DATA REQUEST

KPSC_5_012 Refer to Kentucky Power's response to Staff's Fourth Request, Items 35 and 39. Kentucky Power's answers are unresponsive. Even though Value Line Investment Survey (Value Line) may classify all the proxy group companies as electric utilities, there are large differences between each of the companies and with Kentucky Power both in terms of revenues and lines of business. Kentucky Power is not a regulated combination electric and gas company, is not involved with natural gas storage or distribution or gas liquids exploration or pipeline transportation; it does not own nuclear generation, it has no non-regulated lines of business, and it has no foreign operations. All of these other lines of business present risks that are not applicable to Kentucky Power and that serve to differentiate these companies from Kentucky Power.

a. For each company in the proxy group, provide the total revenue from operations for 2019 as well as the amount and percentage of 2019 revenue derived from regulated electric utility U.S. operations, non-regulated U.S. operations, and foreign operations.
b. Provide an updated proxy group after the elimination of regulated combination gas and electric companies.
c. Explain Value Line's criteria for categorizing a company as an electric utility.
d. Explain the threshold of a company's non-regulated electric utility operations would be such that it would preclude it from being classified as an electric utility by Value Line.

RESPONSE

Kentucky Power disagrees with the premise of this question, which (1) suggests that Kentucky Power's responses to Staff's Fourth Request, items 35 and 39, were unresponsive, and (2) wrongly implies that individual company attributes (e.g., revenue composition, business lines, generating resources) necessarily demonstrate differences in investors' risk perceptions that "differentiate these companies from Kentucky Power."

Company Witness McKenzie's direct testimony at pages 38-42 contains an extensive discussion of the relative risk pertaining to his proxy group of electric utilities. As Mr. McKenzie explains, his identification of a proxy group of risk-comparable electric utilities focuses primarily on credit ratings, which provide an objective indicator of investment risk that considers the key risk factors relevant to investors, including quantitative and qualitative factors. As the Managing Director for Moody's Global Regulatory Affairs noted in comments to the Securities and Exchange Commission:

> To meet market needs over time, credit ratings have developed important attributes including insightful, robust and independent analysis, symbols that succinctly communicate opinions, and broad coverage across markets, industries and asset classes. These attributes have enabled credit ratings to serve as a point of reference and common language of credit that is used by financial market professionals worldwide to compare credit risk across jurisdictions, industries and asset classes, thereby facilitating the efficient flow of capital worldwide. Farisa Zarin, *Letter Re: Credit Rating Standardization Study – Release No. 34-63573*; File No. 4-622 (Feb. 18, 2011). https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=5&cad=rja&uact=8&ved=0ahUKEwjM7uicuMrbAhUGRqwKHeY0BGkQFghJMAQ&url=https%3A%2F%2Fwww.sec.gov%2Fcomments%2F4-622%2F4622-15.pdf&usg=AOvVaw3Lsgo0DWInU17QdvxEuw9v (last visited Sep. 23, 2020).

A comparison of credit ratings is widely accepted as a means of evaluating the relative risks of utilities for purposes of identifying a proxy group in the context of estimating the cost of equity. For example, the Federal Energy Regulatory Commission has concluded that "corporate credit ratings are a reasonable measure to use to screen for investment risk," and that "[c]redit ratings are a key consideration in developing a proxy group that is risk-comparable." *Potomac-Appalachian Transmission Highline, L.L.C.*, 133 FERC ¶ 61,152, at P 63 (2010). FERC has also ruled that the measure of comparable risks afforded a credit rating screen alone is a sufficient test of comparable investment risks. *N. Pass Transmission LLC*, 134 FERC ¶ 61,095 at P 52 & n.70 (2011).

In addition to credit ratings, Mr. McKenzie also examines a number of key metrics (i.e., beta, Value Line Safety Rank, Value Line Financial Strength Rating) that are widely recognized as independent guides to the investment risks associated with common stocks. Moreover, these measures incorporate the impact of a broad spectrum of risks, including business and financial position, relative size, and exposure to company-specific factors. As Mr. McKenzie indicated at page 42 of his direct testimony, these objective measures indicate that the overall investment risks for Kentucky Power are generally comparable to those of the firms in his proxy group. In other words, the evidence examined by Mr. McKenzie disproves the supposition of this question that, "other lines of business present risks that are not applicable to Kentucky Power and that serve to differentiate these companies from Kentucky Power."

