

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF KENTUCKY POWER	)	
COMPANY FOR APPROVAL OF AN AMENDED	)	
COMPLIANCE PLAN FOR PURPOSES OF	)	CASE NO.
RECOVERING ADDITIONAL COSTS OF	)	2006-00307
POLLUTION CONTROL FACILITIES AND TO	)	
AMEND ITS ENVIRONMENTAL COST RECOVERY	)	
SURCHARGE TARIFF	)	

O R D E R

On July 28, 2006, Kentucky Power Company (“Kentucky Power”) filed an application, pursuant to KRS 278.183, seeking Commission approval of an amended environmental compliance plan and to amend its Environmental Surcharge (“E.S.”) tariff. Kentucky Power states that the proposed amendments allow it to include the cost of pollution control projects that are required by the Clean Air Act<sup>1</sup> (“CAA”) and other federal, state, and local regulations that are charged to it pursuant to Federal Energy Regulatory Commission (“FERC”) approved agreements between Kentucky Power and affiliated American Electric Power, Inc. (“AEP”) operating companies. Kentucky Power proposed that its amended E.S. tariff become effective for bills rendered on and after August 28, 2006.

On August 16, 2006, the Commission found that further proceedings were necessary to investigate the reasonableness of the proposed amendments to Kentucky

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<sup>1</sup> As amended, 42 U.S.C.A. § 7401 *et seq.*

Power's compliance plan and E.S. tariff.<sup>2</sup> The Commission stated that until that determination was made, Kentucky Power's proposed E.S. tariff could not be implemented under KRS 278.183. A procedural schedule was established providing for the completion of this investigation within 6 months.

The following parties requested and were granted full intervention: the Attorney General of the Commonwealth of Kentucky, by and through his Office of Rate Intervention ("AG"), and the Kentucky Industrial Utility Customers, Inc. ("KIUC"). A public hearing was held on November 28, 2006. All information requested at the public hearing has been filed, and the parties have submitted briefs.

### BACKGROUND

Kentucky Power is a privately owned electric utility that generates, transmits, distributes, and sells electricity to approximately 175,300 customers in all or parts of 20 counties in eastern Kentucky. Kentucky Power is a wholly owned subsidiary of AEP.<sup>3</sup> Kentucky Power and four other AEP subsidiaries<sup>4</sup> make up the AEP Power Pool ("AEP Pool"). The AEP Interconnection Agreement, which created the AEP Pool, is a tariff that contains rates and terms of service for the wholesale sale of power and is subject

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<sup>2</sup> Pursuant to KRS 278.183(2), the Commission has 6 months to complete its investigation and determine the reasonableness of a compliance plan and rate surcharge.

<sup>3</sup> As a subsidiary of AEP, Kentucky Power is a member of the integrated AEP System, an interstate public utility holding company system. Subsequent to its merger in 2000 with Central and South West Corporation, AEP has operations in Arkansas, Indiana, Kentucky, Louisiana, Michigan, Ohio, Oklahoma, Tennessee, Texas, Virginia, and West Virginia.

<sup>4</sup> The subsidiaries are Appalachian Power Company ("Appalachian"), Columbus Southern Power Company ("Columbus Southern"), Indiana Michigan Power Company ("I&M"), and Ohio Power Company ("Ohio Power").

to regulation by FERC. The members of the AEP Pool share generating capacity and either make or receive capacity-related payments pursuant to FERC-approved rates. Kentucky Power owns two generating units at its Big Sandy Generating Station (“Big Sandy”) in Louisa, Kentucky. It also receives power from I&M’s Rockport Generating Station (“Rockport”) pursuant to the Rockport Unit Power Agreement (“Rockport Agreement”). The Rockport Agreement is also subject to regulation by the FERC. Even with the Rockport capacity, Kentucky Power has less generating capacity than it is responsible for under the terms of the AEP Interconnection Agreement and is considered a deficit member of the AEP Pool. Thus, it is required to make capacity payments to the AEP Pool members that have more capacity than they are responsible for under the AEP Interconnection Agreement.<sup>5</sup>

