EXHIBIT 1

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of

APPLICATION OF KENTUCKY POWER COMPANY FOR) AN ORDER APPROVING ACCOUNTING PRACTICES) TO ESTABLISH REGULATORY ASSETS AND LIABILITIES) RELATED TO THE EXTRAORDINARY EXPENSES) INCURRED BY KENTUCKY POWER COMPANY IN) CONNECTION WITH TWO 2015 MAJOR STORM EVENTS)	CASE NO. 2016-00180

ORDER

On May 31, 2016, Kentucky Power Company ("Kentucky Power") filed an application seeking authority to establish a regulatory asset for incremental operation and maintenance costs it incurred in connection with repairing damages and restoring electric service to customers following two 2015 Major Event[1] storms in its service area.[2] The two storms were a snowstorm on March 4, 2015, and three waves of thunderstorms beginning on July 13, 2015, that passed through Kentucky Power's service territory by the evening of July 14, 2015. Kentucky Power seeks approval for a regulatory asset in the amount of $4,694,230.

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[1] Under Institute of Electrical and Electronic Engineers ("IEEE") Standard 1366, a Major Event is one that exceeds reasonable design and/or operational limits of the electric power system. A Major Event Day is defined by IEEE Standard 1366 as any day in which the System Average Interruption Duration Index ("SAIDI") exceeds the threshold value of $T_{med.}$ The T_{med} threshold value in turn is calculated at the end of each reporting period, typically a calendar year, using data from the previous five years. It is calculated by taking the average of natural logarithm of each daily SAIDA during the previous five-year period. The standard deviation of the five-year data set is then determined and the threshold value of T_{med} is set at 2.5 standard deviations. Any day in the subsequent reporting period that exceeds the T_{med} is classified as a Major Event Day.

[2] Kentucky Power is not proposing to establish a regulatory liability in this case, even though the case style states otherwise. *See* Kentucky Power's response to Commission Staff's Second Request for Information ("Staff's Second Request"), Item 9.

Kentucky Power states that at the peak of the March snowstorm, there were 190 active outage cases affecting 6,326 of its customers. In total, there were 691 outage cases experienced on Kentucky Power's distribution system caused by heavy snow and ice on, and mudslides and flooding near, its distribution system.

Throughout the course of the thunderstorms that began on the afternoon of July 13, 2015, 2,204 outage cases were recorded on Kentucky Power's system. At the height of the outages, there were 883 active outage cases, and 30,707 Kentucky Power customers were without power. As a result of the July thunderstorms, five counties in Kentucky Power's service territory, Johnson, Rowan, Breathitt, Carter, and Perry, were declared federal disaster areas.

Kentucky Industrial Utility Customers, Inc. ("KIUC") is the only intervenor in this proceeding. A procedural schedule was established on June 17, 2016, for the processing of this matter. Commission Staff ("Staff") issued two rounds of information requests, and KIUC issued one round of information requests, to which Kentucky Power responded. Kentucky Power also filed responses to questions posed during a September 23, 2016 informal conference. The record is complete and the case now stands submitted for decision.

KENTUCKY POWER'S REQUEST

Kentucky Power is requesting a deferral of $4,694,230 in incremental Major Event storm-related expenses. The deferral consists of $285,609 for the March 2015 storm and $4,408,621 for the July 2015 storms.[3] Kentucky Power states that the amount of its requested deferral is 3.77 times the $1,243,763 in operation and

[3] Response to Staff's Second Request, Item 1.

maintenance major storm-related expenses currently included in its base rates.[4] Additionally, Kentucky Power states that if the costs for which it is now seeking authority to establish a regulatory asset had been expensed in 2015, its return on equity ("ROE") for 2015 would have been reduced from 4.21 percent to approximately 3.78 percent.[5] Kentucky Power seeks to accumulate and defer for review and recovery in its next base rate proceeding the $4,694,230 in incremental and extraordinary costs it incurred in repairing damage and restoring service in connection with the two 2015 Major Event storms.[6]

Kentucky Power relies on Financial Accounting Standards Board Standards Codification 980-340-25-1 ("FASB Codification 980-340-25-1") as authority for the creation under prescribed circumstances of a regulatory asset.[7] FASB Codification 980-340-25-1 states, in relevant part, as follows:

> Rate actions of a regulator can provide reasonable assurance of the existence of an asset. **An enterprise shall capitalize all or part of an incurred cost that would otherwise be charged to expense if both of the following criteria are met:**

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[4] Kentucky Power's base rates changed on June 30, 2015. The $1,243,763 referenced by Kentucky Power is the average of $904,953, the amount included in base rates in the first half of 2015, and $1,608,410, the amount included in base rates in the second half of 2015, after adjusting for the retail jurisdictional percentage.

[5] Application at 13.

[6] *Id.*

[7] Application at 11, paragraph 29.

