COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

Electronic Application Of Kentucky Power Company For (1) A General Adjustment Of Its Rates For Electric Service; (2) Approval Of Tariffs And Riders; (3) Approval Of Accounting Practices To Establish Regulatory Assets And Liabilities; (4) A Securitization Financing Order; And (5) All Other Required Approvals And Relief	)))))))	Case No. 2023-00159

REBUTTAL TESTIMONY OF

ANDREW R. CARLIN

ON BEHALF OF KENTUCKY POWER COMPANY

**REBUTTAL TESTIMONY OF
ANDREW R. CARLIN ON BEHALF OF
KENTUCKY POWER COMPANY
BEFORE THE PUBLIC SERVICE COMMISSION OF KENTUCKY**

CASE NO. 2023-00159

TABLE OF CONTENTS

SECTION **PAGE**

REBUTTAL TESTIMONY OF
ON BEHALF OF
KENTUCKY POWER COMPANY
BEFORE THE PUBLIC SERVICE COMMISSION OF KENTUCKY

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME, POSITION AND BUSINESS ADDRESS.

A. My name is Andrew R. Carlin. My business address is 1 Riverside Plaza, Columbus, Ohio 43215. My position is Director – Compensation & Executive Benefits for American Electric Power Service Corporation ("AEPSC"), a wholly owned subsidiary of American Electric Power Company, Inc. ("AEP"). AEP is the parent company of Kentucky Power Company (the "Company" or "Kentucky Power"). AEPSC supplies engineering, financing, accounting, and other services to AEP's seven electric operating companies, including the Company. In this testimony, I will refer to AEPSC, Kentucky Power, and other AEP utility operating companies collectively as the "AEP System."

Q. ARE YOU THE SAME ANDREW R. CARLIN WHO OFFERED DIRECT TESTIMONY IN THIS PROCEEDING?

A. Yes.

II. PURPOSE OF REBUTTAL TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. The purpose of my rebuttal testimony is to correct mischaracterizations in the testimony of Attorney General and Kentucky Industrial Utility Customers, Inc. ("AG-KIUC") Witness Lane Kollen with respect to short-term incentive (STI) compensation, long-term incentive (LTI) compensation, Retirement Savings related employee benefits expense and Supplemental Excess Retirement Plan (SERP) expense the Company requested to be included in its cost of service in its filing. I will show that the STI and LTI compensation expenses in question provide substantial benefits to customers and thus should be included in the Company's cost of service. I will show that the retirement savings plan, collectively with the cash balance pension, collectively provide market competitive retirement income benefits and are both part and parcel of a market competitive total benefit program for employees. I will also demonstrate that the requested non-qualified post-retirement plan expenses are reasonable and appropriate costs to be included in the Company's cost of service.

III. SHORT-TERM AND LONG-TERM INCENTIVE COMPENSATION EXPENSE

Q. WHAT ADJUSTMENTS HAVE BEEN PROPOSED WITH RESPECT TO THE COMPANY'S REQUESTED LEVEL OF STI AND LTI COMPENSATION EXPENSE?

A. AG-KIUC Witness Kollen proposes denying cost recovery for financial performance-based STI and LTI compensation.[1] He argues that 60% of the Company's and AEPSC's allocated STI compensation expense is based on financial performance[2] and 90% of the Company's and AEPSC's allocated LTI is based on financial performance.[3]

[1] Kollen Direct at 39, Line 5.
[2] Kollen Direct at 38, Line 18 and Exhibit (LK-3), Incentive Comp tab, p. 1 of 1, column C, row 40.
[3] *Id.* at 38 Lines 7-9 and Exhibit (LK-3), column B rows 11 and 13.

Q. WHAT IS WITNESS KOLLEN'S RATIONALE FOR HIS RECOMMENDATION TO REMOVE ALL FINANCIALLY BASED STI AND LTI EXPENSE FROM THE COST OF SERVICE?

A. AG-KIUC Witness Kollen first references what he believes is the Public Service Commission of Kentucky's ("Commission") historical practice of disallowing and removing incentive compensation expenses from utilities' revenue requirements that were incurred to incentivize the achievement of shareholder goals as measured by financial performance, rather than incurred to incentivize the achievement of customer and safety goals.

Q. DO YOU AGREE THAT IT IS THE COMMISSION'S PRACTICE TO REMOVE ALL FINANCIALLY BASED STI AND LTI EXPENSE FROM THE KENTUCKY POWER'S AND OTHER ELECTRIC UTILITIES' COST OF SERVICE AS STATED BY MR. KOLLEN?

A. No. The Commission's orders in past cases do not foreclose the Company's ability to recover STI and LTI expense tied to financial performance. And, Commission precedent has slightly changed over time.