The Supreme Court has recognized that the degree of risk, not the nature of the business, is relevant in evaluating an allowed ROE for a utility. The cost of capital is based on the returns that investors could realize by putting their money in other alternatives, and the total capital invested in utility stocks is only the tip of the iceberg of total common stock investment. The simple observation that a firm operates in non-utility businesses says nothing at all about the overall investment risks perceived by investors, which is the very basis for a fair rate of return. Similarly, gas distribution operations are regulated by the states in the same manner as electric operations, and there is no basis to distinguish between revenues from electric and gas utility operations. Regulatory standards governing a fair ROE are based on comparable risk, not the nature of the business.

In fact, as Mr. McKenzie's testimony explains at pages 79-80, returns in the competitive sector of the economy form the very underpinning for utility ROEs because regulation purports to serve as a substitute for the actions of competitive markets. Under the regulatory standards established by *Hope* and *Bluefield*, the salient criterion in establishing a meaningful proxy group to estimate investors' required return is relative risk, not the source of the revenue stream or the nature of the asset base. Moreover, due to differences in business segment definition and reporting between utilities, it is often impossible to accurately apportion financial measures, such as revenues and total assets, between regulated (*e.g.*, electric and gas) and non-regulated sources. As a result, even if one were to ignore the fact that there is no clear link between the nature of a utility's revenues or assets and investors' risk perceptions, it is generally not possible to accurately and consistently apply asset or revenue-based criteria. In fact, other regulators have rebuffed these notions, with FERC specifically rejecting arguments that utilities "should be excluded from the proxy group given the risk factors associated with its unregulated, non-utility business operations." *Bangor Hydro-Elec. Co*., 117 FERC ¶ 61,129 at PP 19, 26 (2006).

a. Please refer to the response above. Mr. McKenzie did not compile the requested information in the course of preparing his direct testimony as it was unnecessary to support his analyses and conclusions. Kentucky Power had not prepared the requested analysis prior to this request ,as indicated in the Company's response to Staff 4-35, but it is in the process of doing so now. The Company has not yet completed the analysis, but it will supplement this response with the requested study as soon as practicable.

b. Please refer to the response above. Mr. McKenzie does not agree that it is appropriate to eliminate companies that are engaged in both regulated electric and gas utility operations and he did not compile the requested information in the course of preparing his direct testimony as it was unnecessary to support his analyses and conclusions. Subject to and without waiving the foregoing, the Company states: Of the twenty-three utilities in Mr. McKenzie's Electric Group,

the following companies are not engaged in regulated natural gas utility operations:
American Electric Power Co.
Evergy, Inc.
NextEra Energy, Inc.
OGE Energy Corp.

c. Value Line's analytical methods are proprietary and Mr. McKenzie is not aware of any published criteria governing the categorization of companies in its electric utility industry groups.

d. Please refer to the response to (c), above.

October 16, 2020 Supplement Response

a. Please refer to the response above. Mr. McKenzie did not compile the requested information in the course of preparing his direct testimony as it was unnecessary to support his analysis and conclusions. Subject to the foregoing, please see KPCO_SR_KPSC_5_12_Attachment1 for the analysis described in the Company's September 30, 2020 response.

Witness: Adrien M. McKenzie

Witness: Franz D. Messner (Attachment KPCO_SR_KPSC_5_12_Attachment1 only)

Messner - KY Discovery Verification.docx

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E-Signature Summary

E-Signature 1: Franz Messner (FDM)
October 16, 2020 08:54:23 -8:00 [6D5E9BCC65DC] [167.239.221.84]
fdmessner@aep.com (Principal) (Personally Known)

E-Signature Notary: Sarah Smithhisler (SRS)
October 16, 2020 08:54:23 -8:00 [9A7A32C923ED] [167.239.221.80]
srsmithhisler@aep.com
I, Sarah Smithhisler, did witness the participants named above electronically sign this document.

VERIFICATION

The undersigned, Franz D. Messner, being duly sworn, deposes and says he is a Managing Director of Corporate Finance for American Electric Power Service Corporation that he has personal knowledge of the matters set forth in the forgoing responses and the information contained therein is true and correct to the best of his information, knowledge and belief after reasonable inquiry.

Franz Messner
Signed on 2020/10/16 08:54:23 -8:00

Franz D. Messner

STATE OF OHIO)
) Case No. 2020-00174
COUNTY OF FRANKLIN)

Subscribed and sworn to before me, a Notary Public in and before said County and State, by Franz D. Messner, this 16th ' / of October 2020.

NOTARY PUBLIC
STATE OF OHIO
Sarah Smithhisler
Commission # 2019-RE-775042
Electronic Notary Public
State of Ohio
My Comm Exp. Apr 29, 2024
Notary Stamp 2020/10/16 08:54:23 PST 9A7A32C923ED

S Smithhisler
Signed on 2020/10/16 08:54:23 -8:00

Notary Public

Notary ID Number: 2019-RE-775042