

Application Of Kentucky Power Company For: A General Adjustment
of Rates; Approval of 2014 Environmental Compliance Plan; Approval of Tariffs And Riders; and An Order Granting
All Other Required Approvals and Relief
Case No. 2014-00396
Attorney General's Responses to Data Requests of Kentucky Power Company

WITNESS/RESPONDENT RESPONSIBLE:

Ralph C. Smith

QUESTION No. 1

Page 1 of 1

Please provide all schedules, tables, and charts included in the testimony and exhibits to the testimony of Mr. Smith in electronic format, with formulas intact and visible, and no pasted values.

RESPONSE:

The schedules, tables, and charts included in AG witness Smith's Direct Testimony and exhibits can be found in Attachment KPCo-AG-1-1, in Excel format with formulas intact. Also, see the response to KPCo-AG-1-5.

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WITNESS/RESPONDENT RESPONSIBLE:

Ralph C. Smith

QUESTION No. 2

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Please provide all workpapers, source documents, and electronic spreadsheets used in the development of the testimony of Mr. Smith. The requested information, if so available, should be provided in an electronic format, with formulas intact and visible, and no pasted values.

RESPONSE:

Please see the response to Question Nos. 1 and 5.

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WITNESS/RESPONDENT RESPONSIBLE:

Dr. J. Randall Woolridge

QUESTION No. 3

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Please provide all schedules, tables, and charts included in the testimony and exhibits to the testimony of Mr. Woolridge in electronic format, with formulas intact and visible, and no pasted values.

RESPONSE:

The requested items are included in Dr. Woolridge's work papers, source documents, and work sheets which are being uploaded simultaneously with this response. The requested schedules, tables, and charts are provided in the file 'KPC KY 2015 ROR Exhibits - 3-23-15 - JRWoolridge.xls.'

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WITNESS/RESPONDENT RESPONSIBLE:

Dr. J. Randall Woolridge

QUESTION No. 4

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Please provide all workpapers, source documents, and electronic spreadsheets used in the development of the testimony of Mr. Woolridge. The requested information, if so available, should be provided in an electronic format, with formulas intact and visible, and no pasted values.

RESPONSE:

Please see response to Question number 3.

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WITNESS/RESPONDENT RESPONSIBLE:
Ralph C. Smith; Dr. J. Randall Woolridge; Counsel

QUESTION No. 5
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Please provide all testimony of Mr. Smith and Dr. Woolridge, including exhibits, in native format (e.g. Word).

RESPONSE:

Since the Commission's website does not allow uploading of Word documents, the Word documents will be provided to counsel via separate e-mail. AG witness Smith's Direct Testimony Exhibits RCS-1, RCS-2, RCS-3, and RCS-4, in Excel format, are in attachment KPCo-AG-1-5-A.

WITNESS/RESPONDENT RESPONSIBLE:

Ralph C. Smith

QUESTION No. 6

Page 1 of 2

Please reference page 27 of the testimony of Mr. Smith. Please explain why it is appropriate to reduce the Company's per book balances of long-term debt and common equity for adjustments to items financed with short term debt.

RESPONSE:

For purposes of determining a utility's capital structure and jurisdictional capitalization, the utility should have either a positive or a zero short-term debt balance. As shown on Section V, Exhibit 1, Schedule 3 from the Company's filing, the per books balance for short-term debt was \$0 for the end of the test year ended September 30, 2014. KPCo created a negative short-term debt balance, which otherwise would not have existed, beginning with its adjustment to remove Big Sandy Coal Stock and followed by the Company's other adjustments to its jurisdictional capitalization.

As discussed in his Direct Testimony, it is Mr. Smith's position that it is inappropriate for KPCo to reflect a negative balance for short-term debt in its jurisdictional capitalization. According to the Company's response to AG 2-27, KPCo included negative values in its capital structure in Case Nos. 2009-00459 and 2013-00197. However, Case No. 2009-00459 settled with no specific mention of the capital structure and Case No. 2013-00197 was withdrawn. Furthermore, the Company could not identify any other utilities regulated by the Kentucky Public Service Commission in which approval of negative amounts in the capital structure was authorized.

To artificially create a negative short-term debt balance, by adjustments, where none existed on the Company's books, as KPCo has done in this case, also results in an overstatement of the cost of capital, other things being equal.

Since the Company had a \$0 short-term debt balance as of September 30, 2014, for the reasons discussed above, Mr. Smith reallocated the Company's rate base adjustments, along with the rate base adjustments he recommended in his Direct Testimony, proportionally to the Company's per-book balances of long-term debt and common equity. The non-existence of negative short-term debt in a utility's capital structure was also discussed with AG witness Woolridge, who concurred that short-term debt in a

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utility's capital structure should be either zero or a positive amount, and cannot be negative.

