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 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

POST-HEARING BRIEF OF KENTUCKY POWER COMPANY

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Introduction

Since its base rates were last modified approximately five years ago in Case No. 2009-00459,[1] Kentucky Power Company has experienced a once-in-a-lifetime transformation of its generation fleet, embarked on an extensive distribution vegetation management program to improve customer reliability, and has seen, despite its focused efforts to manage expenses, increasing expenses necessary to provide safe and reliable service to its customers increase, . These increased costs, along with the increased capitalization resulting from the generation fleet changes, reduced Kentucky Power's rates being below levels that are fair, just, and reasonable.[2] Thus, for the test year ended September 30, 2014, Kentucky Power's return on equity was only 8.43%[3] compared to the Commission-approved level of 10.5%. The Company's return on equity has not improved since the test year ended. For the 12 months ended March 2015, Kentucky Power's return on equity fell to 2.4%, or to a level below the current yield on both the Company's bonds and risk-free 30-year United States Treasury bonds.[4]

The proposed rate and tariff changes provided by both the Company's case as filed, and the April 30, 2015 Settlement Agreement between Kentucky Power, Kentucky Industrial Utility Customers, Inc., and the Kentucky School Boards Association ("Settlement Agreement"), are fair, just, reasonable, and will permit the Company to provide reliable and cost-effective service to its customers, while allowing Kentucky Power a reasonable opportunity to earn a fair rate of return. The Settlement Agreement in particular provides significant benefits, many of which would be unavailable in the absence of the agreement:

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[1] Order, *In the Matter of: The Application of Kentucky Power Company For A General Adjustment Of Electric Rates*, Case No. 2009-00459 (Ky. P.S.C. June 28, 2010).

[2] Pauley Direct Testimony at 7.

[3] *Id.*

[4] Avera Hearing Testimony at 153-154.

- A $23 million reduction in base rates;[5]

- Resolution of multiple appeals of the Commission's January 22, 2015 Order in Case No. 2014-00225, secures tens of millions of dollars of refunds or avoided fuel costs for the Company's customers, while resolving the no load cost issue on an on-going basis;[6]

- An enhanced Distribution Vegetation Management Program coupled with an innovative rate agreement that reduces rates by $11.8 million beginning in mid-2019 when the Company forecasts it will complete the interim re-clearing cycle and begin its first five year maintenance cycle,[7] while at the same time bringing over 100 high quality jobs[8] to one of the most economically-distressed areas of the Commonwealth;[9]

- A matching contribution of approximately $300,000 annually by Kentucky Power's shareholder toward economic development efforts in its service territory.[10]

- Implementation of multiple provisions of the July 2, 2013 Stipulation and Settlement Agreement among Kentucky Power, KIUC and the Sierra Club that provided for the Mitchell Transfer at less than full cost for approximately 18 months;[11]

- Establishment of new riders to ensure the Company's customers pay no more and no less than the Company's actual costs with respect to the subject matter of the riders;[12]

- Bringing the Company's 50% undivided interest in the Mitchell generating station fully into rates at a non-fuel cost less than estimated by the Company in the Mitchell Transfer case;[13]

- Provision for the expansion, and funding through the Company's DSM surcharge, of the School Energy Manager Program to the Company's entire service territory and establishment optional reduced pilot rates for most public schools;[14] and

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[5] Settlement Agreement at ¶ 1(a).

[6] *Id.* at ¶ 11.

[7] *Id.* at ¶ 8.

[8] Phillips Hearing Testimony at 228-229.

[9] Rogness Rebuttal Testimony at R3.

[10] Settlement Agreement at ¶ 10.

[11] *Id.* at ¶¶ 4, 6, and 18.

[12] Wohnhas Settlement Testimony at 10.

[13] Settlement Agreement at ¶¶ 6 and 7.

- An increase by 25% the customers' sharing of off-system sales margins.[15]

A. Changes to the Company's Generation Fleet Necessitate the Change in Rates.

The December 31, 2013 transfer of an undivided 50% interest in the Mitchell generating station to Kentucky Power ("Mitchell Transfer"), along with the Commission's subsequent order granting a certificate of public convenience and necessity to convert Big Sandy Unit 1 to a natural gas-fired unit represented the culmination of the Company's multi-year review of alternatives to meet its obligations to serve its customers in light of emerging environmental regulations, particularly the mercury and air toxics standards rule ("MATS Rule"). Absent the transfer and conversion, these emerging regulations would have required the installation of a flue gas desulfurization ("FGD") system at the Company's Big Sandy Unit 2 at a cost of approximately one billion dollars. The Mitchell Transfer, along with the conversion of Big Sandy Unit 1 to natural gas, was the least cost alternative by a wide margin.[16]

Under the Commission-approved Stipulation and Settlement Agreement in Case No. 2012-00578 ("Mitchell Stipulation"), which authorized the Mitchell Transfer, the Company withdrew its then pending base rate case.[17] The case would have recovered the full costs of the Mitchell Transfer during the period between the date of the Mitchell Transfer (January 1, 2014) and the planned retirement of Big Sandy Unit 2 (May 31, 2015) (the "Overlap Period"). Instead, Kentucky Power agreed to recover only a portion of the costs of the Mitchell Transfer during the

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[14] *Id.* at ¶ 15.

[15] *Id.* at ¶ 5.

[16] Order, *In the Matter of: The 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 And Related Requirements; And (5) All Other Required Approvals and Relief* at 31, Case No. 2012-00578 (October 7, 2013)

[17] *In the Matter of: Application Of Kentucky Power Company For A General Adjustment Of Electric Rates*, Case No. 2013-00197 (Ky. P.S.C. Filed June 28, 2013).

Overlap Period. The Mitchell Stipulation also required the Company to file a base rate case no later than December 29, 2014. The filing made in this case satisfies that obligation.

B. The Company's As-Filed Rate Request.

In its December 23, 2014 filing, the Company sought changes in rates that would provide approximately $70 million in additional revenue, or a 12.48% increase of its current revenue requirement. The requested increase consisted of the following components:

- An increase of approximately $37.7 million (54% of the total adjustment) to fully recover the costs of the Mitchell Transfer and the Big Sandy retirements;
- An increase of approximately $12.8 million (18% of the total adjustment) to reflect updated depreciation rates;
- An increase of approximately $10.7 million (15% of the total change) to recover enhanced vegetation management costs; and
- An increase of approximately $8.8 million (13% of the total change) to account for other increases in operating costs.[18]

Under the Company's application, the approximately $70 million increase in revenue requirement would be recovered through the following:

- A base rate *decrease* of approximately $4.8 million;
- Recovery of approximately $21.8 million through the new Big Sandy Retirement Rider ("BSRR");
- Recovery of approximately $18.2 million through the new Big Sandy 1 Operation Rider ("BS1OR");
- Recovery of approximately $34.4 million in capital and operation and maintenance costs associated with Kentucky Power's share of the Mitchell FGD system through the environmental surcharge; and
- Recovery of approximately $300,000 through the new Kentucky Economic Development Surcharge.[19]

The Company sought approval for a return on common equity of 10.62%.[20]

[18] Pauley Direct Testimony at 6.

[19] Wohnhas Direct Testimony at 5-8.

The Company also sought in its application to establish two additional new riders, the PJM Rider and the NERC Compliance and Cybersecurity Rider ("NCCR"). Under the PJM Rider, the Company would have tracked the amount of PJM charges and credits above or below the amount included in base rates. The annual net over or under collection of PJM charges then would be collected from or credited to customers through the PJM Rider.[21] Similarly, the NCCR would have allowed the Company to track and recover through a rider incremental NERC compliance and cybersecurity costs.[22] Under both the PJM Rider and the NCCR, the Company would have contemporaneously recovered its costs – no more and no less.

Finally, the Company sought Commission approval under KRS 278.183 of the Fourth Amendment to its Environmental Compliance Plan ("2014 Environmental Compliance Plan" or "2014 Plan"). The Company's current environmental compliance plan was approved by the Commission in 2007 ("2007 Plan").[23] The proposed 2014 Environmental Compliance Plan accounts for the changes in the Company's generation portfolio, incorporates recently placed-in-service-projects, and removes no longer applicable projects following the termination of the AEP-East Pool Agreement.[24]

The projects in the 2014 Environmental Compliance Plan are reasonable and cost-effective methods for the Company to comply with the applicable environmental regulations.

C. The Settlement Agreement.

On April 30, 2015, following months of litigation, including more than 900 data requests in multiple rounds of discovery, and the filing of testimony by all parties, Kentucky Power and

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[20] Pauley Direct Testimony at 6.

[21] Vaughan Direct Testimony at 16.

[22] Wohnhas Direct Testimony at 26-29.

[23] Elliott Direct Testimony at 3.

[24] *Id.* at 3-4.

two of the four intervenors in the case, Kentucky Industrial Utilities Customers, Inc. ("KIUC") and the Kentucky School Boards Association ("KSBA"), entered into a Settlement Agreement.[25] Another intervenor, Wal-Mart Stores East, LP and Sam's East, Inc. ("Wal-Mart"), was not a signatory to the Settlement Agreement, but filed a statement in the record indicating that it had no objection to the Settlement Agreement and that it was unaware of any reasons the Commission should not adopt and approve the Settlement Agreement in its entirety.[26]

Although a party to many of the settlement negotiations, the Attorney General elected not to enter into the Settlement Agreement.[27] Notwithstanding the Attorney General's decision, neither of the Attorney General's witnesses urged the Commission to reject the Settlement Agreement.[28] Certainly, neither expressly took issue with that portion of Mr. Wohnhas' Settlement Testimony indicating that the Settlement Agreement provided for fair, just, and reasonable rates, that the agreement did not impose an unfair or unreasonable burden on customers, and that it reflected "a fair and proper balancing of the interests of the affected customer classes."[29]

Under the terms of the Settlement Agreement, Kentucky Power's annual revenue requirement will increase by $45.4 million, a 35% decrease from the fair, just, and reasonable amount sought by the Company in its application. In addition to the reduced revenue requirement, the comprehensive Settlement Agreement:

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[25] Wohnhas Settlement Testimony at 4-5.

[26] *See*, Walmart Stores East, LP and Sam's East, Inc. Statement of Position on Settlement Agreement, Case No. 2014-00396 (filed May 1, 2015).

[27] Wohnhas Settlement Testimony at 4.

[28] *See* Woolridge Hearing Testimony at 164-169; Smith Hearing Testimony at 280 ("I'm not the one that's recommending the Commission reject or accept the settlement. That's coming from the Attorney General's office.")

[29] Wohnhas Settlement Testimony at 46-47.

- Establishes a rate of return of 10.25% for certain purposes (a reduction of the 10.62% return on equity requested in the application);
- Establishes the Company's capitalization and gross revenue conversion factor;
- Approves the Company's proposed 2014 Environmental Compliance Plan and Tariff E.S.;
- Amends the Company's off-system sales margin sharing mechanism to increase the customer/Company sharing split to 75%/25%;
- Provides for a revised (as compared to the as-filed version) version of the Company's new Big Sandy Retirement Rider (Tariff B.S.R.R.);
- Provides for the Company's new Big Sandy 1 Operation Rider ("Tariff B.S.1.O.R.");
- Enhances the Company's Distribution Vegetation Management Plan and provides the necessary additional funding;
- Revises the Company's non-distribution depreciation rates and authorizes recovery of amortized deferred costs;
- Establishes an economic development surcharge with matching contributions from the Company;
- Resolves outstanding questions relating to the Company's recovery of no-load costs;
- Revises the Company's Biomass Energy Rider (Tariff B.E.R.);
- Establishes deferral mechanisms for Commission review and approval of the recovery by Kentucky Power of certain PJM costs and NERC compliance and cybersecurity costs (as opposed to the concurrent recovery via riders proposed in the application);
- Expands the DSM-based School Energy Manager Program to the Company's entire service territory and establishes a pilot tariff for K-12 schools (Tariff K-12 School);
- Establishes a new industrial tariff (Tariff I.G.S.) and modifies the Company's existing Tariff C.S.-I.R.P.;
- Increases the residential customer charge to $14.00 per month (as opposed to the $16.00 per month charge proposed in the Company's application); and

- Modifies and establishes certain other tariffs, including modifications to the existing Tariff P.P.A.

The rates proposed in the Company's application are fair, just, and reasonable. From a customer perspective, the Settlement Agreement improves on those rates while providing additional benefits not available in the absence of the agreement. The Settlement Agreement should be approved in its entirety, without modification, by the Commission.

ARGUMENT

A. The Proposed $45.4 Million Settlement Agreement-Based Increase In The Company's Revenue Requirement, And Each of Its Components, Are Fair, Just, And Reasonable.

1. The Increase Is Built Upon The Netting Of Five Components, Four Of Which Are Designed To Ensure The Company Recovers Neither More Than, Nor Less Than, Its Actual Expenses.

(a) The $23 Million Decrease In Base Rates.

Although the Settlement Agreement provides for an overall $45.4 million dollar increase in Kentucky Power's overall rates, the base rate component of that overall recovery will decrease by $23 million.[30] The Company originally proposed a smaller $4.696 million decrease in base rates.[31] The decrease in base rates as originally proposed by the Company in large part reflected two provisions of the previously-approved Mitchell Stipulation: (a) the removal of all Big Sandy coal-related assets, including materials and supplies, from rate base and capitalization; and (b) the removal from base rates of all costs associated with the Mitchell Units 1 and 2 FGD.[32] Instead, in accordance with the terms of the Mitchell Stipulation, the Company proposed to

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[30] Settlement Agreement at ¶ 1(a).

[31] Wohnhas Direct Testimony at 6; Application, Section V, Exhibit 1, Schedule 2. The $4.7 million decrease was calculated without the Company's proposed transmission adjustment. Wohnhas Direct Testimony at 6. The overall decrease in base rates proposed by the Company was $4.823 million with the transmission adjustment. Application, Section V, Exhibit 1, Schedule 1. The Settlement Agreement does not include a transmission adjustment.

[32] Wohnhas Settlement Testimony at 6-7.

recover those costs through separate riders.[33] The costs associated with the retirement of the Big Sandy coal-related assets were to be recovered through the BSRR;[34] the Mitchell FGD costs were to be recovered through the Kentucky Power's amended environmental surcharge.[35]

An agreement was negotiated to reduce the Company's base rates by an additional $18.304 million resulting in the $23 million reduction. The $18.304 million *further reduction* in the Company's base rates is 4.9 times the reduction in base rates originally proposed by Kentucky Power[36] and provides significant savings for the Company's customers. Although the $23 million reduction in base rates represents a "'black box' value negotiated by the parties to the Settlement Agreement,"[37] the Settlement Agreement itself incorporates the removal of both the costs associated with the retirement of the Big Sandy coal-related assets, and the Mitchell Units 1 and 2 FGD costs, from base rates as contemplated by both the Company's application and the Mitchell Stipulation.[38] The $18.304 million further reduction in the Company's base rates proposed under the Settlement Agreement provides approximately 74% of the $24.703 million of the "savings," if the Settlement Agreement is approved,[39] from the Company's originally proposed $70.1 million overall rate increase.[40]

(b) The BSRR.

In conformity with the MATS Rule, Kentucky Power has retired Big Sandy Unit 2, effective May 31, 2015, and will cease operation of Big Sandy Unit 1 as coal-fired unit no later

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[33] *Id.*

[34] Mitchell Stipulation at ¶¶ 3, 4, and 14

[35] *Id.* at ¶ 6.

[36] $23 million/$4.696 million = 489.8%.

[37] Wohnhas Settlement Testimony at 6.

[38] Settlement Agreement at ¶¶ 6, 4.

[39] $18.304 million/[($70.103 million – 45.4 million = 24.703 million] = 74%.

