COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter Of:

An Examination Of The Application Of The Fuel Adjustment Clause Of Kentucky Power Company From November 1, 2013 Through April 30, 2014	)))))	Case No. 2014-00225

BRIEF OF KENTUCKY POWER COMPANY

Mark R. Overstreet
STITES & HARBISON PLLC
421 West Main Street
P. O. Box 634
Frankfort, Kentucky 40602-0634
Telephone: (502) 223-3477
Facsimile: (502) 223-4124
moverstreet@stites com

Kenneth J. Gish, Jr.
STITES & HARBISON PLLC
250 West Main Street, Suite 2300
Lexington, Kentucky 40507
Telephone: (859) 226-2300
Facsimile: (859) 253-9144
kgish@stites.com

COUNSEL FOR KENTUCKY POWER COMPANY

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INTRODUCTION

Kentucky Power Company allocates its highest incremental fuel costs to off-system sales. Fuel costs are thus allocated by employing the same economic dispatch principles used to make the sales. The Company's top-down allocation of its highest fuel cost generation follows Kentucky Power's decades old practice, and is consistent with cost causation principles, Federal Energy Regulatory Commission guidance, and the fuel allocation methodology employed by two other Kentucky-jurisdictional utilities. The close tie between economic dispatch and the Company's fuel cost allocation methodology provides Kentucky Power's customers with fair, just, and reasonable rates, while also allowing them to maximize the benefits of off-system sales margins when sharing is re-established.

Kentucky Power's top-down allocation of the highest incremental fuel costs to off-system sales conforms to the representations the Company made in the Mitchell Transfer Case,[1] including Paragraph 2 of the July 2, 2013 Stipulation and Settlement Agreement,[2] and implements the Company's undertaking in Section 15 of the Mitchell Stipulation to provide its native load customers with "the least cost energy produced by generation owned, leased or purchased by the Company ***consistent with economic dispatch principles***."[3] The Company's

[1] *In the Matter of: Application of Kentucky Power Company for (1) A Certificate of Public Convenience and Necessity Authorizing the Transfer to the Company of an Undivided Fifty Percent Interest in the Mitchell Generating Station and Associated Assets; (2) Approval of the Assumption by Kentucky Power Company of Certain Liabilities in Connection with the Transfer of the Mitchell Generating Station; (3) Declaratory Rulings; (4) Deferral of Costs Incurred in Connection with the Company's Efforts to Meet Federal Clean Air Act Requirements; and (5) All Other Required Approvals and Relief*, Case No. 2012-00578 at 43 (Ky. P.S.C. Filed December 19, 2012).

[2] Stipulation and Settlement Agreement Among Kentucky Power Company, Kentucky Industrial Utility Customers, Inc., and Sierra Club, *In the Matter of: Application of Kentucky Power Company for (1) A Certificate of Public Convenience and Necessity Authorizing the Transfer to the Company of an Undivided Fifty Percent Interest in the Mitchell Generating Station and Associated Assets; (2) Approval of the Assumption by Kentucky Power Company of Certain Liabilities in Connection with the Transfer of the Mitchell Generating Station; (3) Declaratory Rulings; (4) Deferral of Costs Incurred in Connection with the Company's Efforts to Meet Federal Clean Air Act Requirements; and (5) All Other Required Approvals and Relief*, Case No. 2012-00578 (Ky. P.S.C. Filed July 2, 2013) ("Mitchell Stipulation").

[3] *Id.* at ¶ 15 (emphasis supplied).

fuel cost-allocation methodology flows through to Kentucky Power's customers the benefits of the transfer to Kentucky Power of the 50% undivided interest in the Mitchell generating station (the "Mitchell Transfer"). Indeed, the Company's native load customers received $9.9 million in net energy savings during the four months of this review period following the December 31, 2013 Mitchell Transfer.

The challenge by Kentucky Industrial Utility Customers, Inc. and the Office of the Attorney General, Office of Rate Intervention to Kentucky Power's top-down allocation of the highest incremental cost generation to off-system sales, and their recommendation that the Company's fuel cost allocation methodology be changed retroactively, are without merit and should be rejected.

ARGUMENT

A. **Kentucky Power Allocates Fuel Costs Between Native Load and Off System Sales in a Manner That Produces Fair, Just, and Reasonable Rates.**

Kentucky Power's fuel cost allocation methodology follows economic dispatch principles and provides the Company's customers fair, just and reasonable rates consistent with those principles.

1. Kentucky Power's Fuel Cost Allocation Methodology.

Notwithstanding the unsupported and erroneous testimony presented by Messrs. Kollen[4] and Hayet,[5] Kentucky Power employs a top-down (not bottom-up), incremental fuel cost allocation methodology.[6] This allocation methodology reflects three fundamental facts tied to the manner in which Kentucky Power's generation is economically dispatched by PJM:

- ***All Kentucky Power units "always serve some portion of internal load whenever they are on-line.***"[7] Moreover, all Company units "that are recognized as PJM capacity resources must be offered [by Kentucky Power]in the PJM market when they are available."[8] It thus is PJM, and not Kentucky Power, that economically dispatches the units based upon the Company's cost supply curves for each unit, and hence determines how much the units will operate.

- No load costs represent the costs necessary to bring a generating unit on line, but are independent of the output of the unit.[9] As such they are not incremental[10] but are real costs incurred by Kentucky Power to ensure that the unit is available for dispatch.[11] Mr. Kollen's mischaracterization of Kentucky Power's fuel cost allocation methodology as one in which no-load fuel costs are separately allocated

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[4] Kollen Direct at 6-8.

[5] Hayet Direct at 4-5.

[6] Pearce Rebuttal at 7-8, 9-10.

[7] *Id.* at 8 (emphasis supplied).

[8] Pearce Rebuttal at 12.

[9] *Id.* at 8-10; Transcript of Hearing, *In the Matter of: An Examination of the Application Of The Fuel Adjustment Clause Of Kentucky Power Company From November 1, 2013 Through April 30, 2014*, Case No. 2014-00225 at 135.(Ky. P.S.C. Hearing November 12, 2014) ("T.H.")

[10] Pearce Rebuttal at 8-10.

[11] *Id.* at 10-11.

by the Company was refuted not only by Dr. Pearce,[12] but also by Mr. Conroy, who testified concerning a similar top-down allocation methodology used by Louisville Gas & Electric Company and Kentucky Utilities Company.[13]

- Kentucky Power's native load customers have "first-call" on the Company's generation resources, thereby ensuring their needs are first met, while protecting them from volatile energy market prices.[14] Only after the requirements of native load customers are met is Kentucky Power's generation (and purchases) made available for off-system sales. As such, off-system sales are *incremental* to sales made to meet native load.

The Intervenors' arguments and calculations ignore each of these fundamental facts. Instead, KIUC and the Attorney General pretend that native load customers can and are served during most hours from only one or two select units.[15] Indeed, Messrs. Hayet and Kollen go so far as to urge the Commission to ignore the real world economic dispatch of the Company's units,[16] and instead allocate fuel costs based on an allocation methodology Mr. Hayet concedes is "completely different"[17] from the dispatch of Kentucky Power's units in accordance with economic dispatch principles.

The Company allocates fuel costs to off-system sales through an after-the-fact cost reconstruction process that is both incremental and directly follows the economic dispatch of the

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[12] T.H. at 200-01.

[13] See Video Record of Hearing, *In the Matter of: An Examination Of The Application Of The Fuel Adjustment Clause Of Kentucky Utilities Company From November 1, 2013 Through April 30, 2014*, Case No. 2014-00227 (Ky. P.S.C. Filed December 10, 2014); *In the Matter of: An Examination Of The Application Of The Fuel Adjustment Clause Of Louisville Gas And Electric Company From November 1, 2013 Through April 30, 2014*, Case No. 2014-00228 at 11:53:24-12:06:40 (Ky. P.S.C. November 12, 2014) ("V.R."). Kentucky Power respectfully requests the Commission take administrative notice of the testimony and data request responses in these two proceedings. *See* KRE 201. Kentucky Power acknowledges that the Kentucky Rules of Evidence are not binding upon the Commission. Nevertheless, the Commission in the past has taken administrative notice of its own proceedings. *See In the Matter of: Application Of Kentucky Power Company For Approval Of The Terms And Conditions Of The Renewable Energy Purchase Agreement For Biomass Energy Resources Between The Company And EcoPower Generation-Hazard LL; Authorization To Enter Into The Agreement; Grant Of Certain Declaratory Relief; And Grant Of All Other Required Approvals And Relief*, Case No. 2013-00144 at 22 (Ky. P.S.C. October 10, 2013).

[14] Pearce Rebuttal at 8.

[15] See Kollen Direct at 15-16; Hayet Direct at 11-12.

[16] Hayet Direct at 8.

[17] *Id.* ("But generation dispatch and fuel allocation to ensure that the FAC rate is reasonable are two completely different matters.")

Company's units and hence cost causation.[18] As part of this cost reconstruction process, the Company stacks from highest to lowest the incremental costs of each MWh produced for any hour in which an off-system sale is made.[19] The incremental costs for each MWh, above the unit minimums, are then assigned "top-down" (*i.e.*, the most expensive first followed by the next most expensive and so on) to off-system sales until the highest incremental cost MWh across all of Kentucky Power's units have been assigned to off-system sales for that hour.[20] All remaining costs, including the no load costs, remain with native load customers.[21]

This top-down allocation of the most-expensive incremental $/MWh costs to off-system sales reflects the fact that these sales are incremental to serving load requirements and hence made only after the native load requirements are met. If cheaper generation is available in the PJM market, or if the Kentucky Power generation is otherwise required to serve native load, these off-system sales would not have been made by Kentucky Power. Conversely, the resulting allocation of all remaining costs to native load customers follows directly from both the fact that each Kentucky Power unit always serves some portion of native load whenever it is on-line,[22] and the fact that the generation is made available to satisfy the requirements of those customers first.[23] The use of a top-down *incremental* cost allocation methodology thus flows directly from the manner in which Kentucky Power's generation is economically dispatched and is reflective of how the resulting costs are "caused" or incurred.

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[18] Pearce Rebuttal at 7.

[19] *Id.*

[20] *Id.* at 7-8.

[21] *Id.* at 8.

[22] *Id.*

[23] *Id.*

Allocating the most-expensive incremental fuel costs to off-system sales also ensures that its native load customers do not subsidize off-system sales. As confirmed by Dr. Pearce during cross-examination:

> Q: You would certainly agree that native load customers should not subsidize off-system sales, wouldn't you?
>
> A: I agree with that and I do - - they do not, not under the company's methodology.[24]

Kentucky Power's top-down, incremental fuel cost allocation process results in a fair, just, and reasonable allocation that ensures: (a) the incremental fuel costs incurred to make off-system sales are allocated to off-system sales; and (b) the remaining fuel costs that were incurred, and that would have been incurred even if there had there been no off-system sales, remain with native load customers.[25]

2. Kentucky Power's Allocation of Fuel Costs to Native Load Customers Is Fair, Just, and Reasonable Because Its Customers Have a "First Call" on the Company's Generation Assets.

Kentucky Power employs its top-down fuel cost allocation methodology because the Company's generating units exist first and foremost to serve the Company's customers. Not only is such a methodology logical, its use is further supported by the fact Kentucky Power's customers have a first call on the Company's generation units,[26] and that each Kentucky Power unit always serves some portion of native load whenever it is on-line.[27] This gives the Company's customers access to cost-based generation resources and limits significantly the customers' exposure to the volatile real-time energy markets.

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[24] T.H. at 152.

[25] Allen Rebuttal at 7-8; *cf. Golden Spread Electric Cooperative, Inc. v. Southwestern Public Service Co.*, Docket No. EL05-19-002 at ¶ 37 (F.E.R.C. April 21, 2008) ("Pricing an intersystem sale by reference to the incremental fuel cost assures the requirements customers pay no more than they would have paid had the off-system sale never occurred.")

[26] Pearce Rebuttal at 8.

