A. Are you asking if commercial operations takes both companies' best interests in mind?
Q. I suppose it's kind of a vague way of my having phrased it. Yeah. For any reason, whether it's different regulatory approvals or otherwise, does commercial operations basically just make a decision as to the plant, irrespective -- you know, without having a distinction in mind between Kentucky Power and Wheeling?
A. Yes. They're generally viewing the generating assets -- in terms of market offers, they're generally doing it as a single generating unit. They're not taking individual ownership into account.
Q. Okay. Thank you.
A. So they're trying to maximize -- sorry.
Q. Oh, no, no, no. That -- I didn't mean to cut you off.
A. I was -- okay. They're trying to maximize the value of the unit. They're not paying attention to the ownership share.
Q. Understood. Thanks.
Okay. So putting aside the day-to-day commitment decisions, are you aware of any seasonal or perhaps annual, you know, kind of longer

incremental conversations at AEP, or KPC for that matter, where folks make a point of looking back at whether self-scheduling resulted in losses, variable operating losses for significant stretches of time that may have been avoidable if the Company had chosen not to self-schedule Mitchell?

A.   I'm not aware of any specific studies, but keep in mind -- I mean, you yourself listed earlier all the different factors that go into any decision to self-schedule: The determination of whether or not you have adequate fuel supply, or if you can safely operate the unit, or any operational considerations such as a test or for a -- you know, a two-unit power plant like Mitchell whether you need to keep a unit on during cold weather for heat. Things like that.

Q.   Sure. And I appreciate that. And my question, which I think you answered, but just to be clear, you know, sometimes, you know, looking back, you may get a perspective that wasn't anticipated with the day-to-day analyses. You might see that, weeks over weeks or even months, self-scheduling resulted in losses, and losses that might have been avoidable had a plant not been self-scheduled.

And I'm not asking you to admit to or concede that that has happened right here. I'm just wondering if you're aware of conversations, presentations, or certainly any documentary, whether there's a memo or, you know, internal studies that address this as a bigger pattern, if it's come up.

A. I'm not aware of anything formal, but I know that they're reviewing the results of the market and trying to understand how that fits in with fuel supply, fuel obligations, all those other factors to make sure that whatever we're doing makes economic and operational sense for the units.

Q. Thank you.

I suppose a component of that, and I'll just ask to be clear. You know, you may be aware of increasing discussion, some might say debate, studies about coal units self-scheduling -- or sometimes called self-committing, depending on the RTO -- in the trade press at different commissions.

Are you aware of any -- any documents or any dialogue at AEP or KPC reacting to that discussion in the industry?

A. I'm not aware of any documentation. I'm aware of some of the things that you've mentioned. I know that the issues of dispatch have been brought up in front of other commissions. I believe RTOs have each addressed that to an extent.

Q. That's helpful. Thanks.

In that same discovery response, couple subparts down in 2-3D and D-IV, Roman IV, you said that the workbooks that are generated on a daily basis looking ahead six days, they provide a snapshot in time that is used as a starting point for the unit bids that are ultimately submitted to PJM.

When you say "unit bids" -- I just want to make sure I understand -- does that encompass the decision whether to self-schedule the units?

A. These daily files initially come up with a -- say, a recommendation discussion point. These files are generated at the beginning of the daily commitment process. So you've got an analysts looking at unit availability -- current unit availability at that point in time, as well as the current LMP forecast and attempting to come up with some talking points to deal with -- to bring up to the rest of the team.

But, yes, it's a snapshot in time. It's done very early in the process, and there's additional monitoring and analysis and communication with the generating plants that goes on up until the point

where the units are offered into the market.
Q. I see. And so that starting point is then subject to starting point that incorporates the LMP projections and unit costs. That's a starting point, and then other factors, such as fuel contract constraints and the like, are folded in, and then the ultimate decision is made?
A. Yes.
Q. Okay.
A. At a high level, that's the process.
Q. At a high level.
Do you have a sense of if or how often fuel contract obligations were a dispositive reason that Mitchell was self-scheduled in the test year or -- or other recent history?
A. Not -- nothing exact, no. I know that they always take into account the level of fuel that's available at the plant and the scheduled fuel deliveries.
Q. Do you happen to know if self-scheduling has ever been cited as a means of helping the units achieve a particular target capacity factor?
A. I'm not aware of any of those sorts of discussions.
Q. Uh-huh. Do you have an opinion on whether

that would be appropriate, to use self-scheduling to ensure that the plants hit a capacity factor?
A. I don't really have an opinion on that, no.
Q. All right. With respect to the test year in this case, are you aware of any substantial stretches of time, say weeks-long periods, week over week, that Mitchell was self-scheduled and was incurring a consistent operating loss on a variable basis?
A. I'm not aware, but I didn't do the analysis to support any sort of decision in that regard.
Q. Okay. Did you happen to review the controversial data that Kentucky Power produced to Sierra Club in its supplemental discovery response on October 9th? There's a bunch of Excel files.
A. I'm aware of the files. I am not -- I don't know how detailed your question is. I don't know that I could answer anything specific on a specific date or time.
Q. All right. Fair enough. I'm almost done. I might be done. Just give me one moment, please. I have two more questions.
Do you happen to know -- well, I'll ask you, and I don't want you to say the answer if you do know, at least yet, but are you aware, roughly,

the -- take -- from -- from the amount of time that Mitchell actually does dispatch -- not when its units are off, but whether it's actually dispatching in the market -- are you aware of, roughly, the proportion of time that was a result of self-scheduling versus a market or economic commitment mode?

A. I -- I want to refer you to the confidential attachment we provided to Staff Question 5-6.

Q. 5-6. Okay. I believe Mr. Vaughan sponsored that.

Okay. Do you have -- are you aware of whether that -- the tendency to or, I guess, the proportion by which self-scheduling selected, is that on a seasonal basis or, you know, higher incidence based on season or seasons? Or is it kind of independent of seasonal market demand?

A. Seasonal market demand is one of the factors that plays into this, also as well as expectations of outages for other units in PJM and whatever outage schedules and maintenance outages are necessary for the Mitchell units themselves.

Q. Do you know if there have been discussions or have you been a part of any discussions at AEP or KPC about transitioning Mitchell to seasonal operations?

A. I'm not aware of any such discussions.

Q. Okay. The last thing I'll ask is do you have an understanding of whether -- whether the unit commitment decision-making with respect to Mitchell has ever been explicitly offered for approval or specifically challenged or otherwise specifically passed on by this commission -- by this commission, whether that decision of self-scheduling versus market commitment has -- its prudence has been passed on?

A. I'm not aware that the Commission has ever addressed it specifically, but the fuel usage at Mitchell is, obviously, up for review as part of the Company's fuel filings.

Q. Okay. And so would you -- and I'm not asking for a legal conclusion but just your understanding as somebody who supports this decision-making as a technical matter. Is it your understanding that the prudence of these decisions, you know, in tandem with the gains or losses that the Company realizes is at issue in the fuel reconciliation dockets?

A. It's my understanding that, yeah, the off-system sales margin and the fuel expense are things that are reviewed as part of the fuel dockets.

Does that answer your question?

Q. It does. It does. And would you agree that it's also at issue in the general rate case?

A. I think only to the extent that you have any off-system sales margins included in base rates. But even still, anything that you have in base rates, if it's trued up in a rider, would really be addressed in that particular rider, in this case the FAC.

MR. MILLER: Well, Mr. Stegall, thank you very much for walking through this with me. I appreciate your precision and your help.

That's all I have, Mr. Chairman. Thank you very much.

CHAIRMAN SCHMITT: Thank you.

Mr. Frye, any questions?

MR. FRYE: No questions at this time, Mr. Chairman.

CHAIRMAN SCHMITT: Vice Chairman Chandler, questions?

VICE CHAIRMAN CHANDLER: Yeah. Thank you. Just a few, Chairman. I appreciate it.

* * *

EXAMINATION

By Vice Chairman Chandler:

Q. Is it Mr. Stegall or Mr. Stegall?

A. Mr. Stegall.

Q. Stegall. Good afternoon.

In terms of the interaction between the Company's dispatch decisions and the off-system sales calls, is it better to ask questions of you or Mr. Vaughan?

A. I think it depends on the question. I mean, I can -- I can talk about how -- the process at a high level, but the dispatch is just offering the units in. The determine of off-system sales is something that occurs once we have market results and understand our internal load.

Q. Yeah. And I think that's an important distinction, isn't it, is that there's the ultimate decisions, and then the off-system sales is just the result of those decisions, correct?

A. Correct.

Q. Okay. And you agree that off-system sales, pursuant to a commission-approved tariff, is shared between customers and Kentucky Power, correct?

A. Correct.

Q. And do you know on what percentage basis that

is shared?
A. Off the top of my head, I don't recall. I know that there is a sharing mechanism, though.
Q. Okay. And is it your understanding that the Company's customers pay -- pay for the units? For instance, the Mitchell and the Big Sandy I unit?
A. I -- I think the Company's customers pay their financial obligation towards these generating assets.
Q. Okay. And the fuel -- and, you know, other variable O&M expenses -- or the other variable expenses are recovered through a number of different places, right? Base rates plus the different riders that are applicable to those units, right?
A. Correct.
Q. Like the FAC that you were talking about?
A. Yes.
Q. Okay. Is it your experience that the Company makes the appropriate dispatch decisions because they have a sharing mechanism in the off-system sales clause?
Let me withdraw that question. Let me ask the question this way.
Do you think that a no-sharing of the off-system sales clause between customers and the

Company, no sharing with the Company, would change the Company's dispatch procedures or choices?

A. No, because I think commercial operations does the best -- tries to make the best decision for customers regardless.

Q. Okay. And I was just interested in maybe following up on one of Mr. Miller's questions, and I guess I can appreciate the perspective on it. In regards to the Company's -- and if you can't speak to this, please don't. Just push it off to Mr. Kerns or somebody else. Feel free to.

But are you aware of the Company going back and doing after-the-fact reviews of whether -- and I'm really summarizing -- whether -- whether the Company's actions on dispatch decisions have been fruitful, or if there needs to be a change going forward?

A. The evaluation is done whether it's on an annual basis or even on a short-term basis. I've seen -- I've heard discussions about evaluating on a short-term basis. I'm not aware of a formal review on something on a month-by-month or year-by-year, but that doesn't mean that it's not done.

And the Company's own results and off-system sales margins would dictate, at a high level,

whether or not we're successful overall.
Q. Well, it would to a degree, but those are -- the off-system sales margins -- well, let me ask this.
Insofar as sales, right, the revenue received is less than the cost, is it your understanding that the Company shares in those losses?
A. Are you talking about at the end of the day, when we file a FAC with an off-system sales margin, are there individual hours where we came in negative?
Q. No, no. I'm asking the off-system sales clause or the off-system sales margin is shared, a percentage of it, with the Company, correct?
A. Correct.
Q. The profit is shared with the Company.
Insofar as there are losses, is the sharing with the Company zero dollars or that percentage of the losses?
A. I -- I don't have enough knowledge of the mechanism to tell you for sure. I know across the system, I've seen different -- across AEP, I've seen different views, but generally the view is that the Company -- if it's a loss overall, the Company will absorb the loss. If it's a gain overall, then it's

shared, or the customer gets all of it depending on the jurisdiction.

Q. Well, let me make that sure I'm clear. You say the Company would absorb the loss? But doesn't the Company recover the costs through the FAC?

A. Well, any -- any costs for off-system sales, so any fuel that's burned to generate off-system sales in the FAC is recorded as a credit, subject to check.

So we have a cost allocation process at the end -- at the end of the month, and once we know all of our transactions and what serves internal load versus what serves off-system load. And there's a cost recovery mechanism that assigns a -- an offsetting revenue to sort of the contra expense to the fuel for any fuel burned to serve off-system customers.

Q. Okay. So let me ask this question: Insofar as sales are made or generation is produced to make sales in excess of native load need, right, is that a function of a particular action the Company took, or is that a function of being dispatched in the market for an amount in excess of native load demand?

A. I would say it's both. It's making your generation available to the point where it can be dispatched by the market, and then it's market demand requesting that you produce more energy that can be sold. And this energy that you're producing happens to exceed what your internal load is.

Q. So the off-system sales margin is, only for that answer, incentivizing making the units available for PJM's economic dispatch?

A. The way that's characterized seems a bit oversimplified.

I think making sure that a unit is available and operating is -- that's the piece that you're incenting. Obviously, the market does the dispatch from, at the very least, your economic minimum up to your economic maximum, but the units aren't -- it takes a lot of work and supervision and maintenance to make sure that the units are available to the market.

Q. Would you agree that Kentucky Power has an obligation to provide electricity and reasonable service to its customers?

A. Yes.

Q. And wouldn't you agree that -- are you aware of the capacity performance rules in PJM?

A. Broadly, yes.

Q. But you understand that -- that generators have an obligation to produce when called upon and be available when needed?
A. Yes.
Q. Okay.
VICE CHAIRMAN CHANDLER: I appreciate it. Thank you very much. Have a good evening.
CHAIRMAN SCHMITT: Dr. Mathews, questions?
COMMISSIONER MATHEWS: I don't have any.
CHAIRMAN SCHMITT: Ms. Glass, any redirect?
MS. GLASS: Just one quick one, Your Honor.

REDIRECT EXAMINATION

By Ms. Glass:
Q. Mr. Stegall, would Company Witness Vaughan be the best witness to discuss the operation of the Company's system sales clause?
A. Yes.
MS. GLASS: Thank you. That's all I have.
CHAIRMAN SCHMITT: Thank you. You may step down. Thank you, Mr. Stegall.
I guess the next witness is, what, Ms. Cost?
MS. GLASS: Yes, Your Honor.
Your Honor, may I ask?
CHAIRMAN SCHMITT: Thank you.
MS. GLASS: I'm sorry. I think she needs to

be sworn first.

CHAIRMAN SCHMITT: No.

Ms. Cost, would you please raise your right hand?

Do you solemnly swear or affirm under the penalty of perjury that the testimony you're about to give will be the truth, the whole truth, and nothing but the truth?

THE WITNESS: Yes, I do.

CHAIRMAN SCHMITT: Ms. Glass, now you may ask.

* * * *

JACLYN COST, called by the Kentucky Power Company, having been first duly sworn, testified as follows:

MS. GLASS: Thank you.

DIRECT EXAMINATION

By Ms. Glass:

Q. Can you please state your name, business address, and employer for the record.

A. Yes. Jaclyn Cost. American Electric Power Service Corporation, and 1 Riverside Plaza, Columbus, Ohio 43215.

Q. And what's your position with AEPSC?

A. Regulatory consultant senior.

Q. Did you cause to be filed into the record of this case direct testimony and answers to data requests?
A. Yes.
Q. And do you have any changes to your direct testimony or answers to data requests?
A. No, I do not.
Q. If I were to ask you those same questions today, would your answers be the same?
A. Yes, they would.
MS. GLASS: Your Honor, the witness is available for cross-examination.
CHAIRMAN SCHMITT: Ms. Vinsel, questions?
MS. VINSEL: Thank you, Chairman. Staff does not have any questions for Ms. Cost.
CHAIRMAN SCHMITT: Mr. West, questions?
MR. WEST: No questions from AG. Thank you.
CHAIRMAN SCHMITT: Mr. Kurtz, questions?
MR. KURTZ: No questions, Your Honor.
CHAIRMAN SCHMITT: Ms. Grundmann, questions?
MS. GRUNDMANN: No questions, Your Honor.
CHAIRMAN SCHMITT: Mr. Spenard.
MR. SPENARD: No questions, Mr. Chairman.
CHAIRMAN SCHMITT: Mr. Fitzgerald?
MR. FITZGERALD: No questions, Mr. Chairman.

CHAIRMAN SCHMITT: Mr. Miller?

MR. MILLER: None from us. Thank you, Your Honor.

CHAIRMAN SCHMITT: Mr. Frye?

MR. FRYE: Nothing from us as well, Your Honor.

CHAIRMAN SCHMITT: Vice Chairman Chandler?

VICE CHAIRMAN CHANDLER: I have no questions. Thank you, Mr. Chairman.

CHAIRMAN SCHMITT: Dr. Mathews?

COMMISSIONER MATHEWS: I'm going to make it unanimous. I have no questions.

CHAIRMAN SCHMITT: Obviously, there can't be redirect since there's been no cross-examination, Ms. Glass.

Thank you, Ms. Cost. You may step down.

THE WITNESS: Thank you.

CHAIRMAN SCHMITT: I was hoping we'd get one more witness. If we could get Mr. -- is it Messner? And then take a break and begin with Mr. McKenzie.

MS. GLASS: Your Honor, we'll just need to sanitize both of our areas quickly.

CHAIRMAN SCHMITT: Okay. Mr. Garcia, are you ready?

MR. GARCIA: We are, Your Honor.

CHAIRMAN SCHMITT: Okay. Mr. Messner, would you please raise your right hand?

Do you solemnly swear or affirm under penalty of perjury that the testimony you're about to give will be the truth, the whole truth, and nothing but the truth?

THE WITNESS: I do.

CHAIRMAN SCHMITT: Thank you.

Mr. Garcia, you may ask.

* * * *

FRANZ MESSNER, called by the Kentucky Power Company, having been first duly sworn, testified as follows:

MR. GARCIA: Thank you, Your Honor. If I can check that I am being heard. Yes?

