COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

Electronic Application Of Kentucky Power Company For (1) A General Adjustment Of Its Rates For Electric Service; (2) An Order Approving Its 2017 Environmental Compliance Plan; (3) An Order Approving Its Tariffs And Riders; (4) An Order Approving Accounting Practices To Establish Regulatory Assets Or Liabilities; And (5) An Order Granting All Other Required Approvals And Relief	)	Case No. 2017-00179

POST-HEARING BRIEF OF KENTUCKY POWER COMPANY

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I. INTRODUCTION

This case affords the Commission the opportunity to provide Kentucky Power Company the tools necessary to help change the course of eastern Kentucky. With the loss of industrial load, particularly in coal mining and steel manufacturing, and the loss of population, Kentucky Power's fewer remaining customers are faced with picking up an increasing portion of the costs previously paid by others. Beginning in 2012 with the InSite Study, Kentucky Power moved to change the relentless math of this equation by "growing the denominator" through an intensified focus on economic development. These efforts yielded real success in 2017 with the announcements headlined by Braidy Industries, Inc. and EnerBlu, Inc. Braidy, EnerBlu, and the other additions are not the complete answer; much work – both in terms of economic development and investing in the electric infrastructure necessary to serve and attract these and future engines of growth – remains to be done. But, at the beginning of 2018, the prospects for the Company's service territory and Kentucky Power are much different – and brighter – than how they were perceived as recently as the beginning of 2017.

The Settlement Agreement among Kentucky Power, Kentucky Industrial Utility Customers, Inc. ("KIUC"), Kentucky School Boards Association ("KSBA"), Kentucky League of Cities ("KLC"), Wal-Mart East, LP and Sam's East, Inc. ("Walmart"), and Kentucky Cable Telecommunications Association ("KCTA") (collectively the "Signatory Parties") represents a commitment by the signatories to continuing along the path to recovery blazed by Kentucky Power. The Signatory Parties agreed to a creative solution that allows the Company's economic development efforts to continue by deferring the recovery of costs to provide time to "grow the denominator." The Settlement Agreement recognizes the regulatory compact and the importance of ensuring Kentucky Power is in a position to provide its customers with reliable, efficient, and reasonable service by allowing the Company the resources to do so. And it does so at a far lower cost than anyone could have anticipated on June 28, 2017 when Kentucky Power filed its application.

The Settlement Agreement addresses many of the challenges facing the Company's customers, Kentucky Power, and all of eastern Kentucky in a creative and pragmatic fashion. Like any fair agreement, it represents the give and take of negotiation. Like any good agreement, it represents a balance that Kentucky Power urges the Commission to uphold. And, like any equitable agreement, it fairly addresses the concerns and interests of, and affords benefits to, all parties to this proceeding including those who chose not to sign the agreement. Indeed, although the Attorney General declined to join the settlement, the agreement provides an initial revenue requirement increase millions of dollars less than that set out in his filed position.[1]

The Settlement Agreement also provides for reasonable and stable base rates for a three-year period during which Kentucky Power and its economic development partners can build on recent successes by attracting new and expanded economic activity, including good jobs, to the Company's service territory. The agreement does so through a weave of closely-knit provisions that implement the regulatory compact by affording Kentucky Power the financial and regulatory resources required to provide adequate and dependable service to its customers while also providing the opportunity for the Company's shareholder to earn a reasonable return, all the while doing so at fair, just, and reasonable rates. The stay out provision also provides the ultimate incentive for Kentucky Power to manage its finances efficiently as it will not be able to implement new base rates under the agreement for three years. But, like any weaving, it can unravel with the removal of a single thread.

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[1] Smith Direct Testimony at 13-14. In addition to the Attorney General, Kentucky Commercial Utility Customers, Inc. ("KCUC") elected not to join the settlement.

The Settlement Agreement's provisions, many of which are available only through an agreement such as this, include:

- A 47.38 percent reduction (from the $60,397,438 requested in the Company's August 2017 Financing Update to the $31,780,734 provided for in the agreement) in Kentucky Power's requested revenue requirement adjustment. This reduction, along with other changes outside this proceeding, means ***the Company's average residential customer using 1,246 kWh per month will see an average monthly bill increase of $1.35 (0.79%***).[2]

- The elimination of the subsidy provided by industrial and larger commercial customers (Tariff I.G.S.). Doing so enables Kentucky Power to continue to offer attractive industrial rates in furtherance of its economic development and customer retention efforts.

- The allocation in a fair and equitable fashion among the other tariff classes of the balance of the reduction in the Company's revenue requirement.

- Kentucky Power's agreement to freeze base rates for a three-year period.[3] This provision, which is available only through a settlement, provides real benefit to all of Kentucky Power's customers. It also provides the rate stability that will enhance Kentucky Power's economic development efforts and ensures Company operations are managed efficiently.

- Kentucky Power's agreement, through the proposed amendment to Tariff P.P.A., to recover only 80% of its incremental PJM LSE OATT expenses. This provision, whereby the Company foregoes recovery of a portion of federally-approved rates, also ensures that Kentucky Power's customers pay no more than the Company's actual incremental PJM LSE OATT expenses. The amendment of Tariff P.P.A., which is available only through settlement, also serves to limit the impact of one of the most rapidly increasing expenses facing the Company (an estimated $14 million increase in 2018 alone) by addressing upfront this significant challenge to Kentucky Power's finances.

- Kentucky Power's agreement to defer approximately $50 million in Rockport Unit Power Agreement expense during the period 2018-2022 and to recover that deferral over the subsequent five years. This deferral, which can be achieved only through the Company's agreement, allows Kentucky Power's customers to reap the benefits now of the anticipated reduction in expenses beginning December 7, 2022 with the expiration of the Rockport Unit Power Agreement. As described by KIUC Witness Kollen, this is "really a tremendous result."[4]

- Kentucky Power's agreement to make available as an offset during the period until its base rates are next adjusted the difference between its return on its incremental transmission investments calculated using the FERC-approved OATT return on equity ("ROE")

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[2] *See*, Kentucky Power's January 3, 2018 Supplemental Response to AG PH-5.

[3] This base case stay-out provision agreement is subject to the approval of the Settlement Agreement without modification. Rates also can be modified upon the occurrence of certain extraordinary events. Nothing in the agreement seeks to limit the Commission's continuing jurisdiction over Kentucky Power's rates and service.

[4] Kollen Hearing Testimony at 569.

and the return on its incremental transmission investments as calculated using the 9.75 percent ROE provided for by the Settlement Agreement.

- The amendment of the Company's existing distribution vegetation management plan to accelerate by 18 months a reduction in the Company's distribution vegetation management expense. A substantial portion of that expense is borne by the Company's residential customers; the amendment also allows the Company to limit the effect of the Settlement Agreement on residential rates.[5]

- The updating of Big Sandy Unit 1 depreciation rates for the first time since 1991. The revised rates, which are premised upon a reasonable remaining life of service for Big Sandy Unit 1, provide for inter-generational equity by limiting the risk that future customers will be required to fund Big Sandy Unit 1 depreciation expense after it retires.[6]

- Increased funding for low-income heating assistance (and increased matching shareholder contribution) through the Company's Home Energy Assistance Program.[7]

While the record in this case supports approval of relief sought in the Company's application, the Settlement Agreement improves on the application and is in the public interest. Kentucky Power remains eager to continue its commitment to its 168,000 customers and its efforts to improve the economic fortunes of its customers and the Company through enhanced economic development efforts. It asks the Commission to provide it with the tools to do so by approving the Settlement Agreement without modification.

II. CASE BACKGROUND

A. The Regulatory Compact And The Requirement To Strike A Balance.

Variously described as "ly[ing] at the heart of cost of service regulation,"[8] "the keystone of the structure that supports our unique system of regulation by government of investor owned

[5] This benefit also was proposed as part of the Company's application.

[6] A similar benefit, involving a 15-year remaining life of service for Big Sandy Unit 1, was proposed as part of the Company's application.

[7] This benefit also was proposed as part of the Company's application.

[8] Karl McDermott, *Cost of Service Regulation In the Investor-Owned Electric Utility Industry: A History of Adaptation* xi (Edison Elec. Inst. 2012). Available at: http://www.eei.org/issuesandpolicy/stateregulation/Documents/COSR_history_final.pdf

utilities,"[9] and "the bedrock principle behind utility regulation,"[10] the regulatory compact provides the framework by which the Commission must judge the Company's application. The regulatory compact is a "'bargain' struck between the utilities and the state"[11] that embodies "the set of ***mutual*** rights, obligations, and benefits that exist between the utility and society:"[12]

> As a quid pro quo for being granted a monopoly in a regulated geographical area for the provision of a particular good or service, the utility is subject to regulation by the state to ensure that it is prudently investing its revenues in order to permit the most efficient service possible to the consumer. At the same time, the utility is not permitted to charge rates at the level at which its status as a monopolist could command in a free market. Rather the utility is allowed to earn 'a fair rate of return' on its 'rate base.'" Thus, it becomes the Commission's primary task at periodic rate proceedings to establish a level of rates and charges sufficient to permit the utility to meet its operating expenses plus a return on investment which will compensate its investors.[13]

When honored, the regulatory compact embodies and furthers the public interest.[14] In fact, the regulatory compact "has allowed our utilities to offer their most essential contribution to the health and growth of our economy, and it provided consumers with the most reliable and most economic utility service available anywhere in the world."[15]

Inherent in its nature as a *quid pro quo* is that the regulatory compact embodies "a sensitive balance that must be maintained under long standing and common sense standards of justness and reasonableness."[16] "[B]oth parties [to the regulatory compact] made tradeoffs in

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[9] Robert L. Swartwout, *Current Utility Regulatory Practice from a Historical Perspective*, 32 Nat. Res. J. 289, 290 (1992). Available at: http://digitalrepository.unm.edu/cgi/viewcontent.cgi?article=1844&context=nrj

[10] *United States Gypsum, Inc. v. Indiana Gas Co.*, 735 N.E.2d 790, 797 (Ind. 2000).

[11] 735 N.E.2d at 797.

[12] *Cost of Service Regulation In the Investor-Owned Electric Utility Industry: A History of Adaptation* at 5. (emphasis supplied).

[13] 735 N.E.2d at 797.

[14] *Current Utility Regulatory Practice from a Historical Perspective*, 32 Nat. Res. J. at 314.

[15] *Id*. at 313.

[16] *Current Utility Regulatory Practice from a Historical Perspective*, 32 Nat. Res. J. at 313.

establishing their rights and responsibilities…."[17] Under the regulatory compact, "both the utility and consumers give up certain rights, or in contract law terms, exchange detriments."[18] "As with every just and reasonable interaction, for every right or benefit granted, there is a concomitant obligation."[19] The regulatory compact is not a smorgasbord from which either the utility or its customers are free to accept the benefits provided by the other party while refusing to provide some or all the obligations given in return for those benefits:

> [E]ach party, both utilities and their customers, is obliged to accept the costs as well as the benefits that can occur from time to time. Neither the utilities nor their customers can pick and choose when it is convenient to operate under the compact and then, later, choose to go back into the compact with everything forgiven. The regulatory compact is not a switch that may be turned off every now and then and then turned back on with the expectation of easy and immediate return to the former condition.[20]

This Commission, as the overseer of the relational contract comprising the regulatory compact,[21] bears primary responsibility for maintaining the bargains and tradeoffs implicit in the regulatory compact.[22] Where both sides of the bargain are not maintained, "there can be expected many and unpredictable dislocations and disturbances that may not be readily correctable, if correctable at all. In order for the regulatory compact to remain operable and effective, the sensitive balance of its associated rights, benefits, and obligations must be maintained."[23] Conversely, where fair, just, and reasonable rates, such as those proposed by Kentucky Power in its application, and improved upon in the Settlement Agreement, are sanctioned by the Commission, and thus the balance maintained, "investors [will] continue to

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[17] *Cost of Service Regulation In the Investor-Owned Electric Utility Industry: A History of Adaptation* at 5.

[18] *Id*. at 6.

[19] *Current Utility Regulatory Practice from a Historical Perspective*, 32 Nat. Res. J. at 313.

[20] *Id*. at 313-314.

[21] *Cost of Service Regulation In the Investor-Owned Electric Utility Industry: A History of Adaptation* at 6.

[22] *Current Utility Regulatory Practice from a Historical Perspective*, 32 Nat. Res. J. at 314.

[23] *Id*.

provide capital and consumers [will] continue to receive universal service at reasonable prices."[24]

Although the principles of *quid pro quo* and the exchange of benefits and detriments are *implicit* in the regulatory compact, they are *explicit* in the Settlement Agreement. This explicit tradeoff among the Signatory Parties is embodied in the sum of the individual provisions of the agreement, and evidenced by the fact that the Settlement Agreement was not easily reached.[25] Each party to the Settlement Agreement exchanged one or more detriments for offsetting benefits.

The Settlement Agreement likewise represents, and its individual provisions comprise, an overall balance among the parties.[26] The agreement itself so provides: "[n]othing in this Settlement Agreement shall be used or construed for any purpose to imply, suggest or otherwise indicate the results produced through the compromise reflected herein represent fully the objectives of the Signatory Parties."[27] In sum, the Settlement Agreement represents "a package that balances out the interests of the Signatory Parties to provide the Commission a unique opportunity to rule upon the issues in this case."[28] Because the Settlement Agreement represents a package embodying the offsetting detriments and benefits exchanged by the parties, Kentucky Power urges the Commission to judge the fairness and reasonableness of the Settlement Agreement as a whole.

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[24] *Cost of Service Regulation In the Investor-Owned Electric Utility Industry: A History of Adaptation* at 6.

[25] Satterwhite Hearing Testimony at 59.

[26] *Id*. at 325, 397, 409.

[27] Settlement Agreement at ¶ 24(a).

[28] Satterwhite Settlement Testimony at S8. *See also* Carlin Hearing Testimony at 664 (explaining that that provision of the Settlement Agreement excluding $3.15 million of incentive compensation from the Company's revenue requirement "is part of a whole settlement, and the Company is willing to reduce its costs in the manner described in that settlement ***as part of a whole package deal***.") (emphasis supplied).

It similarly is inappropriate to view the individual provisions of the agreement in isolation, or to construe them as being of equal importance to each of the parties:

> Q. So 9.75 is, in your opinion, a reasonable amount [return on equity] for transmission?
>
> A. No. This is part of the overall balance. Believe me, I think, you know, with the territory we have overall, 10.31 is the right ROE for this Company.
>
> …
>
> So the 9.75 is something that we've agreed to that – you know, that's a compromise that we've made by the Company. The case that we've supported supports 10.31. I think that's appropriate for the territory we're in. It's tough.
>
> But for purposes of settlement and the overall package and the affordability of all the partners to the stipulation [that was] put together, 9.75 is where we ended up.[29]

KIUC Witness Kollen recognized this same balance in his description of the operation of the Rockport deferral mechanism. Thus, the Settlement Agreement provides for "cut[ting] off the peak of the revenue requirement for the next five years,"[30] while "rais[ing] slightly the revenue requirement for the five years starting in December 2022."[31] But, the overall balance struck is "really a tremendous result."[32]

There has been much discussion about the role of settlement agreements and the Commission's responsibility. At the opening of the hearing the Chairman noted the Commission's responsibility to examine all of the evidence in establishing rates that are fair, just, and reasonable, and that as a result, the Settlement Agreement was not binding on the

[29] Satterwhite Hearing Testimony at 325-326.

[30] Kollen Hearing Testimony at 569.

[31] *Id*.

[32] *Id*.

Commission.[33] But the two are not at odds; the Commission's responsibility does not preclude it from agreeing that the Settlement Agreement represents the "tremendous result" described by Mr. Kollen. Or from recognizing that it provides the Company's customers with multiple benefits not otherwise available to them,[34] while at the same time providing Kentucky Power the financial ability to provide safe and reliable service and to "grow the denominator" to the benefit the Company's 168,000 customers, Kentucky Power, and the economic vitality of Kentucky Power's entire service territory.

Nor, respectfully, does the settlement have to be exactly what the Commission would have decided in the absence of the agreement to be approved. The Commission can review the agreement to determine if, based on the record, it yields a fair and reasonable result. In that event, the Commission can and should approve the agreement without modification to preserve the balance presented. In doing so, the Commission will be acting just as it would do in setting rates under Kentucky law[35] and the regulatory compact[36] it implements in the absence of a settlement by deciding the issues in terms of the overall balance struck. In short, the Commission's approval of the Settlement Agreement without modification is fully consistent with the Commission's robust exercise of its full regulatory authority or the establishment of fair, just, and reasonable rates.

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[33] Hearing Statement of Chairman Schmitt at 31.

[34] Satterwhite Hearing Testimony at 325. These benefits include the deferral and recovery of a portion of the Rockport Unit Power Agreement expenses over a ten-year period, the Company's agreement to limit its recovery of its PJM LSE OATT expense to 80 percent of the expense, the three-year rate case stay-out provision, and the proposed shareholder funding of both the Company's Home Energy Assistance Program and K-PEGG economic development grants.

[35] *National-Southwire Aluminum Co. v. Big Rivers Electric Corp.*, 785 S.W.2d 503, 512 (Ky. App. 1990) (recognizing the *Hope Natural Gas Co*. doctrine and the importance on appeal of judging the reasonableness of the overall result reached).

[36] *Cost of Service Regulation In the Investor-Owned Electric Utility Industry: A History of Adaptation* at 5.

B. **<u>The Company's Application Squarely And Constructively Addresses The Challenges Facing The Company's Customers, Its Service Territory, And Kentucky Power</u>.**

1. <u>Kentucky Power Is Facing An Unprecedented Decline In Its Number Of Customers And Load</u>.

The parties, even the two intervenors not party to the Settlement Agreement, are in agreement on a single fact: this rate case arises out of the extraordinary circumstances[37] facing eastern Kentucky, the Company's residential, commercial, and industrial customers, and Kentucky Power. The Company's total customers declined by 3.8 percent from 2006 to 2016.[38] Residential customers declined by 5.2 percent over the same period,[39] while the number of industrial customers, including many coal mine and large industrial customers such as AK Steel, declined by 18.5 percent.[40] Energy sales to these two customer groups decreased by 11.65 percent[41] and 27.27 percent respectively over the eleven-year period.[42]

Most of this decline occurred in the last five years of this eleven year period. Thus, 71.29 percent of the decline in the total number of customers over the eleven-year period occurred in the five years between December 2011 to December 2016.[43] Similarly, 65.20 percent of the decline in the number of residential customers[44] and 79.63 percent of the decline in industrial customers occurred over the same five-year period.[45]

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[37] Satterwhite Direct Testimony at 12 ("Kentucky Power's service territory is undergoing historic changes, and it is critical that Kentucky Power act now to address these changes.")

[38] Attorney General Hearing Exhibit 4 (168,848 ÷ 175,571 = 96.2%).

[39] *Id*. (137,013 ÷ 144,447 = 94.85%)

[40] *Id*. (1,191 ÷ 1,461 = 81.5%)

[41] *Id*. (2,128,530 MWh ÷ 2,409,237 MWh = 88.35%).

[42] *Id.* (2,408,194 MWh ÷ 3,311,180 MWh = 72.73%).

[43] *Id*. ((173,641 – 168,848) ÷ (175,571 – 168,848)) = 71.29%).

[44] *Id*. ((141,860 – 137,013) ÷ (144,447 - 137,013)) = 65.20%).

[45] *Id*. ((1,406 - 1,191) ÷ (1,461 – 1,191) = 79.63%).

The decline in energy usage followed this same "end-loaded" pattern: 88.94 percent of total decline in energy usage occurred in the last five years of the eleven-year period.[46] The declines in energy usage by the residential sector (76.05 percent)[47] and the industrial sector (93.21 percent) were similarly pronounced during this same five-year period.[48]

This decline in Kentucky Power's customer base and their load is the single largest driver of the requested rate adjustment.[49] As the number of customers and their load decreases, Kentucky Power is required to spread the same or increasing costs over "the smaller number of remaining customers."[50]

2. Kentucky Power Is Working With Its Communities And Residents To Address The Loss Of Customers And Load.

Kentucky Power acted decisively to address what easily could have become a "death spiral" with more and more customers fleeing the service territory as rates are increased to recover fixed costs from a shrinking customer base. From the Company's innovative "Coal-Plus" program and Appalachian Sky initiative,[51] to its relentless focus on economic development more generally, Kentucky Power worked not only to grow the denominator but to diversify eastern Kentucky's economy. Without turning its back on coal,[52] Kentucky Power aggressively is seeking to attract the aerospace and automotive industries to eastern Kentucky to take advantage of the skills of former coal miners and steelworkers.[53] This diversification brings with it not only good paying jobs, but like a snow ball rolling downhill, it also builds on success,

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[46] *Id*. ((6,983,163 MWh – 5,862,697 MWh) ÷ (7,122,459 MWh – 5,862,697 MWh) = 88.94%).

[47] *Id*. ((2,342,021 MWh – 2,128,530 MWh) ÷ (2,409,237 MWh – 2,128,530 MWh) = 76.05%).

[48] *Id*. ((3,249,891 MWh – 2,408,194 MWh) ÷ (3,311,180 MWh – 2,408,194 MWh) = 93.21%).

[49] Satterwhite Direct Testimony at 12.

[50] *Id*.

[51] Satterwhite Hearing Testimony at 133-135; Satterwhite Direct Testimony at 10-11;

[52] Satterwhite Hearing Testimony at 134.

[53] Hall Hearing Testimony at 825-826; Satterwhite Direct Testimony at 10.

as Toyota demonstrated in central Kentucky,[54] by attracting other industries that either supply the aerospace and automotive industries locating in eastern Kentucky or use their products.[55]

Kentucky Power is focused on attracting employers that make sense for the entire region, and not just ones that use large amounts of electricity. As Company Witness Satterwhite testified in explaining the Company's decision not to recruit data farms to locate in eastern Kentucky:

> What I was explaining there was what I look at when I go to look for companies, and my goal was to bring large users that have a lot of jobs. So if they have very few jobs, I don't want to use the precious flat ground we have in Eastern Kentucky for something that would just help the utility company with usage, I want to provide the balance to make sure I bring back a lot of the jobs would that to bring people – put back – people back to work that are there and bring people back that have left.[56]

This community-focused approach similarly manifests itself in the Company's community advisory panels,[57] as well Kentucky Power's use of K-PEGG grants to local government and regional economic development agencies to improve the infrastructure of its service territory in order to attract new load,[58] build on the capabilities of the local economic development professionals in its service territory,[59] and to provide workforce training.[60]

3. <u>Economic Conditions Are Affecting Kentucky Power's Financial Performance And Threatening Its Ability To Provide Safe And Reliable Service While Growing The Denominator And Bringing Back Good-Paying Jobs</u>.

Notwithstanding the recently announced economic development successes involving Braidy Industries, Inc. and EnerBlu Inc., Kentucky Power's economic development efforts

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[54] Hall Hearing Testimony at 882.

[55] *Id*. at 869-870.

[56] Satterwhite Hearing Testimony at 80.

[57] *Id*. at 118-119, 131, 146.

[58] Hall Rebuttal Testimony at R3-R4

[59] *Id*.

[60] *Id*.; Hall Hearing Testimony at 865

represent a long-term solution to the challenges facing eastern Kentucky and Kentucky Power. Both Braidy,[61] with a projected 60 MW of load, and EnerBlu, with a projected 25 MW of load,[62] for example, will not become operational until 2020.[63] In the interim, Kentucky Power's existing rates are inconsistent with the regulatory compact. Specifically, they are insufficient to permit the Company to recover its reasonable costs of providing safe and reliable service while affording Kentucky Power the opportunity to earn a return on its invested equity "commensurate with the returns on investments in other enterprises having corresponding risks."[64]

Kentucky Power's annual returns on equity for the period 2013-2016 fell far short of any measure –reasonable or otherwise – of a commensurate return on an investment in another enterprise having a similar risk. They ranged from a high of 7.49 percent in 2016 to a low of 2.72 percent in 2013, for an average annual return on equity over the four-year period of 4.89 percent.[65] Nor have the Company's returns on equity in the more immediate past fared any better. The Company's test year return on equity was 5.81 percent[66] while its rolling 12-month return on equity for each of the eleven months from January through November 2107 ranged from a high of 6.45 percent in January 2017[67] to a low of 4.41 percent in August 2017. The rolling 12-month return on equity over this same period averaged 5.37 percent.[68] Over the nine-

[61] Kentucky Power's Company's Response to KPSC 2-7(b).

[62] Hall Hearing Testimony at 823.

[63] Kentucky Power's Company's Response to KPSC 2-7(b); Hall Hearing Testimony at 849.

[64] *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944).

[65] Kentucky Power Company's Response to KPSC 1-38, Attachment 1.xlsx.

[66] *Id*.

[67] Kentucky Power Company's Response to KPSC 1-38, Third Supplemental Attachment 1.xlsx.

[68] *Id*.

month post-test year period of March to November 2017, Kentucky Power's 12-month rolling return on equity averaged 5.2 percent.[69]

By contrast, the Commission found as little as two and one-half years ago in Case No. 2014-00396[70] that a reasonable range of return on equity for Kentucky Power was 9.3 percent to 10.3 percent,[71] and fixed a reasonable return on equity of 9.8 percent for the Company.[72] In that same Order, the Commission determined that a return on equity of 10.25 percent was reasonable for use in connection with the Company's Big Sandy Retirement Rider, Big Sandy 1 Operation Rider, and its environmental surcharge.[73] More recently, the Commission in June 2017 approved a return on equity of 9.7 percent for Kentucky Utilities Company and Louisville Gas & Electric Company,[74] both of which are less risky than Kentucky Power.[75]

In this case, Mr. McKenzie, testifying on behalf of the Company, recommended a return on equity of 10.31 percent for Kentucky Power,[76] while KIUC Witness Baudino recommended a return of 8.85 percent, and Dr. Woolridge, testifying for the Attorney General, recommended a return on equity of 8.6 percent.[77] Finally, although relying solely on awarded returns on equity reported by RRA to fix the return on equity for an individual utility presents the problems

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69 *Id*.

70 Order, *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 Approving Its Tariffs And Riders; And (4) An Order Granting All Other Required Approvals And Relief*, Case No. 2014-00396 (Ky. P.S.C. June 22, 2015) ("2014 Rate Case Order").

71 *Id*. at 42.

72 *Id.*

73 *Id*. at 46-47, 48, 72.

74 McKenzie Hearing Testimony at 631.

75 Woolridge Hearing Testimony at 487.

76 McKenzie Direct Testimony at 3.

77 McKenzie Rebuttal Testimony at 1-2. This is not to suggest that either 8.60 percent or 8.85 percent is the proper return on equity. Absent the approval of the Settlement Agreement, and the multiple protections it provides to customer and Company alike, the proper return on equity is the 10.31 percent recommended by Mr. McKenzie. The returns on equity proposed by both Dr. Woolridge and Mr. Baudino are presented solely for the purpose of comparison, and to illustrate that Kentucky Power's recent returns on equity fall far short of the returns proposed by even the intervenors' witnesses.

identified by Mr. McKenzie in his direct testimony,[78] it is instructive to note that the average return on equity for integrated utilities reported by Regulatory Research Associates for both twelve month periods ended June 30, 2016 and June 30, 2017 lay between 9.5 percent and 10.0 percent.[79]

4. <u>Kentucky Power's Application Respects the Regulatory Compact By Presenting A "Skinny" Rate Case That Balances The Minimum Financial Needs Of The Company And The Effect Of The Requested Increase On All Of The Company's Customers.</u>

Notwithstanding the challenges imposed by the long-lived financial pressure endured by Kentucky Power as a result of the Company's failure to earn a reasonable return on equity, Kentucky Power did not – as the years of earnings far below the authorized level[80] testify – rush into filing this case. Company Witness Satterwhite explained that although he was aware at the time he was offered the position of President and Chief Operating Officer that the Company's financial performance justified a rate case, he did not accept the position until he determined he could help "change the denominator" in the longer run through economic development.[81] That is, he recognized that "over time you can't just constantly come in and file rate cases, so you have to change the denominator overall to be respective [*sic*] of your community and your whole region."[82] Thus, although planning for a rate case was underway on December 9, 2016 when Mr. Satterwhite assumed his position,[83] he asked his staff to "restart" the process[84] by taking a "fresh

[78] McKenzie Direct Testimony at 58-63.

[79] McKenzie Rebuttal Testimony at 2.

[80] Kentucky Power Company's Response to KPSC 1-38, Attachment 1.xlsx.

[81] Satterwhite Hearing Testimony at 120-121.

[82] *Id*. at 76.

[83] *Id*. at 118.

[84] *Id*.

look"[85] at all of Kentucky Power's financials and to provide explanations for what the Company "do[es] and how we do things."[86]

As part of this fresh look, Kentucky Power met with its customers to explain the need for the rate case and to explore its constituent parts.[87] Mr. Satterwhite also met with his operational staff[88] and financial and regulatory team and challenged them to look at all options for the case.[89] Some of the options, such as accelerating the completion of Task 2 vegetation management work and reducing the annual vegetation management expense early, were incorporated in the case.[90] Others, such as "socializing" the cost of processing credit card payments, were rejected after further consideration, including input from the Company's community advisory panels.[91] Finally, in a few instances the Company presented the Commission with alternative proposals, such as the five and six year vegetation management cycles, while providing its recommendation on which proposal the Commission should approve.[92]

The result was that Kentucky Power filed a "skinny" rate case that lacked a host of new initiatives or materially expanded programs and offerings: "I called everybody in, tried to skinny the case down more."[93] Each item was examined in light of the question of: "does it need to be in this case or could it be held off in the future?"[94] Kentucky Power's application seeks the

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[85] *Id*.

[86] *Id*. at 120.

[87] *Id*. at 118-119; 147-148.

[88] *Id*. at 179.

[89] *Id*. at 71.

[90] Phillips Hearing Testimony at 296-297.

[91] Satterwhite Hearing Testimony at 147-148.

[92] *Id*. at 179.

[93] *Id.* at 463.

[94] *Id*. at 146.

minimum necessary to allow it to earn a reasonable return on equity while providing safe and reliable service to its customers.

5. <u>In Furtherance of the Regulatory Compact Kentucky Power Actively And Effectively Manages Its Costs Thereby Helping To Reduce The Revenue Requirement Presented In Its Application</u>.

Mr. Satterwhite also challenged his operational staff to reduce the Company's requested revenue requirement by examining "all avenues of where we could reduce our expenses."[95] Before filing the case, Mr. Satterwhite asked "our whole company and everyone who has a different part of the case to kind of go through it again with a finer tooth comb … [to determine] [c]an we try to manage the Company to cover those costs somewhere else."[96] This focus on cost reduction in identifying Kentucky Power's rate case revenue requirement is a manifestation of what Mr. Satterwhite and his team do daily in actively managing the Company: "[t]hat's what I do every day, try to see if there is a better way, more efficient way to do things, and challenge and empower our employees to raise those."[97]

Mr. Satterwhite's emphasis on cost control builds on existing efforts by "taking a fresh approach at managing the everyday."[98] As Mr. Satterwhite explained, "every day I'm with an employee, when we're going to build our budgets, budget from the bottom up, making sure people justify every dollar we spend."[99] He also brought in "fresh eyes" from the American Electric Power Service Corporation ("Service Corp.") to examine improving the efficiency of the Company's operations and the effect of his leadership.[100] In sum, Kentucky Power is "really

[95] Phillips Hearing Testimony at 305.

[96] Satterwhite Hearing Testimony at 146-147.

[97] *Id*. at 178.

[98] *Id*. at 153.

[99] *Id*. at 184.

[100] *Id*. at 186

creating buy-in and changing the culture overall that we're efficient, that we're smart with the customers' money, and the investments we make are prudent."[101]

The Attorney General's extended cross-examination concerning the existence of formal studies addressing cost reduction[102] misses these essential points. Not every management decision or cost reduction requires an expensive formal study by consultants such as McKinsey & Company, or even a binder on a shelf with tabs that was started and completed on dates certain.[103] Private business, and most aspects of government, actively control costs every day in the absence of third party consultant studies. Such studies are oftentimes unnecessary, costly (even if performed in-house), and delay implementation of cost control initiatives. For example, Kentucky Power was able to examine reducing the number of outside contractors without the cost and delay inherent in performing the sort of formal study inquired about by the Attorney General.[104] Similarly, in response to a challenge by management, Company Witness Phillips and his staff developed a plan to reduce the Company's vegetation management expenditures 18 months earlier than previously projected without the aid of a formal study.[105]

Kentucky Power is acting aggressively "to create a culture in Eastern Kentucky of businesspeople talking to each other and seeing what they can do to create jobs in Eastern Kentucky."[106] The Company also is seeking to build on its own culture to ensure employees are empowered to suggest changes that cut costs and improve the efficiency of the Company.[107]

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[101] *Id*. at 151.

[102] *Id*. at 125-178.

[103] *Id*. at 184.

[104] *Id*. at 178.

[105] Phillips Hearing Testimony at 296-297.

[106] Satterwhite Hearing Testimony at 106.

[107] *Id*. at 151.

Kentucky Power similarly is acting to remove barriers between it and its customers.[108] None of this requires – or perhaps is even possible with – the sort of cookbook studies and plans about which the Attorney inquired.

Equally protracted and equally unfounded were the Attorney General's cross-examination, and the conclusions the Attorney General seeks to draw from it, concerning data derived from the Company's 2006-2016 annual reports that were introduced as Attorney General Hearing Exhibit 4.[109] In particular, the Attorney General's focus on the change over the entire 11-year period ignores the fundamental differences between the two halves of the period and what changes occurred in the interim.[110]

Thus, for example, the Attorney General pointed out in cross-examination that the Company's total sales to ultimate customers increased $180,876,357 or 46 percent over the 11 years comprising Attorney General Hearing Exhibit 4.[111] Ignoring first of all that such number represents increases in costs, and not profits for the Company, the Attorney General's insinuation misses the key fact that 82.46 percent of the total increase occurred during the first five years (2006-2010) of the 11-year period.[112] Stated otherwise, only $31,371,311 of the $180,876,357 increase in total sales to ultimate customers occurred during the last six years of the 11-year period.[113]

Two principal drivers contributed to the increase in total sales and to ultimate customer revenues (principally during the first half) of the 11-year period. First, "all of the coal plants that

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[108] *Id*. at 104.

[109] *Id*. at 191.

[110] *See e.g. Id*. at 312 ("I don't know if you can do the comparison between '6 and '16, what changes in the middle, what's impacted by these numbers.")

[111] *Id*.

[112] Attorney General's Hearing Exhibit 4 (($541,079,466 (2010) – $391,934,420 (2006)) ÷ ($572,810,777 (2016) - $391,934,420 (2006)) = 82.46%).

are still being operated in the AEP system, they were being scrubbed during that time period … that's a lot of capital investment…. So as those plants were being scrubbed and those capital investments were made, Kentucky Power's costs were going up, because they're allocated [under the former AEP-East Pool Agreement] their portion of the AEP system."[114]

The second principal change in the Company's operations contributing to the need for additional internally-generated revenues was the precipitous decline in off-system sales revenues.[115] In 2006, those revenues totaled $181,168,530.[116] By 2016, they had declined 72 percent to $51,246,008[117] as result, in large part, to the 74.25 percent decline in the Company's MWh sales for resale from 5,283,270 MWh in 2006 to 1,413,350 MWh in 2016.[118] Nearly 77 percent of the decline in revenues occurred during the period 2010 to 2016.[119] The decline, which reflects the retirement of coal plants on the AEP system and the resulting reduction in "length" to support off-system sales,[120] as well as the increasing competitiveness of gas-fired units as a result of the fracking-related decline in gas prices,[121] meant the Company had "less of a cost offset"[122] as "those hundreds of million[s] of dollars"[123] of off-system sales margins were no

[113] *Id*. (($572,810,777 (2016) - $541,079,466 (2010)) = $31,371,311.

[114] Vaughan Hearing Testimony at 1036-1037. Paradoxically, the Attorney General's 2013 advocacy of scrubbing Big Sandy Unit 2, and the rejection of the Mitchell Transfer, would have added, as the Commission found in Case No. 2012-00578, hundreds of millions of dollars of additional costs. The Commission rejected the Attorney General's position.

[115] *Id*. at 1037.

[116] Attorney General's Hearing Exhibit 4.

[117] *Id*.

[118] *Id*.

[119] *Id*.

[120] Vaughan Hearing Testimony at 1037.

[121] *Id*.

[122] *Id*.

[123] *Id*.

longer available.[124] Contrary to the canvas the Attorney General attempts to paint, "it's not just a picture that Kentucky Power's revenues keep going up and sales keep going down…."[125]

6. Kentucky Power Respects the Regulatory Compact By Actively Considering And Limiting The Impact Of The Requested Increase In Its Revenue Requirement On The Company's Customers.

By examining each item included in its filing to see if it could be excluded,[126] by filing a "skinny" case,[127] and by actively and successfully managing those costs that could not be pushed out to a later case or avoided altogether,[128] Kentucky Power reduced in substantial part the impact its application otherwise would have had. But Kentucky Power has an obligation, both statutory,[129] and as part of the regulatory compact,[130] to provide adequate, efficient, and reasonable service to each of its 168,000 customers.[131] And "[t]here's costs to having safe and reliable service,"[132] particularly in a service territory that is as challenging as eastern Kentucky.[133] It is these costs this case is paying for.[134]

And these costs must be paid. Kentucky Power cannot avail itself, as the Attorney General did, of the magical thinking required to file sworn testimony indicating the Company's current rates produce a $39.9 million revenue deficiency, and the next day hold a press conference urging the Commission to ignore that deficiency, all the while assuming the Company will be able to continue to provide safe, adequate, and reliable service without the

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[124] *Id*.