[27] *Id.*

The first call on all of the Company's generating assets also serves as a hedge against exposure to the energy market in the event one of Kentucky Power's lower-cost assets goes off-line.[28] The value of this hedge is especially pronounced as the Company prepares to retire Big Sandy Unit 2:

> And particularly this coming winter, Big Sandy 2, as a glide path disposition unit, could have an event at any time. It's going to take just throwing a turbine blade or something that the unit's not there for our customers, and they are going to need every bit of the remaining units. So you just don't know from one day -- you know, you can look backwards. I didn't need my car insurance driving down here because I didn't get in a wreck, but looking forward for the future, the company has an opportunity now to basically have a hedge of all six units.[29]

This is a further benefit to Kentucky Power's customers because to the extent PJM dispatches these units, it means that over the course of the day, those assets will operate at a cost lower than the anticipated PJM market price.[30] Kentucky Power's customers as a result have first call through the day to generation at cost-based pricing that is lower than market price.

3. <u>During This Interim Period, Kentucky Power's Customers Received Net Benefits Of $9.9 Million From Their "First Call" on the Company's Generating Assets.</u>

Kentucky Power on December 31, 2013 completed the Mitchell Transfer.[31] During the interim period between the date of the Mitchell Transfer and the anticipated June 2015 MATS-driven retirement date of Big Sandy Unit 2, Kentucky Power owns generating assets that provide capacity in excess of its typical customer demand.[32] This fact was well-understood when the

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[28] T.H. at 179, 180, 183.

[29] *Id.* at 147.

[30] *Id.* at 184.

[31] Order, *In the Matter of: Application of Kentucky Power Company for (1) A Certificate of Public Convenience and Necessity Authorizing the Transfer to the Company of an Undivided Fifty Percent Interest in the Mitchell Generating Station and Associated Assets; (2) Approval of the Assumption by Kentucky Power Company of Certain Liabilities in Connection with the Transfer of the Mitchell Generating Station; (3) Declaratory Rulings; (4) Deferral of Costs Incurred in Connection with the Company's Efforts to Meet Federal Clean Air Act Requirements; and (5) All Other Required Approvals and Relief*, Case No. 2012-00578 at 43 (Ky. P.S.C. October 7, 2013) ("Mitchell Transfer Order").

[32] T.H. at 35.

Mitchell Stipulation was executed; in fact, it was relied upon by Mr. Kollen in his testimony opposing the Mitchell Transfer as filed:

> **Q. What is the Company's reserve margin using the PJM summer peak for 2014 without Mitchell, with the 20% Mitchell recommended by KIUC, and with the 50% proposed by the Company?**
>
> A. The Company's reserve margin for the 2014 PJM summer peak without Mitchell is 35%, with the 20% Mitchell [it] is 50%, and with the 50% Mitchell [it] is 108%. In other word, the Mitchell units are not needed and represent wasteful duplication at least until Big Sandy 2 is retired.[33]

More importantly, this additional capacity has provided real and significant benefits to the Company's customers.

Market conditions in PJM throughout the first four months of 2014 placed the Company's assets "in the money," and, as a result, the units operated more frequently than might otherwise have been anticipated.[34] When the units ran during the first four months of 2014 they were first and foremost available to serve the Company's customer's needs.[35] When the units are operating, they are incurring no load costs which, consistent with the economic dispatch principles discussed above, are properly borne by the Company's native load customers. The operation of the Company's units during the first four months of 2014 allowed the Company's customers to benefit from the expanded protection from the high prices during this period provided by the units. During this four month period, demand on and, accordingly, prices in the PJM market, exceeded historical averages. The additional generation saved Kentucky Power's

[33] Direct Testimony and Exhibits of Lane Kollen, *In the Matter of: Application of Kentucky Power Company for (1) A Certificate of Public Convenience and Necessity Authorizing the Transfer to the Company of an Undivided Fifty Percent Interest in the Mitchell Generating Station and Associated Assets; (2) Approval of the Assumption by Kentucky Power Company of Certain Liabilities in Connection with the Transfer of the Mitchell Generating Station; (3) Declaratory Rulings; (4) Deferral of Costs Incurred in Connection with the Company's Efforts to Meet Federal Clean Air Act Requirements; and (5) All Other Required Approvals and Relief*, Case No. 2012-00578 at 8 (Ky. P.S.C. Filed April 1, 2013).

[34] T.H. at 74-75; 231-32.

[35] Pearce Rebuttal at 9.

customers $9.9 million during the four months of the review period following the Mitchell Transfer.

To analyze the benefits that the Company's customers received during the first four months of 2014, the Company evaluated what the customer impacts would have been had the Mitchell Transfer not taken place. Dr. Pearce performed this analysis in step-wise fashion:

- First, he removed all of the Mitchell fuel costs, <u>including the no-load costs</u>, startup costs, and incremental costs associated with the unit.
- Second, he removed the megawatt hours provided by the Mitchell Units during the four month period.
- Third, he determined the Company's original energy position (the extent to which its internal demand was above or below its resources on an hour-by-hour basis), and then determined how that hourly energy position would have changed without the benefit of the actual hourly Mitchell output with the generation output still available to the Company's customers from Big Sandy Plant and its share of the Rockport units. The generation output from the Company's assets was evaluated based on their actual day-ahead awards – in other words, if a unit was unavailable due to an outage, it was unavailable for this analysis.
- Fourth, Dr. Pearce compared internal load to available Company generation output to determine which hours the Company would have its surplus position reduced and/or be unable to meet its load without additional purchases.
- Fifth, in those hours when the Company was unable to meet its native load demand with its own generation resources, Dr. Pearce determined what price the Company would have had to pay in the market to purchase energy to meet the native load demand (deficit purchases).
- Sixth, he performed a monthly computation to determine how much less of the Company's other resources, Big Sandy and Rockport, would have been assigned off-system since they would have been required to be retained to serve native load (surplus reductions).[36]

Dr. Pearce's analysis demonstrated that, notwithstanding the Company's ownership of both the Big Sandy generating station and a 50% undivided interest in the Mitchell generating station during the first four months of 2014, the Company's customers received a net fuel cost

[36] T.H. at 192-96; Pearce Rebuttal at 20; Exhibit KDP-5; *see also* Kentucky Power Response to PHDR-4.

benefit – beyond the no load costs associated with the Company's generation – during that same period of approximately $9.9 million as a result of the Mitchell Transfer.[37] This savings equates to $3.90/MWh.[38] This $9.9 million dollar is a net benefit offsetting the increase in no load costs from the operation of the Mitchell units against the avoided market expenses during the period.[39]

4. Kentucky Power's Fuel Cost Allocation Methodology Is Consistent With Historic Practice, FERC Guidance, the Operations of at Least Two Other Utilities in the Commonwealth, and the Stipulation and Settlement Agreement in Case No. 2012-00578.

In addition to being premised on the fundamental principle that the Company's generation assets exist first and foremost to serve native load, Kentucky Power's fuel cost allocation methodology during the review period is consistent with historic practice, FERC Guidance, the methodology utilized by other utilities in the Commonwealth, and the Mitchell Stipulation. As such, the Company's methodology results in an allocation of fuel costs that is fair, just, and reasonable.

(a) Kentucky Power's Fuel Cost Allocation Methodology Is Consistent With Its Historical Practice.

The fuel cost allocation methodology utilized by Kentucky Power during the review period is essentially the same methodology Kentucky Power has utilized for decades.[40] Allocating incremental fuel costs to off-system sales, top-down to the unit minimums, reflects the principle that Kentucky Power's generation assets exist first and foremost to serve native load customers and that off-system sales are incremental to that purpose.[41]

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[37] T.H. at 157-59; Pearce Rebuttal at 20; Exhibit KDP-5 to Pearce Rebuttal.

[38] T.H. at 158; Pearce Rebuttal at 20.

[39] T.H. at 157-58.

[40] Wohnhas Rebuttal at 4; Pearce Rebuttal at 10.

[41] Pearce Rebuttal at 8; T.H. at 165-66.

(b) Kentucky Power's Fuel Cost Allocation Methodology Is Consistent With FERC Guidance.

Kentucky's fuel adjustment clause regulation, 807 KAR 5:056, is modeled on FERC's fuel adjustment regulation codified at 18 C.F.R. § 35.14.[42] Accordingly, FERC's interpretation of its fuel regulations, while not binding on the Commission, is instructive as to the reasonableness of the Company's interpretation and application of 807 KAR 5:056 in connection with its fuel cost allocation methodology. Kentucky Power is unaware of any proceeding before this Commission in which the Commission expressly rejected the allocation of the highest incremental cost generation to off-system, as is done by the Company, and recognized as appropriate by FERC.

FERC requires that utilities determine fuel costs for native load customers utilizing the same type of top-down allocation of fuel costs to off-system sale employed by Kentucky Power.[43] Significantly FERC emphasized that the use of a top-down methodology where "[n]ative load customers pay the remainder ..."[44] protects native load customers from paying for fuel costs recovered through off-system sales. Most importantly, FERC emphasized that, consistent with its regulation:

> [u]tilities generally price the fuel component of intersystem sales ***on the cost of the incremental fuel used in meeting intersystem load. Pricing an intersystem sale by reference to the incremental fuel cost assures the requirements customers pay no more than they would have paid had the off-system sale never occurred.***[45]

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[42] Allen Rebuttal at 4; Order, *In the Matter of: Application of Kentucky Utilities Company To Amortize, By Means Of A Temporary Decrease In Rates, Net Fuel Cost Savings Recovered In Coal Contract Litigation* at 4, Case No. 93-113 (Ky. P.S.C. December 8, 1993) ("The Uniform FAC was derived from the clause in effect at the Federal Power Commission, now the Federal Energy Regulatory Commission ("FERC"), and was implemented to replace the existing company specific clauses.")

[43] *Golden Spread Electric Cooperative, Inc. v. Southwestern Public Service Co.*, Docket No. EL05-19-002 at ¶ 37 (F.E.R.C. April 21, 2008).

[44] *Id.*

[45] *Id.* at ¶ 40.

Further underscoring that the top-down allocation of the highest incremental cost generation to off-system sales used by Kentucky Power is consistent with the FERC fuel clause are the results of two FERC audits of Kentucky Power affiliates utilizing the same fuel cost allocation methodology. FERC audited the fuel cost allocation methodology utilized by Ohio Power Company ("OPCO") and Public Service Company of Oklahoma ("PSO"). OPCO and PSO allocate fuel costs, including no load costs, in the same manner that Kentucky Power does.[46] FERC's audit of the OPCO and PSO resulted in no findings or recommendations relating to the implementation of the companies' wholesale fuel adjustment clauses.[47] As part of the audit, FERC recalculated the fuel allocation to ensure it was properly allocated.[48] Because Kentucky Power utilizes the same fuel cost allocation methodology as OPCO and PSO, the FERC audit results confirm that Kentucky Power's fuel allocation methodology and its treatment of no load costs is consistent with FERC precedent and guidance.[49]

(c) Kentucky Power's Fuel Cost Allocation Methodology Is Consistent With the Methodology Used by Two Other Utilities in the Commonwealth.

In addition to being consistent with its own historical practice and FERC guidance, Kentucky Power's fuel cost allocation methodology also is consistent with the cost allocation methodology utilized by both Kentucky Utilities ("KU") and Louisville Gas & Electric ("LG&E"). This consistency is important evidence of not only the reasonableness of Kentucky Power's long-standing fuel cost allocation methodology, but also its congruence with the language of Kentucky's uniform[50] fuel adjustment clause regulation.

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[46] Allen Rebuttal at 4.

[47] *Id.*; Exhibits WAA-1 and WAA-2 to Allen Rebuttal.

[48] Allen Rebuttal at 4-5; Exhibits WAA-1 and WAA-2 to Allen Rebuttal.

[49] Allen Rebuttal at 5.