MS. VINSEL: Yes. Checking to make sure he's being heard.

CHAIRMAN SCHMITT: Oh, yes, yes. You can be heard. Loud and clear.

MR. GARCIA: Thank you.

DIRECT EXAMINATION

By Mr. Garcia:

Q. Mr. Messner, please talk into the microphone. And if -- at some point we may receive instruction that you may need to speak more clearly, being that

we're in a virtual environment. Is that okay?
A. Okay.
Q. Thank you. Would you please state your name, business address, and for whom you work, and in what capacity for the record, please?
A. Franz Messner. Managing director of corporate finance, American Electric Power Service Corporation. 1 Riverside Plaza, Columbus, Ohio 43215.
Q. Okay. And, Mr. Messner, did you cause in this case direct testimony, rebuttal testimony, and discovery responses to be filed on behalf of Kentucky Power?
A. Yes, I did.
Q. Were those prepared by you or under your supervision?
A. Yes, they were.
Q. Do you have any corrections to those data requests or rebuttal testimony or direct 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.
MR. GARCIA: Your Honor, I would tender the

witness at this point.

CHAIRMAN SCHMITT: Okay. Thank you.

Ms. Vinsel, questions?

MS. VINSEL: Yes, Chairman, we do have some questions.

CROSS-EXAMINATION

By Ms. Vinsel:

Q. Good afternoon, Mr. Messner. How are you today?

A. Good afternoon. I'm well. Thank you.

Q. Good. Good.

Let's jump in with unprotected excess ADIT. Some of the questions that I asked Mr. Mattison he deferred to you and, I believe, to Mr. Vaughan.

As you know, Kentucky Power is proposing to accelerate the return of approximately 65 million in unprotected excess ADIT. And that -- that is about half of the existing balance as of April -- let me be clear -- as of April 2020. Is that correct?

A. To my understanding, I think that's correct, subject to check.

Q. Subject to check.

Mr. Messner, did you participate at all in the -- I think it was a 2018 case involving the tax cut and JOBS Act reduction in corporate income tax?

A. No, I did not.
Q. Let me -- we've discussed several times that in that case Kentucky Power had offered testimony that it needed 18 years -- or minimum of 18 years to return the unprotected excess ADIT because a shorter period would adversely impact credit metrics.
I recognize you weren't part of that. I'm telling you that, hopefully, that you will agree that you have heard that somewhere.
A. Yes, I have.
Q. I'll also note that that period was substantially longer than the Commission authorized for any other utility.
So given that background, I think it's natural to have some concerns about returning roughly half of the balance over a one-year period. So can you tell me, are there impacts on the credit -- on Kentucky Power's credit metrics from returning the unprotected excess ADIT, the 65 million, in a one-year period?
And I recognize that was a long question. I can shorten it if you like.
A. No, I think I understand. Anything that delays or otherwise negatively impacts cash flows has a negative impact on credit ratings.

Q. So then let me jump to another question, and I'll circle back to that one. Is there a level of increased amortization of the excess ADIT that, if reached, will downgrade Kentucky Power's credit metrics?

A. I don't know that one could come up with a definitive calculation. It is a case that Kentucky Power's cash flows are what I would characterize as out-of-bounds low for their current credit rating. So they're already distressed.

Q. And I believe that there's testimony -- I'm sorry, I can't recall who filed this testimony -- that Kentucky Power is planning to finance the accelerated return of the ADIT.

Can you speak to that?

A. Yes. I'm not sure finance as in a proactive, okay, we need to go issue $65 million of -- you know, to offset this. It's my understanding that what the proposal is is to delay the rate increase for a year and offset that with an associated decrease of ADF -- deferred income taxes in the equal amount.

The impact that that will have is Kentucky Power will need to -- will either have negatively impacted cash flows, and depending on where their money pool balance, their short-term borrowing position is, may need to issue additional debt to term out some of the short-term debt.

Q. I may -- it may be Mr. West that had that testimony or Mr. Vaughan. I will follow up with them on that.

Let me ask, is there an ROE value that can offset any potential downgrade from the -- from any acceleration of the ADIT?

Let me ask this another way. Let me ask it a little more artfully. It's okay. You can laugh.

Now I'm trying to think of how I really want to say this. At what point, what -- what -- is there an ROE or a particular point where the excess ADIT, the increased amortization, would not result -- would balance out any credit metric adverse credit impact?

A. Let me think about that question for a second.

Q. Sure. Sure. What I'm really asking is is there an ROE value that can offset a downgrade?

A. ROE is the result of the Company's operations. And, obviously, in this process we agree with an authorized ROE. And it is the case that Kentucky Power has not been earning their authorized

ROE. In fact, I think it's close to half. And, obviously, that has negative financial impacts.

There is no -- there's not necessarily a tipping point in terms of if your ROE is this number that results in an automatic downgrade. The credit rating agencies consider all aspects, both financial, quantitative measures, as well as qualitative measures.

So I think the answer to the question is there's not a specific ROE that leads to a downgrade. Does that make sense?

Q. No, no. It does. It does. Thank you.

There also was testimony that, although the accelerated return of the excess ADIT -- although it would be a negative impact, there would not necessarily be an adverse impact from credit rating agencies because this was being returned over only one year. So, basically, a very limited time period, and that would mute any potential adverse impact.

Do I have that correct, or would you like to add to that?

A. Yes, you do, generally. I equate it to kind of ripping the Band-Aid off. While it will have a negative impact on cash flows, obviously, credit rating agencies, generally -- I'm not sure "accommodate" is the right word, but they take into consideration things that are short duration or one-time events, as being proposed in this rate case. Things that generally lead to being put on negative outlook and/or a downgrade are those things that last for longer than maybe a single one-time event.

And a perfect example of that would be the Rockport deferrals that were part of the last rate proceedings. I believe the order was in January of 2018, and in March of that same year Moody's moved to put Kentucky Power on negative outlook. And, basically, that means over the next 6 to 18 months they're going to evaluate the Company's financial performance and revisit sooner than perhaps they otherwise would, and then actually Kentucky Power was subsequently downgraded to Baa3, I believe, in April of 2019.

Q. I think this was one of the questions Mr. Mattison deferred to you. If -- if the same amount, that approximately 65 million of excess ADIT were -- it was accelerated over a two-year period instead of a one-year period -- so, if you will, split in half, same amount over two years -- would there be an adverse impact from that as opposed to returning the same amount in one year?

A. There will be an adverse impact either way, but, as I hopefully explained a moment ago, I think that the impact would be potentially more severe when the duration is extended other than the singular one-time event.

Q. And other than your professional experience -- and believe me, I'm not downgrading that at all, but other than that, of course, your professional experience, is there any other support that you have for your testimony in regard to the adverse impact from returning the excess ADIT over one year or even two years if that were the case?

A. In the credit -- Moody's credit opinions -- I don't recall the exact language, and I could find it for you, but one of the things that they talk about is a period -- you know, whether it be the ADIT or some of the Rockport deferrals from the last case, they talk about the reason for the downgrade -- I'm paraphrasing here -- was due to anticipated longer duration period of insufficient cash flows.

Q. Okay. And that makes sense because, again, as you said, accelerating the ADIT, that has an impact on Kentucky Power's cash flow.

A. It does, yes.
Q. And you don't have to show me the document. I think we might have it. There are some confidential exhibits that may have that, so we may see that later.
A. That's correct, yes.
Q. Let me move to short-term debt. And I believe, as you know, that during the test year the short-term debt increased from 380 -- excuse me -- 38 million, 38.65 million to over 122 million.
Do you want to check that and make sure that that's correct?
A. I think that's generally correct.
Q. I'm doing some rounding with the numbers.
A. Yeah. I don't -- I didn't see 122, but I do note in February it was 120 or rounded to 121.
Q. Then I misspoke. I meant to say 120.
Can you tell me why the short-term debt balance increased about not quite 82 million during the test year?
A. Well, for a variety of reasons. The primary one is the reason that we're here. Kentucky Power has not been earning their authorized ROE. In addition, they've been deferring some of their earnings. So while they may have earnings, a fair

amount of it is noncash earnings. So the short-term debt is being used to finance the operations of the Company.

Q. So, basically, using that -- as you said, using the short-term debt to operate the Company in the place of expected revenues. Would that be correct?

A. Right. Insufficient cash revenues require use of the short-term borrowing program for working capital purposes.

Q. Also in your testimony you discuss the fact that Kentucky Power had considered issuing private placement debt. I believe -- was that at the end of 2019 or fall 2019?

A. Yes. We started, in the third quarter of 2019, the process to evaluate issuing a private placement for those who are around. For the last rate case we had a similar situation. We issued a private placement in June of 2017, I believe.

But due to the fact that there was uncertainty around Kentucky's economic outlook, it would have made issuing in the private placement market, and those investors are typically insurance companies and the like, it would have been a little bit of a difficult sell in telling Kentucky Power's story.

So we kind of stood down and reassessed in December and then again in January. And, obviously, the rate case activity was going on. So what we did instead was, in lieu of the private placement, we issued a two-year term loan that closed, I believe, March 6 in the amount of 125 million to bring down Kentucky Power's short-term debt balance as it approached their authorized limit of 180 million.

Q. When you talked about uncertainty in Kentucky's economic activity, can you expand upon that?

A. Yes. As a point of comparison, when we did the private placement in 2017, we had investors come in, and we had investor presentation for them. At the time there was a lot of activity related to Braidy Industries. I'm not sure if EnerBlu was in the mix yet or not.

There was potential for the -- there was discussions between then-President Satterwhite and members of Congress about, you know, the potential for bringing investment, bringing manufacturing into the Kentucky Power service territory. So that story was positive.

Segue to 2019, the conditions are markedly different. So we decided to stand down instead.

Issued a two-year term loan to span the period of the rate case and perhaps allow for some further economic development in Kentucky.
Q. That's what I -- my next question, you just partially answered, and that's what is it that led Kentucky Power to make this decision to get that two-year term loan to lower the short-term debt about a month before the rate case?
A. So, originally, we had intended on doing the private placement in the fourth quarter last year. I believe the balances -- we had forecast that the balances would be about where they are in, you know, October-November time frame. So we had looked at originally doing this in the November-December time frame.
And because of the, you know, the decision to delay and the balance at the time, we switched course and went to the term loan. We ended up issuing the 125 million in March.
Q. Was it a question of timing? It was just a question of timing for -- for what, I guess I should say.
A. So we had originally intended to term out, you know, roughly 100 million or so in the fourth quarter of last year to put longer-duration debt on

Kentucky Power that more closely matched the asset lives, but because the conditions didn't warrant that, or we -- banks will tell us that there's a deal to be done, but that means it might be at a price that's unattractive.

So rather than issuing into that market in the private placement world, we decided to do a two-year term loan with two banks and knowing that, you know, the rates were going to be cheaper, and it would basically allow us to span the period of the rate case and perhaps allow for more economic development.

Does that answer your question?

Q. No, no, thank you.

Is there any general principle that prompts Kentucky Power to roll short-term debt into long-term debt?

A. Yeah. Generally, with Kentucky Power and our other operating companies, we use short-term debt as a means of support operations and working capital. And then, when the debt amount either gets close to their authorized limit or to -- not necessarily in Kentucky Power's case but for some of the other SEC registrant companies, when they get to something that's called index eligible size, which is generally 300 million or more, we will term it out at that point, again using -- the typical durations are 10 and 30 years. But -- and, again, that's to match the longer-lived assets.

Q. Thank you.

I'm going to try very hard to ask this next batch of questions without having to refer to a document, but basically I want to talk to you about senior unsecured notes.

In the application, one of the schedules has long-term debt, and that includes ten senior unsecured notes, all with maturity dates between June 2021 and September 2047. I can give you the exact citation if you want it. It's in the application Section 5, Exhibit 2. It's Work Paper S3.

And if I went too fast, I can repeat it.

A. I have that right in front of me.

Q. Okay. So when a debt instrument matures, does Kentucky Power typically refinance that debt instrument?

A. Generally that's the case, yes.

Q. And if the refinancing was at a higher interest rate, would there still be refinancing?

A. If the market conditions indicated that -- yes. I mean, we do the issuances to maintain capital structure, you know, investment grade capital structure that is viewed favorably by the credit rating agencies.

If it's the case that the market rates, prevailing rates are higher, that would -- that would be something that we would do.

Q. Okay. One of the senior unsecured notes matures on June 18, 2021, and it has an interest rate of 7.250 percent.

Do you anticipate that Kentucky Power will refinance with June 2021 bonds if an interest rate savings could be incurred with bonds?

A. Could you restate the last phrase of that sentence -- question?

Q. Sure. Do you anticipate that Kentucky Power will refinance that note with bonds if an interest rate savings could be incurred?

A. I don't know that it's contingent on interest rate savings, but, obviously, it's maturing, so we would need to do something to account for that maturity.

It may be the case -- I know that might have been a little vague. It may be the case, and I'm speculating slightly here, but, we may look to do an issuance depending on whether the Kentucky short-term debt balance that would not only take out -- you know, take down the short-term debt balance but also facilitate the -- you know, offsetting the maturity.

Q. Thank you. And I apologize. I needed to -- we're doing a text as a back channel with my coworkers who cannot be here with me today. So I needed to double-check something with a team member.

A. I understand.

Q. Normally, I would just turn and be able to ask them.

While I'll wait to see if I get a response, just in general, would you agree that interest rates have fallen since 2017 with one exception of a slight uptick in, I think, September of 2018?

A. Yes, I would say that's accurate.

MS. VINSEL: Okay. Staff has no further questions.

CHAIRMAN SCHMITT: Mr. West, any cross-examination for this witness?

MR. WEST: Yes. We have just a few questions.

* * *

CROSS-EXAMINATION

By Mr. West:

Q. Hello, Mr. Messner.

A. Hello.

Q. Just a few questions about the short-term debt issue that Nancy just explored with you a bit, but during the test year the average monthly balance of short-term debt outstanding was 80.621 million, correct?

A. Yes.

Q. But for ratemaking purposes, the Company proposes a capital structure with no short-term debt. Is that also correct?

A. Yes.

Q. So if the Company sets short-term debt at zero dollars assessed year, is that accurately portraying the month-to-month operations of the Company?

A. Well, a couple of things there. One, you know, some of the discussions that we just had about we had actually initially intended to issue the private placement earlier, which obviously would have impacted the average balance, but the capital structure that we proposed in this rate case is consistent with last rate case.

It's based on a 3/31/20 test year, and I believe the requirements mandate that we use the per-books balance on that date. And, as a practical matter, the delay in the private placement and subsequent term loan that we issued actually resulted in a rate -- the term loan on 3/31 actually has a lower rate than the short-term debt rate that's included in the cost of capital.

MR. WEST: Okay. Thank you. That's the only questions I had.

CHAIRMAN SCHMITT: Mr. Kurtz, cross-examination?

MR. KURTZ: Thank you.

CROSS-EXAMINATION

By Mr. Kurtz:

Q. Sorry. Good afternoon, Mr. Messner.

The unprotected excess ADIT, that's money that Kentucky Power owes to consumers; is that correct?

A. Yes.

Q. And you're holding on to it and essentially paying consumers the weighted average cost of capital on the unamortized balance?

A. Could you restate that question, please?

Q. Isn't the weighted average cost of capital carrying charge added to the balance that you owe customers?

A. I am not familiar with that and would defer -- I don't know if it's Company Witness Whitney or West.

Q. Well, if it's money that the Company owes consumers, and you're not providing any interest carrying charge on it, then the longer it takes to give it back, the worse off consumers would be, correct?

A. Again, I'll defer to Company Witness -- now that you're asking the question that way, it may be Company Witness West or Company Witness Vaughan.

Q. Okay. This is an issue that AEP deals with in all of its jurisdictions, the unprotected excess ADIT; is that correct?

A. To the best of my knowledge, yes.

Q. For the protected, the tax rules require that the money be refunded over what's called ARAM, correct?

A. I'm not familiar with that. And, again, I would defer.

Q. For the unprotected, it's up to, essentially, the discretion of the various commissions.

Do you know -- for example, the amortization period in Kentucky, the settlement the Commission awarded was 18 years. Do you know the corresponding terms for Virginia, West Virginia, Indiana, et cetera?

A. No, I do not.

Q. What about for the transmission, the OATT? For transmission same thing -- you have this money that the transmission owner owes consumers, and you give it back. Is there a uniform term that FERC has mandated?

A. I'm not familiar with that.

Q. Okay. Kentucky Power is asking for a 13 percent base rate increase in this case, 70 million; is that right?

A. I'm not familiar with the percentage, but if --

Q. But it is 70 million?

MR. GARCIA: Objection, Your Honor. The witness has indicated that he doesn't know.

CHAIRMAN SCHMITT: I think that's correct. I think he has indicated he's not familiar with that.

MR. KURTZ: Okay. I thought he said he didn't know the percentage.

THE WITNESS: No, I do not.

