COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

GENERAL ADJUSTMENTS OF ELECTRIC RATES OF KENTUCKY POWER COMPANY	))	CASE NO. 2005-00341

O R D E R

Kentucky Power Company ("Kentucky Power"), a wholly owned subsidiary of American Electric Power Company, Inc. ("AEP"),[1] is an electric utility that generates, transmits, distributes, and sells electricity to approximately 175,000 consumers in all or portions of 20 counties in eastern Kentucky.[2]

BACKGROUND

On August 26, 2005, Kentucky Power filed a notice of its intent to file an application for approval of an increase in its electric rates, utilizing a historic test year ended June 30, 2005. On September 26, 2005, Kentucky Power tendered for filing its application seeking an increase in revenues of $64,796,239, an increase of 19.21 percent. Kentucky Power's application included new rates to be effective October 27, 2005 and proposals to revise, add, and delete several tariffs applicable to its electric service.

[1] AEP is an interstate public utility holding company that principally operates in portions of Arkansas, Indiana, Kentucky, Louisiana, Michigan, Ohio, Oklahoma, Tennessee, Texas, Virginia, and West Virginia.

[2] The 20 counties are Boyd, Breathitt, Carter, Clay, Elliott, Floyd, Greenup, Johnson, Knott, Lawrence, Leslie, Letcher, Lewis, Magoffin, Martin, Morgan, Owsley, Perry, Pike, and Rowan. Kentucky Power also furnishes wholesale electric service to the cities of Olive Hill and Vanceburg.

A review of the application revealed that it did not meet the minimum filing requirements set forth in 807 KAR 5:001, Section 10, and a notice of the filing deficiencies was issued. Kentucky Power subsequently amended its application to cure the filing deficiencies. The Commission's October 26, 2005 Order determined that Kentucky Power's application as amended satisfied the minimum filing requirements and the application was accepted for filing as of October 11, 2005. In its November 3, 2005 Order, the Commission determined that the earliest date that Kentucky Power's proposed rates could be effective was November 10, 2005. That Order also determined that an investigation would be necessary to determine the reasonableness of Kentucky Power's request and the proposed rates were suspended for 5 months from their effective date, pursuant to KRS 278.190(2), up to and including April 9, 2006.

Kentucky Power's last increase in rates was authorized in December 1984 in Case No. 9061.[3] Kentucky Power's last rate application was Case No. 1991-00066,[4] which proposed a reduction in base rates. That case was resolved in October 1991 when the Commission adopted a unanimous settlement agreement which provided for greater rate reductions than Kentucky Power had proposed.

The following parties requested and were granted full intervention: the Attorney General of the Commonwealth of Kentucky, by and through his Office of Rate Intervention ("AG"), the Kentucky Industrial Utility Customers, Inc. ("KIUC"), the

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[3] Case No. 9061, General Adjustment in Electric Rates of Kentucky Power Company.

[4] Case No. 1991-00066, Application for Adjustment of Electric Rates of Kentucky Power Company.

Kentucky Cable Telecommunications Association ("KCTA"), and the Kentucky Association for Community Action, Inc. ("KACA").

On November 3, 2005, the Commission issued a procedural schedule to investigate Kentucky Power's rate application. The schedule provided for discovery, intervenor testimony, rebuttal testimony by Kentucky Power, a public hearing, and an opportunity for the parties to file post-hearing briefs. Each of the intervenors filed testimony and Kentucky Power filed rebuttal testimony.[5]

On February 6, 2006, Kentucky Power, the AG, KIUC, KCTA, and KACA entered into a unanimous Settlement Agreement, which addressed and resolved all issues pending in the rate case. The Settlement Agreement was filed at the start of the hearing held on February 7, 2006. After taking public comment, the parties presented testimony in support of the reasonableness of the Settlement Agreement. Kentucky Power filed responses to hearing data requests on February 17, 2006.

On March 1, 2006, an informal conference was held to discuss several issues related to the Settlement Agreement and Kentucky Power's February 17, 2006 data response.[6] As a result of the informal conference discussions, the parties filed an Addendum to the Settlement Agreement on March 3, 2006 ("March Addendum").[7] All

[5] The Commission notes that while the AG also filed rebuttal testimony, neither the initial procedural schedule issued on November 3, 2005, nor the amended procedural schedules issued on November 23, 2005 and December 19, 2005, authorized intervenors to file rebuttal testimony.

[6] See Commission Staff's Notice of Informal Conference dated February 23, 2006.

[7] The March Addendum is attached to this Order as part of Appendix A.

information requested at the informal conference has been filed and the case now stands submitted for a decision.

SETTLEMENT AGREEMENT

The Settlement Agreement, attached as Appendix A to this Order, reflects a unanimous resolution of all issues raised in this case. The major provisions of the Settlement Agreement are as follows:

- Effective for the first billing cycle of April 2006, Kentucky Power's annual revenues should be increased $41 million.

- Kentucky Power will retain its environmental surcharge tariff. $28,106,683 in environmental surcharge costs will be removed from Kentucky Power's monthly environmental surcharge filings and will be recovered through Kentucky Power's base rates.

- Kentucky Power's System Sales Clause for its off-system sales margins will continue, but with the following modifications. First, the off-system sales margins reflected in base rates, the "baseline," will be increased from $11,315,336 to $24,855,326. Second, the sharing of the difference between each month's actual off-system sales margin and the monthly baseline will be shared 70 percent to ratepayers and 30 percent to Kentucky Power. Currently, this difference is shared 50 percent to ratepayers and 50 percent to Kentucky Power. Third, if the annual off-system sales margins in any 12-month period, starting April 1, 2006, exceed $30 million, the monthly off-system sales margins in excess of $30 million for the remainder of the 12-month period will be shared 60 percent to ratepayers and 40 percent to Kentucky Power.

- Kentucky Power will continue to use the depreciation rates approved in Case No. 1991-00066 to calculate its annual depreciation expense.

