to the Commission's December 20, 2001 Order in Administrative Case No. 387, Kentucky Power is required to annually file schedules showing, among other things, its historic and projected peak demand figures, available capacities, and reserve margin. However, since these schedules reflect Kentucky Power on a stand-alone basis, they do not truly present Kentucky Power's ability to meet its native load requirements as a member of the AEP-East Power Pool. Consequently, Kentucky Power agreed, as part of the Stipulation, and subsequently affirmed at the hearing, that its annual filings pursuant to Administrative Case No. 387 will also include schedules showing the current and projected demands, generating resources, and reserve margins for the AEP-East Power Pool. With this information, the Commission will be in a better position to more accurately gauge Kentucky Power's need and timing for additional generating capacity.

IT IS THEREFORE ORDERED that:

1. The terms and provisions of the Stipulation filed by Kentucky Power are approved.

2. Kentucky Power's proposed modifications to its system sales clause tariff set forth in First Revised Sheet Nos. 19-1 and 19-2 are approved for service rendered on and after the date that Kentucky Power receives all necessary regulatory approvals for the 18-year extension of its unit power contract to purchase 15 percent of Rockport.

3. Kentucky Power shall file its next IRP no later than June 30, 2009, reflecting both the resources available to it as a stand-alone company, as well as the resources available to it as a member of any then-anticipated power pool.

4. All future annual responses by Kentucky Power to the December 20, 2001 Order in Administrative Case No. 387 shall include information on both Kentucky Power individually and the AEP-East Power Pool.

Done at Frankfort, Kentucky, this 13th day of December, 2004.

By the Commission

ATTEST:

Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2004-00420 DATED December 13, 2004.

COMMONWEALTH OF KENTUCKY
BEFORE THE
PUBLIC SERVICE COMMISSION OF KENTUCKY

IN THE MATTER OF:

APPLICATION OF KENTUCKY POWER	)	
COMPANY FOR APPROVAL OF A STIPULATION	)	
AND SETTLEMENT AGREEMENT RESOLVING	)	**P.S.C. CASE No. 04-____**
STATE REGULATORY MATTERS	)	

STIPULATION AND SETTLEMENT AGREEMENT AMONG KENTUCKY POWER COMPANY, KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC. AND OFFICE OF ATTORNEY GENERAL, OFFICE OF RATE INTERVENTION

This Stipulation and Settlement Agreement is made as of October 20th, 2004, by and among the Kentucky Office of Attorney General, Office of Rate Intervention ("KOAG"); Kentucky Industrial Utility Customers, Inc. ("KIUC")[1] (the KOAG and KIUC are collectively referred to herein as the "Kentucky Parties"); and Kentucky Power Company ("Kentucky Power.") These entities are sometimes individually referred to herein as a "Party" or collectively as "Parties".

WITNESSETH:

WHEREAS, on December 20, 2001 the Parties and the Public Service Commission of Kentucky ("Kentucky PSC") entered into a Settlement Agreement to resolve two proceedings then pending before the Federal Energy Regulatory Commission ("FERC"): Docket No. EC01-130-000 and Docket No. ER01-2668-000;

WHEREAS, among the issues before FERC in Docket No. EC01-130-000 was a Section 203 Application by American Electric Power Service Corporation to transfer certain jurisdictional assets among American Electric Power Company, Inc. ("AEP") subsidiaries in connection with AEP's proposed restructuring plan;

WHEREAS, in the negotiations leading to the December 20, 2001 Settlement Agreement the Parties addressed state regulatory issues including:

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[1] KIUC consists of AK Steel Corporation; Air Products & Chemicals, Inc.; Marathon Ashland Petroleum LLC; Calgon Carbon; and Specialty Metals Corporation.

