COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

The Application of Kentucky Power Company for:	)	
(1) A General Adjustment of Its Rates for Electric	)	
Service; (2) An Order Approving Its 2014	)	Case No. 2014-00396
Environmental Compliance Plan; (3) An Order	)	
Approving Its Tariffs and Riders; and (4) An Order	)	
Granting All Other Required Approvals and Relief	)	

TESTIMONY

OF

RANIE K. WOHNHAS

IN SUPPORT OF THE SETTLEMENT AGREEMENT

TABLE OF CONTENTS

TESTIMONY

OF

RANIE K. WOHNHAS

IN SUPPORT OF THE SETTLEMENT AGREEMENT

INTRODUCTION.

Q. PLEASE STATE YOUR NAME AND POSITION WITH KENTUCKY POWER COMPANY.

A. Ranie K. Wohnhas, Managing Director, Regulatory and Finance, Kentucky Power Company.

Q. DID YOU FILE TESTIMONY IN THIS RATE PROCEEDING?

A. Yes. I filed both direct testimony and rebuttal testimony.

Q ARE YOU FAMILIAR WITH THE ISSUES PRESENTED IN THIS CASE BY THE COMPANY AND THE OTHER PARTIES GRANTED INTERVENTION?

A. Yes.

Q. DID YOU PARTICIPATE IN THE NEGOTIATIONS WHICH LED TO THE SETTLEMENT AGREEMENT BEING SUBMITTED FOR CONSIDERATION AND APPROVAL BY THE COMMISSION?

A. Yes. I attended the two informal conferences held at the offices of the Commission that led to the agreement in principle. I also participated in the subsequent negotiation and discussion of the Settlement Agreement, including a third informal conference at the Commission offices on April 23, 2015 to review the draft Settlement Agreement and a

April 27, 2015 telephonic conference. The Settlement Agreement is attached as **<u>SETTLEMENT EXHIBIT RKW-1</u>** to this testimony.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. In my testimony I explain and support the terms of the Settlement Agreement, as well as demonstrating why the terms of the Settlement Agreement will produce fair, just and reasonable rates. In my testimony I also describe the impact of the agreement on individual tariff classes. Finally, I sponsor the proof of revenue calculations and the particular tariffs that reflect and implement the agreement.

THE SETTLEMENT AGREEMENT

Q. PLEASE DESCRIBE GENERALLY THE AREAS ADDRESSED BY THE SETTLEMENT AGREEMENT.

A. The comprehensive Settlement Agreement addresses 17 substantive areas:

(1) A net annual increase in the Company's retail revenues of $45.4 million (Paragraph 1);

(2) The establishment of a return on equity of 10.25% for certain purposes (Paragraph 2);

(3) Agreement on the Company's capitalization and gross revenue conversion factor (Paragraph 3);

(4) Approval of Kentucky Power's 2014 Environmental Compliance Plan and establishment of baseline levels for Tariff E.S. (Paragraph 4);

(5) Amendment of the Company's off-system sales tariff (Tariff S.S.C.), including increasing the customer/Company sharing split to 75%/25% with an annual base of $15,136,000 (Paragraph 5);

(6) Establishment of a Big Sandy Retirement Rider (Tariff B.S.R.R.) (Paragraph 6);

(7) Establishment of a Big Sandy Unit 1 Operation Rider (Tariff B.S.1.O.R.) (Paragraph 7);

(8) Revisions to and increased funding for the Company's Distribution Vegetation Management Plan (Paragraph 8);

(9) Revision of the Company's non-distribution depreciation rates and agreement concerning the amortization of certain deferred costs (Paragraph 9);

(10) Establishment of an economic development surcharge and matching contribution by the Company (Paragraph 10);

(11) Dismissal of the appeals by Kentucky Power and KIUC from the Commission's January 22, 2015 Order in Case No. 2014-00225; resolution of the no-load cost issue in Case No. 2014-450; and agreement by Kentucky Power and KIUC concerning the manner in which no-load costs will be treated following the retirement of Big Sandy Unit 2 (Paragraph 11);[1]

(12) Amendment of the Company's Biomass Energy Rider (Tariff B.E.R.) (Paragraph 12);

(13) Establishment of deferral mechanisms for PJM costs and NERC Compliance and Cybersecurity costs (Paragraphs 13 and 14);

(14) Expansion of the DSM-based School Energy Manager Program to the Company's entire service territory and the establishment of a pilot tariff for K-12 schools (Tariff K-12 School) (Paragraphs 15 and 16);

(15) Establishment of Tariff I.G.S. and the modification of the Tariff C.S.-I.R.P. (Paragraphs 17 and 18);

(16) Increase in the Company's customer charge for Tariff R.S. to \$14.00 per month (Paragraph 19(a)); and

(17) Approval of certain other new tariffs set out in the Company's application, as well as modifications of the Company's existing tariffs.

I discuss each of these areas, and the pertinent terms, in more detail below. In addition, the Settlement Agreement contains standard terms regarding its operation, interpretation, and applicability. Chief among these is paragraph 23, which provides that the agreement is void if the Commission does not accept the agreement in its entirety without modification, subject to the affected party's right to accept the modification. A

[1] A similar agreement has been reached by Kentucky Power and the Attorney General, who is not a party to this agreement, by means of a side agreement.

similar term was part of the Company's Settlement Agreement approved by the Commission in the Company's last two rate cases, Case Nos. 2005-00341 and 2009-00459.

Q. BEFORE DISCUSSING THE SPECIFIC TERMS OF THE SETTLEMENT AGREEMENT, PLEASE IDENTIFY THE PARTIES TO THE AGREEMENT.

A. In addition to Kentucky Power, Kentucky Industrial Utility Customers, Inc. ("KIUC") and Kentucky School Boards Association, ("KSBA") are signatories to the agreement.

Q. ARE THERE OTHER PARTIES TO THIS PROCEEDING WHO ARE NOT SIGNATORIES TO THE SETTLEMENT AGREEMENT?

A. Yes. The Attorney General of the Commonwealth of Kentucky, by and through his Office of Rate Intervention ("Attorney General"), and Wal-Mart Stores East, LP and Sam's East, Inc. (collectively "Wal-Mart"), were granted intervention by the Commission but are not signatories to this Settlement Agreement.

Q. DOES WAL-MART OPPOSE THE SETTLEMENT AGREEMENT?

A. Although Wal-Mart did not sign the Settlement Agreement, it is my understanding it will file a sworn statement with the Commission indicating that it has no objection to the Settlement Agreement, and that it is unaware of any reason the Commission should not adopt and approve this Agreement in its entirety.

Q. DID WAL-MART AND THE ATTORNEY GENERAL PARTICIPATE IN THE NEGOTIATIONS THAT LED TO THE EXECUTION OF THE SETTLEMENT AGREEMENT?

A. Yes. The Attorney General participated in the first two informal conferences at the Commission before electing not to participate in the settlement. Wal-Mart participated in the three informal conferences at the Commission and in the April 27, 2015 telephonic conference.

Q. IS THE COMMISSION STAFF A PARTY TO THE SETTLEMENT AGREEMENT?

A. No. While Commission Staff was present at each of the three informal conferences and the April 27, 2015 telephonic conference, it made clear that it could not be a party to any agreement, that it was not speaking for the Commission, and that it could not bind the Commission to the agreement.

Q. DID THE PARTIES TO THIS CASE ACTIVELY LITIGATE THIS MATTER?

A. Yes. In addition to the three sets of data requests propounded by the Commission Staff and answered by Kentucky Power, multiple data requests, consisting of 912 separate data requests, not including subparts, also were propounded by KIUC, the Attorney General, Wal-Mart and KSBA, and answered by the Company. Testimony was filed by witnesses for Kentucky Power, the Attorney General, KIUC, Wal-Mart, and KSBA, and discovery taken regarding certain of these witnesses' testimony by Commission Staff and Kentucky Power. Thus, Kentucky Power and the Parties were fully informed of each other's respective positions before engaging in settlement negotiations.

THE TERMS OF THE SETTLEMENT AGREEMENT.

Q. IN SEVERAL PLACES IN YOUR TESTIMONY BELOW YOU NOTE THAT THE SETTLEMENT AGREEMENT EMBODIES A POSITION ADVOCATED BY ONE OR MORE OF THE INTERVENORS. DOES THE INCORPORATION OF THE INTERVENOR POSITION IN THE SETTLEMENT AGREEMENT

CONSTITUTE AN ENDORSEMENT BY THE COMPANY OF THAT POSITION IN ABSENCE OF THE SETTLEMENT AGREEMENT?

A. Absolutely not. Like any fair and reasonable settlement, the Settlement Agreement represents a compromise by all parties to the agreement of their positions in a fully-litigated case. In fact, paragraph 28 recognizes that the agreement is not to be construed as an admission by any party to agreement. Likewise, the agreement provides that it is not to be read as incorporating fully the objectives of the parties to the agreement.

A. <u>A Net Increase In Annual Revenues</u>.

Q. DOES THE SETTLEMENT AGREEMENT PROVIDE FOR AN INCREASE IN THE COMPANY'S RETAIL BASE REVENUES?

A. No. In paragraph 1 ("General Rate Change"), the Signatory Parties (Kentucky Power, KIUC, and KSBA) agreed to a $23.0 million ***decrease*** in retail base revenues for Kentucky Power based on the September 30, 2014 test year used by the Company in the rate application.