- A Home Energy Assistance Program ("HEAP") account will be created and funded by a $0.10 per month charge on residential customer's bills, which will be shown as a separate line item on the customer's monthly bill. The HEAP funds will be credited to the monthly bills of customers qualifying for the HEAP, through KACA, pursuant to an agreement with KACA which will cap administrative fees at 10 percent. Kentucky Power will match the residential contributions to the HEAP account for a period of 2 years following the approval of the Settlement Agreement, with no further obligation following the initial 2-year period.

- Kentucky Power will design tariffs that will generate the additional $41 million in retail rates. In designing these tariffs, the revenue requirement will be allocated among the customer classes in accordance with the revenue allocation specified in Attachment 1 to the Settlement Agreement.[8]

- The proposed Net Congestion Recovery Tariff will not be implemented and the proposed Tariff States Issues Settlement will be renamed and implemented as the Tariff Capacity Charge.

- Kentucky Power will allow industrial customer participation in the PJM Economic Demand Response Program for a period of 1 year. The program is to be revenue neutral for Kentucky Power as well as other customer classes. The March Addendum clarifies that the Settlement Agreement provides only a framework for participation, and that further discussions and negotiations between Kentucky Power and eligible industrial customers will be necessary. The March Addendum further provides that the PJM Economic Demand Response Program can be implemented in Kentucky only through the filing of an application for Commission review and approval, and that such a filing will be made only if and when an eligible customer elects to participate in this program.

- Numerous proposed changes to the non-rate terms of several existing tariffs will be implemented as proposed, including the modified bill format, the offering of an Average Monthly Payment Plan option, and reducing the line extension that will be made without charge from 2,500 feet to 1,000 feet or less.

ANALYSIS OF THE SETTLEMENT AGREEMENT

Kentucky Power initially proposed an annual increase in its electric revenues of $64,796,239, and subsequently revised its request downward to $61,119,336, an annual increase of 18.12 percent.[9] The AG proposed an annual increase in Kentucky

[8] The retail rates as agreed upon by the parties are attached as Appendix B to this Order.

[9] See Application, Section V, Schedule 1, and Wagner Rebuttal Testimony, Rebuttal Exhibit EKW-3, page 1 of 90.

Power's electric revenues of $15,095,832,[10] while KIUC proposed an annual increase of $25,924,000.[11] Neither KCTA nor KACA proposed a specific amount for an annual increase in total electric revenues. The Settlement Agreement contains the parties' unanimous recommendation that an annual increase in electric revenues of $41 million is reasonable.[12]

Based upon a review of each provision in the Settlement Agreement and the March Addendum, an examination of the record, and being otherwise sufficiently advised, the Commission finds that the provisions of the Settlement Agreement and March Addendum are in the public interest and should be approved. The Commission's approval of the provisions of the Settlement Agreement and March Addendum is based solely on their reasonableness in toto and does not constitute precedent on any issue. Although we are approving all of the agreed-upon provisions, we have some concerns regarding certain provisions as discussed in the findings below.

New HEAP

The Commission's approval of the Settlement Agreement includes the approval of the parameters of a new HEAP for Kentucky Power. The HEAP will be funded by a $0.10 per month charge on residential customer's bills, and will be set forth as a separate line item on those bills.

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[10] Henkes Direct Testimony, Schedule RJH-1.

[11] Kollen Direct Testimony at 5. The KIUC proposed increase is the net result of Kentucky Power's original proposal of $64,796,000 and KIUC's recommended reductions of $38,872,000.

[12] Settlement Agreement at 2.

The Commission certainly recognizes that low income households frequently have difficulties paying their utility bills, and this situation has been compounded by the recent record high prices for natural gas, oil, and coal. Consequently, there is now a heightened need for financial assistance programs that subsidize the utility bills of low-income households. However, when financial assistance programs have previously been funded through mandatory charges on residential utility bills, the common perception is that these charges are forced charitable contributions and they generate sincere objections from many ratepayers. While eliminating every objection may not be possible, the majority of ratepayers will certainly have a higher degree of support and acceptance of the funding for these programs if they know that the utilities are contributing to the programs with shareholder funds.

The Commission has always believed that when a utility is a financial contributor to its own financial assistance program, ratepayers recognize that the funds collected will be properly accounted for and spent in the most efficient manner. This greatly increases ratepayer acceptance of financial assistance programs and is the reason why the Commission has always urged the utility that will be the beneficiary of an assistance program to also be a financial contributor to that program. A utility that is financially contributing to its own assistance program has a greater incentive to monitor the program expenditures and is in a better position to assure its ratepayers that the funds are being spent in the most efficient manner. Consequently, the Commission applauds Kentucky Power's decision to contribute shareholder funds to match the ratepayer funding for the HEAP account for the first 2 years of the program.

Kentucky Power's management has shown great leadership on this issue, as well as a high level of sensitivity to the financial difficulties faced by many of its ratepayers. The Commission will take this opportunity to urge the other energy utilities in the Commonwealth to step forward with dollar-for-dollar matches of ratepayer funds for HEAP programs. Similarly, the Commission encourages Kentucky Power to continue its shareholder match of ratepayer HEA funds beyond the first 2 years of the program.

To ensure the success of this HEA program, Kentucky Power must actively monitor the program's implementation, operation, and expenditures. The Commission expects Kentucky Power to fulfill this role so it can provide its ratepayers the assurances they need and deserve regarding the efficient expenditure of the HEAP funds.

The draft tariff sheets filed by Kentucky Power on February 17, 2006 provide that the HEAP charge will be applied to all residential electric bills rendered, commencing with the billing cycles in April 2006 and continuing thereafter. However, the programmatic details of the HEAP have yet to be submitted to the Commission for approval. The Commission finds that the HEAP $0.10 per month charge on residential bills should be collected as set out in the draft tariff sheets, but none of the funds generated by that charge should be spent until the Commission has approved the programmatic details of the HEAP. Kentucky Power should establish the necessary accounts or subaccounts to record and track the collection of the HEAP funds.

