COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of :

AN APPLICATION OF KENTUCKY POWER COMPANY	)	
FOR APPROVAL OF AN AMENDED COMPLIANCE	)	
PLAN FOR PURPOSES OF RECOVERING ADDITIONAL	)	CASE NO.
COST OF POLLUTION CONTROL FACILITIES AND TO	)	2005-00068
AMEND ITS ENVIRONMENTAL COST RECOVERY	)	
SURCHARGE TARIFF	)	

POST HEARING BRIEF OF THE ATTORNEY GENERAL

In this case, Kentucky Power Company seeks to recover through a surcharge established by KRS 278.183 those elements of cost paid to Ohio Power Company and Indiana and Michigan to compensate them for their cost of environmental compliance related to their Primary Capacity that are included within the capacity settlement charge paid under the Interconnection Agreement. The many projects for which surcharge recovery is now sought in this plan are not Kentucky Power's cost of achieving environmental compliance for its own generation. Its costs of achieving compliance is limited to those plants for which it would be responsible regardless of whether it was a member of the pool covered by the Interconnection Agreement. That is the generation which it is credited to Kentucky Power as Primary Capacity under the Interconnection Agreement.

Instead, the costs for which surcharge recovery is sought are the costs of the facilities owned by other utilities that produce power to which Kentucky Power has access by virtue of the Interconnection Agreement. They are one step removed from Kentucky Power who is paying not a direct environmental cost, but an access fee that will ultimately compensate other utilities for their direct costs of environmental compliance as well as for other things. Errol Wagner testified that when Kentucky Power is unable to meet its peak load or when its generation is out-of-

service, the Interconnection Agreement gives Kentucky Power Company "**access to** OPCo's and I&M's generating facilities (and their associated environmental investments) to meet the Kentucky customer's electricity requirements. For this **access right**, KPCo pays a capacity charge to the AEP Pool …."[1]

The FERC approved rate paid by Kentucky Power Company for the right of access is a rate that includes more than just the environmental costs of Ohio Power and Indiana and Michigan. That rate would be a proper item for full recovery in a future base rate case, and it was included in full in Kentucky Power's last rate case.

Kentucky Power seeks to pull Ohio Power Company and Indiana and Michigan's environmental compliance costs out of the FERC approved rate for surcharge recovery under KRS 278.183. Though the Commission allowed the inclusion of the Gavin scrubber costs in the surcharge in Case No. 96-489 against challenges that those costs could not be found reasonable or cost effective as required by KRS 278.183 based on the fact that federal preemption does not allow that type of determination, it did not look at whether KRS 278.183 should be read so broadly as to permit or require surcharge recovery of compliance costs for other utilities that are included as a part of a more comprehensive rate that is itself already included in full in the base rates. Having successfully sought surcharge recovery of the Gavin scrubber costs from the capacity settlement charge, Kentucky Power now seeks surcharge recovery of a plethora of other Ohio Power and Indiana and Michigan compliance costs for which those utilities are also compensated as a part of the capacity settlement charge Kentucky Power pays under the Interconnection Agreement.

These newly proposed costs are costs that comprise but a part of the actual rate approved by FERC and charged to Kentucky Power. These are costs that are and would be the primary

[1] Wagner Rebuttal, p. 2. Emphasis added.

responsibility of Ohio Power Company and Indiana and Michigan, who continue to have the right to devote the energy produced from their capacity for sale to anyone, but who have and are, under the terms of the Interconnection Agreement, currently making their power available occasionally to Kentucky Power.

KRS 278.183 provides that, "Notwithstanding any other provision of this chapter, effective January 1, 1993, a utility shall be entitled to the current recovery of **its costs** of complying with the Federal Clean Air Act...." KRS 278.183 is incentive legislation designed to level the playing field between achieving environmental compliance by fuel switching or by scrubbing. Scrubbing is necessary to allow the continued use of higher sulfur Kentucky Coal while obtaining compliance by utilities serving Kentucky.[2] The surcharge gives extremely favorable rate treatment to qualifying costs in order to provide utilities an incentive to incur those qualifying costs. Because of that, the language of the statute that limits surcharge recovery for a utility to "its costs" of compliance should be read to preclude delving into comprehensive rates to pull out the elements attributable to environmental compliance attained by other utilities whose product is made available to Kentucky utilities, in this instance to Kentucky Power Company.

Reaching into comprehensive rates to pull out the element of environmental costs incurred by other utilities can in no way achieve the goal that KRS 278.183 was designed to accomplish. The costs the statute was designed to address are the compliance costs for which the utility is primarily responsible associated with that generation over which it has control. Those

[2] KRS 278.183 was enacted in 1992 via SB 341. The preamble to that legislation contained the following statement of legislative purpose:

> WHEREAS, it is hereby declared the policy of the General Assembly to *foster and encourage the continued use of Kentucky coal by electric utilities serving the Commonwealth*; and
>
> WHEREAS, electric utilities *should have incentive to use Kentucky coal in deciding how to best achieve and maintain compliance* with the federal Clean Air Act as amended and those environmental by-products from facilities utilized for production of energy from coal; [Emphasis added] Acts of the General Assembly, Chapter 102, pp. 521-522.

are the only costs that could possibly achieve the result the statute was designed to accomplish, the continued promotion and support of Kentucky coal by Kentucky utilities despite its higher sulfur content in the face of compliance requirements. For the purposes of surcharge recovery, those are "its costs."