KRS 278.183 provides that a utility shall be entitled to the current recovery of its costs of complying with the CAA as amended and those federal, state, or local environmental requirements that apply to coal combustion wastes and by-products from facilities utilized for the production of energy from coal. Pursuant to KRS 278.183(2), a utility seeking to recover its environmental compliance costs through an environmental surcharge must first submit to the Commission a plan that addresses compliance with the applicable environmental requirements. The plan must also include the utility’s testimony concerning a reasonable return on compliance-related capital expenditures and a tariff addition containing the terms and conditions of the proposed surcharge

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<sup>5</sup> Appalachian and Columbus Southern are also deficit members of the AEP Pool. I&M and Ohio Power are surplus members.

applied to individual rate classes. Within 6 months of submission, the Commission must conduct a hearing to:

- (a) Consider and approve the compliance plan and rate surcharge if the plan and rate surcharge are found reasonable and cost-effective for compliance with the applicable environmental requirements;
- (b) Establish a reasonable return on compliance-related capital expenditures; and
- (c) Approve the application of the surcharge.

Kentucky Power's original compliance plan and environmental surcharge were approved by the Commission in 1997 in Case No. 1996-00489.<sup>6</sup> The original compliance plan ("1997 Plan") was comprised of five projects at Big Sandy involving low nitrogen oxide ("NOx") burners,<sup>7</sup> continuous emission monitors ("CEMs"), sulfur dioxide ("SO<sub>2</sub>") emission allowances, Kentucky air emission fees, and three projects at

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<sup>6</sup> Case No. 1996-00489, Application of Kentucky Power Company d/b/a American Electric Power to Assess a Surcharge Under KRS 278.183 to Recover Costs of Compliance with the Clean Air Act and Those Environmental Requirements Which Apply to Coal Combustion Waste and By-Products, final Order dated May 27, 1997.

<sup>7</sup> In its May 27, 1997 Order in Case No. 1996-00489, the Commission excluded the low NOx burners at Big Sandy Units 1 and 2 from the approved compliance plan. After the Commission denied rehearing, Kentucky Power appealed. In *Commonwealth of Kentucky ex rel. Chandler v. Kentucky Public Service Commission*, Nos. 97-CI-01138, 97-CI-01144, 97-CI-01319 (Ky. Franklin Cir. Ct. May 14, 1998), the Franklin Circuit Court reversed in part and directed the Commission to permit Kentucky Power's recovery of low NOx burner costs incurred after May 19, 1997. The Commission and the parties appealed to the Kentucky Court of Appeals. As part of a unanimous settlement in Case No. 1999-00149, the parties agreed to: (1) dismiss their appeals to the Kentucky Court of Appeals; and (2) allow Kentucky Power to recover through its environmental surcharge mechanism the costs associated with the Big Sandy Units 1 and 2 low NOx burners beginning January 1, 2000. See Case No. 1999-00149, Joint Application of Kentucky Power Company, American Electric Power Company, Inc. and Central and South West Corporation Regarding a Proposed Merger, final Order dated June 14, 1999.

generating stations owned by members of the AEP Pool.<sup>8</sup> The original E.S. tariff included a formula to calculate the retail monthly environmental surcharge net revenue requirement (“ES revenue requirement”) and applicable monthly surcharge factor.<sup>9</sup> The authorized rate of return on environmental capital expenditures was Kentucky Power’s overall rate of return on capital.<sup>10</sup> This authorized rate of return on environmental capital expenditures was applied to the compliance rate base for the Big Sandy capital expenditures.<sup>11</sup>

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<sup>8</sup> The three projects are Kentucky Power’s assigned portion of the costs for the installation of scrubbers at Ohio Power’s Gavin Generating Station (“Gavin”), the installation of CEMs at Rockport, and the Indiana Air Emissions Fee for Rockport. The allocation of these costs to Kentucky Power is governed by the AEP Interconnection Agreement and the Rockport Agreement.

