COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In The Matter Of: ELECTRONIC INVESTIGATION OF KENTUCKY POWER COMPANY ROCKPORT DEFERRAL MECHANISM	: : : :	**Case No 2022-00283**

POST-HEARING BRIEF OF ATTORNEY GENERAL AND KENTUCKY INDUSTRIAL UTILITY CUSTOMERS

The Attorney General, by his Office of Rate Intervention ("AG"), and Kentucky Industrial Utility Customers, Inc. ("KIUC") submit this Post-Hearing Brief.

This case will determine how $40.8 million of the $50.8 million total annual Rockport fixed costs savings will be allocated between the Kentucky Power Company ("Kentucky Power" or "Company") and ratepayers. Kentucky Power's base rates include $40.8 million of Rockport fixed costs. The end of the 390 MW Rockport Unit Power Agreement ("UPA") on December 8, 2022 necessitates removal of those costs from rates. The 2017 non-unanimous Settlement Agreement in Case No. 2017-00179 provided an initial framework for how the elimination of those costs would be shared between ratepayers and shareholders. But the reasonableness of that initial framework has changed due to American Electric Power's ("AEP") sale of Kentucky Power to Liberty Utilities Co. ("Liberty"). The sale is expected to close in mid-January 2023.

The only issue in dispute between the AG/KIUC and AEP and Liberty relates to one aspect of that framework. Specifically, the parties disagree on whether there should be a 2023 return on equity ("ROE") true-up in the first quarter of 2024. AEP and Liberty argue that the 2017 non-unanimous Settlement Agreement is binding and requires such a true-up. This argument is in the financial self-interest of the shareholders of AEP and Liberty. A 2023 ROE true-up will almost certainly result in Liberty receiving an additional $18 million of Rockport fixed cost savings which will be charged to ratepayers through Tariff PPA at $6 million per month in March, April and May of 2024. The reason that this is a near certainty is because of the added costs that Kentucky Power will incur due to the Liberty acquisition which will significantly reduce Kentucky Power's per books ROE in 2023.

The AG/KIUC believe that the sale of Kentucky Power to Liberty is an unforeseeable event, materially altering the operation of the true-up, and which will cause the rates resulting from the 2017 Settlement Agreement to be unjust and unreasonable. The AG/KIUC therefore oppose allowing the operation of the 2023 true-up to be carried out as if the Liberty sale had never occurred. Our proposal will still result in AEP and Liberty's shareholders receiving a substantial sum, $22.8 million of the $40.8 Rockport fixed cost savings in 2023, which is a reasonable result given the circumstances.

The AG/KIUC recognize that it is the Commission's legal obligation to ensure just and reasonable rates to all consumers regardless of what the parties to a settlement may agree to. This was best stated in Chairman Chandler's November 23, 2022 letter to the parties of record in this case. *"These distinctions between PSC ratemaking cases and judicial or even quasi-judicial adjudications are important to understand here because of Kentucky Power's insistence that this matter is about adjudicating some non-unanimous settlement. A settlement with regard to ratemaking, unanimous or otherwise, brings with it no effect under the law."* Chairman Letter at p. 4. Nevertheless, it is instructive to recognize where there is no disagreement between AG/KIUC and AEP and Liberty.

There is no disagreement regarding the Rockport deferral. During the five-year period 2018-2022, Kentucky Power deferred $50 million of Rockport costs as part of the 2017 Settlement Agreement in order to keep rates affordable in the near term. Kentucky Power added interest in the form of a deferred return on the 2018-2022 deferrals at the Company's weighted average cost of capital, increasing the regulatory asset to $57.5 million[1], and it will continue to charge interest during the five-year recovery period beginning December 9, 2022, also at the Company's weighted average cost of capital.[2] This will result in a $13,539,510 annual cost to consumers for five years ($67.7 million in total).[3] This annual cost will be recovered in Tariff PPA and will result in Kentucky Power being made whole for its agreement to defer recovery. The AG/KIUC agree with AEP and Liberty on this treatment of the deferral.

There is no disagreement regarding the ability of the Company to recover Rockport replacement capacity costs through Tariff PPA beginning December 9, 2022. The termination of the 390 MW Rockport UPA on December 8, 2022 will leave Kentucky Power short of the capacity needed to meet its PJM FRR capacity requirements. The replacement capacity will be purchased from AEP under the Bridge Power Coordination Agreement at the PJM market price for capacity (which is very low compared to the price of Rockport capacity). Due to loss of load in Eastern Kentucky, the full 390 MW will not need to be replaced.[4] The cost of replacement capacity that will be recovered in the Tariff PPA will be approximately $236,000 during January-May 2023, dropping to approximately $74,000 per month for the remainder of 2023.[5] However, as the Chairman recognized at the hearing, there is no energy entitlement associated with the capacity purchase. This will expose consumers to even more market energy price risk through the FAC.