[40] Wohnhas Direct Testimony at 5.

than April 2016 and convert it to a natural gas-fired unit. Accordingly, the coal-related portions of the Big Sandy Plant will be retired. Paragraph 3 of the Mitchell Stipulation addressed how coal-related costs at Big Sandy are to be treated in this case:

> The Company agrees to remove all coal-related operating expenses relating to Big Sandy 1, and all operating expenses related to Big Sandy Unit 2 from the cost of service study in the Base Rate Case. The Company further agrees to remove all coal-related plant and other capitalized costs, e.g. fuel inventories, materials and supplies inventories, etc., related to Big Sandy Unit 1, and all plant and other capitalized costs, e.g. fuel inventories, materials and supplies inventories, etc., related to Big Sandy Unit 2, from the cost of service study in the Base Rate Case, and instead recover those costs in the manner set forth in Paragraph 14 of this Settlement Agreement.[41]

The Company's proposed BSRR implements the requirements of the Mitchell Stipulation, and provides for the recovery of the costs associated with the retirement of the Big Sandy generating station as a coal-fired facility.[42] In accordance with paragraph 14 of the Mitchell Stipulation as approved by the Commission, these costs are to be recovered, along with "a weighted average cost of capital (WACC) carrying cost," on a levelized basis over 25 years,[43] which was the estimated remaining life of the Mitchell generating station. As initially filed by the Company, the Big Sandy Retirement Rider regulatory asset balance included both actual retirement costs plus estimated future Big Sandy coal-related retirement costs.[44]

The BSRR as proposed by Kentucky Power in its application would have increased the Company's annual revenue requirement by $21,855,982.[45] Under the terms of the Settlement Agreement the initial BSRR annual revenue requirement is estimated to be $16.7 million, or

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[41] Mitchell Stipulation Agreement at ¶ 3.

[42] Wohnhas Settlement Testimony at 14-15.

[43] Wohnhas Direct Testimony at 7; Yoder Direct Testimony at 15.

[44] Mitchell Stipulation Agreement at ¶ 14.

[45] Wohnhas Direct Testimony at 7.

approximately $5.2 million less than originally proposed.[46] This 24% reduction in the BSRR initial annual revenue requirement[47] provides approximately 21% of the $24.703 million of "savings" if the Settlement Agreement is approved.[48]

The $5.2 million reduction in the estimated BSRR annual revenue requirement reflects the agreed upon reduction in the Company's return on equity for purposes of BSRR and other riders from the 10.62% return on equity proposed by Kentucky Power[49] to a 10.25% return on equity.[50] The most significant factor contributing to the $5.2 million reduction in the initial BSRR annual revenue requirement is the removal of all estimated Big Sandy coal-related retirement costs.[51]

With the removal of the estimated Big Sandy coal-related retirement costs from the Big Sandy regulatory asset balance, the Settling Parties also agreed to a mechanism by which the Company may defer and subsequently recover *actual* post-June 30, 2015, Big Sandy retirement costs.[52] As agreed to by the Settling Parties:

- Actual post-June 30, 2015 Big Sandy retirement costs will be deferred as they are incurred and added to the unamortized balance of the Big Sandy Retirement Rider regulatory asset.[53]

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[46] Wohnhas Settlement Testimony at 15.

[47] $5.2 million/$21.9 million = 24%.

[48] $5.2 million/[($70.103 million – 45.4 million = 24.703 million] = 21%.

[49] Avera/McKenzie Direct Testimony at 4-6, 70.

[50] Settlement Agreement at ¶ 2; Wohnhas Settlement Testimony at 19. In addition, the reduced revenue requirement for the BSRR reflects no short-term debt in the calculation of the Company's WACC. Settlement Agreement at ¶ 3; Exhibit 2; Wohnhas Settlement Testimony at 11-12, 19. This change to the calculation of the Company's WACC was recommended by both the Attorney General and KIUC. Wohnhas Settlement Testimony at 11. The reduction in the Company's WACC as a result of setting short-term debt at zero similarly reduces the revenue requirement for the other riders employing the Company's WACC.

[51] Those costs totaled an estimated $104 million. Yoder Direct Testimony at 16. *See also*, Wohnhas Settlement Testimony at 16.

[52] Wohnhas Settlement Testimony at 16-17.

[53] *Id.* at 16.

- The pre-tax WACC carrying charge will be calculated, net of the related Big Sandy Retirement Rider Accumulated Deferred Income Taxes, and added to the unamortized regulatory asset balance.[54]

- Monthly Tariff B.S.R.R. revenues will be applied first to that month's WACC carrying charge, and then, to the extent available, the unamortized balance of the Big Sandy Retirement Rider regulatory asset.[55]

- Beginning in 2016, Kentucky Power will file annually with the Commission and serve on all parties to this proceeding the June 30 unamortized balance of the Big Sandy Retirement Rider regulatory asset, including the pre-tax WACC carrying charges, and supporting documentation. The filing will be made no later than August 15th of each year.[56]

- In connection with its annual BSRR filing, Kentucky Power will also propose revised BSRR rates that will permit the recovery over the remaining life of the 25-year amortization period of the unamortized balance of the Big Sandy Retirement Rider regulatory asset, including pre-tax WACC carrying charges.[57] This is a departure from the as-filed BSRR that provided for adjustments of the BSRR rate only in connection with each rate case filing.[58]

- Subject to Commission review and adjustment, the revised BSRR rate will become effective October 1st of each year.[59]

- The Settlement agreement also provides for a final one-year BSRR rate to "recover completely any remaining unamortized balance of the ... [BSRR] regulatory asset, [and] to recover all actual retirement costs in the final year of the 25 year collection period."[60] In addition, and as is essential to any recovery mechanism with a finite life, the final one-year rate will true-up any over-recovery or under-recovery.[61]

The revised BSRR provides four significant benefits. It expressly obligates the Company to make annual filings documenting the operation of the BSRR and the calculation of the revised BSRR rate. This provides transparency. Second, the Settlement Agreement establishes a

[54] *Id.* at 16-17.

[55] *Id.* at 17.

[56] *Id.*

[57] *Id.* at 18.

[58] *Id.*

[59] *Id.* at 17-18.

[60] Settlement Agreement at ¶ 6(f).

[61] Wohnhas Settlement Testimony at 18-19.

procedure going forward for the review and approval of the annually-revised BSRR rates. Third, limiting the BSRR to actual expenses obviates any concern the Commission or the Intervenors might have regarding the use of estimates of future retirement costs. Finally, the inclusion of a final true-up period ensures customers pay no more, and no less, than the actual Big Sandy coal-related retirement costs.

The rates to be charged under Tariff B.S.R.R. are fair, just, and reasonable, and the recovery of those rates through the BSRR is consistent with the requirements of the Commission-approved Mitchell Stipulation. The Commission should approve the recovery of Big Sandy Retirement Costs through the Big Sandy Retirement Rider.

(c) BS1OR.

The BS1OR is an interim measure that, if approved, will operate only until new base rates are established through the Company's next base rate case. The Settlement Agreement provides for the implementation of the BS1OR as proposed by the Company in its application.[62] As a result, its estimated initial annual costs under the Settlement Agreement are expected to remain unchanged at $18.3 million.[63]

The BS1OR is necessary because Paragraph 3 of the Mitchell Stipulation prohibits the recovery of Big Sandy coal-related costs through the base rates to be established in this case.[64] With the 2014 Commission approval of the natural gas conversion of Big Sandy Unit 1, the Company received a one year extension of the MATS Rule compliance deadline to permit the

[62] Wohnhas Hearing Testimony at 93.

[63] *Id.*

[64] *Id.* at 119-120.

continued operation of Big Sandy Unit 1 as a coal-fired unit until 2016 and hence past the expected effective date for the base rates to be established in this case.[65]

Because Big Sandy Unit 1 will continue to operate as a coal fired unit for a short period following the effective date of the proposed rates,[66] the BS1OR provides a vehicle whereby the Company can transparently recover its non-fuel costs of operating Big Sandy Unit 1 as a coal-fired unit (including associated PJM charges).[67] Also recoverable through the BS1OR are the non-fuel costs of operating Big Sandy Unit 1 once it is converted to natural gas, as well as the return on and of the capital investment in connection with the conversion of Big Sandy Unit 1 to natural gas.[68]

The BS1OR provides numerous advantages. First, it permits customers to reap the benefit of the anticipated lower operating costs once Big Sandy Unit 1 begins operating as a gas-fired unit:

> We anticipate when it's converted from coal to gas, that the O&M – O&M costs will go down. So with the BS1OR in effect as a rider, we will be able to flow through those costs of a reduced O&M cost immediately versus waiting for a base rate case.[69]

Second, it provides a mechanism by which the Commission and interested persons can monitor Big Sandy Unit 1 non-fuel operating costs both as a coal-fired unit, and then later as it begins operation as a natural gas-fired unit.[70] Third, the BS1OR is expected to delay the necessity for

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[65] *Id.* at 119.

[66] *Id.* at 119-120.

[67] Wohnhas Direct Testimony at 7.

[68] *Id.* As explained above, the reduced WACC provided for by the Settlement Agreement will lower the costs associated with the recovery on the capital investment made in connection with the Big Sandy Unit 1 conversion.

[69] Wohnhas Hearing Testimony at 134.

[70] *Id.* at 120.

the Company to file its next base rate case.[71] Finally, the BS1OR limits the Company's recovery of Big Sandy Unit 1 operating costs to their actual amount – no more and no less.[72]

(d) Costs Associated With The Mitchell Units 1 And 2 FGD.

Paragraph 4 of the Settlement Agreement, in conformity with paragraph 6 of the Mitchell Stipulation, provides that all costs associated with the Mitchell FGD are to be recovered exclusively through the environmental surcharge instead of base rates.[73] As proposed in the Company's application, the annual revenue requirement for the Mitchell FGD was projected to be $34.4 million.[74] Under the Settlement Agreement, this annual amount is reduced by approximately four percent to $33.1 million.[75]

Although the Mitchell Stipulation and the Settlement Agreement each modify the vehicle through which the Mitchell FGD costs will be recovered (the environmental surcharge instead of base rates), neither agreement affects the recoverability of the expenses. Indeed, while the Attorney General's witness Mr. Smith argued the annual Mitchell FGD expense should be reduced to reflect the Attorney General's understated recommended return on equity and the elimination of negative short term debt,[76] he nowhere challenged the appropriateness of recovering the costs through the environmental surcharge.[77] More fundamentally, the recovery of the Mitchell FGD costs through the environmental surcharge permits customers to receive on

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[71] *Id.* at 121-122.

[72] Wohnhas Settlement Testimony at 20.

[73] *Id.* at 12-13.

[74] Wohnhas Direct Testimony at 8.

[75] PHDR-15 (Tab AJE-3).

[76] The Settlement Agreement reflects this recommendation by Mr. Smith. *See* Settlement Agreement at ¶ 3 (recalculating the Company's weighted average cost of capital to reflect no short-term debt); Exhibit 2, Settlement Agreement (same).

[77] Wohnhas Settlement Testimony at 15.

a "real-time basis" the benefit of ongoing depreciation, as well as ensuring customers pay no more or less than the actual costs associated with the Mitchell FGD.[78]

(e) Kentucky Economic Development Surcharge.

The Settlement Agreement also provides for the establishment of the Company's proposed Kentucky Economic Development Surcharge ("KEDS"). The surcharge, which is fixed at $0.15 per meter per month, provides customers with a 100% "return" on their payment by requiring Kentucky Power to match on a dollar-for-dollar basis all funds raised through the surcharge. The annual amount to be recovered through the surcharge, approximately $307,500, is unchanged by the Settlement Agreement. When combined with the matching shareholder funds, the KEDS is anticipated to produce approximately $600,000 per year[79] for economic development efforts in one of Kentucky's poorest and most economically-distressed regions.[80]

In contrast to the Kentucky Power Economic Advancement Program ("KEAP") established under the Mitchell Stipulation to provide economic development funding to Lawrence County and the contiguous Kentucky counties, the KEDS program will serve the entirety of the Kentucky Power service territory.[81] Under the terms of the Settlement Agreement, the Company will provide an annual report to the Commission detailing the amount of funds generated through the KEDS program, the Company's matching contributions, and the recipients and purposes of funds awarded.[82]

The funds provided by the KEDS program are not a panacea for the economic development issues in the Company's service territory. Instead, the program is designed to fill

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[78] *Id.* at 7.

[79] Rogness Direct Testimony at 16-17.

[80] *See* Rogness Rebuttal Testimony at R3.

[81] Pauley Hearing Testimony at 18-19.

[82] Wohnhas Settlement Testimony at 27; Settlement Agreement at ¶ 10(c).

gaps in current economic development efforts by, for example, addressing necessary site-specific improvements, improving the economic development capabilities of local officials, or meeting the needs of a particular prospect looking to expand or relocate in the Company's service territory.[83] The flexibility of the KEDS program is its strength.[84]

The economic development efforts supported through the KEDS program will provide real benefits to Kentucky Power's customers. First, economic development successes will result in new or expanded business operations within the Company's service territory.[85] This will produce increased load and, everything else being equal, will allow the Company to spread its fixed costs over a greater number of kilowatt hours and customers and keep the cost of service to individual customers as low as possible.[86] Additionally, economic development successes will necessarily mean increased economic activity in the service territory and, importantly, additional jobs.[87]

Through the proposed KEDS program, the Company will leverage small investments by all of its customers into material contributions to economic development in the service territory. The Commission should approve the innovative KEDS program.

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[83] Rogness Direct Testimony at 19-20; Rogness Rebuttal Testimony at R4-R5.

[84] Rogness Rebuttal Testimony at R4.

[85] Rogness Direct Testimony at 19.

[86] *Id.* at 19-20.

[87] *Id.* at 19.

2. The Settlement Agreement Provides Significant Rate-Related Benefits To All Customers.

The Company's application for a rate adjustment is the next step in Kentucky Power's once-in-a-lifetime transformation of its generating fleet.[88] Because of changing environmental standards, the Big Sandy generating station can no longer operate as presently configured.[89] Kentucky Power – and the Commission – were faced with determining the least-cost option for meeting those changing requirements. With its October 7, 2013 Order in Case No. 2012-00578 approving the Mitchell Transfer, and its Order in Case No. 2013-00430[90] granting a certificate of public convenience and necessity for the conversion of Big Sandy Unit 1 to a gas-fired unit, the Commission approved the least-cost alternative for addressing those environmental requirements.[91]

As part of the Mitchell Stipulation, Kentucky Power agreed to only a partial recovery of its Mitchell-related costs during the approximate 17-month period between the transfer of the 50% undivided interest to Kentucky Power and the retirement of Big Sandy Unit 2.[92] The Settlement Agreement establishes new rates reflecting the retirement of Big Sandy Unit 2, the full integration of the Company's 50% undivided interest in the Mitchell generating station in rates, while implementing other provisions of the Mitchell Stipulation as approved by the Commission. Importantly, it does so at rates substantially less than those initially proposed by

[88] *See* Mitchell Order at 42.

[89] *Id.* at 28.

[90] *In The Matter Of: The Application Of Kentucky Power Company For: (1) A Certificate Of Public Convenience And Necessity Authorizing The Company To Convert Big Sandy Unit 1 To A Natural Gas-Fired Unit; And (2) For All Other Required Approvals And Relief*, Case No. 2013-00430 (Ky. P.S.C. August 1, 2014).

[91] *Id.* The Company's analysis demonstrated that on a cumulative present worth basis the Mitchell Transfer, combined with the conversion of Big Sandy Unit 1 to a gas-fired unit, was from $156 million (Mitchell Transfer plus market purchases) to $819 million (retrofitting Big Sandy Unit 2 with an FGD) less expensive than other alternatives. *Id.* at 19.

[92] *Id.* at 32-33.

