COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

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

REBUTTAL TESTIMONY OF

MARC D. REITTER

ON BEHALF OF KENTUCKY POWER COMPANY

VERIFICATION

The undersigned, Marc D. Reitter, being duly sworn, deposes and says he is the Managing Director, Corporate Finance for American Electric Power Service Corporation and that he has personal knowledge of the matters set forth in the forgoing testimony and the information contained therein is true and correct to the best of his information, knowledge and belief.

Marc D. Reitter

STATE OF OHIO	)	
	)	Case No. 2014-00396
COUNTY OF FRANKLIN	)	

Subscribed and sworn to before me, a Notary Public in and before said County and State, by Marc D. Reitter, this the 27 day of April 2015.

Notary Public

NOTARIAL SEAL STATE OF OHIO

My Commission Expires: David C. House, Attorney At Law NOTARY PUBLIC - STATE OF OHIO My commission has no expiration date Sec. 147.03 R.C.

REBUTTAL TESTIMONY OF
MARC D. REITTER
KENTUCKY POWER COMPANY
BEFORE THE PUBLIC SERVICE COMMISSION OF KENTUCKY

Q. PLEASE STATE YOUR NAME.

A. My name is Marc D. Reitter.

Q. ARE YOU THE SAME MARC D. REITTER WHOSE DIRECT TESTIMONY WAS FILED IN THIS CASE ON DECEMBER 23, 2014?

A. Yes.

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. The purpose of my rebuttal testimony is to respond to the pre-filed testimony of Lane Kollen on behalf of the Kentucky Industrial Utility Customers ("KIUC") as it relates to the appropriate capital structure and cost of capital for Kentucky Power Company ("Kentucky Power" or "Company"). Specifically, I will address Mr. Kollen's testimony as it relates to (1) Mr. Kollen's assertion the Company "excessively" financed its operations in order to invest in the Utility Money Pool; and (2) the adjustment to the Company's capitalization by reducing the long-term debt and equity components by the Company's invested position in the AEP Utility Money Pool at the end of the test year September 30, 2014.

Q. PLEASE SUMMARIZE WITNESS KOLLEN'S ALLEGATION THAT KENTUCKY POWER "EXCESSIVELY" FINANCED ITS BUSINESS IN ORDER TO INVEST IN THE UTILITY MONEY POOL.

A. Mr. Kollen's limited discussion on page 47 of his testimony claims that the Company "excessively" issued long-term debt and equity so that it would have cash to invest into the Utility Money Pool and earn interest income at historic low rates.

Q. DO YOU AGREE WITH MR. KOLLEN'S ASSERTION?

A. No. Mr. Kollen's claim that Kentucky Power issued long-term debt and equity for the sole purpose of investing the proceeds into the Utility Money Pool is incorrect. As discussed in my direct testimony on pages 4-5, the Company has recapitalized to a level that is representative of the Company's capital structure prior to the Mitchell Asset transfer. As part of this recapitalization effort the Company had various finance related activities throughout the test year. The Company's proposed capitalization for rate making purposes included activities that refinanced both short and long-term debt obligations and redeemed a higher cost $25 million affiliated note. Further, the Company reduced equity by distributing $155 million of equity capital in the form of dividends and the return of paid in capital as it related to the Mitchell Asset transfer. The end result of these finance activities returned Kentucky Power's capital structure to approximately 54% debt to capitalization as it was prior to the Mitchell asset transfer and representing a level appropriate for its "BBB/Baa2" credit rating category.

Q. PLEASE SUMMARIZE WITNESS KOLLEN'S PROPOSED ADJUSTMENT TO THE COMPANY'S CAPITAL STRUCTURE FOR THE COMPANY'S SHORT-TERM INVESTMENT IN THE UTILITY MONEY POOL.

A. As described on pages 46 and 47 of his testimony, Mr. Kollen proposes to reduce the Company's per books balances for the amount Kentucky Power was invested in the Utility Money Pool at September 30, 2014. Mr. Kollen reduces the Company's long-term debt balance by $5.169 million and the Company's equity balance by $4.409 million for a total capitalization reduction of $9.577 million.

Q. DO YOU AGREE WITH WITNESS KOLLEN'S ADJUSTMENT TO THE COMPANY'S CAPITALIZATION?

A. No. Mr. Kollen's reduction to the components of the Company's capitalization for the amount the Company was invested in the Utility Money Pool at September 30, 2014 simply disregards the benefits to the customers of Kentucky Power by remaining a participant in the Utility Money Pool program. This is a vital funding mechanism for Kentucky Power that allows the Company to efficiently finance short-term working capital requirements. To make an adjustment such as Mr. Kollen proposes suggests that he believes Kentucky Power should not participate in such a low-cost and efficient funding program. As described below, Kentucky Power's participation in the Utility Money Pool provides considerable benefit to the Company's customers.

