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 AND LIABILITIES; AND (5) AN ORDER GRANTING ALL OTHER REQUIRED APPROVALS AND RELIEF	)	CASE NO. 2017-00179

VOLUME II

* * *

Transcript of December 7, 2017, hearing before Michael Schmitt, Chairman; Robert Cicero, Vice-Chairman; and Talina R. Mathews, Commissioner, at the Kentucky Public Service Commission, 211 Sower Boulevard, Frankfort, Kentucky 40602-0615.

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ALSO PRESENT:
Ms. Pam Hughes, videographer

* * *

(Hearing commenced at 9:01 a.m.)

CHAIRMAN SCHMITT: Okay. We are now back on on the record. Mr. Satterwhite, as we left I guess last evening, was still on the stand undergoing cross-examination by Ms. Vinsel.

Ms. Vinsel, are you ready to proceed?

MS. VINSEL: Yes, I am. Thank you, Your Honor.

CROSS-EXAMINATION (Continuing)

By Ms. Vinsel:

Q. Good morning, Mr. Satterwhite.

A. Good morning.

Q. I'm going to start by clarifying something that we talked about yesterday about the tariffs on CS coal contracts. Staff went back and looked again last night, and we did find all three contracts, so that issue has been resolved.

A. Yeah, I think the confusion probably was one happened after the report that we filed in July, so the end of report will have that. That's probably why there was a mixup. Perfectly explainable.

Q. Thank you very much. Now, when we left off yesterday we were talking about the PJM OATT. I'm going to switch topics just for a few minutes and get back to that.

A. Okay.

Q. When we talked yesterday about the proposed tariff about denial of service, I think that we probably should go ahead and have some -- I have some questions just in general for you.
A. Okay.
Q. If I can get my colleagues to help me. This packet, I'm going to call it the cover sheet, but the first page is the proposed tariff that's already in the record. The other three documents are exhibits that I will introduce.
Just to refresh our discussion from yesterday, under number 18, the denial or discontinuance of service, and we're really looking here at the denial of service.
That first part of that sentence before the semicolon, (Reading) The company reserves the right to refuse service to any customer if the customer or any member of the customer's household is indebted to the company for any service theretofore rendered at any location.
So can we unpack that together?
A. Sure.
Q. See if you agree with me. Just that part of the new tariff seems to indicate four different scenarios: two scenarios involving a customer in

whose name the account is held, and then two scenarios involving a member of the household of that customer.

The first is denial of service at the service address where the debt was incurred by the customer. The second is any location where that customer may ask to receive service.

Similarly, for any member of the household it seems to indicate denial of service at that address, service address, where the other customer first became indebtedness. I'm trying not to make this sound like an algebra calculation.

A. Two trains.

Q. There you go. And then the fourth is if that member of a household where the debt was incurred applies for service at any location.

So I want to walk through those pieces and Commission precedent in regard to them. Let's start with the customer in whose name the account is held.

Let me have you turn to, it's tab number 2 because this is Exhibit Number 2. Yes, the Exhibit Number 2 I'd like to introduce, and this is an order dating back from 2001 in which the Commission accepted a settlement agreement that provided for denial of service only for a customer in whose name the account was held and that's now could be at any location.

Now, I will tell you I did not want to print out all of the tariffs, but we're aware that there are at least three other utilities that have similar provisions where service can be denied to any customer who is indebted, the customer in whose account is held, and I know there wasn't a question in there. I'm trying to do this as background.

(PSC Exhibit 2 marked for identification.)

A. I appreciate the background.

Q. So there is precedent for that particular piece.

(PSC Exhibit 3 marked for identification.)

Can I have you turn to Exhibit Number 3, PSC Exhibit Number 3. This is an administrative case, again from the past, in 1984. Rather than asking you to read this into the record, I'm just going to read some significant parts and see if you concur that this is what the order says.

On the first paragraph on the first page, (Reading) On April 6, 1984, the Commission issued an order inviting public comment on the recurring issue of whether the husband and wife should share the liability for payment of utility bill where the contract for the utility service was made by only one spouse.

Do you agree that's what is on this paper?

A. Yes.

Q. If you turn to page 2, paragraph 2, and it's the fourth line down beginning -- again talking only about, if you will, a member of the household that did not sign the contract for the account.

(Reading) The factual situations that give rise to payment liability problems among family members are virtually infinite, and it is the Commission's opinion that no specific regulation can possibly address even the majority of these problems. Instead, a flexible case-by-case approach in resolving these complicated situations is often fair to both the customer and the utility.

Would you concur that that is what is on this page that I've given you?

A. Yes, from this order.

Q. From this order.

A. Right.

(PSC Exhibit 4 marked for identification.)

Q. And let me have you turn to PSC Exhibit 4. It's the customer bill of rights. And that very first bullet point. See if you would agree that what it reads is, (Reading) The customer, you have the right to service provided you or a member of your household in whose debt -- excuse me, a member of your household whose debt was accumulated at your address are not indebted to the utility.

Correct?

A. That's what that says, yes.

Q. So just a little bit that we've read from the order in the administrative case, the customer bill of rights goes to three of those scenarios for the customer, would you agree, and let me walk through what those three are. The customer -- let's just say the indebted customer.

A. Customer of record.

Q. The customer of record, much better. The customer of record, so denial of service at the service address or in any location.

A. Yes.

Q. And potentially denial of service for a member of the household at that same service address.

A. Yes.

Q. So what is the basis for the broader version for denial of service for a member of a household at any address?

A. As I stated yesterday, I'm sure this changed.

I'm familiar with this overall theory across many jurisdictions. This is a common question that comes up. It's been developing over the years. I think Mr. Sharp would know the exact circumstances that probably led to us wanting to make a change from a general higher policy overall position, not the examples that probably Mr. Sharp would have for why we're requesting the change.

There's something in many jurisdictions called the benefit of service rule. What we find is that customers have, you know, husband, spouse, and grandparents in the house, and they sort of play a game where they put service in one person's name, don't pay their bill, and then put it immediately in somebody else's that's an adult in the house, and sort of play the game where they're not paying their bill, so all the other customers are picking up that charge, but they have received the benefit of service because they've lived in that house.

So that's sort of the global approach of how this is developed since the '80s when the original order came out, and probably maybe even before that. Customers can be very creative.

So an overall policy is that concept of people trying to game the system, and the rest of the customers then picking up the tab because we have, you know, unpaid liabilities from customers sort of staying one step ahead because the rules allow them to.

Q. And acknowledging that, and again I did not want to print out reams of cases, but we do have a case -- we do have cases where the Commission has addressed a member of a household who attempted to get service at that same address where the customer of record had incurred debt, and fact by fact, case-by-case basis, there's Commission precedent for that.

Are you aware of any Commission precedent for a benefit of service argument for a member of -- denying service to a member of a household where the customer of record incurred debt at any other service location beyond the service location where the debt was incurred?

A. Well, as I said, I'm not into the every day. Steve Sharp might have better examples of that. I'm more grabbing from in my former career I was the legal director for the enforcement department for the Public Utilities Commission of Ohio, oversaw the call center, the complaints, the investigators.

This is a common issue that came up, and as the

Commission in Ohio, you know, you try to balance protecting customers, but also making sure customers aren't gaming the system, and so that's where I dealt with a lot of these issues, so when I speak about it I speak more globally from multiple jurisdictions. The exact Kentucky precedent, I'd have to defer to my people that have more expertise in dealing with this.

Q. Okay. I'll ask Mr. Sharp about those questions.

A. Okay.

Q. Because it would be helpful to know. Also some indication as to, for example, how you indicate that someone actually was a member of a household when service is denied at an address other than where the debt was incurred.

There are cases on record where the Commission has made it clear that there was no evidence to support that type of conclusion. I'll just put that out for you right now.

A. Okay.

Q. And I will follow up with Mr. Sharp.

A. And I'm familiar there's been some discussion. I've heard about that. I try to work with our customer service reps a lot because that is my history, that there has to be some amount of proof.

Can't just be by fiat we just declare it, so how that works Mr. Sharp would know better.

Q. Okay. Thank you.

VICE-CHAIRMAN CICERO: May I ask a question and interrupt here for a second?

MS. VINSEL: Yes.

EXAMINATION

By Vice-Chairman Cicero:

Q. So if I understood the language, does the tariff state that say there's a person in the household, he's a minor, he ends up graduating, goes off to find his own place of abode and tries to set up service for himself. He was a member of a household that was delinquent.

Does this tariff say that he can't establish service because of a delinquency in the prior residence? It says any location, any member of the household.

A. Typically when I've dealt with this in the past, and again deferring to Mr. Sharp, it's been people 18 and over that it's applied to. There's probably examples that led right to this, and there was a reason why we put it in there, so short answer is I don't know. That's what that says. In the past it's been people, non-minors.

Q. Well, you can have somebody that turns out to be a non-minor that moves out of the household at a different location and be denied service --
A. I imagine --
Q. -- based on that tariff, if I hear it correctly.
A. Correct. Correct. And maybe, you know, there needs to be clarification to make that clear. Again, Mr. Sharp would know better. The concept I'm familiar with for the benefit of service is it's people that are not minors receiving the benefit of service as a general statement.
Q. I think their only object is to make sure that for legal purposes that the utility doesn't overstep its bounds and try to become all encompassing, and sometimes the goal is to protect the utility, and attorneys get carried away, and they put this big bubble over it, and they're protected from everything, so --
A. Yeah, correct, and I think the root of it is not protecting the utility. It's protecting customers because these costs are out of control.
Q. I understand. They shoulder the bill.
A. Yeah, but clarification is always good, so I appreciate the conversation.

VICE-CHAIRMAN CICERO: Thanks.

RECROSS-EXAMINATION

By Ms. Vinsel:

Q. And my follow-up question, I think would be, would Kentucky Power consider revising the proposed language in the tariff to address these issues?

A. I want to talk to Mr. Sharp to see why, but if there's holes like this that we need to clarify, absolutely.

Q. Thank you.

I would like to talk about the HEAP surcharge, the heating assistance program, and this is more logistical how the program works. We know that it's been in operation for quite a number of years, but it would help to refresh all of our understanding of how this operates.

A. Okay.

Q. So the surcharge is collected by Kentucky Power, and this goes to provide monies to customers who meet, I presume, certain criteria to receive financial assistance with their energy bill, with their -- particularly their electric bills.

A. Correct, and it goes to -- sorry, I'll follow you. Yes.

Q. No. Let's take this step by step. Kentucky

Power collects the money. Is it community -- primarily community action agencies in the Kentucky Power service territory that administrate these funds?

A. That's my understanding. Again, Mr. Sharp deals with this on a regular basis. He's even met with them to talk about improvements, but yes, that's my understanding.

Q. And again, understanding that this may be more of -- your understanding is more global. Does the money remain at Kentucky Power, or is the money actually forwarded to community action agencies?

A. I'm not aware what account it sits in, like the electronic transfer, how long it sits in one place. I don't have those facts.

Q. And this is for year-round assistance; is that correct?

A. I believe so. Typically there's the winter heating season. I know from reading and talking with agencies, you know, by February they say typically they're even out of funds.

I know typically they have federal funds as well. They try to use those first because they could lose those, but they know our funds are going to be there, so we tend to get used on the second half of

the heating season, so I think it's pretty much the heating season.
Q. And when you talk about the federal funds, are you talking about the LIHEAP program?
A. Yes, yes.
Q. So even though they share -- these two programs share similar names, they are, in fact, different programs?
A. Where the funding sources come from.
Q. Okay.
A. We're trying to provide a benefit to help the local agencies help the customers. They might get funds from other places as well, so it's a funding source to try to do that public good.
Q. Do you know if there's an administrative fee included in the HEAP funds?
A. That I'm not sure of.
Q. Okay. I'll follow up with Mr. Sharp on those.
A. Thank you.
Q. And last I'd like to get back to the PJM OATT. Is it correct that if the Commission were to deny that recovery, that Kentucky Power would have to come in for another rate case?
A. Most likely, yes.
Q. So is this a binary decision? The Commission

authorizes -- or authorizes recovery in this case or Kentucky Power comes in for another rate case?

A. Yeah, 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, but I know there's something that's going to immediately impact my ability to earn the authorized return that the Commission says I'm authorized to return.

It's a large amount, and I have to make sure I'm managing the company properly and taking care of that, so my testimony has really been we know it's out there, we can protect against if the number fluctuates up and down, we expect it to by, you know, waiting until October to see what the number is and then applying it on a going forward basis by tracking it, but I'm going to have to deal with it right away. It's such a huge financial, volatile number it's something I have to deal with.

Q. Why is it such a huge number and a volatile number?

A. The way the regulatory compact works, as you know, a test year, historic test year is a snapshot in time. So as I said yesterday, I might spend a thousand dollars on pencils in that test year. It doesn't mean in the future I'm going to spend a thousand dollars on pencils. It just means that's a representative amount of money that I need to manage the company properly and still sort of walk within those parameters and manage the company.

When you introduce 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 snapshot. It's completely volatile and outside that paradigm of that historic test year view, so that volatility forces me to deal with that.

That's why we defer to the tracking mechanisms. The customers pay no more, no less. The settlement agreement has us still not recovering 20 percent of that. That's a big deal. That's a lot of money, but with the overall balance and everything else that's in the agreement, we think we can move forward with that and avoid having to file another case right away, and as you see in the settlement, there's the three year stay-out as well tied to that, but it's volatile because it's completely outside the construct of that snapshot in time. It's such a volatile number.

Q. I have two follow-up questions to that.

A. Okay.

Q. Which I'm sure you expect. Why didn't Kentucky Power file a forecasted test year instead of choosing to do -- to file under an historical test year, knowing that this money was out there and that it's huge and it's volatile?
A. That was one of my decisions. It was certainly on the table of how to decide what to file in this case. As you heard from other witnesses, I sort of sat everyone down and said let's relook at everything. What can we do to decrease the immediate impact on customers.
Mr. Phillips yesterday talked about how he wanted to finish phase one of the tree trimming to give money back to customers as soon as possible.
Knowing that I have this vision and this plan of working on the denominator affecting the economic development over time, you know, I'm sort of betting on ourselves and betting on the region that we're going to do better, and the future test year, which is part of this as well, I really tried to skinny down this case and take out things that the credit card, the amount I talked about yesterday and other things, to really just put in front of the Commission a very basic case.
You know, there's not really a lot in here.

It's our expenses, which all of our witnesses that are here can talk about every single expense that's in the case and justify those, and it's the basics of the regulatory compact.

There's no, you know, interesting pilots that are going to do strange things. And a future test year was part of that. If we filed a future test year, you know, that's something different for our company. We've always done historic test years.

It's something different for the Commission, I think, although others have done it. It is different than the historic model, and I really wanted to come in and say, "Here's the basics, here's what we need. Bet on us. We're going to bring industry here," and not try to put a bunch of extra facts into the case, so that was part of my decision to keep it very focused.

And that's why the tracking of the OATT costs, it's not saying we're going to put this in base, and we're going to get this no matter what. It's saying whatever the costs are, that will be what's flowed through to the customers. Could be a credit, you never know, probably won't be, but the tracking allows customers to pay no more, no less, and it treats it like -- it gives the Commission the surety to know that it's going to be just those costs and nothing else.

If I do a future test year I'm saying it's going to be this, and if it changes that's what's in base rates, so if we assume $17 million and it comes in at $14 million, our base rates have $17 million of collection. The tracker makes sure that this huge volatile cost is tracked, and so the Commission is assured the customers just pay that amount.

Q. Let's talk about the volatility. AEP has had news releases indicating that they are investing in significant transmission projects. Can you tell us what that amount is across the AEP footprint?

A. Yeah, I didn't look for that last night. I know we talked about that yesterday. I think that's a post-hearing data request. Or maybe it was Mr. Vaughn is going to talk about later. That's not one of the things I looked up last night, but yes, there is an intention to do significant investment in the transmission system, and as I testified to yesterday, I'm trying to get as much of that in the state of Kentucky.

(PSC Exhibit 5 marked for identification.)

Q. I have PSC Exhibit Number 5 to help indicate what those amounts are. What we're handing out is

PSC Exhibit Number 5. It's a printout from AEP's website, one of the news releases.

Would you agree that the headline of this reads "AEP to fuel growth with increased investment in regulated operations and renewables"?

A. That's what that says, yes.

Q. If I could have you turn to, at the top it's listed as page 2 of 4, and in the third paragraph where it says, "Is it correct," it says, (Reading) AEP plans to invest approximately $9 billion in its transmission business over the next three years.

A. You mind if I take a second to read this?

Q. Please do.

A. Thank you. I assume I don't need to read the renewable part. We'll just talk about the transmission part.

Q. No, no, that's true.

A. Okay. Then I'm ready.

Q. And again, on the first page this indicates this press release was issued November 1, 2016.

A. Correct, and if it helps, this looks consistent with my understanding of AEP, I can validate this.

Q. That's what I was going to ask, is that consistent, the $9 billion investment?

A. Absolutely.

Q. So of this projected volatility and cost, how much of that comes from this AEP's system-wide investment in transmission?
A. You're saying how does this fit into the equation of the volatility?
Q. Yes.
A. I know -- I'm not sure how many of these projects. The overall transmission spend for AEP could be out of the AEP zone as well, so I'm not sure how much is in. I imagine a lot of it is in the AEP zone.
I know the flip side of transmission investment is reliability for customers, so the network, transmission network needs help or needs to be rejuvenated everywhere, so I know when I look at a transmission project for Kentucky I'm really looking at how I can alleviate our SAIDI metrics to make sure I'm improving service for customers and looking where there is congestion. So I imagine a lot of this is within the AEP overall zone, but the exact number I don't know.
Q. And I like the term you used earlier about two trains.
A. Uh-oh.
Q. In this case with transmission investment there

are two trains, are there not, in that you've got reliability on one side, and then you've got earnings for the company on the other side. And it's not to say that one or the other is wrong.
A. Right.
Q. But can we acknowledge that there are two trains?
A. I think there's probably 12 trains. Those are the two maybe some of the major buckets. I know right now there's the fact that FERC is really incenting and saying please, please invest in the transmission system, and through their actions cyber security probably goes along with reliability as well in the other areas, so there's probably multiple chains, but absolutely those are two of the trains involved on the system.
Q. Thank you. And not to beat a dead horse, I want to be clear about that, but going back to the historical year versus forecasted test year. What would have been the consequences had Kentucky Power not included the tracker -- or the request in this case, but waited until however, one year out, whatever, to see what the costs were and then come back to the Commission? Explain to me what impact that would have had.

A. It probably would have been a continuation in the company not earning a fair rate of return. I think this year we're earning, to date we're scheduled to earn about 4.8 percent for a year. That's well below. During the test year I think it was 5.8.

If it were 14 or $17 million, just off the top of my head I think it was like 150 basis points or something off of whatever, whatever else it turned out to be the return that we would receive, and, you know, even if the Commission approves a 9.75 that's provided by the balance of the settlement agreement, the nature of a test year is there's still lag.

It would almost be impossible to get to a 9.75, so we're already behind that, and then this would further take it down, and then you'd have the expense again for the customers of another rate case, trying to put that in just to deal with that issue we know about.

Q. So what benefits -- what benefits does Kentucky Power gain from being a member of PJM?

A. That's probably a three-day question and answer.

Q. Oh, God, we don't want to do that. Let me -- let me ask this a different way. The benefits that

Kentucky Power gains from being a PJM member, how do they counteract the OATT costs that will be passed on to customers?

A. You have the generation, and you have the transmission side, so there's multiple facets to PJM. Just speaking on the transmission side, the whole network across the country is changing with retirements.

Really what I look for, and all utilities look for, is stability and certainty for customers. Safe, reliable service. Part of that reliability is making sure we have the system that can deliver the power.

We think we have the capacity now to handle for our customers. We hope to change that and make that a problem with economic development, but you could have another polar vortex, and you need to make sure the system is up to date and you have access to all types of generation and you can move that.

So a robust and vital transmission grid is really vital to every citizen in the United States, and the PJM is a large one that allows us to capitalize on the diversity of generation all across the system, that there won't be congestion, and we can get power to our customers.

The things that happen, you know, in back rooms for cyber security that they're constantly trying to stay one step ahead at PJM to make sure the grid is reliable. It's beyond now just a tree branch falling in Akron and putting New York City out. The things that they're doing are pretty amazing to make sure that we have a secure grid for the country, so being part of PJM overall provides us that security. I guess I'll stop there.

Q. In terms of financial benefits, and recognizing you were here when the Commission approved a case approving Kentucky Power becoming a PJM member. One of the guiding principles of the decision was that the potential to save money to customers.

So how does this, these OATT costs, how does that implicate the issue of saving money for Kentucky Power's customers?

A. It's that stability and certainty to make sure that customers, when they flip the switch at their house they're going to have power because the overall transmission system that we're a member of is securing that. It's the backup to make sure if something happens with our internal operations that something is always going to be there.

I used to represent Indiana Michigan Power. They have the Cook Nuclear Plant, gives all kinds of capacity and all kinds of energy. One thing happens and a turbine goes down, they're out for like 18 months. When you have a system there to back you up to make sure that customers aren't beholden to market.

Sometimes when you really need it the most, it's when you have a polar vortex and prices go through the roof, and when you're part of a system like that you have the backup in place to make sure you have the chance to keep costs down for customers.

Q. And building on what you said about keeping costs down for customers, how does the PJM OATT help to keep costs down for customers, other than stability in the general sense?

A. It's making sure the grid works. It's paying our part, and, you know, our share for most of the costs is 6 percent of what goes into the zone, which another benefit, I guess, for Kentucky customers is when I am successful in getting transmission built here and providing local jobs, someone outside of Kentucky is paying for 94 percent of what we put here in Kentucky.

So there's balance overall because there's a recognition that the entire zone is important to make sure -- the entire region is important to make sure

there's a transmission system, or one state far away can affect another state, so the overall benefit is if we're successful in investing here others are paying for that investment, but we also have a duty to pay our share of the rest of the grid to make sure it works properly.
Q. When you -- the 6 percent, that is Kentucky Power's part of the AEP zone, correct?
A. Correct.
Q. Is there any relation between the customer size, customer base at Kentucky Power that goes into that 6 percent? How is that determined?
A. I believe so. Witness Vaughn is more into exactly what's in the PJM bill. He might be a better person to ask. And then beyond the AEP zone that's lower, it's like a 5 percent and maybe even 4 something percent for the total PJM footprint, but he'd know more about that.
Q. Thank you. Switching -- switching topics. If the Commission were to lower the revenue requirement from that contained in the proposed nonunanimous settlement, does Kentucky Power have any suggestions how the lower revenue requirement should be allocated between the classes, or among the classes?
A. Before I give an idea, let me just say I don't

think you should, but like I said before, the balance in the agreement, it was tough to get to the agreement that we have. Giving up 20 percent of these OATT costs, it's a big deal. It's a big impact. So I would hope the Commission wouldn't disturb that and respect the balance we have in the settlement.

How the Commission would apply it, as I said before, I would hope they would then say if we want to change that we'll look at something else in the settlement to make sure the balance is still protected and lower the ROE, but change something else, but at the end of the day, you know, it's up to the Commission. I think applying that to the residential class to further decrease that is a fine idea.

A lot of the things we did in this case, like I talked about before, the tree trimming, that doesn't hit all customer classes, and a past large rate increase from a rate case it was putting $27 million, and that mainly hit the residential customers largely, and that's why I asked Mr. Phillips and Greg Bell and the good people that work for me, "I know the Commission is giving you permission to implement the program this way, and you're allowed to spend

$27 million a year, but do you have to?"

So there were some long days, a lot of spreadsheets, but we looked at that, and that's where it came at in this case, that we could end phase one early and save money for customers, so I think it's perfectly reasonable to apply that to the residential class to further lower that. They were at about 15 percent with our case filed.

One of the benefits of the settlement agreement is the overall bill impact, even beyond the case, where everything that it touches takes that down to about 9 percent. Further decreasing that, I think, is a good application.

MS. VINSEL: We have no further questions at this time, and Commission Staff would like to move that PSC Exhibits 1 through 5 be entered into the record.

CHAIRMAN SCHMITT: Any objection?

MR. OVERSTREET: No objection.

CHAIRMAN SCHMITT: Let the Exhibits 1 through 5 be entered into the record.

(PSC Exhibits 1 - 5 were admitted.)

CHAIRMAN SCHMITT: Mr. Cicero, questions?

* * *

REEXAMINATION

By Vice-Chairman Cicero:

Q. I want to follow up a little bit on the last portion of her conversation. You continue to talk about the 6 percent versus 94 percent, and I'm curious, you talk about zones and the spending in zones and that's how it's determined what portion of the Kentucky Power's 6 percent versus the 94 percent.

What is the transmission capital spending on average per year in the zone that Kentucky Power is in?

A. For the entire AEP zone or the entire PJM footprint?

Q. If Kentucky Power is contributing 6 percent to, what is that capital?

A. I believe that's in the record, but I don't know that off the top of my head. Witness Vaughn would probably have that. That's what leads into the projection for the $14 million.

Q. How much is the spending that Kentucky Power has managed to obtain for capital projects?

A. Going -- when I came in it was about, I believe the estimate was to be about $20 million, and I think we've raised that to $80 million, and then next year I believe it's close to that as well, for Kentucky

Power to make that investment in the Commonwealth.

Q. So just for a point of looking at numbers, 6 percent of a billion in spending is $60 million, so when we talk about 6 percent versus 94 percent, it's really Kentucky Power -- Kentucky rate payers are not enjoying some huge benefit from this 6 percent versus 94 percent split. That's my only point. I was just pointing that out.

A. Yeah. I agree with that, and the more I can get spent in the zone in Kentucky, the more we get both benefits. We get the benefit of the overall benefit of the system, we get the local investment in Kentucky, and it kind of shifts the payment a little bit.

Q. Okay. So now I'm going to kind of start fresh here. I want to go back to yesterday's conversations. You made the comment to the Attorney General that as all Kentucky Power employees and yourself, your stewardship is to control all costs and make sure that nothing is being spent that shouldn't be spent. Is that a pretty accurate statement?

A. We have to manage the company and make sure all costs are reasonable, absolutely.

Q. Okay. Kentucky Power has a defined benefit

pension program?
A. That's my understanding, yes.
Q. Is it still active, has it been grandfathered, has it been locked and frozen, or what is its status?
A. The detail of the pension is probably better left to Mr. Carlin. He knows better the details and the nuances if something is changed or grandfathered, what that is.
Q. Are there participants being admitted into the program now, or have you transitioned into a 401(k)?
A. Again, the nuances of that I would defer to Mr. Carlin.
Q. That's a pretty straightforward question for the president of the company. That's a pension -- are the employees currently being engaged into a defined dollar benefit plan, or do you have a 401(k) plan, or do you have both?
A. I believe there's both, but Mr. Carlin would know for sure. Honestly, you know, I've spent this past year being the new president. I rely on Mr. Carlin, I talk to him a lot. We have an overall benefit of having part of the AEP system of really having a benefit plan that I know is very vigorous and focused on.
I know the company is constantly looking at how

to update that and change that. We've really controlled costs. Costs have not gone up overall the past few years, I know that, so I really rely on the service corps at this point.

Certainly there's many things I'm going to get deeper into as we move forward. I've spent a lot of this year focused on economic development, at this point trusting what Mr. Carlin and the AEP company has set up for our benefits because I think that's not the area I started in of turning over stones, but it's absolutely something I plan to get into.

Q. Let me ask it from a different approach. Are you a member of the defined dollar benefit pension plan?

A. I'm not sure what I'm in.

Q. I don't know what to say to that. Are you a member of the 401(k) plan?

A. I believe -- yes, I have a 401(k).

Q. I was going to say, because usually you have to direct your investments, so if you're not participating -- if you are participating in that and you haven't directed your investments, then you're --

A. I've elected for the moderate risk, so there's different levels you can elect to be in, if you want to be aggressive, moderate, or very low risk, so I know I've elected for the moderate risk for someone to help make those decisions.

Q. So I'm fairly certain that there's a defined dollar benefit plan, at least I'm told that by staff. You're serving one of the poorest economic areas in the country, not just in Kentucky, but in the country. Do you think that you're being a good steward of spending if your employees are enjoying two pension plan benefits when a defined dollar benefit plan by itself is something that's gone the way of the dinosaurs? There's about ten percent of corporations in America today that actually have a defined dollar benefit plan. Most utilities have it. I found that out.

It's the double dipping and allowing employees to both have a 401(k) matching and a defined dollar benefit plan that the Commission has been looking at and saying wait a minute, your rate payers probably don't even have a pension plan, let alone have two pension plans. What is your comment to that?

A. I think part of your question answers part -- is part of the answer, what most utilities have. I know Mr. Carlin -- I know he's done multiple studies he's provided to the Commission.

I know ours is based on really what the

national average is. I don't think you can compare working at the utility with comparing any other business in our territory. It's sort of a national competition level, and you want that because I want safe workers working for me.

If I just say I'm going to do something completely different than the norm in the utility industry, then I might train people for a year, and they all leave for Ohio or California or Florida, and then I'm constantly just the double A team for every other utility, and I don't have safe, reliable service for my customers.

So Mr. Carlin can talk more about why we believe that's appropriate based on the studies that we have, but I know from a management point of view I need to be competitive so I don't keep losing people or in the future lose people to other utilities.

Q. Well, first of all, I would say that your greatest potential for losing employees is in the administrative side because they're more transient and they're willing to work across lines because it's more common to be an accountant or even an engineer, but when it comes to local people that utilities keep referring to on the safety aspect of it, you're referring to your linemen and electricians and those people that are a craft that are supposedly unique to the utility industry.

I would challenge if there's those types of hazardous occupations that occur all across the country. Railroads is not the safest occupation to be in. You could go through a whole litany. Working in a chemical factory. There's all kinds of jobs that are hazardous just by their nature, and those companies can make the same argument, but the benefit that utilities have, especially in a regulated industry, is the fact that you can charge rate payers for it, and I think that's where utilities get off track here.

It's okay to have a good pension plan. I don't think anybody would argue against that. It's where utilities believe that there is this extra bonus that they have to pay to their workers because they work in some special environment that's different or unique than other hazardous occupations, and I think that's where utilities have to start looking at these double dipping.

401(k) matching and a defined dollar benefit plan are a little bit of a stretch for the Commission to look at, and I would challenge Kentucky Power to start looking at those kind of costs to be more competitive and more conscious of the people you serve because many do not have a pension plan.

A. I appreciate that, and that's absolutely something I'll look into. I know from talking to Mr. Carlin, and you can talk to him more, he tells me that utilities in California are advertising extra premiums, even above what is the norm in the industry, to try to get skilled workers out there, and my operation in Kentucky Power, I mostly field field guys, climbing poles.

We've tried to really skinny down the administrative side and rely on the service corps because you don't want me with a company of 168,000 customers and accounts having my own staff that's going to be trading off system sales, my own staff doing all the HR work.

It's better for me to kind of take and pay just a pro rata share of that with the AEP system. So most of what I employ are my customer service folks and linemen in the field. It's vital. I've got very good people that work safely.

Safety is the number one concern across all the AEP. We've expanded that recently. I have a lot of contractors, we want to look at contractor safety. This Commission recently had a case where there was a fatality with a contractor, so it's not in this case we've gone above and beyond.

We're actually -- I'm going to be employing another inspector for safety that's not included in the rates of this case, but I've got to make sure that the contractors, if they're under my flag, are safe, so I can't speak to the other industries, the chemicals and everything else.

I know that someone dealing with a wire and electrons, it's very unsafe, and we're also seeing a rise in the public going into poles and having deaths there as well, so what I'm concerned about is making sure what we do is very safe, and if I'm the one that first starts and says, okay, we're going to end it here in Kentucky, and we're not going to -- we're going to be below the national average, I can look at that.

I can look at that as what employee pool I'm going to have and what that does to safety and what it does for customers. So I appreciate the comment, but that's what I have to weigh as I look at all of this.

Q. So if you walked into AK Steel, what would they tell you the first priority is for AK Steel?

A. There would probably be something on the wall

that says how many days safe they're working.
Q. Exactly. The same thing that you're arguing. They're competing against that same worker pool. The problem is you can't just define it as a pool in the universe of utilities because that's not the case.
A. I appreciate that, but, you know, it takes five years for someone to come from the first lineman up to actually get to journeyman to be trusted to be fully on their own doing things. I know from dealing with the Braidy Industries and the aluminum plant they're going to have, safety is going to be their number one concern. There's a two-year program at ACTC to be certified to work on any piece of equipment there.

So I'm glad everyone is committed to safety. It's just in an area where I am working, it's an economically depressed area, and so I need to be able to attract the top talent to make sure I, the safety I'm responsible for, is at the forefront.

And so I think if you talk to Mr. Carlin he'll tell you this is what I need to do to make sure I can attract that talent. But I understand what you're saying, it's truly a balance, and it's something I need to look at.
Q. One last comment, and then I'll leave that one

go, but you're serving an economically depressed area with a higher unemployment rate, which should make it easier for you to obtain, especially coming out of the coal industry, electricians and those type of crafts to be able to fill your workforce, and you're not competing in the state of California.

And that's a benefit to you, so going overboard on the benefits and the healthcare and whatever else that seems to be prevalent in the utility industry, there has to be a balance in that, I agree, but there doesn't have to be a double down on insurance.

You know, everybody assesses a risk, there's a certain level, and we don't have to be a hundred percent on everything because if we did everybody would be overinsured.

A. I appreciate that. I just look at retention as well. All that factors in there as well.

Q. So now I want to talk about AR, and I know that you yesterday indicated to Ms. Vinsel that it would be more appropriate to ask Mr. Vaughn, or I'm not sure who. Maybe it was Mr. Hill, I'm not really sure.

A. With what subject, I'm sorry?

Q. Accounts receivable, sale of accounts receivable.

A. Yeah, Mr. Ross I think is who.
Q. But I'm going to approach you because we're talking about a policy that's being implemented at either the tariff level or at the executive level of Kentucky Power, so it's more appropriately addressed to you.
A. Okay.
Q. You're selling receivables to the parent company credit corporation. Normally when factoring of accounts receivable is done you transfer the bad debt along with it. You don't retain the bad debt at the organization selling that receivable. That's part of the transfer, which is how you can justify a higher interest rate than what you could attain if you went ahead and just borrowed short-term rate because right now you're paying a premium on it, so I'm trying to understand why Kentucky Power is selling their receivables at a premium and not transferring the bad debt portion with it, or why they're not just utilizing the short-term debt, which is lower.
A. Again, I apologize, I don't have the answers to that. Mr. Ross would have a better response.
Q. So that portion of the interest that they're making off Kentucky Power at the AEP level by

purchasing the receivables and charging Kentucky Power for it, I presume that benefit is going to shareholders and not being reallocated back down to the local level as part of an offset to any other costs that are incurred.

A. I don't know that it is or is not. I'd be guessing if I did. Part of the relationship, I think, that might be factored into what the purchase rate is of the receivable that's set along, but I don't know the answer to that.

Q. I just know that I have a table here that talks about a pool that's set up for funds borrowed, funds loaned, and the average interest rate for funds borrowed from the utility money pool is .48 percent, that Kentucky Power is paying 1.94 percent or somewhere thereabouts on the sale of their receivables to sell it to AEP, so I'm not quite sure why there would be this activity going on, especially when Kentucky Power on the sale of receivable to AEP were 528 million, 604 million, and 522 million for the years '15, '14 and '13. That's -- there's a premium that's being paid on a significant amount of money that I would like to have an answer to.

A. Absolutely.

Q. Lastly is on allocations, and I know yesterday

Ms. Vinsel asked that there be calculations provided to us with specifics that show the portion at AEP that's being allocated in total and how the calculation is being performed.

I understand there's a FERC methodology, and that AEP and Kentucky Power have a very good policy in terms of explaining how it should be allocated based on what, but I would like to see what those allocations are, and I know it's probably not going to be an easy thing to provide, but I'm interested in, since there's a stewardship that's occurring at Kentucky Power, how much control do you have over what's allocated down to you?

Do you discuss it between AEP and Kentucky Power, or do they just dictate to you the amount that's been incurred at the corporate level or the parent level that Kentucky Power is going to take?

A. It's an active conversation. There's a formula that determines what our pro rata share is based on all the companies, and I don't know if that's based on a customer count or revenues that we produce, but I know it's a conversation.

I meet with all the other presidents from all the other operating companies, and we're constantly talking about how we can -- you know, we manage our costs, we manage our O&M, and then we talk to the service corps about how they're managing their O&M.

There's been a change recently in AEP overall of how the assets that we've had, we've sold off some assets in some other areas, and we have some generation personnel. We've looked very closely, as all the presidents, how are they using those employees, are they providing value for the operations of the service corps overall now, so we ask those questions all the time.