Kentucky Power, and, based upon the Company's review of the evidence, at an amount less than the Company would otherwise be entitled to in the absence of the Settlement Agreement:

Rate Element	As Initially Proposed By Kentucky Power In Its Application	As Provided For In The Settlement Agreement	Difference
Base Rates	-$4.7 million	-$23.0 million	-$18.3 million
BSRR	$21.8 million	$16.7 million[93]	-$5.1 million
Mitchell FGD	$34.4 million	$33.1 million	-$1.3 million
BS1OR	$18.3 million	$18.3 million	$0
KEDS	$0.3 million	$0.3 million	$0
Total	**$70.1 million**	**$45.4 million**	**-$24.7 million**

The Settlement Agreement trims the Company's request for a $70.1 million increase[94] by $24.7 million[95] or 35%.[96] Public schools subject to KRS 160.325 and qualifying for service under Tariff L.G.S., were provided savings of $500,000 from the L.G.S. rates they otherwise would have been charged.[97]

Based on the test year ended September 30, 2014, the overall increase in the Company's revenues was reduced from 12.48% to 8.10%.[98] Equally important, all rate classes were limited to a single-digit increase.[99] Perhaps most importantly, the Settlement Agreement contains an innovative proposal to reduce base rates beginning July 2019 by $11.8 million annually coincident with the anticipated completion of the interim vegetation clearing cycle.[100]

The Settlement Agreement also betters the Company's 2013 estimate in Case No. 2012-00578 of the rate impact of bringing the full non-fuel cost of the Company's 50% undivided

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[93] Wohnhas Settlement Testimony at 15.

[94] Wohnhas Direct Testimony at 5.

[95] Settlement Agreement at ¶ 1.

[96] $24.7 million/$70.1 million = 35.2%.

[97] Settlement Agreement at ¶ 16(a); Wohnhas Settlement Testimony at 39.

[98] Wohnhas Settlement Testimony at 8.

[99] Exhibit 1, Settlement Agreement.

[100] Settlement Agreement ¶ 8(f); Exhibit 9, Settlement Agreement (Page 1 of 2).

interest in the Mitchell generating station into rates. In that case, and using the jurisdictional amounts employed by the Company in response to Data Request KPSC 5-10, Kentucky Power estimated that its non-fuel revenue requirements would increase by 8.21% as result of the change in its generation portfolio in connection with the Mitchell Transfer.[101] Although the "black-box" nature of the decrease in base rates provided for by the Settlement Agreement makes an exact replication in this case of methodology used in Case No. 2012-00578 difficult, a reasonable approximation using the same jurisdictional amounts used in the 2013 estimate indicates that the Mitchell Transfer-related portion of the Settlement Agreement, if approved, would result in a 6.8% increase in the Company's revenue requirement.[102] As a result, the Settlement Agreement brings the non-fuel Mitchell-related portion of the increase in the Company's revenue requirement in at approximately 84% of that estimated in the Mitchell Transfer Case.[103]

3. The Settlement Agreement Provides Significant Rate Benefits To Residential Customers While Advancing The Commission's Policy Of A Gradual Reduction Of The Subsidization Of Residential Customers By Other Rate Classes.

As proposed, residential rates without the transmission adjustment would have increased 12.61%.[104] The Settlement Agreement reduces the increase for residential customers by 22% to a single-digit increase of 9.89%. Moreover, residential customers will receive $8.2 million,[105] or nearly 70%,[106] of the $11.8 million base rate reduction planned to begin July 1, 2019. Assuming there is not an intervening rate case, and based upon test year data, beginning July 1, 2019 the

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[101] Wohnhas Settlement Testimony at 10.

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

[103] *Id.* (6.8%/8.1% = 83.95%.)

[104] Application at ¶ 14(a) (without the transmission adjustment). With the transmission adjustment, which is not part of the Settlement Agreement, residential rates would have increased 16.04%. *Id.*

[105] Exhibit 9, Settlement Agreement (Page 1 of 2).

[106] $8.2 million/$11.8 million = 69.5%.

credit will reduce the annual net settlement increase for the residential class from $22,769,279[107] to $14,600,792,[108] and the percentage increase from the initial 9.89%[109] to 6.34%.[110] This post-July 1, 2019 reduced increase compares favorably with other tariff classes after similarly crediting their share of the $11.8 million base rate reduction:[111]

Tariff	Current Revenue (1)	June 30, 2015 Net Settlement Increase (2)	Class Allocation Of July 1, 2019 Base Rate Reduction (3)	Post-July 1, 2019 Net Settlement Increase (4) (2)-(3)	Post-July 1, 2019 % Increase (4)/(2)
Residential	$230,140,567	$22,769,279	($8,168,487)	$14,600,792	6.34%
SGS	$19,611,846	$1,734,293	($376,607)	$1,357,686	6.92%
MGS	$59,677,592	$5,284,965	($1,229,257)	$4,055,708	6.80%
LGS and Pilot K-12 Schools	$70,569,647	$5,738,831	($1,464,981)	$4,273,850	6.06%
IGS	$171,550,109	$9,147,741	($496,224)	$8,651,517	5.04%
OL	$7,256,320	$570,432	($31,131)	$539,301	7.43%
SL	$1,422,709	$113,876	($6,668)	$107,208	7.54%
MW	$364,284	$29,328	($7,053)	$22,275	6.11%
Total	$560,593,074.00	$45,388,745.00	($11,780,408.00)	$33,608,337.00	6.00%

Indeed, as illustrated by the table above, after crediting the July 1, 2019 base rate reduction, residential customers will receive the fourth lowest – out of eight tariff classes – percentage increase.

Even ignoring the post-July 1, 2019 base rate reduction, the Settlement Agreement-proposed increase in residential customer rates is reasonable and produces fair, just, and

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[107] Exhibit 1, Settlement Agreement.

[108] $22,769,279 – $8,168,487 = $14,600,792. Exhibits 1 and 9, Settlement Agreement.

[109] Exhibit 1, Settlement Agreement.

[110] ($22,769,279 – $8,168,487 = $14,600,792)/$230,140,567 = 6.34%.

[111] *See* Exhibit 1, Settlement Agreement; Exhibit 9, Settlement Agreement (Page 1 of 2).

reasonable rates. The Settlement Agreement limits the increase to a single-digit amount,[112] and residential customers continue to be subsidized by other rate classes.[113] Moreover, $8.2 million[114] of the $22.8 million[115] increase in residential customer rates, or 36%,[116] reflects their share of the $10.4 million increase in the Company's Distribution Vegetation Management Plan funding[117] that will be supplied through the proposed increase in customer rates. As the primary beneficiaries of the Distribution Vegetation Management Plan,[118] it is both appropriate and reasonable for residential customers to bear their fair share of the increased costs of the plan.[119]

Finally, even prior to the July 1, 2019 base rate reduction, the 9.89% increase in residential customer rates is consistent with the Commission's policy[120] of gradually reducing the rate subsidy provided residential customers by other classes.[121] Thus, the June 30, 2015 4.25% Settlement rate of return for residential customers shown on Exhibit 1 to the Settlement Agreement represents an increase from the 0.88% rate of return[122] provided by residential customers in connection with the Company's last base rate case. But the increase in the

[112] Exhibit 1, Settlement Agreement.

[113] Wohnhas Settlement Testimony at 8.

[114] Exhibit 9, Settlement Agreement (Page 1 of 2).

[115] Exhibit 1, Settlement Agreement.

[116] $8.2 million/$22.8 million = 36%.

[117] Wohnhas Settlement Testimony at 9.

[118] *Id.*

[119] *Id.*

[120] Wohnhas Hearing Testimony at 78.

[121] Wohnhas Settlement Testimony at 8-9.

[122] Kentucky Power Response to Staff Hearing Data Request 1, *In the Matter of: The Application of Kentucky Power Company For A General Adjustment Of Electric Rates*, Case No. 2009-00459 (Ky. P.S.C. Filed June 2, 2010) http://psc.ky.gov/PSCSCF/2009%20cases/2009-00459/20100602_KY_Powers_Response_to_Hearing_Data_Request_No_1.PDF To the extent required Kentucky Power Company requests the Commission take administrative notice of this data request response. A copy is attached as **EXHIBIT 1**.

residential customer rate of return does not eliminate the subsidy in its entirety;[123] the 4.25% residential customer rate of return remains below the rate of return for all other customer classes, as well as the overall rate of return produced by the Settlement Agreement.[124]

B. The Settlement Agreement's Proposed Resolution Of The Multiple Fuel Adjustment Clause Appeals Supplies Significant Monetary Benefits To The Company's Customers, While Also Providing Certainty For Customers And The Company Going Forward.

1. The Resolution Of The Franklin Circuit Court Appeals And Related Proceedings Benefits Kentucky Power, Its Customers, And The Commission.

Each of the three parties to Commission Case No. 2014-00225[125] filed separate appeals to the Franklin Circuit Court challenging one or more aspects the Commission's January 22, 2015 Order in that proceeding.[126] In addition, the Attorney General and KIUC filed separate counterclaims in Kentucky Power's appeal presenting the same issues raised in their independent appeals.[127] Absent approval of the Settlement Agreement, these independent appeals present the strong likelihood of multiple further appeals stretching out over a number of years.

KIUC and Kentucky Power agreed to resolve fully their separate appeals as part of the Settlement Agreement.[128] In addition, both KIUC and Kentucky Power agreed upon a resolution of the issues surrounding the allocation of fuel costs between off-system sales and native load customers in the pending two-year review case,[129] as well as subsequent reviews of the operation

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[123] Wohnhas Settlement Testimony at 8 ("the Settlement Agreement does not eliminate the subsidy in its entirety…. the Settlement Agreement provides for a modest subsidy reduction.")

[124] *Id.* at 9.

[125] 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 (Ky. P.S.C. Jan. 22, 2015).

[126] Settlement Agreement at 2-3.

[127] *Id.* at 3.

[128] *Id.* at ¶ 11.

[129] *Id.* at ¶ 11(c) ("The signatory parties agree the refund of the Mitchell no load costs required by the Commission's January 22, 2015 Order in Case No. 2012-00225 [*sic*] resolves all issues relating to the recovery through the fuel

of the Company's fuel adjustment clause through May 31, 2015.[130] Finally, KIUC and Kentucky Power agreed to a method for allocating fuel costs between off-system sales and native load beginning June 1, 2015.[131]

Although the Attorney General is not a signatory to the Settlement Agreement, Kentucky Power and the Attorney General entered into a side agreement embodying the terms of the Paragraph 11 of Settlement Agreement.[132] Thus, contingent upon the satisfaction of the conditions set forth in Paragraph 11 of the Settlement Agreement, as well as the identical conditions in the side agreement between the Attorney General and Kentucky Power,[133] the Settlement Agreement and side agreement fully resolve the pending fuel adjustment clause case appeals and all issues concerning the allocation by Kentucky Power of fuel costs between off-system sales and native load.

More particularly, the side agreement between the Attorney General and Kentucky Power, and Paragraph 11 of the Settlement Agreement, each provide for:

- The dismissal with prejudice by the Attorney General, KIUC, and Kentucky Power of their appeals, including all ancillary claims, arising from the Commission's January 22, 2015 Order in Case No. 2014-00225;[134]
- An agreement by Kentucky Power to forego the recovery of any Mitchell no load costs incurred during the Overlap Period,[135] and thereby implementing the Commission's January 22, 2015 Order in Case No. 2014-00225;[136]

adjustment clause of the Company's no load costs in Case No. 2014-00450, and any subsequent fuel adjustment clause review proceedings reviewing the Company's recovery of fuel costs during the Overlap Period.")

[130] *Id.* at ¶ 11(c).

[131] *Id.* at ¶ 11(e).

[132] *Id.* at ¶ 11(b); Wohnhas Settlement Testimony at 33.

[133] Settlement Agreement at ¶ 11; Wohnhas Settlement Testimony at 28, 33.

[134] Settlement Agreement at ¶ 11(a), (b).

[135] *Id.* at ¶ 11(c).

[136] Wohnhas Settlement Testimony at 28-29.

- An agreement by Kentucky Power to refund those Mitchell no-load costs collected by it during the Overlap Period that were not ordered to be refunded by the Commission's January 22, 2015 Order in Case No. 2014-00225;[137] This provision is consistent with the Commission's January 22, 2015 Order in Case No. 2014-00225,[138] and to the extent the refunds were not ordered in that case, goes beyond the Order to implement the Commission's announced intention to disallow the Overlap Period Mitchell no load costs in subsequent review periods;[139]

- An agreement by Kentucky Power, the Attorney General, and KIUC that the refund of Overlap Period Mitchell no load costs fully resolves all issues concerning the Company's allocation of fuel costs between off-system sales and native load during the Overlap Period. This agreement has the effect of putting the fuel cost allocation issue to rest not only in the pending two-year review case,[140] but also in subsequent reviews that encompass the Overlap Period;[141]

- An agreement by Kentucky Power, the Attorney General, and KIUC on the fuel cost allocation methodology to be employed by the Company following the end of the Overlap Period;[142] and

- A commitment by Kentucky Power to inform the Commission of proposed prospective changes in the allocation of fuel costs to Kentucky retail customers prior to implementing the change.[143]

Each of these provisions is contingent upon the Commission approving the Settlement Agreement without modification, and the order doing so becoming final and non-appealable.[144]

The Settlement Agreement's resolution of the fuel adjustment clause appeals and related issues provides significant benefits to the Company's customers and Kentucky Power. Many of

[137] Settlement Agreement at ¶ 11(c).

[138] Wohnhas Settlement Testimony at 28-29.

[139] 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 11, 13 (Ky. P.S.C. Jan. 22, 2015).

[140] As part of their separate agreements with Kentucky Power, the Attorney General and KIUC also agreed to withdraw the testimony of Lane Kollen in the pending two-year review case (Case No. 2014-00450). Settlement Agreement at ¶ 11(d).

[141] *Id.* at ¶ 11(c).

[142] *Id.* at ¶ 11(e).

[143] *Id.* at ¶ 11(f).

[144] *Id.* at ¶ 11; Wohnhas Settlement Testimony at 28, 33.

these benefits are unavailable absent the Settlement Agreement, or would be available only upon the pain of protracted litigation. The Settlement Agreement:

- Accepts without modification the Commission's January 22, 2015 Order in Case No. 2014-00225;
- Resolves issues concerning the Company's fuel cost allocation methodology in Case No. 2014-00450 as well as subsequent review proceedings examining the Overlap Period;[145]
- Provides certainty going forward by establishing an agreed-upon, fair, and reasonable methodology for allocating fuel costs between off-system sales and the Company's native load customers;[146]
- Commits Kentucky Power to informing the Commission of proposed changes in the allocation of fuel costs to Kentucky retail customers prior to implementing the changes;[147]
- Resolves the no load cost issue on an ongoing basis;[148] and
- Provides the advantages attending any fair and reasonable settlement such as provided for by Paragraph 11 of the Settlement Agreement and the side agreement. Chief among these are:
    - ➢ The avoidance of potentially long and protracted litigation.[149] Here the Commission, KIUC, the Attorney General, and Kentucky Power face not only three separate appeals from the Commission's January 22, 2015 Order in Case No. 2014-00225, but also litigation before the Commission in as many as four additional fuel adjustment clause cases addressing the Overlap Period, as well as likely multiple appeals from those decisions;
    - ➢ The elimination of litigation risk and uncertainty for KIUC, the Attorney General, Kentucky Power, and the Commission;[150]
    - ➢ The avoidance of the problems inherent in attempting to resolve difficult and complex issues through the blunt instrument of litigation;[151]

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[145] Settlement Agreement at ¶ 11(c); Wohnhas Settlement Testimony at 29-30.

[146] Settlement Agreement at ¶ 11(e); Wohnhas Settlement Testimony at 31-32.

[147] Settlement Agreement at ¶ 11(f); Wohnhas Settlement Testimony at 32.

[148] Wohnhas Settlement Testimony at 28.

[149] *In re: Prandin Direct Purchaser Litigation,* 2015 U.S. Dist. LEXIS 5964 at * 8 (E.D. Mich. 2015).

[150] *Ford v Federal-Mogul Corporation,* 2015 U.S. Dist. LEXIS 3398 at * 26 (E.D. Mich. 2015).