Q. Okay. You don't know the dollar amount either?

A. I'm sorry. Could you repeat that question?
Q. You don't know the dollar amount of the requested base rate increase?
A. Not offhand. I believe it is in the 65 to 70 million range, but --
Q. Yeah. Do you prepare -- are you on the earnings calls with the investment analysts that occur quarterly?
A. I listen to them as I'm able.
Q. We saw you testify that Kentucky Power has a low earned rate of return currently, and it consistently drags down the AEP average return. Isn't that correct?
A. Yes, they are -- Kentucky Power is underearning.
Q. And historically has underearned?
A. Yes, I believe that's the case.
Q. And we saw earlier that the solution to that product underearning is to grow rate base to increase rates to increase earnings.
Were you here for that?
A. I heard some of that discussion, but I think earning -- earning a -- I guess the authorized return is the reason that we have this rate proceeding. Kentucky is not earning anywhere near

that, so as part of that story or process is a regulatory process, and I'm coming before the Commission and establishing reasonable rates.

Q. Agreed. A big driver of the rate increase is poor sales or loss of sales, correct?

A. I don't know specifically the main driver. All I know is that Kentucky Power's earning nowhere near their authorized ROE.

Q. If base rates go up by 13 percent additional, that's going to cause sales to go down even further because there is some elasticity of demand. People will use less of a product when you charge more.

Doesn't that just exacerbate the problem?

MR. GARCIA: Objection, Your Honor. That's outside of the scope of the testimony of this witness.

CHAIRMAN SCHMITT: I'm sorry. I didn't understand the objection.

MR. GARCIA: Outside of the scope of the testimony of this witness.

CHAIRMAN SCHMITT: Yeah, I understand. We have wide-open cross-examination in Kentucky under our rules. And it is, I think, relevant to the entire proceeding.

MR. GARCIA: Thank you, Your Honor.

Q. Doesn't that just make the problem worse?
A. Would you please restate the question? There's a couple different things going on there.
Q. Kentucky Power has bad earnings, historically has had bad earnings, historically drags down the AEP average. It's entitled to a reasonable rate of return, but when you grow rate base, grow earnings, and you raise rates, you're going to drive down sales even further and just make the problem compound.
Don't you -- do you see that?
A. Not necessarily. I can't speak to consumers' usage. What I can speak to and what I'm supporting here is the cost of capital and the capital structure and this process by which Kentucky will be able to earn a fair and reasonable return.
Q. Have you ever heard the concept of, in finance that, there's a natural owner of an asset?
A. Could you ask that question differently, please? I'm not sure I understand what you're getting at.
Q. Do you believe that AEP is the natural owner of the eastern Kentucky service territory? Is it best suited to serve its own interests and the interests of consumers, or might there be a better,

more natural owner of that (indiscernible)?
A. I don't have an opinion on that.
MR. KURTZ: No more questions, Your Honor. Thank you.
CHAIRMAN SCHMITT: Ms. Grundmann, questions?
MS. GRUNDMANN: No, Your Honor.
CHAIRMAN SCHMITT: Mr. Spenard?
MR. SPENARD: Yes, Mr. Chairman. We have a few questions.

CROSS-EXAMINATION

By Mr. Spenard:
Q. As a preliminary matter, to the witness, can you hear me?
A. Yes.
Q. Okay. And, if you have any difficulty hearing me or understanding a question, just let me know. Okay?
A. I will. I will.
Q. Thank you.
Let's -- let's go back to your testimony from the stand today. If I understand correctly, one of the things that you're testifying about are the cash -- you're talking about cash flow, and you're talking about the earnings from the revenues that are being sought and the cash flow implications.

Is that a fair characterization?
A. It's accurate that there is a relationship typically with revenues and cash flows, but, obviously, in the case of deferrals, you know, the cash would not be there.
Does that make sense?
Q. All right. So, when we're talking about the accumulated deferred income tax and the balance that's currently carried on the books, the accumulated deferred income tax balance is generated, or it comes into existence, based upon a timing difference between the tax liability to the Internal Revenue Service and then the tax liability that's -- that's for calculating rates.
Is it based on a timing difference?
A. I believe that's generally true. I would defer perhaps to Company Witness Whitney on some of the more technical aspects.
Q. Sure. And I appreciate that. And if there's something that another witness needs to discuss, then that's perfectly fine, or if you think it's fair to give a comprehensive answer, that's fine as well. I just want to try to get a very general understanding.
What is your testimony today with regard to

the cash flow -- the cash flow -- the consequences to the cash flow associated with Kentucky Power returning the excess -- a portion of the excess deferred income taxes to the ratepayers over the next year?

A. My testimony is that delaying the implementation of rates and thus the receipt of cash will negatively impact Kentucky Power's cash flows versus a scenario where rates go into effect January 1st of 2021.

It's my understanding from listening to Company Witness Mattison and perhaps others that, you know, this delay and offset to ADIT is being done as a way to, you know, to help customers and perhaps get, you know, beyond the period, you know, with this pandemic crisis.

Q. Okay. So when you're saying in terms of when rates go into effect, that -- to your knowledge, if you know, and if you don't, then we'll ask another witness. For the rates that are the subject to this application, what is the proposed -- as we sit here today, what is the proposed effective rate for the increase in rates subject to this application?

A. Would you define what you mean by "the rate"?

Q. Well, as part of the application -- if you know, as part of the application, did Kentucky Power Company supply new tariffs, proposed tariffs containing new rates?

MR. GARCIA: Your Honor, if I may, I think the objection would be to the use of the term "rates," which, in the context of regulated service, has a different meaning than in the context of finance in which Mr. Messner is testifying. That may be the confusion.

MR. SPENARD: Mr. Chairman, if I may, that's -- if my question is confusing, then I'll add a little more specificity to the question perhaps. Again, if it's a better witness --

CHAIRMAN SCHMITT: Please do. If the witness doesn't understand, the witness needs to say "I don't understand." Either "I don't understand the question" or "I'm not the person who can appropriately answer the question."

But go ahead. Rephrase your question, if you would, Mr. Spenard.

MR. SPENARD: Yes, Mr. Chairman.

Q. Kentucky Power generates revenues by reference to the rates that it has on file, and they're approved by the Kentucky Public Service Commission; is that correct?

A. Yes.
Q. And the current application, among other things, is seeking an increase in the rates for service that Kentucky Power will be authorized to charge its customers; is that correct?
A. Yes. Thank you for the clarification.
Q. Okay. You're quite welcome.
With regard to the effective date of the increase in rates to generate additional revenue, what is the effective date for the rate increase?
A. I'm not aware of that, what that exact date is. It's my understanding is that the proposal is to delay by a year and offset an ADIT balance. The specific date, I would have to defer to probably Company Witness West or Company Witness Mattison.
MR. SPENARD: Okay. Well, thank you. And at this stage what we'll do is we will -- we'll address the issue with Company Witness West, but I certainly appreciate your answers. Thank you.
CHAIRMAN SCHMITT: Anything further, Mr. Spenard, of this witness?
MR. SPENARD: No, no further questions for this witness, Mr. Chairman.
CHAIRMAN SCHMITT: Mr. Fitzgerald?
MR. FITZGERALD: Mr. Chairman, we have no

questions.

CHAIRMAN SCHMITT: Mr. Miller?

Mr. Miller may have dropped off.

Mr. Frye?

MR. FRYE: I am here, Mr. Chairman, and no questions.

CHAIRMAN SCHMITT: Okay. Mr. Miller, are you -- have you come back? If not, if --

MR. CHILDERS: Your Honor, this is Joe Childers.

CHAIRMAN SCHMITT: If you have questions -- well, I'll ask Mr. Miller in a minute. Is he there?

VICE CHAIRMAN CHANDLER: No. I think, Chairman, that -- I just want to say Joe, but Mr. Childers noted that Sierra Club did not have any questions. I think there he is now.

MR. CHILDERS: That's correct. No questions.

CHAIRMAN SCHMITT: I'm sorry. I didn't know you'd come in place of Mr. Miller.

Are you -- do you have questions of this witness?

MR. CHILDERS: No questions, Your Honor.

CHAIRMAN SCHMITT: Thank you.

Vice Chairman Chandler, questions?

VICE CHAIRMAN CHANDLER: Thank you, Chairman.

Sorry about that, Mr. Childers.

EXAMINATION

By Vice Chairman Chandler:

Q. Good afternoon. Can you hear me okay?

A. Yes, I can.

Q. Great. So, as a preliminary question, have you seen the witness list in this case for the witnesses on behalf of the Company?

A. I have -- I believe I have, yes.

Q. Okay. And insofar as you've seen that witness and, at least in a general matter, know who is on that witness list, are you the person in this case that most often would be discussing AEP and Kentucky Power matters with banks?

A. Yes.

Q. Okay.

VICE CHAIRMAN CHANDLER: Chairman, can I ask if we can go into a short confidential session?

CHAIRMAN SCHMITT: Yes. Let's -- Candace, can we go -- can you get us into confidential session?

MS. SACRE: We're in confidential, Chairman.

CHAIRMAN SCHMITT: Okay. We're now in confidential session.

(Confidential testimony of Mr. Messner heard from 3:30 p.m. through 3:50 p.m.)

MS. SACRE: Okay. We're back in normal session, Chairman.

CHAIRMAN SCHMITT: We're back now in public session.

Q. All right. Mr. Messner, can you still hear me?

A. Yes.

Q. Okay. Great. Would you agree that risk and return are positively correlated? Would you like me to ask it differently?

A. Yeah. If the question is is higher risk correlated to higher return?

Q. Well, let me ask it this way. As one increases, do investors, as a general matter, expect the other to?

A. I believe I agree with you. They would -- their intent, I assume, would be to be compensated commensurate with the risk.

Q. Right. And that's the basis for -- for instance, Mr. McKenzie is going to talk to us either later today or tomorrow on it, correct?

A. That's my understanding.

Q. On page 6 of your rebuttal testimony, line 21 and 22, you refer specifically to the ratios that

the Company uses for cash flow.
A.   I'm there.
Q.   So I'm aware of FFO to debt as a general -- I couldn't explain it to you besides the bare bones of it.
       What other ratios may you be referring to there other than FFO to debt, if you are referring at all to FFO-to-debt ratios?
A.   So the Moody's ratings methodology has 40 percent of their methodology based on financial metrics, and those include cash from operations plus interest divided by interest; cash from operations divided by debt, which is the most important of the financial ratios; cash from operations plus dividends divided by debt; and then debt to capitalization, which is not necessarily directly, obviously, a cash flow-related item.
       And then the remaining 60 percent, 25 percent of that is regulatory framework. That includes legislative and judicial underpinnings of the regulatory framework of 12.5 percent, and then consistency and predictability of regulation is another 12.5 percent. So those two together make up the 25 percent regulatory framework measure.
       The next 25 percent is ability to recover

costs and earn returns. And that would include, in equal portions, timeliness of recovery of operating and capital costs, and sufficiency of rates and returns.

And then the remaining 10 percent is diversification split equally between market position and generation and fuel diversity.

Q. Okay. Great.

A. I've submitted, I believe, certain of the Moody's credit opinions, and they have scores in those opinions that -- for each of those measures.

Q. Great. And so, as I understand it, you discussed a couple of these measures, but as I take it away, you only discussed the ones I can think of that were negative or that were going the wrong way. Is that incorrect?

For instance -- let me ask it this way -- are you aware that the company in this case is proposing to recover 100 percent rather than the current 80 percent of LSE OATT expenses through the tariff PPA?

A. In listening to testimony this week, I've heard that discussion, but I was not specifically involved in that, no.

Q. No, no, I agree. But I didn't see your

testimony on it at all. But what I'm asking is, outside of the 40 percent financial, you would agree that that at least is a positive for some of those other categories that Moody's, for instance, takes into account, correct?
A. I'm going to paraphrase your question. If the proposal in this case, they were allowed to earn recovery on hundred percent -- I apologize. I don't know a lot about that issue -- specific issue. So perhaps you can either rephrase the question, or maybe somebody else would be better able to answer it.
Q. Well, we're talking about the timely recovery of costs, right?
A. Right.
Q. And it's a tracker that recovers costs. So we know that it deals with the timely recovery of costs. So we know that. And that's what one of those statements you read was about, correct?
A. Correct.
Q. And instead of recovering 80 percent of the cost through a tracker, they recover 100 percent of the cost through a tracker.
So in terms of timely, great. But, second, wouldn't you also agree that that's also the ability

to recover expenses, one, and that would help in the ability to earn an ROE, right?

A. I would agree that having this automatic recovery is viewed favorably as opposed to being required to go in for a base rate case in order to recover those costs.

Q. Right. And even in addition to that, it helps in the whole idea of a constructive regulatory -- or a constructive regulatory atmosphere environment, correct?

A. To the extent that it's viewed as favorably impacting Kentucky Power's financials, yes.

Q. Okay. So -- but I guess what I'm asking for is would you agree, then, that insofar as what credit ratings agencies look at with risk, that the testimony was only focusing on the downside risks presented in the Company's application, or the status quo without the rate case, rather than any of the positives that it's proposing or that had occurred?

A. I only -- in the testimony that -- my rebuttal testimony that you've referenced, I'm only focusing on the impact that decreased cash flows would have on Kentucky Power's credit rating.

Q. Right.

A. Not discussing other risk-associated items.
Q. Right. But what I'm asking is you're the only person for Kentucky Power that discussed any of these credit-related issues, right?
Let me ask the question differently. Are you aware of any other Kentucky Power witness that spoke to any of those other considerations that Moody -- that Moody's has in making their credit ranking decisions?
A. I've not read all the testimony. I don't know. I do know that I reviewed testimony from a 2018 case, Company Witness Horeled, and I believe he did, in fact, talk about credit ratings. I'm not sure if anyone has in this case.
Q. Okay. One of the financial metrics you mentioned was something something something divided by debt. Was that free cash flow from operations?
A. Yes.
Q. Okay.
A. That's one thing that Moody's, I guess, has the largest weighting from a financial perspective.
Q. Okay. How is Kentucky Power's FFO to debt?
A. As I mentioned earlier, I would characterize it out-of-bounds low for their current credit rating. I wish I had their most recent credit

opinion, but if I remember correctly, I believe it decreased from the mid-teens down to -- I want to say 10 percent, subject to check, at year-end 2019. And I believe that the range that Moody's looks for for Baa entities are -- is 13 percent to 22 percent.

Q. Do we have in this record what the -- what the anticipated FFO-to-debt ratio is in 2021?

A. Not to my knowledge no.

Q. And if we requested that, would the Company be able to provide it? If we asked -- if we asked, based on the application, what is the Company's anticipated FFO-to-debt ratio in the year 2021, the calendar year, would the Company be able to estimate that?

A. The calculation can be done, but I'm not sure how reasonable the estimate would be, only because there's so many other factors that would go into cash from operations. You know, load assumption, more or less all the assumptions that are part of this case.

Q. Right. But what you said was that -- you talk about decreased cash flows having an impact on Kentucky Power's credit rating, but other than talking about it in general, how can the Commission take that into account if we can't look at it in the particulars?

A. I think you can look at Kentucky Power's -- the latest Moody's opinion. And, subject to check, I believe it was April of this year, and they mention a couple of different items related to deterioration in the cash flows.

And there is a schedule in there that shows -- I'm not sure how far back it goes, but you can see that particular metric. And, again, I wish I had it in front of me, but I believe it's now -- at year 2019, I think it was --

MR. GARCIA: Your Honor, if it would be helpful, I actually have a copy handy I can provide to the witness.

VICE CHAIRMAN CHANDLER: If you're going to provide it to the witness, could you identify where in the record it is?

MR. GARCIA: Sure, Your Honor. And this is attachment to AG1-39. And that includes the various credit report updates, and each one of them has a particular date. So I'll let the witness identify once they have them.

VICE CHAIRMAN CHANDLER: Thank you.

MR. GARCIA: May I approach the witness, Your Honor?

VICE CHAIRMAN CHANDLER: Don't forget to turn your microphone back on, Mr. Messner.

MR. KURTZ: Vice Chairman, could I interject something, please?

VICE CHAIRMAN CHANDLER: Up to the Chairman.

CHAIRMAN SCHMITT: I'm sorry? What was the question?

MR. KURTZ: Chairman Schmitt, could I interject at this point?

CHAIRMAN SCHMITT: Yes.

MR. KURTZ: On AG KIUC Hearing Exhibit 1, page 74, it will demonstrate the FFO-to-debt ratio of all the AEP operating companies, and it will confirm that, just like earnings, Kentucky Power is dragging down the AEP average quite considerably. And perhaps that can be put on the screen. I think it would be --

CHAIRMAN SCHMITT: I was going to suggest maybe that would be better than the direction we're going now.

MR. KURTZ: So that's Hearing Exhibit 1, page 74. Nancy?

MS. VINSEL: I was going to say, I'm not sure. I'm not sure exactly -- there it is. There it is.

MR. GARCIA: Thank you, Your Honor. Specifically, the April 2020 credit opinion for Kentucky Power from Moody's is in AG 179, Attachment 6.

VICE CHAIRMAN CHANDLER: Okay. Thank you.

Q. So, Mr. Messner, are you looking at the same thing there we are, page 74 of KIUC Hearing Exhibit 1 -- AG KIUC Hearing Exhibit 1?

A. Yes.

Q. Okay. So is this -- so you're saying that in 2019 that 8.7 percent is the FFO to debt for Kentucky Power?

A. So there are a number of different views that -- of this particular measure. AEP has a view that adjusts for certain -- makes certain adjustments.