[125] *Id*.

[126] Satterwhite Hearing Testimony at 146-147.

[127] *Id*. at 146.

[128] *Id*. at 146, 178.

[129] KRS 278.030(2).

[130] *United States Gypsum, Inc. v. Indiana Gas Co.*, 735 N.E.2d 790, 797 (Ind. 2000).

[131] Satterwhite Hearing Testimony at 431.

[132] *Id.* at 165.

[133] *Id.* at 325.

funds required to do so. The Attorney General's proposal to ignore his own witness' sworn testimony and shred the regulatory compact will only exacerbate the issues facing the region's least well-off residents "by not having power to these people."[135]

Kentucky Power carefully considered the impact of its requested rates on its customers[136] and its economic development activities. Company Witness Satterwhite asked his staff to examine the impact of each item of the Company's rate case on its customers[137] and to take a fresh look at "how we could minimize the impact of what we were going to file."[138] The Company recognized that any increase in any cost could be difficult for some of its customers.[139] Kentucky Power's management is sensitive to that fact and strives to make the best decision for all of its customers.[140] Kentucky Power worked hard to strike a "balance, for the Company, for the regulatory compact, and still respected the community."[141]

The Company also worked to mitigate the impact of the proposed increase on its residential customers. The Company's application, consistent with the Commission's policy of gradualism, reduces the existing $30.6 million subsidy[142] provided to the residential class by other customer classes by only five percent.[143] Kentucky Power also proposed shifting a greater proportion of the fixed costs associated with providing service to residential customers from the

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[134] *Id*. at 165.

[135] *Id*. at 474.

[136] Satterwhite Direct Testimony at 14; Satterwhite Hearing Testimony at 127 ("We talk about the impact it's going to have on our customers. We talk with those customers directly.")

[137] Satterwhite Hearing Testimony at 146.

[138] *Id*. at 118.

[139] *Id.* at 475

[140] *Id.*

[141] *Id*. at 118-119.

[142] Buck Direct Testimony; Exhibit DRB-2.

[143] Wohnhas Direct at 8.

energy charge to the monthly service charge.[144] Doing so benefits residential electric heating[145] and other high energy usage customers, which in Kentucky Power's service territory disproportionately includes low-income customers, by reducing the amount of intra-class subsidy.[146] It also benefits all residential customers by reducing bill volatility.[147]

Again consistent with the Commission's policy of gradualism,[148] the Company proposed increasing the residential service charge to only $17.50 a month instead of to the full-cost monthly basic service charge of approximately $38.[149] Kentucky Power also proposed increasing the HEAP charge, and matching shareholder contribution, by $0.05 per residential meter per month to provide an additional $163,334 annually in low-income assistance.[150] In addition, the Company began working earlier in 2017 with low-income advocates to see how the Company and the advocates could better cooperate.[151] Finally, Kentucky Power's proposed revisions to its distribution vegetation management plan to accelerate the completion of Task 2 work and the corresponding decrease in distribution vegetation expense will primarily benefit residential customers.[152]

These efforts are in addition to the significant cost reductions resulting from the Company's refinancing of long-term debt in June of 2017.[153] Kentucky Power took the initiative to recognize those savings in this case, despite the fact that the refinancing, which produced a

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[144] Vaughan Direct Testimony at 10-15; Vaughan Rebuttal Testimony at R13-R14.

[145] Kentucky Power also proposed an optional residential demand-metered tariff to allow electric heating customers potentially to take advantage of their higher load factor usage characteristics. Vaughan Direct at 18-20.

[146] Vaughan Direct Testimony at 10-13.

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

[148] *Id*. at 14.

[149] *Id*. at 10, 13.

[150] Wohnhas Direct at 7.

[151] Satterwhite Hearing Testimony at 130.

[152] *Id*. at 409-410.

[153] Wohnhas Supplemental Testimony at 2.

$8.1 million dollar reduction in the Company's annual revenue requirement and a 0.53 percent reduction in Kentucky Power's Weighted Average Cost of Capital ("WACC"), occurred approximately four months after the test year.[154] These cost-saving efforts are also in addition to Kentucky Power's efforts to increase its non-retail revenues.[155]

C. <u>Kentucky Power's Economic Development Efforts Have Helped to Turn the Tide in the Company's Service Territory</u>.

1. <u>Kentucky Power's Economic Development Grant Programs</u>.

Beginning in 2012, Kentucky Power began focused economic development efforts that have paved the way for recent successes in the Company's service territory.[156] Recognizing the historical level of poverty in the region, the Company commissioned a study of the economic development potential in the region to restart the process (the "2012 InSite Study").[157] This study identified a series of gaps in the economic development infrastructure that had to be filled before the region could be competitive in attracting new industry.[158] Filling these gaps to make the region competitive is the goal of the Company's formally-defined economic development programs.[159] Every utility is involved in and supports economic development, but Kentucky Power Company developed a partnership with its customers that goes beyond the norm. Through its efforts, Kentucky Power serves as the corporate leader in economic development in the region.

To fill the gaps identified in the 2012 InSite Study, Kentucky Power implemented two separate, but similar, economic development grant programs. The first, the Kentucky Economic

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[154] Wohnhas Supplemental Direct Testimony at 1-4; Vaughan Supplemental Direct Testimony at 4; Miller Supplemental Direct Testimony at 6.

[155] Satterwhite Hearing Testimony at 367.

[156] Hall Direct Testimony at 6.

[157] *Id*. at 6-7; Exhibit BNH-1.

[158] Hall Direct Testimony at 8-9.

Advancement Program ("KEAP"), provides economic development grants to local governments and economic development agencies in Lawrence and the six Kentucky counties contiguous to Lawrence County.[160] The KEAP program arose out of the Settlement Agreement in Case No. 2012-00578 and provides $233,000 annually in economic development grants and contributions to community and technical colleges.[161] The program began in 2014 and, consistent with the Settlement Agreement in Case No. 2012-00578, will expire at the end of 2018.[162] Funds for the KEAP program are provided solely by the Company's shareholder.[163]

The Company's second economic development grant program, the Kentucky Power Economic Growth Grant ("K-PEGG") program, is a joint effort between the Company and its customers authorized by the Commission in Case No. 2014-00396.[164] Through the K-PEGG Program, the Company issues economic development grants to municipalities and local and regional economic development agencies to fill economic development gaps identified in the 2012 Insite Study.[165] These gaps included:

- A lack of functional and properly trained local or regional economic development organizations;
- Limited competitive and marketable industrial parks and buildings;
- Insufficient marketing infrastructure for available opportunities; and
- Insufficient workforce development and training.[166]

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[159] *Id*. at 9.

[160] *Id*. at 21.

[161] *Id*.

[162] *Id*. at 25.

[163] *Id*. at 22.

[164] *Id*. at 12.

[165] *Id*.

[166] *Id*. at 9; Exhibit BNH-1.

The K-PEGG program is funded in equal parts through the Kentucky Economic Development Surcharge ("KEDS"), a $0.15 per meter per month charge approved by the Commission in Case No. 2014-00396, and a corresponding dollar-for-dollar match by the Company.[167]

The K-PEGG program is unique among economic development efforts by utilities in that it is funded by a dedicated source of funds meaning that the Company cannot shift funds from the K-PEGG program to pay for other operational expenses:

> I mean, that's what I would consider a great thing about the K-PEGG program is that it's a commitment between the Company, the customer, and the Commission to dedicate these funds to economic development.
>
> So, you know, an example of if there was a budget constraint within the Company and they needed to reallocate dollars, these dollars cannot be reallocated. They must be spent for economic development within our service territory.[168]

Other utilities can shift money away from economic development at any time. The use of dedicated funds is vital and unprecedented. Also, unlike the KEAP program, which is limited in geographic scope, the K-PEGG program serves the Company's entire service territory.[169]

2. Kentucky Power's Economic Development Grant Programs Produce Results.

Through the KEAP and K-PEGG programs, Kentucky Power has issued 42 grants totaling $1,844,580.[170] Many of these grants provided support and training to economic development agencies in the Company's service territory. Others have provided needed assistance to economic development agencies to attract or retain prospects. For example,

- K-PEGG and KEAP grant funding allowed Ashland Alliance to obtain certifications for the EastPark Industrial Park.[171] Because of these certifications, Braidy Industries was able to keep its proposed aluminum mill in Greenup and Boyd Counties when construction delays associated with its original site put the

[167] Hall Direct Testimony at 13.

[168] Hall Hearing Testimony at 867.

[169] Hall Direct Testimony at 13.

[170] *Id*. at 15-16, 22-23; Hall Rebuttal Testimony at R2.

[171] Hall Hearing Testimony at 845-46; Hall Rebuttal Testimony at R6-R7.

project in jeopardy.[172] Braidy Industries plans to employ 550 full-time employees in addition to over 1,000 construction workers.[173]

- K-PEGG grant funding to the City of Pikeville facilitated the development of the Kentucky Enterprise Industrial Park in Pike County.[174] The Kentucky Enterprise Industrial Park will be the home of SilverLiner Trucking facility with up to 300 employees and the EnerBlu battery manufacturing facility with 875 employees.[175]

- K-PEGG grant funding to the Big Sandy Regional Industrial Development Authority directly supported the relocation of Logan Industries to Magoffin County keeping up to 115 jobs in the service territory.[176]

Through these grant programs and its other economic development efforts, Kentucky Power is turning the tide in its service territory. These efforts, if continued, will "grow the denominator" allowing the Company to spread its fixed costs over a larger load and limit rates for all customers.

D. Kentucky Power In Its Role As A Good Community Partner Cannot Be Required To Supplant The Role Of Government.

Kentucky Power has demonstrated that it is a great corporate citizen that strives to be more than just a corporation located in eastern Kentucky. The Company instead is a community partner, interested in positively impacting the community in which the Company and its customers live and operate. Although such a role is not contemplated under the regulatory compact, Kentucky Power nonetheless has seen real value from the charitable and economic development efforts it has undertaken.

As a regulated utility, Kentucky Power enjoys and adheres to the requirements implicit in the regulatory compact: that in return for providing safe and reliable service to customers, the utility is allowed a reasonable rate of return for that service. Also as a regulated utility, the

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[172] Hall Hearing Testimony at 845-46.

[173] Hall Direct Testimony at 12.

[174] Hall Hearing Testimony at 832-833.

[175] Hall Rebuttal Testimony at R3; Hall Hearing Testimony at 823.

Company part of a unique relationship to its customers and its service territory. Not only does the Company strive to maintain the ability to earn a return on equity sufficient to permit it to attract capital to permit it to invest in its service territory, it also has a duty to provide service to its customers in accordance with Kentucky law. Kentucky Power, in particular, enjoys an even more unique relationship with its customers, as its service territory is located in eastern Kentucky, which has experienced as pronounced an economic downturn in recent years as anywhere in the country.

It is true that Kentucky Power's service territory has some of the highest poverty rates in the country. It is also true that in these same counties Kentucky Power's customers are spread across some of the most difficult terrain in the state.[177] Unfortunately, each of these factors compounds the effect of the other. It costs the Company more to provide safe and reliable service to customers who can least afford it. This fact, and the reality of a decreasing customer base, are two factors of the many that contributed to the Company's need for a rate increase.

Unfortunately, as Community Action Kentucky ("CAK") Witness McCann testified, society will never end poverty.[178] But, that does not mean Kentucky Power is ignoring the challenge. The Company secured grants to provide weatherization assistance to seniors and low income households through the Christian Appalachian Project ($50,000),[179] to provide video distance learning (Go Online And Learn, or GOAL) for every high school in its territory

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[176] Hall Direct Testimony at 17-18; Hall Hearing Testimony at 844-845.

[177] Vaughan Direct Testimony at 18. Kentucky Power has 17 customers per distribution line mile. Louisville Gas and Electric Company/Kentucky Utilities Company have 41 customers per distribution line. Duke Energy Kentucky has 47 customers per distribution line. Compounding this disparity – and the cost differentials inherent in it – is the fact that Kentucky Power's difficult topography increases the distribution capital and O&M expense required to serve each distribution line mile above that required in the much more urban areas of the "Golden Triangle." *Id.*

[178] McCann Hearing Testimony at 1116.

[179] Satterwhite Hearing Testimony at 125.

($500,000),[180] funded the first Red Cross emergency response vehicle dedicated to the region ($150,000),[181] and secured funds to train unemployed coal miners at the eKAMI school teaching advanced manufacturing skills ($123,000).[182] In 2016, AEP directly donated, through the American Electric Power Foundation, $25,000 to God's Pantry in Paintsville, Kentucky and $10,000 to the Kentucky Governors Scholar Program.[183] In addition, in response to the fact that the low income assistance programs each year exhaust the millions provided by the federal government, Kentucky Power proposes to increase its contribution to low income assistance programs in this case.[184]

Kentucky Power did not undertake these actions believing it would alleviate all poverty. It did so to augment a program that already provides support to low income residents by asking for a little more support from residential customers while also guaranteeing equivalent additional shareholder support. In the long run, the focus on economic development will sow more seeds to help alleviate the level of poverty in Eastern Kentucky; in the short run, by also increasing its support to low income assistance programs now, the Company is actively addressing the immediate needs of its communities.

Kentucky Power is looking to do its part and more to address the challenges facing eastern Kentucky. The Company sought through the Settlement Agreement to find a mutually beneficial solution to those challenges so that Kentucky Power can uphold its end of the regulatory compact, without sacrificing what it is promised under that same compact.

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[180] Satterwhite Direct Testimony at 6; Satterwhite Hearing Testimony at 119.

[181] Satterwhite Direct Testimony at 6.

[182] Hall Hearing Testimony at 864-865.

[183] *Id*.

[184] *Id*. at 11-12.

By seeking to improve the overall economic situation of its service territory in the long-run and to provide assistance in the short-term, Kentucky Power is making a meaningful and important contribution to addressing the concerns raised by Mr. McCann and many of those persons who filed public comments. Neither the actions by the Company and its shareholder, nor the challenges facing eastern Kentucky, justify, as the Attorney General and others would have it, shredding the regulatory compact by denying Kentucky Power the opportunity to earn a reasonable return on equity. Nor does either justify transforming this rate case into the vehicle by which Kentucky Power is required to supplant the role of government, if it chooses to exercise it, and become a social welfare agency.

Courts have criticized regulatory bodies' unilateral attempts to implement certain social policies through ratemaking.[185] If "social considerations were to become dominant [in ratemaking practices], the enterprises to which they apply would cease to be public utilities in the accepted sense of the term. They would then become 'socialized,' like the public schools, the tax-financed or endowed universities, and (to a greater degree) the police, the courts, the military, and the city-street departments."[186] Ultimately, legislatures, and not utility regulatory bodies, bear responsibility to address social welfare issues.[187] The General Assembly, and not the Commission nor Kentucky Power, is best equipped to decide whether and how to address the broader concerns identified by Mr. McCann.[188]

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[185] *See Colorado Mun. League v. Public Utils. Comm'n*, 591 P.2d 577 (Colo. 1979) (commission lacked authority to effect social legislation by ordering that pay phone rates be reduced according to age and indigency classification); *Mountain States Legal Found. v. New Mexico State Corp. Comm'n*, 687 P.2d 92 (N.M. 1984) (commission lacked authority to effect social policy through preferential ratemaking for telephone service for elderly and indigent); *Process Gas Consumers Group v. Pennsylvania Pub. Util. Comm'n*, 511 A.2d 1315 (Pa. 1986) (commission's requirement that excess gas rate revenues be used for residential conservation programs exceeded commission's ratemaking authority).

[186] James C. Bonbright, et al., Principles of Public Utility Rates 169 (Public Utilities Reports, Inc., 2nd ed. 1988).

[187] Id. at 170

[188] Id. at 170, 177-178.

Through the balance achieved by Settlement Agreement, Kentucky Power and the Signatory Parties have addressed to the extent possible within the confines of this proceeding the concerns raised by Mr. McCann and others and shared by all parties. The Settlement Agreement does so in a creative and constructive fashion, while providing Kentucky Power with the financial resources required by the regulatory compact, KRS 278.030(1), and the state and federal constitutions. Kentucky Power's current rates fall far short of doing so. Neither the short-term nor long-term needs of Kentucky Power's customers, and eastern Kentucky as a whole, will be advanced if, as the Attorney General argues, Kentucky Power continues to be denied the financial wherewithal to provide adequate and reasonable service.

E. Case History.

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

In its June 28, 2017 filing, the Company sought to adjust its rates to produce approximately $65 million in additional annual revenue, or an 11.8 percent increase over the February 28, 2017 test year level.[189] The Company also proposed additional customer funding for the Home Energy Assistance Program ("HEAP") and the Kentucky Economic Development Surcharge ("KEDS") of $81,667 and $203,224, respectively, for a total additional increase of about 0.6 percent for those programs.[190] Kentucky Power proposed to match, dollar-for-dollar, the additional customer funding of HEAP and KEDS.[191] Further, the Company proposed a revenue increase of approximately $3.9 million in connection with the 2017 Environmental Compliance Plan ("2017 ECP").[192] Thus, the total proposed increase in revenue requirement

[189] Wohnhas Direct Testimony at 5.

[190] *Id.*

[191] *Id.*

[192] *Id.*

totaled around $69 million, or an increase of about 12.56 percent.[193] The Company also sought approval for a ROE of 10.31 percent.[194]

The Company's proposed adjustments yield fair, just, and reasonable rates that will allow the Company to make necessary investments, including vital economic development investments in its service territory, and continue to provide the service that customers and Kentucky regulations require.[195]

2. June 2017 Refinancing Activity.

As part of its ongoing active cost control measures, Kentucky Power refinanced in June 2017 its $325,000,000 6.00% Senior Unsecured Notes, and $65,000,000 WVEDA Mitchell Project, Series 2014A Variable Rate Demand Note (together, the "June 2017 Refinancing Activity").[196] The June 2017 Refinancing Activity resulted in an approximately ten percent reduction of the Company's proposed increase of annual revenue requirement from $69,575,936 to $63,313,785.[197]

As a result of the June 2017 Refinancing Activity, the Company also will see a decrease in estimated interest expense associated with the environmental surcharge in the amount of approximately $1.06 million, and an estimated reduction in the amounts recovered through the Decommissioning Rider (formerly the Big Sandy Retirement Rider) of approximately $800,000.[198] These savings, combined with the decrease in the proposed annual revenue requirement increase, result in a total $8.1 million benefit to customers.[199] The June 2017

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[193] *Id*. at 6.

[194] McKenzie Direct Testimony at 6.

[195] Satterwhite Direct Testimony at 17, 20.

[196] Wohnhas Supplemental Direct Testimony at 1.

[197] *Id*. at 2-3.

[198] Vaughan Supplemental Direct Testimony at 4.

[199] *Id*. at 4.

Refinancing Activity also produced a 53 basis point reduction of the Company's WACC, from 7.28 percent to 6.75 percent.[200]

3. The Settlement Agreement.

Following negotiations to which all parties were invited, Kentucky Power, KIUC, KSBA, KLC, Wal-Mart, and KCTA entered into a Settlement Agreement.[201] The Attorney General and KCUC elected not to sign the agreement. The Settlement Agreement produces an annual revenue increase of $31,780,734.[202] This represents a $28,616,704 reduction from the $60,397,438 sought by the Company in the August 2017 Refinancing Update.[203] Notably, this amount is smaller than the nearly $40 million revenue deficiency calculated by AG witness Smith.[204] The revenue requirement increase agreed to by the Settling Parties, when combined with changes outside this agreement, but not including possible further reductions as a result of the recent enactment of the Tax Cut and Jobs Act, will result in an average monthly bill increase for residential customers of $1.35 or 0.79 percent.[205] The Company filed an executed copy of the Settlement Agreement accompanied by supporting testimony with the Commission on November 22, 2017.[206]

[200] Miller Supplemental Direct Testimony at 6.

[201] Satterwhite Settlement Testimony at S4, S6.

[202] Settlement Agreement at ¶ 2(a).

[203] *Id*.

[204] Compare to the Attorney General's Response to KPSC 1-2(a).

[205] *See* the Company's January 3, 2018 Supplemental Response to AG-PH 5. The total bill impact calculation accounts for changes to the Company's DSM factor effective January 1, 2018. The 9 percent average residential bill increase identified in Exhibit 1 to the Settlement Agreement is relative to the test year revenue amount.

[206] The Settlement Agreement filed on November 22, 2017 was updated on November 30, 2017 to incorporate the signature of a representative of KCTA and updated rates under Tariff C.A.T.V.

III. THE SETTLEMENT AGREEMENT IMPROVES ON THE APPLICATION, IS IN THE PUBLIC INTEREST, AND WILL RESULT IN RATES THAT ARE FAIR, JUST, AND REASONABLE.

A. Settlement Agreement Overview.

The Settlement Agreement is the result of constructive and creative negotiations among the parties and provides for a balanced package that allows the Company to address the financial challenges it has seen recently while mitigating rate impact on its customers. In addition to the revenue requirement reduction, the Settlement Agreement provides additional benefits, including a deferral of significant costs and an agreement by the Company not to seek a new base rate case for almost three years.

The Settlement Agreement also provides that any party may withdraw from the agreement if the Commission does not approve the agreement in its entirety.[207] As Company Witness Satterwhite described, the Settlement Agreement as a whole represents a fair balance:

> I guess the one caveat I would put in there is if the -- I think there's fair balance amongst the parties that did reach a settlement agreement in this case, and if the Commission were to decide to change something in one area, it would be to provide that balance still and change something else in the settlement agreement in a different area to still provide that overall balance that the parties have met.[208]

The rates proposed in the Company's application are fair, just, and reasonable, and in the absence of the Settlement Agreement, should be approved by the Commission as filed. The Settlement Agreement as a whole improves on those as-filed rates while providing additional benefits not available in the absence of the agreement. The Commission should approve the agreement without modification.

[207] Settlement Agreement at ¶ 19.

[208] Satterwhite Hearing Testimony at 58.

B. The Rate Case "Stay-Out" Provision Provide Customers A Significant Benefit Not Otherwise Available Absent Kentucky Power's Agreement In Return For The Balance Achieved By The Settlement Agreement.

The regulatory compact[209] and KRS 278.030(2) impose the obligation on Kentucky Power to provide "adequate, efficient, and reasonable service" to each of the Company's 168,000 customers whether they are located in an urban area in Ashland, Pikeville, or Hazard, or at the end of a six-mile radial distribution line that serves only two customers. Kentucky Power (and every other utility) is neither statutorily[210] nor constitutionally[211] required to bear the costs of doing so. Rate cases are the legislatively sanctioned vehicle through which utilities obtain the financial wherewithal to meet their obligation to provide service to their customers.[212] Kentucky Power has the right – which only it can limit through a settlement agreement – to employ that legislatively-sanctioned vehicle to obtain fair, just, and reasonable rates sufficient to cover its expenses in providing service to its customers.

But the litigation of rate cases imposes burdens and uncertainties on the Commission, the Company's customers, and the Company itself.[213] Rate case litigation also imposes costs – both financial and otherwise – on each of the three.[214] In particular, these uncertainties also can affect Kentucky Power's ability to continue to effect the sort of change required to "grow the denominator" through economic development.[215] The time, energy, and financial resources that are required to prepare and litigate a rate case could otherwise be devoted to the operation of the

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[209] *United States Gypsum, Inc. v. Indiana Gas Co.*, 735 N.E.2d 790, 797 (Ind. 2000).

[210] KRS 278.030(1); *South Cent. Bell Tel. Co. v. Utility Regulatory Com'n*, 637 S.W.2d 649, 652 (Ky. 1982) ("The General Assembly has unequivocally allowed utilities to be fairly paid for their service.")

[211] *Commonwealth ex rel. Stephens v. S. Cent. Bell Tel. Co.*, 545 S.W.2d 927, 930 (Ky. 1976) (a just and reasonable, and hence constitutional, rate is one that "enable[s] the utility to operate successfully, to maintain its financial integrity, to attract capital and to compensate its investors for the risks assumed….")

[212] *See* Satterwhite Hearing Testimony at 165 ("[t]here's costs to having safe and reliable service" and "[t]hat's what this rate case is paying for.")

[213] Satterwhite Rebuttal Testimony at R6-R7.

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

businesses of the Company and the intervenors.[216] The review and administration of rate cases – although among the most important duties undertaken by the Commission and its staff – result in burdens that may be increasingly difficult to meet with the declining resources made available to the government of the Commonwealth.[217]

Because of these burdens, as well as the impact any increase on costs can have the Company's residential customers,[218] Kentucky Power sought through its application to obtain the regulatory tools, coupled with its ongoing economic development efforts,[219] required to enable the Company to extend the period between rate case filings.[220] Chief – but not exclusively – among those tools was the amendment of the Company's Tariff P.P.A. to permit Kentucky Power to refund or recover incremental changes between the level of PJM LSE OATT Charges included in Kentucky Power's base rates and its actual OATT expense.[221]

The Settlement Agreement builds on the Company's efforts in its application to extend the period between future rate applications by including an express three-year base rate case stay out provision.[222] This is a significant benefit to customers. In addition to this direct benefit to all of the Company's customers, the rate stability resulting from the three-year stay out will prove to

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[215] *Id*. at R7.

[216] *Id*. at R7.

[217] *See* General Fund Budget Reduction Order 18-01, Office of State Budget Director, http://apps.sos.ky.gov/Executive/Journal/execjournalimages/2017-MISC-253341.pdf (December 28, 2017).

[218] Satterwhite Hearing Testimony at 76 ("over time you can't just constantly come in and file rate cases, so you have to change the denominator overall to be respective [*sic*] of your community and your whole region.")

[219] *Id*. at 165 ("[w]e're going to really focus on economic development. Hopefully that, in the future, avoids us having to file something or avoids us having to file something with such a large increase, because we have changed that denominator.")

[220] *See* Satterwhite Rebuttal Testimony at R4-R5.

[221] *Id*.

[222] Settlement Agreement at ¶ 5(a) ("Kentucky Power will not file an application for a general adjustment of base rates for rates that would be effective prior to the first day of the January 2021 billing cycle.")

be of a particular benefit as Kentucky Power and its economic development partners build on the Company's existing economic development efforts.[223]

The stay out provision is also a benefit that, *as a matter of law,* only Kentucky Power can agree to provide. *As a matter of the cold finances* necessary to permit Kentucky Power to continue to provide adequate, efficient, and reasonable service, it is a benefit the Company can afford only if the balance achieved in the Settlement Agreement between the detriments agreed to by Kentucky Power in return for the benefits it achieved is preserved by the Commission: "[w]ithout all of the considerations provided by the Settlement Agreement, Kentucky Power lacks that [financial] ability [to stay out.]"[224]

The balance struck in the Settlement Agreement was both intricate[225] and hard to achieve.[226] Critical to that balance, and Kentucky Power's financial ability to agree to the stay-out provision, were the protections provided by the amendment to Tariff P.P.A. to refund or recover variations from test year levels of PJM LSE OATT expenses.[227] The other parties to the Settlement Agreement evidenced their understanding of the importance of maintaining the overall balance struck in the Settlement Agreement by agreeing: "[t]his rate case 'stay out' is expressly conditioned on Commission of this Settlement Agreement without modification including the recovery of the Rockport Deferral Regulatory Asset as described in Section 3

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[223] Satterwhite Rebuttal Testimony at R7 ("With regard to economic development, rats case produce rate uncertainty for customers evaluating whether to locate within Kentucky Power's service territory.")

[224] Satterwhite Settlement Testimony at S16. *See also* Satterwhite Hearing Testimony at 336-337; 487 (requesting the Commission not disturb "the overall balance, I think, the parties have put into the settlement agreement."); 396 (same); 409 (same); 477 (same).

[225] Satterwhite Hearing Testimony at 331, 336.

[226] *Id*. at 324-325.

[227] Satterwhite Settlement Testimony at S16.

above and the incremental PJM LSE OATT expense through Tariff P.P.A. as described in Section 4 above."[228]

Finally, although Kentucky Power is agreeing to assume the financial risk inherent – even with the proposed amendment of Tariff P.P.A. and the recovery of the Rockport Deferral Regulatory Asset – in the stay out provision,[229] the parties recognized that there could be a change of law that could yield "a material adverse effect on the Company's financial condition,"[230] or emergency that could adversely affect the Company or its customers.[231] In those circumstances, the Company may file an application seeking to address the change in law or emergency.[232] The stay out provision, while limiting Kentucky Power's ability to seek base case rate relief, expressly recognizes the Commission's continuing jurisdiction over Kentucky Power's rates.[233]

C. <u>Recovery of Kentucky Power's PJM OATT LSE Charges Through Tariff P.P.A. is Necessary, Reasonable, and Appropriate.</u>

In the application, Kentucky Power seeks Commission approval to amend its Purchase Power Adjustment Rider ("Tariff P.P.A.") to include additional categories of expenses and to change from a monthly to an annual adjustment factor calculation. Currently, the Company recovers through Tariff P.P.A. the costs of (1) demand credits paid to C.S.-I.R.P. customers; (2) certain purchase power expenses not recoverable through the Company's fuel adjustment clause ("FAC"); and (3) power purchased through new Purchase Power Agreements.[234] The Company

[228] Settlement Agreement at ¶ 5(a).

[229] Satterwhite Hearing Testimony at 397.

[230] Settlement Agreement at ¶ 5(b).

[231] *Id*. at ¶ 5(c).

[232] *Id*. at ¶ 5(b); *id*. at ¶ 5(c).

[233] *Id*. at ¶ 5(c).

[234] Vaughan Direct Testimony at 26.

proposes to add the following additional categories of costs for recovery under Tariff P.P.A.: (1) the charges and credits it incurs as a load serving entity ("LSE") in PJM under PJM's FERC-approved Open Access Transmission Tariff ("PJM OATT LSE Charges"); (2) purchase power costs excluded from recovery under the FAC due to the peaking unit equivalent calculation; and (3) gains and losses from incidental gas sales.[235]

Under the Company's application, the aggregate annual amount of costs incurred in the categories identified above ("Tariff P.P.A. Costs") will be compared to the amount of those costs included in base rates.[236] The Company will then set the annual purchase power adjustment factor to recover or credit any over or under recovery of the base rate amount ensuring that customers pay no more or no less than the actual charges.[237] Kentucky Power has set the purchase power adjustment factor initially at zero.[238] The Company will file with the Commission annually no later than August 15 the calculations used to develop subsequent purchase power adjustment factors.[239] The aggregate amount of Tariff P.P.A. Costs included in base rates is $78,737,938.[240] Much like the Commission's desire to address the impact of tax law changes outside the traditional rate case process, the treatment of PJM OATT LSE Charges also deserves special consideration.

1. Kentucky Power's PJM OATT LSE Charges.

As an LSE within PJM, Kentucky Power and its customers receive the benefits of a robust transmission system and access to a diverse market for energy.[241] Each year, PJM

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[235] *Id*.

[236] *Id*. at 35-36.

[237] *Id*. at 36.

[238] *Id*. at 35-36.

[239] *Id*.

[240] *See*, the Company's response to KIUC 1-67; Exhibit AEV-4S.

[241] Satterwhite Hearing Testimony at 405.

determines the annual transmission costs allocated to the AEP Zone (the transmission zone in which Kentucky Power is an LSE). These costs are largely driven by the nature of the transmission projects planned within the system and are allocated to various zones based on the benefits those zones receive from the project.[242] Many of the projects are designed to replace aging transmission infrastructure at (or past) the end of its design life.[243] Others are designed to address congestion or account for recent generation retirements.[244] These costs are almost exclusively outside Kentucky Power's ability to control.[245]

The costs charged to the AEP Zone are calculated using the cost allocations set forth in PJM's FERC-approved OATT,[246] which are based upon the costs arising from the various PJM transmission owners' FERC approved formula rate templates. A portion of costs assigned to the AEP Zone are then allocated to Kentucky Power through the FERC-approved AEP Transmission Agreement.[247] Recently, Kentucky Power's share of the AEP Zone transmission costs have averaged approximately six percent of the total AEP Zone transmission costs.[248] Kentucky Power's adjusted test year PJM OATT LSE charges totaled $74,038,517.[249]

[242] Vaughan Hearing Testimony at 1022-23; Exhibit AEV-R1.

[243] Vaughan Hearing Testimony at 1026, 1038-1039.

[244] Exhibit AEV-R1 at 10.

[245] Satterwhite Hearing Testimony at 319 ("It is not as if I could take a snapshot in time from a test year and have less employee lunches and put a few less generators or transformers and cover that cost. It is completely outside that, my management ability."); Vaughan Rebuttal Testimony at R5-R6.

[246] Vaughan Rebuttal Testimony at R5-R6; Exhibit AEV-R1.

[247] Vaughan Hearing Testimony at 1026-27.

[248] *Id*. at 1033.

[249] Vaughan Direct Testimony at 29 (as corrected during Mr. Vaughan's testimony on December 8, 2017). This amount is included in the $78,737,938 total Tariff P.P.A. Costs that will be used to calculate the annual purchase power adjustment factor.

2. Recovery of Kentucky Power's PJM OATT LSE Charges Through Tariff P.P.A. Benefits Customers.

a. Kentucky Power Will Recover its Actual PJM OATT LSE Charges – No More and No Less.

Kentucky Power anticipates increasing investment in the PJM transmission system by its member transmission owners in the future.[250] This increased investment will address the aging system infrastructure, but will also result in increased PJM OATT LSE Charges for Kentucky Power. These costs, which are volatile and largely outside of the Company's control,[251] will have a material impact on the Company. The Company currently estimates that its share of the PJM OATT LSE Charges for 2018 will total approximately $88 million, a $14 million increase over the amount in the test year.[252] The Company further projects that these amounts will increase to approximately $93 million and approximately $105 million in 2019 and 2020, respectively.[253]

Two pending FERC proceedings have the potential to impact the Company's PJM OATT LSE Charges.[254] In one, a challenge was filed to the return on equity used in calculating the transmission cost of service in the AEP Zone.[255] In the other, a non-unanimous settlement in a case challenging the cost-allocation methodology used to allocate costs to LSEs in PJM is under review.[256] Both of these FERC proceedings may lower the Company's PJM OATT LSE Charges. Likewise, the Tax Cuts and Jobs Act, signed into law by President Trump on December 22, 2017, will affect the level of rates charged by PJM for transmission services under

[250] Vaughan Direct Testimony at 27.

[251] Vaughan Rebuttal Testimony at R5-R6.

[252] Satterwhite Settlement Testimony at S14-S15.

[253] Attachment 1 to the Company's response to KIUC 1-67.

[254] Vaughan Direct Testimony at 28.

[255] *Id.*

[256] *Id.*

its OATT. The specifics of how the tax code changes will impact the Company's PJM OATT LSE Charges is unknown at this time. Under the Company's proposal, however, any corresponding changes in PJM OATT LSE Charges would flow through Tariff P.P.A. to customers.

The volatile nature of these costs makes tracking these charges through Tariff P.P.A. preferable to utilizing forecasted test years. Originally, Kentucky Power estimated that its PJM OATT LSE Charges for 2018 would total approximately $91 million, exceeding the amount included in base rates by approximately $17 million.[257] Subsequently, third party changes, outside of the Company's control, reduced the 2018 AEP Zone transmission expense; as a result, Kentucky Power's estimated 2018 PJM OATT LSE Charges decreased to approximately $88 million, a level that was approximately $14 million in excess of the base rate level.[258] Had the Company used a forecasted test year, the Company's customers would have paid rates based on the original forecasted $91 million expense. With the Company's proposed tracking mechanism, customers will pay the actual amount and save $3 million.[259]

Kentucky Power is entitled to recover these FERC-approved costs.[260] Under the proposed changes to Tariff P.P.A. included in the application, the Company will recover no more and no less than its actual PJM OATT LSE Charges. Because these charges are volatile and, for the most part, beyond the Company's control, recovering them through a tracker ensures that any benefits of the changes in these costs, be it through the pending FERC proceedings, changes in

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[257] Satterwhite Rebuttal Testimony at R8.

[258] Satterwhite Hearing Testimony at 370; Satterwhite Settlement Testimony at S15.

[259] Satterwhite Hearing Testimony at 317-18.

[260] 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*, Case No. 2006-00307 at 11 (Ky. P.S.C. January 24, 2007) ("Rockport Environmental Surcharge Order").

the tax code, or through third party recalculations described above, flow through Tariff P.P.A. and the purchase power adjustment factor to customers.

b. Recovering PJM OATT LSE Charges Through Tariff P.P.A. Will Avoid Immediate and Recurring Rate Cases.

If the Company cannot recover its incremental PJM OATT LSE Charges as proposed through Tariff P.P.A., it will be forced to file another rate case almost immediately. Staff underscored this point in cross-examining Company Witness Satterwhite:

> Q. Is it correct that if the Commission were to deny that recovery [of the PJM LSE OATT expenses through the tracker], that Kentucky Power would have to come in for another rate case?
>
> A. Most likely, yes.
>
> Q. So this is a binary decision. The Commission authorizes – or authorizes recovery in this case or Kentucky Power comes in for another rate case?
>
> A. Yeah, [I] have to obviously look at what the overall decision is of the Commission. Hopefully it respects the balance of what we have in the settlement agreement ….[261]

Mr. Satterwhite continued on cross-examination by making clear that his testimony regarding the need for the amendment of Tariff P.P.A. is not a matter of brinksmanship; instead, it is driven by the economic realities presented by the PJM LSE OATT Charges and his obligation to manage the Company so that it has the financial ability to provide reliable service:

> It's a large amount, and I have to make sure I'm managing the Company properly and taking care of that…. When you're introducing something that is 14, 17, who knows how many million more, that's not something I can adjust what I do day to day to work within that [test year] snapshot. It's completely volatile and outside that paradigm of that historic test year view, so that volatility forces me to deal with that.[262]

[261] Satterwhite Hearing Testimony at 395-396.