- The conservation of Commission, Staff, and judicial resources;[152] and
- The minimization of the parties' litigation and related expenses.[153]

Perhaps the most significant benefit of the Settlement Agreement is the Company's concession, upon the Settlement Agreement's conditions being satisfied, concerning the treatment of Mitchell no load cost during the Overlap Period. The effect of the agreement is to guarantee, without the delay, expense or risk of further litigation, tens of millions of dollars in refunds or avoided Mitchell no load costs to the Company's customers. Through April 2015 Kentucky Power refunded $9,929,169 in Mitchell no load costs. In addition, through the March 2015 expense month, Kentucky Power omitted the collection of $12,606,160 in Mitchell no load costs.[154] Under the terms of the Settlement Agreement Kentucky Power also will relinquish the right to collect its Mitchell no load costs for the April and May 2015 expense months,[155] and will refund or credit an additional $17.8 million in no load costs collected for May through October 2014.[156]

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[151] *In re Cardizem CD Antitrust Litigation,* 218 F.R.D. 508, 530 (E.D. Mich. 2003) ("[T]here is a strong public interest in encouraging settlement of complex litigation and class action suits because they are 'notoriously difficult and unpredictable'….")

[152] *In re: Prandin Direct Purchaser Litigation*, 2015 U.S. Dist. LEXIS 5964 at * 8.

[153] *Williams v. City of New Orleans*, 729 F.2d 1554, 1581 (5th Cir. 1984).

[154] Wohnhas Settlement Testimony at 29.

[155] Settlement Agreement at ¶ 11(c); Wohnhas Settlement Testimony at 28-29.

[156] PHDR-11.

2. The Agreed-Upon Proposal For Allocating The Company's Fuel Costs Beginning June 1, 2015 Is Both Reasonable And Appropriate.

Paragraph 11(e) of the Settlement Agreement establishes the methodology by which Kentucky Power will allocate fuel costs between native load customers and off-system sales following the termination of the Overlap Period:

> (e) Following the end of the Overlap Period, the Company shall allocate fuel costs to off system sales utilizing supply curves for each of the Company's units and any purchases. The Company will then assign the highest dollar per Megawatt-hour incremental variable costs of all of these resources to off system sales down to the applicable minimum of the units on an hourly basis. This method will continue until fuel and/or purchase costs have been allocated to all off system sales. All other fuel and purchase power costs, including no load fuel costs, will remain with internal load. In the event that the sum of the unit minimums exceeds Kentucky Power's internal load, the sum of all of the units remaining costs, excluding the no load costs, is computed on a $/MWh basis, and this cost is assigned to the MWhs of any remaining off-system sales.

The agreed-upon methodology, with minor modifications described by Dr. Pearce in his testimony in Case No. 2014-00225, is identical to that used by the Company for more than 20 years.[157]

The going-forward methodology provided for by Paragraph 11(e) of the Settlement Agreement allocates Kentucky Power's highest incremental fuel costs to off-system sales, and employs the same economic dispatch principles used to make the sales. It 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 proposed fuel cost allocation methodology will provide Kentucky Power's customers with fair, just, and reasonable rates, while also allowing the Company and its customers to maximize the benefits of off-system sales margin sharing as proposed in the Settlement Agreement.

[157] Wohnhas Settlement Testimony at 32.

Because the methodology will become effective following the end of the Overlap Period, the conditions that led the Commission to characterize Kentucky Power's then reserve margin as unusual and abnormal,[158] and that were relied upon to find the Company's allocation methodology during the Overlap Period unreasonable, will no longer exist.[159] Moreover, the retirement of the 800 MW Big Sandy Unit 2 at the end of the Overlap Period almost by definition means fewer off-system sales. In addition, although the allocation methodology proposed for use following the end of the Overlap Period is fair and reasonable in its own right, the 25% increase in the sharing of off-system sales margins accorded native load customers under Paragraph 5 of the Settlement Agreement reduces the impact (at least as a matter of arithmetic) of the allocation methodology to native load customers.[160]

C. The Company's Proposed Enhanced Distribution Vegetation Management Plan And Related Funding Increase Represent A Prudent Investment In Distribution System Reliability And Will Permit Kentucky Power To Build Upon The Progress Made Under Its Current Plan Since 2010.

1. The Enhanced Distribution Vegetation Management Plan Provided For By The Settlement Agreement Is The Least Cost-Alternative For Transitioning Kentucky Power To A Cycle-Based Plan.

The Commission's June 28, 2010 Order in the Company's 2009 rate case established Kentucky Power's existing Distribution Vegetation Management Plan and provided additional funding for $10 million in increased annual distribution vegetation management O&M expenditures by the Company.[161] The additional funding, and the Company's plan, already have produced significant results:

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[158] 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).

[159] Wohnhas Settlement Testimony at 31-32.

[160] *Id.* at 32.

[161] Order, *In the Matter of: The Application of Kentucky Power Company For A General Adjustment Of Electric Rates*, Case No. 2009-00459 (Ky. P.S.C. June 28, 2010) http://psc.ky.gov/PSCSCF/2009%20cases/2009-00459/20100628_PSC_ORDER_01.PDF.

- The Company met its Distribution Vegetation Management Plan expenditure target over the four and one-half years the plan has been in effect.[162]

- The Company has removed over one million trees as part of its distribution vegetation management efforts in clearing approximately 52% of its distribution line miles.[163] That constitutes almost one-third more tree removals than the number of trees the Company initially projected would have to be removed from the total 8,000 mile distribution system.[164]

- As of September 30, 2014, Kentucky Power had completely cleared 87 circuits, cut 7,428 acres of brush, sprayed 10,082 acres of brush, and trimmed 306,453 trees.[165]

- The Company has increased its annual capital expenditures to address outages caused by trees outside the Company's right-of-way.[166]

- Kentucky Power has more than doubled its number of vegetation contractor full-time equivalent employees.[167]

- Inside the right-of-way tree outages have been reduced 34% since implementation of the program.[168]

- There has been a 43% improvement in the Company's SAIDI metric.[169]

Although Kentucky Power in good faith represented to the Commission and the parties to that case that the additional $10 million in annual funding provided for in Case No. 2009-00459 would permit it to transition from a performance-based maintenance plan to a four-year cycle-based plan beginning July 2017,[170] matters largely beyond the Company's control made clear as

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[162] Phillips Direct Testimony at 14.

[163] Phillips Hearing Testimony at 227.

[164] *Id.*

[165] Phillips Direct Testimony at 13-14 (Table 3).

[166] *Id.* at 14 (Table 4); 20-21.

[167] *Id.* at 15.

[168] Phillips Hearing Testimony at 227.

[169] *Id.* at 227. SAIDI, or System Average Interruption Duration Index, is a measure of the average duration of an outage for each customer served. Phillips Direct Testimony at 15-16.

[170] Phillips Direct Testimony at 22-23.

early as 2014[171] that an additional one and one-half years will be required to complete the initial clearing of the Company's distribution right-of-way.[172] Those matters included:

- More than double the number of trees to be cleared than was initially projected;[173]
- Higher than normal precipitation in the Company's service territory led to greater than anticipated vegetation growth rates resulting in more vegetation to be removed and slower than projected clearance rates;[174] and
- The necessity of its contractors to secure and train sufficient employees to carry-out the vegetation management work.[175]

With four years' experience operating the current plan, and the opportunity for in-the-field-assessment of what will be required to complete the initial clearing and establish and maintain a four to five year cycle, Kentucky Power proposed a three-step modified Distribution Vegetation Management Plan in its application.[176] Through further investigation in connection with discovery, and in the course of settlement negotiations, Kentucky Power proposed, and the Settling Parties agreed to, a modification of the Company's initial proposal where the Company would:

- Complete the initial clearing of more than 8,000 miles of distribution lines by the end of 2018;[177]
- Begin the interim re-clearing of 3,112 miles of previously cleared right-of-way in mid-2015.[178] By starting when the previously cleared right-of-way has only 4-5 ½ years of growth, the work can be performed at the lower "maintained cost"

[171] Phillips Hearing Testimony at 197-198.

[172] Phillips Direct Testimony at 22.

[173] Phillips Hearing Testimony at 226-227.

[174] Phillips Direct Testimony at 17-18.

[175] Phillips Hearing Testimony at 213-214; Phillips Direct Testimony at 15.

[176] *See* Phillips Direct Testimony at 23-26.

[177] Exhibit 10, Settlement Agreement (Task 1).

[178] *Id.* (Task 2).

level.[179] The final 371 miles of interim re-clearing work will be completed in the first half of 2019;[180] and

- Begin the five-year cycle of re-clearing of previously cleared right-of-way in mid-2019.[181] The first five-year cycle is scheduled to be completed in 2023, at which point, another five-year cycle[182] will be initiated.[183]

The total projected O&M cost of the Company's vegetation management plan beginning in mid-2010 through the completion of the first five-year cycle in 2023 is $268.0 million. This total cost is from $19.9 million to $87.9 million less expensive than the other scenarios examined by the Company.[184] As such, it not only permits the Company to build on its previous gains,[185] and to transition from its former performance-based vegetation management plan to a five-year plan, but does so in the least-cost fashion.[186]

The Company's proposal to implement its enhanced Distribution Vegetation Management Plan seemingly is unopposed by any of the Intervenors. The Attorney General's witness Mr. Smith accepted the Company's initial proposal to implement Scenario 2.[187] Scenario 2 is identical in many respects to the proposal contained in the Settlement Agreement, except that provides for a four-year cycle beginning in 2019 in lieu of the five-year cycle proposed by the Settlement Agreement. The four-year cycle comes at the additional cost of nearly $22 million, and nothing in Mr. Smith's testimony suggests that the Attorney General is

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[179] Phillips Direct Testimony at 23-24. For 2015, maintenance re-clearing costs per mile are approximately 60% of the cost of initially clearing a mile of right-of-way. *Id.* at 28.

[180] Wohnhas Settlement Testimony at 21-22.

[181] *Id.*; Exhibit 10, Settlement Agreement (Task 3); Phillips Direct Testimony at 24.

[182] Kentucky Power initially proposed a four-year cycle. Phillips Direct Testimony at 30-31. Extending the cycle to five years saves $21.8 million. Settlement Exhibit 9 (Page 1 of 2) (comparing Scenario 2 and Scenario 5); Phillips Hearing Testimony at 225.

[183] Exhibit 10, Settlement Agreement (Task 3).

[184] Exhibit 9, Settlement Agreement (Page 1 of 2).

[185] Wohnhas Settlement Testimony at 25.

[186] *Id.* at 22.

[187] Smith Direct Testimony at 78-79.

willing to "purchase" the shorter cycle at that cost. Moreover, the inclusion of a one-way balancing account, Mr. Smith's sole recommendation with respect to the Company's initial proposal seemingly is satisfied by the provision for such an account in Paragraph 8(e)(ii) of the agreement.

2. The Settlement Agreement's Modified Distribution Vegetation Management Plan Provides Numerous Benefits, Including The Innovative Base Rate Reduction Proposal That Is Unavailable Absent The Agreement.

The Settlement Agreement continues the existing semi-annual reporting requirement and expands the persons to be served with the report.[188] In addition, the expanded vegetation management work will bring over one hundred quality jobs[189] to one of the most economically-distressed areas of the Commonwealth.[190] The Settlement Agreement's enhanced Distribution Vegetation Management Plan provides for the transition to a fully-implemented cycle-based plan beginning in 2019 at a savings of almost $22 million over the plan initially proposed by the Company.[191]

The Settlement Agreement also incorporates a one-way balancing account.[192] As proposed in the Settlement Agreement, the Company commits to make $27,661,060 in Distribution Vegetation Management Plan expenditures each July 1 to June 30 fiscal year

[188] Settlement Agreement at ¶ 8(d),(g); Wohnhas Settlement Testimony at 22-23.

[189] Phillips Hearing Testimony at 228-229.

[190] *See* Rogness Rebuttal Testimony at R3 ("[M]any of the counties in the Company's service territory have unemployment rates that approach or exceed two times Kentucky's state-wide 5.5% unemployment rate. For example, Magoffin County (14.3%), Elliot County (11.8%), and Carter County ("11.1%) all located within the Companies [*sic*] service territory, each reported a February 2015 unemployment rate greater than 11.0%. In fact, six of the ten counties with the highest unemployment rates in Kentucky (Magoffin, Elliot, Carter, Leslie (10.3%), Letcher (10.2%), and Breathitt (10.1%) lie within the Company's service territory.")

[191] Exhibit 9, Settlement Agreement (Page 1 of 2).

[192] Settlement Agreement at ¶ 8(e)(ii); Wohnhas Settlement Testimony at 24. Although recommending a one-way balancing account, Mr. Smith did not provide any specifics on how such an account would function. *See* Smith Direct Testimony at 78-79.

period.[193] Any under-expenditure or over-expenditure in a single fiscal year will be added to or removed from future annual spending obligations.[194] In addition, a regulatory liability will be created on the Company's books to the extent there is a cumulative shortfall in the annual Distribution Vegetation Management Plan expenditures.[195] The regulatory liability, subject to annual additions and subtractions, will be maintained on the Company's books until its next base rate case after June 30, 2019.[196] To the extent the Company's ***cumulative*** annual Distribution Vegetation Management Plan expenditures July 1, 2015 through June 30, 2019 are less than $110,640,240, the regulatory liability will be refunded to customers or used to reduce rates in the Company's first base rate case after June 30, 2019.[197] Importantly, the Settlement Agreement includes language that unambiguously prohibits the Company from recovering any cumulative over-expenditures:

> This deferral shall be a one-way balancing account.... [I]f Kentucky Power has overspent the $27,661,060 of annual vegetation management costs on a cumulative basis, the Company will not be entitled to seek recovery of such costs in a future base rate proceeding.[198]

Even more importantly, Kentucky Power commits in Paragraph 8(f) of the Settlement Agreement to reduce its annual base rate beginning July 1, 2019 by $11.8 million. The reduction reflects the Company's reduced vegetation management expenditures as it completes the final 370 miles of its interim re-clearing and moves solely to a five-year re-clearing cycle.[199] Absent agreement or application by the Company, any such reduction seemingly would require a full

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[193] Settlement Agreement at ¶ 8(e)(ii).

[194] *Id.*

[195] *Id.*

[196] *Id.*

[197] Wohnhas Settlement Testimony at 24-25.

[198] Settlement Agreement at ¶ 8(e)(ii).

[199] Wohnhas Settlement Testimony at 22-23; Exhibit 10, Settlement Agreement.

due process hearing.[200] Under the terms of the Settlement Agreement, this innovative base rate reduction proposal will be incorporated in the Company's tariffs,[201] and$8.2 million of the annual $11.8 million reduction will be credited to residential customers.[202] Finally, the $11.8 million reduction represents the average of the Company's post June 30, 2019 Distribution Vegetation Management Plan expenditures beginning July 1, 2019.[203] Because those expenditures are projected to decline slightly each successive year, the customers, principally residential customers, benefit by "front-loading" the annual decrease in the agreement.[204]

D. The Settlement Agreement's Proposed 75% Customer/25% Company Sharing Of Off-System Sales Margins Fairly And Reasonably Balances The Risks And Rewards Flowing From Off-System Sales Using Kentucky Power's Resources.

Prior to the suspension of the Company's System Sales Clause in accordance with the terms of the Mitchell Stipulation, the Company's customers and Kentucky Power shared the monthly off-system sales margins – both positive and negative – on a 60%/40% basis respectively.[205] While Kentucky Power's customers received 60% of the amount by which monthly net off-system sales margins exceeded the amounts specified in the Company's tariffs, they also were responsible for a like portion of any shortfall.[206] In its application, Kentucky Power proposed reinstituting off-system sales sharing at the former 60%/40% split.[207]

[200] *See* KRS 278.180; KRS 278.190; KRS 278.260(1).

[201] Wohnhas Settlement Testimony at 24; Settlement Agreement at ¶ 8(f); Exhibit 9, Settlement Agreement (Page 2 of 2).

[202] Exhibit 9, Settlement Agreement (Page 1 of 2).

[203] Wohnhas Settlement Testimony at 24.