In the Commission's Order in Case No. 2014-00396, the Commission, in denying the Attorney General's recommendation that 75% of the Company's ICP expense be excluded because it was funded by EPS, found that, "the amount that should be removed for ratemaking purposes should be based on the performance measures of the plan, not the funding measures."[4] The current STI plan for Kentucky Power

[4] Order of the Kentucky Public Service Commission, Case No. 2014-00396, June 22, 2015, at 25-26.

distribution employees includes two financial measures, Kentucky Power earnings and Kentucky Power ROE, each with a 10% weight. Based on the Commission's findings in Case No. 2014-00396, Mr. Kollen's recommended reduction should have been the 20% total weights for these performance measures and not the 60% weight for the AEP Operating EPS measure funding measure. Thus, Mr. Kollen's recommendation is not in line with the Commission's findings in Case No. 2014-00396.

In Case No. 2017-00179 the Commission adopted the incentive compensation reductions reflected in a settlement agreement among all signatory parties, except for the Attorney General and Kentucky Commercial Utility Customers, Inc. ("KCUC") (which were not signatories to the settlement agreement).[5] The terms of any settlement agreement necessarily reflect compromise, and not the litigated outcome as determined by the Commission, and they should not be considered practice or precedent setting for future proceedings.

In its ruling in the Company's most recent base rate case (Case No. 2020-00174) the Commission found "that incentive plan costs for funding metrics and performance metrics tied to financial objectives should be disallowed from recovery for ratemaking purposes *absent a clear showing of benefit to ratepayers*."[6]

Thus, according to the Commission's most recent precedent on these issues, the Commission did not foreclose the Company's ability to recover STI and LTI expenses tied to financial performance. Instead, the Commission held that these expenses were recoverable upon a clear showing of benefit to ratepayers. The Company has provided

[5] Order of the Kentucky Public Service Commission, Case No. 2017-00179, January 18, 2018, at 15.
[6] Order of the Kentucky Public Service Commission, Case No. 2020-00174, January 13, 2021, at 14 (emphasis added).

that clear showing of benefit to ratepayers in this case, and recovery of the expenses should be allowed.

Q. DOES FINANCIALLY BASED INCENTIVE COMPENSATION BENEFIT RATE PAYERS?

A. Yes. First and foremost, financially based incentive compensation is a component of a reasonable and market competitive employee compensation package that enables the AEP System to attract and retain the suitably skilled and experienced employees needed to provide service efficiently and effectively. Whether this cost is provided to employees in the form of incentive compensation or base pay, it is necessary to maintain the market competitiveness of the compensation the AEP system offers employees. Without market competitive compensation, employee turnover and position vacancy would increase to problematic levels, hiring and training expense would increase, and employee productivity would decrease, given the many years it often takes new employees to learn to perform their jobs safely, efficiently, and effectively. Therefore, this portion of employee compensation expense clearly benefits customers.

The many substantial benefits that incentive compensation, financial or otherwise, provides to customers are described in my direct testimony.[7] Without discounting any of these benefits by omission here, it is worth highlighting that the interests of shareholders and customers are aligned with respect to keeping costs low, which is the primary and often only lever most employee-participants have available

[7] Carlin Direct, Section VIII: The Benefits of Incentive Compensation in its entirely, and p. 33 line 10 through p. 34, line 31 and p. 46 line 3 through p. 47 line 13.

to improve the value of their financially based incentive compensation. Financially based incentive compensation also better ensures that sufficient equity capital is available at reasonable costs to maintain and expand Kentucky Power's electric system to meet the needs of our customers for stable and affordable electricity. These are clear and substantial benefits that are afforded to customers by using financially based incentive compensation.

Q. WHAT IS THE PURPOSE OF THE FUNDING MECHANISM FOR STI COMPENSATION?

A. The funding mechanism ensures that AEP can afford employee incentive compensation while also meeting its commitments to other stakeholders, which include Kentucky Power customers. It also ensures that STI compensation does not impair the AEP System Companies financially, which helps avoid the increased costs that would create, such as increased borrowing costs that Kentucky Power customers would likely at least partially absorb if the AEP System were financially impaired even to a small extent. The importance of such a mechanism becomes apparent when utilities are in financial distress. Anyone who has ever managed their living expenses within a budget knows that it is not sustainable, and it is detrimental to their financial wellbeing, as well as that of those they serve and support, to spend more than they can afford.

The AEP Operating EPS component of the Funding Measures also sends a clear message to all employees that it is imperative for them to maintain financial discipline. This drives a relentless pursuit of efficiency and cost reduction that enables the Company to complete work at a lower cost than would otherwise be the case—which benefits customers in the form of a lower cost of service.

The funding mechanism also facilitates business unit and operating company goal setting by shifting the focus to ensuring a consistent degree of difficulty among AEP's business units and operating companies rather than a degree of difficulty for all goals that produces payouts consistent with overall AEP performance.

Q. DO YOU AGREE WITH AG-KIUC WITNESS KOLLEN (AT 39) THAT INCENTIVE COMPENSATION TIED TO FINANCIAL PERFORMANCE BENEFITS SHAREHOLDERS TO THE DETRIMENT OF CUSTOMERS IN RATE PROCEEDINGS SUCH AS THIS?