[262] *Id*. 396-397.

Contrary to the Attorney General's contention, recovery or refund of incremental changes in the Company's PJM LSE OATT Charges through the Company's proposed changes to Tariff P.P.A. does not guarantee that Kentucky Power will earn its authorized return on equity:

> Q: Looking at lines 3 through 4, you state there (Reading) The tracker would allow the Company the opportunity to earn its ROE.
>
> But isn't it true that if the tracker is approved, it would guarantee that Kentucky Power would earn its authorized ROE rather than an opportunity to earn it?
>
> A: Absolutely not. We have an opportunity –
>
> Q: Really?
>
> A: -- if that is included. If it's approved, Kentucky Power has a legitimate opportunity. If it's not approved, we have no opportunity. That's one and a half percent ROE off the top, we know it's happening[263]…

Absent such a tool in its kit, and because the costs are real and are projected to increase in 2018 alone by $14 million over test year levels,[264] Kentucky Power may well be required to seek a further adjustment of its rates within months of the expected date of the Order in this case.[265] That is in no one's interest and would erode public confidence in the regulatory system.

Rate cases are expensive and time-consuming. The Company's rate case expenses in this case were estimated to total $1.3 million – $600,000 of which were exclusively for newspaper advertising expenses.[266] Many, if not all of these costs are incurred in a rate case regardless of the amount of revenue increase sought by the Company, and these necessary and prudently-incurred rate case expenses are properly recoverable from customers. The Company's proposal to track and recover its incremental PJM OATT LSE Charges through Tariff P.P.A. allows the

[263] Vaughan Hearing Testimony at 1035-36.

[264] Satterwhite Settlement Testimony at S14-S15.

[265] Satterwhite Rebuttal Testimony at R5.

[266] *Id*. at R6.

Company to recover these costs without the expense and distraction of nearly continuous rate cases. The proposed change to Tariff P.P.A. is reasonable and should be approved.

3. The Settlement Agreement Minimizes the Rate Impact of Recovering PJM OATT LSE Charges through Tariff P.P.A.

The Settlement Agreement accepts Kentucky Power's proposal to recover incremental PJM OATT LSE Charges through Tariff P.P.A. with two changes. First, as part of the overall balance of the Settlement Agreement, the Company agreed to only recover 80 percent of the its incremental PJM OATT LSE Charges.[267] This means that the Company will not recover the remaining 20 percent of its expenses that it is otherwise entitled to recover in full.[268] Second, the Company agreed to credit against the incremental PJM OATT LSE Charges used in calculating the purchase power adjustment under Tariff P.P.A. 100 percent of the difference between the return on its incremental transmission investments calculated using the FERC-approved PJM OATT return on equity and the return on its incremental transmission investments calculated using the 9.75 percent return on equity included in the Settlement Agreement (the "Transmission Return Difference.")[269] For 2018, the Transmission Return Difference is estimated to be a $607,326 credit to customers in the calculation of the purchase power adjustment factor.[270] Both of these changes to Tariff P.P.A. in the Company's application provide real benefits to customers that are not available outside the settlement agreement.

Although the Settlement Agreement changes to the proposed PJM OATT LSE Charge recovery mechanism make it more challenging for the Company to earn its authorized return,[271]

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[267] Settlement Agreement at ¶ 4(a).

[268] Satterwhite Settlement Testimony at S14.

[269] Settlement Agreement at ¶ 4(b).

[270] *Id*., Exhibit 3.

[271] Vaughan Hearing Testimony at 1036, describing the Company's opportunity to earn its authorized return depending on the recovery of PJM OATT LSE Charges, "And it's no guarantee, because we're still absorbing 20 percent of those incremental costs in the settlement deal."

the Company agreed to the reductions as part of the overall balance of the Settlement Agreement. The Settlement Agreement's provisions authorizing the Company to recover 80 percent of its incremental PJM OATT LSE Charges, less the Transmission Return Difference, is in the public interest and should be approved as part of balance in the Settlement Agreement.

D. The Settlement Agreement's Proposed Deferral of Rockport UPA Expense Is A Creative Means Of Mitigating The Effect Of Required Increase In The Company's Annual Revenue Requirement.

1. The Proposed Rockport Deferral.

Kentucky Power is a party to a FERC-approved Unit Power Agreement ("UPA") under which it receives 15 percent of the output of the Rockport Generating Station in Rockport, Indiana ("Rockport UPA"). Kentucky Power agreed in the settlement agreement to defer a total of $50 million in Rockport UPA expense for recovery following the termination date of the Rockport UPA ("Rockport Deferral"). This creative concept, first suggested by KIUC,[272] allows the Company to defer these contractual expenses until 2022 when they may be offset as a result of the expiration of the Rockport UPA. Because the Rockport UPA is a FERC-approved rate schedule, the Company is authorized full and concurrent recovery through rates.[273] As such, the Rockport Deferral is not something that could otherwise be ordered by the Commission.

Under the Rockport Deferral, the Company will defer $15 million per year in 2018 and 2019, $10 million in 2020, and $5 million per year in 2021 and 2022. The Rockport Deferral creates a $15 million base rate credit. In subsequent years, the difference between the

[272] KIUC's proposal called for the deferral of $20.3 million a year through December 2022 and for the approximate $101.5 million deferral balance to be amortized on a levelized basis over ten years. Kollen Direct Testimony at 11, 15. The amount of the deferral and the length of the amortization period would have unreasonably burdened Kentucky Power's ability to maintain a stable investment grade credit rating by decreasing its cash flows. Wohnhas Rebuttal Testimony at R9-R10. The Rockport Deferral included in the Settlement Agreement only works financially if Kentucky Power is able to strengthen its cash flow by contemporaneously recovering 80 percent of any incremental increase in the Company's PJM LSE OATT Charges. Wohnhas Hearing Testimony at 969.

[273] Rockport Environmental Surcharge Order at 11.

$15 million base rate credit and the annual deferral amount will be recovered through the Company's Tariff P.P.A. The Rockport Deferral timeline is summarized as follows:

YEAR	CREDIT IN BASE RATES	DEFERRAL AMT	AMT RECOVERED VIA TARIFF PPA
2018	$15 million	$15 million	$0
2019	$15 million	$15 million	$0
2020	$15 million	$10 million	$5 million
2021	$15 million	$5 million	$10 million
2022	$15 million	$5 million	$10 million[274]

As it is being deferred, the Rockport Deferral Regulatory Asset will be subject to a carrying charge at the Company's weighted average cost of capital ("WACC"). The Company estimates that the Rockport Deferral Regulatory Asset will total $59 million dollars at the end of 2022.[275] The recovery of the Rockport Deferral Regulatory Asset will begin in December 2022.[276] The regulatory asset will be amortized over five years.[277]

In the event the Company elects not to extend the Rockport UPA, then starting on the termination date, it will no longer incur the costs associated with the Rockport UPA. Under the Settlement Agreement, the Company will, through Tariff P.P.A., credit back to customers these Rockport Fixed Cost Savings.[278] The Rockport Fixed Cost Savings credit will, for 2023 only, be subject to an offset in the amount of revenue, up to the amount of the Rockport Fixed Cost Savings, necessary for the Company to earn its Commission-authorized return on equity.

[274] Satterwhite Settlement Testimony at S11. The amount recovered through Tariff P.P.A. in 2022 will be prorated through December 8 – the termination date of the Rockport UPA.

[275] *Id.*

[276] *Id.*

[277] *Id.*

[278] Settlement Agreement at ¶ 3(f).

2. The Rockport Deferral is In the Public Interest.

a. The Rockport Deferral Allows the Company to Spread Five Years of Costs over Ten Years.

Through the Rockport Deferral, the Company is able to address one of the concerns in the public comments in this case and spread its costs out over a longer period.[279] The Rockport UPA is a FERC-approved rate schedule and, as such, the Company is authorized full recovery through rates. The Rockport Deferral provides a mechanism through which the Company can reduce the rate impact of the Rockport UPA in the near term. The design of the Rockport Deferral provides the necessary balance that allows the Company to do this without impacting the Company's credit rating, thereby avoiding additional borrowing costs to be borne by customers.[280]

b. The Use of a Weighted Average Cost of Capital Carrying Charge is Appropriate.

The Settlement Agreement provides that the Rockport Deferral Regulatory Asset will be subject to carrying charges based on a WACC of 9.11 percent until the regulatory asset is fully recovered.[281] The carrying charge is appropriate; it simply makes the Company whole as a result of its need to finance the deferral through a combination of debt and equity:

> Q. [W]ould that reduction in the amount of expenses be considered a significant reduction such that Kentucky Power would be able to finance it based upon its cost of debt given its capital structure?
>
> A. Well, I think it is a significant reduction in the deferral. That's no question about that. It's half of what my proposal was initially, but then the question is what is -- the next question is what is the likelihood of the company financing it with debt, and I think that right now if you look at their capital structure, and it's roughly 43 percent common equity, if they financed that additional $50 million with debt only, that would end up leveraging them more, and it could result in a down rating of their debt.

[279] Satterwhite Hearing Testimony at 363.

[280] Wohnhas Hearing Testimony at 936.

[281] Settlement Agreement at ¶ 3(c).

For example, now I didn't really investigate this. It wasn't our proposal. Our proposal was for a full rate of return, but in certain circumstances it could make sense to do it on a debt only. I don't think that it is appropriate to do that in this case.

Q. Okay. Even based upon the amount of the expenses associated with the settlement agreement?

A. Yes. I think it's unlikely that the company would finance this exclusively with debt.[282]

The use of a WACC carrying charge for the Rockport Deferral Regulatory Asset is reasonable and appropriate, and should be approved as part of the balanced Settlement Agreement.

c. The Rockport Deferral Establishes a Process for Addressing the Termination of the Rockport UPA.

While the Company has not made a final decision on renewing the Rockport UPA, the Rockport Deferral mechanism included in the Settlement Agreement provides certainty regarding how rates would be affected should the Rockport UPA not be renewed. Through the Rockport Fixed Costs Savings credit and the Rockport Offset in 2023, the Settlement Agreement identifies how the Company will immediately credit to customers those costs that will be eliminated in the event the Rockport UPA is not renewed:

Q. So absent this agreement, the Company would end up receiving how much money in excess that they no longer have expenses for?

A. The fixed costs at Rockport, I believe, of UPA are about $54 million, I think is what we talked about earlier. So that would still be considered in base rates, because the unit power agreement, which is what we're paying for, is already -- is in base rates in this case. So it's a question of how do you remove that from base rates. And so what the stipulation does is provide a mechanism to allow that to happen versus us having to try to figure out at that time how we're going to deal with it.[283]

The Settlement Agreement also provides the Company with needed protection to address the uncertainty in the event it decides not to renew the Rockport UPA through the Rockport Offset:

[282] Kollen Hearing Testimony at 565-66.

Q. So after it expires, the savings of, and I'll take your word, $54 million flows back to customers, correct?

A. Absent the offset, the one-year protection that we put into the settlement agreement.

Q. And what is the protection?

A. Because we don't know what we'll be dealing with, typically you would have an entire rate case to deal with something like this, such a big impact. The offset is put in there to make sure that the Company is recovering the Commission-approved ROE.

So for one year there's an offset in there where some of those costs will be held to the side, just to make sure the Company can earn its ROE for that one year as it transitions away from having the Rockport on its bill and the Rockport generation in its portfolio. So there's that one year just to make sure.

And then what happens at the end of -- because this ends in 2022, so 2023 is the year we're looking at. At the end of 2023, we then take that balance, and in February we file something with the Commission to say -- if we collected too much over that past year that we held back, we give that back to customers over three months, or if it was too little, that we collect that over the next three months.

It's basically a security mechanism for the unknowns of what happens, because we're talking about unwinding such a big deal at $54 million in 2022 as we sit here in 2017.[284]

The Rockport Fixed Cost Savings credit and the Rockport Offset provide the Company's customers immediate rate relief if the Rockport UPA is not renewed while protecting the Company from unknown circumstances surrounding the termination. These provisions are reasonable and should be approved as part of the balanced Settlement Agreement.

E. **In The Context Of The Settlement Agreement The 9.75 Percent Return On Equity Will Permit Kentucky Power To Operate Successfully And Maintain Its Financial Integrity[285] Without Placing An Unreasonable Burden On Its Customers.**

Outside the context of the balance and protections provided by the Settlement Agreement a 10.31 percent return on equity as proposed in Kentucky Power's application is required.[286]

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[283] Satterwhite Hearing Testimony at 330-31.

[284] *Id*. at 332-33.

With the balance and protections provided by the Settlement Agreement, the agreed-to 9.75 percent ROE will allow Kentucky Power to operate successfully and maintain its financial integrity without placing an unreasonable burden on its customers.

The five basis points differential between the 9.75 percent return on equity proposed in the Settlement Agreement and the 9.70 percent rate awarded Louisville Gas and Electric Company and Kentucky Utilities Company six months ago is appropriate. A cornerstone of the analysis in determining that the 9.75 percent ROE stipulated in the Settlement Agreement is just and reasonable, and consistent with the requirements described in the *Hope* and *Bluefield* decisions, is whether the ROE authorized by the Commission allows Kentucky Power the opportunity to achieve earnings comparable to those from alternative investments of similar risk. Approval of a 9.75 percent ROE for Kentucky Power is particularly reasonable when compared with the ROE recently approved for Kentucky Utilities and Louisville Gas & Electric given that it is undisputed that these other Kentucky public utilities are a *lesser investment risk* than Kentucky Power.[287] It would be unreasonable to disregard the difference in risk between Kentucky Power and these other utilities when evaluating the reasonableness of the 9.75 percent ROE in the settlement.

Second, Kentucky Power's capital structure is more heavily weighted toward debt than Kentucky Utilities. As a result, the return on equity has a lesser effect on rates, and thus benefits customers, than it would for a utility, such as Kentucky Utilities, with a higher equity ratio.[288]

The benefit to costumers of approving the 9.75 percent ROE included in the Settlement Agreement is further supported by the extensive analysis of Company witness McKenzie in

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

[286] *See* pages 63-64*, infra*.

[287] McKenzie Hearing Testimony at 630-31; *see also* Woolridge Hearing Testimony at 484-87.

support of his recommended 10.31 percent ROE, reflected in the Company's Application.[289] As Mr. McKenzie explained, alternative ROE benchmarks confirm the reasonableness of the 10.31 percent return on equity requested in Kentucky Power's application.[290] Equally important, so long as it is considered in the context of the overall settlement, the 9.75 percent return on equity prescribed by the Settlement Agreement is, by definition, also reasonable.

The 9.75% return on equity provided for in the Settlement Agreement is not overly-generous; rather it is a conservative one, particularly in light of the Settlement's provision preventing Kentucky Power to file a base-rate increase petition for three years.[291] Approval of the 9.75% ROE in the context of the Settlement is the type of supportive regulatory environment action described in Moody's Kentucky Power's credit opinions, and one that strikes a balance and obtains alignment between the Company's need to maintain its financial integrity and its customers' need for a public utility able to provide them reliable electric service now and in the future.[292]

F. <u>**The Settlement Agreement Modifies the Proposed Expansion of the K-PEGG Program By Reducing the Cost of the Program to Residential Customers**</u>.

1. <u>Kentucky Power's Proposed Expansion of the K-PEGG Program is Necessary to Maintain Economic Development Momentum</u>.

In its Application, Kentucky Power proposed expanding the K-PEGG program by increasing the amount provided through the KEDS from \$0.15 per meter per month to \$0.25 per meter per month (an increase from \$1.80 per meter per year to \$3.00 per meter per year).[293] The

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[288] McKenzie Hearing Testimony at 638; *see also* Woolridge Hearing Testimony at 486-87.

[289] See pages 63-64, *infra*.

[290] McKenzie Direct Testimony at 6; see also *passim*, particularly Exhibit AMM 2.

[291] McKenzie hearing Testimony at 618-19.

[292] *Id.*, *see also* McKenzie Hearing Testimony at 637-40 (discussing the customer benefit, from a capital costs and related revenue requirement, of the Settlement's 9.75% ROE in light of Kentucky Power's low equity capital structure).

[293] Hall Direct Testimony at 19.

Company's matching contribution would increase a corresponding amount.[294] This expansion will provide an estimated $400,000 in additional funds for the K-PEGG Program.[295]

The Company's proposed expansion is vital to maintain the momentum that its economic development grant programs have brought to the region. Without the site development projects funded by grant programs like K-PEGG, the region may not have seen the EnerBlu and SilverLiner Trucking projects and their nearly 1,200 high-paying jobs locate in Pike County. Moreover, Kentucky Power economic development grants allowed Ashland Alliance and the Northeast Kentucky Regional Industrial Authority to obtain site certifications for the EastPark Industrial Park. Without these certifications, Braidy Industries and its 550 full-time and 1,000 temporary construction jobs would almost certainly have left the service territory when construction delays at its original location arose.[296]

The proposed expansion of the K-PEGG program will allow the Company to leverage a small ($1.20 per meter per year) increase into additional economic development opportunities for the service territory. In the absence of other corporate leadership in the region, Kentucky Power stepped to the forefront and began to right the ship on economic development. The Company's economic development grants have buttressed the economic development infrastructure in the region to the point where it is now competitive for diverse industries. The K-PEGG program is a vital component of the Company's economic development efforts. Expanding the program as proposed by the Company is both reasonable and necessary to maintain the economic development momentum in the region.

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[294] *Id*.

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

[296] Hall Hearing Testimony at 845-46.

2. The Settlement Reduces the Cost of the K-PEGG Program to Residential Customers.

Under the terms of the Settlement Agreement, Kentucky Power will expand the K-PEGG Program. The Settlement Agreement, however, modifies the mechanism under which the expansion is financed to the benefit of the Company's residential customers. Under the Settlement Agreement, the KEDS amount for residential customers will decrease from the current $0.15 per meter per month amount to $0.10 per meter per month. The KEDS amount for non-residential customers subject to the surcharge will increase from $0.15 to $1.00 per meter per month.

The Settlement Agreement allows the Company to expand the K-PEGG program to maintain the economic development momentum in the service territory while reducing the rate impact of economic development activities on the Company's residential customers. Under the Settlement Agreement, the Company's residential customers would pay a lower KEDS amount than is currently authorized by the Commission. The Settlement Agreement's provisions for expansion of the Company's K-PEGG program are fair, just, and reasonable, in the public interest, and should be approved as part of the balanced Settlement Agreement.

G. The Company's Proposed Residential Basic Service Charge Represents a Gradual Step Towards Reflecting the Actual Fixed Cost of Providing Service, Thereby Aiding High Energy Users, Including Electric Heating And Many Low-Income Customers.

In its application, the Company proposed to increase its residential basic service charge from $11.00 per month to $17.50.[297] This proposed change is designed – in the spirit of gradualism – to move the residential basic service charge towards the actual fixed $38 per month cost of providing service and, in doing so, to reduce the intra-class subsidy paid by high-use

[297] Vaughan Direct Testimony at 10.

residential customers, many of whom in Kentucky Power's service territory are low-income customers.[298]

Two studies support the Company's calculation of the monthly fixed cost of providing service. In the first, the Company utilized the residential class customer and distribution revenue requirement from the class cost of service study and applied the fixed distribution plant allocation factors to determine what component of distribution revenue requirement was associated with typical distribution plant components.[299] This real world analysis quantified the fixed costs that the Company incurs that only vary with the number of customers and not the demand associated with these customers.[300]

The Company confirmed these results through a marginal customer connection method study.[301] In the marginal customer study, the Company reviewed work orders to determine what actual costs were incurred to add additional customers regardless of demand.[302] The marginal cost to connect a customer was calculated to be $38.91 per customer, confirming that $38 per month was a reasonable cost of providing service to customers.[303]

Moving the residential basic customer charge closer to the actual cost of providing service to customers provides benefits beyond simply following cost-causation principles. Shifting more of the fixed portion of the cost to provide service to the fixed charge will reduce bill volatility, especially for electric heating customers during winter months.[304] Perhaps most importantly, the Company's proposal to recover more of its fixed costs through the residential

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[298] *Id*. at 11.

[299] *Id*. at 14-15; Exhibit AEV-2.

[300] *Id*.

[301] Vaughan Direct Testimony at 15; Exhibit AEV-3.

[302] *Id*.

[303] *Id*.

[304] Vaughan Direct Testimony at 12-13.

basic service charge will benefit the Company's low-income customers. Contrary to the theoretical musings of Attorney General Witness Dismukes,[305] the actual data from the test year demonstrates that the Company's low-income customers have higher usage than the average customer.[306] By reducing the intra-class subsidy that high-use residential customers pay for the benefit of lower-use customers, the Company is reducing the subsidy paid by its low-income customers to the below-average-use customer. The Company's proposed residential basic service charge represents a gradual shift towards recovering the full fixed cost of providing service, reduces the residential intra-class subsidy to the benefit of many low-income customers, and should be approved

1. <u>The Settlement Agreement Reduces the Proposed Increase to the Residential Basic Customer Charge While Still Providing a Gradual Step Towards Eliminating the Intra-Class Subsidy</u>.

The Settlement Agreement reduces the Company's increase in residential basic customer charge from $6.50 per month (as proposed) to $3.00 per month, and sets the new residential basic service charge at $14.00 per customer.[307] This change continues the Company's gradual move towards recovering the fixed cost of providing service to customers through the customer charge and reducing the intra-class subsidy provided by high-use (and in Kentucky Power service territory, low-income) customers to low-use customers.[308] The Settlement Agreement's $14.00 service charge is reasonable in light of the high costs of providing residential service in the rural, mountainous, and lower customer density areas of the Company's service territory. It also is comparable to the service charges of other utilities in the Commonwealth, especially those

[305] Attorney General Witness Dismukes bases his claim that the Company's low-income customers have lower usage on 12 and 8-year old general surveys of household data regarding low income customers and electricity use in Alabama, Kentucky, Mississippi, and Tennessee and not the actual data from the Company's service territory. Dismukes Hearing Testimony at 525-26.

[306] Vaughan Rebuttal Testimony at R14; Exhibit AEV-R3.

[307] Settlement Agreement at ¶ 16(a).

with similar topography and customer densities.[309] The Commission should approve the $14.00 residential basic customer charge as part of the balanced Settlement Agreement.

H. The Settlement Agreement Provides Additional Benefits to Customers.

1. The Settlement Agreement Changes the Company's Capital Structure to Provide for a Lower Weighted Average Cost of Capital.

Through the Settlement Agreement, Kentucky Power agreed to include in its capital structure short term debt as 1.00 percent of total capitalization with an annual interest rate of 1.25 percent.[310] Based on test year data, the Company included no short-term debt in the capital structure proposed in the application.[311] Because it was based on the actual test year data, the Company's decision to include no short term debt in its capital structure was reasonable. However, the Company agreed to include short-term debt in the capitalization as part of the overall balance of the Settlement Agreement. By doing so, Kentucky Power decreased the annual revenue requirement by approximately $350,000.[312]

2. The Settlement Agreement Provides for Updated Depreciation Rates.

In its application, Kentucky Power sought to update the depreciation rates for Big Sandy Unit 1. Depreciation rates for Big Sandy Unit 1 were last updated in 1991.[313] Big Sandy Unit 1 was converted to from a coal-fired unit to a natural gas-fired unit in 2016.

The existing depreciation rate for Big Sandy Unit 1 is 3.78 percent.[314] The depreciation study performed by Company Witness Cash provides for an updated depreciation rate of 5.78

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[308] Satterwhite Settlement Testimony at S23.

[309] Vaughan Hearing Testimony at 1051-52; Vaughan Direct Testimony at 18; Vaughan Rebuttal Testimony at R13; Exhibit AEV-R2.

[310] Settlement Agreement at ¶ 8(b).

[311] Miller Direct Testimony at 4-5; Application Section V, Workpaper S-3, Page 2.

[312] Satterwhite Settlement Testimony at S18; *see also* McKenzie Hearing Testimony at 641-42 (explaining that the 1.25% imputed rate for one percent of total capitalization is cheaper than an equity amount of the same one percent, and indeed cheaper than a long-term debt amount of the same one percent, lowering overall cost of capital from a customer's point of view).

percent.[315] Based on this updated rate, the Company proposes an increase in annual depreciation expense of $3,116,918.[316] These changes are required to reflect the additional investments made since the rates were last updated and the unit's reasonable remaining life of service.[317]

The method used for the Company's depreciation study takes into account, upon the retirement of any depreciable property, its full cost, less any net salvage realized.[318] To determine the net salvage cost for Big Sandy Unit 1, Company Witness Cash relied on a dismantling study performed by Sargent & Lundy, an independent engineering firm, in 2012.[319] The Sargent & Lundy study was then adjusted for inflation, and calculated in terms of 2031 dollars (the estimated retirement date for Big Sandy Unit 1).[320] Because the Sargent & Lundy study was performed for both Big Sandy Units 1 and 2, the study was also adjusted to reflect only the estimated dismantling costs for Big Sandy Unit 1.[321]

Although KIUC Witness Kollen recommended that the Commission eliminate terminal net salvage costs from the calculation of depreciation rates, Company Witness Cash stressed that such a practice could implicate generational equity concerns[322] by forcing future ratepayers to pay for the dismantling costs of Big Sandy Unit 1 from which they received no benefit.[323]

Although the depreciation rates proposed by the Company in its application were fair, just and reasonable, the rates in the Settlement Agreement improve on existing depreciation rates

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[313] Cash Direct Testimony at 3.

[314] *Id*. at 5.

[315] *Id*.

[316] *Id*.

[317] *Id*.

[318] *Id*. at 6.

[319] *Id*. at 7.

[320] *Id*. at 8.

[321] *Id*. at 9.

[322] Cash Rebuttal Testimony at R5.

while providing additional rate relief. As part of the overall balance of the Settlement Agreement, the Signatory Parties agreed to adjust the depreciation rates to use a 20-year expected life for Big Sandy Unit 1 in calculating the related depreciation expense.[324] Although longer than proposed by the Company in its application, the 20-year period is reasonable[325] and thus avoids "kicking the can down the road" as cautioned against by Company Witness Wohnhas.[326] The Signatory Parties also agreed to adjust its depreciation rates for Big Sandy Unit 1 and for the Mitchell Plant to remove terminal net salvage costs.[327] The proposed changes to depreciation rates included in the Settlement Agreement are in the public interest and should be approved.

3. The Settlement Agreement Provides Benefits to Schools in the Company's Service Territory.

Well aware of the role improved education must play in turning the economic tide in the region, Kentucky Power is a strong supporter of the schools in its service territory.[328] In fact, the Company has recently secured a $500,000 grant from the AEP foundation to support video distance learning in the schools in the region.[329] The Settlement Agreement reflects the Company's commitment, within the balance provided by the agreement, to K-12 education in its service territory.

First, under the Settlement Agreement, Kentucky Power committed to seek Commission approval to fund the School Energy Manager Program up to $200,000 in 2018 and 2019 as part

[323] *Id*.

[324] Satterwhite Settlement Testimony at S17.

[325] Osborne Hearing Testimony at 756-757.

[326] Wohnhas Direct Testimony at 22-23.

[327] Satterwhite Settlement Testimony at S17.

[328] The very first action that Company Witness Satterwhite took after he assumed the role of President and Chief Operating Officer was to contact all of the superintendents at the high schools in the service territory to extend an offer of partnership in improving education. Satterwhite Hearing Testimony at 119.

of its demand side management program.[330] The parties to the Settlement Agreement recognize that Commission approval of the School Energy Manager Program will occur in a separate proceeding.[331] Kentucky Power, however, believes that the program provides a valuable tool through which all schools in the Company's service territory can manage their energy usage and reduce the portion of their strained budgets devoted to electric service.[332]

Additionally, the Settlement Agreement provides that the "pilot" designation to Tariff K-12 School be removed and that service under the tariff be made available for both public and private schools within the service territory.[333] Consistent with current practice, rates for schools taking service under Tariff K-12 School will be designed to produce revenues that are $500,000 less annually than they would have produced had they taken service under Tariff L.G.S.[334] The total revenue for the L.G.S./K-12 School class will be the same as if all customers were taking service under Tariff L.G.S.[335]

Even with the rate design for Tariff K-12 School, customers receiving service under Tariff L.G.S. will see a total bill increase of only 5.17 percent which is less than the system average increase of 6.16 percent and the increase for Tariff K-12 School customers of 6.45 percent.[336] The provisions in the Settlement Agreement benefiting schools in the Company's service territory are in the public interest and should be approved as part of the overall balance in the agreement.

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[329] *Id*.

[330] Satterwhite Settlement Testimony at S20.

[331] *Id*.

[332] *Id*. at S20-21.

[333] *Id*. at S21.

[334] *Id*.

[335] *Id*.

[336] *See*, Attachment 1 to Kentucky Power's response to KPSC PH-17.

4. <u>The Settlement Agreement Provides for Fair, Just, and Reasonable Pole Attachment Rates under Tariff C.A.T.V.</u>

Under the Settlement Agreement, Kentucky Power will set pole attachment rates under Tariff C.A.T.V. at $10.82 for attachments on two-user poles and $6.71 for attachments on three-user poles.[337] This represents a reduction from the $11.97 rate for two-user poles and $7.42 rate for three-user poles proposed by the Company in its Application.[338] While the rates sought in the application were calculated using the same methodology that the Company utilized in prior cases, including in Case No. 2005-00341, and data from the Company's most recent FERC Form 1, these agreed-to rates reflect a reasonable increase in the Company's pole costs in the twelve years since the rates were updated. The Settlement Agreement rates are fair, just, and reasonable, and should be approved.

5. <u>The Settlement Agreement Includes an Allocation of Revenues that Supports Economic Development While Gradually Reducing Interclass Subsidies</u>.

As the part of the overall balance included in the Settlement Agreement, the Settling Parties agreed to a revenue allocation that promotes economic development while still reducing interclass subsidies. The revenue allocation agreed to in the Settlement Agreement removed the subsidy paid by the I.G.S. customer class. Company Witness Satterwhite emphasized importance of doing so to the Company's economic development efforts:

> The settlement agreement allows us -- part of the balance of that is to do even more and sort of speed that up for the industrial customers, because it really marries into what we need to do overall in the territory to bring more jobs in.[339]

Company Witness Vaughan expanded on the economic development benefits of reducing the I.G.S. subsidy:

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[337] Settlement Agreement at ¶ 16(c).

[338] Satterwhite Settlement Testimony at S24.

[339] Satterwhite Hearing Testimony at 347.

Q. Okay. Are you aware of any other states that are implementing a policy of eliminating industrial subsidies?

A. Yes. I do work for the Company's affiliates in Virginia and West Virginia, and right now they're -- this is the big topic of discussion in West Virginia, in front of the legislature, the -- you know, they are looking around at their job-creation opportunities, and they want to eliminate all subsidies.

One proposal is to eliminate all subsidies for industrial customers in the electric rates to help their economic development interests and bring new industrial loads to the -- to their service territory, to their state, so --

Q. And, of course, Kentucky competes for jobs with those other states, correct?

A. It's right across the river; yes, sir.[340]

Customers that take service under Tariff I.G.S. tend to be large industrial facilities that provide high-paying jobs[341] and, importantly, have higher job multipliers within the community.[342] Eliminating the subsidy provided by these businesses makes the region more attractive to new, diversified businesses and increases the likelihood that existing customers will remain and grow within the service territory. The revenue allocation proposed in the Settlement Agreement is reasonable and in the public interest.

IV. ABSENT THE APPROVAL OF THE SETTLEMENT AGREEMENT WITHOUT MODIFICATION KENTUCKY POWER IS ENTITLED TO THE REQUESTED $60.397 MILLION INCREASE IN THE COMPANY’S BASE REVENUE REQUIREMENT

As described above, the Settlement Agreement provides a balanced approach to addressing the Company’s financial needs while providing benefits that would be otherwise unavailable. The Commission should approve the Settlement Agreement without modification. In the event, however, the Commission elects not to approve the Settlement Agreement without modification, then the Commission should approve the Company’s application as filed. The

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[340] Vaughan Hearing Testimony at 988-89.

[341] *See* Hall Hearing Testimony at 841-842; 822-823

[342] *Id*. at 880-884.

Company's application proposed rates that were fair, just, reasonable. To the extent not discussed above, key components of the Company's application are described below.

A. **<u>A Return On Equity Of 10.31 Percent Is Just and Reasonable Under the *Hope* and *Bluefield* Standards</u>.**[343]

In the last rate case, the Commission found a return on equity for Kentucky Power of 9.8 percent, within a range of 9.3 to 10.3 percent, was reasonable.[344] In the same Order, the Commission authorized the use of a 10.25 percent ROE for certain specific costs, consistent with the contested settlement agreement in that case. 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 of 10.31 percent.[345] Dr. Woolridge for the Attorney General, and Mr. Baudino for KIUC, recommended that the Company's return on equity be set at punitively low rates of 8.60 percent[346] and 8.85 percent[347] respectively.

1. <u>The Company's Current Rates Fail To Provide Kentucky Power With A Reasonable Opportunity To Earn The Minimally Required Return On Equity</u>.

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

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[343] *See 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); *see also* 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).

[344] 2014 Rate Case Order at 42.

[345] McKenzie Direct Testimony at 6; Application at ¶ 33.

[346] Attorney General Witness Woolridge's recommendation would constitute a 110 basis point reduction from the 9.8 percent ROE deemed reasonable in the Company's last rate case.

[347] KIUC Witness Baudino's original recommendation would have resulted in a 95 basis point reduction from the 9.8 percent ROE deemed reasonable in the Company's last rate case, as compared to the 5 basis point reduction provided for in the Settlement Agreement, and now supported by KIUC.

Kentucky Power to earn an ROE comparable to contemporaneous returns available from alternative investments of similar risk.[348] This is a fundamental part of the regulatory compact.

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 February 28, 2017, Kentucky Power earned a 5.81 percent return on equity.[349] Such a return on equity is neither sustainable nor constitutionally adequate.

The recommended returns on equity recommended by Attorney General Witness Woolridge and the originally by KIUC Witness Baudino (who during re-direct examination by counsel for KIUC at the hearing indicated the 9.75 percent ROE proposed in the Settlement Agreement was within the range of recommendations made to the Commission)[350] likewise would fall woefully short of the minimal constitutional standards. Such punitive ROE levels would threaten both the Company's ability to provide, and its customers' statutory right to receive reliable service at a reasonable price.[351] In light of the recognition by both Standard & Poor's Corporation and Moody's Investors Services of the importance for Kentucky Power and other utilities of the regulatory climate in which they operate, a reasonable ROE is critical to ensure the Company's continuing ability to raise new capital.[352] Absent the balance of the Settlement Agreement, a 10.31 percent ROE is fair, just, and reasonable.

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[348] *See Hope Natural Gas Co.*, 320 U.S. at 603 (1944); *Bluefield Water Works & Improvement Co.*, 262 U.S. at 694 (1923).

[349] Kentucky Power's Response to KPSC 1-38, Attachment 1.

[350] Baudino Hearing Testimony at 591.

[351] McKenzie Rebuttal Testimony at 2, 16-17 (the recommendation of Dr. Woolridge and the original recommendation of Mr. Baudino fall far below the returns available from other investments of comparable risk, thereby preventing Kentucky Power from earning its cost of equity capital and violating regulatory standards).

[352] *Id*. at 17.

B. <u>Kentucky Power's Application Includes a Gradual and Reasonable Reduction in Residential Class Subsidy</u>.

As part of developing the Application in this case, Kentucky Power conducted a class cost of service study to determine the cost to serve each of its customer classes.[353] Through the class cost of service study, the Company was also able to determine the rate of return on rate base for each of its customer classes during the test year.[354] During the test year, the residential class rate or return was the only rate of return less than the average jurisdictional rate of return, meaning that the Company's other customer classes subsidized the residential class.[355]

As part of the revenue allocation process, the Company evaluated how the revenue increase requested in this case should be allocated among customer classes to equalize the rates of return across customer classes. Equalizing rates of return across the customer classes would eliminate all inter-class subsidies. Importantly, equalizing rates of return across customer classes and eliminating subsidies in their entirety would require, contrary to the Commission's principle of gradualism, a base rate increase for the residential class of over thirty percent.[356]

Consistent with the Commission's long-standing policy of gradualism, Kentucky Power did not propose to equalize rates of return in this case.[357] To do so would require certain customer classes, particularly the residential customers, to bear a disproportionate share of the proposed increase.[358] Instead, the Company proposed to reduce the subsidy provided to the

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[353] Buck Direct Testimony at 3-4.

[354] *Id*. at 4.

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

[356] *Id*., Exhibit DRB-2, page 3 of 3.

[357] Wohnhas Direct Testimony at 8.

[358] *Id*.

residential class by five percent.[359] This gradual step towards equalizing rates of return across all customer classes is fair, just, and reasonable.

C. **<u>Kentucky Power's Compensation and Benefits Are Necessary to Remain Market-competitive And Permit The Company To Attract And Retain The Employees It Needs To Provide Adequate Service</u>.**

The costs incurred by Kentucky Power for employee compensation and benefits paid to Kentucky Power and AEPSC personnel are a reasonable cost of providing service to customers.[360] The compensation and benefits paid to these employees is reasonable and market-competitive: neither excessive nor insufficient.[361] These costs are necessary for the Company to provide reliable electric service to its customers and are prudently incurred. They are appropriately controlled and managed to ensure both that Kentucky Power and AEPSC are able to recruit and retain employees with the required level and variety of skills necessary to carry out all the activities involved in providing service to Kentucky Power's customers.[362]

1. <u>Incentive Compensation Pay is a Not a Bonus, but Rather a Key Component of Market-Competitive Compensation</u>.