So we're managing beyond our own companies, we're managing what we see as a third-party vendor providing a service to us as well. It's a question we're constantly looking at to make sure that the costs are reasonable that they're passing down to us.

So we look at how they're spending, we ask questions, we're actually involved in all that, and then the formula that comes out of how that's allocated to us. Mr. Ross might be able to tell you exactly how that works, but I believe that's just based on the representative of what each company as a subsidiary provides to the company, the share of the usage.

Q. So I'm happy to hear that there's feedback that goes up rather than just down because if it just flows from the parent to the subsidiary, then the cost incurrence is just a matter of being dictated and allocated.

A. Yeah.

Q. There's no input in terms of how to control that cost.

A. I am constantly questioning that.

Q. So I'm just going to pick one, because it's a favorite one, the aviation and the planes and the crews. Is that a discussion that occurs, to say here's the cost to fly commercial, here's the cost to fly on corporate jets, and I'm sure the argument is time is valuable, we can fly people from Columbus to wherever it is and get them there and save time and bring them back.

Is there any type of input that flows back from Kentucky Power up through the corporate office that says we don't think our share is fair, we don't really utilize corporate jets? What kind of discussion occurs?

A. Yeah. Personally I think that allocation is fair. I think there's great value in the aviation costs. We only get five percent of those costs, but I think that one really starts at a board level.

We have executives that are in charge of 16, 17,000 people. There's a safety aspect as well to make sure, even if they're flying the same, you know, to make sure they're safely getting where they need to get with the pilots that we have.

One follow-up from yesterday, I did find out it's three planes, and we lease those three planes, just something to correct from yesterday.

But the overall benefit for Kentucky Power, I mean, I have 168,000 customers. Earlier this year, it's not in the test year, but this is a good example, Nick Akens flew to Washington, D.C., for the EEI conference, which is the meeting of all the executives.

He's also President Trump's head of the energy infrastructure business roundtable where President Trump wants to spend a trillion dollars in the country, and our CEO of AEP is one of the chairs of that committee, so he had to make sure he was in the right place at the right time. With the safety and security he used the corporate jet to go there.

I actually drove up from Ashland, Kentucky, to make sure I could fly out with the executives to that rather than fly commercial myself when the plane was already going. We received a five percent share of that trip, but more importantly while we were there

Mr. Akens took me to the White House, to the executive offices, and for half an hour I talked with the executives on President Trump's staff about the workforce in Eastern Kentucky and the possibility for economic development in Eastern Kentucky.

I don't know any other company with 168,000 customers that can get a half an hour in the White House talking about why jobs and manufacturing and infrastructure needs to come to Eastern Kentucky.

So it's examples like that, using the aviation gets the executives, important executives, in the right place, and we benefit from that, and that wasn't charged to Kentucky Power as a Kentucky Power trip. That was what everyone else paid for so that I could go and advocate for Eastern Kentucky.

Q. That almost sounded like a commercial.

A. It's -- that's the benefit. That's the real benefit of what we're getting here and, you know, you say what have I been working on? That's what I've been working on because that rises everything, and it's that important, and I'm screaming and yelling and kicking my way every -- kicking down every door I can get into, including the White House.

Q. I don't think anybody is questioning Kentucky Power's intent to increase its customer base and try to improve the economy in Eastern Kentucky. You have definitely gotten your message out over time.

A. Thank you.

Q. What we're trying to do is to make sure in getting your message out we can also understand the basis for the rate increase.

A. Absolutely.

Q. So those are the reasons for the questions.

A. Absolutely fair. I guess I will say, you know, we were supposed to -- we have a leadership conference where the executives try to tell everyone that manages someone in the company, and they try to locate and move that around.

This past year, you know, weather, it's been a different year for utilities, I guess I'll put it that way. Really challenging. The weather has been very moderate, and that's really hurt utility companies because people aren't -- they can open the windows. It's been nice days.

An example, one of the presidents from one of the companies was supposed to host the leadership conference. Everyone was supposed to go to, I think, Roanoke, Virginia. The entire leadership, they would have taken planes there, and the president of APCO said, "Is this really appropriate? I know it's important to get out, get into our communities. We like Nick Akens to come here as well, but is this the best use of our money right now?"

And what we ended up doing was canceling the trip to Roanoke, doing that from 1 Riverside Plaza in Columbus, and just putting that out on video so everyone could see it live, but that's an example of feedback from an operating company president saying maybe we don't need to have this expense right now. There's value to it, but let's pull back a little bit right now. So definitely goes both ways.

Q. Those are decisions that have to be made, and those are made in good conscience because utilities, especially in regulated states like Kentucky, enjoy a position that's enviable by a lot of companies, and that is the opportunity to earn a guaranteed rate of return. The opportunity. I didn't say earn a guaranteed rate of return, but the opportunity to.

But you have the opportunity also to pass costs on to your rate payers, something that if you look at a lot of other businesses, don't have the opportunity to say, oh, I incurred additional costs, so I'm just going to pass them to the rate payers.

You enjoy a benefit, and therefore that is why you have to come before the Public Service Commission to justify those costs, and that's why I'm sure this is going to be a three-day affair because there's lots of questions.

A. Absolutely, and there's lots of evidence in the record. You know, the Attorney General asked me a lot of questions about studies and what evidence do we have. The companies provided a lot of information. We're providing a lot of witnesses. That's the evidence. That's what the regulatory system has.

And the other side of the other businesses you talked about, what also comes with that, with that opportunity, is a responsibility to serve every single customer. We can't say, "You don't look like you can't pay overall, so we're not even going to talk to you and try to provide you a product." We have a responsibility to serve everyone.

As I said, Mr. Vaughn's testimony shows you on page 18, 17 customers per mile, where Duke and LG&E, 41 and 43. It's tough to serve. It's a hard business. It's riskier in Eastern Kentucky. I think we all know that, but we take it seriously. We serve every corner.

Q. I'm going to save the rest of my questions for the rest of your staff.

A. Thank you.

CHAIRMAN SCHMITT: Commissioner Mathews, questions?

COMMISSIONER MATHEWS: I have a couple.

EXAMINATION

By Commissioner Mathews:

Q. Back to the OATT, and I --

COMMISSIONER MATHEWS: Thank you, Ms. Vinsel, for reminding me that one of the criteria for transmission investment in PJM is to facilitate renewable generation across the footprint, and that also is, I think, quoted as being part of the thought process behind AEP's corporate transmission build-out.

Q. Does Kentucky have an RPS, renewable portfolio standard?

A. No, it does not.

Q. Does Ohio?

A. They did, and then they didn't. I'm not sure where the legislation --

Q. Okay. I don't know any more than that.

A. Ohio's kind of been all over the place.

Q. They did, they didn't, they did, they didn't. West Virginia has a target -- I forget what it's called.

A. Yeah, some states have suggestive --
Q. Suggested target, and Glencoe counts toward that renewable, I think theirs there is an alternative portfolio standard. And Virginia?
A. I want to say I think Virginia does, but I'm not positive.
Q. Just, you know, and that brings me to how projects are chosen within PJM. I believe it's a stakeholder process?
A. Yes.
Q. A very lengthy stakeholder process?
A. Yes.
Q. Are the projects that AEP is building in its footprint, in the zone, I'm not so concerned about the projects outside the zone, are they in the regional transmission expansion plan or are they nominated projects by AEP on an economic basis?
A. This is where we got to yesterday of what the exact names are, I'm not positive. I know there's multiple buckets. There's the PJM sort of mandated projects, and then there's in the zones can be recommended projects that move forward.
I think a lot of what is in the AEP zone are the -- like I would come to the Commission and say I think there's a need to get a certificate to do

something to show the benefit.
Q. Are there any projects in the zone that would fit that facilitate renewable generation development?
A. I haven't reviewed the projects right now. I imagine there are. Mr. Vaughn might be able to give a better answer to that, but definitely I know there's been a big movement to renewables and other areas of the zone, partially to support economic development, so I would imagine there would be.
Q. Okay. Is anyone from Kentucky Power participating in the PJM stakeholder process on what projects get built or how costs are allocated?
A. Absolutely.
Q. Okay. And who is that?
A. Dan Snider and Dana Horton really head up our PJM operations. I'm sure there's a bunch of people --
Q. And that is Kentucky Power or that is AEP?
A. That is the service corps. With 168,000 customers we don't have someone dedicated to that. We really focus on them, and yesterday there was some discussion about what we get involved in, and we're involved every day. We make comments on anything PJM does. We have the benefit of all the operating companies working through the service corps to make

sure our voice gets heard.
Q. And how important is cost containment on those PJM projects? That's one of the concerns that I believe some state commissions have had, is that perhaps there's -- on time may mean more than on budget?
A. I can speak to working with our transmission group, and I know they're very cost conscious in making sure that we're doing stuff as economically as possible.
My understanding as to the PJM stakeholder process, anyone can raise those issues, and I know we always look at that, and to the allocation side I know Mr. Vaughn mentioned something in his testimony about a proceeding where America Electric Power is involved, talking about the allocation, to try to lower the allocation for -- across the system.
Q. And you've said that maybe without the tracker there wouldn't be as much development -- you wouldn't be as successful in getting transmission development in Kentucky? I think maybe -- maybe paraphrasing what you said yesterday?
A. I think the tracker is more a focus of the financial liability of the company moving forward. Overall I'm trying to be a transmission owner as

well. I'm not trying to attract the capital that AEP might spend anywhere in the zone. I'm trying to get that to be attracted -- or spent right here.

Certainly having the track will allow me to make the arguments when I go forth for capital and competing against all the other operating companies, give me a better chance to attract it here.

Q. That brings me to the criteria for transmission expansions or transmission builds in the Kentucky Power footprint. Are there market or reliability concerns that we need to have made in Kentucky?

A. I'm not sure I understand your question.

Q. I guess drawing transmission capital to Kentucky, is that to solve a market problem or a reliability problem or a resilience problem within the Kentucky Power footprint?

A. I would say all of the above. It's something we look at to, one, to the age of our assets that we have. Two, it's to make sure, you know, I look at it as when I came down I asked all of our engineers what have we done to impact reliability, what plans do we have on the shelf that we can provide better service for our customers. That's sort of the criteria I start with for my transmission investment.

It's improving reliability, and are there places for economic development. We need to make sure the system is robust, that we can deliver the megawatts that hopefully large IGS customers will need.

Q. Okay. So maybe there are projects that you would like to have that aren't being funded now that you would like to go lobby for in Columbus. I mean, that's again paraphrasing.

A. Yeah, where I can get capital. The AEP system allows me to get capital and, one, keep it from being spent somewhere else in the zone and have it spent here, but it's all focused for me on economic development and reliability. Then we file certificates here at the Commission before we build those, for permission.

Q. And back to that and have it spent in Kentucky rather than someone else -- rather than somewhere else, how are the projects chosen to be built? I mean, are there -- I mean, if I think AEP transmission, I look at a great map that has a 765 line going across Northern Kentucky, that's, I think, one of the more 765 extra-high-voltage transmission lines than all other U.S. transmissions combined, I think is what your advertisement at the bottom of the article is.

A. Uh-huh.
Q. So I'm -- I guess I'm wondering in Kentucky where are those -- I mean, where are those transmission problems that --
A. Certainly. The system in Eastern Kentucky is -- obviously covers a broad area, and it's very old, so I know that I'm not familiar with the exact aspect of what's in the Hazard-Wooton that's before the Commission right now, but I know there's something that talks about the need for that, and really for me overall it's because we're so mountainous and so populated with trees, our SAIDI, our metric for measuring reliability is higher than it might be here in the middle of the state.
There's transmission fixes for that to improve the quality and reliability for customers, and that's something, if I can get the funds allocated to have that done here, and the Commission approves those with certificates, we would build those.
Q. How are the transmission revenues that flow back to Kentucky Power computed?
A. From a transmission --
Q. Is that also in the 6 percent?
A. From a transmission owner?
Q. As a transmission owner.

A. So as a transmission owner, if I am able to invest as Kentucky Power, that goes to -- and I make revenue from that, that goes to offset my overall return that I'm getting, so when I come here for a rate case that's all factored into customer rates, and if I get revenues from that, that's for the benefit of all the customers. They receive that benefit. That's all calculated in the overall rate base.

Q. How are the administrative costs of PJM allocated across? Is that the 6 percent?

A. The administrative costs are part of, I believe, that LSE OATT, it's all figured in there as well, so it goes into sort of that -- I say bucket because it's not a individual line item, it's multiple line items.

Mr. Vaughn can talk to you more about the PJM bill and everything that's on there, but I consider it a bucket of costs that go together.

Q. And I have one more question that's not OATT related, and I'm certain I've seen it somewhere, but the K through 12 subsidy, the $500,000, where is that being allocated now?

A. I think we're continuing exactly where it is right now, to the LGS customer. My understanding, it's a continuation of what we're doing.

COMMISSIONER MATHEWS: Okay. Thank you. That's all I have.

CHAIRMAN SCHMITT: No questions. Any follow-up?

REDIRECT EXAMINATION

By Mr. Overstreet:

MR. OVERSTREET: Thank you, Mr. Chairman.

Q. Mr. Satterwhite, Ms. Vinsel toward the end of last night's session, I think it was Staff Exhibit 1, showed you an article from, I think it was Sunday's Herald-Leader, and it had a map on that.

A. Yeah.

Q. And she asked you some questions. Have you had a chance to study that map better?

A. Yes, I have.

Q. And do you have anything you'd like to further address?

A. Yeah, I think yesterday when I was asked, in the article underneath it mentions the five highest poverty counties, and I was asked to confirm -- or multiple counties, I was asked to confirm that there were five in my service territory.

I looked down, and I saw these counties that I operate in and do things in, but there's actually only three of these, not five, that are actually in my service territory. That would be Clay County, where I have 17 customers; Martin County, where I have 4,831 customers; and Knott County, where I have 7,906 customers.

I'm in the other counties because my economic development efforts. I can't look at my territory alone. I go beyond the territory because anything for the region is good, is how I look at it, so I thought there were more counties in, but those are the three counties I was able to confirm definitely were involved.

And then I believe there was a question about -- the map is kind of hard to read about the pink, and can't see the clear lines of where the counties are, and I thought the question yesterday about being in pink dealt with the counties, the five counties that we had talked about in the article.

I would just point out, to make sure it's perfectly clear in case I was mishearing the question, if you look to the top of the map you see Greenup and Boyd County, I believe, that are in blue, so it's not every county in our jurisdiction that are in those pink categories, and my hope is through the economic development that we get more of these in the blue. Some excited announcements I think are coming soon.

Q. Okay. Thank you. And with regard to Staff Exhibit 5 and the $9 billion, AEP's plans to invest approximately $9 billion in its transmission business over the next three years, does AEP have transmission operations outside of PJM?

A. Yes.

Q. And would -- and where are those located?

A. I believe, you know, all over the country. The transmission, we have a PJM group that works in our own operating companies, operating territories, but I believe we're the largest transmission owner in the country as far as line miles, and we can operate anywhere, so we could be building transmission across the United States.

Q. Okay. And would you be building transmission in the AEP West companies?

A. Yes.

Q. And are they in the PJM footprint?

A. No, they are not.

Q. And to the extent that you build transmission, invest some of that $9 billion in those AEP West companies or otherwise outside the PJM footprint, would those investment costs flow back to Kentucky

Power?
A. No, they would not. In fact, there's a very large project, I don't know if the Commission is familiar with it, called the Wind Catcher Project that's in Oklahoma, Texas, and Louisiana, and the numbers are so large it's kind of astounding, but they're taking advantage of the tax credit, and I think it's, you know, $4 billion to build, but it's only going to cost half that actually to customers because of all the benefits and efficiencies it builds for moving renewable across that territory, so that's a big investment that the AEP corporation is making that doesn't fit this zone and would never impact Kentucky Power.
Q. And yesterday, Mr. Satterwhite, Mr. Gardner was asking you about Exhibit 1 to the settlement agreement and then the combined large general service, slash, public school line. Do you have that in front of you?
A. One second. Yes.
Q. And what does that settlement exhibit show as the base case settlement increase for the combined LGS/PS classes?
A. I'm looking at everything impacted, so I'm in the middle column, and that would be 5.4 percent.

Q. And still looking in that middle column, what does it show is the average base rate settlement increase for all classes?
A. 6.16 percent.
Q. So that's -- that is greater than the combined LGS/PS; is that correct?
A. Yes, correct.
Q. Okay. After Mr. Gardner asked you these questions, did you have an opportunity to ask somebody to pull apart the percentage increases for that combined LGS/PS class?
A. Yes.
Q. And what is the -- when you pull it apart and the PS class stands on its own, what is the increase that the PS class will receive through the settlement?
A. Yeah, so the 5.4 is sort of combining all those together, so I don't remember the exact number, but the PS class was above 6 percent, above the 6.16 percent average overall, and the LGS was around a little over 5 percent, somewhere between 5, but definitely lower than what the public service -- public school increase is going to be, and definitely lower than the average.
Q. Okay. Thank you. Yesterday I think it was

staff asked you some questions about Kentucky Power and your involvement in deciding whether Kentucky Power will be an RPM or FRR entity in the PJM. And you were a little foggy on that. Have you had a chance to update your understanding?

A. Yes. In fact, I knew that in the spring we talked about what I mentioned, should Kentucky Power go alone or go in the group, and I didn't know if that was -- I couldn't remember if that was what I was thinking about, FRR or RPM, or if that was something different.

I went back and looked through what I had in that time period. This was also during the major storm we had during that time period, so there were a lot of things happening, and I was actually able to find the documentation of what we look at. And we do tend to look in the spring. This one was a little bit later. This was in March.

Typically we try to look a little earlier to level set this as whether we should stay at FRR or become RPM as we look out into the future, so I was able to get that documentation of the recommendation made by our experts at the service corps of how we should look forward that we used to have the conversation about what we should decide to do.

Q. And based on that documentation, what was Kentucky -- what was your decision?
A. We decided to stay an FRR again.
Q. And was there another aspect of that analysis that you undertook?
A. Yeah, I asked a lot of questions because we are long in capacity, whether it makes more sense for me to sort of leave the other AEP companies behind and go alone, for lack of a better term, or stick with the other AEP companies as sort of a group.

So that was part of the discussion I raised to talk about, challenged our people to prove to me why. You know, is there a reason I should stay or should I go alone.

Recently PJM has put in the penalties that if you commit to something and don't meet that, there are high penalties for what you put into the capacity forward, so for this year I decided to stay with the group to manage that risk and give us some certainty, but that's something I made sure our group know I'm going to look at every year to see if it makes more sense to go alone with the length that we have.

Again, like I said, I hope to eat into that length with economic development, but there's an opportunity there to potentially go alone without the others.

There's more risk involved for me if I do that, but it's a matter of like everything else we do, managing that risk and deciding if it makes sense to do that, but for this year we decided to stick in the group and to be decided next year if we're going to go alone or not.

Q. If Kentucky Power were not a member of PJM, would it incur OATT-like costs for transmission services outside of Kentucky Power's footprints?

A. My understanding is, and again, Mr. Vaughn is the expert on PJM, no matter -- you can't just operate and be insulated from costs from a transmission system, so whenever you want to access or access power that comes through the system, there's definitely cost.

If we were to leave PJM there's extreme costs of even leaving that as well, so that's part of the calculus too, to see if you're going to stay on the system or not.

Q. Okay. And yesterday there was some discussion about the Rockport Unit Power Agreement and the 12.16 ROE that's provided for by that agreement. Do you remember that discussion?

A. Yes.

Q. And did you remember me asking Mr. Smith if he had examined the Rockport Unit Power Agreement bills that were provided in response to KIUC 1-43 to determine whether, in fact, Kentucky Power paid an ROE component of 12.16 percent?
A. Yes.
Q. And as I understood his answer, it was yes, and in fact he had appended those bills as RCS-15. Do you remember that?
A. Yes.
Q. Did Kentucky Power, in fact, pay during the test year, as part of its Rockport Unit Power Agreement, an ROE component of 12.16 percent?
A. No.
Q. And what did it pay?
A. By my calculation it's about an 8.18 percent is what was actually charged to Kentucky Power.
Q. So if the agreement provides for a 12.16 percent ROE, why did it pay this approximately one-third less amount?
A. The 12.16 is what's embedded in the Unit Power Agreement as sort of the starting point. There's something called an operating ratio in there which can lower that, what's actually charged and what comes through on the bill to Kentucky Power.

The operating ratio represents this other construction going on at the time that lowers that 12.16 percent, and so in this case I believe part of the, what -- I believe it's what's in this case the Rockport scrubber was being built, that lowered the operating ratio for the units overall, and so by month if you look, add those up from once you apply that formula to the 12.16 starting spot, that's where you get the 8.18 percent.

So that's what's in the test year, so if we -- if the Commission were to approve the settlement agreement and the balance in there, that means for the next three years it wouldn't be 12.16, it would lock in that 8.18 percent because we're making as a base rate item, so we're taking the test year amount of the Rockport bill that has that 8.18 and making that the cost over the next three years. That's reflected in rates.

Q. And did you have an exhibit prepared showing that calculation?

A. Yeah, I asked someone because I thought there was confusion, so I asked someone to prepare for me what the 12.16 percent would reflect in the bill and also take the actuals, and they prepared that, and it shows that it's actually $1.8 million less than the

12.16 assumption if you take what actually is reflected on the bills.

MR. OVERSTREET: I'm going ask Mr. Gish to pass this out. Can I have this marked as -- I believe it's -- well --

CHAIRMAN SCHMITT: Yes.

MR. OVERSTREET: It would be --

CHAIRMAN SCHMITT: 8.

MR. OVERSTREET: 8, thank you.

(KPC Exhibit 8 marked for identification.)

Q. And do you have that in front of you, Mr. Satterwhite?

A. Better take your copy to make sure.

CHAIRMAN SCHMITT: I hate to butt in again, but let me ask Mr. Cook and Mr. Chandler, are you still okay on time?

MR. CHANDLER: I think it would all depend on Mr. Overstreet at this point, if he would be going much longer. I just don't know.

MR. OVERSTREET: No, and that's a very fair question, and the answer is no, I don't intend to go much longer.

Q. Mr. Satterwhite, do you have that in front of you?

A. Yes, I do.

Q. And in the interest of conserving time, can we go down to the bottom line that is grayed? It's called estimated monthly ROE?
A. Yeah.
Q. Do you see that?
A. Yes.
Q. And could you scan across there quickly and tell me what month had the highest ROE and what that was?
A. Sure. I believe that was March of '16, and that's a 9.12 ROE.
Q. Okay, and then what month had the lowest ROE?
A. That appears to be 764, and that's December of '16.
Q. And if you went two months --
A. 759, I'm sorry.
Q. Yeah.
A. Most recent, the last month of the test year 759, February '17.
Q. And then how did you arrive at your 8.18 percent?
A. I added up these numbers and divided by 12.
Q. Okay. Thank you.
MR. OVERSTREET: That's all I have, Your Honor.
CHAIRMAN SCHMITT: Mr. Kurtz?

MR. KURTZ: No questions, Your Honor.

CHAIRMAN SCHMITT: Any other -- any counsel from any of the other intervenors, any friendly cross-examination?

MR. GARDNER: Yes, sir. This is a brief question.

CHAIRMAN SCHMITT: You're not friendly, but you can go ahead.

MR. GARDNER: I'm sorry.

MR. OVERSTREET: Mr. Gardner is always friendly.

CHAIRMAN SCHMITT: You're hostile.

MR. GARDNER: I'm not usually described that way, but I'll take it.

RECROSS-EXAMINATION

By Mr. Gardner:

Q. Just a couple of sort of brief questions, Mr. Satterwhite. When you were referring to a question by Mr. Overstreet about KCUC Exhibit 4, you said you talked to someone who gave you some information about different percentages if LGS and PS were separated. Who was that person you talked to?

A. Yeah, Mr. Vaughn is really the person that can walk through all of these and give more details, so I reached out to him to see what the difference would

be if you separated those.
Q. Okay. And is Mr. Vaughn the same -- so he's the person who could say why in this exhibit LGS and PS are lumped together. He's the one I can talk to about that?
A. Correct.
Q. Okay. And one more similar question. In the settlement agreement itself, item 14, I believe. Item -- excuse me. Item 13 --
A. Before you get there, can I make sure my last answer was clear? They're grouped together as a result of the settlement agreement and the balance of all the parties. Mr. Vaughn can talk about what that means and how the allocations are in there, but overall that's a result of the settlement.
Q. Okay. Sure.
A. Just wanted to be clear.
Q. No, that's fine. That makes sense because you all didn't propose them as one class, did you?
A. Correct.
Q. Okay. I'm asking you about this one line at the end of 13 and 14, which I read to you before. (Reading) Tariff K-12 schools shall reflect rates for customers taking service under the tariff designed to produce annually in the aggregate 500,00 less, and

then it goes on, so that also is --
A. I'm sorry, where are you again? I was thinking about my last answer. Tell me where to go.
Q. Bottom of page 13 of the settlement agreement and the top of page 14 where it's basically talking about the 500,000 number?
A. Yes.
Q. That's also Mr. Vaughn?
A. Well, that -- what that is, it's a continuation of -- the reason why, I guess, is a continuation of the past and the settlement agreement. Mr. Vaughn can apply that and say how that's reflected in the numbers.
Q. Okay.
A. I believe in the initial presentation of the case we didn't pull out the schools separately, and that came out through the settlement discussion of continuing what we do right now.
Q. So again, the person to ask those questions in detail would be Mr. Vaughn?
A. If you want an understanding of unbundling the numbers and doing a lot of math and focusing on that and how it works, Mr. Vaughn is the one to talk to, yes.
Q. But you obviously thought it was important

enough to make that distinction from the stand just a few minutes go, what differences were, right?

A. Absolutely, I think it's -- yeah. I think that's important to show. There's been some concern about, from yourself, about the commercial customers, and I thought it was important to show that the schools are actually -- how that relates to what the LGS if you were to separate them.

Q. And had that, that number or approximate numbers that you gave in response, was that -- had that been previously filed in this case in some form or fashion, whether direct testimony or data responses, that you're aware of?

A. I believe you can get there by doing math on what Mr. Vaughn's provided. I think he has Exhibit 3 to his testimony. It just wasn't, you know, down to the total column, so I asked him to look through what he's provided and provide that to me.

Q. Okay. Thank you.

MR. GARDNER: That's all.

CHAIRMAN SCHMITT: Mr. Chandler?

RECROSS-EXAMINATION

By Mr. Chandler:

Q. Who determines -- under whose jurisdiction are the amounts that Kentucky Power pays for

transmission?
A. I'm not sure I understand your question.
Q. If Kentucky pays transmission costs under an open access transmission tariff, do individual state commissions determine those amounts or does FERC?
A. That's a FERC jurisdiction.
Q. So the amounts that the company estimate in 2018 of $14 million, those are amounts that are FERC jurisdictional; is that fair?
A. The oversight of those costs are FERC jurisdictional, correct.
Q. And those costs would be approved by FERC.
A. Yes.
Q. Through the tariffs.
A. That's who has jurisdiction for those, yes.
Q. And so the proposal by Kentucky Power, and in the stipulation, would be to pass along 80 percent of those costs one for one through tariff PPA; is that correct?
A. It's delayed a little bit. The way we have it we don't reset that until later in the year, but it's to track those, and we don't recover 20 percent of those costs, but 80 percent, yes, would come in through the tariff PPA.
Q. And so when you file that with the Commission,

you just tell them how much those costs were, here's an 80 percent number, these are the rates we're putting into effect with tariff PPA, and you update your tariffs with the Commission?

A. Essentially it's a little deeper than that. I mean, there's these costs in this rate case right now that's provided as part of this. It's in the record. That can be looked at to make sure that those are allocated properly, that those really are the transmission costs, that something else isn't in there, so there's some review by the Commission, but someone can challenge those costs, other than costs that aren't supposed to be in there, that would happen at FERC.

Q. So the Commission would just look at them and say these are OATT charges, they're in the PPA. That's essentially what your understanding would be.

A. And are these the costs that are eligible to fit in here? That's what's part of this case right now. Are these the appropriate costs to fit in here, yes.

Q. Are these the OATT charges. Thank you.

You mentioned earlier that the -- I think your quote was that the nature of a test year is lag, that that's the nature of a test year, is lag?

A. The point I was trying to make is when we're talking about earning an ROE, when you have a historic test year, naturally fit in is some lag to that because expenses can go up in that year, unless you have that's known, fixed, and measurable, or you don't have a tracker, you don't tend to update those unless you do a future test year, so my point is as a base standard typically there's some lag involved in what you're not recovering.
Q. That's what I wanted to clarify. I think you had just mentioned test year. You hadn't distinguished between historical and fully forecasted or a forecasted test year, so if you had requested -- in determining what the best way for Kentucky Power to go about recovering these, and I'm talking about the 2018, the $14 million amount of OATT charges you were referring to, you could have filed a fully forecasted test year and included them into the amount and determined what rates were, or you could have filed a historical test year and then asked for this tracker to pass through those costs, and you chose the latter, correct?
A. Correct. And as we've seen from the updates we've had so far --
Q. So --

A. -- it was assumed at a higher level, and now we know it's going to be a lower level, so I think it's beared out the tracking was the appropriate way.
Q. You mentioned that it's hard to compare the folks that work at a utility with other, maybe with other industries in the region because it's more of a national -- everybody -- everybody in the United States is served by electricity, I guess, basically. It's a national thing. You have 300 something million people, and 300 something million people have electricity. Right? Is that kind of your --
A. Yeah, I think the skills translate anywhere in the country, and so when we look at benefits and pay, well, we think more of a national standard.
Q. Do you have KCUC's Exhibit 3 available?
A. Yes.
Q. And do you mind to turn to the page, and I believe it's unnumbered, 1, 2, 3, 4, page 8?
A. What I have is Appalachian Sky on top? The picture.
Q. Yeah, let's go back one, yes.
A. Okay, the one with the picture on it, yes, of the coal miner.
Q. So I'm going to ask you about some of these, and I just want to confirm that what I say, that

these are, I guess, attributes of the workforce in Eastern Kentucky that you market for potential employers, correct?

A. Correct, and this was focused on the defense and aerospace industry.

Q. Right. So you mentioned an average desired hourly wage of $17, correct?

A. Yeah, we did a workforce study. That's where all this stuff comes from.

Q. Okay.

A. And this was a study that was produced that gave us these documents.

Q. Okay. And you noted that at the bottom two they have skills in manufacturing, correct?

A. Yes.

Q. And the bottom three, again, wood product manufacturing, three in manufacturing. Over to the right you have one that states that they're highly skilled in multiple trades?

A. Yes.

Q. And they're mechanically inclined, but they're at the top.

A. Yes.

Q. Okay. Does Kentucky Power have the opportunity to file taxes on a stand-alone basis or in the

aggregate with AEP?
A. I'll again defer you to our Mark Pyle, our tax expert, to talk more about what we did.
Q. That was only going to be my question. Do you-all have the option to either file on a stand-alone basis or file a joint return with AEP?
A. I'm not sure.
Q. You mentioned earlier, and you went back to the questions I had asked regarding studies, and you noted that the company had provided a lot of information. Not maybe specifically studies, and I think that's a distinction that you've made before, correct?
A. Correct. It's what you consider study is what I consider study. I just wanted to make sure we were talking the same language.
Q. And so you had mentioned that you believe that you've provided a lot of information, but not necessarily maybe studies per my definition.
A. Not knowing what your definition is, I wanted to make sure I was just being clear. I know Mr. Carlin has a number of studies that he relies on for the competitiveness of our wages and our pensions, and I was pointing out, as you had said, there's lots of documents and lots of numbers in this

case, and you had asked what the evidence is to support those, and I was pointing out all those documents and the fleet of witnesses that we provided here to explain what those are.

So I didn't know if you would consider those studies, but I was just saying there's lots of evidence in the record to support all that information, which really are, as you were saying, we have to look at expenses. Those expenses are supported by a number of witnesses.

Q. And yesterday I asked if you had conducted a study specifically about whether customers could afford a rate increase, either in the stipulated amount or the application amount, correct?

A. Correct.

Q. And you had -- and your answer was not a study, specifically a study to that effect.

A. Right. That was my answer when I talked about, and what I was trying to make sure wasn't confusing, we deal with customers all the time. It's certainly something we're sensitive to, but there wasn't a formal study how you were asking that's been done.

Q. So where in the application did you provide information that shows that customers could afford the increase?

A. Again, I don't think we did a study that said that. I think what we talked about is the testimony of myself and other witnesses that talked about how, you know, there's a regulatory compact, and utility has to operate, and what we've done to sort of lower that amount so that we can continue to operate and have an opportunity to get our return without having the price tag be higher.

Examples I used were I called everybody in, tried to skinny the case down more. Mr. Phillips, I brought him in and said, again, you're allowed to spend $27 million. Do you have to spend $27 million?

I think the settlement and the stipulation, as your own witness Mr. Smith testified to, was very creative to look in the short term for customer affordability and defer things down the road.

We're not crazy about deferrals, we try to minimize the level of that deferral, but we realize, just like the customers in Hazard that spoke at the public hearing said, is there something you can do just to push this off a little bit. We're focused on that to try to minimize the impact right away as we all work together to change the denominator that we talked about.

So that's an example of some of the evidence of what we tried to do to address the affordability. We have to have utility service. The question is what do we do to minimize and make that affordable, and the only thing I'd add on to that is what we're doing in economic development is our other effort to make it more affordable. The more jobs we bring, the more industry we bring to the territory help that as well.

Q. Right, but that entire answer was about what you did to determine what the amount the company needed was, what the level of expenses or return would be. I'm asking, and just to clarify, did you provide any information about whatever level was determined, whether customers would actually be able to pay that amount?

A. We didn't do the study that you're asking for. The answer I gave was --

Q. I'm asking for information, just to be clear.

A. I guess I'm not sure what you're asking for.

Q. Well, yesterday I asked for studies, and you told me you provided information. Now I'm asking for information, and you're saying that you didn't do studies. So I just want to clarify, if you did provide information, where can I find it in the application?

A. Yeah, I think we're kind of stuck in a circle on studies. I mean, I guess I testified to the information we did look at. There wasn't a witness that testified exactly to the point that you're talking about, but I think if you take everything that we've done overall with our application, which is supposed to just support the expenses that we have, and then the other testimony we have, how that impacts the region, it will show you that we're a leader in the region focused on affordability for customers.

Q. You mentioned that you have 168,000 customers, correct?

A. Correct. That's the customer account.

Q. Not trying to catch you up, but roughly 168,000 accounts?

A. Correct.

Q. But you mentioned that Kentucky Power itself doesn't have someone at PJM to focus on PJM, that it's somebody at AEP.

A. We have the benefit of having experts at AEP that we can share the costs with all the other operating companies, but they're available to me at any moment.

You know, just last night I had a question. I asked somebody. They're out in Oklahoma participating in another proceeding, and they got back to me at 2:00 in the morning with information, so it's a real advantage we have.

Q. Can you remind me how many employees Kentucky Power has?

A. We have about, I believe it's 500 -- around 550 direct employees, and we have a little over 570 contractors, I believe.

Q. And when you mentioned that you said you had a team, or you asked people to look into going -- basically going it alone if you were to go or transition, Kentucky Power was transition from FRR to RPM, you had someone look at that on a stand-alone basis rather than as the AEP zone, correct?

A. Those are the questions I asked. That's what I thought was proper to ask as we looked whether we're going to be FRR or RPM, and it's a deeper question of whether we want to go alone with what we put into the capacity market.

Q. And who did you ask that of?

A. The experts at the AEP Service Corps to run that information for me.

Q. Okay. You mentioned the Hazard-Wooton line. Do you know if that's a baseline or a supplemental project for Kentucky Power?

A. No. Sorry.
Q. Do you know who I can ask for that?
A. Probably Mr. Wohnhas in charge of my regulatory group. Mr. Vaughn might know too.
Q. And you were able to look at some things last night, it seems like. Were you able to determine whether -- what the amounts on the annual reports that I provided, what those represented?
A. I didn't look any deeper into that exhibit.
Q. Okay.
A. I left this book here.
Q. Okay. So you got answers -- okay.

MR. CHANDLER: That's all the questions we have.

CHAIRMAN SCHMITT: Thank you.

Ms. Vinsel?

MS. VINSEL: Yes. Staff has a few questions.

RECROSS-EXAMINATION

By Ms. Vinsel:

MS. VINSEL: First, because you did provide that answer that I had asked for a written data request, we withdraw that particular data request.

MR. OVERSTREET: Ms. Vinsel, I'm sorry, which one?

MS. VINSEL: Oh, I'm sorry, yes. Mentally thinking of something else. The data request in regard to when a decision was last made.

MR. OVERSTREET: Oh, okay, thank you.