A. No, this is a false dichotomy, and AG-KIUC Witness Kollen has not presented any evidence that this has occurred or even how it theoretically might occur. The primary objective of the Company's STI and LTI compensation is to serve as reasonable and market competitive component of the total compensation package that is needed to attract and retain the appropriately skilled and experienced employees needed to provide electric service to customers efficiently and effectively. This fundamental aspect of these programs clearly primarily benefits customers. None of the Kentucky Power employees and only a handful of the AEPSC employees who participate in these plans have any significant ability to affect performance towards any of the AEP financial incentive metrics that AG-KIUC Witness Kollen recommends removing, which are all measures of AEP financial performance. Note that Kentucky Power generated only about 3.5% of AEP's total revenue in 2022. Furthermore, the Company has consistently requested that only the target level of direct Kentucky Power STI and LTI compensation be included in its cost of service in rate cases, not the significantly higher actual level. Moreover, the target level does not vary based on performance.

Therefore, it is not even possible for the financial measures in question to encourage employee behavior that is detrimental to customer interests.

In addition, AG-KIUC Witness Kollen's concern that financially based incentive compensation is detrimental to customers ignores the Commission's oversight of rates through robust regulatory proceedings such as this rate case. The regulatory process is designed to address such conflicting interests. Witness Kollen's concern that financially based incentive compensation provides "executives, managers, and employees a direct incentive to seek greater and more frequent rate increases from customers"[8] is an unsupported red herring. The Commission, the regulatory process, and the Company's demonstrated commitment to the needs of customers each mitigate this potential issue. Mr. Kollen's proposed disallowance is also greatly disproportional to his stated concerns because the vast majority AEP System employees, all of whom are eligible for financially based incentive compensation, have no input in or responsibility for the decision to seek a rate increase.

Q. DOES FINANCIALLY BASED INCENTIVE COMPENSATION, PRIMARILY BENEFIT SHAREHOLDERS?

A. No. The accumulated cost savings that financially based incentive compensation has produced over the decades that it has been in place are reflected in Kentucky Power's test year cost of service. Maintaining financially based incentive compensation prevents backsliding on previously achieved cost-control and efficiency savings. These savings will again be embedded in rates in this rate case proceeding as they have

[8] Kollen Direct at 40, Lines 17-18.

in prior rate case proceedings, and they will again pass through to customers. There is no mechanism, outside of the Commission's control of rates, for shareholders to benefit from the accumulated value that incentive compensation has produced. Disallowing recovery of these amounts requires shareholders to pay for a large portion of this reasonable, customary, and appropriate cost of doing business without receiving any of the accumulated benefits and while also being required to pay for any incremental benefits that may accrue through above target incentive level.

Although incentive compensation should be expected to occasionally payout at or below target from time to time, the AEP System Companies' and the utility industry's average payout has been significantly above target. This is because it is necessary to maintain employees' perceptions that target performance is achievable and that employees' total compensation opportunity remains market competitive. If this perception is undermined it would increase employee turnover, which would result in cost increases that likely would offset any incentive compensation savings.

Given that customers are already receiving the ongoing benefits of financially based incentive compensation and that it is unknown whether it will provide any new incremental benefits going forward, beyond those provided by a market-competitive Total Compensation package; customers, not shareholders, are the primary beneficiaries of the Company's Incentive Compensation program. Excluding any portion of the target level of incentive compensation from Kentucky Power's revenue requirement is not justified based on the evidence that I have provided herein. Moreover, doing so would impede the Company's ability to earn the rate of return set by the Commission in this proceeding.

Q. ARE THERE ANY OTHER REASONS WHY YOU DISAGREE WITH AG-KIUC WITNESS KOLLEN'S RECOMMENDATIONS ON INCENTIVE COMPENSATION?

A. Yes. It is not proper for the companies to "charge" employee compensation costs to shareholders when this compensation is a reasonable, prudent, and necessary expense, and when it provides a clear benefit to ratepayers.

Q. IS WITNESS KOLLEN'S PROPOSED 60% REDUCTION TO REMOVE THE EPS FUNDING MEASURE WEIGHT FOR STI COMPENSATION BASED ON A COMPLETE AND ACCURATE ASSESSMENT OF THE AEP SYSTEM STI COMPENSATION PLAN?

A. No. Even if the Company agreed with Mr. Kollen's proposal, his calculation is incorrect. The funding measures are multiplied by the operating measures (except for the executive council scorecard for which the funding measures are the operating measures) to produce the overall score. Therefore, the funding measures (which add to 100%) and operating measures (which also add to 100%) have the same potential impact on the overall score. Because the funding measures and operating measures total to 200%, the weight of any one measure should be divided by 200% to accurately reflect its impact on STI payouts. As such, if the Commission were to accept Mr. Kollen's proposal, a maximum of 30% of STI expense should be removed from the Company's cost of service (60%/200%=30%), the value of which can be readily quantified from Company Witness Whitney's workpapers.[9]

[9] Whitney Rebuttal, Exhibit HMW-R6.