Q. WHAT IS THE BASIS FOR THE PROPOSED DECREASE IN RETAIL BASE REVENUES?

A. Although the Settlement Agreement provides for an overall increase of $45.4 million, there is no increase in base rates. To the contrary, and as indicated above, the agreement provides for a $23.0 million decrease in base retail revenues. That decrease is a "black box" value negotiated by the parties to the Settlement Agreement. The Company's application also proposed a reduction, albeit smaller than provided for in the agreement, in base rate revenues. The $4.696 million reduction in the Company's application was premised in significant part upon the removal of Big Sandy coal-related assets, including materials and supplies, from the Company's rate base and capitalization. Big Sandy Unit 2 is scheduled to retire from service May 31, 2015 and Big Sandy Unit 1 is being converted to a natural gas fired unit in accordance with the Commission's Order in Case No. 2014-00430. In addition, in accordance with the July 2, 2013 Stipulation and Settlement Agreement ("Mitchell Stipulation"), which was approved as modified by the Commission in Case No. 2012-00578, all costs associated with the Mitchell Units 1 and 2 Flue Gas Desulfurization ("FGD") units were removed from the base rates established in this proceeding. Instead, they will be recovered through the Company's Tariff E.S.

Q. IS THERE AN ADVANTAGE TO CUSTOMERS BY INCLUDING THE MITCHELL FGD COSTS IN THE ENVIRONMENTAL SURCHARGE AS OPPOSED TO BASE RATES?

A. Yes. The Company's recovery of Mitchell FGD capital costs in the environmental surcharge allows customers to benefit from ongoing depreciation and ensures customers pay no more or less than the actual cost associated with the Mitchell FGD.

Q. YOU INDICATED EARLIER THAT THE NET EFFECT ON THE COMPANY'S RETAIL RATES OF THE SETTLEMENT AGREEMENT WAS AN ANNUAL INCREASE OF $45.4 MILLION. WHAT IS THE BASIS FOR THE NET INCREASE IN LIGHT OF THE DECREASE IN BASE RATES?

A. The $45.4 million overall increase results from netting the $23.0 million base rate decrease and increases associated with four other components. These four components, which are described below and in testimony filed with the application, are: (a) the Big Sandy Retirement Rider (Tariff B.S.R.R.); (b) the Big Sandy 1 Operation Rider (Tariff B.S.1.O.R.); (c) the recovery of the Company's 50% interest in the Mitchell Units 1 and 2

FGD costs through the Company's environmental surcharge; and (d) the Company's $0.15 per meter per month Economic Development Surcharge. In the aggregate, as agreed to in the Settlement Agreement these components total $68.4 million based on the September 30, 2014 test year used by the Company in the rate application. By contrast, the Company's application sought $74.8 million dollars through these same four components.

When these four components are netted against the $23 million decrease in base rate revenues the $45.4 million overall revenue increase is produced.

Q. WHAT PERCENTAGE NET INCREASE IN THE COMPANY'S REVENUES WILL BE PRODUCED IF THE COMMISSION APPROVES THE SETTLEMENT AGREEMENT?

A. In its application, Kentucky Power sought a net increase in revenues of approximately $70 million , or a 12.48% increase, as calculated based on the Company's September 30, 2014 test year. Based on that same test year data, the Company's annual revenues will increase 8.10% if the Settlement Agreement is approved.

Q. DOES THE SETTLEMENT AGREEMENT EQUALIZE RATES OF RETURN ACROSS ALL CUSTOMER CLASSES.

A. No. Residential rates have included a significant subsidy and the Settlement Agreement does not eliminate the subsidy in its entirety. Instead, consistent with what Kentucky Power understands to be the Commission's policy of gradualism, the Settlement Agreement provides for a modest subsidy reduction. Even with this small movement toward equalization, the residential customers (Tariff R.S.) will continue to produce the lowest rate of return (4.25%) of the tariff classes. The 4.25% ROR for Tariff R.S.

customers is less than two thirds of the overall ROR under the settlement agreement, and barely 60% of the ROR of the tariff class (Tariff I.G.S.) producing the next lowest rate of return. In fact, as shown on EXHIBIT 1 to the Settlement Agreement, all tariff classes other than the residential class yield an ROR greater than the 6.96% overall ROR produced by the Settlement Agreement.

Q. SETTLEMENT EXHIBIT 1 INDICATES RESIDENTIAL CUSTOMERS WILL RECEIVE A 9.89% INCREASE IN RATES IF THE SETTLEMENT AGREEMENT IS APPROVED. ALTHOUGH THE PERCENTAGE RESIDENTIAL INCREASE IS LIMITED TO SINGLE DIGITS, CAN YOU EXPLAIN WHY IT IS HIGHER THAN THE OTHER CLASS INCREASES?

A. Yes. First, as explained above, the subsidy received by the residential customers is being reduced. More significantly, the funding for the Company's Distribution Vegetation Management Program is being increased by approximately $10.4 million. This single increase in the Company's revenue requirement constitutes approximately 23% of the entire increase in annual revenues under the Settlement Agreement. As is the case with the existing Distribution Vegetation Management Program, the funding increase will be supplied by customers receiving service at primary or secondary voltages because they are the beneficiaries of improvements in distribution system reliability. Residential customers receive service using the primary and secondary voltage systems. As such, much of the increased funding for the program is properly assigned to the residential customers.

Q. IS IT COMMON FOR RESIDENTIAL CUSTOMERS TO RECEIVE THE LARGEST PERCENTAGE INCREASE?

A. Yes, when, as here, there is an effort to reduce subsidies. Also, when there are increased expenditures that primarily benefit residential customers, such as is the case here, with the Distribution Vegetation Management Program.

Q. HOW DOES THE PROPOSED PERCENTAGE INCREASE FOR RESIDENTIAL CUSTOMERS COMPARE TO THAT PROPOSED BY THE COMPANY IN ITS APPLICATION?

A. The Company's application provided for a 12.61% increase in residential rates without the Transmission Adjustment. The single-digit increase for residential customers under the Settlement Agreement thus is slightly more than 75% of the proposed percentage increase in revenues under the Company's application. Although rates were increased modestly effective January 1, 2014 through implementation of Asset Transfer Rider, Kentucky Power has not had a base rate increase since June 29, 2010.

Q. IN CASE NO. 2012-00578 THE COMPANY ESTIMATED THAT THE 2015 NON-FUEL INCREASE IN REVENUE REQUIREMENTS AS A RESULT OF THE CHANGE IN THE COMPANY'S GENERATION PORTFOLIO AS A RESULT OF THE MITCHELL TRANSFER WOULD BE 8.21%. IS IT POSSIBLE TO CALCULATE ON AN "APPLES-TO-APPLES" BASIS THE INCREASE IN NON-FUEL AMOUNTS IF THE COMMISSION APPROVES THE SETTLEMENT AGREEMENT?

A. Because the $23.0 million decrease in base rates was agreed to through a black box settlement, a similar calculation is not readily made with respect to the $45.4 million

Settlement Agreement increase. It can be approximated, however, by removing the $10.4 million increase in Distribution Vegetation Management Program expenses under the Settlement, which were not part of the calculation provided in Case No. 2012-00578. With that change, and using the same jurisdictional amounts employed in the Company's response to KPSC 5-10 in Case No. 2012-00578, the settlement, if approved, would result in a $35 million or 6.8% increase in revenues. The settlement agreement increase thus compares favorably to the Company's estimate.

B. Return On Equity.

Q. DOES THE SETTLEMENT AGREEMENT SPECIFY A RETURN ON EQUITY?

A. The $23.0 million base rate decrease reflects an agreed amount and the Signatory Parties did not specify a return on equity for that purpose. A number of the riders require the use of a return on equity, and thus the agreement specifies a 10.25% return on equity for those purposes. This is below the 10.62% return on equity recommended by Dr. Avera and Mr. McKenzie; it is likewise above the ROE recommended by Dr. Woolridge and Messrs. Baudino and Chriss.

C. Capitalization And Gross Revenue Conversion Factor.

Q. DOES THE CAPITALIZATION SHOWN ON EXHIBIT 2 OF THE SETTLEMENT AGREEMENT REFLECT A CHANGE FROM THAT USED IN THE COMPANY'S APPLICATION?

A. Yes. As part of the compromise reached in the Settlement Agreement, Kentucky Power's Weighted Average Cost of Capital ("WACC") reflects no short-term debt. As a result, all capitalization adjustments were allocated to long-term debt and equity. This is consistent with the positions advocated by the Attorney General and KIUC. The WACC of 7.34% specified in Paragraph 3 of the Settlement Agreement is less than the 7.71% requested in the Company's application.

The Settlement Agreement also provides for a 1.616424 Gross Revenue Conversion Factor ("GRCF"). This is less than the 1.6402 GRCF proposed by the Company in its filing.