MS. VINSEL: When it was last adopted regarding staying at PJM as FRR or RPM.

MR. OVERSTREET: Sure.

Q. And when you mentioned this took place in the spring, are there any written reports or PowerPoint presentations or memorandum addressing Kentucky Power's continued participation in PJM as FRR versus RPM?

A. Yeah, when I referred or when I asked for the document I had it with me. It's the report that came out making the recommendation about what we should do. That sort of keyed up the conversation that I have, so I have that report.

Q. And would you be willing to provide that to us as a post-hearing data request?

A. Absolutely.

MR. OVERSTREET: No. I can do that right now.

MS. VINSEL: Okay. Even better.

A. Just to be clear, it's marked confidential because as we talk about it it's considered confidential, but I think we -- now that the decision has been made it's okay to share that analysis, but

it does have a confidential marking.
Q. So it doesn't need to be filed as confidential?
MR. OVERSTREET: It is not confidential.
A. Anymore.
MR. OVERSTREET: Anymore.
Q. Anymore, okay.
A. But each year as we go through the process it's confidential until the decision is made.
MR. OVERSTREET: That would be number 9?
CHAIRMAN SCHMITT: Number 9.
(KPCO Exhibit 9 marked for identification.)
Q. While the remainder of these are being passed out I'll ask my next question.
A. Okay.
Q. You mentioned part of that discussion was whether or not Kentucky Power would go it alone, in your own words. When you say "go it alone," did you mean that Kentucky Power would leave PJM, or was a consideration whether Kentucky Power would leave the Power Coordination Agreement with other AEP entities?
A. Good clarification, thank you. It's the Power Coordination Agreement. It's looking at the assets that I have as Kentucky Power and deciding whether in the forward market it's better to offer the capacity solely by myself or stay under the protection of the

coordination agreement that would cover me in case there's penalties, in case we should fall short.
Q. Thank you. And following up on one of Commissioner Mathews's questions regarding PJM, does PJM determine the amount of revenue transmissions received by Kentucky Power, or does PJM only determine the amount of transmission revenues for the AEP zone, and then AEP allocates the amount to its affiliates?
A. Not sure I understand the question. Let me answer it this way and see if that -- if we're talking past each other or not.
PJM is the jurisdictional entity that oversees what's done. They don't pick where -- other than the mandated projects, they don't say we've decided that Kentucky is going to do this much or Ohio or Pennsylvania is going to make this much investment. That's just the clearinghouse for the stakeholder process for reviewing that, but they don't dictate where that's going to be for a number of the projects, other than the mandated ones. Does that help?
Q. Perhaps not quite.
A. Okay.
Q. Transmission revenues get allocated throughout

the PJM footprint. Would that be correct?
A. From the transmission owner point? There's costs that come from, like, the LSE.
Q. Yes.
A. That as a transmission owner, as I make an investment there's a revenue that comes along with the decision to make that investment. There's a return on that, so that comes from the nature of making the investment.
Q. So I think we may be lining up here. So any transmission revenues are tied only to those investments. There's no particular larger allocation? Is that what you're saying?
A. I believe so. If I'm getting over my skis a little bit Mr. Vaughn can clarify, but yeah, the revenues that come from are from the investments made in the transmission system.
Q. I will follow up with Mr. Vaughn on this question.
A. Thank you.
MS. VINSEL: And with that, Commission has no further questions.
CHAIRMAN SCHMITT: Commissioner Cicero?
VICE-CHAIRMAN CICERO: No further questions.
CHAIRMAN SCHMITT: Commissioner Mathews?

COMMISSIONER MATHEWS: No.

CHAIRMAN SCHMITT: I just have a couple of -- I don't know if they're questions or statements.

EXAMINATION

By Chairman Schmitt:

Q. Mr. Satterwhite, in your testimony I guess on redirect or re-redirect by Mr. Overstreet, you talked about the, I guess, poverty levels in your service area, and you seem to indicate that really you had two counties at least you referred to, Boyd County and Greenup County, which were not as, I guess, economically depressed as the rest of the area, but only three of the 30 counties, poorest counties in the United States, were in your service area, and of those you indicated Clay County, you only had 13 customers, seven customers or something?

A. Seventeen.

Q. In any event, I would like to point out to you or ask you if you've seen the testimony of Roger McCann, the executive director of Community Action Kentucky, at page 7, and I'll just read part of it and ask your thoughts on it.

At page 7, quote, (Reading) Many of these counties -- and it lists every county and the poverty rate, and they go from a low of 19.7 percent in

Carter County to a high of 42.4 percent in Owsley County, and most of the counties are like Knott 33.8, Leslie 33.7 percent, Fletcher 33.2, Clay 46.8, Floyd County 29.5 percent.

But it says, (Reading) Many of these counties report some of the highest poverty rates in Kentucky. 18 counties served by Kentucky Power Company report poverty rates above 20 percent, a rate that the census bureau defines as extremely high. 19 of the 20 counties have reported poverty rates higher than Kentucky's poverty rate of 18.3 percent. Every county in Kentucky Power's territory is in the highest 50 percent of poverty rate for Kentucky. Not only are these some of the poorest counties in Kentucky, but they are also ranked as the poorest nationwide in a state that is 47th in the highest poverty rates. Every county in Kentucky Power Company's service territory surpasses the 2015 national poverty rate of 14.7 percent. These counties are in the top 50 percent of highest poverty rates of the 3,142 counties nationwide included in the site data.

Do you have any reason to believe that those figures aren't correct?

A. I haven't checked the sources. I'm not going to say that there's not an economic situation and poverty in my territory. Absolutely is. I know Greenup County and Boyd County, I don't know if that was considered in those numbers or if the old data.

Q. Well, that was considered in those numbers, and they also have poverty rates that are higher than the national average.

A. Right. What I was going to say is there's been some development there in the recent past since 2015. I'm not sure when the dates were, but I don't want to argue that, you know, to make it seem like there's not poverty issues in Eastern Kentucky because there absolutely are.

I think my job is to make sure I'm running a utility so we don't further exacerbate the problem by not having power to these people. We want to make sure we have safe, reliable service, and my job is to sort of do what I've done in this case, to sort of skinny it down to make sure I can provide that.

And then beyond that, you know, I can't solve every social issue by being the electric company, but I have a duty to make sure I'm responsible in doing something, and we're doing that with our economic development efforts to make sure we can really help change all of this.

And we've done that recently. There's been success in the past. You'll hear about success in the future. So I'm focused on changing that. It's a reality, and we're very sensitive to it, and I realize any increase in any costs for my customers is difficult, and so I take that personally, and when we make decisions we want to make sure we're making the best decisions, but at the end of the day under the regulatory compact I have to provide safe, reliable service, and I think that's what we provided to the Commission to make sure we can take care of this community.

Q. I know in your -- in your testimony relative to the, I guess, the Kentucky Economic Development Surcharge you made a statement that, and I know that basically it's changed a little, but you made the statement that the -- to the effect that the charge on customers' meters gave the rate payer, the residential rate payer, the opportunity to participate or partner along with Kentucky Power in economic development in the area, but I would suggest to you that some of these rate payers are old, disabled people on fixed incomes and Social Security, perhaps shouldn't feel like or don't feel like they ought to bear the burden of participating in economic -- in economic development, and I know it's only that you have the 10 cent per meter charge, but I noticed I think in the HEAP program the per meter charge maybe has been 15 cents, and according to Mr. McCann in his testimony, that hasn't been raised since 2006, in 11 years.

And the proposal was in your proposal, or in your application, to raise that meter charge to 20-cents per meter. Is that still -- it wasn't addressed in the settlement, but is that -- what is your position now?

A. Let me check because I believe it was 5 cents before, and it's being raised to 10.

Q. I was thinking it was maybe 15, but whatever it was, let me ask you this: What would Kentucky Power's position be if the Commission determined to eliminate the 10 cent per meter charge for the economic development surcharge and add that on to HEAP? Would Kentucky Power be willing to match that additional HEAP surcharge? It wouldn't cost it any more money one way or the other.

A. Interesting. Would the shareholder match switch as well?

Q. Shareholder match. Shareholder match. It just takes it from economic development for residential customers only and puts it on to the HEAP program to provide additional funds for individuals who have trouble paying their bills, poverty level and below.

A. Yeah, if the Commission wanted to make hopefully the only change to the balance of the settlement agreement that we have, but switch something from an economic development over to the HEAP, I think as long as, you know, the shareholder matching moved as well with the same and didn't still exist in the economic development side, I think that's something that I could be comfortable with as the president to provide more benefit.

That would have lower dollars for the economic development efforts that we're trying to do that have an impact on that, but I think that's something that if the Commission wanted to make that change it wouldn't disturb the overall balance, I think, that the parties have put into the settlement agreement.

Q. Well, the reason too, and I don't know if you've seen these statistics because they're in the evidence in the case, that Kentucky Power has approximately 136,344 residential customers. 26.22 percent of those are at or below the poverty level. That's 35,756 customers of Kentucky Power. 35,756 out of 136 are at or below the poverty level, and during the year 2016 Kentucky Power disconnected 11,438 customers because of their inability to pay their bills, and all I'm suggesting is maybe there's some help somewhere for some of these people who actually during the winter months have a life or death decision on whether they can make their power bill payment or not.

A. Yeah, I understand what you're saying, and to the senior citizens, that's something that came up in our community advisory panels as we talked about rates overall and the impact on senior citizens.

What I would add is that I talk to a lot of grandparents who talk about help rebuild the economy here so my grandkids come home, you know, there's more work around here, so I think it impacts everyone.

The uniqueness of the position we have with the economic development rider and the HEAP rider is it's a guaranteed spend. A lot of utilities can do a lot of things in their test year, and then they don't do it in future years.

Because it's earmarked and approved by this Commission, whether it's HEAP or economic development, it's guaranteeing that I can't move that money somewhere else because I have a need somewhere else. It's locking that in, so I think the path you're going down is locking more in.

Might be interested to talk to Steve Sharp. We've talked to the agencies in the past, as I mentioned before, about trying to find those customers that might need a month or two versus I don't know if they're handcuffed when someone comes to them, and they have to pay the entire bill for someone that they know might be a serial person that doesn't pay their bill, so there might be some room in there, but I think we can continue to work with the agencies if there's more funds available maybe to make sure we're helping those that need help for a month or two versus those that maybe are just unwilling to pay their bill.

CHAIRMAN SCHMITT: Thank you. I have no further questions.

Commissioner Mathews?

COMMISSIONER MATHEWS: Sorry.

REEXAMINATION

By Commissioner Mathews:

Q. The FRR versus RPM, the information made me have more questions. I apologize. I know we would like a break, and I know the Attorney General's folks wanted to get their witness on the stand, but my question is: Was this decision made with all four companies as a whole, or did you -- because it doesn't seem that it was evaluated as Kentucky Power separated out from the other four because the language talks to it's recommended that all four elect FRR, if any or all were to -- the PJM rules would require they have to stay for five planning years. You said yesterday that once you made the decision you didn't go back.

A. Correct.

Q. But it just seems like forever.

A. Yes.

Q. And it keeps saying by combining them into a plan, the company's capacity position can be managed collectively. My question is, and you are welcome to put this in a post-hearing data request, what are the reserve margins of the other three companies, and are they winter or summer peaking, and how would that change a decision about Kentucky Power versus the other three?

A. Yeah. I'll give the exact information in a post-hearing data request for you. I believe APCO is winter peak as well. I think they might be because they're a lot like us, so we'll get the other information in that post-hearing data request, but this is what -- the operating committee, which has the presidents of every one of those companies. I asked a lot of questions before this to kind of analyze what my position overall was to see how that related.

Q. Just I would ask that.

A. No problem.

CHAIRMAN SCHMITT: Mr. Overstreet?

MR. OVERSTREET: No, no further.

CHAIRMAN SCHMITT: Anyone else any questions? If not, let's take a ten minute break until 11:15, and then Mr. Chandler and Mr. Cook can call their witnesses.

MR. OVERSTREET: I think we indicated Dr. Woolridge would be the next witness.

(Recess from 11:02 a.m. to 11:17 a.m.)

CHAIRMAN SCHMITT: We are now back on the record.

Mr. Chandler, as I understand it, we're taking one of your witnesses out of order; is that correct?

MR. CHANDLER: That's right, Chairman.

CHAIRMAN SCHMITT: Do you have anything else to bring before the Commission?

MR. CHANDLER: I do. I'd like to move to introduce AG Exhibit 1 through 5.

CHAIRMAN SCHMITT: Any objection?

MR. OVERSTREET: I would have an objection to number 4, which was the -- I think it's number 4. It was the document that Mr. Satterwhite was unsure of, and so could we just hold up on its admission until Mr. Wohnhas has a chance to testify about it?

CHAIRMAN SCHMITT: Do you have any objection to that?

MR. CHANDLER: I don't have any objection. I just note that I asked about it yesterday before lunch, and he obviously was able to check on quite a few things, and was unable to look into this specific one, but I have no problem asking Mr. -- I think Mr. Cook will ask questions of it and ask to be introduced at a later time. That's fine.

CHAIRMAN SCHMITT: Okay. And let's just -- let's not forget and leave it unaddressed if we otherwise forget it, so but we'll rule on it. I'll let 1 through 5 in, with the exception of 4, and we'll address 4 at a later date.

Do you also have something?

(AG Exhibits 1, 2, 3, and 5 admitted.)

MR. OVERSTREET: Yes, I move the admission of Exhibits 8 and 9.

CHAIRMAN SCHMITT: Any objection, AG?

MR. COOK: No.

CHAIRMAN SCHMITT: So I'll let those be admitted into evidence.

(KPCO Exhibits 8 and 9 admitted.)

CHAIRMAN SCHMITT: Okay. Sir, will you please stand and raise your right hand?

J. RANDALL WOOLRIDGE, PH.D., called by the Kentucky Attorney General, having been first duly sworn, testified as follows:

DIRECT EXAMINATION

By Mr. Chandler:

CHAIRMAN SCHMITT: Please be seated.

Mr. Cook, Mr. Chandler, whoever is asking questions, you may proceed.

MR. CHANDLER: Thank you, Chairman.

Q. Dr. Woolridge, can you please state your name for the record?

A. My name is the initial J. Randall Woolridge, and that's spelled W-O-O-L-R-I-D-G-E.

Q. And with whom are you employed, and what is your position there?

A. I'm a professor of finance at the Pennsylvania State University.

Q. And are you the same Dr. J. Randall Woolridge who caused to be filed prefiled direct testimony and

certain data requests in this case?
A. I am.
Q. Do you have any additions or corrections to your testimony?
A. No.
Q. And if we were to ask you today the same questions, would your responses be the same?
A. Yes.
MR. CHANDLER: The witness is tendered, Mr. Chairman.
CHAIRMAN SCHMITT: Thank you. Cross-examination?
MR. OVERSTREET: Mr. Garcia will do so, Your Honor.
MR. GARCIA: Thank you, Your Honor.

CROSS-EXAMINATION

By Mr. Garcia:
Q. Good morning, Dr. Woolridge. How are you?
A. Good morning. Good to see you again.
Q. Likewise. I would like to start with some basic building blocks. Would you agree that a riskier investment requires a higher ROE than one that is comparably lower risk investment?
A. As a general concept, yes.
Q. And other things being equal, a company with a

capital structure with more equity and less debt capital is comparably less risky, correct?
A. Yes, everything else equal.
Q. Right. And correspondingly, one that has a capital structure with less equity and more debt is comparably more risky, correct?
A. Yes.
Q. Okay. Can you turn to credit ratings -- are you familiar with Moody's long-term credit rating such as A3, Baa2, and so forth?
A. Yes, I am.
MR. GARCIA: And, Your Honor, before we went on the record I tendered to Dr. Woolridge two documents that I would like to circulate and mark as exhibits, please.
CHAIRMAN SCHMITT: Yes. Would these be sequentially 10 and 11?
MR. OVERSTREET: Yes, Your Honor.
MR. GARCIA: Thank you, Your Honor.
(KPC Exhibits 10 and 11 marked for identification.)
Q. And, Dr. Woolridge, if I may --
CHAIRMAN SCHMITT: Let's make sure Kentucky Utilities would be 10 and Louisville Gas & Electric 11?

MR. GARCIA: Thank you, Your Honor. That's correct.
Q. Dr. Woolridge, if I can ask you, would you agree that if you were going to compare the credit ratings in the Moody scale from, say, A3, if you were to compare that with Baa2, that A3 represents a credit rating that is stronger and therefore implies less risk, less --
A. Yes, it would be -- according to Moody's it would be two notches. In other words, you go from A3 to Baa1 in Moody's and then Baa2, yes.
Q. And the less risky investment of the two would be the A3 --
A. Yes.
Q. -- investment, and the riskier investment would be Moody's Baa2?
A. Yes.
Q. Thank you. Dr. Woolridge, are you familiar with the documents that have been marked as Kentucky Power Exhibits 10 and 11?
A. No.
Q. Those are the credit opinions from Moody's Investor Service --
A. Oh, okay.
Q. -- for Kentucky Utilities is number 10, and for

Louisville Gas & Electric it's number 11?
A. Sorry, yes. I'm sorry, yes, I am.
Q. Okay. And would you agree that these documents indicate that both for Kentucky Utilities and for Louisville Gas & Electric, the Moody's long-term credit rating is A3?
A. Yes.
Q. Okay. Were you a witness in the most recent case, base case that Kentucky Utilities and Louisville Gas & Electric had here in Kentucky?
A. I was. I was.
Q. Do you recall whether the capital structure for these entities was more heavily equity or more heavily debt?
A. As I remember, as the companies proposed they had a higher common equity ratio than in this case.
Q. Okay. And if -- just to clarify, that would imply that they are a less risky investment than a company that has a capital structure more heavily debt, correct?
A. Yeah. Again, assuming all else equal.
Q. That's correct.
A. Yes.
Q. Is there a benefit for customers from a cost point of view for a company to have less equity and

more debt capital than if it was otherwise, from the point of view of the impact of, say, every basis point in the ROE?

A. I mean, there's a tradeoff. If there's more debt, then your overall cost of capital can be lower, but it may mean that because you have less equity and more debt that you have a lower credit rating, and as a result, you know, there's a tradeoff in terms of the cost of capital versus your cost of, say, debt and equity, and it's just, you know, it's kind of a normal tradeoff when you're talking about how you capitalize a business.

MR. GARCIA: Thank you, Your Honor. That's the cross-examination that I have at this point, and I would move for the admission of exhibits -- Kentucky Power Exhibits 10 and 11.

CHAIRMAN SCHMITT: Any objections?

Let them be admitted as Kentucky Power Exhibits 10 and 11.

(KPCO Exhibits 10 and 11 admitted.)

CHAIRMAN SCHMITT: Any cross-examination from staff?

MR. NGUYEN: Staff does, Your Honor, yes. Just a few.

CHAIRMAN SCHMITT: Any other -- any other party

have any cross-examination of this witness?
You may proceed.
MR. NGUYEN: Thank you, Your Honor.

CROSS-EXAMINATION

By Mr. Nguyen:
Q. Good morning, Dr. Woolridge.
A. Good morning.
Q. I take it that you've read Dr. McKenzie's rebuttal testimony; is that correct?
A. Excuse me?
Q. I take it that you've read Dr. McKenzie's rebuttal testimony?
A. I have.
Q. Okay. And do you recall that on his rebuttal testimony that he suggested that the ROE that you had recommended would be the lowest in recent history. Do you recall that statement?
A. I don't recall exactly that statement. I would say, given yesterday, there was an order in Illinois for Ameren Illinois, and they came in at 8.4 percent ROE, so at least, I mean, as of yesterday it wasn't the lowest ROE.
I said in my testimony, my -- my ROE, recommended ROE is low, and it's low relative to -- you know, because interest rates have been falling,

capital costs have been low. Despite forecasts for years that interest rates were going up, interest rates have stayed low.

I think that's why you see authorized returns have been about 9.6 percent for the last three years for electric utilities, as it turns out, but I think people believe all these forecasted interest rates are going up, and as I always say, if you can forecast interest rates you run a hedge fund and you live on a yacht, you know. No one can forecast interest rates.

So anyhow, I think that's why, but it is low, and I just believe, you know, authorized returns have been stuck because of the belief that interest rates are always going up, and but after yesterday, no, there's one lower than me.

Q. Do you know what case number for that Illinois proceeding is?

A. I do not know. It was yesterday. The Illinois Commerce Commission came out with a 8.4 percent ROE.

Q. Okay. As a post-hearing data request could I request that you obtain and provide that case number?

A. Okay.

Q. That docket number or the ICC?

A. Okay.

Q. Are you familiar with that proceeding at all?
A. Just what I've read about it.
Q. Okay. Are you aware if Illinois has a formula rate process?
A. They do. They do.
Q. And outside of the interest rates, is it your belief that the risks associated with Kentucky Power and investors' expectations supports an ROE of 8.6 percent?
A. In my testimony I look at the credit ratings of Kentucky Power relative to the proxy groups. Kentucky Power is -- in terms of they have an A minus S&P rating and Baa2. Moody's, I look at the average of the proxy groups is BBB plus for S&P, Baa1 for Moody's, so their S&P rating is one notch above it, their Moody's rating is one notch below it, so I say they're kind of similar. So I assume that credit ratings reflect risk.
I mean, there's different risk measures. The trouble is a lot of them you can't attribute to Kentucky Power because they're all based on stock market measures, so credit ratings are the one risk measure you can use you can compare with other companies.
Q. So what would the impact on investors'

expectations if the Commission were to accept the recommendation of an 8.6 percent for Kentucky Power?

A. Well, I mean, there is a couple things. I mentioned in my testimony when I summarized my results, the whole thing, does it meet Hope and Bluefield standards. Okay? I point out, look, electric utilities in recent years have been earning about a 9 percent ROE, okay.

Now, with a 9 percent ROE, if you look at the graph I show their credit ratings have gone up. The percent of upgrades in the last three years have been like 70 percent upgrades, so their credit ratings are going up with a 9 percent ROE.

I said, number two, they're raising $50 billion a year in capital with about a 9 percent ROE, and number three, you look at their stock prices, I mean, they're not bitcoins, but they're doing awfully well. They're hanging with the S&P 500. So a return of about, you know, 9 percent is close to where it should be.

I mean, you know, Mr. Baudino, the industrials, he was 8.85. He's a little higher than me, but still, I mean, that's -- you know, there's a lot of market indicators suggest that capital costs are low, whether it's interest rates, whether the performance of utility stocks earning a 9 percent ROE, there's a lot of indicators that suggest that, you know, about 9 percent is about what it should be.

Q. So basically you're saying that it would not have a detrimental impact for Kentucky Power at 8.6 percent.

A. Well, no, I mean, yesterday Ameren Illinois got 8.4 percent. They have credit ratings which are about in line, maybe a little above Kentucky Power, so, I mean, 8.4 percent, I mean, and last year they were at 8.6 percent or something like that. I forget.

I mean, they kind of redo these yearly, but, you know, they have good investment grade credit ratings which are in line with other electric utilities. Like I say, electric utilities on average BBB plus from S&P, Baa1 from Moody's.

Q. So in Illinois, you're saying in Illinois they would recalculate the ROE on an annual basis?

A. They have annual cases where they go through and redo the ROE.

Q. Okay. And for Ameren last year was 8 point --

A. I forget.

Q. -- six percent, you said?

A. It was slightly higher. I forget exactly what it was. 30-year treasuries, it's tied in weight to 30-year treasuries, and they were a little higher last year.

Q. Okay. So do you support an ROE of 8.6 percent given recent indications by the Federal Reserve of a December interest rate increase, which could in turn imply higher long-term capital costs?

A. I explained my testimony. The difference between short-term interest rates, which the Fed runs, and long-term interest rates. Short-term interest rates can be influenced by the Fed. The Fed has increased the discount rate. I explained my testimony four times in the last year.

What has happened to long-term interest rates? They've fallen. Beginning of the year they were about 3 percent or so, 3.2 percent. Today they trade -- 30-year treasuries are trading at 2.7 percent, so that's about a 50 basis points decline in long-term interest rates.

We're interested in long-term capital costs. The Fed can increase short-term rates, and they're going to impact short-term rates, but long-term rates are driven by two factors: Economic growth, projected economic growth, and expected inflation, and especially inflation remains low. Economic growth has picked up the last two quarters or two, so but still, long-term investors see muted economic growth.

As a result, you know, that's why long-term rates have declined 50 base points despite the Fed increasing short-term rates.

Q. Okay. So given that, you don't see any impact with respect to a potential increase in -- by the Federal Reserve in its interest rate on your recommended 8.6 ROE.

A. The Federal Reserve is increasing short-term rates. Investors know that the same time they're starting to reduce the size of their balance sheet, and long-term treasures are still 2.7 percent.

Q. Okay. So --

A. I mean, if investors -- as you know, there's an inverse relationship between interest rates and bond prices. If interest rates go up bond prices go down, okay. So what would happen?

If investors expected long-term interest rates to go from 2.7 to 4 percent, the price of those bonds has to go down, so as an investor I wouldn't buy a 30-year treasury at 2.7 percent today if I thought interest rates were going to 3 and a half to 4 percent because the price of my bond would decline

20 to 30 percent. Investors don't invest with the expectation of having a negative return.

So in the end the market says this is what we think long-term rates should be based on inflation and expected growth. The Fed is going to increase the short-term rates, we know that, but so far in the last year they've increased it a full percent, and long-term rates have come down.

Q. If I can refer you to Dr. McKenzie's rebuttal testimony. Do you have that, by chance?

A. I do not have that.

MR. NGUYEN: Do you have --

MR. CHANDLER: We don't have a copy.

Q. Let me provide you with it. Well, let me try to walk you through it without having to refer to specifically, to his rebuttal.

Do you recall his testimony with respect to how ROEs are implied by the expected earnings approach with respect to the utility proxy group? Do you recall that?

A. Yes, yes.

Q. Okay. And --

MR. CHANDLER: Chairman, may I?

CHAIRMAN SCHMITT: Yes, you may.

Q. This may be a little bit easier if you can refer to the rebuttal testimony. On page 12, lines 14 through 18.

A. Okay. Yes.

Q. Okay. Did you have a chance to read that?

A. Yes.

Q. Okay. So what is your opinion on Dr. McKenzie's analysis based on the expected earnings approach?

A. The expected earnings approach, I mean, I haven't seen a utility commission -- that's how -- this was something that was used decades ago. It's not a market-based approach, and I think that's why it hasn't been used.

It's basically saying, you know, what are the expected ROEs from these different utilities. Now, you know, there's several issues with that. One, it's not market based. You don't know if that's what's required by investors, okay. That's why we use things like stock prices and that sort of to see, see what investors actually require.

Also, these business -- these utilities have unregulated businesses. A number of them have like generation riders or incentives, that sort of thing, and as a result you see ROEs for some of these utilities of up to 17 or 18 percent, and that's because of these -- it's not their regulated part of their businesses, and that's what we're looking at. It's the unregulated or the special, you know, some of the transmission with special riders from FERC and that sort of thing, so these ROEs are above what investors require, certainly above what the regulated part of the business would generate.

Q. Okay.

A. And I explain that in my testimony and my rebuttal. I say there's another reason why that marking the books of electric utilities are 2.25. It's because these expected ROEs that you get from the entire business are higher than the returns that investors require. That's why we use market-based models, and you really don't see this approach being used anymore.

Q. So you're saying that's not an apples to apples comparison because there's a premium built into the expects earnings approach?

A. Yeah, there's a premium built into the earnings that utilities are generating the returns that investors require, and that's why they're marking the books that are over 2.

Q. And you had testified that one of the criteria that should be included in the proxy group is

50 percent of the revenue must be from regulated activities; is that correct?
A. Regulated electric operations.
Q. Okay. So specifically regulated electric operations?
A. Yes.
Q. And Dr. McKenzie sort of questions that. Can you explain to the Commission why you believe this should be a criteria for inclusion in the analysis of the utility proxy group?
A. Well, two things. One thing, I think these should be primary electric utilities, and that's why I say 50 percent of revenues, so they're primary electric.
Number two is, I mean, I use Mr. McKenzie's proxy group, so I don't know why the proxy group is a real issue, and on JRW-4 I provide the operating statistics on percent of regulated gas, electric, that sort of thing, so I don't think the proxy group, especially because I use his, is a real big issue.
Q. But I guess my question is, is why the limitation or the factor to consider 50 percent of the electric operations group from a regulated operation?
A. Because there are a lot of utilities that have

merchant generation, which is unregulated, and as we've seen in the last couple years, it's much riskier than the regulated side of the business.

These are holding companies. We have to use the holding companies because they're the ones that have stock outstanding, so these are all holding companies. They have more than just regulated electric utilities.

So I'm trying to just, and again, I'm using a large sample. You use a large sample because, you know, you're going to have -- I believe you get a better measure of the cost of equity because individual company variations will average out when you use a larger sample, and again, I used Mr. McKenzie's proxy group too, so I don't think the proxy group is a real issue.

Q. And the 50 percent is -- how did you arrive at that 50 percent?

A. You comb through the 10Ks, and they --

Q. I mean why the basis for 50 percent?

A. I just -- that they're primarily a regulated electric utility. They're not primarily a merchant generator, so you don't have those in there, not primarily a gas distribution company. You do have combination electric and gas, and I provide those

stats in JRW-4.
Q. Okay. Thank you.
MR. NGUYEN: Those are all the questions I have.
CHAIRMAN SCHMITT: Mr. Cicero, questions?

EXAMINATION

By Vice-Chairman Cicero:
Q. I think you made a statement, correct me if I'm wrong, that investors' expectations for long-term rates are impacted by their expectation on inflation; is that correct?
A. It's two factors: expected GDP growth and expected inflation.
Q. So would you agree that short-term rate increases typically impact inflation?
A. No. I mean, the only thing they could potentially do would probably mute inflation. I mean, as you probably followed, the Feds prefer inflation measure is just called -- they call PCE, personal consumption expenditures, and it's been below 2 percent for some time. Last I saw it was still 1.8 percent, and they've been trying -- they were hoping to go up. It hasn't gone up, and but that's a short-term measure.
But you look at measures of long-term

inflation, for example, you look at the tip spread, it's the relationship between the actual 10-year treasury yield and the treasury -- the inflation protected securities, it's still below 2 percent, so, I mean, obviously we're talking about GDP and inflation, I mean, those are the factors going to drive interest rates.

The reason long-term interest rates are still at 2.7 percent is there's muted expectations about expected economic growth the next five to ten years and expected inflation.

Q. So from a historical perspective would you say it's typical?

A. It's, you know, obviously inflation is lower than it was 5, 10, 15, 20 years ago. And but we know when we can see what the market's expectations are from the market, with like the tip spread and that sort of thing, what investors expect inflation to be, and it's still below 2 percent, even over the next ten years.

Q. We've enjoyed a period here of no rate increases on a short-term basis, and we've just started to see them implemented, and there's been announcements that this coming year there will be more short-term rate increases.

Is there any indication that this will catch up and sooner or later long-term rates will be impacted because of the inflation on the Fed increasing short-term rates?

A. Well, I mean, like I say, the Fed's reacting to primarily better economic conditions, and you read the Fed Minutes it's not because of inflation because they don't see the inflation yet. Their measures aren't picking up inflation.

I mean, obviously what you're having is a flattening of the yield curve. Short-term rates are going up, long-term rates are going down. You've seen a lot on -- a lot of commentary about the risk of a negative yield curve. Why? Because typically negative yield curves you see before a recession.

So, I mean, the data are what they are, and we can see, you know, that that's why -- you know, like I say, people wouldn't be buying long-term treasuries at 2.7 percent if they thought interest rates were shooting to 4 percent because they would get a 30 percent capital loss, and they would feel like they got fooled by a bitcoin, right?

Q. You would also agree that any investment opportunity is always subject to winners and losers.

A. Yeah. Well, the stock market is basically all

been winners.
Q. Absolutely. So far.
A. Yes.
Q. But we've also had downturns and several cases that have experienced 20 percent or greater, and in those cases the stock market seems to bounce back, but it does have its dips, and there are losers during that period.
A. It's like one economist has said, is famous for saying, the stock market is like a gambling casino with the odds in your favor.

VICE-CHAIRMAN CICERO: I don't have anything else. Thank you.

CHAIRMAN SCHMITT: Commissioner Mathews?

COMMISSIONER MATHEWS: I don't have anything.

CHAIRMAN SCHMITT: I have no questions. Mr. Chandler?

MR. CHANDLER: Some redirect.

REDIRECT EXAMINATION

By Mr. Chandler:
Q. You mentioned a case with Ameren Illinois; is that correct?
A. Yes.
Q. And are you aware of what Ameren's Moody's rating is?

A. Ameren's Moody's rating is A3, I believe.

Q. And do you still have Kentucky Power's Exhibits 10 and 11?

A. Yes.

Q. Do you mind to tell me on Exhibit 10 what Kentucky Utilities's long-term Moody's rating was?

A. It is A3.

Q. It is A3?

A. Yes. And Kentucky Utilities, their S&P rating is A minus, which is the same as Kentucky Power Company, so Kentucky Power Company has a slightly lower -- no. Let me double-check that. I might have misspoke. Yeah, Kentucky Power Company's S&P rating is A minus, and their Moody's rating is Baa2.

Q. You mentioned about stock prices generally rising, and I think you kind of said that utilities kind of were joining the party.

Is there any way to tell if the stock prices of Mr. McKenzie's and yours proxy group has increased since you provided testimony, or that Mr. McKenzie provided testimony, is there any metric that could show that?

A. Well, probably the one that shows up most in our testimonies are the dividend yields, the annual dividend divided by the stock price, and so generally -- usually when stock prices are going up the dividend yield goes down because utilities will only increase their dividend once a year, but, I mean, obviously in the last six months interest -- I mean utility stock prices are near an all-time high.

The Dow Jones Utility Index is about 750 or so, so you see dividend yields for electric utilities, which were maybe 3.5 or 3.6 six months ago, are like 3.2 percent. It's generally because the prices have gone up and the dividends haven't been increased yet.

MR. CHANDLER: Pass the witness.

CHAIRMAN SCHMITT: Mr. Garcia, questions?

MR. GARCIA: Yes, a few more, Your Honor. Thank you.

RECROSS-EXAMINATION

By Mr. Garcia:

Q. Dr. Woolridge, you were asked about the Standard & Poors credit rating, and you made some statement about Kentucky Power's credit rating from Standard & Poors. Those are done at the corporate, ultimate corporate parent level and not at the specific company level; isn't that true?

A. What's that?

Q. The Standard & Poors credit rating that you were talking a second ago about Kentucky Power, those

are done at the parent level, correct?
A. It's an integrated model, but if you go to standard&poors.com and you type in "Kentucky Power" it will come up A minus, and so it's an AEP/Kentucky Power Company S&P rating.
Q. But S&P gives the same rating to all the entities under that AEP umbrella, correct?
A. Generally they do, correct.
Q. Okay. The Moody's rating, it's company specific, correct?
A. It's probably more company specific, but obviously, you know, there's two -- you know, S&P is probably better known. I think last I saw two-thirds of the -- two-thirds of ratings are controlled by S&P, so I think S&P is probably the bigger brand name, so if you have an S&P rating.
Moody's is a little more company specific, and so that's why I kind of -- I think most people average them when they're trying to compare riskiness.
You go to FERC, they average S&P and Moody's ratings just because Moody's are a little more company specific, but S&P also will give individual company comments within the overall rating.
Q. Dr. Woolridge, if an investor wanted to get

information that was specific about the credit rating of Kentucky Power and not of any of its sister entities, they would go to the Moody's credit opinions that address them individually, correct?

A. Well, S&P does the same thing.

Q. The credit metrics that are represented in the Moody's credit analysis are specific to the operating company that they relate to, correct?

A. They're specific, and if you read them they also have -- I mean, but S&P has the same thing, and they mention, you know, we look at it as an integrated network, and they look at integrated network because obviously AEP controls everything Kentucky Power does, so they can make a decision about how they want to capitalize it, how they want to -- you know, so -- you know, the common equity ratio for Kentucky Power is not set by the marketplace, it's set by AEP.

So the reason you use an integrated approach is because the parent makes all the calls about the capitalization of financial risk of the subsidiary.