Q. IS WITNESS KOLLEN'S PROPOSED 90% REDUCTION TO REMOVE ALL LONG-TERM INCENTIVE COMPENSATION, EXCEPT WHAT HE DESCRIBES AS THE STRATEGIC PORTION, INTERNALLY CONSISTENT?

A. No. AG-KIUC Witness Kollen recommends removing all performance share expense because it is tied to financial measures, except the 10% portion tied to what he describes as the "strategic goal portion."[10] The inconsistency is that Witness Kollen also recommends removing all restricted stock units (RSUs) from the cost of service, even though RSUs are not tied to any financial measures whatsoever, financial, or otherwise. If the Commission were to accept Mr. Kollen's recommendation with respect to performance shares, then it should also allow cost recovery for RSUs, which is 25% of overall LTIP expense.

Q. GIVEN THAT KENTUCKY POWER'S REQUESTED COST OF SERVICE VOLUNTARILY EXCLUDED THE SUBSTANTIAL VALUE OF ACTUAL INCENTIVE COMPENSATION PAID DURING THE TEST YEAR THAT EXCEEDED THE TARGET LEVEL OF DIRECT KENTUCKY POWER INCENTIVE COMEPNSATION, SHOULD ANY REDUCTION THE COMMISSION CHOOSES TO MAKE BE TAKEN FROM THIS ALREADY REDUCED STARTING POINT?

A. No. The Company voluntarily reduced the value of direct incentive compensation for Kentucky Power employees included in its requested cost of service to the target level

[10] Kollen Direct, Exhibit (LK-3), p. 1 of 1, Incentive Comp tab, column A, rows 11 and 13.

because this reflects the market competitive level. However, if the Commission reduces incentive compensation to remove financially based incentive compensation or for any other reasons, then the Commission should apply this reduction to the actual level of incentive compensation incurred during the test year. This would have the effect of treating Kentucky Power's incentive compensation the same as other Kentucky investor-owned electric utilities for which incentive compensation is not reduced to the target level before other reductions are applied. AEP System and industry practice has shown that above target incentive payouts are the norm (132% 10-year average for CEOs) so this voluntary reduction to target is not a "going level" type of adjustment.[11] As such, if the Commission were inclined to reduce the Company's cost recovery below that target level, the Company would respectfully request to withdraw its voluntary reduction to the target level such that any reduction would apply to the full test-year incentive compensation amount.

Q. HOW WOULD THE COMPANY BE AFFECTED BY REDUCING OR ELIMINATING VARIABLE INCENTIVE COMPENSATION FROM ITS COST OF SERVICE FOR RATEMAKING PURPOSES?

A. Denying cost recovery for such a substantial portion of incentive compensation would reduce the Company's rate of return to below the level to be set in this rate case, all else being equal.[12] It would also encourage shifting variable incentive compensation into fixed base pay to enable the Company to recover its reasonable payroll costs in the

---

[11] 2023 U.S. Energy Services Compensation Survey, October 12, 2023, Results and Trends Webinar, p. 17.

[12] Denying $6.29M revenue requirement associated with prudently incurred incentive cost results in an approximate 63 basis point (BPS) reduction to the Company's requested ROE. Per KPCO_R_KPSC_3_30_Attachment1, 10 BPS = $1,000,190.

future. This would diminish or eliminate the efficiencies, productivity enhancements, and operational benefits gained by the proven strategy of linking pay to performance and ultimately result in increased expenses, reduced performance, and higher rates for customers.

IV. RETIREMENT SAVINGS PROGRAM EXPENSE

Q. PLEASE DESCRIBE THE AEP SYSTEM RETIREMENT SAVINGS PROGRAM?

A. Employees are encouraged to contribute a percentage of their eligible compensation (base pay and annual incentive compensation) to a retirement saving program account. The Company matches the first 1% of eligible compensation from each paycheck on a dollar-for-dollar basis and the next 5% of eligible compensation on a $0.70 per dollar basis.

Q. DO THE AEP SYSTEM COMPANIES ALSO PROVIDE DEFINED CONTRIBUTION PENSION BENEFITS?

A. Yes, AEP System benefits continue to include a cash balance pension benefit for employees with one or more years of service, which vests after 3 years of service. The cash balance pension is structured as an account balance plan, which causes it to operate similarly to a defined contribution plan. Eligible participants are credited with a percentage of eligible compensation, which is also base pay plus incentive compensation, plus interest credits. The eligible compensation crediting rate varies from 3.0% to 8.5% based on age and years of service. The cash balance formula generally provides significantly less benefit value to participants than the AEP System's now-frozen traditional final average pay (FAP) formula would have provided under similar circumstances, although such comparisons are dependent on a variety of factors, such as interest rates and participant elections. The traditional FAP formula was locked to new hires on or after January 1, 2000, or earlier for legacy CSW formulas, and years of service and compensation taken into consideration were frozen effective December 31, 2010.

One change since the last Kentucky Power base rate case is that the cash balance lookback credit on eligible compensation for employees who reach one year of service was eliminated for employees hired on or after January 1, 2021. As a result of this change, employees with less than one year of service no longer participate in any way in this program.

