

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	)	2015-00113
BILLING PERIOD ENDING DECEMBER 31, 2014	)	

ORDER

On April 27, 2015, the Commission initiated a six-month review of Kentucky Power Company's ("Kentucky Power") environmental surcharge<sup>1</sup> as billed to customers for the six-month period July 1, 2014, to December 31, 2014.<sup>2</sup> 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 pursuant to KRS 278.183(1).

The Commission issued a procedural schedule on April 27, 2015, that provided for discovery, the filing of prepared testimony, and intervenor testimony. Kentucky Power requested and was granted a request to amend the procedural schedule in an

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<sup>1</sup> 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).

<sup>2</sup> Kentucky Power's surcharge is billed on a two-month lag. Thus, surcharge billings from July 2014 through December 2014 are based on costs incurred from May 2014 through October 2014.

Order dated May 8, 2015. Kentucky Power filed prepared testimony, and responded to one request for information issued by Commission Staff. There were no intervention requests in this proceeding. On June 23, 2015, Kentucky Power filed a motion that this case be submitted for decision by the Commission based on the existing record. Since 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 April 27, 2015 Order initiating this case indicated that, since the period 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 did not propose any additional over- or under-recovery for the review period. Having reviewed the record, the Commission finds reasonable Kentucky Power's determination that it did not have any additional over- or under-recovery for the review period.

Kentucky Power states that the average residential customer's monthly usage for this review period was 1,421 kilowatt hours.<sup>3</sup> Since Kentucky Power determined it did not have any over- or under-recovery for the review period, there will be no additional impact on an average residential customer's bill.

#### RATE OF RETURN

In Case No. 1996-00489, the Commission found that the debt portion of Kentucky Power's weighted average cost of capital should be reviewed and

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<sup>3</sup> Kentucky Power's Response to Commission Staff's First Request for Information ("Staff's First Request"), Item 7.

re-established 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>4</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, 2014, the last expense month of the review period. It also provided the blended interest rates for the long-term debt, short-term debt, and accounts receivable financing as of October 31, 2014.<sup>5</sup> Using this information, along with the previously approved 10.50 percent return on equity,<sup>6</sup> Kentucky Power calculated a weighted average cost of capital, before income tax gross-up, of 7.37 percent.<sup>7</sup> Kentucky Power also provided its updated income tax gross-up factor of 1.5439,<sup>8</sup> reflecting the methodology approved in Case No. 2005-00068.<sup>9</sup> Utilizing these components, Kentucky Power proposes an overall rate of return of 9.92 percent to be used prospectively in its monthly environmental surcharge filings.

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<sup>4</sup> Case No. 1996-00489, *Kentucky Power Company* (Ky. PSC May 27, 1997), Final Order at 26. 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>5</sup> Kentucky Power response to Staff's First Request, Item 3.

<sup>6</sup> Case No. 2009-00459, *Application of Kentucky Power Company for a General Adjustment of Electric Rates* (Ky. PSC June 28, 2010).

<sup>7</sup> Kentucky Power's Response to Staff's First Request, Item 3.

<sup>8</sup> *Id.*

<sup>9</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).

On June 22, 2015, the Commission issued an Order in Case No. 2014-00396<sup>10</sup> approving Kentucky Power's 2015 Environmental Compliance Plan and revised Environmental Surcharge Tariff E.S. The Order provided that Kentucky Power's Tariff E.S. was approved for service on and after June 22, 2015. Therefore, Kentucky Power should re-establish its rate of return in accordance with the provisions of the Commission's June 22, 2015 Order. Per the Settlement Agreement to the June 22, 2015 Order, Kentucky Power is authorized a 10.25 percent return on equity for environmental surcharge purposes.<sup>11</sup> The Settlement Agreement states Kentucky Power shall utilize a weighted average cost of capital of 7.34 percent, and a gross revenue conversion factor of 1.616424.<sup>12</sup> Kentucky Power was also authorized a gross revenue conversion factor of 1.004977 to be applied to the long- and short-term debt and accounts receivable financing weighted average cost percentages.<sup>13</sup> Therefore, the Commission finds that the combination of these components will produce an overall grossed-up rate of return of 10.128 percent<sup>14</sup> to be used in all monthly environmental surcharge filings subsequent to the date of this Order.

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<sup>10</sup> 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).

<sup>11</sup> Case No. 2014-00396, *Kentucky Power Company* (Ky. PSC June 22, 2015), Order, Appendix A, Settlement Agreement, numbered paragraph 2.