> a. It is probable (as defined in Topic 450) that future revenue in an amount at least equal to the capitalized cost will result from the inclusion of that cost in the allowable cost for ratemaking purposes.
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> b. Based on the available evidence, the future revenue will be provided to permit recovery of the previously incurred cost rather than to provide for expected levels of similar future costs . . . .

(Emphasis in original)

Kentucky Power also relies upon prior Commission decisions granting Kentucky Power and other utilities similar accounting treatment for extraordinary and significant storm damage costs. In Case Nos. 2012-00445[8] and 2009-00352,[9] Kentucky Power was authorized to establish regulatory assets for extraordinary and significant costs incurred associated with restoration efforts resulting from storm damages occurring in 2012 and 2009, respectively. Kentucky Power claims that, relying on the accounting treatment authorized in those cases and on FASB Codification 980-340-25-1, it was allowed to make the appropriate adjustments on its books of account and was permitted to remove its 2015 extraordinary storm-related costs from its income statement for calendar year 2015. Accordingly, Kentucky Power made two entries to record the regulatory asset in Federal Energy Regulatory Commission Account 182, one in July 2015 for $4,377,336 and one in March 2016 for $381,439.90.[10] Kentucky Power's

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[8] Case No. 2012-00445, *Application of Kentucky Power Company for an Order Approving Accounting Practices to Establish Regulatory Assets and Liabilities Related to the Extraordinary Expenses Incurred by Kentucky Power Company in Connection with Four 2012 Major Storm Events* (Ky. PSC Jan. 7, 2013).

[9] Case No. 2009-00352, *Application of Kentucky Power Company for an Order Approving Accounting Practices to Establish Regulatory Assets and Liabilities Related to the Extraordinary Expenses Incurred by Kentucky Power Company in Connection with Three Major Event Storms in 2009* (Ky. PSC Dec. 22, 2009).

[10] Kentucky Power later corrected the amount of the March 2016 journal entry, stating that it should have been for $316,894. *See* September 23, 2016 Informal Conference Memorandum handout.

request for a regulatory asset is for accounting purposes only, with ratemaking treatment deferred for consideration in its next base rate proceeding.[11]

DISCUSSION

Having reviewed the record and being otherwise sufficiently advised, the Commission finds that Kentucky Power's total 2015 storm-related damage and service-restoration costs at issue herein are extraordinary and significant in nature based on their magnitude and the amount of storm damage expenses built into its base rates. Reflecting the entire 2015 storm costs as expenses on Kentucky Power's 2015 books would have a significant impact on its 2015 financial results. The number of customers without service dictated an extraordinary effort on the part of Kentucky Power to restore service, an effort from which it incurred an extraordinarily high level of costs.

The Commission has previously approved regulatory assets for Kentucky Power and other jurisdictional utilities.[12] Such approval has been granted when a utility has incurred (a) an extraordinary, nonrecurring expense which could not have reasonably been anticipated or included in the utility's planning; (b) an expense resulting from a statutory or administrative directive; (c) an expense in relation to an industry-sponsored

[11] *Id.* at 6.

[12] The Commission approved the establishment of regulatory assets for Asset Retirement Obligation-related depreciation and accretion expenses for Louisville Gas and Electric Company and Kentucky Utilities Company when those utilities adopted Statement of Financial Standards No. 143, *Accounting for Asset Retirement Obligations*, respectively, in Case No. 2003-00426, *Application of Louisville Gas and Electric Company for an Order Approving an Accounting Adjustment to be Included in Earnings Sharing Mechanism Calculations for 2003* (Ky. PSC Dec. 23, 2003), and Case No. 2003-00427, *Application of Kentucky Utilities Company for an Order Approving an Accounting Adjustment to be Included in Earnings Sharing Mechanism Calculations for 2003* (Ky. PSC Dec. 23, 2003).

initiative; or (d) an extraordinary or nonrecurring expense that over time will result in a saving that fully offsets the cost.[13]

Kentucky Power believes its request to establish a regulatory asset for the 2015 Major Event storm-related costs, which exceed the storm-related costs in its base rates, is consistent with the first category identified above.[14] Given the nature and impact of these costs, the Commission will authorize Kentucky Power to establish, for accounting purposes only, a regulatory asset based on its incremental, actual storm-related costs for the damage and service restoration costs it incurred and deferred in 2015 as a result of the two Major Event storms occurring in 2015.

The Commission, however, will limit the amount of the authorized deferral to the amount that was not expensed. The Commission is concerned that Kentucky Power's application sets forth conflicting statements with regard to when it recorded on its books the costs related to the 2015 Major Event storms. Only through two rounds of discovery and an informal conference did it become clear that a portion of the amount requested as a regulatory asset had been recorded as an expense on Kentucky Power's 2015 books and was not reflected as a deferral until after its 2015 books were closed and financial statements were finalized. This critical information should have been disclosed by Kentucky Power in its application. In particular, we note that Kentucky Power initially recorded the entire $4,694,230 requested deferral amount on its books as an expense

[13] Case No. 2008-00436, *The Application of East Kentucky Power Cooperative, Inc. for an Order Approving Accounting Practices to Establish a Regulatory Asset Related to Certain Replacement Power Costs Resulting from Generation Forced Outages*, final Order at 4 (Ky. PSC Dec. 23, 2008).