[204] *Id.*

[205] Wohnhas Rebuttal Testimony at R7-R8.

[206] *Id.*

[207] *Id.*

Both Mr. Kollen and Mr. Smith recommended modifying the off-system sales sharing split to 90%/10% in favor of the Company's customers.[208] Both premise their recommendation, at least in part, on the fact that the Company's customers are responsible for the fixed costs associated with the assets used to make the sales.[209] But their contention ignores the fact that the customers would bear those same fixed costs whether off-system sales are made or not. Likewise, each ignores the fact that "[c]ustomers pay for the service, not for the property used to render it."[210] Most importantly, the 90%/10% split advocated by Messrs. Kollen and Smith unreasonably shifts the risks of shortfalls onto the backs of customers.[211] The risk of a shortfall takes on increasing importance with the retirement of Big Sandy Unit 2, and the consequent 800 MW reduction following the Overlap Period in the capacity available to Kentucky Power to make off-system sales, along with the elimination of generating resources through termination of the AEP-East Pool Agreement.[212]

In the context of all of the terms of the proposed settlement, the 75%/25% sharing split proposed in the Settlement Agreement[213] represents a fair compromise of the parties' positions, while continuing to provide customers with some protection against the downside risk of a monthly shortfall in off-system sales. As such, this balanced approach is more reasonable than the 90%/10% split Mr. Smith advocates.

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[208] Kollen Direct Testimony at 65-66; Smith Direct Testimony at 75-76.

[209] *Id.*

[210] *Board of Public Utility Commissioners v. New York Tel. Co.*, 271 U.S. 23, 32 (1926).

[211] Wohnhas Rebuttal Testimony at R7-R8.

[212] *See* Vaughan Direct Testimony at 27.

[213] Settlement Agreement at ¶ 5(a).

The Settlement Agreement also contains a second benefit favoring the Company's customers. Under the Settlement Agreement, the annual off-system sales base rate credit was increased by $836,000 as advocated by Mr. Kollen.[214]

E. The Settlement Agreement's Proposals With Respect To Schools And Industrial And Commercial Customers Are Reasonable And Provide Important Benefits.

1. School-Related Programs.

Among the issues raised by KSBA were expansion of the existing School Energy Manager Program to the entirety of the Company's service territory[215] and the establishment of a lower Tariff LGS rate for schools that is reflective of the KSBA-claimed "lesser cost to serve schools compared to commercial and industrial customers now served collectively on Rate LGS."[216] Through the settlement negotiations, Kentucky Power and the settling parties reached an agreement with respect to two programs to address both of these issues.

(a) Expanded School Energy Manager Program.

First, Kentucky Power agreed to seek up to $200,000 of additional funding through its Demand-Side Management program to fund up to six additional school energy manager positions and thereby extend their services throughout the Company's service territory.[217] Currently, Kentucky Power's shareholder is providing through the Mitchell Stipulation funding for two school energy manager positions to serve public schools in those portions of the Company's service territory in Lawrence and contiguous Kentucky counties.[218] The additional funding through the Settlement Agreement will allow the expansion of those services to public

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[214] Wohnhas Settlement Testimony at 13.

[215] Willhite Direct Testimony at 7.

[216] *Id.* at 9.

[217] Settlement Agreement at ¶ 15(a); Wohnhas Settlement Testimony at 38-39.

[218] Mitchell Stipulation at ¶ 12, as modified by the Commission's October 7, 2013 Order in Case No. 2012-00578; Willhite Direct Testimony at 7.

schools throughout the remainder of the Company's service territory.[219] According to KSBA, expansion of the School Energy Manager Program throughout the Company's service territory is required to prevent the "[l]oss of momentum in capturing demand and energy savings beneficial to KPC and all ratepayers...."[220] Mr. Willhite also testified that school energy manager programs have demonstrated the ability to provide important demand-side benefits.[221]

The $200,000 of additional DSM funding, unlike the funding for the similar program serving Lawrence and contiguous Kentucky counties, will not be provided by the Company's shareholder.[222] In addition, to the extent the funding is not required for school energy managers, it may be used to implement school energy efficiency projects in the Company's service territory.[223] The program, which will be administered in conjunction with KSBA,[224] will be subject to periodic review.[225] In addition, Kentucky Power will make annual informational filings with the Commission, with service on all parties to this proceeding, concerning the manner in which the funds were expended.[226]

(b) Pilot Tariff K-12.

Conflicting testimony was introduced concerning the costs associated with serving schools taking service under Tariff L.G.S., and whether the load profile of the schools was sufficiently different from other Tariff L.G.S. customers to support the establishment of a

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[219] Settlement Agreement at ¶ 15(a); Wohnhas Settlement Testimony at 38.

[220] Willhite Direct Testimony at 7-8.

[221] *Id.* at 6-7.

[222] Wohnhas Settlement Testimony at 38.

[223] Settlement Agreement at ¶ 15(a); Wohnhas Settlement Testimony at 38.

[224] Settlement Agreement at ¶ 15(b).

[225] KRS 278.285(2).

[226] Settlement Agreement at ¶ 15(b).

separate tariff class for such schools.[227] In the context of the settlement, the parties agreed to establish a Pilot Tariff K-12 School that will provide service to public K-12 schools eligible to take service under Tariff L.G.S.[228] at a cost in the aggregate that is $500,000 less annually than what otherwise be the cost to the schools taking service under the new L.G.S. rates to be established in this case.[229] The parties also agreed that the sum of the revenue to be produced by new Tariff L.G.S. rates and the revenue to be produced by the new Pilot Tariff K-12 rates should equal the revenue that would have been produced if the Pilot K-12 and Tariff L.G.S. customers were taking service under a single tariff rate.[230]

As a pilot program, the new tariff will provide rate benefits in the form of the smallest percentage increase (5.13%),[231] to public K-12 schools in one of the most economically disadvantaged regions of the Commonwealth,[232] while reserving for the Company's next base rate case the decision of whether the reduced rate will be continued or revised, at which time it will be reviewed using then-available load research.[233] The proposal thus strikes a reasonable compromise in the parties' positions, and provides for reduced rates to one of the most important public institutions in the Company's service territory.

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[227] *See* Willhite Direct Testimony at 8; Stegall Rebuttal Testimony at R1-R3.

[228] Pilot Tariff K-12 School is limited to schools affected by KRS 160.325 (which is applicable only to public boards of education) with normal maximum demands greater than 100 kW.

[229] Settlement Agreement at ¶ 16(a); Wohnhas Settlement Testimony at 39.

[230] *Id.*

[231] Exhibit 1, Settlement Agreement.

[232] Rogness Rebuttal at R2-R3.

[233] Settlement Agreement at ¶ 16(b); Wohnhas Settlement Testimony at 40.

2. Tariff I.G.S.

As part of the consideration for the Mitchell Stipulation, which was approved by the Commission's October 7, 2013 Order in Case No. 2012-00578, Kentucky Power agreed to propose in this case a new tariff class that, using the existing Tariff C.I.P.-T.O.D. rate design, combined the existing Q.P. and C.I.P.-T.O.D. tariff classes.[234] The effect of combining the two tariff classes is to place all large commercial and industrial customers with demands of one MW or more in a single class, with their rates varying depending on the voltage level at which the individual customer takes service.[235]

Although the Commission's approval of the Mitchell Stipulation did not bind the Commission to approve Tariff I.G.S., the new combined tariff class is an important part of the calculus that led to the agreements in both the Mitchell Transfer case and this proceeding. To the extent the new single rate class receives a smaller than average increase,[236] it is consistent with the claims of KIUC witness Dr. Coomes concerning the importance of low electricity rate to attracting and retaining energy intensive export-based industries in the Company's service territory.[237] It is these export-based industries that Dr. Coomes testifies have the greatest multiplier effect,[238] and thereby bring "new dollars" into the Commonwealth, including Kentucky Power's service territory, "where they are used to purchase goods and services," and to pay their employees and local suppliers who then "spend their paychecks on many local goods and services, thus lifting the economy further."[239] Moreover, to the extent the Tariff I.G.S. rates

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[234] Wohnhas Settlement Testimony at 40; Mitchell Stipulation at ¶ 3.

[235] Vaughan Rebuttal Testimony at R7-R8; Wohnhas Settlement Testimony at 41.

[236] Exhibit 1, Settlement Agreement.

[237] Coomes Direct Testimony at 6.

[238] *Id.* at 2, 5.

[239] *Id.* at 3.

allow Kentucky Power to attract and retain energy intensive industrial customers, which are the subject of competition among the states,[240] these export-based industrial customers will continue to be present in the Company's service territory to subsidize[241] the rates paid by residential customers.

Like the current Q.P. and C.I.P-T.O.D. tariffs its replaces, Tariff I.G.S. uses full cost demand and energy charges.[242] Because the only difference between the customers who take service under Tariff I.G.S. is the voltage level at which they take service, combining Tariff Q.P. and Tariff C.I.P-T.O.D. is "firmly rooted in, and consistent with, cost-causation and rate design principles."[243] Stated otherwise, a single tariff for all large commercial and industrial customers makes sense.[244] Indeed, not only do Kentucky Power's affiliates in Indiana, Michigan, and Virginia have a single tariff for larger commercial and industrial customers, it is Kentucky Power's understanding that at least one other Kentucky utility currently is proposing to combine large industrial and commercial customers in a single rate class, with rates that differ based upon the voltage at which the customer takes service.[245]

Through the settlement process, Kentucky Power and the settling parties addressed certain of the concerns raised about Tariff I.G.S. and its rate design as proposed by the Company. The Company's initial proposal for Tariff I.G.S. was opposed by Wal-Mart Stores East, LP and Sam's East, Inc.[246] Subsequently, following certain modifications, Wal-Mart, although not a signatory to the Settlement Agreement, filed a statement indicating there were no provisions of

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[240] *Id.* at 4.

[241] *See* Exhibit 1, Settlement Agreement.

[242] Vaughan Rebuttal Testimony at R8.

[243] *Id.*

[244] *Id.*

[245] *Id.*

[246] *See* Direct Testimony of Steve W. Chriss at 14-16.

the Settlement Agreement that it objected to or takes issue with,[247] and that it expressly supported the "Rate IGS rate design."[248] Wal-Mart further stated it was unaware of "any reason why the Commission should not adopt and approve the Settlement Agreement in its entirety."[249]

F. The Proposed Deferral Mechanisms Allow Kentucky Power Transparently to Track Emerging, Material Costs for Future Recovery.

In its application, the Company sought approval for two new riders, the PJM Rider and the NERC Compliance and Cybersecurity Rider ("NCCR"). The PJM Rider would have allowed the Company to true-up the actual incurred PJM-related costs relative to the approximately $75 million in PJM charges included in base rates.[250] Recovery of these costs through a rider is appropriate because PJM costs are largely outside the Company's control and can be material.[251] The initial PJM rider would have been set to zero, and any over or under recovery in a given year would have been charged or credited to customers in the following year.[252]

Under the as-proposed NCCR, the Company similarly would have recovered Commission-approved costs incurred by the Company in complying with new and reinterpreted NERC compliance standards as well as new cybersecurity measures.[253] The Company would have submitted costs to be recovered under the NCCR annually to the Commission for review and approval.[254] As with the PJM Rider, it is appropriate to recover costs incurred for NERC compliance and cybersecurity measures because those costs can be material and are largely

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[247] Wal-Mart Stores East, LP and Sam's East, Inc. Statement of Position on Settlement Agreement at ¶ 3.

[248] *Id.* at ¶ 4.

[249] *Id.* at ¶ 5.

[250] Vaughan Direct Testimony at 17.

[251] *Id.* at 16.

[252] *Id.* at 17-18.

[253] Wohnhas Direct Testimony at 26-29.

[254] *Id.* at 27.

outside of the Company's control.[255] Both of these riders would have allowed for the Company to charge fair, just, and reasonable rates as they would have recovered no more or less than the amounts actually incurred by the Company during the year.

In the Settlement Agreement, the Company agreed to forego the proposed riders. Instead of recovering new NERC compliance and cybersecurity costs through the NCCR, the Company will track and defer those costs for future recovery.[256] The NERC compliance and cybersecurity costs to be tracked and deferred include costs incurred by the Company to implement new NERC requirements or new interpretations by NERC of existing requirements.[257] The Company will, subject to the Commission's review and approval, amortize and recover these deferred costs over a five year period beginning when rates are established in the Company's next base rate case.[258] The Company will submit an annual informational filing to the Commission identifying the amount and nature of NERC compliance and cybersecurity costs that have been deferred.[259]

The Company also agreed to forego the PJM Rider. Instead, the Settlement Agreement creates a deferral mechanism under which the Company is authorized, subject to certain limitations, to defer for future recovery those PJM costs incurred during the calendar year in excess of the approximately $75 million in PJM costs in base rates. First, for the company to defer for future recovery any PJM costs, the Company's calendar year return on equity must fall below 10.00%, calculated as a thirteen month average on a per books basis.[260] Second, the Company can only defer those costs incurred in excess of the base rate amount that would be

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[255] Stogran Direct Testimony at 4-6.

[256] Wohnhas Settlement Testimony at 37.

[257] Wohnhas Hearing Testimony at 51; Wohnhas Direct Testimony at 28-29.

[258] Settlement Agreement at ¶ 14(b).

[259] *Id.* at ¶ 14(c).

[260] *Id.* at ¶ 13(a); Wohnhas Hearing Testimony at 129-30.

necessary to increase the return of equity to 10.00%.[261] The Company will not book a carrying charge or earn a return on any PJM Charges deferred for recovery under the Settlement Agreement.[262] Similar to the NERC deferral mechanism, the Company will provide the Commission with annual reports on the amount of costs deferred, and subject to the Commission's approval, amortize and recover the qualifying PJM costs over a five year period beginning when rates are established in the Company's next base rate case.[263]

The deferral mechanisms for PJM costs and for NERC compliance and cybersecurity costs established in the Settlement Agreement are a reasonable method for the Company to address these emerging and potentially material costs. The provisions in the Settlement Agreement regarding these costs provide transparency to the Commission and customers, while providing the Company the opportunity to recover these necessary costs in a fair, just, and reasonable manner. The Commission should approve the PJM and NERC compliance and cybersecurity deferral mechanisms established in the Settlement Agreement.

G. The Proposed Changes To Biomass Energy Rider (Tariff B.E.R.) Are Reasonable And Should Be Approved.

As part of the Settlement Agreement, the Company is proposing to modify the method by which costs associated with the ecoPower-Generation, LLC biomass energy facility are recovered through Tariff B.E.R. Tariff B.E.R. was approved by the Commission in Case No. 2013-00144 and provides for the Company's full recovery pursuant to KRS 278.271 of all costs under its renewable energy purchase agreement with ecoPower.[264] Under the Settlement Agreement, the Company is proposing to modify the method by which rates are calculated across

[261] Settlement Agreement at ¶ 13(a); Wohnhas Hearing Testimony at 129-30.

[262] Settlement Agreement at ¶ 13(c).

[263] *Id.* at ¶ 13(a), (d).

[264] Wohnhas Settlement Testimony at 33.

customer classes. The revised tariff creates both an energy and a demand charge. The total energy charge will be based on the annual average PJM AEP Zone Locational Marginal Price and the total demand charge will be the difference between total charges (based on the contract price) and the total energy charge.[265] Finally, the revised tariff will continue to ensure that Kentucky Power is able to recover all costs as provided for by KRS 278.271.[266]

For residential customers, the demand and energy charges will be calculated based on residential energy use at the customer's meter and will result in the same charges as under the existing Tariff B.E.R.[267] For non-residential customers, the demand charge will be calculated by subtracting the residential demand charge from the total demand charge.[268] The non-residential demand charge will be allocated among non-residential customers based on a percentage of non-fuel revenues.[269] The non-residential energy charge will be based on allocating the residual energy charge (total energy charge less residential energy charge) among the non-residential customers based on non-residential energy use.[270] The methodology in the revised Tariff B.E.R. is similar to the methodology currently used to calculate the environmental surcharge.[271] Nothing in the proposed revision to Tariff B.E.R. affects (1) the validity of the Commission's October 10, 2013 Order in Case No. 2013-00144; (2) the Company's right under KRS 278.271 to full cost recovery with respect to the ecoPower REPA; or (3) the current appeal by KIUC of the Commission's October 10, 2013 Order.[272]

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

[266] *Id.*

[267] *Id.* at 34-35.