Moody's has a view, and they have a standard methodology that they put out, the things that they adjust for, and S&P also has their own methodology. And then there's, of course, GAAP, if you just use the GAAP numbers, but the numbers that I see here are close to what the Moody's view suggests.

Q. Excuse me. Okay. So we've got an FFO-to-debt ratio here in 2019, and I just want to

make sure
that -- your rebuttal testimony talks about the deterioration of cash flows and the impact those reduction to cash flows has on metrics and those metrics have on credit ratings, right?
But what I'm asking, has the Company provided the Commission, in consideration of its request here, or of any other matter in any other, you know, 2019-2020 case, the impact of its proposals?
A. Not to my knowledge, no.
Q. So we know that any cash outlay, whether it be $1 or $100 million, has an impact on cash flow, right?
A. Yes.
Q. And it's -- it's a matter of degree, would you agree, as to what impact it ultimately has, any given proposal?
A. I think that's a reasonable statement.
Q. Okay. So, like, an amortization of $100 million of excess ADIT over 100 years has an impact on cash flow, but it's a greater impact if it's amortized over 50 years. Is that fair?
A. A shorter amortization period has a larger negative impact from a credit perspective.
Q. Has a greater impact. And that's intuitive,

but what I'm asking is 18 years in 2018 35, as I understand from the Company's proposal, was still a concern, 10 years is a concern. But any shorter time is going to have a greater impact on the Company's cash flow. That was your testimony earlier, correct?

A. It will have a larger negative impact on the Company's financial position.

Q. And you're saying, for $113 million balance, that the Company can pay $65 million amortization in one year because it's only one year?

A. I'm not necessarily saying they can take it. I believe my testimony was that a more singular, one-time event may be viewed by Moody's more favorably than if the duration is extended.

And, again, there I'll reference back to the last case -- and they mentioned it in their credit opinions -- the cash deferrals are pressuring their credit metrics.

Q. Okay. So that's perfectly fair, but you understand the Company is proposing the $65 million accelerated amortization to offset their rate proposal, right?

A. Yes.

Q. So I'm asking can the Company financially

take that proposal? Can it weather that proposal that they're making?
A. When you say "weather," do you mean from a credit rating perspective, I assume?
Q. From a financial health and/or a credit rating perspective.
A. It's -- it's a financial burden for sure.
Q. Okay. So -- so to Ms. Vinsel's question earlier about a one-year amortization at approximately $65 million, okay? Work with me here on a hypothetical because I really want to understand the way Moody's and S&P look at this, okay, and you're our insight into that.
If Mr. Mattison gets up at the end of the hearing and says, "We are going to half our revenue requirement ask." Right? So let's just say it's 66 million, that we're proposing that it only be a $33 million-a-year increase.
Do you follow me up to now? In the hypothetical, do you understand up to that point?
A. If I understand you correctly, you're suggesting in lieu of 65 million, you halve it to 33 million.
Q. Yeah. Okay. We're on the same page then.
And in lieu of a one-year, approximately,

$66 million amortization of excess ADIT, Mr. Mattison says no, no, we're going to do two years at 33 million.

Right? Does that make sense? So it's the same amount. What I'm asking for, it's still a limited duration of two years instead of one year, right?

What is your understanding of how that will be -- would be viewed?

A. Again, I apologize if I wasn't clear earlier. The rating agencies, in my view, would be more understanding of a single, one-time event as opposed to something that puts continued pressure on particularly a metric that is already below investment grade.

Q. So a one-time event only counts as one year, is what you're saying, instead of a one-time event that just so happens to occur over two years?

A. It's the duration, I think, that would be viewed unfavorably. I mean, as a practical matter, Kentucky Power's metrics are quite poor now. I think the rating agencies would recognize that this is being done to offset some of the increase -- you know, the impact on the customers.

It may not change their overall opinion, and they may -- you know, may put the Company on a negative outlook or take further rating action. But, again, in my opinion, the one-time event with the one-year duration would have less of an impact than two or more years.

Q. Well, what I want to finally get to is you say less of an impact. What we were talking about earlier about the impact, for instance, cash flow, we agreed that it was a degree, right? It was a matter of degree. Over 100 years, 50 years, 25 years, they all have a negative impact to cash flow. It's to the degree at which.

So what I would ask now is what degree to which will that be viewed negatively as a one-year event -- a limited duration one-year event at the same magnitude as a limited duration two-year event?

A. I can't assign a specific degree, but, as I mentioned earlier, after the last rate case Moody's put Kentucky Power on negative outlook. And, again, their protocol is to revisit that company in the next 6 to 18 months, which they did, and the cash flows were still low over that time.

So the longer the cash flows are not in range, again, in my mind, the higher the probability that they might take action as opposed to an instance

where we do a one-time in a single year.
Q. Okay. And what's the outlook for both S&P and Moody's as it relates to Kentucky Power?
A. Kentucky Power, the outlook is stable.
Q. For both, correct?
A. Yes.
VICE CHAIRMAN CHANDLER: I appreciate it, Mr. Messner. Thanks for bearing with us through the transition there. Thank you.
CHAIRMAN SCHMITT: Dr. Mathews, any questions?
COMMISSIONER MATHEWS: I have a question related to something else.
You probably are the right person since you deal with the ratings agencies and the lenders.

EXAMINATION

By Commissioner Mathews:
Q. Is there an impact of Kentucky Power being so heavily fossil fuel? Does that have an impact on the ratings?
A. I believe -- you're a little bit muffled, but I believe --
Q. Oh, I'm sorry.
A. -- the question was is the fact that Kentucky Power has fossil fuels in their generation mix, does

that impact their credit ratings or how they are viewed by investors?

I can tell you that --

Q. Say both.

A. -- the investors definitely take that into consideration, and there are certain investors who will no longer lend to companies that have any kind of carbon footprint.

From a credit rating perspective, I would need to go back and look at the opinion. I know it's mentioned -- I believe it's mentioned in the credit opinion, but without actually reading it --

Q. That's fine.

A. -- which I'm happy to do, I'm not sure. I think the singular reliance does have -- well, I can't speak to that yet without -- I would need to look and read the opinion.

Q. Okay. And that's in our documents. I'll just read that myself.

COMMISSIONER MATHEWS: That's all I have.

CHAIRMAN SCHMITT: Okay. Thank you. Mr. Garcia, any redirect?

MR. GARCIA: Yes, Your Honor, just a few.

* * *

REDIRECT EXAMINATION

By Mr. Garcia:

Q. Mr. Messner, you were asked some questions regarding the credit metrics of Kentucky Power and the relationship with the authorized ROE?

A. Yes.

Q. And, if you would explain to me, sir, a little bit the relationship between the credit metrics, the authorized ROE and the actual ROE that the Company earns from the point of view of credit metrics and credit rating agencies.

A. So I guess the response to that would be the actual earned ROE are the most important. As we know, Kentucky Power has an authorized ROE that's significantly higher than what their actual earned ROE is. So, in that regard, earned ROE is most important by far.

Q. Do I understand correctly that having an authorized ROE is important, but earning it -- or the actual earned ROE is what affects most significantly the cash flows and the credit metrics?

A. Yes, that's correct.

Q. And, in turn, that would have the greater impact on the credit rating agency's evaluation of the Company?

A. Yes. Actual ROE -- actual earnings has the most impact.
Q. Okay. And you were asked about the ability of the Company to recover its transmission costs.
Do you recall that line of questions?
A. Yes, I do.
Q. Okay. And on a very general level, it's your understanding that the credit rating agencies would view negatively if the ability of the Company to recover those transmission costs in a tracker was eliminated?
A. Yes. The ability to recover via tracker is viewed more favorably than if the Company would have to wait for a base rate proceeding. The current recovery is viewed favorably, yes.
Q. Okay. And in your testimony, if I recall correctly -- and if not, if you could state it right now -- one of the things that the rating companies right now in their evaluation most recently in April of 2020, one of the things that they consider a favorable factor supporting Kentucky Power is its regulatory environment. Is that correct?
A. That is correct, yes.
Q. And having the tracker for recovering transmission costs would be part of that supportive

environment, correct?
A. Yes, it would.
Q. Let me ask you something. And you were also asked some questions about the return of ADIT?
A. Yes.
Q. And do I understand correctly that the -- in terms of credit metrics, starting on 2022 the return -- when I say pace, it was authorized in the 2018 case -- by the Commission in 2018. It's going to be the same as it was authorized in 2018. Is that correct?
A. That's my understanding after the one-time event proposed, that it will be consistent with what was agreed to in the 2018 proceeding.
Q. And does that relate to what you were indicating --
MS. VINSEL: We can't hear.
CHAIRMAN SCHMITT: Sorry. Sorry. Stop. I don't think --
MR. GARCIA: Thank you, Your Honor.
CHAIRMAN SCHMITT: Well, wait, Mr. Garcia. I think people are having difficulty hearing your questions and possibility the witness's answers, but I think it's his questions.
MS. VINSEL: No. Actually, his --

Mr. Messner's last response, we could not hear.

CHAIRMAN SCHMITT: All right. The issue was Mr. Messner's last response to your question, which could not be heard. So I don't know if we can read the question, or if you can remember -- if Mr. Messner can remember the question and try to reanswer.

THE WITNESS: Yeah, it's probably safest to reask the question. I believe the answer -- I know the answer, but --

MR. GARCIA: I can ask the question again, Your Honor, and I'll try to speak slower.

CHAIRMAN SCHMITT: All right. Thank you.

MR. GARCIA: Thank you, Your Honor.

Q. So, Mr. Messner, you were asked about the return of the ADIT?

A. Yes.

Q. And is my understanding correct that starting on 2022, the pace at which the Company is going to be returning to customers if the ADIT would be the same as it was authorized in 2018 by the Commission?

A. Yes, that's my understanding.

Q. Okay. And is there a relationship between that quality and your indication that it does make a difference from the point of view of the credit metrics and the way that they are evaluated by credit rating agencies of whether the duration of the accelerated return that is proposed by the Company in these circumstances that we have today, is there a relationship between those two, that starting in 2022 it essentially goes back to what was approved in 2018?

A. So if I understand your question, I would -- I would assume there would be no difference -- or no difference in opinion of the credit rating agency that they have now if the rate of return goes back to being the same as it was, you know, as part of the '18 proceeding.

Q. But if the duration of the accelerated process was longer, you would expect that it's more likely that there would be a reaction?

A. Yes, that would be viewed negatively, more negatively than the one-time event.

Q. Let me switch topics, if I may. You were asked about the maturity of some debt by Kentucky Power?

A. Yes.

Q. Okay. And, if you can explain to me, Mr. Messner, is it normal for the Company to refinance debt earlier than its expected maturity?

A. That's not -- that's not typical, no.

Q. And why is that?

A. Well, debt, and particularly the debt that was discussed in the rate case proceeding today, is a make-whole requirement. So refinancing it early would require effectively a make-whole is a payment to investors of the interest that will be foregone, and that payment is on top of the principal that will be repaid.

So from the investors' perspective, they're, quote, made whole in that they're getting the interest that they would have otherwise earned, you know, between now and the maturity, as well as the return of the principal amount.

Q. Now, going back to the way that the Company actually did it in this case this year, the new term loan that the Company was able to secure to refinance its debt, the interest rate was actually lower than the short-term debt that it repaid; is that correct?

A. Yes.

Q. And that is a benefit to customers?

A. Yes. The impact is that it would -- resulted in a lower cost of capital than had we left the short-term debt balance outstanding.

Q. Now, to be fair, is that circumstance usual, or was that a situation that was rather unusual?
A. It was a rather unusual situation in that the short-term debt rate was based on the 12-months ending March 31st of 2020, the cost of short-term debt over that period.
And it just so happened that, when we did ultimately issue the term loan, closed March 6, I believe -- I don't have the exact timing, but I believe the fed took -- made two rate cuts, the second one taking the fed funds rate down to zero to .25 percent.
The term loan is a floating rate note, and so the impact on that was that the term loan is actually -- a two-year term loan is actually a cheaper cost rate than the short-term debt would have had in the cost of capital.
Q. Okay. And in the cost of capital that's calculated, you did reflect the benefit to customers, correct?
A. Yes. The lower-cost term loan is in the cost of capital in lieu of the short-term debt that was taken out.
Q. Okay. You were also asked about the relative low interest rates that are right now in the

financial environment.

Do you recall that line of questioning?

A. Yes.

Q. I think that you mentioned that there have been an uptick in 2018, but then interest rates since then have gone lower. Is that correct?

A. Yes. I'm not sure the exact timing, but that sounds about right. The answer would be the interest rates environment today are lower than they were in 2017.

Q. And the reason for that, a significant disturbance in the financial markets related to COVID-19 and the corresponding reaction from the Federal Reserve to reduce interest rates to respond to these unprecedented conditions?

A. Yes.

MR. GARCIA: If I can have a moment, Your Honor?

CHAIRMAN SCHMITT: Yes. Sure.

MR. GARCIA: Those are all the questions that I have on redirect, Your Honor.

CHAIRMAN SCHMITT: Thank you.

Mr. Messner, you may step down.

THE WITNESS: Thank you.

CHAIRMAN SCHMITT: I guess our next witness is Mr. McKenzie.

MR. GARCIA: Yes, Your Honor. And Mr. McKenzie will be joining remotely, and I see him on screen right now. If we can check his sound when we bring him in. Thank you.

CHAIRMAN SCHMITT: Is this a witness that you're responsible for, Mr. Garcia? You'll be doing whatever redirect there may be?

MR. GARCIA: Yes, Your Honor. I have the privilege of asking questions of Mr. McKenzie.

CHAIRMAN SCHMITT: Okay. Thank you.

All right, Mr. McKenzie. Will you please raise your right hand?

Do you solemnly swear or affirm under penalty of perjury that the testimony you're about to give will be the truth, the whole truth, and nothing but the truth?

THE WITNESS: Yes, I do.

* * * *

ADRIEN McKENZIE, called by the Kentucky Power Company, having been first duly sworn, testified as follows:

CHAIRMAN SCHMITT: Mr. Garcia, you may ask.

MR. GARCIA: Thank you, Your Honor.

* * *

DIRECT EXAMINATION

By Mr. Garcia:

Q. Mr. McKenzie, 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, Austin, Texas 78751.

Q. And, Mr. McKenzie, by whom are you employed and in what capacity? What's your title?

A. I'm employed by the firm FINCAP, Inc., and I'm a principal in that firm and its president.

Q. Mr. McKenzie, in this case did you submit testimony, direct testimony, rebuttal testimony, and discovery responses on behalf of Kentucky Power?

A. Yes, I did.

Q. Okay. And you are -- we're going to have a couple corrections to the rebuttal testimony, and I will go through those now.

CHAIRMAN SCHMITT: Okay.

Q. Mr. McKenzie, do you have any corrections to your testimony? And I suppose that you're going to direct me to page 32?

A. Well, actually, the first correction I have to my rebuttal testimony is on page R12, line 2, and the word "not" should actually read "now." So the sentence should read, "I certainly agree with Mr. McKenzie that uncertainty and associated risk is greater now than it was prior to March 2020."

Q. Thank you. When I said 32, I meant 12. You have it in front of you. Thank you.

Mr. McKenzie, do you have another correction to your testimony on page 37?

A. Yes, I do. At R37, the table labeled R-2 had some typographical errors, and in particular there were some numbers that were inadvertently left off that table, and I believe you've provided an errata to that effect.

Q. Yes.

MR. GARCIA: Your Honor, at this point, if I could impose on Staff, the corrections are reflected in the Company Hearing Exhibit 9.

MS. VINSEL: Zack, can you please display Kentucky Power -- excuse me -- Company Hearing 9? I'm sorry, Company Exhibit 9.

MR. GARCIA: Thank you.

Q. And, Mr. McKenzie, you have your own copy of this with you, correct?

A. Yes.

Q. Okay. If you would please describe what was the typographical error on page 37 and how this

revised Table R-2 corrects it?
A. Certainly. If you compare the table on Hearing Exhibit 9 with the original Table R-2 in my filed testimony, you can see that the only difference is that on three lines of the original table under "Projected Bond Units," you'll see that the numbers were left off that table and were not incorporated into the averaging.
So here in Exhibit 9 corrects that table by including the results of my analyses using projected bond yields for the CAPM, the empirical CAPM, and the risk premium approach.
Q. Just to clarify, Mr. McKenzie, it's not that the corrected values were different from your calculations, but instead that the original version of page R27 did not correctly reflect the calculations that you had made?
A. Yes, that's correct. If you turn to page R40 of my rebuttal testimony, lines 13 through 18 discuss the results of applying the CAPM using the projected bond yields.
If you look at page R41, lines 1 through 3, that reflects the results of the projected bond yields under the ECAPM approach, and the risk premium approach results using projected bond yields

are shown on page R41, lines 11 through 18.

So the correction merely reflects those numbers that were already discussed in my testimony.

Q. Thank you, Mr. McKenzie.

With that correction, the direct rebuttal testimony -- I'm sorry -- the direct testimony, the rebuttal testimony, and the discovery responses that you submitted, those were prepared by you under your supervision?

A. Yes, sir.

Q. And with the correction you just made, if I were to ask you the same questions today, would you provide substantially the same answers?

A. Yes, I would.

MR. GARCIA: Your Honor, I would submit for the record what has been identified previously as Company Hearing Exhibit 9 -- it's an errata to the testimony of Mr. McKenzie -- for admission to the record.