<sup>12</sup> *Id.*, numbered paragraph 3.

<sup>13</sup> *Id.*, Exhibit 2.

<sup>14</sup> *Id.*

## OTHER ITEMS

During this review period, Kentucky Power's environmental surcharge billing factor remained at zero percent in accordance with the Settlement Agreement in Case No. 2012-00578.<sup>15</sup> Pursuant to the terms of the Settlement Agreement and the Commission's Order in Case No. 2013-00325,<sup>16</sup> Kentucky Power's environmental surcharge billing factor is to remain at zero percent until changed by the Commission. With the issuance of the June 22, 2015 Order in Case No. 2014-00396, Kentucky Power's environmental surcharge billing factor is no longer set at zero percent.

Two developments affecting Kentucky Power's operation of its environmental surcharge during this review period occurred at the beginning of 2014. Effective December 31, 2013, Kentucky Power acquired an undivided 50 percent interest in Units 1 and 2 of the Mitchell generation station located in Moundsville, West Virginia.<sup>17</sup> As a result of the acquisition, Kentucky Power became responsible for its pro rata share of the Mitchell generating units' environmental expenses. Certain environmental related

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<sup>15</sup> Case No. 2012-00578, *Application of Kentucky Power Company for (1) A Certificate of Public Convenience and Necessity Authorizing the Transfer to the Company of an Undivided Fifty Percent Interest in the Mitchell Generating Station and Associated Assets; (2) Approval of the Assumption by Kentucky Power Company of Certain Liabilities in Connection with the Transfer of the Mitchell Generating Station; (3) Declaratory Rulings; (4) Deferral of Costs Incurred in Connection with the Company's Efforts to Meet Federal Clean Air Act and Related Requirements; and (5) All Other Required Approvals and Relief* (Ky. PSC Oct. 7, 2013).

<sup>16</sup> Case No. 2013-00325, *An Examination by the Public Service Commission of the Environmental Surcharge Mechanism of Kentucky Power Company for the Two-Year Billing Period Ending June 30, 2013* (Ky. PSC Apr. 29, 2014).

<sup>17</sup> Case No. 2012-00578, *Kentucky Power Company* (Ky. PSC Oct. 7, 2013), Final Order.

projects at Mitchell had previously been included in Kentucky Power's 2005<sup>18</sup> and 2007<sup>19</sup> Compliance Plans, and related costs were being recovered through the environmental surcharge due to Kentucky Power's participation in the AEP-East Pool Agreement. Kentucky Power stated that the termination of the AEP-East Pool Agreement on January 1, 2014, resulted in the elimination of all Mitchell-related environmental expenses from its compliance plan. Kentucky Power has not recovered any environmental expenses incurred at Mitchell since the acquisition. Kentucky Power filed an amended environmental compliance plan in Case No. 2014-00396 to recover its share of Mitchell's environmental costs through the environmental surcharge.

The effect of the termination of the AEP-East Pool Agreement is that Kentucky Power is no longer responsible for its proportionate share of, among other expenses, the environmental costs associated with the AEP-East Pool Agreement surplus member companies' generating units.<sup>20</sup> For this review period, Kentucky Power did not include any environmental costs incurred by AEP-East Pool member companies in the monthly environmental surcharge calculations.

IT IS THEREFORE ORDERED that:

1. The charges and credits determined by Kentucky Power through its environmental surcharge for the period July 1, 2014, through December 31, 2014, are approved.

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<sup>18</sup> Case No. 2005-00068, *Kentucky Power Company* (Ky. PSC Oct. 17, 2005), Final Order.

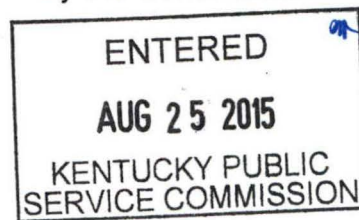
<sup>19</sup> Case No. 2006-00307, *The Application of Kentucky Power Company for Approval of an Amended Compliance Plan for Purposes of Recovering Additional Costs of Pollution Control Facilities and to Amend Its Environmental Cost Recovery Surcharge Tariff* (Ky. PSC Jan. 24, 2007).

<sup>20</sup> Participants in the AEP-East Pool Agreement were Appalachian Power Company, Kentucky Power Company, Indiana-Michigan Power Company, Ohio Power Company, and American Electric Power Service Corporation as agent.

2. Kentucky Power's determination that it had no additional over- or under-recovery for the review period is approved.

3. 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



ATTEST:

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