WITNESS/RESPONDENT RESPONSIBLE:

Ralph C. Smith

QUESTION No. 7

Page 1 of 2

Please reference pages 37 through 42 of the testimony of Mr. Smith.

a. Please confirm that it is the position of the Attorney General that costs prudently incurred by a utility in evaluating a generation resource alternative are recoverable only if the utility's evaluation results in the construction or acquisition of the resource evaluated.

b. If you confirm the position identified in subpart a, please explain the basis for that position.

c. If you cannot confirm the statement in subpart a, please explain the basis for your inability to confirm.

d. Please confirm that it is the position of the Attorney General that costs prudently incurred by a utility in evaluating a generation resource alternative cannot be recovered if the utility's evaluation demonstrates lower cost alternatives to meet its customer needs exist and the company pursues the lower cost alternative.

e. If you confirm the position identified in subpart d, please explain the basis for that position.

f. If you cannot confirm the statement in subpart d, please explain the basis for your inability to confirm.

RESPONSE:

Objection to the form of the question. Without waiving this objection, the Attorney General states as follows:

a. Deny.

b. N/A

c. Based on the Company's reference to pages 37-42 of his testimony, Mr. Smith infers that this data request relates to Mr. Smith's recommendations to remove the costs associated with (1) the amortization of deferred IGCC

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costs; (2) the amortization of deferred CCS FEED Study costs; and (3) the amortization of deferred CARRS Site costs.

For the reasons discussed on the referenced pages of his testimony, Mr. Smith's recommendations with respect to these items are based on evaluating the individual merits of the Company's proposed treatment for each of these specific items as opposed to an overall AG policy of disallowing such costs.

- d. Deny.
- e. N/A
- f. See part "c" above.

WITNESS/RESPONDENT RESPONSIBLE:

Ralph C. Smith

QUESTION No. 8

Page 1 of 2

Please reference pages 43 to 45 of the testimony of Mr. Smith.

- a. Please confirm that the Commission never found that the Big Sandy Unit 2 FGD study costs were imprudently incurred in its order in Case No. 2012-00578.
- b. If you cannot confirm the statement in subpart a, please explain the basis for your inability to confirm.
- c. Please confirm that it is the Attorney General's position that costs incurred by a utility in evaluating an option to address emerging environmental regulations cannot be recovered unless that option is selected.
- d. If you cannot confirm the statement in subpart c, please explain the basis for your inability to confirm.
- e. If the Attorney General confirms the statement in subpart c, please confirm that this is the case even when as a result of the evaluation, a lower costs alternative is discovered and selected by the utility.
- f. If you cannot confirm the statement in subpart e, please explain the basis for your inability to confirm.

RESPONSE:

Objection to the form of the question. Without waiving this objection, the Attorney General states as follows:

- a. Mr. Smith confirms that the Commission's Order dated October 7, 2013 in Case No. 2012-00578 does not address whether the Big Sandy Unit 2 FGD study costs were imprudently incurred.
- b. N/A
- c. Deny.
- d. As discussed on the referenced pages of his testimony, Mr. Smith's recommendation to remove the costs associated with the Big Sandy Unit 2 FGD is primarily predicated on the Commission previously disallowing

QUESTION No. 8

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- e. these costs through striking Paragraph 8 from the Stipulation and Settlement Agreement in its Order in Case No. 2012-00578. This is coupled with the fact that the Company filed its written acceptance of the Commission's modification to the Stipulation and Settlement Agreement on October 14, 2013. In addition, on pages 38 and 39 of its Order, the Commission stated in part:

"The Commission finds that the potential imposition of the \$28 million Scrubber Study Costs, in addition to the costs associated with the Mitchell acquisition, is not reasonable, particularly when the Scrubber Study Costs, although spanning a significant period of time, did not result in a formal Kentucky Power proposal upon which the Commission rendered a decision based on its merits. The Commission likewise finds the potential imposition of the Scrubber Study Costs on ratepayers not reasonable due to the fact that a study of this magnitude did not result in the addition of a scrubber or other pollution control facilities at Big Sandy Unit 2."

- f. Deny. See part "d" above.
- g. See part "d" above.

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WITNESS/RESPONDENT RESPONSIBLE:

Ralph C. Smith

QUESTION No. 9

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Please reference page 60 of the testimony of Mr. Smith.