<sup>9</sup> Kentucky Power’s surcharge mechanism compares a base period revenue requirement with a current period revenue requirement. Retired or replaced environmental compliance plant and associated expenses already included in existing rates are reflected in the determination of the base period revenue requirement, while the current cost of the approved compliance plan is reflected in the determination of the current period revenue requirement. The net of the base period and current period revenue requirement produces the ES revenue requirement. The ES revenue requirement is then divided by the Kentucky retail revenues for the current expense month. The current expense month is defined as the second month preceding the month in which the environmental surcharge is billed.

<sup>10</sup> The overall rate of return on capital was determined to be 9.178 percent, which included a rate of return on common equity of 11.50 percent. The overall rate of return reflected Kentucky Power’s capital structure and cost rates as of December 31, 1999. The overall rate of return was grossed up to reflect the income tax effect resulting from the return on common equity. The gross-up factor reflects a composite uncollectible accounts factor, federal income tax rate, and state income tax rate. The gross-up rate of return on the Big Sandy compliance rate base was 12.35 percent.

<sup>11</sup> The Commission’s authorized rate of return was not applied to the Gavin or Rockport projects. Any rate of return on the Gavin scrubbers is reflected in the charges governed by the AEP Interconnection Agreement. The rate of return on the Rockport CEMs was established by the provisions of the Rockport Agreement.

Kentucky Power's first amendment to its compliance plan and environmental surcharge was approved by the Commission in 2003 in Case No. 2002-00169.<sup>12</sup> The first amendment to the compliance plan ("2003 Plan") was comprised of four projects at Big Sandy involving the installation of an Over-Fire Air system ("OFA") to control NOx emissions at Unit 1, improvements to the electrostatic precipitator at Unit 2, the installation of Selective Catalytic Reduction equipment ("SCR") at Unit 2, an upgrade of the reverse osmosis water system at Unit 2, and NOx emission allowances. The existing E.S. tariff was amended to include the cost recovery for the 2003 Plan.<sup>13</sup>

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<sup>12</sup> Case No. 2002-00169, The Application of Kentucky Power Company d/b/a American Electric Power for Approval of an Amended Compliance Plan for Purposes of Recovering the Costs of New and Additional Pollution Control Facilities and to Amend Its Environmental Cost Recovery Surcharge Tariff, final Order dated March 31, 2003.

<sup>13</sup> The base period revenue requirement determination was expanded to recognize the return on retired utility plant and the removal of associated operating expenses relating to the 2003 Plan additions. The current period revenue requirement determination was expanded to include a return on the 2003 Plan projects and related operating expenses, a cash working capital allowance reflecting operation and maintenance expenses associated with the 1997 and 2003 Plans, and the net proceeds from the sale or transfer of NOx emission allowances. In addition, for purposes of the E.S. tariff, Total Company Revenues is defined as not including Non-Physical Revenues. In March 2004, Kentucky Power filed Case No. 2004-00081, seeking Commission approval to recover additional operating and maintenance ("O&M") expenses associated with the compliance projects approved in Case No. 2002-00169. Kentucky Power stated that the additional O&M expenses were not possible to identify during the processing of Case No. 2002-00169. The Commission's April 16, 2004 Order in Case No. 2004-00081 granted Kentucky Power's request. See Case No. 2004-00081, Motion of Kentucky Power Company d/b/a American Electric Power for Approval of Additional Operating Expenses Associated with Its Environmental Compliance Plan, final Order dated April 16, 2004.

Kentucky Power's overall rate of return on capital was continued as the authorized rate of return on the Big Sandy environmental capital expenditures.<sup>14</sup>

Kentucky Power's second amendment to its compliance plan and environmental surcharge was approved by the Commission in 2005 in Case No. 2005-00068.<sup>15</sup> The second amendment to the compliance plan ("2005 Plan") sought to include Kentucky Power's member load ratio share of environmental compliance costs associated with 53 projects<sup>16</sup> located at Ohio Power and I&M generating stations. The existing E.S. tariff was amended to include the member load ratio share of the costs for the 2005 Plan. No rate of return was sought for the 2005 Plan. While the overall rate of return on the 1997 and 2003 Plan projects remained unchanged, the gross-up factor used in the surcharge

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<sup>14</sup> The Commission included Kentucky Power's accounts receivable financing in the determination of the overall rate of return on capital, which was determined to be 7.46 percent. The overall rate of return on capital reflected Kentucky Power's capital structure and costs rates as of December 31, 2002. The Commission authorized a rate of return on common equity of 11.00 percent. Consistent with the approach used in Case No. 1996-00489, the overall rate of return was grossed up. The gross-up rate of return on the Big Sandy compliance rate base was 10.20 percent.