[268] *Id.* at 34.

[269] *Id.*

[270] *Id.*

[271] *Id.*

[272] Settlement Agreement at ¶ 12(b).

The change proposed in the Settlement Agreement to the cost allocation methodology under Tariff B.E.R. would produce rates for customers that remain fair, just, and reasonable. Indeed, as revised the cost-allocation methodology is similar to that currently used by Kentucky Power in Tariff E.S.[273] Significantly, the changed methodology holds residential customers harmless: "[a]s evidenced by **SETTLEMENT EXHIBIT 2**, a residential customer will pay the same under both the existing and amended tariff."[274]

The Commission should approve the revisions to Tariff B.E.R. as part of the Settlement Agreement.

H. The Company's Amendment Of Tariff P.P.A. Is Reasonable.

The Company proposes to amend its Purchase Power Adjustment ("P.P.A.") mechanism to allow recovery of the full cost of purchase power unrelated to forced generation or transmission outages even if at a price in excess of the peaking unit equivalent limit on recovery through the fuel adjustment clause.[275] To the extent they are prudently incurred, purchased power costs may be recovered in one of three ways: (1) through base rates; (2) through the fuel adjustment clause; or (3) through Tariff P.P.A. As Company Witness Wohnhas explained during questioning from counsel for KIUC at the hearing in this case, with the peaking unit equivalent limit in place on recovery through the fuel adjustment clause, recovery through the PPA is the most efficient mechanism:

> Q. I mean, either it's going to be fuel adjustment, the purchased power tracker, or base rates. Somewhere a utility that buys power to serve native load is allowed to recover the costs?

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[273] Wohnhas Settlement Testimony at 34.

[274] *Id.* at 34-35.

[275] *Id.* at 42; Rogness Direct Testimony at 35; Settlement Agreement at ¶ 19(f).

A. That is true. The PPA - - one of the advantages of PPA is that you collect no more, no less. If you have it in base rates, depending on the amount of purchases and - - that you have versus what's in the test year, you could have more or less - -

Q. Right.

A. - - and the PPA lines that up more efficiently.[276]

The need to recover these costs contemporaneously and efficiently is heightened by the termination of the AEP-East Pool. As a stand-alone company, Kentucky Power cannot automatically rely on excess energy from its affiliates to meet customer demand and will instead be forced to purchase power from the PJM market if its own generation is insufficient to meet demand.[277] It is difficult, if not impossible, to predict with any certainty the amount of purchases that will be required going forward[278] and, accordingly, recovery through a tracking mechanism such as Tariff P.P.A. is appropriate.

Because the peaking unit equivalent limitation precludes the Company from recovering these costs through the fuel adjustment clause, recovering prudently incurred purchased power costs via Tariff P.P.A. is the most efficient method to ensure that the customers pay no more or no less than the cost of power purchased to meet native load. The proposed revision to Tariff P.P.A. is fair, just, and reasonable and should be approved by the Commission.

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[276] Wohnhas Hearing Testimony at 72-73.

[277] *Id.* at 53-54.

[278] *Id.* at 53-54. During the test year, Kentucky Power incurred approximately $600,000 in purchased power expenses that were not recoverable via the fuel adjustment clause; these costs were not included in the cost of service in this case. Rogness Hearing Testimony at 176-77.

I. The Additional Tariff Changes Are Reasonable.

1. The Proposed Residential Service Charge Represents A Reasonable And Modest Step Toward Reducing Subsidies.

In its application, the Company sought to increase the residential service charge from $8 per month to $16 per month.[279] Doing so represented a gradual step towards a basic service charge that more accurately reflects the actual cost of providing service of approximately $40 per customer per month.[280] Because there is no separate demand charge in the residential class, and because of the mismatch between the service charge and actual costs, the majority of fixed distribution costs (the costs of simply connecting a customer to the distribution system) are recovered through the energy charge.[281] As a result, higher usage customers bear more of the fixed distribution costs and subsidize lower usage customers.[282] This subsidy with the Company's current $8/month basic customer charge is evident with the example below.[283]

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[279] Vaughan Direct Testimony at 4-5.

[280] *Id.* at 9.

[281] *Id.* at 5.

[282] *Id.*

[283] *Id.* at 6.

	Customer 1	Customer 2	Customer 3	Total
Home Size (sq. ft.)	2500	800	800	N/A
Household Description	Family of 5	Single Person	Retiree (part time resident)	N/A
Avg. Monthly Usage (kWh)	2,200	1,000	400	3,600
Annual Avg. Usage (kWh)	26,400	12,000	4,800	43,200
Annual Fixed Dist. Connection Cost ($40*12)	$480	$480	$480	$1,440
Annual Basic Service Charge ($8*12)	$96	$96	$96	$288
Per kWh charge ($1,440-$288)/43,200	0.0267	0.0267	0.0267	N/A
Annual Example Bill for Fixed Distribution Costs = $96 + (annual kWh*0.0267)	$800	$416	$224	$1,440
Subsidy Received/(Paid)	$(320)	$64	$256	

This example shows the considerable intra-class subsidy of fixed distribution costs that occurs when the basic service charge is out of line with actual costs.

While the Company proposed in its application to increase the basic service charge to $16 per customer per month, it agreed as part of the Settlement Agreement to increase the basic service charge to only $14 per customer per month.[284] Even with this reduction in the monthly customer charge, the intra-class subsidy of fixed distribution costs will continue to be reduced:[285]

[284] Settlement Agreement at ¶ 19(a).

[285] *See* Vaughan Direct Testimony at 6.

	Customer 1	Customer 2	Customer 3	Total
Home Size (sq. ft.)	2500	800	800	N/A
Household Description	Family of 5	Single Person	Retiree (part time resident)	N/A
Avg. Monthly Usage (kWh)	2,200	1,000	400	3,600
Annual Avgas Usage (kWh)	26,400	12,000	4,800	43,200
Annual Fixed Dist. Connection Cost ($40*12)	$480	$480	$480	$1,440
Annual Basic Service Charge ($14*12)	$168	$168	$168	$504
Per kWh charge ($1,440-$504)/43,200	0.0217	0.0217	0.0217	N/A
Annual Example Bill for Fixed Distribution Costs = $168 + (annual kWh*0.0217)	$740	$428	$272	$1,440
Subsidy Received/(Paid)	$(260)	$52	$208	

In addition to reducing the intra-class subsidy of fixed costs, narrowing the gap between the amount of the monthly service charge and actual fixed distribution costs, provides at least two other customer benefits. First, moving the recovery of fixed distribution costs out of the variable energy costs will reduce customer bill volatility, especially for those customers using electric heat.[286] In addition, average low income customers, who are high usage customers due to the lack of resources to invest in weatherization or energy efficient appliances, will benefit from the new service charge by not subsidizing the fixed costs of lower usage customers through their energy charges.[287]

The proposed increase in basic customer service charge from $8 per month to $14 per month represents a gradually reduction of the gap between the amount charged and the actual fixed distribution costs, and reduces the intra-class subsidy between high usage and low usage customers. The revised basic service charge of $14 per month is fair, just, and reasonable, and should be approved by the Commission.

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

[287] *Id.* at 8; Vaughan Hearing Testimony at 270-71.

2. The Remaining Tariff Changes Also Are Reasonable.

In the Settlement Agreement, the signatories agreed to the inclusion of certain new tariffs and the modification of other existing tariffs. In addition to simple wording changes in many tariffs,[288] the Company is proposing the following:

- Amending Tariff C.S.-I.R.P. to incorporate a new credit rate and expand the total contract capacity authorized under the tariff consistent with the Mitchell Stipulation;[289]
- Amending Tariff A.T.R. to allow a temporary extension of its operation to permit recovery of the full amount of authorized revenue, consistent with the intent of the tariff;[290]
- Amending Tariff C.C. to update the amount of the capacity charge and to implement a true-up mechanism so that the annual amount – no more, no less – is recovered consistent with the agreement of the parties in Case No. 2001-00420;[291] and
- Amending the Terms and Conditions for service to reflect changes to the Company's schedule of special or non-recurring charges to increase those charges to match the Company's actual costs of providing those services.[292]

Each of these changes is reasonable and results in rates that are fair, just, and reasonable. The Commission should approve the Company's proposed changes to its tariffs.

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[288] *See* Settlement Agreement at ¶ 20.

[289] Wohnhas Settlement Testimony at 40; Rogness Direct Testimony at 31; Settlement Agreement at ¶ 19(d).

[290] Wohnhas Settlement Testimony at 42; Rogness Direct Testimony at 35-36; Settlement Agreement at ¶ 19(e).

[291] Wohnhas Settlement Testimony at 42; Rogness Direct Testimony at 6-7; Settlement Agreement at ¶ 19(c).

[292] Rogness Direct Testimony at 24-28; Settlement Agreement at ¶ 19(g). The Company's rates for special or non-recurring charges have not changed since the Commission's order in Case No. 2005-00431. Rogness Direct Testimony at 24-25.

J. The Company's Proposed 2014 Environmental Compliance Plan Is A Reasonable And Cost Effective Method To Comply With Environmental Regulations.

In addition to an adjustment in rates, the Company seeks approval under KRS 278.183 of its 2014 Environmental Compliance Plan. KRS 278.183 provides, in relevant part, that the Company

> ...shall be entitled to the current recovery of its costs of complying with the Federal Clean Air Act as amended and those federal, state, or local environmental requirements which apply to coal combustion wastes and by-products from facilities utilized for the production of energy from coal in accordance with utility's compliance plan as designated in subsection (2) of this section.[293]

Costs associated with the environmental compliance plan, including a reasonable rate of return, may be recovered through the environmental surcharge (Tariff E.S.) if the plan and the surcharge are "reasonable and cost-effective for compliance with the applicable environmental requirements."[294] The Company's 2014 Environmental Compliance Plan meets these criteria and should be approved.

1. The Company's 2014 Environmental Compliance Plan Makes Key Updates To The Current 2007 Plan.

The Company's current environmental compliance plan, the 2007 Plan, is the third amendment to the original plan. The 2014 Plan reflects fundamental changes to the Company's generation portfolio since the filing of the 2007 Plan including:

- The Mitchell Transfer;
- The retirement of Big Sandy Unit 2 on May 31, 2015;
- The planned conversion of Big Sandy Unit 1 to natural gas no later than June 30, 2016;

[293] KRS 278.183(1).

[294] Order, *In the Matter of: The Application of Kentucky Power Company for Approval of an Amended Compliance Plan for Purposes of Recovering Additional Costs of Pollution Control Facilities and to Amend Its Environmental Cost Recovery Surcharge Tariff* at 4, Case No. 2006-00307 (Ky. P.S.C. January 24, 2007).

- The January 1, 2014 termination of the AEP East-System Pool;
- The addition of environmental projects at the Mitchell and Rockport Plants;
- The inclusion of the Company's 50% undivided interest in the Mitchell generating station in lieu of the former member load ratio share; and
- Planned environmental projects at the Rockport Plant.[295]

As a result of these changes in its generation fleet, the Company is proposing the following categories of changes in the 2014 Plan:

- Removal of environmental projects previously included as a result of Kentucky Power's participation in the AEP-East System Pool;
- Removal of environmental projects at the Big Sandy Plant with the exception of certain Big Sandy air emissions allowances;
- Addition of environmental projects, including necessary consumables, at the Mitchell Plant installed since the adoption of the 2007 Plan; and
- Addition of environmental projects, including necessary consumables, at the Rockport Plant installed since the adopt of the 2007 Plan.

More particularly, the 2014 Plan includes the following new environmental projects:

- Precipitator Modifications - Mitchell Plant Units 1 and 2;
- Bottom Ash and Fly Ash Handling - Mitchell Plant Units 1 and 2;
- Mercury Monitoring (MATS) - Mitchell Plant Units 1 and 2;
- Dry Fly Ash Handling Conversion - Mitchell Plant Units 1 and 2;
- Coal Combustion Waste Landfill - Mitchell Plant Units 1 and 2;
- Electrostatic Precipitator Upgrade - Mitchell Plant Unit 2;
- Precipitator Modifications – Rockport Plant Units 1 and 2;
- Activated Carbon Injection (ACI) and Mercury Monitoring – Rockport Plant Units 1 and 2;
- Dry Sorbent Injection (DSI) – Rockport Plant Units 1 and 2;

[295] Elliott Direct Testimony at 3-4.

- Coal Combustion Waste Landfill Upgrade to Accept Type 1 Ash – Rockport Plant; and
- Costs associated with CSAPR allowances.[296]

Additionally, the Company is planning to recover all necessary consumables for the environmental projects included in the 2014 Plan.[297] These consumables include polymer, lime hydrate, limestone, trona, and urea for the projects at the Mitchell Plant and brominated activated carbon and sodium bicarbonate for the ACI and DSI systems at Rockport, respectively.[298]

Each of these projects is necessary for the Company to comply with the requirements of the Clean Air Act or those federal, state, or local environmental requirements that apply to coal combustion wastes and by-products at its coal-fired generation facilities.[299] These projects are a cost effective means for the Company to meet its customers' requirements in compliance with applicable environmental regulations.[300]

2. <u>The Company's Proposed Changes To Tariff E.S. Are Reasonable</u>.

In its application, the Company proposed several changes to Tariff E.S. First, the Company proposed to eliminate the environmental surcharge factor established in the Mitchell Stipulation and Settlement Agreement.[301] Second, the Company is modifying the tariff to reflect the rate of return agreed to in the Settlement Agreement.[302] Third the Company is updating the list of projects in the tariff to match those in the 2014 Plan.[303] Fourth, the Company is updating

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[296] *Id.* at 6-7, 9-12.

[297] *Id.* at 8-10.

[298] *Id.*

[299] McManus Direct Testimony at 21.

[300] LaFleur Direct Testimony at 16.

[301] Elliott Direct Testimony at 14.

[302] *Id.* ; Wohnhas Settlement Testimony at 12. The rate of return on equity for environmental projects at the Rockport plant remains at 12.61% as established in the FERC approved Rockport Unit Power Agreement.

[303] Elliott Direct Testimony at 15.

the revenue allocation and environmental surcharge factor calculations so that the environmental surcharge factor for non-residential customers will be calculated as a function of non-fuel revenues.[304] The Company will continue to calculate the environmental surcharge factor for residential customers as function of total revenues.[305] The change in surcharge factor calculation is consistent with the Mitchell Stipulation.[306]

Finally, the Company updated the tariff to reflect a new environmental base.[307] The Company used test year environmental costs to determine the base and made adjustments to remove any AEP-East pool related costs, to remove any Big Sandy environmental project costs, to add Mitchell non-FDG costs, and to add additional Rockport test year expenses for O&M, depreciation, and return on rate base.[308] The Company did not include in the environmental base any costs associated with projects not in service during the test year.[309] Nor did the Company include any costs associated with the Mitchell FGD. In accordance with Paragraph 6 of the Mitchell Stipulation, all costs associated with the Mitchell FGD are to be recovered via the environmental surcharge and excluded from base rates.[310]

The 2014 Environmental Compliance Plan is a reasonable and cost-effective means for the Company to comply with applicable environmental regulations. The Company respectfully

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[304] *Id.* at 15-16.

[305] *Id.* at 16.

[306] *Id.*

[307] *Id.* at 14.

[308] *Id.* at 12-13.

[309] *Id.* at 13.