Attorney General Witness Smith makes several recommendations attacking particular components of the total employee compensation costs, without credible evidence that these costs are not necessary for the Company to provide service to its customers, or that they are above the market-competitive level.

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[359] *Id.*; Buck Direct Testimony, Exhibit DRB-3, page 3. Contrast the Company's gradual residential subsidy reduction with the more extreme reduction proposed by KCUC. KCUC Witness Higgins proposed reducing the residential subsidy by 50 percent. Higgins Direct Testimony at 15. KCUC's proposal would have resulted in a rate increase for the residential customers of over 22 percent. Higgins Direct Testimony at 17. KCUC's proposal ignores gradualism and is neither fair, just, nor reasonable.

[360] Carlin Direct Testimony, *passim* (e.g., at 6-8, 12-14).

[361] *Id.*, *passim* (*e.g.*, at 3, 6-8). In fact, as explained by Company witness Carlin and shown in ARC Exhibits 4, 5, and 6, the Company's target employee compensation ranks below the market 12 median.

[362] *Id.; see also Id.* at 14-22, particularly 21-22 (discussing specific measures such as freezing external hiring from November 2008 through 2009, freezing line of progression increases from November 2008 through 2010 other than for physical and craft positions, implementation of efficiency measures, among several others).

In doing so, Mr. Smith ignores the benefits Kentucky Power's customers enjoy as a result of the services and work these employees provide and particularly the way in which the Company has structured and managed its employee compensation and benefits.[363] His approach is arbitrary and is intended only to achieve some level of decrease.

Specifically, Mr. Smith recommends reducing the Company's cost of service to reflect only 3.0 percent merit increases for 2017 for salaried employees instead of the actual 3.5 percent reflected in the Company's cost of service.[364] Absent from his recommendation is any mention of how the actual amount of these increases were necessary to address lagging employee compensation levels resulting from then-necessary cost management measures dating back to 2009, nor of the fact that the 3.5 percent actual increase results in present compensation levels that are well within the market-competitive range.[365] He also neglects to consider that the additional 0.5 percent is reserved for equity adjustments and line of progression promotional increases that frequently are not included in salary increase budgets. Mr. Smith does not mention the savings passed on to customers resulting from the 2009 cost management measures, nor the benefit to customers resulting from the Company addressing this lag in compensation level, particularly in terms of retention of skilled personnel and the value of the work they do.[366]

Mr. Smith also recommends denying cost recovery of 25 percent of the Company's annual incentive compensation expense along with 100 percent of the Company's long-term compensation expense. Nowhere does Mr. Smith deny that these components of employee compensation are simply building blocks of the total compensation each employee receives for

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[363] Carlin Rebuttal Testimony at R6-R8, R11, and R14-R22 (also discussing, in passing, rebuttal evidence in connection with original recommendations of KIUC witness Kollen that are no longer part of KIUC's position in this case, in light of the balance reached in the Settlement regarding the Company's overall revenue requirement and recovery mechanisms and timing); *see also, Cf.*, Carlin Direct Testimony at 5-8.

[364] Carlin Rebuttal Testimony at R2.

[365] *Id*. at R2-R4; *Cf.*, Carlin Direct Testimony at 18-22..

her or his work, nor that this total compensation is not excessive and instead is well-within the range of the market-competitive compensation that is necessary to recruit and retain suitable employees.[367]

Mr. Smith's recommendation is premised on a fundamental misapprehension of the Company's compensation practices, and the types of employees who receive part of their total compensation in the form of annual incentive compensation pay or long-term incentive compensation pay.[368] Part of every Kentucky Power and AEPSC employee's compensation opportunity in every year is subject to the achievement, individually and as part of a team, of performance goals ultimately tied to the service provided to customers.[369] This compensation structure provides a myriad of benefits to customers, not the least of which is that the service they receive is better as a result: safer, more reliable, and less costly.[370]

Similarly, the long-term compensation benefits that Kentucky Power pays employees are not the exclusive perk of top executives and management, nor are they a reward primarily directed to benefit the parent company's stockholders.[371] To the contrary, and as explained in detail by Company Witness Carlin in his direct and rebuttal testimonies, and data request responses, approximately 1,025 employees of Kentucky Power and AEPSC received a portion of

[366] Carlin Rebuttal Testimony at R2-R6.

[367] *Id*. at R6-R8; *Cf., Id.* at R9.

[368] *Id., e.g.,* at R18; *see also Id.* at R7-R8, R14 ("objections to the form of the Company's compensation arrangements, but not its reasonableness, is literally a matter of form over substance."); Carlin Direct Testimony at 5-6.

[369] Carlin Direct Testimony at 6; *see also Id.* at 11-17 (emphasizing that "annual and long-term incentive compensation [are paid to employees] as part of a market-competitive Total Compensation package; it is not provided as a 'bonus' on top of an already market competitive compensation package. In other words, if incentive compensation were not provided, the same target value of incentive compensation would need to be added to base pay in order for the Companies to provide a market-competitive compensation package to its employees.").

[370] Carlin Rebuttal Testimony at R9-R11; R15-R17.

[371] *Id.* at R17-R20, R24-25, R28-R30; *Cf., Id.* at 25-26 (emphasizing the importance allowing Kentucky Power to recover the Company's total compensation costs, which without dispute are reasonable and appropriate costs of providing service to customers, and highlighting that disallowing arbitrarily certain components of the total employee compensation would erode the Company's "ability to earn an appropriate rate of return on its investment [, which] is fundamental to the regulatory compact.")

their market-competitive compensation in the form of stock-based long-term compensation during the test year.[372] The benefits to Kentucky Power customers of long-term compensation are numerous, but the most important of all is that it results in the ability to retain on a long-term basis personnel with particularly valuable experience and skills. These employees by and large perform work that has long-term impacts on the service that Kentucky Power customers receive.[373]

Mr. Smith's recommendation is particularly pernicious in the false dichotomy that lies at its core: that the interest of the Company's customers and shareholders cannot be aligned. The opposite, of course, is true: aligning the benefits and interests of customers, employees, and shareholders is not only desirable and possible, but imperative in the long run.[374] The Company's provision of long-term compensation to employees is consistent with this objective, is simply a portion of the cost of paying employees for the work they do, and is a cost of providing service to customers that encourages the achievement of long-term goals critical for the provision of safe, reliable, and less costly service to Kentucky Power's customers.[375]

The benefits to customers from the work performed by Kentucky Power and AEPSC employees are visible throughout the record. These extend from the efforts led by Company President Satterwhite to mitigate the impact on customers of the costs the Company incurs to provide them electric service, to the significant savings achieved by refinancing of Company's long-term debt, to the significant savings achieved in connection with the Company's performance of its vegetation management plan led by Company Witness Phillips, and to the remarkable successes achieved by the team led by Company Witness Hall in attracting to

[372] *See, e.g., Id.* at R18.

[373] *See Id.* at R18-R22, R24-R25;

[374] *Id.*

Kentucky Power's service territory economic and industrial investment resulting in thousands of much needed jobs and increased economic development for the region. Mr. Smith's recommendation to discount the incentive and long-term compensation paid to Kentucky Power's employees to provide service to its customers is short-sighted and arbitrary, and should be rejected.

2. <u>The Company's Retirement Package is Not Double Dipping – It is a Swirled Cone the Same Size as Other Cones on the Market</u>.

The last target of Attorney General Witness Smith's attack on the Company's employee compensation and benefits package is his effort to characterize the retirement benefits the Company offers to its employees as duplicative or excessive. The retirement benefits package paid by the Company is neither.

As explained by Company Witnesses Cooper and Carlin in their respective rebuttal testimonies, data request responses, and testimonies at the hearing, the retirement benefit costs paid by Kentucky Power and included in the Company's cost of service, are appropriate, market-competitive, and must be evaluated as a whole.[376] Mr. Smith's criticism overlooks that regardless of how many different components or varieties of employee retirement benefits the Company may offer, the underlying basic question remains the same: is the cost of the total employee retirement benefits offered to employees reasonable and prudently incurred? There is nothing in the record that would suggest that they are not.

At the hearing, Company Witness Carlin provided a clear illustration of the need to evaluate the Company's retirement benefit package as a whole:

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[375] *Id.*

[376] *See, e.g.*, Cooper Hearing Testimony at 705-707; Carlin Hearing Testimony at 688-689; *see also* Carlin Hearing Testimony at 666-667 ("[T]he [C]ompany does have defined benefit and defined contribution plans. The way I would describe it is that these plans are part of a market competitive benefit package that we benchmark against both utility industry, energy industry, and general industry companies. (…) In total. (…) [The Company] paid the same for it as [it] might if [it] had all of one or all of the other").

[A.] Think of it as the soft serve swirl where half is chocolate and half is vanilla, still fitting in the same size cup. So it's a single serving cup. We paid the same for it as we might if we had all of one or all of the other, but it's a swirl of the chocolate and the vanilla in this case.

Q. Are there employees who qualify for both defined benefit and defined [contribution plans]?

…

A. Yes. In fact, almost all employees qualify for both of those. Again, it's part of an overall market competitive benefit package that's a single serving. It's not a double dip.[377]

As explained in further detail by Company Witness Cooper at the hearing, the employee retirement benefits offered by the Company have changed overtime, and different employees have different benefits depending not only on their years of service, but also on when they started employment with Kentucky Power or AEPSC.[378] These different plans or components have the underlying objective of enabling employees to retire when appropriate through the provision of a market-competitive benefits package. In some cases, different retirement benefits have specific objectives such as, for example, enabling and encouraging employees to take greater responsibility, have greater flexibility, save for retirement (such as the Company's 401k plan),[379] increase the level of certainty that some level of retirement income will be available after an employee's active career is complete (such as the Company's pension plan),[380] or aligning the Company's measures to control costs with the employees' interests in judicious use of available benefits (such as in the Company's Health Reimbursement Arrangement ("HRA")

[377] Carlin Hearing Testimony at 666-667.

[378] Cooper Hearing Testimony at 709-715.

[379] Carlin Hearing Testimony at 683 ("The [401]K plan encourages employees to save because [the Company] know[s] that [its] contribution to the retirement program isn't enough for most employees. They aren't going to be able to retire comfortably with that, so they need to be encouraged, and the K plan does that, encouraged to save for their own retirement."), 684

[380] *Id.* at 684.

and Health Savings Account ("HSA") benefits).[381] In the end, the real question, and the question Mr. Smith ignores, is whether the total combination of these benefits adds up to an appropriate package for employees. Company Witness Cooper's testimony leaves no doubt that in the aggregate, there is nothing excessive or duplicative about these employee benefit plans.[382]

The key virtue of a retirement benefits package that includes "multiple plan flavors in a single-serving swirl" is that it allows the Company to offer an integrated package to all its employees that is better tailored to provide adequate retirement to employees with different years of service, who started service at different times, and who may be affected differently by their ability and attitude towards saving for retirement or the ups-and-downs of different retirement savings vehicles. "The pension plan solves some of those problems, not all of them, and therefore it's got value that the [401] K plan doesn't have. Both pieces together, we think, are the best way to go for employees."[383] Kentucky Power's retirement benefits package achieves this without duplication or excess, as the amount of the Company's contribution to the aggregate of its different retirement plans, combined, is still the same amount that it would be if it only offered one plan.[384]

The Company is not alone in adopting such a structure for its retirement benefits package. Beginning this year, the United States armed forces are adopting a retirement benefit structure similar to that employed by Kentucky Power:

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[381] Cooper Hearing Testimony at 704, 717-719.

[382] *Id*. at 705-715.

[383] Carlin Hearing Testimony at 684.

[384] *Id*. at 666-667; *see also Id.* at 679-680 ("[The Company has] designed these two plans together to do what other companies are doing, to provide the median amount of pension benefits together as a total, and so yes, [the Company has] two plans, but they're not creating a value for participants that's any greater than if [it] had a full-blown 401(k) plan with 100 percent or 125 percent match or a full-blown pension plan with a greater employee contribution there as well."), 681 ("What I think you're saying is the utility industry should take into account other industries, and we do. Other large employers offer benefits very similar to those that we offer."), 688-689 (clarifying that the Company's evaluation of whether its total compensation and retirement benefits package is "market competitive" the employment market considered is broader than only the market of employees for utilities).

> [T]he United States military, in an effort to reduce costs and increase retirement savings by its members, is modernizing its retirement benefits effective for 2018 in a fashion similar to the approach [the Company] is currently utilizing.
>
> The changes are based on a recommendation by the Military Retirement Modernization Commission which conducted a long-term study of the military retirement benefit and made a recommendation to Congress. The [Military Retirement Modernization] Commission's recommendation was included in the National Defense Authorization Act of 2016 and will be effective in 2018.
>
> The new U.S. military retirement system is known as the "Blended Retirement System" or BRS. The "blending" in BRS comes from the blending of two sources of retirement income: the existing defined benefit provision, plus a new defined contribution "Thrift Savings Plan" (TSP). The TSP is a government run retirement plan that offers the same types of savings and tax benefits that are provided under 401(k) plans. It allows members to invest their own money in either stocks or government securities and also get a contribution to that account from their employer.[385]

This new structure is similar to what Kentucky Power offers through its defined benefit cash balance retirement plan and defined contribution 401k retirement savings plan.[386]

Mr. Smith asserts that the Commission had, in other cases involving other utilities with different plans (and critically, *with very different levels of employer contribution as a percentage of employee wages*,) determined that those plans were not reasonable.[387] The description and differentiation provided by Company Witness Cooper makes quite clear that Mr. Smith's efforts to conflate other utilities' plans (which when viewed in the aggregate as evaluated by the Commission were found to be excessive) with Kentucky Power's employee benefit plans (which when viewed in the aggregate are reasonable) have no credible basis. The Cumberland Valley

[385] Kentucky Power's December 27, 2017 Supplemental Response to KPSC 1-61.

[386] *Id.*

[387] Cooper Rebuttal Testimony at R2-R5.

plan, one of the plans found by the Commission to be unreasonable, provided a benefit of 30 percent of employee compensation, more than twice the costs paid by Kentucky Power when adding up the Company's contribution under both its pension and 401k plans *combined*.[388]

D. **<u>The Proposed Changes To Vegetation Management Plan Are In The Customer's Interest</u>.**

1. <u>Kentucky Power Proposes To Accelerate The Start Of Task 3 Work 18 Months Early And Thereby Accelerate A Reduction In Rates</u>.

The Company's current vegetation management plan ("2015 Vegetation Management Plan") provides for the completion of Task 1 work by December 31, 2018; the completion of Task 2 work by June 30, 2019; and the start of Task 3 work beginning July 1, 2019, at which time, Kentucky Power's entire distribution system would be re-cleared on a five-year cycle.[389] The 2015 Vegetation Management Plan is funded at approximately $27 million until the Company began the five-year maintenance cycle on July 1, 2019.[390]

In response to a challenge by management to reduce costs, and leveraging past successes, Kentucky Power is proposing to begin Task 3 work 18 months early.[391] Doing so enables Kentucky Power to reduce its current $27.6 million total annual expenditure to a $21.465 million annual expenditure—a difference of $6.135 million – when rates become effective in this case.[392] The Company also has honored its spending commitment in the 2014 rate case:

388 Cooper Hearing Testimony at 705-07. In discussing the other utility plans raised by Mr. Smith, Company witness Cooper explained that the contributions found objectionable in connection with the Kentucky Utilities and Louisville Gas & Electric 401k plan added on the high end to a contribution by the utilities of 11.2 percent of employee compensation, making the contribution to just *one* of their plans (i.e., without factoring in any costs of those utilities pension plans) close to the 13 percent maximum that Kentucky Power aggregate contribution to *both its plans together*. *Id.* at 707-08.

389 Phillips Direct Testimony at 31.

390 *Id*. at 32.

391 *Id*. at 34.

392 Phillips Hearing Testimony at 296-297.

actual distribution vegetation management Operation and Maintenance expenditures through December 31, 2016 totaled 101 percent of its target expenditures.[393]

Kentucky Power's vegetation management efforts are success story. The Company has been able to obtain the significant improvements in reliability described at page 78 *infra,* while providing significant cost reductions 18 months early.

2. <u>Kentucky Power's Request To Amend Its Vegetation Management Plan To Allow The Company To Manage Annual Expenditure Requirements On A Company Basis Is Reasonable And Will Provide Efficiencies</u>.

Kentucky Power currently is required to seek Commission approval prior to deviating by more than ten percent in its projected annual vegetation management spending for each of its three districts.[394] The Company was required once to seek leave to deviate from budgeted district spending levels since this requirement was imposed on June 22, 2015.[395]

Kentucky Power is seeking to eliminate this requirement to improve the efficiency of its vegetation management operations and to provide it with the flexibility required to respond to developments over the course of the 15 months between when the district plan is filed with the Commission (October 1 of the preceding year) and the completion of the annual district plan (December 31 of the following calendar year).[396] Although the Company was required to seek a deviation only once in the two years between the imposition of the requirement and the filing of the Company's application, it on other occasions has idled experienced crews, or deferred the use

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[393] Phillips Direct Testimony at 35.

[394] *Id*. at 47-51. Small changes in the Company's vegetation management operations within a single district can affect spending in amounts that approach the ten percent limit. For example, the 2015 budgeted total O&M funding for the Hazard District was $3.4 million. Phillips Direct Testimony, Exhibit EGP-4 at 7. The ten per cent limit would be triggered by a $340,000 change.

[395] *Id*. at 49-50.

[396] *Id*. at 48-50.

of roving crews, so as to manage its district expenditures within the ten percent limit on deviations.[397] These such actions can impede the Company's vegetation management efforts.

The Company understands and joins in the Commission's concern that customers in each of the Company's three districts equally share in the benefits of Kentucky Power's vegetation management efforts. Kentucky Power respectfully submits that the Commission and the Company can best address this concern through careful monitoring of the Company's annual vegetation management reports in lieu of the current ten percent deviation "trip wire." Doing so will allow the Commission address any concerns regarding inter-district inequities, while ensuring e the vegetation management program is managed in the most efficient manner to the ultimate benefit of all customers.

E. <u>Kentucky Power's Application Includes Other Reasonable Changes That Should be Approved</u>.

1. <u>Kentucky Power's Proposed Amortization Of Its Storm Damage Deferral And Adjustment To Test Year Amortization Expense Are Appropriate And Consistent With Prior Practice</u>.

The Company proposes to increase its test year annual major storm amortization expense by $875,467.[398] The increase from the test year level of $2,429,200 reflects the amortization over five years, beginning with the effective date of the rates established in this case, of the $4,377,336 of incremental major storm expense the Commission authorized the Company in Case No. 2016-00180[399] to defer for later review and recovery.[400] The test year amounts reflect

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[397] *Id*.

[398] Wohnhas Direct Testimony at 14.

[399] Order, *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 at 9 (Ky. P.S.C. November 3, 2016) ("2015 Major Storms Expense Deferral Order").

[400] Wohnhas Direct at 14.

the amortization, beginning in June 2015, of the regulatory asset approved in Case No. 2012-00445.[401]

In approving the establishment in Case No. 2016-00180 of the major storm expense regulatory asset, the Commission indicated that the recovery of the deferred expense, if any, was contingent on the Commission's detailed review in the Company's next rate case of Kentucky Power's storm preparedness, including its efforts to "harden its system," its response to outages, the reliability of its system, and the improvements in reliability as a result of the additional funding for the Company's distribution vegetation management plan.[402]

Kentucky Power provided detailed evidence through the testimony of Company Witness Phillips concerning each of these topics.[403] Specifically, Mr. Phillips testified about Kentucky Power's efforts to upgrade many of its distribution facilities from Grade C facilities to Grade B facilities,[404] its installation of equipment to improve grid reliability, including the installation of over $3 million of Supervisory Control And Data Acquisition Technology since the Company's last base rate case,[405] its implementation of an Incident Command System to improve its storm responsiveness,[406] its Distribution Asset Management programs, and its Major Distribution Reliability and Capacity Addition programs,[407] as well as its more than $21 million in reliability and system restoration capital investment since September 30, 2014.[408] Mr. Phillips also testified at length concerning the evolution and accomplishments of the Company's distribution

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[401] *Id*.

[402] 2015 Major Storms Expense Deferral Order at 8-9.

[403] Phillips Direct Testimony at 4-12, 13-26, 33-43.

[404] *Id*. at 5.

[405] *Id*. at 6.

[406] *Id*. at 9-12.

[407] *Id*. at 18-23.

[408] *Id*. at 23

vegetation management program,[409] including the decline by at least 60 percent since 2011 in number of interruptions of service (61 percent), total customers affected (60 percent), and total customer minutes interrupted (64 percent) as a result of vegetation within the Company's rights-of-way:[410]

Minor Cause Code	Year - 12 Month Ending Dec	Number of Interruptions	Total Customer Affected	Total Customer Minutes Interrupted
TIR + VIN	2010	2,250	64,360	12,280,664
TIR + VIN	2011	2,427	72,076	16,388,594
TIR + VIN	2012	1,674	43,934	11,369,680
TIR + VIN	2013	1,555	48,099	8,866,856
TIR + VIN	2014	1,462	36,471	8,617,318
TIR + VIN	2015	1,102	30,040	6,236,943
TIR + VIN	2016	943	28,713	5,949,862

None of the intervenors challenged, much less filed testimony disputing, the showing made by the Company in response to the Commission's Order, or its right to recover the deferral in full.

KIUC Witness Kollen nevertheless challenged the method by which Kentucky Power proposed to amortize the balance of its 2012 major storm deferral.[411] First, he argues that the amount of the regulatory asset should be adjusted to its January 2018 balance when the rates approved in this case are likely to be implemented.[412] He errs. Mr. Kollen's proposal is inconsistent with the test year concept as a snap shot in time of the utility's operations. That concept recognizes that the multitude of expenses captured in the test year will change over the period the rates are likely to be in effect – with some decreasing and many increasing – but that on the whole the changes will tend to offset each other.

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[409] *Id*. at 33-54.

[410] *Id*. at 36.

[411] Kollen Direct at 26-28.

[412] *Id*. at 26.

Here, Mr. Kollen proposes to isolate a single decrease without providing the Company the benefit of an adjustment of any offsetting increase in test year expenses. Certainly, he offers no authority for recalculating in this case the annual amortization expense amount for the deferral resulting from the Commission's decision in Case No. 2014-00396. More fundamentally, his adjustment and his claim of resulting over-recovery[413] is premised on the assumption that the Company has been recovering the amortization expense since the end of the test year. That assumption is refuted by the fact that the Company's return on equity since the test-year end has averaged 5.26 percent[414] or approximately 54 percent of the 9.8 percent return on equity found reasonable by the Commission in Case No. 2014-00396.[415] A company that is earning only slightly better than one-half of its authorized return on equity is by definition not recovering many of its expenses.

Even more troubling is Mr. Kollen's proposal to extend (he labels it "reset") the previously five-year amortization period by an additional two and one-half years. Again, he offers no authority for such a do-over. More fundamentally, Mr. Kollen's proposal will extend the Company's recovery of 2012 major storm expenses until January 2023, or more than ten years after they were incurred.

2. <u>Kentucky Power Properly Normalized Its Test Year Storm Expense</u>.

Kentucky Power adjusted its test year level of major storm expense, less in-house labor, to the three year average of storm damage expense, less in-house labor, and adjusted the average

[413] Mr. Kollen also argues that the risk of over-recovery is exacerbated since the Commission and the intervenors do not know when the Company may file its next rate application. It is equally true that the Company has indicated that unless the Commission approves a mechanism for the contemporaneous recovery of its volatile PJM LSE OATT expenses it will be forced to file another application within months of the expected order in this case. Satterwhite Rebuttal Testimony at R5-R6; Vaughan Hearing Testimony at 1035-36.

[414] Kentucky Power's Response to KPSC 1-38, Third Supplemental Attachment 1.xlsx.

[415] 2014 Rate Case Order at 42.

for inflation using the Handy-Whitman Contract Labor Index.[416] The use of the three year average adjusted for inflation resulted in a $595,932 increase in the test year amount.[417]

Attorney General Witness Smith criticized the Company's use of the normalized level of expense but provided no evidentiary or legal basis for his challenge.[418] Instead, he simply opined that the Company failed to provide a compelling reason for the normalization.[419]

Normalization is appropriate where expenses may vary significantly and unpredictably on a yearly basis[420] because it provides a reasonable ongoing level of expense.[421] Moreover, it is appropriate to adjust a multi-year average used to normalize test year levels for inflation.[422]

Storm expense is the archetypical unpredictable and volatile expense: "the random occurrence of severe storm damage cannot be accurately predicted."[423] Certainly, Mr. Smith offers no evidence to the contrary. Nor can he. Over the past eight years, the Company's incremental annual major storm expense varied by almost 2,900 percent from $0.8 million to $23.1 million. Moreover, the three-year period chosen by the Company produces a reasonable value: the three-year average upon which the Company calculated the adjustment to the test year amount is less than 25 percent of the $6.4 million average over the eight-year period.[424] Moreover, the Handy-Whitman Index, which calculates cost trends for different types of utility

[416] Wohnhas Direct Testimony at 13.

[417] *Id*.

[418] Smith Direct Testimony at 44.

[419] *Id.*

[420] Order, *In the Matter of: Adjustment Of Gas And Electric Rates Of Louisville Gas And Electric Co.*, Case No. 90-158 at 30 (Ky. P.S.C. December 21, 1990).

[421] *Id*.

[422] *Id*. ("[S]imply taking the average of an historic period (Commission used Consumer Price Index – Urban to adjust ten-year average).

[423] *Id*.

[424] Wohnhas Rebuttal at R18-R19; Application, Section V, Exhibit 2, Workpaper W17.

construction, is at least as appropriate to use as an inflation adjustment as the Consumer Price Index – Urban sanctioned in Case No. 90-158.

The Company's use of an inflation adjusted and normalized level of major storm expenses is consistent with the Company's past practice and Commission precedent.

3. <u>Tariff Changes to Provide Clarity To Limit Fraud And Thereby The Costs Ultimately Borne By Other Customers Are Reasonable and Should Be Approved.</u>

Kentucky Power proposed changes to the terms and conditions of service to provide clarity for customers on how service will be provided. In addition, the Company proposed changes to protect the Company from fraud. These changes will ultimately benefit customers as well through reduced uncollectable accounts expense.[425]

Chief of the provisions addressing fraud are the Company proposed changes to the section of its terms and conditions regarding Denial or Discontinuance of Service. In a post-hearing data request response, the Company updated its requested change to Sheet 2-10 of its Tariff to the following to address a request from Staff and the Commissioners:

> The Company reserves the right to refuse or discontinue service to any customer if the customer is indebted to the Company for any service theretofore rendered at any location. *Service will not be supplied or continued to any premises if at the time of application for service the Applicant is merely acting as an agent of a person or former customer who is indebted to the Company for service previously supplied at the same, or other premises, until payment of such indebtedness shall have been made*; provided however, the customer shall be notified in writing in accordance with 807 KAR 5:006, Section 15, before disconnection of service.[426]

The Company's proposed language will protect the Company from fraudulent attempts to request service and is consistent with language used by other utilities in the state. It should be approved.

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[425] Satterwhite Hearing Testimony at 388-389; Sharp Hearing Testimony at 776.

[426] Attachment 1 to the Company's Supplemental Response to KPSC PH-23.

4. The Company's Proposal to Consolidate Billing Line Items Addresses Customer Confusion and Should be Approved.

In response to customer complaints about the complexity of the Company's bills because of the number of line items presented on the bills, Kentucky Power seeks to consolidate several of the surcharge and rider-related line items into a single "rate billing" line item.[427] Customers have expressed frustration with the number of line items appearing on the bill.[428] Typical is a Resident Public Comment filed in this case:

> One charge that I do not like is the Big Sandy Retirement Rider Many people are paying this out of their own Retirement Checks.
>
> We are paying for 10 things and these charges add up.[429]

Many customers simply want to know how much is owed and when payment is due.[430] The proposed roll-up will not leave customers without reasonable bill detail. Under the Company's proposal, the number of line-items shown on the bill would decrease from fifteen to eight.[431] If greater detail is still desired, customers can still obtain detailed information through the Company's website or by contacting a customer service representative.[432]

Understanding public utility regulation is not easy. The Company realized there was more it could do to aid customers' understanding. As Company Witness Satterwhite testified, public utilities confuse customers by calling our "prices" tariffs. Customers, therefore, assume

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[427] Kentucky Power filed an application in Case No. 2017-00231 to update the appearance of its bills and to consolidate certain billing line items. By order dated July 17, 2017, the Commission consolidated Case No. 2017-00231 into this proceeding. By further order dated September 12, 2017, the Commission approved the Company's request to update the appearance of the bill, reserving a determination on the request to consolidate line items to be part of the final order in this case.

[428] Sharp Direct Testimony (Case No. 2017-00231) at 3.

[429] Resident Public Comment, Case No. 2017-00179 (Ky. P.S.C. Filed December 27, 2017) (emphasis in original).

[430] *Id*.

[431] *Id*. at 6.

[432] *Id*.

the rates for public utility services are taxes.[433] These little things matter. The items Kentucky Power Company is requesting to include as part of "rate billing" all involve the costs of providing electric service.

The utility business – and its regulation – is data driven. Utility professionals and regulators appreciate the granularity this data provides. In an attempt to emulate this model, and to be more transparent, utilities – including Kentucky Power – largely have succeeded in frustrating customers by making them believe they were paying for more than just electric service. In effect, the Company has unintentionally misled its customers by forcing them (through the level of bill detail) to miss the forest by focusing their attention on the trees. Kentucky Power's request to roll-up billing line items is based on conversations with its customers and an understanding on how the Company may be eroding trust in the regulatory model with its current bill format.

The Company's proposed billing line item consolidation reduces clutter on the bill and provides, in response to customer concerns, only the most important information regarding the bill. It is not an attempt to hide costs from customers. Consolidating line items as proposed by the Company is reasonable and should be approved.

V. THE COMPANY'S 2017 ENVIRONMENTAL COMPLIANCE PLAN SHOULD BE APPROVED

The Company also seeks approval of its 2017 Environmental Compliance Plan. The 2017 Environmental Compliance Plan adds two new projects. First, the Company is adding Project 19 which is the selective catalytic reduction ("SCR") technology at Rockport Unit 1.[434] Second, the Company is adding Project 20 to clarify the inclusion of all consumables necessary

[433] Satterwhite Hearing Testimony at 134.

[434] Elliott Direct Testimony at 4.

to operate approved projects and to add the return on the consumable inventory to the environmental surcharge calculation.[435]

The Rockport Unit 1 SCR is necessary to comply with the Clean Air Act.[436] It is a reasonable and cost-effective means for the Company to comply with its environmental requirements.[437] Accordingly, the Rockport Unit 1 SCR should be added to the Company's environmental compliance plan.

The Commission should also approve Project 20 identifying specifically the consumables necessary to operate approved projects and including the return on consumables inventory. Adding the environmental project consumables as a separate project merely clarifies that all costs associated with those consumables are properly recovered through the environmental surcharge. Similarly, recovering the return on the inventory of environmental project consumables through the environmental surcharge aligns the costs of operating the environmental projects with the costs recovered through the environmental surcharge.[438]

Finally, the Company is also seeking to add a gross-up factor to the costs incurred to operate approved environmental projects.[439] This gross-up factor accounts for the Commission maintenance assessment fee expense and uncollectable accounts expense; it is necessary to ensure that the Company recovers the full costs of operating its approved environmental

[435] *Id*.

[436] McManus Direct Testimony at 6-7.

[437] Osborne Direct Testimony at 15; 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) (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.").

[438] Elliott Direct Testimony at 9.

[439] *Id*. 14.

projects.[440] There will be no double-recovery of the gross-up factor costs when environmental projects are rolled into the environmental base in subsequent rate case proceedings.[441] The Company's proposed use of a gross-up factor will help ensure full cost recovery of the operation of its approved environmental projects and should be approved by the Commission.

VI. THE INTERVENORS' POSITIONS ARE UNREASONABLE

A. <u>The Attorney General's Recommendation That The Commission Deny The Company's Proposed Rate Adjustment In Its Entirety Is At War With The Law And His Own Witness' Testimony</u>.

On October 3, 2017, the Attorney General filed the testimony of Ralph W. Smith. Mr. Smith, who served as the Attorney General's expert witness in this proceeding and multiple other rates cases before this Commission, calculated that the Company's current rates produce a $39,876,068 revenue deficiency. In fact, Mr. Smith testified that the $39.9 million increase was the Attorney General's recommended revenue requirement for the Company.[442] Almost simultaneously, the Attorney General held a press conference to announce that his Office of Rate Intervention "is recommending that the Public Service Commission (PSC) deny AEP/Kentucky Power's more than $60 million proposed increase."[443] At the same press conference, the Attorney General also asserted that in lieu of the three scheduled public meetings "the PSC ***should be required***, however, to hold public hearings in each of the 20 counties and hear concerns about the its proposed increase…."[444]

When asked by the Commission to place the square peg of his publicly-announced litigation position within the round hole of his witness' testimony, the Attorney General, not

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[440] *Id*.

[441] Elliott Hearing Testimony at 817.

[442] Smith Direct Testimony at 13-14; Exhibit RCS-1 at 2.

[443] Appendix, KPSC Data Request 1-2(b) to the Attorney General.

[444] *Id*. (emphasis supplied).

surprisingly, failed.[445] Nowhere in his response to the Commission's inquiry did the Attorney General explain how a $39.9 million revenue deficiency can be made to equal $0. Given an opportunity on cross-examination to correct or disavow his calculation of the $39.9 million revenue deficiency Mr. Smith declined to do so.[446] To the contrary, he stood by his calculation explaining "it's a number that was calculated at that point in time ***using adjustments that are documented and supported in the record***."[447] Mr. Smith, in fact, confirmed that his calculation of a $39.9 million revenue deficiency remained his recommendation to the Commission:

> Q. And that [the $39.9 million calculated revenue deficiency] is your recommendation, right?
>
> A. Yes, as of the date this was filed.[448]

The Attorney General's equivocation that the $39.9 calculated revenue deficiency was correct "as of the date" Mr. Smith's testimony was filed is an exercise in futility. Most tellingly, when asked by his attorney on direct examination the morning of his testimony, and only minutes before his equivocation, whether he had any changes to his October 3, 2017 direct testimony, which included his calculation of the $39.9 million revenue deficiency, Mr. Smith confirmed the accuracy of his October 3, 2017 direct testimony other than his December 4, 2017 correction to his qualifications and his December 5, 2017 errata sheet.[449] Yet, neither of those filings include any change to his calculation of a $39.9 million revenue deficiency.[450] Nor does either propose to update to Mr. Smith's direct testimony by recommending that the Commission

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[445] Attorney General's Response to KPSC Data Request 1-2(b).

[446] Smith Hearing Testimony at 248-249.

[447] *Id*. at 248 (emphasis supplied); *id*. ("At that point in time it was a number we had calculated and supported.")

[448] *Id*. at 243.

[449] *Id*. at 201.

[450] Appendix A, Attorney General's December 4, 2017 Errata Filing; Attorney General's December 5, 2017 Corrections to Ralph C. Smith's Direct Testimony.

"stack on a bunch of deferral items"[451] or that it "stack[] some other adjustments on top of what we had calculated."[452]

The value of these never-disclosed adjustments and deferrals is best evidenced by the fact that having gone to the trouble of filing the day before the hearing corrections to his testimony adding the letter "s" to the name "AEP Generation Resource," and to include the missing "a" from Company Witness Vaughan's name, Mr. Smith failed to update his testimony on one of the most – if not the most – important aspect of this case: the revenue deficiency produced by Kentucky Power's current rates. Equally telling, being afforded the opportunity on redirect examination to have Mr. Smith identify and quantify any additional recommended adjustments or deferrals he earlier had alluded to, the Attorney General failed to ask Mr. Smith to do so.[453]

At the end of the day, the Attorney General's attempt to save his litigation position that the Commission should deny the Company's requested rate adjustment in its entirety from the only conclusion to be drawn from the sworn testimony of the Attorney General's witness is best captured by the Vice-Chairman's observation to Mr. Smith:

> So if I take the $2.5 million and I reduce it out there, I still don't come close to your 39.9 vs. 31.2. And the only difference is whether we amortize costs in the future, which you're objecting to, and I – so I don't know how I – I can't reconcile your position. That's my problem. I can't get to where you are.[454]

The Attorney General's recommendation that the Commission deny the Company's requested rate adjustment in its entirety also stands in opposition to the law and the underlying principles of the regulatory compact.

> The federal and state constitutions protect against the confiscation of property, not against a mere reduction of revenue…. Rates are non-confiscatory, just and

[451] Smith Hearing Testimony at 249.

[452] *Id*.

[453] Smith Hearing Testimony at 270-275, 291.

[454] Hearing Statement of Vice Chairman Cicero at 288.

> reasonable so long as they enable the utility to operate successfully, to maintain its financial integrity, to attract capital and to compensate its investors for the risks assumed even though they might produce only a meager return on the so-called "fair value" rate base.[455]

This standard, enunciated by the United States Supreme Court in *Hope Natural Gas*,[456] was recognized as controlling by the Attorney General's own return on equity witness, Dr. Woolridge,[457] and agreed to by Mr. Smith.[458] Indeed, Mr. Smith confirmed at the hearing that he not only relied upon Dr. Woolridge's calculation of the required return on equity to meet the *Hope* standard in arriving at his determination that the Company's current rates yielded a $39.9 million revenue deficiency, but that he was still relying on Dr. Woolridge's calculation.[459] The Attorney General's position and recommendation to ignore the law and regulatory compact should be denied.