Q. Are you aware that in 2014 Moody's did a general upgrade of several electric utilities all at the same time as a result of a perception that the industry was essentially requiring a credit rating

upgrade of one notch?
A. Yes. Actually if you look at my testimony at page 61, I have the credit utility upgrades and downgrades from EEI, the Electric Institute -- Edison Electric Institute, and you can see in recent years the upgrades have been about 70 percent, but in 2014 it was like 97 percent because Moody's viewed -- views the industry as less risky mainly because of a lot of riders and that sort of thing, so the overall -- I mean, as I show, the overall health of the electric utility industry as measured by credit ratings has clearly gone up in recent years.
Q. Kentucky Power was one of the utilities that was left behind from that upgrade and that kept their credit rating from Moody's the same when everybody else's was upgraded; isn't that true?
A. I believe so. I don't remember.
Q. Can I turn your attention again to Exhibit 10 and 11 from Kentucky Power that I asked a few questions about before?
And if you go to the next to last page of each one of those exhibits, do you see a table there that includes the ultimate parent Moody's rating?
A. Yes.
Q. What's the ultimate parent of both Kentucky

Utilities and Louisville Gas & Electric? The ultimate parent is PPL Corporation, correct, and their Moody's rating is Baa2?

A. No, I'm sorry, I'm missing your point. What am I supposed to look at?

Q. The ultimate parent of both Kentucky Utilities and Louisville Gas & Electric, which is PPL?

A. Yes.

Q. Moody's gives them a rating as well, and that rating is reflected in this document, correct?

A. They do. And there's a reason for that.

Q. Okay. Actually --

A. And they do, and I'll tell you why. If you look at PPL, their common equity ratio is 34 percent. That means they finance a lot by debt, very heavy by debt, and as a result they have a lower overall rating because they -- again, they've made some acquisitions obviously, and they do that with debt, and so a lot of their rating issues are tied to the amount of debt they use.

Q. Okay. And that rating for the parent of both Kentucky Utilities and Louisville Gas & Electric is less strong. It's riskier than the ones that Moody's have assigned to the operating companies, Kentucky Utilities and Louisville Gas & Electric.

A. Yes.

MR. GARCIA: Okay. No further questions.

CHAIRMAN SCHMITT: Mr. Kurtz, questions? Anyone else? Any intervenor questions?

MR. NGUYEN: No further questions.

CHAIRMAN SCHMITT: Commissioner Cicero, Commissioner Mathews?

I have nothing. If nothing further, may this witness be excused?

MR. CHANDLER: Thank you.

MR. OVERSTREET: Certainly.

CHAIRMAN SCHMITT: You may stand down, and you're excused.

MR. GARCIA: Thank you, Your Honor.

CHAIRMAN SCHMITT: Do you have another witness at this time, Mr. Chandler, or is someone else scheduled to testify?

MR. CHANDLER: Do you mind if we take a two minute -- would it be okay if we took a two minute recess?

CHAIRMAN SCHMITT: Yes, let's do that. We'll take five. We'll be in recess for five minutes.

(Recess from 11:56 a.m. to 12:02 p.m.)

CHAIRMAN SCHMITT: We're now back on the record.

Mr. Chandler, do you have another witness to call at this time?

MR. CHANDLER: I believe Mr. Cook does.

CHAIRMAN SCHMITT: Mr. Cook.

MR. COOK: Yes. At this time we'll call Dr. David Dismukes.

CHAIRMAN SCHMITT: Dr. Dismukes, please raise your right hand.

DAVID E. DISMUKES, PH.D., called by the Kentucky Attorney General, having been first duly sworn, testified as follows:

DIRECT EXAMINATION

By Mr. Cook:

CHAIRMAN SCHMITT: Please be seated.

Counsel, you may ask.

MR. COOK: Just one second, Your Honor. I'm sorry.

Q. Could you state your name and business address for the record?

A. David E. Dismukes, D-I-S-M-U-K-E-S. My business address is 5800 One Perkins Place Drive, Suite 5F, Baton Rouge, Louisiana, 70808.

Q. Are you the same Dr. David Dismukes that caused to be filed prefiled direct testimony in this case as well as responses to data requests?

A. Yes.
Q. And do you have any -- did you at any time have any changes to your testimony or responses?
A. I did have some editorial revisions, I think, that were provided to counsel yesterday or so, and a revised change on an exhibit that changed some markings on it.
Q. And other than those, do you have any other changes to your testimony?
A. No, sir, I do not.
MR. COOK: The witness is available for cross.
CHAIRMAN SCHMITT: Cross-examination?
MR. GISH: Thank you, Mr. Chairman.

CROSS-EXAMINATION

By Mr. Gish:
Q. Good morning. No, sorry, good afternoon, Dr. Dismukes.
A. Afternoon.
Q. I believe from looking at your resume that this is the first time you've testified in front of the Kentucky Public Service Commission; is that correct?
A. Yes, sir.
Q. Is this your first time in Kentucky?
A. No, not the first time in Kentucky.
Q. Are you familiar with the Kentucky Power

service territory?
A. Yes, sir.
Q. And what is the largest city served by Kentucky Power?
A. I don't know.
Q. Would you believe, subject to check, that it's Ashland, Kentucky, is the largest service territory?
A. Yes, I agree with that.
Q. And do you happen to know the population of Ashland, Kentucky?
A. No, sir, I don't.
Q. Would you believe, subject to check, that it's 21,000 people?
A. Sure.
Q. Do you know what the second largest city in the Kentucky Power service territory is?
A. No, sir, I do not.
Q. Would you believe, subject to check, that it's Pikeville, Kentucky, with a population of approximately 7,000?
A. I can agree, subject to check.
Q. Can you -- I have provided a copy for reference only. These are all documents that are already in the record, and I'll refer to them by their location in the record as well.

Can you refer to page 22 of your testimony, which is not in the packet, I apologize. I presume you have the testimony with you.

A. Yes. Okay, I'm there.

Q. This is in the section of your testimony regarding the company's proposed residential customer charge; is that correct?

A. Yes, sir.

Q. Okay. Can you look at page -- I'm sorry, line 19 of page 22?

A. Yes, sir.

Q. There's a sentence there that reads (Reading) The true driving factors of utility distribution system costs are much more complicated and depend on a host of other factors such as the size of a service territory and the population density within. Incremental costs of constructing an appropriate distribution system to serve an additional customer within an urban area with existing nearby infrastructure is substantially less than the cost to extend an existing utility system by potentially miles to serve an additional customer located in a rural area.

Then you go on to say that this fact was ignored by the company; is that correct? Did I read

that correctly?
A. Yes.
Q. Can you turn to what is the Attorney General's response to Kentucky Power's data request number 15, which is the first page of the demonstrative or referencing document I've provided?
A. Yes, sir.
Q. Okay. This question asked to identify the bases for selecting the peer utility group used in Exhibits DED-4 and DED-6; is that correct?
A. Yes, sir.
Q. And then the response talks about Dr. Dismukes developed his peer group for Exhibits DED-4 and DED-6 on mainly a geographic basis. Is that correct?
A. Yes, sir.
Q. And then it says, (Reading) Specifically the peer group chosen represents investor-owned utilities operating in the Appalachian region with a prior focus on neighboring states in the South Atlantic and East South Central regions.
Can you explain what you mean by "prior focus"?
A. That probably should be particular focus.
Q. Particular focus.
A. Not prior.
Q. And then the company requested whether or

not -- or requested the number of customers per distribution line mile and the nature of terrain for each of the utilities identified as peer utilities in your testimony; is that correct?
A.   Yes, sir.
Q.   And you had not done that analysis.
A.   No, sir.
Q.   Okay. Turn to the next page within this packet I've provided, which is Exhibit DED-6; is that correct?
A.   Yes, sir.
Q.   Okay. So Exhibit DED-6 identifies the utilities that are part of your peer group, correct?
A.   Yes, sir.
Q.   Okay. And you have identified, just looking at it, probably about 15 different utilities; is that correct?
A.   Yeah, I think it was 13 or 14.
Q.   13 or 14?
A.   Uh-huh.
Q.   Okay. And so we discussed earlier that the largest city within the Kentucky Power service territory is Ashland, Kentucky, at 21,000. You have identified Alabama Power Company as a peer utility. Does Alabama Power Company serve Birmingham?

A. It does.
Q. And you identified Ameren Missouri as a peer utility. Does Ameren Missouri serve St. Louis?
A. Yes, it does.
Q. You identified Appalachian Power Company of Virginia, and that serves Roanoke; is that correct?
A. That's correct.
Q. And Appalachian Power Company West Virginia serves both Charleston and Huntington; is that correct?
A. I don't know for a fact, but I can agree subject to check.
Q. Duke Energy Carolinas, LLC, serves Charlotte, North Carolina; is that correct?
A. Yes, sir.
Q. And Duke Energy Carolinas, LLC, also serves Greenville, South Carolina?
A. Yes, sir.
Q. Duke Energy Kentucky serves the Covington and Northern Kentucky suburbs.
A. Okay.
Q. Correct?
A. Yes, sir.
Q. I don't know how familiar you are with those. The vice-chairman is familiar with this. Lots of

cities up there, but together they're a fairly dense urban area.

Duke Energy Progress serves the Raleigh area; is that correct?

A. Yes.

Q. Duke Energy Progress also serves Florence, South Carolina; is that correct?

A. I believe so.

Q. Entergy Arkansas serves Little Rock; is that correct?

A. Yes.

Q. Entergy Mississippi serves Jackson?

A. Yes.

Q. Kentucky Utilities Company serves Lexington.

A. Yes.

Q. Louisville Gas & Electric serves Louisville; is that correct?

A. Correct.

Q. South Carolina Electric & Gas Company serves Columbia, Charleston, South Carolina?

A. Yes, that's correct.

Q. The Virginia Electric Power Company serves the D.C. suburbs and also Norfolk, is that correct, Alexandria and the Norfolk area?

A. Yes.

Q. So Dr. Bonbright, who is the seminal work on public utility rates, identified the need to look at population density as one of the things in determining utility distribution costs, correct?
A. When you're -- yes, I think that was one of the things that he raised in terms of the shortcomings in minimum distribution studies, which is a methodology that was -- methodology that was comparable in what the company had used in calculating their customers' share off their primary and secondary voltage cost.
Q. But your peer group includes utilities that have much larger urban areas than Kentucky Power does, right?
A. They do, but I think something to keep in mind, though, is I think there's a little bit of mixing apples and oranges here. I mean, there's one discussion that we're talking about with regards to the distribution and the appropriate methodology for doing a minimum distribution study, and then there's this comparison that was made on customer charges, which was presented more from a perspective of affordability and relative ranking of customer charges to other types of utilities that operate in this region.
So one is really discussing methodological

issues on demand and customer-related costs with primary and secondary voltage, and others just making essentially an affordability and rate comparison, and I don't know that there's -- it's not that there's a disconnect between the two because rates often measure those costs, but they're not as closely aligned as I think is suggested between kind of this discussion here.

Q. Right, but in fact there are in these utilities, I mean the difference between Eastern Kentucky and the Washington D.C. suburbs is pretty significant, yes?

A. They are, but I think you need to keep in mind when customer charges are set, and it's been my experience in working in several hundred rate cases and regulatory proceedings throughout the country, is customer charges are often, if not most of the time, set with regards to public policy issues as opposed to cost-related items strictly.

So this is usually the case in my experience that not only are demand-related costs not included in a customer charge, but it's often the case that the full range of customer-related costs that I outlined in my testimony aren't usually included in there either.

It's very uncommon to see a utility that gets customer costs related -- customer charge-related revenues that are in excess of say 75, 76 percent of their customer-related costs, so that's where you get that disconnect between the costs that you're trying to get at here with the geographic differences and the customer penetration versus, you know, kind of the public policy of setting customer charges for residential customers.

Q. Can you turn to the third page that's in that document there in the package, the demonstrative?

A. Yes.

Q. This is an exhibit to the rebuttal testimony of company witness Vaughn, which compares the Kentucky Power current and proposed and residential basic service charges to those with the cooperatives and utility providers that are, in fact, immediately adjacent within the state of Kentucky to the company.

Are you familiar with what the residential -- proposed residential basic service charge is within the settlement agreement?

A. It's $14.

Q. $14. And the average of Kentucky Utilities here is $15.51; is that correct?

A. That's correct.

Q. So it's below average; is that right?
A. It's below this average that's been presented here, yes.
MR. COOK: Just want to enter an objection for the record as to this being an accurate reflection of customer charges of Kentucky Utilities. It's just for the record, not as to the admissibility.
CHAIRMAN SCHMITT: You may proceed.
MR. GISH: I would -- I would note that Mr. Vaughn will be available for cross-examination, but we can proceed as well.
Q. Okay. Can you please turn to page 30 of your testimony?
A. Okay.
Q. And there's a question that begins on line 3.
A. Yes, sir.
Q. And are you familiar with the HEAP program?
A. Yes.
Q. And that is the program through which customers are able to receive assistance on their electric bills?
A. Correct.
Q. And it's a -- would you assume -- or you would agree that it's a reasonable proxy for low income customers?

A. No.
Q. And why not?
A. Well, I mean, there's a participation requirement associated with the programs that are tied to low income households, but again, I think this gets to the questions that the Chairman had earlier. Those programs and the subscriptions to those programs don't match one for one to the poverty levels that you would see in a particular area.

So if you look at the participation rates of the HEAP program for the company, I think they have somewhere around 7 to 9,000 participants in there. That's probably about 5 percent of all customers, give or take.

As the Chairman pointed out, most of the counties in Eastern Kentucky have poverty rates that in excess of 20 percent, so you can't say that the HEAP program is a good reflection of overall low income population when it's at 7 percent and the census data is at 20 percent.
Q. But the people who participate within the HEAP program are low income customers.
A. That's true, but I think your question was does it reflect low income in that service territory, and I can't agree with that.

Q. Fair enough. On page 30, line 3, you were asked, (Reading) Have you conducted any analysis examining the relationship of electricity usage and income.
Is that correct?
A. Yes.
MR. COOK: Is this of his testimony?
MR. GISH: His testimony, I'm sorry.
MR. COOK: Thank you.
Q. Can you read the first sentence, or I guess the first two sentences, if "yes" is a sentence, of your testimony beginning on line 5 with "Yes"?
A. You want me to read it out loud?
Q. Please.
A. (Reading) Yes. Page one of schedule DED-7 provides the results of an analysis I performed using data from the 2009 -- should say 2005 and 2009 residential electricity consumption survey, or RECS, produced by the United States Energy Information Administration and household data from the census division in which Kentucky is located.
Q. And this census division includes Alabama, Kentucky, Mississippi, and Tennessee; is that correct?
A. Yes, sir.

Q. Okay. And that is what's shown in Exhibits DED-7 and DED-8, correct?
A. Yes, sir.
Q. Okay. So is it your testimony that the Commission should rely on data from a 12 and 8-year-old general survey of household data regarding the relationship between low income customers and electricity use over the actual data within the company's system?
A. Yes.
MR. GISH: I have no further questions.
CHAIRMAN SCHMITT: Questions?
MR. KURTZ: No questions.
CHAIRMAN SCHMITT: Anyone else? Any intervenors? Staff?
MR. NGUYEN: Yes, Your Honor.

CROSS-EXAMINATION

By Mr. Nguyen:
Q. Good afternoon, Dr. Dismukes.
A. Good afternoon.
Q. You recommended in your testimony to reject any increase to the economic surcharge and the elimination of the total charge and said that the program shifts performance risks onto the rate payer; is that correct?

A. Yes, sir.
Q. Have you had a chance to read any of the provisions of the nonpartial settlement agreement?
A. I have.
Q. Okay. And are you aware that the settlement agreement includes provision to decrease the economic surcharge to residential customers to 10 percent per meter per month?
A. Yes, sir, that's my understanding.
Q. Okay. And it also provides for an increase in a per meter charge for any nonresidential customers to a dollar per month; is that correct?
A. Yes, sir.
Q. Okay. So do you still believe this proposed allocation shifts the performance risk onto the rate payer, basically onto the residential class?
A. Yes. I mean, the performance has nothing to do with the fee itself. The fee could be 10 cents, could be 80 cents. It's the nature of what those dollars are being used for that addresses the performance risk issue, and that is if these funds don't yield the returns that they are anticipated, there's no accountability for going back and clawing those dollars back. Rate payers had to pay for it, and there's no accountability for that. So that's

the performance risk in all this.

It's not tied to the rate itself or who is paying the relative share of the rate. It's the fact that there's no way of going in and essentially figuring out whether or not these costs were prudently incurred because the company is taking those dollars, they're essentially taxing rate payers for them, and they're turning around and using and essentially filling in as a legislative function of allocating those dollars to various different categories of institutions in their region for economic development purposes.

Q. Do you have any recommendations for sort of mitigating against those performance risks?

A. Well, I don't because I don't think the nature of a plan like that probably lends itself very well to that kind of performance metric.

That's why those kinds of programs need to be left at the legislature and not with utilities. It's not that the utilities don't have a role to play in promoting economic development, but a lot of times these kinds of expenses, much like they are for private industries, just like Exon Mobile or Dow Chemical or PPG or others who help promote economic development in their regions, they do those below the line. If they want to make those grants or those kinds of contributions to their area.

So there is a role for the company. They have an economic development rider. There are performance guidelines that are included in that that require increasing load, that require increasing employees for the supplemental discount. It's a relatively generous program.

I mean, those are the kinds of things that you typically tend to see in economic development programs for utilities, at least that are regulated for surcharge or for rate-making purposes around the country.

Q. So there are no metrics that can be measured against for a private entity, corporation to measure to see whether the performance is producing some sort of return.

A. I don't because I think even as the company has testified, the purpose of these programs wasn't directly to create jobs, but to facilitate, for lack of a better word, the economic development infrastructure in those areas.

And again, it's well-intentioned, but for rate-making purposes I don't see how you can assure that rates are fair, just, and reasonable when you don't know how those dollars are being spent.

MR. NGUYEN: Yeah, those are all the questions that I have, by the way.

EXAMINATION

By Vice-Chairman Cicero:

Q. So given the fact that the settlement agreement talks about 10 cents and a dollar for the economic development where the residential is 10 cents, and the Chairman asked Mr. Satterwhite if he would be willing to move that 10 cents over into the HEAP program, which basically leaves it at zero at residential and a dollar on the other participants in the settlement who have agreed to that dollar per meter charge, do you still believe that it's an unfair rate-making decision based on the fact that the participants in the settlement agreed to that dollar, and you're moving the other 10 cents off?

A. I don't know if I understand your question. Try one more time. Are you saying does the Chairman's proposal to move it to low income support make it any better or different?

Q. Yes, that's my question.

A. I would say that that's a little different proposal because if those dollars were shifted into a social support program such as the Home Energy

Assistance Program, that has broader benefits for the broader class of rate payers.

It winds of helping rate payers generally, it could potentially help in reducing uncollectibles and disconnects. It could wind up keeping sales on the system in maybe by a very small amount, but at least some amount, reducing this attrition problem that the company has with its sales, so there are some external benefits that could be tied to that from a public policy perspective that I would argue are a little more strained, a little more tenuous relative to how those dollars are being used for economic development right now.

Q. Yeah, but the dollar remaining is being shared by those in the settlement agreement that believe that their classes can absorb that dollar per meter charge, and they don't believe that it's unreasonable, so the rate payers that are going to pay that fee are okay with that. So do you still believe that that's --

A. Yeah, subject to check, I don't think that's true with all the -- well, for the people who -- there's another class of customers, I think commercial customers that would be subject to that dollar increase and would --

Q. And I'll agree with you on that part, that there may be a participant that hasn't settled, that doesn't agree with the settlement that could be impacted by it, but looking at just the dollar for those that are in the settlement piece, you would agree that those rate payers have agreed that that is acceptable.

A. I don't think that's relevant, though, to my position in this, and that is it's your, the Commissioners', responsibility to determine what's fair, just, and reasonable in terms of setting rates and having the accountability for that.

The rate-making process isn't kind of up for vote. They may have agreed to that, but it's up to you to be able to account for those dollars, regardless of where they're spent.

Q. I think the question --

A. And it may be that some of those customers are benefited by that, but other customers are having to pay for it, and they have no way of going out to see what that benefit is that they're paying for.

Q. I think the question that was asked by staff, though, was did you agree as far as economic development if it was, based on the split, it was okay, and your answer was you didn't believe that --

you believed it was a legislative process. It was not left to private companies to make those determinations because there was no measurement of how those dollars were being spent or if they were actually beneficial, and so my comment is if you have a settlement agreement where the rate payers are actually paying the fee, believe it's beneficial enough to include it in the settlement, do you not believe that the rate payers believe that there's some benefit to that?

A. No, I don't. I mean, I don't know that those customers represent the entire class, customer class. They represent their intervenor group and the customers that are part of that, for one.

Secondly, residential customers are still making a payment in that and were not part of that settlement process.

Q. And I qualified mine by saying if you took the 10 cents and put it in HEAP, and took that off of there, I'm not quite understanding how you're defending your position.

A. Well, because if they think -- it doesn't matter if those customers think it's a good expenditure of money. What matters is do you think it is and can you justify the fact that those dollars are used and useful.

Q. And I agree it is the Commission's decision to make that determination.

A. And one other thing, if I could just interject. I mean, once you start going down this slippery slope as a policy perspective of delegating that authority and saying, well, customers agree with it, you start today with economic development, then tomorrow you add on renewables, the next day you start up with social programs, and before you know it you've got a host of a precedent that you've set up, and you're using essentially the regulated rate base for funding social programs that go well beyond the provision of providing electricity service.

Q. I can see you're obviously not familiar with this Commission because this Commission hasn't delegated anything to anybody. It has taken probably more than what people would like it to take.

I would say at this point we are trying to take testimony and make a decision based on all the parties participating and trying to work, at least reviewing the settlement and seeing if it has any valuable points to it, looking at the past rate, looking at the future rate, and trying to determine what our position should be on it, and that's why I'm asking the questions specifically about the economic development because while it's not a consensus settlement, we still have to take into account the parties that are most impacted by it to determine whether it has benefit or not, and I understand your comment that it's not measurable in terms of determining whether it did actually provide any benefit or not.

It's kind of like the stock market with the last witness we had, yes, it goes up and it goes down. If you can pick exactly what's going to happen you're going to make a fortune, but unfortunately it's all unknown, so we've got to base it on the testimony and what's presented to us. So that's the extent of my comments or questions.

CHAIRMAN SCHMITT: Have you completed your cross?

MR. NGUYEN: Yes, Your Honor.

CHAIRMAN SCHMITT: Commissioner Mathews, questions?

COMMISSIONER MATHEWS: I just had one.

EXAMINATION

By Commissioner Mathews:

Q. I believe your argument on the customer service charge was more on affordability and not whether or not that was an attempt to shift more fixed costs into the service charge?

A. It was both. I mean, the company has attempted to take not only its customer-related costs, those costs such as metering the service drop, customer service expense, et cetera, and recover those through the customer charge, but they're also trying to recover a portion of their distribution-related investment costs and putting that into the fixed customer charge.

So the combination of what I would say is a methodologically inappropriate allocation of those costs into the charge is one issue, and the second issue is in addition to that and as a result of that it creates an affordability issue in terms of where that customer charge is going to be relative to other regional investor-owned utilities.

Q. And the $14 that was agreed to in the settlement, is that higher than the fixed costs associated with serving those customers?

A. That would -- I have not run the exact numbers, but it would likely be -- well, yeah, it was still less than that amount because I believe that the company actually reduced that amount from what was a full estimated cost of somewhere around $30 a customer.

So they had already reduced it for gradual adjustment already, so the full cost was estimated I think $30.57 a customer or something like that. They reduced it down to a proposal of I think around 17, and now the settlement is down at 14.

So 17 would have been a 59 percent increase in the customer charge. You're still looking at an increase that is 27 percent, which is still well over two times the system average request that is in the settlement, and it's still relatively large, and the company is already recovering 100 percent of their customer-related costs anyways through those charges, so I would argue they don't need to be increased.

COMMISSIONER MATHEWS: Okay. Thank you.

THE WITNESS: Yes, ma'am.

CHAIRMAN SCHMITT: Mr. Cook? Mr. Chandler? Anyone?

REDIRECT EXAMINATION

By Mr. Chandler:

MR. CHANDLER: Thank you.

Q. Can we go back to page 22 of your testimony, Dr. Dismukes? And I believe you read into the record a sentence or two that runs from 22 to 23; is that correct?

A. Yes, sir.
Q. And can I ask do you know how Kentucky Power determined their customer charge?
A. Yes, sir.
Q. And what -- what did they use to determine the proposed customer charge?
A. They took their customer-related costs and a share of their essentially primary and secondary distribution costs and put them in the customer charge.
Q. And so did they take into account specifically density?
A. No.
Q. Okay. Can you also refer to, I believe it's your DED-6. It's the second page of what I assume is going to be an exhibit from the company, but I didn't write it down if they had announced it. Your DED-6.
Is it your understanding, I believe your testimony speaks to this, but is it your understanding that all of the companies listed on this are investor-owned utilities?
A. Yes.
Q. And is it your understanding that Kentucky Power is an investor-owned utility?
A. Yes.

Q. Can you turn the page to what I believe is Mr. Vaughn's Rebuttal 2, R2 exhibit?
A. Okay.
Q. And do you mind to -- let's run through this list, if you don't mind. Subject to check, would you agree that Grayson RECC is a rural electric cooperative?
A. Yes.
Q. And that the RECC part kind of stands for rural electric cooperative? So can we mark off Grayson and Meade, Licking Valley, Big Sandy, Farmers, Nolin, South Kentucky, Taylor, Pennyrile, Warren, West Kentucky, all those are RECCs by name?
A. Correct.
Q. And that Jackson Energy, Shelby, Owen are all, by name, cooperatives? Would you agree that none of these seem to be investor-owned utilities?
A. They don't appear that way to me, except for Kentucky Power.
Q. So it appears that in looking at this chart, none of the -- at a glance none of these appear to be investor-owned utilities.
A. That's correct.
MR. CHANDLER: May I?
CHAIRMAN SCHMITT: Yes, you may.

Q. Would you mind to turn to page 13 in this order, please?
A. Okay.
Q. This is a recent Commission order in 2016-365, Application of Farmers Rural Electric Cooperative Corporation for an increase in retail rates. Do you mind to look on that list for a second in AEVR-2 and see if Farmers is on there? I believe it may be three notches above Kentucky Power?
A. Yes, it is.
Q. Okay. Do you mind to take a second and read under Section Rate Design the first full sentence in the second paragraph on page 13?
A. You want me to read it out loud?
Q. Yes, sir.
A. (Reading) The Commission concludes that for an electric cooperative that is strictly a distribution utility, there is merit to the argument that there is a need for a means to guard against the revenue erosion that often occurs due to the decrease in sales volumes that accompanies poor regional economics, changes in weather patterns, and the implementation of demand-side management and energy efficiency programs.
Q. Is it your understanding that Kentucky Power

has a demand-side management surcharge that it recovers?
A.   Yes, that's my understanding.
Q.   And is it your understanding that Kentucky Power is a vertically integrated utility as opposed to a distribution only utility?
A.   Yes.
      MR. CHANDLER: That's all we have, Chairman.
      CHAIRMAN SCHMITT: Is there any cross-examination, Mr. Gish?
      MR. GISH: No, Mr. Chairman.
      CHAIRMAN SCHMITT: Anyone else have any further questions of this witness?
      MR. NGUYEN: No, Your Honor.
      CHAIRMAN SCHMITT: Commissioner Cicero? Mathews?
      COMMISSIONER MATHEWS: Mr. Gardner does.
      CHAIRMAN SCHMITT: Mr. Gardner? Mr. Gardner, I guess at the last break Mr. Rhodes, who operates our system, asked that you speak louder so that the equipment could pick you up on the video.
      MR. GARDNER: Thank you, Your Honor. If I could approach the witness, please.
      CHAIRMAN SCHMITT: Yes, you may.
      COMMISSIONER MATHEWS: And raise that mike

because it's not working.

MR. CHANDLER: While we're waiting for Mr. Gardner, do you mind, if I can number this Exhibit Number 6.

CHAIRMAN SCHMITT: Yes.

MR. CHANDLER: Thank you.

CHAIRMAN SCHMITT: Would you like -- are you going to offer this into evidence or just have it marked?

MR. CHANDLER: I'm happy to move it into the record.

CHAIRMAN SCHMITT: Is there any objection?

MR. GISH: There's no objection.

CHAIRMAN SCHMITT: Then let it be marked as AG Exhibit 6 and filed into evidence.

(AG 6 admitted.)

CHAIRMAN SCHMITT: Mr. Gish, the handout that you had is not to be introduced; is that correct?

MR. GISH: That's correct, Mr. Chairman. Those are all documents that are in the record. I hope I referenced them by their proper location.

CHAIRMAN SCHMITT: Okay, Mr. Gardner, you may proceed.

MR. GARDNER: Thank you, Your Honor.

* * *

CROSS-EXAMINATION

By Mr. Gardner:

Q. Dr. Dismukes, I've handed you what has been marked and introduced KCUC Exhibit 4. Do you have that in front of you?

A. I do.

Q. And this is in response to Commissioner Cicero asking you a question about the KEDS, the economic development 10 cent and dollar. In looking at that chart, does it appear that GS category and LGS/PS category have by far the greatest percentage of the total dollars of 326,687 that appear to be going into these programs?

A. They're large, yes, relative to the other customer classes.

Q. Okay. And, in fact, is it your understanding that the customer, the commercial customers have not consented to the settlement?

A. Yes, sir, that's my understanding.

MR. GARDNER: That's all I have. Thank you.

CHAIRMAN SCHMITT: Any questions from anyone else?

MR. GISH: Still no.

CHAIRMAN SCHMITT: Anyone?

MR. NGUYEN: No, Your Honor.

CHAIRMAN SCHMITT: May this witness stand down and be permanently excused?

MR. OVERSTREET: Yes, Your Honor.

CHAIRMAN SCHMITT: Thank you. You may stand down.

We still have a few minutes. Maybe we ought to call another witness and get started if we can.

MR. OVERSTREET: I think that would work well. I think we're going to do Mr. Higgins next. Wasn't that the deal?

MR. OSTERLOH: That's correct. The parties have agreed that Kevin Higgins will be called on behalf of the commercial utility customers.

MR. CHANDLER: At this time can I move for Exhibit, AG's Exhibit 6 to be introduced?

CHAIRMAN SCHMITT: I think we just did that.

MR. CHANDLER: We did that?

CHAIRMAN SCHMITT: Attorney General Exhibit 6 will be filed into evidence.

MR. CHANDLER: I completely forgot about that. Thank you. It's been a long two days.

CHAIRMAN SCHMITT: Thank you. Mr. Higgins, will you please stand and raise your right hand?

KEVIN C. HIGGINS, called by the Kentucky Commercial Utility Customers, having been first duly sworn, testified as follows:

DIRECT EXAMINATION

By Mr. Osterloh:

CHAIRMAN SCHMITT: Please be seated. Mr. Osterloh, you may interrogate or ask of your witness.

MR. OSTERLOH: Thank you, Mr. Chairman.

Q. Mr. Higgins, can you please state your name for the record?

A. My name is Kevin C. Higgins.

Q. And your business address?

A. My business address is 215 South State Street, Suite 200, Salt Lake City, Utah, 84111.

Q. Did you cause to be filed in this case direct testimony dated August the 3rd, 2017, and settlement direct testimony dated December the 4th, 2017?

A. Yes, I did.

Q. If the same questions in those documents were asked today, considering them collectively would your answers be the same?

A. Yes.

Q. Thank you, Mr. Higgins.

MR. OSTERLOH: Mr. Chairman, this witness is available for cross-examination.

CHAIRMAN SCHMITT: Mr. Overstreet? Oh,

Mr. Gish.

CROSS-EXAMINATION

By Mr. Gish:

MR. GISH: Yes, Mr. Chairman, I have a few questions.

Q. Can you turn to page 15 of your testimony?

A. Of my direct testimony?

Q. Direct testimony, yes.

A. Yes.

Q. Can you read the question -- the question on line 11 says, (Reading) Do you recommend any changes to Kentucky Power's proposed revenue allocation?

And your response begins, (Reading) Yes, I recommend that the current residential subsidy according to the Company's total cost-of-service study be reduced by 50 percent in this case.

Is that correct?

A. That is correct.

Q. Is that still your recommendation?

A. No. That is -- while I believe that that is a reasonable premise for rate making, my current testimony responds to the settlement agreement, and with respect to the settlement agreement, which is a compromise among other parties to this case, KCUC is also adopting a position of compromise, and, for

purposes of response to the settlement agreement, no longer challenges the revenue allocation to the residential class, but rather focuses in on a specific element of the settlement agreement that we believe is unreasonable.
Q. And in your settlement testimony you suggest that if the Commission were to change the revenue allocation by reducing the return on equity, that that revenue allocation should first go to -- the first $500,000 of that should go to the LGS customers; is that correct?
A. That's correct, but if you don't mind I would like to clarify a little bit of what you said. If the Commission changes the revenue requirement below or what the stipulating parties agree to, then as part of the revenue allocation my recommendation is that the first $500,000 of any reduction in overall revenue requirement should go to reduce the rates for the LGS class.
Q. But you have not in this case provided any testimony regarding the revenue requirement itself, correct?
A. That is correct.
Q. And do you have any -- well, never mind. And do you have any testimony regarding the revenue

allocation that's agreed to by the parties in the settlement agreement?

A. Is your question whether or not there are aspects of the settlement agreement that are consistent with my recommended testimony?

Q. I'm asking if you have provided testimony in this case regarding any potential change to the revenue allocation, the revenue requirement that was agreed to by the parties in the settlement agreement?

A. Oh. To the extent that the revenue requirement does not change as a result of the Commission's decision in this case, then my recommendation would not change the revenue allocation that's been stipulated.

Q. But you have not prepared or proposed any testimony on what changes should be made to the revenue allocation in the settlement testimony; is that correct? I'm sorry, not allocation, that was my mistake. The revenue requirement that was agreed to by the parties in the settlement agreement, correct?

A. Correct.

MR. GISH: I have no further questions.

MR. COOK: The AG has no questions.

CHAIRMAN SCHMITT: Mr. Kurtz?

MR. KURTZ: I do, thank you. Just a few.

CROSS-EXAMINATION

By Mr. Kurtz:

Q. Good afternoon, Mr. Higgins.

A. Good afternoon, Mr. Kurtz.

Q. For full disclosure we've known each other quite a while?

A. That is quite a disclosure.

Q. We worked probably on cases in six, seven, eight states over the last 15 years?

A. Yes, we have.

Q. Okay. You did two additional cost of service studies in your initial testimony, the winter-summer peak as well as the 3 winter peak studies?

A. Yes.

Q. Is that correct? Okay. And those studies showed that the residential customers were even being more subsidized than the 12CP which the company relied on, correct?

A. Correct.

Q. Will you turn to page 16 of your original testimony?

A. Yes.

Q. Okay. I'm just going to ask you to read a little bit. On line 3 the sentence beginning "although." Can you read to the end of the

paragraph, please?
A. Sure. (Reading) Although the Winter 3CP and Summer/Winter CP methods indicate that a rate decrease for the IGS class would be warranted, I conservatively recommend that the IGS class revenue be set at full cost of service under the 12CP method. At Kentucky Power Company's proposed revenue requirement this will result in an increase of 4.38 percent for the IGS class as compared to the Kentucky Power Company's proposed 8.54 percent increase.
Q. Would it be fair to say what that means is instead of the 5 percent subsidy reduction for IGS, the Industrial General Service that the company recommends, you recommended a 100 percent subsidy reduction, correct?
A. Yes.
Q. Okay. And that was the same recommendation that KIUC witness Mr. Baron made, correct?
A. Correct.
Q. And your recommendation and Mr. Baron's recommendation found their way into the settlement agreement, correct?
A. Correct, with respect to the IGS class, yes.
Q. And you support that still?

A. Yes.

Q. Okay.

MR. KURTZ: Thank you. No more questions.

CHAIRMAN SCHMITT: Counsel for any intervenors? Mr. Malone?

MR. MALONE: I've just got a couple.

CROSS-EXAMINATION

By Mr. Malone:

Q. Mr. Higgins, my name is Matt Malone. I represent the school boards.

A. Good afternoon.

COMMISSIONER MATHEWS: Let's see if that mike works now.

MR. MALONE: Hello? No?

MR. OVERSTREET: Let me stand up and he can sit here.

CHAIRMAN SCHMITT: Yeah, if someone would give up a seat. Mr. Overstreet, thank you.

MR. OVERSTREET: I've been glued there for two days.

Q. Sir, I've just got a few questions for you. I just was going through your -- I guess we call it the direct settlement testimony, the most recent testimony that you filed?