- a. Please confirm that the rider effective January 1, 2014 designed to collect \$44 million annually for a partial recovery of costs relating to the Mitchell transfer is the Asset Transfer Rider ("ATR") and not the Asset Transfer Rider - 2 ("ATR-2").
- b. If you cannot confirm the statement in subpart a, please explain the basis for your inability to confirm.

RESPONSE:

- a. Confirmed. The "-2" on page 60, lines 10-11 will be corrected so the reference is to the ATR not ATR-2.
- b. N/A

WITNESS/RESPONDENT RESPONSIBLE:

Ralph C. Smith

QUESTION No. 10

Page 1 of 1

Please reference pages 63 to 64 of the testimony of Mr. Smith.

- a. Please confirm that any Big Sandy Retirement costs tracked in the deferral accounts proposed by the Attorney General would be recovered through a period that ends in 2040 regardless of when they were incurred.
- b. If you cannot confirm the statement in subpart a, please explain the basis for your inability to confirm.

RESPONSE:

- a. Deny.
- b. The "regardless of when they were incurred" is vague. As explained on page 64, lines 1-4:
"Such estimated future costs would not be included in the initial BSRR, but as the actual expenditures were made, the costs would be tracked in a deferral account, and would be reviewed in KPCo's next base rate case. The BSRR revenue requirement would be adjusted accordingly at that time, after such costs were reviewed in the KPCo rate case."

WITNESS/RESPONDENT RESPONSIBLE:

Ralph C. Smith

QUESTION No. 11

Page 1 of 2

Please reference page 67 of the testimony of Mr. Smith.

- a. Please identify all support for Mr. Smith's testimony that the recovery of PJM costs through the BS1OR could lead to abuse by the Company.
- b. Please confirm that the Company provided hourly test year detail for the PJM charges and credits that the Company proposes to include in the BS1OR in its response to KIUC 1-17.
- c. If you cannot confirm the statement in subpart b, please explain the basis for your inability to confirm.
- d. Please confirm that the PJM charges and credits relating to Big Sandy Unit 1 while operating as a coal fired generation plant are operating expenses.
- e. If you cannot confirm the statement in subpart d, please explain the basis for your inability to confirm.

RESPONSE:

Objection to the form of the question. Without waiving this objection, the Attorney General states as follows:

- a. The parameters that distinguish the PJM costs that KPCo proposes to include in the BS1OR versus other forms of recovery of PJM costs are not well defined. PJM invoices can be very complicated and the Company has not provided a clear definition or a clean audit trail of which specific PJM charges would be included in the BS1OR and the PJM charges that would be recovered in base rates or elsewhere.
- b. Confirmed in part and denied in part.
- c. Confirmed that hourly data was provided in KPCo's response to KIUC 1-17. Deny that KPCo's proposal to include PJM cost in the BS1OR is based on hourly PJM data for the entire test year because KPCo's proposed amount is based on January through September 2014, annualized, and the test year is October 1, 2013 through September 30, 2014.
- d. Deny.

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- e. KPCo's response to KIUC 1-17 states that support for the \$4,562,334 value is in the line item for FERC Account 4470093, Sales for Resale, which is typically considered to be a revenue account, not "operating expenses."

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WITNESS/RESPONDENT RESPONSIBLE:

Ralph C. Smith

QUESTION No. 12

Page 1 of 1

Please reference page 72 of the testimony of Mr. Smith. Please supply all calculations and other evidence to support the basis for your statement "Transmission cost recovery should continue in KPCo's base rates, and this KPCo proposed adjustment, which reduced KPCo's requested revenue requirement by the \$126,908, is not needed."

RESPONSE:

- a. See Exhibit RCS-1, Schedule A, page 1, line 12, and the Excel file provided in response to KPCo-AG-1-5.

WITNESS/RESPONDENT RESPONSIBLE:

Ralph C. Smith

QUESTION No. 13

Page 1 of 2

Please reference page 76 of the testimony of Mr. Smith.

- a. Please provide all support for the claim that the Company "has abundant generation, more than sufficient to serve its own load" after the Mitchell Transfer.
- b. Please confirm whether this statement accounts for the retirement of Big Sandy Unit 2 no later than May 31, 2015 and the derating of Big Sandy Unit 1 following the approved natural gas conversion.
- c. If you cannot confirm the statement in subpart b, please explain the basis for your inability to confirm.