(a) Kentucky Power's need for additional capacity beyond the December 31, 2004 expiration of the Unit Power Supply Agreement ("UPSA") between American Electric Generating Company ("AEGCo") and Kentucky Power for 195 MW of Rockport Unit No. 1 and 195 MW of Rockport Unit No. 2;

(b) Resolution of Kentucky Power's claim against AK Steel Corporation for late payment charges claimed due then pending in P.S.C. Case No. 2000-428, *Kentucky Power Company d/b/a American Electric Power v. AK Steel Corporation*;

(c) The date for filing by Kentucky Power of its next Integrated Resource Plan pursuant to 807 KAR 5:058;

(d) The amendment of Kentucky Power's System Sales Clause to permit the offset against system sales revenues of the environmental costs currently allocated to Non-Associated Utilities in calculating Kentucky Power's environmental surcharge pursuant to KRS 278.183;

(e) The setting of Kentucky retail rates in connection with the extension of the UPSA for 195 MW of Rockport Unit No. 1 and 195 MW of Rockport Unit No. 2.

WHEREAS, as part of the December 20, 2001 Settlement Agreement the Parties agreed to a settlement of the state regulatory issues, subject to approval by the Kentucky PSC;

WHEREAS, as part of the December 20, 2001 Settlement Agreement the Parties and the Kentucky PSC agreed that extending the UPSA between AEGCo and Kentucky Power for 195 MW of Rockport Unit No. 1 for five years beyond its December 31, 2004 expiration date was in the best interest of Kentucky Power and its ratepayers;

WHEREAS, as a further part of the December 20, 2001 Settlement Agreement the Parties and the Kentucky PSC agreed that extending the UPSA between AEGCo and Kentucky Power for 195 MW of Rockport Unit No. 2 until the December 7, 2022 end of the lease agreement dated as of December 1, 1989 between Wilmington Trust Company as Lessor and AEGCo was in the best interest of Kentucky Power and its ratepayers;

WHEREAS, on December 17, 2002 the Kentucky PSC approved the December 20, 2001 Settlement Agreement, finding that the extension of the UPSA for Rockport Unit No. 1 and Rockport Unit No. 2 was in the best interest of Kentucky Power and its ratepayers;

WHEREAS, the corporate restructuring and transfer of assets was never consummated;

WHEREAS, the Commission in its March 29, 2004 and May 29, 2004 Orders in Administrative Case No. 387, *In the Matter of: A Review of the Capacity of Kentucky's*

Generation and Transmission System, directed Kentucky Power to continue to seek extensions of the UPSA for Rockport Unit No. 1 and Rockport Unit No. 2;

WHEREAS, the Parties believe that extension of the UPSA for 195 MW of Rockport Unit No. 1 and for 195 MW of Rockport Unit No. 2 is in the best interest of Kentucky Power's ratepayers and will enable Kentucky Power to secure long-term low-cost, coal-fired base load generation;

WHEREAS, the Parties agree that the additional revenues set out in Section III(a)(1) and Section III(a)(2) of this Stipulation and Settlement Agreement are fair, just and reasonable consideration for the extension of the UPSA for Rockport Unit No. 1 and Rockport Unit No. 2 and the resolution of the other matters considered herein, and that the rates imposed to recover the additional revenues are fair, just and reasonable rates;

WHEREAS, the Parties agree that the state regulatory issues that were the subject of the December 20, 2001 Settlement Agreement should be resolved;

WHEREAS, the Parties have engaged in good faith negotiations to resolve the matters set forth below;

NOW THEREFORE, the Parties have reached a settlement and agree as follows:

I. ROCKPORT UNIT NO. 1 CAPACITY

1. The UPSA between Kentucky Power and AEGCo for 195 MW of Rockport Unit No. 1 will be extended beyond the current expiration date, which is December 31, 2004. The UPSA for 195 MW of Rockport Unit No. 1 will be extended until the expiration of the lease agreement for Rockport Unit No. 2 between Wilmington Trust Company as Lessor and AEGCo, which expires December 7, 2022. All other terms and provisions of the existing UPSA will continue through December 7, 2022. Except as provided in Section VI(3) of this Stipulation and Settlement Agreement neither Kentucky Power nor any of its affiliates, nor any party to this Stipulation and Settlement Agreement will seek to have the UPSA terminated before its new expiration date of December 7, 2022.