[310] *Id.* at 16.

requests that the Commission approve the 2014 Plan and the recovery of costs associated with the 2014 Plan through Tariff E.S. as amended by the Settlement Agreement.[311]

K. The Attorney General's Opposition To The Company's As-Filed Request And The Settlement Agreement Is Without Merit.

1. A Return On Equity Of At Least 10.25% Is Required To Permit Kentucky Power, At A Reasonable Cost To Its Customers, To Attract Capital And Provide An Appropriate Return To Its Shareholder.[312]

Kentucky Power's current allowed return on equity, which was established by the Commission's June 28, 2010 Order in the Company's last base rate, is 10.5%.[313] In its application, Kentucky Power sought, in light of anticipated conditions when the rates are expected to be effective, to increase its return on equity modestly to 10.62%.[314] Dr. Woolridge for the Attorney General, and Mr. Baudino for KIUC, recommended that the Company's return on equity be slashed to 8.65%[315] and 8.75%[316] respectively. The Settlement Agreement provides a 10.25% return on equity for certain purposes,[317] but because the agreed-upon $23 million reduction in base rates is a "black box" value, the Agreement does not specify a return on equity for base rates.

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[311] The only effect of the Settlement Agreement on the proposed Tariff E.S.as submitted by the Company was the reduction in the total and monthly amounts included in the environmental base against which monthly environmental costs would be compared. The reduction was a function of the agreed-upon changes to the Company's depreciation, capitalization, and return on equity included in the Settlement Agreement. Wohnhas Settlement Testimony at 12-13.

[312] *See* Order, *In the Matter of: The Application Of Cincinnati Bell Telephone Company For Authority to Increase And Adjust Its Rates And Charges And To Change Regulations And Practices Affecting Same*, Case No. 98-00292, 1999 Ky. PUC LEXIS 2493 at * 9 (Ky. P.S.C. January 25, 1999).

[313] Order, *In the Matter of: The Application of Kentucky Power Company For A General Adjustment Of Electric Rates*, Case No. 2009-00459 (Ky. P.S.C. June 28, 2010).

[314] Application at ¶ 36.

[315] Wooldridge Direct Testimony at 2. Dr. Woolridge's recommendation would constitute a nearly 18% reduction in the Company's allowed return on equity. (8.65%/10.5% = 63.14%.)

[316] Baudino Direct Testimony at 13. Mr. Baudino's recommendation would constitute more than a 16% decrease in Kentucky Power's allowed return on equity. (8.75%/10.5% = 83.3%.)

[317] Settlement Agreement at ¶ 2.

(a The Company's Current Rates Fail To Provide Kentucky Power With A Reasonable Opportunity To Earn The Minimally Required Return On Equity.

The Company's authorized return on capital, including its return on equity, "must be sufficient to assure investors' confidence and adequate, under efficient and economical management, to maintain and support … [its] credit and enable it to raise money necessary to provide safe and reliable service to its customers," while also providing a reasonable opportunity for Kentucky Power "to earn an ROE comparable to contemporaneous returns available from alternative investments of similar risk …."[318]

Kentucky Power's current rates do not provide it with a reasonable opportunity to earn its allowed rate of return, or even the constitutional minimum. For the twelve months ended March 31, 2015, Kentucky Power earned a 2.4% return on equity.[319] That is below both the current yield on risk-free United States 30-year Treasury bonds and the Company's own debt.[320] Such a return on equity is not sustainable:

> Well, that is the return on equity. Kentucky Power's bonds, its rate is triple B. Triple B bonds now yield about 4 and a half to 4.6 percent. So it doesn't make sense that a company could return less to its equity holders who bear the risk of the company –
>
> …
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> So if you compare the bond yields, and all of the witnesses in this case have bond yields as a benchmark to the analyses they do, a realized 2.4 ROE is insufficient to compete with fixed income bonds either issued by the Treasury or issued by other utilities.[321]

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[318] Avera/McKenzie Rebuttal Testimony at R3-R4, citing *Federal Power Com'n v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944); *Bluefield Water Works & Improvement Co. v. Pub. Serv. Comm'n*, 262 U.S. 679, 694 (1923).

[319] Avera Hearing Testimony at 153.

[320] *Id.* at 153-154.

[321] *Id.* at 154-155.

Nor is it constitutionally adequate.[322]

The Intervenors' recommended returns on equity likewise fall short of the minimal constitutional standards. Moreover, both would threaten the Company's ability to provide, and its customers statutory right to receive, reasonable service.[323] Moreover, ensuring the Company's continuing ability to raise new capital is particularly important for Kentucky Power in light of the recognition by both Standard & Poor's Corporation and Moody's Investors Service last year of the Company's need to do so.[324]

(b) The Returns On Equity Proposed By Kentucky Power In Its Application And Provided For By And In The Context Of The Settlement Agreement Will Permit Kentucky Power To Operate Successfully And Maintain Its Financial Integrity[325] Without Placing An Unreasonable Burden On Its Customers.

Dr. Avera[326] employed multiple quantitative analyses using a "proxy group of publicly traded companies that investors regard as risk-comparable"[327] in developing his 10.62% recommended return on equity.[328] First, he developed four separate sets of estimates of the cost of equity for companies in a comparable risk proxy group, based upon earnings growth projections from four independent investor services, using the constant growth discounted cash flow ("DCF") model.[329] The constant growth DCF model is the "form of the [DCF] model most

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[322] *See e.g.*, Avera/McKenzie Direct Testimony at 27-29; Roger A. Morin, UTILITIES' COST OF CAPITAL 28-29 (1984).

[323] *Cf.* Avera/McKenzie Rebuttal Testimony at R11 (the recommendations of Dr. Woolridge and Mr. Baudino fall far below the returns available from other investments of comparable risk, thereby preventing Kentucky Power from earning its cost of capital and violating regulatory standards).

[324] *Id.* at 9.

[325] *See Public Service Commission v. Dewitt Water District*, 720 S.W.2d 725, 730 (Ky. 1986).

[326] The Company's direct and rebuttal testimonies regarding the appropriate return on equity were submitted jointly by Dr. Avera and Mr. McKenzie. Dr. Avera alone testified at the hearing. For ease of reference, the Company's direct, rebuttal, and hearing testimony will be ascribed in the body of this brief to Dr. Avera.

[327] Avera/McKenzie Direct Testimony at 20.

[328] *Id.* at 19-20.

[329] *Id.* at 39.

commonly relied upon to establish the cost of common equity for traditional regulated utilities and the method most often referenced by regulators."[330] The midpoints of these four sets of estimates ranged from 10.1% to 10.8%.[331]

Next, Dr. Avera employed the Empirical Capital Asset Pricing Model to evaluate the cost of equity for the comparable risk proxy group. The Capital Asset Pricing Model, upon which the ECAPM is founded, "is considered to be the most widely referenced method for estimating the cost equity among academicians and professional practitioners, … and is "the dominant model for estimating the cost of equity outside the regulatory sphere…."[332] As such, it provides "insight into investors' required rate of return for utility stocks, including Kentucky Power."[333] Using a forward-looking application of the ECAPM approach yielded an implied unadjusted ROE estimate of 11.3% and 12.2% after accounting for the impact of firm size.[334]

Third, Dr. Avera used the risk premium method, which is routinely used in the investment community and in regulatory proceedings,[335] to estimate the Company's required return on equity.[336] Using surveys of allowed returns on equity, the risk premium method implied a current cost of equity of 10.1%. Performing the same analysis, but using forecasted bond yields for BBB public utility bonds, resulted in an implied cost of equity of 11.3%.

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

[331] Avera/McKenzie Direct Testimony, Exhibit WEA/AMM 6 (page 3 of 3). The averages of these four estimates ranged from 9.4% to 10.1%. *Id.*

[332] Avera/McKenzie Direct Testimony at 46-47.

[333] *Id.* at 47.

[334] *Id.* at 50.

[335] *Id.* at 51.

[336] *Id.* at 51-56.

Dr. Avera next evaluated the strengths and weaknesses of each of the three analyses he employed to develop a range of 9.7% to 11.3% for the Company's "bare bones cost of equity."[337] To the mid-point of the range – 10.5% – he finally added flotation costs of 0.12% to arrive at his recommended 10.62%.

Despite the robustness of his initial analyses, Dr. Avera took extra steps to validate the reasonableness of his conclusions by employing CAPM analyses using historical and projected bond yields, an expected earnings analysis, and a DCF analysis of non-utility companies. These analyses produced average implied returns on equity ranging from 9.9% (expected earnings for the proxy group) to 11.9% (size-adjusted CAPM analysis using projected bond yields.) The mid-points of these same analyses ranged from 10.4% (non-utility DCF analysis using earnings growth projections from IBES) to 11.9% (size-adjusted CAPM analysis using projected bond yields.)

As Dr. Avera explained, these alternative ROE benchmarks confirm the reasonableness of the 10.62% return on equity requested in Kentucky Power's application.[338] Equally important, so long as the Company agrees to it as part of an overall settlement, the 10.25% return on equity prescribed by the Settlement Agreement for certain purposes is, by definition, also reasonable.

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[337] *Id.* at 5.

[338] *Id.* at 69; Exhibit WEA/AMM 3 (page 2 of 2).

(c) The Intervenors' Recommended Returns On Equity Are Based Upon Flawed And Unreasonable Analyses.

Both Dr. Woolridge and Mr. Baudino attempted some or all of the analyses employed by Dr. Avera.[339] But as Dr. Avera explained in detail in his rebuttal testimony, their analyses are both incomplete and otherwise flawed. In particular,

- Both failed to test the reasonableness of their calculated required ROEs against the expected earned rates of return for other utilities;[340]
- The screening criteria and data used by both to develop their proxy groups was flawed, and as a result their proxy groups must be rejected;[341]
- Several of their analyses employed illogical or otherwise unreasonable data that resulted in downward-biased cost of equity estimates;[342]
- Their failure to consider flotation costs contradicts the findings of financial literature;[343]
- Dr. Woolridge's decision to use a hodgepodge of historical data in employing his CAPM analysis violates the assumptions of this method and implies illogical results;[344] and
- Both Dr. Woolridge and Mr. Baudino employed other methodological errors.[345]

In addition, to these and other analytical shortcomings, a failing common to the return on equity recommendations of both Mr. Baudino and Dr. Woolridge is their refusal to account for widely-held expectations of higher capital costs during the period the rates are expected to be

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339 *See e.g.* Woolridge Direct at 28 (indicating that Dr. Woolridge performed both a DCF analysis and a Capital Asset Pricing Model study in making his recommendation. He further indicates he gave the CAPM study less weight); Baudino Direct at 13 (noting that Mr. Baudino relied upon a DCF analysis alone to estimate the Company's required rate of return. He also performed CAPM analyses, the results of which he contends support his conclusion, but he expressly states he did not rely upon those analyses in arriving at his recommended 8.75%).

340 Avera/McKenzie Rebuttal Testimony at R5-R6, R8.

341 *Id.* at R55-R57.

342 *Id.* at R18-R23; R26-R29.

343 *Id.* at R52-R54.

344 *Id.* at R2-R3.

345 *Id.*

effective.[346] As Dr. Avera explained under cross-examination by Staff, recent events evidence that interest rates can be expected to rise in the near term:

> If you look at the financial media, the big game being played is when the Federal Reserve is going to be – quit being patient…but I don't think there is any analyst out there that expects the Federal Reserve to maintain its extraordinary monetary ease beyond this year or even, if beyond this years, for the first few months of 2016.
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> …
>
> [I]n the market where the capital costs arise there is an expectation that interest rates are going to go up because we have an improving, slowly improving U.S. economy…unemployment, again, slowly, is trending down…and slowly there are indications of inflation, and I think the chair of the Federal Reserve has made clear that the ultimate goal is to return to a normal interest rate regime. We are in an abnormal interest rate regime now.[347]

Dr. Woolridge seeks to counter these investor expectations by arguing that similar expectations in the past have proven unfounded. He twice errs. First, whatever the batting average of analysts ***in the past***, Kentucky Power and other utilities will be competing for investor dollars in the future, and the expectations of those investors concerning future interest rates,[348] and not Dr. Woolridge's opinion of the accuracy of those expectations, will drive the required returns on equity.[349] Second, neither Mr. Baudino nor Dr. Woolridge seriously contest the fact that current interest rates constitute an anomaly "outside of historical norms."[350] Yet, their recommendations in large part reflect[351] the expectation that "the yields on utility bonds will

[346] Avera Hearing Testimony at 148-150.

[347] *Id.* at 149-150.

[348] Avera/McKenzie Rebuttal Testimony at R51-R52.

[349] Avera Hearing Testimony at 149; Avera/McKenzie Direct Testimony at 13-14.

[350] Avera/McKenzie Direct Testimony at 13 (quoting Federal Reserve President Charles Plosser); *see also*, *id.* at 12 (Figure 1).

[351] Avera/McKenzie Rebuttal Testimony at R51; *see also* Woolridge Direct Testimony at 14; Baudino Direct Testimony at 9.

remain near their lowest levels in modern history."[352] Such magical thinking is not a substitute for reliable analysis.

The returns on equity recommended by Dr. Woolridge and Mr. Baudino are further refuted by the authorized returns on equity for the utilities in their ***own*** proxy groups. Thus, while recommending an 8.75% return on equity, the average authorized return on equity of the utilities in Mr. Baudino's proxy group was almost 130 basis points higher at 10.03%.[353] The average authorized return on equity for the utilities in Dr. Woolridge's proxy group was 10.16%, or approximately 150 basis points higher than Dr. Woolridge's proposal. In short, the Intervenors' recommendations are at war with data for their own proxy groups, and fall far short of investors' opportunities based on risk-comparable investments.

Nor do the recommendations of Dr. Woolridge and Mr. Baudino compare well with recently awarded electric utility returns on equity:[354]

	Basis Points Deviation From Dr. Woolridge's Recommendation (8.65%)	Basis Points Deviation From Mr. Baudino's Recommendation (8.75%)	Basis Points Deviation From Dr. Avera's Recommendation (10.62%)	Basis Points Deviation From Settlement Agreement Proposed ROE (10.25%)
RRA Average For Calendar 2014 (9.91%)	-126	-116	71	34
RRA Average For Calendar 2014 (Excluding Virginia Cases) (9.76%)	-111	-101	86	49
RRA Average For Q1 2015 (10.37%)	-172	-162	25	-12
RRA Average For Q1 2015) (Excluding Virginia Cases) (9.67%)	-102	-92	95	58

Smallest Deviation
Largest Deviation

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[352] Avera/McKenzie Direct Testimony at 12.

[353] Avera/McKenzie Rebuttal Testimony at R11. (10.03%/8.75% = 114.63%.)

[354] Kentucky Power Hearing Exhibit 1; Avera Hearing Testimony at 147.

In all cases, the Settlement Agreement-proposed return of 10.25% deviated the least from the RRA- reported average-awarded ROE. Conversely, in all cases Dr. Woolridge's proposed ROE of 8.65% showed the greatest deviation from the average-ROE. Moreover, with a single exception,[355] Dr. Avera's recommended 10.62% ROE showed a smaller deviation from the reported average than did the recommendations of either Dr. Woolridge or Mr. Baudino. These relationships held even when, as suggested by the Attorney General in his cross examination of Dr. Avera,[356] the returns awarded by the Virginia State Corporation Commission are eliminated.

The upward deviation implied by both Dr. Avera's proposed 10.62% ROE and the 10.25% return contained in the Settlement Agreement[357] from the RRA-reported average awarded returns on equity in 2014 properly reflect the additional riskiness of Kentucky Power.[358] Conversely, the substantial downward deviations in the recommendations of Dr. Woolridge and Mr. Baudino from the RRA-reported averages for 2014 run counter to their acknowledgement that Kentucky Power "is on the high risk end of the electric utility industry."[359] Indeed, even Dr. Woolridge explicitly acknowledged Kentucky Power's higher risk and recommended a 0.25% upward adjustment to Kentucky Power's return to account for differences from his proxy group.[360] Moreover, neither explains why the Company's currently authorized return on equity

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[355] Dr. Avera's recommendation deviated by three basis more than that of Mr. Baudino when each is compared to the average awarded ROE in the first quarter of 2015 excluding the Virginia decisions.

