Q. IS THE COMPANY REQUESTING THE INCLUSION OF ALL TEST YEAR ANNUAL INCENTIVE COMPENSATION IN ITS REVENUE REQUIREMENT IN THIS CASE?

A. No. The Company is requesting that the O&M expense for the amount of annual incentive compensation supported by Company witness Yoder for the test year be included in cost of service rather than the actual per books O&M expense. Annual incentive compensation during the test year was actually higher than the target amount due to above target EPS results for the test year. The Company is requesting the normalization of these costs to the level supported by Company Witness Yoder. The target amount of annual incentive is the amount of compensation that the Company needs to pay, on average, in order to provide market competitive total compensation. The annual incentive compensation amount was adjusted to a level as supported by Company Witness Yoder in Section V, Exhibit 2, W25.

Q. WHAT ARE THE BENEFITS TO CUSTOMERS OF THE EARNINGS AND OTHER FINANCIAL MEASURES INCLUDED IN THE COMPANY'S ANNUAL INCENTIVE PROGRAM?

A. Tying funding for annual incentive compensation to the Company's earnings and cost control promotes efficient use of financial resources, which is paramount to providing reliable service at a reasonable cost to customers. The earnings and O&M measures included in the Company's incentive compensation programs convey the importance of maintaining financial discipline, and directly encourage employees to reduce expense, operate efficiently, and conserve financial resources. This has and will even stringent annual O&M budgets when major unbudgeted work additions and reductions are excluded.

Most of such savings have already reduced Kentucky Power's cost of service and rates for Kentucky customers on a dollar for dollar basis through prior base rate proceeding. If only 1 percent of the Company's O&M expense is saved each year due to the incentive compensation program, then millions of dollars per year has been saved by Kentucky customers by virtue of tying incentive compensation to the Company's financial performance measures.

Q. ARE THERE ANY INDIRECT COSTS TO CUSTOMERS OF THE COMPANY'S ANNUAL INCENTIVE PROGRAM?

A. No, there are no indirect costs that offset its benefit to customers. The earnings goals in the Company's annual incentive plan are established with stretch but achievable earnings targets. This ensures that incentive compensation up to target does not encourage company employees to pursue excessive earnings to the detriment of customers. Because the Company is only seeking inclusion of the amount of incentive compensation supported by Company Witness Yoder in its cost of service, the cost of any compensation above this amount would be born entirely by shareholders. Furthermore, since the Company's revenue is regulated through this and other robust rate case proceedings, the only remaining way for the Company's employees to achieve these earnings objectives is through cost control, which benefits customers. In addition, the balanced scorecard of objectives the Company uses in its annual incentive program help ensure that some measures are not achieved at the expense of other important objectives, such as the safety, operations and environment objectives.