II. ROCKPORT UNIT NO. 2 CAPACITY

1. The UPSA between Kentucky Power and AEGCo for 195 MW of Rockport Unit No. 2 will be extended until the expiration of the lease agreement for Rockport Unit No. 2 between Wilmington Trust Company as Lessor and AEGCo, which expires December 7, 2022. All other terms and provisions of the existing UPSA will continue through December 7, 2022. Except as provided in Section VI(3) of this Stipulation and Settlement Agreement neither Kentucky Power nor any of its affiliates, nor any party to this Stipulation and Settlement Agreement will seek to have the UPSA terminated before its new expiration date of December 7, 2022.

III. ADDITIONAL REVENUES

1. In consideration of the benefits conferred by the extension of the UPSA and other matters resolved herein, all Parties further agree not to oppose an application by Kentucky Power to the Kentucky PSC to amend its retail tariffs to permit Kentucky Power to collect additional retail revenues as follows:

(a) Kentucky Power shall collect $5.1 million in additional revenue each year of this Stipulation and Settlement Agreement for the five years beginning January 1 of 2005 through 2009;

(b) Kentucky Power shall collect a further increase in additional annual revenues of $1.1 million (yielding a combined total increase in annual revenue of $6.2 million) each year for the approximately thirteen years beginning January 1 of 2010 through December 7, 2022, except that the additional revenues for the year beginning January 1, 2022 shall be $5,792,329 (341/365 of $6.2 million.)

(c) Following approval of the retail rate adjustments set forth in Section III(1)(a) and Section III(1)(b) of this Stipulation and Settlement Agreement Kentucky Power will:

(i) implement those rate adjustments by revising its monthly System Sales Clause Schedule filed with the Kentucky PSC in the fashion illustrated on Exhibit 1 to this Stipulation and Settlement Agreement. The increased annual revenues will be generated by two different kWh rates. The first rate will be for all customers except the CIP-TOD tariff customers and the second kWh rate will be for the CIP-TOD tariff customers. The kWh rate to be applied to each of these two customer class groups shall be sufficient to generate that portion of the total increase in annual revenues required under this Stipulation and Settlement Agreement equal to the percentage of total annual revenues produced by each of the two customer class groups (CIP-TOD and all other tariffs) for the twelve months ending June 30, 2004 and for each twelve month period thereafter during which the revenues are collected through the system sales tracker.

(ii) calculate each calendar year during the period between January 1, 2005 and the effective date of the Company's next change in retail base rates a Balancing Adjustment Factor (BAF) in the same manner as the Company does for the current Net Merger Savings Credit tariff and include the factor in the combined System Sales Clause factor as shown on Exhibit 1 to this Stipulation and Settlement Agreement.

(d) In any retail rate case pursuant to KRS 278.190 or KRS 278.260 following approval by the Kentucky PSC of the retail rate adjustments set forth in

Section III(1)(a) and Section III(1)(b) of this Stipulation and Settlement Agreement the Parties agree that:

(i) the additional revenues collected by Kentucky Power from the retail rate adjustments set forth in Section III(1)(a) and Section III(1)(b) of this Stipulation and Settlement Agreement will not be considered by the Kentucky Public Service Commission in establishing Kentucky Power's retail base rates. In any such retail rate case Kentucky Power shall be permitted to exclude from the test year period the revenues collected pursuant to Section III(1)(a) and III(1)(b) of this Stipulation and Settlement Agreement;

(ii) Kentucky Power shall collect the additional revenues as set forth Section III(1)(a) and Section III(1)(b) of this Stipulation and Settlement Agreement in addition to such base retail rates established by the Kentucky PSC. The costs associated with the underlying Rockport Unit 1 and 2 UPSA will continue to be included in base rates;