[14] Application at 12.

in 2015.[15] However, prior to the closing of its 2015 books, Kentucky Power recorded $4,377,336 of the $4,694,230 as a deferral on its 2015 books.[16] As a result, the balance of the requested deferral, $316,894, remained on Kentucky Power's 2015 books as an expense. The remaining $316,894 was recorded as a deferral in March 2016 on its 2016 financial statements.[17] The Commission has historically not allowed a utility to establish a regulatory asset after a cost has been recorded as an expense and the utility has closed its books for the relevant fiscal year. This is in recognition of the fact that the recorded expense item is reflected in the utility's earnings for that fiscal year. To do otherwise could result in a specific cost being recorded as an expense twice. Accordingly, the Commission finds that Kentucky Power should be allowed to create and record a regulatory asset for its actual costs incurred to restore service during the two 2015 Major Event storms, and which it deferred in 2015 prior to closing its 2015 books, in the amount of $4,377,336. Kentucky Power has not requested to earn a return on this regulatory asset and the Commission is not authorizing a return on this regulatory asset.

The Commission is also troubled that Kentucky Power recorded the 2015 Major Event storm-related expenses in its 2015 books as a regulatory asset without first obtaining Commission authorization to do so. With respect to the March 4, 2015 snowstorm, the last journal entry was recorded in September 2015; for the July 2015

[15] Kentucky Power's response to Commission Staff's Informal Conference Information Request, Item 2 ("Staff's IC Request").

[16] *Id.*

[17] *Id. See* also fn. 10.

thunderstorms, the last journal entry was recorded in January 2016.[18] Because it wanted to ensure that the actual costs associated with the 2015 Major Event storms would be booked as a regulatory asset, and due to when the last actual cost was recorded, Kentucky Power indicated that there was insufficient time for it to obtain Commission approval for the deferral before closing its 2015 books.[19] Kentucky Power knew, or should have known, that the application should have been filed before Kentucky Power recorded the regulatory asset, even if doing so meant that cost estimates would have been used in the application. Based on the information provided by Kentucky Power in its application and in responses to information requests, the Commission believes the circumstances merit approval of a regulatory asset of $4,377,336. As previously stated, the authorization to establish the regulatory asset as requested by Kentucky Power is for accounting purposes only. The Commission's determination of the amount of the regulatory asset authorized herein that is to be amortized and recovered in rates will be determined in Kentucky Power's next rate case, following a detailed review of Kentucky Power's storm preparedness, its response to the outages, and system reliability, all of which are issues of great interest to the Commission. Particular attention will be paid to the effectiveness of Kentucky Power's vegetation management program to mitigate outages as a result of additional funds for reliability improvements authorized in Case No. 2014-00396, Kentucky Power's last rate case. It is expected that the scope of the Commission's review will include Kentucky Power's efforts to "harden" its system as opportunities to do so arise and the

[18] Response to Staff's Second Request, Item 2.b. and the response to Staff's IC Request, Item 1.

[19] Response to Staff's Second Request, Item 2.a.(1).

recommendations it adopted in response to the Commission's Report on the 2008 Wind Storm and the January 2009 Ice Storm.[20]

Finally, we take this opportunity to place Kentucky Power and all jurisdictional utilities on notice that Commission authorization is required before a utility can record as a regulatory asset an expense that meets one or more of the four criteria cited earlier in this order. The Commission believes that to provide reasonable assurance of a utility's ability to recover the cost of items that meet one or more of the four criteria cited earlier in this order which the Commission has used to authorize the establishment of regulatory assets the utility must be able to show that Commission approval to establish the regulatory asset has been granted.

IT IS THEREFORE ORDERED that:

1. Kentucky Power is authorized to establish a regulatory asset in the amount of $4,377,336 based on its actual costs deferred in 2015 for storm damages and service restoration due to the two 2015 Major Event storms that affected customers in its service area.

2. Kentucky Power is denied authority to establish a regulatory asset in the amount of $316,894 of storm-damage costs related to the two Major Event storms that were expensed in 2015.

3. The regulatory asset account established in this case is for accounting purposes only.

4. The amount, if any, of the regulatory asset authorized herein that is to be amortized and recovered in rates shall be determined in Kentucky Power's next rate

[20] Kentucky Power's response to Commission Staff's First Request for Information, Items 14 and 15.

case based on an examination of its storm preparedness, its storm-damage restoration efforts, reliability improvement efforts and the reasonableness of the costs incurred.

5. Kentucky Power and all jurisdictional utilities shall receive Commission authorization prior to recording regulatory assets on its books for accounting purposes as discussed in this order.

By the Commission

ENTERED

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KENTUCKY PUBLIC SERVICE COMMISSION

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