<sup>15</sup> Case No. 2005-00068, Application of Kentucky Power Company for Approval of an Amended Compliance Plan for Purposes of Recovering Additional Costs of Pollution Control Facilities and to Amend Its Environmental Cost Recovery Surcharge Tariff, final Order dated September 7, 2005 and rehearing Order dated October 17, 2005.

<sup>16</sup> In its September 7, 2005 Order, the Commission excluded all or parts of 4 projects involving sulfur trioxide ("SO<sub>3</sub>") mitigation systems. The AG and KIUC sought rehearing on the inclusion of costs from out-of-state projects in the surcharge. The Commission denied rehearing and the AG and KIUC appealed. In *Commonwealth of Kentucky ex rel. Stumbo v. Kentucky Public Service Commission*, Nos. 05-CI-1534, 05-CI-1543, 05-CI-1544 (Ky. Franklin Cir. Ct. October 30, 2006), the Franklin Circuit Court upheld the Commission's decision that the costs relating to the out-of-state generating facilities did qualify for environmental surcharge recovery. The AG and KIUC appealed to the Kentucky Court of Appeals on November 17, 2006.

mechanism for the Big Sandy environmental surcharge rate base was revised to reflect changes in federal and state income tax statutes.<sup>17</sup>

In Case No. 2005-00341,<sup>18</sup> the approved settlement agreement provided that \$28,106,683 of environmental costs would be incorporated in Kentucky Power's base rates and that this "roll-in" would become the base period revenue requirement component in the environmental surcharge mechanism. In addition, the overall rate of return on capital was updated and continued to be the authorized rate of return on the Big Sandy environmental capital expenditures.<sup>19</sup>

#### 2007 COMPLIANCE PLAN

In its third amendment to its environmental compliance plan ("2007 Plan"), Kentucky Power is seeking to include its member load ratio share of environmental

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<sup>17</sup> The change in federal tax statutes was the recognition of the Internal Revenue Code Section 199 deduction. The change in state tax statutes was the reduction in Kentucky corporate income tax rates resulting from the passage of House Bill 272 from the 2005 Regular Session of the Kentucky General Assembly. Kentucky Power sought rehearing on the recognition of the Internal Revenue Code Section 199 deduction. After rehearing was denied by the Commission, Kentucky Power appealed. In *Commonwealth of Kentucky ex rel. Stumbo v. Kentucky Public Service Commission*, Nos. 05-CI-1534, 05-CI-1543, 05-CI-1544 (Ky. Franklin Cir. Ct. October 30, 2006), the Franklin Circuit Court upheld the Commission's treatment of the Internal Revenue Code Section 199 deduction. Kentucky Power appealed the Franklin Circuit Court decision to the Kentucky Court of Appeals on November 28, 2006.

<sup>18</sup> Case No. 2005-00341, General Adjustment of Electric Rates of Kentucky Power Company, final Order dated March 14, 2006.