RESPONSE:

Objection to the form of the question. Without waiving this objection, the Attorney General states as follows:

- a. This is based on public information. The transfer of the 50% interest in the Mitchell Plant to KPCo added approximately 780 MW of capacity. With the transfer of the undivided 50% interest in the Mitchell units (as authorized in Case No. 2012-00578), the repowering of Big Sandy Unit-1 to natural gas (as authorized in Case No. 2013-00430), the on-going purchases of power from the Rockport plant, and the renewable energy purchase agreement for biomass energy resources (as authorized in Case No. 2013-00144), it is abundantly clear that KPCo's capacity and energy needs are currently and will be fully met.

Moreover, as the Commission noted in Case No. 2014-00225: "...during the period January 1, 2014, through May 31, 2015 ("the Overlap Period"), Kentucky Power will own and operate both the 800-megawatt ("MW") Big Sandy Unit 2 and its 50 percent undivided interest in the Mitchell Station, or 780 MW. During the 17-month Overlap Period, Kentucky Power will be operating with an unusually large reserve margin, estimated at 57 percent for 2014." (Case No. 2014-00225, Final Order dated Jan. 22, 2015, p. 6). Kentucky Power's recent IRP filing indicates its reserve margin is 57.3% as a result of the transfer of the interest in the Mitchell units. (Application, Case No. 2013-00475, p. 20).

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b. Not specifically.

c. N/A.

WITNESS/RESPONDENT RESPONSIBLE:

Ralph C. Smith

QUESTION No. 14

Page 1 of 2

Please reference page 77 of the testimony of Mr. Smith.

- a. Please confirm that the values represented in the table on Page 77 reflect the Company's generation capacity during the period following the Mitchell Transfer but prior to the retirement of Big Sandy Unit 2.
- b. If you cannot confirm the statement in subpart a, please explain the basis for your inability to confirm.
- c. Please also confirm that during the interim period, in accordance with the Commission-approved Stipulation and Settlement Agreement in Case No. 2012-00578, the Company retains all off system sales margin partially in exchange for only recovering \$44 million annually for its share of the Mitchell plant.
- d. If you cannot confirm the statement in subpart c, please explain the basis for your inability to confirm.

RESPONSE:

Objection to the form of the question. Without waiving this objection, the Attorney General states as follows:

- a. Mr. Smith confirms to the extent that, as discussed in Company witness Vaughan's direct testimony at page 27, the \$76.09 million test year amount reflects margins "from the Company owning a fifty percent share of the Mitchell Plant while Big Sandy 2 was still in operation." However, as discussed on page 32 of Mr. Vaughan's testimony, the \$14.3 million value is the Company's going-level Kentucky jurisdictional OSS margins and which reflects the removal of Big Sandy Unit 2 as shown on Exhibit AEV-7, which was filed in conjunction with Mr. Vaughan's testimony.

The table on page 77 of Mr. Smith's testimony essentially replicates the calculation shown on page 32 (line 7) of Mr. Vaughan's testimony and was included for illustrative purposes to show the amount of OSS margins that KPCo would retain under its proposed 60/40 customer sharing scenario.

- b. N/A

QUESTION No. 14
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- c. Mr. Smith confirms to the extent that Paragraph 7 of the Stipulation and Settlement Agreement states: "Effective January 1, 2014, the Company will set and maintain the System Sales Adjustment Factor (Tariff S.S.C.) to 0.0000 mills/kWh until new base rates are set by the Commission. The revised Tariff S.S.C. is attached hereto as Exhibit 3. Calendar year off-system sales margins above \$15,290,363, the level in current base rates, will be retained by the Company until new base rates are set."
- d. N/A

WITNESS/RESPONDENT RESPONSIBLE:

Ralph C. Smith

QUESTION No. 15

Page 1 of 1

Please identify all proceedings in Ohio, West Virginia, Virginia, Michigan and Indiana where Mr. Smith provided testimony in opposition to the inclusion of PJM charges and credits in riders.

- a. Please provide copies of all testimony offered by Mr. Smith in those proceedings.
- b. Please provide copies of the State Commission Orders in those proceedings where the State Commissions agreed with the testimony of Mr. Smith opposing the inclusion of PJM charges and credits in riders.
- c. Please confirm that the Company's affiliates in Ohio, West Virginia, Virginia, Michigan, and Indiana, all collect their PJM charges and credits through riders, or track the actual annual PJM charges above and below an amount in base rates.
- d. If you cannot confirm the statement in subpart c, please explain the basis for your inability to confirm.

RESPONSE:

Objection to the form of the question. Without waiving this objection, the Attorney General states as follows:

- a. Objection: the request seeks research which has not been performed, and which would be unduly burdensome to perform. Additionally, the data is not relevant to the specific issues in this KPCo case. Without waiving the objection, Mr. Smith is not aware of any.
- b. Mr. Smith does not have copies of the requested orders.
- c. - d. Cannot confirm or deny because research of how all PJM costs are treated in these states has not been conducted.