A. Yes.

Q. I wanted to ask you, as I understand it, KCUC represents a sawmill that's in rate LGS. Is that your understanding?
A. They are included in the membership, yes.
Q. And as I understand it, you've suggested that other benefits should be found to support a approximate $500,000 benefit to LGS; is that accurate?
A. I'm not sure what you mean by "other benefits should be found."
Q. Cutting expenses or some other way to support the 500,000. How are you suggesting that the Commission would come up with this additional 500,000?
A. My -- what my testimony says is that to the extent that the Commission changes the revenue requirement below the stipulated level, because revenue requirement is still an issue that's being contested in this case, and to my understanding the Commission also reviews the revenue requirements and stipulations and has on occasion reduced those revenue requirements.
To the extent that the revenue requirement is changed by the Commission, my recommendation is the first $500,000 of any reduction should go to correct

what I believe is an inequity in the revenue allocation of the stipulation and should go to reduce the rates for the LGS class.
Q. Given that KCUC represents the sawmill, have you calculated basically what that benefit would mean for the sawmill?
A. Not specifically for the sawmill. It's approximately about a 1 percent reduction in the rates for the LGS class.
Q. Okay. Taking that logic, giving you a hypothetical question. Imagine that the reduction that the Commission -- let's say the Commission went along with that logic and suggested rather than a $500,000 benefit they did a $100,000 benefit, for easy math.
A. Okay.
Q. And let's imagine that the sawmill pays $100,000 in expenses, in electric costs per year. What does that mean to their bottom line?
A. Well, your hypothetical is you're assuming what the sawmill's usage is.
Q. Correct.
A. And I believe that would be quite a bit lower than what it actually is, but for $100,000 a year customer, if the Commission reduced the revenue

requirement by $100,000 and that went to the LGS class, that would be a reduction of about two-tenths of one percent for the LGS class and two-tenths of one percent reduction on a customer that had a hundred thousand dollar bill.

Q. Okay. Going to the schools, do you know anything about the load profile of the schools versus the commercial class?

A. Well, I know something generally about the load profile of schools.

Q. Okay. Would you agree that the load profile of the schools is fairly homogeneous? In other words, most schools track similar load profiles?

A. That wouldn't surprise me.

Q. Okay. Turning to the commercial class, would you agree that there's much more level of difference between them compared to the schools?

A. They're more heterogeneous, which actually from a cost allocation standpoint is favorable because when you've got diversity in your load profile that actually brings down the unit cost of serving -- of spreading the fixed costs of a utility.

Q. But in determining rate design of a certain tariff, wouldn't you agree that a homogeneous class provides some benefit to the company in determining

how to design the rate?
A. It would -- I don't know that it provides benefit to the company. It would provide information to the company, but it doesn't necessarily, for example, by itself mean that that class should get a discount off of the rate that would otherwise apply, but the fact that its load profile looks a certain way may give the utility some information that it could use to design rates.
Q. In your testimony you pointed out some, and I'm speaking of your most recent testimony, you spoke of public policy benefits for economic development and whatnot with respect to the commercial class.
A. Yes.
Q. Would you not also agree that there are some significant, if not more significant, public policy concerns supporting schools here?
A. Well, certainly education is an important component of public policy, and I want to clarify that my recommendation does not object to the discount --
Q. Okay.
A. -- that schools receive as part of the settlement agreement. My recommendation points to the fact that it was only one group of customers, the

LGS customers, who pick up the tab for the discount.

So if it's a matter of broad public policy, then the right thing to do, in my opinion, is that you spread that discount cost across the system, or if the utility believes that that's an important matter of public policy, the utility absorbs the cost rather than a single class of customers.

So I just want to be clear. The KCUC position is not to object to the school discount. It's how it's funded, that is where the objection lies, and, you know, as evidence of the fact that we wish to be reasonable, we're not even asking the Commission to undo that discount as part of the stipulated revenue allocation. Simply to address the issue going forward to the extent the Commission has a -- reduces the revenue requirement.

Q. Understand. Okay.

MR. MALONE: No further questions. Thank you.

CHAIRMAN SCHMITT: Staff? Questions?

MS. SANDERS: Thank you, Your Honor.

CROSS-EXAMINATION

By Ms. Sanders:

Q. Mr. Higgins, so just to clarify one more time, you're no longer recommending that the residential subsidy be reduced by 50 percent, correct?

A. That is correct, not in the context of the settlement agreement that has been presented.

Q. All right. Which -- KCUC is representing two clients in this action; is that right?

A. My understanding is that it's an association, but there are two customers that I'm aware of that are served in Kentucky Power service territory.

Q. Okay. And which rates are each of those clients on?

A. The hospital -- hospital group is served under the industrial rate and the LGS rate, and BPM Lumber is served under the LGS rate primarily.

Q. Okay. So BPM Lumber is only under the LGS rate?

A. They have some load that is on medium and small as well, but the largest amount of their load is on LGS.

Q. For each one of those two entities, what percent of their power bill is a result of each one of those rate classes?

A. For the hospital, the split between their bill on LGS and the industrial rate is about 50/50. And for sawmill it is almost 100 percent LGS.

MS. SANDERS: No other questions.

CHAIRMAN SCHMITT: Commissioner Cicero,

questions?

VICE-CHAIRMAN CICERO: No questions.

CHAIRMAN SCHMITT: Commissioner Mathews?

COMMISSIONER MATHEWS: No.

CHAIRMAN SCHMITT: I have no questions. Anyone else?

MR. OSTERLOH: If I can just clarify two points.

REDIRECT EXAMINATION

By Mr. Osterloh:

Q. Mr. Higgins, you testified earlier to Mr. Malone's questions that if the Commission were to accept your recommendation of a $500,000 reduction in the LGS class, that you thought that would be approximately a 1 percent reduction; is that correct?

A. Yes.

Q. And just to clarify that, is that a 1 percent reduction to current rates or is that 1 percent less than what the proposed settlement proposes for the LGS class?

A. It's a 1 percent reduction to current rates.

Q. And then with respect to BPM Lumber, it was a suggestion that it may have been a sawmill. Do you know how many -- or whether BPM Lumber only operates one sawmill in Kentucky Power's testimony --

territory?

A. Let me just clarify the question, my answer to your question before. When I said 1 percent reduction, it's 1 percent of current rates. So it's not reducing current rates by 1 percent, so $500,000 is approximately 1 percent of the LGS current revenue requirement. Slightly more than 1 percent, but it's in that ballpark.

Q. In other words, your proposal would not result in a reduction of rates to the LGS class.

A. No, no. They would still get a rate increase. It would just be 1 percent less as a proportion of their total bill than as provided in the settlement agreement.

Q. Thanks for that clarification. And then do you know if BPM Lumber operates one or more sawmills in Kentucky Power's territory?

A. My understanding, they've got more than one operation.

MR. OSTERLOH: Thank you. That's all the questions I have.

CHAIRMAN SCHMITT: Mr. Malone, questions?

MR. MALONE: Nothing further, Your Honor.

CHAIRMAN SCHMITT: Anyone else? Is there any reason why this witness cannot be permanently excused?

Okay. You may step down, and you're excused.

THE WITNESS: Thank you.

It's five till 1:00. Why don't we take a lunch break until 2:00 o'clock, and we'll come back and see how far we can get. Thank you.

(Recess from 12:55 p.m. to 2:00 p.m.).

CHAIRMAN SCHMITT: We're now back on the record. Mr. Chandler, Mr. Cook, as I understand it you've completed all your testimony; is that correct?

MR. CHANDLER: That's correct, Chairman.

CHAIRMAN SCHMITT: And that at this time then the parties have agreed that Kentucky Industrial Utility Customers will present its evidence. Is that right, Mr. Kurtz?

MR. KURTZ: Yes, sir.

CHAIRMAN SCHMITT: Did you have a witness to call at this time?

MR. KURTZ: He's up there, yes, sir. Mr. Kollen.

CHAIRMAN SCHMITT: Okay, Mr. Kollen.

* * *

LANE KOLLEN, called by the Kentucky Industrial Utility Customers, having been first duly sworn, testified as follows:

DIRECT EXAMINATION

By Mr. Kurtz:

CHAIRMAN SCHMITT: Please be seated.

Mr. Kurtz, you may ask.

Q. Thank you. Mr. Kollen, will you state your name and business address for the record, please?

A. My name is Lane Kollen. My business address is J. Kennedy & Associates, Incorporated, 305 Colonial Parkway, Suite 570, Roswell, Georgia, 30075.

Q. Do you have in front of you a document marked "Direct Testimony and Exhibits of Lane Kollen"?

A. Yes.

Q. Was this prepared by you or under your direct supervision?

A. Yes.

Q. If I were to ask you the same questions as though contained therein, would your answers be the same?

A. Yes.

Q. Any corrections or additions?

A. No.

MR. KURTZ: Your Honor, I tender the witness for cross.

CHAIRMAN SCHMITT: Well, I guess we'll go with those of like mind. Mr. Overstreet?

MR. OVERSTREET: No questions, Your Honor, at this time.

CHAIRMAN SCHMITT: Any intervenors who participated in the proposed settlement have any questions?

If not, Mr. Chandler and Mr. Cook, do you have cross?

MR. CHANDLER: The Attorney General does not have any cross for Mr. Kollen.

CHAIRMAN SCHMITT: Okay. Mr. Gardner?

MR. GARDNER: No, Your Honor.

CHAIRMAN SCHMITT: No? Staff?

MR. NGUYEN: We do, Your Honor, just very brief.

CROSS-EXAMINATION

By Mr. Nguyen:

Q. Do you have KIUC's responses to Commission staff's data request, by chance?

A. I don't.

MR. NGUYEN: May I approach, Your Honor?

CHAIRMAN SCHMITT: Yes, you may.

Q. This is --

MR. NGUYEN: I'm not going to introduce it into evidence, so.

Q. This is KIUC's response to Commission Staff's

data request, item one; is that correct?
A. Yes, it is.
Q. And you are the witness that responded to these or this question and the subparts; is that correct?
A. Yes.
Q. Okay. 1A asks you to confirm that the revenue requirement for deferral of the expenses related to the Rockport Unit 2 Unit Power Agreement would be reduced by 20.307 million per year through 2021 and 341/365th of that amount in 2022 based upon your recommendation in your prefiled testimony; is that correct?
A. Yes, that's correct, and that's because the recommendation in my direct testimony was focused on the Rockport 2 unit only. That unit is under lease, and our proposal was for $20 million of that lease expense to be deferred through December 8 of 2022, and that's where the 341 divided by 365 comes into play, and that also is consistent with the termination date of the Unit Power Agreement, which covers both Unit 1 and Unit 2.
Q. Okay. So and when asked in part B, (Reading) Explain why the carrying charge should not be based on Kentucky Power's cost of debt, your response is that under KIUC's proposal Kentucky Power would be

required to finance nearly a hundred million dollars over the approximately five-year period until the lease is terminated in 2022, and that the company is unlikely to finance a deferral of this magnitude solely through debt given its present capital structure.

Is that correct?

A. Yes.

Q. Okay. But then it says, (Reading) However, it could be appropriate to assume that the deferral is financed through debt if such deferrals are significantly less than under the KIUC proposal.

Was that your response?

A. Yes.

Q. Okay. So with respect to the settlement, the nonunanimous settlement agreement that includes provision of the Rockport Unit Power Agreement deferral of those costs, is that for both Units 1 and 2?

A. It is not unit specific, so it's just a generalized deferral of the UPA expenses.

Q. Okay. And so those expenses associated with that provision to defer the cost associated with the Rockport UPA, would that be significantly less than the hundred million dollars over the five-year period

as you had recommended in your testimony?
A. Well, it would be about half because we had recommended a $20 million deferral, and over five years that would be 100 million, and under the settlement it's 15, 15, 10, 10 and 5.
Q. Right.
A. And so that adds up to 50 million.
Q. Okay. So given your, I guess your qualification in responding to staff's question 1B with respect to Kentucky Power's ability to finance the carrying charge to be based upon cost of debt, would 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.

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.

MR. NGUYEN: Those are all the questions I have. Thank you.

CHAIRMAN SCHMITT: Commissioner Cicero, questions?

VICE-CHAIRMAN CICERO: No questions.

CHAIRMAN SCHMITT: Commissioner Mathews?

I have none.

MR. KURTZ: I do have one redirect a little bit.

REDIRECT EXAMINATION

By Mr. Kurtz:

Q. I know you're not a lawyer, but I do want to ask you this. In order --

A. Praise God. No, I'm just kidding.

Q. I'm sorry, what?

CHAIRMAN SCHMITT: He said thanks a lot.
Q. Okay. I don't want a legal --
A. I have a lot to be grateful for, yes.
Q. The Rockport Unit Power Agreement is a FERC approved rate?
A. It is.
Q. And under federal law, federal preemption, the Commission must give effect or allow the utility to recover the FERC approved rate, correct?
A. That's my understanding. The retail recovery can vary, but over time it has to provide recovery unless there's by determination of imprudence by the retail regulator, but that's not the case here for sure.
Q. Yeah, and that's not even really true. This is the Nantahala decision and Mississippi Power & Light, U.S. Supreme Court, correct?
A. Yes, that's correct.
Q. And full recovery would be the weighted average cost of capital pursuant to your recommendation and pursuant to what's in the stipulation.
A. I would agree with that, yes.
Q. And, in fact, if it was a debt only return, one might argue that the Commission is trapping costs and not giving full recovery and stepping into this

federal preemption minefield.

A. One might argue that.

Q. Okay. Thank you.

A. This is fair. It's equitable to provide an overall rate of return.

Q. And just for the record, it's a $9 million carrying charge on the 50 million over five years?

A. That's correct. And in conjunction with that, the company has agreed to amortize it on an annuitized basis over five years, so what that means is that rather than starting high and then amortizing a certain dollar amount each year, what you're doing is you're getting the same dollar amount of recovery from customers, just like paying off a home mortgage, and so that's extremely beneficial to customers, and it minimizes the effect on customers.

So essentially what we're doing now is we're cutting the peak of the rate increase, and then there would be a rate reduction in December of 2022 when the UPA is either -- Unit 2 portion of it is not renewed or maybe the entirety of it is not renewed.

There would otherwise have been a very significant rate increase. All this does is mitigate the amount of the rate -- I'm sorry, a rate decrease. All this does is mitigate the decrease to some extent, so what you've done is you've cut off the peak of the revenue requirement for the next five years, and you've raised slightly the revenue requirement over the five years starting in December 2022. It's really a tremendous result.

MR. KURTZ: No further questions.

CHAIRMAN SCHMITT: Any cross-examination?

MR. OVERSTREET: None, Your Honor.

MR. CHANDLER: Just two questions.

CROSS-EXAMINATION

By Mr. Chandler:

Q. In your testimony when you discussed this, your deferral position, did you consider or include anything in testimony that looked like or was similar to the credit offset that's provided for in the stipulation, where following the five year -- the expiration of the UPA in five years, that the company will be allowed to essentially earn its ROE, guaranteed earn on its ROE?

A. I did not address that.

Q. You did not address that?

A. I did not.

Q. So that wasn't your proposal in your testimony?

A. That was not included in my direct testimony, that's correct.

Q. And generally the discussion has been about the weighted average cost of capital, and the weighted average cost of capital, there are generally two components, debt and equity, correct?
A. Yes.
Q. And does the debt portion contain a time value of money component?
A. Well, by definition it is a time value of money because you provide a rate of return on the investment cost for whatever period of time it's providing service to customers.
MR. CHANDLER: No more questions.
CHAIRMAN SCHMITT: Any other questions? Cross?
MR. NGUYEN: Just one additional, Your Honor.

RECROSS-EXAMINATION

By Mr. Nguyen:
Q. So in your follow-up to Mr. Kurtz's question with respect to the FERC preemption and, excuse me, the full recovery, Kentucky Power's full recovery of that cost under the EPA, in your response to Commission staff's 1B, even though you qualified it as it could be appropriate to assume that the deferral is financed through debt, if such deferrals are significantly less than the KIUC proposal there was no limitation with respect to FERC jurisdictional

grounds on the ability of Kentucky Power to recover fully those costs under the EPA.

A. In the response of the discovery, that's correct.

Q. So were you not aware of that limitation when you provided this response?

A. I was aware of that limitation. The only point here was that there might be certain circumstances where it could be appropriate. I didn't say it would be. I said perhaps it could be appropriate if there was a much smaller dollar amount.

And I can think of one instance. For example, if the deferral were a few million dollars, and it was for six months, you know, then you probably would assume that it was financed with short-term debt, but the longer the period of deferral and the greater the magnitude, the more necessary in effect it is that it would be the full weighted cost of capital unless there's an exclusive or dedicated type of financing associated with that deferral.

And just to add on to that a little bit, in some of the states that have gone to open access or deregulation, a portion of the costs have been considered stranded, and rather than allowing those utilities a full rate of return on the stranded costs, under state law or through some other mechanism the utilities have securitized those costs through lost cost forms of debt, and so there are certain circumstances where it makes sense to do a debt only financing.

In this one I don't think it is, given the magnitude still of the 50 million. The five-year time frame for the deferral and then another five years until the company fully recovers. So you're looking at a span of a ten year period. It's really kind of unlikely that it's going to be financed with either short-term debt or exclusively with long-term debt.

MR. NGUYEN: Those are all the questions. Thank you.

CHAIRMAN SCHMITT: Commissioner Cicero? Commissioner Mathews?

Anything further?

MR. KURTZ: No, sir.

CHAIRMAN SCHMITT: If there's no other cross-examination of this witness, may he be finally excused?

MR. OVERSTREET: Yes, he may.

CHAIRMAN SCHMITT: Thank you. Mr. Kollen, you may be excused.

THE WITNESS: Thank you.

CHAIRMAN SCHMITT: Call your next witness.

MR. KURTZ: We call Mr. Baron.

STEPHEN J. BARON, called by the Kentucky Industrial Utility Customers, having been first duly sworn, testified as follows:

DIRECT EXAMINATION

By Mr. Kurtz:

CHAIRMAN SCHMITT: Please be seated.

Counsel, you may ask.

MR. KURTZ: Thank you, Your Honor.

Q. Will you state your name and business address for the record?

A. Yes. Stephen J. Baron. My business address is J. Kennedy & Associates, Inc., 570 Colonial Park Drive, Suite 305, Roswell, Georgia, 30076.

Q. Do you have in front of you a document marked "The Direct Testimony and Exhibits of Stephen J. Baron"?

A. Yes.

Q. Was this prepared by you or under your direct supervision?

A. Yes.

Q. If I were to ask you the same questions as those contained herein, would your answers be the

same?
A. Yes.
Q. Any corrections or additions?
A. Not that I'm aware of.
MR. KURTZ: Your Honor, I tender the witness.
CHAIRMAN SCHMITT: Mr. Overstreet?
MR. OVERSTREET: No questions, Your Honor.
CHAIRMAN SCHMITT: Any counsel for any of the settling intervenors have any cross-examination of this witness?
If not, Mr. Cook, Mr. Chandler?
MR. CHANDLER: The Attorney General has no questions for Mr. Baron.
CHAIRMAN SCHMITT: Mr. Gardner, Osterloh?
MR. GARDNER: No questions.
CHAIRMAN SCHMITT: Staff?
MR. NGUYEN: No questions, Your Honor.
CHAIRMAN SCHMITT: Commissioner Cicero, Commissioner Mathews?
COMMISSIONER MATHEWS: None.
CHAIRMAN SCHMITT: I have none. In that case, may this witness be finally excused?
MR. OVERSTREET: Yes, he may, Your Honor.
CHAIRMAN SCHMITT: Thank you. You may stand down. You're our favorite witness.

THE WITNESS: This was one of my toughest appearances.

MR. OVERSTREET: In that regard, does that mean Mr. Satterwhite was your least favorite since he was on the longest?

CHAIRMAN SCHMITT: No comment.

THE WITNESS: I'm going to have to give Mr. Kurtz a discount.

MR. KURTZ: Yeah, we have a rate of return witness, Mr. Baudino.

CHAIRMAN SCHMITT: Please raise your right hand.

DIRECT EXAMINATION

By Mr. Kurtz:

CHAIRMAN SCHMITT: Please be seated.

Counsel, you may ask.

MR. KURTZ: Thank you, Your Honor.

Q. Will you state your name and business address for the record?

A. Yes, Richard Baudino. My business address is 570 Colonial Park Drive, Suite 305, Roswell, Georgia, 30075.

Q. Do you have in front of you a document marked "The Direct Testimony and Exhibits of Richard A. Baudino"?

A. Yes.
Q. Was this prepared by you or under your direct supervision?
A. Yes, it was prepared by me.
Q. If I were to ask you the same questions as those contained herein, would your answers be the same?
A. They would.
Q. Any corrections or additions?
A. No.
MR. KURTZ: Your Honor, I tender the witness for cross.
CHAIRMAN SCHMITT: Mr. Overstreet?
MR. OVERSTREET: No questions, Your Honor.
CHAIRMAN SCHMITT: Counsel for any of the settling intervenors have any questions of this witness? If not, Mr. Chandler, Mr. Cook?
MR. CHANDLER: We do have questions, Your Honor. May I approach and --
CHAIRMAN SCHMITT: Yes, you may.

CROSS-EXAMINATION

By Mr. Chandler:
Q. Good morning -- good afternoon, Mr. Baudino.
A. Good afternoon.
Q. It's a long day yet. So first I would like to

just confirm, you did provide testimony in this case, correct?
A. I did, yes.
Q. And your testimony was on the reasonable return on equity for Kentucky Power Company, correct?
A. Right.
Q. And what was the recommendation that you provided for return on equity?
A. 8.85 percent.
Q. Now, if you don't mind, can you please turn to tab B in the binder that I provided you?
A. Okay. I have that.
Q. Tab B, can you confirm that this is page 29 -- or subject to check it's page 29 of your testimony in this case?
A. Yes, this is page 29 of my testimony.
Q. So this table on page 29 notes the outcomes of your DCF results, the outcome of your DCF methodology and the CAPM, correct?
A. Right.
Q. And the CAPM stands for the capital asset pricing model, correct?
A. That's right.
Q. DCF stands for?
A. Discounted cash flow.

Q. Discounted cash flow. Now, can you look towards your CAPM results there, and can you provide what the CAPM results were based on the 5 and 20 year treasury bonds?
A. Sure. Those results ranged from 6.9 percent to 7.15 percent.
Q. And using historical returns, what was the range that you had there?
A. 5.99 to 7.32 percent.
Q. Now looking at those numbers, did you give any weight to those amounts when you recommended your 8.85 recommendation?
A. No.
Q. Do you ever give weight to CAPM results?
A. I haven't in my memory. I have not -- I just use it for additional information for the Commission since often CAPM and risk premium models are presented for the Commission's information and as also to form the basis for certain witness's recommendations. For me I primarily rely on the DCF.
Q. So other witnesses, though, do use the CAPM or variations of it like the empirical CAPM, correct?
A. Certain witnesses do use a variety of methods, yes.
Q. And with CAPM being one of them?

A. Yes.
Q. Now, if you had given weight to your CAPM, all things equal, would your 8.85 recommendation, would it have been higher or lower?
A. Well, if I had incorporated these results it would have been lower. I didn't really incorporate it. I'm sort of speculating in a way because, you know, I think 8.85 is reasonable, but obviously if you chose to give some weight to those lower results the number would have been below 8.85.
Q. All things equal, of course, the caveat.
A. Yes.
Q. Thank you. Now, on page 29 you asked yourself the question, or you asked -- you're asked the question in testimony. Mr. -- on line 9, (Reading) Mr. Baudino, are you concerned that your recommended cost of equity is too low?
How do you answer that question?
A. I can read, would you like me to read?
Q. Yeah, just the result of the answer.
A. Okay. No, I said I'm not concerned about it at all being too low. In fact I think it's very reasonable for a Baa A-rated utility like Kentucky Power in this current interest rate environment, as I said.

Q. And you stated that -- you stated that one of the basis for that is the low interest rate environment, correct?
A. Right.
Q. Do -- looking back to table 3 on page 29, do any of the amounts you have presented there support a 9.75 ROE?
A. No. In fact, the -- really the high end is 9.55 percent in the median growth rate method.
Q. If we turn one page in tab B to page 30?
A. Okay.
Q. Would you agree that on line 4 through 7 you address the inclusion of short-term debt in the Kentucky Power capital structure?
A. Yes.
Q. Was that incorporated in the settlement?
A. I believe it was. I believe the cost agreed to was 1.25 percent, I believe. I could double-check that, but I believe that's right.
Q. Okay. Now, I've provided you a copy on tab C of your testimony in this case. For everybody else it's just telling them that's what I did since it's already of record in this case, but in case you need to refresh your memory, but I'm just going to ask you a couple of questions about your direct testimony, if

that's okay.
A. Sure.
Q. So you discuss Mr. McKenzie's testimony in your direct testimony; is that correct?
A. Yes.
Q. So do you agree with Mr. McKenzie on the outlook for capital costs or using, incorporating an outlook for capital costs in your --
A. No, I did not. Definitely not.
Q. You agree with the forecasted interest rates of 4.2 percent that he used in his CAPM and URP studies?
A. Well, I mean, I agree that those are what the consensus interest rate forecasts are right now. However, I do not agree that they should be used in a risk premium or a capital asset pricing model analysis. They should use current -- current interest rates should be used for those analysis.
Q. Do you agree with Mr. McKenzie on admitting low end DCF results in his DCF study?
A. No, I think that was -- I criticized that on being sort of an asymmetric analysis, and I had -- if you can just hold on.
Q. I believe you discuss that on page 36.
A. Okay. Thank you. I'm just going to go to that. Right, in fact I presented an analysis on

table 6, page 38, where I incorporated all of the numbers and presented an average and median set of results from that.
Q. Using his proxy group; is that correct?
A. Yes.
Q. Did you agree with Mr. McKenzie's -- excuse me. Do you agree with the expect --
A. Well, actually, I'm sorry. Let me just -- yes, that's right. It was from his proxy group, yeah.
Q. Do you agree with the expected market return component of Mr. McKenzie's CAPM or empirical CAPM analysis?
A. No.
Q. Do you agree with Mr. McKenzie's application of the utility risk premium?
A. No.
Q. Why don't you agree with Mr. McKenzie's application of utility risk premium?
A. Now that -- I believe this was -- when you talk about utility risk premium, I just want to make sure we're talking about the same thing.
Q. I believe you discuss it on page 41.
A. All right, 41, yes. Okay. This was an historical analysis using Commission-allowed returns from '74 through 2016, and what I said on page 41 was

generally the bond deal plus risk premium approach is imprecise and can only provide very general guidance on current authorized ROEs -- current authorized ROEs for regulated electric utility, and I say risk premiums can change over time, and they're sort of a blunt instrument.

Q. How can they change over time?

A. Investor perceptions of risk. Changes in interest rates. Those sort of general things.

Q. The idea being that maybe not relative, but individually the risk of a single utility changes between 1974 -- or let's just say the utility sector, the risk of utility sector may change between 1974 and 2016.

A. Well, it could. The other thing I think that, if I can, I'll give you my interpretation of what Mr. McKenzie did, was we know that interest rates change, required risk premiums change, so other things being equal, when interest rates rise the required risk premium in terms of the required return on equity tends to get smaller, and likewise as interest rates fall the required risk premium tends to get bigger, and I think that's what Mr. McKenzie was trying to measure with that.

Q. And in that risk premium he used forecasted

bond rates, correct?
A. He did.
Q. Okay. And those are forward looking for four years; is that correct?
A. I need to go back and see.
Q. That's okay. I'll withdraw the question.
A. Oh, okay.
Q. Do you agree with Mr. McKenzie's application of the expected earnings approach?
A. No.
Q. Why don't you agree with Mr. McKenzie's application of the expected earnings approach?
A. Well, now expected earnings, he used expected earnings, just to make sure we're talking about the same thing.
Q. The next page, I believe.
A. Yeah, on page 42. These were Value Line forecasted returns for the 2020 to 2022 period. I said the Commission should not rely on those for the same reason you shouldn't rely on forecasted interest rates, and instead really should be looking at current required returns from investors as measured by current stock prices through the DCF model.
Q. And is there any way to know whether, are there any metrics available to determine whether or not the

current market book -- the current value of stocks exceed investors' expectations such as possibly the use of -- of the relationship between book value and market value?

A. You can infer that -- you can infer some of it, but right now it's kind of a guess because one theory is if a utility company is expected to earn more than its required return, the market to book ratio would be greater than 1.

So in other words, since utilities earn on their rate base or earn on their capitalization, if the investor required return is set by the Commission according to their investor required -- what it really is in the marketplace, the market to book ratio should be about 1.

Now, for some time now, for some number of years, utility market to book ratios have been significantly above 1, and they certainly have been above 1 in this low interest rate environment, and I think a lot of that is due to investors reaching for yield, you know. Reaching for yield and safety in the current market environment.

Obviously you have very low, you know, treasury yields are quite low right now, and investors are looking for higher yield with some growth, which utilities offer, and safety. So some of that and, in fact, I would say is a good deal of that greater than market to book ratio of 1 now is being driven by the current low interest rate environment.

Q. Do you agree with Mr. McKenzie's -- I'll go ahead. Please refer to your page 43. Do you agree with Mr. McKenzie's application of the nonutility benchmark approach? I believe it's page 43.

A. Okay. No, I do not.

Q. And why don't you agree with the nonutility benchmark approach?

A. Because the nonutility companies he used are from unregulated companies, and I describe here beginning on line 18 utilities have protected markets, service territories, and may increase prices they charge in the face of falling demand or loss of customers, and unregulated companies cannot do that.

So and investors know that, and so other things being equal, you would expect unregulated companies to -- well, for investors in unregulated companies to expect and require returns on equity that are greater than regulated utility companies.

Q. Due to that additional risk, correct?

A. Yes. Yes.

MR. CHANDLER: That's all the cross I have of

Mr. Baudino.

CHAIRMAN SCHMITT: Mr. Osterloh? Staff, cross?

MR. NGUYEN: Yes, Your Honor.

CROSS-EXAMINATION

By Mr. Nguyen:

Q. Good afternoon, Mr. Baudino.

A. Good afternoon.

Q. I take it that you've read Dr. McKenzie's rebuttal testimony with respect to your recommendations in your testimony?

A. I've reviewed it.

Q. Okay. Do you recall his review of your dividend data use in the growth rate portion of the DCF analysis? Do you recall that?

A. What are you referring to? I don't have his testimony in front of me.

Q. You do not have his testimony?

A. I have it on computer. I have it on my computer.

Q. If you can bring that up. Can you bring that up really quick?

A. Sure.

Q. It's on page beginning 63 of Dr. McKenzie's rebuttal.

A. Okay. Which page did you say that was?

Q. 63, at the bottom of 63 and beginning top of 64.
A. Okay.
Q. It's the question and answer to number 88.
A. 63 and 64?
Q. Yes, sir.
A. Okay. I just need a few moments to review this.
Q. Sure. Go right ahead.
A. Okay. I've read that. What's your question?
Q. Okay. So Dr. McKenzie states that the growth rates in dividends per share are not likely to provide meaningful guide to investors' current growth expectations; is that correct?
A. That's what he said.
Q. Okay. But that professional analysts rely on growth rates provided by the earnings per share approach; is that correct?
A. That is what he said.
Q. Okay. Can you provide the Commission with your view of why also looking at dividends per share is appropriate in a discounted cash flow analysis?
A. Sure. It's because dividends represent the cash flows that are actually received by investors, not earnings. The DCF model assumes that dividends

and earnings and book value grow at the same rate, so investors obviously would take into account forecasted growth and dividends if they had that kind of forecast available.

Now, there is evidence in the literature that suggests that it's -- that earnings are important and perhaps the more important forecast that investors would look at, and I would agree with that, but I think it would not be a good idea to exclude or ignore dividend growth forecasts that are available to investors through the Value Line Investment Survey, so I have included that.

And really in my weighting I use four sources. Three sources are earnings growth forecast, one source is dividend growth, so dividend growth should be weighted. It's weighted 25 percent. The earnings growth forecasts are weighted 75 percent, so I do give greater weight to earnings forecasts, but I think you should have dividend growth in there.

Q. Okay. Are you saying that you should also -- one should also factor in the earnings approach as well?

A. Oh, absolutely. And I do that too. In fact, that's the bulk of the weight given to my growth forecast, is earnings growth forecast.

MR. NGUYEN: Okay. Those are all the questions. Thank you.

CHAIRMAN SCHMITT: Commissioner Cicero?

VICE-CHAIRMAN CICERO: No questions.

CHAIRMAN SCHMITT: Commissioner Mathews?

I have none. Is there any other questions to be asked of this witness?

MR. KURTZ: Well, I would do a very quick redirect.

REDIRECT EXAMINATION

By Mr. Kurtz:

Q. How many rate cases have you testified are return equity, about?

A. I was afraid somebody was going to ask me that one day. I haven't actually counted, but quite a few since I've been doing this work since 1982.

Q. Is it typical in your experience that the utility will bring in an expert that comes in high, the consumer advocates or rate payer interests will come in with an expert that comes in low, and the Commission typically ends up somewhere in between?

A. I'd answer that this way. I mean, that's sort of been like the end result, but I will say that, you know, Mr. McKenzie and I and Dr. Woolridge all really believe in what we're testifying to, and, you know, typically the utility is higher, consumer advocates and staff may be lower, and often I've seen Commission come in between those numbers, and sometimes they go for one of the witness's numbers.

Q. In the context of the settlement that's presented to the Commission here, in your opinion is 9.75 percent reasonable?

A. I think within the context of the global settlement like the parties have -- even though it's nonunanimous, that the parties have agreed to is certainly within the range of recommendations to this Commission.

MR. KURTZ: Thank you. No more questions.

CHAIRMAN SCHMITT: Any further cross-examination?

MR. CHANDLER: I don't believe so, Chairman. Thank you.

CHAIRMAN SCHMITT: Anyone else care to further question this witness?

MR. OVERSTREET: No, Your Honor.

CHAIRMAN SCHMITT: If not, may Mr. Baudino be excused?

MR. OVERSTREET: Yes, Your Honor.

CHAIRMAN SCHMITT: Thank you. You may stand down.

THE WITNESS: Thank you.

CHAIRMAN SCHMITT: Mr. Kurtz, do you have any other witness, or does this conclude your proof?

MR. KURTZ: This concludes. We had two other witnesses, but they were not called by the Commission. We had Mr. Kornstein, who is an economic development kind of expert, as well as the plant manager at Marathon Petroleum, Brad Levi, who testified, but staff did not request them, nor did any of the parties, so their testimony, I guess, is in the record.

MR. OVERSTREET: Our next witness, Your Honor, is Mr. McKenzie.

CHAIRMAN SCHMITT: Mr. McKenzie, please raise your right hand.

ADRIEN M. MCKENZIE, called by the Kentucky Power Company, having been first duly sworn, testified as follows:

DIRECT EXAMINATION

By Mr. Garcia:

CHAIRMAN SCHMITT: Thank you. Please be seated.

Mr. Overstreet, you may ask.

MR. OVERSTREET: Mr. Garcia.

CHAIRMAN SCHMITT: Mr. Garcia, you may ask.

MR. GARCIA: Thank you, Your Honor.
Q. Good afternoon.
A. Good afternoon.
Q. Would you please state your name and business address for the record?
A. My name is Adrien McKenzie, and my business address is 3907 Red River Street, and that's in Austin, Texas, and the zip code is 78751.
Q. And, Mr. McKenzie, did you submit in this case direct testimony consisting of 78 pages of questions and answers and 11 exhibits?
A. Yes, I did.
Q. Okay. And were these prepared by you or under your supervision?
A. They were.
Q. If I were to ask you the same questions today, would you provide substantially the same answers?
A. I would provide exactly the same answers.
Q. Do you have any corrections or changes to your testimony?
A. I have one small correction. This was actually addressed in a data request, but I'd like to go ahead and correct it formally here. On page 24 of my direct testimony, on line 13 the sentence reads, (Reading) A Value Line safety rank of 1 or 1.

That second 1 should be a 2.
Q. And does that change -- change in any way your analysis?
A. No, it does not. It was just a typographical error.
Q. Thank you. And did you also cause to submit rebuttal testimony consisting of 77 pages of questions and answers and appendix containing three exhibits?
A. Yes.
Q. And those exhibits were numbered 12, 13, and 14 to reflect that the last exhibit of your testimony had been 11 in your direct?
A. That's correct.
Q. And do you have any changes to that testimony or exhibits?
A. I do not.
Q. If I were to ask you the same questions today, will you provide substantially the same answers?
A. Yes, I would.
Q. And did you also cause responses to discovery answers to be submitted in this case?
A. I did.
Q. Do you adopt your direct testimony, rebuttal testimony, exhibits, and the discovery answers that

you provided as your evidence in this case?
A. Yes, sir, I do.
MR. GARCIA: Your Honor, the witness is tendered for cross.
CHAIRMAN SCHMITT: Okay. Mr. Kurtz, do you have any questions for this witness?
MR. KURTZ: No, I do not.
CHAIRMAN SCHMITT: Do counsel for any of the settling intervenors have questions for Mr. McKenzie? If not, Mr. Cook, Mr. Chandler, any cross-examination?
MR. CHANDLER: Yes, sir, and may I approach?
CHAIRMAN SCHMITT: Yes, you may.