D. Tariff E.S. And The Company's 2014 Environmental Compliance Plan.

Q. PLEASE EXPLAIN THE SETTLEMENT AGREEMENT'S TREATMENT OF THE COMPANY'S 2014 ENVIRONMENTAL COMPLIANCE PLAN ("ECP").

A. The Signatory Parties agree as part of the settlement that the Company's 2014 ECP should be approved. The 2014 ECP reflects the following changes to the Company's existing ECP: (a) the removal of all Kentucky Power affiliate company environmental projects included in the ECP as a result of the termination of the AEP-East System Pool Agreement January 1, 2014; (b) to the extent not already in the ECP, the addition of the Company's share of the Mitchell Units 1 and 2 environmental projects; (c) the removal of Big Sandy environmental projects, with the exception of Big Sandy Title IV, CSPAR and NO_x allowances; (d) updating the ECP to reflect the addition of new environmental projects since the last ECP; and (e) updating the ECP to include environmental projects at Rockport and Mitchell that, while not in service during the test year, are anticipated to be placed in service in the near future.

Q. WERE THERE CHANGES TO THE COMPANY'S PROPOSED TARIFF E.S AS A RESULT OF THE SETTLEMENT AGREEMENT?

A. Yes. Principally as a result of the agreed-upon changes to the Company's depreciation, capitalization, and return on equity, the base net environmental costs identified in Tariff

E.S. were reduced from $36,338,660 to $34,902,677. The calculation of this total, as well as the base monthly amounts, is shown on EXHIBIT 4 to the Settlement Agreement.

E. Off-System Sales And Tariff S.S.C.

Q. HAVE THE SIGNATORY PARTIES AGREED TO CHANGES TO THE PROPOSAL CONTAINED IN THE COMPANY'S APPLICATION FOR OFF-SYSTEM SALES?

A. Yes. The Company proposed in its Application the reinstitution of the same 60% (customer)/40% (Company) sharing of off-system sales margins above the amount credited to customers in base rates that was employed prior to the Mitchell Transfer. The sharing mechanism had been suspended, and the Company had retained all off-system sales margins, since January 1, 2014 in accordance with the Mitchell Stipulation. Through the Settlement Agreement, the Signatory Parties agreed to two changes. First, off-system sales margins above the amount credited through base rates will be shared on a 75% (customer)/25% (Company) basis. This represents a compromise of the positions advocated by the Company and witnesses for the Attorney General and KIUC. Second, for purposes of compromise, the Company agreed to increase the annual off-system sales base rate credit by $836,000 to $15,136,000 as advocated by KIUC Witness Kollen.

As I discuss in more detail below, the Company, KIUC, and the Attorney General (through a separate agreement) have agreed to settle their appeals of the Commission's January 22, 2015 Order in Case No. 2014-00225. That agreement is contingent upon the entry of a final and nonappealable order of the Commission approving the Settlement Agreement without modification. In connection with the settlement of the appeals from the Commission's January 22, 2015 Order, Kentucky Power, the Attorney General, and

KIUC have agreed to a settlement of the no-load cost issues in the Company's pending two-year fuel adjustment clause review case, and for the period following the planned retirement of Big Sandy Unit 2 on June 1, 2015. Paragraph 5 of the Settlement Agreement provides that off-system sales margins for purposes of Tariff S.S.C. will be calculated in a fashion consistent with the settlement by KIUC, the Attorney General, and Kentucky Power of the no-load cost issues.

Finally, for purposes of clarity, and consistent with the practice prior to the suspension of the sharing of off-system sales margins effective January 1, 2014, the agreement provides that actual off-system sales margins for May 2015 and June 2015 will be used for the July 2015 and August 2015 billing cycles.

Q. **HAS THE COMPANY'S PROPOSED TARIFF S.S.C. BEEN MODIFIED TO REFLECT THE CHANGES AGREED TO IN THE SETTLEMENT AGREEMENT?**

A. Yes. The modified Tariff S.S.C., including the new base monthly revenues from off-system sales and the 75%/25% sharing, are illustrated on EXHIBIT 5 to the Settlement Agreement.

F. Big Sandy Retirement Rider – Tariff B.S.R.R.

Q **WHAT IS THE BIG SANDY RETIREMENT RIDER?**

A. Although described in further detail in my direct testimony filed with the application, along with the direct testimony of Company Witness Yoder, the Big Sandy Retirement Rider implements paragraphs 3 and 14 of the Mitchell Stipulation. Generally, all Big Sandy coal-related assets, including all coal-related plant and other capitalized costs, are being retired and removed from base rates. In accordance with the Mitchell Stipulation, the Big Sandy Retirement Rider provided for the recovery of these retirement costs, both actual and estimated, along with a WACC carrying cost, on a levelized basis over 25 years. As filed by Kentucky Power, the Big Sandy Retirement Rider would have provided $21.9 million in additional annual revenues. Under the Settlement Agreement, the amount of annual revenues to be produced by the initial Big Sandy Retirement Rider will be reduced by $5.2 million to $16.7 million.

Q. DID THE ATTORNEY GENERAL'S WITNESSES RECOMMEND THAT THE COMMISSION REJECT THE BIG SANDY RETIREMENT RIDER?

A. Although Mr. Smith recommended that adjustments be made to the rider, he did not recommend that the Commission deny the Company the authority to implement the rider. Among the recommendations made by Mr. Smith concerning the Big Sandy Retirement Rider was his contention that estimated Big Sandy retirement costs be excluded from the ongoing calculation of its revenue requirement. As I discuss below, the Settlement Agreement does just that.

Q. PLEASE EXPLAIN THE COMPANY'S PROPOSAL FOR THE OPERATION OF THE BIG SANDY RETIREMENT RIDER AS SET FORTH IN ITS APPLICATION.

A. As filed by the Company, Tariff B.S.S.R. included both actual and estimated Big Sandy retirement costs. Using these costs, a levelized annual revenue requirement was calculated to recover the costs, plus a carrying charge computed using the Company's WACC and the balance of these costs, over a 25-year basis. The Company also proposed adjusting the remaining Big Sandy Retirement Rider revenue requirement at each subsequent base rate case to reflect: (a) the difference between actual costs incurred and those costs estimated at the prior base rate case filing (b) the Company's revised estimates for future retirement costs; and (c) any over/under recovery through Tariff B.S.S.R. during the period the then current base rates were effective. An annual Big Sandy Retirement Revenue Rider rate would then be recalculated to provide for the recovery of the revised remaining Big Sandy Retirement Rider revenue requirement, and a WACC-based carrying charge, over the remaining portion of the 25-year period.

Q. WHAT CHANGES WERE MADE THROUGH THE SETTLEMENT AGREEMENT TO THE BIG SANDY RETIREMENT RIDER?

A. The Settlement Agreement provides for several changes to Tariff B.S.R.R. as filed by the Company. These changes are reflected in the calculations supporting EXHIBIT 5 to the Settlement Agreement. In particular, no estimated Big Sandy retirement costs are included in the unamortized Big Sandy Retirement Rider regulatory asset, or in the calculation of the tariff's revenue requirement. The exclusion of estimated costs from the calculation of the Big Sandy Retirement Rider regulatory asset led the parties to a corresponding agreement concerning the manner in which post June 30, 2015 actual Big Sandy retirement costs will be recovered.

Q. PLEASE EXPLAIN THAT AGREEMENT.

A. Actual Big Sandy retirement-related costs incurred subsequent to June 30, 2015 (the proposed effective date of the new rates to be established through the Settlement Agreement), will be deferred *as they are incurred* and added to the unamortized balance of the Big Sandy Retirement Rider regulatory asset. In accordance with paragraph 14 of the Mitchell Stipulation, the pre-tax WACC carrying charge will be calculated net of the related Big Sandy Retirement Rider Accumulated Deferred Income Taxes and applied to the unamortized Big Sandy Retirement Rider regulatory asset. The monthly Tariff B.S.R.R. revenues will be applied first to that current month's pre-tax WACC carrying charge on the unamortized balance of the Big Sandy Retirement Rider regulatory asset. The unamortized balance of the Big Sandy Retirement Rider regulatory asset, including both the initial Big Sandy Retirement Rider costs and the post June 30, 2015 actual costs subsequently deferred, will be amortized to the extent the current month's Tariff B.S.R.R. revenues exceed the current month's pre-tax WACC carrying charge.

Q. **AS ORIGINALLY PROPOSED BY KENTUCKY POWER, THE TARIFF B.S.R.R. REVENUE REQUIREMENT WAS TO BE ADJUSTED ONLY AT THE TIME OF EACH BASE RATE CASE FILED BY KENTUCKY POWER. WILL THAT CONTINUE UNDER THE SETTLEMENT AGREEMENT?**

A. No. The rates will be adjusted annually, although the initial rate will be in effect for approximately 15 months. To permit Commission review of the actual Big Sandy Retirement Rider costs added to the unamortized balance of the Big Sandy Retirement Rider regulatory asset, and to provide for an annual adjustment of the Tariff B.S.R.R. charges, the Company will annually file, beginning on or before August 15, 2016, and each August 15^{th} thereafter, a report detailing the amount of the actual Big Sandy retirement costs, including the pre-tax WACC, incurred between July 1 of the prior year and June 30 of the reporting year. The Company also will file supporting documentation. In addition, the annual report will detail the June 30 current year unamortized balance of the Big Sandy Retirement Rider regulatory asset, and the adjusted Tariff B.S.R.R. rates.

Q. **WHEN WILL EACH YEAR'S ADJUSTED TARIFF B.S.R.R. RATE BECOME EFFECTIVE?**

A. The Settlement Agreement provides that the adjusted Tariff B.S.R.R. rates will become effective cycle 1 of the October billing month of the year in which the annual filing is made, subject to any adjustments made by the Commission.