(iii) Kentucky Power will develop, and the other Parties will not oppose, a new tariff that provides for the receipt by Kentucky Power of the additional revenues as described in Section III(1)(a) and III(1)(b) of this Stipulation and Settlement Agreement that will allow the Company to receive the additional revenue amount in addition to its base rates and other charges. Such new tariff will be consistent with the revenue allocation and rate design principles set forth in this Agreement. Such new tariff will include two different rates, one for CIP-TOD tariff customers and one for all other tariff customers. The allocation of the additional revenues to be collected from the CIP-TOD tariff customers and all other tariff customers will be based upon the total annual revenue of each of the two customer classes. Once the additional revenues have been allocated between the two customer classes based upon total annual Kentucky retail revenue, the additional revenue will be collected within the two customer classes (CIP-TOD and all other tariffs) on a kwh basis.

(e) In the first retail base rate case pursuant to KRS 278.190 or KRS 278.260 following approval by the Kentucky PSC of the retail rate adjustments set forth in Section III(1)(a) and Section III(1)(b) of this Stipulation and Settlement Agreement the Parties agree that the modification of the System Sales Clause under Section III(1)(c) of this Stipulation and Settlement Agreement to permit the receipt by Kentucky Power of the additional revenues shall be eliminated upon the implementation by the Kentucky PSC of the provisions of Section III(d) of this Stipulation and Settlement Agreement.

(f) This Stipulation and Settlement Agreement is made upon the express agreement by the Parties that the receipt by Kentucky Power of the additional revenues called for by Section III(1)(a) and III(1)(b) shall be accorded the ratemaking treatment set out in this Section III. In any proceeding affecting the rates of Kentucky Power during the extension of the UPSA under this Stipulation and Settlement Agreement, the provisions of this Section III are an express exception to Section VI(4) of this Stipulation and Settlement Agreement.

IV. INTEGRATED RESOURCE PLAN

1. The Parties agree that Kentucky Power will submit an Integrated Resource Plan ("IRP") to the Kentucky PSC no later than June 30, 2009. The filing shall reflect the resources available to Kentucky Power. The filing shall also reflect the resources available to Kentucky Power as a member of any pool arrangement that Kentucky Power expects to exist during the period reflected in the IRP. The Kentucky Public Service Commission will initiate a formal review of that IRP and issue an order setting forth its findings and conclusions.

2. Notwithstanding the provisions of Section IV(1) of this Stipulation and Settlement Agreement, within 120 days of filing with FERC an application to amend the AEP-East Interconnection Agreement to change the generation resources available to Kentucky Power under the AEP-East Interconnection Agreement the Parties and the appropriate members of the Staff of the Kentucky PSC shall meet and confer concerning the need for Kentucky Power to file an IRP prior to June 30, 2009. If after such discussions one or more of the Parties or the Staff of the Kentucky PSC in good faith requests that Kentucky Power make an IRP filing in conformity with Section IV(1) of this Stipulation and Settlement Agreement Kentucky Power shall do so within 90 days of receiving such request.

3. During the period of the extension of the Rockport UPSA required under this Stipulation and Settlement Agreement, Kentucky Power shall provide in connection with its annual filing pursuant to the Kentucky PSC's December 20, 2001 Order in Administrative Case No. 387 that information provided in Kentucky Power's Integrated Resource Plan concerning the combined load and resources of the parties to the AEP Interconnection Agreement and Kentucky Power.

V. ENVIRONMENTAL COSTS

1. All Parties agree not to oppose an application by Kentucky Power seeking approval by the Kentucky PSC for the environmental costs currently allocated to Non-Associated Utilities as required by the Kentucky Public Service Commission in Kentucky Power's environmental surcharge pursuant to KRS 278.183 to be reflected in Kentucky Power's monthly filing of the System Sales Clause Schedule as shown on Exhibit 2 to this Stipulation and Settlement Agreement. This change in the recovery of such environmental costs will occur on the effective date of the Kentucky PSC's order approving the terms of this Stipulation and Settlement Agreement. When Kentucky Power's base rates are next changed by order of the Kentucky PSC, the appropriate ratemaking treatment for the environmental costs allocated to Non-Associated Utilities may be addressed by the Kentucky Public Service Commission.