CROSS-EXAMINATION

By Mr. Chandler:
Q. Good afternoon, Mr. McKenzie.
A. Good afternoon.
Q. You provided direct testimony in this case, correct?
A. Yes, I did.
Q. And your testimony was on your recommended return on equity for Kentucky Power Company, correct?
A. That's correct.
Q. And can you remind the Commission what that number was?

A. Well, the bottom line number was 10.31. It was based on a range of 9.71 to 10.91.
Q. 9.71 was the lower end of that range?
A. That's correct.
Q. In the company's last rate case, the case, to best of my memory 2014-396, you provided testimony for Kentucky Power along with Dr. Avera; is that correct?
A. Yes, it is.
Q. And in that case do you remember what your recommended ROE was?
A. I do not.
Q. Do you mind to turn to tab A in the binder I provided you?
A. Certainly.
Q. Subject to check, and you may check on your own at tab B that I provided you, has your entire direct testimony from that case, but subject to check would you believe that this is -- would you agree that this is page 4 of your testimony from that case?
A. Yes, I would.
Q. And do you mind to reacquaint yourself with the recommended ROE in that matter?
A. Yes, it's 10.62 percent.
Q. Based on your recommendations in the last two

cases, would you agree that the equity cost rates for the company have decreased?

A. Yes.

Q. If you would please turn to tab C. And tab C, and this is subject to your own check, but this is page 16 through, I believe, 23 of your testimony. Does that look right?

A. In the prior Kentucky Power case?

Q. In this case, excuse me, I'm sorry. I believe that anything in the prior case notes Avera/McKenzie in the top right-hand corner.

A. I understand. Okay.

Q. I've confused myself in the last week between them. Does this, subject to check, look like page 16 through 23 of your testimony?

A. Yes, it does.

Q. Now, on these pages, and it's starting with between line 17 and 18 on page 16, you discuss your opinion on the outlook for capital costs, correct?

A. Well, I clarify that somewhat. I don't regard it to be my opinion. I regard it to be my presentation of really what I see in the market. I'm not making a personal prediction.

Q. Okay. On page 21 that's there. I guess this will be five or six back, you cite to Blue Chip

Financial Forecasts, correct, which I guess you short reference there as Blue Chip.

A. That's correct.

Q. And you cite to Blue Chip as your reference to what you believe -- well, excuse me. Let me try to ask this question in light of your recent clarification.

You provide these figures as what Blue Chip expects interest rates to be between now and 2022, correct?

A. Well, Blue Chip is one of the sources that I rely on, and that's one of the forecasts that is considered in developing this graph, so I would agree with that, subject to the proviso that there are others included in there.

Q. And if you'll turn to page 22, I believe it's the -- no, excuse me, 23. Do you mind to read into the record the paragraph starting on line 12 through line 17?

A. Certainly. (Reading) Given investors' expectations for rising interest rates and capital costs, the Commission should consider near-term forecasts for higher public utility bond yields in assessing the reasonableness of individual cost of equity estimates and in evaluating the ROE for

Kentucky Power. The use of these near-term forecasts for public utility bond yields is supported below by economic studies that show that equity risk premiums are higher when interest rates are at very low levels.

Q. Now, do you mind to turn to tab D, please. And subject to check, would you agree that this is your Exhibit AMM-7 in this matter?

A. Yes.

Q. And in AMM-7, page 2, what is the risk-free rate that you use in your analysis there?

A. Okay. Well, first just to clarify, page 1 of this exhibit presents the capital asset pricing model using the current risk-free rate, so I do consider current rates.

Page 2 presents the CAPM using a forecasted rate of 4.2 percent, which is roughly comparable to the 4 percent that Dr. Woolridge used in his CAPM.

Q. So thank you for clarifying that. I wasn't -- I will follow up. On page 1 then, what's the risk-free rate you used for current?

A. 3 percent, and as I indicated in the footnote, that was based on the average yield for the six months ending May 2017 when I prepared my testimony.

Q. And are you aware of what the 30 -- and that's

based on the 30-year treasury bill, correct?
A. 30-year treasury bond, yes.
Q. Treasury bond, sorry.
A. Yes, sir.
Q. Do you know what the current 30-year Treasury bond is today?
A. I don't know today's yield, no.
Q. How about do you mind to turn to tab E? What it was as of the 4th of December per the U.S. Department of Treasury?
A. The 4th of December, just a one-day spot yield was 2.77 percent, by the look of it.
Q. And would you be surprised to find out if yesterday the one-day spot yield was 2.71 percent?
A. That wouldn't surprise me. It wouldn't be my recommendation to use a spot yield in this analysis. I used six-month averages.
Q. Six-month historical averages, right?
A. Correct, as one basis.
Q. So what did you use, going back to tab D, what did you use as the current rate?
A. 3 percent.
Q. 3 percent. And on page 2, what was the forecasted amount you used as the risk free rate?
A. 4.2 percent.

Q. 4.2 percent, and that was based on a 2007 to 2022 time frame that we looked at previously, right?
A. I think you said 2007. 2017.
Q. 2017, excuse me. I'm sorry.
A. Correct.
Q. 2017 to 2022.
A. Yes.
Q. And so when you incorporate the forward looking forecasted risk-free rate, the expectation is that in the next four years -- excuse me.
When using that risk free rate, the calculation anticipates an increase from the current interest rate to the risk free rate you use in the calculation, correct?
A. Right. In other words, just as Dr. Woolridge did not use the current 30-year treasury bond yield in his CAPM, I used a higher rate in this example. My rate in the previous page is actually lower than the rate that Dr. Woolridge used, the idea being that the Commission is trying to establish a cost of equity that's going to present a meaningful estimate of investors' required return over the time when rates are set. So this is one gauge that I offer the Commission in making that determination.
Q. And so if we just assume that -- and I agree

the one-day snapshot, we'll throw out the one-day snapshot, that over the last few weeks, we'll say, the Treasury rate has been at roughly 2.8 percent; is that correct?

A. Yes.

Q. So the forecast on page 2 here anticipates 140 basis point increase over that time frame that you've applied.

A. Over the five years, yes.

Q. Over the five years. Do you mind to also turn to tab F, and on page 2 of that -- well, to be fair, we'll go to page 1. For your applied cost of equity, under implied cost of equity, under B, is that the -- is that -- what percentage does that represent? What number does that represent?

A. That's the six-month average yield on Baa utility bonds as reported by Moody's for the month end of May --

Q. So looking at corporate utility bonds, that rate is sort of comparable to the 3 percent we were discussing in the last --

A. That's correct.

Q. It's a six-month historic.

A. Yes, sir.

Q. And on the next page you use the same calculation. I believe the only difference between the two calculations is the -- is a different utility bond yield and the different adjusted equity risk of premium, correct?

A. Yes, because the equity risk premium moves inversely to the bond yield, so by substituting a new bond yield we need to calculate that.

Q. Yeah, you can't use the current interest rate and a future risk premium, and vice versa, right?

A. Right.

Q. Okay. So what does the 6.28 percent represent?

A. The 6.28 percent is a forecast of Baa utility bond yields for 2018, 2022. It's actually based on forecasts for AA utility bond yields. Those are the only forecast rates that are available, and then onto that I add an average spread, the difference between a AA and a Baa bond yield.

Q. Which -- would you agree that those -- is it your opinion that those -- that the difference between those two are very similar over time, the spread between the two?

A. They can fluctuate, depending on risk perceptions in the market.

Q. Do you feel the adjustment you made was reasonable?

A. Yes, I do.
Q. Now, if you'll turn to tab G.
MR. CHANDLER: And I apologize to additional counsel. We ran out of Gs, so for some of you it may be tab T.
Q. If you'll turn to tab G, and this is the Mergent -- a copy of the Mergent Bond Record. Are you familiar with this publication?
A. Yes, I am.
Q. And you -- this is a trustworthy publication for -- to determine what the bond yield has been?
A. Yes.
Q. Okay. On page 2 of that will you please note what the -- and this is the most recent version that we could come about, what the September 2017 Baa public utility bond yield was?
A. This reports it as 4.24 percent.
Q. And do you have any reason to believe that this is incorrect?
A. No.
Q. And so between the September rate, which a caveat is a snapshot in time, to the rate you use on AMM-9, page 2, would you agree that that's about a 200 basis point different -- difference?
A. Can you tell me which tab you are on?

Q. Yeah, I apologize. It's tab F, page 2 of tab F. I'm more than happy to give you time if you'd like to put it into the three-ring binder if it would make it easier.
A. No, that's correct.
Q. So 200 basis points?
A. Approximately.
Q. Approximately 200 basis points, and again with the caveat that the Mergent September is a snapshot in time. It's not an average of the past six months, it's just a snapshot of the day.
A. Correct.
Q. And so in this case you've given consideration and incorporated an outlook for higher capital costs in your ROE determination; is that correct?
A. Yes, that's one aspect of my recommendations.
Q. Now, do you mind to turn to tab H, which we had plenty of, so -- and I believe you have a copy of yours and Dr. Avera's testimony if you would like to check, but subject to check, from the 2014 rate case would you agree that this is page 19 of that testimony?
A. Subject to check. I don't have any reason -- I don't have any ability to confirm or deny, but I'm sure --

Q. I do believe -- you do have a copy of the full version up there, if you would like. I believe it's tab --
A. I'm going to trust you on this one.
Q. Okay. All right. I appreciate it. Do you mind to read into the record line 12 through 18?
A. Certainly. (Reading) Given investors' expectations for rising interest rates and capital costs, the KPSC should consider near-term forecasts for public utility bond yields in assessing the reasonableness of individual cost of equity estimates and in evaluating a fair ROE for Kentucky Power from within the range of reasonableness. The use of these near-term forecasts for public utility bond yields is supported below by economic studies that show that equity risk premiums are higher when interest rates are at very low levels.
Q. So would it surprise you to know that this is the -- nearly the exact same paragraph that you provided on page 23 of this current rate case?
A. No, not at all. In fact, the expectations for bond yields and what investors are looking for in the capital markets haven't changed substantially based on the projections that I've looked at.
Q. And it would be fair to say that you've been

consistent on this point since the last rate case.
A. Yes.
Q. So if you'll turn to tab I?
A. I'm there.
Q. This is Exhibit WEAAMM-8 from the last rate case. I believe this is your CAPM, your empirical CAPM work sheet from the last rate case. Subject to check, would you agree?
A. Yes.
Q. And can you provide the Commission with the number that you used in the current risk-free rate?
A. It was 3.3 percent at that time.
Q. And would you agree that we discussed earlier that at least recently in the last few weeks the 30-year treasury bond has been roughly 2.8 percent?
A. Yes, that's correct.
Q. And will you turn to the second page of that exhibit or that, yeah, your exhibit, and tell the Commission what the risk-free rate you used in the forward looking determination was?
A. It was 4.7 percent at that time.
Q. 4.7 percent at that time.
A. Correct.
Q. So the current risk-free rate is roughly 2.8 percent. Excuse me. The risk-free rate you use

is a 30-year treasury, correct?
A. Yes, sir.
Q. And we discussed that that is roughly right now at 2.8 percent?
A. Yes.
Q. And your forecast from the last rate case forecasted it, not your forecast, excuse me, the forecast you used that was provided pursuant to the -- I think one of the things you included was the Blue Chip Financial Forecast, correct?
A. Yeah, I've used those sources consistently. I'd have to look back to see if that source was applied then, but I expect it could have been.
Q. I think in footnote C there you note that it included Blue Chip Forecast Volume 33.
A. Thank you. Yes, sir.
Q. Okay. So your forecasted interest rate from the case 2014-396 in which you filed testimony in, the forecasted interest rate for the time period 2005 to 2019 was 4.7 percent, and the current risk-free rate of a 30-year treasury bond is 2.8 percent.
A. Right, that's correct.
Q. Thank you.
A. We don't have any dispute about the fact that the forecasts don't necessarily turn out to happen in

real time. Dr. Woolridge makes a big point about this in his testimony, and my point is it's expectations that matter, not the comparison of what people thought, and did it actually happen.

Q. Would you agree that the Commission used your ROE recommendation in the last rate case to determine whether the rates were fair, just, and reasonable?

A. I don't know that the Commission used our ROE determination in the last case solely. I'm sure they considered the evidentiary support in the record and made their own determination.

Q. Would it surprise you to know that the only ROE that came out of the last rate case was a stipulated 10.25 that applied to a single tracker?

A. No.

Q. And would it surprise -- and do you mind to reconfirm with the Commission what your ROE recommendation was in the last case? Subject to check, 10.62 percent sound okay?

A. Yes.

Q. And do you mind to turn to tab J. This is Exhibit WEAAMM-9 from the previous rate case.

A. I'm there.

Q. Go to page 2 and allow the -- tell the Commission what the BBB utility bond yield 2015 to

2019 that was used in the applied cost of equity in this, what percentage it was?
A. At that time it was 6.77 percent.
Q. And so according to Mergent, in September, a snapshot in time, it was 4.24 percent in September.
A. That's correct.
Q. And so it's 2000 -- it's 25 days away from 2018. Essentially three years through the time period in which Blue Chip forecasted interest rates; is that correct?
A. Yes. Well, it's not just -- again, it's not just Blue Chip. It's also Global Insight and the Energy Information Administration of the U.S. Government.
Q. Okay, the U.S. Government, thank you. And it looks like the -- okay. So we're three quarters of the way through the time period they estimated and forecasted through, and the current bond yield for a -- a comparable bond yield is 4 -- for comparable risk, excuse me, is 4.24 percent, and you incorporated -- as one of the items you incorporated to come to your 10.62 in the last rate case was a forecasted 6.77 percent, correct?
A. That's correct. We don't have any dispute about the fact that the forecast did not materialize.

The question is sitting here today what's the basis of an investor's expectations, and I'm telling you again that I believe it to be forecasts, not backward looking information.
Q. But you recommended the same thing in the last case, correct, using the same sort of forecasts, the same data?
A. My approach in this case is consistent with the last proceeding, yes, sir.
Q. Do you mind to turn to tab, hope I'm right here, tab F, please, and page 3 of that.
A. Okay. I am there.
Q. As a general proposition, has the investment risk of electric utilities gone up or down over the last 40 years?
A. It's gone up.
Q. You think it's gone up. And what studies do you have that --
A. Well, I've looked at bond ratings for the electric utility industry over time, and back in the '70s and early '80s probably the industry average was a AA. There's certainly, there was an A average, and much more companies -- much fewer companies in the BBB category.
Over time they've migrated, and today I would

say there's the majority of firms in the electric utility industry are rated Baa, and fewer are rated single A or above. In fact there's really only one company I'm aware of that's rated AA, Madison Gas & Electric Company.

Q. Okay. Would you agree -- excuse me. Excuse me. What risk measures do you use for Kentucky Power?

A. Are you referring to the establishment of the proxy group?

Q. No, excuse me. I'm not trying to trip you up. Trying to ask it in -- what do you believe the most appropriate measurement of risk is to compare two different utilities to each other?

A. Well, that depends on what you're trying to compare. If you're trying to compare the risk of a utility bond, for example, the easy and most objective benchmark would be a bond rating.

On the other hand, two publicly-traded utility companies, you would presumably look to other risk measures such as financial strength ratings and other ratings that are published in the investment industry, which Beta is another example of a risk indicator that's related to the risk of common stock.

Q. Would you please turn to tab M, please? That's

a lot of pleases. Would you please turn to tab M, and this is an exhibit that's located in Dr. Woolridge's, along with Dr. Woolridge's testimony, and as industry average Beta, according to Value Line Investment Survey February 2017, do you have any reason to believe that the information on this is incorrect?
A. I don't have any reason to believe it's incorrect, but I haven't verified any of it.
Q. Would you please look at the bottom right-hand corner of it?
A. Yes.
Q. And would you agree that Natural Gas, Water Utilities, Electric Utilities (Central), Electric Utility (West), and Electric Utility (East) have the five lowest Betas on this?
A. Yes, they do have the five lowest Betas on this.
Q. And as a general proposition, would you agree that in recent years that of the ratings changes, the credit changes -- excuse me. That the majority of credit rating changes in recent years have been upgrades to electric utility stocks? To electric utilities, excuse me.
A. I think you'd have to be more specific. I mean

certainly, you know, there's a graph in Dr. Woolridge's testimony that shows over some period of time a general strengthening in credit ratings for utilities.

We spoke this morning about a Moody's article that actually involved a pretty much an industry-wide upgrade based on perceptions of support from regulatory mechanisms, although Kentucky Power was not upgraded at that time.

Q. And perceptions of -- why make the qualifier "perceptions"?

A. Well, it's the perceptions of the credit rating agencies in terms of their view of how those mechanisms impact the solvency and default risk associated with the bonds that they're rating.

Q. And do you believe that those rating agencies are a valid -- are a valid measure of actual risk?

A. Absolutely, yes, sir, and I rely on those in my testimony.

Q. And so if you'll turn to tab L in your testimony. I believe this is the page with Dr. Woolridge's testimony that you were just referring to. You note, and I believe Dr. Woolridge admitted this earlier, that in response to Kentucky Power counsel, that the single year upgrade that you

were just referring to was in 2014, correct?
A. Yes.
Q. And that was where 97.2 percent of utilities were upgraded?
A. Right.
Q. And since that in 2015, according to EEI, do you know if Kentucky Power belongs to EEI?
A. Kentucky Power? No. I imagine that American Electric Power Company does, but I don't know.
Q. Okay. So according to data from EEI, is it true that 70 percent of utility credit rating changes have been upgrades?
A. I haven't reviewed that report. I don't know that to be the case.
Q. Subject to check, does this chart depict that?
A. Yes. What time period were you referring to?
Q. The year 2015.
A. Yes, that's correct. According to this chart, that's what it says.
Q. Do you mind to turn back to tab F? Okay?
A. I'm there.
Q. And column A, allowed ROE?
A. Oh, excuse me, I must have the wrong tab.
Q. That's okay.
A. Column F?

Q. Column A.
A. Which page?
Q. It's tab F, page 3.
A. Page 3.
Q. ROE A. It's your authorized returns in the electric utility risk premium.
A. Yes, sir.
Q. Would you agree that you -- that the percentages in column A were taken from major rate case decisions regulatory focused from RRA?
A. Yes.
Q. And the 9.7 percent that you use there, is that the overall average for 2016?
A. Yes, I just used the overall averages in every year for this study.
Q. And in 2016, RRA reports authorized ROEs for individual cases; is that right?
A. Yes.
Q. But you did not use the individual cases. You just took the overall average.
A. I took the reported average in each year.
Q. Does RRA provide more than one average every year, one that incorporates Virginia surcharge -- Virginia cases that provide additional bumps to ROEs and one that does not?

A. They do now, although that's a recent feature of their reporting, so going back there would be no way for me to develop a comparable measure. For instance, they also report ROEs that include penalties like the Indianapolis Power Case last year where the company was penalized, so I just use the average.
Q. So this does incorporate cases from Virginia, for instance, where they add additional basis points to the ROE?
A. That's correct, it does.
Q. And do you know what the 2016 average ROE was without those Virginia cases?
A. I may be able to tell you that. 2016, I believe it was 9.6 percent.
MR. CHANDLER: That is all the questions the Attorney General has.
CHAIRMAN SCHMITT: Mr. Gardner, Mr. Osterloh, any questions? Staff, question?
MS. VINSEL: Yes. I have a few questions.

CROSS-EXAMINATION

By Ms. Vinsel:
Q. I'm going to pass out a packet. Mr. McKenzie, this is not all geared to you. This contains information that's in the case record for several of

the witnesses that will come up.
A. Now that I see the size of the stack, I appreciate the preamble.
Q. Mr. McKenzie, can I have you turn to tab number 14, and the very last page there. We'll discuss that in a minute, but I thought we might as well go ahead and do this.
As you know, in the nonunanimous -- the proposed nonunanimous settlement, it recommends a 9.75 return on equity, and your recommendation was 10.31, correct?
A. That's correct.
Q. Could you provide us with a general analysis of the 9.75 return as compared to your recommended 10.31?
A. Well, clearly I would view the 9.75 as a conservative return, given my recommendations and given the methodologies that I apply in my testimony. However, it is within the range that I identify in my testimony, albeit right at the bottom end of the range or close to it.
My view is that it's a very positive, reasonable settlement, although it's I think a conservative ROE for the company, both based on the evidence that's presented in my testimony and my

analyses, as well as comparisons to other recent decisions of the Commission, in particular the 9.7 percent ROE that was approved for Kentucky Utilities in June this year, and as was discussed earlier in the cross of Dr. Woolridge.

Kentucky Utilities is a less risky utility than Kentucky Power, so that argues for a higher ROE, and I think five basis points is really not enough to compensate for that risk difference.

Q. To follow up on what you've just said, is it your opinion that the 9.75 ROE reflects the risk and return requirements of investors?

A. Again, I think all things considered, which I think is the proper way to consider the ROE in this case, given that we have a settlement agreement, I think the settlement agreement inherently involves tradeoffs between all the parties to reach a comprehensive positive solution that the parties can agree to, so I would view this ROE as being somewhat on the low side, considering my recommendation.

I think it's, again, a little bit lower than it should be, given the differential and the risk between Kentucky Power and Kentucky Utilities, but I think if it's examined within the scope of all the evidence, that it would be reasonable.

I don't think it's the type of recommendation, the type of finding that would cause concern among the investment community, unlike an ROE of 8.6 or 8.82, which is essentially off the charts in terms of ROEs.

Q. Do you believe that the 9.75 ROE aligns with the current economic conditions, but also with the indications that the Federal Reserve will raise interest rates in December?

A. Again, I think it generally aligns with the present conditions given recent authorized returns in the utility space. I think my concern with it in light of widespread expectations for interest rates to rise, we have a very stimulative tax reform act that may come to pass, we have the Federal Reserve, which is winding down its balance sheet investments and raising short-term rates. All of those, in my view, are confirming the forecasts, the independent forecasts that are in my testimony which suggests investors expect interest rates to go up, and I think that's consistent with Dr. Woolridge's own analysis which uses a higher treasury bond yield for his CAPM.

What that suggests to me, given that there's a stay-out provision in the settlement, the investors are locked in at the ROE now and facing the prospects that capital market conditions could change and could ramp up, so I think in light of that it's a conservative value.

Q. Turning to the tab 14, and this is -- this is from your supplemental testimony, Exhibit Number 14. This is a chart with the expected earnings approach for this utility group.

A. Yes.

Q. Could you first explain for the Commission what the expected earnings approach measures?

A. Well, the expected earnings approach goes back to the comparable earnings standards that underlie the Supreme Court's Hope and Bluefield decisions, which basically say that the allowed return should be one that allows the utility to earn a return on its investment that's equal to other enterprises of comparable risk, and how the Supreme Court initially implemented that was actually looking at book returns, so the fundamental premise is that rates are established based on the book equity investment in the utility, and so if the allowed ROE is set less than what investors expect other utilities to earn on their book value, the company will be disadvantaged in the capital markets.

Dr. Woolridge pointed out that it's not a capital market-based method, and he's right on that. It's not. It's based on the regulatory standards that underlie the determination of a fair ROE.

He also -- on the other hand, he said that nobody uses the expected earnings approach, and I don't agree on that point. The Federal Energy Regulatory Commission has recognized the approach that's applied to my testimony in its evaluation.

The Virginia Commission is mandated to consider earning returns on book value for companies in the region, in an immediate geographical region, when they establish an allowed ROE.

Q. And according to your chart, you've got the average ROE under this approach as 11.8 percent.

A. That's correct.

Q. So can you again just discuss how that 11.8 percent compares to the ROE, proposed ROE of 9.75 percent?

A. Clearly it's much higher. As I talk about in my testimony, there's no single way to precisely estimate the cost of equity. It's an unobservable quantity, and so we have to use various quantitative methods to try to get a handle on what the investors' cost of equity is.

We've talked about earlier today the DCF approach. I was walked through some of my capital asset pricing model and risk premium approaches. This is another independent approach to try to get a handle on where the range is for investors' rate of return, so I'm not suggesting, obviously I wasn't recommending 11.8 percent return for Kentucky Power in this case, but it's another benchmark that I think is useful in trying to frame a zone of reasonableness from which we draw what we consider to be the best estimate.

Q. And this is a little bit different than what I've already asked you, but in your testimony you discuss investor risk, particularly that a utility needs to offer a return similar to returns available from other opportunities of comparable risk.

So in your opinion, does the proposed settlement ROE of 9.75 allow for sufficient investment and offer a return similar to returns available from investments with comparable risks?

A. In my opinion, it does. Again, given my analyses I believe it falls at the low end of a reasonable range. I know the Commission in the past has referenced RRA reports and recent allowed ROEs as a basis to at least benchmark a company's ROE.

The most recent publication from RRA, the range of returns is 9.2 to 10.25. The midpoint of that is 9.73. As I point out in my testimony, there's issues with using RRA for those purposes because as I point out, the 9.2 percent at the low end has some features that don't apply in this case, so again, it's a rough approximation, but what it tells me is that the 9.75 is certainly within a reasonable range, and I think conservative given its relative risk, Kentucky Power's risk vis-a-vis the KU.

Q. Thank you.

MS. VINSEL: That's all the questions we have.

CHAIRMAN SCHMITT: Commissioner Cicero, questions?

VICE-CHAIRMAN CICERO: Just two quick comments.

EXAMINATION

By Vice-Chairman Cicero:

Q. Did you say the Virginia Commission mandates geographical proximity assessment for ROEs within the area that they're contiguous to or somewhere thereabouts?

A. Yes. What they do is there is a geographical boundary. They look at publicly-traded utilities operating within that boundary, and they look at their average earned returns over the last three years, and then they develop a matrix, and they have -- they are required by statute to consider the majority of those values.

Now they obviously have a great deal of flexibility in terms of what the majority is. There's usually seven to eight companies, so the Commission has the flexibility to move that up or down as they see fit, but those -- those earned returns provide a basis upon which to set a floor and a ceiling for the actual allowed return, so there's some premium on top of those earned returns that's used to put a ceiling on it.

Q. So given the comments this morning about Illinois having a return of 8.4 and 8.6, should we be considering those returns, given the proximity of Illinois?

A. No. I don't believe you should. There's -- and this again is a good example of why I think you need to be very circumspect when you look at RRA data as a basis to establish the ROE.

This particular case, first off, involves a distribution only utility, so they have no generation. It's a different risk class from the company here. It's a different operating circumstance. There's structural differences.

Second, it operates under a formula rate plan with an annual true-up, so to the extent the company over earns or under earns, it's trued up every year. I think most importantly, the ROE established for Ameren Illinois and other -- there's other Illinois utilities that are under the same scheme, is determined based on a formula approach, and it's basically a fixed risk premium which is added to a 30-year bond yield. That risk premium doesn't change. If the 30-year bond yield changes the annual ROE changes.

Ameren's allowed ROE has been consistently the lowest in the industry. I think it was 8.64 percent last year as a result of this formula, and I don't believe that that's a very sound basis upon which to estimate investors' cost of money for a utility because it doesn't vary necessarily with treasury bond yields.

I mean, we can see a situation in the market where you have a flight to quality. There's some event that triggers fear in the markets. That generally drives treasury bond yields down, but on the other hand, the risks for common stocks would go up, so in this case we'd have exactly the opposite behavior in this allowed ROE based on this fixed formula.

Q. I just find it's interesting that the Illinois ROE is 135 basis points below the settlement and 190 basis points below your 10.31. That's a significant difference.

A. But I would proposition that it's really exception that proves the rule. I don't believe it's a sound basis. I can give you another example on the other side in the gas utility industry. I mean, basically if we look at the RRA data for the most recent -- the most recent quarter, you'll see that the allowed return for gas utilities averages 10.14. Well, on its face that seems a little high, but if we don't look behind it we're not going to get the whole story.

In fact, based in there is an 11.88 percent return for Enstar Natural Gas up in Alaska. Now, this is -- obviously we're not talking about a utility in Alaska today here, but what I'm suggesting is --

Q. Or in proximity to Kentucky.

A. Or in proximity to Kentucky, but there's a lot of differences between the individual cases that I think make setting an ROE based solely on RRA data tricky, and I think the example that Dr. Woolridge pulled out this morning is not indicative of investors' expectations for the industry as a whole.

VICE-CHAIRMAN CICERO: I don't have any other questions.

CHAIRMAN SCHMITT: Commissioner Mathews?

COMMISSIONER MATHEWS: I have none.

CHAIRMAN SCHMITT: I have no questions.

Mr. Garcia, redirect?

MR. GARCIA: Just a few, Your Honor. Thank you.

REDIRECT EXAMINATION

By Mr. Garcia:

Q. Mr. McKenzie, in your discussion with Commissioner Cicero about the Ameren case in Illinois, you described that that ROE was determined through a formula. Does that ROE in that case for Ameren Illinois take into consideration any of the type of analysis like DCF that you and the other witnesses in this case have provided?

A. No, it does not. It's just basically take a number, add it to the bond yield. There's been other instances in the past where, for example, FERC tried to develop a generic type of ROE approach to minimize controversy.

In every case my experience is those break down because the relationships don't hold over time. Risk premiums aren't constant. Treasury bond yields behave in ways that don't necessarily match the cost of equity for a utility.

Q. You were asked during your examination by the attorney for the Attorney General, and one of the things that you were asked about was the ROE of 10.25 that was approved for certain tracker in the last base case of Kentucky Power. Do you recall that discussion?

A. Yes, I do.

Q. Are you aware of whether that last rate case was resolved through a settlement?

A. I believe it was resolved through a settlement, yes.

Q. Okay. And if you know, do you know whether the settlement provided for either a range or for an indication of what the ROE was for the company generally?

A. It did provide a range, yes.

Q. If I told you that the average --

A. I can't recall it.

Q. -- of that range was something approximately around 9.8 percent, would that be consistent with your recollection?

A. Yes.

Q. You were also asked about the comparison of different utilities, asked to -- the investment risk, and just to -- to clarify a basic building point, that's one of the requirements of the Bluefield and Hope decisions, correct?
A. Correct, yes, that the return reflect a risk -- or reflect the requirements for comparable risk investments.
Q. Now, when you said comparable risk investments, would you consider Baa2 Moody's credit rating to be a comparable risk investment in that sense as investment into a company that has a Moody's credit rating of A3, so just as Kentucky Utilities?
A. Well, as Dr. Woolridge discussed a little bit, there's gradations within the investment grade ratings scale, so there's two notches difference between a Kentucky Utilities bond rating, which is less risky, and Kentucky Power's bond rating. Now clearly that indicates higher risk for Kentucky Power, at least based on that indicator.
Bond yield spreads between Baa and A rated bonds are about 40 basis points. That entire span would be about three notches. We're talking about two here. So it would be something less than 40 basis points, but clearly there would be a

difference.
Q. And the 9.75 percent ROE that's provided for in the settlement in this case is just five basis points above that which was authorized for the settlement of the KU and Louisville Gas & Electric case, correct?
A. That's correct. And I think it's also important for me to point out that the 40 basis point bond yield spread is based on the risks of bonds, and when we move to the higher risks of common stock we would expect spreads to be higher.
Q. You were also asked about one-day spot yields, and I think that in your answer you started indicating that that was not something that could be used, and acknowledging that counsel indicated that those were out of the window.
If you could illustrate for the record a little bit why can those not be used as a reliable measure in order to determine the long-term return on equity for the company?
A. Well, just like we do with stock prices, when we apply the DCF model we typically use an average over some period like 30 days, 180 days. Analysts do it different ways.
The point is that in any given day yields and stock prices can fluctuate, so it doesn't necessarily

provide a very accurate picture of investors' expectations that are consistent with current capital market conditions.

Now, that's why I use a six-month average bond yield. Some people could use shorter time periods, but I think a day would be a poor basis upon which to make those decisions.

Q. You were also asked about the table that has the average ROE, allowed ROEs that are published by the Regulatory Research Associates, or RRA?

A. Yes.

Q. Do you recall that?

A. Yes, I do.

Q. And there was some indication during the questions that for some period of time those averages would include Virginia authorized ROEs that may or may not include basis point increases based on Virginia law. Do you recall that?

A. Yes, that's correct. And actually in my rebuttal testimony, in Exhibit 12 to my rebuttal testimony I show the effect of that for the most recent two-year period, so if the Commission was interested in looking at RRA data for the last two years, the most recent -- and excluding the impact of those Virginia riders, they could look there, and as

I present there the range was 9.2 to 10.55 with a midpoint of 9.88 and an average of 9.73.

Q. Mr. McKenzie, do the ROEs that are included in that average calculation include ROEs for utilities that, for example, would be distribution only, or is that only for integrated ones?

A. The numbers I just discussed are integrated only, so they're comparable to Kentucky Power. The ROEs in the schedule that the AG was having me review earlier would contain ROEs for distribution only companies.

Q. Now, a distribution only company, all other things being equal, would be less risky investment than an integrated one?

A. That's generally the perception. Obviously you could have perhaps specific, company specific differences. Again, that's why I think it's important to look at the RRA data carefully, but in general, yes. The risks of distribution-only utilities are perceived to be lower than those of integrated companies.

Q. Okay. You were also asked about corporate bond yield averages for the year 2017 that were related, I think it was either tab T or tab G of that --

A. G, yes.

Q. When you analyzed that data, Mr. McKenzie, do you take into consideration the actual numbers from a historical point of view, or is this information more relevant to your analysis as it would be perceived prospectively by investors?

A. Well, again, I do rely on information very much comparable to what's included in this tab. And I would normally rely on a six-month average bond yield as the basis upon which to apply, for example the risk premium method in my testimony and as a benchmark in evaluating DCF methods.

My testimony also is that, however, given the current state of economic situation, the Federal Reserve policies, and expectations in the independent forecasts that are presented in my testimony, that the Commission should give some weight to the idea that interest rates will increase, and I think the Commission cited that fact in its recent decision in the Kentucky Utilities case.

Q. And if you were to go to the next tab that has an excerpt from your testimony and Dr. Avera's testimony. If I can draw your attention to something that is mentioned there on line 3, where it's talking about historically anomalous capital market conditions.

Would you mind elaborating a little bit on what those anomalous capital market conditions were at the time that this testimony was written and how they may affect the perception of investors as we sit here today in looking at the 9.75 percent ROE that is proposed in the settlement?

A. Well, the quotation in the testimony that you're referencing is actually a quotation from a FERC order, and there the FERC determined that because of the Federal Reserve's policies, in particular its actions to suppress interest rates, both short-term and long-term, Dr. Woolridge said that the Fed doesn't impact long-term rates. He's partly right. Their short-term monetary policies do not.

However, the QE measures that they undertook and the $4.2 trillion worth of long-term debt that they have on the balance sheet was specifically purchased in order to impact short-term rates and to suppress them.

FERC determined basically that these types of conditions and the disconnect between the low rates we have now and expectations of higher rates, were having some type of an impact on stock prices, and the resulting -- excuse me, on the resulting DCF results, and in fact that they were leading to downward biased DCF numbers.

Mr. Baudino spoke about the idea that chasing yield perhaps has led to higher stock prices, but we don't know what growth expectations are behind those. We don't know what those individual investors are expecting, and it's hard within all of the assumptions of the DCF model to know that we're accurately capturing those, so I think within this context, and given the stay-out provision of the settlement, to me the 9.75 is pretty much -- is a very conservative spot for the ROE for Kentucky Power, both given its risk relative to other utilities in the states, given the expectations for higher capital costs, which investors are assuming the risks of those currently under the stay-out provisions.

Q. Thank you, Mr. McKenzie.

MR. GARCIA: Your Honor, for the last question that I was going to ask Mr. McKenzie we have a demonstrative exhibit that may help follow what he's going to say. Can we take care of that?

CHAIRMAN SCHMITT: Yes.

MR. GARCIA: Thank you, Your Honor.

MS. GLASS: May I approach?

CHAIRMAN SCHMITT: Yes, you may.

MR. GARCIA: Well, this will relate to the settlement. May I approach?

CHAIRMAN SCHMITT: This will be marked as Kentucky Power what, 10, 11?

MR. GARCIA: I believe it is Exhibit 12, Your Honor.

CHAIRMAN SCHMITT: 12, yeah.

(KPCO Exhibit 12 marked for identification.)

Q. Mr. McKenzie, what has been marked as Kentucky Power's Exhibit 12, this is a document that was prepared by you?

A. Yes.

Q. And if you would describe what it represents, please.

A. This is analogous to figure 2 in my direct testimony which discusses this issue. Basically what this presents is the weighted cost of equity both for -- implied by the Kentucky Power settlement, 4.06, Kentucky Power's equity ratio is 41.68 percent.