[50] *See, e.g.* Order, *In the Matter of: Application of Kentucky Utilities Company To Amortize, By Means Of A Temporary Decrease In Rates, Net Fuel Cost Savings Recovered In Coal Contract Litigation* at 3, Case No. 93-113

During cross-examination in LG&E and KU's most recent fuel adjustment clause review proceeding,[51] Robert Conway, Director – Rates for LG&E and KU Services Company, explained both the incremental nature of fuel cost allocation methodology used by LG&E and KU, and that, as is the case with Kentucky Power's allocation methodology, the highest incremental costs allocated to off-system sales do not include the minimum costs of maintaining its units online:

> Q. Can you also confirm that no-load costs are included with all other fuel costs when determining the cost of each unit each hour and that fuel costs are then allocated to native-load and non-native-load with non-native-load being allocated to highest energy cost?
>
> A. Again, AFB system is not there to allocate costs of native-load. ***It is there to allocate the highest cost to off-system sales on an incremental cost basis*** and to determine the split savings between LGE and KU. All costs that we incur to serve load is included in our fuel expense for the month and then we exclude those costs that are allocated on off-system sales.[52]
>
> . . .
>
> Q. So will the fuel cost allocated to off system sales include some no load costs?
>
> A. And again, we don't utilize the term "no-load cost" in our system. Through AFB, we utilize the heat rate curves and the fuel cost ***to calculate an incremental cost for the highest cost units that are allocated to off-system sales***.
>
> Q. So, just to be clear, if I can be, since no load costs are not accounted for separately, they are assigned 100 percent to the native-load or . . .
>
> A. All the costs we incur are part of "the bucket of fuel expense for the month," from that we exclude the items that are not recoverable through the FAC, and those items are for off-systems sales, for forced outages, and purchases greater than the highest cost unit. ***Those cost for off-systems sales are determined on an incremental basis and are the highest incremental costs; therefore, it does not***

(Ky. P.S.C. December 8, 1993) ("After lengthy proceedings involving all interests, in 1977 the Commission, by Order, adopted a uniform FAC to be applicable to all electric utilities in Kentucky.")

[51] Case Nos. 2014-00228 (LG&E) and 2014-00227 (KU).

[52] V.R. at 11:54:53 – 11:55:41 (emphasis supplied).

include minimum costs of maintaining a unit online. It is the highest cost incremental cost for those units.[53]

Subsequent to the hearing, Mr. Conroy confirmed the clear import of his testimony, and the fact that, like Kentucky Power, KU and LG&E allocate their highest incremental cost generation to off-system sales, thereby leaving all other costs (including no load and other minimum costs) with native load customers:

> Q-1. Refer testimony of Robert Conroy at the November 12, 2014 hearing in this matter at 12:05:00 through 12:06:36 of the video hearing. Confirm that Mr. Conroy's testimony indicates that, for KU's coal units, the minimum costs to operate the units are paid for by native load customers. If this cannot be confirmed, explain what is meant by Mr. Conroy's testimony.
>
> A-1. Yes, Mr. Conroy's testimony is confirmed. KU's coal units are operated to serve native load customers and all fuel costs of those units, which have not been allocated to off-system sales or otherwise excluded from the Fuel Adjustment Clause ("FAC") recovery due to a forced outage, are recovered from native load customers through the FAC. As noted in the Company's October 31, 2001 AFT Presentation for PSC Informal Conference, the minimum blocks of each generating unit are stacked at the bottom and the incremental cost for each source (generation or purchases) is then stacked from lowest to highest on a MW by MW basis. The highest incremental costs are allocated to off-system sales for exclusion from the FAC.[54]

Like Kentucky Power, LG&E and KU assign their highest incremental fuel costs, and only their highest incremental fuel costs, to off-system. While LG&E and KU do not utilize the term "no load costs," it is clear that the costs required to maintain their units online, including no load costs, remain with their native load customers. Like Kentucky Power, LG&E and KU do so because their baseload coal units are online first and foremost to serve their native load

[53] *Id.* at 11:56 -11:58:08 (emphasis supplied).

[54] Response of Kentucky Utilities Company, Staff Second Request for Information, No. 1, *In the Matter of: An Examination Of The Application Of The Fuel Adjustment Clause Of Kentucky Utilities Company From November 1, 2013 Through April 30, 2014,* Case No. 2014-00227 (Ky. P.S.C. Filed December 10, 2014); accord Response of Louisville Gas and Electric Company, Staff Second Request for Information, No. 1, *In the Matter of: An Examination Of The Application Of The Fuel Adjustment Clause Of Louisville Gas And Electric Company From November 1, 2013 Through April 30, 2014,* Case No. 2014-00228 (Ky. P.S.C. Filed December 10, 2014).

customers.[55] Even though the relative magnitude of off-system sales by Kentucky Power during this interim period is higher than the off-system sales made by LG&E and KU, the cost allocation methodologies are functionally similar and are a fair, just, and reasonable method of allocating fuel costs.

(d) Kentucky Power's Fuel Cost Allocation Methodology Is Consistent With the Stipulation and Settlement Agreement in Case No. 2012-00578.

Finally, Kentucky Power's fuel cost allocation methodology is consistent with the terms of the Mitchell Stipulation. Paragraph 15 of the Mitchell Stipulation recognizes the cost causation link between the allocation of fuel costs and economic dispatch principles :

> Customers shall at all times be entitled to the least cost energy produced by generation owned, leased or purchased by the Company consistent with economic dispatch principles.[56]

As described by Dr. Pearce, Kentucky Power's allocation of only the highest incremental fuel costs to off-system sales follows from the economic dispatch of the units where the units are available first to meet native load:

> And I - - you know, one - - I kind of came into this and noticed this - - the stipulation and settlement, I couldn't help but note paragraph 15 that talks about, you know, Mitchell on top of everything else being dispatched in an economic dispatch order, which seems to validate, the way I read paragraph 15, that it would basically support that we're going to put Mitchell into the stack just like all the other units. With the pool gone, Kentucky doesn't have that to lean on, so they are going to get the benefit of Mitchell, and they get the benefit of Big Sandy too, hopefully, knock on wood, until next May. We'll see what happens.[57]

Kentucky Power's allocation methodology is consistent with economic dispatch principles and, accordingly, required by Paragraph 15 of the Mitchell Stipulation.

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[55] *Id.*; V.R. at 12:02:10 – 12:03:14; 12:05:20 – 12:06:34.

[56] Mitchell Stipulation at ¶ 15.

[57] T.H. at 182.

Certainly, neither Messrs. Kollen nor Hayet challenged the manner in which the Company's generation is dispatched by PJM, or suggested that it was not dispatched by PJM in a fashion consistent with economic dispatch principles.[58] Instead, both contended[59] that dispatch and fuel cost allocation "are two completely different matters."[60] This assertion is both wrong, as Dr. Pearce explained, and in direct contradiction to Paragraph 15 of the Mitchell Stipulation.

B. <u>Kentucky Power Acted Forthrightly and Did Not Hide the No Load Cost Issue From the Commission or the Intervenors During the Mitchell Transfer Case.</u>

The Attorney General and KIUC allege that Kentucky Power "failed to disclose the material fact that customers would be harmed through an increase in fuel costs due to the Company's allocation approach,"[61] and that the Company "incorrect[ly]" represented "$16.75 million in fuel savings,"[62] in connection with the Mitchell Stipulation. Both intervenors imply, if not expressly argue, that the result of, if not the reason for, the Company's alleged failure to disclose these claimed material facts, as well as the claimed incorrect representation by Kentucky Power, was to permit the Company to collect unreasonable off-system sales margins during the interim period during which there is no sharing of off-system sales margins.[63] Each of these allegations and arguments lack merit.

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[58] *See* Hayet Direct at 8 ("Utilizing no-load fuel costs is proper for purposes of PJM dispatching the generation under its control. "); Kollen Direct at 10 ("The 'no load' fuel cost is a dispatch concept and represents the constant in generating unit's incremental cost curve.")

[59] Kollen Direct at 10; Hayet Direct at 8.

[60] Hayet Direct at 8.

[61] Kollen Direct at 5.

[62] *Id.* at 25.

[63] *Id.* at 27-29.

1. The Estimated $16.75 Million in Fuel Savings.

(a) The $16.75 Million Estimate Was Represented by the Company As the Differential Between the Fuel Blends at the Mitchell and Big Sandy Generating Stations.

(i) As Represented by the Company in Filings With the Commission.

The Attorney General and KIUC misconceive what was represented by the estimated $16.75 million in fuel savings referred to in Paragraph 2 of the Mitchell Stipulation and included on Line 3 of Attachment 1 to the Company's Response to Staff 5-10. The $16.75 million value was not an effort to estimate a $16.75 million reduction in total fuel costs flowing through the Company's FAC. Instead, it was an estimate, based upon 2012 historical data, of the differences in the cost of the coal that could be burned at the Big Sandy generating station, which is not scrubbed, and the high-sulfur/low-sulfur coal blend that can be burned at the Mitchell generating station, both units of which are scrubbed.[64] Moreover, it was an estimate based upon historical data. As Mr. Allen explained in response to a question from Vice-Chairman Gardner concerning Line 3 of Attachment 1 to the Company's Response to Staff 5-10:

> If you look at these three columns, these are but-for calculations, okay. So they don't reflect what I would call temporal changes in fuel costs. So the DFGD that we talked about, that would have been sometime well in the future....
>
> We don't include in that column a change in fuel costs due to new fuel contracts. All that is reflected in there is a change in Big Sandy fuel savings, and I can assume from this is it's moving from a high sulfur to a – or from a low sulfur coal to a less expensive, high sulfur coal. And all we reflected in the second column is just the net change between the costs of the two units.[65]

The limited nature of the Company's $16.75 million estimate was made explicit in the language of Paragraph 2 of the Mitchell Stipulation:

> Because of the anticipated lower fuel costs of Mitchell Units 1 and 2 vis-à-vis the anticipated fuel of the Big Sandy units, the transfer of Mitchell Units 1 and 2 to

[64] *See e.g.* T.H. at 65.

[65] *Id.* at 215.

> Kentucky Power is expected to provide Kentucky Power customers with the benefit of reduced fuel costs of approximately $2.50/MWh. Based on 2012 jurisdictional kWh sales of 6.7 GWh, the benefits are estimated to total $16.75 million annually.[66]

In particular, the use in paragraph 2 of the Mitchell Stipulation of the preposition vis-à-vis, meaning "as compared with,"[67] makes clear that the $16.75 million value represents a simple comparison of the costs of the differing fuel blends at the two generating stations.[68] Underscoring the limited nature of the representation is the use of the value of $2.50/MWh – the difference in the cost of the fuel blends but nothing more – as the measure of the cost differential.[69] Finally, the $16.75 million estimated total benefit of the fuel blend differential between the two generation stations is the simple arithmetic product of multiplying the $2.50/MWh cost differential by the 2012 historic jurisdictional sales of 6.7 GWh.

By contrast, the total fuel cost benefit accruing to the Company's customers following the Mitchell Transfer would have involved a much different and more sophisticated net energy cost analysis. In particular, such a net energy cost analysis would have required the use of information concerning unit outages, fuel contracts, and energy market prices in lieu of the simple cost differential in fuel blends.[70] In addition, all such data would have had to have been forecasted 2014 data and not historic 2012 information.[71] Most importantly, this more sophisticated net energy cost analysis would have required the use of the cost reconstruction and

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[66] Mitchell Stipulation at ¶ 2.

[67] WEBSTER'S NINTH NEW COLLEGIATE DICTIONARY at 1318 (9th ed. 1989).

[68] *See also* Kentucky Power Response to Post Hearing Data Request 4(a).

[69] *Id.*

[70] *Id.*

[71] *Id.*

allocation methodology[72] detailed by Dr. Pearce.[73] Thus, the very nature of the analysis refutes the mistaken characterization of the $16.75 million value by KIUC and the Attorney General.

(ii) As Represented at the July 2013 Hearing in the Mitchell Transfer Case.

The limited nature of the $16.75 million calculation in Paragraph 2 of the Mitchell Stipulation, as well as the significance of the same value in Line 3 of Attachment 1 of the Company's Response to KPSC 5-10, was underscored during the July 2013 Mitchell hearings. As Mr. Wohnhas sought to make clear in his response to a question from Vice-Chairman Gardner, the $16.75 million value was simply the difference in the costs of the differing fuel blends at the Mitchell and Big Sandy generating stations:

> Q. Okay. And is there – will – in the Mitchell fuel savings in line 3, where – now, that's the savings because of using Mitchell coal; is that right? Or the lower sulfur coal. Higher sulfur coal.
>
> A. It's the higher sulfur coal, which is a cheaper – cheaper coal per MMBtu.[74]

Absent from Paragraph 2 of the Mitchell Stipulation, as well as Mr. Wohnhas' response to Vice-Chairman Gardner's cross-examination, is any representation suggesting the $16.75 million value constitutes anything other than the difference in the costs of the fuel blends as a result of the Mitchell generating station being scrubbed. More fundamentally, neither Mr. Wohnhas'

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[72] *Id.*

[73] *See* Pearce Rebuttal at 7-9.