Q. WILL THE BIG SANDY RETIREMENT COSTS CONTINUE TO BE AMORTIZED OVER THE PERIOD ENDING 2040?

A. Yes. Paragraph 14 of the Mitchell Stipulation provided that Big Sandy retirement costs were to be amortized over a 25-year period. The 25-year period was selected to align the amortization period with the projected remaining life of the Mitchell generating station. Thus, consistent with Mitchell Stipulation, the annually-adjusted Tariff B.S.R.R. rates will be re-calculated annually to amortize the Big Sandy Retirement Rider regulatory asset over the remaining portion of the 25-year projected life of the Mitchell generating station. For example, while the initial Tariff B.S.R.R. rates (to become effective June 30, 2015) were calculated to amortize the Big Sandy Retirement Rider regulatory asset over 25 years, the adjusted rates to become effective cycle 1 of the *October 2016* billing month will be calculated using a 24-year amortization period. The amortization period for each subsequent annual adjustment will be reduced accordingly. Thus, except for the final tariff rate discussed below, if required, the retirement costs will be amortized over 25 years.

Q. DOES THE SETTLEMENT AGREEMENT PROVIDE FOR A FINAL TARIFF B.S.R.R. RATE FOLLOWING THE CONCLUSION OF THE INITIAL 25-YEAR RECOVERY PERIOD?

A. Yes. If following the end of the initial 25-year collection period there is a remaining unamortized balance of the Big Sandy Retirement Rider regulatory asset, or if all actual retirement costs incurred in the final (25th) year of the collection period have not been recovered, or if otherwise required to true-up any over or under-recovery, a final rate will be established. The final rate will be effective for one year. This final rate is consistent with the proposal made by the Company with respect with Tariff A.T.R., and simply ensures that the full amount awarded – but no more nor no less – is recovered.

Q. YOU INDICATED EARLIER THAT THE INITIAL TARIFF B.S.R.R. ANNUAL REVENUE REQUIREMENT WAS REDUCED BY $5.2 MILLION UNDER THE SETTLEMENT AGREEMENT. WAS THAT THE RESULT OF CHANGES MADE TO THE TARIFF?

A. In part. The exclusion of all estimated Big Sandy retirement costs from the calculation of the initial Big Sandy Retirement Rider revenue requirement as a result of agreed modifications to the rider reduced the annual revenues initially to be produced by the rider. In addition, the agreed reduction from 10.62% to 10.25% of the Company's return on equity used in computing the retirement rider WACC further reduced the initial Tariff B.S.R.R. revenue requirement. Finally, the WACC was further reduced by the Company's acceptance, in connection with the Settlement Agreement, of the recommendation by witnesses for the Attorney General and KIUC to use no negative short term debt in computing the Company's initial capitalization and resulting WACC.

G. <u>Big Sandy 1 Operation Rider – Tariff B.S.1.O.R.</u>

Q. WHAT IS THE BIG SANDY ONE OPERATION RIDER?

A. The Big Sandy 1 Operation Rider is designed to recover the costs associated with the operation of Big Sandy Unit One. The rider is an interim measure for use during the period between the date when the rates to be established in this case become effective, and the effective date of the rates to be established in the Company's next base rate case. The Company proposed the rider to permit the Company to demonstrate in a transparent fashion the removal of all Big Sandy coal-related costs from base rates. It also avoids the necessity of filing a base rate case following the conversion of Big Sandy Unit 1 from a coal-fired to a natural gas-fired generating unit. Tariff BS1OR permits the Company to recover the cost, but no more or no less, of the operation of Big Sandy Unit 1 during the period including its fundamental transformation from a coal-fired to a gas-fired unit. The Company anticipates that with the Big Sandy 1 Operation Rider it can postpone filing its next base rate until sometime after the proposed 2016 in-service date for the converted Big Sandy Unit 1.

H. Modification Of The Company's Distribution Vegetation Management Program.

Q. DID THE SIGNATORY PARTIES REACH AN AGREEMENT CONCERNING MODIFICATION OF THE COMPANY'S DISTRIBUTION VEGETATION MANAGEMENT PROGRAM?

A. Yes. Mr. Phillips' testimony identified five scenarios by which the Company's existing Distribution Vegetation Management Program could be modified to place Kentucky Power on a four-year vegetation management maintenance cycle. In that same testimony, the Company recommended that its Distribution Vegetation Management Program be modified consistent with Scenario 2 of Mr. Phillips' direct testimony.

Q. PLEASE EXPLAIN SCENARIO 2 AS PROPOSED BY KENTUCKY POWER.

A. Under Scenario 2, Kentucky Power would continue with the initial clearing of the Company's distribution rights-of-way through a projected end of 2018 completion date. In addition, beginning in 2015 Kentucky Power would begin an interim four year re-clearing of those circuits that were initially cleared beginning July 2010 (the starting date of the existing program). This interim re-clearing would continue for four years, at which point the entire distribution system would be on a four-year maintenance cycle.

Q. DOES THE SETTLEMENT AGREEMENT PROVIDE FOR THE IMPLEMENTATION OF SCENARIO 2 AS RECOMMENDED BY THE COMPANY?

A. Yes, in large part. In Staff Data Request 3-7 the Company was asked by Staff to examine a modest modification of Scenario 2; the Settlement Agreement adopts the modified Scenario 2 (labeled Scenario 5) indicated by the Staff data request. Under Scenario 5, the initial clearing, and the four-year interim re-clearing are to be performed on the same schedule, and at the same cost, as under Scenario 2. Beginning in 2019, Scenario 5 provides for a 5-year maintenance cycle instead of the four-year cycle shown in Scenario 2. The lengthening of the maintenance cycle from four years to five years yields significant cost savings for the customers.

Q. THE SCENARIO 5 TABLES PROVIDED IN THE COMPANY'S RESPONSE TO KPSC 3-7 DIFFER SOMEWHAT FROM THE SAME TABLES INCLUDED AS EXHIBITS 9 AND 10 TO THE SETTLEMENT AGREEMENT. PLEASE EXPLAIN THE REASON FOR THE DIFFERENCE.

A. For clarity and ease of illustration, the Company's initial four scenarios, along with its response KPSC 3-7, assumed that the first twelve months of work under the modified Distribution Vegetation Management Plan would be performed in calendar year 2015. To align the increased work with the increased revenues required to fund it, which is anticipated to be received beginning July 2015, the Settlement Agreement shifts the interim re-clearing work six months into the future. Thus, only 371 miles of interim re-clearing will be performed in calendar year 2015 instead of the 741 miles shown on the Company's response to KPSC 3-7. In addition, the final 370 miles of interim re-clearing will be performed in 2019 instead of being completed in 2018 as shown on the Company's response to KPSC 3-7. The six-month shift under the Settlement Agreement affects only the interim re-clearing work. Under the Settlement Agreement, as under Scenario 5, the initial five year maintenance cycle will begin in 2019 and be completed in 2023.

Q. HOW DO THE ESTIMATED O&M EXPENSES UNDER THE MODIFIED SCENARIO 5 AGREED TO IN THE SETTLEMENT AGREEMENT COMPARE TO THE ESTIMATED O&M EXPENSES SHOWN FOR SCENARIO 5 IN THE COMPANY'S RESPONSE TO KPSC 3-7?

A. Although there are differences on a yearly basis, the cumulative projected expenses through 2023 for both versions of Scenario 5 total $268,000,223. As such, the proposal contained in the Settlement Agreement provides for the lowest cumulative expense among the scenarios examined.

Q. DOES THE SETTLEMENT AGREEMENT CONTAIN ADDITIONAL PROVISIONS CONCERNING THE IMPLEMENTATION OF THE COMPANY'S ENHANCED VEGETATION MANAGEMENT PROGRAM?

A. Yes. First, it continues the reporting requirements currently in place, although the agreement expands the persons upon whom the reports are to be served. The Settlement Agreement also provides for a base rate reduction beginning in July 2019 to reflect the reduced expenditures agreed to in EXHIBIT 9 to the Settlement Agreement. Finally, the agreement contains a provision aligning on a cumulative basis the Distribution Vegetation Management Program O&M expenditures with the amounts agreed to in EXHIBIT 9 to the Settlement Agreement.

Q. PLEASE EXPLAIN THE BASIS FOR THE BASE RATE REDUCTION IN JULY 2019.

A. If the Settlement Agreement is approved, increased Distribution Vegetation Management funding is required for 48 months (through July 2019) to underwrite the expense of the new interim re-clearing cycle, while simultaneously funding for 42 months the completion of the initial right-of-way clearing cycle. Thus, Distribution Vegetation Management Program O&M expenses are projected to increase from the 2014 total of $17,237,965 to $22, 327,777 in 2015 to fund six months of interim cycle re-clearing. The funding will increase to $27,664,598 in 2016 to reflect twelve months of funding for the interim re-clearing cycle. The initial distribution right of way re-clearing cycle is projected to be completed at the end of 2018. The projected funding shown on EXHIBIT 9 of the Settlement Agreement thus declines to $21,534,740 in 2019. With the completion of the interim re-clearing cycle in mid-2019, the required O&M expenditures will be limited to the five-year maintenance clearing cycle. That further reduces the annual amount to $16,039,443 in 2020.