Q. WHAT IS THE UTILITY MONEY POOL?

A. The AEP Utility Money Pool is the portion of the Corporate Borrowing Program that is the short-term funding mechanism for the regulated utilities, including Kentucky Power. It is structured to meet the combined short-term cash management needs of those companies. The Utility Money Pool meets the short-term cash needs of its participants by providing for short-term borrowings from the Utility Money Pool by its participants and short-term investment of surplus funds by its participants. The AEP Utility Money Pool is governed by the AEP System Amended and Restated Utility Money Pool Agreement dated as of December 9, 2004, a copy of which has been filed with FERC and was provided by the Company in response to KIUC's data request 1-39.

Q. HOW DOES THE UTILITY MONEY POOL OPERATE?

A. AEP Service Corporation ("AEPSC") acts as the administrative agent of the Corporate Borrowing Program, including the Utility Money Pool. On a daily basis, members of the AEPSC Cash Management group gather information from each company participating in the Utility Money Pool to determine its cash needs for the current day. Available funds from the companies are "pooled" against borrowing requirements to determine a "net" amount for the entire group. If the cash needs of the group exceed the cash available from the group, i.e., the Money Pool is in a borrowed position, then, AEP will fund the difference by issuing short-term debt externally, typically AEP commercial paper, or using a portion of AEP's available cash. If cash available from the group exceeds the cash needs, i.e., the Money Pool is in an invested position, then AEP will invest the difference externally in accounts designated for the Utility Money Pool.

Q. PLEASE DESCRIBE WHAT IT MEANS FOR KENTUCKY POWER TO BE IN A BORROWED OR INVESTED CASH POSITION IN THE AEP UTILITY MONEY POOL.

A. On any single day, Kentucky Power could be in either a borrowed cash position or invested cash position in the Utility Money Pool. If Kentucky Power at any given point in time has short-term debt, then it is in a borrowed position within the AEP Utility Money Pool. On the other hand, if the Company at any given point in time does not have any borrowings from the AEP Utility Money Pool, then the Company is effectively lending to the pool and is in an invested position in the AEP Utility Money Pool.

When the Money Pool as a whole is in a borrowed position, an average interest rate is calculated daily and applied to each company's borrowings or investments in order to allocate the actual interest costs to all the participants. The interest rate is the composite weighted average daily effective cost incurred by AEP for short-term borrowings from external sources. However, if the Money Pool is in an invested position, a 30-day Federal Reserve "A2/P2" Non-Financial Commercial Paper Composite Rate is used as the daily interest rate. When the Money Pool is invested, an average interest rate is calculated daily and applied to each participant company's borrowings or investments in order to allocate the actual interest to all the participants. The interest rate is the composite weighted average daily effective rate received by AEP for short-term investments from external sources. In this way, both the borrowing and investment interest rates are the same for all participants.

Q. WOULD YOU CONSIDER ANY INVESTMENT BY KENTUCKY POWER IN THE UTILITY MONEY POOL TO BE TEMPORARY?

A. Yes. This is true for Kentucky Power and all the participants of the Utility Money Pool. Cash positions for each entity in the Utility Money Pool change day to day regardless of whether the entity is borrowed or invested, thus any investment is temporary as the capital is normally returned to Kentucky Power as the Company invests in its business.

Q. WAS KENTUCKY POWER IN A BORROWED POSITION IN THE UTILITY MONEY POOL DURING THE TEST YEAR ENDING SEPTEMBER 30, 2014?

A. Yes. Although Kentucky Power was in an invested position in the Utility Money Pool at the end of the test-year September 30, 2014, it borrowed short-term debt from the Utility Money Pool during eight out of the twelve months of the test year. Mr. Kollen omits this fact even though he was provided this data in the Company's response to KIUC 1-41.

Q. PLEASE DESCRIBE THE BENEFITS TO KENTUCKY POWER OF BEING A PARTICIPANT IN THE AEP UTILITY MONEY POOL.

A. The Utility Money Pool benefits Kentucky Power in several ways as compared to managing its short-term funding requirements independently. First, each participant does not have to obtain and maintain a short-term credit rating from a rating agency, as would be required if that subsidiary were to operate a separate money pool and use it to issue commercial paper. The fees to maintain these ratings depend on the amount of commercial paper issued, but in any case, this represents a significant cost. Second, in order to issue commercial paper, each subsidiary would need to obtain its own credit facility to act as a "backstop" for the issuance. The Utility Money Pool allows the participants to use the AEP credit facility as the backstop; thereby eliminating the upfront and ongoing costs associated with obtaining a separate credit facility and allowing for an overall smaller credit facility than if each utility had to maintain separate commitments. Third, the system-wide approach reduces overhead costs to its participants, as they benefit from the economies of scale associated with the program.

Another benefit is that the Utility Money Pool is used to fund inter-company transactions, thereby reducing bank charges and minimizing the amount of cash required to be on hand. By settling the inter-company transactions through this internal mechanism, the number of transactions with external banks is reduced, thereby reducing the transaction fees paid to banks.