[74] Transcript, *In the Matter of: Application of Kentucky Power Company for (1) A Certificate of Public Convenience and Necessity Authorizing the Transfer to the Company of an Undivided Fifty Percent Interest in the Mitchell Generating Station and Associated Assets; (2) Approval of the Assumption by Kentucky Power Company of Certain Liabilities in Connection with the Transfer of the Mitchell Generating Station; (3) Declaratory Rulings; (4) Deferral of Costs Incurred in Connection with the Company's Efforts to Meet Federal Clean Air Act Requirements; and (5) All Other Required Approvals and Relief*, Case No. 2012-00578 at 335 (July 11, 2013); Video Recording, *In the Matter of: Application of Kentucky Power Company for (1) A Certificate of Public Convenience and Necessity Authorizing the Transfer to the Company of an Undivided Fifty Percent Interest in the Mitchell Generating Station and Associated Assets; (2) Approval of the Assumption by Kentucky Power Company of Certain Liabilities in Connection with the Transfer of the Mitchell Generating Station; (3) Declaratory Rulings; (4) Deferral of Costs Incurred in Connection with the Company's Efforts to Meet Federal Clean Air Act Requirements; and (5) All Other Required Approvals and Relief*, Case No. 2012-00578 at 335 (July 11, 2013) ("Mitchell Transfer Transcript"); Video Transcript 10:51:30-10:58:21 (November 12, 2014).

response nor Paragraph 2 of the Mitchell Stipulation address the Company's long-standing allocation methodology.

(b) The Company's Post-Mitchell Transfer Operations During the First Eight Months of 2014 Indicate That the $16.75Million Estimate Was Reasonable.

As part of his rebuttal testimony in this case Mr. Wohnhas calculated the 2014 cost differential between the high-sulfur/low sulfur coal blend employed at the Mitchell generating station and the more expensive low-sulfur coal burned at Big Sandy.[75] That is, he made the same calculation presented in Paragraph 2 of the Mitchell Stipulation and Line 3 of the Company's Response to KPSC 5-10 in the Mitchell Transfer Case, but used actual 2014 data instead of 2012 historical data. From January through August 2014, the fuel blend used at Mitchell was $9.9 million less expensive than the cost of coal to produce the same MWh using the low-sulfur coal burned at Big Sandy.[76] On an annualized basis this eight month coal cost differential would equal $14.8 or approximately 89% of the $16.75 million estimate.[77] (For the four months of the review period the differential was $3.2 million.[78]) Thus, notwithstanding its inherent limitations, the $16.75 million value calculated by Kentucky Power and incorporated in Paragraph 2 of the Mitchell Stipulation and Line 3 of the Company's Response to KPSC 5-10 was a reasonable estimate of the cost differential of the Mitchell and Big Sandy fuel blends.

2. <u>Kentucky Power Acted in Good Faith in the Mitchell Transfer Case in Making Its Representations Concerning the Fuel Blend Cost Differential Between the Mitchell and Big Sandy Generating Stations.</u>

There is no evidence in the record to support the Intervenors' apparent contention that the Company acted in bad faith in presenting the limited fuel blend cost differential calculation in

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[75] Wohnhas Rebuttal at 5-6.

[76] *Id.* at 6.

[77] *Id.*

[78] Exhibit RKW-1 to Wohnhas Rebuttal Testimony.

the Mitchell Transfer Case in lieu of a more sophisticated net energy cost analysis. To the contrary, because Kentucky Power did not intend to make substantial modifications to its methodology for allocating fuel costs between its native load customers and off-system sales, there was no reason to perform the net energy cost analysis.[79] Certainly, there was not a conscious decision to withhold the information from the Commission or the Intervenors in the Mitchell Transfer Case.[80]

The record is uncontroverted that the Company acted quickly to alert Commission Staff concerning the increased costs flowing through the fuel adjustment clause following the termination of the AEP-East Interconnection Agreement, the Mitchell Transfer, and the extreme weather during the early part of 2014.[81] After performing its internal investigation, and conferring with appropriate AEPSC subject matter experts, Kentucky Power contacted Commission Staff in late February or early March 2014 to request an informal conference at which the post-Mitchell Transfer operation of the Company's FAC could be discussed.[82] Thus, far from attempting to hide anything, Kentucky Power took the initiative in reviewing the operation of its FAC following the Mitchell Transfer, and once the Company's due diligence was completed, it proposed a meeting where the operation of the FAC could be addressed informally in detail with Staff and Intervenors.[83]

Further evidence of the absence of any bad faith on the part of Kentucky Power in negotiating the Mitchell Stipulation and presenting it to the Commission is the fact that it was not until after the commencement of this proceeding that a net energy cost analysis was performed to

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[79] Kentucky Power Response to KPSC 3-5.

[80] *See* Wohnhas Rebuttal at 6.

[81] T.H. at 67.

[82] *Id.* at 68-69.

[83] *Id.*

assess the effect of the Mitchell transfer and the Company's long-standing allocation methodology on the total fuel costs flowing through the FAC to Kentucky Power's native load customers following the Mitchell Transfer:

> A more detailed analysis of the net energy cost differences would have factored in no-load costs as well as unit dispatch utilizing projections regarding 2014 unit outages, fuel contracts, and energy market prices. ***No such analysis was performed in connection with Case No. 2012-00578, the settlement negotiations leading to the July 2, 2013 Stipulation and Settlement Agreement, or the July 10-12, 2013 hearing in that case. The Company subsequently prepared a net energy cost analysis in 2014 in connection with this case***, using the projections for 2014 unit outages, fuel contracts, and energy market prices that existed at the time of the settlement negotiations with respect to Case No. 2012-00578.[84]

Stated otherwise, not only did Kentucky Power not hide anything from the Commission or the Intervenors in the Mitchell Transfer Case – there was nothing to hide.

Nor did Kentucky Power or AEPSC personnel turn a blind eye to the possible post-Mitchell Transfer results of the Company's allocation methodology by declining to conduct a net energy cost analysis in connection with the Mitchell Transfer Case proceedings. The Company has used the same cost-allocation methodology for decades.[85] The Company did not intend to modify, and in fact did not modify, this methodology as a result of the Mitchell Transfer.[86] In fact, Paragraph 15 of the Mitchell Stipulation, which provided that "[c]ustomers shall at all times be entitled to the least cost energy produced by the generation owned, leased or purchased by the Company ***consistent with economic dispatch principles***,"[87] mandated that the Company continue to allocate fuel costs in a fashion consistent with economic dispatch principles.

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[84] Kentucky Power Response to PHDR-4 (emphasis supplied). *See also* Kentucky Power's Response to KPSC 3-5 ("nor did any calculation performed in Case No. 2012-00578 specifically address 'no load costs.'")

[85] Wohnhas Rebuttal Testimony at 6; Pearce Rebuttal at 5.

[86] Kentucky Power Response to KPSC 3-5.

[87] Mitchell Stipulation at 15 (emphasis supplied).

Kentucky Power's decades old fuel cost allocation methodology, which it continued essentially unchanged following the Mitchell Transfer, did and continues to do just that.

Moreover, the increase in no load costs following the Mitchell Transfer resulted from circumstances that were neither intended nor discussed at the time of the settlement negotiations.[88] Because the Company did not intend to change its allocation methodology as a result of the Mitchell Transfer, and because the Mitchell generating station was anticipated to remain an important mainstay of Kentucky Power's generation portfolio for almost 25 years following the 2015 retirement of Big Sandy Unit 2,[89] there was no evident need to perform a 2014 net energy cost analysis.[90]

3. <u>A Net Energy Cost Analysis Performed at the Time of the Mitchell Transfer Stipulation Would Have Demonstrated, and Actual Review Period Results Following the Mitchell Transfer Would Have Subsequently Confirmed, the Significant Net Fuel Cost Benefits Accruing to the Company's Native Load Customers As a Result of the Mitchell Transfer.</u>

Although with the benefit of hindsight it could be argued that all parties to the Mitchell Transfer Case, including Kentucky Power, would have been better informed if the Company had performed a net energy cost analysis in connection with the Mitchell Transfer Stipulation, the record is clear that such an analysis ***still*** would have shown a substantial benefit accruing to the Company's native load customers as a result of the Mitchell Transfer. In fact, when such net energy cost analysis was first performed a year later in connection with these proceedings, using forecasted 2014 data available at the time of the Mitchell Transfer Stipulation, it demonstrated that if the analysis had been performed prior to the time of the July 2013 hearing it would have projected that the Company's native load customers stood to receive millions of dollars of fuel

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[88] T.H. at 37.

[89] T.H. at 123.

[90] Kentucky Power Response to KPSC 3-5.

cost savings as a result of the Mitchell Transfer. Most importantly, these fuel cost savings ***are net of the 100% allocation of no load and unit minimum costs to native load customers.***[91] As explained by the Company in its response to KPSC PHDR-4:

> The [net energy cost] analysis shown on Attachment 1 to this response indicates that adding a 50% undivided interest in the Mitchell generating station to Kentucky Power's generation fleet would have produced $6.51 million in ***projected*** net energy cost savings in 2014 … for native load customers using the Company's existing fuel cost allocation methodology. As such, these savings reflect no load costs.[92]

Moreover, even when the analysis is limited to the four months following the Mitchell Transfer under review in this proceeding, the net energy cost analysis projects savings for Kentucky Power's customers of $2.82 million.[93]

In fact, the ***actual*** (not estimated using 2014 forecasted data) ***post-Mitchell Transfer net energy cost savings*** accruing to the Company's customers during the review period were $9.9 million[94] or more than 350% greater than those that would have been forecasted for the same four month period:

[91] Kentucky Power Response to PHDR-4(a).

[92] *Id.* (emphasis in original).

[93] *Id.*

[94] Pearce Rebuttal at 19-20.

KPCO Internal Load Fuel Cost
Estimated Jan-April 2014 Impact without Mitchell
(Dollars in $Millions unless noted)

2014	**Actual as Occurred**	**Estimate without Mitchell**	**Fuel (Decrease) /Increase due to Mitchell**	**Internal Load (GWhs)**	**$/MWh Impact (Decrease) /Increase**
(1)	(2)	(3)	(4)=(2)-(3)	(5)	(6)=(4)/(5)
January	$25.6	$31.0	($5.3)	796	($6.71)
February	$20.4	$20.4	($0.0)	643	($0.01)
March	$18.0	$24.3	($6.3)	616	($10.27)
April	$16.4	$14.6	$1.8	484	$3.65
Total	$80.3	$90.2	($9.9)	2,539	**($3.90)**[95]

To be clear, these savings are net of the no load and unit minimum costs the Company's native load customers paid during the four post-Mitchell Transfer months of the review period.[96] Stated otherwise, although the Company's customers incurred an additional $13 million in no load costs as a result of the Company's simultaneous ownership of its interests in both the Big Sandy and Mitchell generating stations, they avoided nearly $24 million in additional costs by not having to go to the extremely volatile energy markets because of the addition of the Mitchell capacity.[97]

In sum, even if the Commission were inclined to accord the estimated $16.75 million in savings reflected in Paragraph 2 of the Mitchell Stipulation, and shown on Line 3 of Attachment 1 to the Company's response to KPSC 5-10, the talismanic significance urged by KIUC and the Attorney General, the fact remains that just during the four months of the review period following the Mitchell Transfer Kentucky Power's native load customers received $9.9 million,

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[95] Pearce Rebuttal at Exhibit KDP-5.

[96] Kentucky Power Response to PHDR-4(b); T.H. 157-160.

[97] *Id.*

or 59%, of those annual savings.[98] The record in this proceeding is clear: the Mitchell Transfer provides the Company's customers with millions of dollars of net energy cost savings even accounting for the allocation of no load and unit minimum costs under the Company's long-standing methodology.