And with that, he's tendered for cross-examination.

CHAIRMAN SCHMITT: Let it be added to the record.

(Company Hearing Exhibit 9 admitted.)

MR. GARCIA: Thank you, Your Honor.

CHAIRMAN SCHMITT: Ms. Vinsel, any cross-examination?

MS. VINSEL: Yes, Chairman.

CROSS-EXAMINATION

By Ms. Vinsel:

Q. Good afternoon, Mr. McKenzie.

A. Good afternoon.

Q. If you have any problems hearing me, please let me know.

A. Okay. I can't see you, but I can hear you very well.

Q. I -- yes, I can see that. There. There I am.

Can you see me now?

A. I certainly can.

Q. Okay. Mr. McKenzie, are you aware of any rating agencies or any industry observer that has singled out this commission for awarding abnormally low or punitive ROEs?

A. No. That would definitely not be the case. I think, generally, the Kentucky Commission is viewed as being a supportive regulatory agency.

I will note that in the Moody's reports they have voiced some concerns regarding apparent links between economic conditions and service territories and a downward movement on ROEs, but I don't think that rises to the level that you were discussing.

Q. Thank you. I had some -- some general principles I would like to cover with you initially.

Would you agree that, in terms of investing, there's a rule of thumb that the higher the risk, the better the return?

A. Yes, that's correct. There's an expectation, certainly on the part of investors, that compensation should reflect risk. So, if they're going to bear more risk, they need a higher expected return to do that.

Q. Can you tell me what's generally considered the least risky investment?

A. Well, generally, that would be a security issued by the U.S. government. So, for example, 30-year Treasury bonds are typically viewed as close to risk-free as you can get, and those serve as the risk-free rate in applying the CAPM, for example.

Q. And what you mentioned, that the government securities, the Treasury bills, Treasury bonds, are generally considered to be less risky because the risk of the government going bankrupt is rather low?

A. That's correct. I mean, they have taxing ability, they have the ability through their --

through issuing debt and through monetary policies to basically meet their obligations.
Q. Would you agree that risk and return typically follow an upward slope linear relationship, again, in that the greater the risk, the greater the expected return?
A. Well, I agree that there is a relationship. It's not necessarily linear.
Q. Okay.
A. I think if you have an extreme change in risk, you can have a very marked change in the return. So, for example, going from an investment-grade bond rating of Baa3 down to a BB+ rating would imply a very significant upward move in the ROE that wouldn't necessarily apply for staying within the investment-grade scale.
Q. Okay. Thank you.
Would you agree that utility bonds are a more risky investment than a Treasury bond?
A. Yes, generally, that's true.
Q. And would you agree that, in general, corporate stocks are typically considered to be at the higher end of the risk and return relationship?
A. I'm sorry. You said corporate stocks? Do you mean common stocks? Equities?

Q. Yes, common stocks. Yes.
A. Yes, they would be considered to be riskier than debt instruments.
Q. And, finally, would you agree that, in general, utility investment falls somewhere between Treasury bonds and common stocks on that -- that relationship between risk and return?
A. Well, if we're speaking of utility common stocks, that is a common stock. The risks of a utility common stock would exceed the risks of a utility bond, and those would, in turn, exceed the risks of a Treasury bond.
If you're speaking about the relationship between returns from different classes of common stocks, we would need to look at the industry, but the risk of the utility industry generally is considered to be lower than that of the market as a whole.
Q. Thank you. I think your answer -- I wish I had put it that artfully. Yes, the market as a whole is what we were looking at.
MS. VINSEL: Zack, can I have you bring up Mr. McKenzie's rebuttal testimony?
Q. While he's bringing that up, I would like to go -- I have some questions in regard to

Exhibit AMM-21.
And, Mr. McKenzie, I know you're turning to the page. Please let me know when you're there.
A. I'm there. Thank you.
Q. Thank you. Is it correct that the companies that are listed --
MS. VINSEL: And, Zack, could you resize it just a little bit -- I'm sorry -- to make it bigger. I need it to be clearer. Thank you.
Q. It's correct that these companies are public companies who do not operate in a regulated environment. Is that correct?
A. That's correct. Their prices are not regulated. Obviously, they have to comply with various regulations depending upon the industry they're in, but they are not -- they wouldn't be considered regulated utilities.
Q. That distinction is taken. Thank you.
MS. VINSEL: Zack, can I have you scroll down to the bottom? Okay. That's it.
Q. I'm looking at the average. I'm sorry. I didn't capture which column is which, but each of these three columns -- one is for Value Line, one is for IBES, and the other is for Zacks.
Mr. McKenzie, as I understand, you eliminated

the highs and lows as you were working on the average and the midpoint; is that correct?
A. Yes.
Q. If the eliminated highs and lows are removed, would you agree the average earnings growth for Value Line would be 9.92, for IBES, 8.84, and for Zacks, 8.86?
A. Actually, I'm sorry. I didn't understand the question.
Q. I think the question -- I think the question actually is not removed. If they're included.
So if we were to include to not remove the highs and lows --
A. Well, that would surprise me. I mean, I'm looking at page 3 of Exhibit AMM-21, and just looking down the column under Value Line there's more numbers at the high end that were excluded than at the low end, I believe, or at least they're equal.
So it looks like there's actually more high numbers excluded than low numbers. There's only two -- three low numbers excluded, five high numbers excluded. So I'm --
Q. Okay.
A. I'm not sure that it would have much of an

impact on the average. I haven't done the math. So I can't tell you, but that would surprise me.

Q. Okay. Thank you. I appreciate that.

MS. VINSEL: Zack, you can take down the document. Thank you.

Q. This is one I'm just going to have you refer to your testimony. We don't need to bring this up, I don't think.

In your rebuttal testimony you note that the average allowed ROE by state commissions -- let me back up.

You have a table with the average allowed ROE by state commissions for the past four years.

A. Yes.

Q. And through -- okay. And according to that table -- I'm sorry, I'm going to look at it just to make sure -- the average allowed is 9.69 percent, correct?

A. That's correct.

MS. GRUNDMANN: This is Carrie Grundmann. Would you just point out the table so I can quickly find it in the testimony?

MS. VINSEL: Sure. Zack. Let me have you bring up Mr. McKenzie's rebuttal testimony.

MS. GRUNDMANN: I'm happy to just have you refer to it as well. I have it in front of me in hard copy.

MS. VINSEL: I think this is something that's probably better. If I'm going to ask these questions, we need to have them in front of us.

Zack, will you scroll -- you're going to need to go back. We're going to look for it's on rebuttal page 5. I don't have the PDF handy. Probably about 37 pages. Almost there. Two more pages. There you go. If you'll resize it so it's a little bigger.

Q. So this is the table I'm referring to, and the average return -- the average ROE by state commissions is 9.69 percent.

Let me ask, the average return for your proxy group is 9.79, correct?

A. That's correct. I will point out there is a distinction between those numbers, and I think the Commission should be aware of what that distinction is.

The Table R-1 is a reporting of allowed ROEs by RRA. And the 9.79, which is shown lower down on my testimony, that is the -- that is the allowed ROE that Value Line reports as being in effect for the utilities in the proxy group.

So Value Line typically informs investors as to what ROE is currently authorized for that company.
And it might report a weighted average if the Company operates over multiple jurisdictions.

So there is a distinction between the two sets of data in that respect.

Q. Okay. And does that distinction impact the fact that between 2017 and this -- I believe it's September of 2020 -- that there's a downward trend in the ROEs?

A. Yeah. I mean, first off, I'm not -- a downward trend, you could say that. I think we're not through 2020 yet. We don't know what will be coming down the pike. Those numbers move around. Obviously, the 9.68, it went up to 9.73 in 2019, but the primary difference is -- and I think you're correct here, it's timing. So the 9.79 number is the actual ROE that the utilities in the proxy group are currently authorized to earn.

Now, those authorized ROEs may have been set some time ago, but, nevertheless, that's the opportunity cost. That's the earned return that the companies in the proxy group have been authorized, but there is timing differences there.

Q. In your rebuttal factor you explain that you used an adjustment factor to convert year-end returns to average returns to address that difference between the flow of earnings and a book value or point estimate.

Can you explain how you determined these adjustment factors? Or expand upon them?

A. Yeah. Basically, the adjustment factor -- and this refers to the expected earnings approach, which is shown on Exhibit 20 of my rebuttal testimony, and it's also reported in my direct testimony at AMM-9.

But, basically, the adjustment is required because Value Line reports year-end returns on equity. So, in other words, we're taking the amount of equity at the end of the year and dividing that by the earnings over the year.

So that's really a mismatch because the earnings are a product of the investment over the entire year. So that's the purpose of averaging a beginning-of-year equity and an end-of-year equity in order to compute that.

Just as if -- if you had a bank account with a thousand dollars in it at the beginning of the year and $10,000 in it at the end of the year, you wouldn't compute your interest return by dividing the interest earned over the year by the 10,000 at the end of the year; you'd use an average balance.

So that's essentially what this adjustment factor does. The adjustment factor, it's not indicated in the footnotes; it's actually a formula that's reported in regulatory finance, which is a treatise on utility finance. It's the same factor that FERC uses for the same purpose. It's been used there since, I believe, 2000 to recognize that same distinction.

Q. The market has recently seen an increase in utility beta values; is that correct?

A. Yes, a very significant increase.

Q. And do you know if the betas for most investments made an upward or downward adjustment?

A. I don't know the answer to that. You know, the market equals one, so, presumably, if some went up, some went down. But I haven't done an industry-by-industry study to look at what changes were for other industry groups with respect to betas.

Q. And for the utility sector?

A. Well, the utility sector, they've decidedly increased. I mean, the average beta for the proxy

group in the last case was about .66, and it's now about .87. So that's about a 32 percent rise.
Q. Do you believe this is a permanent adjustment, or is it a reaction to the economic situation resulting from the pandemic?
A. Well, it's certainly a reaction to -- a response to the pandemic, and its investors' adjustments to the prices that they're willing to pay for common stocks in the market that leads to this observed change in beta.

Now, we can't see forward. I mean, the beta that should be used in the CAPM is actually kind of the -- the true beta is a projected value. And there is no way to estimate that except by looking at historical information, which is the accepted approach. It's how Value Line measures beta. It's how Bloomberg measures beta. And the question is how do those pricing relationships change over time?

In this case, you know, none of us have the ability to see into the future to see what relationship utility stock prices will have to the broader market going forward, but, in my view, there is no basis to ignore the actual behavior that took place earlier this year which indicates a sharp change in beta values and an upward revision in the risk perceptions of investors.

I think anytime we get into subjectively trying to decide what part of the five-year history we're going to accept and what part we're going to throw out, we get on really shaky ground, because it just opens the door to subjective arguments about what prices might be reasonable or indicative of future relationships and what might not be.

I think beta has been an accepted risk measure at the Commission. I know we've had discussions here about beta when they were going down. So I think that the appropriate course is to take betas at their face value.

MS. VINSEL: Thank you. That answered all of Staff's questions. We have nothing further.

CHAIRMAN SCHMITT: Mr. West or Mr. Cook or Attorney General?

Any questions, Mr. West?

MR. WEST: Yes, Your Honor.

CROSS-EXAMINATION

By Mr. West:

Q. Mr. McKenzie, how are you?

A. I'm well. Thank you, sir.

Q. I want to start out with some questions about your analysis of the utility proxy group. When you

initially calculated your DCF in this case, you excluded six low-end estimates, correct?
A. That's correct, sir.
Q. Okay. And did you also exclude any high-end DCF results?
A. No, I did not.
Q. In fact, did you keep one in your analysis that was actually 13.6 percent?
A. Yes. That's correct. I discussed that in my testimony. In my most recent analysis, the number is still 13.6. It's for Sempra under the Value Line growth estimates.
Q. When was the last time a 13.6 return on equity was approved by a commission in a rate case?
A. I don't know. I haven't done that research. If you look at my risk premium analysis -- let's see.
So if you look at page 3 of AMM-19, you'll see that there were some numbers, you know, up in that territory back in the early '80s.
I think the other thing to recognize too is that, while I've excluded some numbers at the low end of my DCF range, I've also retained quite a few numbers that I don't think would be considered to be reasonable that there's no regulatory commission

that has approved either.

So, for example, on page 3 of AMM-15, you can see a 6.4 percent ROE included in the BR plus SV growth calculation. So I haven't excluded that number, but I'm not aware of any regulatory commission approving an ROE of 6.4 percent either.

Q. Thank you.

And you mentioned that possibly back in the '80s some ROEs were set at that level. Weren't interest rates much different than they are now at that time?

A. Yes. They were considerably higher.

Q. And based on your initial calculations applying your DCF, you came up with a range of mean and median returns between 8.6 and 10.2., and then in your updated analysis that range went from 8.2 to 10.3; is that correct?

A. Yes.

Q. I want to move on for a moment and talk about your analysis related to the competitive proxy group.

Is it fair to say that utilities reap certain economic benefits that make them attractive to potential investors that your typical unregulated competitive firm working in an open market would not have access to?

A. Well, I certainly think it's true that there's trade-offs. I addressed this in my testimony, that it's not the case that Coca-Cola, for example, faces the same business conditions as Kentucky Power.

That's certainly clear.

So there's pluses and minuses. I mean, Coca-Cola can leave markets if -- if demand is declining, they can decline to serve customers, they can reduce their product offerings, they can change their pricing.

But, again, at the end of the day, as my testimony discusses, it really comes back to risk. And I think if you look at the risk measures, you'll see clearly that the risks of that group are comparable or, in some cases, less risky than the utility group. And I think that's what matters at the end of the day.

Q. Well, don't utilities have a big advantage in that they have a fixed pool of customers that are obligated to purchase from them in some respect?

A. Yes, that's true that utilities, by and large, don't face competition. So they're the only game in town. And if you want electricity delivered to your home, then you need to purchase service from that one company.

But, again, that specific fact doesn't necessarily indicate that the utility is higher or lower risk than any particular firm in the competitive sector.

As I indicated earlier in responding to Staff, it's certainly clear that, if you look at the market as a whole, utilities are viewed as less risky. But in the case of the nonutility group that I've identified in my testimony, I don't believe that's true, and I presented evidence to demonstrate that.

Q. Let's talk about some of that.

MR. WEST: Could Staff bring up AMM-21 in the rebuttal testimony of Mr. McKenzie?

MS. VINSEL: Zack, I don't know if you caught that. This is Mr. McKenzie's rebuttal testimony, which is a document you had just brought up. And it's Exhibit AMM-1.

Is that correct, Mr. West?

MR. WEST: AMM-21. And that's at page 170 of the PDF that was filed.

Is there any way we can enlarge that just a little?

Q. So, Mr. McKenzie, can you see the exhibit on

the screen?
A. Yes.
Q. Okay. So this is -- this is the cost of equity estimates for the competitive proxy groups, is it not?
A. Yes.
Q. And this -- we were already talking about this, so I thought I'd skip ahead to it, but can you just explain why Kentucky Power should earn a comparable return to, say, Lockheed Martin, Coke, Pepsi, Walmart, Apple, some of the companies listed on this exhibit?
A. Yeah. Sure.
I mean, this goes back to the very fundamental standards that underlie a return, which we discussed from a financial standpoint earlier in the day. We all agreed that as risk goes up, return goes up, and for comparably risky investments, the returns should be comparable.
So if -- you know, when a common equity investor is trying to decide where to put their money, they are not restricted to considering only utility stocks. They can invest their money in Lockheed Martin and Coca-Cola.
And if you look, for example, at Coca-Cola,

you're looking at a company with an A-plus bond rating, an A1 rating from Moody's, the highest safety rank that Value Line issues.

So there's -- it's a very strong firm with dependable earnings. It's paid regular dividends for many years. It's an established product. So it's not just the case that because Coca-Cola is selling soft drinks that it's inherently riskier than Kentucky Power.

I think if you look at the legal standards underlying a fair rate of return -- and I'm not a lawyer -- but interpreting those, again, the Supreme Court in Hope and Bluefield is saying that the return has to be commensurate with opportunities of comparable risk.

It didn't say "other utilities" or "other utilities with the same credit ratings." It said "other investment opportunities." And Mr. Baudino recognizes this in his testimony as well.

Q. But to go back to your discussion with Ms. Vinsel, in general you would say that investing in a utility presents less risk than in other industries, in competitive industries?

A. Well, if we're looking at it on an industry-by-industry basis, you know, again, what I told her was I haven't done a comparison of various industry groups to decide which industries might be higher risk than utilities and which might be lower.

I think, as a general proposition, we're all agreed that utilities are less risky than the market as a whole, but when it comes to individual companies, that's a different proposition.

Again, you know, if you look at Johnson & Johnson, that's an established company that has a AAA rating. It has a rating that's the same as the U.S. government. So it's not a high-risk common stock; it's a very conservative common stock.

And, from that standpoint, I think this nonutility analysis is an important benchmark. And that's all it is. I haven't used that as the basis of my recommendation, but I do believe it deserves consideration.

Q. Okay. One final question -- or maybe two -- on competitive proxy -- the competitive proxy group, and then I'll move on, but on page 14 of your initial testimony, you said that the average and midpoint DCF estimates for the low-risk group of firms in the competitive sector of the economy ranged from 9.5 to 10.8 before consideration of flotation costs.