Q. HOW DOES THE SETTLEMENT AGREEMENT REFLECT THESE REDUCED FUNDING REQUIREMENTS?

A. In paragraph 8(f) of the agreement, Kentucky Power agrees to file tariffs reducing base rates by $11,780,408 effective July 1, 2019. The reduction will be allocated among the rate classes with primary and secondary service offerings in the same fashion the increased funding was allocated beginning June 30, 2015. That allocation is shown on page 1 of <u>EXHIBIT 9</u> of the Settlement Agreement. In addition, the Company's tariffs will include the language shown on page 2 of <u>EXHIBIT 9</u> of the Settlement Agreement specifying the $11,780,408 reduction.

Q. HOW WAS THE $11,780,408 REDUCTION IN ANNUAL BASE RATES CALCULATED?

A. The $11,780,408 reduction is the difference between the $27,661,060 built into base rates and the $15,880,652 average on-going annual spending after the interim clearing cycle is completed. Because the on-going annual spending is projected to decrease slightly as the Company continues the five-year maintenance cycle, the use of an average benefits customers (principally residential customers) by "front-loading" the annual decrease.

Q. YOU INDICATED EARLIER THAT THE SETTLEMENT AGREEMENT CONTAINS A PROPOSAL TO ALIGN DISTRIBUTION VEGETATION MANAGEMENT SPENDING WITH THE PROJECTIONS SHOWN IN EXHIBIT 9. PLEASE EXPLAIN HOW THAT WILL FUNCTION IF THE AGREEMENT IS APPROVED.

A. The signatory parties agreed to a "one-way" balancing account. Beginning July 1, 2015, to the extent Distribution Vegetation Management Program spending *on a cumulative basis* is less than the cumulative amount shown on <u>EXHIBIT 9</u> through June 30, 2019 ($110,640,240), a regulatory liability will be created and recorded on Kentucky Power's books in the amount of any shortfall until the Commission sets base rates in the Company's next base rate case. At that time, the amount of the shortfall, if any, will either be refunded to customers or used to reduce the Company's revenue requirement in that case.

Q. WILL THE COMPANY BE ABLE TO RECOVER THE AMOUNTS, IF ANY, IT MAY OVERSPEND THROUGH JUNE 30, 2019 AS COMPARED TO THE AMOUNTS ON EXHIBIT 9?

A. No. The Company expressly agrees in the Settlement Agreement not to seek recovery of any cumulative overspending in a future rate proceeding.

Q. DOES PARAGRAPH 8 OF THE SETTLEMENT AGREEMENT PERMIT KENTUCKY POWER TO CONTINUE AND EXPAND UPON THE PROGRESS IN ITS DISTRIBUTION SYSTEM RELIABILITY EFFORTS MADE SINCE JULY 2010?

A. Yes. Mr. Phillips has addressed this issue in more detail in his direct testimony. But it is my belief that the additional funding, and the provision for the interim clearing cycle, should permit the Company to continue its progress in improving distribution reliability and to migrate to a five-year maintenance cycle in 2019.

Q. DID THE ATTORNEY GENERAL OPPOSE THE COMPANY'S PROPOSAL TO MODIFY ITS DISTRIBUTION VEGETATION MANAGEMENT PROGRAM?

A. The Attorney General has not indicated whether he supports Scenario 5. Mr. Smith testified that the Attorney General accepted the Company's proposal to modify its Vegetation Management Plan in accordance with Scenario 2. Further, Mr. Smith indicated the Attorney General was not proposing an adjustment of the amounts requested for Scenario 2. Scenario 5 implements Scenario 2, except that the maintenance cycle is extended (resulting in an overall lower cost) to five years, and the spending and work is shifted six months to align expenditures with the receipt of the increased revenues. Finally, the Settlement Agreement provides for a one-way balancing account that seems to track Mr. Smith's recommendation.

I. Depreciation And Amortization Of Deferred Costs.

Q. WILL KENTUCKY POWER'S DEPRECIATION RATES CHANGE IF THE SETTLEMENT AGREEMENT IS APPROVED?

A. Yes. Kentucky Power's depreciation rates have not been modified since 1991. Under the terms of the Settlement Agreement, new depreciation rates (as shown on EXHIBIT 11) will be implemented for generation, transmission and general plant. The Company will continue to include in the calculation of its annual depreciation expense the current depreciation rates for the Company's distribution property.

Q. DOES THE SETTLEMENT AGREEMENT ADDRESS THE AMORTIZATION OF ANY DEFERRED COSTS?

A. Yes. It provides that the $12,146,000 in 2012 storm costs the Commission approved for deferral in Case No. 2012-00445 will be amortized over a five-year period at an annual amount of $2,429,200. The Company also agreed to modify its proposal for the amortization of the $4,657,731 jurisdictional balance of Accumulated Deferred State Income Tax related to the acquisition of the Company's 50% undivided interest in the Mitchell generating station. That balance will be amortized over three years as recommended by Mr. Kollen instead of the 25 years proposed by the Company.

J. Economic Development Surcharge.

Q. HOW DOES THE SETTLEMENT AGREEMENT ADDRESS THE $0.15 PER METER PER MONTH ECONOMIC DEVELOPMENT SURCHARGE PROPOSED BY THE COMPANY?

A. The Settlement Agreement provides for the implementation of the surcharge. Kentucky Power recognizes the need to assist the communities in its service territory with their economic development efforts. It currently is annually contributing pursuant to the Mitchell Stipulation $200,000 of shareholder funds to economic development efforts in Lawrence and contiguous counties in its service territory. Recognizing the need to do more throughout its service territory, Kentucky Power proposed to increase the annual amount of shareholder contributions by matching on a dollar-for-dollar basis the proceeds of the economic development surcharge. This anticipated $300,000 of additional shareholder contributions, when combined with a like amount provided by the surcharge, will provide a real economic development benefit to the Company's service territory.

Q. WHAT REPORTING WILL THE COMPANY PROVIDE CONCERNING THE ECONOMIC DEVELOPMENT SURCHARGE?

A. Paragraph 10 of the Settlement Agreement provides for Kentucky Power to make annual reports detailing the amounts generated through the surcharge and Company shareholder contributions. The reports also will identify the recipients and purpose of the awards. Copies of these annual reports will be served on all parties to this proceeding.

K. <u>No Load Costs</u>.

Q. THERE CURRENTLY ARE THREE APPEALS PENDING IN FRANKLIN CIRCUIT COURT FROM THE COMMISSION'S JANUARY 22, 2015 ORDER IN CASE NO. 2014-00225. THAT CASE IN PART EXAMINED THE MANNER IN WHICH KENTUCKY POWER ALLOCATED FUEL COSTS, INCLUDING NO-LOAD COSTS, BETWEEN NATIVE LOAD CUSTOMERS AND OFF-SYSTEM SALES. DOES THE SETTLEMENT AGREEMENT ADDRESS THOSE APPEALS AND THE COMPANY'S ALLOCATION METHODOLOGY GOING FORWARD?

A. Yes. Kentucky Power wishes to put the issues that are the subject of the appeals behind it. In addition, the Company proposes to resolve issues concerning its fuel-cost allocation methodology going forward. The Settlement Agreement thus provides that upon the entry of a final and nonappealable order affirming the Settlement Agreement without modification, Kentucky Power and KIUC will dismiss with prejudice their respective appeals (including KIUC's counterclaim) of the January 22, 2015 Order.

Q. WHAT PROVISION DOES THE SETTLEMENT AGREEMENT MAKE WITH RESPECT TO THE DETERMINATION MADE BY THE COMMISSION IN ITS JANUARY 22, 2015 ORDER CONCERNING KENTUCKY POWER'S SHARE OF MITCHELL NO LOAD COSTS AND THE CORRESPONDING REFUNDS?

A. Although I am informed that dismissal of the appeals alone would have the same effect, Kentucky Power expressly agreed in paragraph 11(c) of the Settlement Agreement that it will not recover any Mitchell no load costs incurred during the Overlap Period described in the January 22, 2015 Order, and that it will make the refunds, to the extent not already refunded, identified by that order. In essence, the agreement embodies the terms of the January 22, 2015 Order with respect to Mitchell no load costs during the Overlap Period.

Q. WHAT IS THE TOTAL AMOUNT OF MITCHELL NO LOAD COSTS THE COMPANY HAS REFUNDED OR FOREGONE THE COLLECTION OF IN ACCORDANCE WITH THE COMMISSION'S JANUARY 22, 2015 ORDER?

A. Through April, 2015, Kentucky Power has refunded $9,929,169 pursuant to the Commission's January 22, 2015 Order in Case No. 2014-00225. Further, Kentucky Power has not collected Mitchell no load costs incurred after October 31, 2014. As a result, and consistent with the Commission's order, the Company has foregone the collection of an estimated $12,606,160 in Mitchell no load costs through the March 2015 expense month.

Q. IN CASE NO. 2014-00450 THE COMMISSION CURRENTLY IS EXAMINING THE OPERATION OF THE COMPANY'S FUEL ADJUSTMENT CLAUSE FOR THE PERIOD NOVEMBER 1, 2012 THROUGH OCTOBER 31, 2014. THAT INCLUDES THE PERIOD OF REVIEW BEFORE THE COMMISSION IN CASE NO. 2014-00225, AS WELL AS A LARGER PORTION OF THE OVERLAP PERIOD. WHAT PROVISION DOES THE SETTLEMENT AGREEMENT MAKE CONCERNING THE NO-LOAD COSTS AT ISSUE IN CASE NO. 2014-00450?