Q. DID AG-KIUC WITNESS KOLLEN PROPOSE AN ADJUSTMENT TO RETIREMENT SAVINGS PROGRAM EXPENSE?

A. Yes, Witness Kollen proposed eliminating all retirement savings program expense from Kentucky Power's cost of service in its entirety based on past Commission precedent.

Q. WHAT WAS THE COMMISSION'S RATIONALE FOR DISALLOWING RETIREMENT SAVINGS PROGRAM EXPENSE IN THE COMPANY'S LAST BASE RATE CASE, CASE NO. 2020-00174?

A. First it should be noted that the Commission allowed the Company's requested retirement savings program expense to be recovered as part of the Company's cost of service in its 2017 base rate case, Case No. 2017-00179.[13] In its next base rate case,

[13] Order of the Kentucky Public Service Commission, Case No. 2017-00179, January 18, 2018, at 15.

Case No. 2020-00174, Kentucky Power made the same proposal with respect to retirement savings program expense. In that case, "[n]one of the intervenors directly addressed Kentucky Power's savings plan expense."[14]

Then, the Commission's final order in Case No. 2020-00174 held:

> First, the Commission notes that it made an erroneous finding of fact in its final Order in Case No. 2017-00179 because the Order referenced only the 401(k) contributions and a defined benefit plan that was locked and frozen but was silent regarding a third retirement plan funded entirely by Kentucky Power in the form of the cash balance formula pension. In Case No. 2017-00179 and in this proceeding, Kentucky Power testified that the contributions to the 401(k) and cash balance formula pension were designed so that, taken individually, the contributions are less than would be required to provide a market competitive retirement benefit, but, taken together, are market competitive. However, the Commission finds that Kentucky Power has not provided substantial evidence to support this assertion. For this reason, the Commission has reduced jurisdictional 401(k) savings plan expense by $1,684,045.[15]

Q. WHY DID THE COMPANY NOT PROVIDE ADDITIONAL EVIDENCE ON RETIREMENT SAVINGS PROGRAM EXPENSE IN CASE NO. 2020-00174?

The Company did not provide additional evidence to support retirement savings program expense because the Commission had approved the same proposal in the Company's previous base rate case, no intervening Witness contested the expense, and the Company had no reason to believe it was at issue.

---

[14] Order of the Kentucky Public Service Commission, Case No. 2020-00174, January 13, 2021, at 17.
[15] *Id.* at 18.

Q. HAS KENTUCKY POWER PROVIDED SUBSTANTIAL EVIDENCE TO SUPPORT THE RECOVERY OF RETIREMENT SAVINGS PLAN EXPENSE IN THIS CURRENT CASE?

A. Yes, the Company has provided substantial evidence of this. Confidential Exhibit ARC-10 to my direct testimony and Confidential Attachment 1 to the Company's response to KPSC 1-22, show that AEP System benefits are in the middle of the pack overall (between the 6th and 7th highest out of 11 peer employers)[16] with an overall value score of 100.4 compared to the average of the comparator group.[17] AEP System retirement income benefits ranked between the 3rd and 4th highest out of 11 employers with a retirement income value of 106.5 score compared to the average of the comparator group.[18] Such peer comparisons are a moving target due to employer benefit changes, new employers entering the survey, and current employers exiting the survey. Nonetheless, these results remain well within a reasonable market competitive range and show that the retirement income combination, and AEP System benefits overall, remain market competitive.

Q. HOW HAS THE COMPANY DEMONSTRATED OR DESCRIBED THAT THIS COMBINATION OF RETIREMENT INCOME IS PRUDENT, REASONABLE, AND RECOVERABLE IN THE PAST?

A. In past rate cases, I have described this combination like an ice cream swirl cone that is made up of more than one flavor of ice cream. I use this metaphor because it aptly

[16] Carlin Direct, CONFIDENTIAL EXHIBIT ARC-10, excerpt p. 14 of 224 and KPCO_R_KPSC_1_22_ConfidentialAttachment2, p. 7.
[17] Carlin Direct, CONFIDENTIAL EXHIBIT ARC-10, excerpt p. 15 of 224 and KPCO_R_KPSC_1_22_ConfidentialAttachment2, p. 8.
[18] Id.

describes the AEP System's mix of pension and retirement savings plan matching contributions because and it shows that these benefits - singularly or in combination – can provide a market competitive value of retirement income benefits compared to peer utilities. In other words, the AEP System's swirl of pension (chocolate) and matching savings program contributions (vanilla) fit in the same size retirement income cup or cone as used by other peer utilities to provide retirement income benefits to their employees.

It should be noted that the Aon Benefit Index survey (Confidential Exhibit ARC-10) groups pension and savings plan matching contributions together into a single Retirement Income category. This shows that providing cost recovery to utilities for only one or the other type of retirement income benefit is an unnecessary and unreasonable distinction. Instead, the market competitiveness of the total value of retirement income benefits or, better still, the total value of all employee benefits, would provide meaningful comparisons.