Just to be clear -- and I'm sure we all know this -- but the 9.5 represents average and not the low end that you analyzed, correct?

A. That's correct.

Q. Okay. So it would be fair to say that some investors in the competitive proxy group are accepting returns below the 9.5 percent, correct?

A. Yes. The DCF results in that respect are analogous to those for the utility proxy group. We have a range of results, some high, some low. And the effort in trying to identify this unobservable quantity is to distill that range down to a more discrete quantity.

Q. Okay. I want to move on and ask a couple questions about the impact that COVID had on your analysis or it's had on the industry.

On page 36 of your initial testimony you said that it would be unreasonable to disregard current capital market conditions in establishing a fair rate of return -- or return on equity. I'm sorry.

You say that (Reading) The challenges posed by the COVID-19 crisis have the potential to significantly impact the financial pressure of the investor-owned utilities, increasing the overall level of investor risk, and will have to be addressed by state regulators.

Am I quoting you correctly on that?

A. Yes.

Q. Okay. When you initially calculated your DCF, it was -- apparently you retrieved the data in May of 2020. Does that seem about right?

A. Yes. That's correct.

Q. Okay. Wouldn't it be fair to say that, given the timing of COVID-19 and the response to it, the DCF calculations that you arrived at may have already accounted for the volatility and uncertainty associated with COVID, given that we're talking six months -- or six weeks or a few months after COVID emerged?

A. Well, I think the -- I think the stock prices at May 1st certainly reflected some aspects of the COVID pandemic and the market's reaction. I think you could argue about whether analysts had enough time at that point to incorporate their expectations about what that might mean going forward into their growth rates.

But, you know, and I think part of the issue back then when I did my -- when I originally filed my direct testimony, is just the high degree of uncertainty and not knowing where the markets were going to head from that point.

So I think there was a greater degree of uncertainty about market direction when I did my analysis that are included in my direct testimony.

Q. That's fair. And on some level isn't uncertainty equated with risk or a greater degree of risk?

A. Yes. That's true.

MR. WEST: If we could pause for just a moment, I think we have someone, a caller, who has their phone on, Caller 15.

MS. VINSEL: If we could ask everyone on phones to make sure that their phones are on mute.

MR. WEST: Okay. Thank you. I believe they've taken care of it.

Q. So I'm going to move on to another general question. I believe Ms. Vinsel may have touched on this with you, but I wanted to make sure I understand your answer, and maybe my question is a little bit different, but it's regarding beta values.

And you-all discussed the fact that, in the utility industry, betas have increased recently. And I believe you said that that would, by implication, mean that betas in other industries have decreased, but my question is whether it's possible that those betas could return to their pre-COVID levels fairly quickly. Do you have any insight on that?

A. Well, I don't have any insight for you into what will actually transpire. If I did, I'd love to share it with you, and we could both go live on that island somewhere, but, you know, the -- it's certainly possible.

I mean, betas change over time. There's no question about that. They respond in kind with changes in stock prices. So they will presumably change one way or another over time, but we don't know how.

There's nothing to say that the market couldn't go through another period of disruption just as it did back in March going forward. I mean, in response to some development that we don't know, whether to do with COVID or some other financial, political, or other crisis.

So the point is not that betas will be forever constant, but the point is is that the information that we have now is the best we have now, and that, in my view, ignoring it or tinkering with it or suggesting that somehow because it moved in one particular direction or another it's now no longer valid, I think that's dangerous.

Q. Well, if betas in the utility group increase or decrease, one or the other, in the future, in your opinion is it more likely that they decrease or increase from their current levels?

A. Yeah, I can't put a probability on that. It all depends again on how utility stock prices move going forward relative to the market. So I can certainly grant that if they return to their old pattern of behavior, by and large over time utility betas could moderate, but as I just indicated, it's possible they could increase. I mean, we don't know.

And that's why I think the best course is to use the accepted published benchmark which has been used in rate cases for many, many years, and that's the Value Line betas.

Q. Okay. Thank you.

Moving on to -- I just have a couple questions about a previous Commission case that you may or may not be aware of. Have you had an opportunity to review the Commission's final review in the Duke Energy Kentucky case in 2020-271 that was issued earlier this year?

A. Yes.
Q. Okay. You're aware that the Commission awarded a 9.25 return to Duke in that case?
A. Yes, I'm aware of it. And I'm also aware of a number of distinctions which I think warrants them not doing that in this proceeding.
Q. Well, that's fine. I appreciate that. I believe you spelled that out in your testimony -- rebuttal testimony that you gave. That was included in your testimony, correct?
A. No, I didn't address the Duke order directly in my testimony. I mean, my testimony presents the reasoning behind why -- supporting my recommendations, but I think with respect to Duke, there's clear differences, both --
Q. Well, maybe I'm mistaken, but I assumed maybe -- maybe I'm thinking of someone else, but did you not address it in your rebuttal testimony? I might have the wrong -- I apologize.
A. I'm not sure. If you have a specific reference, I'm happy to look for it.
Q. No. I'm sorry. I was just noting that we had that to refer to if we needed to, but my real question was are you aware about -- whether Duke Kentucky has been downrated by S&P or Moody's

because of that Commission order?
A. No. In fact, they have not been, but, again, there's differences between Duke and Kentucky Power, and I think the Commission should be mindful of those when it establishes an ROE in this case.
Q. Noted. Thank you.
Are you also aware of the portion of that order where the Commission said that in regards to flotation costs the Commission has historically rejected and continues to reject the notion of flotation costs to be included in ROE estimates?
A. Yes.
Q. Okay. But you recommended inclusion of the flotation costs, did you not?
A. Yes, I do.
Q. Okay. Moving on. Just a couple questions regarding your conclusions, and then I'll wrap up.
But excluding flotation costs, your recommended range was 9.3 to 10.4 for the ROE, correct?
A. Yes.
Q. Your CAPM and your ECAPM results don't fall within that range, do they? In fact, they're quite higher, aren't they?
A. Yeah, as is the expected earnings. So all of

those numbers fall outside the range. The only -- and so does the DCF. So what we're really trying to do is take some disparate results and distill them down to a reasonable range that reflects the cost of equity. And that's what I've tried to do.

Q. Did you say "a reasonable range"?

A. Yes. I believe that 9.3 to 10.4 is a reasonable range, excluding flotation costs.

Q. So if your results from your CAPM analysis and your ECAPM analysis all exceeded the upper bound of the range that you're saying is reasonable, would that make them unreasonable?

A. No, I don't believe so. I mean, again, the CAPM, ECAPM, and expected earnings approaches all produce numbers that are above the top of my range, but the range is constructed based on those values and considering the range of outcomes, including the risk premium and DCF numbers.

So it's not a question of suggesting that because the CAPM numbers fall outside the range I've distilled from those results that they're somehow rendered unreasonable.

Q. Okay. Just a couple more questions about the CAPM and the ECAPM, and I want to go back to if you recall the table that you looked at with Ms. Vinsel in her cross-examination previously where you showed the average allowed ROEs in 2020. I believe it was Table R-1 on R5 of your rebuttal testimony.

We don't have to pull it up or look back at it. I mean, I think you recall that the average was in the 9.69 -- it was 9.69, wasn't it?

A. That's correct.

Q. Okay. And, again, your ECAPM and your CAPM analysis is much higher than the average allowed ROEs so far in 2020, isn't it?

A. Yeah. And I think that, in large part, reflects what we discussed earlier in terms of this dramatic upward move in betas, which is probably not reflected in most of the record evidence in cases that were decided earlier this year.

Q. Okay. Give me just one second.

On -- in your rebuttal testimony, don't you state that allowed ROEs should be used to evaluate whether recommended ROE is sufficient to meet regulatory standards?

A. Yeah, it's one benchmark. It has limitations.

I don't think the Commission should look blindly to determinations based on RRA and make a finding with respect to Kentucky Power using that.

I think they need to take a broader approach and consider the record evidence in this proceeding, but it certainly is one benchmark.

Q. Understood. Thank you.

MR. WEST: I believe that's all the questions I have.

CHAIRMAN SCHMITT: Mr. Kurtz, cross-examination?

MR. KURTZ: Very briefly.

CROSS-EXAMINATION

By Mr. Kurtz:

Q. Good evening, Mr. McKenzie. Your recommended return on equity is 10.3 percent, correct?

A. Yes.

Q. That's an after-tax return on equity?

A. Yes.

Q. Okay. For ratemaking purposes, the utility has to recover a pretax return to yield your recommended after-tax return of 10.3 percent, correct?

A. That's correct. They recover an income tax allowance.

Q. What is the pretax rate of return on equity that would result from your recommendation?

A. I don't know the answer to that.

Q. If the gross revenue conversion factor was 1.34482, what would it be?
A. What did you say that was?
Q. 1.34482.
A. I think it's over 14 percent, if my math is right.
Q. So a 14 percent pretax return on equity being requested in this case is what consumers would actually pay, if your recommendation is adopted?
A. That's correct.
Q. How did your recommendation take into account that the Company's proposed 13 percent base rate increase would hurt -- potentially hurt the economy of eastern Kentucky, which is already one of the weakest economies in the United States?
A. Well, I address this briefly in my rebuttal. You know, it isn't my purview to advise the Commission on social issues or those types of factors. My -- the purpose of my testimony is to present an independent appraisal of what the cost of equity is demanded by investors in the market.

So that cost is not driven by the specific situation faced by ratepayers within the service territory. It's -- just like the cost of any other input, it's determined in a market.

So when Kentucky Power buys coal, they pay a price for that coal. And the price of the coal isn't based on how things are going in the service territory; it's what the market price is.

Q. So does that mean you did not take into account the fact -- the effect that your recommendation would have on the businesses and people of eastern Kentucky?

A. That's correct.

MR. KURTZ: No further questions.

CHAIRMAN SCHMITT: Ms. Grundmann, cross-examination?

MS. GRUNDMANN: I do, briefly.

And I apologize, Your Honor. My cocounsel is here with me, and he may or may not be as cooperative as I might otherwise hope he would be for purposes of this cross-exam. So I'll be brief.

Ms. Vinsel, do you think we could pull up AG KIUC Hearing Exhibit 1 and go to page 28 of that document?

CROSS-EXAMINATION

By Ms. Grundmann:

Q. Mr. McKenzie, while we're turning to that exhibit, have you been observing the last couple of days of this hearing?

A. Not all of it. I've seen some.
Q. So this presentation has made its way into the record a couple of times, and I just wanted to ask you your opinion on some information in one of these slides.
Have you seen this exhibit brought up thus far in the hearing?
A. Yes.
Q. Okay. So you're at least vaguely familiar with it. So I am looking at page 28 of the document. And I want to link it to some of your testimony. Do you see there in the dark blue line the information that says "2021 Forecasted Regulated ROE is 9.0 percent"?
A. Yes, I see that.
Q. Do you agree with me that that is AEP's estimate as to what its average likely ROE is expected to be for its regulated business lines, including Kentucky Power?
A. Yeah. I'm assuming that's their forecast of an actual earned ROE, which is consistent with what's reported in the table or in the little balloons above.
Q. Well, I think that the balloons above, would you agree with me, are actual numbers and -- so the

light blue are actual numbers, and the navy blue is a forecasted estimate.

A. That's right.

Q. Okay.

A. I would agree with that.

Q. And then if you look a little closer under the blue balls, you'll see that under AEP Ohio, APCO, Kentucky Power, SWEPCO, that all of those have pending base rate cases, and I think that you were involved in the APCO case in Virginia. So you're familiar with those?

A. Yes.

Q. So it looks as though the Company is forward-looking as to what it might expect its ROE to be in 2021, partially accounting for the results of some of these base rate cases. Doesn't that seem fair?

A. Yeah, I would expect that they would need to make some assumption about what allowed ROEs would be in order to construct an estimate of earned ROE for 2021.

Q. Okay. And so does the notion that the Company would want to earn a 9.0 ROE, is that something that the Commission should take into account in setting the return on equity for purposes of this proceeding?

A. Well, I'm going to push back on your question.

I mean, you said the Company would want to earn an ROE of 9. I mean, there's a lot of factors that go into actual earned returns and -- in terms of, you know, as we see in this service territory, for example, the pattern of sales, the pattern of costs, the pattern of investment and how much those are being recovered through rates or not being recovered through rates, as is the case in this particular instance.

So I don't think the 9 percent represents a goal of the Company or, alternatively, a weighted average of the allowed ROEs that they necessarily expect for their jurisdictions.

I think it might be an outcome of some forecast model but considers a wide variety of factors which I'm not privy to. I don't know how it was arrived at.

Q. Understood. And you didn't take part in putting together this presentation that was given a couple of weeks ago to EEI, were you?

A. No, I did not.

Q. So I guess you don't have an opinion as to the Company's conclusions about its strong financial position based upon a 2021 forecasted regulated ROE of 9.0 percent for its regulated entities, do you?

A. No. Again, I can't really speak to what exactly that number represents or how it was arrived at.

Q. Understood.

Mr. McKenzie, can I have you take a look at your rebuttal testimony? I actually wanted to ask a couple of questions about Exhibit -- I believe it's AMM-13.

A. I'm there.

Q. The question that I have about this document that I'm trying to understand is you have identified the document as state-allowed ROEs. Is that fair?

A. Yes.

Q. And so when you say that, for example, Duke Energy Corporation has an allowed ROE of 10.10, you've taken this document from Value Line; is that right?

A. That's correct. This is what Value Line is reporting to investors in their individual reports for the various companies listed.

Q. So I guess I'm just trying to understand because I couldn't understand the math so as to tell whether this document is useful or not because, for example, Duke Energy was awarded a 9.5 percent ROE in South Carolina recently and a 9.25 percent ROE in Kentucky.

I'm just trying to understand what that -- where that 10.1 came from and how it's calculated because it seems, just looking at Duke, it seemed a little high to me, and I'm trying to understand whether it includes all of the Company's regulated operations or just state-based vertically-integrated utilities.

A. Well, there's -- there's -- basically what Value Line reports generally is -- how they break that up is between electric and gas utility operations.

So they don't -- in certain instances they break it up between jurisdictions and report different numbers from different jurisdictions, in which case I just developed a weighted average based on that, but that's about the extent of the detail.

So as the quarterly publications of Value Line are released, they typically update those numbers to reflect what proceedings might have taken place in the interim.

Q. I guess I'm just trying to understand. Does this allowed ROE potentially include transmission or FERC-approved rates, or is it solely state-authorized ROEs? Because you phrased it as a state-allowed ROE, and I'm -- just looking at Duke, I saw that number at 10.1 and was, like, that seems really high because I think that they've been awarded a 9.9 in North Carolina, a 9.5 in South Carolina, a 9.25 in Kentucky, and all of those are lower than 10.1., so I'm trying to understand how there's an allowed ROE of 10.1 under the circumstances.

A. Right. Yeah, I mean, generally, as again --

Q. So I guess I'm asking do you know what the inputs were that Value Line used to arrive at the 10.1?

A. Right. And I think the answer to that question is clear, no, I don't. And the reason I still think that the numbers are valid is because that's what Value Line reports to investors.

So from an investors' standpoint, it does form the basis of an expectation with respect to allowed ROEs, but they do not report any of the details or underlying calculations supporting those figures.

Q. And so then I guess it's fair to say that when we look at this average 9.79, that's for the

totality of the operations of these companies.
A. Electric operations.
Q. Does it include any nonregulated affiliates?
A. No, it does not. They're allowed returns, so they are -- purportedly by Value Line, they are based on the actual allowed returns that are currently in effect for the regulated operations of these companies, and specifically the electric operations because some of them, obviously, have gas operations too, and those are reported separately.
Q. And did you -- I just don't know the answer off the top of my head, but was the underlying data forming the basis for AMM-13, were those produced in some of your work papers?
A. Yes, they are in my work papers. I don't know that my --
Q. Sorry. Go ahead.
A. Pardon me. I don't know that there's been a request for my rebuttal work papers, so I'm not sure that those have been produced, but the Value Line sheets underlying the original direct testimony are included in my work papers.
MS. GRUNDMANN: Your Honor, would it be possible to make a posthearing data request for these Value Line investment surveys dated July 24,

August 14, and September 11, 2020?

CHAIRMAN SCHMITT: It certainly will, and at the close of the testimony we'll discuss time periods. It would have to be in writing in, like, an interrogatory. No, you'll have an opportunity to do that.

MS. GRUNDMANN: Thank you, Your Honor.

Q. Mr. McKenzie, I think that in response to some questions from the Attorney General you were asked a question of whether you were aware whether a commission has ever issued a 13 percent ROE to the extent it was included in some of the results that you didn't exclude in the DCF.

Do you remember that line of questions?

A. Yes.

Q. And do you -- so when you're forming your estimates as to what an appropriate return on equity would be, do you look -- does it matter to you that, if awarded, your requested ROE would be essentially the highest ROE awarded in the last 18 months across the country to any utility?

A. Well, my recommendation certainly isn't predicated on the findings of regulatory agencies in prior proceedings. It's predicated on the analyses that I've presented in my testimony, so there isn't a direct connection between regulatory findings in other cases and my recommendation, no.