4. Kentucky Power's Long-Standing Allocation Methodology Is Wholly Unrelated to the Company's Ability to Retain 100% Of Off-System Sales Margins Beyond the $15.3 Million Embodied in Base Rates.

Mr. Kollen, testifying on behalf of KIUC and the Attorney General, argued that:

> Kentucky Power's fuel cost allocation approach during the review period was improper because it forced native load customers to pay unjust and unreasonable FAC rates ***in order to enhance the profitability of the Company's off-system sales.***[99]

He later attempted in the same testimony to tie this claimed unreasonably "enhanced" profitability to Paragraph 7 of the Mitchell Stipulation.[100] That provision allows the Company to retain 100% of off-system sales margins beyond the amount built into base rates during the interim prior to the implementation of full Mitchell cost-based rates[101]

Mr. Kollen's argument founders upon, and he fails to account for, the fact that the fuel cost allocation methodology at issue in this case predated Paragraph 7 of the Mitchell Stipulation by decades.[102] At the time of the Mitchell Stipulation the Company did not intend, as is

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[98] As detailed at pages 17-19 *supra*, the simple calculation embodied in the $16.75 million **estimate** of annual savings and Dr. Pearce's net energy cost analysis that demonstrated **actual** net savings of $9.9 million during just one third of the annual period represented by the $16.75 million are neither comparable nor represent the same concept. For the same reason, it is happenstance that the $9.9 million in differential coal costs testified to by Mr. Wohnhas at page 6 of his rebuttal testimony as a result of the different fuel blends used at the Big Sandy and Mitchell generating stations during the first four months of 2014 is equal to the actual $9.9 million in net energy cost savings testified to by Dr. Pearce and illustrated on Attachment 1 to KDP-5 of Dr. Pearce's testimony.

[99] Kollen Direct Testimony at 3.

[100] *Id.* at 29 ("One factor contributing to Kentucky Power's high profits from January 1, 2014 through April 30, 2014 was that the Company was able to make substantial off-system sales during the period and keep all of the profit from those sales.")

[101] Mitchell Stipulation at ¶ 7.

[102] Wohnhas Rebuttal at 3-4.

evidenced by Paragraph 15 of the Mitchell Stipulation, to make any changes to its fuel cost allocation methodology as a result of the Mitchell Transfer.[103] And the allocation methodology it has employed following the Mitchell Transfer is essentially unchanged from that employed for the past three decades.[104] As a result, the Company's faithful adherence following the Mitchell Transfer to essentially the same fuel cost allocation methodology it has employed for decades hardly constitutes the sort of effort to "game" Paragraph 7 of the Mitchell Stipulation that KIUC and the Attorney General seek to imply.

Further undermining Mr. Kollen's testimony is that Kentucky Power, which is required to bid all of its available generation into PJM, and not just that required to meet its native load,[105] did not modify the operation of its units beginning January 1, 2014. As Mr. Wohnhas testified without contradiction:

> **Q. DID THE EXISTENCE OF PARAGRAPH 7 OF THE STIPULATION AND SETTLEMENT AGREEMENT AFFECT THE COMPANY'S OPERATION OF ITS GENERATION ASSETS?**
>
> A. No. Kentucky Power operated its generation assets in the same fashion it would have if it [had] continued after December 31, 2014 to split OSS margins with its customers.... It did just this [offer all of its available units into the PJM Day Ahead Market and not just those required to meet its native load] and in the same manner both before and after January 1, 2014....[106]

In addition, contrary to Mr. Kollen's argument, the Company's total off-system sales margins during the review period were far from unreasonable. Although the Company's net income in January 2014 through April 2014 increased over the same four-month period in 2013,

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[103] Kentucky Power Response to KPSC 3-5.

[104] *See* Kentucky Power Response to KIUC 2-5(c).

[105] Wohnhas Rebuttal at 8.

[106] *Id.* at 8-9.

so did its equity investment as a result of the Mitchell Transfer.[107] As a result, the Company's on-going return on equity for the twelve months ended April 2014 of 6.44%[108] was 406 basis points below its authorized return on equity of 10.5%. Having received not only the benefits of the Company's 50% undivided interest in the Mitchell generating station during this interim period, benefits that are expected to continue until 2040, and having seen the Company's return on equity drop to arguably constitutionally confiscatory levels, the Attorney General and KIUC now seek to reduce that return on equity further by rewriting the Mitchell Stipulation to require that Kentucky Power's decades old allocation methodology be amended retroactively. Such a result is neither fair, nor just, nor reasonable.

More fundamentally, Mr. Kollen's testimony ignores the fact that Paragraph 7 of the Mitchell Stipulation Agreement as approved by the Commission was intended to provide Kentucky Power with the opportunity – but not a guarantee – to earn back some portion of the foregone revenue during the interim period between the Mitchell Transfer and the effective date of its new base rates.[109] As the Commission found, this foregone revenue is not insignificant:

> Kentucky Power also agrees to maintain its current base rates through at least May 31, 2015 and to withdraw its pending base rate case. In the absence of the Stipulation, the increase in Kentucky Power's stand-alone Mitchell-related annual revenue requirement would be approximately $138 million. The limited recovery under the Stipulation would result in Kentucky Power's customers saving $133 million over the 17-month base-rate-freeze period.[110]

Thus, the risk that the anticipated off-system sales would not materialize and the Company would be required to shoulder the $133 million shortfall in its entirety lay, and continues to lie,

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[107] *Id.* at 11-12.

[108] *Id.* at 8.

[109] *Id.* at 11-12.

[110] Mitchell Transfer Order at 33.

solely with Kentucky Power during the interim period.[111] Moreover, and taking into account the unforeseen increased sales resulting from the 2014 Polar Vortex and other PJM market conditions, the increase in the Company's net income lamented by Mr. Kollen can hardly be characterized as unexpected, much less unjust or unreasonable.

Finally, there was concern expressed that during the interim period when there is no sharing of off-system sales margins beyond the $15.3 million built into base rates that the Company's native load customers receive no benefit from off-system sales.[112] Respectfully, the concern is unfounded. As a result of the Commission's Order approving the Mitchell Transfer and the Mitchell Stipulation as amended, the Company's native load customers received and will continue to receive during this interim period when there is no sharing of off-system sales margins:

- The least-cost alternative to Big Sandy Unit 2.[113] Big Sandy Unit 2 will be forced to be retired because, as the Commission found, it cannot continue to operate after mid-2015 because it lacks environmental controls that cannot be economically justified.[114]
- First "call" on the fully environmentally-Mitchell Plant at a $133 million "discount" during the entirety of the interim period when there is no sharing of off-system sales margins beyond the amounts built into base rates;[115]
- "Protection against unreasonably higher costs due to unanticipated greenhouse gas regulation."[116]
- The tangible financial commitments that extend beyond the interim period to be provided by the Company to its native load customers through its undertakings in the Mitchell Stipulation.[117]

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[111] Wohnhas rebuttal at 12-13.

[112] *See* T.H. at 177-180.

[113] Mitchell Transfer Order at 23-24.

[114] *Id.* at 28

[115] *Id.* at 33.

[116] *Id.* at 33-34.

- A hedge against being forced to market (at a cost of nearly $24 million during the four months of the review period following the Mitchell Transfer) during times of high native load energy requirements and volatile market prices.[118]

A portion of the quid pro quo for these benefits was the Company's opportunity during the interim period to earn back through off-system sales some portion of the $133 foregone revenue. Even with this opportunity, Kentucky Power's on-going 6.44%[119] return on equity for the twelve months ended April 2014 was well below its authorized return on equity of 10.5%. It is neither fair nor reasonable to treat these benefits accruing to native load customers as "sunk," while simultaneously seeking to re-write the Mitchell Stipulation, as the Attorney General and KIUC urge, by retroactively changing the fuel allocation methodology that was in place both at the time of the settlement negotiations and for almost 30-years prior to then.

5. Even If the Millions of Dollars of Net Energy Cost Savings Provided Kentucky Power's Native Load Customers Through the Mitchell Transfer Are Ignored the Mitchell Transfer Stands on Its Own Merits As the Least Cost Alternative.

The Commission made multiple findings concerning the benefits of the Mitchell Transfer in support of its decision to approve the transfer pursuant to KRS 278.020(1) and KRS 278.300. These included:

- "[W]e find that Kentucky Power has established that the proposed Mitchell acquisition is needed to address the disposition of the nearly 1078 MW Big Sandy Generating Station because the station can no longer operate as it is currently configured and be in compliance with strict federal environmental regulations."[120]

- "The Commission further finds the record is sufficient to demonstrate the proposed Mitchell acquisition represents the least-cost resource to meet Kentucky Power's capacity and energy needs resulting from the decision to retire Big Sandy Unit 2....[121]

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[117] *Id.* at 36.

[118] Kentucky Power Response to KPSC PHDR-4(b).

[119] Wohnhas Rebuttal at 8.

[120] Mitchell Transfer Order. at 28.

[121] *Id.*

- "Accordingly, we conclude that the proposed Mitchell acquisition represents the least-cost alternative to meeting Kentucky Power's capacity and energy needs and would not result in wasteful duplication of facilities."[122]

- "Based on Kentucky Power's analyses, the cost of retrofitting the Big Sandy Station would not be economically justified, resulting in the Company's decision to retire Big Sandy Unit 2 by June 2015."[123]

- "Sensitivity and break-even analyses also demonstrated that the Mitchell acquisition is the least-cost option."[124]

- Because Mitchell fuel costs are anticipated to be lower than the fuel costs for the Big Sandy Station, the Mitchell acquisition would result in annual fuel savings of approximately $16.75 million to the benefit of Kentucky Power's customers."[125]

- "The Stipulating Parties point out that the Stipulation also provides protection against unreasonably higher costs due to unanticipated greenhouse gas regulation. The significance of this was highlighted by the fact that on June 25, 2013, President Obama issued his Climate Action Plan and Presidential Memorandum…."[126]

- "In addition to our finding that the Mitchell acquisition is the least cost alternative to address the unit disposition of Big Sandy Unit 2, the Commission believes that the benefits achieved through the Stipulation, as modified, would provide Kentucky Power's customers with rate savings and tangible financial commitments."[127]

- That "with only normal maintenance the Commission can expect the Mitchell Station to be operational in 2040."[128]

Although the Commission recognized the $16.75 million estimate of differential fuel blend costs as one of the benefits of the Mitchell Transfer, it also pointed to the fact that the Big Sandy Unit 2 would have to be retired, and that the Mitchell Transfer was the least cost alternative to its

[122] *Id.*

[123] *Id.* at 28.

[124] *Id.* at 31.

[125] *Id.* at 33.

[126] *Id.*

[127] *Id.* at 38.

[128] *Id.* at 40.

continued operation.[129] Indeed, the Company's economic modeling evidence indicated that the Mitchell Transfer was $379 million to $819 million less expensive on a cumulative present worth basis than any non-Mitchell alternative.[130] Without in any way minimizing the $16.75 million estimate, the fact remains that the Mitchell Transfer was and remains by far the "best deal" for Kentucky Power's native load customers, and that without the Mitchell Transfer the Company's native load customers would have paid an additional $9.9 million in net energy costs in the four post-Mitchell Transfer months of this review period.

C. The Effort by the Attorney General and KIUC to Re-Write the Mitchell Stipulation by Retroactively Modifying the Company's Long-Standing Fuel Cost Allocation Methodology Is Unfair and Unreasonable and Will Harm the Company's Native Load Customers.

The Attorney General and KIUC recommend that the Commission order the Company to adopt retroactively a different fuel cost allocation methodology and to refund, based upon Mr. Hayet's calculations, $12,648,107[131] in fuel costs for the four months during the review period following the Mitchell Transfer.[132] The recommendation is premised principally upon their witnesses' mischaracterization of the Company's fuel cost allocation methodology,[133] as well as the demonstrably erroneous contention[134] that no other utilities in the Commonwealth use a similar fuel cost allocation methodology whereby the highest incremental fuel costs are allocated to off-system sales.[135] Mr. Kollen compounds his error by arguing that the Company's fuel cost allocation methodology is contrary to that permitted under the Federal Energy Regulatory

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[129] *Id.* at 28.

[130] *Id.* at 19.

[131] *See*, Kollen Direct at 30; Hayet Direct at 18.