Q. DID THE COMMISSION FIND THAT THERE WAS AN ERRONEOUS FINDING OF FACT IN ITS FINAL ORDER IN CASE NO. 2017-00179?

A. Yes. The Commission's findings with respect to retirement savings expense in the final order in Case No. 2017-00179 require additional context. In its order for Case No. 2020-00174, the Commission stated that the finding of fact in its final order in case No. 2017-00179 was erroneous because it "referenced only the 401(k) contributions and a defined benefit plan that was locked and frozen, but was silent regarding a third retirement plan funded entirely by Kentucky Power in the form of the cash balance formula pension."[19] The next section of the final order in case No. 2017-00179 addresses Supplemental Executive Retirement Plan ("SERP") expense, which is an expense largely associated with the cash balance pension formula.[20] The missing context here is that the Commission in the 2017 case found that the cash balance pension formula should be treated as a defined contribution type plan because it functions and is funded by a defined contribution formula similar to a typical 401k plan formula. In my testimony in the 2017 case, I distinguished between the locked and frozen final average pay pension formula,[21] the ongoing cash balance pension formula,[22] and the retirement savings plan benefits[23] and the swirl cone analogy was particularly memorable. The distinction between the pension formulas and the savings plan contributions was acknowledged in the transcript by Vice-Chairman Cicero.[24] I believe the transcript of this case was clear that the Company was maintaining both an ongoing cash balance pension benefit and a retirement savings program.[25] I also believe the record was clear that these two types of benefits, in total, were the swirl cone that the Company considered to be market competitive.[26]

---

[19] Order of the Kentucky Public Service Commission, Case No. 2020-00174, January 13, 2021, at 18.
[20] Order of the Kentucky Public Service Commission, Case No. 2017-00179, January 18, 2018, at 16.
[21] KPCO December 7, 2017 Hearing Transcript, at 675, Lines 10-14.
[22] Id., Lines 15-18.
[23] Id. at 677, Lines 13-19.
[24] Id., Lines 20-21.
[25] Id., Lines 14-19
[26] KPCO December 7, 2017 Hearing Transcript, at 677-678, Line 22-1 and 679-680, rows 22-6.

Q. WHAT ARE SOME OF THE ADVANTAGES OF HAVING BOTH DEFINED BENEFIT PENSION PROGRAM AND A DEFINED CONTRIBUTION RETIREMENT SAVINGS PROGRAM?

A. The retirement savings program encourages employees to save for their retirement, which is important because the Company's contribution to employees' retirement income in total would not be enough for most employees to retire comfortably, even with social security benefits. However, a distinction of the retirement savings program is that employees can take loans and distributions before retiring and they are responsible investment decisions.

The cash balance pension program is funded by the Company and backed by the AEP System Companies and the Federal Pension Benefit Guaranty Corporation, which moves the investment risk to the Company and ensures that sufficient funds will be available for employees' and their spouses' retirements. The AEP System is also able to invest more efficiently and with a longer time horizon than employees can on their own. The AEP System also may choose, at times, to take on more investment risk than employees would, which, if successful, may reduce the cost of pension benefits by funding them through investment gains. In fact, the expense for the pension program is a large enough credit in this case, to more than offset the retirement savings program expense. However, pension benefits are less accessible to participants in times of need and do not encourage retirement savings. Since each of these types of retirement benefits address some of the shortcomings of the other type, taken together, they provide a more robust retirement income benefits than either would provide alone.

Q. ARE THERE OTHER REASONS THAT THE BENEFITS THAT THE AEP SYSTEM PROVIDES TO EMPLOYEES ARE BENEFICIAL FOR KENTUCKY POWER CUSTOMERS?

A. Yes, as I have shown, AEP System benefits are reasonable and market competitive overall compared to peer utilities. As such they enable the Company to attract and retain the suitable employees necessary to provide electric service to customers efficiently and effectively. Due to economies of scale and well-designed benefit programs, AEP System benefits are very efficient, in fact 11% more efficient than other employers in the Energy/Utility industry.[27] Developing and maintaining different employee benefits for Kentucky Power employees would undermine the efficiency of the benefits provided to all AEP System employees, particularly those for Kentucky Power employees.

Q. HOW DO CURRENT AEP SYSTEM RETIREMENT INCOME BENEFITS COMPARE TO THOSE OF EMPLOYERS WHO WERE SEEMINGLY THE IMPETUS FOR THE COMMISSION'S PRACTICE OF DENYING COST RECOVERY FOR MORE THAN ONE RETIREMENT INCOME PLAN BENEFIT?

A. The AEP System retirement income benefits provide less value to employees and have less cost than the plans described by, for example, Cumberland Valley Electric, Inc. (Cumberland Valley Electric) in Case No. 2016-00169. By way of example, the Cumberland Valley Electric plan's defined benefit contribution had a 30.22% rate.