Q. Okay. Okay.

A. The only clarification I would add is that my risk premium approach is predicated entirely on the findings of regulatory agencies, but it's over a long period of time, back to 1974, and then it's also adjusted for changes in interest rates over that study period. But, again, it does -- it is based on regulatory findings directly.

Q. Understood.

Mr. McKenzie, could I ask you to turn to page R2 of your rebuttal testimony focusing on Figure R-1?

A. Okay. I'm there.

Q. And I just want to make sure that I'm understanding this correctly, but you have created a figure in response to some testimony from AG KIUC Witness Baudino about where his ROE recommendation falls as related to certain benchmarks.

Is that a fair description as to what you're trying to show in Figure R-1?

A. Yes.

Q. And so then, as I look at Figure R-1, you had four benchmarks -- allowed ROE, expected earnings, electric authorized 2019, and electric authorized 2020. Is that fair?

A. Yes.

Q. And the large bars, the large thick bars -- I apologize, my copy here is in black and white -- that is the range of results that your analysis reveals for each of those four benchmarks?

A. That's correct.

Q. And then the dark line that runs horizontally across that, that's Mr. Baudino's -- those are his conclusions and his ROE results at 9.0, correct?

A. Yes, that's correct.

Q. And so they fall within the range for each of these four metrics, do they not?

A. Yes. They fall within the range, although considerably below the indicated average.

Q. Understood.

MS. GRUNDMANN: I don't have any further questions at this time. Thank you, Mr. McKenzie.

THE WITNESS: Thank you.

CHAIRMAN SCHMITT: Mr. Spenard, questions?

MR. SPENARD: Yes, Mr. Chairman, just a few.

CROSS-EXAMINATION

By Mr. Spenard:

Q. Good evening. Can you hear me, Mr. McKenzie?

A. Yes, sir, I can. Thank you.
Q. Thank you.
MR. SPENARD: Could Staff please share on the screen a cross-examination exhibit? It's the application Section 3, Volume II, McKenzie direct testimony, page 7. Is that -- is that document available?
MS. VINSEL: Yes, Mr. Spenard, it should be available.
MR. SPENARD: Thank you.
MS. VINSEL: I'm going to give them a little help.
Zack, we're talking about document Number 9.
Q. This will be page number 221 of 333.
Good. Thank you.
A. Thank you.
Q. There is a question that begins on line 9, Question Number 13. "What part does regulation play in ensuring that Kentucky Power has access to capital under reasonable terms and on a sustainable basis?"
Do you see that question?
A. Yes, sir.
Q. Okay. And beginning on line 12, the answer, the first sentence, "Regulatory signals are a major

driver of investors' risk assessment for utilities."
Do you see that?
A. Yes.
Q. With regard to the phrase "regulatory signals," what does the phrase "regulatory signals" comprise?
A. Well, in my view, it would really come down to the actions as well as pronouncements from regulatory agencies with respect to rate cases, rate proceedings, and other proceedings involving the utility.
Q. And I apologize. I'm trying to -- I appreciate that answer to get on the same page. For example, is it your testimony that the Commission order that will be produced from this application falls within the set of regulatory signals?
A. Sure. I think that's true. I think that the Commission's order in any proceeding will be examined by investors and evaluated with respect to how whatever actions the Commission took in that particular proceeding would impact that utility, as well as perhaps other utilities that operate in the state.
Q. Okay. And with regard to the -- again, the first sentence on line 12, "Regulatory signals are a

major driver of investors' risk assessment for utilities," in terms of the phrase "risk assessment," what does that phrase comprise?

A. Well, it really comprises -- I guess there's a couple of things. First is the security of the capital that's invested in the utility. So certainly debt investors are concerned with the ability to -- of the utility to meet the obligations under the debt instrument itself and repay the principal.

With respect to common shareholders, they're interested in whether there's a reasonable opportunity that they're going to earn a return that's comparable to what they could earn on another investment.

So I think those are the two major issues with respect to what drives the risk, is the uncertainty surrounding those -- those events.

Q. And that -- and, again, this is your testimony. I'm just trying to make sure I'm on the same page.

In terms of the -- when you say "risk assessment," that phrase, that ties into the investors' view as to the uncertainty associated with a return? Or did I miss -- did I miss that?

A. No, that's part of it. And, again, I mean, regulatory signals are one driver. They're not the sole driver, but they're certainly a consideration. So there's timeliness of recovery, regulatory lag. All of those considerations would be part of what investors would be interested in when they look to see what the regulatory climate is in any particular jurisdiction.

Q. So perhaps this can be wrapped up with one more question.

With regard to the regulatory signals, for regulatory signals for Kentucky Power Company, are they more or less unique to Kentucky Power Company, or does -- or is the regulatory signals associated with Kentucky Power Company -- do they share those with the rest of the AEP family?

A. Well, I think when we're trying to, at least from my standpoint, look at an ROE for Kentucky Power Company, we're focused primarily on what's happening in Kentucky, not what's happening in Ohio or other jurisdictions. I think that's what we're trying to do here, is to establish a fair ROE for the Kentucky jurisdictional electric operations of Kentucky Power.

So when I talk generally about regulatory drivers here, it's a general statement. If we're talking about this particular case, it really comes down to the actions of this commission.

MR. SPENARD: Okay. Thank you. That's all the questions that I have.

CHAIRMAN SCHMITT: Mr. Fitzgerald?

MR. FITZGERALD: Mr. Chairman, I do have a few questions.

CROSS-EXAMINATION

By Mr. Fitzgerald:

Q. Give me just a second. There we go.

Mr. McKenzie, can you hear me okay?

A. Yes, sir. Thank you.

Q. Wonderful. When Mr. Kurtz asked you whether your analysis considered the dire economic conditions that have faced most of the 20 counties comprising the KPC service area, you responded that you didn't consider, quote, "social matters." Your response sounded dismissive of those conditions, and I wanted to follow up a little bit to give you a chance to clarify that.

Is it your testimony that the conditions of the ratepayers, the economic conditions, should not be considered by the Commission when it's reviewing the proposed rate increases and what ROE to approve?

A. Well, I think, you know, clearly we're in agreement that the Commission's job is to balance the interests of consumers and investors. So I don't dispute that.

I think there are various regulatory standards that have been established that provide the Commission with guidance as to how to accomplish that, and there are regulatory and judicial standards governing what a fair rate of return is.

And I'm certainly not being dismissive of economic hardships faced by customers in Kentucky Power service territory. My only clarification was really to note that, as an ROE expert, my job is to present an independent assessment of what the capital markets tell me, and that assessment doesn't really involve assessing economic hardship on the part of consumers and adjusting the ROE in any way to account for that.

I think there's also some dangerous implications that can result from those types of adjustments as well.

Q. Okay. That was what I was trying to clarify. You weren't suggesting that those considerations are not appropriate for the Commission; it's just that they weren't part of your particular analysis?

A. They're not part of my analysis, and they also -- again, I mean, purely from the standpoint of a regulatory analyst looking at the cost of equity and looking at the financial integrity and health and viability of the utility, I would suggest that deviating markedly from the market cost of equity presents a lot of challenges and pitfalls for -- ultimately, for consumers as well because if the utility is unable to earn a fair ROE, that has implications for reliability ultimately and the quality of service ultimately.

And I think, obviously, there's fairness issues to investors as well in terms of what a return should be granted for them putting up their capital.

So it's not -- it's not a swag where we get to say, well, things are tough in the service territory, and the cost of equity is sort of an amorphous number. We know it's not a fixed number that we can look at in the market, so we're just going to chop an increment off because there's hardship in the service territory. I don't think that's good policy.

Q. Okay. Would you agree that whether rates are fair, just, and reasonable, which, as you noted, is the standard that the Commission uses and one that has been adjudicated in the courts in Kentucky, necessarily includes consideration of whether those rates are reasonable in light of the economic conditions of the 28 counties that comprise the KPC service area?

A. I think that's a legal question I'm not qualified to weigh in on.

Q. Okay. You mentioned in response to questions a minute ago that you looked to Kentucky to see what was an appropriate range for the ROE. Is it -- were you aware -- because it sounded like you were looking at a report that suggested a higher ROE than Duke has actually been getting.

Were you aware that the most recently litigated case involving Duke Power Kentucky was a 9.25 ROE?

A. Yes, I'm aware of that. And that's the order that I was referring to in the earlier cross-examination, and my only point on that was that there are distinctions in the sense that Duke is a higher-rated company, and the Commission specifically cited Duke's ability to mitigate regulatory lag when they gave that order.

And if we look at President Mattison's

testimony with respect to earned ROEs for Kentucky Power, it presents a very different picture. This utility has not been able to mitigate regulatory lag. It's earning returns which are dramatically below what it's authorized.
Q. Right. Last question. Do you think that it's inappropriate in the balancing that you acknowledge has to occur between the interests of a utility that's been underearning and a region that has been underemployed and is having a fairly dire economic time meeting its bills, do you think it's appropriate that the Commission consider something on the lower end of the ROE range rather than the golden plate or the gold standard?
A. Well, I mean, again, you're putting me in a hard position because that's not really --
Q. Well, I tell you what --
A. The purpose of my testimony is to really give the Commission the data it needs with respect to what the market demands.
Q. Okay. Well, let me ask you that question, then. If it's a hard question for you, I just -- I wanted to distinguish your role is to produce one set of numbers, and the Commission's is to balance the interests of all the parties in order to

determine what's fair, just, and reasonable.
You wouldn't disagree with that, would you?
A. No, I wouldn't disagree with that.
MR. FITZGERALD: Okay. I appreciate your time and didn't mean to put you in a hard spot.
CHAIRMAN SCHMITT: Mr. Miller or Mr. Childers, cross-examination?
MR. MILLER: Hi, Mr. Chairman. I'm back. Sierra Club has no questions. Thanks a lot.
CHAIRMAN SCHMITT: Mr. Frye?
MR. FRYE: No questions at this time, Mr. Chairman.
CHAIRMAN SCHMITT: Vice Chairman Chandler?

EXAMINATION

By Vice Chairman Chandler:
Q. Good evening, Mr. McKenzie.
A. How do you do.
Q. Wore out. It's been a long day. Thank you for asking.
Let me just clarify. What role do the Hope and Bluefield cases that you cite on page 5 of your testimony play in your determination of an adequate or proposed return on equity?
A. Well, I think it's important to go back to realize that one thing the Hope and Bluefield cases

don't do is they don't tell the Commission how to come to an answer, so they specifically leave that up to the regulators. They do not specify a particular methodology that should be employed. It's the end result that matters.

So with respect to the end result, my view is that there's a variety of methods that are accepted in terms of analyzing the market cost of equity. I think this Commission noted in its order in the Duke case that it was appropriate to present multiple methodologies. That's what I've done.

But I think, again, coming back to this end result standard, it's not a good end result if a commission authorizes an ROE of, let's say, 9.7 percent, and the utility is earning something less than 6 or consistently earning less than 9.7. That's a problem that needs to be addressed, and I think that goes to the heart of the Hope and Bluefield standards.

Q. Let me ask, on that front, have you provided the Commission, as it relates to the return on equity, the final product, the end result?

A. Well, in my view, the purpose of my testimony is to present the market cost of equity. I'm recommending 10.3. The company is asking 10. And

I'm supporting 10 as a reasonable end result.
Q. Right. But I just want to make sure I'm clear that, as it relates to a return, you believe that your proposal is -- is enough of an end result that the Commission can accept it without making any other adjustments necessary to reflect the legal standards required.
A. That's correct.
Q. Okay. So you --
VICE CHAIRMAN CHANDLER: Can we get -- Mr. Ripy, can we get the document -- and I believe it would be page 219, if it was 221 earlier -- but the document that -- Ms. Vinsel, was it Number 9, Mr. McKenzie's direct testimony?
MS. VINSEL: Yes, that's correct, Vice Chair.
VICE CHAIRMAN CHANDLER: So it will be Number 9 at 219, Mr. Ripy. You mind to share that?
Q. And I believe this will be page 5 of your direct testimony, Mr. McKenzie, if it's easier to -- if you've got a version in front of you you'd prefer to look.
A. Thank you.
Q. I'll ask you to look at the screen in a minute, but I'd rather save your eyes until then.
So page 5, you cite both Hope and Bluefield.

When we get there, just please confirm that.
A. That's correct.
Q. Okay. And so your first one there is at Bluefield, the Footnote 1, you started with a public utility. There's something missing in the middle, and then it ends with "public duties" at the end.
Do you see that?
A. Yes.
Q. Okay. And have you read the Bluefield case, Bluefield Water Works & Improvement Company v. Public Service Commission?
A. Yes.
Q. Okay. And so are you aware that there's -- well, are you aware that there's important text prior to "a public utility is entitled"?
A. Yes, certainly.
Q. Okay. And what -- do you know what is missing in between there where the ellipsis is between "risks and uncertainties" and then "that return should be"?
A. No, not offhand.
Q. Okay. So would you be surprised to know that it says, "But it has no constitutional right to profits, such as a realized or anticipated and highly profitable enterprises or speculative

ventures"?

A. No. I've read that language before. That's -- that sounds familiar.

Q. Okay. And so would you agree that that language sounds like firms that are unregulated? Is that a fair assessment, that are not rate-regulated?

A. No, I wouldn't agree with you on that.

Q. So you would agree that those highly speculative ventures would likely be rate-regulated.

A. No. What I'm saying is that I don't agree that just because a firm is unregulated it's a highly speculative venture.

Q. I apologize. That wasn't the question that I asked. I believe -- I meant to ask it the other way, which was, although it may be one, it's not necessarily the other, but you would agree that if it's highly speculative it is not a rate-regulated entity, correct?

A. I see what you're saying. Yes, I would agree with that. Well, actually, let me take that back.

Q. Go ahead.

A. There can be instances where rate-regulated firms can be considered highly speculative. So the most recent example would be PG&E. They just got through getting out of bankruptcy, and they were highly speculative for quite some time, and the stockholders lost all their money.

Q. I appreciate it. Were they highly profitable?

A. No. That was the problem. They couldn't recover their costs and meet their liabilities with respect to inverse condemnation associated with wildfires.

Q. Right. Right. And with your quote there about Hope, it starts off, I believe, "The investor or company point of view"; is that correct?

A. Yes.

Q. Okay. Would you be surprised to know that the portion just above that -- or just before that in the order says that "the ratemaking process under the Act," which is, I believe, the Natural Gas Act. Is that your understanding as well?

A. Yes.

Q. Okay. "The ratemaking process under the Act, i.e., the fixing of just and reasonable rates, involves a balancing of investor and the consumer interests." And then would you agree that the quote you cited there goes on to discuss the investor interests?

A. Yes.

Q. Okay. And so is it your testimony that the balancing act only occurs after an ROE is determined, or would you agree that customers should be considered in the determination of an ROE?

A. Well, I think -- I'm not trying to cop out here, but I think it does call a little bit for a legal opinion in terms of analyzing the exact language of Hope and Bluefield in terms of what that means.

But, to me, again, it comes back to that end result and is the end result fair, and the end result is, I think clearly, based on the language included in my testimony and also the language that you've supplied today, it does anticipate a balancing. I don't disagree with that whatsoever.

I just wanted to clarify that my only point is that I don't think it's an imbalance for the Company to be offered an opportunity to earn in the market cost of equity, whatever the Commission decides that actually is.

Q. Well, and that's why I wanted to ask about going back to the end result portion we talked about earlier. So is it your understanding -- or let me ask this: Is it your testimony that, as it relates to return, what you've proposed is the end result in that matter, and are you proposing for the Commission to make no adjustments in balancing the consumer interests in making the determination of the return on equity?

A. Yeah, I think how the Commission balances interests, when it comes to the return on equity, is to consider the record evidence in this proceeding and make a determination as to what the actual market cost of equity is. It's not --

Q. Excuse me. Go ahead.

A. Well, I just wanted to clarify that, and again, I think I mentioned this earlier, it's not a question of deciding that, well, as a Commission we think the market cost of equity is 9.7, but we're going to cut it down to 9 because the economy is suffering. I think that's bad policy.

Q. Yeah, and what I wanted to be clear about -- what I'm asking here is there's -- one of the things that was addressed in rebuttal testimony was one of the parties proposed an adjustment, the Company said we've already made that adjustment, right? And the concern was that it's unfair for the same adjustment to be made twice.

What I'm effectively asking you is have you balanced, in your determination of your ROE recommendation, the interests of investors and consumers insofar as it's included in your end product, or are you providing only the perspective of the investor and leaving the balancing of the consumer to the Commission?

A. I think when it comes to Hope and Bluefield and the requirements for a return, I think they're not -- there's not a distinction. I think the Commission's job is to establish what it believes to be the market cost of equity and allow the utility an opportunity to recover that.

So just -- again, getting back to any other input that goes into providing service, if the cost of wire is X, the Commission doesn't multiply that by 90 percent and put that in the cost of service based on a balancing of consumer interests and investor interest. The cost is the cost.

And I think the same is true for the cost of equity, that, clearly, based on the language we've discussed, Kentucky Power is not entitled to earn an ROE that exceeds its costs or that is equivalent to a speculative enterprise or a highly profitable enterprise. I think that's what we're kind of talking about when we try to balance these issues.