A. The Settlement Agreement recognizes that KIUC and Kentucky Power, and Kentucky Power and the Attorney General through the separate side agreement, have resolved, consistent with the Commission's January 22, 2015 Order, all issues relating to the Company's recovery through its fuel adjustment clause of Mitchell no load cost issues for the review period (ending October 31, 2014) before the Commission in Case No. 2014-00450. Kentucky Power agrees it will not recover Mitchell no load cost for that portion of the Overlap Period under review in Case No. 2014-00450, and further that it will refund Mitchell no load costs, to the extent not already refunded, identified by the Commission's January 22, 2015 Order.

Q. DOES CASE NO. 2014-00450 REVIEW PERIOD INCLUDE THE ENTIRE OVERLAP PERIOD?

A. No. It includes only the first ten months of the Overlap Period (January 1, 2014 through October 31, 2014). The remaining seven months of the Overlap Period will be the subject of future fuel adjustment clause cases. The Company and KIUC have agreed that the resolution of the issues in the appeals from the Commission's January 22, 2015 Order resolves the treatment of Mitchell no load costs during the entirety of the Overlap Period, including future Commission review cases, in a manner consistent with their resolution, by means of this settlement agreement. A similar agreement was reached through the side agreement with the Attorney General.

Q. ALTHOUGH DISALLOWING RECOVERY OF MITCHELL NO LOAD COSTS FOR THE ENTIRETY OF THE OVERLAP PERIOD, THE COMMISSION'S JANUARY 22, 2015 ORDER DIRECTS THE COMPANY TO MAKE REFUNDS ONLY FOR THE FIRST FOUR MONTHS OF THE SEVENTEEN MONTH OVERLAP PERIOD. HOW WILL THE REMAINING REFUNDS REQUIRED BY THE SETTLEMENT AGREEMENT BE MADE?

A. The Company recognizes its obligation, once authorized by the Commission to do so, to continue to refund those Mitchell Overlap Period no load costs that have not been refunded, and that were collected prior to the Commission's January 22, 2015 Order, until all Mitchell Overlap Period no load costs have been refunded. The Company recommends that the Commission in its Order approving this Settlement Agreement direct Kentucky Power to initiate those refunds beginning with its first FAC filing made subsequent to the Commission Order approving this Settlement Agreement without modification becoming final and nonappealable. The six month refund period equals the period over which the Mitchell no load costs were collected.

Q. IS AN AGREEMENT REACHED IN THE SETTLEMENT AGREEMENT AS TO THE TREATMENT OF KENTUCKY POWER'S NO LOAD COSTS FOLLOWING THE CONCLUSION OF THE OVERLAP PERIOD?

A. Yes. The Commission's January 22, 2015 Order in Case No. 2014-00225 concluded that the Company's fuel cost allocation methodology was unreasonable in light of the Company's reserve margin during the Overlap Period:

> During the 17-month Overlap Period, Kentucky Power will be operating with an unusually large reserve margin, estimated at 57 percent for 2014. Given that most utilities operate with much smaller reserve margins, Kentucky Power's operations during the temporary Overlap Period cannot be considered "usual" or "normal."…. the Commission finds that during the Overlap Period, when its reserve margin is unusually large and operating conditions are not "normal," Kentucky Power's fuel allocation methodology is unreasonable….[2]

Following the retirement of 800 MW of Big Sandy Unit 2 capacity at the end of the Overlap Period (June 2015), the condition that led the Commission to conclude that the Company's operations during the Overlap Period were not usual or normal, will no longer exist. Thus, consistent with the Company's efforts to put the no load cost issue behind it following the end of the Overlap Period, the Signatory Parties have agreed to a

[2] Order, *In the Matter of: An Examination Of The Fuel Adjustment Clause Of Kentucky Power Company Form November 1, 2013 Through April 30, 2014*, Case No. 2014-00225 at 7-8 (Ky. P.S.C. Jan. 22, 2015).

fuel allocation methodology going forward. The methodology, which is described in detail in paragraph 11(e) of the Settlement, embodies the methodology described by Dr. Pearce in Case No. 2014-00225, and represents, with minor modifications made with the termination of the AEP-East Pool Agreement and also described by Dr. Pearce in that case, the same methodology used by Kentucky Power for more than 20 years.

Q. DOES THE INCREASE OF THE CUSTOMER SHARE OF OFF-SYSTEM SALES MARGINS TO 75% UNDER THE SETTLEMENT AGREEMENT REDUCE THE IMPORTANCE OF THE SPECIFIC METHODOLOGY USED TO ALLOCATE FUEL COSTS BETWEEN NATIVE LOAD CUSTOMERS AND OFF-SYSTEM SALES?

A. Although, the Company believes the agreed methodology for allocating fuel costs after the conclusion of the Overlap Period fairly and appropriately does so, simple mathematics suggests that as the native customer share of off-system sales margins increases, and hence the native load customer share of all fuel costs increases, the allocation methodology takes on less importance to native load customers.

Q. DID KENTUCKY POWER MAKE ANY COMMITMENTS IN THE SETTLEMENT AGREEMENT CONCERNING INCREASED EFFORTS TO KEEP THE COMMISSION APPRISED OF ANY CHANGES IN ITS FUEL COST ALLOCATION METHODOLOGY?

A. Paragraph 11(f) of the Settlement Agreement commits the Company to inform the Commission of prospective changes to the allocation of fuel costs to Kentucky retail customers prior to implementing the change.

Q. THE ATTORNEY GENERAL, WHO IS NOT A PARTY TO THE SETTLEMENT AGREEMENT, ALSO APPEALED THE COMMISSION'S JANUARY 22, 2015 ORDER IN CASE 2014-00225. HAS ANY AGREEMENT BEEN REACHED WITH THE ATTORNEY GENERAL REGARDING HIS APPEALS IN LIGHT OF THE AGREEMENT BETWEEN KIUC AND KENTUCKY POWER?

A. Yes. Kentucky Power and the Attorney General have entered into a separate agreement, embodying the relevant terms of paragraph 11 of the Settlement Agreement. As with the Settlement Agreement's treatment of the appeals, the agreement with the Attorney General is contingent upon the Commission's approval without modification of the Settlement Agreement, and the Commission order approving the settlement agreement without modification becoming final and nonappealable without modification on appeal or rehearing.

L. <u>Biomass Energy Rider (Tariff B.E.R.)</u>

Q. WHAT MODIFICATIONS TO TARIFF B.E.R. DOES THE SETTLEMENT AGREEMENT PROPOSE?

A. Tariff B.E.R. is the tariff approved the Commission in its October 10, 2013 Order in Case No. 2013-00144. The tariff provides for the full recovery by Kentucky Power pursuant to KRS 278.271 of all costs associated with the Company's biomass renewable energy purchase agreement with ecoPower Generation-Hazard LLC beginning when that facility begins generating energy. In paragraph 12 of the Settlement Agreement, the Signatory Parties agree to revise the tariff to modify the manner in which total charges to be recovered through the tariff are calculated and allocated among rate classifications. As originally approved by the Commission, total charges are to be recovered through a single per kWh Biomass Adjustment Factor for all tariff classes. As amended, the total charges will include both an energy charge and a demand charge. The total energy charge will be based upon the annual average PJM AEP Zone Locational Marginal Price. The demand charge will be the difference between the total charges and the energy charge.

Q. UNDER THE EXISTING TARIFF A SINGLE RATE IS CALCULATED FOR ALL CUSTOMER CLASSES. DOES THE PROPOSED AMENDED TARIFF B.E.R. CONTINUE THAT PRACTICE?

A. No. The rates are calculated differently for residential and non-residential customers. For residential customers, both energy and demand will be calculated using residential energy use at the customers' meters. For non-residential customers the demand charge and energy charge are calculated separately. The residual demand charge for non-residential customers will be calculated by subtracting the total residential demand cost from the total demand cost, as calculated in the fashion I describe above, and then allocated to non-residential customers based on a percentage of non-fuel revenues. Non-residential energy charges first are calculated by subtracting the energy charge for residential customers from the total energy charge and then allocating the difference based on non-residential energy. This new methodology approximates closely the method currently used to calculate the environmental surcharge.

Q. DOES THE MODIFICATION ADVERSELY AFFECT RESIDENTIAL CUSTOMERS?

A. To the contrary, the revised tariff holds residential customers "harmless" as a result of the change in the manner in which the Tariff B.E.R. charges are calculated. As evidenced by

<u>SETTLEMENT EXHIBIT RKW-2</u>, a residential customer will pay the same under both the existing and amended tariff.

Q. **THE COMMISSION'S OCTOBER 10, 2013 ORDER IN CASE NO. 2013-00144 CURRENTLY IS BEING APPEALED BY KIUC TO THE KENTUCKY COURT OF APPEALS. DOES THE SETTLEMENT AGREEMENT, OR THE REVISED TARIFF B.E.R., IN ANY WAY AFFECT THE COMMISSION'S ORDER OR THAT APPEAL?**

A. No. Paragraph 12(b) expressly provides that the Settlement Agreement in no way affects the Commission's October 10, 2014 Order (other than the modification of the tariff) or the appeal.