<sup>19</sup> Utilizing the test-year-end capital structure and cost rates as of June 30, 2005 and a rate of return on common equity ("ROE") of 10.50 percent, the Commission determined that Kentucky Power's overall rate of return on capital was 7.48 percent. The ROE was included as a provision of the settlement agreement. Consistent with the approach used in Case No. 2005-00068, the overall rate of return was grossed up, resulting in a gross-up rate of return on the Big Sandy compliance rate base of 9.97 percent.



compliance costs associated with 44 projects located at Ohio Power and I&M generating stations.<sup>20</sup> Kentucky Power contends that the 44 projects relate to its, and AEP's, compliance with the CAA and other federal, state, or local environmental requirements that apply to coal combustion and by-products from facilities used to generate electricity from coal. The 44 projects are listed in Appendix A to this Order.<sup>21</sup> The environmental compliance costs Kentucky Power seeks to include in its environmental surcharge are determined under the provisions of the AEP Interconnection Agreement and the Rockport Agreement. Based on the provisions of those agreements, Kentucky Power estimated that the annual retail ES revenue requirement would increase approximately \$8.3 million, an annual increase to Kentucky retail customers of 2.05 percent.<sup>22</sup>

In support of the 2007 Plan, Kentucky Power explained the steps taken by AEP to ensure that the environmental projects were undertaken in a reasonable and cost-effective manner. Kentucky Power described AEP's use of a state-of-the-art multi-emission compliance optimization model ("MECO") to arrive at the least cost compliance plan for AEP on a system-wide basis. Kentucky Power provided the inputs used in the MECO modeling and the results from three different modeling runs.<sup>23</sup>

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<sup>20</sup> Application at 4.

<sup>21</sup> Information shown in Appendix A is taken from McManus Direct Testimony, Exhibit JMM-1, as corrected in the Response to the Commission Staff's First Data Request dated August 24, 2006, Item 8.

<sup>22</sup> Application at 5.

<sup>23</sup> Response to the Commission Staff's First Data Request dated August 24, 2006, Item 3.

Kentucky Power also provided the capital improvement requests (“CIs”) submitted to AEP management for approval of the 2007 Plan projects. Kentucky Power stated that the CIs constitute the written evaluations made by the AEP Service Corporation after considering the results of the optimization model runs. Kentucky Power contended that this information has been presented to assure the Commission that AEP has adequately evaluated the projects for reasonableness and cost effectiveness.<sup>24</sup> The AG and KIUC did not challenge the reasonableness or the cost effectiveness of the proposed 2007 Plan.

As it did in Case No. 2005-00068, the Commission examined the appropriateness of Kentucky Power’s inclusion of projects dealing with the mitigation of SO<sub>3</sub> emissions. Kentucky Power stated that AEP’s experience with the operation of SCRs indicated that the use of this technology to control NO<sub>x</sub> emissions resulted in an increase in the formation of SO<sub>3</sub> in the flue gas. When combined with water in saturated flue gas from flue gas desulfurization (“FGD”) equipment, the SO<sub>3</sub> produces sulfuric acid mist, which is a regulated pollutant under the New Source Review (“NSR”) Programs of Title I of the CAA. Failure to control sulfuric acid mist, and in turn SO<sub>3</sub>, could trigger NSR Program requirements which would result in additional permits and control equipment.<sup>25</sup> Kentucky Power provided copies of the Environmental Protection Agency’s Notice of Violation against Ohio Power’s Gavin generating station, which indicated multiple violations of plume opacity limits during a 2-year period.<sup>26</sup> Kentucky

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<sup>24</sup> Kentucky Power Brief at 16.

<sup>25</sup> McManus Direct Testimony at 20-21.

<sup>26</sup> Kentucky Power’s Response to Hearing Data Requests, Exhibit 1.

Power also described the chemical interactions and the expected production of SO<sub>3</sub> from operating an SCR.<sup>27</sup>

Based on the evidence of record and being otherwise sufficiently advised, the Commission finds that Kentucky Power has submitted an environmental compliance plan that conforms to KRS 278.183. As a member of the AEP Pool, Kentucky Power purchases energy from the other pool members under the terms of the AEP Interconnection Agreement. Under the terms of that agreement, Kentucky Power is required to pay its member load ratio share of the cost of environmental projects installed by the surplus members of the AEP Pool.

In this case, Kentucky Power is proposing to amend its compliance plan to include the costs of the environmental projects that Kentucky Power is required to pay under the AEP Interconnection Agreement. Since that agreement is a FERC-approved rate, the judicial doctrine of federal preemption forecloses any inquiry here into the reasonableness of that rate or the costs recovered through that rate.