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[1] BKW-Exhibit 2 (Errata) Excel workbook cited in Direct Testimony of Brian West at 6, although the amount cited was not updated in the Errata testimony to reflect the BKW-Exhibit 2 (Errata).

[2] Direct Testimony of Brian West, BKW-Exhibit 1 page 40 of 49.

[3] BKW-Exhibit 2 (Errata) Excel workbook cited in Direct Testimony of Brian West at 9, although the amount cited was not updated in the Errata testimony to reflect the BKW-Exhibit 2 (Errata).

[4] Only 152.2 MW will be required in the 2022/2023 PJM Planning Year and 70.2 MW will be required in the 2023/2024 PJM Planning Year. Response to KPSC 2-4.

[5] Response to KPSC 2-6.

There is no disagreement that the Tariff CC ("Capacity Charge") will terminate on December 9, 2022. The Capacity Charge is currently $6.2 million per year.[6] The Capacity Charge is a below-the-line payment to the Company which is not used as a reduction to revenue requirements in rate cases. The Capacity Charge is not cost-based. It was simply negotiated by AEP as a condition for extending the Rockport UPA in 2004. Since 2004, Kentucky Power has received $105.7 million (nominal) through the Capacity Charge.

There is no disagreement that Rockport costs currently being recovered in the Environmental Surcharge will end effective December 9, 2022. The estimated reduction is approximately $26 million per year.[7]

There is no disagreement that from December 9, 2022 through December 31, 2022, twenty-three days of the annual $40.8 million savings (approximately $2.6 million) will go to ratepayers through Tariff PPA.

There is no disagreement that when new bases go into effect on January 1, 2024 no Rockport costs will be incurred by the Company or charged to consumers.[8]

There is no disagreement that the $10 million of Rockport fixed costs currently being recovered in Tariff PPA will end on December 9, 2022. The total Rockport fixed cost savings is $50.8 million per year.[9] That leaves $40.8 million of Rockport fixed cost savings to be addressed by the Commission. The allocation of that amount between ratepayers and shareholders is in dispute.

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[6] Tariff CC and Response to KPSC 2-6.

[7] Response to KPSC 2-6.

[8] Case No. 2020-00174, *Electronic Application of Kentucky Power Company for (1) a General Adjustment of Rates for Electric Service; (2) Approval of Tariffs and Riders; (3) Approval of Accounting Practices to Establish Regulatory Assets and Liabilities; (4) Approval of a Certificate of Public Convenience and Necessity; and (5) All Other Required Approvals and Relief*. Order of January 13, 2022 at 32. "[T]he Commission finds that Kentucky Power should file a general base rate adjustment application for rates effective January 1, 2024."

[9] Direct Testimony of Lane Kollen at 9.

Based upon per books information (the 2017 Settlement Agreement requires the use of per books information with no ratemaking adjustments for charitable contributions, advertising expenses, etc.), in order to earn its 9.3% authorized ROE based upon the historic test year ending June 30, 2022, Kentucky Power needs $22.8 million of the $40.8 million.[10] The $22.8 million is the estimated 2023 ROE Off-Set. The Company proposes to recover the $22.8 million through Tariff PPA during 2023. We agree. But we disagree with the 2023 ROE true-up.

Because the amount of the Rockport fixed cost savings the Company requires in order to earn its 9.3% authorized ROE in 2023 cannot be determined until the books are closed in 2024, the 2017 Settlement Agreement called for a true-up. Under the 2017 Settlement Agreement, the true-up will be reflected in Tariff PPA during March, April and May of 2024. The concept of a true-up was reasonable in 2017 as it could have been either a charge or credit. But it is not reasonable today. The sale of Kentucky Power to Liberty will cause the Company's per books earnings to dramatically decline.[11] Under the framework of the non-unanimous 2017 Settlement Agreement and due to the effects of the sale on the Company's per books earnings, it is a near certainty that the Company will retain all of the $40.8 million fixed costs savings for 2023 – $22.8 million in 2023 and $6 million per month in March, April and May of 2024.

The sale of Kentucky Power to Liberty has already had a negative impact on the Company's earnings. As Mr. Kollen testified at the hearing, the AEP Receivables Agreement has been terminated because of the acquisition. This has caused Kentucky Power to finance approximately $50 million of receivables at its overall cost of capital instead of at AEP's short-term debt rate. The increased cost will be approximately $4 million per year. Post-acquisition, the AEP Tax Allocation Agreement will be terminated, resulting in the Company recording the

[10] Direct Testimony of Lane Kollen at 10.