The Attorney General presented sworn testimony calculating that Kentucky Power's current rates must be modified to produce an additional $39.9 million annually if they are to produce the opportunity for the Company to earn a reasonable rate of return under the *Hope* standard. Yet, the Attorney General nevertheless implores the Commission to cast aside both the *Hope* legal standard underlying the regulatory compact and the Attorney General's own witnesses' recommendations and disallow any increase. Doing so would deny Kentucky Power the opportunity to earn a reasonable return on equity. The Attorney General's litigation position is an invitation to ignore the law that the Commission can and must decline.

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[455] *South Central Bell Tel. Co. v. Stephens*, 545 S.W2d 927, 930-931 (Ky. 1976) (citing *Hope Natural Gas Co. v. Federal Power Com'n*, 320 U.S. 591 (1943)).

[456] *Hope Natural Gas Co. v. Federal Power Com'n*, 320 U.S. 591 (1943).

[457] Woolridge Direct Testimony at 2-3.

[458] Smith Hearing Testimony at 239-240, 242.

[459] *Id*. at 241-242.

B. **<u>The Intervenors' Recommended Returns On Equity Are Based Upon Flawed And Unreasonable Analyses</u>.**

As Company Witness McKenzie explained in detail in his rebuttal testimony, the analyses of the other witnesses, and in particular of Attorney General Witness Woolridge, are both incomplete and downwardly biased, resulting in inadequately low ROE recommendations that would not satisfy the requirements of *Hope* and *Bluefield*. Of particular note, however, are two of Dr. Woolridge's concessions during cross-examination. Both illustrate the dissonance between real-world investor expectations about risk-comparable required returns in the present capital market on one hand, and Dr. Woolridge's unrealistically biased recommendation that Kentucky Power's ROE be reduced to 8.6 percent.[460]

The first, and most telling, is Dr. Woolridge's statement, during cross-examination by counsel for the Commission's Staff on the topic of investors' expectations for long-term interest rates to rise in the future and the implied upward pressure on capital cost, that "people believe all these forecasted interest rates are going up…."[461] This brief moment of candor sheds a bright light on the underlying fact that is missing from Dr. Woolridge's analysis and resulting recommendation: his analysis ignores a realistic perception of investors' *present expectations* about required long-term returns under *current* market conditions and the information that

[460] The 8.6% ROE recommended by Dr. Woolridge would be a 120 basis point reduction from the ROE determined reasonable by the Commission for Kentucky Power in Case No. 2014-00396. *See* 2014 Rate Case Order at 42. Dr. Woolridge's recommended 8.6% ROE would also be an incongruent 110 basis points lower than the 9.7% ROE authorized by the Commission for Kentucky Utilities ("KU") and Louisville Gas & Electric ("LG&E") in Case Nos. 2016-00370 and 2016-00371 respectively. This recommendation makes no sense considering that KU's and LG&E's Moody's credit rating is two notches above Kentucky Power's. *See, Cf.*, Woolridge Hearing Testimony at 486 (conceding that a Moody's credit rating of A3 (KU's and LG&E') represents a less risky investment that a Baa2 credit rating (Kentucky Power's)); *see also* McKenzie Direct Testimony at 58-63; McKenzie Rebuttal Testimony at 2 (illustrating that although relying solely on awarded returns on equity reported by Regulatory Research Associates ("RRA") to fix the return on equity for an individual utility is not an appropriate methodology, it is nonetheless further demonstration of unreasonableness of Dr. Woolridge's recommendation that the average return on equity for integrated utilities reported by RRA for both twelve month periods ended June 30, 2016 and June 30, 2017 lay between 9.5% and 10.0%).

[461] Woolridge Hearing Testimony at 490.

influence those investors' expectations.[462] This admission is especially pertinent in evaluating the reasonableness of the 9.75 percent ROE contained in the Settlement Agreement, given that the settlement also precludes Kentucky Power from seeking an increase to its ROE for three years, during which time capital costs are anticipated to increase significantly.

The second concession from Dr. Woolridge's cross-examination concerns the tradeoff implied by the risk of lower credit ratings and the cost of capital, particularly from a customers' point of view.[463] Dr. Woolridge's admission is significant, as it illustrates the underlying benefit to Kentucky Power's customers from ensuring that the Company's rates are adequate to support its financial integrity. It is crucial for Kentucky Power's customers that the Company does not incur increased costs as a result of not having an opportunity to earn an adequate return on equity. This concession cannot be reconciled with Dr. Woolridge's low 8.6 percent ROE, a result that, if adopted, would send a very negative signal to credit rating agencies and mark a severe departure from Kentucky Power's supportive regulatory environment. Dr. Woolridge reluctantly conceded the well-known fact that in 2014, Kentucky Power was *one of the few* public utilities reviewed by Moody's that did not receive a credit rating upgrade.[464]

Equally illustrative of Dr. Woolridge's downward bias, and of the unreasonableness of his recommendation, was his effort to justify his 8.6 percent ROE by comparing it to the ROE

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[462] *See*, McKenzie Hearing Testimony at 634-36 (discussing, among other facts, the $4.2 trillion worth of long-term debt the U.S. Treasury has in its balance sheet); at 642 (discussing the Federal Reserve's decision to sell up to approximately $10 billion per month worth of these securities, and the expectation that this policy coupled with the possible effects of the recent tax reform legislation contribute to present investors' expectations for higher long-term interest rates and increased capital costs in the future); *see also* McKenzie Hearing Testimony at 620-24 (discussing the expectation that tax reform legislation will have a stimulative effect on the United States economy, and highlighting that the 9.75 percent ROE in the Settlement is a conservative rate beneficial to customers viewed in light of current investors' expectations about future economic growth).

[463] Cf. Woolridge Hearing Testimony at 487-88 (discussing the effect on customers from a cost point of view for a company to have a lower equity ratio).

[464] *Compare* Woolridge Hearing Testimony at 508-09 *with* the Company's response to KIUC 1-55, Attachment 1 at 21-22 (Moody's Kentucky Power Credit Opinion dated February 10, 2014, maintaining the Company's Baa2 credit rating unchanged, and emphasizing the importance for Kentucky Power of a supportive regulatory environment, and highlighting that "KPCo's [i.e., not AEP's, but Kentucky Power's specifically] ratings could be downgraded if the

provided for in a single formula rate proceeding in Illinois. This ROE pertains to Ameren Illinois Company, which is rated A3 by Moody's, versus the Baa1 credit rating assigned to Kentucky Power.[465] Ameren operates under a completely different regulatory framework than Kentucky Power and presents a completely different investment risk profile.[466]

Again, shedding light on the unbridgeable gap between Dr. Woolridge's analysis on one side and the perception of real-life investors about present capital markets and the required returns for Kentucky Power compared to investments of *similar* risk, it is either naïve or ill-informed to suggest that the ROE calculated for Ameren Illinois under the provisions of its formula rate plan is in any way relevant to the ROE that is appropriate for Kentucky Power. First, Ameren Illinois is a distribution-only utility that does not face the risks associated with owning and operating generating facilities. Ameren's ROE is recalculated under Illinois' re-structured regulatory framework on a yearly basis pursuant to a formula rate that automatically sets the ROE by adding a fixed risk premium to the 30-year U.S. Treasury bond yield.[467] Such methodology neither takes into consideration nor is indicative of investors' expectations for the electric utility as a whole, let alone for a Kentucky-regulated, vertically-integrated, electric utility rated Baa2 by Moody's, such as Kentucky Power.[468]

Second, and critical in distinguishing Dr. Woolridge's insinuation that Ameren Illinois' ROE would lend support to his recommended reduction in Kentucky Power's authorized ROE, the formula rate by which Ameren Illinois' ROE is prescribed is subject to a true-up mechanism.

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regulatory environment were to take a more adversarial tone, especially;" precisely the direction of Dr. Woolridge's recommendation.

[465] Woolridge Hearing Testimony at 504-05.

[466] McKenzie Hearing Testimony at 624-28; 648; *see also* the Attachment to the Attorney General's Response to KPSC PH-1 ("Ameren ICC Order").

[467] McKenzie Hearing Testimony at 624-28; 648.

[468] *Id.*

Thus, Ameren's formula rate plan provides a level of certainty that the ROE will, in fact, be earned that is not available to Kentucky Power.[469] Kentucky Power, by contrast, is not *guaranteed* to earn its authorized return and, in fact, has suffered the impact of attrition and the inability to earn the returns authorized by the Commission in past cases.[470]

Investors note rating agency credit opinions and use them to differentiate investment risks among the various investment options they have available in the capital markets. To obtain an evaluation of risks specific to Kentucky Power, investors look to the information provided by Moody's, given that Moody's differentiates company-specific credit risks from those of the parent company (*i.e.*, independent credit ratings for an operating utility like Kentucky Power, as opposed to a uniform umbrella rating such as the one provided by Standard and Poor's for AEP and its subsidiaries).[471] Similarly, Dr. Woolridge's recommendation entirely ignores the seismic negative signal that would be sent to credit agencies and investors if the Commission were to give any credence to his attempt to equate an isolated 8.4% ROE for Ameren Illinois to investors' expectations for Kentucky Power's ROE. This further demonstrates that Dr. Woolridge's recommendation is inconsistent with the requirements of *Hope* and *Bluefield*, is not based on the reality of investors' expectations and perceptions, and is not in the best interest of Kentucky Power's customers.[472]

[469] McKenzie Hearing Testimony at 640-41; *see also* Ameren ICC Order at 3, 9, 28 (describing and applying the Illinois statutory framework for the formula to calculate and true-up Ameren Illinois' ROE at 580 basis points plus the average for the applicable calendar year of the monthly average yields of the 30-year U.S. Treasury bonds).

[470] Kentucky Power Company's actual earned return on equity of 5.81% during the test year, and of 4.89% over the years 2013 to 2016 on average leave no question on the matter. *See* Kentucky Power's Response to KPSC 1-38, Attachment 1.xlsx; *see also* McKenzie hearing Testimony at 641.

[471] *Compare* Woolridge Hearing Testimony at 506-509 *with* the Company's response to KIUC 1-55, Attachment 1 at 61 (Moody's Credit Opinion dated February 10, 2014).

[472] *Cf.* Woolridge Hearing Testimony at 487-88 (conceding that a lower credit rating would result in increased capital costs).

The 9.75 percent provided for in the Settlement Agreement is not overly-generous, but rather it is conservative, particularly in light of the Settlement Agreement's provision preventing Kentucky Power to file a base-rate increase petition for three years.[473] A reduction of that rate, as recommended by Attorney General Witness Woolridge, could be catastrophic for Kentucky Power and its customers, and is not supported by the credible evidence in the record. Approval of the 9.75 percent ROE in the context of the Settlement Agreement, in contrast, is the type of supportive regulatory environment action described in Moody's Kentucky Power credit opinions, and one that strikes a balance and obtains alignment between the Company's need to maintain its financial integrity and its customers' need for a public utility able to provide them reliable electric service now and in the future.[474]

C. The Attorney General' Recommendation That The Commission Disallow Some Or All Of The Amounts Being Recovered Through The Big Sandy Retirement Rider Lacks Any Basis In Fact Or Law And Should Be Dismissed Out Of Hand.

Attorney General Witness Smith advances the Attorney General's theme of throwing out applicable regulatory law and undoing past approvals in connection with his recommendation that Commission write-off the Big Sandy Retirement Rider ("BSRR") regulatory asset. Laboring under the fundamental misconception that "[b]ut for the AEP consent decree, the retirement of Big Sandy Unit 2 and the purchase of the 50 percent undivided interest in the Mitchell Plant by KPCo might not have been necessary,"[475] Mr. Smith urges the Commission to abandon its decision authorizing the establishment of the Big Sandy Retirement Rider regulatory

[473] McKenzie Hearing Testimony at 618-19.

[474] *Id.*, *see also* McKenzie Hearing Testimony at 637-40 (discussing the customer benefit, from a capital costs and related revenue requirement, of the Settlement's 9.75% ROE in light of Kentucky Power's low equity capital structure).

[475] Smith Direct Testimony at 64.

asset,[476] as well as its subsequent decision authorizing the Company to recover the regulatory asset through the BSRR,[477] and "disallow all or a portion of the costs currently being recovered" through the BSRR.[478] The Attorney General's recommendation finds no support in fact, law, or policy.

Significantly, Mr. Smith lacks the courage of his convictions regarding the factual premise for his recommendation: that, but for the 2007 Consent Decree, Big Sandy Unit 2 could have continued to operate without the installation of a $1 billion scrubber. Instead, he simply states that, but for the Consent Decree, the retirement of Big Sandy Unit 2 "might not have been necessary."[479] His trepidation is well-advised.

Company Witness McManus made clear that even in the absence of the 2007 Consent Decree, Big Sandy Unit 2 could not have continued to operate past April 2015 without the installation of a scrubber.[480] He underscored this point at the hearing:

> The MATS rule established very stringent unit-specific emission limitations for mercury, for acid gases, for particulate matter. For Big Sandy to comply with the MATS rule, it would have had to install a flue gas desulfurization system on both of the units or it could not have complied.[481]

Mr. Smith's belief that the 2007 Consent Decree led to the retirement of Big Sandy Unit 2 is particularly surprising given that almost two-and-one-half years earlier, the Commission found in

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[476] Order, *In the Matter of: 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 Requirements; and (5) All Other Required Approvals and Relief*, Case No. 2012-00578 (Ky. P.S.C. October 7, 2013)

[477] 2014 Rate Case Order at 45-47.

[478] Smith Direct Testimony at 64.

[479] *Id*.

[480] McManus Rebuttal Testimony at 9 ("The fate of Big Sandy Plant was ultimately determined by the requirements of EPA's Mercury and Air Toxics Standards (MATS) Rule.")

[481] McManus Hearing Testimony at 49-50.

the Company's 2014 rate case,[482] a case in which Mr. Smith testified, that "[t]he closure of Big Sandy Unit 2 and the conversion of Big Sandy Unit 1 to a natural gas-fired generating facility were precipitated by the MATS compliance deadline."[483]

Lacking a factual predicate, Mr. Smith's recommendation that the Commission deny recovery of the costs currently being recovered through the BSRR falls of its own weight. The legal basis for his recommendation fares no better.

The Commission requested during discovery that the Attorney General provide "any case(s) in which this Commission or another state public utility regulatory agency has denied recovery of costs that are similar to the … Big Sandy costs that the Attorney General proposes be denied in this proceeding."[484] Responding on behalf of the Attorney General, and under oath, Mr. Smith provided a list with 18 entries.[485] At the hearing, it was revealed that the list was compiled not by Mr. Smith – the witness who purported to sponsor the list – but, instead by his counsel.[486] More troubling was the fact that Mr. Smith had not even read each of the cases he testified under oath were responsive to the Commission's inquiry.[487]

Whatever Mr. Smith's lack of knowledge, much less the fundamental lack of understanding of the decisions he demonstrated upon cross-examination, of his purported list of authority for his recommendation, none of the decisions support his recommendation. A number of the decisions offered in support of Mr. Smith's recommendation involved decisions to disallow recovery of costs associated with abandoned nuclear facilities that had never been

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[482] Mr. Smith indicated on cross-examination that he read at the order "at some point." Smith Hearing Testimony at 205.

[483] 2014 Rate Case Order at 69. *See also id.* at 67 ("Due to the planned retirement of Big Sandy Unit 2 by June 1, 2015 to comply with the Mercury and Air Toxics Standards ("MATS") Rule ….")

[484] KPSC Data Request 1-4(b) to the Attorney General.

[485] Attorney General's Response to KPSC Data Request 1-4(b.

[486] Smith Hearing Testimony at 220.

placed in service.[488] Others addressed the constitutionality of statutes.[489] At least three of the decisions involved decisions by regulatory agencies to defer for later recovery certain expenses (the antithesis of what Mr. Smith is advocating here) or to cap the costs associated with plants under construction.[490] One entry did not even involve a decision by "this Commission or another state public utility regulatory agency," but, instead was the decision by Kentucky Power's parent to write down the value of certain deregulated units in Ohio.[491] Another entry was stricken from the record because it held the opposite of what Mr. Smith represented it as holding.[492]

Here the Attorney General asks the Commission to disallow the costs related to the BSRR regulatory asset. Those costs, based upon the testimony of the Attorney General's own witness, Mr. Smith, involve a regulatory asset that:

- was established by Order of this Commission;[493]
- is being amortized over a 25-year period as authorized by this Commission;[494]
- is being recovered on a levelized basis as authorized by the Commission;[495] and
- is being recovered through a regulatory mechanism approved by this Commission.[496]

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[487] *Id.* at 221 ("I don't think I have read every single one, no.")

[488] *See e.g. In the Matter of the Application of Sunflower Electric Cooperative, Inc., for approval of the State Corporation to make certain changes in its charges for sale of electricity to its member cooperatives* [Entry 11]; *Wabash Valley Power Ass'n, Inc. v. Rural Electrification Admin.* [Entry 12]; *Citizens Action Coalition v. NIPSCO* [Entry 15].

[489] *Duquesne Light Co. v. Barasch* [Entry 13]; *Petition of Public Service Co. of New Hampshire* [Entry 14].

[490] Case No. 2013-00199 [Entry 1]; Cause No. 43114 IGCC 11-15 [Entry 17]; *In re Construction Monitoring Proceeding for Georgia Power Company's Plant Vogtle 3 and 4; Supplemental Information, Staff Review, and Opportunity for Settlement* [Entry 18].

[491] Smith Hearing Testimony at 227 [Entry 2].

[492] Hearing Statement by counsel for the Attorney General at 224-225 [Entry 10].

[493] Smith Hearing Testimony at 230-231.

[494] *Id*. at 231.

[495] *Id*.

[496] *Id*. at 231-232.

None of the decisions discussed above, or the remaining entries supplied by Mr. Smith, involve a regulatory asset, or recovery mechanism, that include any of these characteristics. Most telling is that unlike the decisions upon which Mr. Smith purports to premise his recommendation, the Big Sandy Retirement Rider regulatory asset involves the undepreciated investment in and costs related to two generating stations that provided service to Kentucky Power's customers for approximately 50 years.[497]

Also without merit is Mr. Smith's suggestion that the Commission should disallow some or all of the costs associated with the BSRR because Kentucky Power's parent, American Electric Power Company, Inc. ("AEP"), has the financial wherewithal, in Mr. Smith's opinion, to "weather" "the non-recovery of the remaining net book value of Big Sandy Unit 2 at the time that unit was retired."[498] The question is not whether a separate corporate entity that is more than 25 times larger than Kentucky Power (as measured by common equity)[499] and is not regulated by the Commission,[500] would be bankrupted by the Attorney General's proposal. Rather, the issue is whether consistent with the "takings clause" of the Fifth Amendment, as made applicable to the States by the Fourteenth Amendment to the Constitution of the United States,[501] and Kentucky law, including Sections 2[502] and 13[503] of the Kentucky Constitution, the Commission can deny Kentucky Power recovery of its one quarter of a billion dollars of investment in assets

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[497] *Id*. at 231-233.

[498] Smith Direct Testimony at 64-65.

[499] *Cf*. https://www.aep.com/investors/FinancialFilingsAndReports/Filings/docs/AEP10-Q-3rd-2017.pdf (showing AEP common shareholder equity of $18.106 billion as of September 30, 2017) and Kentucky Power Company's Response to KPSC 1-44, November 30, 2017 Supplemental Response, Attachment 1.pdf (showing Kentucky Power shareholder equity of 665.3 million).

[500] Wohnhas Rebuttal Testimony at R11.

[501] *Nollan v. California Coastal Commission*, 483 U.S. 825 (1987).

[502] *God's Ctr. Fdn. V. Lexington-Fayette Urban County Gov't*, 125 S.W.3d 295, 299 (Ky. App. 2002) (recognizing that taking private property may violate Section 2 prohibition against arbitrary action).

[503] *Bobby Preece Facility v. Commonwealth*, 71 S.W.3d 99, 103 (Ky. App. 2001) (recognizing that Section 13 of the Kentucky Constitution provides protections similar to the takings clause of the Fifth Amendment).

that were used to provide service to Kentucky Power's customers for approximately one-half of a century. It cannot; certainly the Attorney General failed to provide any authority supporting such a course of action notwithstanding the Commission's direction that he do so.

Nor is it appropriate for the Commission to require, as Mr. Smith appears to advocate, customers of Kentucky Power's sister companies in other states (through AEP) to bear the costs associated with write-down of the BSRR regulatory asset:

> I think people see AEP, again, 16, 17,000 employees, regulated and unregulated business, and they think, "Oh, they should just take care of us because their stock is doing well," potentially from unregulated business. But this Commission is charged with regulating just what happens to Kentucky Power in the state. And the benefit of that really is, something could happen in Oklahoma next year, and this Commission wouldn't want me suddenly me to put something on my bills to pay for a problem that happened in Oklahoma or somewhere else.[504]

At bottom, the Attorney General asks this Commission to rewrite the terms of the regulatory compact by denying Kentucky Power the opportunity to earn a return on and of its investments that were used to provide safe, adequate, and reliable service to Kentucky Power's customers:

> Kentucky Power is required to invest the capital necessary to provide reasonable and adequate to its customers. In return, it is entitled to the opportunity to receive the return on and of that capital. Based upon that understanding, Kentucky Power has invested hundreds of millions of dollars of capital in its service territory, which has been used to bring electric service to tens of thousands of customers. Mr. Smith's proposal would tear up that understanding, and toss to the side a mutually beneficial arrangement that has benefitted [the] Company and its customers since the beginning of the 20th century.[505]

Compounding the injury, both legal and to the regulatory compact, is that the Mitchell Transfer was made, and Kentucky Power's customers received the benefits of that transfer for the past four years, based upon the Commission's express authorization of the establishment, and Kentucky Power's recovery through the BSRR, of the BSRR regulatory asset the Attorney

[504] Satterwhite Hearing Testimony at 366.

[505] Wohnhas Rebuttal Testimony at R14-R15.

General now recklessly suggests be written off. Requiring Kentucky Power to absorb – assuming it could – a quarter of a billion dollar blow to its balance sheet would threaten Kentucky Power's ability to attract the capital necessary to provide the infrastructure necessary to support new and expanded business in the Company's service territory.[506] Such an arbitrary action would cross a line this Commission cannot and should not trammel.[507]

D. <u>Equally Lacking A Basis In Fact Or Law Is The Attorney General's Proposal To Penalize Kentucky Power For Not Seeking To Amend The Return On Equity Provisions Of The Rockport Unit Power Agreement</u>.

Characterizing the return on equity portion of Kentucky Power's payments under the Rockport Unit Power Agreement as excessive,[508] Mr. Smith, on behalf of the Attorney General, urges the Commission to impose three separate penalties on the Company: (a) the denial of Kentucky Power's rate case expenses; (b) the imposition of an "Affiliate Charge ROE-Reduction Rider" to flow back hypothetical cost reductions from a non-existent proceeding before the Federal Energy Regulatory Commission (FERC");[509] and (c) the imposition of an order barring Kentucky Power from filing an application to adjust its rates until the Company files a proceeding at FERC to adjust the return on equity provisions of the Rockport UPA.[510] Mr. Smith's recommendation is ill-conceived and reflects a fundamental misunderstanding of – or indifference to – the facts and law. It can and should be rejected.

It appears that Mr. Smith understands that the payments made by Kentucky Power under the Unit Power Agreement contain a return on equity component that reflects a nominal rate of

[506] *Id*. at R15.

[507] Satterwhite Rebuttal Testimony at 11 (explaining the risk posed by the Attorney General's proposal to write-off the BSRR regulatory asset).

[508] Smith Direct Testimony at 69.

[509] Mr. Smith also fails to note, much less explain why a different result should obtain here, that the Commission rejected his recommendation in Kentucky Power's last rate case that it establish an "Affiliate Charge ROE-Reduction Rider." 2014 Rate Case Order at 81.

[510] Smith Direct Testimony at 69.

12.16 percent.[511] What he does not comprehend, or otherwise chooses to ignore,[512] is that this nominal rate is limited by an operating ratio.[513] During the test year, the operating ratio (which reflects that amount of investment in service)[514] reduced the return on equity rate actually paid by Kentucky Power by approximately one-third to 8.18 percent.[515] This 8.18 percent rate is less than even the 8.60 percent return on equity rate that the Attorney General's own return on equity witness deemed appropriate for Kentucky Power.[516]

Further, the 8.18 percent return on equity component of Rockport expense is the test year level and hence provides the basis upon which the rates to be set upon in this case to recover the Rockport UPA expenses will be established. As such, Mr. Smith's arguments concerning the nominal 12.16 percent return on equity rate are inapplicable to this case.

Even if Mr. Smith were accurate in his misunderstanding that the return on equity component of the Rockport UPA payments during the test year were calculated at 12.16 percent, and he is not, he nevertheless erred in his characterization of that rate as excessive. To the contrary, the Commission explained in its order in the Company's last rate case – an order Mr. Smith testified he read[517] – that the 12.16 percent rate had been "found to legally constitute a fair, just, and reasonable rate."[518]

Mr. Smith's recommended penalties are also contrary to federal and state law. The Rockport UPA is a FERC-approved rate and as such, "the judicial doctrine of federal preemption

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[511] *Id.* at 67.

[512] Mr. Smith testified on cross-examination that he did not calculate the actual return on equity rate paid by Kentucky Power under the Rockport UPA. Smith Hearing Testimony at 290.

[513] Satterwhite Hearing Testimony at 448-449.

[514] *Id*. at 449.

[515] *Id*.; Kentucky Power Hearing Exhibit 8.

[516] Woolridge Direct Testimony at 4.

[517] Smith Hearing Testimony at 205.

[518] 2014 Rate Case Order at 81.

forecloses any inquiry here into the reasonableness of that rate or the costs recovered through that rate."[519] Mr. Smith seemingly recognizes this principle,[520] but through the artifice of triple penalties invites the Commission to accomplish indirectly what it is constitutionally prohibited from attempting directly. "[A] state agency's 'efforts to regulate commerce must fall when they conflict with or interfere with federal authority over the same activity.'"[521] Each of Mr. Smith's proposed penalties would violate Kentucky Power's right to recover the costs associated with the FERC-approved rate; in fact the "Affiliate Charge ROE-Reduction Rider" to flow back hypothetical cost reductions would be a direct violation of hornbook constitutional principles and this Commission's statutory authority and long-held precedent.

Mr. Smith's recommended penalties also run afoul of state law. KRS 278.180 and KRS 278.190 authorize regulated utilities to file applications for a general adjustment of their rates. That authorization is unconditional. An administrative agency "cannot amend, alter, or enlarge, or limit the terms of [a] legislative enactment,"[522] yet Mr. Smith's recommendation that the Commission "direct KPCo not to file another rate case until" the Company files a FERC proceeding to amend the Rockport UPA would do just that.[523] By the same token, "[t]he General Assembly has unequivocally allowed utilities to be fairly paid for their service,"[524] and the Commission may not in a rate proceeding refuse to establish rates that provide that fair payment as a means of penalizing the utility.[525]

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[519] Rockport Environmental Surcharge Order at 11.

[520] Smith Direct Testimony at 67.

[521] *Mississippi Power & L. Co. v. Mississippi*, 487 U.S. 354, 377 (1988).

[522] *Camera Center, Inc. v. Revenue Cabinet*, 34 S.W.3d 39, 41 (Ky. 2000).

[523] *See also* Satterwhite Settlement Testimony at S16.

[524] *South Cent. Bell Tel. Co. v. Utility Regulatory Com'n*, 637 S.W.2d 649, 652 (Ky. 1982).

[525] *Id*. at 652-653.

The Attorney General's failure to produce any legal authority supporting his recommendation that the Commission penalize Kentucky Power for not seeking to amend the Rockport UPA – despite being directed through discovery to do so[526] – only underscores the lawlessness of his recommendation. Not one of the 17 public utility regulatory agency or court decisions the Attorney General listed in response to KPSC 1-4(b) involved an agency decision disallowing the recovery through retail rates of costs incurred through a FERC-approved rate.[527] The Attorney General's silence speaks volumes.

E. <u>**KIUC's Proposal To Defer $20.3 Million In Rockport Unit 2 Expenses Annually For A Five Year Period – Although A Constructive Concept – Would Jeopardize Kentucky Power's Stable Investment Grade Credit Rating**</u>**.**

KIUC recommended deferring $20.3 million a year of Rockport Unit 2 expenses Kentucky Power currently pays through the Rockport Unit Power Agreement ("Rockport UPA").[528] Under KIUC's proposal, the deferral would continue through December 2022[529] when the Rockport Unit Power Agreement terminates coincident with the expiration of the Rockport Unit 2 lease and the Rockport UPA.[530] Upon the expiration of the Rockport UPA and the Rockport Unit 2 lease in December 2022, the approximate $101.5 million deferral balance[531] would be amortized on a levelized basis over ten years.[532] KIUC argues that the deferral is appropriate because of what it characterizes as "the severely depressed state of the Eastern Kentucky economy."[533]

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[526] KPSC Data Request 1-4(b) to the Attorney General.

[527] Attorney General's Response to KPSC Data Request 1-4(b).

[528] Kollen Direct Testimony at 11, 15.

[529] *Id*. at 11.

[530] *Id*. at 8.

[531] $20.3 million/year x five years = $101.5 million.

[532] Kollen Direct Testimony at 15.

[533] *Id*. at 11.

Under KIUC's proposal, the amortization payments beginning in December 2022 would be "funded" through the annual $38.9 million dollar reduction in Rockport Unit 2-related expenses following the expiration of the Rockport UPA on December 7, 2022.[534] Significantly, KIUC's proposal recognizes the importance to all parties of Kentucky Power's recovery of its Rockport expenses in full[535] and the Company's receipt of a carrying charge on the deferral balance at Kentucky Power's weighted average cost of capital ("WACC").[536] The WACC-based carrying charge is critical because Kentucky Power would be required to finance the deferral through a combination of debt and equity.[537] Although a constructive concept that was incorporated in the Settlement Agreement in a materially modified fashion,[538] the deferral as proposed by KIUC would unreasonably burden Kentucky Power's ability to maintain a stable investment grade credit rating by decreasing its cash flows.[539]

Specifically, KIUC's proposal required the deferral of too large of an amount and provided for its recovery over too long of a period – 15 years from the beginning of the deferral period until the conclusion of the amortization period.[540] The Company will continue to incur on a monthly basis, and be required to pay contemporaneously, the Rockport UPA expense during the five-year period prior to the start of the amortization period. Thus, while the Company's Rockport UPA expense will not decrease during the deferral period, its cash flow would be

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[534] *Id*. at 9, 11.

[535] *Id*. at 12.

[536] *Id*. at 15. Mr. Kollen also testified that any attempt to finance the reduced deferral balance provided for by the Settlement Agreement (approximately 50 percent of the amount provided for by the KIUC proposal) using only debt would risk a credit downgrade. Kollen Hearing Testimony at 565-566.

[537] KIUC Response to KPSC 1-1(b) ("The Company is unlikely to finance a deferral of this magnitude solely through debt given its present capital structure"). KIUC Witness Kollen testified upon cross-examination at the hearing that Kentucky Power would be unlikely to finance the reduced deferral amounts provided for by the Settlement Agreement solely using debt. Kollen Hearing Testimony at 565.

[538] Satterwhite Hearing Testimony at 86.

[539] Wohnhas Rebuttal Testimony at R9-R10

[540] Wohnhas Hearing Testimony at 968-969; Wohnhas Rebuttal Testimony at R10.

reduced by $20.3 million annually.[541] This decreased cash flow could lead to a deterioration of Kentucky Power's credit metrics and a consequent downgrade of its credit rating.[542] This, in turn, would lead to increased financing costs that ultimately would be borne by the Company's customers.[543] Indeed, even with a 50 percent reduction in both the amount deferred (from $101.5 million to $50 million)[544] and the period over which it is recovered once amortization starts (from ten years to five years), agreed to in the Settlement Agreement, the deferral works financially only if Kentucky Power is able to strengthen its cash flow by contemporaneously recovering 80 percent of any incremental increase in the Company's PJM LSE OATT costs:

> Q. Okay. Do you have those same concerns about the settlement deferral?
>
> A. No, because, you know, again, ***you look at it in total package***, all right, ***the Company is able to recover 80 percent of the OATT cost***, so that's a very -- that's a positive when we talk about this whole package. So it definitely reduces the risk, so I do not have the same concerns.[545]

F. <u>KIUC's Proposal To Employ A Hypothetical Capital Structure Reflecting Two Percent Short Term Debt Is Inconsistent With Past Practice And Lacks Support In The Record</u>.

KIUC also proposed that Kentucky Power's rates be established using a capital structure reflecting a hypothetical two percent level of short term debt.[546] KIUC offered this recommendation notwithstanding the fact that its proposed hypothetical level of short term debt proposed by KIUC is more than *3,300 percent greater* than Kentucky Power's actual short term debt capitalization at the end of the test year.[547]

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541 Kollen Direct Testimony at 11, 12.

542 Wohnhas Rebuttal Testimony at R9-R10.

543 *Id*. at R10.

544 With carrying charges the deferral balance will total approximately $59 million at the time amortization begins. Satterwhite Settlement Testimony at S11.

545 Wohnhas Hearing Testimony at 969 (emphasis supplied).

546 Kollen Direct Testimony at 45.

547 *Id*. at 44. KIUC Proposed level of short term debt capitalization (2.0 percent) ÷ Actual short term debt level of capitalization (0.06 percent) = 3,333 percent.

Because the Company typically uses short term debt to finance its coal pile, Kentucky Power first allocated the $6.8 million reduction in capitalization as a result of the net over-target coal pile levels at the Mitchell generating station to eliminate the test year end short term debt balance of $1,022,872 and thereby produce an adjusted level of short term debt of $0.00.[548] Kentucky Power's proposed adjusted capital structure reflecting zero short term debt reflects its practice in prior cases[549] and is consistent with the position KIUC advocated in the Company's last rate case.[550] Mr. Kollen and KIUC offer no reason to depart from either.

Equally problematic is that KIUC's recommendation to include a hypothetical two percent level of short term debt in Kentucky Power's capitalization lacks an evidentiary basis. The only test year evidentiary basis offered by Mr. Kollen for using a two percent level of short term debt is that the Company relied on short term debt during the test year.[551] But the Company's need for short term debt changes daily. In fact, the Company was in an invested position for almost 90 days during the test year.[552] More fundamentally, KIUC was unable to offer any test year evidentiary support for its recommended two percent hypothetical level. On

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548 Wohnhas Direct Testimony at 10-11. Mr. Kollen also objects to Kentucky Power's $1,249,691 adjustment to *increase* Mitchell low-sulfur coal stocks to target levels. Kollen Direct Testimony at 43. Mr. Kollen errs. The increase was netted against the $8,054,063 *reduction* of Mitchell high-sulfur coal stocks to yield the $6,804,372 reduction in capitalization. Wohnhas Direct Testimony at 11. Both adjustments – up and down – reflect the appropriateness of using inventory target levels for the purpose of establishing capitalization and should be applied even handedly and without regard to the result. Wohnhas Rebuttal Testimony at R3-R4. More fundamentally, Kentucky Power's share of the Mitchell coal pile inventory target level is 172,823 tons (115,215 tons of low sulfur coal plus 57,608 tons of high sulfur coal). This total tonnage of coal, albeit distributed between two types of coal, is required to "ensure adequate coal is available to meet the Company's generation needs." *Id*. at 3. If Mitchell burned only high sulfur coal the reduction in capitalization as a result of the adjustment to target inventory levels would have been less because its target level would have been greater. KIUC seeks to take advantage of the full amount of the reduction in the high-sulfur inventory but refuses to give recognition to the fact that the reduction would have been less but for the two different coal piles. Kentucky Power appropriately netted the two adjustments.

549 Wohnhas Rebuttal Testimony at R3.

550 *See* Kollen Direct Testimony at 43-46; *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 Approving Its Tariffs And Riders; And (4) An Order Granting All Other Required Approvals And Relief*, Case No. 2014-00396 (Ky. P.S.C. March 23, 2015) (using test year-end level of short term debt but not adjusting it below zero. The balance of adjustments was ratably allocated between long term debt and equity).

551 Kollen Direct Testimony at 45.

552 Kentucky Power's Response to KIUC 1-50, Attachment 1.

discovery, the only test year basis – which in fact refuted its recommended two percent level of short term debt – was that some monthly test year balances "were as much as" 1.1 percent.[553] Nowhere does KIUC explain how a maximum month end test year level of short term debt[554] of slightly more than 50 percent of its recommended hypothetical level supports departing from test year values in general, or, specifically, abandoning Commission practice of using the test year end adjusted level.

KIUC's proposal to use a hypothetical two percent level of short term debt in Kentucky Power's capitalization should be rejected.

G. **<u>The Aviation Expenses Allocated And Assigned To Kentucky Power Are Necessary Costs And Are Reasonable In Amount</u>.**

Despite its importance to the efficient and economical conduct of business[555] and the use by business and government alike of private aviation,[556] the Attorney General recommends the Commission disallow in its entirety the corporate aviation expenses assigned and allocated to Kentucky Power.[557] In both his direct testimony and in response to discovery on behalf of the Attorney General, Mr. Smith argued that the expense should be disallowed because it was paid to

[553] KIUC Response to KPCo 1-16.

[554] The use of a maximum level also ignores that other month-end levels were lower and that the Company was in an invested short term position for approximately one-quarter of the test year. *See* Wohnhas Rebuttal Testimony at R5-R6.