Finally, the Utility Money Pool benefits Kentucky Power's customers by allowing the Company to fully invest any available funds on a daily basis and earn better rates than it could on its own. Without the Utility Money Pool, the Company would have to invest funds externally. A minimum initial investment amount ranging from $1 million to $10 million is required to participate in the institutional investment funds used by AEP. As a result, Kentucky Power might not be able to externally invest all available funds each day and any funds not able to be invested externally would remain in the Company's bank account and earn a lower return from the bank. However, because the Utility Money Pool has no minimum requirements, it allows Kentucky Power to invest all available cash on a daily basis and earn the average interest rate on the full amount regardless of the level of its cash-on-hand, resulting in the Company earning a better return on its cash than it would earn if it were on a stand-alone basis.

Q. DID KENTUCKY POWER EARN INTEREST INCOME DURING THE TEST YEAR AS A RESULT OF THE COMPANY AT TIMES BEING IN AN INVESTED POSITION IN THE UTILITY MONEY POOL?

A. Yes. Kentucky Power received interest income during periods when the Company was in an invested position in the Utility Money Pool. The income is recognized on the Company's income statement, thus available for reinvestment in the Company's business operations.

Q. WHAT WOULD HAPPEN IF KENTUCKY POWER WERE NO LONGER A PARTICIPANT OF THE AEP CORPORATE BORROWING PROGRAM?

A. Kentucky Power like most utilities is a large user of capital. Reliance on access to short-term and long-term capital is critical to maintain the obligation to serve its customers in a safe low-cost manner. If Kentucky Power and its customers no longer able to benefit from being a participant in the Utility Money Pool, the Company would have to establish a similar program on a stand-alone basis in order to efficiently fund working capital requirements. Doing so would materially increase costs to Kentucky Power and its customers.

Q. WHAT WOULD BE REQUIRED FOR KENTUCKY POWER TO ESTABLISH A SHORT-TERM WORKING CAPITAL LIQUIDITY PROGRAM?

A. For Kentucky Power to establish a stand-alone short-term funding mechanism, the following must occur: (1) Kentucky Power would have to obtain and maintain short-term debt ratings from Moody's and Standard & Poor's of at least an "A2/P2" rating to access the investment grade commercial paper market; (2) Kentucky Power would have to approach numerous banks willing to lend and be part of a syndicate for a credit facility, which is required as it will act as a backstop for the new commercial paper program; (3) Kentucky Power would have to maintain and manage new bank accounts to ensure appropriate controls and oversight of the daily processing of cash and forward placement of commercial paper funding requirements; and (4) Kentucky Power would have to attract and dedicate newly qualified resources to manage the overall effort of the new stand-alone liquidity program.

Q. IF KENTUCKY POWER HAD TO OBTAIN A SHORT-TERM DEBT RATING, IS IT GURANTEED THAT THE RATING AGENCIES WOULD ASSIGN THE SAME SHORT-TERM DEBT RATING AS AEP?

A. No. The rating agencies will assign a short-term debt rating based upon the underlying merits of Kentucky Power's financial health and credit profile. The rating agencies will likely view the absence of access to the Utility Money Pool for short-term working capital as a credit negative. If the rating agencies assign a rating below AEP's short-term debt rating of “A2/P2”, then this would result in a material increase in the cost of commercial paper for Kentucky Power.

Q. IF THE UTILITY MONEY POOL WERE NOT AVAILBLE TO KENTUCKY POWER, WOULD YOU EXPECT THE SHORT-TERM BORROWING AND RELATED COSTS INCURRED BY KENTUCKY POWER TO INCREASE?

A. Yes. If Kentucky Power did not participate in the AEP Utility Money Pool, then it would lose all the cost efficiencies and benefits that it is afforded today by being a participant in the Utility Money Pool. Kentucky Power’s cost to maintain a similar short-term liquidity program would increase nearly three times the amount the Company incurs by being a participant in the Utility Money Pool program.

Q. WHAT DOES MR. KOLLEN’S PROPOSED RECOMMENDATION SUGGEST FOR KENTUCKY POWER’S PARTICIPATION IN THE AEP UTILITY MONEY POOL?

A. Mr. Kollen’s proposed adjustment represents an effort to cherry-pick among the terms of the Utility Money Pool. The Utility Money Pool is able to function as it does, and provide the benefits of lower-cost short term borrowing to Kentucky Power, because it is funded in full or part, on a daily basis, by those members who have surplus cash. Mr. Kollen is more than willing to accept the benefits of the Utility Money Pool when the Company is in a borrowed short-term position, but is unwilling to recognize the corresponding responsibility (for which the Company receives interest income that is used to reduce its working capital needs) of investing surplus cash. His testimony suggests that he effectively supports restricting the Company’s participation in the Utility Money Pool to only borrowing funds from the other participants and not reciprocating by lending during days of excess cash. This will encumber the efficiency and purpose of the corporate borrowing program.

Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

A. Yes.