Q. Yeah. And I can appreciate that -- that --

that -- you know, understanding our role, I think I somewhat do, but what I'm wanting to make sure of, in consideration of your evidence, is have you considered that, or should we assume that that hasn't -- that consumer interest has not necessarily been considered in the amounts that you've provided us? That's what I want to be sure of in this matter.

A. Well, again, my evidence presents my independent estimate of the market cost of equity, and I think that establishing the ROE based on the market cost of equity does represent the appropriate balancing. I think that's what the Commission is supposed to be doing.

Q. Okay. And I do have just one more question. And I apologize.

One of the items that I believe is mentioned in your -- the Bluefield quote maybe is -- can you still see that?

A. I have my testimony here in front of me.

Q. I believe it's on line 7 --

A. Uh-huh.

Q. -- where it talks about the part of the country, same general part of the country.

A. Right.

Q. And so in terms of the economy, for instance, in the 20 eastern Kentucky counties that Kentucky Power serves, the broader eastern Kentucky area, the Appalachian area, Kentucky as a state, did any part of your analysis specifically look at that, or was your analysis more -- more generalized than looking at specifically the area in which Kentucky Power operates to determine if -- I think the quote says that, you know, the rates, the return "being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties."

A. Yeah, I mean, it's difficult to translate that language into monitoring capital markets, because, obviously, Kentucky Power and AEP are competing on a global basis for capital, and it's generally accepted that a utility -- an investor in AEP, or let's take Kentucky Power, has the opportunity to invest in any number of other equivalent common stocks in the utility space.

So it's really pretty impractical to think that we're going to go to eastern Kentucky and find some kind of a comparable group on which to evaluate a fair ROE. I think, in olden times, when the

Supreme Court was looking at this, there was the notion that we would look to nonregulated firms and see --

Q. Mr. McKenzie, I don't mean to interrupt you. I will ask the question again and give you an opportunity, but I'm afraid we may have had an issue with our connection to the system, and it may have stopped recording. So I just want to make sure that's not the case.

MS. VINSEL: Yes, it's --

CHAIRMAN SCHMITT: What happened?

MS. VINSEL: -- that failure that we experienced yesterday where they can't see and hear. It's that failure.

VICE CHAIRMAN CHANDLER: We can hear you now, Ms. Vinsel.

CHAIRMAN SCHMITT: As far as we know, it's still working. I don't know.

MS. VINSEL: It's working again, Chairman.

VICE CHAIRMAN CHANDLER: Ms. Vinsel, you can hear us?

MS. VINSEL: Yes, we can hear you, Vice Chair.

VICE CHAIRMAN CHANDLER: Okay. Can we just confirm that it's still recording and that it recorded throughout that period?

CHAIRMAN SCHMITT: It did.

Q. All right. I apologize, Mr. McKenzie.

A. Yeah, I think I was just wrapping up my answer, but I was just suggesting that it's really impractical to think that we could go to the Company's service territory and look for investment -- businesses of comparable risk and develop a market return based on that kind of a notion, because capital markets are much broader.

And I think back when the Supreme Court was looking at this, there was an idea that they would look to nonregulated businesses as the basis of the earned returns that were used in evaluating the fair ROE, but I think that's not really how that type of analysis should be done.

Q. Okay. But I just want to make sure that I'm clear. You did not, as part of your analysis, look at the returns or earnings of companies that do operate in Kentucky Power to determine whether the ROE proposed for Kentucky Power was appropriate in light of those circumstances?

A. In light of businesses that are operating within the service territory of the utility?

Q. Right, the same general part of the country that Kentucky Power operates at. I just want to confirm that that was not the case.

A. I did not do that.

VICE CHAIRMAN CHANDLER: All right. I very much appreciate it, Mr. McKenzie, sticking with us for three days. Thank you very much.

CHAIRMAN SCHMITT: Dr. Mathews, questions?

COMMISSIONER MATHEWS: I have one. Well, I have a question about timing. I know you said earlier, Mr. Chairman, that you would like to break by 6:00?

CHAIRMAN SCHMITT: Yes, but let's see if we can finish this witness and go on.

COMMISSIONER MATHEWS: Well, my concern is not so much myself, but the reams of notes that I see
Mr. Garcia taking during everyone else's questioning.

CHAIRMAN SCHMITT: Well, Mr. Garcia can ask all the questions that he wants. Personally, I don't think it's necessary to have asked very many questions during the cross, but whatever.

Go ahead. Let's finish it up unless -- the only thing that would make me take a contrary position, what -- I'd want to first talk to

Ms. Grundmann and see how her law partner is doing, because that -- that would be a primary concern.

How is your partner, Ms. Grundmann?

MS. GRUNDMANN: My cocounsel has adopted a far more agreeable demeanor and is prepared to join us for as long as we need.

CHAIRMAN SCHMITT: Okay. Well, if that becomes a problem, you just let us know. Okay?

MS. GRUNDMANN: No, we're good. He had his moment. It corresponded with almost exactly when I was preparing to ask my cross, and then of course as soon as I was done, he was perfectly fine with quieting up and taking a nap. So thank you.

CHAIRMAN SCHMITT: All right. Thank you.

Dr. Mathews, do you have a question or two or three or whatever?

COMMISSIONER MATHEWS: I think maybe we can do it in one.

EXAMINATION

By Commissioner Mathews:

Q. When you're looking at the -- because is it not important that we look at relative risk of companies?

A. Yes, it is important that we look at the overall risk.

Q. Still getting the proper (indiscernible) and so forth?

A. That's correct.

Q. So companies that have trackers such as the fuel adjustment clause, companies that are granted the opportunity to earn their environmental surcharge mechanisms and so forth, those companies would be lower in risk in your group, correct?

A. Yeah, other things equal. I address this in my testimony, and I presented it in my direct testimony. Exhibit AMM-3 compares the various regulatory mechanisms that are in place for the proxy group companies.

So on that basis it's my determination that Kentucky Power is not lower risk compared with the proxy group on the -- based on those considerations.

I think the other factor to keep in mind that was discussed earlier with Mr. Messner is that investors really care about what actually transpires. They don't so much care about what the -- they care about what the authorized ROE is, but they also are very invested in whether the utility is able to earn it.

And I think the evidence in Mr. Mattison's testimony shows that despite the tracking mechanisms and regulatory mechanisms in place, Kentucky Power has been unable to do that for quite some time. I think that's a significant risk for investors.

Q. And I was having that conversation from that all other things being held equal.

COMMISSIONER MATHEWS: I'm done, Mr. Chairman.

CHAIRMAN SCHMITT: I'm sorry. Have you completed your --

COMMISSIONER MATHEWS: I'm finished.

CHAIRMAN SCHMITT: Mr. Garcia? I know you probably have 20 pages of notes, but go right ahead. You're welcome to spend all the time you want on redirect.

MR. GARCIA: Your Honor, first of all, let me emphasize I will ask the questions at your pleasure. If you would prefer that we go on, I am ready to proceed now or we can --

CHAIRMAN SCHMITT: Let's go ahead and finish. If we finish now, we can start with Mr. Phillips in the morning, and I suspect your last four witnesses will probably take some time. So we might as well go ahead and finish this witness now and start fresh in the morning with someone else.

MR. GARCIA: I will do my efforts to do it quicker, Your Honor, but I need --

CHAIRMAN SCHMITT: You take whatever time you -- no, Mr. Garcia, you take whatever time you need. Don't worry about that. We want you to have every opportunity to ask every question that you'd like to ask, and that's only fair.

MR. GARCIA: I'll try to be efficient. I have been teased before about lawyer minutes, which are, like, three times longer than everybody else's.

CHAIRMAN SCHMITT: I'm a lawyer. I know how lawyers are.

MR. GARCIA: Thank you, Your Honor. May I proceed?

CHAIRMAN SCHMITT: Yes, you may.

MR. GARCIA: Thank you.

REDIRECT EXAMINATION

By Mr. Garcia:

Q. Mr. McKenzie, if I can draw your attention to AMM-21. You were asked questions about that.

A. Yes.

Q. Actually, let me ask you at a general level. The DCF model, is it vulnerable to market anomalies?

A. Yes. I mean, there's model risks associated with any approach we use to estimate the cost of equity. That's why I recommend using multiple approaches. I think that's one of the problems that I have with Mr. Baudino's analysis because he relies only on the DCF for his recommendation.

So I think it's important to use more than one model. And certainly there's -- there's the potential that conditions in the market can cause a method like the DCF to be -- to produce results that are unrepresentative.

Q. Great. And under your analysis, one of the things that you did was the information in AMM-21 was it to -- I'm going to use the word temper it with the use of other methodologies to arrive at your conclusions about what is the required ROE from investors for Kentucky Power?

A. Yes, that's correct. I mean, AMM-21 was the DCF model for the nonutility group, which actually didn't factor directly into my recommendations, but as I indicated earlier, I think it's an important benchmark that should be considered, but it's just one of a number of methods that I believe the Commission should give weight to.

Q. If I can, then, turn your attention on the same spirit of the question to AMM-14, which I think follows the table, the exhibit that you were asked about, AMM-13. So I'm asking you about AMM-14.

A. AMM-14? Okay.
Q. Okay. And am I correct, Mr. McKenzie, if you could explain a little bit the relationship between the information that you present in AMM-14 and the midpoint -- the range of reasonableness in the Baudino proxy group as illustrated in AMM-13, please.
A. Okay. I'm having a little bit of a problem. AMM-14 in my rebuttal testimony is the summary of my updated results. Is that where you wanted to point me?
Q. That's correct, with the use of the multiple methodologies that you have?
A. Okay. I mean, I think in some ways it's better summarized in Hearing Exhibit 9, which basically condenses those numbers down using averages which demonstrates that the indicated ROE for the proxy group is on the order of 10.1, which is actually higher than my recommended midpoint.
And so I think that is adequate support for my recommendation. The range is certainly reflective of the results. As I pointed out earlier, it's not the case that the range reflects the extremes, but it reflects a necessary narrowing of the results of the individual analysis down to a reasonable range.

Q. Okay. And I'm going to take a shortcut and ask you a question that I think will consolidate some of the pages that the Commissioner Mathews so aptly observed.

Kentucky Power, within the range of utilities, with its Baa3 Moody's rating would tend to be a riskier investment. Like, for example, Duke Utilities with -- Duke Kentucky with Baa1 or Louisville Gas & Electric with A3 or similar peers that are rated higher by credit rating agencies, correct?

A. Yes, that's correct. And, as I think I indicated earlier, as you get down to the very bottom of the investment grade scale, that consideration becomes even more important because any further degradation of the Company's credit metrics or credit rating would imply speculative grade rating, which entails a very significant increase in risk and cost of capital.

Q. Thank you. If I can draw your attention to AMM-19, please.

A. Okay. I'm there.

Q. And this page reflects a portion of the analysis for the risk premium methodology; is that correct?

A. Yes.

Q. Okay. And that is, again, one of the alternative methodologies that would provide a richer picture than relying, for example, only on the DCF methodology?

A. Yes, sir.

Q. Okay. Can you explain to me why is it necessary to have dates range that goes in this page from 2019 to 1974? Would it be possible to have a significantly shorter sample and still be able to rely on this analysis, like, say, five years?

A. Well, in my view, that wouldn't be the proper approach. I think when we look at historical studies, we really should consider all of the available data. Just like I don't think it's appropriate to suggest that we should subjectively take out information when we construct beta values based on an argument about whether it applies or didn't apply. I think the more sound basis for this analysis is to consider all of the available data, which is what I've done here.

Q. Okay. And, Mr. McKenzie, you were asked about beta and about the utility industry as it compares to the oil market. Do you recall that line of questioning?

A. Yes.

Q. And, if you could explain, sir, projected beta, future beta, you know, the ones that would make us lots of money if we could know them, are they any or predictable than, say, for example, interest rates, which cannot be predicted even if they can be projected?

A. Yeah. It's analogous. It's analogous to many of the inputs that goes into estimating the cost of equity. The same -- the same is true about the growth rate that's used in the DCF study, for example. It's an unknown quantity. It presumably shouldn't reflect investors' expectations, but we can't observe those. So we have to go out and develop a proxy, and the Value Line beta is the most widely relied upon for that purpose.

Q. Okay. You were asked about distinctions with the Duke Kentucky order that recently authorized 9.2 percent ROE?

A. Yes.

Q. And I think you started to point out that there were some important distinctions, and I want to make sure that the record is clear what those important distinctions are.

A. Well, the first one we discussed earlier is the credit rating. So Duke's Moody's rating is Baa1 versus a Baa3 rating for Kentucky Power. Now, their S&P rating is A minus, which is the same at Kentucky Power, but I think it's important to point out that S&P's rating methodology is generally based on the entire corporate entity. So it focuses -- it focuses on AEP and all of the subsidiaries. It's less company-specific.

So if you look, for example, in the S&P reports, they indicate a company-specific credit profile for Kentucky Power of BBB. So, in other words, they're saying that on a stand-alone basis perhaps the risk of Kentucky Power would be considerably lower, but they get support from AEP, they're not paying dividends right now, and they're able to access the capital markets through AEP, and all of those things contribute to the A minus rating.

Aside from the distinction of ratings, the capital structure was different. Duke had about 48 percent equity. That's higher than what the Company is requesting in this case.

And then, as I mentioned earlier, the order specifically noted that Duke was in a position to be able to mitigate regulatory lag. And as I think you know, the evidence that we've seen in President Mattison's testimony in this case demonstrate that isn't the case for Kentucky Power. They're well behind the eight ball in terms of actually earning the allowed ROE that the Commission has found to be just and reasonable in the last case.

Q. You mentioned the equity layer of Kentucky Power as a point of comparison. Is it your understanding that the equity for Kentucky Power is relatively lower at 42 percent?

A. Yes, it is, and this goes back to an earlier question about -- that I had about pretax versus after-tax returns as well. I mean, the fact that Kentucky Power's equity layer is lower than the companies in the proxy group. If you look at the allowed equity layers for utilities where -- that were authorized ROEs in 2020, for example, those are averaging around 49 percent. Many of them are well above 50.

So that's implying a greater tax burden as well as a greater cost burden and is associated with Kentucky Power's capital structure.

Q. In other words, am I correct that authorizing a higher ROE for Kentucky Power actually has a lessened effect on customers because of that

relatively low equity layer?
A. Yes, that's correct. And, in fact, there's a chart in my direct testimony that illustrates that impact, that compares Kentucky Power's weighted average cost of equity with comparable statistics for others in the industry that were recently authorized at the time I prepared my direct testimony, and Kentucky Power's is right in the low end.
Q. Okay. You were asked some questions about the relationship between the ability of Kentucky Power to attract capital and the economic circumstances in its service territory.
From an investor point of view, Mr. McKenzie, the economic condition of Kentucky Power, would that be a -- a risk factor actually would make an investment riskier and, therefore, would require a higher return?
A. Yes, that's true. I mean, that is one of the features of the utility that credit rating agencies and other investors would consider, common equity investors would consider because it directly impacts the utility's ability to earn a fair return and meet its financial obligations.
So to the extent that the service territory is

weak, that would imply greater risks to investors.
Q. And then let me then ask you one last question in connection with this. You were asked about the Bluefield and Hope standards. And it's your understanding, sir, that the interest of the consumers and the utilities are misaligned under the Hope and Bluefield standard? Or are they consistent with each other?
A. No, I think under the Hope and Bluefield standards there's a balancing of those interests. So they would not be misaligned if those standards are applied.
Q. So let me ask you, then, one final question just to verify that. Would it be bad for the customers of Kentucky Power if the Company had an ROE that wasn't sufficient to attract capital and assure financial integrity?
A. Yes. There's definite harms that can come to consumers if the utility is unable to attract capital.
Q. And, conversely, it's good for customers if the Company actually has an ROE and is able to achieve that ROE that is consistent with Bluefield and Hope?
A. That's correct. And as Vice Chairman pointed

out, that doesn't imply a return on a speculative enterprise, but it implies a fair return that's based on capital market evidence.

MR. GARCIA: Your Honor, if I can have a second?

CHAIRMAN SCHMITT: Yes, you may.

MR. GARCIA: Your Honor, that's it.

CHAIRMAN SCHMITT: Okay. Thank you.

Well, we'll now go into recess until 9:00 in the morning, at which time we'll come back. And I guess is Mr. Phillips our next witness?

MR. GARCIA: That's my understanding, Your Honor.

CHAIRMAN SCHMITT: Okay. We'll now be in recess until 9:00 a.m. in the morning. Thank you-all.

(Hearing adjourned at 6:30 p.m.)

* * *

STATE OF KENTUCKY)
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) SS.
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COUNTY OF JEFFERSON)

We, Laura J. Kogut and Jennifer R. Janes, Notaries Public within and for the State at Large, with commissions expiring 25 July 2023 and 1 May 2023 respectively, do hereby certify that the foregoing hearing was taken before us at the time and place and for the purpose in the caption stated; that witnesses were first duly sworn to tell the truth, the whole truth, and nothing but the truth; that the hearing was reduced by us to shorthand writing; that the foregoing is a full, true, and correct transcript of the hearing to the best of our ability; that the appearances were as stated in the caption.

WITNESS our hand this 22nd day of November 2020.

Laura J. Kogut

Laura J. Kogut, RMR, CRR, CRC
Notary Public, State at Large

Jennifer Janes

Jennifer R. Janes, RPR, CRR, CRC
Notary Public, State at Large