[27] Carlin Direct, CONFIDENTIAL EXHIBIT ARC-11 – 2023 WTW Industry Efficiency Healthcare Financial Benchmarks (FBS) 042023C, p. 2.

This is more than three times greater than the upper range of Kentucky Power's defined contribution, and more than ten times greater than the lower range. This compares to the AEP System's maximum contribution of 13% (3.0% to 8.5% cash balance pension credit plus 4.5% matching saving plan contribution), which is less than half of Cumberland's defined benefit contribution.

Q. WHAT WOULD BE THE IMPACT OF DISALLOWING COST RECOVERY FOR RETIREMENT SAVINGS PLAN EXPENSE?

A. Denying cost recovery for such a substantial expense would impair the Company's ability to earn the rate of return set by the Commission in this case. Long-term continuation of this situation would be unsustainable and would impair Kentucky Power's ability to offer market competitive employee benefits and erode its ability to attract and retain qualified employees. This would likely result in the need for the Company to change the mix of retirement income benefits for Kentucky Power employees to a mix that is recoverable. However, because the AEP System Companies' benefits are market competitive and other AEP System utilities do not have similar cost recovery issues, it would be necessary to break Kentucky Power employees out of the AEP System benefits program, to eliminate either the pension or retirement savings benefit. Additionally, Kentucky Power's compensation and benefits are market competitive. If these pension or retirement savings benefits were discontinued, the Company likely would not see cost savings because those costs would be offset by increasing some other type of compensation or benefit, such as an offsetting increase in base pay, to keep total compensation market-competitive and to avoid impeding the Company's ability to attract and retain suitable employees. This would undermine the efficiency of the benefits provided to Kentucky Power employees and result in increased costs to Kentucky Power customers.

V. SUPPLEMENTAL EMPLOYEE RETIREMENT PLAN (SERP) EXPENSE

Q. PLEASE EXPLAIN THE COMPANIES' SERP BENEFITS.

A. The AEP System maintains Supplemental Employee Retirement Plans or "SERP" (the AEP Supplemental Benefit Plan and the CSW Executive Retirement Plan) to provide benefits outside of the limits imposed on ERISA-qualified defined benefit pension plans. The Federal ERISA law limits the value of pension benefits that are deductible in the current year from employers' income taxes but amounts in excess of this limit remain deductible when paid to participants. ERISA does not limit total (qualified and non-qualified) pension benefits. The CSW plan is applicable to former CSW pension plan participants, and the AEP plan is applicable to all other participants. The applicable SERP plan provides benefits to employees using the same formulas used under the ERISA-qualified AEP Retirement Plan, except that the value of non-qualified benefits is reduced by the value of qualified benefits so that the SERP plan provides only the value that cannot be provided in the qualified plan due to ERISA limits. In this way the Company's SERPs provide benefits that would be provided under the qualified plan formulas but for the ERISA limits.

Q. HOW PREVALENT ARE NON-QUALIFIED DEFINED BENEFIT PENSION PLANS?

A. In my experience, most companies that provide ERISA-qualified defined benefit pension plans to employees also provide non-qualified restoration plans like AEP's non-qualified pension plans. Such plans are a prevalent component of total rewards offered by large U.S. utility and industrial companies with qualified defined benefit pension plans. Many large Kentucky Power commercial and industrial customers and governments also utilize non-qualified defined-benefit retirement plans.

Q. WHAT TREATMENT OF SERP EXPENSE IS RECOMMENDED BY AG-KIUC WITNESS KOLLEN AND WHAT IS HIS RATIONALE FOR HIS RECOMMENDATION?

A. AG-KIUC Witness Kollen recommends excluding all SERP expense from Kentucky Power's cost of service because of past Commission practice. In its ruling in Case No. 2020-00174, the Commission stated that it "typically disallows SERP costs when retirement plan expenses offered exclusively to certain highly-compensated employees exceed the cost of pension plans for all employees because, absent substantial evidence to the contrary, retirement plans that benefit highly-compensated employees without providing a benefit to ratepayers are the type of costs the Commission finds should not be borne by ratepayers."[28]

Q. DOES THIS RATIONALE APPLY IN THIS CASE AND, IF NOT, WHY?

No, for two reasons. First, the Company's SERP plan is not "exclusive" to any "certain" group of employees. It is provided to all AEP System employees who are pension participants, which requires one-year or more of service, whose eligible compensation exceeds the IRS eligible compensation limit for ERISA qualified retirement plans. Secondly, read literally, the order only excludes SERP plan expense

[28] Order of the Kentucky Public Service Commission, Case No. 2020-00174, January 18, 2018, at 16.

if it "exceed[s] the cost of pension plans for all employees"[29] and it does not do so in this case.

Q. HAS THE COMMISSION PREVIOUSLY MADE A DETERMINATION ON THE REASONABLENESS OF THE COMPANY'S SERP EXPENSE IN OTHER PRIOR CASES?