However, while Kentucky Power's costs under the AEP Interconnection Agreement must be accepted as reasonable for rate-making purposes, that does not mean that such costs must be accepted for recovery by environmental surcharge under KRS 278.183. To qualify under KRS 278.190 and 278.192 for rate recovery in a base or general rate case, a cost must be reasonable, and any cost incurred pursuant to a FERC rate is presumed to be reasonable. Thus, a FERC-approved rate cannot be disallowed as unreasonable. But to qualify under the restrictive provisions of

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<sup>27</sup> Response to the Commission Staff's Second Data Request dated September 21, 2006, Item 3.

KRS 278.183 for environmental surcharge recovery, a cost must be “reasonable and cost-effective for compliance with the applicable environmental requirements.” Thus, even though a FERC-approved rate is presumed to be reasonable, there is no presumption that such a rate is both reasonable and cost effective for complying with the environmental requirements listed in KRS 278.183. Kentucky Power must carry its burden to prove that a FERC-approved rate qualifies for environmental surcharge recovery.

The Commission has reviewed the information provided by Kentucky Power that addresses the need for the projects. AEP’s MECO analysis demonstrates that it has evaluated the alternatives available for environmental compliance and formulated a cost effective plan for that compliance. A review of the CIs submitted for the projects does reveal that compliance alternatives have been noted by AEP’s engineering staff. The documentation does support a finding that the projects are reasonable and are a cost-effective means of controlling SO<sub>2</sub>, SO<sub>3</sub>, and NO<sub>x</sub> emissions. The Commission has also considered the information provided concerning the need for SO<sub>3</sub> mitigation and finds that Kentucky Power has demonstrated that projects controlling this chemical should be included in Kentucky Power’s 2007 Plan.<sup>28</sup>

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<sup>28</sup> The Commission also takes administrative notice of its December 21, 2006 decisions in Case No. 2006-00206, The Application of Kentucky Utilities Company for a Certificate of Public Convenience and Necessity to Construct a Selective Catalytic Reduction System and Approval of Its 2006 Compliance Plan for Recovery by Environmental Surcharge, and Case No. 2006-00208, The Application of Louisville Gas and Electric Company for Approval of Its 2006 Compliance Plan for Recovery by Environmental Surcharge, where we approved SO<sub>3</sub> mitigation projects for inclusion in the respective utilities’ environmental compliance plans.

Therefore, the Commission finds that the projects proposed by Kentucky Power to be included in its environmental compliance plan are reasonable and cost effective and should be approved.

### SURCHARGE MECHANISM AND CALCULATION

#### Costs Associated with the 2007 Plan

Kentucky Power has proposed to incorporate the costs associated with the 2007 Plan into the existing surcharge mechanism used for the 1997, 2003, and 2005 Plans. As noted previously in footnote 9, Kentucky Power's surcharge mechanism determines the ES revenue requirement by comparing the base period revenue requirement with the current period revenue requirement. Kentucky Power proposed to include its member load ratio share of environmental compliance costs charged to it under the AEP Interconnection Agreement and the Rockport Agreement in the same manner as was approved in Case No. 2005-00068.

In his brief, the AG noted his appeal of the decision in Case No. 2005-00068 and stated his objection to the recovery of the 2007 Plan costs through the surcharge, arguing that the recovery of costs that are not Kentucky Power's cost of compliance are not authorized by KRS 278.183. The AG argued that these costs are subject to recovery only through a base rate case, and urged the Commission to deny surcharge recovery to the 2007 Plan costs.<sup>29</sup>

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<sup>29</sup> AG Post Hearing Brief at 1-2. KIUC notified the Commission it would not be filing a brief, but noted that the issue of whether environmental compliance costs incurred at the out-of-state facilities of Kentucky Power's affiliated companies are recoverable through KRS 278.183 was currently on appeal at the Kentucky Court of Appeals.