[11] Direct Testimony of Lane Kollen at 17.

tax effects of a net operating loss.[12] Most significant will be the write-offs and earnings reductions that will occur at the closing of the sale of Kentucky Power which is expected to occur in mid-January 2023. For example, the $40 million fuel fund which AEP and Liberty agreed to, and which the Commission ordered as a condition for its approval of the sale. Under Liberty ownership, Kentucky Power will incur $40 million of fuel and purchase power costs that will not be recovered in the FAC. This will reduce per books earnings in 2023 and the 2023 ROE true-up would be a mechanism for Liberty to claw-back part of the $40 million fuel fund that is supposed to go to consumers. There will also likely be one-time write-offs for items such as the $15 million annual refund for up to five years for transmission subsidization, thus further reducing earnings.[13]

AEP and Liberty were on notice that the allocation of the Rockport fixed cost savings outlined in the 2017 Settlement Agreement was subject to change well before a final sales price for Kentucky Power was agreed to. This notice was made clear in the Commission's January 13, 2021 and February 22, 2021 Orders in Case No. 2020-00174. Seven months later, on October 26, 2021, Liberty agreed to buy Kentucky Power and Kentucky Transco for $2.846 billion. Almost a year later when the instant case was opened on September 2, 2022 the same notice regarding the Commission's intent to investigate the treatment of the Rockport fixed cost savings was given. Then on September 29, 2022, AEP and Liberty entered into the First Amendment to the Stock Purchase Agreement where the sales price was reduced by $200 million to $2.646 billion.[14] Therefore, the purchase price Liberty paid did or should have reflected the risk that

[12] Direct Testimony of Lane Kollen at 16.

[13] Id. at 17.

[14] The $200 million price reduction "*includes the sole contribution of Sellers and its Affiliates in respect of the Transaction Commitments*" ordered by this Commission as conditions to its approval in Case No. 2021-00481. Therefore, AEP effectively reimbursed Liberty for the financial conditions imposed by the Commission.

the Commission's treatment of the Rockport fixed cost saving might differ from the 2017 Settlement Agreement.

Kentucky Power claims that the Commission and the parties are sophisticated enough to adjust the 2023 per books ROE to eliminate the expenses that would not have occurred but for the acquisition.[15] This argument has some appeal on its face, but in practice would prove extremely difficult to implement. As the Chairman's questioning at hearing illustrated, drawing conclusions regarding whether a particular cost is driven by the transition from AEP to Liberty is complicated. To allow the Company the discretion to make individualized determinations about whether particular costs are related to the transition is problematic given that the Company will be incentivized to determine that costs are not related to the transition. In such a case, the ratepayer's only defense would be the Commission's ability to effectively review every major expenditure, after the fact, to review the Company's internal accounting and decision-making. The Commission, even with the assistance of interested intervenors, would be overburdened by such an endeavor.

Further, by inviting the Commission to engage in piece-meal adjustment of Kentucky Power's per books earnings to eliminate the effects of the sale to Liberty, Kentucky Power's argument against the AG/KIUC proposal is hoisted on its own petard. It is logically inconsistent for Kentucky Power to argue that the Commission is foreclosed from amending the 2017 Settlement Agreement to eliminate the 2023 ROE true-up as proposed by AG/KIUC, while simultaneously proposing its own amendments to the 2017 Settlement Agreement.[16]

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[15] Rebuttal Testimony of Brian West at 11.

[16] See Company's Response to AG-KIUC 2-9. "The 2017-00179 settlement agreement regarding the Rockport Offset requires the Company to utilize 2023 "per-books" net income. Nonetheless, the Company agrees that an adjustment(s) would be considered to neutralize the 2023 net income impact of conditions contingent upon close of the acquisition (such as the decommissioning rider rate "holiday," eastern Kentucky fuel relief fund, $43.561 million liability to offset deferred distribution restoration expenses, and $15 million annual refund for Kentucky Power customers' alleged transmission subsidization), if any." See also Rebuttal Testimony of Brian West at 11.

Rather than attempting to deconstruct the per books financial effects of the acquisition, which would be very complicated if not practically impossible, the better approach is for the Commission to amend the 2017 Settlement Agreement by eliminating the 2023 ROE true-up. This will result in AEP and Liberty receiving $22.8 million of the $40.8 million Rockport fixed cost savings in 2023.

Arguably, all of the Rockport fixed cost savings should go to consumers. That would constitute standard cost-based ratemaking. The argument for this is strong, especially given the extremely depressed economic conditions in Eastern Kentucky as described in the Public Comments of Representative Hatton. But given all of the facts and circumstances, allowing Kentucky Power to retain $22.8 million of the Rockport fixed cost savings, in 2023 only, is reasonable.

Respectfully submitted,

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"The items related to the sale to Liberty Utilities Co. noted in the Company's response to AG-KIUC 2-9 should be addressed, to the extent necessary, in the 2024 Rockport Offset True-Up filing."

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