The Kentucky Utilities case earlier this year where the ROE -- where the ROE was 9.7 and the company's equity ratio was approximately 53 percent, and I've compared those two with the resulting weighted ROEs for all companies in 2015 covered by

RRA where an ROE and a equity ratio was reported.

The reason I think this is important, again getting back to this risk concept, a lower equity ratio means greater risk. Kentucky Power's equity ratio is well below industry average. It's certainly well below Kentucky Utilities'.

And also as far as the rate payer impacts, the fact that Kentucky Power is using a much lower equity ratio basically dilutes down the impact of the ROE on customers, both through the tax impact, as well as just the fact that the cost of debt is lower than the cost of equity, so I think this graph helps to illustrate that the settlement, considering capital structure as well as ROE, provides a very conservative outcome, given other recent regulatory decisions.

Q. Thank you, Mr. McKenzie. So if I can ask you a few questions then about Exhibit 12. On the right side where it says the Kentucky Power settlement, that 4.06 percent, how does that relate to 9.75 percent ROE that it's --

A. That's the product of the 9.75 ROE and the company's capital structure equity ratio of 4.186, I believe.

Q. Okay. And asking you the same question about how the 5.22 percent on the right of the chart is established for Kentucky Utilities. If you can explain, how is that number calculated?

A. That is the product of the 9.7 percent ROE approved by the Commission multiplied by the company's equity ratio 53.85 percent.

Q. Now, since Kentucky Utilities has a capital structure that is more heavily weighted towards equity, does that mean that every basis point in ROE has potentially a revenue impact for customers, that it's greater that if its capital structure, for example, was flipped and it had more debt than equity?

A. Right. Certainly there's a lot of factors that go into capital structure decisions, so there's company specific reasons why capital structure would be right for one company and not for another, but all that equal, a higher equity ratio will result in higher costs just because of course the equity return is higher than the debt return, and there's the tax impact associated with it.

Q. And I'm not going to ask you about rates, but from a customer point of view, what you just said, does that mean that a 9.75 percent ROE as proposed in the -- as stipulated in the settlement for Kentucky

Power, because of Kentucky Power's capital structure will have a lesser impact on a basis point for basis point basis than the Kentucky Utilities 9.7 authorized ROE?

A. That's correct, and I think this chart illustrates that.

Q. Okay.

MR. GARCIA: No further questions, Your Honor. I would move for the admission of the Company Exhibit 12 as a demonstrative.

CHAIRMAN SCHMITT: Any objections? None? Then let the exhibit be introduced, filed into evidence as Kentucky Power Exhibit 12.

(KPCO Exhibit 12 admitted.)

Mr. Kurtz, questions?

MR. KURTZ: Can I ask a few questions?

CHAIRMAN SCHMITT: You sure can.

CROSS-EXAMINATION

By Mr. Kurtz:

Q. I'm curious about this Illinois 8.4 percent. You said it's trued up with the over-earned or under-earned. Is it trued up to the 8.4?

A. That's my understanding.

Q. So that's not an authorized return. That's a guaranteed return.

A. Well, it's a formula rate plan, so that's why it's so much lower.
Q. Well, what kind of incentive does the utility have to control costs if you're guaranteed a return?
A. Well, they certainly still have regulatory oversight. They still have the -- they still operate under the purview of the regulatory commission, so there is obviously an incentive to make sure that they operate in an efficient manner.
Q. Well, let's contrast that to the settlement here. There's a three year stay-out with a 9.75 authorized. Wouldn't Kentucky Power have every incentive to control costs over the three years to maybe earn its authorized return?
A. Yes, and I think that's certainly the company's objective. It's been a problem in the past that the impact of attrition and the inability to earn the return, so clearly there's a motivation to do that.
Q. One last thing. The settlement includes a 1 percent cap -- imputed essentially short-term debt at 1.25 percent for 1 percent of total capitalization. Are you aware of that?
A. I'm vaguely aware of it, yes.
Q. Okay. Well, 1.25 percent is cheaper than long-term debt --

A. Yes.
Q. -- and certainly cheaper than an equity amount of the same 1 percent, correct?
A. Yes.
Q. One last thing. This QE2 Federal Reserve, how much money do they have on their balance sheet? This is a big news issue.
A. 4.2 trillion, give or take. Now they've started a process of normalizing the balance sheet holdings so they're reducing those up to a cap of 10 billion, I believe, per month.
Q. So as they sell bonds, that creates more supply of the bonds, which tends to drive down the price of bonds, which will tend to increase the yield, the interest rate.
A. That's correct. And then coupled with expectations of perhaps increasing deficit spending as a result of the Tax Reform Act, it's another factor that would contribute to expectations for higher interest rates.
MR. KURTZ: Okay. Thank you, Mr. Chairman.
CHAIRMAN SCHMITT: Counsel for any of the other settling intervenors have questions? If not, Mr. Chandler?
MR. CHANDLER: I do have some more questions,

Your Honor. But if I may, I believe I negated to, in my haste, number and reference the specific exhibits. Can I do that now?

CHAIRMAN SCHMITT: Yes, you may.

MR. CHANDLER: I think the only ones that I referenced that are not in the testimony would be the tab E, I'd like to make Attorney General Number 7. Tab G/T, Attorney General Number 8.

CHAIRMAN SCHMITT: This is under tab 2?

MR. CHANDLER: Yes. Yes, sir. Tab H, Attorney General's Number 9, tab I, Attorney General's Number 10, and tab J, Attorney General's -- no, excuse me. Tab -- no, that would have been all of them. Excuse me. Got ahead of myself again. Just ten, Your Honor.

CHAIRMAN SCHMITT: Any objection?

MR. GARCIA: Your Honor, the only objection that I have is to the extent that some of these tabs are excerpts from previously filed testimony, that the entire testimony be included instead of just the excerpts.

CHAIRMAN SCHMITT: Well, the entire testimony is already in the record anyway, so it will be a part of the official record, but what he's asking is, I guess, is for purposes perhaps later if it goes somewhere else or for briefing that this be filed as an exhibit, and I'm going to sustain his motion and let those exhibits be introduced.

MR. GARCIA: Your Honor, if I may clarify my observation. It's only for the testimony excerpts that are not part of the record in this case.

CHAIRMAN SCHMITT: Well, I understand. Okay. What part -- what part are you talking about?

MR. GARCIA: Like, for example, Exhibit H.

MR. CHANDLER: I believe there are excerpts from Mr. McKenzie and Dr. Avera's testimony in the last Kentucky Power rate case, which are on file with the Commission, and I've provided Mr. McKenzie with a copy of that on the stand for his references to check if they were correct. I'm more than happy to tender an entire one for the record for those pages, but one was tendered to the application -- to the witness.

CHAIRMAN SCHMITT: Well, I'm going to overrule your objection and allow it to be sustained. If in the future or at the conclusion of the case, if you have some reason to need the other testimony and want to use it, if you'll file a motion then we will allow that entire transcript to be introduced into the record in this case.

MR. GARCIA: Thank you, Your Honor.

CHAIRMAN SCHMITT: Before the final order is entered. Fair enough?

MR. GARCIA: Yeah. That was the only observation that I had.

CHAIRMAN SCHMITT: And I think you did have somewhere, Mr. Cook, maybe there was an Exhibit 4, but we were waiting on another witness. There was an objection from --

MR. OVERSTREET: That would be Mr. Wohnhas.

CHAIRMAN SCHMITT: Yeah, Mr. Wohnhas. So let's not forget that one.

MR. CHANDLER: I hope Mr. Wohnhas doesn't forget it, and if we do maybe he'll remind us, so --

CHAIRMAN SCHMITT: Well, if Mr. Wohnhas forgets it we'll introduce it anyway, okay.

Anything further?

(AG Exhibits 8, 9, 10 admitted.)

MR. CHANDLER: I do have just a little bit of recross.

RECROSS-EXAMINATION

By Mr. Chandler:

Q. Do you mind to turn to the Mergent, the excerpt from Mergent. I think it was tab T slash G, AG's Exhibit Number 8. Let me know when you're there.

A. I'm there.

Q. Do you mind to look at the area roughly between the column for public utility bonds, Baa, the end of 2005, would you agree that the bond yields then were essentially 5 and a half percent?

MR. GARCIA: I'm sorry --

Q. Excuse me, column under public utility bonds, Baa?

A. Which year?

Q. 2015. That's the second time today. Excuse me. 2015. Would you agree that they're roughly 5 and a half percent, in the neighborhood?

A. Well, at the end of the year they were.

Q. At the end of the year. And you've already agreed that right now they're roughly 4.24 percent?

A. Yes.

Q. What causes bond yields to go down?

A. There's any number of factors. There could be changes in risk perceptions for an industry or a sector that could cause risk premiums to change. Changing inflation rates can cause bond yields to change.

Preference for one asset class over another, for instance if people want to buy more stocks than bonds there could be more demand for stocks, less demand for bonds, and then obviously inflation, if I hadn't already mentioned that, and general conditions in the economy.

So if we have a economy that's running well, and there's demand for credit, then typically interest rates will go up, and I think then there's also competition between various kinds of bonds, so we have arguments about whether the treasury crowds out private issuers and causes bond yields to rise if there's deficit spending, those types of features.

Q. We've talked quite a bit, maybe not specifically, but around capital and capital markets.

A. Right.

Q. In the United States is there one big capital market, or are there a lot of different smaller capital markets as a general proposition?

A. Well, I mean --

Q. Can I rephrase the question? I know I'm putting you in a spot because I'm asking you -- for a company like AEP, is there generally just the capital market? Is there one big place, is that kind of how it's looked at by investors? Is everybody getting their money from the general same place by investors?

A. Yes, I think that's the question. It's really about investors when we're talking about capital markets, and in theory investors have any number of asset classes they can invest in, including fancy sports cars and paintings, so the class of assets that compete for an investor's capital is almost unlimited.

Now, of course to kind of get our hands on that, within that framework we've talked about U.S. capital markets or the U.S. stock market or the U.S. bond market or even Nasdaq versus the New York Stock Exchange, so --

Q. But so as a general proposition there's the U.S. bond market and the U.S. stock market, correct, and there may be subsets of those, but those are, as a general proposition, those are the two big ones, right?

A. Right.

Q. Would you agree that Ameren competes for capital in both of those markets?

A. Yes, I do, and again, as I discussed earlier, I think based on their specific risks, so they're a distribution-only utility, and they have a particular structural rate format that goes into that equation.

Q. Thank you. You mentioned earlier, and I just need to clarify, you were discussing different approaches earlier, and I believe it was one of your approaches, and you specifically mentioned something along the lines of it is an approach similar to that that the Supreme Court looked at and then followed up with book returns. What were you speaking about specifically?

A. The expected earnings approach.

Q. And when was that used by the Supreme Court?

A. Back in the -- in really before the advent of kind of what we would consider modern capital market methods, so, I mean, the DCF is a recent newcomer. It really wasn't used in the utility industry until the late '70s, so before that, and the capital asset pricing model and other models were nonexistent back in the early days of regulation, so that is what was typically relied on. It was often applied to nonutility companies as a basis to try to figure out what the comparable earned return on book value should be.

Q. And so because it was used then you believe that's a reasonable basis for looking at it now for direction?

A. No, my basis for using it now is not because it was used then. I think it's still a valid benchmark. I think when someone pulls up a Value Line sheet, a potential investor, and looks at an expected earned return on book value for utility Y, and it's

10.2 percent, and they look at an expected earned return on book value for utility Z, and it's 8.6 percent, they're going to go with the 8.2.

Q. And so if enough people look at stocks and make the decision like you were just discussing, what happens generally, all things equal, to stock prices, to those individual stock prices?

A. You'll have to clarify your question.

Q. When people purchase stocks as a general proposition, what happens to the stocks, the price of the stocks?

A. You're asking me what happens to the price? Stock prices can move up and they can move down. We could have capital gains or losses.

Q. All things equal, if it's purchased more often than sold, or if it's -- excuse me. If it's purchased for an increasing price, what happens to the price?

A. I think by default it goes up. I think what you're saying is if there's certainly more demand for a stock than current supply exists, then the price will be bid up until the market reaches equilibrium, or vice versa.

Q. You mentioned LG&E and KU as a global settlement; is that correct?

A. No, I don't believe I said that.
Q. Is it your understanding that the LG&E settlement that was offered to the Commission for acceptance or modification or denial was a global settlement and that it was a unanimous settlement?
A. That's my recollection.
Q. And do you -- is it your understanding that the current stipulation or non -- the current stipulation is a nonunanimous settlement?
A. Yes, sir, that's my understanding.
MR. CHANDLER: That's all the questions I have.
CHAIRMAN SCHMITT: Mr. Gardner, Osterloh, questions? Staff, question?
MS. VINSEL: Nothing further.
CHAIRMAN SCHMITT: Commissioner Cicero, Mathews?
COMMISSIONER MATHEWS: No.
MR. GARCIA: Your Honor --
CHAIRMAN SCHMITT: Mr. Garcia.
MR. GARCIA: -- actually just to clean up the record, I think there might be a number that was flipped.

REDIRECT EXAMINATION

By Mr. Garcia:
Q. Mr. McKenzie, when you were answering some of

the questions from the AG, and you were talking about expected choice of investment between -- I think that the numbers were presented to you is a 10.8 or a 10.2. I think that your answer might have referred to 8.2, and I just wanted to make sure if you could restate.

If you have an investor that is choosing between investment choices.

A. Yes.

Q. And say that both of them are of similar risk, and one is pricier than the other, what would the investor pick?

A. I think if we're going back to the example of the expected earnings approach, if I misspoke I apologize, but what I was trying to say is that for two investments of comparable risk, if one is expected to earn a return of 8.6 percent, and another is expected to earn a return of 10.2 percent, for example, the investors will prefer to purchase the stock of the company that's expected to earn 10.2 percent.

Q. Right. At the core of the Bluefield and Hope doctrine is that a company needs to be allowed to earn a return, that it's able to attract that investment against similarly -- similar risk investments.

A. That's correct. One of the fundamental principles of Bluefield and Hope is the financial integrity principle, so the company should be allowed to maintain its access to capital in its financial integrity, which in my view is undermined if the allowed ROE is set far below what other utilities are expected to earn.

MR. GARCIA: Thank you. That's all, Your Honor.

CHAIRMAN SCHMITT: Mr. Kurtz?

MR. KURTZ: No, sir.

CHAIRMAN SCHMITT: Anyone else? Mr. Chandler?

MR. CHANDLER: I'm done, thank you.

CHAIRMAN SCHMITT: If there are no further questions, may Mr. McKenzie be excused as a witness?

MR. OVERSTREET: Yes, Your Honor.

CHAIRMAN SCHMITT: Thank you, Mr. McKenzie. You may step down.

At this time we're going to take a -- let's take a 15 minute recess, but when the gavel falls and we go off the record would Counsel please approach so I can have a brief conversation with you? Thank you. We'll be in recess until 25 after 4:00.

(Recess from 4:09 p.m. to 4:23 p.m.)

CHAIRMAN SCHMITT: Okay. We're now back on the record. Would Kentucky Power please call its next witness?

MR. OVERSTREET: Thank you, Mr. Chairman. Our next witness is Mr. Carlin, and Mr. Garcia will present.

CHAIRMAN SCHMITT: Okay. Thank you.

Mr. Carlin, please raise your right hand.

ANDREW R. CARLIN, called by the Kentucky Power Company, having been first duly sworn, testified as follows:

DIRECT EXAMINATION

By Mr. Garcia:

CHAIRMAN SCHMITT: Thank you. Please be seated.

Mr. Garcia, you may ask.

MR. GARCIA: Thank you, Your Honor.

Q. Would you state your name and business address for the record, please?

A. Andrew R. Carlin, 1 Riverside Plaza, Columbus, Ohio, 43015.

Q. And by whom are you employed and what capacity?

A. I'm employed by American Electric Power Services Company in the capacity of director of compensation and executive benefits.

Q. Thank you, Mr. Carlin. Did you cause direct testimony consisting of 39 pages of questions and answers and ten exhibits be submitted in this case?
A. Yes, I did.
Q. And did you also cause rebuttal testimony consisting of 35 pages of questions and answers to be submitted in this case?
A. Yes, I did.
Q. And did you also submit discovery answers in this case?
A. Yes, I did.
Q. Do you have any corrections or additions to either your direct testimony or your rebuttal testimony?
A. No, I do not.
Q. If I were to ask you the same questions today would you substantially provide the same answers?
A. Yes, I would.
Q. And was that direct testimony and rebuttal testimony and the corresponding exhibits prepared by you are or under your supervision?
A. Yes, they were.
Q. Do you adopt your direct testimony, including exhibits, rebuttal testimony, and the discovery answers that you have provided in this case as your

evidence?
A. Yes, I do.
MR. GARCIA: Your Honor, witness is tendered for cross.
CHAIRMAN SCHMITT: Okay. Thank you.
Mr. Kurtz, questions?
MR. KURTZ: No, sir.
CHAIRMAN SCHMITT: Counsel for any of the settling intervenors, any questions of this witness?
If not, Mr. Chandler, Mr McNeil?
MR. CHANDLER: Mr. McNeil has some questions, but may I approach?
CHAIRMAN SCHMITT: Yes, you may.

CROSS-EXAMINATION

By Mr. McNeil:
Q. Good afternoon, Mr. Carlin.
A. Good afternoon.
Q. Let me know as soon as you've got that settled.
A. It doesn't actually fit in the binder, but I'm good. Go ahead.
Q. Okay. All right. Earlier today Mr. Satterwhite testified, and were you in the room for that?
A. I've seen it on video.
Q. Okay. At one point he said something to the

effect that you've dealt with lots of studies and as far as wage and pension competitiveness; is that correct?

A. Yes.

Q. Can you tell me, has the company prepared any studies regarding the ability of rate payers to afford the SERP, the Settlement Employee Retirement Program, expenses embedded in the application?

A. The company does study its nonqualified benefit expense and finds it to be a normal cost of doing business. We have not done a study specific to customers' ability to pay for those costs. I don't think anyone has ever done that study, but one would expect that as a reasonable cost of -- imprudent cost of doing business, that it would be included in the company's cost of service.

Q. Are the sort of studies you mention, are those company facing only? Do they address sort of the rate payers and customers?

A. They address the compensation benefits expense that we find in the marketplace for similar positions for similar companies, both in general industry and in the utility industry.

Q. Okay. Could you please refer to your rebuttal testimony? Do you have that available?

A. Yes, I do.
Q. At page 31, please. Let me know when you're there.
A. I'm there.
Q. Okay. So at lines 11 and 12. It's your sworn testimony that incentive compensation adjustments should not flow through to cause savings plan adjustments, isn't it?
A. Yes, it is.
Q. Okay.
A. The reason for that is that our incentive compensation expense is part of a market competitive compensation package, and if we were to change or eliminate incentive compensation, reduce it, we would need to increase base pay, and base pay would be included in that savings plan as well as the incentive compensation is currently included, so it wouldn't flow through. A change like that would not flow through to reduce savings plan expense.
Q. Would you please then turn to tab 1 in the documents I handed you. This tab consists of documents that are already in the record.

First two pages are 15 and 16 of Mr. Ross's direct testimony, and then the next two pages are from Section 5, Exhibit 2 of the company's

application, pages 33 and 37. Do you see those pages there?
A. Yes, I do.
Q. Okay. Prior to filing your rebuttal testimony, had you read the portions of the company's application and direct testimony filed here that related to savings plan expense?
A. Probably had not read all of it, no.
Q. Okay. Well, then isn't it true that company witness Ross's direct testimony on page 15, line 18, addresses the company's proposed adjustment to savings plan expense with the question, (Reading) Please describe the cost of service adjustment for savings plan expense.
And then it has the section relevant. Do you see that?
A. I do see it.
Q. Now turning to page 16 of Mr. Ross's direct testimony, lines 3 to 6, doesn't it say (Reading), This cost of service adjustment for savings plan expense is determined by taking the net forecasted decrease related to changes in incentives, et cetera?
A. Yes, it does say related to changes in incentives.
Q. So the company itself calculated an adjustment

to savings plan expense based on its adjustment to incentive compensation expense, didn't it?
A. Let me carefully read the testimony here.
Q. Sure, go ahead.
A. I think there's a difference between the changes that Mr. Ross is contemplating here and the changes that I'm responding to, which would be to remove the substantial portion, or a substantial portion of the company's incentive compensation expense from its cost of service, and so the change I'm responding to would be much more substantial than what Mr. Ross is responding to here.
Q. But you had said that, in your testimony, that compensation -- incentive compensation adjustments should not flow through to cause savings plan adjustments, right?
A. It depends what those adjustments or those changes are related to. If it's related to replacing annual incentive compensation with base pay, which is what we would need to do if we eliminated incentive compensation expense to a substantial degree, then no, they should not flow through because base pay is included in the 401(k) match as well.
If it's related to an adjustment related to head count or something like that, then yes, it

probably should flow through.
Q. So did you not make a distinction as to the amount?
A. Well, I was responding to the specific situation in which the intervenor testimonies, the AG and the industrials had suggested eliminating a very large portion of the company's annual incentive compensation expense, and I was pointing out that if we did that we would need to replace it with additional base pay, and therefore that adjustment would not flow through or should not flow through because base pay would also be included. The offsetting increase in base pay would also be included in the savings plan.
Q. Okay. But I just want to make sure before you had filed your rebuttal you said you hadn't read the application or direct testimony that was referenced here?
A. I've read a great deal in this case. I'm not sure if I've read this specific testimony of Mr. Ross or the application in total, but I've read a great deal.
Q. All right. If you would refer to the third page of that tab. It has a label of W32 at the top. Did you review either of these next two pages?

A. I see one that says page 33 of 60.
Q. Yes, and the next page. If you can just look at those and tell me if you remember reviewing those prior to filing your rebuttal testimony?
A. I don't recall.
Q. Okay. Well, that page that is 33 of 60, doesn't that show that the company's own proposed adjustment to incentive compensation is here on this page?
A. What line would it be on?
Q. Looks like line 29.
A. It reads, (Reading) Combined adjustment to incentive compensation cost.
I assume that's what it is.
Q. All right. And if you turn to the next page, which would be labeled 37 of 60, that shows the company's own proposed adjustments to savings plan expense, doesn't it?
A. Yes, it does.
Q. Okay. And it's clear from looking at line 1 at that page that the company itself calculated its own proposed adjustment to savings plan expense by, among other things, multiplying its adjustment to incentive compensation expense by the 4 percent savings plan loading rate. Right?

A. That's correct, but as I previously stated, that's not replacing annual incentive compensation with base pay, which was what I was responding to in my testimony.

What this is is it's bringing -- it's normalizing the value of incentive compensation to the target level, and that adjustment would flow through, as opposed to a replacement where you would substitute base salary for incentive compensation.

Q. But doesn't that still -- doesn't the application contradict your rebuttal testimony where you said any incentive compensation adjustments should not flow through to cause savings plan adjustments?

A. Well, not in the context in which I said that. It does not, no. I'm talking about replacing base salary with an annual -- or, I'm sorry, replacing annual incentive compensation with additional base salary, so in that context it should not flow through.

That's what was contemplated by the intervenors that I was responding to, and that was the discussion prior to that paragraph in my testimony. I think that's clear.

Q. Okay. Now, isn't it true -- turning to tab 2

actually, if you would. Isn't it true that the Commission made an adjustment to disallow some of the company's incentive compensation expense in its last rate case?
A. That is correct.
Q. Since the company's last rate case, was the company able to hire and retain competent employees?
A. Generally speaking, yes.
Q. What do you mean by "generally speaking"?
A. We are always in a constant struggle to hire competent and capable employees. It's -- it's something that we work hard at each and every day. Sometimes we win, sometimes we don't get the competent employees that we would like to get, and we get someone else, but most of the time we're successful.
MR. MCNEIL: Sorry. One second, Judge.
Q. So doesn't the stipulation in this case exclude incentive compensation?
A. It excludes a portion of incentive compensation, which was a management decision. The stipulation in this case makes it clear that it's 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.

And that's a management decision, not a compensation decision, that I support, but I still am arguing and my testimony supports recovery of the full amount should the Commission decide not to agree to the settlement.

Q. Do you recall the total amount of that portion?

A. The way we divide the work load is that the accounting witnesses cover the dollars, and I cover the reasons for, so that may be in my testimony, but it would be better to rely on witness Ross for those numbers.

Q. Okay. So you don't know the total incentive compensation number that was disallowed in the stipulation?

A. 3.15 million was the dollar value that the company agreed not to include in its cost of service in the stipulation, if that stipulation is adopted.

Q. Okay.

MR. MCNEIL: That's all the questions we have at this time, Your Honor.

CHAIRMAN SCHMITT: Mr. Gardner, Mr. Osterloh, questions?

MR. GARDNER: No, Your Honor.

CHAIRMAN SCHMITT: Staff?

MS. VINSEL: Yes, we have a few questions.

CROSS-EXAMINATION

By Ms. Vinsel:

Q. Good afternoon, Mr. Carlin.

A. Good afternoon.

Q. I don't know if you were here this morning when Vice-Chairman Cicero was asking Mr. Satterwhite about, particularly about the defined benefit plans. Were you here then?

A. I was not in the room, but I have heard about it, and we've discussed it, so I'm familiar with it.

Q. Okay. Could you first just give us an overview of all of the -- of these particular retirement plans, defined benefit, defined compensation?

A. Certainly. For details on that, I can cover it at a high level, but for details on that Mr. Cooper, who is up next, is the director of benefits, and he is the best witness on detailed questions on benefits in particular.

But the company 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.

It is market competitive. By that I mean it's a single serving. In total. We do have two different kinds of plans. 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 compensation?

A. Defined contribution.

Q. Contribution, excuse me, yes.

A. Is the word you're looking for there.

Q. Thank you.

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.

Q. Can I have you turn to -- do you have this packet that --

A. This one here?

Q. Yes.

A. What number?

Q. Tab 7. And this is an exhibit to your direct testimony. It's Exhibit ARC-4, and in this case it's

Kentucky Power's target total compensation versus market compensation for technical, craft, and clerical jobs, correct?
A. Correct.
Q. Okay. In looking at this exhibit, it indicates that Kentucky Power's total compensation for technical, craft, and clerical jobs lagged behind the survey medians; is that correct?
A. That is correct. 5.4 percent behind survey median.
Q. Can you explain the reason for that compensation lag?
A. The primary reason is that our base wage rates have lagged, and that is because we had a salary freeze back in 2009, and we've -- over the period since then we've had some years where we've done a little better than market and other years that we've done a little worse, and so we haven't really made up much ground, and we're trying to make up some ground now, but we got behind market back in '09, back in the great recession because we had a salary freeze, which we felt was the right thing to do for our customers at that point in time, but it's been difficult for us to catch up. Now seven, eight years down the road we still haven't caught up.

Q. So I think you may have answered this, but I'm going to ask it anyway. That compensation lag, has that played a role in recent years' payroll increases or salary increases?
A. Yes, that's -- that is the main reason why, we're trying to catch up, and we -- to catch up we necessarily have to provide bigger increases than the market median. Otherwise we won't make any progress in catching up to the market, but that's the whole reason we're behind, and we're trying to catch up.
Q. Okay. In your testimony you indicated that the salary structure, the overall salary structure is designed to reward performance through incentive compensation. Is there a similar lag in terms of the incentive compensation?
A. Well, incentive compensation is a product of base wages, so every employee has an incentive compensation target. The physical workforce that's used in this example, the target is 5 percent of their base wages. And so if base wages lag, then their total compensation will lag because 5 percent of a lower number is still a lower number.
Q. Point taken. I want to make sure I'm understanding the dates of the various surveys. The most recent salary surveys are from 2016, is that

correct, or that were used, reported on this application.
A. Used in this case, that's correct. We have since gotten the 2017 surveys in, but they came in after we filed our testimony in this case.
Q. And then the incentive plan surveys, is the last date of that 2010?
A. It is. We're hoping to get an update on that, but these surveys cost money, and we don't have one at this time.
Q. So the reason that you haven't updated it since 2010 is just a question of money?
A. Yes.
Q. Primarily.
A. Primarily money. Participation. It also takes time to participate in these studies, and for whatever combination of those reasons we don't have it.
Q. Does Kentucky Power either conduct or contract with a third party to conduct a salary survey for regional companies, other than utilities, so getting a sense of a local or regional. Say, for example, in the Kentucky Power service territory?
A. We do benchmark jobs that are not unique to the utility industry to general industry, so about, I

think it's either 40 or 60 of our jobs, 60 percent of our jobs, let's say that subject to check, are not unique to the industry, so we benchmark those against general industry, and we have general industry surveys that we do that against.

MS. VINSEL: That's all the questions I have at this time.

CHAIRMAN SCHMITT: Commissioner Cicero, questions?

EXAMINATION

By Vice-Chairman Cicero:

Q. Let me understand. The last survey you had was 2010?

A. No, that's the last survey we have that was specific incentive compensation designed. That's a pretty unique type of survey. It's not a survey of wages. It's just a survey of how incentive plans are designed and their prevalence, the prevalence of different design factors in them. It's an exhibit in my testimony if you wish to read it. We do benchmark our wages annually.

Q. Against?

A. Against the -- well, the utility industry jobs, there's only one place to benchmark them against, and that's utility industry data. If the job is

available in the general industry we benchmark it against general industry data, which is a wider cut.
Q. But your chart, table ARC-3, you indicate that -- I think that's where you were saying you were behind because you didn't give an increase in 2009, and then you have '10, '11, '12, '13, '14, '15, '16, and you compare only to the utility industry market. Are you saying that those percentage increases are strictly related to the hourly and craft employees?
A. So you've mixed a couple of things there. The wage increases that I showed in my testimony have really been the same for the utility industry as they have been for general industry. Those have been remarkably consistent since -- for years. There's very little variance in those surveys. The wages on the tab ARC-4 --
Q. This is ARC-3.
A. Well, the one that the staff handed me before, physical and craft positions, is marked ARC-4.
Q. I'm not talking to the one that -- I'm --
A. Oh, okay.
Q. I'm referring to your Carlin page 20, table ARC-3, and I don't have a handout for you.
A. Oh, okay. Yes. Let me just make sure I find that in my testimony. There's ARC-2. ARC-3. So

these are the wages for physical and craft positions, and the conference board is the source for this data. This is not, make sure, this is not -- no, this is specific --

Q. To utility.

A. -- to utilities. I would venture to say that there's very little difference in any of these years between the utility and general industry. The numbers have been quite consistent.

Q. Well, you chose to go back all the way to 2009 to do your comparison so I guess that you could show that the company was below the market?

A. Well, correct. We're still catching up. We haven't had an opportunity to fully catch up yet, so it felt that that period was relevant for that reason.

Q. So all the way back to 2009 because it appears, if you take the last five years, you're basically right on top of the market, 14 percent versus 15.

A. But that leaves out the year that we had the zero, and that's a big difference. When everyone else is moving by 3 percent and you're moving by zero.

Q. But I don't know what happened prior to 2009. It could have been above. At 2008 it could have been

3 percent and the rest of the market be 1 percent.

A. And that's a good point, but I would refer you to ARC Exhibit -- Exhibit ARC-4, which shows where we are in total relative to the market, so these are the increases we provided that you're talking about in table ARC-3.

The exhibit ARC-4 shows where we stand relative to the market for these physical and craft jobs, and it shows that we are also behind, so we have confirmation from two different points of view that we remain behind the market.

Q. First of all, I'd like to say that I believe that the utility industry should pay market price, but not just based on the utility industry. It should be a comparison that includes other salary surveys for geographic area and other industries, so I'm -- I personally am not opposed to you paying a market-based price for salaries, so I'm not even really arguing that point, but now I'm going to get into benefits, and that's where I think that the utility industry does tend to overreach in what they believe is a way to compensate their employees.

In my opinion, it's not necessary to overcompensate on the benefits side if you're paying market value on the salary side, and here's where

we're going to come in to you talked about this -- your double twist, there's the vanilla and the chocolate, but the cone is the same size. When was the defined dollar benefit plan put into place? How long has that existed?
A. So the company's had a pension plan for at least two decades. Probably well before that, certainly before my time.
Q. As a defined dollar benefit?
A. Well, so I was going to explain that. I think we need some background there. So there are two formulas in the current company -- in the company's current pension program. There is a final average pay formula that was put in well before my time.
It was in -- 2000, at the end of 2000 we added a cash balance formula, which looks very much like a 401(k) defined contribution, but it falls under the rules of defined benefit plans. And we put that in, and we ran the two formulas. The participant got the two formula -- higher of the two formulas. We ran them side by side for ten years, but at the end of the 2000 we froze the final average pay formula for participation, so I think that's what you mean by --
Q. Thank you. So was it lock and freeze or was it grandfathered?

A. It was -- more background needed here.
Q. Okay.
A. We froze participation at the end of 2000.
Q. Grandfathered.
A. At the end of 2010 we froze the benefit.
Q. Okay. Lock and freeze.
A. Okay. So two different periods, but it's locked and frozen at this point. No -- there aren't any significant costs in this case related to that formula. There are still people who, myself included, that's still the higher benefit, so the cash balance has -- was loaded with an amount back in 2000 and has continued to grow, but because of the way interest rates have changed, have been low through the period 2000 through 2017, the final average pay formula grew pretty fast up until 2010 when it was frozen, and it remains, for me at least, the higher of the two benefit formulas, which means since 2010 my pension formula hasn't grown at all.

So my -- and there's a significant chunk of the employee population that's in the same camp that I'm in because I've got a frozen benefit that's the higher benefit, and it's the winning formula. The cash balance hasn't caught up, and so I've not gotten a bigger benefit. It's not grown at all since 2010.

Q. That's okay. That was a very good background because I understand what you're saying is the plan was locked and froze in 2010. You're not earning any additional benefit by being in that plan, and so now the company is offering another formula, if I understand correctly, that's basically a 401(k) type savings plan that for new participants, new employees, they go into that plan, and you're saying right now there's a parallel formula running.

You're not earning in both, you're going to catch up one way or the other to whatever the best benefit is. Is that a correct statement?

A. It's close. So a little bit more background. I apologize. I think -- well, the cash balance plan is not a savings plan. Employees don't contribute to it. Only the company contributes to it. We also do have a savings plan, which the employees do contribute to, and the company then matches their contribution.

Q. Okay. We're going to talk about that in a moment.

A. All right? So but the rates for the cash balance pension plan are set knowing what we're also contributing in the K plan, so that the total amount of the company's subsidy, or contribution on behalf of employees, is market competitive, so we know we're matching 75 -- well, it comes out to 75 cents on the dollar for a 6 percent contribution. That's not exactly the way it works, but it's close enough, in the K plan, and we know the rates, they start at 4 and a half percent of eligible compensation, and the pension plan, those two add up to a market competitive total retirement benefit.

Q. Yes, and you keep referring to market competitive plan, and here's where I'm coming from. A pension plan, either a defined dollar benefit or a cash value plan, I have no problem with that, or a 401(k) plan by itself with a company match, have no problem with that, or a 401(k) plan not matched by the company, that participants in a pension plan, defined dollar benefit or cash value where the company doesn't contribute, no problem with that.

I do have a problem if you're going to contribute a match into a 401(k) at the same time you're allowing an individual to earn a pension plan that is either defined dollar benefit or a cash value plan. That is double dipping. That's not one cone. That's two cones. That's whatever you want to call it, but it's two pension plans.

You're allowing -- and you're just saying that it's market competitive, and that's how you're justifying it, and I'm saying that you show me an industry outside the utility industry that allows people to earn two pension plans, and I'll show you something that exists on a very minute percentage basis because it doesn't exist out there.

I find it exists in the utility industry. I call the utility industry an incestuous industry because you compare against each other, and then it all looks like it's what you've got to pay for market, but you don't have to -- you can argue this hourly craft employee argument because those are very specific, highly valued people that work for you, but when you get into office personnel and the rest of the people who work there, those people don't have such a specialized craft or profession that they can't be found anywhere out in the marketplace, geographically or otherwise, and I don't understand why the company is incurring this greater cost and passing on to the rate payers. I don't see the justification.

A. Well, I disagree that it's greater cost. We are -- our cost is the market competitive cost. We have 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, we have two plans, but they're not creating a value for participants that's any greater than if we 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.

Q. You're matching .75 up to 6 percent?

A. Yes.

Q. Okay. So you've got basically what some plans offer on a 401(k) plan just stand alone by itself because it can be 1 percent maxed on 4 percent or half half, and then another 3 to get the employee contributes 4 and ends -- or 5 and ends up with 4, but at the same time you're permitting earnings on a defined dollar benefit plan or a cash value plan, that those by themselves are a valid pension plan.

How much of the industry in general offers a defined dollar benefit plan? Is it about ten percent? I think that's what it is in private sector.