[555] Satterwhite Hearing Testimony at 426-428; Kentucky Power's Response to KPSC PH-10, Attachment 1 at 1 (recognizing that corporate aviation is a tool "that allows AEP employees, board members and their third party advisors to conduct business in a safe, effective, and efficient manner.")

[556] Kentucky Power's Response to KPSC PH-10.

[557] Smith Direct Testimony at 43; Smith Hearing Testimony at 258. Expenses are assigned to Kentucky Power when the Company directly benefits from the flight or Company personnel are aboard. Even then, the Company may be assigned only a small proportion of the cost. Thus, Kentucky Power was assigned five percent of the cost from Columbus, Ohio to Washington D.C. when Mr. Satterwhite traveled using corporate aviation to meet at the White House with executives in President Trump's administration. Satterwhite Hearing Testimony at 427-428. Allocated corporate aviation expenses, like other service corporation expenses, are those expenses not directly assigned to another operating company or business unit and that benefit the companies generally.

an affiliate and because the Company had not demonstrated the expenses were cost-effective.[558] The Attorney General twice errs.

First, the fact that expenses are paid to an affiliate does not render them *per se* improper as Mr. Smith seems to believe. To the contrary, the lease by the Service Corporation of the three aircraft provides Kentucky Power the benefit of the aircraft without bearing the full cost as it would have to do on a stand-alone basis.[559]

Mr. Smith's objection to the cost-effectiveness of the use of private aviation also runs directly contrary to the Commonwealth's understanding in promoting the use of state aircraft by elected officials and other state employees:

WHAT ARE THE ADVANTAGES OF USING STATE AIRCRAFT?

- Conduct business while traveling. Maximize time management
- Privacy
- Security
- Interruptions and distractions eliminated
- Flexible departure and arrival schedule
- No wasted time waiting in line for a commercial flight
- Less travel time, therefore, savings of expenses for lodging and meals
- Post trip fatigue eliminated
- Safest form of transportation available[560]

Mr. Smith's speculative concerns that the leased aircraft are being misused[561] are equally unfounded. The use of the aircraft is governed by a six-page written policy that limits aircraft

[558] Smith Direct Testimony at 43; Attorney General's Response to KPSC Data Request 1-7(b).

[559] Satterwhite Direct Testimony at 427-428.

[560] Kentucky Power Company's Response to KPSC PH-10 (citing https://transportation.ky.gov/Aviation/Pages/Aircraft-Fleet-Services.aspx).

[561] Smith Hearing Testimony at 260.

use to business purposes except when approved on a case-by-case basis at the highest levels of AEP.[562] Business travel in turn is narrowly defined as "a trip where the primary purpose is integrally and directly related to the performance of the executive's, board member's or third party advisor's duties to AEP."[563] Tellingly, Mr. Smith failed to identify a single instance of misuse of corporate aircraft by Kentucky Power or AEPSC despite being provided in discovery complete information about each flight, the passengers on the flights, their departure and arrival points, and their purposes.[564] Instead, he only pointed to claimed abuses in the use of military and other non-commercial aircraft by governmental personnel.[565]

Finally, presumably because the information was not available at the time he filed his direct testimony, Mr. Smith mistakenly overstates the amount of test year aviation expense recorded by Kentucky Power as an O&M expense. As the Company clarified in response to KSPC PHDR-13, the amount was $280,906 because the balance of $107,944 was assigned to Wheeling Power Company under the Mitchell Operating Agreement.[566]

H. **Kentucky Power's Test Year Relocation Expenses Are Representative Of Future Levels And Should Not Be Adjusted.**

Abandoning any pretense of consistency in his recommended adjustments, Mr. Smith urges the Commission to reduce the Company's test year relocation expense by $140,972 to reflect his calculation of the Company's three-year average relocation expense.[567] Mr. Smith makes this adjustment despite his challenge to the Company's proposal to use a three-year

[562] Kentucky Power's Response to KPSC PH-10, Attachment 1.

[563] *Id*.

[564] Kentucky Power's Response to KPSC 2-55, Attachment 1.

[565] Smith Hearing Testimony at 260-261.

[566] Kentucky Power's Response to KPSC PH-13.

[567] Smith Hearing Testimony at 46.

average to normalize its much larger and much more unpredictable and volatile storm expense.[568] Mr. Smith's feckless adherence to principle should be rejected.

Implicit in the historic test year concept is that the test year serves as a snapshot of the Company's operations.[569] The individual expenses comprising the test year will increase or decrease, but in the case of smaller and less volatile expenses, those changes will either tend to cancel each other out[570] or can be managed by the utility.[571] Thus, normalization of test year expenses is appropriate where the expenses are large and volatile.[572] To pick a single expense, or a handful of smaller expenses, and to normalize the expenses using historical averages, undermines the utility of the test year concept by ignoring the fact that the test year amounts of other expenses that are not being normalized may have been lower than their historical average.[573] To do so, as Mr. Smith proposes, only where it reduces the Company's revenue requirement compounds the error and is unsupported by Commission precedent and insupportable.

Mr. Smith premises his proposed normalization on the fact that Kentucky Power relocated its corporate headquarters from Frankfort to Ashland during the test year.[574] This effort involved the movement of two employees.[575] Far from being an anomaly, the test year level of relocation expenses is likely to be more representative than historic data of future levels of relocation expense as the Company builds on its successes:

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[568] Smith Direct Testimony at 44.

[569] *Id.*

[570] *Id.*

[571] Satterwhite Hearing Testimony at 396-397.

[572] Kentucky Power's Response to KPSC PH-14.

[573] Kentucky Power's Response to KPSC PH-14.

[574] Smith Hearing Testimony at 45.

[575] Kentucky Power's Response to KPSC PH-14.

> Kentucky Power is actively recruiting top talent to help lead its regulatory and business operations in the Commonwealth. As the Company continues to succeed in locating new industry more opportunity arises for current employees to be recruited away to other states and for Kentucky Power to recruit new talent with fresh ideas to Kentucky. The Company intends to be active in recruiting talented staff to lead Eastern Kentucky; meaning that although there is not a single identified budget for relocation there is a high likelihood that the Company will continue to relocate employees and executives to the region. As such, past years['] data may not be representative.[576]

The Commission should reject Mr. Smith's proposed normalization of Kentucky Power's test year level of relocation expense.

I. <u>Kentucky Power's Treatment Of Its Post-Year Increase In Employee Complement Should Be Approved</u>.

Because the test year is a snapshot of the Company's operations, the Commission's regulations recognize the appropriateness of adjusting test year amounts for *future*[577] known and measurable changes.[578] Kentucky Power proposed, in accordance with the Commission's regulation, to increase its test year employee expense by $172,594[579] to reflect the Company's plans to hire five additional employees.[580] All five employees were hired prior to the hearing in the case.[581]

Both the Attorney General and KIUC challenge some aspect of the proposed adjustment. Mr. Kollen argues on behalf of KIUC that the Commission should reject the adjustment in total

[576] Satterwhite Hearing Testimony at 189; *see also id.* at 180-181 (discussing need to hire additional line mechanics in the Company's Hazard division).

[577] The selective use of a *historical* average to "normalize" test year amounts as Mr. Smith proposes to do with the Company's test year relocation expense is different in concept from a known and measurable post-test year change. *See* Kentucky Power's Response to KPSC PH-14.

[578] 807 KAR 5:001, Section 16(5).

[579] Section V, Exhibit 2, Adjustment W52.

[580] Wohnhas Direct Testimony at 19-22; Satterwhite Direct Testimony at 19-20.

[581] Wohnhas Rebuttal Testimony at R.22.

because Kentucky Power is seeking, but has yet to receive, Commission approval to hire the five employees.[582] Mr. Kollen errs.

It is unclear why Mr. Kollen believes the Company was seeking Commission authorization to retain the five employees. No such authorization is sought in the application and neither Mr. Satterwhite nor Mr. Wohnhas indicated in their testimony or data request responses that such approval was being sought or required. Nor would it be appropriate for the Company to involve the Commission in such management decisions. The Commission regulates Kentucky Power's rates and service;[583] it does not directly manage the Company as Mr. Kollen seems to understand.

Mr. Kollen also errs in his contention that Kentucky Power failed to justify the need for the employees.[584] Both Messrs. Satterwhite and Wohnhas addressed the previously unmet need for the additional employees in their testimony as well as the benefits they were expected to provide.[585] In addition, Company Witness Satterwhite underscored the need for these and other employees in his hearing testimony.[586] Kentucky Power met its burden of going forward with the evidence and proof. Mr. Kollen and KIUC must do more than just raise debating points.

Mr. Smith takes a different tack on behalf of the Attorney General. He does not attack the proposed adjustment. Rather, he offers his own adjustment. He proposes to increase the Company's income to reflect a 50 percent increase in theft recoveries as a result of the addition of 1.5 full time employees devoted to revenue protection.

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[582] Kollen Direct Testimony at 24-25.

[583] KRS 278.040(2).

[584] Kollen Direct Testimony at 25.

[585] Wohnhas Direct Testimony at 19-22; Satterwhite Direct Testimony at 19-20.

[586] Satterwhite Hearing Testimony at 180-182.

Mr. Smith bases his adjustment on Company Witness Wohnhas' testimony that the addition of the employees could "increase its energy theft recoveries by up to 50 percent."[587] The estimate was just that. It was not a guarantee of the level of recoveries that might be achieved.[588] Most importantly, there was no timeline over which the increase was expected to be achieved. As such, and unlike the increase in the employee complement, all of whom have been hired, it is not a known and measurable change.

The employee-complement related adjustments proposed by KIUC and the Attorney General should be rejected.

J. <u>The Attorney General's Arguments Against The K-PEGG Program Are Unfounded</u>.

In his testimony, Attorney General Witness Dismukes assails the K-PEGG Program as flawed for "shifting performance risk" onto Kentucky Power's customers.[589] The Attorney General misconstrues the nature of the K-PEGG program, and his argument in opposition of successful economic development programs in the Company's service territory must be rejected. The Attorney General argues that somehow because the Company does not require grant recipients to commit to certain employment, load, or other metrics, it is flawed.[590] This argument represents a fundamental misunderstanding of the K-PEGG program and its purpose.

As described above, the K-PEGG program is designed to fill the economic development infrastructure gaps in the region through grants issued to improve the skill of economic development professionals and the marketability of sites available for development.[591] K-PEGG grants are fundamentally different than incentives handed out by the Kentucky Cabinet for

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[587] Wohnhas Direct Testimony at 22.

[588] Wohnhas Rebuttal Testimony at R.23.

[589] Dismukes Direct Testimony at 45-51.

[590] *Id*. at 48.

Economic Development or even the rate discounts available under the Company's economic development rider. Kentucky Power issues K-PEGG programs not to incent specific development by specific target companies, but rather to upgrade the ability of the communities in its service territory to compete for economic development opportunities.[592] The purpose of the K-PEGG program makes the criteria proffered for use by Dr. Dismukes impossible.[593]

The K-PEGG program has been a success but can be even better with more resources. The Company's proposed expansion of the program provides such additional resources with, if the Settlement Agreement is approved, a reduction in the contribution to the program by residential customers. The proof of the success of Kentucky Power's economic development efforts can be found in the new jobs it has brought to eastern Kentucky. The Attorney General's attempt to discredit a low-cost, successful economic development program in eastern Kentucky is without merit and should be rejected.

VI. IMPACT OF THE TAX CUTS AND JOBS ACT OF 2017

On December 22, 2017, President Trump signed the Tax Cut and Jobs Act ("TCJA") of 2017 into law. Among the provisions of the TCJA is a reduction from 35 percent to 21 percent in the federal corporate tax rate that Kentucky Power pays. Kentucky Power is evaluating the overall impact of the TCJA on the Company's cost of service and how the reduction in federal corporate tax rate will impact rate payers.[594]

Although a determination of the effect of the TCJA on the Company's overall revenue requirement will not be possible for some time, and is currently being evaluated in Case No.

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[591] Hall Rebuttal Testimony at R5.

[592] *Id.*

[593] *Id.*

[594] The Company will establish a regulatory liability to track the tax savings resulting from the TCJA as required by the Commission's December 27, 2017 Order in Case No. 2017-00477.

2017-00477, the Company took the initiative on January 3, 2018 to file draft forms for use in calculations under Tariff P.P.A. and Tariff ES that incorporate the 21 percent federal corporate tax rate into the gross revenue conversion factor ("GRCF") calculation, thus potentially accelerating the impact of the federal tax savings on these rates.

The change in the federal corporate tax rate also is expected to reduce the Settlement Agreement GRCF from 1.6433 to a revised GRCF of 1.3521. Likewise, the pre-tax WACC has been reduced from 9.11 percent as included in the Settlement Agreement to 7.9227 percent. This pre-tax WACC will be used in subsequent Company rider calculations, including those made under the Decommissioning Rider, the Purchase Power Adjustment, and the Environmental Surcharge.

The revised forms filed with the Commission do not yet reflect any applicable changes in connection with the accumulated deferred income tax ("ADIT") calculations, as the Company is still evaluating those impacts. However, the Company intends to incorporate in subsequent calculations of the Company's riders changes in the ADIT calculation caused by the TCJA, if any and to the extent appropriate, once these changes and their effect are evaluated and determined.

VII. CONCLUSION

Kentucky Power respectfully requests that the Commission give the Company the tools to serve its customers and "grow the denominator" through economic development by approving, without modification, the Settlement Agreement in this case.

Respectfully submitted,

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COUNSEL FOR KENTUCKY POWER COMPANY

APPENDIX

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1

To the Public Service Commission:

I would Like to protest Ky. Power's Add on Charges. They are getting outrageous. Some people are getting outrageous electric bills.

One charge that I do Not Like is the Big Sandy Retirement Rider. Many people are paying this out of their own retirement Checks.

We are Paying for 10 things and these Charges add up.

Please help us.

RECEIVED

DEC 27 2017

PUBLIC SERVICE
COMMISSION

Fuel Adj @ 0.0029429 Per KWH
DSM Adj @ 0.0080130 Per KWH
Residential HEAP @ $0.15
Kentucky Economic Development Surcharge
Capacity Charge @ 0.0014350 Per KWH
Big Sandy 1 Operation Rider @ 0.0034100 Per KWH
Purchased Power Adj 0.0928000%
Big Sandy Retirement Rider 3.7089000%
Environmental Adj 7.3671000%
School Tax

2

happening. And it's no guarantee, because we're still absorbing 20 percent of those incremental costs in the settlement deal.

Q. Isn't it true that despite the fact that Kentucky Power is losing customers and is experiencing declining usage, nonetheless revenues continue to grow?

A. I missed Mr. Wohnhas' discussion of this, so I assume you're referring to the ten-year period in question where revenues were going up; however, the load has been shrinking?

Q. Yes. As a matter of fact, there is an exhibit to the testimony of Dr. Dismukes, Exhibit 9 --

A. Yeah.

Q. -- that -- it's based on the Company's FERC Form 1. That's where the data comes from.

A. That's fair. And there are some caveats. There's some color around that. There's many things happening. Over that same time period all the coal plants that are still being operated in the AEP system, they were scrubbed during that time period, so during -- that's a lot of capital investment.

And in 2006 through 2014 Kentucky Power was still a member of the AEP's pool. So as those plants were scrubbed and those capital investments were made, Kentucky Power's costs were going up, because they're allocated their portion of the AEP system. So you had that going on.

You also have during that time period the decline in off-system sales margins, because after a peak in 2008, you had lower -- you had the economic recession, which really hurt -- hurt off-system sales. Prices went down. Gas prices began to come down it with fracking. You also had the retire -- the generation retirements, where the AEP's pool became a lot shorter.

And those off-system sales revenues that used to get allocated, those hundreds of million of dollars that used to get allocated to Kentucky Power through the old East pool, those were rate credits. Those were shared back with customers through the system sales clause. So as those off-system sales margins were reduced, our retail revenues grew, because we had less of a cost offset.

So, yeah, I agree with you that revenues have gone up and sales have gone down, but it's -- there's a lot of color within those, a lot of -- there's a lot of nuance to it. It's not just -- it's not just a picture that Kentucky Power 's revenues keep going up and sales keep going down and -- there's a lot to it.

Q. All right, sir. Of the amounts Kentucky Power pays each year in OATT charges, how much are to affiliates and how much are to nonaffiliates?

A. Huh. I don't have that number on me.

Q. If I -- I'd like to request that in a post-hearing data request.

A. We could. We could certainly -- certainly provide that.

Q. Thank you. Of the amounts Kentucky Power pays each year in OATT charges to affiliates --

A. Yeah.

Q. -- how much was paid for projects designated as baseline upgrades, network upgrades, or supplemental projects as defined by PJM?

A. So I'm not sure we track it at that level. However, a couple -- a couple of distinctions there. Network upgrades are like when a generator wants to connect within the system, and network upgrades are paid for by whomever is requesting that.

So if there's an IPP entering the AEP system and they require a $10 million transmission investment to be connected to our system to deliver power to PJM, they're paying that, not our customers. You know, or vice versa. A new wind

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STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Ameren Illinois Company d/b/a	:	
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Rate MAP-P Modernization Action	:	
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ORDER

December 6, 2017

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PROPOSED ORDER

By the Commission:

I. PROCEDURAL HISTORY

Section 16-108.5 of the Public Utilities Act (the "Act") provides that an electric utility or combination utility (providing electric service to more than one million customers in Illinois and gas service to at least 500,000 customers in Illinois) may elect to become a "participating utility" and voluntarily undertake an infrastructure investment program as described in the Section. 220 ILCS 5/16-108.5(b). A participating utility is allowed to recover its expenditures made under the infrastructure investment program through the ratemaking process, including, but not limited to, the performance-based formula rate and process set forth in Section 16-108.5. 220 ILCS 5/16-108.5(b). Section 16-108.5(d) of the Act requires a participating utility to file, on or before May 1 of each year, with the Chief Clerk of the Illinois Commerce Commission ("Commission"), its updated cost inputs to the performance-based formula rate for the applicable rate year and the corresponding new charges, based on final historical data reflected in the utility's most recently filed annual Federal Energy Regulatory Commission ("FERC") Form 1, plus projected plant additions and correspondingly updated depreciation reserve and expense for the calendar year in which the inputs are filed. 220 ILCS 5/16-108.5(d).

On January 3, 2012, the Ameren Illinois Company d/b/a Ameren Illinois ("AIC" or "Ameren") filed with the Commission its performance-based formula rate tariff, Rate MAP-P Modernization Action Plan—Pricing Tariff ("Rate MAP-P"). That docket established the terms of the formula.

On April 13, 2017, Ameren filed its annual update of cost inputs pursuant to Section 16-108.5(d) of the Act. This docket is Ameren's seventh filing under the Electric Infrastructure Modernization Act ("EIMA"). In this docket, the Commission will establish a new revenue requirement to take effect on January 1, 2018 based on the historical FERC Form 1 reports for 2016 and projected plant additions for 2017 and reconcile the revenue requirement for 2016 with actual costs for 2016. The reconciliation balance will be added to the new revenue requirement and collected in rates effective on January 1, 2018.

Petitions to Intervene in this proceeding were filed by the Citizens Utility Board ("CUB"), as well as by Caterpillar Inc., Cargill, Inc., Viscofan USA, Inc., Tate & Lyle Ingredients Americas, Inc., Marathon Petroleum Company, CCPS Transportation, LLC, Keystone Consolidated Industries, Inc., Illinois Cement Company and Archer-Daniels-Midland Company, collectively as the Illinois Industrial Energy Consumers ("IIEC"). A notice of appearance was filed by the Illinois Attorney General's Office on the behalf of the People of the State of Illinois ("AG"). Staff of the Commission ("Staff") also participated in this proceeding.

An evidentiary hearing was held in this proceeding at the offices of the Commission at 527 E. Capitol, Springfield, Illinois. At the conclusion of the hearing, the Record was marked "Heard and Taken". Initial Briefs were filed by AIC, Staff, and IIEC-CUB. Reply Briefs were filed by AIC and IIEC-CUB. A Proposed Order was served on the parties. Briefs on Exceptions were filed by IIEC-CUB and Staff. The schedule adopted in this proceeding did not provide the parties with the opportunity to file Reply Briefs to Exceptions.

II. LEGAL STANDARD

The provisions of EIMA, specifically, Section 16-108.5(d), provides in relevant part:

> Subsequent to the Commission's issuance of an order approving the utility's performance-based formula rate structure and protocols, and initial rates under subsection (c) of this Section, the utility shall file, on or before May 1 of each year, with the Chief Clerk of the Commission its updated cost inputs to the performance-based formula rate for the applicable rate year and the corresponding new charges.

220 ILCS 5/16-108.5(d).

Section 16-108.5(d) further specifies the requirements for this annual filing as follows:

> Within 45 days after the utility files its annual update of cost inputs to the performance-based formula rate, the Commission shall have the authority, either upon complaint or its own initiative, but with reasonable notice, to enter upon a hearing concerning the prudence and reasonableness of the costs incurred by the utility to be recovered during the applicable rate year that are reflected in the inputs to the performance-based formula rate derived from the utility's FERC Form 1. During the course of the hearing, each objection shall be stated with particularity and evidence provided in support thereof, after which the utility shall have the opportunity to rebut the evidence. Discovery shall be allowed consistent with the Commission's Rules of Practice, which Rules shall be enforced by the Commission or the

> assigned hearing examiner. The Commission shall apply the same evidentiary standards, including, but not limited to, those concerning the prudence and reasonableness of the costs incurred by the utility, in the hearing as it would apply in a hearing to review a filing for a general increase in rates under Article IX of this Act.
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> . . .
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> In a proceeding under this subsection (d), the Commission shall enter its order no later than the earlier of 240 days after the utility's filing of its annual update of cost inputs to the performance-based formula rate or December 31.
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> . . .
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> A participating utility's first filing of the updated cost inputs, and any Commission investigation of such inputs pursuant to this subsection (d) shall proceed notwithstanding the fact that the Commission's investigation under subsection (c) of this Section is still pending and notwithstanding any other law, order, rule, or Commission practice to the contrary.

Id. Section 16-108.5(d) further specifies the requirements for the reconciliation filing as follows:

> The filing shall also include a reconciliation of the revenue requirement that was in effect for the prior rate year (as set by the cost inputs for the prior rate year) with the actual revenue requirement for the prior rate year (determined using a year-end rate base) that uses amounts reflected in the applicable FERC Form 1 that reports the actual costs for the prior rate year. Any over-collection or under-collection indicated by such reconciliation shall be reflected as a credit against, or recovered as an additional charge to, respectively, with interest calculated at a rate equal to the utility's weighted average cost of capital approved by the Commission for the prior rate year, the charges for the applicable rate year. Provided, however, that the first such reconciliation shall be for the calendar year in which the utility files its performance-based formula rate tariff pursuant to subsection (c) of this Section and shall reconcile (i) the revenue requirement or requirements established by the rate order or orders in effect from time to time during such calendar year (weighted, as applicable) with (ii) the revenue requirement determined using a year-end rate base for that calendar year calculated pursuant to the performance-based formula rate using (A) actual costs for that year as reflected in the applicable FERC Form 1, and (B) for the first such reconciliation only, the cost of equity, which shall be calculated as the sum of 590 basis points plus the average for the applicable calendar year of the

> monthly average yields of 30-year U.S. Treasury bonds published by the Board of Governors of the Federal Reserve System in its weekly H.15 Statistical Release or successor publication. The first such reconciliation is not intended to provide for the recovery of costs previously excluded from rates based on a prior Commission order finding of imprudence or unreasonableness. Each reconciliation shall be certified by the participating utility in the same manner that FERC Form 1 is certified. The filing shall also include the charge or credit, if any, resulting from the calculation required by paragraph (6) of subsection (c) of this Section.
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> Notwithstanding anything that may be to the contrary, the intent of the reconciliation is to ultimately reconcile the revenue requirement reflected in rates for each calendar year, beginning with the calendar year in which the utility files its performance-based formula rate tariff pursuant to subsection (c) of this Section, with what the revenue requirement determined using a year-end rate base for the applicable calendar year would have been had the actual cost information for the applicable calendar year been available at the filing date.

Id.

III. AIC'S PROPOSED REVENUE REQUIREMENT

AIC proposes a net revenue requirement (after consideration of the filing year and reconciliation year revenue requirements, with interest and the return on equity collar) of $998,448,000. Overall, AIC's proposed update to its formula rate delivery service revenue requirement results in a decrease of $17,339,000 from the electric revenue requirement ordered by the Commission in Docket No. 16-0262. AIC's calculations use a rate of return of 7.040% for the filing year and 7.040% for the reconciliation year.

Staff agrees that AIC's proposed revenue requirement, and the costs reflected in that revenue requirement, as adjusted by Staff and agreed to by AIC, are prudent and reasonable and should be approved by the Commission.

IV. RATE BASE

A. Uncontested or Resolved Issues

1. Cash Working Capital

Staff and AIC agree on the methodology to calculate Cash Working Capital ("CWC") for the final revenue requirements ordered by the Commission in the instant case, and for all leads and lags. AIC agreed to Staff's proposed adjustment to cash working capital to reflect Staff's proposed level of operating expense.

The Commission finds that the parties are in agreement on this issue, and therefore adopts the parties' agreed amount of CWC.

2. Projected Plant Additions

In supplemental testimony, AIC identified a project in its 2017 plant additions that would not be in service by the end of 2017 as originally intended. The deferred project will be replaced by other electric distribution projects of similar cost, which will be in service by the end of 2017. Thus, the amount of projected plant additions remains the same as originally filed. However, the replacement projects have different depreciable lives than the original project, which results in derivative impacts to depreciation expense, accumulated depreciation, and accumulated deferred income tax ("ADIT"). Staff and AIC, therefore, agreed to a corresponding adjustment to projected plant additions based on AIC's supplemental testimony.

The Commission finds that the proposed adjustment to AIC's 2017 projected plant additions is uncontested, and therefore adopts the adjusted level of projected plant additions for use in this proceeding.

3. Accumulated Deferred Income Tax (ADIT)

Staff and AIC agreed to an adjustment to ADIT based on an inadvertent omission of ADIT associated with a July 2016 storm cost deferral.

The Commission finds that the proposed adjustment to ADIT is uncontested, and therefore adopts the adjusted level of ADIT for use in this proceeding.

B. Original Cost Determination

Staff and AIC agree that the Commission's Order should state the following with respect to the Original Cost Determination:

> (x) the Commission, based on Ameren's proposed original cost of plant in service as of December 31, 2016, before adjustments, of $6,582,534,000 and reflecting the Commission's determination adjusting that figure, approves $6,582,534,000 as the composite original cost of jurisdictional distribution services plant in service as of December 31, 2016.

The Commission finds that this issue is uncontested, and that it would be reasonable to use the parties' agreed original cost determination in this Order.

C. Incremental Plant Investments

AIC provided the actual and projected incremental plant investment that is included in the revenue requirement in compliance with Section 16-108.5(b)(2) of the Act, as ordered by the Commission in Docket No. 12-0293, to which Staff agrees. The Commission will therefore adopt the following agreed conclusion for use in this proceeding:

The Commission is setting a revenue requirement in this proceeding for the recovery of $102.6 million in actual 2016 plant additions and $128.4 million of projected 2017 plant additions in compliance with Section 16-108.5. The detail of these actual and projected plant additions by categories as required by Section 16-108.5(b)(2) are as follows:

	Category	Actual (In Millions)					Projected (In Millions)	Cumulative 2016 (In Millions)
		2012	2013	2014	2015	2016	2017	
(A)(i)	Distribution Infrastructure Improvements	$7.3	$3.5	$26.1	$54.8	$36.9	$49.5	$128.6
(A)(ii)	Training Facility Construction or Upgrade Projects	$5.8	$1.6	$0.0	$0.0	$0.0	$0.0	$7.4
(A)(iii)	Wood Pole Inspection, Treatment, and Replacement	$0.0	$0.0	$0.0	$0.0	$0	$0	$0
	Total Electric System Upgrades, Modernization Projects, and Training Facilities	$13.1	$5.1	$26.1	$54.8	$36.9	$49.5	$136.0
(B)(i)	Additional Smart Meters	$0.0	$0.4	$51.0	$48.4	$37.8	$67.8	$137.6
(B)(ii)	Distribution Automation	$6.5	$5.6	$20.1	$19.7	$24.8	$10.7	$76.7
(B)(iii)	Associated Cyber Secure Data Communications Network	$0.0	$2.5	$2.8	$2.2	$1.1	$0.4	$8.6
(B)(iv)	Substation Micro-processor Relay Upgrades	$0.3	$0.0	$2.5	$1.7	$2.0	$0.0	$6.5
	Total Upgrade and Modernization of Transmission and Distribution Infrastructure and Smart Grid Electric System Upgrades	$6.8	$8.5	$76.4	$72	$65.7	$78.9	$229.4
	Total Plant Additions in Compliance with Section 16-108.5(b)(2) of the Act	$19.9	$13.6	$102.5	$126.8	$102.6	$128.4	$365.4

D. Recommended Rate Base

1. Filing Year

The Commission finds, based on the decisions presented earlier on the various uncontested issues, that a reasonable rate base for the filing year is as shown on Appendix A, Schedule 2 (per Staff Ex. 4.0, Schedule 4.03 FY).

2. Reconciliation Year

The Commission finds, based on the decisions presented earlier on the various uncontested issues, that a reasonable rate base for the reconciliation year is shown on Appendix B, Schedule 2 (per Staff Ex. 4.0, Schedule 4.03 RY).

V. OPERATING REVENUES AND EXPENSES

A. Uncontested or Resolved Issues

1. Staff Adjustment to Ameren Services Company Costs

In discovery, AIC and Staff agreed to an adjustment of ($3,000) to reduce administrative and general expense for office supplies costs allocated from Ameren Services Company ("AMS"), which AIC determined should not be recoverable in electric distribution rates.

The Commission finds that the adjustment is uncontested, and therefore approves it. There are no other proposed adjustments to AIC's AMS costs.

2. Lobbying Costs

In discovery, AIC agreed that certain administrative and general expenses for lobbying costs should not be recoverable. Staff proposed an adjustment to lobbying costs, and AIC agreed that this adjustment is reasonable.

The Commission finds that AIC's proposed adjusted level of lobbying costs is uncontested, and therefore approves it.

3. Rate Case Expense

Section 9-229 of the Act requires the Commission to assess the justness and reasonableness of AIC's rate case expenses. 220 ILCS 5/9-229. The Commission's Part 288 Rules are intended to guide that assessment. 83 Ill. Admin. Code, Part 288. AIC explains that consistent with that authority, it supplied for the Commission's review extensive documentation supporting the justness and reasonableness of its 2016 formula rate case expenses. Staff and AIC agree that the Commission's Order should state the following with respect to those expenses:

> The Commission has considered the costs expended by AIC during 2016 to compensate attorneys and technical experts to prepare and litigate rate case proceedings and assesses that the amount included as rate case expense in the revenue

> requirements of $1,254,203 is just and reasonable. This amount includes the following costs: (1) $624 associated with Docket No. 15-0305; (2) $1,252,241 associated with Docket No. 16-0262; and (3) $1,338 associated with Docket No. 17-0197.

The Commission finds that the total rate case expense that AIC incurred to litigate its formula rate cases in 2016 is supported by the evidence and is just and reasonable. The Commission, therefore, adopts Staff and AIC's suggested language in this Order.

4. Interest Synchronization

Staff proposed an adjustment to interest synchronization, reflecting the tax effect of the difference between the interest expense used by AIC to compute income tax expense and the interest expense computed based on Staff's proposed rate base. AIC agreed to this adjustment.

The Commission finds that the proposed adjustment to interest synchronization is uncontested, and therefore approves it.

5. Gross Revenue Conversion Factor

Staff proposed a gross revenue conversion factor ("GRCF"), which is used to derive the change in AIC's revenue requirement. The GRCF is based on the applicable federal tax rate, state income tax rate, and uncollectible rate. AIC does not contest Staff's proposal.

The Commission finds that Staff's proposed GRCF is uncontested, and therefore approves it for use in this proceeding.

B. Recommended Operating Revenues and Expenses

1. Filing Year

The Commission finds, based on the decisions presented earlier on the various uncontested issues, that a reasonable total amount of operating revenues and expenses for the filing year is shown on Appendix A, Schedule, 1 (per Staff Ex. 4.0, Schedule 4.01 FY).

2. Reconciliation Year

The Commission finds, based on the decisions presented earlier on the various uncontested issues, that a reasonable total amount of operating revenues and expenses for the reconciliation year is shown on Appendix B, Schedule 1 (per Staff Ex. 4.0, Schedule 4.01 RY).

VI. COST OF CAPITAL AND RATE OF RETURN

A. Uncontested or Resolved Issues

1. Cost of Capital and Overall Rate of Return on Rate Base

a) Filing Year

As shown in the table below, Staff and AIC agree that a capital structure comprising 48.82% long-term debt, 1.18% preferred stock, and 50.00% common equity is reasonable for setting rates for the filing year and the reconciliation year. Staff and AIC further agree that a cost of short-term debt of 0.9%, a cost of long-term debt of 5.619%, and a cost of preferred stock of 4.979% are reasonable for both the 2018 rate setting and the 2016 reconciliation. In addition, Staff agrees that AIC's bank facility costs add 3.8 basis points to AIC's weighted average cost of capital. Finally, Staff and AIC agree that the cost of equity is 8.399% for the 2018 revenue requirement and for the 2016 reconciliation year revenue requirement. The 8.399% return equals the 2.599% monthly average 30-year U.S. Treasury bond yield, plus 580 basis points, as required under Section 16-108.5 of the Act. 220 ILCS 5/16-108.5(c)(3). Staff and AIC agree that the Commission should find that a reasonable overall rate of return for the filing year is 7.040%.

The Commission finds that the overall rate of return of 7.040% for the filing year is reasonable and uncontested, and it will be adopted for use in this proceeding.

Component	Weight	Cost	Weighted Cost
Short Term Debt	0.000%	0.900%	0.000%
Long Term Debt	48.820%	5.619%	2.743%
Preferred Stock	1.180%	4.979%	0.059%
Common Stock	50.000%	8.399%	4.200%
Bank Facility Costs			0.038%
Total Capital	100.000%		7.040%

b) Reconciliation Year

Staff and AIC also agree that the Commission should find that a reasonable overall rate of return for the reconciliation year is 7.040%.

The Commission finds that the overall rate of return of 7.040% for the reconciliation year is reasonable and uncontested, and it will be adopted for use in this proceeding.

VII. RECOMMENDED REVENUE REQUIREMENT

The Commission finds, based on the determinations presented above on the various uncontested issues, that the reasonable revenue requirement for the filing year is shown on Appendix B. The Commission further finds, based on the determinations presented above on the various uncontested issues, that the reasonable revenue requirement for the reconciliation year is shown on Ameren Exhibit 13.1, Schedule FR A-1 REC.

The Commission finds that no party contested AIC's cost of service or pricing proposals, and, therefore, adopts those proposals for purposes of this proceeding.

VIII. OTHER ISSUES

A. Uncontested Issues

1. Income Tax Rate Changes

The Illinois General Assembly enacted a change to the state income tax rate, effective July 1, 2017, that increases the rate applicable to AIC from 7.75% to 9.50%. AIC did not reflect any changes to the Formula Rate Revenue Requirement calculation as a result of the tax change. Since the first Formula Rate proceeding in Docket No. 12-0001, the Formula Rate schedules have been designed to apply the same state and federal income tax rates to both the filing year and reconciliation year calculations. Section 16-108.5(d)(1) of the Act, which authorizes use of a performance-based formula rate, states in pertinent part: "[t]he inputs to the performance-based formula rate for the applicable rate year shall be based on final historical data reflected in the utility's most recently filed annual FERC Form 1 plus projected plant additions and correspondingly updated depreciation reserve and expense for the calendar year in which the inputs are filed." 220 ILCS 5/16-108.5(d)(1). Since the most recently filed FERC Form 1, at the time of filing, was for the 2016 calendar year, the 7.75% state income tax rate in effect in 2016 is used for both the filing year and reconciliation year calculations. In next year's Formula Rate update filing, when AIC reconciles 2017 costs (and subsequent year reconciliations, to the extent applicable under the Act), the actual state income tax rate(s) in effect for the applicable calendar year will be used to reconcile actual costs, with any differences in actual costs, and costs included in rates for the reconciliation year, reflected in the reconciliation with interest adjustment.

B. Contested Issues

1. IIEC/CUB Proposed Independent Third-Party Audit of Ameren Services Company Costs

a) IIEC/CUB's Position

IIEC-CUB assert that the Commission has never had the benefit of an independent audit of total AMS service costs, or costs billed to AIC, arguing that such an audit could determine whether AMS reasonably manages its costs, and is able to provide services to AIC at just and reasonable prices. IIEC-CUB suggest that the audit would review the reasonableness of total AMS costs, and allow for a full and complete review of these costs and their allocations to AIC in future rate cases and formula rate filings. Accordingly, IIEC-CUB recommend that the Commission order AIC to perform an independent third-party audit of total AMS costs and the related allocations to AIC. IIEC-CUB note that the only Commission review of Ameren's AMS costs has been in the truncated formula rate proceedings that address all areas of revenue requirements in a period of 240 days.