Allowing utilities to reach into comprehensive rates to pull out and obtain the incentive surcharge recovery of the environmental costs incurred by other utilities who sell them power under pooling or other agreements, thereby receiving surcharge recovery of costs not within the scope if KRS 278.183, dilutes the ability of KRS 278.183 to achieve its purpose by granting incentive rate treatment to all compliance costs incurred for all generation on an equal footing regardless of whether that compliance will promote and foster the use of Kentucky coal. This lessens the incentive of a utility to own or control its own generation in order to achieve the favorable rate treatment. The further away the generation is located from Kentucky and the less connected the utility owning the generation is to Kentucky, the lower the probability that Kentucky coal will be chosen to fire the plant. The statute's power to act as an incentive should not be diluted or turned into a windfall surcharge recovery of the compliance cost element of other utilities' generation by an overbroad reading of what constitutes "its cost" of compliance.

What Kentucky Power is buying is access rights to power. It has no ownership right in or direct responsibility for the generation of Ohio Power and Indiana and Michigan on which Ohio Power and Indiana and Michigan have the responsibility and obligation to achieve environmental compliance. Ohio Power and Indiana and Michigan would be required to achieve environmental compliance of their coal-fired capacity whether or not they participated in the Interconnection Agreement. Having chosen to participate in that agreement, Kentucky Power is being charged a comprehensive rate for access to their power.

Kentucky Power's cost is that rate. It is not the underlying one-step-removed compliance costs of Ohio Power and Indiana and Michigan that go into that rate. Delving into that rate to pull out the compliance cost elements of that rate for specialized advantageous surcharge recovery cannot further the goals which KRS 278.183 is designed to address. Given that fact, there is no reason to expand the statute's limiting language that allows surcharge recovery to "its costs" of compliance to permit or require advantageous surcharge recovery for portions of the capacity settlement charge paid under the Interconnection Agreement.

Refusal to allow surcharge recovery of a portion of the more comprehensive rate does not result in trapping the costs for the purposes of federal preemption because full recovery of the rate is available in a base rate case.[3] Consequently, the Commission should feel free to limit surcharge recovery to those costs that fit the statute's definition of qualifying costs. Just as achieving environmental compliance in connection with natural gas turbines is not subject to surcharge recovery because they fail to fit the part of the definition of those costs that can be recovered because they are not coal combustion wastes and byproducts from facilities utilized for the production of energy from coal,[4] the access fee paid by Kentucky Power cannot be recovered via the surcharge because it falls outside the definition of "its costs" of compliance as set forth in KRS 278.183.

Further, the Commission should not feel constrained to award rate recovery for newly posited costs under the Interconnection Agreement because it ruled in Case No. 96-489 that similar costs were not excluded from surcharge recovery on the grounds there presented. In each new rate filing, all parties are free to marshal all arguments, both factual and legal, they may

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[3] See, *Nantahala Power and Light Company v. Thornburg,* 476 US 953 at 970-971, 90 L Ed 2d 943, 106 S Ct 2349 (1986).

[4] See, Order of March 17, 2005, *In the Matter of: Application of East Kentucky Power Cooperative, Inc. for Approval of an Environmental Compliance Plan and Environmental Surcharge*, Case No. 2004-00321.

have against newly posited rates. The setting of rates, though done in a quasi-judicial context, is the performance of a legislative function.[5] In this case Kentucky Power posits some 21 new costs for rate recovery as well as seeking continued surcharge recovery of costs approved in previous compliance plans. The Commission has full authority to look at the governing legislation as applied to the newly posited rates and should use that authority to refuse to allow the recovery of the AEP pool costs via surcharge.

Respectfully submitted

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[5] *Southern Bell Telephone and Telegraph Companyvf. City of Louisville*, 265 Ky. 286, 96 S.W.2d 695 (1936); *Stephens v. South Central Bell Telephone Company*, 545 S.W.2d 927 (KY 1976); *Simpson County Water District v. City of Franklin*, 872 S.W.2d 460 (KY 1994)

NOTICE OF FILING AND CERTIFICATION OF SERVICE

I hereby give notice that I have filed the original and ten true copies of the foregoing with the Executive Director of the Kentucky Public Service Commission at 211 Sower Boulevard, Frankfort, Kentucky, 40601, this the 9th day of August, 2005, and certify that this same day I have served the parties by mailing a true copy of same, postage prepaid, to the following:

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