[132] Hayet Direct at 17.

[133] *See* Hayet Direct at 4-5; Kollen Direct at 6. *Cf.* Pearce Rebuttal at 5-8.

[134] *See* pages 12-15 *supra*.

[135] *See* Kollen Direct at 17-19.

Commission's fuel adjustment clause and thus contravenes 807 KAR 5:056, which was premised upon the FERC fuel adjustment clause.[136] Finally, Mr. Kollen and Mr. Hayet double down on their errors and argue that economic dispatch principles and cost allocation methodologies are independent concepts, and that in allocating fuel costs Kentucky Power can and should ignore the very dispatch principles giving rise to those costs.[137]

Messrs. Kollen and Hayet also ignore the clear requirement of Section 15 of the Mitchell Stipulation providing that customers "at all times [shall] be entitled to the least cost energy produced by generation owned, leased or purchased by the Company ***consistent with economic dispatch principles***."[138] Those economic dispatch principles, under which generation is dispatched by PJM for off-system sales using *incremental costs*, are fully consistent with the Company's fuel allocation methodology.

In place of Kentucky Power's decades-old fuel cost allocation methodology, KIUC and the Attorney General argue the Company should be required retroactively to adopt a different fuel cost allocation methodology.[139] Their argument is made notwithstanding its flawed premises, and without regard to the long-term practical detriment likely to be imposed upon the Company and ultimately its native load customers. It is an invitation the Commission can and should reject.

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[136] *Id.* at 19-20; Order, *In the Matter of: Application of Kentucky Utilities Company To Amortize, By Means Of A Temporary Decrease In Rates, Net Fuel Cost Savings Recovered In Coal Contract Litigation* at 4, Case No. 93-113 (Ky. P.S.C. December 8, 1993) .

[137] *See* Kollen Direct at 10; Hayet Direct at 8. *Cf.* Pearce Rebuttal at 6.

[138] Mitchell Stipulation at ¶ 15 (emphasis supplied).

[139] *See* Hayet Direct at 11-12.

1. <u>The Intervenors' Recommended Fuel Allocation Methodology Is Contrary to the Mitchell Stipulation.</u>

Messrs. Hayet[140] and Kollen[141] urge the Commission to order Kentucky Power to adopt retroactively East Kentucky Power Cooperative, Inc.'s fuel cost allocation methodology. Doing so, Mr. Hayet claims, "results in the average costs allocated to each [native load customers and off-system sales] being much closer to the unit's actual ***average*** costs than under Kentucky Power's method."[142] But PJM does not dispatch the Company's units based upon their actual average cost. To the contrary, PJM dispatches the Company's units based upon Kentucky Power's offers of blocks of its generation at increasing incremental prices.[143] The Company's fuel cost allocation methodology matches the manner in which its generation is dispatched by assigning the highest incremental cost generation first to off-system sales.[144]

Neither Mr. Kollen nor Mr. Hayet dispute that Kentucky Power allocates fuel costs based upon economic dispatch principles. To the contrary, Mr. Hayet contends that generation dispatch and fuel cost allocation, including presumably his recommended methodology, "are two completely different matters."[145] Whatever, the non-litigation driven basis for Mr. Hayet's position, and there does not seem to be one because it divorces cost allocation from cost causation,[146] Paragraph 15 of the Mitchell Stipulation directs that fuel costs are to be allocated in accordance with "economic dispatch principles."[147] By their witness' own admission, the

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[140] *Id.* at 18.

[141] Kollen Direct at 29.

[142] Hayet Direct at 16 (emphasis supplied).

[143] Pearce Rebuttal at 11-12.

[144] *Id.* at 12.

[145] Hayet Direct at 8.

[146] Pearce Rebuttal at 6 ("Cost causation requires the cost reconstruction to follow the dispatch.")

[147] Mitchell Stipulation at ¶ 15.

Intervenors' recommended methodology fails to do so and thus is contrary to Paragraph 15 of the Mitchell Stipulation.

2. <u>The Intervenors' Recommended Fuel Cost Allocation Methodology Will Limit Off-System Sales to the Detriment of the Company and Its Customers.</u>

Under Paragraph 7 of the Mitchell Stipulation Kentucky Power is entitled to retain 100% of the off-system sales margins in excess of the $15.3 million of off-system sales margins included in the Company's existing base rates only until new base rates are established.[148] On November 14, 2014 the Company filed its notice of intent[149] to file an application to establish new base rates. Once those new rates are established, presumably in mid-2015, the Company and its customers may return to the nearly three decade old practice of sharing off-system sales margins. The adoption of the Intervenors' recommended allocation methodology may reduce significantly the benefits flowing to the Company's customers and the Company from off-system sales.[150]

Because Kentucky Power's native load customers have a first and superior call on the Company's generation assets,[151] off-system sales are incremental to, and made only when the Company's assets are not required to meet that native load.[152] Although the costs assigned to off-system sales are the highest incremental $/MWh costs,[153] the allocation methodology recommended by KIUC and the AG would force additional costs, in the form a portion of the no

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[148] Appendix A, Mitchell Transfer Order at ¶ 7.

[149] Notice of Intent, *In the Matter of: Application Of Kentucky Power Company For: (1) A General Adjustment Of Its Rates For Electric Service; (2) An Order Approving Its 2014 Environmental Compliance Plan; (3) An Order Approving Its Tariffs And Riders; And (4) An Order Granting All Other Required Approvals And Relief*, Case No. 2014-00396 (Ky. P.S.C. Filed November 14, 2014).

[150] Pearce Rebuttal at 12-13.

[151] *Id.* at 9.

[152] *Id.* at 9, 11-12.

[153] *Id.* at 12.

load and unit minimum costs incurred to ensure that the native load customers always have first call on the generation,[154] "onto" to these sales. Doing so would have two effects. First, it would divorce fuel cost allocation from the manner in which the Company currently bids its units into PJM and thus require a modification in the manner in which the Company does so.[155] Second, and more fundamentally, it could reduce the Company's ability to make off-system sales and thus the amount of the sales margins to be shared with its native load customers once new base rates are established:

> [U]nder the KIUC/AG methodology, the Company would effectively be directed to factor a [*sic*] non-incremental costs into its decision to make an off-system sale. This would result in a number of hours in which a sale that was made using incremental costs would not now be made. The result is the Company's customers and the Company would lose the benefit from OSS, because rather than receiving a credit that lowers total cost, there is a *cost increase* in terms of lost opportunity cost.[156]

At a minimum, the Company's native load customers could face higher base rates than otherwise because a lesser amount of off-system sales margins would be available to be credited against those rates.[157]

3. The Methodology Proposed by KIUC and the Attorney General Ignores the Realities of the Operation and Economic Dispatch of Baseload Units

KIUC and the Attorney General propose a bottom-up fuel allocation methodology through which Kentucky Power would be required first to calculate an average (dollar per MWh) total fuel cost and then allocate the lowest cost MWh to native load and any remaining costs to off system sales.[158] KIUC and the Attorney General ignore the reality of how the Company's

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[154] *Id.* at 8.

[155] *Id.* at 13

[156] *Id.*

[157] *Id.*

[158] Hayet Direct at 12-13.

baseload generation units operate and the manner by which they are dispatched by PJM.[159] Because it disregards these fundamental concepts, the Commission should similarly ignore the proposed methodology of KIUC and the Attorney General.

The methodology proposed by KIUC and the Attorney General ignores the fundamental principle that Kentucky Power's assets are first and foremost available to serve the Company's native load.[160] Further, the proposed methodology ignores the manner in which PJM operates.[161] Companies operating in PJM must bid their available generation assets into the day-ahead market.[162] When companies do so, they provide a minimum run time and, for many of the supercritical units, that minimum run time is the entire 24 hour period.[163] In determining how to award generation units, PJM ensures that the generator will recover its costs (total no load and incremental) over the course of the entire daily offer period.[164] Importantly, however, PJM does not dispatch the units so that it will recover its costs in any given hour.[165] As a result, there may be individual off-peak hours where the units will not recover their total costs, but those units will be available to protect native load customers from the volatility of the market.[166]

KIUC and the Attorney General further ignore the manner in which baseload coal units operate. Kentucky Power cannot simply turn off the units in the hours where they cannot recover their costs and turn them back on during the hours when they can.[167] Startup times for

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[159] Pearce Rebuttal at 14-15.

[160] *Id.* at 15.

[161] *Id.* at 14.

[162] *Id.*

[163] *Id.*

[164] *Id.*

[165] *Id.*

[166] T.H. at 167-68.

[167] Pearce Rebuttal at 15; T.H. at 167.

Kentucky Power's assets vary from 5 hours (a hot startup at Big Sandy Unit 1) to 29 hours (cold start up at Rockport).[168] The units cannot be flipped off and on like light switches.[169] Having the generation operating during the off-peak times is what ensures it is available to Kentucky Power's customers during the on-peak, high-price times.[170] Kentucky Power's customers have the right to the below market generation during on-peak hours, but with that right comes the obligation to pay the no load costs necessary to have those units available.[171]

The cost allocation methodology sponsored by Messrs. Kollen and Hayet ignores each of these realities. Instead, they argue the Company should allocate fuel costs to mimic a world that does not exist, and in which baseload generation can be turned on and off hourly without regard to the physical capabilities of the units. Similarly, while enjoying the benefits of "first call" on the Company's available generation resources to the exclusion of non-native load, KIUC and the Attorney General want to limit the obligation of the Company's native load customers to pay for that availability to mimic a world in which native load customers enjoyed only a pro rata ability to call on the Company's resources. Moreover, while acknowledging the manner in which PJM dispatches the Company's generation resources, and that off-system sales are incremental to the Company's obligation first to serve its native load customers, they nevertheless argue that the costs associated with making off-system sales should be calculated on a non-incremental basis.

Finally, were the Commission to adopt KIUC's proposal, it may force Kentucky Power to build no load costs into the $/ MWh bid into the PJM day ahead market to the detriment of Kentucky Power's customers.[172] Increasing the offer costs will result in PJM selecting Kentucky

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[168] Pearce Rebuttal at 15.

[169] *Id.*

[170] *Id.*

[171] *Id.*

[172] Pearce Hearing Testimony at 171.

Power's units for dispatch less often.[173] While this may decrease the amount of no load costs allocated to native load, it will also expose Kentucky Power's customers to the volatility of the market more often as Company-owned generation is idled. Kentucky Power's customers would lose the valuable protection from the market that its cost-based generation units provide.

4. It Is Unreasonable and Unfair to Modify the Fuel Cost Allocation Methodology So Long As Current Base Rates Remain in Effect.

The Company's current "top-down" fuel cost allocation methodology is fair, just, and reasonable, and consistent with FERC guidance and the requirements of 807 KAR 5:056.[174] If the Commission nevertheless elects to require the Company to modify its methodology, the change should only be made prospectively and at the time the Company's base rates are modified. Moreover, the amount of the off-system sales margins to be included as a credit in base rates must be calculated using the new allocation methodology.

Kentucky Power's current base rates are $15.3 million less than they otherwise would be as a result of the credit provided by the 2009 test period off-period sales margins.[175] These 2009 test period off-system sales were determined to be "economic," and hence were made, using the Company's current fuel cost allocation methodology.[176] Likewise, the actual margins credited to the Company's native load customers were calculated using the current allocation methodology.[177] The Intervenors' preferred methodology, which would shift non-incremental fuel costs to off-system sales would likely have had two effects if it had been used in connection with the test year used to establish the Company's current base rates. First, it likely would have

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[173] Pearce Hearing Testimony at 171.

[174] *See* Allen Rebuttal at 3-10.

[175] Wohnhas Rebuttal at 9-10.

[176] *Id.* at 10-11.

[177] *Id.* at 10.

rendered certain sales uneconomic and thus they would not have been made. Second, even those sales that would have remained economic would have produced lesser margins because of higher allocated fuel costs.[178]

Any attempt to change the Company's fuel cost allocation methodology outside of a rate case would unfairly and unreasonably give native load customers credit for reduced fuel costs while allowing them to retain the credit for off-system sales margins that would not have been received.[179] Such a result is not fair, just or reasonable.

D. The Award of Interest on the Amounts, If Any, Ultimately Required to Be Refunded by Kentucky Power Is Neither Authorized Under Kentucky Law nor Reasonable.