IIEC-CUB note that AMS organizes the business and support services provided to AIC and other Ameren Corporation affiliates into functional areas including Ameren Services Center, Controllers, Corporate Communications, Corporate Planning & Environmental, Energy Delivery Technical, Executive, General Counsel, Human Resources, Information Technology ("IT"), Internal Audit, Supply Services & Safety, Tax, Transmission, and Treasurer. IIEC-CUB state that AMS charged total service company fees of $386.2 million to Ameren affiliates in 2016, of which $175.5 million, or 45.4% of the total charges, was allocated to AIC. IIEC-CUB note that in 2015, the total AMS cost was $364.4 million, of which $162.6 million was charged to AIC; again, approximately 45% of the total AMS charges. IIEC-CUB note that from 2015 to 2016 there was an increase in total AMS cost of $21.9 million (6%) and an increased AIC share of $12.9 million (8%).

IIEC-CUB note that total AMS costs have increased over 22% since 2012 — from $316 million to $386 million, a $71 million increase, and that AMS costs have increased every year since 2012, including in 2013 when Ameren Corporation sold its merchant generation businesses. IIEC-CUB state that these costs increased not only in the year after the sale, which, might be attributed to the need to recover fixed costs that were borne by the merchant company, but they also increased each and every year after that, as well. In 2012, the year prior to the sale, the merchant generation affiliate had been subject to $51 million in AMS charges, or over 16% of the total AMS charges in that year. IIEC-CUB posits that these charges to the merchant generation company were for services AMS employees provided to it, and given the size of those charges, the sale of that company should have reduced the need for a substantial number of AMS employees or services, resulting in a decrease in total AMS costs, however this has not occurred. IIEC-CUB aver that in order to maximize profits, Ameren Corporation has a financial incentive to ensure that AMS costs are passed along to its other subsidiaries, including its regulated subsidiaries - AIC, Union Electric Company, and Ameren Transmission Company of Illinois.

IIEC-CUB note that it is well recognized that the purpose of allowing a regulated utility to take services from an affiliated service company is to allow the utility to provide essential services to its customers in a least cost manner by allowing it to take advantage of economies of scale that the service company is supposed to provide, as opposed to utilizing a third-party provider or the utility itself to provide those services. IIEC-CUB believe however, that the constant, significant annual increases in both total AMS costs and costs charged to AIC raise substantial doubt that AMS is achieving its purpose as a service company in providing essential services to AIC customers in a least cost manner. IIEC-CUB state that the record in this case shows that no regulatory commission, including this Commission, has conducted an audit of total AMS "actual" costs underlying the charges for services provided to AIC and other affiliates, or whether the total cost of services provided to affiliates and AIC is prudent and reasonable.

AIC asserts that the General Services Agreement ("GSA") and other protocols are sufficient to ensure proper charges are being assessed by AMS to AIC. Ameren claims that it employs cost controls like AIC buyers' joint planning process, in which AIC buyers meet with AMS Business & Corporate Services providers to review certain AMS services, discuss costs, explore outsourcing opportunities, cost containment, and savings opportunities, service reduction opportunities and other matters. IIEC-CUB suggest that these procedures provide no assurance that AMS charges or costs are reasonable, and note that the record is devoid of any specific instance in which AIC seriously disputed any significant charge from AMS or refused to pay a charge.

IIEC-CUB state that there is a fundamental difference between overseeing the allocation of AMS costs that the GSA governs, and determining whether AMS costs are reasonable and prudent, and argue that an audit is critical because AMS costs are either directly assigned or allocated to AIC based on services provided to AIC and other affiliates. While AIC does undertake internal audits to determine whether the allocation and assignment of AMS costs to AIC are reasonable and consistent with the GSA, IIEC-CUB note that AIC does not conduct a formal audit itself of AMS total costs to ensure that AMS is effectively managing its costs, via budgeting and operating assessments, and is able to provide services based on effectively managed and reasonable costs.

In Docket No. 16-0287, the GSA approval Order, the Commission rejected IIEC-CUB's proposal for an independent third-party audit of AMS costs in part because it expected that the reporting requirement of new Appendix C would provide the means to determine if the service company charges are just and reasonable. Ameren Illinois Co., Docket No. 16-0287, Order at 25 (April 7, 2017). Mr. Gorman explained that this internal audit requirement does not provide the type of independent assessment that an independent audit would.

IIEC-CUB note that AMS service charges to client companies are based on recovery of all AMS costs, and are classified as either direct costs, which are applicable to one or more affiliates and are directly charged to the affiliates; or indirect costs, which are general overhead costs that are not applicable to a single affiliate or group of affiliates. IIEC-CUB avers that evidence of what AMS actual costs are, does not establish whether those costs are just and reasonable. Without a review of total AMS costs, it is not possible to ensure that the proportion of AMS costs charged to AIC are appropriate.

While AIC suggests that audits of AMS costs are conducted by FERC, IIEC-CUB note that the audits provided by AIC do not include an audit of total AMS costs, nor do they include an assessment of whether AMS costs are reasonable based on the services provided to client companies, including AIC. It appears to IIEC-CUB that AIC witness Russi agrees with the limitations of the FERC audits, stating that they do not distinguish between direct and direct allocated AMS charges, noting that AMS direct charges to other affiliates do not affect AIC.

While Ms. Russi offers that the newly approved GSA and internal audit requirements provide AIC customers sufficient protection in the manner of a report, IIEC-CUB disagrees, asserting that there are several reasons why the internal audit requirement and its report cannot accomplish the objective of providing the Commission with independent assessments of the reasonableness of AMS total costs, and a demonstration that AMS's prices for services provided are reasonable. Those include the following:

1. Ameren internal audits will be overseen by executives of Ameren. As such, these are not independent audits, but rather the audits are controlled by Ameren executives who have an economic interest in the outcome of the audit.

2. The requirement to conduct the audit specifically states that the internal audit will review charges billed by the Service Company pursuant to the agreement during the calendar year. As such, the audit does not require an independent audit of the reasonableness of AMS total costs. Rather, the audit is limited to ensuring that AMS bills to AIC are performed consistent with the GSA. The GSA does not control AMS or direct how it manages operating costs.

3. Allocation of AMS costs will not show that AMS total costs are reasonable. In order to ensure that costs paid by AIC retail customers are reasonable, there needs to be both a demonstration that AMS total costs are reasonable, as well as the allocations of total costs are reasonable. A review of allocations would include allocation of common costs and direct assignment of AIC direct charges.

IIEC-CUB assert that the audits under the GSA do not address the reasonableness or prudence of AMS costs to AIC, but instead address allocations, time reporting, GSA training, and an investigation of whether all charges under the GSA reflect AMS's actual costs. Verifying that AMS is charging all of its "actual" costs is not the same as a determination that actual costs are just and reasonable. IIEC-CUB note that the audit is being conducted by AMS for AMS, of the AMS activities as described, and cannot be considered an independent third-party audit of AMS costs being charged to AIC.

IIEC-CUB note that when the Commission declined to order an independent audit in the Order in Docket No. 16-0287 approving the GSA, it did so in part because it "intends that the reporting requirements of Appendix C will provide the means to determine whether the service company services are provided at rates that are just and reasonable." Ameren Illinois Company, Docket No. 16-0287, Order at 25 (April 7, 2017). IIEC-CUB suggest that the record in this docket demonstrates that neither the GSA, nor the protocols relied upon by AIC, in fact test the reasonableness of total AMS costs and their allocation to AIC.

IIEC-CUB assert that an independent review of these AMS total costs is necessary in order to ensure the Commission is in a position to protect the public interest from the affiliate transactions that constitute a significant portion of AIC's cost of service. It appears to IIEC-CUB that Ameren relies on the assumption that, because the Commission has not made an explicit finding that particular AMS costs are unreasonable or imprudent, they are conversely deemed prudent and reasonable. The purpose of the audit, however, is to provide the Commission with the opportunity to review the reasonableness of total AMS costs, which review has not previously been done. IIEC-CUB suggest that the fact that AMS costs have been recovered in AIC rates is more an indication of the lack of objection to those costs than it is to the depth and breadth of Commission review of those costs. IIEC-CUB aver that the material increases in AMS service costs to AIC in the last five years has not been fully explained or justified by AIC, and believe that these material increases in AMS allocated service costs demand more detailed and focused justifications for changes in the cost of service provided by AMS, and an explanation of the additional services provided to AIC by AMS over this time period.

IIEC-CUB note that part of the process by which AMS charges AIC is a reliance on service project requests, and while the number of service requests from AIC to AMS changes from year to year, it appears there is no clear disclosure on the number of service requests produced by AMS for all its client companies. IIEC-CUB believe that this information, along with the costs of such requests, would assist in showing that the allocation of service requests to AIC from AMS reflect reasonable rates for services.

IIEC-CUB believe that there are flaws in the allocation process, and suggest that there has also been a showing of disproportionate AMS costs being charged to other Ameren affiliates when compared to AIC. IIEC-CUB state that through direct charges, other affiliate companies do receive some AMS costs related to human resources, information technology and corporate communications, however in 2016, the other affiliate companies combined only receive 2% of all the AMS charges related to human resources and information technology; and only 6% of all the AMS charges related to corporate communications. IIEC-CUB note that little of the AMS costs associated with functions that are common to the operations of any business are being charged to any affiliate companies other than the regulated retail utilities.

IIEC-CUB note that in a comparison of allocated costs for AIC to those of Ameren Transmission Company of Illinois ("ATXI"), AIC is charged nearly $5.4 million for human resource services as compared to ATXI, which was only charged approximately $322,000. Additionally, ATXI was charged $1.7 million for IT services while AIC was charged almost $39 million. ATXI was also charged about $144,000 for corporation communication services while AIC was charged over $2.9 million.

IIEC-CUB state that in 2016, AIC used 33 allocation factors that applied to more than one affiliate company, however 17 of those allocation factors applied AMS costs to only the regulated retail utilities. IIEC-CUB argue that this in itself is dubious given the nature and extent of AMS services purportedly available to all Ameren affiliates, and highlights once more the financial incentives at stake.

IIEC-CUB propose a structure of an audit to review the prudence and reasonableness of AMS total cost for services provided to take a form similar to the following:

1. AMS total costs by functional area should be audited over the last five years.

2. The number of service requests from AIC to AMS, and other client companies that procure common services from AMS should be audited to determine the volume of services provided by AMS to affiliate companies. An assessment should also be made of how AMS costs are impacted by the volume of affiliate service requests.

3. AMS direct services charged to AIC should be audited and compared to the cost of similar services from non-affiliated providers.

4. AMS common service costs allocated to AIC should be compared to the cost of similar services provided by non-affiliated providers.

5. An assessment should be made of AMS's effectiveness in managing service costs. This should include a comparison of budgeted to actual AMS costs for services recognizing the volume of service requests from affiliate companies to AMS.

IIEC-CUB opine that the significance of the cost of the audit must be weighed against the magnitude of the increase in AMS costs to AIC since 2012, which amounts to a total of $64 million, or 57%, and it appears that with this substantial increase, the cost of an audit is worthwhile and justified. IIEC-CUB aver that the cost of the audit can be overseen by the Commission and administered by Staff, and the Commission has the authority to limit audit costs to an amount it finds to be reasonable. IIEC-CUB recommend the Commission require an independent third-party audit of AMS costs.

IIEC-CUB suggest that there is ample legal authority upon which the Commission may rely in ordering the audit, noting that Section 7-101(2)(ii) of the Act provides the Commission with ". . . jurisdiction over affiliated interests having transactions, . . . with electric and gas public utilities under the jurisdiction of the Commission, to the extent of access to all accounts and records of such affiliated interests relating to such transactions, including access to accounts and records of joint and general expenses with the electric or gas public utility any portion of which is related to such transactions. . . ." 220 ILCS 5/7-101(2)(ii).

IIEC-CUB state that the Commission is also able to require a third-party management audit or investigation of any public utility or any part thereof under Section 8-102 of the Act (220 ILCS 5/8-102), which provides that the Commission may conduct or order a management audit or investigation under two circumstances. First, when "... it has reasonable grounds to believe the audit or investigation is necessary to assure that the utility is providing adequate, efficient, reliable, safe and least-cost service and charging only just and reasonable rates therefor." Second, when ". . . the audit or investigation is likely to be cost-beneficial in enhancing the quality of service or the reasonableness of rates therefor."

In addition to the above statutory provisions, IIEC-CUB state that the Commission has broad general supervisory authority – and responsibility – under Section 4-101 of the

Act to inquire into the management of the utility. Pursuant to this provision, the Commission "shall inquire into the management of the business thereof and shall keep itself informed as to the manner and method in which the business is conducted." 220 ILCS 5/4-101.

IIEC-CUB assert that along with the substantial escalation in the AMS costs allocated and/or directly charged to AIC, and the failure to provide a clear description of the number and type of services provided by AMS, it appears that the current protocols and internal audits do not scrutinize or test the justness or reasonableness of total AMS charges or costs being passed along to AIC customers, therefore the Commission is justified in requiring a third-party audit.

IIEC-CUB argue that it is unclear from the record whether AIC is exercising due diligence to control unnecessary AMS costs from being passed along to its customers, nor does it appear that AIC has ever informed AMS that it was charging too much or that a particular cost would not be paid. IIEC-CUB also submit that there has been no showing that service company costs are routinely lower than what might be procured from outside service providers.

IIEC-CUB state that the Commission has a continuing obligation to ensure that AMS costs passed along to AIC customers are reasonable and prudent, however in the 20 years in which various iterations of the GSA have been in place, there has been no independent audit of AMS total costs or charges to AIC.

IIEC-CUB note that the Commission has previously ordered an audit of affiliate management service company costs in other utility rate cases, and thus an audit of the type and magnitude suggested by IIEC-CUB is not unprecedented. In Illinois-American Water Company's 2007 rate case, Docket No. 07-0507, the Commission addressed the propriety of IAWC management fees being passed along to IAWC customers by the utility's service company, much like that which is at issue here. IIEC-CUB note that the Commission ordered the utility to perform a study, including an analysis of the services provided by its Service Company to all of IAWC's affiliates.

In IAWC's 2009 rate case, Docket No. 09-0319, the Commission found, based on its review of the record, that IAWC had not justified the increase it requested for the Service Company fees, and that the studies IAWC submitted in compliance with the Commission's directive in Docket No. 07-0507 were inadequate. The Commission held, "[w]ith no basis for comparison of the lower of cost or market for these services, the Commission cannot adequately determine whether the increases in management fees proposed in this case by IAWC are just and reasonable." Illinois-American Water Co., Docket No. 09-0319, Order at 47, (April 13, 2010). IIEC-CUB note that the Commission then ordered the audit pursuant to Section 8-102 of the Act as follows;

> The Commission agrees that an independent audit is of benefit and necessary in evaluating whether the Service Company fees assessed to IAWC, are in fact provided on a lower of cost or market basis as we directed in the 07-0507

> Order. Therefore, pursuant to our authority under Section 8-102 of the Public Utilities Act, the Commission directs IAWC to engage outside consultants to perform a management audit of its Service Company fees to compare the cost of each service obtained from the Service Company to the costs of such services had they been obtained through competitive bidding on the open market.

Id. at 48.

IIEC-CUB state that the Commission then entered an Amendatory Order in Docket No. 09-0319, which directed Staff to conduct a management audit to evaluate whether the Service Company's fees assessed to IAWC are in fact provided on a lower of cost or market basis. If Staff was unable to perform the audit, the Commission directed Staff to select an independent firm to do so. Illinois-American Water Co., Docket No. 09-0319, Amendatory Order at 1-3 (May 5, 2010).

IIEC-CUB suggest that the 2009 IAWC rate case shows that the study by IAWC ordered by the Commission in 2007 proved to be inadequate. The Commission then required an independent third-party audit pursuant to Section 8-102 of the Act. Thus, IIEC-CUB argue that internal audits and monitoring activities – much like IAWC's study, have proven to be inadequate when independently testing for the reasonableness or prudence of AMS costs. IIEC-CUB therefore urge the Commission to order an independent audit of AIC's AMS costs.

IIEC-CUB suggest in their Reply Brief, that the purpose of the proposed audit is not necessarily to identify specific costs for the purpose of disallowance, rather the audit is needed to confirm that total AMS costs are reasonable, and the related allocation of those costs to AIC is reasonable. IIEC-CUB argue that the proposed audit will provide the Commission, and the customers who must pay for AMS services, with the confidence that AIC is doing everything possible to manage and control these costs, so that the AMS services are provided in a least cost manner and comparable to the cost for similar services had they been provided by an unaffiliated third party or by the utility itself.

IIEC-CUB assert that while the proposed audit may not ultimately result in a determination that any costs should be disallowed, it may well identify areas where AIC's procurement practices regarding necessary services could be improved, or its management and cost control practices could be enhanced, which would help hold down future costs. In the face of repeated significant increases and the other matters discussed herein, IIEC-CUB believe that ratepayers are entitled to know these answers, and, contrary to AIC's position, there is no legal authority that bars the Commission from seeking these answers.

IIEC-CUB also disagree with AIC that the scope of the proposed audit is unclear from the testimony, noting that Mr. Gorman proposed the scope of the audit set forth above.

IIEC-CUB differ with the position taken by Staff as well. IIEC-CUB aver that postponing the audit to await compulsory compliance with the requirements of the approved amended GSA will accomplish nothing more than what the current GSA reporting requirements provide. Furthermore, as AIC acknowledged in its brief, Ameren voluntarily provided the GSA reports, of 2016 AMS cost, in this proceeding. Staff and other interested parties have already had the opportunity to evaluate the GSA reports for AIC's 2016 costs. IIEC-CUB argue that this does not now, and will not in the future, provide an assessment of whether AIC is doing everything possible to manage and control AMS costs, or that those costs are being provided in a least cost manner and comparable to the cost for similar services had they been provided by an unaffiliated third party or by the utility itself, without relying on AMS.

b) Ameren's Position

Ameren notes that the only contested issue in this proceeding is one the Commission has already decided - whether it should order an independent audit of AMS costs. Ameren states that in Docket No. 16-0287, the Commission approved an amended GSA between AIC and AMS, and the Commission "note[d] IIEC/CUB's concern about the growth of AIC's AMS costs and [IIEC/CUB's] proposal for a third-party audit of AMS costs." Ameren Ill. Co., Docket No. 16-0287, Order at 25 (Apr. 7, 2017). Ameren states that the Commission concluded in Docket No. 16-0287 that the reporting requirements of the new GSA will provide the means to determine whether service company services are provided at rates that are prudent and reasonable, and the Commission therefore declined to order an independent audit at this time.

Ameren suggests that nothing has happened in the last six months to change that conclusion. Nevertheless, IIEC/CUB witness Gorman in this proceeding again has proposed that the Commission order AIC to perform an independent third-party audit of AMS costs. In support of his proposal, Mr. Gorman offered largely the same reasons that IIEC/CUB offered in support of their independent audit proposal in Docket No. 16-0287: concern regarding an increase in historical AMS costs, and belief that the statutory formula rate case timeframe is too short to enable the Commission to assess the prudence and reasonableness of AMS costs. Ameren urges the Commission to again reject IIEC/CUB's independent audit proposal, for various reasons.

AIC notes that it obtains many of the business and corporate services that it needs to operate and provide electric distribution, electric transmission, and gas distribution services to its customers from AMS, an Ameren-affiliated centralized services company organized under the Public Utilities Holding Company Act and regulated by the FERC. AMS charges AIC, and the other Ameren affiliates that obtain its services, AMS's actual costs to provide those services.

AIC states that pursuant to the GSA recently reapproved by the Commission as amended in Docket No. 16-0287, AIC is required to submit several annual reports to the Commission regarding AMS charges. In particular, beginning in 2018, AIC must provide the Commission a report summarizing monthly AMS charges to the Ameren affiliates during the preceding year. AIC must also provide a detailed report of every prior-year AMS charge by the service description (or service request project name and number); the AMS functional area (or department) that provided the service; the affiliate(s) charged; whether the charge was a direct or indirect charge and, if a direct allocated charge, the allocation factor used to allocate the charge among multiple affiliates; the FERC account the charge was recorded to; whether the charge represents AMS employee labor costs or non-labor costs, such as unaffiliated vendor costs; and whether the charge was attributable to AIC's gas distribution operations or its electric transmission and distribution operations. Additionally, AIC must provide, among other reports, a variance report that identifies and explains any material variance—10% or more and $1 million or more—in any AMS functional area cost charged to AIC over the previous year's cost.

This year, before the Commission issued its Order in Docket No. 16-0287, AIC states that it voluntarily provided these reports, for 2016 AMS costs. AIC also provided the reports to the parties in this proceeding, and AIC will begin compulsory compliance with the newly-amended GSA's extensive reporting requirements in 2018.

Using the AMS cost reports, AIC identified the drivers for the 2015 to 2016 increase in its AMS costs, noting that the increase was largely attributable to investments in 30 new or upgraded software assets needed to support AIC's operations and the attendant increased need for IT services. AIC states that it provided additional information in discovery regarding the drivers of the increase, including the software investments. AIC also suggests that it explained significant variances in the Administrative and General expenses recorded to its electric FERC Accounts 920-935, which include AMS charges, noting that the total AMS charges recorded to those accounts remained flat from 2015 to 2016.

AIC notes that no witness disputed any explanation that AIC provided for the increase in total AMS costs charged to AIC in 2016, nor has any party identified a 2016 AMS service to AIC as imprudent or a 2016 AMS charge to AIC as unreasonable. Accordingly, AIC states that there is no contested adjustment in this proceeding to disallow any of AIC's 2016 AMS costs.

Despite the lack of any adjustment, IIEC/CUB witness Gorman complained that an increase in total AMS costs charged to AIC from 2012 to 2016 is unreasonable, focusing specifically on an increase in total AMS costs charged to AIC after the 2013-2014 divestiture of Ameren's merchant generation business. AIC asserts that Mr. Gorman's complaint is meritless, noting that he ignores the Commission's order in AIC's 2016 formula rate update proceeding, which found that AIC's AMS costs were reasonable and prudent. *See* Docket No. 16-0262, Order at 17-18.

AIC states that while Mr. Gorman proposes no adjustment to AIC's 2016 AMS charges, and those costs are not in dispute, Mr. Gorman nevertheless proposes that the Commission order an independent audit of AMS costs. Mr. Gorman believes that, without his audit—and despite AIC's rate case proceedings—the Commission cannot ensure the prudence and reasonableness of AMS costs.

AIC suggests that one of the first problems with Mr. Gorman's proposed independent audit is that its scope is unclear. For example, while Mr. Gorman has consistently maintained that the audit should review historical AMS costs, his proposal has otherwise fluctuated from his direct testimony—where he focused on an audit comparing the cost of AMS services to the costs of unaffiliated provider services—to his rebuttal testimony—where he focused on a far broader audit of "total AMS costs" and general AMS management practices. AIC notes that Mr. Gorman leaves the "ultimate scope of the audit," as he terms it, to the Commission to work out.

AIC submits that regardless of the indefinite scope of Mr. Gorman's proposal, one thing is certain: his independent audit is unnecessary, unlawful, and would not be cost-beneficial to AIC's electric distribution customers who—Mr. Gorman concedes—would have to pay for it. The Commission, therefore, should reject Mr. Gorman's proposal.

AIC submits that an independent audit of AMS costs is unnecessary, given the extensive reporting requirements in the newly-amended GSA, noting that the amended GSA that the Commission approved in Docket No. 16-0287 is the result of a three-and-a-half-month, eight-workshop process and a year-long docketed proceeding, with AIC, Staff, and IIEC/CUB participating.

AIC states that under the newly-amended GSA, the Commission now requires AIC to annually submit AMS cost and cost allocation reports, as well as requiring AIC to annually submit an AMS Internal Audit report, which is an enhancement of the Internal Audit report of AMS's Service Request System, Service Request policies, operating procedures, and controls that AIC has provided the Commission, every year, since AIC's predecessors' 2006 rate cases. Specifically, AMS Internal Audit must now test, and report to the Commission, that: (i) internal controls are adequate to ensure costs associated with transactions under the GSA are properly and consistently allocated and billed; (ii) AMS employees' time reporting is properly charged to service request projects for allocation to AIC; (iii) allocation factors are correctly calculated; (iv) all costs charged under the GSA are determined in accordance with allocation factors; (v) all charges under the GSA reflect AMS's actual costs; and (vi) AMS employees are trained with respect to their responsibilities under the GSA at least biennially.

AIC believes that the newly-amended GSA's extensive reporting requirements and enhanced annual Internal Audit report render Mr. Gorman's proposed independent audit unnecessary and submits that in Docket No. 16-0287 the Commission reached the same conclusion.

AIC states that in Docket No. 16-0287, the Commission concluded that it expects that the new and enhanced reporting requirements in the amended GSA will facilitate the prudence and reasonableness assessment of AMS costs that already occurs in AIC's rate cases: "[t]he Commission intends that the reporting requirements of Appendix C [to the amended GSA] will provide the means to determine whether service company services are provided at rates that are prudent and reasonable." Docket No. 16-0287, Order at 25. The Commission, therefore, found an independent audit to undertake the same assessment unnecessary.

AIC avers that Mr. Gorman's audit proposal does not afford the newly-amended GSA an opportunity to operate. Although AIC voluntarily complied with the reporting requirements this year, it will not begin compulsory compliance with GSA Appendix C's reporting requirements until 2018. While Mr. Gorman attempted to cure his failure to acknowledge newly-amended GSA Appendix C's reporting requirements by asserting that those requirements are insufficient to ensure that AIC's AMS costs are prudent and reasonable, AIC argues that Mr. Gorman fails to acknowledge the Commission's Docket No. 16-0287 conclusion.

AIC further suggests that Mr. Gorman's proposal doesn't meet the legal criteria for an independent audit under Section 8-102 of the Act, which defines the Commission's authority to order an independent audit. AIC submits that Section 8-102 of the Act provides that the Commission may order an independent audit:

> only [i] when it has reasonable grounds to believe that the audit . . . is necessary to assure that the utility is providing adequate, efficient, reliable, safe, and least-cost service and charging only just and reasonable rates therefor, or [ii] that the audit . . . is likely to be cost-beneficial in enhancing the quality of service or the reasonableness of rates therefor.

220 ILCS 5/8-102. AIC avers that Mr. Gorman's independent audit proposal fails these statutory prerequisites.

AIC notes that in Docket No. 16-0262, the Commission found that AIC's 2015 AMS charges were prudent and reasonable, and that AIC's Administrative and General ("A&G") expenses, which include the AMS charges, were reasonable when compared to other utilities' expenses. Docket No. 16-0262, Order at 18. While the Commission at the same time acknowledged the increase in Ameren's A&G expenses, specifically AMS expenses, AIC notes that the Commission did not order an independent audit of AMS costs, but instead concluded that AIC's rate case proceedings provide an adequate opportunity to assess AIC's AMS costs.

In this proceeding, AIC submits that it has shown that the 2016 AMS charges recorded to its A&G accounts remained flat from 2015 to 2016, and notes that there is no proposed prudence and reasonableness adjustment to AIC's 2016 AMS costs, despite the ample AMS cost data provided in AIC's direct testimony, exhibits, and discovery.

Thus, AIC submits that Section 8-102's first prerequisite is not met: there are no "reasonable grounds" to believe that an independent audit is necessary to assure that AIC is providing adequate, efficient, reliable, safe, and least-cost service and charging only just and reasonable rates therefor, per Section 8-102 of the Act.

AIC opines that ratepayers must bear the cost of an independent audit, which would be recovered as an expense through normal ratemaking procedures. AIC submits that the Commission is required, therefore, to find that an independent audit is "likely to be cost-beneficial" to ratepayers before it orders the audit. AIC avers that Mr. Gorman could not say whether his audit proposal was likely to be cost-beneficial to AIC's electric distribution customers, and Mr. Gorman admitted that "[t]he benefit or cost to customers from such an audit cannot be determined at this time." IIEC/CUB Ex. 2.0 at 3. AIC states that Mr. Gorman also admitted that if the audit confirms that AMS charges to AIC are just and reasonable, then the audit cost will increase costs to retail customers. AIC suggests that such a speculative benefit is far short of what Section 8-102 of the Act requires.

AIC notes that under EIMA, AIC's formula rate "shall . . . [p]rovide for the recovery of the utility's actual costs of delivery services that are prudently incurred and reasonable in amount consistent with Commission practice and law." 220 ILCS 5/16-108.5(c)(1). EIMA further provides that "[t]he Commission's determinations of the prudence and reasonableness of [such] costs incurred for the applicable calendar year shall be final upon entry of the Commission's order and shall not be subject to reopening, reexamination, or collateral attack in any other Commission proceeding, case, docket, order, rule or regulation . . . ." 220 ILCS 5/16-108.5(d).

AIC believes that Mr. Gorman's independent audit proposal ignores these EIMA mandates, noting the Mr. Gorman's proposed audit would review historical AMS costs over a five-year period. Mr. Gorman testified that "if the audit uncovers costs charged to AIC from AMS that the Commission finds to be unreasonable or imprudent, . . . the reduction in AMS charges to AIC that are included in retail cost of service may offset the cost of the audit." IIEC/CUB Ex. 2.0 at 10.

Yet, insofar as historical AMS costs have been included in AIC's historical formula rate revenue requirements, AIC suggests that they have already been approved by the Commission as prudent and reasonable, and per the EIMA, they are not subject to reexamination or attack in another Commission proceeding, including an audit proceeding, pursuant to Section 16-108.5(d) of the Act. AIC argues that the Commission cannot lawfully find historical AMS costs, which it once found prudent and reasonable, imprudent or unreasonable in a later, separate audit proceeding.

Likewise, AIC believes that future AMS costs included in future formula rate revenue requirements—which are actually incurred and shown to be prudent and reasonable—cannot lawfully be reduced by a hypothetical level of historical AMS costs that, again, the Commission once found to be prudent and reasonable, but later—in violation of EIMA—found to be imprudent and unreasonable. 220 ILCS 5/16-108.5(c)(1).

AIC states that Section 7-101 of the Act establishes the Commission's jurisdiction over AIC's transactions with affiliated interests, and that jurisdiction is limited to transactions that affect AIC: "The Commission shall not have access to any accounts and records of, or require any reports from, an affiliated interest that are not related to a transaction . . . with the electric or gas public utility." 220 ILCS 5/7-101(2)(ii).

AIC submits that Mr. Gorman's proposed independent audit ignores Section 7-101's jurisdictional limits, noting that it would review AMS costs that do not affect AIC. AIC states that Mr. Gorman emphasized that his audit would review total AMS costs, and Mr. Gorman defined "total AMS costs" as "'the total costs AMS incurs to provide services to all client companies, and other affiliate companies, including AIC.'" Ameren Ex. 14.0 at 2.

As explained, however, "total AMS costs" include AMS costs that are direct charged to affiliates other than AIC, for services that do not affect AIC. Those costs, therefore, are not related to AIC. In 2016, for example, "total AMS costs" included approximately $39 million in direct charges to Ameren Missouri, which reflect transactions between AMS and Ameren Missouri that are not related to AIC. Yet, Mr. Gorman's proposed audit, in reviewing "total AMS costs"—a review that he insists is necessary—would review those transactions.

AIC argues that Mr. Gorman's proposed independent audit would increase costs to Illinois customers, without a corresponding benefit, and that the cost of Mr. Gorman's proposed audit would be substantial. AIC asserts that Mr. Gorman's testimony and Commission precedent suggest that the cost of the audit that Mr. Gorman proposes would be substantial. AIC notes that Mr. Gorman admits that the period of his independent audit would be lengthy—at least longer than the statutory nine-month period of this formula rate case, since Mr. Gorman contends that period is too short to assess the prudence and reasonableness of AMS costs.

AIC states that the Commission has routinely approved full recovery of independent audit costs in rates, including incremental audit costs, and notes that when the utility incurs audit costs beyond the cost of the independent auditor, like outside consultant and counsel fees, printing costs, and affiliate expenses, those costs are also recoverable by the utility. Given this Commission precedent, and Mr. Gorman's testimony regarding the duration and complexity of his proposed independent audit, AIC is concerned that the cost of an audit of AMS costs would be substantial.

AIC does not believe that the substantial cost of the audit would result in a corresponding benefit to AIC's customers, believing that the audit would constitute nothing more than a duplicative layer of AMS cost review, especially in light of the extensive AMS cost reporting requirements that the Commission has imposed on AIC via the newly-amended GSA.

AIC asserts in its Reply Brief that the Commission has successfully reviewed AIC's AMS charges in every EIMA rate case to date, noting that the information to enable that review was available and even expanded for this proceeding. AIC avers that the parties with the necessary expertise to undertake the review were present in this docket, and suggest that the statutory process affords those parties and the Commission ample time to perform that review, as the Legislature has deemed.

AIC argues that because IIEC/CUB did not fully utilize the information available in this case, the discovery process, or the rate case period is not a reason to order an independent audit, or to impose the cost of an independent audit proceeding on AIC's customers. AIC believes that this docket (and AIC's future formula rate cases) provide the appropriate vehicle to review AMS charges, and suggest that another layer of review is wholly unnecessary.

In its Reply Brief, AIC also opines that IIEC-CUB are incorrect in arguing that the circumstances which caused the Commission to order an audit of IAWC in Docket No. 07-0507 are at all similar to the facts in this proceeding. AIC asserts that IIEC-CUB's description of the IAWC audit is misleading, and overlooks the context of, and the impetus for, the IAWC audit.

AIC states that in IAWC's 2007 rate case, the Commission expressly "question[ed] whether IAWC [was] doing everything possible to ensure low costs for ratepayers . . . ." Illinois-American Water Co., Docket No. 07-0507, Order at 30 (July 30, 2008). Therefore, the Commission directed the utility to include a services company cost study in its next rate case filing. *Id.* at 30-31.

AIC notes that in IAWC's next rate case, Docket No. 09-0319, the Commission found that the utility had not complied with its directive. Illinois-American Water Co., Docket No. 09-0319, Order at 47 (Apr. 13, 2010). The Commission further found that the record lacked justification for the 22.5% increase in IAWC's service company expenses. *Id.* Thus, the Commission concluded, it could not find IAWC's requested cost increase just or reasonable, and the Commission adopted an adjustment proposed by the AG and intervening municipalities, capping the increase at 5% and disallowing the remainder of IAWC's test year service company expenses as unreasonable and imprudent. AIC notes that the Commission also ordered, under Section 8-102 of the Act, Staff, or at Staff's direction an independent party, to conduct the service company cost study that the Commission had directed IAWC to conduct in Docket No. 07-0507. Illinois-American Water Co., Docket No. 09-0319, Amendatory Order at 1 (May 5, 2010).

AIC notes that none of that has happened here. The Commission has not disallowed AIC's AMS charges as imprudent or unreasonable. Moreover, the Commission found that the benchmarking study that AIC provided in Docket No. 16-0262 further supported the reasonableness of AIC's AMS charges.

AIC notes that Mr. Gorman did not identify a single 2016 AMS service that is imprudent, a single 2016 AMS cost that is unreasonable, or a single 2015 to 2016 AMS cost variance that is unjustified. AIC suggests that there are no facts or valid arguments presented by the evidence that would warrant AIC, Staff or any other parties expending the time and resources demanded by a lengthy and complex independent audit.

c) Staff's Position

Staff notes that previously, IIEC proposed a third-party audit of AMS charges in Docket No. 16-0287, a proceeding in which the Commission approved a new affiliate services agreement for Ameren. In that proceeding, Staff recommended that the Commission reject the proposal for a third-party audit, and suggested that the third-party audit would duplicate the validation efforts that are already provided for in the Illinois Provisions of the proposed GSA. Staff stated that this specifically references the compliance testing in the internal audit provision.

Ameren notes in this proceeding that it will not begin compulsory compliance with the requirements of the approved amended GSA until March and April 2018. Staff asserts that Mr. Gorman's proposal for a third-party audit does not afford the amended GSA an opportunity to operate, therefore Staff believes that for the Commission to order a third-party audit prior to evaluation of Ameren's compliance with the amended GSA would be premature.

Staff recommends that the Commission reject IIEC/CUB's proposal for a third-party audit of AMS and defer consideration of a third-party audit until (1) compulsory compliance with the amended GSA has begun, and (2) Staff and other interested parties have had the opportunity to evaluate and respond to the reports required under the amended GSA.

d) Commission Analysis and Conclusion

In Docket No.16-0262, the Commission noted that in future rate case proceedings, it would continue to closely examine AIC's A&G Expenses, which include AMS charges. In this proceeding, as in that docket and AIC's other electric formula rate update proceedings, AIC suggests it has explained any significant variances from 2015 to 2016 in the expenses recorded to its electric distribution A&G expenses accounts (FERC Accounts 920-935).

The Commission further notes that, as in AIC's past electric formula rate update proceedings, AIC explained in direct testimony in this proceeding how it evaluates, processes, and controls AMS services and their costs, and how the costs for AMS services are charged to AIC under the General Services Agreement between AIC and AMS. The Commission notes that it recently re-approved the GSA, as amended, on April 7, 2017 in Docket No. 16-0287. The Commission's order in that docket requires AIC to, beginning in 2018, annually submit to the Commission extensive AMS cost data reports. Those reports include a detailed report of every prior year AMS service and AMS charge as well as an explanation of any material variances in AMS functional area charges to AIC over the prior year's functional area charges. The Commission notes that AIC voluntarily submitted the extensive AMS cost data reports for 2016 AMS services and charges as a compliance filing in Docket No. 16-0287, and AIC provided that AMS cost data in direct testimony and discovery to the parties in this proceeding.

The Commission notes that in this proceeding, there is no proposed adjustment to AIC's 2016 AMS charges, with the exception of an agreed to adjustment proposed by Staff. The Commission notes that although there is no contested adjustment in this proceeding to AIC's 2016 AMS charges, IIEC/CUB propose that the Commission order an independent third-party audit of total AMS costs over a historical five-year period. IIEC/CUB argue, namely, that the increase in AMS charges to AIC from 2012 to 2016, the truncated statutory period of AIC's formula rate update proceedings, and the need to review total AMS costs support their independent audit proposal.