VI. PROCEDURAL TERMS

1. The parties will not oppose in proceedings before the Kentucky PSC or FERC or on appeal the issuance of an Order by the Kentucky PSC or FERC approving the terms of this Stipulation and Settlement Agreement.

2. The terms of this Stipulation and Settlement Agreement are expressly conditioned upon:

(a) the approval by the Kentucky PSC and by any court reviewing such action of the Stipulation and Settlement Agreement and all supporting or related tariff filings without any change or condition that is unacceptable to the Parties;

(b) the approval by FERC and by any court reviewing such action of the extension of the UPSA without any change or condition that is unacceptable to the Parties;

(c) the receipt without any change or condition that is unacceptable to the Parties of all approvals from or non-objections by FERC and any state regulatory bodies exercising jurisdiction over other AEP operating companies, and any court reviewing such action, required to implement the terms of this Stipulation and Settlement Agreement.

3. If at any time prior to the expiration of the extension of the UPSA under this Stipulation and Settlement Agreement the Kentucky PSC or its successor enters an Order that prevents Kentucky Power from charging rates consistent with the provisions of Sections III(1)(a), Section III(1)(b), III(1)(d)(i) and III(1)(d)(ii) of this Stipulation and Settlement Agreement Kentucky Power may, upon 120 days notice to the Commission and the parties to this Stipulation and Settlement Agreement, begin legal or regulatory proceedings necessary to terminate the extension of the UPSA and withdraw from all other obligations under this Agreement. During any such proceedings no Party to this Stipulation and Settlement Agreement shall make any arguments nor take any position inconsistent with the provisions of this Stipulation and Settlement Agreement. During the 120 day notice period the Kentucky PSC shall be authorized to cure any noncompliance with this Agreement.

4. This Stipulation and Settlement Agreement further is made upon the express understanding that it constitutes a negotiated settlement, and except as otherwise expressly provided for herein to effectuate this Stipulation and Settlement Agreement, no Party shall be deemed to have agreed to any ratemaking principle, precedent or policy, nor shall any party be deemed to have agreed or consented to any matter not expressly stated in this Stipulation and Settlement Agreement. Nothing in this Paragraph is intended to prevent the admission of this Stipulation and Settlement Agreement as evidence in any proceeding in which it is relevant.

5. In the event the conditions set forth in Section VI(2) of this Stipulation and Settlement Agreement are not satisfied the Parties, upon notice by any Party, shall meet with appropriate members of the Kentucky PSC Staff and in good faith discuss amendments of this Stipulation and Settlement Agreement, if any, that are satisfactory to the Parties. If, despite such good faith discussions, the Parties are unable to agree upon amendments within 30 days of the commencement of such discussions or such longer period as mutually agreed, then this Stipulation and Settlement Agreement shall become void and of no effect.

IN WITNESS WHEREOF, the Parties have caused this Stipulation and Settlement Agreement to be signed by their duly authorized officers and representatives as of the date first written above.

Agreed to and Accepted:

Kentucky Power Company

By: Errol K Wagner

Name: Errol K Wagner

Title: Assistant Secretary

Agreed to and Accepted:

Kentucky Industrial Utility Customers, Inc.

By:

Name: Michael L. Kurtz

Title: Attorney

Agreed to and Accepted:

Office of Attorney General, Office of Rate Intervention

By: ____________________

Name: Elizabeth Blackford

Title: Assistant Attorney General

Exhibit 1

Exhibit 1 illustrates Page 1 of 2 of the revised monthly System Sales Clause Schedule that Kentucky Power will file with the Public Service Commission of Kentucky to collect $5.1 million in the first five years and $6.2 million in years six through eighteen in additional revenues in consideration of the agreements reached in this Stipulation and Settlement Agreement. Collecting $5.1 million in years 1-5 and $6.2 million in years 6-18 will result in Kentucky Power collecting approximately $106.1 over the 18-year period. The revised System Sales Clause Schedule includes three new lines.