As Kentucky Power and the intervenors develop the programmatic details of the HEAP, it may be helpful for the parties to review the Commission's decisions in Case

Nos. 2004-00303[13] and 2004-00304.[14] These Orders discuss how the parties in those cases addressed the Commission's concerns relating to home energy assistance programs. The Commission expects the proponents of this new HEAP to also address those concerns when the programmatic details are filed for Commission review and approval.

Depreciation Study

In its March 31, 2003 Order in Case No. 2002-00169, the Commission directed Kentucky Power to perform and submit for approval a new depreciation study within 3 years or by the filing of its next general rate case, whichever occurs first.[15] Kentucky Power's last formal depreciation study was performed in 1990, prior to Case No. 1991-00066. Kentucky Power did include a new depreciation study in this rate case, pursuant to the requirements of Case No. 2002-00169. However, the Settlement Agreement provides that the depreciation rates approved in Case No. 1991-00066 will continue to be utilized to calculate Kentucky Power's annual depreciation expense.

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[13] Case No. 2004-00303, Joint Application of Kentucky Utilities Company, Kentucky Association for Community Action, Inc., and Community Action Council for Lexington-Fayette, Bourbon, Harrison and Nicholas Counties, Inc. for the Establishment of a Home Energy Assistance Program, final Order dated November 24, 2004.

[14] Case No. 2004-00304, Joint Application of Louisville Gas and Electric Company, Metro Human Needs Alliance, Inc., People Organized and Working for Energy Reform, and Kentucky Association for Community Action, Inc. for the Establishment of a Home Energy Assistance Program, final Order dated November 24, 2004.

[15] Case No. 2002-00169, The Application of Kentucky Power Company d/b/a American Electric Power for Approval of an Amended Compliance Plan for Purposes of Recovering the Costs of New and Additional Pollution Control Facilities and to Amend Its Environmental Cost Recovery Surcharge Tariff, final Order dated March 31, 2003, at 47.

While the Commission is accepting the provision of the Settlement Agreement regarding depreciation rates, we are concerned about the age of the depreciation study supporting the agreed-upon depreciation rates. Therefore, the Commission finds that Kentucky Power should perform and submit for approval a new depreciation study within 5 years from the date of this Order or by the filing of its next general rate case, whichever occurs first. Kentucky Power should not use for accounting or rate-making purposes any new depreciation rates until it has secured the approval of the Commission.

PJM Economic Demand Response Program

Paragraph 13 of the Settlement Agreement provides that Kentucky Power will allow industrial customer participation in the PJM Economic Demand Response Program for a period of 1 year. The program will be available only to industrial customers, and the program is to be revenue neutral for Kentucky Power and the other customer classes. This provision of the Settlement Agreement was one of the topics discussed at the March 1, 2006 informal conference and the subject of the March Addendum.

The March Addendum states that paragraph 13 of the Settlement Agreement provides a framework for further discussions and negotiations between Kentucky Power and customers eligible to participate in the PJM Economic Demand Response Program. The parties agree that this PJM program can be implemented in Kentucky only through the filing of an application for Commission review and approval, and such a filing will be made only if and when an eligible customer elects to participate.

The clarifications contained in the March Addendum address and satisfy the Commission's concerns that the record in this case lacks sufficient details regarding Kentucky Power's role and obligations under the PJM Economic Demand Response Program. Our finding that the Settlement Agreement is reasonable is based in part on the assurances contained in the March Addendum that the details of the program will be set forth in a special contract that will be filed for Commission review and approval when an eligible customer elects to participate in the program.

Vegetation Management

In its application, Kentucky Power had proposed significant adjustments to its operating expenses, capitalization, and rate base to reflect its proposal to establish a transmission and distribution cycle-based vegetation management program.[16] Kentucky Power sought the recovery of the costs associated with this expanded program prior to it incurring the costs. The AG and KIUC had expressed concerns about the proposed adjustments and opposed them. The Settlement Agreement does not address the vegetation management program or any costs associated with it. At the public hearing, Kentucky Power stated that with the amount of revenue increase provided under the Settlement Agreement, the vegetation management program would not be implemented as proposed. Kentucky Power indicated that it would continue to perform the work that could be done within the available funding and that it would be working toward a cycle-

[16] The proposed cycle-based vegetation management program was developed in response to the findings in the Commission's Focused Management Audit, performed by Schumaker and Company, and issued on March 24, 2003.

based program, but could not say how long it would take to get there without additional funds.[17]

While we are approving the Settlement Agreement, with the March Addendum, the Commission reminds Kentucky Power it has an obligation to provide adequate, efficient, and reasonable service to all its ratepayers. Kentucky Power has indicated that the largest single cause of outages on its system is related to vegetation management issues.[18] Consequently, the Commission expects Kentucky Power to utilize its available resources in the most efficient manner in order to have an effective vegetation management program.

Environmental Surcharge

The Settlement Agreement contains three provisions related to Kentucky Power's environmental surcharge. Paragraph 3 provides that $28,106,683 of environmental costs will be incorporated into Kentucky Power's base rates and that this "roll-in" will be reflected as proposed by Kentucky Power. Paragraph 7 provides that, for purposes of the environmental surcharge, Kentucky Power will utilize a 10.5 percent rate of return on equity. Paragraph 14 provides that Kentucky Power will continue to reflect the Internal Revenue Code Section 199 deduction in its environmental surcharge

[17] Transcript of Evidence ("T.E."), February 7, 2006, at 50-51 and 94-95.

[18] Phillips Direct Testimony at 3. Mr. Phillips testified that tree- and animal-related outages caused approximately 47.3 percent of the sustained, non-major event outages on the Kentucky Power system in 2004.

mechanism consistent with the Commission's decision in Case No. 2005-00068,[19] and subject to the final result of the appeal of that Order.