The Commission has reviewed the record in this case and is aware of the appeals of our decisions in Case No. 2005-00068. Kentucky Power has identified the environmental compliance costs for the 2007 Plan projects charged to it under the provisions of the FERC-approved AEP Interconnection Agreement and Rockport Agreement. These are the costs for the 2007 Plan projects that Kentucky Power proposes to recover through its environmental surcharge. The Gavin scrubber costs, the Rockport CEMs, and Indiana air emission fees in the original environmental surcharge case, as well as the 2005 Plan costs, were handled in the same manner. The costs identified here by Kentucky Power are eligible for surcharge recovery if they are shown to be reasonable and cost effective for complying with the environmental requirements specified in KRS 278.183.

The Commission finds that the costs identified for the 2007 Plan projects have been shown to be reasonable and cost effective for environmental compliance. Thus, they are reasonable and should be approved for recovery through Kentucky Power's environmental surcharge.

#### Qualifying Costs

As noted previously, Kentucky Power's environmental surcharge mechanism determines the ES revenue requirement by comparing a base period revenue requirement with a current period revenue requirement. The qualifying costs included in Kentucky Power's base period revenue requirement will be the amount rolled into base rates in Case No. 2005-00341. The qualifying costs included in the current period revenue requirement will reflect the Commission-approved environmental projects from Kentucky Power's 1997, 2003, 2005, and 2007 Plans. Should Kentucky Power desire

to include other environmental projects in the future, it will have to apply for an amendment to its approved compliance plans.

### Rate of Return

Kentucky Power did not request a rate of return on the 2007 Plan projects, but sought only the recovery of the environmental costs it incurred to comply with the CAA as a result of the costs it incurs under the AEP Interconnection Agreement and the Rockport Agreement.<sup>30</sup> The Commission agrees, and will not set a rate of return for the 2007 Plan projects. The rate of return currently authorized on the 1997 and 2003 Plan projects will remain as is.

### Surcharge Formulas

The inclusion of the 2007 Plan into Kentucky Power's existing surcharge mechanism will not result in changes to the surcharge formulas. However, the description of the items included in the components of the formulas will change. The Commission finds that the formulas used to determine the ES revenue requirement as proposed by Kentucky Power<sup>31</sup> should be approved.

### Reporting Formats

The inclusion of the 2007 Plan into the existing surcharge mechanism will require modifications to the monthly environmental surcharge reporting formats. Kentucky Power provided revised formats in response to a data request.<sup>32</sup> The Commission finds

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<sup>30</sup> Wagner Direct Testimony at 11.

<sup>31</sup> Application, Exhibit 3.

<sup>32</sup> Response to the Commission Staff's First Data Request dated August 24, 2006, Item 13.

that Kentucky Power's revised monthly environmental surcharge reporting formats should be approved.

#### SURCHARGE ALLOCATION

No party to this case proposed to change the allocation of the environmental surcharge, which is now based on total revenues. This allocation was found to be reasonable by the Commission in Case No. 2002-00169 and it should continue to be used for Kentucky Power's environmental surcharge.

#### TARIFF EFFECTIVE DATE

Kentucky Power proposed that its amended E.S. tariff should become effective for bills rendered on and after August 28, 2006. As noted previously in this Order, the Commission's August 16, 2006 Order rejected this effective date, as KRS 278.183(2) provides that the Commission has 6 months to review and approve environmental surcharge compliance plans and surcharge mechanisms. The Commission finds that the E.S. tariff should become effective for service rendered on and after the date of this Order.<sup>33</sup> The Commission will not make the revised E.S. tariff effective for bills rendered on and after the date of this Order because doing so would result in retroactive rate-making by requiring customers to pay for increases in environmental costs prior to the approval of those increases.

IT IS THEREFORE ORDERED that:

1. Kentucky Power's 2007 Plan is approved.

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<sup>33</sup> While Kentucky Power proposed that its E.S. tariff should become effective for bills rendered on and after a specific date, it indicated that in this case there would be no difference between bills rendered and service rendered. See Transcript of Evidence, November 28, 2006, at 33-34.