Line 8, entitled "State Issues Settlement Factor," will be a fixed amount equal to $0.000847 for all customers except the CIP-TOD customers and $0.000500 for CIP-TOD customers. Line 9, entitled "State Issues Settlement BAF," will be calculated once a year until the Company's effective date of a change in base rates. The purpose of the BAF factor is to collect or refund any difference between the actual amount collected and $5.1 million or $6.2 million whichever is in effect. Line 10, entitled "Net System Sales Clause Factor - $ kWh," will be the combined result of line 7 "System Sales Clause Factor", line 8 "State Issues Settlement Factor" and line 9 "State Issues Settlement BAF".

Page 1 of 2 of the revised monthly System Sales Clause Schedule will be in the following format:

Kentucky Power Company

System Sales Clause Schedule
Case No. 9061 and
Stipulation and Settlement Agreement

Line No.			All Other Customers	CIP-TOD Customers
1	Current Month (Tm) Net Revenue	(+)		
2	Base Month (Tb) Tariff Sheet No. 19-1 Net Revenue Level	(-)		
3	Increase (Decrease) of System Sales Net Revenue			
4	Customer 50% Sharing	(x)	50%	
5	Customer Share of Increase (Decrease) in System Sales Net Revenue			
6	Current Month (Sm) Sales Level	(/)		
7	System Sales Clause Factor - $/kWh*			
8	State Issues Settlement Factor	(+)	$0.000847	$0.000500
9	States Issues Settlement BAF	(+)	$0.000000	$0.000000
10	Net System Sales Clause Factor - $ kWh	(=)	________	________

*This factor is a credit to the customer when current month net revenue levels exceed the base month; and a charge when current month net revenue levels are below the base month.

Effective Date for Billing:

Submitted by:

Signature

Title:

Date Submitted:

Exhibit 2

Exhibit 2 illustrates Page 2 of 2 of the revised monthly System Sales Clause Schedule that Kentucky Power will file with the Public Service Commission to reflect Kentucky Power's environmental surcharge pursuant to KRS 278.183 in accordance with Section V(1) of this Stipulation and Settlement Agreement. Specifically, on page 2 of 2 of the Schedule, Kentucky Power will add a new line (Line 6) entitled "Non-Associated Utilities Monthly Environmental Costs". Line 4 ("Sales for Resale Expense") and Line 5 ("Interchange-Delivered Expense") will be added to Line 6 ("Non-Associated Utilities Monthly Environmental Costs") to arrive at Line 7 ("Total System Sales Expenses"). "Total System Sales Revenues" (Line 3) less "Total System Sales Expenses" (Line 7) will determine "Total System Sales Net Revenue" (Line 8) for the current month. Line 8 will be carried over to Page 1 of 2 of the Schedule, Line 1("Current Month (Tm) Net Revenue Level"), to be used in calculating the monthly "System Sales Clause Factor - $ kWh" (Line 9) on that page. Page 2 of 2 of the revised monthly System Sales Clause Schedule will be in the following format:

Kentucky Power Company

System Sales Clause Net Revenue

Month Ended__________________

Line No.		CURRENT MONTH	PRIOR MO. TRUE-UP ADJUSTMENT	TOTAL
1	Sales for Resale Revenues			
2	Interchange-Delivered Revenues			
3	Total System Sales Revenues			
4	Sales for Resale Expenses			
5	Interchange-Delivered Expenses			
6	***Non-Associated Utilities Monthly Environmental Costs****			
7	Total System Sales Expenses			
8	Total System Sales Net Revenue			

*Source: ES Form 1.0, Line 3
ES Form 3.3, Line 4
Non-Associated Environmental Costs