During the processing of this case, Kentucky Power had offered two proposals on how to reflect the roll-in of the environmental surcharge into base rates.[20] Both proposals were discussed at the March 1, 2006 informal conference, and Kentucky Power clarified the parties' intent that the roll-in amount should become the base period revenue requirement component in the environmental surcharge mechanism.[21] The Commission's approval of the Settlement Agreement on this issue is based in part upon this clarification, which the Commission finds is a reasonable treatment of the environmental surcharge roll-in.

Kentucky Power indicated in its application that the rate of return for the Kentucky Power portion of the current period revenue requirement would be the weighted average cost of capital authorized by the Commission in this proceeding.[22] While the Settlement Agreement established the rate of return on equity to be used to determine the weighted average cost of capital, it did not specify the capital structure to

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[19] Case No. 2005-00068, Application of Kentucky Power Company for Approval of an Amended Compliance Plan for Purposes of Recovering Additional Costs of Pollution Control Facilities and to Amend Its Environmental Cost Recovery Surcharge Tariff, final Order dated September 7, 2005.

[20] See Wagner Direct Testimony at 54-55 and Exhibits EKW-11 and 12 and Response to the Commission Staff's Fourth Data Request dated January 9, 2006, Item 1.

[21] The revised draft tariffs filed in response to the data request from the March 1, 2006 informal conference reflect this treatment. See Responses to the March 1, 2006 Informal Conference, Item 1, Sheet 29-1 through 29-5.

[22] See Wagner Direct Testimony, Exhibit EKW-5, page 99 of 103.

be used in the calculation. At the public hearing, Kentucky Power indicated that it had no preference as to whether the calculation of its weighted average cost of capital was based on the current capital structure used in the surcharge or the capital structure used in this case.[23]

If the weighted average cost of capital is to be set in this proceeding, the Commission believes a capital structure corresponding to the test year in this case should be utilized. In determining the capital structure to use, the Commission notes that Kentucky Power proposed several adjustments to its capital structure. Given the nature of the Settlement Agreement, the Commission is unable to determine whether the parties have accepted or rejected Kentucky Power's adjustments to its capital structure.[24] Therefore, under the circumstances present here, the Commission will use the actual per books capital structure for Kentucky Power as of test-year end, and we will not reflect any of the proposed adjustments to the capital structure.

Therefore, the Commission finds that the weighted average cost of capital for the Kentucky Power component of the current period revenue requirement should be determined using the unadjusted test-year-end capital structure, the test-year-end costs for debt and accounts receivable financing, and a rate of return on equity of 10.5 percent as stated in the Settlement Agreement. Based on the information contained in this record, Kentucky Power's weighted average cost of capital, before income tax gross-up, is 7.48 percent. As the Commission has done for previous Kentucky Power

[23] T.E., February 7, 2006, at 95-96.

[24] For example, one of the adjustments to Kentucky Power's capital structure reflected the capital investment related to the proposed vegetation management program.

surcharge cases, the weighted average cost of capital will be grossed up to reflect the income tax effect resulting from the return on equity.[25] These calculations are shown on Appendix C to this Order.

The approval of the Settlement Agreement will require changes in the monthly environmental surcharge reporting formats. Since the amount of the surcharge roll-in to base rates will now constitute the base period revenue requirement component of the environmental surcharge mechanism, ES Forms 2.00 through 2.21 are no longer necessary and should be deleted. Instead, Kentucky Power should submit a schedule labeled "ES Form 1.10" that will show the monthly base period revenue requirement as listed in the environmental surcharge tariff. Further, on ES Form 1.00, line 2 should be identified as "BRR from ES Form 1.10."

IT IS THEREFORE ORDERED that:

1. The rates and charges proposed by Kentucky Power in its application are denied.

2. The Settlement Agreement and the March Addendum, attached hereto as Appendix A, are approved in their entirety.

3. The rates and charges set forth in Appendix B hereto, are the fair, just, and reasonable rates for Kentucky Power to charge for electric service, and these rates are approved for service rendered on and after March 30, 2006.

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[25] The gross-up factor of 1.6073 applied to the equity component results in a grossed-up rate of return of 9.97 percent.

4. Kentucky Power shall begin billing the $0.10 monthly HEAP charge to residential customers, but shall not expend any of the HEAP funds collected until authorized to do so upon Commission approval of the HEAP programmatic details.

5. Kentucky Power shall perform and submit for Commission approval a new depreciation study within 5 years from the date of this Order or by the filing of its next general rate case, whichever occurs first. Kentucky Power shall not use for accounting or rate-making purposes any new depreciation rates until it has secured the approval of the Commission.

6. Kentucky Power's weighted average cost of capital for environmental surcharge purposes for the Kentucky Power component of the current period revenue requirement shall be 7.48 percent. During subsequent 6-month surcharge reviews, the cost of debt and accounts receivable financing shall be reviewed and re-established. During subsequent 2-year reviews, the rate of return on equity shall be reviewed and re-established.

7. The monthly environmental surcharge reporting formats shall be modified as described herein.

Done at Frankfort, Kentucky, this 14th day of March, 2006.

By the Commission

ATTEST:

Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2005-00341 DATED March 14, 2006

SETTLEMENT AGREEMENT

Dated February 6, 2006

ADDENDUM TO SETTLEMENT AGREEMENT
DATED FEBRUARY 6, 2006

Dated March 3, 2006

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of: GENERAL ADJUSTMENTS IN ELECTRIC RATES OF KENTUCKY POWER COMPANY	CASE NO. 2005-00341

SETTLEMENT AGREEMENT

This Settlement Agreement, made and entered into this 6th day of February, 2006, by and among Kentucky Power Company ("KPC"), Attorney General, Commonwealth of Kentucky, Kentucky Industrial Utility Customers, Inc., (KIUC) Kentucky Association for Community Action, Inc., (KACA) and Kentucky Cable Telecommunications Association, (KCTA) (parties and addresses),

W I T N E S S E T H:

WHEREAS, on September 26, 2005 KPC filed an application with the Kentucky Public Service Commission ("Commission") pursuant to KRS 278.190, for an increase in retail rates of $64,796,239 and to implement tariffs as proposed, styled "In the Matter of: General Adjustments in Electric Rates of Kentucky Power Company," PSC Case No. 2005-00341; and

WHEREAS, the Attorney General, KIUC, KCTA and KACA filed motions for leave to intervene in Case No. 2005-00341 (collectively, the "intervenors"), which Motions were granted by the Commission; and

WHEREAS, the parties to Case No. 2005-00341 have filed written testimony in the administrative proceeding which raised several issues regarding the rate application filed by KPC; and

WHEREAS, all parties have filed written responses to numerous data requests filed by the parties and by the Commission Staff; and

WHEREAS, the parties have reviewed the respective issues raised in Case No. 2005-00341 by the Company and/or the various Intervenors, and have reached an overall settlement and resolution of the case, including the various issues raised therein; and

WHEREAS, the parties hereto execute this Settlement Agreement for purposes of submitting it to the Kentucky Public Service Commission for approval pursuant to KRS 278.190, and for further approval by the Commission of the rate increase, rate structure and tariffs as described herein;

NOW, THEREFORE, for and in consideration of the mutual premises set forth above, and the agreements and covenants set forth herein, the parties hereby agree as follows:

ARTICLE I. <u>GENERAL TERMS</u>

1. Effective for the first billing cycle of April, 2006 (March 30, 2006), the Company shall implement an increase in retail base rates sufficient to generate additional annual retail revenues of $41 million based on the June 30, 2005 KPC test year. The proposed Net Congestion Recovery Tariff shall not be implemented.

2. Within 10 days of approval by the Commission of this Settlement Agreement, the Company shall file tariffs in the same format as set forth in the Application, except as otherwise provided herein, and , which are designed to produce the revenue increase set forth in paragraph 1 above.

3. The Company shall retain its existing ECR tariff except that the annual baseline level for ECR costs under the tariff shall be $28,106,683 and the monthly baseline amounts shall be as set forth in the Company's proposal in this case.

4. The Company's System Sales Clause tariff for its off-system sales margins shall continue in full force and effect, except as follows. Effective for the first billing cycle of April

2006 the sharing of off-system sales margins shall be calculated using an annual baseline of $24,855,326. The monthly amounts shall be as set forth in Section V Workpaper S-4 page 26 and described as "New System Sales Tariff Base." The difference between each month's actual off-system sales margins and the monthly baseline shall be shared by the ratepayers and Company on a 70%-30% basis respectively. The 50%-50% ratepayer and Company sharing shall be discontinued effective April 1, 2006. If the Company's annual off-system sales margins in any twelve (12) month period, starting April 1, 2006, exceeds $30,000,000, then the monthly off-system margins sales in excess of $30,000,000 for the remainder of the twelve (12) month period shall be shared by the ratepayers and Company on a 60%-40% basis respectively.

5. Effective April 1, 2006, the CATV tariff shall be adjusted as follows: Two User Pole Rate = $7.21 per pole/year; Three User Pole Rate = $4.47 per pole/year.

6. The Company shall continue to include in the calculation of its annual depreciation expense the depreciation rates currently approved and utilized by the Company as a result of the Company's 1991 rate case, Case No. 91-066.

7. The parties have not specified a return on equity for purposes of determining the rate increase referred in paragraph 1 above. For purposes of the ECR tariff, and for accounting for allowance for funds used during construction (AFUDC), the Company shall utilize a 10.5% rate of return on equity.

8. The Company shall impose a $.10/month charge through a separate line item on the monthly bill of each residential customer to create a Home Energy Assistance Program (HEAP) account, which funds will be credited to the monthly bills of customers qualifying for the HEAP program (through KACA) pursuant to an agreement with KACA providing for, *inter alia*, a 10% cap on administrative fees. This charge will be recovered as provided by KRS

278.285(4). In addition, the Company agrees to match the residential contributions to the HEAP account for a period of two years following approval of this Settlement Agreement by the Commission. The Company shall have no further obligation following the two (2) year contribution period.

9. The Company agrees to design tariffs that will generate the additional $41 million in retail rates. In the design of the tariffs, revenue requirements shall be allocated among the customer classes in accordance with the attached revenue allocation. (Attachment 1)

10. The customer charge for the Residential Class shall be $5.86 and the descending block shall be replaced with a flat rate.

11. The Miscellaneous charges shall be as follows: $12.94 Reconnect for Non-Payment-Regular Hours; $17.26 Reconnect for Non-Payment-Overtime End-of-Day; $35.95 Reconnect for Non-payment – Call Out; $44.58 Reconnect for non-payment – Sundays & Holidays; $8.63 Termination of Service Field Trip; $7.00 Returned Check Charge; and, $14.38 Meter Test Charge.

12. Tariff State Issues Settlement (Tariff S.I.S.) shall be renamed Tariff Capacity Charge (Tariff C.C.).

13. The Company shall allow industrial customer participation in the PJM Economic Demand Response Program for a period of one (1) year. The program will be available solely for such industrial customers, and is to be revenue neutral for the Company as well as the other customer classes. In order to preserve this revenue neutrality, the participating customer will pay the Company's tariff charges for any reductions under the program when the customer's payment from PJM has not been reduced by such amounts. In offering this Program, the Company is not waiving or compromising its right to take a position on the merits of the

Program, including its right to oppose the Program, in any FERC proceeding, PJM stakeholder process or other public forum.

14. The Company will continue to reflect the IRC Section 199 deduction in its ECR consistent with the Commission's decision in Case No. 2005-00068, consistent with the final result of the appeal in that case.