A. Yes. In Case No. 2017-00179, the Attorney General recommended adjustments for the expense associated with the Company's SERP arguing that such plans provide benefits to executives that exceed amounts limited in qualified retirement plans by the Internal Revenue Service and that additional retirement compensation to the Company's highest paid executives is not a reasonable expense that should be recovered in rates. In its January 18, 2018 Order, the Commission found, "the [Company's] SERP expenses reasonable and, therefore, should be allowed for ratemaking purposes."[30] The Company respectfully requests that Commission find the Company's SERP expense is reasonable consistent with its previous ruling in Case No. 2017-00179.

Q. DOES SERP BENEFIT CUSTOMERS?

Yes. The AEP System Companies need many employees with scarce experience, knowledge, capabilities, and skills to provide electric service to customers efficiently and effectively. It is reasonable, prudent, and in customers' interests for the Company to attract and retain such employees. These attributes enable many of these employees to command compensation that exceeds IRS-qualified plan compensation limits. Therefore, the cost associated with attracting and retaining such employees is necessary

---

[29] Id.
[30] Order of the Kentucky Public Service Commission, Case No. 2017-00179, January 18, 2018, at 16.

and prudent if the Company is to provide its electric service to customers efficiently and effectively. While continuing to provide SERP benefits is a discretionary decision, eliminating this benefit without an offsetting increase in some other form of remuneration would have negative consequences on the Companies' ability to attract and retain such highly talented employees and this would ultimately have negative impacts on the cost and quality of the service the Company is able to provide to customers. Therefore, while SERP is discretionary, the need to provide market-competitive total remuneration to employees is not, nor is the cost associated with that, which includes SERP expense.

One of the primary reasons for the ERISA limits on qualified plan benefits is so that the Federal government can meet its need for current tax revenue. It is arbitrary to use limits established for this purpose to set the maximum level of pension expense that is necessary and prudent for the provision of efficient and reasonable electric service. Moreover, the IRS limit has varied significantly over time due to changes in the law. The Commission should consider whether using this limit to determine recoverable vs. non-recoverable pension expense makes sense given the potential for such variability. In fact, utilizing any fixed limit for such a determination is biased against larger companies, including those with economies of scale that lower costs and improve service quality for customers. This is because more skilled and experienced managers and other highly compensated employees are needed to manage larger companies, and such employees command higher compensation in the marketplace, which is more likely to exceed any fixed limit.

The Companies' non-qualified defined contribution pension benefits have been designed as part of the market-competitive total rewards package. Without SERP benefits, most highly paid employees would be stunned to find that their pension benefit is not based on all their otherwise eligible compensation as it is for lower-paid employees due to such an arbitrary limit, and many would demand equivalent value in another form. SERP is not an additional benefit above and beyond what is needed to provide market-competitive total rewards to these employees. As such, customers benefit from the provision of SERP benefits as part of a market-competitive total rewards package that enables the company to attract and retain suitable employees in the same way as customers benefit from the provision of base pay as part of the same market-competitive package.

VI. CONCLUSION

Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

A. Yes, it does.

Carlin Verification Form.doc

DocVerify ID:	7865D97E-A0D5-4EED-8A76-B6CBD44011EF
Created:	November 03, 2023 12:29:25 -8:00
Pages:	2
Remote Notary:	Yes / State: KY

This document is a DocVerify VeriVaulted protected version of the document named above. It was created by a notary or on the behalf of a notary, and it is also a DocVerify E-Sign document, which means this document was created for the purposes of Electronic Signatures and/or Electronic Notary. Tampered or altered documents can be easily verified and validated with the DocVerify veriCheck system. This remote online notarization involved the use of communication technology.

Go to www.docverify.com at any time to verify or validate the authenticity and integrity of this or any other DocVerify VeriVaulted document.

E-Signature Summary

E-Signature 1: Andrew R. Carlin (ARC)
November 03, 2023 12:38:49 -8:00 [57649E89E5A7] [167.239.221.104]
arcarlin@aep.com (Principal) (Personally Known)

E-Signature Notary: Marilyn Michelle Caldwell (MMC)
November 03, 2023 12:38:49 -8:00 [358AC51FA953] [167.239.221.103]
mmcaldwell@aep.com
I, Marilyn Michelle Caldwell, did witness the participants named above electronically sign this document.

VERIFICATION

The undersigned, Andrew R. Carlin, being duly sworn, deposes and says he is the Director of Compensation and Executive Benefits, for American Electric Power Service Corporation, that he has personal knowledge of the matters set forth in the foregoing testimony and the information contained therein is true and correct to the best of his information, knowledge, and belief after reasonable inquiry.

Andrew R. Carlin

Andrew R. Carlin

Commonwealth of Kentucky)
) Case No. 2023-00159
County of Boyd)

Subscribed and sworn to before me, a Notary Public in and before said County and State, by Andrew R. Carlin, on ________________.

Notary Public

MARILYN MICHELLE CALDWELL
ONLINE NOTARY PUBLIC
STATE AT LARGE KENTUCKY
Commission # KYNP71841
My Commission Expires May 05, 2027

Notarial act performed by audio-visual communication

My Commission Expires ____________________

Notary ID Number ____________________