In addressing IIEC/CUB's audit proposal, the Commission finds that it must start with Section 8-102 of the Act, which defines the Commission's authority to order an independent audit of a utility's services company costs. Section 8-102 provides that the Commission may order such an audit:

> only when it has reasonable grounds to believe that the audit . . . is necessary to assure that the utility is providing adequate, efficient, reliable, safe, and least-cost service and charging only just and reasonable rates therefor, or [ii] that the audit . . . is likely to be cost-beneficial in enhancing the quality of service or the reasonableness of rates therefor.

220 ILCS 5/8-102.

The Commission acknowledges that it may not exercise its Section 8-102 authority lightly; Section 8-102 also provides that "[t]he cost of an independent audit shall be borne initially by the utility, *but shall be recovered as an expense through normal ratemaking procedures.*" *Id.* (emphasis added).

The Commission has determined in AIC's past electric formula rate update proceedings, based on the record evidence in those proceedings, that AIC's 2012 to 2015 AMS charges, including year-over-year increases in those charges, are just and reasonable. As explained, the prudence and reasonableness of AIC's 2016 AMS charges in this proceeding are not in dispute. The Commission reminds the parties that, per the EIMA, "[t]he Commission's determinations of the prudence and reasonableness of the costs incurred for the applicable calendar year shall be final upon entry of the Commission's order and shall not be subject to reopening, reexamination, or collateral attack in any other Commission proceeding." 220 ILCS 5/16-108.5(d)(3). The Commission further reminds the parties that the discovery process is available to them in AIC's annual electric formula rate update proceedings, and, if they dispute a cost of service, the EIMA requires that "each objection shall be stated with particularity and evidence provided in support thereof." *Id.* The Commission rejects IIEC/CUB's suggestion that if the rate case parties do not particularly object to a cost of service, then the Commission has not reviewed the cost or determined that it is prudent and reasonable, as inconsistent with the law.

The Commission notes that the Illinois Legislature has determined in the EIMA that AIC's annual electric formula rate update proceedings continue to provide the appropriate opportunity for the Commission and the parties to review the prudence and reasonableness of all of AIC's costs of service, including AMS charges. 220 ILCS 5/16-108.5(d)(3). The Commission believes that those proceedings have to date provided the parties an appropriate avenue of review.

The Commission also recognizes that in Docket No. 16-0287, it found that the extensive AMS cost data reports and enhanced internal audit of AMS processes that AIC is required to annually submit per the re-approved, amended GSA "will provide the means to determine whether service company services are provided at rates that are prudent and reasonable." Docket No. 16-0287, Order at 25 (Apr. 7, 2017).

The Commission does not believe that it is necessary, at this time, to order the independent audit as proposed by IIEC-CUB. The Commission notes that the audit ordered in Docket No. 16-0287 has not as yet occurred, and the Commission believes that it would be premature at this time to adopt IIEC-CUB's independent audit proposal in this docket without the opportunity to judge the results of the audit adopted in Docket No. 16-0287. The Commission will therefore not adopt IIEC-CUB's independent audit proposal, at this time.

Because the Commission is not adopting IIEC/CUB's proposed independent audit, the Commission does not believe it is necessary to make any findings pursuant to Section 8-102 of the Act in regards to such an audit. Should this issue be before the Commission in a future proceeding, the Commission will make any necessary findings under Section 8-102 of the Act at that time.

The Commission also finds that it is not necessary at this time to adopt any finding regarding IIEC/CUB's argument that it must review total AMS costs to ensure the prudence and reasonableness of AIC's AMS charges. The Commission notes that AIC argues that to adopt IIEC-CUB's argument would be inconsistent with Section 7-101(2)(ii) of the Act, which provides that "[t]he Commission shall not have access to any accounts and records of, or require any reports from, an affiliated interest that are not related to a transaction . . . with the electric or gas public utility."

The Commission notes that the level of A&G expenses charged to AIC has been a contested issue in several previous dockets, and the Commission has previously indicated that it will continue to observe the level of A&G expenses closely in future dockets. The Commission believes that the audit process adopted in Docket No. 16-0287 will aid the Commission in its review of those expenses, however the Commission will certainly entertain a discussion in future dockets of a more rigorous process should the audit ordered in Docket No. 16-0287 be found to be wanting.

The Commission does note that in Docket No. 16-0287, IIEC/CUB proposed that the Commission order an independent audit of AMS charges, as it did in this proceeding, arguing that historical increases in AMS charges and the truncated statutory period of AIC's formula rate update proceedings supported their independent audit proposal. The Commission notes that it rejected IIEC/CUB's independent audit proposal and the arguments supporting that proposal in its Docket No. 16-0287 order, which IIEC/CUB did not appeal.

IX. FINDINGS AND ORDERING PARAGRAPHS

The Commission, having considered the record herein, is of the opinion and finds that:

(1) Ameren Illinois Company d/b/a Ameren Illinois is a corporation engaged in the distribution of electricity and natural gas to the public in the State of Illinois and, as such, is a public utility within the meaning of the Public Utilities Act ("Act"), 220 ILCS 5/1-101 et seq.;

(2) the Commission has jurisdiction over Ameren Illinois and of the subject matter of this proceeding;

(3) the recitals of fact and conclusions of law reached in the Commission conclusions of this Order are supported by the evidence of record, and are hereby adopted as findings of fact and conclusions of law; the Appendices attached hereto provide supporting calculations for the approved rates;

(4) AIC's proposed update to its Rate MAP-P should be approved, subject to the conclusions contained herein;

(5) the rates herein found to be consistent with Public Acts 97-0616, 97-0646, and 98-0015 are based on AIC's FERC Form 1 for 2016;

(6) for purposes of this proceeding, the net original cost rate base for AIC's electric delivery service operations is $2,608,938,000 for the 2016 reconciliation year and $2,738,545,000 for the 2017 filing year;

(7) the rate of return that AIC should be allowed to earn on its net original cost rate base is 7.040% for the 2016 reconciliation year; this rate of return incorporates a return on common equity of 8.399%;

(8) the rate of return that AIC should be allowed to earn on its net original cost rate base is 7.040% for the 2017 filing year; this rate of return incorporates a return on common equity of 8.399%;

(9) the rates of return set forth in Findings (7) and (8) result in base rate electric delivery service operating revenues of $998,448,000 (reflecting the reconciliation and ROE Collar adjustments) and net annual operating income of $192,784,000, as shown on Appendix A;

(10) AIC's electric delivery service rates which are presently in effect are insufficient to generate the operating income necessary to permit AIC the opportunity to earn a fair and reasonable return on net original cost rate base consistent with Public Acts 97-0616, 97-0646, and 98-0015; these rates should be permanently canceled and annulled;

(11) the specific rates proposed by AIC in its initial filing do not reflect various determinations made in this Order regarding revenue requirement;

(12) AIC should be authorized to place into effect amended Rate MAP-P Informational Sheets, consistent with the findings of this Order;

(13) AIC should be authorized to place into effect the Rate MAP-P tariff informational sheets designed to produce annual base rate electric delivery service revenues of $998,448,000, which represents a decrease of

$17,339,000 or (1.71%); such revenues, in addition to other tariffed revenues, will provide AIC with an opportunity to earn the rates of return set forth in Findings (7) and (8) above; based on the record in this proceeding, this return is consistent with Public Acts 97-0616, 97-0646, and 98-0015;

(14) the new charges authorized by this Order shall take effect beginning on the first billing day of the January billing period following the date of the Final Order in this proceeding; the tariff sheets with the new charges, however, shall be filed no later than December 15, 2017, with the tariff sheets to be corrected thereafter, if necessary;

(15) the Commission, based on AIC's proposed original cost of plant in service as of December 31, 2016, before adjustments, of $6,582,534,000 and reflecting the Commission's determination adjusting that figure, unconditionally approves $6,582,534,000 as the composite original jurisdictional distribution services plant in service as of December 31, 2016;

(16) the Commission has considered the costs expended by AIC during 2016 to compensate attorneys and technical experts to prepare and litigate rate case proceedings and assesses that the amount included as rate case expense in the revenue requirements of $1,254,203 is just and reasonable pursuant to Section 9-229 of the Act. This amount includes the following costs: (1) $624 associated with Docket No. 15-0305; (2) $1,252,241 associated with Docket No. 16-0262; and (3) $1,338 associated with Docket No. 17-0197; and

(17) all motions, petitions, objections, and other matters in this proceeding which remain unresolved should be disposed of consistent with the conclusions herein.

IT IS THEREFORE ORDERED by the Illinois Commerce Commission that the tariff sheets at issue and presently in effect for electric delivery service rendered by Ameren Illinois Company d/b/a Ameren Illinois are hereby permanently canceled and annulled effective at such time as the new electric delivery service tariff sheets approved herein become effective by virtue of this Order.

IT IS FURTHER ORDERED that Ameren Illinois Company d/b/a Ameren Illinois is authorized to file new tariff sheets with supporting workpapers in accordance with Findings (12) and (13) of this Order, applicable to electric delivery service furnished on and after the effective date of said tariff sheets.

IT IS FURTHER ORDERED that Ameren Illinois Company d/b/a Ameren Illinois shall update its formula rate in accordance with this Order.

IT IS FURTHER ORDERED that all motions, petitions, objections, and other matters in this proceeding which remain unresolved are disposed of consistent with the conclusions herein.

IT IS FURTHER ORDERED that subject to the provisions of Section 10-113 of the Act and 83 Ill. Adm. Code 200.880, this Order is final; it is not subject to the Administrative Review Law.

By Order of the Commission this 6th day of December, 2017.

(SIGNED) BRIEN SHEAHAN

Chairman

Ameren Illinois Company

Revenue Requirement Summary
For the Test Year Ending December 31, 2017
(In Thousands)

Line No.	Description	Granted in Prior Case (16-0262)		Company Proposed Changes (e) - (b)		Company Proposed Changes (c) / (b)	Company Proposal FR A-1		Adjustments (h) - (e)	Adjustments (f) / (e)	Net Revenue Requirement Per Staff	
	(a)	(b)		(c)		(d)	(e)		(f)	(g)	(h)	
1	Base Revenue Requirement - Filing Year	$ 944,155	(1)	$ 29,260			$ 973,415	(2)	$ (639)		$ 972,776	(8)
2	Reconciliation Adjustment with Interest	71,632	(1)	(45,598)			26,034	(3)	(362)		25,672	(9)
3	ROE Collar Adjustment	-	(1)	-			-	(4)	-		-	(10)
4	Total Net Revenue Requirement	$ 1,015,787	(1) & (6)	$ (16,338)	(7)	-1.61%	$ 999,449	(5)	$ (1,001)	-0.10%	$ 998,448	(11)
5	Total $ Change - Total Net Revenue Requirement										$ (17,339)	(12)
6	Total % Change - Total Net Revenue Requirement										-1.71%	(13)

Notes
(1) Commission Order in Docket No. 16-0262, Appendix A, Summary, Column (h)
(2) Ameren Direct Testimony, Ameren Ex. 1.1, Sch FR A-1, line 22 + line 26
(3) Ameren Direct Testimony, Ameren Ex. 1.1, Sch FR A-1, line 28
(4) Ameren Direct Testimony, Ameren Ex. 1.1, Sch FR A-1, line 29
(5) Ameren Direct Testimony, Ameren Ex. 1.1, Sch FR A-1, line 30
(6) Ameren Direct Testimony, Ameren Ex. 1.1, Sch FR A-1, line 31
(7) Ameren Direct Testimony, Ameren Ex. 1.1, Sch FR A-1, line 32
(8) Appendix A, Schedule 1, line 1
(9) Appendix A, Schedule 1, line 3
(10) Appendix A, Schedule 1, line 4
(11) Appendix A, Schedule 1, line 5
(12) Column (h) line 4 minus Column (b) line 4
(13) Line 5 divided by Column (b), line 4.

Ameren Illinois Company
Statement of Operating Income with Adjustments
For the Filing Year Ending December 31, 2017
(In Thousands)

Line No.	Description	Company Pro Forma Jurisdictional Operating Income (Ameren Ex. 13.1, p 2)	Adjustments	Pro Forma Present (Cols. b+c)	Effect of Proposed Rates Per Company (Ameren Ex. 13.1, p 2)	Gross Revenue Conversion Factor	Proposed Rates With Adjustments (Cols. d+e+f)	Adjustment To Proposed Increase	Operating Statement Per Order (Cols. g+h)	Net Revenue Requirement Per Order
	(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)
1	Base Revenue Requirement - Filing Year	$ 943,980	-	$ 943,980	$ 28,796	$ 2	$ 972,778	$ (2)	$ 972,776	$ 972,776
2	Other Revenues	32,888	-	32,888	-	-	32,888	-	32,888	
3	Reconciliation Adjustment	-	-	-	-	-	-	-	-	25,672
4	Return on Equity Collar Adjustment	-	-	-	-	-	-	-	-	-
5	Total	976,868	-	976,868	28,796	2	1,005,666	(2)	1,005,664	$ 998,448
6	Uncollectibles Expense	9,084	-	9,084	241	$ -	9,325	-	9,325	
7	Distribution	267,200	-	267,200	-	-	267,200	-	267,200	
8	Customer Accounts	41,317	-	41,317	-	-	41,317	-	41,317	
9	Customer Services and Informational Services	6,834	-	6,834	-	-	6,834	-	6,834	
10	Sales.	-	-	-	-	-	-	-	-	
11	Administrative and General	123,895	-	123,895	-	-	123,895	-	123,895	
12	Depreciation and Amortization	241,047	-	241,047	-	-	241,047	-	241,047	
13	Taxes Other Than Income	53,151	-	53,151	-	-	53,151	-	53,151	
14	Regulatory Asset Amortization	2,712	-	2,712	-	-	2,712	-	2,712	
15	Pension Asset Funding Cost	-	-	-	-	-	-	-	-	
16	Other Expense Adjs	(9,116)	-	(9,116)	-	-	(9,116)	-	(9,116)	
17	Total Operating Expense									
18	Before Income Taxes	736,124	-	736,124	241	-	736,365	-	736,365	
19	State Income Tax	(7,081)	-	(7,081)	2,213	-	(4,868)	-	(4,868)	
20	Federal Income Tax	(29,501)	-	(29,501)	9,220	-	(20,281)	(1)	(20,282)	
21	Deferred Taxes and ITCs Net	101,665	-	101,665	-	-	101,665	-	101,665	
22	Total Operating Expenses	801,207	-	801,207	11,674	-	812,881	(1)	812,880	
23	NET OPERATING INCOME	$ 175,661	-	$ 175,661	$ 17,122	$ 2	$ 192,785	$ (1)	$ 192,784	192,784
24	Rate Base (Apendix A, Schedule 2, column (d), line 24)								$ 2,738,545	
26	Overall Rate of Return								7.040%	

Ameren Illinois Company
Rate Base
For the Filing Year Ending December 31, 2017
(In Thousands)

Line No.	Description	Company Pro Forma Jurisdictional Rate Base (Ameren Ex. 13.1, pp. 7-8)	Adjustments	Rate Base per Order (Col. b+c)
	(a)	(b)	(c)	(d)
1	Distribution Plant	$ 6,246,643	$ -	$ 6,246,643
2	G & I Plant	554,113	-	554,113
3	Accumulated Depreciation on Distribution Plant	(2,925,960)	-	(2,925,960)
4	Accumulated Depreciation on G & I Plant	(199,466)	-	(199,466)
5	Net Plant	3,675,330	-	3,675,330
6	Additions to Rate Base			
7	Materials and Supplies	37,802	-	37,802
8	Construction Work in Progress	1,068	-	1,068
9	Plant Held for Future Use	411	-	411
10	OPEB Liability	3,547	-	3,547
11	Cash Working Capital	15,933	-	15,933
12	Deferred Charges Greater Than $3.7M	15,279	-	15,279
13	Other Deductions From Rate Base	-	-	-
14	Accumulated Deferred Income Taxes	(947,416)	-	(947,416)
15	Accrued Vacation Reserve	-	-	-
16		-	-	-
17		-	-	-
18	Accumulated Misc. Operating Provisions		-	-
19	Asset Retirement Obligation	-	-	-
20	Other Deferred Credits	(15,880)	-	(15,880)
21	Customer Advances	(14,935)	-	(14,935)
22	Customer Deposits	(32,594)	-	(32,594)
23		-	-	-
24	Rate Base	$ 2,738,545	$ -	$ 2,738,545

Ameren Illinois Company
Gross Revenue Conversion Factor
For the Filing Year Ending December 31, 2017
(In Thousands)

Line No.	Description	Rate	With Bad Debts	Without Bad Debts
	(a)	(b)	(c)	(d)
1	Revenues		1.000000	1.000000
2	Uncollectibles	0.8450%	0.008450	
3	State Taxable Income		0.991550	
4	State Income Tax	7.7500%	0.076845	0.077500
5	Federal Taxable Income		0.914705	0.922500
6	Federal Income Tax	35.0000%	0.320147	0.322875
7	Operating Income		0.594558	0.599625
8	Gross Revenue Conversion Factor (Line 1 / Line 7)		1.681922	1.667709

Ameren Illinois Company

Reconciliation Computation for the Year Ending December 31, 2016

For the Filing Year Ending December 31, 2017
(In Thousands)

Line No.	Description	Source	Amt				
	(a)	(b)	(c)	(d)	(e)	(f)	(g)
1	Actual Revenue Requirement	Appendix B, Schedule 1, col. (i), line 1	$ 942,829				
2	Revenue Requirement in effect during Reconciliation Year	Ameren Ex. 1.1, p.6 [Sch FR A-4]	920,521 (1')				
3	Variance - Reconciliation Before Collar	(Ln 1) - (Ln 2)	22,308				
4	ROE Collar Adjustment	Appendix A, Schedule 5, Col (b), Ln 43	-				
5	Variance with Collar	(Ln 3) + (Ln 4)	$ 22,308				
6	Monthly Interest Rate	Staff Ex. 3.0, Wtd. Cost of Debt/12	0.5866%				
			Variance	Interest Rate	Months	Interest	Surcharge (Refund)
			(Ln 5) / 12	Ln 6		(c) * (d * (e)	(c) + (f)
	2015						
7	January		$ 1,859	0.5866%	11.5	$ 125	$ 1,984
8	February		1,859	0.5866%	10.5	115	1,974
9	March		1,859	0.5866%	9.5	104	1,963
10	April		1,859	0.5866%	8.5	93	1,952
11	May		1,859	0.5866%	7.5	82	1,941
12	June		1,859	0.5866%	6.5	71	1,930
13	July		1,859	0.5866%	5.5	60	1,919
14	August		1,859	0.5866%	4.5	49	1,908
15	September		1,859	0.5866%	3.5	38	1,897
16	October		1,859	0.5866%	2.5	27	1,886
17	November		1,859	0.5866%	1.5	16	1,875
18	December		1,859	0.5866%	0.5	5	1,864
19	Total	Sum of (Ln 7) thru (Ln 18)	$ 22,308			$ 785	$ 23,093
			Balance	Interest Rate	Mons	Interest	Balance
				Ln 6		(c) * (d * (e)	(c) + (f)
	2015						
20	January - December	Col G Ln 19	$ 23,093	0.5866%	12	$ 1,626	$ 24,719
			Balance	Interest Rate		Amort	Balance
				Ln 6		(2')	(c) + (c) * (d) - (f)
	2017						
21	Jan	Col G Ln 20	$ 24,719	0.5866%		$ 2,139	$ 22,725
22	Feb	Col G Ln 21	22,725	0.5866%		2,139	20,719
23	Mar	Col G Ln 22	20,719	0.5866%		2,139	18,701
24	Apr	Col G Ln 23	18,701	0.5866%		2,139	16,671
25	May	Col G Ln 24	16,671	0.5866%		2,139	14,630
26	Jun	Col G Ln 25	14,630	0.5866%		2,139	12,576
27	Jul	Col G Ln 26	12,576	0.5866%		2,139	10,511
28	Aug	Col G Ln 27	10,511	0.5866%		2,139	8,433
29	Sep	Col G Ln 28	8,433	0.5866%		2,139	6,343
30	Oct	Col G Ln 29	6,343	0.5866%		2,139	4,241
31	Nov	Col G Ln 30	4,241	0.5866%		2,139	2,127
32	Dec	Col G Ln 31	2,127	0.5866%		2,139	0
33	Variance with Interest	Sum of (Ln 21) thru (Ln 32)				$ 25,674	
34	Remove ROE Collar Adjustment (3')	Ln 4				$ -	
35	Reconciliation with Interest	(Ln 33) - (Ln 34)				$ 25,672	To Sch. 4.01 FY, col. (j), line 3

Notes:

(1') Calculated in accordance with Section 16-108.5 (d)(1) of the Act. Reconciliation for 2015 will reflect the amount shown on Sch. FR A-4 Ln 2 of the calculation used to determine revenue requirement in effect during the reconciliation year.

(2') (-1.0) * (PMT((Ln 21 Col (d)),12,(Ln 20, Col (g)))

(3') Remove ROE Collar Adjustment from calculation as this amount is included on Appendix A, Schedule 1, Col (j), Ln 4.

Ameren Illinois Company

ROE Collar Computation for the Year Ending December 31, 2016
For the Filing Year Ending December 31, 2017
(In Thousands)

Line No.	Description (a)		Amount (b)	Column (b) Source (c)
1	DS Rate Base	$	2,608,938	Appendix B, Schedule 2, Column (d), Line 24
	Capital Structure:			
2	Common Equity %		50.00%	AIC Schedule WPC-5.4, Line 4
3	Preferred Stock%		1.18%	AIC Schedule WPC-5.4, Line 3
4	Short-Term Debt %		0.00%	AIC Schedule WPC-5.4, Line 2
5	Long-Term Debt %		48.82%	AIC Schedule WPC-5.4, Line 1
6	DS Equity Balance		1,304,469	Ln 1 x Ln 2
7	DS Preferred Stock Balance		30,785	Ln 1 x Ln 3
8	DS Short-Term Debt Balance		-	Ln 1 x Ln 4
9	DS Long-Term Debt Balance		1,273,684	Ln 1 x Ln 5
10	Cost of Short-Term Debt (%)		0.00%	
11	Cost of Long-Term Debt (%)		5.62%	
12	Cost of Preferred Stock		4.98%	
13	DS Operating Revenue	$	950,637	FERC Form 1, p. 300, line 12 and Note (1')
14	[blank]			
15	Accrued Reconciliation and Collar Revenues Included on Line 13	$	24,205	FERC Form 1, p. 300, line 12 and Note (1')
16	Updated Reconciliation Amount before Collar	$	22,308	Appendix A, Schedule 4, line 3
17	Other Revenue	$	32,888	Appendix A, Schedule 1 Column (t) line 2
18	DS Applicable Operating Revenue	$	981,628	Ln 13 - Ln 15 + Ln 16 + Ln 17
19	Total DS Operating Expenses	$	719,227	Appendix B, Schedule 1, Column (i), line 18
20	DS Operating Income Before Interest & Taxes	$	262,401	Ln 18 - Ln 19
21	DS Short-Term Interest Expense	$	-	Ln 6 x Ln 10
22	DS Long-Term Interest Expense	$	71,568	Ln 9 x Ln 11
23	Credit Facilities Expense	$	997	Line 1 times 0.038% Credit Facility Fees
24	DS Operating Income before Taxes	$	189,836	Ln 20 - Ln 21 - Ln 22 - Ln 23
25	Income Tax Rate (%)		40.038%	Appendix B, Schedule 3, Column (d), Ln 4 + Ln 6
26	DS Income Taxes	$	76,006	Ln 24 x Ln 25
27	Impact of ITCs & Permanent Tax Differences	$	(1,349)	Company Sch FR C-4, Ln 12
28	DS Income Taxes	$	74,657	Ln 26 + Ln 27
29	DS Net Income before Dividend	$	115,180	Ln 24 - Ln 28
30	DS Preferred Stock Dividend	$	1,533	Ln 7 x Ln 12
31	DS Net Income	$	113,647	Ln 29 - Ln 30
32	DS ROE (%)		8.71%	Ln 31 / Ln 6
33	ROE Collar			
34	Allowed ROE (%)		8.40%	Company Sch FR D-1, Col. (D), Ln 17
35	Maximum Allowed ROE (%)		8.90%	Ln 34 + .5%
36	Minimum Allowed ROE (%)		7.90%	Ln 34 - .5%
37	Percent Above Maximum Allowed ROE (%)		0.00%	
38	Amount Above Allowed ROE Collar	$	-	Ln 6 x Ln 37
39	Percent Below Minimum Allowed ROE (%)		0.00%	Ln 36 - Ln 32
40	Amount Below Allowed ROE Collar	$	-	Ln 6 x Ln 39
41	ROE Collar Adj After Tax	$	-	Ln 38 + Ln 40
42	ROE Collar Tax Gross-up	$	-	Ln 41 x Ln 25/(1- Ln 25)
43	ROE Collar Adj	$	-	Ln 41 + Ln 42

Ameren Illinois Company

Statement of Operating Income with Adjustments

For the Reconciliation Year Ending December 31, 2016

(In Thousands)

Line No.	Description	Company Jurisdictional Operating Income (AIC Ex. 13.1, p. 3,6)	Adjustments	Adjusted Jurisdictional Operating Income (Cols. b+c)	Reconciliation Adjustment Per Company (Ameren Ex. 13.1, p 6)	Gross Revenue Conversion Factor	Company Proposed Revenue Requirement (Cols. d+e+f)	Adjustment To Reconciliation Adjustment	Actual 2016 Revenue Requirement Per Order (Cols. g+h)
	(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)
1	Revenue Requirement	$ 920,521	-	$ 920,521	$ 22,308	$ (1)	$ 942,828	$ 1	$ 942,829
2	Other Revenues	32,888	-	32,888	-	-	32,888	-	32,888
3	-	-	-	-	-	-	-	-	-
4	-	-	-	-	-	-	-	-	-
5	Total	953,409	-	953,409	22,308	(1)	975,716	1	975,717
6	Uncollectibles Expense	6,597	-	6,597	-	-	6,597	-	6,597
7	Distribution	267,200	-	267,200	-	-	267,200	-	267,200
8	Customer Accounts	41,317	-	41,317	-	-	41,317	-	41,317
9	Customer Services and Informational Services	6,834	-	6,834		-	6,834	-	6,834
10	Sales	-	-	-	-	-	-	-	-
11	Administrative and General	123,895	-	123,895	-	-	123,895	-	123,895
12	Depreciation and Amortization	226,637	-	226,637	-	-	226,637	-	226,637
13	Taxes Other Than Income	53,151	-	53,151	-	-	53,151	-	53,151
14	Regulatory Asset Amortization	2,712	-	2,712	-	-	2,712	-	2,712
15	Pension Asset Funding Cost	-	-	-	-	-	-	-	-
16	Other Expense Adjs	(9,116)	-	(9,116)	-	-	(9,116)	-	(9,116)
17	Total Operating Expense								
18	Before Income Taxes	719,227	-	719,227	-	-	719,227	-	719,227
19	State Income Tax	(7,310)	-	(7,310)	1,729	-	(5,581)	-	(5,581)
20	Federal Income Tax	(30,456)	-	(30,456)	7,203	(1)	(23,254)	-	(23,254)
21	Deferred Taxes and ITCs Net	101,665	-	101,665	-	-	101,665	-	101,665
22	Total Operating Expenses	763,126	-	763,126	8,932	(1)	792,057	-	792,057
23	NET OPERATING INCOME	$ 170,283	-	$ 170,283	$ 13,376	$ -	$ 183,659	$ 1	$ 183,660
24	Rate Base (Appendix B, Schedule 2, column (d), line 24)								$ 2,606,938
25	Overall Rate of Return per Order								7.040%
26	Reconciliation Balance Before Interest (column (i), line 5 minus column (b), line 5) (Agrees to Appendix A, Schedule 4, line 3.)								$ 22,306

Ameren Illinois Company
Rate Base
For the Reconciliation Year Ending December 31, 2016
(In Thousands)

Line No.	Description	Pro Forma Jurisdictional Rate Base (Ameren Ex. 13.1, pp. 7-8)	Adjustments	Rate Base per Order (Col. b+c)
	(a)	(b)	(c)	(d)
1	Distribution Plant	$ 5,876,632	$ -	$ 5,876,632
2	G & I Plant	494,321	-	494,321
3	Accumulated Depreciation on Distribution Plant	(2,733,972)	-	(2,733,972)
4	Accumulated Depreciation on G & I Plant	(168,507)	-	(168,507)
5	Net Plant	3,468,474	-	3,468,474
6	Additions to Rate Base			
7	Materials and Supplies	37,802	-	37,802
8	Construction Work in Progress	1,068	-	1,068
9	Plant Held for Future Use	411	-	411
10	Deferred Debits	15,279	-	15,279
11	Cash Working Capital	16,084	-	16,084
12	OPEB Liability	3,547	-	3,547
13	Deductions From Rate Base		-	
14	Accumulated Deferred Income Taxes	(870,318)	-	(870,318)
15	Accrued Vacation Reserve	-	-	-
16		-	-	-
17		-	-	-
18	Accumulated Misc. Operating Provisions	-	-	-
19	Asset Retirement Obligation	-	-	-
20	Other Rate Base Adjustments	(15,880)	-	(15,880)
21	Customer Advances	(14,935)	-	(14,935)
22	Customer Deposits	(32,594)	-	(32,594)
23		-	-	-
24	Rate Base at End of Year	$ 2,608,938	$ -	$ 2,608,938

Ameren Illinois Company
Gross Revenue Conversion Factor
For the Reconciliation Year Ending December 31, 2016
(In Thousands)

Line No.	Description	Rate	With Bad Debts	Without Bad Debts
	(a)	(b)	(c)	(d)
1	Revenues		1.000000	1.000000
2	Uncollectibles	0.0000%	0.000000	
3	State Taxable Income		1.000000	
4	State Income Tax	7.7500%	0.077500	0.077500
5	Federal Taxable Income		0.922500	0.922500
6	Federal Income Tax	35.0000%	0.322875	0.322875
7	Operating Income		0.599625	0.599625
8	Gross Revenue Conversion Factor (Line 1 / Line 7)		1.667709	1.667709

4

KENTUCKY POWER
CASE NO. 2017-00179
STAFF'S FIRST SET OF DATA REQUESTS
DATED MAY 22, 2017

REQUEST

KPSC_1_61 Provide all wage, compensation, and employee benefits studies, analyses, or surveys conducted since the utility's last base rate case or that are currently utilized by the utility.

RESPONSE

AEP has participated in benefits surveys performed by Alight (previously Aon Hewitt), Willis Towers Watson and Havens & Company. The Company uses these results to benchmark its benefit plans for reasonableness in terms of plan design and value as compared to other non-affiliated utility employers. It is standard practice in benefits design work to rely on resources such as survey data to gauge the reasonableness of employee benefit plans. Please refer to

KPCO_R_KPSC_1_61_Redacted_Attachment1.pdf,

KPCO_R_KPSC_1_61_Redacted_Attachment2.pdf,

KPCO_R_KPSC_1_61_Redacted_Attachment3.pdf, and

KPCO_R_KPSC_1_61_Redacted_Attachment4.pdf.

AEP also conducted a nearly company-wide compensation study and redesign of the Company's compensation structure. Please refer to KPCO_R_KPSC_1_61_Redacted_Attachment5.pdf and KPCO_R_KPSC_1_61_Redacted_Attachment6.pdf.

The HR Committee of the Board of Directors annually conducts an executive compensation study covering approximately 25 executive positions. These studies are conducted by the HR Committee's external compensation consultant, which is currently Meridian Compensation Partners LLC and previously was Pay Governance LLC. Please refer to KPCO_R_KPSC_1_61_Redacted_Attachment7.pdf.

The market compensation surveys are voluminous and are subject to the Company's motion to deviate. KPCO_R_KPSC_1_61_Redacted_Attachment8.pdf.

The Company is seeking confidential treatment for all attachments provided in this response.

Supplemental Response filed January 2, 2018:

As part of AEP's ongoing analysis and review of the Company's benefits plans and programs, AEP recently become aware that the United States military, in an effort to reduce costs and increase retirement savings by its members, is modernizing its retirement benefits effective for 2018 in a fashion similar to the approach A.E.P. is currently utilizing. https://www.military.com/benefits/military-pay/upcoming-changes-to-military-retirement-system-explained.html. The changes are based on a recommendation by the Military Retirement Modernization Commission which conducted a long-term study of the military retirement benefit and made a recommendation to Congress. The Commission's recommendation was included in the National Defense Authorization Act of 2016 and will be effective in 2018.

The new U.S. military retirement system is known as the "Blended Retirement System" or BRS. The "blending" in BRS comes from the blending of two sources of retirement income: the existing defined benefit provision, plus a new defined contribution "Thrift Savings Plan" (TSP). The TSP is a government run retirement plan that offers the same types of savings and tax benefits that are provided under 401(k) plans. It allows members to invest their own money in either stocks or government securities and also get a contribution to that account from their employer. This new structure will now be similar to what AEP offers through its defined benefit cash balance retirement plan and defined contribution 401k retirement savings plan.

Witness: Curt D. Cooper
Andrew R. Carlin

VERIFICATION

The undersigned, Andrew R. Carlin, being duly sworn, deposes and says he is the Director, Compensation and Executive Benefits for American Electric Power Service Corporation, that he has personal knowledge of the matters set forth in the forgoing responses and the information contained therein is true and correct to the best of his information, knowledge and belief.

Andrew R. Carlin

Andrew R. Carlin

STATE OF OHIO)

) Case No. 2017-00179

COUNTY OF FRANKLIN)

Subscribed and sworn to before me, a Notary Public in and before said County and State, by Andrew R. Carlin this the 2nd day of January 2018.

MARTIN ROSENTHAL
Attorney at Law
Notary Public, State of Ohio
My Commission Has No Expiration
Section 147.03 R.C.

Notary Public

My Commission Expires: ____________________

VERIFICATION

The undersigned, Curt Cooper, being duly sworn, deposes and says he is the Director of Employee Benefits for American Electric Power, that he has personal knowledge of the matters set forth in the forgoing responses and the information contained therein is true and correct to the best of his information, knowledge and belief.

Curt Cooper

STATE OF OHIO)
) Case No. 2017-00179
COUNTY OF FRANKLIN)

Subscribed and sworn to before me, a Notary Public in and before said County and State, by Curt Cooper this the 2nd day of January 2018.

NOTARIAL SEAL
STATE OF OHIO

[illegible]
Attorney At Law
Notary Public, State of Ohio
My Commission Has No Expiration
Section 147.03 R.C.

Notary Public

My Commission Expires: ____________

Test Year Rockport ROE Charge

If AEG Rockport Earned the Allowed 12.16%

	Mar-16	Apr-16	May-16	Jun-16	Jul-16	Aug-16	Sep-16	Oct-16	Nov-16	Dec-16	Jan-17	Feb-17	Total
Total at 12.16%													
Return on Common Equity	1,201,957	1,223,410	1,227,178	1,197,901	1,207,061	1,216,348	1,225,874	1,239,881	1,247,632	1,252,014	1,264,019	1,270,384	14,773,659
Return of Interest	272,022	250,771	267,787	333,178	303,634	309,077	313,510	309,558	363,956	338,013	361,689	334,936	3,758,131
Total Return Component	1,473,979	1,474,181	1,494,965	1,531,079	1,510,695	1,525,425	1,539,384	1,549,439	1,611,588	1,590,027	1,625,708	1,605,320	18,531,790
I&M Portion	1,031,785	1,031,927	1,046,476	1,071,755	1,057,487	1,067,798	1,077,569	1,084,607	1,128,112	1,113,019	1,137,996	1,123,724	12,972,253
KY Portion	442,194	442,254	448,490	459,324	453,209	457,628	461,815	464,832	483,476	477,008	487,712	481,596	5,559,537

Actual Amount Billed Out - Limited by Operating Ratio

	Mar-16	Apr-16	May-16	Jun-16	Jul-16	Aug-16	Sep-16	Oct-16	Nov-16	Dec-16	Jan-17	Feb-17	Total
Total AEG Bill													
Return on Common Equity	901,644	888,132	866,416	785,407	844,866	818,688	822,593	823,462	785,063	786,749	819,297	793,239	9,935,556
Return of Interest	204,056	182,047	189,064	218,449	212,524	208,030	210,374	205,591	229,016	212,366	234,435	209,137	2,515,089
Total Return Component	1,105,700	1,070,179	1,055,480	1,003,856	1,057,390	1,026,718	1,032,967	1,029,053	1,014,079	999,115	1,053,732	1,002,376	12,450,645
I&M Portion	773,990	749,125	738,836	702,699	740,173	718,703	723,077	720,337	709,855	699,381	737,612	701,663	8,715,452
KY Portion	331,710	321,054	316,644	301,157	317,217	308,015	309,890	308,716	304,224	299,735	316,120	300,713	3,735,194

	Mar-16	Apr-16	May-16	Jun-16	Jul-16	Aug-16	Sep-16	Oct-16	Nov-16	Dec-16	Jan-17	Feb-17
Estimated Operating Ratio	75.01%	72.59%	70.60%	65.57%	69.99%	67.31%	67.10%	66.41%	62.92%	62.84%	64.82%	62.44%
Estimated Monthly ROE	9.12%	8.83%	8.59%	7.97%	8.51%	8.18%	8.16%	8.08%	7.65%	7.64%	7.88%	7.59%

For the test year period, Kentucky received a $1,824,343 benefit due to the reduction of the AEG Rockport ROE due to the limiter.

KPCo ex. 8