

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN EXAMINATION BY THE PUBLIC SERVICE	)	
COMMISSION OF THE ENVIRONMENTAL	)	
SURCHARGE MECHANISM OF KENTUCKY	)	CASE NO.
POWER COMPANY FOR THE SIX-MONTH	)	2009-00038
BILLING PERIODS ENDING DECEMBER 31, 2007;	)	
JUNE 30, 2008; AND DECEMBER 31, 2008	)	

ORDER

On February 12, 2009, the Commission initiated three six-month reviews of Kentucky Power Company's ("Kentucky Power") environmental surcharge<sup>1</sup> as billed to customers for the following periods: the six-month periods of July 1, 2007 to December 31, 2007; January 1, 2008 to June 30, 2008; and July 1, 2008 to December 31, 2008.<sup>2</sup> Pursuant to KRS 278.183(3), the Commission must review, at six-month intervals, the past operations of the environmental surcharge. After hearing, the Commission may, by temporary adjustment in the surcharge, disallow any surcharge amounts found not to be just and reasonable and reconcile past surcharge collections with actual costs recoverable pursuant to KRS 278.183(1).

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<sup>1</sup> Case No. 1996-00489, The 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 (Ky. PSC May 27, 1997).

<sup>2</sup> Kentucky Power's surcharge is billed on a two-month lag. Thus, surcharge billings for July 2007 recover costs incurred in May 2007, and every subsequent monthly surcharge billing under review recovers costs incurred two months prior to billing.

The Commission issued a procedural schedule on February 12, 2009, that provided for discovery, the filing of prepared testimony, an informal conference and a public hearing. Kentucky Power filed prepared direct testimony, responded to requests for information and appeared at an informal conference on March 27, 2009. There were no parties requesting intervenor status in this proceeding. In its April 23, 2009 response to the Commission's April 22, 2009 Order, Kentucky Power stated that there were no material issues of fact that warranted a hearing in this case. Kentucky Power further stated that this case may be submitted for decision on the current record without hearing.

#### SURCHARGE ADJUSTMENT

The February 12, 2009 Order initiating this case indicated that, since each of the periods under review in this proceeding may have resulted in over- or under-recoveries, the Commission would entertain proposals to adopt one adjustment factor to net all over- or under-recoveries. Kentucky Power determined that it had a net under-recovery of its environmental costs in the amount of \$5,156.<sup>3</sup> Kentucky Power proposed that the net under-recovery be recovered by increasing the total jurisdictional environmental surcharge amount by a one-time adjustment of \$5,156 in its first monthly surcharge filing following the Commission's decision in this proceeding.<sup>4</sup>

The Commission has reviewed and finds reasonable Kentucky Power's calculation of a net under-recovery of \$5,156 for the review periods covered in this

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<sup>3</sup> Wagner Direct Testimony at 5 and Response to the Commission Staff's First Data Request dated February 12, 2009, Item 1, page 2 of 35.

<sup>4</sup> Id.

proceeding. The Commission also finds reasonable Kentucky Power's proposal to collect the under-recovery amount by a one-time adjustment of \$5,156 in its first monthly surcharge filing following the date of this Order.

#### RATE OF RETURN

In Case No. 1996-00489,<sup>5</sup> the Commission found that Kentucky Power's debt portion of its weighted average cost of capital should be reviewed and reestablished during each six-month review case and that the rate of return on common equity would remain fixed and subject to review during the two-year environmental surcharge reviews. The weighted average cost of capital constitutes the rate of return applicable to Kentucky Power's environmental compliance rate base.<sup>6</sup>

Kentucky Power provided the outstanding balances for its long-term debt, short-term debt, accounts receivable financing, and common equity as of October 31, 2008, the last expense month of the review periods. It also provided the blended interest rates for the long-term debt, short-term debt, and accounts receivable financing as of October 31, 2008.<sup>7</sup> Using this information, Kentucky Power calculated a weighted average cost of capital, before income tax gross-up of 7.71 percent.<sup>8</sup> Kentucky Power

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<sup>5</sup> Id. at 1.

<sup>6</sup> This weighted average cost of capital is applied only to the environmental compliance rate base associated with plant installed at Kentucky Power's Big Sandy generating units.

<sup>7</sup> Response to the Commission Staff's First Data Request dated February 12, 2009, Item 11.

<sup>8</sup> Id.

also provided its updated income tax gross-up factor reflecting the methodology<sup>9</sup> approved in Case No. 2005-00068.<sup>10</sup>

The Commission has reviewed Kentucky Power's determination of its weighted average cost of capital and finds the 7.71 percent calculation to be reasonable. The Commission has also reviewed the determination of the tax gross-up factor and finds that it is consistent with the approach approved in Case No. 2005-00068. Therefore, the Commission finds that the weighted average cost of capital of 7.71 percent and the income tax gross-up factor of 1.5773 should be used in all monthly environmental surcharge filings subsequent to the date of this Order.

IT IS THEREFORE ORDERED that:

1. Kentucky Power shall increase its jurisdictional environmental revenue requirement determined in the first billing month following the date of this Order by \$5,156, as discussed herein.

2. Kentucky Power shall use a weighted average cost of capital of 7.71 percent and a tax gross-up factor of 1.5773 in all monthly environmental surcharge filings subsequent to the date of this Order.

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<sup>9</sup> Response to the Commission Staff's Data Request dated February 12, 2009, Item 11, page 21 of 22. In the response, Kentucky Power determined that its updated income tax gross-up factor was 1.5773.

<sup>10</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 (Ky. PSC Oct. 17, 2005).

By the Commission

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MAY 14 2009 *sl*  
KENTUCKY PUBLIC  
SERVICE COMMISSION

ATTEST:

  
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