15 The parties agree that the non-rate terms of the following tariffs may be modified or implemented as described in the indicated direct testimony:

Tariff Modified or Implemented	**Testimony**
Small General Service (SGS), Medium General Service (MGS), MGS Time-of-day; Large General Service (LGS), Quantity Power (QP), Commercial and Industrial Power-Time-of-Day (CIP-TOD)	D.M. Roush – Pages 8-9 (Pre-filed Direct Testimony)
Average Monthly Payment Plan	E.K. Wagner – Pages 42-46 (Pre-filed Direct Testimony)
Terms and Conditions (Miscellaneous Changes)	E.K. Wagner – Page 53 (Pre-filed Direct Testimony)

In addition, the Parties further agree that (i) the Bill Format may be modified as described at page 46 of Mr. Wagner's Pre-filed Direct Testimony; and (ii) the Residential Special Terms and Conditions Tariff shall be amended as described at page 53 of Mr. Wagner's pre-filed testimony to conform to Exhibit EKW-5, Sheet No. 6-3 to reduce the line extension that will made without charge from 2,500 feet or less to 1,000 feet or less.

16. Following the execution of this Settlement Agreement, the signatories shall cause the Settlement Agreement to be filed with the Commission with a request to the Commission for consideration and approval of this Settlement Agreement so that the Company may begin billing under the approved adjusted rates for the first billing cycle of April , 2006 (March 30, 2006).

17. The signatories to this Settlement Agreement shall act in good faith and use their best efforts to recommend to the Commission that this Settlement Agreement be accepted and approved. The parties further agree and intend to support the reasonableness of this Settlement Agreement before the Commission, and to cause their counsel to do the same, and in any appeal from the Commission's adoption and /or enforcement of this Settlement Agreement.

18. If the Commission does not accept and approve this Settlement Agreement in its entirety, then: (a) this Settlement Agreement shall be void and withdrawn by the parties hereto from further consideration by the Commission and none of the parties shall be bound by any of the provisions herein; and (b) neither the terms of this Settlement Agreement nor any matters raised during the settlement negotiations shall be binding on any of the signatories to this Settlement Agreement or be construed against any of the signatories.

19. Should the Settlement Agreement be voided or vacated for any reason after the Commission has approved the Settlement Agreement and thereafter any implementation of the terms of the Settlement Agreement has been made, then the parties shall be returned to the *status quo* existing at the time immediately prior to the execution of this Settlement Agreement.

20. This Settlement Agreement shall in no way be deemed to divest the Commission of jurisdiction under Chapter 278 of the Kentucky Revised Statutes.

21. This Settlement Agreement shall inure to the benefit of and be binding upon the parties hereto, their successors and assigns.

22. This Settlement Agreement constitutes the complete agreement and understanding among the parties hereto, and any and all oral statements, representations or agreements made prior hereto or contained contemporaneously herewith shall be null and void and shall be deemed to have been merged into this Settlement Agreement.

23. For the purpose of this Settlement Agreement only, the terms are based upon the independent analysis of the parties to reflect a just and reasonable resolution of the issues herein and are the product of compromise and negotiation. Notwithstanding anything contained in the Settlement Agreement, the parties recognize and agree that the effects, if any, of any future events upon the operating income of KPC are unknown and this Settlement Agreement shall be implemented as written.

24. Neither the Settlement Agreement nor any of the terms shall be admissible in any court or commission except insofar as such court or commission is addressing litigation arising out of the implementation of the terms herein or the approval of this Settlement Agreement. This Settlement Agreement shall not have any precedential value in this or any other jurisdiction.

25. Making this Settlement Agreement shall not be deemed in any respect to constitute an admission by any party hereto that any computation, formula, allegation, assertion or contention made by any other party in these proceedings is true or valid. Nothing in this Settlement Agreement shall be used or construed for any purpose to imply, suggest or otherwise indicate that the results produced through the compromise reflected herein represent fully the objectives of an party.

26. The signatories hereto warrant that they have informed, advised, and consulted with the respective parties hereto in regard to the contents and significance of this agreement and based upon the foregoing are authorized to execute this Settlement Agreement on behalf of the parties hereto.

27. This Settlement Agreement is subject to the acceptance of and approval by the Public Service Commission.

28. This Settlement Agreement is a product of negotiation among all parties hereto, and no provision of this Settlement Agreement shall be strictly construed in favor of or against any party.

29. This Settlement Agreement may be executed in multiple counterparts.

30. Nothing in this Settlement Agreement shall preclude, prevent or prejudice any party hereto from raising any argument/issue or challenging any adjustment in any future rate case proceeding of the Company.

IN WITNESS WHEREOF, this Settlement Agreement has been agreed to as of this 6th day of February 2006. By affixing their signatures below, the undersigned parties respectfully request the Commission to issue its Order approving and adopting this Stipulation Agreement the parties hereto have hereunto affixed their signatures.

KENTUCKY POWER COMPANY

By:

ATTORNEY GENERAL

COMMONWEALTH OF KENTUCKY

By: ______________________

KENTUCKY INDUSTRIAL UTILITY
CUSTOMERS, INC.

By: Michael L. Kurtz

KENTUCKY ASSOCIATION FOR
COMMUNITY ACTION, INC.

By: ______________________

KENTUCKY CABLE
TELECOMMUNICATIONS
ASSOCIATION

By: ______________________

KE057:KE180:13616:3:FRANKFORT

Attachment 1

Kentucky Power Company
Settled Revenue Allocation
Twelve Months Ended June 30, 2005