[356] Avera Hearing Testimony at 147. As Dr. Avera further explained on cross-examination there is no principled basis for excluding the Virginia decisions. *Id.* at 147 ("[b]ut we average out all of the returns, the ones that may be high for some reason or low for some reason, to get an annual average, and we compare that to the contemporaneous bond yield, and we get a very good statistical relationship.")

[357] The Settlement Agreement's recommended ROE of 10.25% was 12 basis points less than the RRA-reported average for the first quarter of 2015.

[358] *See* Avera Hearing Testimony at 151, 153.

[359] *See id.* at 151.

[360] Woolridge Direct Testimony at 2. As discussed subsequently, however, comparing Dr. Woolridge's end-result in this case with his recommendations in other Kentucky proceedings, or indeed any of the objective benchmarks discussed by Dr. Avera, indicates that his own recommendation contradicts his findings that Kentucky Power warrants a higher allowed return to account for its greater relative risk

should be adjusted downward by approximately 18% when the average return on equity for the first quarter of 2015 is slightly higher than the average return on equity in 2010 when Kentucky Power's current return on equity was established.[361]

Finally, although provided with a copy of the Settlement Agreement prior to being presented for cross-examination, Dr. Woolridge did not avail himself of the opportunity to consider the effect of Kentucky Power's agreement to forego the opportunity to recoup up to $54 million in Mitchell no load costs on the reasonableness of the parties' agreement to use a 10.25% return on equity for certain purposes.[362] If he had done so, the approximate $7.73 million in additional annual revenue[363] that would be produced by the 155 basis points[364] spread between the average of the Intervenors' recommended returns on equity and the 10.25% return provided for by the Settlement Agreement, pales in comparison to the certainty of the up to $54 million in avoided fuel costs gained by the Company's customers through the Settlement Agreement.

Dr. Woolridge's proclivity for ignoring contrary facts continued during his testimony at the May 5, 2015 hearing in this case. When asked to reconcile Kentucky Power's credit rating, which is lower than either Louisville Gas and Electric Company and Kentucky Utilities Company,[365] thus indicating it was a riskier investment requiring a higher return on equity,[366] with his insistence that the Commission should limit Kentucky Power to an 8.65% return on equity, his repeated response was that his 8.65% recommendation accounted for Kentucky

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[361] *See* Kentucky Power Hearing Exhibit 1 at 3.

[362] Woolridge Hearing Testimony at 165-167.

[363] *See* Exhibit 2 Settlement Agreement. ($498,888,221 (test year ended common equity shown on Exhibit 2 to Settlement Agreement) x 1.55% (155 basis points) = $7,732,767.)

[364] (8.65% + 8.75%)/2 = 8.70%; 10.25% - 8.70% = 155 basis points.

[365] Kentucky Power Hearing Exhibit 2; Woolridge Hearing Testimony at 163.

[366] Woolridge Hearing Testimony at 160-161.

Power's credit rating and comparatively higher risk.[367] Yet, two months before the Kentucky Power hearing, and slightly more than two weeks prior to filing his testimony in this case, Dr. Woolridge recommended a ***higher not lower*** return on equity for both the less risky Kentucky Utilities[368] and Louisville Gas and Electric (electric operations).[369]

Dr. Woolridge's recommendation of an 8.65% return on equity for Kentucky Power, and his contention that this end-result reflects any meaningful attempt to account for Kentucky Power's relative riskiness vis-à-vis Louisville Gas and Electric and Kentucky Utilities, is not credible and should be rejected.[370]

2. The Company's Incentive Compensation Program Is Part Of A Market-Competitive Total Compensation Package Necessary To Hire And Retain Personnel Required To Provide "Adequate, Efficient, And Reasonable Service."[371]

Through the testimony of Mr. Smith, the Attorney General adjusted the Company's proposed compensation expense to remove 100% of the Company's Long Term Incentive Plan

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[367] *Id.* at 163, 168, 169.

[368] Direct Testimony of J. Randall Woolridge, Ph.D., *In the Matter of: The Application Of Kentucky Utilities Company For An Adjustment Of Its Electric Gas Rates*, Case No. 2014-00371 at Summary, 2, 54-56 (Ky. P.S.C. Filed March 6, 2015) ("Therefore I conclude the appropriate equity cost rate for the Company is 8.75%.") available at http://psc.ky.gov/pscecf/2014-00371/rateintervention%40ag.ky.gov/03062015060339/JRW_371_Testimony_and_Exhibits.pdf. To the extent required Kentucky Power Company requests the Commission take administrative notice of this testimony. A copy of the relevant portion is attached as **EXHIBIT 2**.

[369] Direct Testimony of J. Randall Woolridge, Ph.D., *In the Matter of: The Application Of Louisville Gas And Electric Company For An Adjustment Of Its Electric And Gas Rates*, Case No. 2014-00372 at 56 (Ky. P.S.C. Filed March 6, 2015) ("Therefore I conclude the appropriate equity cost rate for the Company's electric operations is 8.75%.") available at http://psc.ky.gov/pscecf/2014-00372/rateintervention%40ag.ky.gov/03062015060919/372_JRW_Testimony_and_Exhibits.pdf. To the extent required Kentucky Power Company requests the Commission take administrative notice of this testimony. A copy of the relevant portion is attached as **EXHIBIT 3**.

[370] Even discounting the point for the fact that a settlement represents concessions on both sides, and that agreement on one point may be offset, in the eyes of a particular party to the agreement, by gains made on a different point, it is instructive that approximately two weeks before the Kentucky Power hearing Dr. Woolridge's client agreed to a 10.0% return of equity for certain purposes in settlement agreements with the less risky Louisville Gas and Electric and Kentucky Utilities. *See* Woolridge Hearing Testimony at 168-169.

[371] *See* KRS 278.030(2). There is no separate provision in the Settlement Agreement addressing the Company's incentive compensation programs. Thus, their costs are reflected, if at all, as part the black box settlement that led to the $23 million decrease in base rates.

("LTIP") expense and 75% of the Company's Annual Incentive Compensation Plan ("AIP") expense.[372] No objection was made by the Attorney General to the reasonableness or market competitiveness of the Company's total compensation levels which include both LTIP and AIP amounts.[373] Both the LTIP and AIP are necessary parts of the Company's market competitive compensation packages and are necessary to attract and retain key employees to the benefit of customers.

(a) The AIP Provides Benefits To The Company's Customers And Should Be Included In Compensation Expense.

The Attorney General argues that 75% of the Company's AIP expense should be excluded from the Company's recoverable expenses. In doing so, the Attorney General misconstrues the fundamental difference between funding measures, which AEP uses in the AIP to ensure that the annual overall incentive compensation payouts are affordable at the parent company level, and performance measures which provide the incentive for employee behavior.[374] In reality, only one part of the Kentucky Power 2014 AIP performance measures (Kentucky Power Net Income) is related to the Company's financial performance.[375] The remainder of the performance measures, the standards that drive employee behavior, are related to items such as safety and customer reliability.[376] The AIP is simply a mechanism for the Company to provide goal oriented compensation to its employees, and as such incentivizes their efforts to reduce costs, operate safely and efficiently, and provide reliable service to the

[372] Smith Direct Testimony at 47-55.

[373] Carlin Rebuttal Testimony at R2.

[374] *Id.* at R4.

[375] *Id.* at R6-R7.

[376] *Id.* at R7.

Company's customers.[377] The Attorney General's arguments against including AIP expense are without merit and should be rejected.[378] The Company's AIP expense is prudently incurred and should be recoverable as part of the Company's market competitive total compensation package.

(b) The Company's LTIP Benefits Customers And Should Be Recoverable.

In addition to challenging the recovery of the Company's prudently incurred AIP expense, the Attorney General proposes removing 100% of the Company's LTIP expense. As with his challenge to the AIP expense, the Attorney General's arguments in opposition to the Company's LTIP expense are without merit and should be rejected. Contrary to the assertions of Mr. Smith, the financial performance measures in the LTIP benefit customers by providing an incentive to key employees to control costs, the only lever most utility employees have to affect the Company's financial performance.[379] Without the LTIP, the Company would need to increase other types of compensation, including salary, to ensure that the total compensation package offered remains market competitive.[380] Tying a portion of the compensation package to performance based incentives provides efficiency benefits (through an employee's heightened focus on managing costs) in excess of those provided by fixed compensation.[381] The Company's long-term incentive compensation program provides substantial benefits to the Company's customers by serving as a component of the Company's market competitive total compensation

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[377] *Id.* at R8.

[378] In addition to being meritless, the Attorney General's adjustment to AIP expense is miscalculated. The Attorney General ignores the adjustments in the case to remove Big Sandy generation expense and to annualize Mitchell expense. As a result, the Attorney General double-counts the effect of his proposed removal of generation related AIP expense. Yoder Rebuttal Testimony at R3-R6.

[379] Carlin Rebuttal Testimony at R13.

[380] *Id.* at R3.

[381] *Id.* at R13.

package that incents employees to manage costs. LTIP expenses are prudently incurred and should be recoverable by the Company.

3. Costs Associated With The Engage To Gain Program Were Prudently Incurred And Should Be Recovered By The Company.

The Attorney General seeks to remove from the Company's rates those costs associated with Kentucky Power's Engage to Gain Program.[382] The Engage to Gain program provided incentives to employees to submit cost-saving and revenue-enhancing ideas.[383] This program and the costs incurred through it have contributed to long-term savings reflected in the Company's cost of service.[384] In fact, the savings produced by the Engage to Gain Program were more than twice the costs.[385] Along with those savings, the corresponding costs that produced the savings should be reflected in the cost of service.[386] The Attorney General ignores this key relationship and, accordingly, his adjustment must be rejected.

4. Any Liability Associated With Conner Run Impoundment Is Consistent With Ownership Of An Industrial Facility.

Mr. Smith testified on behalf of the Attorney General that the Company's customers should not be responsible for any liabilities associated with a hypothetical accident at the Conner Run Impoundment.[387] This argument is baseless. As an initial matter, the Conner Run Impoundment is maintained and operated in accordance with all applicable regulations.[388] Second, because the Company has converted to a dry fly ash handling system and is

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[382] Smith Direct Testimony at 55. Like the incentive compensation program costs, these costs are reflected, if at all, in the $23 million black box reduction in base rates.

[383] Wohnhas Rebuttal Testimony at R14.

[384] *Id.*

[385] Carlin Hearing Testimony at 242.

[386] Wohnhas Rebuttal Testimony at R14.

[387] Smith Direct Testimony at 73-75.

[388] LaFleur Confidential Hearing Testimony at 26-27. This portion of Mr. LaFleur's hearing testimony was given during closed session; however, his testimony in this regard is not confidential.

reconfiguring its cooling tower blowdown system, the Company will soon no longer place any material in the Conner Run Impoundment.[389] As a result, the Company is negotiating with Murray Coal Company to transfer its ownership interests in the Conner Run Impoundment.[390]

More fundamentally, in Case No. 2012-00578, the Commission approved the transfer to the Company of an undivided 50% of the assets, and the accompanying associated liabilities, of the Mitchell generating station.[391] The Conner Run Impoundment was part of the assets transferred to the Company and with it the associated liabilities.[392] Conner Run provided valuable service to the Company and its customers as a repository for fly ash and cooling water blowdown.[393] The Attorney General provides no basis for its assertion that hypothetical future liability relating to this portion of the valuable asset acquired by the Company should be treated any different than any other asset.[394] The Attorney General's meritless arguments about the Conner Run impoundment must be rejected.

5. Recovery Of PJM Costs Associated With Big Sandy Unit 1 Through The BS1OR Is Reasonable And Consistent With The Mitchell Stipulation.

The Attorney General argues that Company's PJM charges associated with Big Sandy Unit 1 should be removed from the annual revenue requirement to be recovered under Tariff B.S.1.O.R. As justification for removing these costs, the Attorney General claims, without support, that including such costs in the BS1OR could "lead to abuse" because PJM invoices can

[389] LaFleur Confidential Hearing Testimony at 19-20.

[390] McManus Hearing Testimony at 32-33.

[391] Mitchell Order at 43.

[392] Wohnhas Rebuttal Testimony at R15.

[393] *Id.*

[394] *Id.*

be "quite complicated."[395] The Attorney General's position is unsupported and otherwise without merit.

First, PJM charges resulting from the operation of Big Sandy Unit 1 are properly considered "coal related operating expenses" as contemplated in Paragraph 3 of the Mitchell Stipulation and Settlement Agreement.[396] These PJM costs are incurred as the direct result of amount of MWh of generation produced by Big Sandy Unit 1 and should, therefore, be recovered through the BS1OR.[397] Additionally, the Attorney General's thinly veiled accusation that the Company would somehow use the BS1OR to hide the true PJM costs from the Commission and other interested parties lacks record support. Because of the annual filing requirements, recovering Big Sandy related operating costs via the BS1OR is particularly transparent. [398] Moreover, the Company has agreed to set up a separate PJM subaccount for Big Sandy Unit 1 alleviating any of the Attorney General's unfounded concerns about an audit trail.[399] The PJM charges associated with Big Sandy Unit 1 are properly included in the annual revenue requirement to be recovered under Tariff B.S.1.O.R.

CONCLUSION

The Settlement Agreement fairly balances the interests of the Company's customers and Kentucky Power alike. The agreement provides Kentucky Power with a reasonable opportunity to earn a fair rate of return, furnishes the Company with the financial and regulatory resources to furnish reliable and cost-effective service to its customers, while providing the Company's customers with significant benefits, a number of which exceed those available in the absence of

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[395] Smith Direct Testimony at 67.

[396] Vaughan Rebuttal Testimony at R6.

[397] *Id.*

[398] Wohnhas Direct Testimony at 26.

[399] Vaughan Hearing Testimony at 266-67.

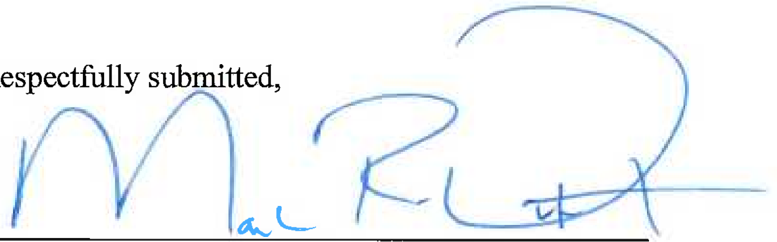
the Commission's approval of the Settlement Agreement. Among the benefits flowing to customers through the Settlement Agreement are:

- A $23 million reduction in base rates;
- The resolution of the multiple appeals from the Commission's January 22, 2015 Order in Case No. 2014-00225, along with the resolution of the no load cost issue on an on-going basis;
- The establishment of the Company's enhanced Distribution Vegetation Management Program and migration to a five-year cycle beginning in 2019 at an overall cost of approximately $20 million less than originally proposed by Kentucky Power;
- An innovative rate reduction provision in connection with the Company's enhanced Distribution Vegetation Management Program;
- An estimated annual $300,000 contribution by Kentucky Power's shareholder to economic development efforts in the Company's service territory; and
- Implementation of multiple provisions of the Commission-approved Mitchell Stipulation, while bringing the Company's 50% undivided interest in the Mitchell generating station fully into rates at a non-fuel cost less than estimated by the Company in the Mitchell Transfer case.

Neither of the Attorney General's witnesses recommended that the Settlement Agreement be rejected. Most importantly, there is substantial and compelling evidence that the Settlement Agreement, and the rates and tariffs to be established pursuant to it, are fair, just, and reasonable.

Kentucky Power respectfully requests that the Commission enter an Order approving the Settlement Agreement and the Company's 2014 Environmental Compliance Plan, and authorizing all further relief necessary to implement their provisions.

Respectfully submitted,



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I hereby certify that a copy of the foregoing Post-Hearing Brief of Kentucky Power Company was filed using the Public Service Commission of Kentucky's electronic filing service, which will send an e-mail message to with a link to the brief to:

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on this 5th day of June 2015.

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