

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC EXAMINATION BY THE PUBLIC)	
SERVICE COMMISSION OF THE ENVIRONMENTAL)	
SURCHARGE MECHANISM OF KENTUCKY)	CASE NO.
POWER COMPANY FOR THE SIX-MONTH)	2016-00336
BILLING PERIOD ENDING JUNE 30, 2016)	

ORDER

On October 11, 2016, the Commission initiated a six-month review of Kentucky Power Company's ("Kentucky Power") environmental surcharge¹ as billed to customers for the six-month period January 1, 2016, to June 30, 2016.² Pursuant to KRS 278.183(3), the Commission must review, at six-month intervals, the past operations of the environmental surcharge. 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.

The Commission issued a procedural schedule on October 11, 2016, that provided for discovery, the filing of prepared testimony, and intervenor testimony. Kentucky Power filed prepared testimony and responded to two requests for information from Commission Staff. There were no intervention requests in this proceeding. On

¹ Kentucky Power was authorized to implement an environmental surcharge in 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).

² Kentucky Power's surcharge is billed on a two-month lag. Thus, surcharge billings from January 2016 through June 2016 are based on costs incurred from November 2015 through April 2016.

February 17, 2017, Kentucky Power filed a motion that this case be submitted for decision by the Commission based on the existing record. Because there are no intervenors in this case and a hearing is not necessary in the public interest, the Commission will adjudicate this case based on the evidence of record.

SURCHARGE ADJUSTMENT

The Commission issued the final Order in Case No. 2014-00396³ on June 22, 2015, approving Kentucky Power's Environmental Surcharge Tariff for service rendered on and after that date. Beginning on June 22, 2015, the calculation of Kentucky Power's environmental compliance rate base was to be adjusted to reflect additions and retirements of environmental equipment at the Rockport and Mitchell Generating Stations on a monthly basis, as opposed to annually. However, Kentucky Power failed to reflect monthly retirements from June 2015 through September 2016, which resulted in an overstatement of the monthly revenue requirement and over-recovery of environmental surcharge revenues.⁴ Because the expense months affected extend before and after the review period in this case, Kentucky Power is proposing: 1) to return the amounts associated with the review period as an adjustment to the jurisdictional revenue requirement in the first month after the Commission's Order in this proceeding; 2) to return the amounts associated with the expense months subsequent to the review period as an adjustment to the jurisdictional revenue requirement for four months beginning in November 2016; and 3) to address the remaining amounts

³ Case No. 2014-00396, *Application of Kentucky Power Company for: (1) A General Adjustment of Its Rates for Electric Service; (2) An Order Approving Its 2014 Environmental Compliance Plan; (3) An Order Approving Its Tariffs and Riders; and (4) An Order Granting All Other Required Approvals and Relief* (Ky. PSC June 22, 2015).

⁴ Direct Testimony of Amy J. Elliott ("Elliot Testimony") at 4-6.

associated with the expense months prior to the review period in Kentucky Power's next two-year review of the environmental surcharge.⁵ Kentucky Power over-recovered \$81,197 for the period June 2015 through October 2015, \$118,185 for the period November 2015 through April 2016, and \$225,754 for the period May 2016 through September 2016.

For the expense months of July 2015 through August 2016, Kentucky Power identified a formulaic error that overstated non-residential, non-fuel revenues, and understated the non-residential surcharge factor that resulted in a misallocation of costs between residential and non-residential customers.⁶ The expense months affected by the misallocation extend before and after the review period in this case. Kentucky Power is proposing to address the misallocation of \$173,686 for the period July 2015 through October 2015 in the next two-year review of Kentucky Power's environmental surcharge.⁷ To correct the misallocation of \$877,392 for the review period, Kentucky Power is proposing to reduce the residential environmental revenue requirement by \$146,232 for the six months after the Commission's Order in this proceeding and to increase the non-residential environmental revenue requirement by the same amount.⁸ For the misallocation of \$537,612 that occurred during the expense months of May

⁵ *Id.* at 6.

⁶ *Id.* at 6-10.

⁷ *Id.* at 10 and Kentucky Power's Response to Commission Staff's Second Request for Information ("Staff's Second Request"), Item 3, Attachment 1.

⁸ Elliott Testimony at 9–10 and Kentucky Power's Response to Staff's Second Request, Item 3.a. The Elliott testimony identified the misallocation for the review period as \$898,635, resulting in a proposed correction of \$149,773 per month for six months. In its Response to Staff's Second Request, Item 3.a., Kentucky Power revised the misallocation for the review period to \$877,392, which divided by six months results in the \$146,232 adjustment.

2016 through August 2016, Kentucky Power is proposing to make adjustments of \$134,403 to the November 2016 through February 2017 expense month calculations.⁹

The Commission has reviewed and finds reasonable Kentucky Power's calculation of a net over-recovery of \$118,185¹⁰ and a misallocation of \$877,392¹¹ for the six-month billing period covered in this proceeding. The Commission also finds reasonable Kentucky Power's proposal to refund the over-recovery by decreasing the total jurisdictional environmental surcharge revenue requirement by \$118,185 beginning in the first month following the date of this Order. Additionally, the Commission finds reasonable Kentucky Power's proposal to correct the misallocation by decreasing the residential surcharge revenue requirement and increasing the non-residential surcharge revenue requirement by \$146,232 for six months beginning in the first month following the date of this Order. Kentucky Power states that the average residential customer's monthly usage for this review period was 1,258 kWh.¹² Using rates and adjustment clause factors in effect for the June 2016 billing month, an average residential customer's bill would decrease by approximately \$1.66.¹³

RATE OF RETURN

In previous environmental surcharge reviews, the Commission has been guided by its findings in Case No. 1996-00489 with respect to the determination of the weighted

⁹ Elliot Testimony at 10 and Kentucky Power's Response to Staff's Second Request, Item 3.