Ln No	Tariff	Current Revenues	KPCo Proposed Increase $	KPCo Proposed Increase %	Settled Non-Recurring Charges Increase Revenues	Settled Proposed Increase $	Settled Proposed Increase %	Total Settled Proposed Increase (Cols 6 + 7)
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
1	Non-Recurring Revenue				$71,890			$71,890
2	RS	$130,089,965	$35,508,669	27.30%		$19,157,568	14.73%	$19,157,568
3	SGS	$6,396,711	$977,925	15.29%		$942,005	14.73%	$942,005
4	MGS	$40,049,839	$5,330,812	13.31%		$5,322,900	13.29%	$5,322,900
5	LGS	$41,639,263	$6,715,919	16.13%		$6,707,264	16.11%	$6,707,264
6	QP	$39,023,377	$5,207,626	13.34%		$2,669,597	6.84%	$2,669,597
7	CIP-TOD	$74,184,655	$9,504,584	12.81%		$5,251,404	7.08%	$5,251,404
8	MW	$367,037	$53,773	14.65%		$53,750	14.64%	$53,750
9	OL	$4,776,969	$1,353,543	28.33%		$703,476	14.73%	$703,476
10	SL	$815,872	$143,388	17.57%		$120,149	14.73%	$120,149
11	Total	$337,343,688	$64,796,239	19.21%	$71,890	$40,928,110	0.1213	$41,000,003

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of: GENERAL ADJUSTMENTS IN ELECTRIC RATES OF KENTUCKY POWER COMPANY	CASE NO. 2005-00341

ADDENDUM TO SETTLEMENT AGREEMENT DATED FEBRUARY 6, 2006

The parties to the Settlement Agreement dated February 6, 2006 agree that paragraph 13 of the Settlement Agreement provides a framework for further discussions and negotiations between Kentucky Power Company and those customers eligible to participate in the PJM Economic Demand Response Program. The parties further agree the PJM Economic Demand Response Program can be implemented in Kentucky only through the filing of an application for Commission review and approval. Such a filing will be made only if and when a customer elects to participate in the PJM Economic Demand Response Program.

IN WITNESS WHEREOF, this Addendum to the February 6, 2006 Settlement Agreement has been agreed to as of this 3rd day of March, 2006.

KENTUCKY POWER COMPANY

By: ____________________

KENTUCKY ASSOCIATION FOR
COMMUNITY ACTION, INC.

By: ______________________________

KENTUCKY INDUSTRIAL UTILITY
CUSTOMERS, INC.

By:

KENTUCKY CABLE
TELECOMMUNICATIONS
ASSOCIATION

By:

KE057:KE180:13729:1:FRANKFORT

ATTORNEY GENERAL

COMMONWEALTH OF KENTUCKY

By: ______________________

APPENDIX B

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2005-00341 DATED March 14, 2006

SETTLEMENT RATE SUMMARY

KENTUCKY POWER COMPANY
CASE NO. 2005-00341
Settlement Rate Summary

Tariff (1)	Description (2)	Customer (3) $/mo	Energy (4) ¢/kWh	Demand (5) $/kW
RS		5.86		
	All kWh		6.002	
	Storage Water Heating kWh		2.664	
	Load Management Water Heating kWh		2.664	
RS-LM-TOD		8.36		
	On-Peak		10.177	
	Off-Peak		2.664	
	Conservation and Load Management Credit		0.745	
	Separate Metering	3.00		
RS-TOD		8.36		
	On-Peak		10.177	
	Off-Peak		2.664	
SGS		11.50		
	First 500 kWh		8.824	
	Over 500 kWh		4.805	
SGS Non-metered		7.50		
	First 500 kWh		8.824	
	Over 500 kWh		4.805	
SGS-LM-TOD		15.10		
	On-Peak		12.227	
	Off-Peak		2.664	

KENTUCKY POWER COMPANY
CASE NO. 2005-00341
Settlement Rate Summary

Tariff (1)	Description (2)	Customer (3) $/mo	Energy (4) ¢/kWh	Demand (5) $/kW
MGS				
	Secondary	13.50		1.31
	kWh equal to 200 times kW of monthly billing demand		6.988	
	kWh in excess of 200 times kW of monthly billing demand		5.826	
	Primary	21.00		1.28
	kWh equal to 200 times kW of monthly billing demand		6.318	
	kWh in excess of 200 times kW of monthly billing demand		5.526	
	Subtransmission	153.00		1.25
	kWh equal to 200 times kW of monthly billing demand		5.744	
	kWh in excess of 200 times kW of monthly billing demand		5.321	
Recreational Lighting		13.50		
	All kWh		6.519	
	Industrial and Coal Mining Minimum Charge			5.46
MGS-LM-TOD		3.00		
	On-Peak		11.391	
	Off-Peak		2.781	
MGS-TOD		14.30		
	On-Peak		11.391	
	Off-Peak		2.781	
LGS				
	Secondary	85.00	5.120	3.45
	Primary	127.50	4.415	3.36
	Subtransmission	535.50	3.350	3.30
	Transmission	535.50	2.965	3.24
	Excess kVA Charge			2.97

KENTUCKY POWER COMPANY
CASE NO. 2005-00341
Settlement Rate Summary

Tariff (1)	Description (2)	Customer (3) $/mo	Energy (4) ¢/kWh	Demand (5) $/kW
LGS-LM-TOD		81.80		
On-Peak			9.592	
Off-Peak			2.753	
QP				
Secondary		276.00	2.096	
On-Peak				13.28
Off-Peak Excess				4.79
Primary		276.00	2.044	
On-Peak				11.53
Off-Peak Excess				3.31
Subtransmission		662.00	2.012	
On-Peak				8.81
Off-Peak Excess				0.88
Transmission		1,353.00	1.987	
On-Peak				7.47
Off-Peak Excess				0.77
Excess kVAr Charge				0.67
CIP-TOD				
Primary		276.00	1.685	
On-Peak				13.79
Off-Peak				3.68
Minimum Demand Charge				14.79
Subtransmission		662.00	1.660	
On-Peak				10.83
Off-Peak				0.98
Minimum Demand Charge				11.80
Transmission		1,353.00	1.640	
On-Peak				9.35
Off-Peak				0.84
Minimum Demand Charge				10.32
Excess kVAr Charge				0.67