M. <u>Cost Deferral Mechanisms</u>.

1. PJM Costs.

Q. **THE COMPANY'S APPLICATION REQUESTED A PJM TRACKER WHEREBY THE COMPANY WOULD RECOVER OR REFUND PJM COSTS ABOVE OR BELOW THE AMOUNT BUILT INTO BASE RATES. DOES THE SETTLEMENT AGREEMENT PROVIDE FOR COMMISSION APPROVAL OF THE PROPOSED TRACKER?**

A. No. In lieu of the PJM tracker, the Signatory Parties agreed to a deferral mechanism whereby Kentucky Power would be authorized under certain circumstances to create a regulatory asset to defer for Commission review and approval those PJM charges and credits identified by Company Witness Vaughan at page 15 of his direct testimony in this case.

Q. UNDER WHAT CIRCUMSTANCES WOULD KENTUCKY POWER BE AUTHORIZED TO DEFER THE IDENTIFIED PJM CHARGES AND CREDITS FOR SUBSEQUENT REVIEW AND APPROVAL FOR RECOVERY?

A. The Company would be authorized to defer the eligible PJM charges and credits only in those calendar years when the Company's return on equity, calculated as a thirteen month average on a per books basis, is less than 10%.

Q. WHAT AMOUNT OF IDENTIFIED PJM CREDITS AND CHARGES WILL BE ELIGIBLE FOR DEFERRAL?

A. There are two limitations. First, the Company is eligible to defer only those PJM costs incurred during the calendar year in excess of the $74,856,675 amount included in base rates. There will be no deferral if the PJM costs do not exceed the amount included in base rates. Second, the Company may defer only that amount of PJM costs in excess of the amount included in base rates required to increase the Company's return on equity for the calendar year to 10%. Any amounts that would increase the Company's return on equity to more than 10% cannot be deferred.

Q. WILL THE COMPANY BE ENTITLED TO A CARRYING CHARGE ON THE AMOUNT DEFERRED?

A. No. Paragraph 13(c) expressly prohibits doing so.

Q. WILL THE COMMISSION HAVE THE OPPORTUNITY TO REVIEW AND APPROVE THE AMOUNTS DEFERRED?

A. Yes. The Company will make annual informational filings, with service on all parties to this proceeding, quantifying and describing the amounts deferred. In addition, paragraph 13(b) recognizes that the Company's ability to recover and amortize the regulatory asset over five years as provided for by the agreement is expressly subject to Commission review and approval.

2. Incremental NERC Compliance and Cybersecurity Costs.

Q. BOTH THE COMPANY'S APPLICATION AND THE SETTLEMENT AGREEMENT ADDRESS NERC COMPLIANCE AND CYBERSECURITY COSTS. HOW DOES THE SETTLEMENT AGREEMENT PROPOSAL DIFFER FROM THE COMPANY'S APPLICATION?

A. As originally proposed by Kentucky Power, a placeholder tariff would be approved. The initial rate would be established at zero, and the Company would defer and track its *incremental* NERC compliance and cybersecurity costs arising from new requirements or new interpretations of existing requirements. At each base rate case, and subject to Commission review for prudency, a rate would be established through the rider tariff to recover these deferred costs.

Under the Settlement Agreement a tariff will not be established. Instead, the Company will track and defer for future recovery any post-June 30, 2015 incremental costs incurred by Kentucky Power in complying with new NERC compliance or cybersecurity requirements. These are the same incremental costs described by Mr. Wohnhas at pages 27 and 28 of his direct testimony, and include costs arising from both new requirements and new interpretations of existing requirements.

Q. DOES THE SETTLEMENT AGREEMENT ADDRESS THE MANNER IN WHICH THE DEFERRED COSTS WILL BE RECOVERED?

A. Yes. First, paragraph 14(b) expressly makes the Company's ability to recover and amortize the costs subject to Commission review and approval. Second, the agreement provides the approved costs will be amortized and recovered over five years beginning when the Commission sets new base rates in the Company's next base rate case.

Q. WHAT REPORTS WILL THE COMPANY FILE CONCERNING THESE COSTS?

A. Kentucky Power will make annual information filings with the Commission quantifying and describing the deferred costs. Copies of these filings will be served on counsel for all parties to this case.

N. <u>School-Related Provisions</u>.

Q. THE KSBA IS A SIGNATORY TO THE SETTLEMENT AGREEMENT. DO ANY OF THE SETTLEMENT AGREEMENT'S PROVISIONS ADDRESS THE ISSUES RAISED BY THE KSBA IN MR. WILLHITE'S TESTIMONY?

A. Paragraphs 15 and 16 of the agreement deal with the issues raised by KSBA. Under Paragraph 15 Kentucky Power agrees to seek Commission approval to expand its existing DSM-based School Energy Manager Program to the entirety of the Company's service territory. In paragraph 16, the parties agreed to a pilot rate for schools.

Q. PLEASE EXPLAIN THE EXPANSION OF THE DSM-BASED SCHOOL ENERGY MANAGER PROGRAM.

A. As part of the Mitchell Stipulation, Kentucky Power sought and received Commission approval to establish a DSM-based school energy manager program in conjunction with KSBA for Lawrence and its contiguous Kentucky counties. That program provides funding for two school energy managers in the identified counties. Through the Settlement Agreement, Kentucky Power agrees to seek similar Commission authority to fund through the DSM program, at an annual cost not to exceed $200,000 a year, up to an additional six school energy managers as part of the expansion of the school energy manager program to all of Kentucky Power's service territory. In addition, to the extent that some portion of the $200,000 is not required to fund the additional school energy managers, the funds may be used to fund school energy efficiency projects in the Company's service territory.

As part of this expansion of the program, the Company also agrees to make an annual informational filing concerning the expenditure of the funds. These annual reports will be served on counsel for all parties to the proceeding.

Q. PLEASE EXPLAIN TARIFF K-12 SCHOOL.

A. This is a pilot program whereby eligible schools may elect to take service under the new tariff. The new tariff provides rates designed to produce $500,000 less annually in the aggregate from the Tariff K-12 eligible customers than would be produced if those same customers took service under the Tariff L.G.S. proposed as part of this Settlement Agreement. Also, the agreement provides that the total annual revenues produced by both Tariff L.G.S. and Tariff K-12 under the new rates will equal the total revenues that would be produced if all customers taking service under the two tariffs were taking service under the new Tariff L.G.S.

Q. WHICH SCHOOLS ARE ELIGIBLE FOR TARIFF K-12?

A. The pilot tariff is limited to general service to those K-12 schools subject to KRS 160.325 with normal maximum demands greater than 100 kW.

Q. YOU INDICATE THIS IS A PILOT PROGRAM. WHEN WILL IT BE REVIEWED?

A. The program will be examined in the Company's next general base rate case. At that time, the operation of the tariff will be examined for continued operation or revision using the then-available load research.

O. New and Revised Industrial and Commercial Tariffs.

Q. PLEASE EXPLAIN THE SETTLEMENT AGREEMENT'S TREATMENT OF THE COMPANY'S PROPOSED TARIFF C.S.-I.R.P.

A. The Company's existing Tariff C.S.-I.R.P. was last modified in accordance with the Mitchell Stipulation to expand its availability to customers (subject to the limitations contained in the tariff) electing to take interruptible service. The Settlement Agreement merely recognizes that in the event PJM revises its criteria for what constitutes interruptible load for capacity purposes, the Company will amend the tariff to reflect the revised PJM criteria.

Q. WHAT IS THE COMPANY'S NEW TARIFF I.G.S.?

A. In paragraph 3 of the Mitchell Stipulation, Kentucky Power agreed to propose combining in this case, using the existing C.I.P.-T.O.D. rate design, the existing Q.P. and C.I.P.-T.O.D. rate classes. The Company's proposed Tariff I.G.S. fulfills that portion of the Mitchell Stipulation, and, consistent therewith, the Settlement Agreement provides for the adoption of the proposed tariff.

Q. IS THE MITCHELL STIPULATION THE ONLY REASON THE COMMISSION SHOULD APPROVE THE PROPOSED TARIFF I.G.S.?

A. Although the Company's proposal of the tariff was part of the bargained-for consideration for the Mitchell Stipulation, which was approved by the Commission, independent reasons exist for approval of the tariff. These are explained in more detail in Mr. Vaughan's rebuttal testimony, but essentially the new I.G.S. Tariff will provide all large commercial and industrial customers with demands of one MW or more with the same rates. The only difference among the customers' rates will be the voltage level at which they take service. It is my understanding from Mr. Vaughan's rebuttal testimony that this is consistent with cost-causation and rate design principles, and that the same sort of design may be found in other utilities' tariffs. Finally, I am informed that Wal-Mart, which initially objected to the proposal, has indicated it will file a statement stating it now supports the proposed tariff.

P. <u>Residential Customer Charge</u>.

Q. WHAT CHANGE DOES THE SETTLEMENT AGREEMENT PROPOSE WITH RESPECT TO THE COMPANY'S PROPOSED $16.00 PER MONTH RESIDENTIAL CUSTOMER CHARGE?