2. Kentucky Power's E.S. tariff is approved for service rendered on and after the date of this Order.

3. The base period and current period revenue requirements shall be calculated as described in this Order.

4. The reporting formats described in this Order shall be used for each Kentucky Power monthly surcharge filing. Previous reporting formats shall no longer be submitted.

5. Within 10 days of the date of this Order, Kentucky Power shall file with the Commission tariff sheets setting out the E.S. tariff as approved herein.

Done at Frankfort, Kentucky, this 24<sup>th</sup> day of January, 2007.

By the Commission

ATTEST:

A handwritten signature in black ink, consisting of several overlapping loops and a long horizontal stroke at the end, positioned above a solid horizontal line.

Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE  
COMMISSION IN CASE NO. 2006-00307 DATED January 24, 2007

SCHEDULE OF ENVIRONMENTAL PROJECTS PROPOSED AND APPROVED FOR INCLUSION IN KENTUCKY POWER'S ENVIRONMENTAL COMPLIANCE PLAN		
COMPANY and GENERATING UNIT	PROJECT DESCRIPTION	APPROVED FOR INCLUSION
Ohio Power – Amos	Unit 3 – FGD	Yes
	Unit 3 – Balance Draft Conversion	Yes
	Unit 3 – Controls Modernization	Yes
	Unit 3 – Steam Generator Modifications	Yes
	Unit 3 – SO <sub>3</sub> Mitigation	Yes
	Unit 3 – FGD Purge Stream Water Treatment System	Yes
	Unit 3 – Plant Common	Yes
	Unit 3 – Coal Blending Station	Yes
	Units 1, 2 & 3 – Landfill	Yes
	Unit 3 – Precipitator Modification	Yes
Ohio Power – Cardinal	Unit 1 – FGD	Yes
	Unit 1 – Controls Modernization	Yes
	Unit 1 – Steam Generator Modifications	Yes
	Unit 1 – Balance Draft Conversion	Yes
	Unit 1 – Forced Draft Fan Modification	Yes
	Unit 1 – FGD Purge Stream Water Treatment System	Yes
	Unit 1 – SO <sub>3</sub> Mitigation	Yes
	Unit 1 – Catalyst Replacement	Yes
	Unit 1 – Landfill	Yes
Ohio Power – Gavin	Units 1 & 2 – SO <sub>3</sub> Mitigation	Yes

SCHEDULE OF ENVIRONMENTAL PROJECTS PROPOSED AND APPROVED FOR INCLUSION IN KENTUCKY POWER'S ENVIRONMENTAL COMPLIANCE PLAN		
COMPANY and GENERATING UNIT	PROJECT DESCRIPTION	APPROVED FOR INCLUSION
Ohio Power – Mitchell	Unit 1 – FGD	Yes
	Unit 1 – SCR	Yes
	Unit 1 – Balance Draft Conversions	Yes
	Unit 1 – Controls Modernization	Yes
	Unit 1 – Steam Generator Modifications	Yes
	Unit 1 – SO <sub>3</sub> Modifications	Yes
	Unit 1 – FGD Purge Stream Water Treatment System	Yes
	Unit 1 – Coal Blending Station	Yes
	Unit 2 – FGD	Yes
	Unit 2 – SCR	Yes
	Unit 2 – Balance Draft Conversions	Yes
	Unit 2 – Controls Modernization	Yes
	Unit 2 – Steam Generator Modifications	Yes
	Unit 2 – SO <sub>3</sub> Modifications	Yes
	Unit 2 – FGD Purge Stream Water Treatment System	Yes
	Unit 2 – Coal Blending Station	Yes
	Units 1 & 2 – Impoundment	Yes
	Units 1 & 2 – Gypsum Material Handling	Yes
	Units 1 & 2 – Gypsum Material Handling	Yes
	Units 1 & 2 – Transformer Rectifier Set Replacement	Yes
Ohio Power – Sporn	Units 2, 4 & 5 – Landfill	Yes
I&M – Rockport	Units 1 & 2 – Landfill	Yes
I&M – Tanners Creek	Unit 4 – Coal Blending Project	Yes