Messrs. Kollen[180] and Hayet[181] also each argue that the Commission should award interest, calculated at the Company's weighted average cost of capital, on the FAC amounts, if any, Kentucky Power ultimately is required to refund. The Commission's ability to award interest with respect to FAC over-collections must ultimately be grounded in a delegation of authority by the General Assembly to do so. No such authority exists. Moreover, the record is devoid of any basis for awarding interest even if the Commission were authorized to do so.

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[178] Pearce Rebuttal at 12-13.

[179] Wohnhas Rebuttal at 9-11.

[180] Kollen Direct at 29-30.

[181] Hayet Direct at 18.

1. <u>Neither Chapter 278 of the Kentucky Revised Statutes nor the Commission's Regulations Authorize the Award of Interest on Any Amounts Ordered to be Refunded.</u>

(a) No Authority Exists Under Chapter 278 of the Kentucky Revised Statutes for the Award of Interest With Respect to FAC Refunds, If Any, Awarded by the Commission.

Although the Commission's authority may be inferred from necessity or fair implication,[182] at bottom any such necessity or implication concerning the Commission's authority must be grounded in the express language of Chapter 278:

> Although the Commission is granted sweeping authority to regulate public utilities pursuant to KRS Chapter 278, it is nonetheless a creature of statute. Therefore, it "has only such powers as granted by the General Assembly."[183]

Fundamental to the limitation of the Commission to those powers granted it by statute is that the Commission "cannot add to its enumerated powers."[184]

Only two provisions of Chapter 278 of the Kentucky Revised Statutes provide for the payment of interest by utilities. KRS 278.190(4) expressly authorizes the Commission, in its discretion, to require the payment of interest on amounts required to be refunded where a utility places its proposed rates in effect pending a final decision of the Commission on an application to implement new rates.[185] KRS 278.460(1) also requires the payment of interest by a utility "on amounts required to be deposited by patrons to secure utility service." Neither statute is applicable – either expressly or by implication – to the amounts refunded by a utility in connection with the Commission's review of the operation of a utility's FAC. Neither the FAC

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[182] *Public Service Commission v. Commonwealth,* 320 S.W.3d 660, 665 (Ky. 2010).

[183] *Commonwealth ex rel. Stumbo v. Kentucky Public Service Commission,* 243 S.W3d 374, 378 (Ky. App. 2007); *Accord, Cincinnati Bell Tel. Co. v. Kentucky Public Service Commission*, 223 S.W.3d 829, 836 (Ky. App. 2007).

[184] *Boone County Water & Sewer District v. Public Service Commission,* 949 S.W.2d 588, 591 (Ky. 1997); *accord, South Central Bell Telephone Co. v. Utility Regulatory Commission,* 637 S.W.2d 649, 654 (Ky. 1982).

[185] KRS 278.190(4) (" the utility shall make the refund of within sixty (60) days after a final determination of the proceeding by an order of the court or commission ***with or without interest in the discretion of the commission***.")

nor this six-month review proceeding are a general rate case instituted under KRS 278.180 and KRS 278.190; nor are collections through the FAC a proposed "change of rate, charge, classification, or service" placed in effect pursuant to KRS 278.190(2) five months after the date the rate change would otherwise go into effect. By the same token, amounts collected through the FAC are not deposits to secure service, and thus are not subject to the interest provisions of KRS 278.460(1). Neither statute gives rise to an implication – fair or otherwise – that the Commission, as a creature of statute, is authorized to award interest on FAC over-collections.

The specific requirements in KRS 278.190(4) and KRS 278.460(1) concerning the payment of interest would have been unnecessary if the General Assembly had otherwise provided the Commission with general authority to award interest on any amounts repaid by a utility to its customers .[186] Indeed, dispositive of the demand for interest by Messrs. Kollen and Hayet is the principle "that where legislation includes particular language in one section of a statute, but omits it another section of the same Act, it is generally presumed the legislature acted intentionally and purposefully in the disparate inclusion or exclusion."[187] In enacting and subsequently amending Chapter 278 of the Kentucky Revised Statutes the Commission limited the payment of interest by a utility to two narrow circumstances, and its failure to provide a more general authority to the Commission to award interest was both intentional and purposeful.

(b) The Commission's FAC Regulation Does Not Provide for the Award of Interest on FAC Refunds.

The Commission itself seemingly understood that interest is not payable on amounts over-collected by a utility through a FAC. 807 KAR 5:056, which authorizes and governs fuel

[186] See *Kentucky Department of Corrections v. McCullough*, 123 S.W.3d 130, 140 (Ky. 2003) (holding no general right of recovery of punitive damages for statutory violation under statutes governing punitive damages in light of express inclusion of the right of recovery of punitive damages in actions for violations of two other statutes. The express right of recovery would have been unnecessary if a general right to punitive damages in actions for statutory violations existed.)

[187] *Palmer v. Commonwealth*, 3 S.W.3d 763, 764-765 (Ky. App. 1999).

adjustment clauses generally, and 807 KAR 5:056, Section 11, which expressly provides for the refund of any over-collections,[188] nowhere provide for the payment of interest. Administrative regulations are governed by the same rules of construction governing statutes.[189] Among these are the black letter rule that statutes (and hence regulations) are limited to the words employed, and the provisions of a regulation may not be interpreted by adding to the unambiguous language used:

> [T]he applicable rule of construction with respect to matters not expressed in a statute is that a court must refer to the words used in enacting the statute rather than surmising what may have been intended but was not expressed. . .. Where a statute is intelligible on its face, the courts are not at liberty to supply words or insert something or make additions which amount, as sometimes stated, to providing for a *casus omissus,* or cure an omission.[190]

Similarly, a statutory or regulatory enactment may not be construed by surmising what may have been intended but was left unexpressed.[191] 807 KAR 5:056, Section 11 is clear on its face, and it nowhere provides for the award of interest in connection with any "temporary decrease of rates."

There is no basis, either in the clear language of Chapter 278 of the Kentucky Revised Statutes or the Commission's own FAC regulation, for the award of interest on the FAC amounts, if any, ordered to be refunded.

2. <u>As a Form of Compensatory Damages the Award of Interest Is Beyond the Commission's Jurisdiction.</u>

Outside of contract or statute, neither which is applicable here, the award of interest is a form of consequential damages.[192] Both the courts and he Commission recognize that the

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[188] The pertinent part of 807 KAR 5:056, Section 11 provides: "The Commission will order a utility to charge off and amortize, by means of a temporary decrease in rates, any adjustments it finds unjustified due to improper calculation, or application of the charge, or improper fuel procurement practices."

[189] *Comprehensive Home Health Services, Inc. v. Professional Home Health Care Agency, Inc.*, 434 S.W.3d 433, 441 (Ky. 2013).

[190] *Travelers Indemnity Co. v. Reker,* 100 S.W.3d 756, 765 (Ky. 2003) (internal citations and quotations omitted).

[191] *Stogner v. Commonwealth*, 35 S.W.3d 831, 835 (Ky. App 2000).

Commission lacks authority to adjudicate claims for compensatory damages. The signal decision on the issue is *Carr v. Cincinnati Bell, Inc.* in which the court of appeals explained:

> Nowhere in Chapter 278 do we find a delegation of power to the PSC to adjudicate contract claims for unliquidated damages. Nor would it be reasonable to infer that the Commission is so empowered or equipped to handle such claims consistent with constitutional requirement. Kentucky Constitution § 14.[193]

This Commission consistently has followed *Carr* and dismissed, as being outside its jurisdiction, claims seeking compensatory damages:

> The Commission is also without jurisdiction to award compensatory and punitive damages. Pursuant to KRS 278.040, the Commission has jurisdiction of only the "rates" and "services" of utilities as defined by KRS 278.010. Complainant's request for compensatory and punitive damages falls under neither category.[194]

Although it is unclear whether the Commission has addressed this issue with respect to compensatory damages in the form of interest, there is no jurisdictional, statutory, or other principled basis for treating interest differently than other forms of compensatory damages for purposes of the Commission's exercise of its jurisdiction.

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[192] See, *Nucor Corp. v. General Electric Co.*, 812 S.W.2d 136, 143 (Ky. 1991) ("We accept the premise that interest may be appropriate as part of consequential damages in tort as well as contract as provided for in the Restatement (Second) of Torts § 913.") See also, 22 AM. JUR. 2D, Damages § 462 (2003) ("Prejudgment interest is normally designed to make the plaintiff whole, and is part of the actual damages sought to be recovered. Such interest is merely another element of pecuniary damages, and is in the nature of compensatory damages.")

[193] 651 S.W.2d 126, 128 (Ky. App. 1983) (holding that circuit court and not the Commission had jurisdiction over claim for compensatory and punitive damages in connection with alleged tortious breach of contract.)

[194] *In the Matter of: Strother v,. AT&T Communications of the South Central States, Inc.*, Case No. 2007-00415 at 4 (Ky. P.S.C. Feb. 28, 2008). *Accord, In the Matter of: Stipes v. Farmdale Water District*, Case No. 2014-00193 at 2 (Ky. P.S.C. June 20, 2014); *In the Matter of: Bulldog's Enterprises, Inc. v. Duke Energy Kentucky, Inc.*, Case No. 2010-00404 at 2 (Ky. P.S.C. Nov. 15, 2010).

3. Any Award of Interest With Respect to the Amounts, If Any, Ordered Refunded Would Violate the Separation of Powers Provisions of Kentucky's Constitution and KRS 13A.130.

(a) Any Effort to Add to the Provisions of Chapter 278 of the Kentucky Revised Statutes by Engrafting Onto it the General Authority to Award Interest Would Violate the Strict Separation of Powers Provisions of the Kentucky Constitution.

Sections 27 and 28 of the Kentucky Constitution embody the separation of powers provisions of the constitution and erect a wall between the three coordinate branches of government that is higher and less easily breached than that in other states and the federal system.[195] In *Sibert v. Garrett*, for example, the Court explained:

> Perhaps no state forming a part of the national government of the United States has a constitution whose language more emphatically separates and perpetuates what might be termed the American tripod form of government than does ... [the Kentucky] Constitution.[196]

The Kentucky Supreme Court has characterized the Kentucky Constitution's separation of powers provisions as a "double-barreled, positive negative approach."[197] That is, "our present constitution contains explicit provisions which, on the one hand, *mandate* separation among the three branches of government, and on the other hand, specifically *prohibit* incursion of one branch of government into the powers and functions of the others."[198]

Because the legislative power is vested exclusively with the General Assembly, an administrative agency may not, consistent with the requirements of the separation of powers

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[195] *Legislative Research Commission v. Brown, Ky.*, 664 S.W.2d 907, 912-913 (1984). See also, *Fletcher v. Commonwealth, ex rel. Stumbo*, 163 S.W.3d 852, 863 (Ky. 2005) ("[W]e and our predecessor court have interpreted Sections 27 and 28 to mandate a strict separation of powers."); *Diemer v. Commonwealth,* 786 S.W.2d 861, 864 (Ky. 1990) ("Kentucky is a strict adherent to the separation of powers doctrine.")

[196] 246 S.W. 455, 457 (1922).

[197] *Legislative Research Commission v. Brown*, 664 S.W.2d at 912.

[198] *Id.* (emphasis in original).

doctrine, "amend, alter, enlarge or limit the terms of legislative enactment."[199] Instead, an agency is "authorized only to administer the law as written,"[200] and thus may not employ administrative procedures and remedies not embodied in statute.[201] Any reasonable doubts concerning an agency's authority to exercise a power is to be resolved against its existence.[202]

With the single exception addressed above and not applicable here,[203] Chapter 278 of the Kentucky Revised Statutes nowhere authorizes the Commission to award interest on refunds made by utilities to their customers. Absent such statutory authorization, any award of interest by the Commission on the refunds, if any, Kentucky Power might be required to make would be an unconstitutional usurpation by the Commission of legislative authority in violation of the Commonwealth's strict separation of powers doctrine.

(b) KRS 13A.130 Prohibits the Award of Interest by the Commission With Respect to Any Refunds Ordered.