WITNESS/RESPONDENT RESPONSIBLE:

Dr. J. Randall Woolridge

QUESTION No. 16

Page 1 of 2

Please reference page 29, lines 24-25, of the testimony of Mr. Woolridge. Please provide copies of all documents supporting Dr. Woolridge's position that the "three-stage DCF" is a "common application" for investment firms.

RESPONSE:

Dr. Woolridge has not performed an analysis of the DCF models of individual investment firms. His observations on this issue are based on years of teaching and research on issues related to Wall Street practices, including overseeing the placement of about 50 students per year in full-time and summer internship positions in analysts positions on Wall Street.

All investment valuation books include details of DCF valuation models, including the multi-stage DCF model. Dr. Woolridge has provided as attachments two chapters on DCF valuation from Aswath Damodaran, a very well-known finance professor from NYU who has written extensively on stock valuation. Also, valuation websites include multi-period growth DCF models, which provide for the estimation of different growth rate for different time periods in the future, which are therefore multi-stage DCF models.

Damodaran's, (<http://people.stern.nyu.edu/adamodar/>),

LundholmSloan (<http://www.lundholmandsloan.com/index.html>) and

ValuePro (<http://www.valuepro.net/index.shtml>)

Finally, Dr. Woolridge also provides two recent studies by Green, Hand, and Zhang on the use of DCF valuation models by Wall Street firms. In the article entitled, "The dual use of residual income and discounted cash flow valuation methods by U.S. sell-side equity analysts," on pages 4-5, the authors provide a summary literature review on the use of the DCF model by investment analysts. In the other article entitled, "A new perspective on analyst sophistication: Errors and dubious judgments in analysts' DCF valuation models," the authors highlight DCF application errors by Wall Street analysts based on their review of 120 analysts' reports over the 2012-13 time period. In both of

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these articles, the authors discuss alternative approaches to the estimation of terminal values in DCF valuations. The inclusion of a terminal value in a DCF valuation approach is a multi-stage model.

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WITNESS/RESPONDENT RESPONSIBLE:

Dr. J. Randall Woolridge

QUESTION No. 17

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Is Dr. Woolridge aware of any current allowed ROEs for electric utilities in the U.S. at or below 8.65%? If so, please identify the utility and state jurisdiction.

RESPONSE:

No, but as Dr. Woolridge discusses in his testimony, public utility commissions have been slow to reduce authorized ROEs to reflect the historic low capital costs in the U.S. Nonetheless, the trend is for lower authorized ROE, and the norm is now below 10.0%.

WITNESS/RESPONDENT RESPONSIBLE:

Dr. J. Randall Woolridge

QUESTION No. 18

Page 1 of 1

Please reference Exhibit JRW-10, page 5, of the testimony of Mr. Woolridge.

a. Please indicate the number of analysts estimates included in the consensus growth rates reported from Yahoo, Reuters, and Zacks. If Dr. Woolridge did not review this information or does not have it in his possession, please so state.

b. Does Dr. Woolridge contend that a negative growth rate reflects a meaningful estimate of investors' long-term expectations for purposes of applying the constant growth DCF model? If yes, provide a complete explanation and all materials relied on by Dr. Woolridge to support his opinion.

RESPONSE:

a. The requested items are included in Dr. Woolridge's work papers, source documents, and work sheets which are being uploaded simultaneously with this response. Of the three services, only Reuters reports the number of analysts. The Reuters estimates are included within the uploaded documents.

b. Dr. Woolridge has reviewed thirteen different growth rate measures for the twenty-nine companies in the Electric Proxy Group. This produces distributions of outcomes for historic and projected growth in EPS, DPS, and BVPS. He has used the medians of the distributions of these growth rates as the measure of central tendency in his summary analysis. Several companies in the group have negative historic and/or projected growth rate measures. The fact is that negative growth is a possibility for some time periods and some companies. If these were eliminated, it would distort the measures of central tendency by eliminating relevant information about the possible outcomes and distributions of growth rates.

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WITNESS/RESPONDENT RESPONSIBLE:

Dr. J. Randall Woolridge

QUESTION No. 19

Page 1 of 1

Please reference Exhibit JRW-11, pages 5 and 6, of the testimony of Mr. Woolridge. Please provide copies of each of the referenced studies supporting the reported risk premiums.

RESPONSE:

The requested documents are included within the documents being uploaded in response to this question.