A. The agreement provides that the Residential Customer Charge will be increased from the current $8.00 per month to $14.00 per month. Although the new charge is less than the $16.00 monthly charge requested, it is a step towards the fixed cost of providing distribution service. There are several advantages to doing so. As Company Witness Vaughan explains, recovering fixed distribution costs through a fixed charge can help limit monthly volatility and reduce intra-class subsidy. It also may assist lower income customers, who can be higher energy users, and thus receive a disproportionate share of these fixed distribution costs when a larger portion of the costs are recovered through energy charges.

Q. Other Tariff Changes.

Q. DOES THE SETTLEMENT AGREEMENT PROVIDE FOR THE APPROVAL IN CONFORMITY WITH THE COMPANY'S APPLICATION OF MODIFICATIONS OF OTHER COMPANY TARIFFS?

A. Yes. Under the Settlement Agreement, the Signatory Parties have agreed to modify certain tariffs as proposed in the Application and described in more detail in the testimony of the Company's witnesses. The subject tariffs are listed in paragraphs 19 and 20 of the Settlement Agreement. Some of these changes are discussed above. Others (those listed in paragraph 20) are text and not rate changes. Some of the more significant tariff rate changes are:

(1) The existing Tariff A.T.R. will be amended to allow a temporary extension of its operation to permit recovery of the full amount of authorized revenue. This is consistent with the intent of the tariff.

(2) Tariff C.C. is being amended to implement a true-up mechanism to ensure that the annual amount – no more and no less – agreed to by the parties in Case No. 2001-00420 is recovered.

(3) Tariff P.P.A. is amended to permit the Company to recover through Tariff P.P.A. the full cost of purchased power unrelated to forced generation or transmission outages even if at a price in excess of the Peaking Unit Equivalent. The Company also expressly recognizes that the costs of purchases recovered under this revised tariff will be subject to periodic Commission review.

Each of these proposed modifications is reasonable. In fact, the first two simply implement earlier agreements approved by the Commission.

Reasonableness Of The Settlement Agreement And The Proposed Rates

Q. DID KENTUCKY POWER CALCULATE THE RELATIVE RATE IMPACT ON THE INDIVIDUAL TARIFF CLASSES AS A RESULT OF THE SETTLEMENT AGREEMENT?

A. Yes. Attached to the Settlement Agreement, and attached hereto as Exhibit 1 of **Settlement Exhibit RKW-1**, is the revenue allocation and relative rate impact on the various tariff classes resulting from the $45.4 million increase in base rates under Paragraph 1 of the Agreement.

Q. HAS THE COMPANY DESIGNED TARIFFS CONSISTENT WITH THE SETTLEMENT AGREEMENT?

A. Yes. Attached to this testimony collectively as **Settlement Exhibit RKW-3** are tariffs designed in accordance with the terms of the Settlement Agreement. These tariffs have been designed to produce $45.4 million of additional revenues above the level of revenues of $560,593,075 for the Test Year ending September 30, 2014. In addition, modifications to certain tariff terms have been included in the Settlement Agreement; those amended terms are included in the tariffs filed collectively as **Settlement Exhibit RKW-3**.

Q. HAS THE COMPANY PERFORMED AN ANALYSIS DEMONSTRATING THAT IF THE PROPOSED RATES HAD BEEN IN EFFECT DURING THE TEST YEAR ENDING SEPTEMBER 30, 2014 THE INCREMENTAL REVENUES WOULD HAVE BEEN THE AGREED UPON $45.4 MILLION?

A. Yes. Attached as **<u>SETTLEMENT EXHIBIT RKW-4</u>** is the proof of revenues. The Company used the September 30, 2014 billing determinants and applied the proposed rates and the incremental revenues generated that resulted in approximately a $45.4 million increase.

Q. DOES THE SETTLEMENT AGREEMENT FAIRLY BALANCE THE INTERESTS OF THE COMPANY AND ITS CUSTOMERS?

A. Yes. The Settlement Agreement represents a fair and proper balance between Kentucky Power's right to a fair return on its investment, and the requirement that customers be charged fair, just and reasonable rates.

Q. WHAT IS THE BASIS FOR THAT CONCLUSION?

A. As I mentioned earlier, Kentucky Power's last general rate increase was effective June 29, 2010. Since that time, the Company has earned a substandard return on equity for four of the five years ended 2010 through 2014 of 8.12%, 9.28%, 10.85%, 2.63%, and 5.13%, respectively. Through the filing in this case, the Company sought to address this situation, and to implement other initiatives, including securing additional funding to improve its distribution system reliability, by seeking an annual increase of approximately $70 million. The settlement amount of $45.4 million represents approximately 65% of the request. It was reached by meaningful, thoughtful and thorough negotiation by the Signatory Parties, and provides Kentucky Power with the opportunity to earn a fair and reasonable return on its investment.

Q. IS THAT THE ONLY CONSIDERATION?

A. No. The Settlement Agreement also provides for:

- The contingent resolution of the appeals by Kentucky Power and KIUC of the Commission's January 22, 2015 Order in Case No. 2014-00225, along with an agreement on the Company's fuel cost allocation methodology after the conclusion of the Overlap Period. In addition, the Company commits to inform the Commission of prospective changes in its fuel allocation methodology prior to implementing the changes.

- A base rate reduction of $23 million compared to the Company's proposed $4.696 million base rate reduction.

- A $45.4 million overall rate increase (8.10%) compared to the Company's proposed approximate $70 million dollar (12.48%) overall increase.

- Limiting rate increases for all tariff classes to single digit percentages.

- Modest progress toward the gradual reduction of rate class subsidization. Even with the reduction of the subsidy for residential customers, the ROR of Tariff R.S. is less than two-thirds of total settlement ROR.

- The commitment by Kentucky Power to spend an additional $10.4 million annually for distribution vegetation management O&M beginning July 1, 2015 until the completion of the initial right-of-way clearing cycle. This brings the Company's total annual distribution vegetation management O&M expenses to $27,664,598 in the first full calendar year (2016) of the increased spending.

- A balancing of the need for increased funding for reliability initiatives with the need to minimize the impact on the ratepayers by extending the maintenance clearing cycle from four years, as proposed by the Company in Scenario 2, to five years as suggested by the response to KPSC 3-7. Through 2023, this results in almost $20 million in cumulative savings over the estimated cost of Scenario 2.

- A tariff provision that reduces annual rates $11,780,408 beginning July 1, 2019 without the need for a rate case. The reduction reflects reduced distribution vegetation management spending upon completion of the four-year interim re-clearing cycle.

- A one-way balancing account whereby customers will receive any distribution vegetation management amounts underspent on a cumulative basis, as compared to the amounts shown on Exhibit 9 to the Settlement Agreement, during the four year period July 1, 2015 through June 30, 2019. The Company is prohibited from seeking recovery of any amounts overspent, on a cumulative basis, during the same period.

- An additional investment of approximately $300,000 annually by Kentucky Power's shareholder in economic development efforts in the Company's service territory. The Company will match on a dollar-for-dollar basis the amounts generated by a $0.15 per meter per month economic development surcharge.

- The first change in generation, transmission, and general plant depreciation rates since 1991. The adjustment of these rates more closely aligns the expense with the rates paid by the customers receiving the benefit of the depreciable property.

- The commitment by Kentucky Power to seek Commission approval to expand its School Energy Manager DSM program to the Company's entire service territory.

- A new pilot rate class for K-12 public schools in the Company's service territory.

- Innovative deferral mechanisms to address possible volatile changes in the Company's PJM and new NERC compliance and cybersecurity expenses.

- A balancing of the continued gradual reduction of the subsidy received by residential customers with an effort to limit the increase to be experienced by those rate payers.

- A new Tariff I.G.S., to attract and retain large industrial and commercial customers.

In short, as a result of significant give and take between Kentucky Power and the Settling Intervenors during the settlement negotiations, the Settlement Agreement provides for a pragmatic, reasonable, and fair balancing of the interests of all parties to this proceeding.

Q. DOES THE SETTLEMENT AGREEMENT PROVIDE FOR FAIR, JUST AND REASONABLE RATES?

A. Yes. Rates and tariffs should be designed to reflect and capture the opportunity to earn revenues that will produce a fair return on equity for the Company, without posing an unfair or unreasonable burden on the ratepayers. The terms of the Settlement Agreement accomplish these objectives. In particular, the revenue allocations, tariffs and charges, while not those originally proposed by the Company, reflect a fair and proper balancing of the interests of the affected customer classes.

Q. **DO YOU HAVE A RECOMMENDATION FOR THE COMMISSION?**

A. Yes. The Settlement Agreement should be approved by the Commission. In addition, the Commission should establish rates and charges in conformity with the agreement.

Q. **DOES THIS CONCLUDE YOUR TESTIMONY?**

A. Yes.

VERIFICATION

The undersigned, Ranie K. Wohnhas being duly sworn, deposes and says he is the Managing Director Regulatory and Finance for Kentucky Power Company, that he has personal knowledge of the matters set forth in the forgoing testimony and the information contained therein is true and correct to the best of his information, knowledge, and belief.

Ranie K. Wohnhas

Ranie K. Wohnhas

COMMONWEALTH OF KENTUCKY)
) Case No. 2014-00396
COUNTY OF FRANKLIN)

Subscribed and sworn to before me, a Notary Public in and before said County and State, by Ranie K. Wohnhas, this the 30th day of April 2015.

Judy K Rosquist 481393

Notary Public

My Commission Expires: January 23, 2017