In addition to the constitutional limitations on the Commission's ability to add to or amend Chapter 278 by providing for the award of interest on refunds other than where authorized under KRS 278.190(4), KRS 13A.130(1) likewise prohibits the Commission from awarding interest on any refunds except where authorized by statute to do so:

> An administrative body shall not by internal policy, memorandum, or other form of action:
>
> (a) Modify a statute or administrative regulation; [or]
>
> (b) Expand upon or limit a statute or administrative regulation....

[199] *Appalachian Racing, LLC v. Family Trust Foundation of Kentucky, Inc.*, 423 S.W.3d 726, 736 (Ky. 2014).

[200] *Johnson v. Correll*, 332 S.W.2d 843, 845 (Ky. 1960).

[201] *Revenue Cabinet v. Cherry*, 803 S.W.2d 570, 572-573 (Ky. 1990).

[202] *United Sign, Ltd. v. Commonwealth*, 44 S.W.3d 794, 798 (Ky. App. 2000).

[203] KRS 278.190(4).

Because nothing in Chapter 278 of the Kentucky Revised Statutes provides the Commission with general authority to award interest on refunds, and the Commission's fuel adjustment clause regulation, KAR 5:056, likewise nowhere provides for the award of interest in connection with the administration of the fuel adjustment clause, any award of interest by the Commission in this proceeding would be tantamount to the modification and enlargement of both the applicable statutes and the Commission's fuel adjustment clause regulation. As such it would be proscribed by KRS 13A.130(1).

4. <u>The Commission's 1994 Decision in a Big Rivers Electric Corporation FAC Proceeding Does Not Support the Award of Interest With Respect to the Refunds, If Any, Awarded in This Case.</u>

During the November 12, 2014 hearing in this case, Commission Staff questioned Mr. Wohnhas concerning his knowledge of the Commission's decision in Case No. 1990-360-C[204]:

> Q. Page 17 of your rebuttal testimony, beginning at line 12, where you say that "not aware of any FAC proceeding where an adjustment (credit or charge) has ever included interest at any rate," would you accept, subject to check, that the Commission did order Big Rivers to pay interest on disallowed fuel costs in PSC Case 1990-360-C.
>
> A. Subject to check; yes, sir.[205]

The decision is inapposite. First, Big Rivers did not contest the Commission's authority to award interest.[206] As such, it appears the Commission did not have the opportunity to address the challenges raised by Kentucky Power in this case to the award of interest. More fundamentally, *Big Rivers FAC* involved findings, among allegations of self-dealing and conflicts of interest by Big Rivers' former management, that during the review period Big Rivers

[204] *In the Matter of: An Examination By The Public Service Commission Of The Application Of The Fuel Adjustment Clause Of Big Rivers Electric Corporation From November 1, 1991 To April 30, 1992*, Case No. 1990-360-C (Ky. P.S.C. July 21, 1994) ("Big Rivers FAC").

[205] T.H. at 101.

[206] *Big Rivers FAC* at 28.

incurred more than $10 million of unreasonable jurisdictional fuel costs under multiple coal contracts.[207] Here no party to this proceeding is challenging the reasonableness of Kentucky Power's fuel costs. Instead, at issue is a challenge to the Company's decades old methodology for allocating those reasonable fuel costs between off-system sales and native load.

Respectfully, whatever the Commission's practice in a single case decided more than 20-years ago, the award of interest by the Commission in this case must be bottomed upon statutory authorization to do so.[208] As detailed above, no such authorization exists. Moreover, the putative basis for ordering a refund in this proceeding – the Commission's rejection of a decades old allocation methodology never before challenged at the state or federal level, and that is similar to the methodology used by two other jurisdictional utilities – is so dissimilar from the facts presented in *Big Rivers FAC* as to make that decision inapplicable here.

5. Even If the Commission Concludes It Is Authorized to Award Interest in Connection With FAC Refunds This Case Does Not Present the Sort of Extraordinary Circumstances Justifying Such an Award.

The decision in *Big Rivers FAC* appears to represent a limited exception to the customary Commission practice of not awarding interest in connection with FAC refunds. Certainly, Kentucky Power is unaware of interest being awarded in the past in connection with refunds made by the Company following Commission-review of its FAC.[209] By the same token, Kentucky Power also is unaware of a utility being awarded interest on any under-collection through its fuel adjustment clause.[210] Absent the types of aggravating factors presented in *Big*

[207] *Id.* at 14, 17.

[208] *Boone County Water & Sewer District v. Public Service Commission*, 949 S.W.2d 588, 591 (Ky. 1997).

[209] *See* Wohnhas Rebuttal at 17; T.H. 62.

[210] Basic fairness mandates that if interest is to be awarded customers in the case of an over-collection through the fuel adjustment clause that the customers likewise be required to pay interest to the Company in the case of an undercollection.

Rivers FAC, the Commission should hew to its customary practice and decline to award interest on the refunds, if any, ordered in this case.

Factors militating against the award of interest on any refund amounts in this case include:

- Neither Staff nor any party to this proceeding has challenged the reasonableness of the Company's fuel procurement practices or the reasonableness of the fuel costs actually incurred by the Company in connection with the implementation of its FAC;

- Unlike the circumstances presented in *Big Rivers FAC*, the subject Kentucky Power coal contracts are not the focus of criminal prosecutions or civil restitution agreements;[211]

- Kentucky Power acted in good faith in continuing to use its decades old methodology for allocating fuel costs between its native load customers and off-system sales;[212]

- The Company's methodology for allocating fuel costs between native load customers and off-system sales is consistent with FERC precedent and guidance concerning the FERC wholesale FAC regulation, which served as a model for this Commission's FAC regulation.[213] In fact, the administration by two of Kentucky Power's sister companies of their wholesale FAC was audited by the FERC Division of Audits without any findings or recommendations;[214]

- It appears two other utilities operating subject to the Commission's jurisdiction allocate fuel costs between native load and off-system sales in a fashion "that is not far afield from the Company's method;"[215] and

- Kentucky Power's fuel cost allocation methodology is premised upon cost causation and follows unit economic dispatch.[216] As such, it is both logical and reasonable. The Company's methodology provides operational benefits now that Kentucky Power no longer has "back-up" in the form of cost-based generation from other AEP operating companies, while allowing the Company's units to be offered into the PJM market in the most economically efficient manner possible,

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[211] *See*, Big Rivers FAC at 26 n. 14.

[212] *See*, Wohnhas Rebuttal at 4; Pearce Rebuttal at 5.

[213] Allen Rebuttal at 4-5; Pearce Rebuttal at 11.

[214] Allen Rebuttal at 4.

[215] Pearce Rebuttal at 17-18; T.H. at 185.

[216] Pearce Rebuttal at 5-6.

thereby maximizing their value to the Company and its customers, and the units' availability to serve native load.[217]

Although both Messrs. Kollen[218] and Hayet[219] recommend that the Commission award interest on any refund amounts, they fail to provide any basis for the Commission's departure from its apparent customary practice of not doing so. The Commission should reject their recommendation and follow its substantial precedent to the contrary.

6. Any Award of Interest Should Be Calculated at a Rate No Greater Than the Average Three-Month Commercial Paper Rate and Not Kentucky Power's Weighted Average Cost of Capital.

Like his recommendation to award interest on any refund ordered by the Commission in connection with its review, Mr. Kollen's use of the Company's weighted average cost of capital to calculate the interest is bottomed upon nothing more substantial than his unsupported opinion. In fact, when asked to identify his "basis for using the Company's weighted cost of capital in calculating the interest claimed due, including, but not limited to, all statutes, regulations, and orders of the Public Service Commission of Kentucky relied upon by Mr. Kollen in doing so,"[220] Mr. Kollen was unable to identify a single statute, regulation, or Commission decision authorizing the use of a utility's weighted average cost of capital.[221]

In the single instance where the Commission is authorized by statute to award interest on refunds,[222] the Commission's practice is to order that the interest on refunds be calculated using the Three-Month Commercial Paper Rate:

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[217] *Id.* at 9.

[218] Kollen Direct at 29-30.

[219] Hayet Direct at 18.

[220] Kentucky Power Company's Data Requests To Intervenors KIUC And the Attorney General, Request No. 19(f) (Ky. P.SC. Filed October 17, 2014)

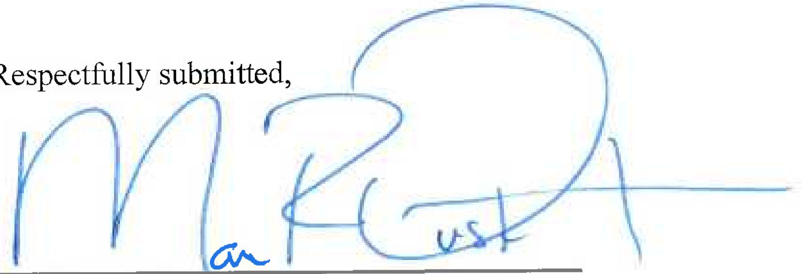
[221] Response of KIUC and the Attorney General to KPCo-19(f).

[222] KRS 278.190(4).

> Consistent with the Commission's requirement in other rate cases in which refunds were required, Big Rivers will be required to pay interest on the refunded amounts at the average of the Three-Month Commercial Paper Rate as reported in the Federal Reserve Bulletin and the Federal Reserve Statistical Release on the date of this Order.[223]

Similarly, when the Commission awarded interest on FAC refunds in *Big Rivers FAC*, it directed that the interest be calculated "at the average of the Three-Month Commercial Paper Rate as reported in the Federal Reserve Bulletin and the Federal Reserve Statistical Release for the period…" under review.[224] Thus, although Kentucky Power does not waive its arguments that there is no legal or factual basis for awarding interest on any amounts ordered to be refunded, if the Commission nevertheless concludes that it is authorized to award interest, and that interest is appropriate, the rate used to calculate the interest should be limited to the Three-Month Commercial Paper Rate and not the Company's weighted cost of capital as recommended by Mr. Kollen.

Respectfully submitted,



Mark R. Overstreet
STITES & HARBISON PLLC
421 West Main Street
P. O. Box 634
Frankfort, Kentucky 40602-0634
Telephone: (502) 223-3477
Facsimile: (502) 223-4124
moverstreet@stites.com

[223] Order, *In the Matter of: Application Of Big Rivers Electric Corporation For An Adjustment Of Rates*, Case No. 2012-00535 at 52 (Ky. P.S.C. October 29, 2013).

[224] *Big Rivers FAC* at 29.

Kenneth J. Gish, Jr.
STITES & HARBISON PLLC
250 West Main Street, Suite 2300
Lexington, Kentucky 40507
Telephone: (859) 226-2300
Facsimile: (859) 253-9144
kgısh@stıtes com

COUNSEL FOR KENTUCKY POWER COMPANY

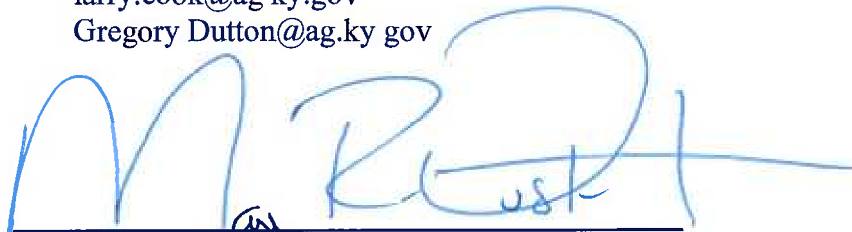
CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing was filed using the Public Service Commission of Kentucky's electronic filing service, which will send an e-mail message to

Michael L. Kurtz
Jody Kyler Cohn
Boehm, Kurtz & Lowry
36 East Seventh Street, Suite 1510
Cincinnati, Ohio 45202
mkurtz@bkllawfirm.com
KBoehm@bkllawfirm.com
jkylercohn@bkllawfirm.com

Jennifer Black Hans
Angela Goad
Gregory T. Dutton
Lawrence W. Cook
Kentucky Attorney General's Office
1024 Capital Center Drive, Suite 200
Frankfort, Kentucky 40601-8204
jennifer.hans@ag.ky.gov
Angela Goad@ag.ky.gov
larry.cook@ag ky.gov
Gregory Dutton@ag.ky gov

this 23rd day of December 2014.



Mark R. Overstreet