KENTUCKY POWER COMPANY
CASE NO. 2005-00341
Settlement Rate Summary

Tariff (1)	Description (2)	Customer (3) $/mo	Energy (4) ¢/kWh	Demand (5) $/kW
MW		22.90		
	All kWh		5.677	
	Minimum Charge			3.65
OL				
	Mercury Vapor			
	175 Watt	6.95		
	400 Watt	11.60		
	High Pressure Sodium			
	100 Watt	6.70		
	150 Watt	7.50		
	200 Watt	9.05		
	400 Watt	14.35		
	Floodlights			
	200 Watt HPS	10.30		
	400 Watt HPS	14.10		
	250 Watt MH	16.15		
	400 Watt MH	21.05		
	1000 Watt MH	45.20		
	Post Top			
	175 Watt MV	8.10		
	100 Watt HPS	10.05		
	150 Watt HPS	16.45		
	Wood Pole	2.30		
	Overhead Span	1.30		
	Underground Lateral	5.35		

KENTUCKY POWER COMPANY
CASE NO. 2005-00341
Settlement Rate Summary

Tariff (1)	Description (2)	Customer (3) $/mo	Energy (4) ¢/kWh	Demand (5) $/kW
SL				
	Overhead Service on Existing Distribution Poles			
	High Pressure Sodium			
	100 Watt	5.45		
	150 Watt	6.15		
	200 Watt	7.65		
	400 Watt	10.90		
	Service on New Wood Distribution Poles			
	High Pressure Sodium			
	100 Watt	8.75		
	150 Watt	9.50		
	200 Watt	10.90		
	400 Watt	14.15		
	Service on New Metal or Concrete Poles			
	High Pressure Sodium			
	100 Watt	14.65		
	150 Watt	15.20		
	200 Watt	19.20		
	400 Watt	20.00		
CATV				
	Charge for attachments on a two-user pole	7.21		
	Charge for attachments on a three-user pole	4.47		

KENTUCKY POWER COMPANY
CASE NO. 2005-00341
Settlement Rate Summary

Tariff (1)	Description (2)	Customer (3) $/mo	Energy (4) ¢/kWh	Demand (5) $/kW
COGEN/SPP I and COGEN/SPP II				
	Metering Charges			
	Standard Measurement - Single Phase	6.75		
	- Polyphase	8.45		
	TOD Measurement - Single Phase	7.55		
	- Polyphase	8.85		
	Capacity and Energy Credits			
	Standard Meter		2.81	0.72
	TOD Meter			
	On-Peak kWh		3.54	1.73
	Off-Peak kWh		2.29	
NUG				
	Subtransmission			4.16
	Transmission			2.31
	Excess kVAr Charge			0.67
Terms and Conditions of Service				
	Reconnect for non-payment - regular hours	12.94		
	Reconnect for non-payment - overtime hours	17.26		
	Reconnect for non-payment - call out	35.95		
	Reconnect for non-payment - double time	44.58		
	Termination or field trip	8.63		
	Returned Check Charge	7.00		
	Meter Test Charge	14.38		

APPENDIX C

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2005-00341 DATED March 14, 2006

Capital Structure and Weighted Average Cost of Capital

Component of Capitalization	Test-Year-End Per Book Balances	Capital Structure	Annual Cost Rate	Weighted Aver. Cost of Capital
Long-Term Debt	$487,716,122	57.43%	5.70%	3.27%
Short-Term Debt	0	0.00%	3.34%	0.00%
Accounts Receivable Financing	30,139,598	3.55%	2.99%	0.11%
Common Equity	331,354,481	39.02%	10.50%	4.10%
Totals	$849,210,201	100.00%		7.48%

Note: Test-Year-End Per Book Balances taken from the Application, Section V, Schedule 3.

Rate of Return with Gross-Up Factor

Component of Capitalization	Weighted Aver. Cost of Capital	Gross-Up Factor	Pre-Tax Weighted Aver. Cost of Capital
Long-Term Debt	3.27%		3.27%
Short-Term Debt	0.00%		0.00%
Accounts Receivable Financing	0.11%		0.11%
Common Equity	4.10%	1.6073	6.59%
Totals	7.48%		9.97%

Note: The Determination of the Gross-Up Factor is shown on page 2 of this Appendix.

APPENDIX C (continued)

Determination of Gross-Up Factor

The income tax gross-up factor to be applied to the rate of return for the Kentucky Power component of the current period revenue requirement is as follows:

1.	Pre-tax Production Income	100.0000
2.	Uncollectible Accounts Expense (0.47%)	0.4700
3.	State Taxable Production Income before § 199 Deduction	99.5300
4.	State Income Tax Expense, Net of § 199 Deduction (see below)	6.0450
5.	Federal Taxable Production Income before § 199 Deduction	93.4850
6.	§ 199 Deduction Phase-In	2.8050
7.	Federal Taxable Production Income	90.6800
8.	Federal Income Tax Expense After § 199 Deduction (35%)	31.7380
9.	After-tax Production Income	58.9420
10.	Gross-Up Factor for Production Income:	
11.	After-tax Production Income	58.9420
12.	§ 199 Deduction Phase-In	2.8050
13.	Uncollectible Accounts Expense	0.4700
14.	Total Gross-Up Factor for Production Income (rounded)	62.2170
15.	Blended Federal and State Tax Rate:	
16.	Federal (line 8)	31.7380
17.	State (line 4)	6.0450
18.	Blended Tax Rate	37.7830
19.	Gross Revenue Conversion Factor (100.00 / line 14)	1.6073

State Income Tax Calculation:

1.	Pre-tax Production Income	100.0000
2.	Uncollectible Accounts Expense (0.47%)	0.4700
3.	State Taxable Production Income before § 199 Deduction	99.5300
4.	Less: State § 199 Deduction	2.8050
5.	State Taxable Production Income	96.7250
6.	State Income Tax Rate	6.2500
7.	State Income Tax Expense (line 5 x line 6)	6.0450

In order to reflect the fact that the Kentucky corporate income tax rate would be going from 7.00 percent to 6.00 percent beginning in 2007, a blended Kentucky corporate income tax rate of 6.25 percent has been used as the State Income Tax Rate. See Wagner Rebuttal Testimony at 13.