A. I think it's a little larger than that, but it's certainly been shrinking. It's been 25, 20 percent maybe recently.

Q. So even at 20 percent you're offering a plan that only 20 percent of the general industry offers

in the private sector, and you're saying that you have to offer an additional savings plan besides?
A. I'm saying that the total dollars that the company is contributing to these plans is what our peer companies are contributing. It's actually a little bit less.
Q. I know, and you keep referring to peer companies. It's the utility industry that offers this dual type of incentive to their employees. It's two pension plans. And you're calling it market valued.
A. If you look at -- and so you're not disagreeing, I don't think, that other companies in the utility industry are offering the same pension in total that we're offering, the same market competitive amount. Or you're not disagreeing that we're market competitive relative to the utility industry.
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.
Q. I think what I'm trying to say is in the Commonwealth of Kentucky that utilities should start looking for the rate payers' benefit and saying this

is a reasonable compensation.

Again, I'm not arguing paying market price for salary. I just don't believe that utilities should be overpaying -- what I talked to Mr. Satterwhite about, doubling insuring yourself. What's the turnover rate for Kentucky Power?

A. It's four-ish, three and a half, four, somewhere in there.

Q. Three and a half to four?

A. Three to four, maybe three and a half. I'm not exactly sure, but it's low. I'll agree to that.

Q. It's low, yes. It's low because the benefits that are offered are probably in excess what they need to be, and I continue to argue, and I argued this point, and the Commission has argued this point with all the rate cases that have come before us in recent time about double dipping, having two pension plans.

There's no argument that employees deserve a pension plan. That goes without saying. I don't think any of us on the Commission would disagree that that is a benefit that's enjoyed by a lot of people, not all, but a lot of people, but certainly having the opportunity for two pension plans is considered to be a little excessive. I know you keep saying market, I hear that argument, but I'm not certain that it's valid.

A. So my other point besides it being market is that you certainly can design a pension, or a retirement program that would include both pieces that would be reasonable. I mean, you can have a K plan that didn't have a match, or you could have a pension plan with a very low contribution rate. They both have benefits to customers.

The K plan encourages employees to save because we know that the company's 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.

The pension plan is managed by the company, and the employee doesn't have the investment risk. And that pension plan takes that investment risk away. We're able to do it much more efficiently and without taking on much risk ourselves when it's fully funded, so that --

Q. Who fully funds it?

A. The company funds it.

Q. Of course.

A.   But I guess what I'm saying is if you were to design this so that you would think it's reasonable, in your view, that the two pieces would be small enough in total that they're reasonable, well, that pension plan has value because employees don't always make the best investment decisions, and they have a lot of control over what they do with those assets when they retire, and they may disappear.

The pension plan solves some of those problems, not all of them, and therefore it's got value that the K plan doesn't have. Both pieces together, we think, are the best way to go for employees.

Q.   So I would agree that a defined dollar benefit plan is the best -- it's obviously the most benefit rich for the employee because a defined dollar benefit plan is just that. It doesn't matter how well the employee makes a decision because it's taken out of his hands.

There's a formula. It's run by the company based on an actuarial calculation. At the end of the day you're going to multiply the formula times earnings, and he's going to have a benefit; is that correct?

A.   That's correct.

Q.   That's correct. So I'm guessing one of the reasons why Kentucky Power decided to first grandfather in employees and then lock and freeze it was because it was an expensive plan, and so they decided to go to something less expensive. Is that pretty reasonable?

A. That's very reasonable.

Q. Yes.

A. That's exactly right. We also saw that the market was moving, and we wanted to move with the market, which is why we made the change.

Q. Uh-huh. But instead of doing what a lot of companies did, which was just eliminate any type of other pension plan and go to a 401(k) savings plan, Kentucky Power has retained, either through a cash value plan or a defined dollar benefit plan, one piece of the pension, and on the other side said, well, people aren't smart enough to invest on their own, even though we're going to allow them to match three quarters of a percent on every percent up to six percent, we don't know how good they'll do or how good the stock market will do, so we'll also going to protect them on the other side.

Go out to the industry and look. How many companies say, well, our employees aren't smart enough to do that, so we're going to have a backup

plan?
A. So what I would suggest, and what I think we actually did, was we looked at where the market was when we put in the cash balance plan for benefits in total, and at the time we froze -- or we froze participation and then we've ultimately froze the benefit from the final hours paid formula, put in the cash balance plan.
We made the decision that in total we're going to design the combination of the two going forward formulas to be market competitive rather than going all one direction or all the other direction.
That to me is not a material difference in terms of cost. It's just the administration. For the customers in Kentucky or anywhere else. It's the same total cost.
Q. Based on a market value that you consider to be cost competitive for your employees that that's what you need to do to maintain a good workforce, and here again, you're valuing it on a valuation to a market that basically at this point is the utility industry, and that's your primary comparison. Is that a fair assessment?
A. It's -- it's one of our comparisons. I'll let Mr. Cooper decide and tell you whether it's our

primary comparison or not. We use several comparisons.
Q. So let's just take one more step and go towards the benefit side, which is the healthcare, and I noticed that the chart that was supplied gave a blended formula on the company cost for different levels of healthcare.
So if you had employee, employee plus spouse, employee plus children, it still had the same value, and can you verify that the company is paying the same rate regardless of whether it's a single or a married with children or whatever, or whether that chart needs to be updated?
A. This would be a great question for Mr. Cooper.
Q. Okay. I'll save that for Mr. Goodwin?
A. Cooper.
Q. Cooper.
A. He's up next.
Q. I'll save that for him.
CHAIRMAN SCHMITT: He can't wait, can he?
Commissioner Mathews, questions?
I have none. Mr. Garcia?
MR. GARCIA: Just a few, Your Honor.
* * *

REDIRECT EXAMINATION

By Garcia:

Q. Mr. Carlin, you had a thorough discussion with Commissioner Cicero, and I wanted to ask you a couple questions about that.

But stepping back for a second, when we are looking at the question of employee benefits, does the company, and when I say "the company," in this case I mean Kentucky Power and the American Electric Power Service Corporation employees that provide services to Kentucky Power. When you look at the market value of total compensation, are you looking only at the benefits portion, only at the incentive compensation portion, only at the wages portion, or are you looking at everything as a whole?

A. We look at everything in total, and we also look at the individual pieces, so our primary benchmark on the compensation side is total compensation, but we also are looking at total cash compensation, which is base pay plus annual incentive. Total compensation also in addition to that includes long-term compensation for higher paid employees, and we look at base salary, so we want to make sure the mix of those elements is reasonable within the market practice and fits the company's needs and that in total the compensation is market competitive.

Q. And one observation that you make, just to clarify the record, when you're talking about market competitive, are you talking only about the market for employees for utilities, or is it a broader market?

A. It's broader. So obviously the jobs that only exist in utility industry you're going to have to benchmark against utility industry because that's the only industry they're in. You won't find line mechanics, for the most part, outside the utility industry.

But admin jobs we benchmark against general industry. That's because we can recruit them from across the street, to Your Honor's point, and so that's why we do benchmark against them, against a broader general industry survey data when we do that.

Q. Okay.

MR. GARCIA: Nothing further, Your Honor.

CHAIRMAN SCHMITT: Mr. Kurtz, questions?

MR. KURTZ: No questions.

CHAIRMAN SCHMITT: Anyone else?

Well, let me ask, we've been going to the Attorney General. Mr. McNeil, do you have any questions?

MR. MCNEIL: I have a few follow up, Your Honor.

CHAIRMAN SCHMITT: Okay. Then Mr. Gardner, we'll let Mr. Gardner go after you do.

RECROSS-EXAMINATION

By Mr. McNeil:

Q. Mr. Carlin, as a general proposition are wages rising 3 percent in Kentucky Power's service territory?

A. So when we talk about the wage increases I'd say yes, wages are -- for salaried employees are going up 3 percent. There is attrition in the marketplace, so when you talk about the general rate of wage increases, it goes up by something less than that amount, and we've been moving our salary structure by two percent. That's -- that's very common practice of among companies in our industry and outside our industry.

Q. Well, specific to the Kentucky Power territory, what do you base that on?

A. Survey information for wage increases in general. I don't have a lot of survey information on specific positions for Kentucky because Kentucky doesn't have enough companies in our surveys that we use to have a Kentucky only cut, so -- and in addition, we are in 11 states, 18,000 employees, and it is a problem when we have rates that are at different levels in different locations.

Our line mechanics, for instance, have been to, you know, they work in Kentucky, they've been to Maine, they've been to Texas, they've been to Florida, all in the last few months. We -- you know, it can cause issues. Our labor unions are negotiating with us to standardize our rates across our service territories, and we're working towards that.

Q. Would you be able to provide in a post-hearing data request that info that you have for the 3 percent -- wages are rising at a rate of 3 percent in this territory, in your service territory?

A. I think I said that the wages -- the wage -- I'm sorry, the salary increase budgets tend not to vary, and so I don't know that I have a Kentucky cut for that, but they've been very consistent throughout the U.S. by location and by industry as well, so I don't know that I have a Kentucky cut of that, but they've been consistently 3 percent. It's almost a foregone conclusion at this point.

Q. So what about in Hazard in Perry County, do you

think that holds true there?
A. For salaried employees, yes, I do. There may be more attrition, maybe the wages in general are going down in Hazard if population is shrinking because people are leaving Hazard, but those people that have jobs for the beginning of the period and the end of the period that we're talking about here, their salary increased budget for those companies probably was 3 percent. Not been a lot of variance around that.
Now, you know, any one company or any group of companies it could be different, but you get a statistically significant sample, they all seem to show 3 percent.
Q. Do you have a study that shows a sample like that that you're talking about to support this?
A. There are many studies. I don't have one specific to Kentucky. I'm using some of my general knowledge here to having looked at these studies throughout the years, and for the last number of years it's been 3 percent with very little variance, if any, by industry or geography.
Q. But hasn't the information in this case, testimony, studies, documents shown that Eastern Kentucky is not like the national trend, the national

average? Isn't it different in that it's not increasing in the same way?

A. Well, as I explained, the wage increase budgets of the companies in Hazard, it's a different thing from the wage level or the average wage level for any position, say welder or something like that in Hazard. Those are two different -- those are apples and oranges.

The companies in Hazard, if they're -- if it's a significant sample, statistically significant sample, I should say, they're probably following the trend throughout the U.S., which is 3 percent.

Q. I'm not trying to do apples to oranges here. I just mean as a general proposition you still think 3 percent is what that entire area is --

A. For the wage and increase budgets, which again is different from general wage levels, yes, I do.

MR. MCNEIL: That's all the questions we have, Your Honor.

CHAIRMAN SCHMITT: Mr. Gardner?

MR. GARDNER: Thank you. Thank you, Your Honor.

CROSS-EXAMINATION

By Mr. Gardner:

Q. Mr. Carlin, I just have a couple quick questions. How many of the 30,000 commercial customers in the Kentucky Power territory do you think can afford a pension plan or pension plans as generous as Kentucky Power's?

A. I have no idea.

Q. How many of the 30,000 commercial customers can even afford one pension plan in Kentucky Power's territory?

A. Again, I would have no idea.

MR. GARDNER: Okay. Thank you.

CHAIRMAN SCHMITT: Staff, questions?

MS. VINSEL: Nothing further.

CHAIRMAN SCHMITT: Commissioner Cicero?

REEXAMINATION

By Vice-Chairman Cicero:

Q. Just one other. In your testimony on page 21, you talked about steps to control compensation expense in light of the great recession and weak recovery, and there was a list of about 1, 2, 3, 4, 5, 6 items, okay?

As a post-hearing data request, can I have those dollarized to see what the cost savings or what the company actually ended up saving through these programs, through these efforts?

A. Unfortunately, I don't know that there -- we can get a dollarized amount for each of these. A lot of these programs were in years past that that information may never have been collected or may now be lost.

Q. Well, I understand that you go back to 2008 and 2009, which I think stretches the whole process, but it does say in light of the great recession, which did start in 2008, but there's items like reduce the employee workforce through staff reduction and severance programs, implemented efficiency measures such as Lean and other continuous improvement initiatives.

Those types of programs I would have thought as part of the corporate culture there would have been some dollarization in order to go back to management and say we implemented these programs, and here's the dollar savings associated with it.

A. There undoubtedly was at one point in time. Those may have been local management, not collected at a central location, especially the Lean programs. There's been many, many Lean initiatives, two or three in the HR department, for instance, over that long period. I don't know that those have been aggregated in a central location that I'd be able to provide to you the dollar impact.

Q. So how does Kentucky Power manage their costs if they don't somehow have an overview of savings programs or a way to go back to management to review whatever those savings that are associated with these type of initiatives? How can management determine whether they're doing effective job or not unless there's some kind of review?

A. Well, I didn't say there wasn't a review. I think there probably was at some point in time. Whether that information has been collected and aggregated in a central place that's now accessible to me is a much different question, and I don't think it probably is.

It may be that management knew that, for instance, we had the integrated disability center in the HR department went through a process improvement as part of the Lean initiative, and those budget dollars were baked into the budget two or three years ago. Don't know what that -- and that was -- it was implemented, we got the savings, the budget year went on, and I don't know now whether that's information is accessible.

That's one, that one probably is because it's in the HR department, but there may not be somebody at the corporate center that collected all the different initiatives from all the different departments and to be able to provide you a total.

Q. Let me approach it from the other direction. Typically when a program is implemented there's a target that says this is what we expect to achieve through this program, this initiative. Do those target dollars exist that are associated with this?

I mean, only reason why I'm asking is because from a managerial standpoint one of the worst things that I hate to see personally is when savings are referenced with no dollars, and I call them foo-foo dollars. They make things look good, but there's nothing to substantiate them, and it's always nice to have something that goes along with it that says, you know, we had savings, here's what our target was. I always like to see them make good on it, but this is what we actually achieved, but somewhere a measurement process that says we were successful, unsuccessful, this is we were trying to do, but shows an approach by the organization to reach some target.

A. So the Lean initiative is an example. A lot of -- and some of those had very explicit targets that were probably achieved. Others did not. They had sort of save ourselves targets.

If we've got 40 percent more work than we can

really handle in our integrated disability center, and we can cut 30 percent of that out, we're cutting back nonexempt overtime, which is not paid overtime, so there's no dollar savings, but that process improvement enables us to get our work done without being there till 8:00 o'clock every night, and that's a huge improvement on company culture.
Q. But this specifically says take into control compensation expense. This wasn't an efficiency list. This was a control compensation expense list.
A. And many of the Lean initiatives were. The one example I just used was not, I'm sorry, but I still don't know that those have been collected in a central location. In fact I don't believe they have. You are not the first one to ask.
Q. Well, how about making an attempt to see what you can do?
A. I shall do so.
Q. Thank you.
CHAIRMAN SCHMITT: Commissioner Mathews?
I have none.
Mr. Garcia, any follow-up?
MR. GARCIA: Nothing further, Your Honor. Thank you.
CHAIRMAN SCHMITT: Any questions from anyone

else? If not may, this witness be excused?

MR. OVERSTREET: Yes, Your Honor.

CHAIRMAN SCHMITT: Like to call your next witness?

MR. OVERSTREET: Our next witness is Mr. Cooper, and Mr. Garcia will present him.

CURT D. COOPER, called by the Kentucky Power Company, having been first duly sworn, testified as follows:

DIRECT EXAMINATION

By Mr. Garcia:

CHAIRMAN SCHMITT: Please be seated. Mr. Garcia, you may ask.

MR. GARCIA: Thank you, Your Honor.

Q. Would you please state your name and business address for the record?

A. My name is Curt D. Cooper, business address 1 Riverside Plaza, Columbus, Ohio, 43215.

Q. By whom are you employed and in what capacity?

A. American Electric Power Service Corporation, and I'm the director of employee benefits.

Q. Mr. Cooper, did you cause in this case rebuttal testimony to be submitted consisting of five pages of questions and answers?

A. Yes.

Q. And if -- was that prepared by you or under your supervision?
A. Yes.
Q. And if I were to ask you the same questions today, would you provide substantially the same answers?
A. Yes.
Q. Do you have any changes or additions to your testimony?
A. No.
Q. Did you also provide answers to discovery requests?
A. I did.
Q. And do you adopt your rebuttal testimony and the answers to your discovery questions as your evidence in this case?
A. Yes.

MR. GARCIA: Your Honor, the witness is tendered for cross.

CHAIRMAN SCHMITT: Mr. Kurtz, any questions?

MR. KURTZ: No, sir.

CHAIRMAN SCHMITT: Counsel for any of the settling intervenors have any questions for this witness? If not, Mr. Chandler, Mr. McNeil, any questions?

MR. CHANDLER: The AG does not have any cross for this witness.

CHAIRMAN SCHMITT: Mr. Osterloh or Mr. Gardner?

MR. GARDNER: No, Your Honor.

CHAIRMAN SCHMITT: Staff, questions?

MS. VINSEL: We do have just a few questions.

CROSS-EXAMINATION

By Ms. Vinsel:

Q. Also I'm going to hand out the filing that the Vice-Chair was just referring to. I will explain as I'm going along. This will not be introduced as an exhibit. This is a schedule that was filed into the record.

A. Thank you.

Q. This is an updated schedule of a schedule that was originally filed, Mr. Cooper, by you and Mr. Ross. Its updated version was filed only by Mr. Ross in staff's fourth data request.

I'll give you a minute to look at it. And this is a printout of an Excel spreadsheet.

A. Okay.

Q. If you look at, it's column number 3 called Blended Funding. It's underneath where it says Expected 2017 Employee Medical Benefit Cost.

A. Uh-huh.

Q. So that where you see -- let me give you example, lines 3 through 6. Employee only, the blended funding is $1,338.10. For employee and spouse, same amount. Employee and children, same amount. Employee and family, same amount.

So in this case it looks like Kentucky Power pays the same amount no matter if it's a single employee, an employee and his spouse, an employee and children, or an employee and family. And that continues through other of the entities -- other of the plans.

A. So, sorry, could you repeat the question then?

Q. So does in fact -- is there blended funding -- does Kentucky Power pay the same amount, for example, under the Anthem HRA, for a single employee as for an employee and the employee's family?

A. No, that's not the way it works. And because I didn't put together this chart I'm not sure exactly where all the numbers were derived, but I can tell you, describe in general the process that AEP uses to calculate employee contributions for medical coverage.

And so the starting point is we work with our actuaries to predict what the costs are going to be for our medical plans, and we have three different medical plans, so we predict costs for all three of the different plans, and then based on that overall cost we divide that by the number of employees that work for the company to get a per employee cost. But then we change that cost based on the coverage level of the family group, so an employee overall cost is going to be lower than, say, a family cost.

And once we get those tier rates, then we apply a percentage to that rate, and let's say the single rate, let's just say it's a thousand dollars. Then we apply a percentage to that overall thousand dollar rate to determine what the company will contribute towards that cost.

And, for example, for the HRA plan the company contribution is about 76 percent. So that would mean that the company would contribute $760, whatever is left over is what the employee would contribute, but we don't use the thousand dollars for all four tiers, so for a family it would be three times the thousand. But the same methodology is used for all of the different tiers.

Now that's the HRA plan. It's our starting point. What we have decided to do as a company and what we've done historically is that we've taken a plan that we see as the target plan, and that's the plan that has the sort of the broadest level of coverage, and we determine our subsidy based on that plan.

And then we contribute the same dollar amount towards the other two plans that we have. So we have three plans. They're all consumer-driven plans. We moved to all consumer-driven plans in 2016, so we do not have a traditional medical plan anymore.

We have three consumer-driven plans, and the way the -- because the -- well, the HRA plan is the target plan, and of the three plans that's the closest one to a traditional plan. We moved away from a PPO type plan, so the HRA is the closest to the plans we used to have. That's the most expensive plan. The company subsidizes a piece, and then the employee covers the rest.

Then we have two what we call health savings account plans, and under those plans, both of those plans, the deductible is higher, so that means the total overall cost for those plans is lower.

What we do as a company, though, is that we normalize our subsidies, so the same subsidy we provide to the HRA plan we provide to those two HSA plans, and we think that's fair because that results in a lower employee contribution for those plans.

So they're trading off a lower employee premium for probably more out of pocket. So that at high level is how we run through the methodology for coming up with both the company subsidy, as well as the employee contribution.

Q. Thank you. That was helpful in clarifying.

I will be asking for a post-hearing data request, but I will reserve it until Mr. Ross is on the stand.

A. Okay.

Q. And on a topic that gets to what Mr. Carlin was recently testifying to, in your rebuttal testimony in your responding to one of the Attorney General's witness recommendations to exclude certain retirement benefit costs, and in that testimony you distinguished Kentucky Power's retirement plans from -- there were some reductions in -- disallowance of portions in three other cases involving utilities, Kentucky Utilities, Louisville Gas & Electric, and Cumberland Valley.

Could you speak to that, and why, why you say that the Kentucky Power plant is not duplicative?

A. Sure, be happy to. So let's take, for example, the Cumberland Valley plan. Our understanding was that Cumberland Valley had both a defined benefit pension plan and a 401(k) plan.

With respect to the defined benefit plan, Cumberland Valley's company contribution towards that benefit was a little bit north of 30 percent, so that was the company's contribution to the defined benefit pension plan.

They also had a 401(k) plan. The information we had didn't describe what the match was there, but let's just take the 30 percent. So we compare that to AEP's contribution to both our cash balance pension plan and our 401(k) plan, and if I could, I think witness Carlin did a fine job of describing general terms how the plans work, but I think I'm a little bit more familiar, so let me try to fill in a few blanks.

So let's start with the cash balance plan first. The way that contribution works is it's based on employee's age and years of service with the company, and it can be as low as 3 percent for the younger new hires with the company, and it can go up to 8 and a half percent on the high end, so that's the most for the long service older employees, that's the most that contribution can be for the cash balance plan. So that's our cash balance plan.

Now let's move over to the 401(k) plan because as Andy was -- Mr. Carlin, sorry, was referring to, we sort of have a swirl here. We have vanilla and chocolate. So if we say the vanilla is the pension plan, now we'll talk about the chocolate.

The chocolate would be the 401(k) plan, and the company contribution there is based on what an employee contributes. So if an employee contributes 1 percent, say the company matches 1 percent all the way up to 6 percent. If the employee puts in 6 percent the company will match 4 and a half.

So if you look at the top end of both of those contributions, the 8 and a half percent for the cash balance, defined benefit pension, and I apologize for all the terms, plus the 4 and a half percent 401(k) contribution, you can see that in total the maximum the company would contribute, and this again would be for the longer service employees who are maxing out on their 401(k), would be 13 percent. So you compare that 13 percent to the 30 percent for Cumberland Valley, and it's pretty apparent that their benefit was significantly higher than ours.

So let's move over now to the Kentucky Utilities and the LG&E case. Now they're a little closer to what we have. Our understanding is that for a group of employees they did have a defined benefit pension that they made a contribution to.

They also had a 401(k) plan, but unlike AEP where we make one contribution based on what the employee contributes, those companies had two contributions. And so the first contribution was not based on what the employee contributed, and that could be between 3 and 7 percent, and that was strictly a company contribution in the plan for them.

They also had a 401(k) match component, and the maximum match, if an employee contributed 6 percent the company would match it 4.2 percent, I believe, was the max.

So again, if you look at the contribution amounts, and let's just look at the 401(k) contribution amounts. On the low end it's 3 percent and 4.2, so 7.2 percent. On the high end it could be 7 percent plus the 4.2, so that's 11.2.

So you can see that those percentages are close to what AEP's contributing under both our 401(k) and our pension, and that doesn't even factor in what Kentucky Utilities and LG&E were contributing towards the pension plan. We didn't have that information on their contributions immediately available, but it wouldn't take much of a contribution at all for them to significantly exceed what AEP is doing.

MS. VINSEL: We have no further questions.

CHAIRMAN SCHMITT: Mr. Cicero?

EXAMINATION

By Vice-Chairman Cicero:

Q. So I want to make sure that I understand your last explanation. It was good to compare to Cumberland Valley and LG&E and KU, obviously Cumberland Valley was out somewhere, I'm not even sure where they were.

Right now you've got a savings plan or a dollar savings plan that basically has taken the place of your defined dollar benefit plan.

A. I wouldn't say taking the place. I'd say it's the defined benefit plan in conjunction with the 401(k) provide a reasonable retirement benefit in total.

Q. Let me restate it. You have a defined dollar benefit plan that's locked and frozen as of 2010; is that correct or not correct?

A. Well, we have two formulas under the defined benefit plan.

Q. You guys get me right to the edge, and then you always say but.

A. Apologize for that. It's the benefit director full employment act: If we make these benefits complicated enough I always have a job.

So the old plan that we used to have was what we called a final average pay plan, and that plan was your traditional defined dollar benefit plan. And so the way that formula worked is if you looked at the employee's compensation in their last three years of employment, and then you applied a formula percentage to that, and because the last three years typically were their highest earning years, that created a benefit. So that's formula number one under our defined benefit program.

Q. Typically based on years of servicer determined the factor.

A. Right. Right. So that formula was frozen. No new employees were allowed into that program after 1/1/2001.

Q. Okay.

A. But between 1/1/2001 and 12/31/2010 we continued to run that formula.

Q. Uh-huh.

A. Then at the end of 2010 that formula was, as you say, frozen, so additional service after 2010 did not change the amount of that benefit. So that benefit is frozen as of the end of 2010.

The other benefit that we have, the one that I described the contribution can be between 3 percent and 8 and a half percent, that formula is still running, so that -- that formula is not frozen. That one is still, it still lives on, but the old final average pay formula is frozen.

Q. So I'm an employee that's hired after 2001. My service year is 2003. I never qualified for the defined benefit plan in its traditional form.

A. Correct.

Q. I only qualified for a dollar savings plan; is that correct? The 3 percent to the 8 and a half percent.

A. That's right.

Q. That's all I qualified for.

A. Dollar savings plan will work, yes.

Q. Okay. So I get 3 to 8 percent. In addition to that I can save an additional three quarters of a point up to 6 points as a company match. I can put in more than that, but the company is only going to match 4 and a half percent of whatever it is.

A. Right.

Q. So the two of those, if I'm employed -- if my employment service date is 2003 is 4 and a half percent, and if I hit my years of service it puts me at 8 percent, so I think you explained that these are

12 and a half to 13 percent or something?
A. Yeah, on the top end it's actually 8 and a half percent, so the 8 and a half and 4 and a half would get you to 13.
Q. Okay. I understand that piece. You can call that one cone, whatever, that's fine.
Now let's go back to the defined dollar benefit plan. My service year is 1995, okay, so now I'm in the old plan, I'm grandfathered through to 2001 cutoff date that doesn't mean anything, and I make it all the way up to 2010.
A. Yes.
Q. So in 2010 I've got 15 years of service under defined dollar benefit plan.
A. Yes.
Q. Okay. What happens? Where do I go to from there? What plan do I fall into?
A. At the end of 2010 you -- and now let's say you would retire, you want to retire in 2015, so in 2015 you'd become eligible for your defined benefit pension.
Q. Fifteen years of service, and the calculation is based on 15 years of service, and the average is three years at the 2008, '9, '10?
A. That's right, that's right. So here you are in

2015, so you've got that benefit under the final average pay, you described very well what that amount would be. You've also since your date of hire, which we -- well, the cash balance formula, we started running that in 2000.

Q. Okay.

A. So since 2000 you've also been accruing a benefit under the cash balance plan, that 3 percent to 8 and a half percent. So we contribute an amount into your account every year based on those contribution amounts, and then in 2015 when you retire we compare what that amount has grown to with what your old final average pay benefit was. Based on your 2010 date was when we locked in what that benefit amount was going to be, so we compare your 2010 final average pay benefit with your 2015 cash balance benefit. Whichever one of those is higher, that's what you're going to receive.

Q. And you will also receive whatever the balance is in your 401(k) that's accrued through your retirement date.

A. That's correct, yes.

Q. So you're not making a contribution into -- you're not making additional contributions -- you're not making an actuarial calculation into the plan,

other than for what's determined to pay the benefits for employees up through 2010, which has already been actuarial calculated, and it should be minor.
A. Right.
Q. Shouldn't be much of a contribution into that plan whatsoever.
A. A contribution to cover that benefit, yes.
Q. Right. Because actuarially you should have already been -- I know there's -- no actuarial calculation is guaranteed, so I know there's going to be fluctuations, but it should be minor fluctuations.
A. Right.
Q. And then after that it's the cash value, which is a pretty straightforward number, and whatever the contribution is that is the match.
A. That's correct. And that dynamic is what Mr. Carlin was describing. The final average pay formula for a subset of employees has resulted in a higher benefit even up to the present day, so even though an employee is not accruing any more after 2010, for Mr. Carlin, and just so happens myself and I think about 1,500 employees, that final average pay benefit is still the winning benefit.
So what that really means is from an actuarial perspective, from 2010 to now there's no additional

actuarial cost because we already accrued that back in 2010.

Q. Okay. So thank you for that explanation.

A. You're welcome.

Q. Now let's go to the blended formula that you've got here in healthcare. So I think the data request that was made --

VICE-CHAIRMAN CICERO: You asked for a data request; is that right?

MS. VINSEL: Yes.

Q. Requested a -- there was a spreadsheet requested to be filled out that lists the total cost for the company, the total cost for the employee by class, and I understand when we've done this with the smaller utilities they list it by employee, but I understand with the number of employees you have that's too difficult to do, so in the LG&E KU case they did it by employee class.

A. Okay.

Q. But it's still broken out by inside those classes what the coverage level is, whether it's single, employee and family. In your case you've got four different levels.

A. True.

Q. So the way you've presented it here, it

distorts the true contribution made by the employee because if I look at your target class, which is HRA --
A. Yes.
Q. -- it looks like the employee only is contributing 10 percent, and the employee plus family is contributing 30 -- 33 percent, but if I drop down to the next one it's 7 and 22, and the next one it's 3.3 and 10, but I'm pretty certain that if I looked at employee plus family, that blended rate, if I actually had the actual rate, would be much higher than 1,338, and the contribution that the employee is making to that on a family basis would be lower, and the employee only would be higher; is that correct?
A. That is correct, yes.
Q. So can I have those numbers so that I can see -- it looks like you don't have -- you've got 513 employees, doesn't look like it should be that difficult to split out what's associated by those classes and those, because your premium has to identify it.
A. It does, yes.
Q. Okay. Post-hearing data request?
A. Yes, absolutely.
Q. Thank you.

VICE-CHAIRMAN CICERO: I don't have any more.
CHAIRMAN SCHMITT: Mr. Mathews?
I have none. Mr. Garcia?
MR. GARCIA: Just one, Your Honor. Thank you.

REDIRECT EXAMINATION

By Mr. Garcia:
Q. Mr. Cooper, if you could explain in the context of what you are talking about a second ago, how do the HSA deductibles work and affect that calculation that you were talking about a second ago?
A. In Mr. Carlin's testimony, direct testimony, he -- we provided an exhibit, and that is exhibit ARC-10, and the third and fourth pages is where we weigh out -- is where he we lay out the plan design for the three plans that we offer: HSA Basic, HSA Plus, and the HRA plan.
So with respect to the HSA Basic plan, that as the name implies is our sort of basic low level plan, and for that particular plan there is a $2,700 deductible for single coverage, and that amount can go up to $8,100 if it's full -- if it's a full family tier. So what a deductible means is that is what the employee has got to pay out of his or her pocket before the plan will provide any benefit, so that's the HSA Basic.

With respect to the HSA Plus, the reason we call that a plus plan is because the company does make a small contribution towards the health savings account for the employee that helps them meet their deductible, but with respect to the HSA Plus, the deductible can go from 2,000 for a participant up to 4,000 for a participant and family.

Then the last plan is the HRA Plan, and that particular plan for single coverage, the deductible is $1,500. That goes up to 3,000 for family. Now with the HRA plan as well the company does make a contribution into the HRA account for the employee, and that amount varies from 1,000 to 2,000, so those are the deductibles.

As I mentioned, we moved to this approach in 2016. The idea was for us to increase the amount of deductibles, which in turn would make the employees more prudent with respect to their healthcare usage because they're going to be paying for the first portion of their costs, in effect out of their own pocket because of the application of the deductible. So we moved to that approach in 2016.

Another significant change we made in 2016 was we combined our vendors. We had two vendors previously. We had Aetna and Anthem, and we combined all of our coverage through Anthem, and as a result of that change as well we were able to reduce the admin fees because Anthem gave us additional discounts based on the higher volume, and that savings roughly was in the $8 million range annually, so the net effect of moving to the new plan design, as well as consolidating our vendors actually allowed us in 2016 to achieve a per person medical cost that was slightly below what we saw in 2015.

And that's significant when you talk about medical plans because medical plan inflation has been increasing five to six percent a year, sometimes more in a given year, so for us actually to reduce our cost slightly was a significant achievement, and I think it does speak to our broader approach, which is to continuously look for cost savings opportunities with respect to all of our benefit programs, and we focus a lot on medical because a significant portion of our benefit dollars is incurred under the medical plan, so I think that's an example of that.

MR. GARCIA: Nothing further, Your Honor.

CHAIRMAN SCHMITT: Mr. Kurtz?

MR. KURTZ: No questions.

CHAIRMAN SCHMITT: Counsel for any of the other parties wish to ask any additional questions of this witness?

MR. CHANDLER: Can I just ask one?

CROSS-EXAMINATION

By Mr. Chandler:

Q. The $8 million number that you just cited, that was a savings to AEPSC?

A. That was actually savings to the medical plan itself, and the medical plan costs are spread amongst all of the subsidiaries, so a portion of that savings would have flown through to Kentucky Power.

Q. And is that evidenced anywhere in the record as a reduction to a specific amount or a specific allocation?

A. We talked about in the -- in Mr. Carlin's testimony we referred to that total dollar amount of savings that I mentioned, the per person savings under the medical plan was about 13,000, so we did mention that in the testimony.

Q. I guess I just want to ensure that the savings -- that it wasn't a savings to -- is there any evidence that would show that it was a savings ultimately to Kentucky Power, that there was any savings ultimately to Kentucky Power pursuant to that?

A. Nothing that I provided in the case would

provide that evidence.
Q. Do you know if there's any evidence outside of the case that might provide that?
A. I'm not sure about that. I think, as Mr. Carlin indicated, we tend to be more focused on the design of the plans and the structure. With respect to the exact dollar amounts, we might want to -- you might want to ask witness Ross when he takes the stand. He might be able to show that.
MR. CHANDLER: No other questions.
CHAIRMAN SCHMITT: Anyone else have any questions?
MR. GARCIA: Nothing further, Your Honor.
VICE-CHAIRMAN CICERO: Yes, I do.
CHAIRMAN SCHMITT: Commissioner Cicero.

REEXAMINATION

By Vice-Chairman Cicero:
Q. So you were asked if -- you were asked about the different plans, and you mentioned that there's a contribution made by the company in the form of is it a debit card, or what do you give them to help them with their deductible?
A. So we establish an account for them and we contribute money into an account.
Q. So when you provide the company cost, that

should be included as company costs on the medical side because that's a medical expense to the company. You're contributing to the deductible, so please include that in your --
A. That's true. okay.
VICE-CHAIRMAN CICERO: Thank you.
MR. GARCIA: Actually if I may, a quick redirect on that very point.

REDIRECT EXAMINATION

By Mr. Garcia:
Q. Mr. Cooper, if you would indicate are the premium that the employees pay for these plans affected by the question that you just described?
A. Yes. So when we calculate the amount of the employee premium, we calculate what both the claims cost is projected to be as well as the administrative costs, so we add all those costs together, come up with a total, and then the premium is a based on -- or the contribution is based on that.
MR. GARCIA: Thank you, Your Honor. Nothing further.
CHAIRMAN SCHMITT: If there's nothing further, may this witness be excused?
MR. OVERSTREET: Yes, Your Honor.
CHAIRMAN SCHMITT: Thank you. You may step

down.

All right. We're now at almost 6:00 o'clock, so we will recess until tomorrow morning at 9:00 a.m.

MR. OVERSTREET: Thank you, Your Honor.

(Hearing adjourned at 5:58 p.m.)

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STATE OF KENTUCKY)
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) SS.
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COUNTY OF JEFFERSON)

I, Jennifer R. Janes, a Notary Public within and for the State at Large, my commission as such expiring 1 May 2019, do hereby certify that the foregoing hearing was taken at the time and place stated and for the purpose in the caption stated; that the witnesses were first duly sworn to tell the truth, the whole truth, and nothing but the truth; that the hearing was reduced by me to shorthand writing in the presence of the witnesses; That the foregoing is a full, true, and correct transcript of said hearing; that the appearances were as stated in the caption.

WITNESS my hand this 14th day of December 2017.

____
Registered Professional Reporter
Certified Realtime Reporter
Notary Public, State at Large