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

Direct Settlement Testimony of Kevin C. Higgins

on behalf of

Kentucky Commercial Utility Customers

December 4, 2017

DIRECT SETTLEMENT TESTIMONY OF KEVIN C. HIGGINS

Introduction

Q. Please state your name and business address.

A. Kevin C. Higgins, 215 South State Street, Suite 200, Salt Lake City, Utah, 84111.

Q. By whom are you employed and in what capacity?

A. I am a Principal in the firm of Energy Strategies, LLC. Energy Strategies is a private consulting firm specializing in economic and policy analysis applicable to energy production, transportation, and consumption.

Q. Are you the same Kevin C. Higgins who pre-filed direct testimony in this proceeding on behalf of the Kentucky Commercial Utility Customers (“KCUC”)?

A. Yes, I am.

Q. What is the purpose of your settlement testimony?

A. My settlement testimony responds to the Settlement Agreement, as updated November 30, 2017, filed by Kentucky Power Company (“KPCo”) and certain other parties to this proceeding (collectively, “Signatory Parties”).

Q. Is KCUC a Signatory Party to the Settlement Agreement?

A. No.

Q. Do you believe the Settlement Agreement produces a fair, just, and reasonable result?

A. No, I do not.

Q. Please explain the basis for your opinion.

A. The revenue allocation in the Settlement Agreement does not provide a fair or reasonable treatment for the Large General Service ("LGS") class. In addition to continuing to require LGS to bear a significant subsidy burden as part of KPCo's overall rate structure, the Settlement Agreement further singles out the LGS class to absorb an additional subsidy to provide a $500,000 benefit for another customer class, Public and Private School service ("PS," served under Tariff K-12 School). As a result, the Settlement Agreement produces an unreasonable revenue allocation outcome.

Q. What is your basis for contending that LGS continues to bear a significant subsidy burden?

A. Exhibit 1 to the Settlement Agreement shows the rate of return for LGS and PS *taken together* as 10.46%[1] under Settlement rates, well above the overall rate of return of 6.48%. This difference in returns is attributable to the subsidy these two classes are jointly paying under the Settlement Agreement. As LGS and PS are to remain separate classes, and the Settlement Agreement specifically requires LGS to pay a subsidy to ensure lower rates for PS, the standalone rate of return for LGS is even greater than 10.46%.

Q. What provision in the Settlement Agreement requires LGS to pay a subsidy to ensure lower rates for PS?

A. This requirement appears in Section 13 of the Settlement Agreement, which states:

[1] While Exhibit 1 to the original version of the Settlement Agreement filed November 22, 2017 clearly stated the LGS/PS rate of return as 10.46%, Exhibit 1 to the updated Settlement Agreement filed November 30, 2017 is not entirely legible, and may state the LGS/PS rate of return as 10.45%.

(a) Kentucky Power shall continue its current Pilot Tariff K-12 School but shall remove the Pilot designation as set forth in EXHIBIT 7. Tariff K-12 School shall be available for general service to all K-12 schools in the Company's service territory, public and private, with normal maximum demands greater than 100 kW. Tariff K-12 School shall reflect rates for customers taking service under the tariff designed to produce annually in the aggregate $500,000 less from Tariff K-12 School customers than would be produced under the new L.G.S. rates to be established under this Settlement Agreement from customers eligible to take service under Tariff K-12 School. The aggregate total revenues to be produced by Tariff K-12 School and Tariff L.G.S. shall be equal to the revenues that would be produced in the aggregate by the new rates in the absence of Tariff K-12 School. Service under Tariff K-12 School shall be optional. [Emphasis added.]

The effect of this provision is to provide a $500,000 discount to Tariff K-12 School relative to LGS rates. KCUC is not objecting to this discount *per se*, but I note that the Settlement Agreement ensures that this discount is funded exclusively by the customers in the LGS class, and is not borne or spread among the other customer classes, nor is it borne by KPCo.

Q. Why is it important to address the subsidies paid by the LGS class?

A. The LGS class applies to customers in the range of 100 kW to 1,000 kW. While it may be more common for manufacturing enterprises to be found in the IGS class, there are nonetheless smaller enterprises such as BPM Lumber with sawmill operations that are served under the LGS rate schedule that must also compete in the global economy and are important for the local economy. The economic health of small businesses is important to the Commonwealth. My understanding, based on a report jointly released by the Kentucky Small Business Development Center and the Community and Economic Development Initiative of Kentucky, is that small businesses account for 45 percent of the private sector workforce in Kentucky.[2] It is an important matter of policy to address the significant subsidies paid by the LGS class, under which many small businesses take service.

Q. What is your proposed remedy to address the inequitable treatment of the LGS class in the Settlement Agreement?

A. While KCUC disagrees with the revenue allocation in the Settlement Agreement, my recommendation does not ask the Commission to reject that agreement at the stipulated revenue requirement agreed to by the Signatory Parties. Rather, to the extent that the Commission makes any additional revenue requirement reductions to the stipulated revenue requirement, I recommend that the first $500,000 of any such reduction be directed first to reduce the revenue requirement of the LGS class. This amount is equal to the discount that the Settlement Agreement requires the LGS class to absorb for the benefit of another customer class. Any revenue requirement reduction beyond $500,000 should be apportioned pro rata in proportion to each class's revenue requirement (including LGS).

Q. Why is your recommendation directed to any additional revenue requirement reductions that the Commission might require?

A. My understanding is that revenue requirement issues are still in contention in this case. Moreover, it is my understanding that the Commission will independently evaluate the merits of the stipulated revenue requirement, including return on equity (ROE), irrespective of the agreement of the Signatory Parties. I

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[2] "State of Small Business and Entrepreneurship in Kentucky 2016-17," Kentucky Small Business Development Center Community and the Economic Development Initiative of Kentucky, p. 4.

am also aware that in the recent general rate cases of the Kentucky Utilities Company and Louisville Gas & Electric Company, the Commission found that an ROE of 9.70% was a better reflection of current economic conditions and investor expectations than the 9.75% ROE stipulated by the parties to those cases. Certainly, it is plausible that the Commission could make a similar and consistent finding regarding the 9.75% ROE that has been stipulated in the Settlement Agreement in this case. Therefore, rather than ask the Commission to unwind the specific settlement package negotiated by the Signatory Parties, KCUC asks the Commission to make a modest adjustment to remedy part of the subsidy being paid by LGS to the extent that the Commission determines that additional revenue requirement adjustments are warranted.

Q. Does this conclude your direct settlement testimony?

A. Yes, it does.