¹⁰ Kentucky Power's Response to Commission Staff's First Request for Information ("Staff's First Request"), Item 1.

¹¹ *Id.* and Kentucky Power's Response to Staff's Second Request, Item 3.a.

¹² Kentucky Power's Response to Staff's First Request, Item 6.

¹³ *Id.* As revised through discovery.

average cost of capital (“WACC”) to be used prospectively in Kentucky Power’s monthly environmental surcharge filings. However, the Settlement Agreement in Case No. 2014-00396 now supersedes the findings in Case No. 1996-00489. The Settlement Agreement authorized a return on common equity of 10.25 percent for environmental surcharge purposes.¹⁴ It also specified that Kentucky Power utilize a WACC of 7.34 percent and a gross revenue conversion factor of 1.616424 to be applied to the return on equity, which would remain constant until changed by the Commission in Kentucky Power’s next base rate case.¹⁵ The Settlement Agreement also authorized a gross-up factor of 1.004977 to be applied to the long-term and short-term debt and accounts receivable financing weighted average cost percentages.¹⁶ Together, these factors produce an overall rate of return of 10.128 percent. Therefore, the Commission finds that the combination of these components, which produces an overall grossed-up rate of return of 10.128 percent, should be used in all monthly environmental surcharge filings subsequent to the date of this Order.

CONCLUSION

Although we find that Kentucky Power’s proposed rate of return and surcharge adjustment are reasonable, the errors in this proceeding regarding the failure to include the retirements of the environmental equipment at the Rockport and Mitchell generating stations, and the misallocation of \$1,588,690 to residential rather than non-residential customers, concern us. These errors follow on the heels of an attempt by Kentucky

¹⁴ Case No. 2014-00396, *Kentucky Power*, Settlement Agreement, paragraph 2 at 5.

¹⁵ *Id.*, paragraph 3 at 5–6.

¹⁶ *Id.*, Exhibit 2.

Power in Case No. 2016-00109¹⁷ (Kentucky Power's prior environmental surcharge mechanism review proceeding) to apply an incorrect environmental surcharge to the expense months of May, June, and July 2015, which would have allowed it to collect an under-recovery of \$3,556,085 for the review period. The Commission, finding the application of the surcharge to the expense months unreasonable, disallowed the recovery and subsequently denied Kentucky Power's request for a rehearing of the Commission's decision.

Taken separately, the incidents for these two review proceedings may not be cause for much concern. However, when viewed together, the incidents raise concerns with the Commission regarding what might be the start of a troubling trend in Kentucky Power's environmental surcharge filings. Therefore, we exhort Kentucky Power to take extra care to avoid such incidents in its future environmental surcharge filings.

IT IS THEREFORE ORDERED that:

1. Kentucky Power's request to submit this case for a decision on the existing evidence of record without a hearing is granted.
2. The environmental surcharge amounts determined by Kentucky Power for the review period January 1, 2016, through June 30, 2016, are just and reasonable.
3. Kentucky Power's determination that it had an over-recovery of \$118,185 for the review period is approved and it shall return the over-recovery of \$118,185 in the first month subsequent to the date of this Order.

¹⁷ PSC Case No. 2016-00109, *An Examination by the Public Service Commission of the Environmental Surcharge Mechanism of Kentucky Power Company for the Six-Month Billing Period Ending June 30, 2016*. (Ky. PSC Nov. 4, 2016).

4. Kentucky Power's determination that it had a misallocation between the residential and non-residential customer classes of \$877,392 for the review period is approved, and it shall correct the misallocation of \$877,392 in the first six months subsequent to the date of this Order.

5. Kentucky Power's determination that it had an over-recovery of \$81,197 and misallocation between the residential and non-residential customer classes of \$173,686 for the expense months prior to the review period shall be further reviewed and addressed in Kentucky Power's next two-year review of the environmental surcharge.

6. Kentucky Power's determination that it had an over-recovery of \$225,754 and misallocation between the residential and non-residential customer classes of \$537,612 for the expense months subsequent to the review period shall be further reviewed and addressed in the environmental surcharge review case that covers the applicable expense months.

7. Kentucky Power shall use a weighted average cost of capital of 7.34 percent, tax gross-up factors of 1.616424 and 1.004977, a return on equity rate of 10.25 percent, and an overall grossed-up return of 10.128 percent in all monthly environmental surcharge filings subsequent to the date of this Order.

By the Commission

ENTERED
APR 18 2017
KENTUCKY PUBLIC
SERVICE COMMISSION

ATTEST:


Executive Director

*Amy J Elliott
Kentucky Power Company
855 Central Avenue, Suite 200
Ashland, KY 41101

*Kentucky Power Company
855 Central Avenue, Suite 200
Ashland, KY 41101

*Judy K Rosquist
Kentucky Power Company
855 Central Avenue, Suite 200
Ashland, KY 41101

*Kenneth J Gish, Jr.
Stites & Harbison
250 West Main Street, Suite 2300
Lexington, KENTUCKY 40507

*Honorable Mark R Overstreet
Attorney at Law
Stites & Harbison
421 West Main Street
P. O. Box 634
Frankfort, KENTUCKY 40602-0634